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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BRITISH NATIONAL OIL CORPORATION: TIMING OF  
CLYDE OILFIELD DEVELOPMENT

Memorandum by the Secretary of State for Energy

1. At E(80)33rd Meeting on 15 September I was invited to arrange for the deferral of Clyde field development by five years unless further detailed examination convinced me that we should reconsider the question.
2. The Secretary of State for Scotland in his letter of 2 October, copied to colleagues, has expressed his strongly held view that the economic consequences of deferment for five years could be very grave. I too am extremely concerned at the effect which a five-year delay would have, not only on the prospects of our offshore supplies industry but also on the British National Oil Corporation (BNOC) and oil exploration activity generally.
3. The Chairman of BNOC has expressed great concern to me (see Annex A) and has put forward proposals which would neutralise the public expenditure costs of a two-year delay for Clyde compared with a five-year delay. The Chairman of Shell UK, one of BNOC's Clyde partners, has also warned of the serious consequences of a five-year delay (see Annex B).
4. I would urge colleagues to reconsider this decision and reduce the deferral to the two years I proposed.

PUBLIC EXPENDITURE

5. Assuming a two-year deferral of Clyde, BNOC consider that a practical means of matching the extra public expenditure involved in production of first oil in 1987 rather than 1990 would be to undertake sales of oil for advance payment in each year.

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The additional costs could be rolled forward annually until capital expenditure declined and revenues from Clyde crude oil were received. Deliveries of oil would take place in the financial year following the sale. Only a very small quantity of oil would have to be delivered before 1983 and none before mid-1982; and significant volumes in relation to BNOC's availability would not be involved before 1985/86. On BNOC's current assumptions about out-turn prices, the cumulative total of sales required would be:

	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
£M	4	25	81	165	245	200	-

6. BNOC consider this proposal to be in their best commercial interest and I intend to accept it if we decide on a two-year delay. There might be some international reaction but even at the peak the sales involved would be much smaller than in the exercise undertaken by BNOC earlier this year. I would envisage the sales taking place as an independent exercise in due course, without special publicity or any link with Clyde.

7. The public expenditure costs of a two-year delay would therefore be the same as for a five-year delay. We can consider the issues without regard to the public expenditure implications.

OFFSHORE SUPPLIES INDUSTRY

8. The offshore supplies industry is one of the most successful to have been built up in the UK in the last decade. Last year it won around 80% of all new orders placed for the UK Continental Shelf, business worth £2,100 million. Platform orders placed in the UK help other British suppliers to secure associated orders, for instance for fabrication work and process plant. The existing five platform yards have been particularly beneficial in reducing the high unemployment in the remote areas of Scotland where they are located.

9. The offshore supplies industry is now, however, entering a period of great uncertainty. Even assuming that a platform order for Clyde is placed by 1984, there will be insufficient orders to sustain more than two steel fabricating yards beyond that date. We need two such yards for the longer-term and the problem is to ensure an orderly run-down of capacity from the present five yards. Clyde can play a crucial part in this since it is the only order which we can be confident will come to the UK.

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10. Exploration rigs would not be an adequate alternative. The skills and facilities required are more in keeping with a shipyard and it would take time, and possibly investment, before the platform yards could take on any rig work. Rig orders would have to be won in the face of fierce competition from shipyards in the Far East. Even then, they could still leave the platform yards, which carry heavy overheads, severely underutilised, and not ease the problems of the module builders process plant and equipment manufacturers. A rig employs only some 600-700 persons over the 18-24 month construction period whilst a major platform can employ on-site up to 2,000, mainly on steel work, over a similar period. A rig also requires very little additional equipment apart from its structure, perhaps only around £10m - £20 m, whereas a production platform can lead to orders worth £200m - £300m, providing employment across industry.

BRITISH NATIONAL OIL CORPORATION

11. BNOC have no other development in prospect in any way comparable with Clyde and, unlike the multi-national oil companies, lack any other projects on to which they could redeploy staff. They could accommodate with some difficulty a two-year delay. A five-year delay would be a much more serious blow, and prevent the development of their offshore operating capability. Their project management teams would have to be rundown and it would not be easy to build them up again.

