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From: THE PRIVATE SECRETARY

Prime Minister (2)

To note and await further Irish reaction.

AT 4/7

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

Andrew Turnbull Esq
Private Secretary
10 Downing Street
LONDON SW1

4th July 1984

Dear Andrew,

KINSALE GAS

Mr Butler met Mr Spring, the Irish Minister of Energy in Dublin earlier today. Mr Butler explained that the combination of oil price changes, exchange rate changes and new market assessments had shown that the project, hitherto considered marginally viable, would now offer no return at all on the Government's investment. The magnitude of the change was illustrated by the fact that a price cut of 13-15p per therm would be needed to restore the original, marginal, real rate of return. We were naturally embarrassed at this development, for we had hoped that a viable agreement had been reached last autumn. Like the Irish, we attached great importance to the project, which both sides had seen as a unique example of economic co-operation with mutual benefits. But the latest information could not be ignored, and it showed that the project was no longer the economically advantageous proposition anticipated last autumn.

Mr Spring said he was astounded. The public perception, north and south, was that a deal had been concluded last autumn, and that (irrespective of the present legal position - Mr Spring seemed aware that the Memorandum of Understanding (MOU) is not, strictly, binding) the public would expect it to go ahead - particularly after its endorsement at the Chequers Summit. Mr Spring and his officials said they could not understand that the current problems were not foreseen in the protracted and detailed negotiations that preceded the MOU. There was in any case a review clause in the MOU - why not wait until the first review in 5 years time? And was our market assessment to be relied upon: vigorous marketing was surely the key? Moreover, they added, we should understand that any cut in the price of gas would break the Irish Government's firm policy of selling the gas at a price that would enable them to replace it eventually with oil.

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Mr Butler stressed that we were as unhappy as the Irish at the turn of events. We were satisfied that the market assessment was realistic (it had been confirmed by a separate assessment by the prospective private sector investor), and it was in any case only one of three adverse changes we had to face. The assessment took account of Northern Ireland's recent vigorous promotion campaign for natural gas, and there was no reason to believe that future marketing efforts would improve the expected sales. We could not rely on the 5 year review because the MOU required the agreement of both parties to any change. Neither Mr Spring nor Mr Butler could bind their successors on the decision to be taken in 5 years time. We realised that concessions now by the Irish would conflict with their policy on replacement by oil, but that was a measure of the seriousness of the situation - further contribution by HMG to the financing of the project would be equally painful.

We had, he said, to face up to the facts now before us. Was the Irish Government willing to make a move to save the project? If so, HMG would consider what moves it could make - although it would be a major departure from our normal practice, and would represent a considerable cost, we might be able to consider disregarding the capital costs of the project if the Irish could make a similarly generous move. Mr Butler made it clear that a major movement of price would be necessary, but did not quote a specific figure in pence per therm (thus avoiding any implication that HMG would be likely to settle for that amount). But Mr Butler emphasised that it would be essential for HMG, if the project continued, that it should be in the reasonable expectation that it would recover all its operating costs. He suggested to Mr Spring that it should be possible to devise some arrangement whereby the benefit of any movement more favourable than those currently anticipated by HMG should not accrue solely to us.

Mr Spring said that his Government had not had occasion to consider Kinsale Gas in Cabinet since last autumn. He could not therefore respond to Mr Butler today, but would report to Dr Fitzgerald, and the Government would no doubt discuss the issue at its meeting tomorrow, after which Dr Fitzgerald might well want to raise it with the Prime Minister.

In response to a question from Mr Spring, Mr Butler confirmed that the Prime Minister and senior colleagues were aware of the difficulties that had arisen, and had authorised the approach he was making to Mr Spring.

The Irish clearly appreciate now the urgency of coming to a conclusion on this: and they should now understand that the magnitude of the changes in circumstances requires a major movement on their part if there is to be a chance of the project going ahead. In view of the replies to my Secretary of State's minute of 22 June we have not discussed with the Irish the size of the movement we want from them: but if the Irish will not agree to something equivalent to at least 5p off the present price of the gas, the project is unlikely to be able to recover its operating costs.

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The next move is for the Irish. Mr Spring has promised to keep in touch ~~with Mr Butler, but the~~ next contact may be from Dr Fitzgerald to the Prime Minister. If so, Dr Fitzgerald seems likely to argue that it is politically too late, and too dangerous for Anglo-Irish relations, to let the project fail. The key question is then whether Dr Fitzgerald is willing to agree that the Irish should make a major concession on the price of gas (not less than 5p per therm); he will not agree to this if he believes the Irish are being asked to carry the whole burden of the changed circumtances. He may therefore seek an understanding from the Prime Minister that HMG would be willing to make a significant contribution - perhaps on the lines of disregarding some or all of the £140m capital expenditure on the project.

I am copying this letter to the Private Secretaries to members of E(A), the Foreign and Commonwealth Secretary, and to Sir Robert Armstrong.

Yours sincerely,

Graham Sandiford

G K Sandiford

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10 DOWNING STREET

From the Private Secretary

5 July, 1984.

Kinsale Gas

The Prime Minister has seen and noted your letter to me of 4 July reporting on Mr. Butler's discussions with Mr. Spring on the Kinsale Gas project. She awaits a further report when the Irish have reacted.

I am sending copies of this letter to the Private Secretaries to the members of E(A), to Len Appleyard (Foreign and Commonwealth Office) and to Richard Hatfield (Cabinet Office).

Andrew Turnbull

G.K. Sandiford, Esq.,
Northern Ireland Office.

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