Qa 04282

To: MR LANKESTER

From: SIR KENNETH BERRILL

BP/BNOC Oil Trading

1. In his minute of 26 September, the Secretary of State for Energy described for the Prime Minister the problem of BP's shortage of crude oil and the limits to BNOC's ability to help. The Prime Minister might find it useful to have a little background information on this issue.

2. BP's approach to HMG, which is set out somewhat more fully in Sir David Steel's letter of 19 September to Lord Carrington (copy attached), in effect marks a turning point in the relations between BP and HMG. For decades BP has acted as a very independent international oil major doing what it thought best in the company's long term commercial interest. For the most part it has done this with the full blessing of HMG. Even at times of crisis, for example in 1973, BP has applied a policy of equality of misery to British customers as well as to its other customers. This approach reflected (i) BP's intense desire to be seen as a genuinely independent company and not as the United Kingdom national oil company; and (ii) the fact that the United Kingdom represented only a small share of BP's total market and the UK has only become a producer of oil in recent years. So although there have always been close relations between HMG and BP, in some ways they have been less close than HMG's relations with Shell.

3. The events of the past year have changed all this. The UK is now a major oil producer and BP has shifted from a major with a large crude surplus into a crude deficit company (which is the position of Shell, Exxon and Mobil). In his letter, Sir David Steel is seeking HMG's help not only for its UK operations, but also for its worldwide activities.

4. BP's predicament is serious but probably not as serious as indicated in Sir David Steel's letter or Mr Howell's minute. First, it is unlikely that BP will need to find as much as 36m. tons of crude in 1980. This figure would appear inter alia to be based on estimates by BP's marketing managers throughout the world on what they would ideally like to have to sell compared to their reliable sources of supply. Secondly, leaving aside what they can obtain from BNOC at 'official prices'(see paragraph 6 below), BP are unlikely to have to purchase the remainder of their deficit on the spot market. Some they should be able to purchase at 'official' prices. Thirdly, it is not unlikely that the gap between spot prices and official prices will be less next year than they currently are.

5. In sum, BP's figures ($500m. cost of operating in the spot market) not unnaturally paint the worst case and should not be taken at their face value. It is, however, fair to point out that it is possible to paint scenarios which would put BP in an even worse position, for example, if it lost all its Kuwait supplies.

6. All parties are agreed that BNOC should help BP. The question is to what degree and on what terms. Nobody is suggesting that BNOC by itself should meet BP's forecast deficit. This would pre-empt the greater part of BNOC's crude availability in 1980 and would totally undermine the Government's policy of using BNOC's oil to achieve security of the UK's oil supplies at a time of great uncertainty. I think the balanced approach proposed by the Secretary of State between the need to help BP and maintain our security of supply is the right one. BNOC have in fact already offered to meet BP's UK refinery deficit for 1980 (some 7½m. tons) and to provide a little more (say 2½m. tons) direct to BP's EEC subsidiaries. If BNOC goes much further it will inevitably reduce its ability to use its crude to ensure our security of supply. This 2½m. tons of net exports to help BP are not as much as they would like but will help close the gap.

7. As a quid pro quo BP should undertake to make its own North Sea oil (or an equivalent amount of non-North Sea oil) available to its UK refineries at all times. Shell and Exxon gave such undertakings under their Participation Agreements. BP has never given a parallel undertaking and that indicated in Sir David Steel's letter to Lord Carrington is not as firm as it might be. I would, however, expect this matter to be resolved in BNOC's negotiations with BP.

8. On this basis HMG would be going some way to help a British company (BP) in its new predicament but taking the occasion to specify a new relationship under which BP would give preference to its UK operations in times of shortage and direct any net exports of North Sea oil over and above the needs of BP UK refineries to our EEC partners. A move from which we should be able to extract some credit in Brussels.

9. There is some urgency about these negotiations. If the UK Government sells a large block of BP shares the company is obliged under the rules of the US Securities and Exchange Commission to publish a prospectus. That prospectus will need to include forecasts of BP's oil availability and if these are poor the share price could be affected. Any BNOC arrangements should therefore be included. BP have to complete their prospectus for filing with the Securities and Exchange Commission by 12 October at the latest and preferably by 5 October - a fact that BNOC are currently not aware of, although BP may tell them tomorrow. It is desirable that BP's negotiations with BNOC should be concluded at least in principle by then.

10. I am sending a copy of this minute to Sir John Hunt.

KB

1 October 1979

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