12. The repercussions of such a setback would be damaging, as the Chairman of BNOC has stressed to me (see Annex A). It would weaken the British presence on the UK Continental Shelf which, apart from BP, is otherwise dominated by overseas companies. It would not encourage the public to participate in the revenue bond scheme which we have announced. It would reduce our chances of successfully introducing equity into BNOC's upstream activities by affecting the confidence of investors.

13. More generally, it would weaken the ability of BNOC to form partnerships for North Sea exploration and development. The five-year delay would inevitably be interpreted, as it already has been in the Press, as based on PSBR rather than other considerations, and it would not be possible convincingly to refute this. Other companies would in future be much more chary of links with BNOC. The letter from the Chairman of Shell UK in Annex B illustrates the dangers very clearly.

WIDER EFFECTS

14. The arguments for and against two and five year delays of the field on depletion grounds were included in my earlier paper (E(80)98). I would only add that whichever

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course we adopt the bulk of production from Clyde will take place in the 1990s when on current forecasts we expect production to be in decline and self-sufficiency to have ended.

15. Shell and Esso - BNO's partners in Clyde - would not be too seriously affected by a five-year delay as such, but both they and the oil industry generally would undoubtedly look closely at the implications, particularly for our attitude on depletion. In my statement of 23 July I said that we would implement depletion policy flexibly and on a case-by-case basis, and the industry will expect this to mean that proper regard is paid to their interests. A five-year deferral of Clyde would raise doubts about this.

16. We have hitherto assumed that depletion policy will not affect the oil industry's willingness to step up exploration work because little oil from new finds is likely to come ashore until the 1990s (ie after the hump of surplus production we foresee). There have, however, been recent warnings from the industry that extensive delays in new field developments could cause them to hold back exploration and other expensive appraisal work needed to establish the extent of recoverable reserves before development proposals can be formulated.

17. It is hard to assess this risk. But the attitude of companies towards exploration appraisal work is bound to be affected by our decision on Clyde, particularly in the aftermath of the proposed tax on oil production which we have recently announced.

#### CONCLUSIONS

18. A five-year delay on Clyde would damage our offshore supplies industry, greatly weaken BNO and the British presence on the UK Continental Shelf and possibly raise doubts in the oil industry about our intentions on depletion, with long-term consequences for exploration.

19. Given BNO's proposal for advanced sales of oil, the public expenditure cost of a two-year delay would be the same as for a five-year delay.

20. I hope therefore that colleagues will be prepared to reconsider their decision and adopt a two-year delay as I recommended.

DARF

Department of Energy  
11 December 1980

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ANNEX A

## MEMORANDUM - THE BRITISH NATIONAL OIL CORPORATION

### CLYDE

In approaching this subject, it is necessary, I believe, to set it in the context of the development plans of The British National Oil Corporation as a whole.

BNO is the principal direct involvement of the British Government and people in the ownership of the equity of oil production from the British sector of the North Sea. (It also exercises certain powers on behalf of the British Government, but these are not in question here.) There is, therefore, a considerable degree of public interest in the operations and the future of BNO. It is the duty of the Board of BNO to ensure that its present profitable position is carried forward as long as possible in and beyond this century and that its present wealth is employed to build and maintain a powerful national oil company, contributing to the energy and to the financial resources of the Nation, from the Corporation's operations both here and overseas. The Corporation has already started, with the consent of the Department of Energy, on a number of modest operations overseas, but it is likely that its operations in the North Sea will always (as we believe they should) be more significant than anything that it does overseas, more particularly at the present time and in the near future.

The development of the Clyde field (the first actually discovered by BNO and the third to be operated by it) is of critical importance to the immediate future of the Corporation,

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its operations and its standing in the North Sea. Despite this, the Corporation has already agreed with the Department of Energy to postpone the first delivery of oil from Clyde to 1987, in order to comply with the Department's view of the correct depletion policy for the North Sea. Annexe I shows the latest forecast of UKCS production, together with the effect of a 1987 start-up for Clyde. Even with the postponement of Clyde, it will be observed that the gap between North Sea production and U.K. requirements will increase dramatically from 1987 onwards. In the view of the oil industry as a whole, it is necessary for the Government and for the industry to take urgent steps to fill that gap.

