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PRIME MINISTER

BNOC AND OIL PRICES

Mr. Walker has failed to produce any papers for this meeting, though I am told he will be bringing with him a factual paper setting out BNOC's legal and contractual position. I have set this out briefly in the internal note I prepared after your conversation with Mr. Walker on the phone. Nor has Mr. Walker produced a paper setting out the options for BNOC and their implications. These are:-

(i) To set a new lower term price, though this would leave BNOC vulnerable to a repetition of its present difficulties.

(ii) A move to a market-related formula.

(iii) For BNOC to back out as quickly as it can from its existing participation agreements, leaving it simply with the disposal of the Government's royalty oil. This option could be combined with leaving BNOC's official price at $28.65, though this would cease to have much meaning.

(iv) Abolish BNOC while appointing someone to handle royalty oil on an agency basis.

Option (iv) would require legislation and the contradiction of many of the arguments the Government used in 1982 when Britoil was hived off from BNOC. Option (iii) would require commercial negotiations with the companies. It would also raise the question of whether security of supply would be adequately provided for, though many would argue that BNOC does not materially enhance Britain's position.

It is clear Mr. Walker sees tomorrow as a preliminary discussion before he meets with Sheikh Yamani early next week. The Chancellor is worried that BNOC's loss-making position will drag on and on, and he will want to pin Mr. Walker down on what HMG's preferred course of action should be in order that Mr. Walker goes to the meeting with Yamani with some clear propositions in mind. At a minimum, the meeting should extract an undertaking from Mr. Walker to submit a paper on the options and their implications as soon as possible.

AT

9 January 1985

Flh

EXTRACT FROM PROSPECTUS FOR 'ENTERPRISE OIL' — Xref

Depletion Control

The development of oil fields on the UKCS and the level of production therefrom require the approval or consent of HM Government and are subject to observance of "good oilfield practice". In December 1974 the then Government stated that no delays would be imposed on the development of UKCS oil fields discovered before the end of 1975 under licences held at the time of the statement and that no cutbacks would be made in production from these fields until 1982 at the earliest, or until four years after start of production, whichever was the later. (The Commercial Fields fall into this category). As regards oil fields discovered after 1976 under pre-1975 licences, no cutbacks in production would be made until 150 per cent of the capital investment in the field concerned had been recovered. Any production cutbacks would have full regard to the technical and commercial aspects of the fields in question which would generally limit cuts to 20 per cent at most. There would also be full consultation with the companies on any proposal to delay the development of post-1975 discoveries.

In July 1980, HM Government announced that its aim was to prolong high levels of oil production from the UKCS to the end of the century. As well as taking action to increase exploration it would be concerned to ensure good oilfield practice consistent with optimum oil and gas recovery both at existing fields and in regard to new field development proposals. It would also consider delaying the development of post-1975 discoveries and would continue to tighten control of gas flaring. Decisions would be taken on a case-by-case basis and the assurances given in December 1974 would continue to be honoured. HM Government further announced in June 1982 that it would not require production cutbacks at least in the period to the end of 1984.

In July 1982, HM Government published a Memorandum on North Sea oil depletion policy. This reaffirmed the decision on production cutbacks. It also stated that clear economic advantages would have to be demonstrated before a restrictive depletion policy could be justified; and that in HM Government's view there was no case in the foreseeable future for deferring new field developments. Reserve powers of intervention would, however, be maintained, but the circumstances of their use would relate to "specific and overriding requirements in the national interest, or to a radical change in circumstances pertaining to the UKCS and its development". If circumstances should change so that it became necessary to consider seriously the use of reserve powers, HM Government would consider what assurances might be given in parallel. If reserve powers had to be used, development delay would be preferred to other options such as production cutbacks. Further, the importance attached by HM Government to ensuring the maximum exploitation of oil and gas resources through good oilfield practice and the avoidance of wasteful gas flaring was reaffirmed, and it was made clear that HM Government's powers over oilfield operations would be used to ensure these ends.

DG2ABD

~~Enterprise oil~~

Energy North Sea Oil licences.