1. Mr Powell
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NOTE FOR THE RECORD

Visit of Prince Bandar

The Prime Minister spoke to Mr. Walker on the phone this afternoon about the suggestion relayed by Prince Bandar that the Saudis would buy Tornados provided a number of conditions were met. One of these would be an undertaking by HMG to hold consultations with the Saudis and particularly before any major change in UK oil prices.

Mr. Walker said this had to be seen against a background of continuing Saudi criticism of the UK which was designed to put the blame on the UK for weakness in the oil market. The Saudis argued that they were bearing too much of the burden of production restraint and that the UK was benefiting from sustained oil prices while continuing to produce at its maximum. The Saudi's claimed that any cut by the UK in its oil price would bring the price structure tumbling down. Mr. Walker said he had met Sheikh Yamani before Christmas and had told him that he was greatly overestimating the ability of the UK to influence the oil market, one way or the other. Trading in the term market had declined in significance. The Saudi's criticism could more rightly be directed at the US whose production, at 8.7 mbd was far greater than that of the UK. US policy was to seek a reduction in the oil price to around $25.

The Prime Minister asked Mr. Walker how BNOC came to be buying oil which it could sell only at a loss. Was this by statute or by contract? Mr. Walker said this arose from the participation agreements which were a condition of production licences. Under these agreements BNOC had the right to buy up to 51% of a producer's output at the market price. He offered to provide a note with further details of how these arrangements put BNOC in a loss-making position.

Mr. Walker said BNOC had sent a telex to its customers stating that it could not fix a price at present and would do so later in the month backdated to 1 January.

Mr. Walker said the Saudis were putting pressure on the UK to cut production though they knew that the Government had very limited powers to do this. He offered a note on the extent of production cutbacks which were possible.

The Prime Minister said she would tell Prince Bandar that there would be no objection to greater consultation with the Saudis and that Mr. Walker would be willing to meet Sheikh Yamani at any time. But there could be no question of agreeing to limit our production. HMG would have to take its own decisions on production and prices, as the Saudis would expect to do themselves. Mr. Walker said that BNOC was of no importance to the Department of Energy; it was not needed for the development of North Sea Oil. He believed, however, it could contribute to the Chancellor's aims. In the past it had helped to maintain prices and might do so at some time in the future though currently its influence was much diminished.

I spoke subsequently to Sidney Fremantle in the Department of Energy who gave me answers to the points on which Mr. Walker had been unable to respond to the Prime Minister's questions:

i) US production is currently 8.7 mbd compared with 3.5 mbd for Saudi Arabia and 2.4 mbd for the UK.

ii) BNOC's telex had stated simply that it was unable to set a price in current market conditions. It had given no suggestion as to whether a new term price would be set or whether a new market related formula would be substituted.

iii) On production cutbacks, the Varley assurances had now largely expired and the assurances given by Conservative Secretaries of State for Energy had expired at the end of 1984. The Government had the power for most fields to require cuts in production of up to 20%. Ministers give production consents for specified levels of production for six month periods. For most fields the consents for the first half of 1985 have already been given at existing production levels. There are some smaller fields which cannot have cuts imposed on them for the next two or so years. Production from the Forties Field could be varied within six weeks. This would produce a cut of 100,000 bd, i.e. 20% of 420,000 bd. From 1 July production cuts could be imposed at 20% of 1.4 mbd. Thus although legal power exists it cannot be introduced at short notice. The main objection, however, is that production cutbacks would represent a major reversal of policy and would bring the UK into direct conflict with the US.

Attached is an extract from the Enterprise Oil prospectus which sets out the position on depletion of control.

iv) Under legislation introduced by the Labour Government BNOC was given the right to purchase 51% of output at market prices. This was also made a condition of subsequent licensing rounds. The participation agreements are commercial contracts. In a typical case, BNOC gives six months notice of its wish to exercise its participation option which normally lasts for one year. In most cases notice is given in June of each year. Thus BNOC is committed for the whole of 1985 under the announcements made in June 1984 and in June 1985 it will announce whether to exercise its options for 1986. BNOC is currently committed to around 620,000 bd.

Mr. Fremantle thought that it would be possible for BNOC to bring some of the participation options to an end by mutual agreement at relatively short notice. He suggested that perhaps 50% of the agreements could be wound up within six weeks.

AT

7 January 1985