It is now suggested that the Government will require BNOC to delay Clyde for a further three years (making five years in all) for reasons connected with the PSBR. We recognise the seriousness of the position with regard to the PSBR, but we submit that a restriction of spending on Clyde would be far more damaging than any short term saving that might be achieved in connection with the PSBR. It will be realised, of course, that BNOC is entirely self-sufficient financially. Its operations do not increase the PSBR; it is only a question of how large a positive contribution it makes to the reduction of the PSBR.

The particular reasons why further postponement of Clyde would be so damaging to BNOC are as follows :-

1. The Beatrice field and its associated facilities at the Nigg Terminal are likely to come into production in the Autumn of 1981. From then on there will arise a surplus of specialist project staff who are intended in the Corporation's plans to be deployed in the Clyde field. If they cannot be so employed, they are almost certain to leave

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the Corporation for other employment. The Corporation is not able to offer them satisfying alternative employment since the Clyde field is the only project of this sort which the Corporation has on hand. While their redeployment could be phased over a two year delay, it could certainly not be phased over a five year delay. The Multi-national oil companies, on the other hand, can readily provide alternative employment in their large overseas operations (pending their recall to the North Sea) and this would put BNOC at a distinct competitive disadvantage. The Corporation, in its short life, has been able to build up an efficient and well motivated team for North Sea operations, often through such fortuitous events as the takeover of Burmah and National Coal Board operations. If this team were to be dissipated, it would be difficult, if not impossible, to rebuild it in the competitive circumstances now prevailing in the North Sea.

2. Were it to become a matter of common knowledge (as it inevitably would do) that the Corporation has been prevented from developing the Clyde field by circumstances outside energy policy, i.e. those relating to the PSBR, partners of the Corporation in this and other projects would regret their involvement with the Corporation and would seek ways to terminate it, since the Corporation would be in the uniquely disadvantageous situation of having its commercial decisions affected not only by energy considerations (which will apply to companies generally), but also by financial restrictions which apply to the Corporation only because it is owned by the British Government. While this could be seriously damaging to the present position of the Corporation, it would

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undoubtedly be even more damaging in the future since other oil companies will be loath to co-operate with the Corporation in joint ventures, which are so much a part of the scheme of development in the North Sea. The long term disadvantages of such a situation are hard to over-estimate.

3. If the Corporation proceeds with the Clyde field, this will almost certainly lead to an order for a platform from a British yard, thus providing help for British industry and better prospects for employment in critical areas. The record of the Corporation for ordering British (and persuading its partners to do so) is well known. The longer the delay in Clyde, the longer the postponement of such orders and their consequential business and employment benefits.

4. The Government has proposed, with the full support of the Corporation, an issue of Bonds to the public in the near future, followed by - at some distance in time - a sale of a minority equity in the Corporation. The public enthusiasm for such issues would undoubtedly be diminished if it became apparent that the Corporation's commercial activities were being restricted by circumstances entirely exterior to the commercial needs of the Corporation and the energy policy of the Nation.

5. We are well aware that the Corporation has not yet contributed to the national funds in terms of actual tax paid. It will, in fact, pay its first Petroleum Royalty Tax in 1982 and thereafter will make very substantial payments of tax, like other companies operating in the North Sea. This is undoubtedly proper. It can also

be said to be proper that, in the period before the payment of tax, the Corporation should make substantial payments to the Government via the National Oil Account. These are likely to be of the order of £200m in the year ending 31st March 1981 and substantially more in the year ending 31st March 1982. Furthermore, the Corporation, by means of forward oil sales, made the only really significant contribution to asset sales in 1979/80 and is willing to do so again in 1980/81. In Annexe II we show the monies that can be made available in the 1980s by the Corporation directly to the Government and also by means of royalty, PRT and Corporation Tax. In Annexe III we show the advantages to the PSBR of postponing Clyde by the additional three years and the disadvantages which will inevitably follow in terms of the loss of income in the following years. We submit that the positive yield of royalty, PRT and Corporation Tax from the Corporation as a whole will much more than outweigh the temporary expenditure on Clyde in the years in question.

