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Prime Minister Energy 3

There is also a CPAS paper in this folder which you have not seen.

Ref. A0475

PRIME MINISTER

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Seventh Round of Offshore Licensing
(E(79) 53, 58 and 59)

When you have read this brief you may decide to postpone this item.

BACKGROUND

(a) Procedure

The Committee decided in July to postpone a decision on the size of the next licensing round until the review of depletion policy, then in progress, was complete. (The issue was also tangled up with the problems over the future of BNOG, and the related sale of BP shares, but it was doubts over depletion which really led to the reference back).

2. The Secretary of State for Energy has now come forward with revised proposals (E(79) 53) which, because of the delay, have in his view become urgent. His plan requires an early announcement, a period of consultation, a pause for preparation of applications, time for consideration, and issue of new licenses next August so as to allow oil companies to start drilling seriously in the summer 1981 'weather window'. He has also circulated the completed report on depletion policy (E(79) 38) which, if the Committee was right in its fears last time is essential background to the licensing decision. But, decisions on depletion policy generally, though desirable, could be postponed without damage. No announcement on depletion policy is needed till next spring, and for international reasons it would be preferable not to make one till then. (Recommendation xvii of Depletion Report).

3. However, the Bank of England threw a large spanner into the works late last week. They pointed out that the prospectus for the sale of BP shares includes a statement (text at annex) about Government depletion policy which could, of course, affect the future profits of BP and thus the sale price. That statement would be invalidated if the Government decided on or announced a fresh

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policy. Once the Bank had raised the point the Chancellor immediately consulted the Attorney General, who will attend for this item and explain the problem. (He also hopes for a private word with you first if time permits.) His advice is that the Government must take no new decision and make no announcement about depletion policy in the next few weeks. Otherwise there is a risk that the sale will fall foul of Stock Exchange and SEC requirements. Essentially the prospectus would amount to misrepresentation which would invalidate the contract at civil law. Moreover the officials concerned with the BP sale could risk criminal prosecution for failing to disclose relevant facts in the offer document. (This is why it was the Chancellor, who is answerable for the BP shares, who consulted the Attorney General.) But the Attorney General is satisfied that Ministers can go ahead and discuss the licensing round provided that:

- (a) the depletion report is regarded as background information only, no decisions are taken on it for the time being and no substantive discussion is minuted;
- (b) the report itself and covering paper is limited in its distribution and classified secret; (it had already been circulated but all copies are being withdrawn except from Ministers attending the meeting and the classification upgraded).
- (c) He is allowed to attend the meeting to explain the problem, without however being recorded. (Even this brief should be seen only by those who 'need to know').

4. On this basis, and because of the reported urgency of decisions on licensing, we have put the item on the agenda. It is however fourth, in a busy and difficult meeting. You could allow it inconspicuously to be crowded off the end; or you could decide now to take it off (in which case I can stand down the various invitees). I should welcome instructions before the meeting. The rest of this brief assumes that we go ahead.

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(b) Substance

5. The main features in the Secretary of State's paper are:

- (i) a 100-block licensing round (twice as big as the last one);
- (ii) No oil flow till 1990, when on present depletion policy we shall be over the production hump and looking for more supplies. (This is why he argues depletion policy is not relevant.)
- (iii) 20 out of the 100 blocks in deeper water - thus postponing oil flow still further because of technical difficulties.
- (iv) A bigger United Kingdom private sector stake to take up the slack left by a smaller BNOC interest.
- (v) (Optional) a statement on longer-term licensing intentions, pointing to further big rounds annually.

6. By contrast, the CPRS (E(79) 59) argue for a 70-block round; they believe that the level of activity is picking up again, thus adding to the peak production problem, and that if existing depletion controls were properly applied, production could be postponed into the 1990s and the need for a big new licensing round reduced. This emphasises the extent to which licensing and depletion go together. We have put this point to the Attorney General's staff, who confirm that nevertheless his original advice can stand.

7. There are also a number of other second-order problems, but the key issue for the Committee, either this week or later, is the choice between a 100-block round and a 70-block round.

HANDLING

8. If this item goes ahead at all, I think you should ask the Attorney General to speak first, to explain the legal problem, and to lay down the limits within which discussion can take place. If he does not volunteer an answer you might ask him when the Government can safely consider depletion policy. You might also ask the Secretary of State for Energy to explain the reasons why a decision on the seventh licensing round has to be taken in advance of the Attorney General's safe limits for a discussion on depletion policy.

