

PREM 19/1474

SECRET

Confidential filing.

The Future of BNOG.

ENERGY

Proposed Sale of BP Assets.

Part 1: July 1979

MATERIAL USED BY OFFICIAL HISTORIAN

Part 5: January 1982

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
15.7.82		22.9.85					
20.7.82		14.12.83					
23.7.82		14.3.84					
26.7.82		15/6/84					
5.8.82		19.6.84					
11.8.82		22.6.84					
14.8.82		25.6.84					
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4.10.82		6.3.85					
11.10.82		4.3.85					
26.10.82		13.3.85					
27.10.82		21.3.85					
2.11.82		25.3.85					
5.11.82		4.4.85					
11.11.82		15.4.85					
16.11.82		30.4.85					
22.11.82		4.7.85					
24.11.82		12.11.85					
24.11.82							
2.12.82							
27.6.83		PTS					
26.6.83		BNOG					
5.7.83							
25.7.83							

PREM 19/1474

PART FIVE ends:-

D/ENERGY to PS/LPS 12/11/85

PART SIX begins:-

D/ENERGY to PS/LPS 24/3/86.

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

House of Commons HANSARD, 13 March 1985, columns 305 to 313: British National Oil Corporation

House of Commons HANSARD, 25 July 1983, columns 783 to 787: Energy Assets (Sale)

House of Commons HANSARD, 25 July 1983, columns 795 to 799: Energy Assets (Sale)

House of Commons HANSARD, 22 November 1982, columns 596 to 601: Britoil

House of Commons HANSARD, 10 November 1982, columns 547 to 555: Britoil

House of Commons HANSARD, 27 October 1982, column 1060: Britoil

Signed J. Gray Date 5/12/2013

PREM Records Team

01 211 6402

David Morris Esq
Private Secretary to
The Lord Privy Seal &
Leader of the House of Commons
House of Commons
LONDON
SW1A 0AA

12 November 1985

Dear David,

ESTABLISHMENT OF OIL AND PIPELINES AGENCY

I enclose a copy of an announcement Alick Buchanan-Smith proposes to make, by an arranged written Parliamentary Question and Answer, about the establishment of the Oil and Pipelines Agency, the small successor body to BNOC.

The two Orders referred to in the announcement will have the combined effect of bringing into force on 1 December all provisions of the Oil and Pipelines Act 1985 (except for a few repeals which will need to await the final abolition of BNOC) and establishing the new Agency as an operational body from that date.

The Orders are not subject to either negative or affirmative procedure. But clearly the House needs to be informed; hence the proposed announcement which the Department also intends to publicise more widely by the issue of a press notice.

We plan to make the announcement on Friday 15 November. Since the Orders simply give effect to a policy which was extensively debated during the Parliamentary passage of the Act, it seems unlikely that the announcement will provoke much comment.

I should be grateful if you would let me know whether you have any comments on our proposals as soon as possible.

I am sending copies of this letter to Tim Flesher and Bernard Ingham at No 10.

*Yours,
G S D*

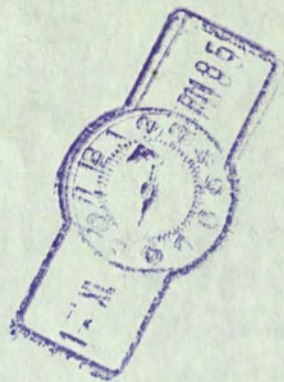
G S DART
Private Secretary

DRAFT ARRANGED PARLIAMENTARY QUESTION AND ANSWER

Q To ask the Secretary of State for Energy whether he has yet appointed a date for the transfer to the Oil and Pipelines Agency of the property, rights and liabilities of the British National Oil Corporation, and if he will make a statement?

A Pursuant to section 3(1) of the Oil and Pipelines Act 1985, I have today made the Oil and Pipelines Act 1985 (Appointed Day) Order 1985 (SI No) appointing the 1st of December 1985 as the date on which the property, rights and liabilities of BNOC are to be transferred to the Oil and Pipelines Agency. The Order has the effect of bringing into force section 3, Schedule 2 and Part I of Schedule 4 to the Act.

I have also made today the Oil and Pipelines Act 1986 (Commencement) Order 1985 (SI No) appointing the 1st of December 1985 as the date on which all other provisions of the Act are to come into force with the exception of the repeals set out in Part II of Schedule 4 to the Act which will take effect on the dissolution of BNOC.



MR TURNBULL

Prime Minister ②

To note that the process of winding
down BNOC is very largely
complete

4 July 1985

AT 4/7

THE RUN-DOWN OF BNOC

Against the background of the current OPEC meeting, it occurs to me that you might like a note on the progress which has been made in running down BNOC, in case the Prime Minister should have any queries.

The 500,000 barrels per day (bpd) of oil available to BNOC under Participation Agreements has all been returned to the producers. Separate third-party contracts at the official BNOC price accounted for an additional 120,000 bpd. That volume has now been reduced to some 50,000 bpd, and within 2 months the Department of Energy expect it to be down to 20,000 bpd. Further pressure will be applied to the producers - which incidentally are likely to include Burmah - to withdraw voluntarily from the contracts.

In principle, it would be nice to wind up all these contracts and, with them, the existence of a BNOC official price. On the other hand, the BNOC official price is no longer a significant factor in the oil market. There is no merit in the Government attracting criticism by applying unreasonable pressure to the residue of small producers.

In any case, initial fears that the small producers would be taken to the cleaners by the large producers, who are the

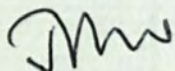
natural outlet for small additional streams of oil, have not materialised. Now that BNOC has withdrawn, some of the medium-sized producers are lifting their own oil and competing with the majors to offer attractive terms to mop up the small residual volumes from the minor producers.

The Government Oil Pipelines Agency is likely to be established either on 1 October or 1 December 1985, depending on whether the associated legislation is completed before or after the Summer Recess. The Department of Energy have had some difficulty in retaining a core of traders from BNOC. Assuming that GOPA continues to dispose of the Government's Royalty Oil (currently 250,000 bpd) a total manpower establishment of 40-45 is envisaged.

Some of the major oil companies with refineries in the UK - notably at this stage BP - are pressing the case to buy back the Royalty Oil relating to their own production. The attraction for them would be to run this oil through their own refineries. Because of difficulties in establishing an arm's length tax reference price, the rest of their production is normally traded through the spot market and, where necessary, bought back by the producers' subsidiaries. The Department of Energy have yet to reach a policy decision on whether or not to concede this. They feel that if the concession is made for one integrated oil company, they would have to make the concession for all. This would remove the majority of GOPA's availability from its

portfolio. The remaining trading operation would hardly be meaningful.

The removal of BNOC from the oil market is seen with hindsight as having eliminated two destabilising effects: the tendency for traders to speculate against BNOC whenever the oil market is critically weak; and the removal of a seller in the inherently weak position of having to sell a large volume of oil in a buyer's market. For all that, the oil market is still fragile.



JOHN WYBREW

NBPS.



Y SWYDDFA GYMREIG
GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-233 3000 (Switsfwrdd)
01-233 8545 (Linell Union)

ODDI WRTH YSGRIFENNYDD
PREIFAT YSGRIFENNYDD
GWLADOL CYMRU

WELSH OFFICE
GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-233 3000 (Switchboard)
01-233 8545 (Direct Line)

FROM THE PRIVATE SECRETARY
TO THE SECRETARY OF STATE
FOR WALES

30 April 1985

Dear Private Secretary,

BNO

Thank you for having sent a copy of Andrew
Turnbull's letter to Michael Reidy dated 6 March.
I am writing to acknowledge the receipt of this
letter.

Yours Sincerely
P. Edwards.

P EDWARDS
Private Office

Private Secretary
10 Downing Street
Whitehall
LONDON SW1

WELSH OFFICE
GWYBYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel: 01 233 3000 (Whitewall)
01 233 8848 (Direct Line)
FROM THE PRIVATE SECRETARY
TO THE SECRETARY OF STATE
FOR WALES

GWYDDFA CYMRU
GWYBYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel: 01 233 3000 (Whitewall)
01 233 8848 (Direct Line)
ODD WYTH YGRIFFENYDD
PRYD YGRIFFENYDD
GWJADOL CYMRU

1 MAY 1985



1000

Handwritten initials



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

15 April 1985

The Rt. Hon. Peter Walker MBE MP
Secretary of State for Energy

ngm
N 15/4

Handwritten signatures: Stan Peter

BNOC AND THE FUTURE OF THE GOVERNMENT PIPELINE SYSTEM (GPSS)

Thank you for copying to me your letter of 1 April to Michael Heseltine.

I agree that it would be useful for officials to examine the scope for efficiency improvements within the present management structure so long as these do not close off any of the longer term options for the GPSS, including privatisation.

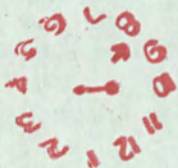
I am copying this letter to the Prime Minister, Willie Whitelaw, Geoffrey Howe, Michael Heseltine, John Biffen and Sir Robert Armstrong.

Handwritten signature: Nigel Lawson

NIGEL LAWSON

ENERGY: brook

A5



175 APR 1985

CONFIDENTIAL



cc 110

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

The Rt Hon Michael Heseltine MP
Secretary of State for Defence
Whitehall
London
SW1A 2HB

NLSM

1 April 1985

BNOC

Thank you for your letter of 12 March on the question of the future management of the Government Pipeline System. It was very helpful of you to give me such a prompt reply. I am grateful too for Nigel Lawson's letter of 25 March on this subject.

I note that Nigel Lawson would like the report by officials on privatisation of the GPSS to be completed and considered after Easter. Early privatisation would be inconsistent with the recent statement on BNOC, which, following discussion at the Prime Minister's meeting on BNOC and my subsequent consultation with you, was based on the assumption that the new Oil and Pipeline Agency would continue to handle the GPSS. Unless we proceed on the basis announced on 13 March we will add greatly to the difficulties in effecting a smooth transfer of responsibilities and staff to the new Agency. I propose, therefore, that no further work on the privatisation option should be done at present; and that we proceed in our dealings with BNOC staff and GPSS customers on the basis of the 13 March statement.

However, I think it would be helpful as you suggest to consider any alternative ways consistent with the new Agency's management role by which the management and use that is made of the GPSS can be improved. Clearly the intention to set up the new Agency will limit the scope for any major changes to the management in the near future but subject to this I think it would be sensible for officials to look at any options for improvement.

I am copying this letter to the Prime Minister, Willie Whitelaw, Geoffrey Howe, Nigel Lawson, John Biffen and Sir Robert Armstrong.

PETER WALKER

CONFIDENTIAL

Energy: BNOOC A5.

02 APR 1965





Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

25 March 1985

The Rt. Hon. Peter Walker MBE MP
Secretary of State for Energy

NBM

Peter Walker

BNOC AND THE FUTURE OF THE GOVERNMENT PIPELINE SYSTEM

I have seen Michael Heseltine's letter to you of 12 March, setting out the difficulties we could encounter with the privatisation of the Government Pipeline System (GPSS).

I understand officials are in the process of finalising a report on the practicalities and problems of privatisation of the GPSS and the alternatives. It would in any case be difficult to take a decision on the future of the GPSS in time for legislation to be included in the BNOC bill. I therefore think it would be helpful if officials completed their report so that we could discuss after Easter what should be done about the GPSS. The report will of course need to discuss the issues raised in Michael's letter.

I am copying this letter to the Prime Minister, the Lord President, the Foreign and Commonwealth Secretary, the Secretary of State for Defence, the Lord Privy Seal and Sir Robert Armstrong.

NIGEL LAWSON

Nigel Lawson

26 MAR 1985



DEPARTMENT/SERIES <i>PREM 19</i> PIECE/ITEM <i>1474</i> (one piece/item number)	Date and sign
Extract/Item details: <i>Mesettine to Howe dated 25 March 1985</i>	
CLOSED FOR <i>40</i> YEARS UNDER FOI EXEMPTION	<i>S. Gray</i> <i>5/12/13</i>
RETAINED UNDER SECTION 3(4) OF THE PUBLIC RECORDS ACT 1958	
TEMPORARILY RETAINED	
MISSING AT TRANSFER	
MISSING	
NUMBER NOT USED	

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10 DOWNING STREET

From the Private Secretary

21 March 1985

Dear Michael,

BNOC'S PRICE FOR MARCH

The Prime Minister held a short meeting this morning with your Secretary of State, the Chancellor and the Foreign and Commonwealth Secretary to discuss the BNOC price for March, about which there has been correspondence.

It was noted that OPEC's reaction to the announcement of BNOC's abolition had so far been restrained and understanding. It would be a mistake to dispel this by suddenly announcing a lower price for March. The delicate state of morale in BNOC was also a relevant factor. The decision on the March price was the last price announcement which BNOC would make. Thereafter individual companies with which BNOC continued to hold contracts would simply be told that they would get the market price. The message to the companies about the March price might also make this point.

The Prime Minister concluded that the clear balance of advantage lay in sticking to the present price of \$28.65 for March and moving to realisation prices thereafter.

I am copying this letter to Rachel Lomax (H M Treasury) and Len Appleyard (FCO).

Yours sincerely
C D POWELL

Michael Reidy Esq
Department of Energy

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BNOC EMPLOYMENT

Line to Take

My RHF the Minister of State for Energy has already paid tribute in this House to the staff of BNOC. Their future is a matter which should most properly be discussed with the Chairman and those who represent them.

[If pressed on an alleged breach of an earlier undertaking.]

As my noble Friend Lord Grey, the then Minister of State for Energy, said during the Committee stage of the Oil and Gas (Enterprise) Bill on 18 February 1982 "Nobody has the power to give a guarantee of eternal employment to anyone".

21 March 1985

Prime Minister

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MR FLESHER

20 March 1985

BNOC'S PRICE FOR MARCH

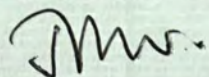
The current exchange of letters between Peter Walker, Nigel Lawson and Geoffrey Howe on BNOC's March price turns on the question of whether it is worth risking the finishing touches of a thoroughly successful exercise for the sake of £3 million.

Since we are talking about the cost to the Exchequer, it may be worth drawing the Prime Minister's attention to another factor which could offset the Chancellor's gain from a market-related March price. Inevitably, BNOC is a dispirited organisation. The better traders will be looking outside for new jobs. The others will be pre-occupied with their prospects in the new Agency. Meanwhile, BNOC still has to sell oil worth around £20 million per day through a volatile spot market. The cost of not doing so with acumen could easily be \$0.2 per barrel, ie £3 million per month - with no tax offset to the Exchequer.

Clearly, the more rapidly BNOC's participation contracts can be run down the better. Contractually, nothing can be done in the short term. We depend on pressure from the Government and voluntary withdrawal by the producers. Antagonising them over March pricing, perhaps to the point of initiating legal action against BNOC, will hinder the wind-down.

We would side with Peter Walker and not risk impeding progress on the last lap.

JOHN WYBREW



CONFIDENTIAL



cc/fo

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

20 March 1984

The Rt. Hon. Peter Walker MBE MP
Secretary of State for Energy

Prime Minister

Handwritten signature

with TF?

Handwritten initials and date
20/3

BNOC'S PRICE FOR MARCH

You wrote to me on 19 March about BNOC's price for March. I have also seen Geoffrey Howe's minute to you of 20 March.

I remain of the view that we should move to market related pricing for March. I am not convinced that the oil companies would mount a legal challenge. The announcement of BNOC's abolition has been generally welcomed and a move to market related pricing will be seen as entirely consistent with the run-down of participation options. Moreover suppliers may well not want to take on the Government so close to the award of the Ninth Round licences.

As regards OPEC, I entirely agree with Geoffrey Howe's assessment.

below

Copies of this letter go to the Prime Minister and Geoffrey Howe.

NIGEL LAWSON

Large handwritten signature

20 MAR 1965





20

FCS/85/67SECRETARY OF STATE FOR ENERGYBNOC Prices

with TF??

1. I have now seen your letters of 18 and 19 March to Nigel Lawson about BNOC's prices, and his letter of 18 March to you.
2. I agree BNOC should move to market pricing for the second quarter. I would also see advantage, as Nigel argues, in handling March prices on the same basis. The change to market pricing is the main message OPEC will pick up from BNOC's telex, and whether or not it is applied to March is unlikely to affect their reaction significantly.
3. Most OPEC governments have so far reacted with understanding to the announcement of BNOC's abolition. I see advantage in completing the change in arrangements while they are still digesting the announcement, and before they can have second thoughts. Moreover, the spot market is at present fairly strong. If it were to decline by the end of the month, a move to market related pricing at that point would seem that more significant to the market, as well as to OPEC. And the postponement of a change would imply to OPEC that we and BNOC might be open to pressure to hold prices even into the second quarter.
4. As to the timing of BNOC's telex, I hope it will wait until the current OPEC meeting in Geneva is over. To act while it is under way would seem unnecessarily

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provocative. Our understanding is that it will finish today, unless it finished late last night.

5. I am copying this minute to the Prime Minister and to Nigel Lawson.

A handwritten signature in black ink, appearing to be 'G. Howe', written in a cursive style.

GEOFFREY HOWE

Foreign and Commonwealth Office
20 March, 1985

CONFIDENTIAL

20 MAR 1985

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CONFIDENTIAL



CCAO

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

19 March 1985

Nigel

with AT?

Thank you for your letter of 18 March. We have succeeded in making the announcement on BNOC with the minimum of disruption in the market, with no hostility from OPEC, and with the Parliamentary Party pleased with the result.

We have achieved this by careful briefing of all those concerned and very careful handling of the major OPEC members.

I think it would be disastrous suddenly to announce a lower price for March. Not only will it create a hostility throughout OPEC, particularly from Saudi Arabia and Nigeria, but it would also create considerable objections from a number of oil companies - including, I am advised, the possibility of a successful legal challenge.

To create bad will with such companies must be wrong when I shall be relying on their co-operation to phase out their existing contracts with BNOC.

The financial implications for you are minute when you consider that 75% of any loss is recouped through the tax system.

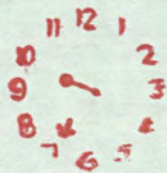
I therefore hope you will agree that we maintain a March price of \$28.65 and move to a market-related basis during the wind-down period from 1 April.

I am copying this letter to the Prime Minister and Geoffrey Howe.

PETER WALKER

CONFIDENTIAL

19 MAR 1925



AMERICAN AIR MAIL

Pine Martin

01 211 6402

The Rt Hon Nigel Lawson MP
 Chancellor of the Exchequer
 Treasury Chambers
 Parliament Street
 LONDON
 SW1P 3AG

B notes. The
 Chancellor's response
 is attached.

18 March 1985

1875

ms

ms

ms

BNOC'S PRICES FOR MARCH AND THE SECOND QUARTER

Following Wednesday's announcement we need to consider what price BNOC should propose for this month and for the second quarter of 1985.

I see no alternative to maintaining the present price of \$28.65 for March. This will result in further losses of around £12m and reduce BNOC's reserves after payment of full grant to some £16m. But a move to a market related basis retrospectively would attract reactions of OPEC countries and might well be resisted by some suppliers.

For April onwards we have basically two choices, continuing maintenance of the price at \$28.65 or a move to a market related basis.

Even with the fastest possible run-down of volumes maintenance of the price of \$28.65 will exhaust BNOC's reserves during May unless spot prices show an unexpected improvement. We would thus be forced to go again to Parliament for further provision of grant. Moreover the maintained price well above market levels would give licencees every financial inducement to delay the process of running down supplies.

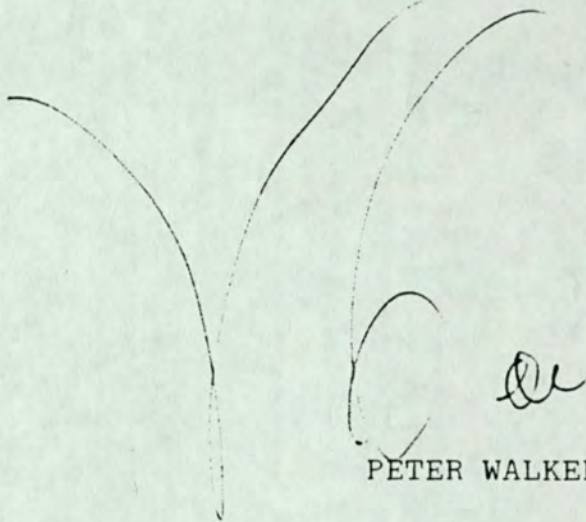
The alternative of a market related approach would eliminate these problems but would suffer from some presentational disadvantages in relation to the market and OPEC and in relation to the case we have presented for abolishing BNOC. But I believe these disadvantages can be minimised by presenting the approach as purely a transitional arrangement to ease the process of running down BNOC.

CONFIDENTIAL



Neither pricing approach is without disadvantage, but in my view the financial and negotiating disadvantages of maintaining the price of \$28.65 outweigh the presentational disadvantages of moving to a market related approach. I therefore propose to authorise BNOC to approach its suppliers in the terms of the attached draft telex.

I see advantage in moving as quickly as possible while OPEC is still digesting the abolition of BNOC. I hope therefore I can have your agreement to this proposal in time for BNOC to approach licencees on Tuesday 19 March.



PETER WALKER

CONFIDENTIAL

DRAFT TELEX

FROM BNOC TO SUPPLIERS

UKCS CRUDE OIL PRICES

In the light of recent announcements, you will be aware that the Corporation will wish to wind down its acquisitions of crude oil under the terms of its participation and/or purchase arrangements with you as soon as practicable. We wish however to confirm our willingness to lift all committed volumes throughout the second quarter although we would be pleased for you to retain cargoes which would otherwise be delivered to BNOC later on in the quarter.

In view of the forthcoming legislation, we shall wish to begin discussions with you shortly regarding your retention of oil otherwise due to be delivered under our agreements with effect from 1 July. We shall contact you for this purpose as soon as practicable.

With reference to our telex of 13 February 1985 we now propose that the prices already agreed for crude oil delivered by you to BNOC during January and February should remain unchanged and should also apply to deliveries under our agreements for the month of March 1985.

As regards the price to apply with effect from 1 April, we believe the appropriate solution in this wind-down period would be to tackle it on a monthly pricing basis related to the prices

actually realised in the market. Our intention would be to calculate the appropriate prices shortly before the beginning of each month by reference to published reports of market transactions relating to oil for delivery in that month concluded over an appropriate prior period. We would then propose these prices to our suppliers, including yourselves, and apply them accordingly. Where no adequate volume of a specific grade appears in the market to provide a reliable reference we would agree an appropriate differential to apply to the price of the widely-traded Brent Blend.

We look forward to your agreement to the foregoing and to discussion with you on its detailed implementation.

18 MAR 1985

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0 2 2
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CONFIDENTIAL



CC. Mr Bailey
 Mr Cassell
 Mr Mond
 Mr Boyer
 Mr Robson
 Mr Fleshe-N20
 Mr Ricketts-FCO

Treasury Chambers, Parliament Street, SW1P 3AG
 01-233 3000

The Rt Hon Peter Walker MBE MP
 Secretary of State for Energy
 Department of Energy
 Thames House South
 Millbank
 London SW1

18 March 1985

Dear Secretary of State,

BNOC's PRICES FOR MARCH AND THE SECOND QUARTER

You wrote to me today about BNOC's prices.

I entirely agree that BNOC should move to market related pricing for the second quarter. As you say, such a move removes the risk of BNOC losses and can be presented as a transitional arrangement while BNOC is run-down.

In my view the March price should be handled in the same way. Suppliers will find it hard to resist the logic of the link to BNOC's run-down and OPEC are likely to see the move in a very different light as a result of the announcement of BNOC's abolition. I appreciate that the participation agreements say prices should only be changed in the quarter in exceptional and unforeseen circumstances. The announcement of BNOC's abolition is, arguably, such an event. In any case, the companies have previously acquiesced in other moves on pricing which are not consistent with the letter of the agreements and may well acquiesce again. In these circumstances, I do not believe it would be appropriate to continue with the price of \$28.65 for March and so incur losses of another £12 million, and additional public expenditure of the same amount.

Finally, on the text of the other parts of the telex, I would hope the second sentence of the first paragraph could convey greater urgency and enthusiasm about the run-down and be redrafted:

"We would be willing to lift committed volumes in the second quarter but we would be pleased for you to retain cargoes which would otherwise be delivered to BNOC."

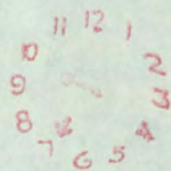
Yours sincerely,

Philip Wynne Owen

ff NIGEL LAWSON

(Approved by the Chancellor and signed in his absence)

18 MAR 1985



Why is BNOC being abolished

In current circumstances BNOC is no longer capable of contributing to stability in the oil market. We have maintained the functions of BNOC which we believe are necessary and important to the national interest and are discouraging those which we believe are unnecessary in a changing market.

How will security of supply be secured?

We will maintain the participation agreements which will be activated by the new Oil and Pipeline Agency to secure access to oil supplies should the need arise.

What part did the Policy Unit play in this?

While the Policy Unit provide me with advice on many issues, including the oil market, they have not conducted a review of BNOC. The formulation of policy on this issue has, quite rightly, been the responsibility of the Secretary of State for Energy, in consultation with other Ministers.

Will the Government restrict production?

Our policy is to allow the oil companies, subject to good oil field practice, to determine the rate at which they develop an oil field. This provides the best assurance that the North Sea will remain a major oil province. The recent rate of drilling and the response to the Ninth Licencing Round indicate that our policies are providing the necessary incentive to development.

14 March 1985

13

FOREIGN SECRETARY

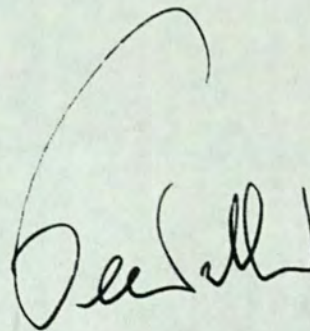
BNOG

Thank you for your minute of 11 March.

I have looked at a copy of the draft telegram to posts, which your officials left with mine. I believe a number of amendments are required, particularly to bring out the point for OPEC Governments that far from contributing to stability of oil prices, continued existence of BNOG would have exactly the opposite effect. I therefore attach a draft of the telegram.

You will see that I have added personal messages to Shaikh Yamani and David West. I do not, however, believe special messages to my Venezuelan and Mexican counterparts are necessary.

I am copying this minute to the Prime Minister, the Chancellor of the Exchequer and Sir Robert Armstrong.



SECRETARY OF STATE FOR ENERGY

March 1985

FUTURE OF BNOC

The Minister of State for Energy is to announce to Parliament at 3.30 pm tomorrow, 13 March, that the British National Oil Corporation is to be abolished. Legislation to this effect will be introduced as soon as possible. The text of the statement will be telegraphed to you as soon as it is finalised.

In his Statement to Parliament, Mr Buchanan-Smith will explain that, since the BNOC Review was completed last Summer, there has been a major change in the structure of the oil market away from term contracts and towards spot and similar short-term transactions. This structural change means that BNOC can no longer operate in its traditional way of purchasing and selling oil under term contracts at prices fixed for a period of months ahead. If it had continued to exist, BNOC would be forced to link its prices more closely to spot prices and be prepared to move its prices frequently. It would therefore have been in danger of increasing instability.

Before BNOC is wound up, the volumes of oil it purchases under participation agreements (under which it acquires most of its oil) will be run down rapidly. However, the agreements themselves will be retained for use if there was a danger to security of supply. Custody of the agreements, together with some residual functions of BNOC (handling royalty oil, management of the Government pipeline and storage system and certain contracts prior to complete disengagement) will be transferred to a small, specially created public agency, the Oil and Pipelines Agency.

For posts in OPEC countries, Mexico and Norway. On receipt of a trigger telegram, you should hand over a copy of the statement to your host government as soon as possible after 15.30Z on Wednesday 13 March. You should not, repeat not, arrange meetings in advance. In handing over the text, you should lay particular stress on the points made in paragraph 2 above and draw on the line set out in paragraphs 7 to 9 below.

For Washington. On receipt of the trigger telegram, please hand a copy of the statement to the US Government. You may draw on the points at paragraph 7 to 9 below. We would expect the US Government to welcome this decision.

For UKRep Brussels, UKDel Paris and other OECD posts. You may act as in paragraph 5 above.

Line to Take

HMG's concern remains to avoid destabilisation of the oil market. BNOC has consistently handled its pricing proposals accordingly.

However, it has become increasingly clear that the Corporation cannot change its purchase prices without risking the destabilisation of the market. When the market has weakened other producers have tended to match or exceed BNOC's price cuts. In anticipation of this the market has reacted by drawing on stocks and postponing purchases. This has reduced demand and exacerbated the existing weakness of the market. (For Lagos. You may wish to refer to David West's remark in a recent Financial Times interview that in BNOC we have built a Frankenstein monster).

North Sea spot prices have been almost invariably below BNOC's purchase price of \$28.65 since it was set last October. At times spot prices have fallen to levels up to \$2 below term. Since the spot market is a ready alternative source of oil to BNOC's customers, the Corporation has lost its term sales and with them the power to contribute.

[To Riyadh only]. When handing over the text of Mr Buchanan-Smith's Statement you should also pass on the following personal message to Shaikh Yamani from Mr Walker: Quote: Further to our conversation at lunch at Cowley Street last month, we are today announcing that BNOC is to be abolished and that consequently it will be ending the selling of participation oil. We agree with your view that in changed circumstances in the oil market BNOC would increasingly become a force

for instability rather than stability. I am setting up a small agency to carry out some of BNOC's secondary residual functions, notably those relating to our security of supply.

[To Lagos only]. When handing over the Statement to David West, please also pass the following personal message from Mr Walker. Quote: Since we met in Geneva in January I have been considering how the UK can contribute best to the stability of the oil market, to which both our countries attach great importance. You will have seen that BNOC maintained their term price at \$28.65 for January and February, despite the fact that the spot price was normally well below this level. With the structural change from term prices to spot transactions throughout the world oil market, BNOC became ever less able to make a contribution to stability. Increasingly BNOC seemed in danger of undermining stability, especially if it had been forced to move to market-related prices like Statoil. I therefore believe abolition of BNOC will now make a significant contribution to stability.

S E C R E T



12

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

13 March 1985

Michael Reidy Esq
Private Secretary to the
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1

Dear Michael

BNO

The Chancellor of the Exchequer has seen the draft Statement attached to your letter of 12 March. He has also seen your Secretary of State's letter of the same date to the Foreign Secretary.

The Chancellor is concerned that the line of argument in the fourth and fifth paragraphs of the draft Statement (and in the corresponding section of the draft telegram) could prejudice the use of market related, or average realisations, pricing in the period during which the participation options have not been completely removed. In view of this, the Chancellor would prefer the second sentence of the fifth paragraph to be expressed in terms of the change not enabling BNO to contribute to stability, rather than in terms of being destabilising. This points to amending the sentence to read "Such a system would mean that BNO could no longer contribute to stability in the markets." A similar change would be needed to the end of the second paragraph of the draft telegram.

Apart from that, the Chancellor is concerned that the references to RIK in the draft Statement will not enable us to return to this issue in the future. As you will have seen from his minute to the Prime Minister of 12 March, he attaches importance to this point. He would, therefore, prefer to substitute

S E C R E T



"we have the power to receive oil" for "oil is received" in the first sentence on page 2 of the draft. This reference to powers in relation to RIK picks up the point in the final paragraph on page 1 and parallels what is being done in relation to participation agreements.

I am copying this letter to Andrew Turnbull (No 10), Janet Lewis Jones and David Beamish (Lord President's Office), Len Appleyard (FCO), Richard Mottram (MOD), David Morris (Lord Privy Seal's Office), Murdo MacLean (Government Whips' Office) and Richard Hatfield (Cabinet Office).

Yours sincerely,

Margaret O'Mara

MISS M O'MARA
Private Secretary

13 MAR 1965

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CONFIDENTIAL

AO



PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

13 March 1985

NMPM

Dear Peter,

BNOG

I have seen the proposed text of the statement you will be making this afternoon about BNOG.

I note that you have elected to retain the commitment to introducing legislation this session, which I would have preferred to see excluded. This preference was not based merely on the convenience of the Business Mangers. There have been many occasions when the introduction of a Bill has been delayed because difficulties have arisen that were not foreseen when policy approval was given. Were that to happen to this Bill the consequences could be severe.

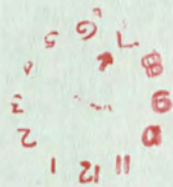
I understand that you expect to be able to provide drafting instructions by Easter; and on that basis am content for the phrase in question to be included. I must, however, make it clear that I regard its inclusion as an undertaking that your Department will adhere to that deadline.

I am copying this letter to the Prime Minister, the Lord President of the Council, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Defence, the Chief Whips in both Houses and Sir Robert Armstrong.

JOHN BIFFEN

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy

Rowe



13 MAR 1995



MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

MO 26/17/1

12th March 1985

De Lita

*AT to see
9/5*

BNOG

I have seen the recent correspondence on the future of BNOG, including your minute of 8th March and Mr Turnbull's record of the meeting held at No 10 on 6th March. We spoke about the need for an early decision on the privatisation of the Government Pipeline System (GPSS), and you will now be aware that I do indeed see problems with this suggestion. It might be helpful if I set out the reasons for taking this line.