6. The Corporation has a present rate of return on its assets employed of 28% before tax. We calculate that the rate of return on the investment in Clyde field will be 32%, which will be lost to the Nation in every year in which the project is delayed. Since, in effect, the monies paid over by the Corporation to the Government will inevitably go into funding some other activity, it is relevant to ask what other activity will produce yields comparable to those of the Clyde field. It is a general principle of good business to re-inforce success and to eliminate loss-makers. We believe that this principle should be applied in the present case, with the result that the carrying out of Clyde should take precedence over other, less profitable, activities.

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For the reasons given above, we most strongly request that there should be no postponement of Clyde beyond the two years already agreed with the Department of Energy. The effect of such a delay on the morale of those who work for the Corporation and on its future relations with partners would be damaging beyond the short term gains to the PSBR. The relatively small savings to the Government in purely financial terms in the years in question would be significantly outweighed by (a) the contributions of royalty, PRT and Corporation Tax then being made to the Government by the Corporation and (b) the specific contributions from the Corporation as a result of the earlier development of the Clyde field. The savings would, of course, be insignificant compared to the yield to the Government from the North Sea as a whole.

Chairman and Chief Executive.

21st October 1980.

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ANNEXE Ia

Future UKCS Oil Production 1980-1990

Average Production for year

Year End 31st Dec.	Proven Fields* '000 b/d	Clyde** '000 b/d	Total '000 b/d
1980	1663	-	1663
81	2024	-	2024
82	2313	-	2313
83	2492	-	2492
84	2663	-	2663
85	2582	-	2582
86	2384	-	2384
87	2076	12	2088
88	1691	47	1738
89	1407	47	1454
90	1183	47	1230

\* based on operator estimates

\*\* production commencing in the fourth quarter 1987

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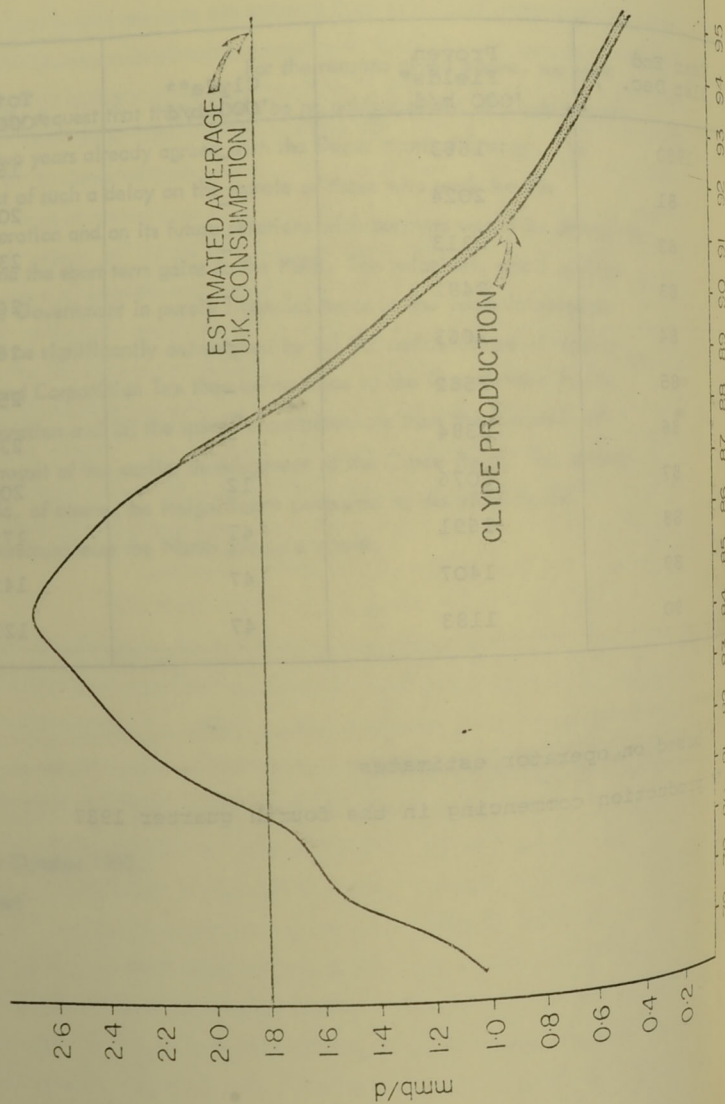
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ANNEXE I

