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EUROPEAN COUNCIL, LUXEMBOURG

27/28 APRIL 1980

NORTH SEA OIL POLICY

Brief by the Department ofEnergy

OBJECTIVE

(i) To persuade our partners of the constructive contribution to Community objectives made by our North Sea Policies;

(ii) [If tactically desirable] to use the "cosmetic" statement on energy and North Sea policies if it will secure a budget settlement, bearing in mind that the statement cannot be improved and is not negotiable.

POINTS TO MAKE

(a) North Sea Policies [for use as necessary]

1. North Sea oil exports

About half our production is exported and over half these exports go to the Community. In 1979/Community countries took some 57% of our total exports - nearly a third of our total production. This contribution (22 M tonnes) to the Community's needs is considerable in relation to both our limited resources, and the UK's own oil demand. Expect that quantity of exports to the Community will continue to rise as our production continues to rise over the next few years.

2. North Sea oil prices

Prices for North Sea oil follow but do not lead world market for similar high quality, low sulphur crudes. We have made clear to the companies operating in the North Sea our expectation that this will continue. Latest price increases are an indication of continuing moderation by UKCS producers. All but about 1% of

/sales ....

sales are at term prices with no additional premia.
[Annex A can also be drawn on as necessary.]

3. EC Companies interest in North Sea

Substantial Community share in activities on UK Continental Shelf. Companies of EC countries, other than UK, have an interest in 6 of the 14 oil fields in production, and a further 4 oil fields under development, as well as a significant interest in a number of gas fields. Companies of other Member States hold some 14% of total area under licence: this fairly reflects the interest they have shown in licence rounds so far.

4. Supply of Off-shore equipment

Other Member States' companies have enjoyed a high level of involvement. For example, of 35 major oil and gas platform structures so far ordered for the UKCS, 19 were built by other Member States' companies, or by EC/UK or EC/Norway joint ventures. Of the remainder, most involved a substantial input from other Member States' companies, in the provision of technology, top-side, fabrication, steel, etc. Other Member States' companies particularly Dutch, French and Italian, have also been much involved in off-shore installation work. This involvement has brought them valuable business and helped enhance their role in world markets.

5. Increased UKCS production

Virtually no scope for increasing production from the North Sea in the short-term. Production is already at the highest level compatible with good oilfield management. Our policy has been to bring fields into production as fast as possible. By the end of 1979, 14 fields were in production. It took the UK only 4 years to reach production of over 1½ mbpd, much quicker than any other country (Libya: 6 years; others longer). With platforms costing £500 m or more no-one has developed fields to leave them non-productive.

6. Seventh Round of Off-shore Licensing

If appropriate: We will shortly announce the detailed

/arrangements ....

arrangements for the Seventh Licensing Round. We will be awarding licences for up to 90 blocks, and the Round will thus be somewhat larger than previously proposed.

7. Depletion /Defensive - only if raised/
We are considering the question of depletion policy against the background of managing a limited resource. Production is still rising, and we have set a UK net import target for 1985 of minus 5 M tonnes.

North Sea Oil "Wealth" and the Budget

8. North Sea oil contributed only 2.5% to UK GNP in 1979 and will contribute only 4% even at peak production. Contribution of North Sea oil is fully caught in our GNP calculations. Our case on the budget is that with third lowest GNP per capita we should not be highest net contributor.

9. We are not yet net exporters. Rising world oil prices do not therefore benefit balance of payments. Even at peak production we will only be marginal net exporters. Rising world oil prices damage an open economy such as the UK (with about 30% of GDP in exports). We share the interests of other industrialised states in mitigating these ill effects. While we are nearly at self-sufficiency we are still heavy importers of crude, so price rises cut both ways for us.

(b) Cosmetic Statement

10. /If appropriate/ If it will help to achieve a final agreement on the Budget, and assist others with any problem of presentation, we should be willing to make the following statement about our policies in respect of energy and North Sea oil. /The statement is at Annex B/
/If necessary/ This statement is not negotiable.

(c) Community - Reserved UKCS area and Community Stockpile (Defensive)

11. Community reserved UKCS area and Community stockpile in North Sea likely to uneconomic. Cost to Community would be very

/high ....

high. No guarantee of finding oil. Any oil thus found likely to be only fraction of Community requirements.

12. May well be a case for higher stock levels. Work in hand on this in IEA and Community. Should await results before considering new initiatives.