Essentially there are three areas where we could encounter difficulties:

- a. The GPSS is to feature prominently in the development of the RAF's Fixed Telecommunications System. The degree of security that will be required is such that I believe adequate safeguards could not be obtained within the terms of contract to maintain its integrity.
- b. Operationally the RAF and USAF depend on the GPSS for 80% and 100% respectively of their peacetime supplies. The RAF's dependence will increase as more stations are linked

The Rt Hon Peter Walker MBE MP



to the system. The volume of fuel involved makes it highly unlikely that delivery could be made by road, should supplies be interrupted for any reason.

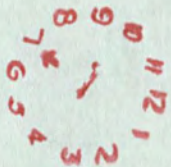
c. Considerable amounts of money have been invested to develop the GPSS for defence needs. Large elements of this investment have come from the NATO Infrastructure Fund and the USAF, under their cost sharing arrangements with the RAF, and more investment is planned. This could be placed in jeopardy if we were to proceed with privatisation. We could also be faced with repaying the NATO Infrastructure Fund.

Although I am not in favour of privatisation, I would of course be very willing to consider any alternative ways of improving the management and use we make of the GPSS. I therefore suggest that our officials should be asked to produce a report later this year on the alternative options to privatisation. These might include reorganising the GPSS as a Trading Fund, or the establishment of a Government Owned/Contractor Operated Company involving this department and the British Pipeline Agency, but I think officials should look at the full range of possibilities.

I am copying this letter to the Prime Minister, the Lord President, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Lord Privy Seal and to Sir Robert Armstrong.

Michael Heseltine

Energy : BNOc AT.



13 MAR 1985



AD

W

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

N BPM

BNO

I have seen Peter Walker's minute to you of 8 March and Geoffrey Howe's subsequent minute of 11 March.

2. I very much agree with Peter that the Statement should be made quickly and that, if at all possible, the necessary legislation should be introduced in the present session. I am quite content with the procedure he proposes.

3. On the pipeline and on royalty in kind, I am sure the conclusions Peter reaches are right for the present. But I hope he will be able to make his announcement in a way that would not prevent us returning to these issues, in particular royalty in kind, if we were to find ways around the difficulties he describes.

4. Copies of this minute go to Willie Whitelaw, Geoffrey Howe, Peter Walker, Michael Heseltine, John Biffen and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'N.L.' with a flourish.

N.L.

12 March 1985

pmc



Library, Chamber of Commerce Building, 100 N. 1st St.,
Philadelphia, Pa. 19106

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12 MAR 1985

CONDOR

SECRET

Copy No 1 of 10



MM AT 1413 9

SECRETARY OF STATE FOR ENERGY

THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 7214

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON SW1

12 March 1985

Dear Andrew

I attach the text of the statement on BNOC to be made by the Minister of State for Energy tomorrow at 3.30 pm.

Copies also go to Janet Lewis-Jones, Len Appleyard, Rachel Lomax, Richard Mottram, David Morris, Murdo Maclean, David Beamish and Richard Hatfield.

Yours sincerely
M. F. Reidy

M F REIDY
Private Secretary

SECRET

With permission, Mr Speaker, I wish to make a statement about the British National Oil Corporation. I hope it is for the convenience of the House that I should make this statement now in view of the debate arranged for tomorrow.

In the summer of last year the Government reviewed the institutional arrangements and operations of BNOC. It then concluded that the balance of advantage lay in retaining the Corporation in its present form, given the contribution it was able to make to deriving full benefit from our oil resources.

Since then the environment in which BNOC has to operate has undergone important changes. BNOC has traditionally operated by purchasing and selling oil under term contracts at prices fixed for a period of months ahead. Its purchases under participation contracts have been in this form which, as I explained to the Select Committee on Energy, has enabled BNOC to make a contribution to stability of markets in the short term.

There has however now been a major change in the structure of the oil market away from term contracts and towards spot and similar short-term transactions. This trend is unlikely to be reversed in the near future.

In these circumstances BNOC could avoid the risk of losses only by linking its prices for participation oil closely and continuously to movements in the spot market. Such a system would be more likely to increase instability in the markets than to contribute to stability. The Government has concluded that this shifts the balance of advantage decisively against the retention of BNOC in its present form. I see no advantage in retaining a public sector body to operate on that basis.

The change in market structure I have described has led me to the conclusion that BNOC should no longer purchase oil by exercising its options under participation agreements. Dealing in participation oil has been the dominant part of BNOC's activities.

The Government considers it essential to retain powers that would enhance security of supply if that proved to be necessary. We will therefore retain the participation agreements themselves so that we can activate them to have access to these oil supplies should the need arise.

We will also retain the arrangements under which oil is received from Continental Shelf licensees as royalty in kind.

These two factors together mean that security of supply will continue to be safeguarded.

I see a need in present circumstances to retain one other function of BNOC, namely the management as agent for the Government of the Government oil pipeline system. This system is important for both defence and civil purposes.

The retention of these three functions - custody of the participation agreements, disposal of oil received as royalty in kind and management of the Government pipeline system - requires the establishment of a small Government Oil and Pipelines Agency as a successor body to BNOC. The abolition of BNOC and the establishment of the Agency for the purposes I have described will require legislation and I intend to introduce this in the present Session of Parliament.

Finally I wish to express the Government's thanks for the valuable work carried out by the Chairman, Board and staff of BNOC.

AAA

CONFIDENTIAL



10 DOWNING STREET

From the Private Secretary

12 March 1985

BNOC

This is to confirm the message which I have already passed to your office that, subject to the comments of the Chancellor and the Lord Privy Seal, the Prime Minister was content that your Department should make the statement envisaged in your Secretary of State's minute of 8 March.

(TIM FLESHER)

Michael Reidy, Esq.,
Department of Energy.



CC/10

8

PRIME MINISTER

BNOC

- Attached

1. I have seen Peter Walker's minute to you of 8 March with its request for a new bill to be added to this Session's programme. Fortunately, I was able to get the Lord President's views, as well as those of the two Chief Whips, before he left for Brazil.

2. You will not be surprised to learn that the addition of a Bill of this nature at such a late stage in the programme is unwelcome to the Business Managers. Nevertheless, we recognise its importance and will of course do our best to ensure that it receives Royal Assent as soon as possible. However, on the timing, I have to say that the situation as we approach the summer Adjournment in the House of Lords may well be particularly difficult this year. I can therefore give no guarantees about the date at which Royal Assent can be reached and I would therefore think it prudent if Peter Walker's statement tomorrow did not mention a specific date for the abolition of BNOC.

3. What is important now is to ensure that instructions reach Parliamentary Counsel as soon as possible and that they are limited to the minimum necessary to secure abolition and deal with the essential consequences. To put additional items into the Bill will inevitably extend the drafting time and, depending on their nature, may cause additional problems in getting the Bill through Parliament.

4. At the risk of seeming unnecessarily pessimistic, I must also point out that the addition of this Bill may well have an impact on next Session's programme. It is at this time of year that Parliamentary Counsel starts to devote his resources to the drafting of next Session's programme and to have to turn to a completely new and unexpected Bill at very short notice can only be disruptive. All concerned will, of course,

do their best, but this is a feature that we shall need to bear in mind when we come to consider the final decisions on next Session's programme.

5. I am copying this minute to the Lord President, the Foreign Secretary, the Chancellor of the Exchequer, the Secretary of State for Defence, the Secretary of State for Energy and the Secretary to the Cabinet.

W J B
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W J B

12 March 1985



FCS/85/53

SECRETARY OF STATE FOR ENERGY

BNOC

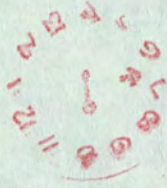
1. I have no objection to the proposal in your minute to the Prime Minister of 8 March, to make an announcement on the future of BNOC on Wednesday 13 March, provided that we can make the necessary arrangements within this timescale to inform other interested governments, in particular those of OPEC countries, about our decision.
2. Despite the assurances we have received from some OPEC member countries, I am not confident that we shall be given an easy ride on our decision by the oil producers. I hope you will send personal messages to Yamani, David-West and perhaps also to the Venezuelan and Mexican Oil Ministers. We shall be pleased to transmit these. My officials will be in touch with yours about the texts of these messages and instructions to other posts.
3. I am copying this minute to the Prime Minister, the Chancellor of the Exchequer, the Secretary of State for Defence, the Lord Privy Seal and the Secretary of the Cabinet.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
11 March 1985

ENERGY AT'S
BNOC

1987 MAR 23 11 21 AM
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PRIME MINISTER

②
 To await comments from Treasury and Business Managers,
 AT 8/13

BNO

Following our discussion on 6 March I have been considering further how we should announce and legislate the decisions we took then on the future of BNO.

You will recall that I was asked to prepare for an announcement within the following two weeks. Yesterday's Business Statement included a debate on Thursday of next week, 14 March, on the spring supplementary estimate for BNO and the report of the Energy Select Committee on it. In the light of this I think the best course is that I should make a statement on BNO's future after questions on Wednesday 13 March, making it clear that I thought it right to give the House notice of the decisions taken by Government in advance of the debate on Thursday 14 March.

All the alternative courses seem to me much inferior from the Government's point of view. An announcement soon after 14 March risks complaint that decisions were concealed from the House at the time of the debate. A long delay risks leaks and embarrassment and would be contrary to our decision on 6 March. Announcement during the debate on the Select Committee Report looks like yielding to their pressure and would be particularly unsatisfactory because it would presumably have to come at the end of the debate. I hope therefore that it would be generally agreed that I should make a statement on 13 March. I will circulate a draft as soon as possible.

On the timing of legislation, I see grave disadvantages about delay even into the 1985/86 Session. Until we legislate we still have on our hands both BNO as a body and the symbolic BNO price, even if we succeed progressively in reducing losses by getting rid of the exposed



participation contracts. So long as we have BNOc and its price, we are exposed to OPEC pressure and in some degree to political pressures also. The Opposition will hope to achieve delay or a change of policy. There are also acute managerial problems. The BNOc staff, who are not civil servants, will want to find other employment. While the BNOc board can no doubt be persuaded to run down loss-making contracts, there is no legal authority to require them to run down the functions of BNOc more generally; arguably their duty points the other way.

The earliest date we could realistically hope for the abolition of BNOc, following a Bill early in the 1985/86 Session, would be 1 March or 1 April 1986. I believe this is much too late. I would urge that we do our utmost to obtain a Bill in the present Session, with a view to abolition if at all possible by 1 September 1985. I see no difficulty about speedy preparation of instructions to Counsel, since the policy is clear and has been decided. The Bill will be relatively short; perhaps a dozen clauses and two schedules.

To help accommodate this Bill I would be ready to defer from this Session the Opencast Coal Planning Bill, for which a place has been reserved.

I very much hope that it would therefore be agreed that we should proceed with this Bill as speedily as possible in this Session and that I might have the help of Parliamentary Counsel accordingly.

I have been trying to find a suitable opportunity to speak to Michael Heseltine but my clear understanding is that his Department would see major dangers to our national security, and particularly to communications in emergency, if the Government pipeline system were to be privatised. The prime objective of the system is to ensure that our bases are supplied in times of emergency of war, although we secure through the agency of BNOc that the system is also used to the maximum extent possible by private sector oil suppliers, who pay commercial rates for its use.

Energy : bnoc . 175



CONDENSER

175



My officials and Nigel's have had further discussions on royalty in kind. They have not identified any workable alternatives to the options set out in my paper. The alternatives to allowing the new Oil and Pipelines Agency to act as the Department's agent for selling RIK all have serious drawbacks, either by putting at risk the amount of royalty that will be collected and its value to the PSBR, or by adding to the functions of Government Departments. I therefore hope that the Chancellor can now agree that the new Agency should handle RIK.

I ought to add for the record that my officials and those of the Treasury have agreed that for 1985/86 the correct estimates for the cost of taking royalties in cash and for the once for all cost to the PSBR are £54 million and £350 million respectively, as indicated in my paper. I think we should use these figures rather than the lower ones quoted in your Private Secretary's letter to mine of 6 March which were earlier estimates.

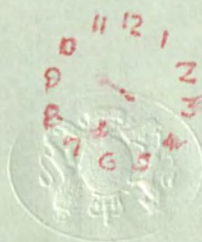
I am copying this minute to the Lord President, the Foreign Secretary, the Chancellor of the Exchequer, the Secretary of State for Defence, the Lord Privy Seal and the Secretary to the Cabinet.

SECRETARY OF STATE FOR ENERGY

8 March 1985

CONDRETOI

- 8 MAR 1965



DEPARTMENT/SERIES <i>PREM 19</i> PIECE/ITEM <i>1474</i> (one piece/item number)	Date and sign
Extract/Item details: <i>Howe to Secretary of State for Energy with attachment dated 6 March 1985</i>	
CLOSED FOR <i>40</i> YEARS UNDER FOI EXEMPTION	<i>J. Gray</i> <i>5/12/13</i>
RETAINED UNDER SECTION 3(4) OF THE PUBLIC RECORDS ACT 1958	
TEMPORARILY RETAINED	
MISSING AT TRANSFER	
MISSING	
NUMBER NOT USED	

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File

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bc: John Wybrew
Richard Hatfield, Co.
cc Welsh Office.

10 DOWNING STREET

cc MASTER SET

From the Private Secretary

6 March 1985

Dear Michael,

BNOC

The Prime Minister held a meeting today to discuss the future of BNOC. Present were the Foreign Secretary, Chancellor of the Exchequer, Secretary of State for Energy and the Minister of State, Department of Energy. The meeting had before it the paper circulated under your letter of 5 March.

The Secretary of State for Energy said three options had been identified in the paper - a much-reduced BNOC still operating under the same name; a new statutory body carrying out limited functions, and operating under a new name such as the Oil and Pipelines Agency; dispersal of BNOC's functions to other parts of Government.

The Secretary of State for Energy recommended the second option. It would be misleading to scale down BNOC's functions while still retaining the old name. This body could prove a focus for those who wished to recreate BNOC. The third option would bring Government too close to day-to-day operations in the oil market.

If the second option were adopted, legislation would ultimately be required. The first place in the legislative programme was likely to be in 1986-87, but it would be better to legislate earlier if a place became available in the 1985-86 programme. It would be possible within the existing legislation to scale down the supplies available to BNOC by not renewing participation contracts.

The Secretary of State for Energy said that if the second option were pursued it would be necessary to meet public concern about security of supply. Although in current circumstances the existence of BNOC did not add material to security of supply (the leverage available to Government in its role as the licensing authority in the North Sea was in practice more powerful), this was an argument which Ministers had deployed in the past and which had a great deal of public appeal. It would be possible for the new body to retain participation rights which would be held in abeyance until an emergency occurred.

MJ2 AEG
SECRET

At present BNOC was the operator for the Government Pipeline System. The Department of Energy favoured privatising the Pipeline, but there were Ministry of Defence objections to this. This issue would have to be resolved before an announcement was made on the future of BNOC. Another issue to be resolved was the payment of royalties. Currently royalty was taken in kind, requiring an organisation to dispose of it. It was for consideration whether it would be better to take royalty in cash. A disadvantage of this was the once-over cost of £300 million to the PSBR, with a continuing interest cost of around £30 million a year. It was difficult to justify such a windfall gain to the oil companies. One possibility was to change the timing of payments in any legislation on the status of BNOC.

The Secretary of State for Energy said he wished to make an early announcement about the future of BNOC. Not only would this be fair to BNOC's staff but it would also make it easier to conduct negotiations with companies for withdrawal from participation contracts.

Summing up the discussion, the Prime Minister said the meeting agreed that BNOC's functions should be scaled down and absorbed into a new statutory agency. This would require legislation. Meanwhile BNOC should begin negotiations for disengagement from its participation contracts. The Secretary of State for Energy and the Chancellor of the Exchequer should ask officials to examine the implications of switching to royalty in cash. The Secretary of State for Energy should discuss with the Secretary of State for Defence whether the Government Pipeline System should be privatised or should remain in Government ownership to be operated by the new agency. The Secretary of State for Energy should prepare for an announcement in about two weeks' time.

I am sending copies of this letter to Len Appleyard (Foreign and Commonwealth Office), Rachel Lomax (H.M. Treasury), Richard Mottram (Ministry of Defence) and Sue Killen (Office of the Minister of State, Department of Energy).

Yours sincerely
Andrew Turnbull

Andrew Turnbull

Michael Reidy, Esq.,
Department of Energy.

DEPARTMENT/SERIES <i>PREM 19</i> PIECE/ITEM <i>1474</i> (one piece/item number)	Date and sign
Extract/Item details: <i>Ricketts to Powell with attachments dated 6 March 1985</i>	
CLOSED FOR <i>40</i> YEARS UNDER FOI EXEMPTION	<i>J. Gray</i> <i>5/12/13</i>
RETAINED UNDER SECTION 3(4) OF THE PUBLIC RECORDS ACT 1958	
TEMPORARILY RETAINED	
MISSING AT TRANSFER	
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NUMBER NOT USED	

CONFIDENTIAL

PRIME MINISTER

5 March 1985

ABOLITION OF BNOC

The objections to BNOC's high-volume, high-profile, interventionist role in the oil market are well rehearsed. The oil market is prone to over-supply and prices are weak. The outlook is for little change over the next few years, although uncertainty is endemic in the oil business. In its present form, BNOC reinforces the downward pressure on oil prices by having to sell some 800,000 b/d of oil through weak spot markets. Invidiously, BNOC loses money at the expense of the exchequer and to the benefit of already well-rewarded North Sea producers. Whereas the US oil market is more influential in depressing oil prices, it is the British Government which gets the odium from OPEC Governments.

The immediate priority is to scale down BNOC's loss-making participation contracts as fast and as far as possible before primary legislation is required. Of the three options achievable through legislation, we are not attracted by transferring BNOC's residual trading functions to a Government department. Creating a new statutory body for the purpose seems unnecessarily messy and disruptive. A much reduced rump of BNOC with a correspondingly narrow remit is our preferred option. || → This may have presentational advantages vis a vis OPEC and nervous oil markets.

John Wybrew

JOHN WYBREW

SECRET

Copy No | of 5



cc. J. Hybrow.
5

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 7214

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON SW1

5 March 1985

Dear Andrew

BNOG

In preparation for tomorrow's discussion at 3.30 pm, my Secretary of State has asked me to circulate the attached paper.

Copy no 2 goes to Len Appleyard, and copy no 3 to Rachel Lomax.

Yours sincerely
Michael Reidy

M F REIDY
Private Secretary

SECRET



SECRET

COPY NO. 1 OF 10

ABOLITION OF BNOC

Introduction

1. The BNOC Review, which was completed in May 1984, concluded that on balance BNOC should be retained for the time being for the following main reasons :-

- (i) BNOC provided significant valuation evidence for the Revenue of UK crude oil sold at arms length at transparent prices. Without that evidence, the Inland Revenue would be in a weaker position with consequential risk of lower revenues.
- (ii) On balance BNOC, which then retained a significant number of term contracts, probably made some positive contribution to price stability.
- (iii) OPEC would probably oppose the abolition of BNOC. This in itself might have an adverse effect on price stability.
- (iv) The running costs of BNOC were more than offset by the benefit of taking Royalty in Kind, for which BNOC acts as the Government's agent.
- (v) BNOC might make a limited but useful contribution to UK security of supply, in terms of both physical supplies and information.

2. Ministers endorsed these conclusions, but agreed that there should be a further review of BNOC in 2-3 years time. The results of the review were announced by the Minister of State in a written Parliamentary Answer on 1 August 1984.

3. While the Government's policy objectives underlying these conclusions remain the same, (i.e. valuation evidence for tax purposes; price stability; maximising value of Royalty in Kind; and security of supply) events over the past 9 months



have resulted in BNOC no longer being able to make a significant contribution to those objectives. Specifically:

- (a) BNOC's term prices no longer provide useful evidence for valuing disposals of UKCS oil, since no commercial sales take place at them.
- (b) BNOC no longer has any term contracts which enable it to contribute significantly to price stability. The BNOC term price has gained a symbolic importance which has turned it into a positive liability. If BNOC's price is reduced in line with the market this now runs the danger of having a disproportionately adverse impact on price stability. But failure to bring it in line with market prices results in losses which are politically embarrassing even though most of the losses are recouped through the tax system.
- (c) Some OPEC leaders now accept that BNOC is no longer in a position to contribute significantly to the stability of oil prices and have indicated they will not object to its abolition. (It is, however, unclear whether Nigeria accepts this.)
- (d) Alternative methods of obtaining the cash flow benefits of the present system of taking Royalty in Kind are possible, although they may be more costly. These are dealt with in ANNEX A.

4. It will, however, be much more difficult to allay worries that the abolition of BNOC will seriously jeopardise our security of supply, if there is an oil crisis. In the event of a shortage, Parliament and the public-at-large will undoubtedly expect the Government to ensure that the British market is supplied with oil, even if this is at the expense of other OECD countries. When Britoil was privatised in 1982, Department of Energy Ministers at the time defended BNOC's retention primarily on grounds of security of supply. The Minister of State advanced a similar defence, when the House debated the BNOC Supplementary at the end



of 1984. While the BNOC review pointed out that the Corporation's role in security of supply was less than generally believed, the fact that BNOC has since lost most of its term contracts means that it can now make a more immediate and significant contribution in this field.

5. Opposition to the abolition of BNOC will almost certainly centre on this security of supply argument. Our opponents will draw attention to earlier Ministerial statements on the subject. The most effective way of meeting these attacks would be to maintain the participation agreements with 65 licensees, but leave these in abeyance (see para. 10(c) below).

6. While abolition should reduce OPEC pressures on us, notably on oil prices, we shall certainly continue to be subject to such pressures in one form or another as long as we remain a significant net exporter. For example, there is likely to be increased pressure on us to reduce production, if prices weaken in the weeks ahead, when CEGB is no longer burning 500,000 b/d. OPEC is also likely to put pressure direct on the majors (and perhaps indirectly through us) in relation to oil prices - OPEC will recall that a reduction in Statoil's prices set off the price falls last October.

(RIK) 7. There is now a clear case for abolishing BNOC's main existing functions. It is for consideration whether certain residual functions, notably Royalty in Kind and the ability to reactivate the participation agreements in times of an oil crisis, should be retained by a rump BNOC or by a successor statutory body or whether the residual functions should be parcelled out to other bodies. Paras. 8 and 11 below consider those functions which should be terminated as quickly as possible and those which might be retained in one form or another.



Reduction of BNOC's Oil Supplies

8. Our main objective should be to reduce as soon as possible all the oil supplies available to BNOC with the exception of RIK. The following categories should be covered :

	<u>'000 b/d</u>
Participation saleback	690
Participation non-saleback	400
Third Party Contracts	100
	<u>1090</u>

9. As indicated in ANNEX B on reducing BNOC's supplies, while a few of BNOC's commitments run out on 1st July 1985, others do not run out for much longer. Indeed, some of them cover the full life of the oil fields concerned. In order to cut back on BNOC's activities rapidly, it will therefore be necessary for the Corporation to negotiate the early termination of its existing contracts. Priority should be given to reducing those supplies which will result in continuing losses, if BNOC's term price is set above the market price. This process will inevitably take some time. However, most companies would probably be willing to terminate their contracts rapidly, although some will try to impose conditions for doing so. A few companies may resist premature termination without excessive compensation. BNOC should also negotiate the termination of its profitable LPG contracts. (see ANNEX B on reducing BNOC's supplies.)

BNOC's Residual Functions

10. On the other hand it would seem desirable or may prove unavoidable to keep the following functions currently carried out by the Corporation :-

(a) Royalty-in-Kind: This is considered in greater detail in ANNEX A. The simplest and most cost-effective way of maintaining the considerable financial and other advantages of RIK would be for this oil to be handled by a rump BNOC or by a successor body. While the sale of this oil could in theory be handled by the Treasury or the Department of Energy, perhaps using outside



brokers ^{or} agents to auction it, neither Department currently possesses the necessary skills. Furthermore this would involve an undesirable increase in the Government's functions. Other possibilities, e.g. using companies as HMG's agents to sell their own oil, present even greater problems.

(b) Handling residual participation oil, third party contract oil or LPGs: As indicated in paragraph 9 above, our objective will be to negotiate the termination of all these contracts as soon as possible, with particular emphasis on the potentially loss-making contracts. It may, however, prove impossible to negotiate out of some of the third party oil contracts and LPG contracts without having to pay unacceptably high compensation. If so, the most cost-effective solution might be for the rump BNOC or a successor body to continue to handle these contracts.

(c) Participation Agreements: BNOC would cease to take the 1,090,000 b/d under the participation agreements as soon as possible. It would also not enter into any new participation agreements. The existing agreements would, however, be left in place, but in abeyance. They would only be activated on security of supply grounds, if there was a major oil crisis. Unless the crisis was long-lasting they would be of little immediate use, as the first oil could only be obtained under them after 6 months at the earliest. Their existence would, however, provide HMG with important leverage on companies to honour their informal undertakings to provide supplies for the UK market in times of crisis/shortage, when the IEA emergency sharing arrangements were not activated. This leverage could be valuable given that the informal undertakings are not legally enforceable and that both in 1973 and 1979 a number of companies did not maintain their supplies to their UK customers.

(d) The Government Pipeline System: Both the Treasury and the Department see advantages in privatising this, even though it would be some 2 years before the process could be completed. The Ministry of Defence are strongly opposed to privatisation on grounds of national security. If Ministers eventually decide not



to privatise the GPS, the simplest solution would be to let BNO or its successor body to continue to manage it. An alternative would be for MoD to manage it. But this again would represent an unwelcome increase in Government functions.

11. (b) and (d) above are unavoidable, until the residual contracts can finally be disposed of and the GPS privatised. (a) and (c) depend on our decision.

RHC. idyann

Options for Abolishing/Reducing BNO to a Rump

12. BNO's residual functions might be handled by -

Are these mutually exclusive ie can we scale down and later abolish, providing for residual functions?

- A. a much reduced BNO;
- B. a new statutory body created to take on BNO's activities - The Oil and Pipelines Agency;
- C. Piecemeal by existing bodies.

13. All these options would require legislation (see ANNEX C). This is probably true even in the case of Option A in view of the Attorney-General's recent advice that a radical change in the objectives of a statutory body should be sanctioned by legislation. The legislation could be incorporated in the proposed Petroleum Bill, although this Bill no longer has a place in the 1985/86 legislative programme.

Can a start be made in backing out of contracts before legislation? Annex C implies a partial rundown is possible, but how far can this go?

14. The following paragraphs consider the arguments for and against these three options.

15. OPTION A - REDUCING BNO TO A RUMP

Advantages

(a) There would need to be very strong reasons for setting up a new institution to carry out functions that BNO can continue to fulfil.



(b) It would therefore be administratively much simpler and much less time-consuming. The total abolition of existing institutions and the setting up of new institutions almost invariably take longer and are more problematical than originally envisaged.

(c) It would provide the best defence against our critics who claimed that our proposals were endangering our security of supply, if the rump BNOC retained the participation agreements, albeit on ice.

(d) The legislation would be shorter and might be more easily postponed to the 1986/87 Session.

(e) It would avoid having to terminate the contracts of all existing employees and having to rehire some of them.

Disadvantages

(a) It would be criticised by the Select Committee, oil companies, etc. as a half-way measure. But so would Options B and C, although to a lesser extent. For reasons of self-interest the oil companies would like the total abolition of RIK and the participation agreements.

(b) OPEC might believe that with sufficient pressure it could persuade HMG to recreate BNOC in its present form. This is not a real danger, provided HMG stands firm. OPEC invariably is looking for a short-term action. But once the participation agreements were in abeyance, it would take up to 24 months to revive BNOC in its present form.

16. OPTION B - SET UP A NEW STATUTORY BODY (THE OIL AND PIPELINES AGENCY) TO CARRY OUT LIMITED FUNCTIONS

Advantages

(a) It should go further to meeting those critics calling for the complete ~~abolition~~ abolition of BNOC.

(b) It would make it clear to OPEC that the Government had definitely abandoned the old-style BNOC.



(c) After a settling down period, it should be able to carry out the residual functions just as efficiently as BNOC.

(d) It would provide a mechanism for carrying on BNOC's reduced security of supply role.

Disadvantages

These are essentially the obverse of the case for keeping the rump BNOC. In addition the oil companies will be against RIK and the retention of the participation agreements regardless of whether they are administered by a rump BNOC or a new statutory body.

17. OPTION C - PARCELLING BNOC'S RESIDUAL ACTIVITIES OUT AMONGST EXISTING BODIES

It would probably be possible to place BNOC's residual functions in existing bodies. As indicated in ANNEX A, RIK might be handled by the Treasury or Department of Energy, who might employ brokers to sell the oil or agents to auction it. Residual oil and LPG contracts could be treated in the same way. But this would involve an unwelcome increase in the functions of Government and a small increase in civil service numbers. At the moment these Departments do not have the necessary expertise. Using the oil companies as the Government's agents for selling RIK would put at risk at the margin the achievement of the best prices for RIK, which is worth some £2 billion p.a. Similarly the MoD or the Department might take on the responsibility for running the Government Pipeline System. Once again this would involve the Government taking on a new responsibility and new specialist staff. It would be more difficult to find a home for the frozen Participation Agreements. While there is provision for transferring these to a new statutory body, their transfer to the Secretary of State would raise legal questions and would require legislation or the agreement of the licensees. There would be serious practical difficulties, if they ever had to be activated in a crisis. Moreover such a solution would reduce the political impact of being able to argue that the rump BNOC still retained its security of supply functions.



Public Announcement

18. Whichever option we decide on, we should announce it as soon as possible. This would reduce criticism in Parliament and the Press about allowing BNOC to incur continuing losses. An early announcement should also encourage the oil companies to negotiate for the rapid termination of their contracts with BNOC. It is also desirable to make an announcement before some OPEC leaders have a chance to change their mind. It will, of course, also be necessary to explain the position fully to the Nigerians. The good offices of other OPEC leaders might be used in this context.

Impact on BNOC

19. An announcement that HMG is planning to abolish BNOC or reduce it to a rump will inevitably have a severe impact on BNOC morale, even if it is not totally unexpected. I believe, however, that it will be in the staff's best interests to clarify the position as soon as possible and that this will contribute to an orderly run down. I will, of course, need to inform the Chairman shortly before any announcement. Furthermore I should wish to consult him on the modalities of running down BNOC's supplies as rapidly as possible and on the key staff which we shall need to retain for this purpose and also to carry out BNOC's residual functions either in a rump BNOC or in a successor body. I am confident that we should be able to retain the necessary staff provided we are prepared to offer the necessary inducements to some key members. These would be small compared with the financial advantages of running down BNOC's loss-making activities as rapidly as possible.

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ABOLITION OF BNOC

HANDLING OF ROYALTY IN KIND: ALTERNATIVES TO BNOC

Summary

1. The present system of taking royalty in kind has three main advantages:

- (a) it increases HMG's take by £55 m p.a. and avoids a one for all increase in the PSBR of £350 m;
- (b) it provides useful evidence of valuation for the Revenue;
- (c) it increases the UK's security of supply.

2. These benefits would continue, if Ministers decided to retain a rump BNOC inter alia for this purpose or to transfer this responsibility to a new statutory body. Either of these solutions would be more advantageous and cost effective than the alternatives considered in this annex.

3. However if Ministers decide to go for full abolition of BNOC without setting up a new statutory body there are a number of other options for retaining some or all of the benefits listed in paragraph 1 above, the most attractive ones being

- (a) use of brokers to handle RIK;
- (b) use of agents to auction RIK;
- (c) use of licensees as agents for RIK disposal.



Current position

1. About 85% of royalty oil or 260,000 barrels a day, worth over £2 billion a year, is currently taken in kind. The exception is royalty from some small fields. Future fields are generally exempt from paying royalty whether in kind or not. RIK oil is currently lifted and sold by BNOB in conjunction with its other supplies of oil. BNOB is paid an agency fee of about £1-1.5 m a year for this service - the fee is settled on an annual basis.

Benefits from taking RIK

2. These are:

- (i) a cash flow benefit because payments for the oil accrue to the Exchequer 30 days after lifting whereas, if royalty were taken in cash, they would not accrue until, on average, 5 months after lifting. This benefit is worth some £55 m p.a. (This is, of course, one of the reasons why the oil companies would like RIK abolished). If we revert to taking cash royalties, the addition to the PSBR in the year of such reversion would be about £350 million;
- (ii) sales of RIK are genuine arms length deals which provide evidence of price for use in valuation of non-arms length deals. If BNOB were to cease to take participation oil, the value of this benefit would significantly increase since most other oil from the UKCS would then probably not be disposed of at arms length, but rather on an inter-affiliate basis;



- (iii) taking RIK gives the public sector control of more than 10% of total UKCS production and can thus contribute to security of supplies in an emergency.

3. Publicly, taking RIK has been justified in terms of security of supply since justification solely or mainly in terms of (i) could open the taking of RIK to challenge as an unlawful use of the PSPA model clause powers.

Constraints on taking RIK

4. These are:

- (i) legally we must take RIK from all the licensees in any particular field or none of them. We cannot pick between them;
- (ii) we cannot handle RIK in less than a tanker load at a time. In effect availability at a delivery point has to exceed 50,000 b/d before we can take royalty on it in kind.

