Agreed
WR 5/6

Energy
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PRIME MINISTER

BNOC Prices

I believe Mike told you that BNOC were proposing to reduce their selling price of oil because of the world over-supply situation and the weakening of oil prices generally. They have now formally asked for authority to reduce their prices by $2 per barrel. Without such a reduction, they say that they could find themselves with 100,000 barrels a day and possibly more on their hands, which could only be disposed of at a significant loss on the spot market. Spot prices are currently some $6 per barrel below term prices. The Africans (to whose prices North Sea oil is of course closely linked) have not so far reduced their prices formally. They have cut back production instead - Nigeria by about 30%. But there are reports now coming in that Nigeria is offering a $2 per barrel reduction.

The Department of Energy go along with BNOC's proposal. So does the Chancellor.

Mr. Howell is seeing the BNOC Chairman at 1200. Can I say that you are content?

T P Lankester

5 June 1981

CONFIDENTIAL

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
TELEPHONE: 01-211 3000
211 6402

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Prime Minister
The Chancellor mentioned this to you.

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament St
London
SW1

5 June 1981

9/6

Dear Geoffrey

BP-FORTIES

Thank you for your letter of today's date in which you accept that BNOC may negotiate a $2 a barrel reduction in the price of UKCS crude. You should be aware that Sir David Steel rang this lunchtime to inform me that as from mid-day today he had reduced production from Forties to 350,000b/d. I explained to him that BNOC would be negotiating on the basis of a $2 a barrel reduction in the price of UKCS crude for the next quarter. Sir David noted the point but suggested that in the absence of a price reduction of at least $4 a barrel the decision would stand for the time being. However, he did assure me that BP would give no publicity to this decision.

attached

BP's present consent for production from Forties calls for a minimum production of 430,000 b/d for the current quarter. Thus, if they maintain production at 350,000 b/d from today they will soon be in breach of that consent. However, we have no formal sanction against such a reduction short of revoking BP's licence which we could hardly contemplate. I will keep you in touch with developments in the oil market following BP's action and the response to BNOC's pricing negotiations.

I am copying this letter to the Prime Minister, the Lord Privy Seal and Sir Robert Armstrong.

Yours ever

David

D A R HOWELL

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

5 June 1981

The Rt Hon David Howell MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Dear Secretary of State,

UKCS OIL PRICES

Thank you for your letter of 3 June in which you seek agreement to informing BNOC that they go ahead with their proposed reduction of $2 a barrel in UKCS oil prices third quarter starting on 1 July.

As you recognise, the loss of revenue, about £150 million for the financial year 1981-82, is a matter of considerable concern. It is only some comfort that this revenue loss is likely to be offset by the increase in the sterling price of oil in recent months as the dollar has strengthened.

Yet a further disadvantage of a reduction in the oil price is that this could well be interpreted as a change in UKCS oil pricing policy. Hitherto North Sea oil prices have followed, but not led, prices of the comparable African crudes. Indeed, it appears that we get the worst of all worlds. When the oil market is tight, we follow the market up and forswear premia, or selling on the spot market and other devices to maximise oil revenues. When the market is slack, we are forced to reduce prices before others do. Certainly there is nothing to be done about this in the present circumstances. But it would be worthwhile for the official group on North Sea Oil Pricing Policy to consider whether there is a real problem here.

/Despite these real

Despite these real disadvantages, I accept that BNOC should be informed that they may go ahead with their proposed reduction of $2 a barrel for the third quarter prices starting on 1 July. This is on the understanding that all the press and other briefing should emphasise that the reduction does not signal any change in the policy that UKCS prices should be set in line with market conditions and that prices will be increased directly market conditions justify this. I also would not want to go out of our way to win credit for moving our price down before other producers. To emphasise this would be to increase the risk of international criticism when UKCS prices rise again. Indeed, it is quite conceivable, and I hope accepted, that in order to restore the relationship with the African crudes, UKCS prices will either have to rise before the African prices rise or will increase by a larger amount when they next increase.