UKCS CRUDE OIL PRODUCTION FORECAST



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B.N.O.C. - Contribution to HMG

ANNEXE II

Year End 31st Dec.	Royalties £'m	PRT £'m	CT £'m	Sub-Total £'m	BNOCSurplus Funds £'m	Total £'m
1980	45	-	-	45	155	200
81	60	-	-	60	450	510
82	100	160	-	260	490	750
83	125	430	-	555	450	1,005
84	160	550	150	860	360	1,220
85	190	650	230	1,070	200	1,270
86	190	780	170	1,140	20	1,160
87	185	700	110	995	250	1,245
88	245	600	200	1,045	275	1,320
89	240	550	275	1,065	200	1,265
90	240	650	265	1,155	80	1,235
Total	£1,780m	£5,070m	£1,400m	£8,250m	£2,930m	£11,180m

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ANNEX A

Net loss to HMG resulting from deferral of Clyde from 1987 to 1990.

Year end 31st Dec.	Net Reduction in BNOG Contribution to HMG. £'m	Net Reduction in CT + PRT Payments by Clyde Partners £'m	Net Reduction in Royalty Payments by Clyde Partners £'m	Total Net Reduction to HMG £'m
1981	2.0	-	-	-
82	11.0	-	-	-
83	49.4	-	-	-
84	44.7	63.7	-	108.4
85	62.9	78.6	-	141.5
86	(42.3)	105.1	-	62.8
87	(220.5)	11.6	-	(208.9)
88	(239.6)	(218.3)	(71)	(528.9)
89	(152.1)	(358.0)	(76)	(588.1)
90	(23.6)	(116.4)	(82)	(422.0)
Total	£(508)m	£(434)m	£(229)m	£(1171)m

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ANNEX B

Shell Mex House Strand London WC2R 0DX  
Telephone 01-438 3701

22nd October 1980

Dear Secretary of State,

You will not be surprised if I express to you the concern which we in Shell feel about the widely rumoured possibility that the Government may decide to defer the development of the Clyde field by five or more years for reasons connected with the relationship between BNOG's capital expenditure and the PSBR. As private sector partners in Clyde we would regard such a deferment as an unwarranted frustration of our own willingness to spend capital in order to develop a profitable new oilfield in the North Sea.

Writ large, such a policy would pose a threat to all exploration and oilfield development projects in which BNOG has an equity interest. Given the spread of BNOG's interest, in many cases for statutory reasons, this would in turn undermine the ability of the oil industry to explore and develop the resources of the UK Continental Shelf with the speed and vigour necessary to ensure the prolongation of oil self sufficiency for Britain for as long as possible with all the attendant benefits in terms of job and wealth creation.

It would also seriously reduce BNOG's attraction to the private sector as a partner in future ventures, and in this connection you will be aware of our association with them in a number of Seventh Round applications. In fact, the logical consequences of applying such a policy, if overall development is not to be curtailed, is that there would have to be a restructuring of BNOG's role to permit its private sector partners to buy out or in some way take over its interests whenever public sector expenditure constraints required it to opt out of capital expenditure programmes. Whilst we might not be averse to doing this in the case of Clyde, for example, we wonder whether it would be in line with Government intentions about the role of BNOG. Alternatively consideration might be given to the option of allowing the public to subscribe funds to finance BNOG's share of this project.

I would very much welcome your reassurance that the application of the Government's monetary policies will not impede the investment plans of private sector companies such as ours, when in partnership with a nationalised industry, for the timely development of offshore resources.

I am taking the liberty of sending a copy of this letter to the Chancellor of the Exchequer.

Yours sincerely  
John ...

The Rt. Hon. David Howell, MP,  
Secretary of State for Energy,  
Thames House South,  
Millbank,  
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