Options

5. These are:

- (i) Use of brokers for RIK disposal. The Treasury or the Department would hire brokers to dispose of RIK. This would be more expensive than the existing arrangements. Typical commission rates are 15 ¢/bbl; that would amount to a fee of £15 m a year, or 10 times the present fee to BNOC. But it might be possible to employ 3 or 4 brokers as agents and allow them to compete for further business



according to their success in marketing. With either approach it should be possible to negotiate a considerably lower rate than 15 ¢/bbl. Shown of its other activities, BNOB might have to increase its existing fee for handling RIK;

- (ii) the Treasury or Department would appoint an agent to seek tender bids for each cargo or series of cargoes. Since the agent would need to organise lifting arrangements the cost might not be much less than BNOB's current agency fees. It would, however, enable HMG to obtain direct evidence of prices, either spot or, possibly, term which could be of significant value for tax valuations. If there were an interruption in world oil supplies, the auction could be abandoned (or conducted on special terms) so that RIK could be devoted to the British market.

Both options (i) and (ii) would involve a Government Department taking on a new task. Furthermore the existing staffs of the Treasury or Department of Energy do not have the necessary marketing qualifications for managing sales of RIK.

- (iii) Use of licensees as agents for RIK disposal. We could in effect sell back the RIK to the producing companies by appointing them as our agents. (When advocating the abolition of BNOB, Esso have informally proposed this solution). That would preserve the cash flow



advantage; the terms of the appointment could be drafted also to preserve some of the security advantages of the current system. But it would be difficult to ensure that licensees sold RIK for the highest price. Checking that would impose a major administrative burden on the Treasury or Department;

- (iv) Legislation to introduce an instalment system for royalty in cash (RIC). This would require both legislation to amend the Model Clauses (which could be done in the proposed Petroleum Bill) and tax legislation (for which a Finance Bill could be used). The latter is needed to ensure that the advance in cash flow from the change in the RIC system was not largely cancelled out by an advance in tax deductions. The earliest date at which legislation could be effective is 1 January 1987. Instalment RIC would apply to all UKCS oil and gas fields, not just to 85% of UKCS oil production. So it could bring in greater cash flow advantages than the existing system. But the measure would unilaterally amend licence terms; it would be liable to challenge as expropriatory and would certainly attract strong opposition from licensees. We would no longer obtain the benefits under para 2 (ii) and (iii).

CONCLUSION

6. The most promising routes for obtaining the benefits we currently get from BNOC handling RIK, if the Corporation

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is abolished or is not replaced by a new statutory body, appear to be either the employment of brokers or auctions run by the Treasury's or Department's agents. But much more detailed work is needed on the terms under which RIK would be auctioned or brokers employed as HMG's agents and on the lifting arrangements in either case before a sensible choice could be made between them.



S E C R E T

ABOLITION OF BNOC

REDUCING BNOC'S OIL SUPPLIES

BNOC obtains its supplies from the following sources:

	<u>'000 b/d</u>
Royalty in Kind (RIK)	280
Participation - <u>saleback</u>	690
Participation - <u>non-saleback</u>	400
Third party contract	100
	<u>1,470</u>

In addition BNOC has some profitable contracts for handling LPGs (butane and propane). See Appendix C.

2 RIK, which is considered in a separate paper, involves no financial risks. Participation saleback oil involves minimal financial risk - none until 31 August 1985. It can be dealt with in a similar way to participation non-saleback oil which does give rise to financial risks.

3 This paper therefore concentrates on the rapid elimination of the supplies which involve BNOC in financial risk - non-saleback participation and Third Party contract. On the assumption that it will be politically difficult to bring BNOC's term prices in line with market prices over the next few months, it will be essential to reduce these supplies as soon as possible, if continuing BNOC losses and hence the need for further Supplementaries are to be avoided.

REDUCTION WITHIN EXISTING CONTRACTUAL TERMS

4 The participation agreements either last last indefinitely or at least for the life of the relevant field. But BNOC obtains supplies under them only if it exercises options. These are normally exercised annually either 6 or 12 months in advance of BNOC actually receiving the oil, and are valid for 6 months or a

S E C R E T



S E C R E T

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year at a time. My Department does not have the details of all the third party contracts. They normally run for a fixed period or the life of the relevant field. In all those about which we know, the price is BNOc's term price to suppliers or is affected by that price.

5 If BNOc were to shed supplies solely in accordance with its contractual terms, its supplies involving financial risk would ... diminish as shown by the attached chart (Appendix A). That is far too slow, leaving BNOc with 96% of its current potentially loss-making supplies from 1 July and over 40% from 1 January next year. We therefore need to force the pace.

6 That can only be done by agreement between BNOc and the licensees to waive the exercise of options already in place.

VOLUNTARY WAIVERS OF CONTRACTUAL RIGHTS

7 BNOc draws its non-saleback from 65 licensees. But 6 licensees provide half those supplies; 20 licensees provide 80%. (See Appendix B). Negotiations would need to be concentrated on these 20.

8 Most of these licensees could probably be persuaded without too much difficulty to agree to waive options already exercised, particularly if they knew that was a general Government policy. An announcement would facilitate the rapid reduction of BNOc's supplies.

9 There are 4 main obstacles to that rapid reduction:

i) the licensees gain financially from BNOc having exercised the options so long as BNOc's term price is above the market price. However, most of the licensees concerned accept that they have been receiving above-market prices for their oil for a number of months and that such a state of affairs

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S E C R E T

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will not continue indefinitely. It is therefore important that BNOC makes it clear that no decision has yet been taken on BNOC's term price after February.

- ii) BNOC normally ~~sells~~ oil up to 6 weeks ahead. Licensees cannot, of course, sell their oil if it has already been sold by BNOC. However, it may be possible to persuade licensees to waive the options with immediate effect and appoint BNOC as their agent for those cargoes that had already been sold. But this could prove over-ambitious.
- iii) Many licensees will wish to stipulate conditions in return for agreeing to waive existing options. This could delay the waivers for several months until negotiation had been completed. But it may be possible to persuade licensees to waive the options and then negotiate, if in so doing they did not forfeit all their negotiating strengths. They could avoid that forfeit if, for example, they retained the right to reinstate the option for a limited period at, say, 30 days' notice.
- iv) Level of co-operation from BNOC which has the formal responsibility in this matter.

PROCEDURES

10 As soon as we have taken a decision on BNOC's future I recommend the following:-

- i) Inform Chairman of BNOC of the Government's decision;
- ii) Make an announcement to Parliament:
- iii) Convey the decision to oil companies coupled with a:

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S E C R E T

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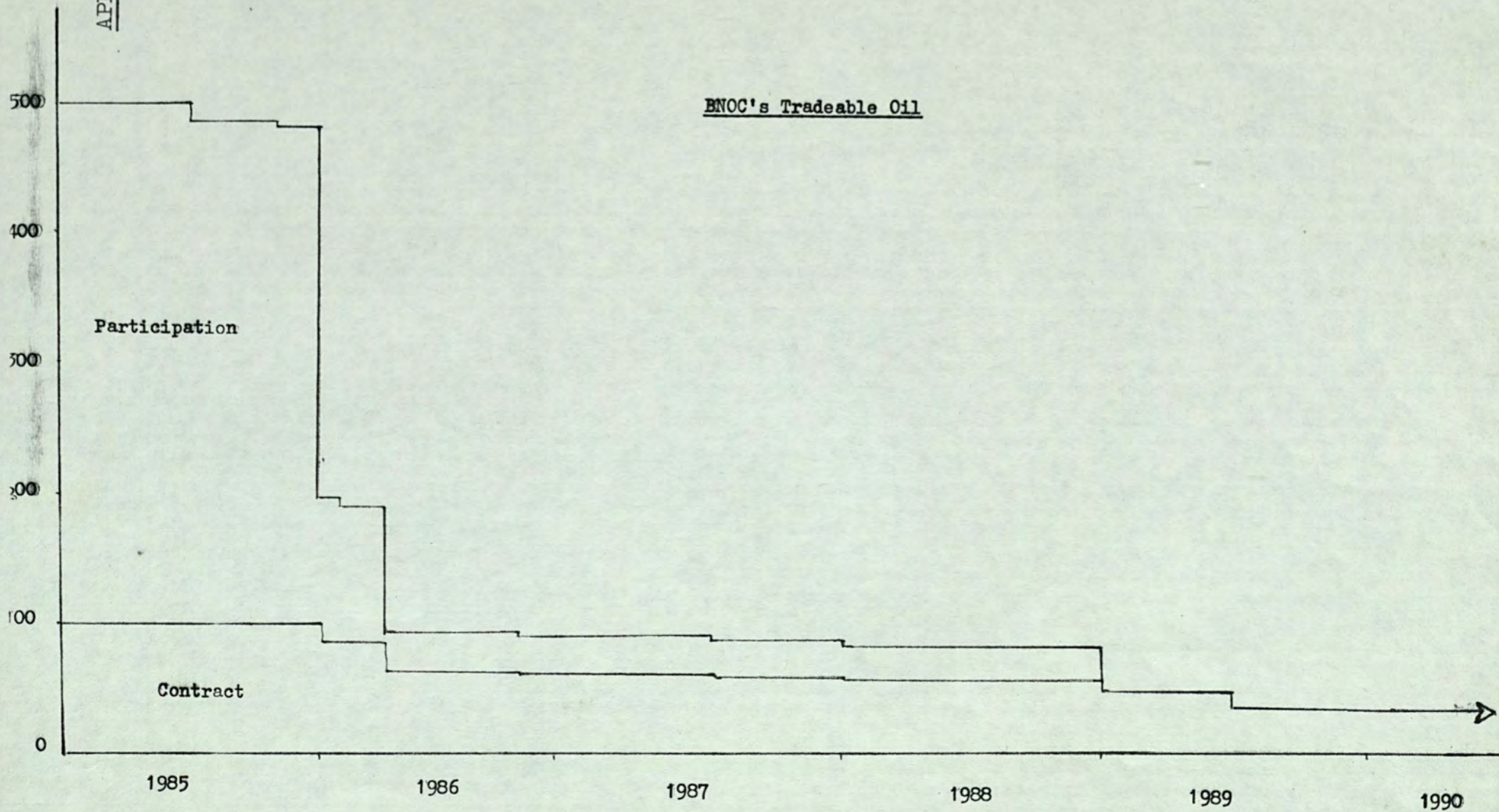
- request to BNOC not to exercise options until further notice.
- statement that BNOC is willing to waive options already exercised and third party contracts.
- invitation to licensees to agree to such a waiver;
- iv) co-ordinate with BNOC a campaign to shed avails, involving both pressure from my Department and detailed negotiations between BNOC and its suppliers;
- v) Department to apply pressure to the main targets;
- vi) BNOC to prepare draft letter agreement on waiver incorporating as appropriate the negotiating suggestions in paragraph 9(ii) and (iii) above;
- vii) BNOC to negotiate in detail with licensees stipulating conditions, though Department may also need to become involved.

CONCLUSIONS

11 BNOC cannot reduce its supplies rapidly enough merely by not exercising options. Licensees will therefore need to be persuaded to agree to the waivers of options already exercised. That will require both the co-operation of BNOC and pressure from my Department. I recommend that I proceed as outlined in the preceding paragraph.

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BNOC'S LARGER SUPPLIERS:

1.	Britoil	74,000	b/d
2.	BP (Leg 2b)	58,000	
3.	Oxy	40,000	
4.	Enterprise	35,000	
5.	Allied (Union Texas)	25,000	
6.	Deminex	21,000	
7.	Amerada	20,000	
8.	Texas Eastern	16,000	
9.	Chevron	15,000	
10.	Marathon	13,000	
11.	Phillips	13,000	
12.	Conoco	13,000	
13.	Gulf	13,000	
14.	LASMO	12,000	
15.	Fina	11,000	
16.	Ultramar	11,000	
17.	Thomson	9,000	
18.	Kerr-McGee	9,000	
19.	Agip	9,000	
20.	Transworld	9,000	

- Notes: 1. Includes "third-party contract" oil as well as non-saleback participation oil.
2. These twenty total 420,000 b/d; the remaining 80,000 b/d is from a further forty-five companies.



LPG (BUTANE AND PROPANE)

BNOG also trades some 750,000 tonnes of LPG a year. About 70% of this is obtained under participation agreements. BNOG acquires the LPG FOB and sells it CIF arranging its own shipping. This enables it to makemodest profits on the business - about £3.3m per year - while keeping to the principle of paying market prices to licensees. Prices for LPG both internationally and in the North Sea are much more flexible than those for crude oil. If participation agreements were put in abeyance, it would be necessary also to run down the LPG supplies. This could be difficult because options can last for 5 years at a time and small licensees, who have third party contracts with BNOG, would be very reluctant to handle their own supplies. Since the business is profitable, shedding it is less urgent than shedding crude oil. Despite these difficulties, it should be possible to negotiate out of most, if not all these contracts.

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ANNEX C

ABOLITION OF RESTRUCTURING OF BNOC - LEGISLATIVE IMPLICATIONS

A Retention of BNOC, but with much reduced functions (OPTIONAA)

1 For constitutional rather than strictly legal reasons, Parliamentary approval - and hence legislation - would be required to achieve a radical reduction in the level and nature of BNOC's activities (as opposed to a partial run-down which could be justified under its existing statutory powers as a response to the need to curtail loss-making activities) since the existing statutory framework of BNOC was designed to enable the Corporation actively to pursue the role envisaged for it, and approved by Parliament, in the Petroleum and Submarine Pipe-lines Act 1975 and the Oil and Gas (Enterprise) Act 1982.

2 BNOC would be placed under a duty, if required to do so by the Secretary of State -

- (a) To negotiate releases from or the cancellation of its remaining third party contracts.
- (b) To retain the benefit of existing participation arrangements (but without exercising options to lift petroleum).

3 BNOC is already under a duty to handle sales of royalty in kind and to manage the Government pipeline system if required by the Secretary of State.

4 Legislation would also be required to revise BNOC's corporate structure under the Petroleum and Submarine Pipe-lines Act 1975, e.g. its general statutory duties, borrowing powers,

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the size and formal qualifications of the Board, in order to reflect the reduced level of its activities.

5 Between 5 and 7 clauses would be needed to give effect to these provisions.

B Abolition of BNOC, replacing it with a new statutory corporation to carry out its residual functions (OPTION B)

1 Legislation would be required -

- (a) To provide for the constitution of the new statutory corporation, the appointment of its members, its working capital and accounting and other financial obligations.
- (b) To enable the successor body to perform BNOC's residual functions.
- (c) To provide for the dissolution of BNOC, the preparation of final accounts up to the date of dissolution, and the laying of those accounts before Parliament.
- (d) To provide for the transfer of BNOC's assets and liabilities on dissolution to the successor body.

2 Between 10 and 12 clauses (plus two schedules) would be needed to give effect to these provisions.

C Abolition of BNOC, with its residual functions transferred to other existing bodies (OPTION C)

1 Subject to a decision on which "existing body" would be required to carry out which of the residual functions of BNOC,

and assuming such body or each such body had the necessary powers, the following framework is tentatively suggested as forming a possible basis for the necessary legislation.

2 Legislation would be required -

- (a) To enable BNOC to wind down its activities, including power to negotiate releases from or the cancellation of its existing contracts.
- (b) To provide for the dissolution of BNOC.
- (c) To require final accounts of BNOC to be prepared in respect of the period up to the date of dissolution, and for copies to be laid before Parliament.
- (d) To enable the Secretary of State
 - (i) to make provision (e.g. by a scheme or schemes) for the vesting of the residual assets and any outstanding liabilities of BNOC;
 - (ii) to discharge, out of voted monies, any outstanding liabilities of BNOC; and
 - (iii) to pay any proceeds received from the dissolution of BNOC into the Consolidated Fund.
- (e) To enable the Secretary of State to make provision for the carrying out of BNOC's residual functions by such body or bodies as he may designate.

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3 Between 8 and 10 clauses (plus one schedule) would be needed to give effect to these provisions, plus any additional clauses needed to amplify the powers of any existing body in which residual functions were vested.

DEPARTMENT/SERIES <i>PPGM 19</i> PIECE/ITEM <i>1474</i> (one piece/item number)	Date and sign
Extract/Item details: <i>Powell to Ricketts dated 4 March 1985</i>	
CLOSED FOR <i>40</i> YEARS UNDER FOI EXEMPTION	<i>S. Gray</i> <i>5/12/13</i>
RETAINED UNDER SECTION 3(4) OF THE PUBLIC RECORDS ACT 1958	
TEMPORARILY RETAINED	
MISSING AT TRANSFER	
MISSING	
NUMBER NOT USED	

DEPARTMENT/SERIES <i>PREM 19</i> PIECE/ITEM <i>1474</i> (one piece/item number)	Date and sign
Extract/Item details: <i>Walker to Howe with attachment dated 1 March 1985</i>	
CLOSED FOR <i>40</i> YEARS UNDER FOI EXEMPTION	<i>S. Gray</i> <i>5/12/13</i>
RETAINED UNDER SECTION 3(4) OF THE PUBLIC RECORDS ACT 1958	
TEMPORARILY RETAINED	
MISSING AT TRANSFER	
MISSING	
NUMBER NOT USED	



ccdp

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215 5422
GTN 215
(Switchboard) 215 7877

Secretary of State for Trade and Industry

26 June 1984

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Millbank Tower
London SW1

NDA
AT 27/2

R. Peter.

BNO C REVIEW

You sent me a copy of your letter of 13 June to Nigel Lawson. I support your proposal that BNO C should be allowed to continue subject to another review in two or three years' time.

BNO C has a useful role to play in promoting stability in the oil market and in helping to safeguard security of supply in the event of a crisis. To abolish it now would risk a disproportionate reaction in the market place and could incur hostility from OPEC and other oil producers to the detriment of our exports and overseas investments in these countries.

There seems no point in running such risks now; if we wish to disengage from intervention in the oil market, a time may come in the future when it would be easier to do so.

I am copying this letter to the Prime Minister, Geoffrey Howe, Nigel Lawson, George Younger and to Sir Robert Armstrong.

NORMAN TEBBIT

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Energy AS

BNOJ

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CONFIDENTIAL



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cc J Pascall

10 DOWNING STREET

From the Private Secretary

25 June 1984

BNO C REVIEW

The Prime Minister has seen the paper attached to your Secretary of State's letter to the Chancellor of 13 June and the Chancellor's reply of 21 June. She accepts that, on balance, it is preferable to retain BNO C, subject to a review in two or three years time. She notes that the guidelines for BNO C's commercial trading are to be reviewed in order to reduce the exposure of the taxpayer.

I am copying this letter to David Peretz (HM Treasury), Len Appleyard (Foreign and Commonwealth Office), John Graham (Scottish Office), Callum McCarthy (Department of Trade and Industry) and Richard Hatfield (Cabinet Office).

(ANDREW TURNBULL)

Michael Reidy, Esq.,
Department of Energy.

(W)

CONFIDENTIAL

①

PRIME MINISTER

c. Mr. Pascall

BNOC REVIEW

The Chancellor has responded to Mr. Walker's paper on BNOC. He accepts the recommendation that BNOC should be kept in being, but should be reviewed in two or three years time. Both Mr. Walker and the Chancellor recognise that the arguments for keeping BNOC are pretty thin, as the Policy Unit note makes clear, and their endorsement of it is entirely without enthusiasm. The Chancellor's main motivation seems to be that abolishing BNOC would cause a political row disproportionate to the benefit and that all the statements made at the time of the BNOC/BRITOIL split could be quoted back at the Government.

Do you

- (i) want a meeting to challenge these arguments, or
- (ii) accept, albeit without enthusiasm, the judgement of Mr. Walker and the Chancellor?

Answer no *AG*

22 June 1984

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CC No



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

21 June 1984

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

A handwritten signature in cursive script, appearing to read 'Peter Walker'.

BNOC REVIEW

You wrote to me on 13 June enclosing the report by officials on the future of BNOC.

We were forced to use the security of supply argument for BNOC during the Parliamentary debates on the privatisation of Britoil, since the only alternative - the abolition of BNOC at the same time as we were privatising Britoil - would have been far too difficult in political terms. But I have to say that I have never regarded our security of supply as in fact depending on BNOC to any significant extent.

I am also keenly aware of the wider political and diplomatic difficulties to which we are exposed as a result of the existence of BNOC. Although the events of the spring of 1983 worked out very satisfactorily in the end, they could easily not have done, and we were put on the spot internationally in a way that the United States, despite being a very much larger non-OPEC oil producer, never was. We had a very difficult hand to play.

But I recognise that abolishing BNOC could still generate a good deal of political heat. We would certainly be accused of endangering the nation's security of supply, weak though that argument is. And BNOC is still of use to us in establishing the tax reference price on which the North Sea fiscal regime is based. So on balance I would agree that we should retain BNOC at about the present size and with its current objectives at least until the debates on the Oil and Gas Enterprise Bill have receded further into the mists of time. But I am sure you are right that we should review the position in two or three years' time.

CONFIDENTIAL



I agree that officials should consider the terms of an early announcement and undertake a further study of the guidelines for BNOC commercial trading. I also think it would be worth picking up the suggestion in the Report for an independent check on the form and level of the management controls on BNOC's traders. The capacity of BNOC to lose massive sums of taxpayers' money is something of which you will be keenly aware.

I am copying this letter to the Prime Minister, Geoffrey Howe, George Younger, Norman Tebbit and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read "Nigel Lawson".

NIGEL LAWSON

ENERGY : BNOC : PLS,



22 JUN 1984

PRIME MINISTER

①

BF with Chancellor
response AT 19/6

Mr. Walker has written to colleagues on the outcome of the review of BNO. He concludes, though without enthusiasm, in favour of retaining BNO with another review in 2-3 years. The arguments are summarised in pages 1-4 of the report.

Policy Unit think the balance of argument is for abolition - they start from the premise that public sector bodies should go unless proved otherwise. Chancellor is still considering.

Do you

(i) find Mr. Walker's arguments persuasive;

or

(ii) have sufficient doubts to want a Ministerial discussion;

or

(iii) prefer to wait until Chancellor has expressed a view?

Yes, no AT

15 June, 1984

ANDREW TURNBULL

Basically I think it's a mistake to abolish something which has only very recently been set up unless the case is overwhelmingly not

~~e.DP.~~

MILLBANK LONDON SW1P 3AG

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

13 June 1984

Nigel Lawson

BNOC REVIEW

I attach a report prepared by officials from the Treasury, the Revenue, the Foreign and Commonwealth Office, and my Department, which reviews the case for and against retaining BNOC.

I endorse its conclusion that BNOC should be retained for the time being with its current objectives and on much the same scale as at present. I also agree that the question should be looked at again in 2 - 3 years time.

The review concludes that there is a case for retaining BNOC both on grounds of its potential contribution to the security of our oil supplies in a supply crisis and of helping to ensure that the UK economy receives the maximum economic benefits from UKCS production.

In an oil shortage BNOC could make a limited, but useful contribution to our security of supply, unless the IEA emergency sharing scheme is activated. The fact that the UK Administration now seems reluctant to see that scheme activated, except as a last resort, enhances the potential role of BNOC.

The report also draws attention to BNOC's role in providing reliable market intelligence in a crisis. The oil companies followed courses of action in 1973 and in 1979, which were detrimental to our national interest. In any further crisis they would undoubtedly again be under pressure to do so both from their parent companies and from other Governments. It is vital that we have reliable information in a crisis so that we can protect our interests and in particular ensure that the British public does not go short unnecessarily. I am confident that BNOC under Douglas Croham and Ian Goskirk would be willing and able to provide valuable information and thus help to achieve our policy objectives.

There is also an important political dimension to the security of supply argument. The public, Parliament and the Press all tend to believe that BNOC can make a considerably greater contribution to our security of supply in a crisis than is likely to be the case. This belief is likely to persist. Indeed I understand that when the 1982 Oil and Gas (Enterprise) Bill was being considered in the House, Energy Ministers at the time laid stress on BNOC's potential contribution to our security of supply. I believe it would be particularly damaging to start dismantling BNOC at a time when we are living with the continuing threat of the closure of Straits of Hormuz. We would be criticised universally for undermining BNOC at a time when everybody believed it had a great deal to contribute. Unravelling the participation agreements with all the companies with oil on the UKCS would be very complicated and ensure the process was long drawn-out.

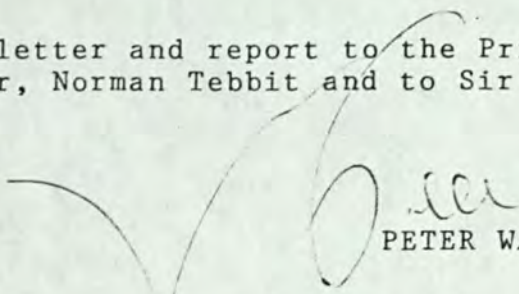
I agree with the report's conclusion that over the last year and a half or so BNOC, working closely with the Government, has played an important role in helping stabilise the world oil market. It has thus helped to avoid large price gyrations with all their disruptive effects and maintained our oil revenues at a higher level than would otherwise have been the case. OPEC would certainly see abolition of BNOC as a de-stabilising factor in the market, and if it were abolished would still look for ways of putting pressure on us to restrict production, so as to reduce the burden on them of restraining production in order to prevent a fall in prices.

The report lays particular stress on the BNOC's contribution to the economy through helping to ensure that enough arms-length transactions in the various grades of UKCS oil take place at transparent prices which can then be used by the Oil Taxation Office in valuing inter-affiliate transfers of oil. As long as things remain as they are in the oil market, this consideration alone would seem to justify retention of BNOC. Furthermore BNOC is not expensive to run. Indeed it makes a net contribution to the Exchequer, as its annual operating costs of about £5 m are more than offset by the £25 m - £30 m benefit of taking royalty oil in kind, for which BNOC acts as the Government's selling agent.

I also accept the report's conclusion that retaining BNOC but at a lower volume of activity would achieve the worst of both worlds.

I should be glad to hear if you and other colleagues agree with the report's conclusions. If so, our officials will need to meet to consider the terms of an early announcement as well as to undertake the proposed further study of the guidelines within which BNOC engages in commercial trading.

I am sending copies of this letter and report to the Prime Minister, Geoffrey Howe, George Younger, Norman Tebbit and to Sir Robert Armstrong.


PETER WALKER

REVIEW OF BNOC

Note by OfficialsINTRODUCTION AND CONCLUSIONS

A. During the period of serious difficulty in the world oil market in the spring of 1983, questions were raised about the impact of BNOC's operations and institutional arrangements. The Select Committee on Energy in the last Parliament took evidence about BNOC and the oil market during March to May last year. The then Secretary of State was examined orally (on the basis of a factual written memorandum); Shell, BP, Esso, Brindex and Thomson N Sea submitted other significant memoranda. The Select Committee did not complete any report before the election; but Mr Lawson instructed officials to review the position of BNOC in the light both of the evidence submitted and of experience gained in the world oil market. While in his evidence to the Select Committee he mentioned the need to review BNOC's operations and institutional arrangements, he asked officials to study the implications of abolishing the Corporation. His main concerns were that the existence of BNOC might involve Government unnecessarily in the market with an attendant risk of financial loss in participation trading, and that the BNOC price acted as a focus for political pressure from OPEC countries in a weak market and importing countries in a shortage.

B. We have examined BNOC's effectiveness in meeting its objectives as listed in para 10. The review is in four sections:

- i) background information (paras 1-10);
- ii) BNOC's economic role (paras 11-28);
- iii) BNOC's contribution to UK security of supply (paras 29-39);
- iv) policy options (paras 40-45).

C.

We conclude that

- (i) the advantage lies with retaining the present system of taxing arm's length sales on the prices actually realised and valuing non arm's length transfers on the price the oil would have fetched if sold at arm's length. While these rules would probably be workable without BNOC, at present BNOC does provide valuation evidence of a significant volume of UK crude sold at arm's length at transparent prices. Without this evidence, the Inland Revenue would be in a weaker negotiating position in certain circumstances with a consequential revenue risk. However the evidential value of BNOC's prices has declined in the last year or two and other evidence of market prices is growing (paras 4-7, 12-17);
- (ii) the UK is not a large enough oil producer for BNOC to be able to contribute decisively to stability in the international oil market. But it did contribute in March and December 1983 and the balance of probability is that it helped achieve higher world, and thus UKCS, prices than would otherwise have been the case. Per contra, there is little doubt that it could have destabilised the market in the spring of 1983 had that been the Government's policy. The act of abolishing BNOC now would be interpreted by OPEC as a signal that HMG was no longer interested in stability and would also create a new uncertainty in a fragile market with a consequent risk to stability (paras 18-20);
- (iii) given a structure of world oil prices established through OPEC discipline, there is no clear evidence for or against BNOC as an instrument for securing relatively high prices for UKCS crude

within that overall structure. Undoubtedly in 1979/80 it facilitated the policy of holding down UKCS prices during the shortage, which may have cost the Exchequer several £ hundred millions: but that policy was also applied to individual licensees in the UKCS and the only complete remedy is to resist the temptation (and pressures from consuming countries) to adopt such a policy in future emergencies (paras 21-26);

- (iv) abolishing BNOC would save the £5 million per year administrative and running costs. But the net cost of running BNOC is lower, and is more than offset by the £25-30 million per year benefit of taking Royalty in kind rather than in cash (paras 27-28);
- (v) in an emergency, BNOC may make a limited but useful contribution to physical security of supply, by diverting some additional crude into the UK in certain circumstances, by acting as a source of pressure on the refining companies and by providing Government with a greater insight into the workings of the market place (para 39).

D. We also conclude that if BNOC is retained, any significant reduction in the quantity of crude oil it traded would threaten its most valuable contribution to the UK - that at C(i) above, although that does not imply that in all circumstances BNOC's business volume has to be maximised particularly in hydrocarbons other than crude oil. While some non-participation trading is essential if BNOC is to stand a reasonable chance of making a profit, that needs to be kept within strict bounds both to avoid abuse of market position and to limit exposure to loss. It may be appropriate to arrange for an independent check on the form and level of management control on BNOC's traders (para 42).

OVERALL CONCLUSION

E. The balance of argument at each of C(i) to C(v) is either neutral, or in favour of retention. We conclude that if BNOC did not exist, we would not recommend its creation but that, given its presence, the balance of the arguments points clearly, though not strongly, to retention. However, the judgements in C depend on current circumstances; that at C(i) depends particularly on the present lack of transparent arm's length UKCS sales other than BNOC's. Circumstances may well change and we therefore recommend that the assessment is again reviewed in 2-3 years' time.

I

BACKGROUND

World Market

1. The significant net exporters of oil fall into two groups
 - (i) those countries, the Soviet bloc, the UK and Norway, Egypt and one or two minor OPEC countries who do not constrain production and allow the market to set the price;
 - (ii) the main OPEC producers and perhaps Mexico who attempt to set prices and allow the market to set production levels or seek to agree a production programme to allocate their aggregate sales.

Although the US is not a net exporter, its free market in which imported crudes compete with those produced domestically has a very substantial effect on overall world market prices.

2. Maximum sustainable production capacity in the OPEC countries is some 34 mb/d against a demand for their oil of only about 18 mb/d. Production costs are only a fraction of prices - operating costs lower still. Accordingly unless there is an emergency, or OPEC countries agree to effective constraints on the amount of oil they will produce, strong downward pressure on oil prices is likely to emerge. Moreover because the demand for OPEC oil is not very sensitive to price changes in the short term, once oil prices begin to fall they could fall a long way. In the medium to long term both demand for oil and non-OPEC oil production are much more price sensitive and will limit the period over which any given price fall could be sustained. Ultimately, given the amount which OPEC are willing and able to produce, a new equilibrium price would be established. We cannot be confident what that equilibrium price is,

but our own calculations suggest that if the price declined from the current level of \$29-30/b to \$20/b, a shortage would threaten to occur before the end of the decade.

3. In the Sixties a small group of international oil companies, integrated both horizontally and vertically, set prices and allocated oil administratively between their various sources and to their various markets. In the Seventies, OPEC countries effectively wrested from them the power to set prices but they retained control over the allocation of oil through their remaining equity interests and long term contacts with the producing Governments. From 1979 on oil has been increasingly allocated by the market, firstly through "annual evergreen" contracts under which, while producer and consumer retained bonds of loyalty, prices were renegotiated quarterly or more frequently, and then through the development of a substantial level of spot of spot related sales, especially of North Sea crudes.

The UKCS Tax Regime

4. The OPEC countries set in advance Government Selling Prices (GSPs) which generally act both as the prices at which their national oil companies sell oil (though discounting in one form or another frequently occurs) and as tax reference prices for any companies which still have equity interests there (although the tax reference price is in some cases set higher). These prices are applied to all oil of the same grade. Norway also applies a simple tax reference price for each grade, though that price is determined administratively in the light of market prices from time to time and applied retrospectively to sales during the relevant period. The general rule in western developed countries (including the US and Canada as well as the UK) is however based on the arm's length principle. This means that for oil from the UKCS sold at arm's length, whether under term contract or spot, profits are assessed for tax on the price received. For oil transferred other than at

arm's length it is necessary to establish a market value - ie the price it would have fetched if sold at arm's length. If oil were valued at above its market value, the industry would be overtaxed compared with the intended balance in the Budget and marginal fields would suffer disproportionately. Moreover, the arm's length principle of transfer pricing is written into the UK's network of tax treaties; departure from it could lead to challenges by foreign tax administrations either by way of loss of creditability for UK taxes or by way of different transfer prices being fixed by the foreign fisc. Either response would lead to double taxation of investors in the UK. This is a particularly sensitive issue at a time when the UK is defending the arm's length principle against the use by US States of the unitary system of taxation.