Finally, it is worth bearing in mind that the $2 reduction in UKCS prices in no way undermines the case for the tighter fiscal regime for the UKCS announced in the Budget. The reduction in the sterling profitability of the North Sea fields caused by the lower dollar oil price is likely to be more than compensated for by the effect of the weakening pound against the dollar.

I am sending a copy of this letter to the Prime Minister, the Lord Privy Seal and Sir Robert Armstrong.

Yours sincerely

Peter Jenkins

GEOFFREY HOWE

(Approved by the Chancellor & signed in his absence)

Foreign and Commonwealth Office
London SW1

4 June 1981

With TPL or not copied?

Thank you for sending me a copy of your letter of 3 June to Geoffrey Howe about BNOC's request to reduce their prices by $2 a barrel with effect from 1 July. I agree that we should let BNOC go ahead and entirely endorse your view that it is important to act quickly, inter alia to secure some credit internationally without undermining our position that oil prices are set by the market. Our officials will need to stay in close touch over the terms of suitable guidance for overseas Posts should a price reduction be agreed.

I am sending copies of this letter to the recipients of yours.

Ian

The Rt Hon David Howell MP
Secretary of State for Energy
Thames House South
Millbank
London SW1P 4QJ

G10

Energy

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
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Prime Minister

MS Mrd 26/5

The Rt. Hon. Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London SW1P 3HE

22 May 1981

Dear Geoffrey

NORTH SEA PRICES

You will be aware that there has been much talk in the press of an oil glut and that Saudi Arabia has hinted that it will continue to keep the market over supplied until OPEC prices are reunified on a single marker price. Pressure is developing in the oil market for a reduction of prices including UKCS crude oil prices. The pressure essentially stems from the fact that companies without access to Saudi Arabian crude are now making quite substantial refining losses. If BNOC were to yield to this pressure without waiting for the Africans to move it would break the principle of following the market. I have agreed with them that they should hold their prices at least until after the meeting of OPEC in Geneva on 25 May. There is a strong possibility that there will be no agreement in Geneva and that market pressures and official African prices will remain unchanged. If this is indeed the case the pressure on BNOC is likely to be intensified. Their response would depend upon a number of factors which cannot yet be quantified, such as the number of companies seeking a price change and whether the companies concerned would be likely to allow their contracts to cease if no price reduction is agreed. It also depends on the willingness of North Sea producers to accept a lower price for oil they sell to BNOC. Even if BNOC are able to resist a price change this quarter the same pressures may still persist when the normal quarterly price review takes place to set prices for 1 July.

Other oil producing countries are able to deal with pressures to reduce price by allowing sales volumes to fall. That option is not available to BNOC since their available supplies are obtained through agreements with North Sea producers which cannot easily be over-ridden. Nor is there much opportunity for Government to take action to reduce the availability to BNOC even though in principle there are two possibilities: reduction of oil taken as royalty in kind and reduction of output from some fields. The option to take royalty in kind can only be changed by giving notice of six months. As far as North Sea production is concerned only BP is producing above the formal profile limit and agreement to this was given because of the increased Exchequer revenues which would flow. This lack of flexibility in availability means that if BNOC finds itself under strong pressure a choice may have to be made between negotiating a lower price for UKCS crude, which would go aganist our policy of following not leading the market, and BNOC being left with some oil which might have to be sold on the spot market where the current loss would be nearly $6/barrel. From the Exchequer point of view I understand the revenue lost through an across the board price reduction of $2/barrel would be greater than the loss incurred if BNOC were forced to dispose of 100,000 barrels a day on the spot market (which is likely to be the largest volume the spot market would bear). The Corporation could well however, be unwilling to accept such a loss on its trading account without a Direction.

At this stage there can be no certainty that such a situation will arise; even if it does it may not be for some time. If the Africans neither move nor offer covert discounts I believe BNOC have real prospects of holding prices at current levels. On the other hand we should be prepared for a worse outcome which could require a decision to be taken within a week of the OPEC meeting.

I am copying this letter to the Prime Minister and the Lord Privy Seal.

Yours ever

David

D A R HOWELL

26 MAY 1981