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9. The Secretary of State for Energy could then introduce his paper, followed by the Chancellor of the Exchequer, and Sir Kenneth Berrill. Other Ministers with a particular interest are the Secretaries of State for Scotland, Industry, Employment and Trade (shipping interest); the Foreign Secretary (EEC aspects); the Minister of Agriculture (fisheries interest); Secretary of State for Defence (restrictions on certain blocks).

10. The main issues which arise on licensing are these:

- (a) The need to restore momentum - which Mr. Howell uses (paragraph 3) as his main argument for a bigger round. It has two aspects: the 'right rate' of activity (i. e. depletion policy weighed against all other considerations) and the more political argument 'of making clear our determination to restore the momentum'. The second is a rather shaky argument if the facts justify rather slower momentum. Does the Committee really believe it is essential to restore momentum? If so, why?
- (b) Demand - The underlying assumption seems to be that United Kingdom demand for oil will be between 92 and 100 million tonnes in 1985 and 91-108 million tonnes in 1990 (Fig. 2 of the Depletion Report). These numbers are based on earlier economic forecasts and for 1985 at least are now probably on the high side. Is it wise to base the case for a big round on these forecasts?
- (c) United Kingdom production from present licenses. Fig. 2 shows that existing and prospective finds from present licenses produce a bulge over the central demand forecast until 1988. On the lower demand forecast the crossover point is almost 1990, even on the central production forecast. Activity has picked up again this year; present licenses may actually keep us in net balance another year or two. Does this too point to a smaller round?
- (d) The need for self-sufficiency. The crossover point is a bit bogus anyway. For reasons of refinery balance we shall always be a gross importer even when in a net export surplus. This alone makes our supplies a little insecure, physically and politically (see paragraphs 15-18).



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In economic terms what matters is the net balance on oil account. Whether this should be positive or negative depends on the overall balance of payments position at the time. The depletion report sets out quite well (paragraphs 22-27) the macro-economic case for a flatter depletion rate, and paragraphs 19-21 imply that the rate at licensing is the most effective control available - it involves a smaller economic cost than production cutbacks. Does trying not to exceed a self-sufficiency target justify accepting economic penalties?

- (e) The needs of industry, regional employment, etc. Some Ministers may argue that these alone justify a faster rate of development. However, the offshore industry is already past its peak of activity and has got to run down further eventually. It may not be sensible to re-expand it artificially and temporarily. The new licenses would not affect activity until 1981.
- (f) Effect on other interests: defence, fisheries, environment. The new provision for consultation within and outside Government seems adequate. You may want to discourage too much special pleading at this meeting. It should be reserved until the 'shopping list' of potential blocks is available.
- (g) EEC aspects. We know of no difficulties but you should ask the Foreign Secretary to confirm.
- (h) Future rounds. Whatever the decision about this round, the Treasury will probably suggest that there is no need for the Government to commit itself now on the size of future rounds. On the general principle that one does not needlessly close off options before one has to this would seem sensible.
- (i) BNOC involvement. It seems entirely consistent with the decisions Ministers have already taken that BNOC should undertake much less exploration and development, but should nevertheless retain an option over part of the oil. This would be a condition of the license from the start, and thus quite different from the rather more dubious, and retrospective, 'participation deals'.

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CONCLUSIONS

11. The conclusions required are:

- (i) To agree that the next licensing round should consist of approximately 70 / 100 blocks and should proceed on the timetable set out in E(79) 53 with a statement on the lines of the annex to that paper but without the reference to future licensing rounds in paragraph 2 of that statement.
- (ii) To agree to consider the Depletion Report (E(79) 58) at a later meeting you should not, for the reasons stated, record any decision on depletion policy as such.

M.H.
PP
(John Hunt)

22nd October, 1979

EXTRACT FROM DRAFT PROSPECTUS FOR SALE OF PART OF HMG'SHOLDING OF SHARES IN BP

All the above reflects the statement by the Government on Friday 29 June 1979* that in applying depletion policy to discoveries made on first to fourth round licenses, it will be guided by the assurance given in December 1974 by the then Secretary of State for Energy. Depletion policy will, of course, continue to be kept under regular review like all other Government policies.

Notes:

1. * Hansard Col 350 Mr Hamish Gray to Mr Skeet.
2. The present timetable assumes that the Chancellor will agree the sale price with the Prime Minister on 30 October; announce this on 31 October, issue the prospectus on 2 November; applications will close on 9 or 10 November.