5. There is no single arm's length price for valuing non-arm's length transactions. When the market is in flux prices for the same grade can vary by \$2 a barrel or more (6%) depending on the precise date of the transaction, the type of transaction (spot or term), and the bargaining strength of the parties. Traditionally a term transaction has been regarded as the appropriate analogue for valuation. Following the spring 1983 price crisis, however, the Inland Revenue accepted that in certain circumstances regard would also be paid to prices in the spot market.

6. Taxes on production of UKCS oil are much higher than those on the downstream operations of the oil companies in any consuming country (often tax liability downstream is nil because of losses or tax allowances). The level of upstream tax means that usually about three-quarters of any change in proceeds caused by a price change will accrue to or be borne by the Exchequer. As a consequence, when oil is plentiful and spot prices below term prices integrated companies with both production in the UKCS and downstream interests have a strong incentive to switch disposal from inter-affiliate transactions

to arms length spot sales. (This is called "oil spinning" by Esso.) While at first sight this practice appears to reduce Exchequer take, without it as a safety-valve term prices might have to be lower, and since tax valuations have generally been based mainly on term prices, overall tax take might be lower. Though some OPEC countries have claimed that increased volumes placed on the spot market could, at the margin, add to instability of the market in times of weakness, we would regard the effect as mainly psychological and limited since the practice increases both supply and demand on the spot market equally.

7. Ministers have from time to time considered whether to change the valuation rules to a norm-type or other administrative system. They rejected such a proposal in autumn 1982 on grounds of general taxation principles, because of the danger that such a system would endanger our tax agreements with other countries, especially the USA on double taxation and because of doubts whether the system would be workable in the absence of any mechanism for the objective determination of market value. With the current market-based system, however, there is a case for strengthened information powers, and relevant measures have been included in this year's Finance Bill.

BNOC's Operations

8. Current UKCS oil production is about 2.5 million barrels a day (mbd). About 52 per cent of this (1.3 mbd) passes through BNOC's hands either as participation oil or as "Royalty in Kind" (ie oil directly taken by the Government in lieu of money royalties, equivalent to $12\frac{1}{2}\%$ per cent of output). Nearly half of the oil accruing to BNOC is sold back to its producers who refine and market in the UK; the remainder is sold at arm's length by BNOC, traditionally on a term basis. Despite the operation of sale-back, BNOC is the dominant supplier of UKCS oil to the world market.

9. BNOC has to give at least 6 months notice of an election to take participation oil from any licensee: it is then obliged to take the oil throughout the election period which runs for a year (or sometimes longer). For each quarter, or if there has been a substantial change in the market, it will propose a single price for each grade of oil. That should represent the world market term price. If BNOC's suppliers are not satisfied with it, they can have it referred to an expert, but neither they nor BNOC can unilaterally reduce the proportion of output taken by BNOC. BNOC strives to sell all its oil (other than saleback) on normal annual evergreen contracts at the same price as that offered to BNOC's suppliers. The customers do not have the right to appeal to an expert but, if they disagree with the price, can at 15 days notice progressively reduce the volumes they take. BNOC has no control over the rates of production and HMG has foresworn use of its own powers of control until the end of 1984. It lacks the financial strength to store oil, though it may be able to juggle with the timing of particular cargoes and thus achieve the effect of storing some of its avails for up to a month. Accordingly BNOC is at risk of losing term outlets while being unable to reduce its purchases.

BNOC's Objectives

10. Any review of BNOC must start from the Corporation's objectives, and consider whether those objectives could better be achieved if changes were made. BNOC's objectives, set out in the Financial Guidelines given by the Government to the Corporation, are in essence:

- (a) to assist in ensuring that the maximum benefit is secured for the UK economy from the exploitation of UKCS oil resources; and
- (b) to contribute to the security of UK supplies of crude oil and oil products.

II ECONOMIC ROLE

11. In explaining the retention of BNOC as a public sector trading operation when the Corporation's upstream interests were privatised as Britoil, Ministers emphasised security of supply - too clear an explanation of the economic role of BNOC could have provoked Commission questioning of the compatibility of the participation system and other aspects of our licensing regime with the Treaty of Rome. In the view of officials, however, the economic role is probably the more important. The latter objective can be discussed under 3 heads:

- (i) establishing transparent arm's length prices to aid tax valuation;
- (ii) promoting stability in the world oil market.
- (iii) maximising the value of UKCS crude within a given world price band;

BNOC's role in tax valuation

12. To value non-arm's-length disposals of UKCS crude, the Oil Taxation Office (OTO) of the Inland Revenue requires evidence of transparent arm's length prices for all the North Sea grades. The prices obtained by BNOC for non-saleback participation and royalty oil are accepted by willing buyers and also by the licensee sellers. BNOC therefore performs two functions:-

- (i) It ensures that a significant volume of UK crude is sold in arm's length deals.

- (ii) It provides a relatively transparent price which the OTO believe can be quoted in evidence in appeals.

The latter has been the more important.

13. In the absence of BNOB's sales of participation and royalty in kind, the bare minimum that would be sold on the open market would be about 14% of UKCS production - the volume produced by companies without downstream interests. In normal circumstances the proportion is likely to be substantially higher though there would remain the risk that arm's length sales would be minimised if companies believed this would reduce their tax bill.

14. In the absence of sales by BNOB of participation and royalty-in-kind, evidence for valuation would present a more difficult problem. The OTO would have to rely on one or a mixture of the following:

- (i) Arm's length prices for UKCS crudes. Significant volumes are currently sold by licensees at arm's length, and this evidence would continue to be available to the OTO, and to provide an important source of data in forming the Revenue judgement in valuation. The data is however commercially confidential, and, unlike the relatively transparent BNOB Price, cannot be used without consent as evidence in another company's appeal. In appeal proceedings it would doubtless be necessary to support the OTO's views - as indeed we would do in current circumstances - by putting in evidence from consultants based on their own general experience and published material. Another possible weakness is that for some grades there are no arm's length sales apart from those made by BNOB.

- (ii) Spot and futures prices. Over a period of years the Exchequer would not necessarily be worse off if all inter-affiliate sales were valued at spot rather than term prices. But the spot market is not at present transparent - reports are selective - and the market may sometimes be thin enough for it (or the reports) to be manipulated by large companies. Prices in the futures markets which have been established in the USA for about a year and have just started in London, are true market clearing prices but volume at present is very small and it is not clear that futures prices have any relevance to current transactions.
- (iii) OPEC Government selling prices. These are not market determined and may not represent the true price. Hidden discounts or premia often exist; non-standard credit-periods may be used; often there is an element of barter or other non-price inducements. None of the OPEC grades is exactly comparable with North Sea grades and the appropriate differentials to take account of quality and geographical differences are difficult to determine and vary over time.
- (iv) International arms-length market selling prices. The Soviet Union and Egypt price their crudes competitively and their prices usually become public. But they differ significantly in quality from UKCS grades. Some US grades, eg West Texas Intermediate (WTI), are similarly sold at transparent market prices and are not dissimilar in quality to UKCS grades; indeed BNOC prices have historically closely tracked WTI. But UKCS crudes are sold both in US and European markets which may well differ in the values attributable to different crudes. For the

future, Statoil's sales are expected to rise to around 300,000 barrels a day (equivalent to 12% of UK production) during the mid-1980s thus providing a substantial and we would hope transparent source of evidence of North Sea prices. But we would still need to make the appropriate allowance for the differences in quality of other North Sea crudes.

- (v) Netback values from product sales. BP has proposed such an approach. It would, of course, base valuation on true market prices, though for products rather than crude. It would also have the advantage to BP of eliminating downstream losses on UKCS production. But it could lead to endless argument about the proper method of deriving the crude valuation from the ultimate product realisation; when losses are made downstream, it would tend to depress the value of UKCS crudes below other crudes; it would remove much of the incentive companies now have to maximise product realisations; if product realisations outside the UK were to be used there would be different tax valuations for the same grades of oil; and if we confined sale of such crude to the UK, we would be in breach of the Treaty of Rome.

15. The position may change. Large non-integrated UK licensees such as Britoil and Enterprise may, like Statoil, propose uniform transparent selling prices. Some large integrated companies have occasionally entertained the possibility of introducing into Europe the US system of transparent purchase prices posted by refiners. Spot markets may develop, perhaps influenced by the futures market, into truly transparent commodity markets. However if BNOC were abolished, and there was insufficient transparency or there were problems of evidence on appeal, it would be necessary to consider controversial

legislation which either required disclosure of commercially confidential transactions by one company to another involved in an appeal, or to deny companies the effective right to appeal against valuations (for example by setting up a special board to determine tax reference prices on the lines of the Norwegian norm price board).

16. In recent years moreover, the value of BNOC's prices has been partially undermined as BNOC has had to resort to discounts and spot sales and as the companies have refused to follow BNOC's prices, believing them not to be market prices, and have resorted to the spot market. Under pressure from the industry, the Inland Revenue made a public statement last year accepting that in some circumstances it would be appropriate to take spot prices into account in tax valuations. Were such circumstances to recur on a large scale, the evidential value of BNOC's price would be substantially eroded. Apparent Government intervention in BNOC's pricing policy would also reduce its evidential value.

17. For the time being we conclude that the present system with BNOC is superior to the present system without BNOC. Though the latter would be workable, somehow or other, satisfactory evidence from arm's length transactions could be in short supply; even BNOC's spot sales could have important evidential value, although such sales could if large enough undermine the value of the term price as evidence. In the absence of BNOC, the difficulties of establishing the appropriate valuation for non-arm's length transactions could cause the Revenue to lose amounts which, though small in terms of price per barrel, could be large overall. Abolition of BNOC could subject a substantial amount of revenue to some uncertainty.

Stability in the world oil market

18. Early last year Venezuela claimed that as well as leading term prices down in a weak market due to its participation trading arrangements, BNOC acted as a price leader in world markets without the powers (ie to hold oil off the market) to make such leadership effective.

19. Undoubtedly in early 1983, Nigeria was comparing its prices with BNOC's then published prices; any move in those prices risked attracting a competitive move in Nigerian prices and ultimately in OPEC prices as a whole. More generally, the existence of a semi-official price for UKCS crude may be used as grounds for trading and diplomatic pressures against the UK from OPEC countries. But Nigeria was determined in any event for budgetary reasons to sell a certain quantity of oil, and was convinced that its competitor was the UKCS. It is difficult to believe that it would not have cut prices to promote sales even if there had been no BNOC price. With hindsight, it does seem likely that the slide in spot oil prices from December 1982 through the first quarter of 1983 would have occurred whether or not BNOC existed and that BNOC's actual performance under that pressure helped crucially in halting that slide. Wherever the balance of argument lies on these points, it is undoubtedly true now that OPEC countries believe that the actions of HMG and BNOC in postdating price changes and minimising them to fit into an OPEC pattern of prices were intended to and did help stabilise the market. To abolish BNOC now would be interpreted by them as a signal that HMG no longer had an interest in stabilising prices. It would also create a new uncertainty in a fragile market which had grown accustomed to the presence of BNOC. That would tend to be destabilising.

20. Nor - leaving aside these important issues of sentiment - is there any general reason to expect that the absence of BNOC would contribute to the stability of the world oil market. If abolition of BNOC led to channelling more UKCS oil through inter-affiliate deals rather than through the spot market, the amount and visibility of spot transactions would be reduced (but it is not clear that the volume of spot transactions would decline - the result could well be the opposite). Whatever the outcome, it would do nothing to affect the underlying weakness, which springs from excess world supply: spot buyers would be removed from the market to exactly the same extent as spot sellers. The real OPEC complaint against the UK is not that BNOC prices are too low but that the UK refuses to assume part of the burden of price support by restricting its current output.

BNOC as Maximiser of UKCS Prices

21. The criticism of BNOC's role under this head have been two-fold:
- (i) BNOC has to dispose of all its avails at the same price. It must therefore price all its disposals at the low clearing price. That price also has a predominant influence on inter-affiliate transfers (because of the tax regime) and de facto rules for arms-length contracts covering sales by licensees. In the absence of so monopolistic a seller, individual licensees could cream higher prices off buyers when North Sea crude was more valuable than the BNOC clearing price. Moreover, for a quiet life and to avoid losses, BNOC tends to come down in favour of the customers, who are at the same time the more powerful producers.

(ii) The existence of a semi-official selling price proposed by a public sector body provides a target for pressure from consumer countries on HMG to restrain price rises in conditions of shortage. During the 1979/80 emergency, HMG kept the rise in BNOC's prices behind the rise in spot prices, though this did not, in fact, moderate the increase in world prices. On average the differential between the spot and the BNOC term prices was \$10. Tax valuation at the BNOC price was thereby lower than it would otherwise have been had the BNOC price been allowed to rise in response to market forces (though the spot price, in a very thin market might not have risen so high if larger volumes had been traded on it) and substantial amounts which could have run into £ hundreds of millions of tax were foregone. However at that time, the Government also put heavy pressure on licensees to restrain prices and much of that loss cannot be held to BNOC's account.

22. The counter-arguments to (i) are:

- (a) the non-integrated companies producing in the North Sea are in the main small and no match in negotiating strength for the large integrated companies who would be their customers. BNOC effectively acts as a cartel for them obtaining higher prices;
- (b) in particular BNOC holds UKCS prices high by offering term contracts that are expected to be honoured in all circumstances. BNOC's customers believe that BNOC oil is secure from political interference or shortages, and are prepared to pay some premium for this. (This aspect of course may conflict with BNOC's security of supply role.)

(c) on occasion when the market has been exceptionally weak, BNOC has - rather than lower term prices across the whole range of its sales - sold the marginal barrel at a lower price, by means of spot sales or discounts, than the bulk of its sales. This course may well be more beneficial to the UK than the alternative of an across the board term price reduction despite the losses to BNOC of buying participation oil term and selling it spot. Because of the very high marginal tax rate on oil production, the Exchequer receives on average 75 per cent of the benefit from prices being higher than they would otherwise have been; on this basis it would be worth BNOC selling, say, 250,000 barrels a day spot at a discount of \$1 a barrel, in order to keep average prices over the remaining 2mbd of UKCS production 17 cents a barrel higher than they would otherwise have been. This practice served to stabilise prices last spring (see para 25 below), but can only work against short-term weakness; over an extended period, the credibility of BNOC's prices as market prices would be weakened.

23. The circumstances of (c) above arose in early 1982, and again in early 1983, when spot sales exceeded 50% of BNOC's total arm's length sales. The approach is costly to BNOC: a reduction in term prices can be passed on to its suppliers; the loss from selling spot cannot so be passed on. (Fortunately in the summer of 1983 spot prices rose above term and BNOC managed to recoup much of its loss by spot sales of the oil for which it had lost term custom and showed a small overall profit for 1983 as a whole.) Moreover the theoretical advantages to the nation would decline the more extensively or frequently BNOC had to sell spot in weak markets; the Corporation would tend to lose its term customers, and the validity of its term prices as an indicator of arm's length prices for tax purposes would diminish over time -

indeed as already noted in paragraph 16 that validity has already to some extent diminished because last spring's crisis obliged OTO to consider evidence from spot as well as term transactions. In particular if BNOC's losses exhausted its capital and borrowing limits so that grants had to be made under Section 6 of the Oil and Gas (Enterprise) Act 1982, it is unlikely that BNOC's term price could any longer be regarded as significant market evidence.

24. On (i) we do not find the arguments that BNOC prevents some sales at above market clearance levels and favours customers conclusive. More certain is the very much more limited point that BNOC has succeeded in improving the prices paid for some particular grades of crude from fields in which one or more weak licensees have been dominated by one or two powerful integrated companies (eg Buchan, Fulmar) and that some licensees have welcomed BNOC's presence in field, pipeline and terminal committees as a protection against unfair transportation or offlift terms.

25. In the absence of BNOC, each licensee would be responsible for selling all his oil in whatever combination of term and spot transactions best suited him. One result would be a large increase in the proportion of UKCS oil where the licensees could choose, depending on circumstances, between spot sales and disposal through inter affiliate transactions. To the extent that term contracts continued to be made, one would expect term customers to be lost more rapidly in crumbling markets than under current arrangements: there would be so many alternative supplies of crude that customers would have a much reduced incentive to preserve a term relationship with any one particular supplier. Moreover there would be even less opportunity to manage disposals on the spot market so as to minimise their impact on prices.

26. We find it hard to assess the effectiveness of BNOC as a maximiser of UKCS prices within a given level of world oil prices. For the present we consider that there is a risk that prices for UKCS oil could tend to be lower in the absence of BNOC. However, this is an area which needs to be looked at year by year in the light of market developments. There is little doubt that BNOC's prices acted as a focal point for pressure from consuming countries in 1979/80. and HMG's decision to hold them down may have cost the Exchequer substantial revenues; but the main safeguard against such a possibility in the future is a determination by Government to resist such pressure rather than abolition of BNOC (which might merely direct the focal point to the main non-integrated licensees such as Britoil and Enterprise Oil).

27. Royalty in Kind and BNOC operating costs At present the Government takes royalty in kind, rather than in cash, from most producing oilfields. This policy was confirmed by Ministers in 1982, following consultations with the Treasury. Because royalty in kind is taken as the oil is produced, and proceeds of sale realized shortly afterwards, there is a cash flow benefit to the Government through taking royalty in kind as compared to royalty in cash (which is not payable until two months after the end of each half year). The net value of this cash flow advantage to the Government is expected to be £25-30 million per year over the next few years.

28. The Government has no facilities for handling royalty in kind: the use of an agent is essential. BNOC does the job for an agency fee of some £1.5 million per year, within its total operating costs of about £5 million per year. If BNOC did not exist. we would have to consider asking a major oil company or a broker to act as our agent. Such an agent would enjoy a considerable, and possibly undesirable, degree of market power through handling such a large quantity (some 12-13 million tonnes a year, worth £1.8 billion) of HMG's oil, and could not be relied on in all circumstances to maximise HMG's

receipts. Furthermore, the agent's fee would still have to be paid, with the cost to the Government likely substantially to exceed the just over 2 cents/barrel hitherto paid to BNOC.

III SECURITY OF SUPPLY

The UK Objective

29. The Government's policy in the event of a significant interruption of part of the world's oil supply has been the subject of a separate paper circulated to Ministers. Essentially UK objectives would be to ensure that UK demand is met and at prices as close to current levels as possible. The policy to be pursued during any period of world supply difficulty will depend on whether or not a decision has been taken by the IEA to implement its programme of demand restraint, stock drawdown and oil allocation - and this cannot happen until a world supply shortfall of at least 7 per cent has been confirmed. As the recent paper to Ministers showed, once the IEA allocation scheme is in force, appropriate action to mobilise stocks should be sufficient to ensure full product supplies to UK consumers during a disruption lasting up to a year without any infringement of our Treaty obligations to other IEA members. (A situation in which the IEA scheme has been triggered is referred to as a "full crisis"). But particular attention has been given to action to improve the position of UK oil product consumers in a situation falling short of a full crisis (which we refer to as a "sub-crisis") or where there is a full crisis but the IEA scheme is not activated.

Government policy in a sub-crisis

30. In accordance with the UK's position as a member of the European Community and as an open market economy, successive Governments have refrained from imposing controls on the use of UKCS oil or on exports and imports of crude oil and oil products. UK refiners have been permitted to process whichever grades were most economic, depending on the structure of the UK product market and the refinery facilities available. Some 60 per cent of UKCS crude output is exported, while more than 40 per cent of the throughput of UK refineries is imported crude (or refinery feedstock).

Against this background the Government has sought to improve security of supply in a sub-crisis through the negotiation of a series of informal assurances

- i) with UKCS producers who are also refiner/marketers in the UK, that they will either maintain normal deliveries to UK customers (where their UKCS crude supplies are sufficient to meet the requirements of their market), or will ring fence such UKCS crude as they have available and only apply "equal misery" restrictions to supplies in proportion to the fraction of their UK product market not covered by UKCS oil;
- ii) with producers who have no UK downstream activity, that they will, on being given 45 days notice by the Secretary of State, offer their UKCS Oil at the going price to UK refiners.

(These assurances cease to have effect when the IEA allocation scheme is brought into force.)

31. Participation and royalty oil is sold back by BNOC to most producers covered by (i) essentially in return for the supply assurance. Many companies covered by (ii) have been content to give this assurance in order to maintain good relations with the Government in relation to future licensing and development; participation and royalty oil is not automatically sold back to them by BNOC. All these assurances depend for their validity and effectiveness on their remaining informal although this is unlikely to detract seriously from their usefulness in a sub crisis; any attempt by the Government to enforce them would require overt use of emergency powers and might well fail on the ground that it was inconsistent with Article 34 of the Treaty of Rome. Indeed the assurances may themselves contravene that Article but the Commission has not yet challenged them.

The role of BNOC

32. In the event of a sub-crisis, the following steps would be open to the Government (apart from pressing producer/refiners to honour their assurances):

- i) require non-refiners (at 45 days notice) to repatriate some or all of their UKCS equity production;
- ii) ask BNOC to steer back into the UK market some of the participation and royalty oil previously exported under term contracts or on a spot basis; and
- iii) invite BNOC to discuss with certain major international companies whether UKCS oil in excess of the requirements of their UK downstream markets, and sold to them on a term basis for use outside the UK, could be diverted in whole or in part into the UK market.

Under present arrangements BNOC might act as the Government's agent in offering "repatriated" oil to UK refiners who were short of crude or marketers who could enter into process deals. The Corporation could reinforce this by selling its spot availabilities into the UK and, in principle, by not renewing "annual evergreen" term contracts with overseas purchasers as they fall due; they estimate that they could by this means (possibly supplemented by some action under (iii)) in 3-6 months make available an extra 100,000 barrels a day (7% of UK demand) to UK refiners. There would, however, be commercial costs to BNOC, (and consequential tax losses on non arm's length disposals) since failure to renew evergreen contracts would make them appear less reliable as term suppliers; once the market had returned to "normal" and the underlying position of over-supply had reasserted itself, they would then find it more difficult to recover term customers. Nevertheless these arrangements

should in principle be sufficient to offset any imaginable sub-crisis supply shortfall in this country; provided the major producer/refiners honour their assurances, these additional supplies would more than cover any shortfall of deliveries by refiners with inadequate UKCS crude supplies or independent distributors previously reliant on imports.

Full crisis with IEA triggered

33. If the situation moved into a full crisis and the IEA allocation scheme were triggered BNOC like other oil suppliers would become subject to it. It would not then be open to the Corporation to redirect contracted supplies, however informally, to the UK as long as IEA member Governments and other oil companies were generally observing the rules: BNOC would then make no direct contribution to security.

Full crisis without IEA triggered

34. However both the USA and Germany appear hesitant about the desirability of activating the IEA allocation scheme even if Iran succeeds in closing the Straits of Hormuz - an action more than sufficient to trigger the scheme. Moreover the allocation scheme has not been tested in real life, and could be difficult to implement. In a full crisis in which the IEA scheme had not been implemented (or even had broken down), we would initially rely on the steps described in para 32 above. We would however be pushing the assurances to the limits. Our ability to instruct BNOC not to sell back RIK could be an additional means of holding companies to their assurances; but the provisions of the Treaty of Rome might make the employment difficult and risky. If the world shortage of oil exceeded that covered by the possibilities in para 32, then, if it wished to avoid shortages in the UK, the Government would have to direct supplies under the Energy Act and there would be no independent role for BNOC (though the Corporation might be useful as the Government's agent in some transactions).

35. The contribution BNOC can make by repatriating oil or putting pressure on refiners cannot be relied on without qualification. Repatriating crude can help only if we can be sure that supplies of imported oil are not reduced (or product exports increased) in line with the increase in UKCS supplies reaching the UK market. That requires the co-operation of the oil companies. While we possess through BNOC some pressures to achieve that co-operation, the companies are also in a strong position since so long as we do not activate the Energy Act powers they can deny product to the UK consumer. The pressures we can bring on refiners through BNOC are very unlikely to persuade them to go beyond their assurances; though the pressures might be needed to keep the refiners to the mark and perhaps to resolve any ambiguities in the assurances in the UK's favour. The powers HMG has to award licences and make life easy or difficult for licensees are much more significant. BNOC's role in diverting crude oil back to the UK is limited, although still useful when the shortfall is also limited.

36. BNOC has two further roles, whether in a subcrisis or in a full crisis, which are potentially important. First, in periods of market difficulty the prices of different crude grades could well diverge by margins greater than would be warranted by differences between the values of the products refined from them. It may be open to licensees to export UKCS oil at a relatively low price to their affiliates overseas leaving UK consumers to pay prices based on the term price or even spot price of other crudes. So long as there was sufficient evidence of higher arm's length prices, the Inland Revenue could over-ride low inter-affiliate prices for tax purposes but, as discussed above, such evidence could be limited. The role of BNOC would be to ensure that UK term prices kept pace with term prices elsewhere in the world, and thereby remove (or at least greatly limit) the scope for UKCS producers to transfer profit margins to other parts of the world where taxes were lower. In essence we are back to the subject matter of the first part of this paper; no satisfactory mechanism has been identified to replace BNOC's present role.

37. Second, BNOC could help the Government through the provision of information about what is really happening in the oil market at a time of crisis - information that Ministers are likely to attach considerable importance to having readily available at such a time. Information from oil companies might be coloured; and the views and experience of BNOC could provide a useful independent check on it. Through its continuing operations (and its continuing discussion with its suppliers and customers), the Corporation has access to a great deal of information about physical supply arrangements and market prices for UKCS oil. By virtue of this BNOC would be in a position to advise the Department on the difficulties and constraints which oil companies might face; the Government would thus better be able to assess whether the performance of some of the companies fell short of their reasonable expectations - as was the case in 1979.

38. BNOC could not however assure supplies of oil to the UK at prices lower than those faced by other industrial countries. As a member of the EC, the UK could not insulate its domestic oil market from domestic markets elsewhere in the Community, meanwhile forcing UKCS producers to supply the UK market at preferential prices. It must, however, be doubtful whether such a policy could ever make economic sense if pursued for an extended period; the example of the US and Canada in the 1970s confirms that this policy can both discourage the development of new production and delay the adjustment consumers have to make in response to major changes in relative prices. UK experience in 1979 provides an example of the practical difficulties involved in seeking to keep domestic prices below those ruling at any time in international trade; the UK, although not yet self-sufficient in oil, was the only substantial oil producer in the EC, but was still alone among EC members in suffering shortages at the petrol pumps. As soon as price controls were lifted however, the supply position righted itself. Following this experience, the sub-crisis supply assurances are generally drafted so that they cease to be applicable if the UK imposes price controls; the implication of this is that the UK consumer can

expect, in a sub-crisis or a full crisis, to be subject to a less stringent regime of administered demand restraint (or none) than his counterparts in other countries without domestic oil production, but he will have to pay the world market price for his supplies. Prices should be broadly the same from one country to another, with the world level reflecting on the one hand the extent of the original reduction in supply and on the other hand the effectiveness in the aggregate of the demand restraint and destocking measures taken by the consuming countries collectively.

The value of BNOC's contribution to security of supply

39. The present position of the UK is that in a sub-crisis the main element (other than facilitating the use of stocks and not constraining price increases) in the Government's policy to assure the security of UK oil product supplies is the network of voluntary assurances given by UKCS producers who are also major refiners and marketers in the UK, with repatriation of UKCS equity oil by non-refiners in response to a requirement by the Secretary of State as the next element. In a full crisis, it could be argued that the supply position would essentially be determined by the IEA (and EC) oil allocation arrangements. This note suggests that in the absence of such arrangement BNOC might be able to divert some supplies of crude normally exported into the domestic market. More important, whether or not the IEA arrangements have been triggered, BNOC as an actual player in the market, can give the Government greater insight into the position in the market place, together with some limited capacity to intervene in response to actions by UKCS oil producers damaging to UK interests or to breaches of the allocation scheme by other participants. But the role of the Corporation in protecting Government revenue from the effects of insufficient evidence of arm's length prices in a crisis or sub-crisis is likely to be the more important one.

IV OPTIONS FOR POLICY TOWARDS BNOC

40. The Government has three broad policy options to consider in any review of the future of BNOC:

- (i) abolish the Corporation, as an unnecessary interference in the operation of a free market;
- (ii) confirm the Corporation in its present role, while maintaining proper discipline over its costs and suitable incentives for it to undertake a limited amount of profitable, but not risk-free trading; and
- (iii) retain the Corporation, but with a narrower remit so as to reduce public sector exposure to the risk of losses.

The advantages and disadvantages of these courses, reflecting the considerations set out in this paper, are as follows.

Abolition

41. For:
- (a) removal of Government involvement from the market and avoidance of financial risk;
 - (b) removal of a focus for pressure from OPEC countries on prices in a weak market and from importing countries on supplies and prices in a crisis.
 - (c) avoidance of BNOC's administrative costs of £5 million a year.

- (d) reduction in the taxation penalties arising from integrated companies' ability to choose to pay tax at term prices when (in tight markets) they are below spot, and through 'oil spinning' at spot prices when (in slack markets) they are below term.

Against:

- (a) risk of erosion of tax revenue through insufficient evidence of arm's length prices being available in certain circumstances;
- (b) loss of information for purposes both of revenue and security of supply;
- (c) loss of some limited practical support for Government policy on security of supply;
- (d) OPEC criticism of UKCS production relates fundamentally not to BNOC's operations but to the Government's refusal to impose restrictions on field output: OPEC would probably now regard abolition of BNOC as an unhelpful act;
- (e) the benefits of taking Royalty in Kind (£25-30 million per year) considerably outweigh BNOC's administrative costs of £5m per year (less any profits made for the public sector by BNOC's non-participation trading);

and

- (f) political embarrassment arising from inconsistency with previous Government statements (eg in the context of Britoil privatisation) when BNOC's contribution to security of supply was emphasised.

Confirmation in present role

42. Essentially the arguments are the obverse of those for and against abolition. If BNOC is to continue to function effectively as a commercial organisation playing a full part in the market, maintaining an effective information-gathering and intervention capability, and generating the revenues needed to meet its administrative costs, the Corporation will need to continue to develop a limited volume of trading activity, including spot purchases and sales of crude oil and oil products as well as LPG trading, which is not related directly to participation. The financial guidelines under which BNOC are operating already provide for this, up to a limit which the Corporation's Board intend to keep well within. That limit is needed both to keep exposure to financial loss within bounds and to avoid the danger that the corporation might be regarded as abusing a dominant position, contrary to Article 86 of the Treaty of Rome. It may also be appropriate to arrange for an independent check on the form and level of management control on BNOC's traders.

Retention, but with a narrower remit

43. The idea would be just to keep BNOC in existence so that the full apparatus of participation could be re-established (although the notice periods are such that the exercise could take up to 18 months to complete). While the arguments over BNOC's exposure to the risk of loss on participation trading would be substantially reduced, the Corporation would have little or no freedom to engage in other trading activities. The difficulties are that it would be impossible to retain a staff of the quality needed to take a successful part in any oil trading activity with such a drastically reduced remit; that the information and advice available to the Government would be

reduced; that the overhead costs in relation to the volume of business would be increased; and that the risk of loss would not be reduced pro tanto with the volume of business - the problems are likely to arise with the marginal barrels as the market moves out of balance, and the reduction in BNOC's activity could not be relied on to reduce either that balance, or the Corporation's difficulty in disposing of its marginal barrels. Moreover any significant reduction in its activities would threaten BNOC's function of providing clear market evidence for the purposes of taxation. To do this:

- i. BNOC must have enough crude net of saleback to construct a number of term deals. This certainly requires several hundred thousand barrels of oil a day.

- ii. It is helpful to the OTO if worthwhile volumes are sold from as many fields as possible - from small fields this points to retaining at least half, again net of saleback, where we can. Reducing participation proportions in large fields while retaining full participation in small fields stands to attract accusations of discrimination.

44. If BNOC is to be retained, therefore, the advantage lies with continuing its business on much the same scale as at present. That does not imply maximising its access to all forms of petroleum and particularly not to forms other than crude oil.

45. The judgments in this review point clearly, though not strongly, to the retention of the Corporation. But they depend on circumstances, which could well change over time. For instance, greater evidence of arm's length North Sea prices (perhaps through developments in the spot market or transparent pricing of Norwegian crude) could reduce BNOC's contribution to tax valuation.

Similarly, if BNOc's prices are seen frequently to be politically determined, rather than representing the 'true' market price, then BNOc's effectiveness both in stabilising the market and providing tax valuation evidence may be prejudiced. Accordingly, we recommend that if BNOc is retained, we should look again at it in say 2-3 years time in the light of changing circumstances and experience gained.

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MR TURNBULL

6 June 1984

BNOC

We do not agree with Peter Walker and consider that there is a strong case for abolishing BNOC.