BACKGROUND

ANNEX A	:	UKCS PRICES
ANNEX B	:	PRESENTATIONAL STATEMENT ON ENERGY
ANNEX C	:	NORTH SEA OIL DISPOSALS

(a) **North Sea Policies**

1. Other Member States have criticised aspects of our North Sea policies, usually without justification, and have sought to use our benefits from North Sea oil to rebut our Budget claim. Intensified efforts to explain our record seem recently to have damped down criticism. Points to make are given, however, to counter any renewed criticism and present the constructive contribution to Community objectives made by our North Sea policies.

2. UKCS Oil Production 1980 Forecast (Avoid figures if possible)
Our Production in 1980 is expected to be in the range 80-90 M tonnes (probably towards the lower end) compared with consumption of about 90 M tonnes. Present forecasts suggest that we shall probably need rather less imports in 1980 than the 12 M tonnes we negotiated as our 1980 net oil import target following the Strasbourg and Tokyo Summits. But we may need it if anything went seriously wrong with North Sea production this year (although we have no reason to expect this), and production fell below 80 M tonnes. It would be best to avoid quoting forecasts if questioned since, this early in the year, they are still very uncertain.

North Sea Exports and Prices

3. Production will probably rise until about 1984-86 even if the Government adopts a conservationist depletion policy (see below). The pattern of approximately 50% UKCS oil consumed in the UK and the rest exported is likely to continue. Annex C illustrates crude disposals to Community Member States in 1978

/and 1979 .....

and 1979, in volume terms and as percentages of total exports and production.

4. It now seems generally accepted that our prices follow the world market for similar high quality crude (in practice that produced by Algeria, Nigeria and Libya). BNOC's latest price rise on 4 February, the same date as the African increases, was $4 (21 cents lower than the increase imposed by Algeria and Nigeria). Annex A gives background to UK price increases in the context of the world oil market.

5. <u>EC companies' interest in the North Sea</u>
Fourteen North Sea oil fields are now in production and in the following 6, companies from EC countries other than the UK have an interest:-

Brent	)	
Dunlin	)	
South Cormorant	)	Shell (60% Netherlands
Auk	)	
Forties (minor interest)	)	
Thistle		Deminex (FRG)

Ten North Sea oil fields are under development and companies from EC countries other than the UK have an interest in 4:-

Beatrice	-	Deminex (FRG)
Maureen	-	Petrofina (Belgium) Agip (Italy)
Fulmar	)	Shell (60% Netherlands
North Cormorant	)	

6. <u>Seventh Round of Off-shore Licensing</u>
The proposed arrangements for the Round, announced on 5th December, included the proposition that licences should be awarded for about 70 blocks. Re-consideration of the proposal in the light of strong industry pleas for a larger Round have shown that licensing more blocks would not be detrimental to other policies, such as on depletion. Ministers have also concluded that a timely announcement of a somewhat larger Round (ie. of 90 blocks) would be helpful in persuading our Community

/partners .....

partners that the UK is doing what it can to encourage exploration for further oil and gas resouces on the UK Shelf. If the opportunity arises, emphasis can also be laid on the non-discriminatory nature of licensing which gives full opportunity for participation by Community companies'.

7. Depletion

"E" Committee considered the report on depletion by officials on 11 March and 3 April, and considered that the Government should implement a depletion policy through development delays, control of gas flaring, and profile controls. However, it agreed that a statement (and necessary preparatory explanation to international partners) should be deferred until after the European Council.

North Sea Oil Wealth and the Budget

8. The Germans and the French have argued that increased oil prices have made redress of our net budget contribution less urgent; and that new found wealth from the North Sea makes us better able to pay it. Our case on the budget stands on our relative position in per capita GNP terms, which itself reflects North Sea resources.

9. The UK remains a predominantly manufacturing and trading nation, and a substantial consumer of oil. Our industries and consumers pay the full market price. Far from our being immune to its depressive effects the immediate impact of a price increase is negative both on our balance of payments and on resources available for domestic use in the economy.

(b) Cosmetic Statement

10. The interest in energy and pressure on North Sea oil by some of our Community partners continues and the potential for linkage with the Budget problem - either to our disadvantage or advantage - remains.

11. The Prime Minister has approved the text of the statement at Annex B for use in the negotiations, if she considers that it could help us to attain our Budget objectives by helping

others to present a Budget settlement to their publics.

