E.R.

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SLEIPNER GAS CONTRACT

Markets do work! Sir Dennis Rooke saw the Sleipner contract as a means of covering 30% of UK gas demand in the 1990s. As a monopoly buyer, he could have kept UK suppliers under his thumb and cost us £2 billion pa on the balance of payments and countless lost jobs.

Dramatic - but nonetheless predictable - developments have been taking place on the UKCS to forestall that ambition. Around 1980 BGC came back into the market perforce offering higher prices for the next generation of UK gas supply contracts. That stimulated the producers to explore for new gas, appraise earlier finds and dust-off development plans for gas already found. The gas supply/demand outlook has been transformed. Energy's revised forecast of UKCS gas availability (for the mid-1990s, up 16% since last May's estimate) would be sufficient to cover their best estimate of demand throughout the 1990s.

This makes it easy to concur with the first of Peter Walker's proposals - inform BGC and the Norwegians that HMG is not prepared to endorse the Sleipner contract.

The second proposal smacks of the interventionist hand of Sir Dennis Rooke:

"open <u>immediate</u> negotiations with potential suppliers with a view to securing a smaller import on the best competitive terms available, up to about 200 bcf a year (or 10% of likely demand in the 1990s);"

The one thing that is certain is that gas supply and demand in the 1990s are highly uncertain. Department of Energy views have changed markedly - and favourably - over the last few months. We are close to the major gas market place of continental Europe. For perhaps a decade - maybe more - that market will be a bargain basement. The Russians, the Algerians, the Dutch, the Danes and the Norwegians are all competing for business. There is no need to move quickly to line up half a Sleipner. As and when the need for gas imports is clearly foreseen - and that may be post 2000 - we can quickly tap into the continental European supply system. Meanwhile, if the Norwegians want to mount ambitious schemes, like using the UK as a "land bridge" into Europe, let them entice us with the economic benefits to the UK.

Peter Walker's conclusions do not cover the concept of a controlled gas export regime which is analysed in his paper. His primary reason for rejecting it is potential conflicts with the Treaty of Rome. However, his footwork may be a bit fast, since the legal advice was predicated on the Sleipner contract being concluded and thereby releasing UKCS gas for export.

That apart, we feel that there are other reasons why one would now feel less comfortable with such a regime. With Sleipner rejected, we will probably need all the UKCS gas we can get to sustain self-sufficiency through the 1990s. As noted above, Europe will be a bargain basement for at least a decade. Only low-cost Southern Basin gas could find a niche in that market - for bargain basement prices. To replace that export, we would require either imports or more expensive UKCS gas. Politically and logistically that looks odd.

Conclusions

i) Reject Sleipner.

ii) Reject BGC's efforts to rush back into the market for gas imports. By all means explore for bargains, but not urgently.

iii) First, see what the stimulus of market-related prices will do for UKCS supplies. So far the signs are encouraging.

(iv) Do not change rules on exports yet; leave that as a future option if we develop a big gas surplus. The Sleipner statement may need to refer to the export regime still being under consideration, since Treasury will not want to be hustled on this point.

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