We have been involved in the official discussions and have considered the issues carefully. Given our commitment to a market-based North Sea policy and our general wish to reduce the size of the public sector, we start from the premise that BNOC should be abolished unless there is a good reason to keep it.

- Security of Supply

BNOC can only make a very limited contribution to security of supply. The only way, short of force majeure, in which BNOC could redirect supplies which we would not otherwise receive, is not to renew term contracts when they become due. Over a 3-6 month period, this would produce at most an extra 100,000 barrels per day for the UK. This compares with UKCS production of 2.5 million barrels per day.

We would be able to safeguard the UK's interests without BNOC. In a sub-crisis (a world shortfall of less than 7%) we would rely on the series of informal assurances with UKCS producers to maintain supplies. In a full crisis, the IEA allocation scheme would come into force. In both these cases the Government could, if necessary, take wide-ranging powers under the Energy Act 1976 to regulate supplies within the UK.

Peter Walker argues that the more important role for BNOC in times of crisis is in providing the Government with a greater insight into the market place. We consider that the Department of Energy together with the major oil companies can provide Ministers with sufficient and more soundly-based information.

- Market Stability

BNOC does not play a pivotal role in the stability of the world oil price.

It is true that the BNOC price did assist stability in the Spring of last year but only after it had achieved a totally inappropriate price leadership role. Without the existence of a politically exposed BNOC price, we would probably not have reached such a crisis situation in the first place. In a slack market, the underlying

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interests of producers, consumers and the oil majors are to maintain stability in the market.

Abolition would have the added advantage of removing the UK Government from the diplomatic spotlight, particularly during times of crisis.

We have always stressed that the setting of North Sea prices is subject to market forces, and it is unlikely that OPEC would interpret abolition as a signal that the Government was no longer interested in oil price stability, despite some initial adverse comment.

- Tax Revenue

There is no evidence that BNOC has helped in securing greater tax revenues from UKCS crude. There have been occasions when the BNOC price has maximised revenues but there have also been cases when a policy of holding down prices has cost the Exchequer significant sums of tax revenue.

Furthermore, it has not proved easy to change the BNOC price in either a tight or a slack market. The result is a loss of opportunity profits in the former and trading losses in the latter. Over an extended period the influence of BNOC on tax revenues is likely to be marginal.

The relevance of the BNOC price as a tax reference point will continue to decline as the structure of the oil market changes. The Revenue acknowledge that a BNOC price is not essential for tax reference purposes.

- Costs

Abolition would save £5 million per year of administrative and running costs. The Government would also have to make other arrangements to handle royalty in kind although we do not accept that the use of a private sector agent would be more costly or undesirable in principle.

More importantly, BNOC is not a normal commercial trader. It continually has difficulty in attracting high-quality traders. Abolition would remove the potential for significant BNOC losses in both participation and non-participation trading. The former occur in a weak market when BNOC is forced to make disposals on the spot market. As for non-participation trading, it makes little sense for a public sector body to be involved in speculative commodity trading.

Conclusion

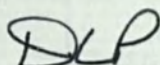
A slightly easier life for the Inland Revenue, a very limited contribution to security of supply and provision of market information does not add up to a convincing case for the retention of BNOG.

The continued existence of the Corporation is incompatible with our desire to reduce the size of the public sector and with a market force based North Sea policy. It results in an unnecessarily high diplomatic profile for the Government every time there is uncertainty in the oil market.

Furthermore, if BNOG is retained, any future Labour Government would have an ideal opportunity to reimpose Government control on North Sea Oil policy. Abolition would make such an objective practically impossible.

The political objections are only valid if Peter Walker encourages the view that BNOG contributes significantly to security of supply. As the reality is different, and if this is clearly explained, the political criticism falls away.

We recommend that BNOG should be abolished.



DAVID PASCALL

D.R.

File

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MR TURNBULL (for your own information)

6 June 1984

cc Mr Redwood

BNOC

The BNO C Review is with Peter Walker and is likely to be circulated shortly. I expect the Secretary of State to recommend retention based on political considerations and a wish to preserve flexibility. The Chancellor may well agree.

We take the opposite view for the reasons in the attached note which is intended to accompany Peter Walker's forthcoming submission. It is drafted without knowledge of his covering note and may require some small amendments.

I should be grateful for any comments you may have on substance and on handling. I hope our note will persuade the Prime Minister that this issue should be discussed by a small group of Ministers rather than being cleared in correspondence. However, I would also like to avoid a repetition of the DBS case when the Prime Minister won all the arguments but deferred to her Ministers.

DLP.

DAVID PASCALL

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MR TURNBULL

6 June 1984

BNOC

We do not agree with Peter Walker and consider that there is a strong case for abolishing BNOC.

We have been involved in the official discussions and have considered the issues carefully. Given our commitment to a market-based North Sea policy and our general wish to reduce the size of the public sector, we start from the premise that BNOC should be abolished unless there is a good reason to keep it. The onus of proof should be on justifying retention.

Peter Walker identifies five main issues:

- Tax Reference Price

The existence of a BNOC price is helpful to the Inland Revenue. However the structure of the oil market is changing and the Inland Revenue are having increasingly to consider the spot market in setting a tax reference price for non-arm's length transfers. The relevance of the BNOC price will continue to decline and the Revenue acknowledge that a BNOC price is not essential for tax reference purposes.

- Market Stability

BNOC does not play a pivotal role in the stability of the world oil price.

It is true that the BNOC price did assist stability in the Spring of last year but only after it had achieved a totally inappropriate price leadership role. Without the existence of a politically exposed BNOC price, we would probably not have reached such a crisis situation in the first place. In a slack market, the underlying interests of producers, consumers and the oil majors are to maintain stability in the market.

We have always stressed that the setting of North Sea prices is subject to market forces. The abolition of BNOC could be presented as a logical outcome of such a policy. It is unlikely that OPEC would interpret this as a signal that the Government was no longer interested in oil price stability, despite some initial adverse comment.

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- Costs

Abolition would save £5 million per year of administrative and running costs. The Government would also have to make other arrangements to handle royalty in kind although we do not accept that the use of a private sector agent would be more costly or undesirable in principle.

More importantly, BNOC is not a normal commercial trader. Abolition would remove the potential for significant BNOC losses in both participation and non-participation trading. The former occur in a weak market when BNOC is forced to make disposals on the spot market. As for non-participation trading, it makes little sense for a public sector body to be involved in speculative commodity trading.

- Security of Supply

BNOC can only make a very limited contribution to security of supply. We would be able to safeguard the UK's interests without BNOC.

In a sub-crisis (a world shortfall of less than 7%) we would rely on the series of informal assurances with UKCS producers to maintain supplies. In a full crisis, the IEA allocation scheme would come into force. In both these cases the Government could, if necessary, take wide ranging powers under the Energy Act 1976 to regulate supplies within the UK.

Peter Walker argues that the more important role for BNOC in times of crisis is in providing the Government with a greater insight into the market place. We consider that the Department of Energy together with the major oil companies can provide

Ministers with sufficient and more soundly based information.

Additional arguments in favour of abolition include:

- Reduction of public sector involvement.
- Confirmation of our market force policy.
- BNOC's lack of experience in judging the market compared with the oil majors. The Corporation has a disproportionate influence over the setting of "market prices" in the North Sea.
- Removal of the UK Government from the diplomatic spotlight in times of crisis in the oil market.
- BNOC's difficulty in attracting high-quality traders in what is a very competitive business.

Conclusion

A slightly easier life for the Inland Revenue, a very limited contribution to security of supply and provision of market information does not add up to a convincing case for the retention of BNOC.

The continued existence of the Corporation is incompatible with our desire to reduce the size of the public sector and with a market force based North Sea policy. It results in an unnecessarily high diplomatic profile for the Government every time there is uncertainty in the oil market.

Furthermore, if BNOC is retained, any future Labour Government would have an ideal opportunity to reimpose Government control on North Sea Oil policy. Abolition would make such an objective practically impossible.

We recommend that BNOC should be abolished.

D.P.

DAVID PASCALL

CENTO.

Prime Minister ②

To note.

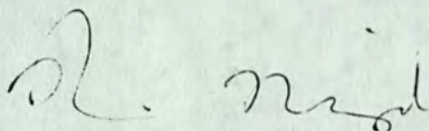
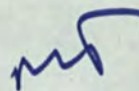
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SECRETARY OF STATE FOR ENERGY
THAMES HOUSE, SOUTH
MILLEBANK, LONDON, SW1P 4QJ

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

14 March 1984

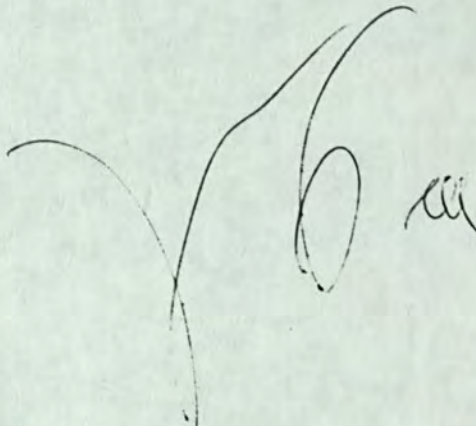
BNOC: SECOND QUARTER PRICES

For the past few weeks spot prices for crude oil have hovered around the levels of term prices. This is doubtless partly the effect of the Iran/Iraq war - though no signs of panic buying have yet appeared. But since I wrote to you on 14 December about first quarter prices, the fundamentals also appear to have improved. We have a little more confidence than then in the revival of oil demand; the very cold winter in North America has reduced commercial stocks there to near minimal levels; and most OPEC producers, especially Saudi Arabia, are at or even below their production quota levels.

BNOC accordingly intends to propose no change in prices for the second quarter except for an increase of 10 c in the price of Maureen crude. The latter is a new grade which accounts for a very small proportion of North Sea production and has not yet found its market level. I understand that both suppliers and customers accept that an increase is justified.

I have let BNOC know that I have no objection to their proposals.

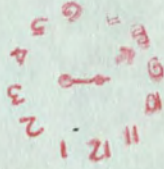
I am sending copies of this letter to the Prime Minister, Geoffrey Howe and Norman Tebbit.



PETER WALKER

Energy PART 5

Future of BNOC



14 MAR 1984

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

14 December 1983

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

Handwritten signature: Peter Walker

BNOC: 1984 FIRST QUARTER PRICES

Thank you for your letter of 14 December. I agree that BNOC's approach offers the best prospect of avoiding instability in the oil market, and, as my office reported to yours earlier today, I was entirely content that you should proceed as you suggested.

Copies of this letter go to the other recipients of yours.

Handwritten signature: Nigel Lawson

NIGEL LAWSON

CONFIDENTIAL

Energy BNOC

16 JUL 1983

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DEPT
98765

010
Prime Minister ⁽²⁾

With Treasury agreement BNOC
announced unchanged prices,
thereby staying in line with
OPEC who also held prices.
The aim was to scotch
rumours of a cut by BNOC.
Customers have yet to agree.

01 211 6402

CONFIDENTIAL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

December 1983
mf

BNOC: 1984 FIRST QUARTER PRICES

BNOC's contracts with its customers require it to propose prices for the first quarter of 1984 by 15 December (although these provisions have frequently been breached without ill consequences). I discussed the way ahead with Douglas Croham and Ian Goskirk of BNOC this morning.

The oil market is weak. World production significantly exceeded consumption in the third quarter thus causing a build up of stocks higher than intended. The winter in the main consuming countries has so far been mild. There remain ambiguities about Saudi intentions in respect of their role as swing producer. As a consequence, spot prices for UKCS crudes have been around \$1.50 below term, US spot prices have declined and Russia has twice cut the official prices for its exports. The immediate market by itself would justify a reduction of perhaps 50c to \$1 a barrel in the price of UKCS crude. However our slightly longer term assessment is that, given a normal winter and observance by OPEC of their production ceiling, there is no underlying reason for a reduction of prices. That perception is shared by Shell, Esso and BP as well as by BNOC.

Earlier this year, in consultation with you, BNOC tackled the problems created by the market weakness by postponing proposals on prices, undertaking to backdate them when they had eventually been agreed. But that was against a background of patent disunity within OPEC when it was known that Saudi Arabia wished to see a cut in official prices. Now OPEC has just concluded a conference at which all Member States reaffirmed their commitment to the production levels and prices agreed last March in their "London agreement". Any delay by BNOC in current circumstances would signal a lack of belief in these OPEC commitments and increase the instability in the market.

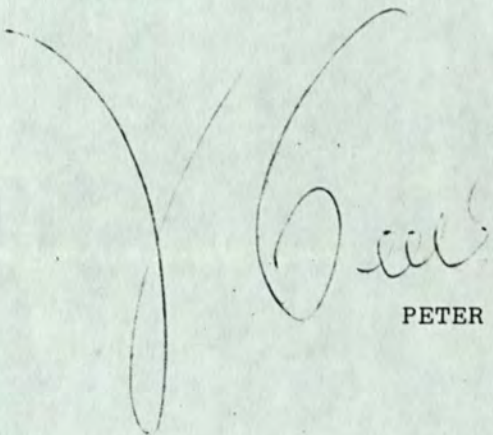
BNOC's choice is, therefore, to propose that either its current term prices continue or that they are reduced to bring them more in line with spot prices. Yamani indicated to me yesterday that OPEC will maintain and indeed improve

discipline. He warned me in confidence that any reduction in BNOC's prices would be followed by reductions at least as great in the official prices of Nigeria, the North African producers and the UAE. It may well be that Nigeria and perhaps other producers would also expand production in order to maintain revenue. In that case, a price reduction by BNOC would not enable it to retain its term customers; it would merely drive spot prices down in front of it and pose a major threat to the stability of the oil market.

We have to take Yamani's warnings seriously. BNOC has concluded, and I agree, that it has no option but to propose that existing prices be maintained. It is likely as a consequence to lose some term customers and therefore be forced to sell spot. However, a proposal now to maintain prices would not preclude later acceptance, after negotiation, of a reduction if that loss of custom became so great as to pose as much of a threat to market stability as a proposal to reduce prices.

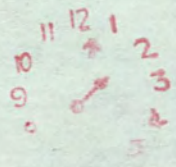
The Daily Mail and other papers have published today a report that BNOC is about to reduce prices by \$1 a barrel or more. We need now to show all the confidence we can in current prices. That is best done by very swift rebuttal through BNOC going out today to its customers and suppliers proposing no change. Unless I hear from you, I shall let BNOC know at 3.00 pm that I see no objections to such a move.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe and Norman Tebbit.

A large, stylized handwritten signature in dark ink, appearing to read 'Peter Walker', is written over the typed name.

PETER WALKER

14 DEC 1985





NIS PM

ms 23/9

FCS/83/180

SECRETARY OF STATE FOR ENERGY

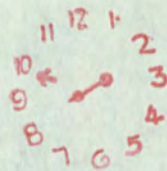
BNOC: FOURTH QUARTER PRICES

1. You sent me a copy of your letter to Nigel Lawson about BNOC's fourth quarter prices.
2. I confirm that I have no objection to your informing BNOC later today that you are content. I am glad to hear that BNOC will be in touch with a number of national oil companies, in particular that of Nigeria. As you know, we think it important that this contact take place in order to reduce the risk of upsetting the market.
3. I am sending copies of this letter to the Prime Minister and the Chancellor of the Exchequer.

GEOFFREY HOWE

Foreign and Commonwealth Office
22 September 1983

22 SEP 1983





Prime Minister ⁽²⁾
ms 21/9

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE 60 THE
MILBANK LONDON SW1P 4DJ
01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

21 September 1983

Nigel

ms

BNOC: FOURTH QUARTER PRICES

BNOC is proposing no change in the price of the UKCS marker crude, but intends to seek increases of 15-50¢ per barrel in the price of other UKCS crudes. Full details are attached.

The oil market remains relatively fragile. Spot prices, though still above BNOC's term prices have fallen significantly in recent weeks. A general rise of North Sea prices for the coming quarter would increase the risk of having to cut prices early next year when the oil market is likely to be unstable as a result of falling demand for OPEC oil. We could therefore incur the same difficulties as we experienced earlier this year. It would appear, however, that the market is sufficiently firm to enable BNOC to re-establish appropriate differentials between UKCS crudes by modest increases in all but the marker crude, as BNOC propose. I therefore see no need to intervene in BNOC's proposals.

BNOC would like to approach its suppliers and customers with the new prices, which will appear in the press, as soon as possible to prevent speculation about price changes. Unless you have any comments, I propose to tell BNOC at four o'clock tomorrow (Thursday 22 September) that I am content.

I am sending copies of this letter to the Prime Minister and Geoffrey Howe.

Peter Walker

PETER WALKER

UKCS CRUDE OIL PRICES

All in U.S.\$ per barrel

Grade	Current Price	New Price	Change
	<u>FOB</u>		
Brent Blend	30.00	30.00	-
Forties	29.75	29.90	0.15
Ninian Blend	29.35	29.60 *(1)	0.25
Flotta Blend	28.80	29.30	0.50
Beatrice	29.00	29.30	0.30
	<u>DELIVERED</u>		
Argyll	29.45	29.70	0.25
Auk	29.05	29.30	0.25
Beryl	30.00	30.25	0.25
Brent Spar	30.05	30.30	0.25
Buchan	28.50	29.00	0.50
Fulmar	30.00	30.35	0.35
Montrose	30.10	30.35	0.25
Statfjord	30.00	30.40	0.40
Maureen	-	29.90 *(2)	-

NOTES

*(1) Price to be subject to further review when the impact of Magnus in Ninian Blend has been assessed.

*(2) New crude. Proposed level will test the market.



Prime Minister

Content? *

Mus 5/7

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

FUNDING: SALE OF BP SHARES

* Alan thinks the sooner we do this the better, and that a 7% discount is reasonable. He supports.

I have been examining urgently the possibilities of reducing public sector holdings of assets, both to make an early start on the programme of disposals, and to assist in containing the PSBR in 1983-84.

2. The current strength of the oil share market has created an immediate opportunity for placing some of the Treasury's holdings of BP shares with financial institutions. The Bank have explored what might be feasible with BP, its merchant bankers and its brokers, and have advised that it should be possible to make an early placing of 80 million shares (which would reduce HMG's holding of the BP equity from the present 38.9 per cent to 34.5 per cent). This would raise about £350 million with payments spread over the period to November. This would make a useful contribution to our efforts to control the money supply over that short term.

3. The precise terms of the placing are still to be agreed, but the discount on the market price would probably be around 7 per cent. This would make the cost of the placing fairly close to that of the two offers for sale of BP shares, in 1977 and 1979. But it could attract adverse comment. To avoid the charge that the shares were being sold off on the cheap to big institutions, I would propose to provide for a 'clawback' under which up to 15 per cent of the shares would be made available to jobbers to meet any demand from the general public at about the placing price.

4. I considered the alternative of delaying the disposal until an Offer for Sale could be organised. This could be rather bigger

SECRET



(perhaps up to £500 million at today's prices), but would mean a delay of two months, and market conditions in the autumn might not be as favourable as they are now. It might also get in the way of our own plans for further asset sales (I have asked officials to explore the possibility of a sale in the autumn of part of our holding in Cable and Wireless).

5. I have agreed therefore that the Bank of England should proceed with planning for a BP placing next week, subject to no significant deterioration in market conditions.

M.

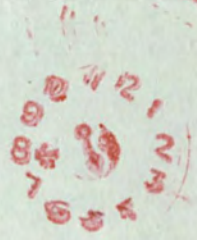
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5 July 1983

SECRET



5 JUL 1983



COMMISSIONER

III

cf no



FCS/83/119

NBPM

SECRETARY OF STATE FOR ENERGY

MAN 28/6

BNOC Third Quarter Prices

1. Thank you for sending me a copy of your letter of 27 ~~June~~ to Nigel Lawson.

2. I am glad to hear of BNOC's decision not to propose changes in the prices of UKCS crudes for the third quarter. It is a welcome sign of further stabilisation in the oil market.

3. I am sending a copy of this letter to the Prime Minister and to Nigel Lawson.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

28 June 1983

Energy
BNO, p. 5



28 JUN 1983



cc N.O.

Prime Minister

SECRETARY OF STATE

01 211 6402

MUS 27/6

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

ms

27 June 1983

Handwritten signature

BNOc THIRD QUARTER PRICES

BNOc is proposing no changes in the prices of UKCS crudes, which it offers to its suppliers and customers for the third quarter.

OPEC's London agreement appears to be holding up and markets are calm. While spot prices are currently a little above BNOc's term prices, the margin is too small to justify any increase in the latter. I am not therefore minded to intervene in BNOc's proposal.

BNOc would like to approach its suppliers with the new prices, which will appear in the press, as soon as possible so as to dampen the slight speculation in the market that it is considering price increases. Unless you have any comments, I shall tell BNOc at four tomorrow (Tuesday 28 June) that I am content.

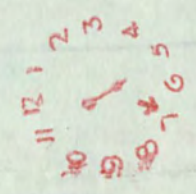
I am sending copies of this letter to the Prime Minister and Geoffrey Howe.

Large handwritten signature

PETER WALKER

Essay: Bruce Pt 5

27 JUN 1983



BNO

Penney

Prime Minister (2)

SECRETARY OF STATE FOR THE TREASURY
11, DOWNING STREET
LONDON SW1A 2AA

MS 3/12

01-211 6402

Gerry Spence Esq
CPRS
Cabinet Office
70 Whitehall
London SW1A 2AS

2 December 1982

De 6-71

BNO TRADING AFTER THE SEPARATION OF BRITOil

The Secretary of State was grateful for Mr Sparrow's letter of 24 November. Officials here have sought to cover the main substance of his points in the notes of guidance which have been sent to the Corporation (I attach a copy).

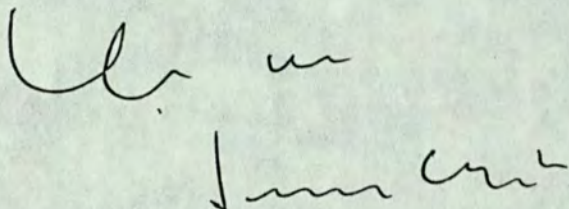
We have the following specific comments on points Mr Sparrow has raised:-

- (i) the guidance makes clear that the limits of £5m on participation trading and £6m on other activities refer to perceived risks of financial loss. Broadly these limits would be measured by reference to the difference between the cost of particular volumes of crude oil or other material to the Corporation and the amount realisable if that material had to be sold spot;
- (ii) restriction of non-participation trading to back-to-back deals with no exposure to risk of loss would prevent the Corporation from doing much of its present business (for example, most "freighting" involves some small element of exposure), and would add substantially to its difficulty in earning a sufficient trading profit to cover its operating costs;
- (iii) the choice of "inform" and "consult" in paragraph 1.3 of the Annex is deliberate: we need to be particularly careful to avoid giving any impression that the Government has the last word on UKCS term prices. BNO's prices are set in negotiation with its suppliers and customers, in the light of market conditions.

More generally, it is important to remember that the reconstituted BNOC Board is only just settling in, and that the Corporation has had to give priority to the scheme and privatisation exercises, to the exclusion of effort directed towards the planning and detailed financial control of its business activities. Discussions are now under way on future trading strategy, and fresh impetus will be given to this work when the new Finance Director takes up his post on 1 January.

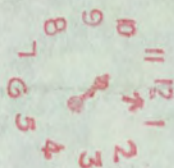
The issues which Mr Sparrow has raised will be fully taken into account during the reconstituted Corporation's running-in period, and there will be an opportunity to look again at the position in the context of the review of the trading guidelines and limits on exposure to the risk of loss which the Corporation will be undertaking next summer.

I am sending a copy of this letter to the Private Secretaries to the Prime Minister, other members of E(NI) and to Richard Hatfield (Cabinet Office).

Handwritten signature of Jeremy Clayton, consisting of a stylized 'J' followed by 'eremy Clayton'.

JEREMY CLAYTON
Private Secretary

ENERGY : FUTURE OF BNOC : PTS .



DEC 1982

BNOC AFTER THE SEPARATION OF BRITOL

1. General Objectives for BNOC

- (i) Through participation, to secure and dispose of UK and UKCS petroleum in a way which contributes to our national security of supply.
- (ii) Through effective trading and marketing, to ensure that the UK economy receives the maximum benefits from BNOC's access, through participation rights, to UK and UKCS petroleum. [REDACTED]
- (iii) To trade profitably in all non-participation petroleum and petroleum products, within limits which may be set by the Secretary of State (Annex 1). 'Trading' may include the arrangement of shipping and of processing, although the Corporation would be expected not to seek to invest in ships or in refining and processing.

2. Specific Duties not covered by the general objectives

- (i) To act as the Government's agent in the sale of oil taken as royalty in kind (RIK). (Although some small fields are being excluded from RIK, oil will continue to be available in future from this source on roughly the present scale.)
- (ii) To discharge the requirements of the agency agreement covering the Government pipeline system.

3. Financial structure and financial target

- (i) After disposing of its upstream assets BNOC will be provided with £30 million of retained profits.
- (ii) The Department of Energy with Treasury consent will arrange to guarantee short-term borrowing facilities of up to £50 million on terms similar to those enjoyed by other nationalised industries.

- (iii) The Corporation's surplus funds are to be invested in public sector securities in accordance with existing general guidelines.
- (iv) BNOC and the Department are agreed that a financial target set in terms either of annual percentage return on assets or a percentage on turnover would not be appropriate. BNOC will instead be asked to earn a net surplus pre tax of £10 million over the first four year period, after meeting all its administrative and other costs.
- (v) Section 6(i) of the Oil and Gas (Enterprise) Act provides powers for the Government to make grants to BNOC, in support of the participation agreements. While the Government would expect to be called on to provide grants of this kind only in exceptional circumstances, BNOC would not, in the event of it making a loss too large to be covered by its own resources, be expected to reply for more than a short period on additional short-term borrowing.
- (vi) Section 5(i) of the Oil and Gas (Enterprise) Act provides powers for the Corporation's profits to be recouped by the Exchequer. It is expected that these powers would be used either if BNOC generated continuing surpluses or if circumstances allowed a single large profit to be made.
- (vii) The Corporation will not expose itself to risks in excess of limits set by the Secretary of State. These are set out at Annex 1 but may be reviewed from time to time.

4. Reporting and Control

- (i) BNOC will submit to the Department of Energy not later than April each year a business plan covering the following four calendar years. Following discussion at official level, this will be submitted, subject to any necessary modifications, for the approval of

/ Ministers

Ministers not later than June. The business plan will cover the general sales strategy, and the extent of the risks to which BNOC might be exposed, as well as figures on forecast physical availabilities and projected financial results.

- (ii) An updated version of the business plan covering the immediately following calendar year only will be prepared each October. Unless it is invalidated by unforeseen changes in market circumstances, this will provide a yardstick for assessing the Corporation's trading performance.
- (iii) Six-monthly consultations will be held with the Department as hitherto.
- (iv) Each quarter in January, April, July and October, the Department of Energy will review formally the trading results for the most recently completed quarter together with the prospects for the next two quarters ahead.
- (v) The Chief Executive will report every month to the Corporation on trading results, plans and opportunities.
- (vi) Each month the Corporation will provide a funds flow statement to the Department of Energy.

26 November 1982

LIMITS TO EXPOSURE TO FINANCIAL RISK1. Crude Oil Trading

1.1 It is recognised that the major element of crude oil passing through BNOC's books is the aggregate of participation oil and royalty in kind. In addition, the Corporation is committed to buy some 40,000 b/d of oil on long term contracts from small producers. These latter arrangements were put in place in lieu of participation arrangements even though they cover 100 per cent rather than 51 per cent of production (net of royalty). For the purposes of defining financial risk, these existing contracts will be considered as quasi participation oil and subject to the same trading limits.

1.2 However, new contracts of this kind will not automatically be regarded in this light. The Corporation may enter into unlimited contracts where the seller agrees to accept from BNOC the same price as that at which BNOC disposes of the oil providing a sales fee is charged which covers adequately the administrative costs of managing both the buying and selling operations. Where the Corporation wishes to enter into contracts where the buying price is specified in the same way as for participation purchases, a handling fee should be sought sufficient to cover costs and provide cover against trading losses. Moreover, new contracts of this kind should not in total commit the Corporation to purchases in excess of 25,000 barrels per day at any time.

1.3 As far as participation and quasi participation oil is concerned, the Secretary of State expects the Corporation to follow past practice and inform him in advance of the event when market pressures require a change in BNOC's prices. In addition, the Corporation should consult the Secretary of State immediately if it finds itself exposed to a risk of loss of £5 million or more within a quarter on crude oil trading.

1.4 Where the Corporation is forced to buy or sell individual cargoes in order to balance volumes under long term selling contracts coupled with the acquisition of participation and quasi

/ participation

participation crude, this is to be regarded as falling under the rules for participation trading.

2. Other Trading Activities

2.1 This heading includes, but is not limited to:

- (i) all trading in LPGs;
- (ii) trading in petroleum products;
- (iii) freighting arrangements;
- (iv) true spot market trading in crude oil, including that which might stem from a deliberate policy to sell short (i.e. to enter into term supply commitments in excess of those to purchase participation oil or quasi participation oil).

2.2 In entering into contracts under these headings, the Corporation should not at any time allow itself to be exposed to a risk of loss in excess of 20 per cent of its reserves. At the point of severance from the National Oil Account, this means a limit of £6 million. In calculating its exposure, the Corporation should take account both of the risks on fully open positions and those associated with buying contracts where prices are fixed quarterly without provision on associated selling contracts for price variations within the quarter to be passed through on a back-to-back basis.



CABINET OFFICE
Central Policy Review Staff

With the compliments of
John Sparrow

70 Whitehall, London SW1A 2AS
Telephone 01-233 7765



Energy

Prime Minister (4)

Ms 24/11

CABINET OFFICE
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

Qa 06155

From: John Sparrow

CONFIDENTIAL

24 November 1982

The Rt Hon Nigel Lawson MP
Department of Energy
Thames House South
S W 1

MS

Dear Nigel,

BNOC Trading after the separation of Britoil

I have only just seen your letter to Geoffrey Howe of 15 November, together with his reply of 22 November.

As you know, the CPRS has been closely involved with your officials in preparing the objectives and criteria for BNOC Trading. Although I agree with the Chancellor's view that the proposals are a considerable improvement on earlier suggestions, I would like to make a number of comments, which I hope will arrive before the proposals are communicated to the Corporation.

Our intention must be to leave BNOC management full discretion in commercial decisions within the scope of the strategic objectives and overall financial exposure limits set by Government. It is therefore important that these objectives and limits are clear and unambiguous at the outset.

With this in mind there does seem to me to be some confusion in the documents between financial exposure and risk. Financial exposure should be an objective concept which can be measured according to defined criteria whereas the risk of loss is inherently a subjective assessment. I suggest, therefore, that the terms "financial exposure" and "risk of loss" need to be clearly defined in order to avoid any later misunderstandings.

CONFIDENTIAL

I am generally content with the proposals for the trading of participation and quasi-participation oil subject to clarification of whether the £5m. limit refers to a perceived risk of loss or to an agreed definition of financial exposure.

As far as non-participation trading is concerned, I must admit to being unclear whether and with what discretion BNOG Trading will be allowed to enter into open positions or whether all trading will be on a back-to-back basis. The latter approach is one which I would favour and which would remove the risks which make financial exposure limits so necessary in normal commodity trading.

If all deals were to be on a back-to-back basis, there is no need for a limitation on financial exposure, which does not then arise. This does not rule out the possibility of losses which, if they occurred, would require a reconsideration by Government of whether, and with what scope, non-participation trading should be continued.

Annex 1 of the guidelines which will be forwarded to the Corporation includes a financial exposure limit but does not set out any other restrictions on type of business, open positions, back-to-back deals, etc. for non-participation trading. Although I note that it is your intention to provide the Corporation at a later date with these limitations, I do feel that they should be included in the current proposals as their scope could influence the appropriateness of a financial exposure limit of £6m.

One alternative approach would be to give BNOG Trading full discretion on non-participation trading, subject only to a limitation on financial exposure. This discretion could be curtailed if annual losses exceeded the financial exposure limit and could be reviewed if the Corporation failed to meet the financial target. Such an approach could meet our requirements with minimum involvement by Government in BNOG Trading's activities.

On a more detailed point, would it not be preferable in 1.3 of Annex 1 for the Corporation to be required to "inform" rather than "consult" the Secretary of State if it finds itself exposed to a risk

CONFIDENTIAL

of loss of £5m. or more. The current draft gives the impression that the Corporation is constrained from reacting on its own initiative which I presume is not the intention. Conversely, in the same paragraph, would not "consult" be better than "inform" when market pressures require a change in BNOc's prices?

I am sending a copy of this letter to the Prime Minister, other members of E(NI), and to Sir Robert Armstrong.

*Yours sincerely,
John*

John Sparrow

Energy, BNOC, P75

✓

Thank

I think we had better keep this in CF.

ADJ 25/11/82

Energy



HLK

DG

10 DOWNING STREET

From the Private Secretary

24 November 1982

Dear Julian,

I attach a copy of an exchange of correspondence between the Prime Minister and the senior partner of Rowe and Pitman, lead brokers to the Britoil flotation. I am sending this to you for your information only.

I am sending a copy of this letter and its enclosures to Margaret O'Mara (HM Treasury).

