MR TURNBULL 12 June 1984

SLEIPNER

The Government has been placed in a ridiculous position over the Sleipner deal. We are expected to second guess estimates of future gas supply, demand and price which runs completely counter to our market based policy for energy.

We must now ensure that the Government are never again put in this position. The establishment of a market price for gas is the best way of regulating future supply and demand. Allowing exports is the best way of ensuring a market price.

The Sleipner Deal

The volume of gas proposed by the Norwegians is too large. Even if no further discoveries of UK gas are made, the Department predict an excess of supply over demand in the mid-1990s if Sleipner is purchased. Several of the oil companies predict such a surplus even without Sleipner. In these circumstances it is unclear even whether we need Sleipner and the purchase of the proposed volumes will undoubtedly discourage UK companies from exploring for gas.

There has also not been any serious attempt to renegotiate the terms of the initial Dutch approach and to play the Norwegians off against the Dutch in a normal commercial negotiation. We have the strong impression that the Dutch price could be improved, and that if this is the case, we may well be better off with the lower Dutch volumes.

In these circumstances, Peter Walker should, as he proposes, re-enter negotiations immediately with the Norwegians in order to secure a smaller volume of gas. He should also re-open commercial negotiations with the Dutch.

Establishing a Gas Market

Allowing exports would be the quickest method of creating a gas market. Once market prices dominate the UK, more domestic production would be stimulated whatever British Gas may wish to do on price.

Without the discipline of exports, we cannot expect BGC to operate in a commercial manner. The risks of under-supply dominate their thinking and they are much less concerned with the risk to national income, the PSBR and the balance of payments of deferring UKCS production.

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BGC have consistently refused to pay international prices for gas from the UKCS. In consequence, all gas drilling stopped during the 1970s and we are now faced with the ludicrous position that a country full of energy sources may well have to rely on imported gas to meet its needs in the early 1990s.

ie to repeat the Frigg error

The attitude of BGC today has not significantly changed. They are not prepared to offer UKCS producers the same price which they are contemplating for Sleipner. Although the removal of BGC's monopoly over purchasing gas and the potential supply gap has forced them to offer higher prices in recent years, these prices are still some 20% below market prices. Indeed, John Allcock, BGC's lead negotiator on Sleipner, has argued in public that the gap between prices offered to UKCS producers and international prices has narrowed too much.

The Export Regime

Any export regime must give clear signals to the companies in order that the future development of gas can proceed on market principles.

Although self-sufficiency is a curious argument to deploy in an international trading environment, we accept that long lead times and rigidity in the gas market do require some conditions on the free export of gas.

We suggest that exports should be allowed with immediate effect for as long as established reserves not contracted to export are at least a factor of ten greater than current annual supplies. Today's figure is fourteen. We also suggest that BGC are given an opportunity to match any negotiated export deal and that these conditions are publicly announced. These concessions should meet Peter Walker's and BGC's concerns about security of supply.

We do not agree with Peter Walker that it should be left to the Government's* discretion to look after security of supply and the rate of development in the North Sea. Neither do we agree that allowing exports would precipitate a sharp rise in prices to the consumer. As the Chancellor points out, we would only be ensuring that international prices apply to new supplies. BGC are anyway proposing to pay international prices for Sleipner and a greater incentive to UKCS producers would not significantly affect future prices. Arguments about economic pricing are not relevant to the export decision and need not be discussed in E(S).

* advised inevitably by BGC

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Conclusions

We recommend

- That any decisions on gas imports should depend upon a renegotiation of Sleipner volumes and Dutch prices.

- That permission to export is essential to ensure that market forces dictate the development of gas reserves in the North Sea to the maximum benefit for our economy.

- That the gas export regime is based on objective and published criteria allowing unrestricted exports as long as established reserves not contracted to export exceed 10 x current annual supplies and provided that BGC are given an opportunity to match the terms of any export deal.

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