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Prime Minister

BNOC are now proposing to drop their prices by $4-5 rather $2 already agreed.

I agree with BNOC. Further, we should not be resistant to dropping prices.

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

cc Walters Duguid Lyton

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1A 0AA

10 June 1981

10/6

Dear Chancellor,

NORTH SEA OIL PRICES

Philip Shelbourne, the Chairman of BNOC, came in today to bring me up to date with developments, following the Corporation's proposal of a $2/barrel price reduction on UKCS crude prices. Their customers have responded uniformly that this is inadequate; a $5 reduction was the suggestion generally made. A cut of this magnitude would bring UKCS prices down somewhat below the level, on a quality adjusted basis, consistent with the Saudi $32 'marker'. But a $4 reduction would appear to line us up more nearly with a price consistent with the Saudi level, and BNOC believe that their customers - particularly BP, Shell and Esso, - are seriously set on forcing UKCS prices down this far. The benefits to them would be a lower tax threshold, diminution of downstream losses and the chance of shaking the upper tier of the OPEC price structure.

BNOC see themselves as being in a weak negotiating postion. Their major customers could walk away from contracts as from 1 July, drawing stocks for a month or so. In the meantime BNOC would have to unload exceptional quantities of oil on the spot market at great financial sacrifice. If that market could not absorb such quantities production cut backs would need to be invoked, again at a serious cost to BNOC.

BNOC have put it to me that there are two options open. First, the Government could intervene with the three major companies to encourage them to accept the proposed $2 reduction, mentioning as an inducement possible loss of Government goodwill connected, for instance, with saleback arrangements, disposal of royalty oil and production consents. They accept that the likely success of such an exercise is uncertain, in terms of the impact on the finally agreed price.

The second option would be to allow BNOC a free hand. In this case they judge that we shall end up with an overall reduction of around $4-5/barrel.

There are clearly disadvantages in intervening. We would be departing from our customary arms-length stance. We would tend to undermine BNOC's future position as a trader. And we would attract the criticism - both domestic and international - that we had intervened to hold up prices contrary to the momentum of market forces and would expose ourselves to future pressure to hold them down by intervention. Against this, there would be adverse implications for Government revenues and perhaps for the value of sterling.

On timing, BNOC need to tie up their third quarter sales by the end of next week, given the nature of contractual commitments. They judge that if there was to be Government intervention with the companies it would need to be made by this Friday to have an impact. We need therefore to make up our minds quickly. Our officials have already been in touch but I think we need ourselves to discuss this urgently.

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

Yours sincerely,

B. D. Ward

pp. D A R HOWELL
(Approved by the Secretary of State and signed in his absence)

10 JUN 1981

File

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Energy

10 DOWNING STREET

From the Private Secretary

12 June 1981

North Sea Oil Prices

The Prime Minister has seen your Secretary of State's letter of 10 June. She has commented as follows:

> "I agree with BNOC. Further, we should not be resistant to their dropping their prices".

I am sending a copy of this letter to John Wiggins (HM Treasury), Stephen Gomersall (Lord Privy Seal's Office), and David Wright (Cabinet Office).

T. P. LANKESTER

CS

Julian West, Esq.,
Department of Energy.

CONFIDENTIAL

Prime Minister

It has now been agreed that BNOC should be allowed to negotiate a $4-5 price reduction.

TL 12/6

SECRETARY OF STATE FOR ENERGY
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Good news

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

12 June 1981

Dear Geoffrey

NORTH SEA OIL PRICES

I explained in my letter of 10 June the possible courses of action in response to the failure of BNOC to find any takers for UKCS oil at $2/barrel below the present price. Nigel Lawson and I had a useful discussion on Thursday morning and that evening I saw Sir David Steel at his request. He explained that the combination of higher North Sea prices, a high rate of tax on the Forties field and severe downstream competition was leading to serious losses for BP. The question of the relationship between price and output for Forties naturally arose. BP indicated that at a price of about $35/b (corresponding to a cut of $4) they would wish to produce in the region of 350,000 b/d in the third quarter. At $34/b they would expect to reach 400,000 b/d.

Our officials subsequently agreed that in terms of Government revenues there was little to choose between a price reduction of $4 and one of $5, allowing for the likely effect on Forties production. In the circumstances I have authorised BNOC to open negotiations on Monday in the expectation that they will be able to settle with their suppliers and customers at a price $4-5 below present levels, preferably nearer $4.

BNOC intend to brief selected journalists in the course of Monday. For our part, we are able to maintain our stance that the Government do not intervene and that UKCS prices properly reflect the market position.

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

Yours ever

David

D A R HOWELL