Yours sincerely,

Michael Scholar

Julian West, Esq.,
Department of Energy.

EW

FILE



10 DOWNING STREET

cc: HMT
D/Energy

THE PRIME MINISTER

24 November, 1982

Dear Mr. Wilmot-Sitwell,

It was kind of you to write with your views on the result of the Britoil flotation.

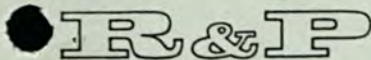
I entirely agree with much of what you say. We have achieved our objective of privatising Britoil; and in doing so we have obtained a very fair price for the shares. We have also raised some £625 million, which would otherwise have had to be raised by additional taxation or additional borrowing. We shall certainly not be dissuaded by the Britoil experience from further privatisation issues.

Again, it was good of you to write. I was much interested in your view of the matter.

Yours sincerely
Margaret Thatcher

P. S. Wilmot-Sitwell, Esq.

MT



Prime Minister

An interesting letter

ms 23/11

Rowe & Pitman

City-Gate House, 39-45 Finsbury Square
London EC2A 1JA

Telephone: 01-606 1066 Telex: 8952485

D. A. Innes	P. S. Wilmot-Sitwell
W. R. D. Robson	R. H. A. Southby
D. S. Milne	A. O. Taylor
The Hon. James Ogilvy	A. J. Radcliffe
R. D. C. Brooke	O. A. G. Baring
J. N. Littlewood	P. E. Morley
P. B. Hardy	C. C. Surtees
J. C. R. D'Albiac	S. R. Stradling
G. S. Finn	R. J. Rhodes
H. N. Verey	A. R. Bonsor
N. R. Elwes	M. J. Franzman
M. F. M. O. Jodrell	P. Heming Johnson
D. I. Harding	D. H. Back
D. I. Russell	G. W. Pilkington
R. G. Newman	P. Thompson
D. A. Childs	H. T. Pelham
J. D. A. Wallinger	E. R. Carbutt
	J. Appleby
	D. K. L. Ruck Keene
	<i>Associate Members</i>
G. J. Lewington	A. N. Whitney
G. F. English	G. L. Price
R. A. Bateman	A. P. W. Phillips
K. M. McVie	P. R. Hamilton
M. J. Hesketh	P. F. Ellick

22nd November, 1982.

PSWS/PAR

The Rt. Hon. Mrs. Margaret Thatcher, M.P.,
10 Downing Street,
London, S.W.1.

Dear Prime Minister,

As senior partner of Rowe & Pitman, lead brokers to the Britoil flotation, I thought it might be helpful if you had my views on the result of this issue and of its implications for future Privatisation issues.

My views are as follows :

- (i) The Government achieved what we understood to be its main objectives of (a) privatising Britoil and (b) obtaining the maximum possible price, within reason, for the shares. In that sense the flotation was a success.
- (ii) The City played a full part in this success. As lead brokers, with a balancing act to perform, we may possibly have attached more weight to our obligations to you, the vendor, than to our relationship with our institutional clients, the underwriters, who count on us not to "take them for a ride." However I believe that the underwriters do not feel that they have been taken for a ride and that at the time of decision the price was considered perfectly reasonable. We were simply overtaken by adverse news between the date of sub-underwriting and the date of application.
- (iii) I can assure you that I would only say this to you privately (despite certain comments in the Press) but I do not believe that the tender method was suitable for this particular issue (although there are undoubtedly occasions on which it should be used). Anyway, in the event, I doubt if the result would have been much different if we had used the fixed priced method (at 215p).

- (iv) I believe that you should not be dissuaded by the Britoil experience from further privatisation issues. Certainly the five firms of brokers, and my friends in the merchant banks, feel we have jointly done a good job for you and are prepared to stand up and do it again.
- (v) On the question of small shareholder involvement I would make one point. This is that if there is not an obvious short-term profit to be made, the new issue process is probably too quick to attract the small investor in large numbers. But over time they will come in. In a year or two's time the Britoil share register, in my opinion, will contain numerous individual names.

I do hope you do not mind my writing to you like this but I thought that the first impressions of someone who was very much at the sharp end of this particular operation might be useful. If you would like me to discuss it further either with you or with one of your colleagues I will be very happy to do so.

In the meantime all of us at Rowe & Pitman wish you continued success in your endeavours.

Yours sincerely,

Peter Wilmot - Sitwell

P.S. Wilmot-Sitwell

cc Energy: BNOG

TOP copy on

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PT 5

Next Ind: Steel Pt 11

Argentina = Relections Pt 31

M

ENERGY

PRIME MINISTER

PNQ AND STATEMENTS

This afternoon John Nott answered a PNQ from Teddy Taylor about the French sale of Exocets to Argentina, Patrick Jenkin made a statement on the informal industry council on steel, and Nigel Lawson made a statement about the Britoil offer for sale. I think Patrick Jenkin had the easiest ride. John Nott faced some outrage from the Government backbenches, and the Opposition were determined to shout and hoot at Nigel Lawson.

Exocets

John Nott argued that our defence capability in the Falklands, and especially our early warning systems, were sufficient to ensure their protection. The Government regretted the French action since there was no formal cessation of hostilities, and our views had been made clear to the French. On the other hand, they could be said to be simply honouring long-standing contracts. On the sale of Rolls Royce engines to the FRG for frigates destined for Argentina, Mr. Nott said that the Government would naturally be concerned if these frigates were to be delivered soon. But again this was a long-standing contract with a major NATO ally and trading partner. All Governments, including the last Labour Government, had traded in arms. It would be very difficult to control this trade through NATO, as Mr. Silkin suggested.

Tam Dalyell raised the old story of the seven hour telephone conversation between an Aero-Spatiale executive and the Argentines, but Mr. Nott said that these reports had never been confirmed, and that he was satisfied that France had supported us fully over the Falklands.

Towards the end of the questioning, Frank Allaun asked Mr. Nott why he regretted the French decision to export Exocets, while at the same time allowing the export of Rolls Royce engines. He also argued that "long-standing contracts" like these had surely

been overtaken by the hostilities. In answer, Mr. Nott repeated that these were long-standing contracts, and that the FRG had been told we regretted their contract to supply frigates. This was not very well received by the House. Peter Viggers repeated that there was no end to the hostilities, and said that we must ensure that the missiles did not arrive. Bernard Braine made the same point. Mr. Nott argued that he had only seen reports of missiles being shipped, and that these had not been confirmed.

Steel

Mr. Jenkin was committed to make this statement because the Opposition had called for a statement, if not a debate, on last week's closures. Stan Orme, leading for the Opposition, said that Mr. Jenkin's statement was merely words and no action. The UK was bearing the brunt of the closures in Europe. Community imports now accounted for two-thirds of total steel imports into the UK. Third country imports were growing. The industry needed protection. He called for an assurance that there would be no closure of any of the five integrated steel plants. He urged the Government to provide money to maintain capacity in the steel industry.

Patrick Jenkin pointed out that the meeting last week had been an informal council, and that it was not in the business of making firm proposals for action. It had, however, allowed him to say that the UK would make no more sacrifices in meeting capacity reductions in Europe. The Commission would be putting forward formal proposals shortly on the enforcement of price rules. The Foreign Affairs Council had agreed a negotiating mandate on voluntary restraint arrangements on imports from third countries. He would not be drawn on closures. He would make a statement before Christmas. The industry needed to be competitive, and it was the function of the BSC Board to restore the Corporation to viability. He would not stand in the way of capacity reductions, unless these raised a question mark over the future of the five major plants. The Government would have to be involved in any decision on these plants.

Most of the questioning concentrated on the inadequacy of the Commission's response to the problems facing the steel industries, and the recent closures at Craig Neuk and Round Oak were given as examples. There were also accusations that other members of the Community were cheating on the rules, particularly on prices. But, to some extent, the House recognised that they could not have expected firm decisions from last week's meeting.

Britoil

Merlyn Rees said that Amersham had been over-subscribed by 23 times, and that Britoil had been under-subscribed by 70%. This showed that Mr. Lawson did not understand the workings of the free market. Mr. Lawson had claimed that Britoil was a strong soundly based company, but clearly the City did not agree with him. The small shareholders who had bought shares would lose from this sale. It was an absurd way to value the nation's assets. There should be a Select Committee inquiry and a full debate, and Nigel Lawson should resign.

Nigel Lawson had to struggle to make himself heard over the hooting of the Opposition, which became all the louder when he said he would not resort to abuse. He said he would welcome a PAC inquiry. Less than a week ago the Opposition had said the sale would be "a City rip-off". Now they complained when the shares were left with the underwriters. There was always a risk in an offer for sale. That is why he had gone to such pains to have this one underwritten. He quoted Merlyn Rees as having said "There is no need for underwriting. It would not matter in the short run if all the shares were not sold". There were always changes of sentiment in the nine or ten days between the announcement of the sale and the closing date for applications. He quoted Lord Kearton who considered that the sale was "not managed badly at all".

In questions, the Opposition simply continued to paint the sale as a failure, and called for Parliamentary scrutiny. The Government backbenches accused the Opposition of having caused the under-subscription by talking down the sale; they drew

attention to Sheikh Yamani's unhelpful remarks, and pointed out that a fixed price sale would probably have been under-subscribed as well.

Merlyn Rees wound up by claiming that he had never objected to the underwriting, which allowed Mr. Lawson to have another go at him. He accused the Opposition of hypocrisy: they had been horrified at the prospect of "a City rip-off", now they were horrified when the City had itself paid a good price for the taxpayer.

If for WFSR

22 November 1982

EK 30



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

22 November 1982

The Rt. Hon. Nigel Lawson MP
Secretary of State for Energy

NBPM

ms 23/11

Dear Nigel

BNO C TRADING AFTER THE SEPARATION OF BRIT OIL

Thank you for your letter of 15 November.

The arrangements for limiting the Corporation's exposure are a considerable improvement on earlier suggestions and I am content for them to be formally communicated to the Corporation. I am sure that you are right in proposing that the whole issue of limiting risks should be reviewed once the Corporation, under the direction of its new Board, has had a clear period of six months' experience of operating under the guidelines. No doubt my officials will be involved in that review. It will be important then to check that the guidelines are having the practical effect of limiting exposure, and that the Corporation are operating within both their letter and spirit.

Finally, now that we have agreed the guidelines, I agree that the Corporation should have a starting capital of £30m.

I am sending copies of this letter to the Prime Minister, other members of E(NI), Sir Robert Armstrong and John Sparrow.

A large, stylized handwritten signature, likely belonging to Geoffrey Howe, written in dark ink.

GEOFFREY HOWE

Energy

BNOC

23 NOV 1982
23 NOV 1982
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Energy

(2)

Prime Minister

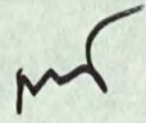
Nov 16/11

SECRETARY OF STATE FOR ENERGY
TRAVERS WING SOUTH
MILBANE ROAD, LONDON SW1P 4QR

01-211 6402

The Rt Hon John Biffen MP
Lord President of the Council
Privy Council Office
Whitehall
London SW1A 2AT

16 November 1982



Dear Lord President

BRITOil OFFER FOR SALE

I wrote to you on 14 October attaching a legal note about the risk of Ministerial statements being taken by prospective purchasers to be relevant to the sale of Britoil shares.

Now that the prospectus has been published, it is particularly important to avoid statements about Britoil until after the Application List for the shares has closed. We expect this to be on Friday, 19 November. I should also be grateful if you and Ministerial colleagues would continue to be guided by the legal note in the period immediately following the close of the Offer for Sale.

The sale of shares by tender has naturally aroused interest in the procedures we are adopting. I attach for information a short description of these procedures.

As before, I am copying this letter and the attached note to the Prime Minister, Cabinet colleagues, and to Sir Robert Armstrong.

Nigel Lawson
N. Lawson

PI NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)



BRITTOIL OFFER FOR SALE : TENDER PROCEDURES

1. Prospective purchasers may apply for Britoil shares in one of two ways. They may either:

(a) apply at the minimum tender price of £2.15 per share or bid any higher price they think appropriate (a 'Tender Application'); or

(b) apply without bidding a specific price in advance by writing the words 'Striking Price' in the appropriate box on the application form (a 'Striking Price Application').

Once the Striking Price has been set (see below), successful applicants will be deemed to have applied for shares at that price. Such applications may only be made by small investors, defined as those applying for up to 2,000 shares.

2. Payment is by two instalments, with the first instalment fixed at £1 for each share applied for. The balance payable on the second instalment, which is due in April 1983, will be the difference between the minimum payment of £1 and the Striking Price.

3. Once the Application List has been closed the number and value of applications received will be assessed. The Striking Price may be set above the minimum tender price of £2.15 if both:

(a) Tender Applications at or above the Striking Price have been received for at least half the shares on offer; and

(b) Tender Applications at or above the Striking Price, together with Striking Price Applications, are accepted in respect of all the shares on offer.

Once the Striking Price has been set, shares will be allocated in the light of the number of applications received.

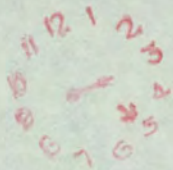


3. (Continued)

The Government has made clear its wish to see a wide-spread ownership of shares, particularly among small investors.

4. The Government are also anxious to ensure that Britoil employees have the opportunity to acquire shares in their company. Under special arrangements employees will be given approximately £60 worth of free shares and a maximum of £400 worth of shares to match shares they themselves buy (subject to an average cost per employee of £250). In addition, employees' applications for up to 11,500 shares will be given preference and Britoil has established profit-sharing and save-as-you-earn share option schemes.

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116 NOV 1982



SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01-211 6402

Prime Minister (2)

Plus 15/11

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

15 November 1982

Dear Chancellor,

BNOc TRADING AFTER THE SEPARATION OF BRITOil

Thank you for your letter of 5 August. My officials, in conjunction with yours and with traders from BNOc have examined the question of exposure to risk in some detail. As a result I enclose a revised version of the note I circulated with my letter of 13 July, which now has an annex setting controls and limits on BNOc's trading activities within which the Corporation will be content to work.

In the annex the risk of financial exposure is covered on two fronts:-

- (i) the trading of participation and quasi participation oil;
- (ii) BNOc's other trading activities.

Under the heading of participation trading the Corporation is required to continue the present practice of letting me know in advance of any change in their prices for UKCS crude oil. It further limits to £5m any risk to which the Corporation may expose itself without first obtaining my consent.

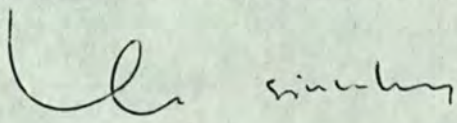
All the Corporation's other activities are designed to provide a basis for making sufficient money to cover the Corporation's business costs and to give the traders sufficiently interesting opportunities that they will remain with the Corporation. The motive for the Corporation undertaking these opportunities is thus one of profit. Against that there are bound to be risks. I believe that at any one time their exposure to possible losses should be limited to 20 per cent of their reserves.

With an initial starting capital of £30 million that limits exposure under this heading to £6 million; but of course if they are successful and are permitted to retain some part of the increase in reserves, so the opportunity to take risk will increase - albeit modestly. The attached annex assesses the risks associated with current trading activities and demonstrates that the limit I propose, while protecting the public purse, is not so low as to constrain unduly the Corporation's activities.

If you agree, I propose that the note be sent to the Corporation and that we confirm a starting capital of £30 million. In giving these guidelines it would be made clear, in a covering letter, that if the Corporation were to incur within a financial year losses under the general trading heading in excess of the exposure limit, there would have to be a review of the permissible extent of their future exposure to risk of financial loss. The letter would also make clear that the guideline note will need to be supplemented by limitations on non-participation trading (provided for in 1(iii) of the note). The question of spot trading in crude oil will be considered when these limitations are set. The guideline note makes clear that the BNOB-Britoil purchase agreement will not count towards the limits on 3rd party crude oil trading; these arrangements are short-term and it would be inappropriate for them to constrain BNOB's activities in the longer term.

I am satisfied that the Corporation under Douglas Croham's leadership will operate in a way fully consistent with the guidelines. However, I shall ensure that the whole issue of limiting risk in this way is reviewed once the Corporation, under the direction of its new Board, has had a clear period of six months experience of operating under those guidelines. In the meantime I propose to ask the civil servant member of the Board to press for appropriate delegation of financial responsibilities, including arrangements for monitoring exposure to risk within the Corporation.

I am sending copies of this letter to the Prime Minister, other Members of E(NI) and to Sir Robert Armstrong and John Sparrow.


Nigel Lawson

Yp NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)

EXAMPLES OF CURRENT TRADING EXPOSURES

1 LPG trading Whilst the LPG market is by its nature volatile and often difficult to predict, BNOC's acquisition and disposal structure has been developed on a "risk-avoidance" basis. There have been occasions, though not many, when traders and even the oil majors have reported losses as high as \$100/ton but this tends to be on spot or speculative trade, neither of which activities BNOC engages in. BNOC acquires and disposes of its LPG on term contracts to a very high percentage, and its trade is essentially of a back-to-back nature; as a result of its bulking up and freighting activity, BNOC would normally expect to earn a profit of several dollars/ton. The level of trade is currently around 160,000 tons per quarter; there can be a trading exposure but it is unlikely that the maximum could exceed \$25/ton and thus a quarter's loss on the whole business is most unlikely to exceed \$4 million (£2.3 million) with the probability that at least a part would be covered by back-to-back arrangements.

2 Product trading The arrangements BNOC currently has are essentially back-to-back both on volume and price and there is currently no exposure other than where unforeseen ambiguities or errors are found in contracts.

3 Freighting The Corporation are able to pass their total costs onto customers and normally make a modest profit. There is little prospect of loss in this area unless a crude oil contract is broken leaving BNOC with unwanted freight. However, that could normally be relet albeit at a small loss. In future, BNOC aims to tie freighting more tightly to the crude oil contracts so that such risks no longer exist.

4 Non-participation crude oil trading Total volumes purchased under long term contracts at present amount to some 40,000 barrels a day, or 3 per cent of BNOC's total available crude. The nature of BNOC's trading business prevents losses being attributed directly to specific volumes of oil. Losses should be regarded as distributed pro-rata between different classes of oil. On this

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basis, the largest loss made by BNOC to date averaged some eight cents per barrel for one quarter. The share to be allocated to non-participation would be £190,000. If BNOC finds it must sell oil on the spot market which has been purchased at term prices, the worst scenario would be a loss of \$5/barrel for one month (thereafter there could in principle be a realignment of term prices). It is unlikely that BNOC would have more than 150,000 b/d of such oil and it would be split pro-rata between participation and royalty and non-participation; on this basis the loss attributable to non-participation crude would correspond to that on 5,000 b/d, i.e. about £400,000 for a 30 day period. But at the same time there would be a loss of £13 million on participation and royalty; thus in practice the position ^{would be covered by} the overriding provision for participation oil.

5 Spot trading If there were to be pure spot trading at the margins (hitherto BNOC have not engaged in this) a reasonable upper bound would be some 100,000 b/d. Any open position could be closed within one day with no more than 50 cents/b loss even in rapidly falling markets. Typically, oil is sold in individual cargoes of some 500,000 b/d; assuming at most two cargoes left outstanding, this would imply a risk of loss of £600,000. BNOC recognise that they are not to initiate trading of this kind without prior consultation with the Department.

6 Total exposure On the basis set out in this Annex, non-participation trading - even taking pessimistic assumptions on all aspects simultaneously - should not lead to an exposure to potential losses of more than £3 million.

BNOC AFTER THE SEPARATION OF BRITOil

1. General Objectives for BNOC

- (i) Through participation, to secure and dispose of UK and UKCS petroleum in a way which contributes to our national security of supply.
- (ii) Through effective trading and marketing, to ensure that the UK economy receives the maximum benefits from BNOC's access, through participation rights, to UK and UKCS petroleum. (A simple guide may be to seek to maximise sales revenue for participation oil.)
- (iii) To trade profitably in all non-participation petroleum and petroleum products, within limits which may be set by the Secretary of State (annex 1). 'Trading' may include the arrangement of shipping and of processing, although the Corporation would be expected not to seek to invest in ships or in refining and processing.

2. Specific Duties not covered by the general objectives

- (i) To act as the Government's agent in the sale of oil taken as royalty in kind (RIK). (Although some small fields are being excluded from RIK, oil will continue to be available in future from this source on roughly the present scale.)
- (ii) To discharge the requirements of the agency agreement covering the Government pipeline system.

3. Financial structure and financial target

- (i) After disposing of its upstream assets BNOC will be provided with £30 million of retained profits.
- (ii) The Department of Energy with Treasury consent will arrange to guarantee short-term borrowing facilities of up to

£50 million on terms similar to those enjoyed by other nationalised industries.

- (iii) The Corporation's surplus funds are to be invested in public sector securities in accordance with existing general guidelines.
- (iv) BNOC and the Department are agreed that a financial target set in terms either of annual percentage return on assets or a percentage on turnover would not be appropriate. BNOC will instead be asked to earn a net surplus pre tax of £10 million over the first four year period, after meeting all its administrative and other costs.
- (v) Section 6(i) of the Oil and Gas (Enterprise) Act provides powers for the Government to make grants to BNOC, in support of the participation agreements. While the Government would expect to be called on to provide grants of this kind only in exceptional circumstances, BNOC would not, in the event of it making a loss too large to be covered by its own resources, be expected to rely for more than a short period on additional short-term borrowing.
- (vi) Section 5(i) of the Oil and Gas (Enterprise) Act provides powers for the Corporation's profits to be recouped by the Exchequer. It is expected that these powers would be used either if BNOC generated continuing surpluses or if circumstances allowed a single large profit to be made.
- (vii) The Corporation will not expose itself to risks in excess of limits set by the Secretary of State. These are set out at Annex 1 but may be reviewed from time to time.

4. Reporting and Control

- (i) BNOC will submit to the Department of Energy not later than April each year a business plan covering the following four calendar years. Following discussion at official level, this will be submitted, subject to any necessary modifications, for the approval of Ministers not later than

June. The business plan will cover the general sales strategy, and the extent of the risks to which BNOc might be exposed, as well as figures on forecast physical availabilities and projected financial results.

- (ii) An updated version of the business plan covering the immediately following calendar year only will be prepared each October. Unless it is invalidated by unforeseen changes in market circumstances, this will provide a yardstick for assessing the Corporation's trading performance.
- (iii) Six-monthly consultations will be held with the Department as hitherto.
- (iv) Each quarter in January, April, July and October, the Department of Energy will review formally the trading results for the most recently completed quarter together with the prospects for the next two quarters ahead.
- (v) The Chief Executive will report every month to the Corporation on trading results, plans and opportunities.
- (vi) Each month the Corporation will provide a funds flow statement to the Department of Energy.

11 November 1982

LIMITS TO FINANCIAL EXPOSURE

1. Crude Oil Trading

1.1 It is recognised that the major element of crude oil passing through BNOC's books is the aggregate of participation oil and royalty in kind. In addition, the Corporation is committed to buy some 40,000 b/d of oil on long term contracts from small producers. These latter arrangements were put in place in lieu of participation arrangements even though they cover 100 per cent rather than 51 per cent of production (net of royalty). For the purposes of defining financial risk, these existing contracts will be considered as quasi participation oil and subject to the same trading limits.

1.2 However, new contracts of this kind will not automatically be regarded in this light. The Corporation may enter into unlimited contracts where the seller agrees to accept from BNOC the same price as that at which BNOC disposes of the oil providing a sales fee is charged which covers adequately the administrative costs of managing both the buying and selling operations. Where the Corporation wishes to enter into contracts where the buying price is specified in the same way as for participation purchases, a handling fee should be sought sufficient to cover costs and provide cover against trading losses. Moreover, new contracts of this kind should not in total commit the Corporation to purchases in excess of 25,000 barrels per day at any time.

1.3 As far as participation and quasi participation oil is concerned, the Secretary of State expects the Corporation to follow past practice and inform him in advance of the event when market pressures require a change in BNOC's prices. In addition, the Corporation should consult the Secretary of State immediately if it finds itself exposed to a risk of loss of £5 million or more within a quarter on crude oil trading.

1.4 Where the Corporation is forced to buy or sell individual cargoes in order to balance volumes under long term selling contracts coupled with the acquisition of participation and quasi participation crude, this is to be regarded as falling under the rules for participation trading.

2. Other Trading Activities

2.1 This heading includes, but is not limited to:

- (i) all trading in LPGs;
- (ii) trading in petroleum products;
- (iii) freighting arrangements;
- (iv) true spot market trading in crude oil, including that which might stem from a deliberate policy to sell short (ie to enter into term supply commitments in excess of those to purchase participation oil or quasi participation oil).

2.2 In entering into contracts under these headings, the Corporation should not at any time allow itself to be exposed to a loss in excess of 20 per cent of its reserves. At the point of severance from the National Oil Account, this means a limit of £6 million. In calculating its exposure, the Corporation should take account both of the risks on fully open positions and those associated with buying contracts where prices are fixed quarterly without provision on associated selling contracts for price variations within the quarter to be passed through on a back-to-back basis.

Energy, BNOC, P45

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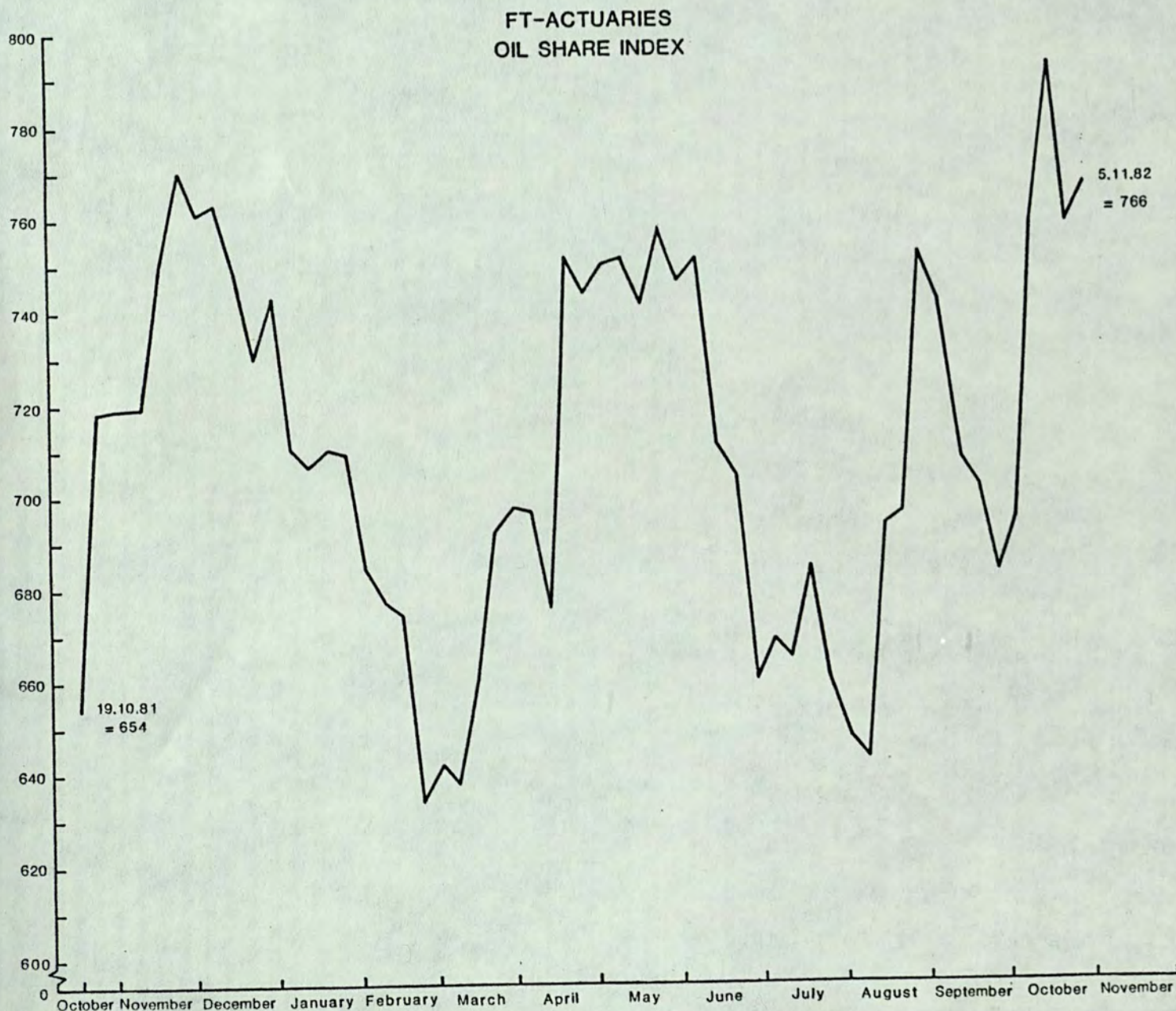
Britoil Flotation

It is hoped that members will find this note useful in connection with the sale of shares in Britoil.

Conservative Research Department,
32 Smith Square,
London SW1
Tel. 222 9000

Enquiries on this brief to:

The attached graph charts the course of oil share prices from 19 October 1981, when the Government first announced the privatisation of Britoil, to last week's close (5 November). Over the period as a whole, the index rose by a little over 17 per cent.





10 DOWNING STREET

From the Private Secretary

5 November 1982

Energy. HL
CC HMT
Fin Sec's Office
CO.

Dear Julian,

Britoil flotation

The Prime Minister was grateful for your Secretary of State's minute of 5 November. She agrees with his proposal to proceed on the basis of a tender with a minimum price of at least 210p..

I am sending a copy of this letter to John Kerr (H.M. Treasury), David Willetts (Financial Secretary's Office) and Richard Hatfield (Cabinet Office).

Yours sincerely,

Michael Scholar

Julian West, Esq.,
Department of Energy.

CONFIDENTIAL



PRIME MINISTER

Agreed mt

BRITTOIL FLOTATION

We need to take final decisions on the Britoil flotation.

The method of sale has to be settled by the end of this weekend so that the prospectus can be finalised. The price will need to be agreed with the underwriters on Tuesday and I propose to inform the House of the method of sale by a written Parliamentary Answer on that day. Impact Day will be on Wednesday, as we have agreed.

We shall be selling approximately 255 million shares, 51 per cent of Britoil's issued share capital. We have had a first discussion on the price with Warburgs. In a fixed price offer they would be prepared to price the shares at 214p which would yield gross proceeds of £545 million, and they might go up a further 1p or so under this route. They can, I believe, be persuaded to underwrite the minimum price of a tender at 210p per share which would yield gross proceeds of at least £535 million. I intend to press them hard to raise this minimum price to 215p.

I see a strong case for proceeding by a tender with special arrangements for small investors; both to buy shares at the striking price without bidding a specific price in advance, and to receive a bonus of one share in ten if they hold their shares for 3 years.

A fixed price offer would admittedly be more familiar to the market and, in normal circumstances, more likely to tap the fullest range of investors. But even a small misjudgement in the price could lead to an apparent shortfall in the proceeds, representing a substantial sum on an offer of this size (£2½ million for every 1p a share), and so to large profits for the stags.

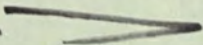
A tender would be novel for an offer of this size, and to an extent more risky. However, the special arrangements for small investors described above should make it attractive. A tender would allow the market to set the price and be seen to do so; and it would give the Government the benefit of any favourable movement in the market during the offer period. Although the minimum price per share might be below what we could obtain in a conventional offer, the proceeds could of course still be greater if the market bids up the price.

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I recommend that we should proceed on the basis of a tender with a minimum price of at least 210p. The Chancellor and the Financial Secretary agree. I would be grateful for your agreement also.

I am copying this minute to the Chancellor of the Exchequer, the Financial Secretary to the Treasury and Sir Robert Armstrong.

S. D. 

Approved by the Secretary of State for Energy
and signed in his absence

5 November 1982

CONQUEROR
LONDON



Your Ref

PA

with compliments

P. E. MIDDLETON

Treasury Chambers
Parliament Street
London SW1P 3AG
Tel: Direct Line 01-233
Switchboard 01-233-3000

FROM: N L Wicks
DATE: 5 November 1982

1. MR MIDDLETON
2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir D Wass
Mr Burgner

PRICING OF THE BRITTOIL ISSUE

The Secretary of State for Energy and the Financial Secretary had two long discussions last night with David Scholey and Lord Garmoyle of Warburgs on the Britoil pricing. There were separate meetings with our independent pricing advisers, stockbrokers Fielding Newson-Smith & Co. The purpose of the discussion was:

i) to establish, before the final negotiations next Tuesday, the price at which the issue could be underwritten for both fixed price and tender offers; and

ii) to ascertain in particular the gap, if any, between the underwritten price for a fixed price offer and a tender so that Ministers can come to a final decision this weekend on the method of sale.

2. Warburgs opened the negotiations by saying that the consensus of view of the six underwriting banks was that in that day's market conditions and on the basis of their initial view of the prospectus, the underwritten price for a fixed price offer would be 214p and the minimum price for a tender offer would be some 10 per cent lower, say 205p. David Scholey said that Warburgs had been willing to contemplate a fixed price offer at around 217p and a tender at around 212p, but he had been in a small minority in the underwriting group in arguing for this. He explained that the underwriters attached great importance to the price earnings ratio being no more than 6.0 which suggested the price of 214p. Surprisingly the brokers to the issue had been willing to contemplate the price of 215p for both fixed price and tender (though see their views on the reception to a tender in paragraph 4 below). After a lot of discussion Warburgs agreed that the underwriters might be persuaded to underwrite a fixed price offer at 215p and a tender at 210p, even if this meant dropping unco-operative underwriters from the syndicate.