12. There is a risk that offering such a largely cosmetic statement will provide a platform on which damaging demands can be built for substantive concessions which would be unacceptable to us. If the Prime Minister uses the statement, therefore, any pressures for change will need to be resisted firmly; it is not negotiable. This points to holding the offer to make a statement in reserve for use at a late stage, and only if its use seems likely (perhaps after informal consultation in the margins) to result in a final settlement.

(c) Community - Reserved UKCS area and Community Stockpile

13. French officials have suggested informally that an area of the North Sea might be set aside for the Community to explore and exploit in a sub-crisis. They envisage that the Community would be responsible for providing finance and much of the spending would be in the UK.

14. We have examined this idea and concluded that it would be uneconomic as:

(i) there would be no guarantee of finding oil;
(ii) to have a reasonable chance of finding fields capable of producing a total of 100,000 bpd, ie. enough to cover a short-fall of only 1%, at least 50 licensing blocks would have to be set aside (ie. more than the whole of the sixth round);
(iii) exploration and appraisal costs (at least 50 wells) would be at least £250 M over 2 to 3 years;
(iv) production platforms (assuming 2 or 3) would add another £2,000 M or more. Total cost would thus be at least £2,250 M (as against £32 M on the energy section of the Community budget of 1979).

15. Another possibility being covered canvassed is the creation of a Community and/or IEA stockpile. This idea was among those considered by OD(E) in October/November in the context of a possible UK initiative to strengthen the Community in a sub-crisis.

Ministers concluded that in view of the disadvantages (eg. expense; additional pressure on prices; possibility of adverse OPEC reactions;) there was no scope for a UK initiative on stocks at that stage. IEA Ministers commissioned further work from the IEA Secretariat on stocking policies at their meeting in December; and work is also under way in the Community. The results of the IEA work will be considered by Ministers in May.

Department of Energy
15 April 1980

ANNEX A

UKCS Price Setting

1 UKCS crude is comparable to African crudes (appendix 1). The participation agreements entitle producers to the market price for crude oil they must sell to BNOC. If the price cannot be agreed there is provision for recourse to expert determination.

2 Only one sixth of the oil BNOC is currently selling is its own equity oil. Participation oil makes up the bulk of the remainder purchased at the market price prior to selling. BNOC is not therefore a free market/price setter.

3 HMG has no statutory powers to determine UKCS prices. Reserve powers exist in the Energy Act 1976, but may be exercised only in an emergency or to implement formal obligations to the EC or IEA. This power would, in any case, not extend to crude oil traded offshore.

Crude Oil Market Development and Government Intervention in UKCS prices

4 Between 1974 and mid 1978 world oil prices were relatively stable. Term prices were set by a Saudi marker with differentials for other crudes reflecting quality differences and location only. Spot prices were close to term prices.

5 The Iranian crisis changed the market from demand constrained to supply constrained. Spot prices rose well above term prices and the term market became fragmented (appendix 2). The downward trend of price in real terms was reversed and real prices are now about 50% above the 1974 level (appendix 3).

6 This anarchy in the market led to considerable pressure for Government to intervene on UKCS prices particularly from the middle of 1979; both BNOC and companies were urged to be moderate with price increases.

~~7 In November 1979 the timing of BNOC's increases (appendix 4) was premature and attracted much international criticism. But further increases in January and February were better timed; the decision was left for longer giving the impression that the UK was the last to come into line (although the effective date of the increases was similar to that for other producers). During January UKCS crude were probably below the market level and the settlement was only achieved through pressure being applied to a number of companies. One company still has an outstanding claim against BNOC for higher January prices.~~

7. See corrigendum adjacent.

UK interest in oil prices

8 Much play is made by our partners of the value of North Sea oil to us. But we are not yet self sufficient and increases in world oil prices are a net cost to the economy. Some 30% of GDP comes from international trade; thus GDP will be affected by any recession caused by high oil prices and the loss will not be offset by higher oil revenues (which in total only account for a few per cent of GDP).

Community benefits from UKCS

9 There is no restriction on exports and about one third of UK production is exported to the EEC. Only 1% of output is sold at spot prices; all the rest is sold at term prices and there are no premia or surcharges equivalent to those levied by some OPEC countries. Prices themselves are moderate. When African prices increased by $4.21/b in February, the UK prices increased by $4/b only.

10 If UK crudes were sold at spot related prices our EEC partners would have to pay another $3/b or about £250m a year in total.

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