3. On the basis of this 5p gap the Secretary of State's and the Financial Secretary's firm view, for the reasons set out below, is that a tender is preferable. Fielding Newson-Smith agree. So do Treasury officials.

4. The advantage of a tender is that sale proceeds will reflect market bidding; there is less risk that the price will shoot to an immediate premium and there is the opportunity that any under-valuation of the underwritten price will be compensated by a striking price, reflecting market bidding, which is above the minimum underwritten tender price. On the other hand, the striking price might have to be fixed at the minimum tender price. The brokers to the issue believe this to be a real possibility since market reception to a tender might not be good. Fieldings agree. If the striking price had to be fixed at the minimum tender price of 210p, sale proceeds would be some £12.50m lower compared to a fixed price offer at the suggested 215p. (A sale at 210p would produce gross proceeds of some £535.75m and at 215p proceeds of £548.25m. Public presentation of the proceeds could also add in the Company's £85m repayment of debt on floatation.) The Secretary of State and the Financial Secretary think that the balance of the arguments point firmly towards a tender.

5. Mr Lawson will now send a minute to the Prime Minister seeking her agreement to a tender. This is the only decision which is needed at this stage. The draft will be at Northholt for your clearance. If you disagree, and we would not recommend you to do so, the draft could be quickly adapted to include your views. A decision is needed from the Prime Minister by 10:00 am Monday at the very latest, though all concerned with the issue would appreciate it very much if there could be an answer by Sunday afternoon, so that there is adequate time for proof reading etc. Thereafter pricing meetings have been arranged for Tuesday morning and early evening which the Secretary of State and Financial Secretary will attend. If the tender route is agreed, our objective at thos meeting would be to hold the underwriters to 210p and if possible to try to beat the price up, particularly if the market had strengthened in the interim.

N.L.W.

N L WICKS

SECRET

Energy

3

MR. SCHOLAR

PA

BRITTOIL: LOYALTY SCRIP

Today I discussed with the Secretary of State for Energy the various points that I raised in my memorandum to you, and which you included in your letter to the Private Secretary of Energy.

On the first point of substance, the Secretary of State agreed that the loyalty scrip would be demand-led and that it would be difficult to make forecasts of the amount that was taken up. However, he proposed to introduce into the prospectus a statement that the seller reserved the right to restrict the allotment of the loyalty scrip. He was thinking in terms of only about one-fifth of the total issue being allotted to individuals under loyalty scrip arrangements.

In order to offset the argument that the holders of the loyalty scrip might sell after two years, the Secretary of State was proposing to increase the period to three years. This, he argued, would be more likely to induce people to hold on to the stock after the three-year period had elapsed. So far as I can see, as I mentioned to the Secretary of State, only the lethargic will continue to hold the scrip. Most will sell. But no-one can be sure at this stage what will happen on that occasion.

In essence, the Secretary of State said that he knew that the loyalty scrip didn't make very much economic sense, but it had political advantages that outweighed the small economic disadvantages. I agree that the economic costs should be quite small, and may well be more than offset by the political advantages.

The critical issue of tender or fixed price as the basis of the issue, and the details of the offer, have still yet to be decided. The Secretary of State clearly would prefer a tender, but I gather there are some difficulties with the under-writer, even at this late stage. Unlike other capital markets of the world, the City has been protected by the Bank from any substantial tender issues. They are not used to them. And for this reason, the under-writing costs of a tender may be significantly larger than those for a fixed price. There is a lot of hard bargaining yet to be done. But even if the under-writing price differed by as much as 10%, I still think that the advantages of a tender offer are sufficient to offset this. And

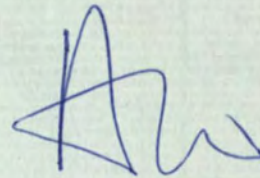
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- 2 -

in principle the difference in under-writing could be offset by the suitable choice of a minimum choice for the tender. All this is, I believe, still under discussion.

2 November 1982



ALAN WALTERS

SECRET



file

bc A. Walker ^{BM} 2

10 DOWNING STREET

BT

From the Private Secretary

29 October 1982

N.B. MGS said that no reply required now
SR 10/11/82

BRITTOIL - LOYALTY SCRIP ISSUE

May I raise with you a number of points which have arisen here in connection with your Secretary of State's letter of 25 October to the Chancellor about the proposal to include a loyalty scrip in the Britoil offer for sale?

Would a loyalty scrip be, in fact, no more than a minor variation in the sale strategy? It is an open-ended offer and it seems to us that the loyalty scrip may dominate the issue. For example, if all 100,000 eligible shareholders - which is said to be "higher than the working party thought likely" - were each to take up £5,000 worth of shares then that would amount to a total of £0.5b.

Is it assumed that the loyalty scrip would be issued on a fixed price basis? If that is the case, then will the rest of the issue for individuals above a holding of £5,000 and for institutional holders etc. be by tender? Or will that also be at the same fixed price? On the face of it, it looks as if the loyalty scrip issue may predetermine the method of issue in favour of the fixed price route.

The main advantage which is argued for the loyalty scrip is a wide dispersion of ownership. But clearly this will be true only for two years. After the end of the period the owners will collect their additional 10% loyalty bonus and then adjust their portfolios. There seems to be no reason for believing that the inducement to hold the scrip for a two year period will lead those so induced to continue to hold onto the stock. So at the end of two years one might expect the sort of distribution of stock which would have occurred without the loyalty scrip issue. There would be no fundamental change in the ownership of Britoil, nor is it clear how the loyalty scrips will inhibit renationalisation. It is very likely that at least two years would have elapsed before renationalisation could take place and even then it is always in the realms of possibility for the renationalising Government to pay a higher compensation to small loyalty scrip shareholders.

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- 2 -

There are a number of additional objections to the loyalty scrip. Obviously, two years after the date of the issue there will be a depression in the price of Britoil shares caused primarily by the loyalty scrip issue. Furthermore, it does not seem wise for the Government to lock in small savers so that they would run a considerable loss in liquifying their Britoil assets within the two year period.

I would be grateful if you could let me have a note on these points.

M. C. SCHOLAR

8

Julian West, Esq.,
Department of Energy

SECRET



Prime Minister (2)

ms 29/10

Treasury Chambers, Parliament Street, SW1P 3AG

Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1

28 October 1982

Dear Secretary of State

BRITTOIL: LOYALTY SCRIP

2nd PP

Thank you for your letter of 25 October to the Chancellor asking for his agreement to the inclusion of a loyalty scrip in the Britoil offer for sale. He has asked me to reply.

As you know from our earlier discussion, we are not much attracted by the loyalty scrip. It is a highly artificial device for persuading investors to retain shares and will be seen as such. It will probably have some net costs, though I note Warburgs' view that with a tender the loyalty scrip could prove a net benefit because of the extra interest generated at the margin. Nevertheless, as my office has already told yours, I agree to the principle of a loyalty scrip on the lines described in your letter, provided that you agree that you regard the loyalty scrip as sufficient attraction to small investors to keep their interest in the sale at the desired level, even if we decide to carry out the sale by way of tender. Our decision on the method of sale can then be taken without having to consider again the small investor dimension.

On this understanding I agree the proposals set out in your letter but would be grateful if you could consider the following when you are working up the details of the proposal. A bonus issue of one for ten after two years is on the generous side and I wonder whether you might consider increasing the qualifying period from two to three years? Second, the Bank of England have pointed out that limiting eligibility to the loyalty scrip to those who apply for up to £5,000 might encourage relatively small individual investors to restrict themselves to this amount when they might have otherwise been prepared to invest a little bit more. If this happened, proceeds might be adversely affected. Provided the cost of the scheme was not significantly increased, it might be worthwhile allowing the bonus issue to be paid on the first £5,000 of an application for a maximum of say £10,000 worth of shares. There would still be some disincentive for investors ready

to invest a little more than this amount, but clearly fewer people would be affected than by a £5,000 limit. Perhaps your officials should discuss this further with mine. I would only be willing to see this extension if the extra costs were small and there was some real reasonable expectation that they would be recovered in higher proceeds.

Finally, I should be glad if your people could let mine have an estimate in due course of the likely administrative costs of issuing the loyalty scrip since the Treasury, as new owner of the shares, will be responsible for running the scheme.

I am copying this letter to the Prime Minister and to Sir Robert Armstrong.

*yours sincerely
Martin Donnelly*

PP NICHOLAS RIDLEY

*(Approved by the Financial Secretary and
signed in his absence.)*

Energy, BNOC, P44

17 OCT 1982

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11 10 9 8 7 6 5

SECRET

R. SCHOLAR

BRITOIL

I understood that the method of floating Britoil was to be discussed and approved by the Prime Minister. However, in the letter of 25 October from Energy to the Chancellor, there is a proposal, apparently to be agreed between Energy and the Chancellor, for a rather peculiar loyalty scrip [which might pre-empt this decision. The letter suggests that the loyalty scrip is a sort of minor variation in order to ensure that, over a period of two years, small stockholders hang on to their initial allotment.] But I cannot see that the loyalty scrip is merely small change. [It is an open-ended offer and the loyalty scrip may dominate the issue. (For example, if all 100,000 eligible shareholders - which is said to be "higher than the Working Party thought likely" - were each to take up £5,000 worth of shares, then that would amount to a total of half-a-billion. So it may not be the small beer that is suggested.)

The letter does not say how the loyalty scrip is to be issued, but all the indications suggest that it is anticipated to be on a fixed price basis. If that is the case, then will the rest of the issue for individuals above a holding of £5,000 and for institutional holders etc, be by tender? Or will that also be at the same fixed price? I suspect, therefore, that the loyalty scrip issue tends to pre-judge the method of issue in favour of the fixed price.

You will recall that I was arguing the case for a tender system with a minimum price, say some five percentage points or so below the price which the advisers thought should be the appropriate level for a fixed price sale. This would give us room for any substantial ~~staging~~ and would ensure that no "give away" a la Amersham could be the subject of any accusation. I suspect it would also maximise the yield of the sale. Of course, if there are immense advantages to the loyalty scrip, then I would be happy to concede that my suggestion is very much second best. But I do not believe that to be the case.

The main advantages are thought to be the wide dispersion of ownership. But clearly this will only be true for two years. After the end of the period the owners will collect their additional 10% loyalty bonus and then adjust their portfolios. I cannot see how the bribe of holding the scrip for this two-year period will induce them to continue to hold on to the stock. If they did so, it would only be because of lethargy.

SECRET

/So at the

So at the end of the two years, one would expect the sort of distribution of stock which one would have had without the loyalty scrip issue. There would be no fundamental change in the ownership of Britoil. Nor should one expect any such change. The tax system inhibits the individual ownership of shares and encourages participation through institutions. It is the tax system that is, in this sense, wrong. Ad hoc arrangements like the loyalty scrip will merely provide a temporary cosmetic veneer of the "wider ownership" desiderata.

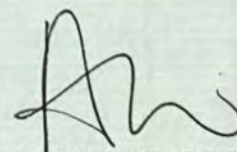
The Energy letter claims that the loyalty scrips will inhibit re-nationalisation. I cannot see how. It is very likely that at least two years will have elapsed before re-nationalisation takes place and even then it is always in the realms of possibility for the re-nationalising government to pay higher compensation to small loyalty scrip shareholders. Loyalty scrips are not like council houses.

There are a number of additional objections to the loyalty scrip. Obviously, two years after the date of the issue there will be a depression in the price of Britoil shares caused primarily by the loyalty scrip issue. Furthermore, it does not seem wise for the Government to lock in small savers (and, I believe, Energy are thinking primarily of small savers here) so that they would run a considerable loss in liquifying their Britoil assets within the two-year period. After all, the ability to market the asset, without any additional loss, is a great attraction for any portfolio holder.

Conclusion

I believe we need a little more information about the state of the loyalty scrip and how it will affect the issue process. I suggest that we write to Energy asking how far they have proceeded with their discussions, and perhaps also reminding them of the requirement of the ultimate approval of the Prime Minister.

27 October 1982


ALAN WALTERS

PRIME MINISTER

1
Energy

Statements: 27 October 1982

There were three statements this afternoon: Mr. Pym on the Foreign Affairs Council, Mr. Walker on the Fisheries Council and Mr. Lawson on Britoil.

The Foreign Affairs Council

The House was in a somewhat end-of-term mood.

It was pretty clear that the Opposition, led by Eric Heffer, had not grasped all the details of the agreement reached in the Foreign Affairs Council. They pointed out that the Council had not reached an agreement covering the long term, and sought to paint this as a failure. Mr. Pym pointed out in turn that arrangements for the long term had not been on the agenda of the Council, and would be discussed in November. The Opposition, aided by Nicholas Winterton, then turned to an attack on the Multi-Fibre Arrangement. From there, they moved on to call for firm action against unfair trade in the GATT Ministerial meeting, and some Opposition Members also called for mandatory Community measures on steel. This led Mr. Pym to say that a slide into protectionism would only make the recession worse. He hoped that the GATT Ministerial meeting would help to maintain the open trading system. Teddy Taylor asked whether the Government would consider withholding its contributions if the Community failed to reach agreement on the budget in 1983, to which Mr. Pym gave a non-committal answer. Tony Marlow ended up the questioning by saying that our trade deficit with the Community was a scandal, to which Mr. Pym replied that the recent trade figures had been very satisfactory overall.

The Fisheries Council

The questions on this statement followed a very familiar line. The Opposition, led by Norman Buchan, said that the agreement reached in Luxembourg was a retreat from the Conservative Manifesto, that the industry had only accepted the agreement under duress, that the £15 million aid announced by Mr. Walker was:

a bribe to induce the industry to accept the agreement, and that the Government should have allowed time for the proposals to be debated in the House before they signified agreement in Luxembourg. Mr. Walker replied that he had ^{offered} told the industry ~~he had been offered~~ the £15 million aid some time before the Council, that the leaders of the industry had all been in Luxembourg and had readily accepted the agreement, which was better than anything achieved by the Opposition while in office.

Britoil

Merlyn Rees asked a long list of questions, but his most important points were that the Government were selling Britoil at the wrong time, that they were giving Britoil a cash injection to improve their balance sheet, but that they were making no arrangements to protect Britoil acquisition by foreign investors, and that the PAC should be allowed to investigate the Government's proposals. Mr. Lawson had no difficulty in dealing with any of these points. He pointed out that the FT Actuaries' oil share index had risen considerably in the last year, that he had made no agreement to inject cash into Britoil, that he would welcome an investigation by the PAC, and that only the market could determine the value of the Company. He made play with the fact that the Opposition had sold shares in BP in 1977 with no prior consultation of Parliament, and that this sale was a financially unwise move from the point of the Exchequer. The Government would be retaining a special share in Britoil in order to ensure that it did not fall under foreign control. The only excitement was caused by Mr. Lawson's refusal to answer a suggestion from the Opposition that Ministers should not be allowed to buy shares in Britoil so as to avoid any suspicion of insider dealing. At first Mr. Lawson simply refused, with some encouragement from the Lord President, to rise to answer this question. When it was repeated by Mr. Cryer, he dismissed it as beneath contempt. The Opposition became somewhat excited and accused Mr. Lawson of arrogance, and repeated this when he dismissed another question from Frank Haynes as "far fetched."

Stephen Jear
pp Willie Rickett.

27 October 1982

BRITOIL STATEMENT: 27 OCTOBER 1982

With permission, Mr Speaker, I wish to make a statement about the privatisation of Britoil.

Almost exactly a year ago, I told the House that I hoped to transfer the entire oil-producing business of the British National Oil Corporation to the private sector this year.

These plans were set out in full and debated at length during the passage of the Oil and Gas (Enterprise) Act. That Act is now on the statute book. Britoil has been set up as a BNOOC subsidiary, and the oil-producing business has been transferred to it. As from next Monday, the shares in Britoil will be directly owned by the Government.

The way will thus soon be clear for an underwritten Offer for Sale of 51 per cent of the shares in the company. Subject to market conditions, I intend the flotation to take place next month.

The choice between a conventional fixed price offer and a tender must be made nearer the time. I will inform the House, as I have undertaken to do. If the sale is by tender, consideration will be given to the inclusion of special arrangements for small investors to buy shares at the striking price, without having to bid a specific price in advance. In either case, payment for the shares will be in two instalments, spread over a period of several months.

The Offer will also include special arrangements to encourage small investors not only to participate but also to retain a long-term interest in the company.

Finally, arrangements will be made to encourage Britoil's own employees to take a stake in their company. BNOC employees, too, will enjoy the right to make preferential applications for Britoil shares.

Mr Speaker, as the House knows, the privatisation of Britoil will in no way affect the system of participation agreements, which will remain in place, under 100% Government control, as a means of safeguarding our national security of supply. But what it will do is enable the people of Britain to take a direct personal stake in the North Sea. It will create an independent British oil company free to seize the opportunities open to it. And it will substantially reduce the size of the public sector in an area where state ownership has no rational justification whatsoever.



SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

Press Office
ms

Willie Rickett Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

26 October 1982

Willie

I attach the draft of the statement my Secretary of State proposes to make in the House tomorrow on Britoil. Please could I have any comments by 11 am tomorrow morning.

I am copying this to Nick Huxtable (Lord President's Office), Murdo Maclean (Commons Chief Whip's Office), Michael Pownall (Lords Chief Whip's Office), Bernard Ingham (No 10), Richard Hatfield (Cabinet Office), Margaret O'Mara (Treasury) and Roger Bone (Foreign and Commonwealth Office).

Jeremy Clayton

Jeremy Clayton
Private Secretary



P.S. A copy also goes to DF Middleton (Scottish Office), with briefing for Lord Mansfield.

DRAFT

BRITTOIL

With permission, Mr Speaker, I wish to make a statement about the privatisation of Britoil.

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[The Offer will also include special arrangements to encourage small investors not only to participate but also to retain a long-term interest in the company].

OR

[I have repeatedly stressed the Government's wish to see the shares widely spread among the public. This will be reflected in the arrangements for the Offer].

Finally, arrangements will be made to encourage Britoil's own employees to take a stake in their company. BNOC employees, too, will enjoy the right to make preferential applications for Britoil shares.

Mr Speaker, as the House knows, the privatisation of Britoil will in no way affect the system of participation agreements, which will remain in place, under 100% Government control, as a means of safeguarding our national security of supply. But what it will do is enable the people of Britain to take a direct personal stake in the North Sea. It will create an independent British oil company free to seize the opportunities open to it. And it will substantially reduce the size of the public sector in an area where state ownership has no rational justification whatsoever.

BRITOIL STATEMENT: 27 OCTOBER 1982

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AW

Prime Minister

Mus 26/10

01-211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

25 October 1982

Dear Chancellor,

BRITOIL: LOYALTY SCRIP

When we met on 29 September we discussed the loyalty scrip, an idea put forward by the Working Party on the Britoil Method of Sale as a way of encouraging small shareholders to buy and retain Britoil shares.

In the light of further work by Warburgs, Freshfields and my Department, I propose that the Government should make a free issue of one share for every 10 shares to every individual shareholder who applies for up to £5,000 worth of shares and retains them for 2 years. Your officials have details of the proposal. I understand that the Inland Revenue have confirmed that income tax would not be payable by recipients.

I attach great importance to encouraging small investors to participate in the Britoil offer and to maintain their interest in the Company. It would show that the public, and not merely the institutions, had taken the opportunity to acquire a stake in the North Sea. It would provide a disincentive to later renationalisation. The scrip would also help to discourage excessive staggings and prevent the much criticised sharp reduction in the size of the share register immediately following flotation that has occurred with previous privatisation offers.

Arrangements are in hand for the prospectus to be widely available and for the offer to be well publicised. While this should go some way to creating interest, I think it essential to encourage small investors to demonstrate a longer-term commitment to the Company. Philip Shelbourne agrees with this. Warburgs advise that failure to include the loyalty scrip in the Offer would now disappoint expectations and get the offer off to a bad start.

I have considered carefully the cost to Government and believe it to be acceptable. If for instance, we aim at a total of 100,000 eligible shareholders, which is higher than the Working Party thought likely and compares well with all but the largest UK industrial companies, the gross cost could be around £10m. Warburgs consider moreover that the net cost would be less than this, and that with a tender the loyalty scrip could even prove a net benefit because of the extra interest which it would generate at the margin. Fielding Newson-Smith similarly think that it will help to increase the Government's proceeds because underwriters will be more confident that applications will be higher, though they do not expect more than £20 million to be recouped by way of an increase in price.

I hope therefore that you can agree that the loyalty scrip should be included in the Britoil Offer for Sale.

I am copying this to the Prime Minister and to Sir Robert Armstrong.

Nigel Lawson
J. C. [unclear]

11 NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)

Energy : Future of BNOE PLS.

010
ENERGY.

01 211 6402

The Rt Hon John Biffen MP
Lord President of the Council
Privy Council Office
Whitehall
London
SW1A 2AT

14 October 1982

Dear Lord President,

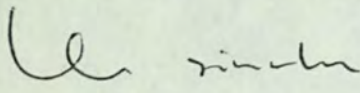
BRITTOIL FLOTATION

The period reserved for the flotation of Britoil begins in less than four weeks. Before then Ministers should avoid making comments about Britoil which might be taken by prospective purchasers as relevant to the flotation and which could in the extreme render the Government liable to prosecution.

I attach a note, prepared by my Department's and City legal advisers, setting out the legal position. I should be grateful if you and copy recipients would draw it to the attention of all ministerial colleagues.

While my concern is directed particularly at statements and comments made outside Parliament, it should also be taken as applying to Parliamentary proceedings. Such proceedings are of course privileged and cannot de jure be used to found a legal action. However, I do not think that a Parliamentary statement which was misleading in the context of the Britoil flotation could be defended satisfactorily by invoking Parliamentary privilege. Any attempt to do so would gravely undermine the Government's reputation in the conduct of flotations, with adverse consequences for future privatisation.

I am copying this letter and the attached note, to the Prime Minister, Cabinet colleagues, and to Sir Robert Armstrong.


J.P. Clark

pp NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)

LIABILITY OF THE GOVERNMENT FOR STATEMENTS
MADE, OTHER THAN IN THE PROSPECTUS

A purchaser of shares may be able to claim some form of relief on the grounds that he was induced to enter into the contract to purchase by a misleading statement. The liability may arise whether the misrepresentation was made fraudently, negligently or even wholly innocently.

The misrepresentation must be material ie it must be one that would affect the judgment of a reasonable man in deciding whether or not to enter into the contract to buy the shares, and the representee must show that he relied upon the misrepresentation in deciding whether to enter into that contract.

(In practice, however, it is difficult to maintain a defence that the misrepresentation was immaterial or that the representee did not rely on it.) It is sufficient if the misrepresentation was only one of several inducements. Despite the fact, therefore, that the prospectus, which will be carefully vetted, may be read by prospective purchasers they may also have relied upon statements made other than in the prospectus, for instance by Ministers in Parliament or outside. The closer to the issue that statements are made the more likely it is that a purchaser will be able to show that he relied upon such statements. It also seems likely that the risk of reliance on such statements would be magnified in the case of employees who, it is thought, would be more likely to decide to buy shares because of the statements of Ministers than because of a careful study of the prospectus.

The general rule is that the liability will arise only where the misrepresentation involves a mis-statement of existing fact.

There may be no liability, therefore, if the statement falls into one of the following categories:

(i) Mere Puffs

ie sales patter, eg Britoil produces crude oil of super quality.

(ii) Statements of Opinion

Some statements of opinion may not give rise to liability either because they are mere puffs or because the maker of the statement had, as the other party knew, no personal knowledge of the facts on which he based his opinion, and it is understood that he could only state his belief. Eg. if a Minister stated that in his opinion Britoil would be even more successful in private ownership it would be understood that this was his belief and he could have no knowledge of whether it would in fact be more successful.

However, where the opinion is or appears to be based on facts particularly within the knowledge of the maker there may be a misrepresentation because the maker has implied that he has reasonable grounds on which to base his opinion. Eg. if a Minister states that it is his belief that investment in Britoil as a private sector company will be particularly rewarding he may be taken to have represented that he knows as a fact that Britoil will be able to make profits and will pay dividends to its shareholders. If this proves not to be the case, there may well be a liability for a misrepresentation.

It should be stressed that in the case of Ministers giving opinions on the new Company there is a particular risk that they will be believed to have a knowledge of facts on which the opinion is based. The very fact that it is a Minister speaking will bring a certain authority to the statement. What may genuinely be merely a belief of a Minister, therefore, may not be recognised as such and he may be believed to have based his opinion on facts which are not in his possession.

(iii) Statements as to the Government's Future Conduct

A promise to do something in the future may, in the particular context in which it is made, amount to nothing more than a statement as to the present intention of the maker's future conduct. If so, the maker of the statement does not misrepresent a fact merely because he fails to fulfil the promise. It will however be a misrepresentation if the maker does not in fact have the intention of fulfilling the promise at the time he makes the statement: eg. if a Minister stated that the Government would continue to maintain certain privileges formerly of BNOC for the benefit of Britoil and the Government subsequently failed to do so there would be a misrepresentation if the Government did not have the intention of continuing to do so at the time the promise was made. It must be stressed, however, that a statement of intent as to future conduct if carelessly made may lead to serious consequences and there may be some difficulty in showing that a Minister actually had the intention when he made the statement.

(iv) Statements of Law

Misrepresentations as to the interpretation of a statute do not give rise to a liability but a statement that a statute applies to a certain set of facts which are incorrect may well be a misrepresentation giving rise to a liability.

Conclusion

In every case it will be a question of fact to be judged by the Court whether the grounds stated above are satisfied in order to give rise to a liability for a misleading statement. There is frequently a fine distinction to be drawn in deciding whether a misrepresentation was in fact material. Likewise it is often difficult to conclude whether the statement was a mere puff or in fact a misrepresentation of existing fact; whether the maker of an opinion was understood only to have been stating his belief or to have based his opinion on facts within his knowledge; or whether at the time he made a statement as to the future he did have the intention of fulfilling his promise.

The best advice to Ministers is that they should confine their remarks to:

- (a) statements of published facts eg past profits or published financial targets; or
- (b) statements on matters within the Government's control eg the rate at which applications for development approval are processed; or
- (c) statements which are clearly expressions of honestly-held opinion or belief, rather than factual forecasts

eg that Britoil's chances of success are better in the private sector than as a public sector business.

Ministers should avoid statements which are of opinion or belief but which may appear to have some factual basis eg. predictions about Britoil's level of profits or dividend performance in future years. Again, it must be remembered that statements of belief by Ministers may be relied upon because they may be believed to have firm facts on which to base their opinions.

Ministers should also avoid statements which only partially disclose facts. Whilst there is no general duty to disclose material facts, to reveal some facts, all of which are true, but to fail to reveal other facts which affect the weight of those stated and make the statement misleading, by virtue of the omission, may be a misrepresentation.

Finally, it should be pointed out that statements true at the time they are made may cease to be true later. If the statement is not corrected it may be a misrepresentation. It may, therefore, be necessary to disclose any facts which falsify statements previously made.

CONFIDENTIAL

ENERGY

50



be A. Walters

10 DOWNING STREET

From the Private Secretary

4 October 1982

SALE OF BRITTOIL SHARES

The Prime Minister is content with your Secretary of State's plans for the Britoil flotation as set out in his minute of 30 September.

She would be grateful to be consulted before a final decision is made on the method of sale, as between fixed price or tender.

I am sending a copy of this letter to John Kerr (HM Treasury) and Richard Hatfield (Cabinet Office).

M. C. SCHOLAR

J.D. West, Esq.,
Department of Energy.

CONFIDENTIAL

88

PRIME MINISTERSALE OF BRITTOIL SHARES

Nigel Lawson has agreed all of the proposals in the attached minute with the Treasury. Do you agree to what is proposed?

The major issue, it seems to me, is between a fixed price sale or tender sale. Given the scale of the Britoil sale, and its importance in the privatisation programme we must look very hard, with Amersham hindsight in mind, at the proposal to go via the fixed price route again. The objection to the tender route is that because the City has no experience of a tender sale on this scale (the largest ever done before was £80 - 90 million), potential underwriters will be wary, and they will set a lower underwritten minimum tender price than the underwritten fixed price they would go for. This does not seem a very powerful argument. A further consideration is that there is very much less scope for staggung via the tender route, and much less likelihood therefore of public criticism that the assets were disposed of at too low a price.

All the City advice - partly I suspect, because this is the charted, and easier, route for them to follow - is in favour of the fixed price route. It is a matter for satisfaction that the Chancellor and Mr Lawson have agreed to keep open the final decision as between fixed price and tender. I understand that they are asking the underwriters to tell them what both the minimum tender price and the underwritten fixed price would be.

Would you like to be consulted (you might like to have Alan Walters and/or John Sparrow's views) before a final decision is made as between fixed price or tender?

MCS

Yes please
mb1 October, 1982



cc JV

CONFIDENTIAL

PRIME MINISTER

SALE OF BRITTOIL SHARES

We have reached the point where we need to decide in principle whether the Britoil sale should go ahead. The period reserved for flotation is five weeks away.

I believe that we should go ahead as planned subject to a final review of market conditions just before the sale. There is nothing to be gained by waiting; and if we deferred the offer, we might lose the opportunity completely in this Parliament. This view is supported by our professional advisers, Warburgs, who see no reason to think that the prospects for flotation would be better six months from now. I have discussed the matter with the Chancellor who concurs.

I have also agreed with the Chancellor that the final decision on the method of sale - whether it should be by fixed price or tender - should be taken as late as possible, in the light of market conditions. Whichever course is adopted we take the view that the offer should be underwritten, given the scale and risks of the flotation and the importance of moving the Company into the private sector.

In order to meet the timetable for flotation the shares in Britoil will have to be transferred from the British National Oil Corporation to Government on 1 November and the Order effecting this will have to be made in the next ten days. I would like to announce this in my reply to the energy debate at the Party Conference on Wednesday.

I have agreed with the Chancellor that the Government shareholding in Britoil remaining after flotation should be held by the Treasury Solicitor on behalf of the Lords Commissioners of the Treasury, as with BP, and not by the Secretary of State for Energy. This should be helpful with the market.

/I would.....



CONFIDENTIAL

I would be grateful if you could confirm that you are content with these plans.

I am copying this minute to the Chancellor of the Exchequer and to Sir Robert Armstrong.

NA

Secretary of State for Energy

30 September 1982

CONQUEROR
BY AIR
LONDON
THE



Prime Minister (2)
This was the meeting which I suggested you should take (it happened more quickly than I had expected). You will

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

see that Mr Lawson

30 September 1982 has abandoned the

idea of a quick review of the oil tax régime, but the Chancellor has agreed to a review, to be concluded by Budget time.

MCS 1/10

Michael Scholar, Esq.,
No.10, Downing Street

MS

Dear Michael,

..... The Chancellor has asked me to send you the attached note of a meeting he held on 29 September with the Secretary of State for Energy on the proposed Britoil flotation, and on the North Sea fiscal regime.

The Chancellor, and the Secretary of State for Energy, are concerned that the Prime Minister should know how matters now stand on the flotation; that they agree that preparations for it should continue as planned; and that the Secretary of State will make it plain, in his speech at Brighton, that the Government's intention is to go ahead with the sale this autumn (paragraph 2 of the record).

The Prime Minister may also wish to note that the Chancellor has accepted the case - the Secretary of State's letter of 24 September - for a new review of the North Sea fiscal regime.

A copy of this letter goes to Julian West in the Department of Energy.

Yours ever,

J.O. Kerr

J.O. KERR



RECORD OF A CONVERSATION BETWEEN THE CHANCELLOR AND THE SECRETARY
OF STATE FOR ENERGY IN NO.11 DOWNING STREET AT 4 PM ON WEDNESDAY,
29TH SEPTEMBER 1982

Present:-

Chancellor
Financial Secretary
Mr. Middleton
Mr. Wicks
Mr. Kerr

Secretary of State for Energy
Mr. T.P. Jones
Mr. A.J. Wiggins
Mr. J. Dorken
Mr. R. Wilson

Papers

The meeting considered the Secretary of State's letters of 23 September on the Britoil flotation, and of 24 September on the North Sea oil tax climate.

Britoil

2. Mr. Lawson said that he was clear that it would be wrong to postpone the proposed flotation. There was no reason to expect that the proceeds would be higher after a delay, for oil market prospects were not encouraging. And it would be difficult to gear up the operation a second time. Warburgs, whom he had seen earlier on 29 September, were keen to go ahead: so was he. The Chancellor and the Financial Secretary agreed, while noting that it would be possible up to the last minute to retain the option of calling the sale off if market conditions were to deteriorate very sharply. It was agreed that any indication - e.g. at the Party Conference - of doubt about whether the flotation would take place on schedule would be taken as confirmation that the Government were backing off, and should therefore be avoided.

3. On method of sale, it was agreed that the choice lay between a conventional fixed price offer, and a modified tender, along the



lines described in paragraph 70 of the report of the method of sale working party. The compromise "hybrid" option should be dropped. It was also agreed that, whichever option were chosen, underwriting would be essential. Mr. Lawson thought that the straightforward marketing arguments pointed to a fixed price offer; but the tender route would avoid the political problems of success with a fixed price offer. One would wish dealings in the shares to start at a small premium: yet a premium of only 10 per cent on a sale of this size would bring accusations that some £50 million of the taxpayers' money had been put into City pockets. On the other hand, the underwritten minimum tender price would probably be lower than the underwritten fixed price. It was agreed that both options should be kept open for the present, and that price advice on both bases should be secured. This would enable a final judgement to be taken in the light of a clear estimate of the price to be paid for avoiding the potential criticism of a fixed price success. The Financial Secretary, and the Chancellor, thought that there would be considerable attractions in a tender, provided that the underwritten tender price were not far below the obtainable underwritten fixed price.

4. In a brief discussion of the future ownership of the Government's 49 per cent shareholding, it was agreed that the Treasury should eventually hold the shares.

5. In a further brief discussion of Britoil management, it was agreed that it would be desirable that the oil expertise on the Board should be increased before the flotation. Mr. Lawson explained that steps to this end were being taken.

6. On measures to encourage a wide spread of ownership, the Chancellor agreed that the prospectus should be made widely available, and that the arrangements and timetable should be tailored to accommodate the small investor, who should be given priority in the share allocation. He was however less convinced of the value of a loyalty scrip. The Financial Secretary pointed out that Warburgs apparently estimated that the loyalty scrip



might cost some £20 million: it could be seen as an odd use of so much public money. Mr. Lawson thought that the figure was as yet uncertain: the cost would depend on how large was the inducement to hold the shares for a minimum of two years. And the cost would not of course arise until after that period. Moreover the £20 million figure took no account of the fact that a loyalty scrip might make it possible to agree a higher price with the underwriters. It was agreed that no final decision on the loyalty scrip need yet be taken. Independent advice on it, as on all other issues relating to the flotation, should be sought from Fielding, Newsome Smith.

North Sea fiscal regime

7. The Chancellor said that he fully accepted the case, set out in Mr. Lawson's letter, for a new study of the fiscal regime. There was no question of making it tighter: what was at issue was whether it should be relaxed by action in the Budget. A key issue would be whether there could be any assurance that substantial reductions in tax take would lead to more investment in the North Sea, rather than elsewhere.

8. Mr. Lawson was clear that there had been a sea-change in the oil market, and that there was a serious risk that the flow of investment in the North Sea would dry up unless the regime were relaxed. The aim should be to make sufficient changes to affect the companies' psychological approach to new investment decisions: changes which would affect revenue in 1983/84 would not necessarily be essential.

9. Mr. Lawson went on to say that he would see considerable advantage in completing the proposed review in time to announce its outcome before the Britoil flotation. The Chancellor and Mr. Middleton however thought it important to consider all the Budget fiscal issues in the round, and saw risk in a rushed two-week study. Announcing the outcome would also pose a major



presentational problem, given what had been said to the Select Committee as recently as July. The objective situation had not changed in the interim, and it would be assumed, particularly if tax changes would not affect the revenue until 1984/5, that the Government's haste was entirely related to the Britoil sale. The UKOA report would be available by the end of the year, and should be taken into account in the review.

10. Mr. Lawson said that, while he would have seen considerable advantage in a very rapid review, and early announcements, his first priority was to secure a joint study leading to some mitigation of the North Sea fiscal regime. It should not be too mechanistic, and should take full account of psychological factors. The Chancellor agreed: the study should be set up forthwith, but it was agreed that it should be on an in-depth basis, and against a Budget, not an October, deadline.

J.O. KERR

30 September 1982

Distribution:-

PS/Secretary of State for Energy

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (R)
Sir Douglas Wass
Mr. Middleton
Mr. Quinlan
Mr. Burgner
Mr. Monck
Mr. Moore
Mr. Ridley
Mr. Wicks

Mr. Green (Inland Revenue)

Mr. Plenderleith (Bank of England)

ce

Prime Minister

①

MILLBANK LONDON SW1P
01-211 6403

*Yes please
not*

*Would you wish
to take this discussion?*

Mus 24/9

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
London SW1P 3AG

24th September 1982

Stan Geoff

NORTH SEA OIL TAX CLIMATE

Thank you for copying to me your letter of 10 September responding to David Howell's of 27 August.

I am less confident than you that the current regime leaves the industry with a fair range of attractive development prospects and that major changes are neither necessary nor desirable. It has become increasingly clear to me over the last few months that, despite the very modest relaxations to the regime in this year's Finance Act, the companies remain genuinely concerned about the levels of taxation and that this is undoubtedly colouring their attitude to further investment in the UKCS. The attractiveness of the North Sea and the willingness of the companies to invest has to be seen against prospects elsewhere in the world. In this context I am afraid that the work of Kemp and Rose, encouraging though some of its conclusions may be, cannot be taken to provide an adequate answer to the industry's criticisms.

The outlook for future development activity is distinctly worrying. North Sea development and, in particular, those firms which ride on its back are among Britain's best industrial prospects for the '80s and '90s. As things stand now, we are in danger of sacrificing those prospects.

It is inevitably difficult to come up with quantified evidence linking the current regime to the level of North Sea activity. However, North Sea projects tend to be large and risky, and companies' willingness to invest in them depends in a large part on their attitude to risk taking: this is not something that can easily be expressed in estimates of post-tax returns. Clearly, factors other than tax have contributed to the caution now being shown towards new development - particularly the much less bullish prospects for the real price of oil and the greater



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technical problems associated with the smaller and more difficult second generation of North Sea fields. However, the tax regime - which after all is practically the only instrument we can use to encourage the companies to undertake new investment - cannot be independent of these factors: rather it inevitably reflects them. This point was, I think, pretty clearly accepted in our decisions to tighten up the regime in 1980 and 1981 in the light of our then more buoyant central view about the longer term prospects for oil prices. If the tax regime was "right" for the climate of 1980, it can hardly be so in the climate of 1982.

For these various reasons, I am now satisfied that there is a strong case for early changes to reduce the level of taxation. I think it would be sensible for us to meet to discuss this as soon as possible.

I am copying this letter to the Prime Minister and David Howell.

NIGEL LAWSON

Yn Ew
Nigel

Even Rd, Public Exp, Przo



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13/4

CABINET OFFICE

Central Policy Review Staff

With the compliments of
John Sparrow

70 Whitehall, London SW1A 2AS
Telephone 01-233 7765



Energy
90/20

CABINET OFFICE
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: John Sparrow

CONFIDENTIAL

Qa 06035

12 August 1982

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
SW1

Dear Nigel,

BNOC Trading After the Separation of Britoil

Thank you for sending me a copy of your letter of 5 August to the Chancellor of the Exchequer, commenting on the earlier correspondence.

I am glad that you have agreed to include the words that we suggested in the third objective, but I reiterate that it is important to exercise your power to set financial exposure limits on all of BNOC's trading activities, particularly for non-participation trading, as soon as possible.

All trading activities involve risk, and all participants in commodity trading recognise this by setting fixed exposure limits on transactions, related to their ability to withstand the losses that might occur. The normal method, in my experience, is to set limits related to the organisation's capital and reserves and I suggest that this could be the basis in this case.

The delay in forming the BNOC board and in acquiring a finance member does not argue for a lack of limits in the meantime but rather for stringent limits which may conceivably be relaxed when the new team have played themselves in and perceptions of risk have accordingly improved.

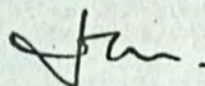
CONFIDENTIAL

I note your arguments in favour of non-participation trading and would only comment that profitability must be the main justification for BNOC involvement in this area. I suggest that, in addition to limits on both the nature of business and the financial exposure, a separate financial target for this activity could be developed, perhaps based on an assessment of independent traders' margins.

On other matters raised in correspondence, I accept that there are difficulties in setting financial targets, in view of the possible conflict between BNOC's profits and maximum public sector revenues, and I support your objective of maximising sales revenue.

I am sending a copy of this letter to the Prime Minister, other members of E(NI) and to Sir Robert Armstrong.

Yours sincerely,



John Sparrow

13 AUG 1982

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Energy
CC JV

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

11 August 1982

The Rt. Hon. Nigel Lawson MP
Secretary of State for Energy

17

12/8

In Nyl

BNOc TRADING AFTER THE SEPARATION OF BRITOil

Thank you for your letter of 5 August.

It is helpful that you are going to make a further effort to define with BNOc the limit on financial exposure. As you know from my letter of 23 July, this is something on which I think early progress ought to be made. We ought not to wait until BNOc's new Board, including a finance member, is complete and has played itself in. The Corporation ought to have at least interim financial guidelines and limits on its financial exposure from the outset of its separation from Britoil.

You suggest that too much emphasis on the avoidance of risks would put us in danger of suffering a substantial loss of oil tax revenues and that consequently that this is a difficulty in defining the financial guidelines. I quite take this point so far as participation oil is concerned, but it is hardly relevant to the non-participation business which should not affect oil tax revenues. In that business the Corporation will be acting very much like a commodity trader, but backed by Exchequer credit. In those circumstances it seems most important to lay down clear guidelines limiting the financial exposure,

I am sending a copy of this letter to the Prime Minister, other Members of E(NI) and to Sir Robert Armstrong and John Sparrow.

[Handwritten signature]

GEOFFREY HOWE

Energy

cc to
WA
etc

01-211 6402

The Hon. Sir Geoffrey Howe QC MP -
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London
SW1P 3AG

5th August 1982

Dear Chancellor

BNOC TRADING AFTER THE SEPARATION OF BRITOil

Thank you for your letter of 23 July. I am also grateful for the letters from Patrick Jenkin of 21 July, John Sparrow of 22 July and George Younger of 26 July. *will request is required*

Our difficulties in defining the limits on the risks to which the Corporation may expose itself arise because, in the rather weak markets likely to prevail over the next few years, BNOC would be best able to minimise its own risk of loss by pitching its prices low, since its suppliers have considerably less bargaining power than its customers, who can walk away from purchasing BNOC's crude as we discussed last March.

Laying too much emphasis, therefore, on avoidance of risk puts us in danger of suffering a substantial loss of oil tax revenues. I will make a further effort to define with BNOC the limit on financial exposure in such a way as to avoid that danger, but it may be difficult to achieve complete satisfaction until BNOC's new Board (including a finance member) is complete and has played itself in. I shall let you know in the early autumn what progress has been made. We can then return to the question of the level of BNOC's retained profits.

Because the BNOC price for UKCS oil to a great extent sets the price for all UKCS oil which is not sold at arms' length (about 70% of total production) I think it would be wrong to consider any form of discount of BNOC's prices in order to attract inward investment. Should such investment be desirable, there will be cheaper ways of securing it. I am therefore sure that we should retain the objective of maximising sales revenues.



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

NBPM

MUS 27/7 26 July 1982

Dear Nigel,

BNOC TRADING AFTER THE SEPARATION OF BRITOil

I am grateful to you for copying to me your letter of 13 July to Geoffrey Howe on this subject.

The guidelines you propose for the British National Oil Corporation's operations after the "privatisation" of Britoil seem entirely reasonable. I have, therefore, no comments to offer at this time but I would appreciate being kept in touch with any future developments.

I am copying this letter to the recipients of yours.

Yours sincerely,

George

27 JUL 1982

1 2 3 4 5 6 7 8 9 10 11 12

As for the means of a secure contract to supply BNOC's oil at market prices I very much doubt whether, on current market conditions, this could be used as an inducement to inward investment, or to anything else for that matter.

Finally, to answer John Sparrow's question, if BNOC were to trade solely in participation oil, it would inevitably make a loss because of the terms of its participation agreements. Continuing losses would put the Oil Taxation Office under pressure from the integrated oil companies to rule that the BNOC prices were above the market price at which oil trade between affiliates should be valued. We therefore should allow BNOC to seek profits from other activities such as trading in third party oil to cover its own salaries and overheads and give some cover against the risks inherent in trading participation oil. Access to third party oil from overseas also helps the Corporation to gain maximum value for UKCS crude through providing scope for dealing in a package of crudes. It will also assist us in the important job of ensuring that BNOC is staffed by thoroughly competent oil traders. However, I entirely agree with you and John Sparrow that the scope for such third party business should be kept firmly under control and I should be glad to add the words he suggests to the third "general objective".

I am sending copies of this letter to the Prime Minister, other Members of E(NI) and to Sir Robert Armstrong, and John Sparrow.

Yours sincerely
Nigel Lawson

NIGEL LAWSON

(Approved by the Secretary of State
and signed in his absence)

CONFIDENTIAL

of the Energy



Prime Minister (2)

MUS 23/7

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

23 July 1982

The Rt. Hon. Nigel Lawson, MP
Secretary of State for Energy

Nigel

[Handwritten mark]

BNOC TRADING AFTER THE SEPARATION OF BRITOil

Thank you for your letter of 13 July.

It is disappointing that you have not been able, with the Corporation, to define and set limits on the risks to which the Corporation may be exposed at any one time. I attach considerable importance to this. Now that the pressures on the traders of preparing for the privatisation of Britoil have reduced, I believe that a further effort should be made to fix limits, expressed in financial terms, to come into effect as soon as possible.

Until these limits are set, it will be difficult to assess the case for as high a level of retained profits as £30 million. We should be careful not to set too high a level, firstly because it might encourage the traders to take unnecessary risks and secondly because the opening level of reserves will add, either directly or indirectly through the diminution of proceeds from the Britoil sale, to public expenditure. I recognise that you have arrived at the figure you propose after negotiation with the Corporation, but before agreeing to a figure as high as £30 million I really do think we need to be sure of a satisfactory limitation of the Corporation's exposure.

The Corporation's surplus funds should of course be invested in public sector securities in accordance with the existing general guidelines.

As to the Corporation's temporary borrowing, I am content that it should be subject to an overall limit of £50 million, and that your Department may, with Treasury approval, guarantee

/facilities

CONFIDENTIAL



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Prime Minister (4)

hus 22/7

CABINET OFFICE
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: John Sparrow

CONFIDENTIAL

Qa 05991

22 July 1982

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
THAMES HOUSE SOUTH
S W 1

Dear Nigel,

BNOC Trading after the Separation of Britoil

Your letter of 13 July ^{-JPM} proposes a regime for the public sector trading operations of BNOC.

I agree with you about the importance of setting limits to the extent of BNOC's trading activities, outside its main duty of trading in participation oil. It is not entirely clear to me why BNOC will need to carry on any trading in non-participation oil, after a transitional period when Britoil may depend on BNOC expertise in selling its own non-participation products. Beyond that, there may be some need to spread risks at the margin, and to offer enough challenge to attract and retain skilled trading staff. But the risks of allowing the Corporation to go in for speculative commodity trading without clear limits are of course very great, as your letter recognises.

You suggest setting these limits from year to year, in the context of the annual business plan. I understand why it is difficult to set firm limits now. But I think it would help to make it quite clear from the outset that you intend to keep the scope of the business firmly under control, by adding to the third 'general objective' something like the words underlined:

"(iii) To trade profitably in all non-participation petroleum and petroleum products, within limits which may be set by the Secretary of State."

CONFIDENTIAL

It will then clearly be desirable to get actual limits set as soon as possible.

I am sending copies of this letter to those who received copies of yours.

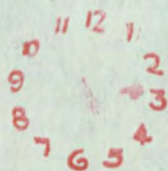
Yours sincerely,

John Sparrow

John Sparrow

CONFIDENTIAL

22 JUL 1982



PRIME MINISTER

You asked about the objectives for BNOc after the
privatisation of Britoil. *see Nigel Lawson's letter (attached)*

The paragraph you questioned said that BNOc's most important role will be "in setting term prices for UKCS crude at levels which maximise overall public sector revenues from our North Sea oil production, even though that might sometimes result in a trading loss". I understand that BNOc's term price, i.e. their price for a three month contract and not for a one-off cargo is both a market price, and also a tax reference price. That is to say that the Treasury's tax revenues from the oil of North Sea oil production are based on this BNOc price. Sometimes the Secretary of State for Energy and the Chancellor will put discreet pressure on BNOc to squeeze this price up somewhat, in the interests of increasing North Sea revenue. In doing so they may make BNOc's price on the high side so far as maximising its own profits are concerned, since these are largely based on the term price *even ('mark-up') it* makes when it buys oil from its suppliers and sells it to refiners and distributors.

I am told that the theory is that BNOc is wholly independent and that its term prices should be totally determined by the market. But the practice is as I have described above. Much is at stake, since an increase in BNOc's term price of 50 cents a barrel brings in £125m. to the Treasury.

MUS

20 July 1982

SV

Prime Minister (2)

ms 16/7

01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1

13th July 1982

Handwritten signature/initials

BNOC TRADING AFTER THE SEPARATION OF BRITOL

With the enactment of the Oil and Gas (Enterprise) Bill, we are proceeding with the steps necessary to privatise BNOC's upstream interests. We need at the same time to formulate clear guidance to those who will be in charge of the continuing public sector trading operation. My officials have therefore prepared the attached note which covers the Corporation's general objectives, certain specific duties, financial structure and financial targets, and reporting and control. The note has been prepared in a form in which it could be published if necessary.

It may be helpful if I explain the thinking behind the note.

(i) Objectives

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mt
Apart from contributing to security of supply, the Corporation's most important role will be in setting term prices for UKCS crude at levels which maximise overall public sector revenues from our North Sea oil production, even though that might sometimes result in a trading loss. BNOC are in no doubt about this. However, too bald a statement to this effect could prejudice the Corporation's independent standing and the status of its prices as market, rather than Government determined prices.

(ii) Initial capital

It could be argued that, since the Corporation will not be doing any investing, and will be expected at least to cover its costs from its gross trading profits, it will have no need for any financial reserves. I am persuaded, however, that it would be unreasonable to give BNOC nothing but a guaranteed overdraft to accommodate swings in its trading position. This is because - particularly in the short run - trading in participation oil is subject to considerable market fluctuations; if it had no reserves the Corporation would have to seek fresh grants from Government whenever it went through a period of trading difficulty.

The result would be an exceptional degree of dependence in the short run on Government support, and the Corporation would clearly be seen as having no standing in the market independent of the Government. Leaving aside any other difficulties, I do not believe we could secure and retain competent people to run the trading operation if we insisted on a regime of this kind. How large the reserves should be is a matter of judgment in which ordinary commercial precedents are of little value; I believe that £30 million would give the Corporation a reasonable prospect of avoiding the need to ask Parliament for fresh grant money for several years.

(iii) Financial target

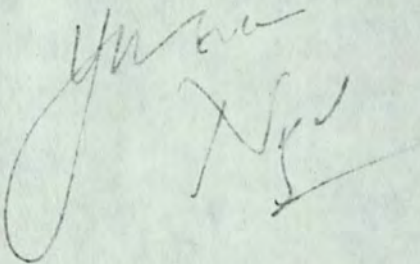
We shall be lucky if the trading operation as such does much better than break even, taking one year with another. As emerged clearly from officials' recent work on oil production and pricing in weak market conditions, BNOG - whether before or after the separation - cannot earn significant profits on trading in participation oil, since it is obliged to buy the oil from the Companies at the full market price, but it remains exposed to the risk of significant losses. Assuming, however, that BNOG's earnings cover the administrative costs of participation trading, the Corporation should be able to show an overall profit through the investment of its reserves. The financial target is designed in effect to require the Corporation to break even on its trading activities; I would envisage using the powers in the OG(E) Act periodically to extract from BNOG the cash generated through the investment of its reserves. If, against our present expectations, the trading results were markedly better than break even, then of course we should require the Corporation to pay over larger amounts.

(iv) Limits on trading activities

Paragraph 4(i) of the guidance note records that BNOG's business plan will cover the general sales strategy and the extent of the risks to which the Corporation might be exposed. I attach great importance to ensuring that BNOG does not get deeply involved in risky trading activities; indeed it is highly desirable that the Corporation should actively seek ways of reducing the risks inherent in its present operations. I should by now have preferred our officials, with BNOG, to have defined and set limits to the risks to which the Corporation may be exposed at any one time. However, those responsible in the Corporation have had to give their main attention in recent weeks to aspects of privatisation - the participation arrangements with Britoil and the preparation of the scheme. I consider that BNOG Trading's activities not connected with participation should be restricted to their present levels for the remainder of this calendar year. BNOG and my officials will meanwhile re-examine the Corporation's trading strategy, with the objective of devising new and more relevant limits to take effect in 1983. In particular, I shall be considering - although I am by no means certain we can achieve this - whether the limits might be set by reference to the financial exposure on transactions, rather than, as hitherto, limits to the physical volume of business over a period without any regard to risk.

Now that the Prime Minister and other colleagues have accepted my proposals for the Chairman and Chief Executive of BNOC after the flotation of Britoil: and the Chairman's appointment has been announced, I should like to convey the guidance formally to Lord Croham and Ian Goskirk as soon as possible. I am anxious to ensure that there is no loss of confidence or reduction in commitment on the part of the trading team on account of doubts or uncertainties about what the Government expect from them in future. I hope, therefore, that you and others will be able to agree to my proposals within the next few days.

I am copying this letter to the Prime Minister, other members of E(NI) and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Nigel Lawson', is written over the typed name. The signature is fluid and cursive, with a large loop at the beginning.

NIGEL LAWSON

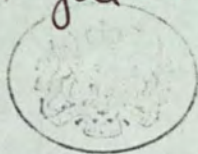
JUL 1982



Energy Assoc
file Pt 5

with
MCE

Pl attach



CF

To all recipients
of letter.

Secretary of State
for Energy

14 / 7 / 82.

We copied you a letter from
us to Geoffrey Howe MP about
BNOC Trading after the Separation
of Britoil on 13th July.

Attached is the Enclosure that
should be with the letter. If
you could please attach this I
would be most grateful

DeTupper.

APS/SOS for Energy
Nigel Lawson's office
Thames House South.

BNOc AFTER THE SEPARATION OF BRITOil

1 General objectives for BNOc


- (i) Through participation, to secure and dispose of UK and UKCS petroleum in a way which contributes to our national security of supply.
- (ii) Through effective trading and marketing, to ensure that the UK economy receives the maximum benefits from BNOc's access, through participation rights, to UK and UKCS petroleum. A simple guide may be to seek to maximise sales revenue for participation oil.
- (iii) To trade profitably in all non-participation petroleum and petroleum products. 'Trading' may include the arrangement of shipping and of processing, although the Corporation would be expected not to seek to invest in ships or in refining and processing.

2 Specific duties not covered by the general objectives

- (i) To act as the Government's agent in the sale of oil taken as royalty in kind (RIK). (Although some small fields are being excluded from RIK, oil will continue to be available in future from this source on roughly the present scale.)
- (ii) To discharge the requirements of the agency agreement covering the Government pipeline system.

3 Financial structure and financial target

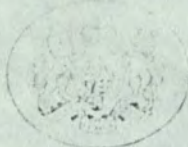
- (i) After disposing of its upstream assets BNOc will be provided with £30 million of retained profits.
- (ii) The Department of Energy with Treasury consent will arrange to guarantee short-term borrowing facilities of up to £50 million on terms similar to those enjoyed by other nationalised industries.

- 
- (iii) BNOC and the Department are agreed that a financial target set in terms either of annual percentage return on assets or a percentage on turnover would not be appropriate. BNOC will instead be asked to earn a net surplus pre tax of £10-15 million* over its first four year period, after meeting all its administrative and other costs.
- (iv) The Oil and Gas (Enterprise) Act contains powers for the Government to make grants to BNOC, to support the participation agreements. While the Government would not expect to be called on to provide grants of this kind frequently, BNOC would not, in the event of it making a loss too large to be covered by its own resources, be expected to rely for more than a short period on additional short-term borrowing.
- (v) The Oil and Gas (Enterprise) Act provides powers for the Corporation's profits to be recouped by the Exchequer. It is expected that these powers would be used either if BNOC generated continuing surpluses or if circumstances allowed a single large profit to be made.

4 Reporting and control

- (i) BNOC will submit to the Department of Energy not later than April each year a business plan covering the following four calendar years. Following discussion at official level, this will be submitted, subject to any necessary modifications, for the approval of Ministers not later than June. The business plan will cover the general sales strategy, and the extent of the risks to which BNOC might be exposed, as well as figures on forecast physical availabilities and projected financial results.

* The exact figure will be determined in the light / (ii) of a re-evaluation currently being made of BNOC (Trading)'s financial prospects by the company's accounting advisers.

- 
- (ii) An updated version of the business plan covering the immediately following calendar year only will be prepared each October. Unless it is invalidated by unforeseen changes in market circumstances, this will provide a yardstick for assessing the Corporation's trading performance.
 - (iii) Six-monthly consultations will be held with the Department as hitherto.
 - (iv) Each quarter in January, April, July and October, the Department of Energy will review formally the trading results for the most recently completed quarter together with the prospects for the next two quarters ahead.
 - (v) The Chief Executive will report every month to the Corporation on trading results, plans and opportunities.
 - (vi) Each month the Corporation will provide a funds flow statement to the Department of Energy.

7 July 1982

Energy

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DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-2123301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

15 January 1982

Rt Hon Nigel Lawson MP
Secretary of State for Energy
Thames House South
Millbank
London SW1P 4QJ

Dear Nigel,

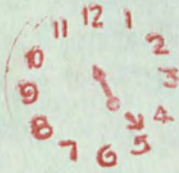
BNOC'S ACCESS TO BRITOIL'S OIL

Thank you for the letter of 14 January dealing with the terms of a participation agreement between BNOC (T) and BRITOIL when plans to privatise the oil-producing business of BNOC are implemented. I am content with the proposals.

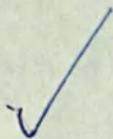
I am sending copies of this letter to the Prime Minister, the Secretary of State for Scotland, the Attorney General, the Lord Advocate and Sir Robert Armstrong.

Yours ever
Patel

15 JAN 1982



*With the compliments of
the Attorney-General*



NBPM ycl

*Attorney General's Chambers,
Law Officers' Department,
Royal Courts of Justice,
Strand. W.C.2A 2LL*

01 405 7641 Extn. 3201

2/2 JV
AD

Energy



15 January 1982

Dear Nigel

Your letter of 14 January to Geoffrey Howe concerning the proposed participation agreement between BNOC(T) and Britoil arrived here late yesterday. As I indicated on the telephone, there is no way in which I can give you any legal advice on a problem of this complexity by noon today.

On the same day, without any prior warning, I received a lengthy case to advise from your lawyers which was of course copied to the Lord Advocate. James and I are extremely concerned over the novel elements in this agreement and the consequential Treaty of Rome implications. We must get this advice right and we will need to confer. James will be in Court in Luxembourg for most of next week, therefore you cannot expect considered advice within the next ten days.

However, I shall do my utmost to form some preliminary view before Tuesday's debate. I must emphasise that this will be at best preliminary and may well be changed after I have had an opportunity to consider the proposal in detail and consult with James.

I am sending a copy of this letter to the recipients of yours.

May I beg of your Department to give us reassurance which is a different case like this.

Yours
Michael.

Rt.Hn.Nigel Lawson M.P
Secretary of State for Energy.

Handwritten: Prime Minister

Handwritten: MS 25/1

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

CONFIDENTIAL

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

Handwritten signature

14 January 1982

Dear Chancellor,

BNOC'S ACCESS TO BRITTOIL'S OIL

Back in July, E agreed that ENOC should acquire a normal 51% option over Britoil's oil so as to put it on the same footing as other independent oil companies covered by participation agreements. It also accepted that those agreements, which give access to 51% of North Sea oil, are essential to our policies on oil pricing and security of supply.

In most cases where BNOC or BGC has an equity interest in a licence, ENOC has participation options to less than 51% of the private licensees' oil. In such licences, options to 51% of Britoil's oil will not give ENOC(T) access to 51% of all the oil produced from that licence. At the extreme, ENOC(T) has no options to any of the oil produced by private licensees from the 5th and 6th Rounds and therefore participation of 51% in Britoil could reduce Government access to only 25% of the total oil produced from such licences.

There can be no question of seeking options to additional oil from the private licensees. Their co-operation is essential to the privatisation of Britoil; they have every reason to suppose that the current arrangements fully satisfied the previous administration's requirements; if we were to come back for more, we would imperil the whole exercise. It is my view that we equally cannot seek more than 51% of Britoil's oil in affected licences of the first 4 rounds. To seek 51% of the total licence production would add insignificantly to our security of supply, increasing ENOC(T)'s oil by only some 2m out of 46m tonnes. But it would reduce Britoil's availabilities to less than half of what that company would have under 51% participation and might effectively destroy its marketing independence.

It is more difficult to know what to do with the 5th and 6th Round licences. In principle there could come a time when nearly all the UK's oil would be produced from those licences and seeking only 51% participation in Britoil could reduce government access to only 25% of total UKCS production. In practice, only Clyde will be producing from such licences this decade, and the acreage and its prospects are such that it is extremely unlikely that

production from those licences will ever predominate. In any case, if it does so, it will probably not be until next century. Nevertheless, I judge that we should not expose ourselves unnecessarily to the charge of diluting the Government's access to oil. I accordingly propose to require BNO(T) and Britoil to set up a participation agreement which will give the former access to up to 51% of all the oil from those licences. Insofar as BNO(T) or Britoil can obtain additional oil from private licensees in the 6th Round through use of BNO(T)'s special privileges such as rights to call for additional oil or increase equity, such oil would be allowed against the 51% and thus Britoil could be sure of retaining some of the licence production.

I shall have to announce my intentions in general terms in the Second Reading Debate next Tuesday on the Oil and Gas (Enterprise) Bill. I shall need to let Mr Shelbourne know them in advance. Unless I hear from you by noon on Friday 15 January, I shall assume that you and other colleagues are content with my proposals.

I am sending copies of this letter to the Prime Minister, the Secretary of State for Scotland, the Secretary of State for Industry, the Attorney General, the Lord Advocate and Sir Robert Armstrong.

Yours sincerely,

Janet Chadwick

PP NIGEL LAWSON

(Approved by the Secretary of State
and signed in his absence)

† 4 JAN 1982



PART 4 ends:-

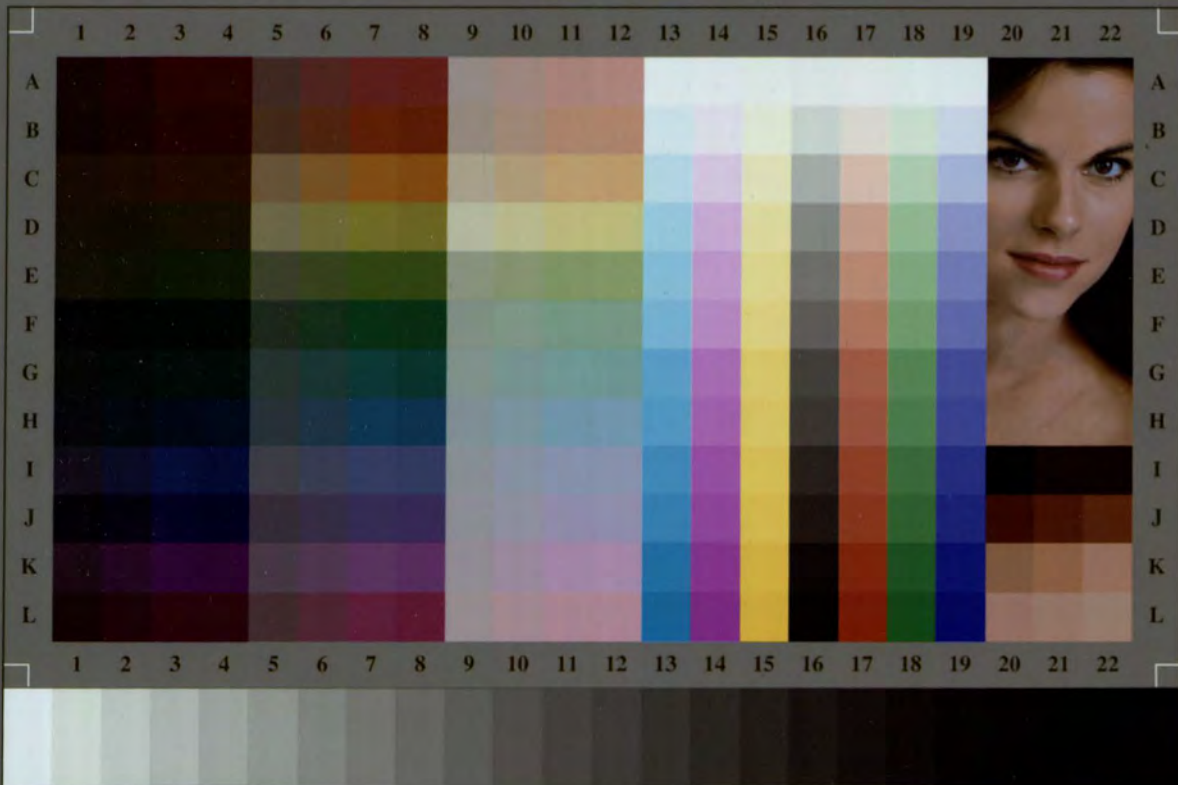
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PART 5 begins:-

s/s Energy to ch of Ex of 14/1/82

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