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Ref. A0737

PRIME MINISTER

BNOC - Future Structure and Private Sector Participation

(E(79) 67 and 68)

BACKGROUND

17.7.79 24.7.79

The Committee agreed in July (E(79) 5th and 6th Meetings) to a considerable curtailment of BNOC's powers, although it decided to keep the Corporation in existence. At that time it was still the intention to sell a substantial part of the Corporation: oil field assets. In September (as the Secretary of State's paper says) the Committee agreed (E(79) 7th Meeting) not to sell physical assets, but to a forward sale of oil yielding £500 million (since increased to £600 million). At the same time, the Secretary of State secured agreement that he should bring forward separate proposals for private sector participation in BNOC's production operations.

2. Unfortunately, it has taken him two months to formulate these proposals and discuss them with you. You saw him on 14th November. Until he had your approval, he had been reluctant to talk to BNOC at all. He has thus had less than a week to discuss his proposals with the Corporation, get figures from them, agree them with the other Departments, and circulate a paper. As a result, the paper is late, deficient (the original financial annex had to be withdrawn and recirculated) and in some respects unclear.

3. The proposal, which is not very different from the one you saw last week, is to divide the Corporation in two ('trading' and 'operating' subsidiaries); to retain the 'trading' operation in the public sector so as to give the Government an instrument for influencing the supply of North Sea oil in the United Kingdom; to keep all the existing up-stream assets in the 'operating' company; to dispose of 75 per cent of the shares in 'operating' over the next two years; to hold open the option of a 'British Columbia' style free issue of the second tranche of shares; to remove Government from the management of 'operating'; and to make a number of other changes in the present statutory framework for North Sea operations.

4. The CPRS paper identifies the three main questions on which they suggest Ministers should focus: the potential cost to the PSBR; the problem of getting the best price; and the risk that the split will make BNOC's operations harder to defend against the Commission. It ends by recommending that Ministers need more time to consider these proposals.

5. Mr. Howell's timetable, however, is to get a decision in principle now; to consult other colleagues on detail during December and January; to bring a Bill to Legislation Committee early in February; and to introduce it and get a Second Reading before Easter. If this timetable slips much, the option of legislating in the present Session may be lost (because of the congestion at the end of the Session) if indeed it is still realistically available.

6. This would not have mattered, on the original Treasury plans for next year (they assumed that there would be a further £500 million worth of disposals, none from BNOC). But if the public expenditure figures for 1980-81 are to be reopened, as seems likely now, a flotation of shares in BNOC could be a useful supplement. Ministers might prefer to forgo the longer-term benefits of holding on to BNOC (to which the CPRS draw attention) in order to reduce the number of very nasty decisions they would otherwise have to take next year. You will want to weigh up these factors at the end of the meeting.

HANDLING

7. You might say at the beginning that you intend to focus discussion on the three questions raised by the CPRS. You might then ask the Secretary of State for Energy to introduce his paper, and then call for comments from the Chancellor (or Chief Secretary); from the Lord Privy Seal (in the absence of the Foreign Secretary); and from Sir Kenneth Berrill.

8. You might then divide the discussion under the three headings proposed by the CPRS.

(a) The potential costs to the PSBR. The essential choice is between jam today and jam tomorrow. There are two sorts of jam. First, the proceeds from the sale of the shares where the question is whether realisation price of BNOC at this stage will fully reflect its future earning power (a similar point to that which arose over the sale of BP shares). Second, the cash flow of BNOC which under present arrangements comes to the Exchequer whenever it is surplus to their requirements, whether or not a dividend is declared. There is room for argument about the point at which privatisation affects this latter flow. The technicians would argue that the Company stays in the public sector until its shares are more than 50 per cent in private hands. But even before this point is reached the private participants might well object to BNOC's spare money being provided to the Exchequer. The Committee will not wish to get bogged down in these technicalities. But they will want to be sure just what trade-offs there are between present and future gains to the Exchequer. Annex 1 provides some information but (despite being the second effort) is still far from clear. The comparison between options 1 and 2 in the Annex should be made by comparing line "(a) PES capital expenditure programme" in option 1 with the final line of the table in option 2. (The essential differences between these numbers and those quoted in the first table of option 1 are that they are at "survey" rather than "outturn" prices and that they exclude the tax take which is constant in each case.) It is also worth noting that the apparent lack of proceeds from privatisation in option 3 is a technicality. There are proceeds, but they would be counted as a contribution to financing the PSBR rather than a reduction in the PSBR itself.

(b) How to get the best price. Mr. Shelbourne's memorandum, at Annex 3, sets out the options in great detail. Although the Treasury has been involved, with the CPRS, the Bank of England has not yet been brought in. There is obviously a lot of detailed work to be done. Essentially, Shelbourne proposes a two-stage operation by two successive underwritten Offers for sale, in successive years. The second could include the 'British Columbia' option, but you have made it very clear to Mr. Howell that you do not favour this course - which is complex, bureaucratic and expensive. (Paragraph 16 of his paper suggests that he himself is now less enthusiastic). He also suggests that it could have a wider application than BNOC. You will not want the Committee to chase this hare which could, if necessary, be remitted to E(DL) for further study - though whatever it merits it is too late in the disposals operation to change the way in which e.g. BA or BAe shares are to be sold. Certainly E itself cannot, and should not try to settle issues of this kind at this meeting.

(c) How to minimise EEC interference. The CPRS worry is that the division of BNOC into two will make the operations of the 'trading' company more transparent and thus more liable to attack. (There is a subsidiary objection too: that the trading company will be a much less viable operation without the profits of the operating end to cushion it against fluctuations). The legal advice is summarised, very opaquely, in Annex 2. The FCO were only consulted yesterday, and have considerable doubts about all this. They already feel that they were not properly consulted about the forward oil sale and the subsequent arrangements with BP, both of which risk running foul of the Treaties; and are anxious not to repeat this mistake.

OTHER ISSUES

9. As the CPRS says, other Ministers may wish to raise other points on these proposals. For example, if the Committee decides to take its profits in the short term, and dispose of part of BNOC, why not sell the lot instead of retaining 25 per cent? Or (as I think the Chief Secretary may propose) why not simply turn the whole BNOC operation into a Companies Act company, and sell 49 per cent of the shares, retaining control? These and other options could be explored in more detail if time allowed. There are also a number of subsidiary changes to the law, listed in Annex 5, which have apparently not been discussed with Departments in any detail.

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10. In the light of this part of the discussion, you may want to take stock, towards the end of the meeting, and decide whether the timetable allows more leisured considerations. If so, the options are:-

(i) Invite Mr. Howell to go away, discuss the issues with the other Ministers concerned, and report back to the Committee just before or just after Christmas with either an agreed proposal or a properly worked out display of the options.

(ii) To remit the issues to E(DL); (this will not help much: because calls on the Chancellor's time in the next few weeks are almost as great as those on your own).

(iii) To agree in principle now on the split of BNOC, on the need for large realisations in 1980-81, and on the need to minimise the EEC complications, and instruct Mr. Howell to devise a scheme which meets these objectives, agreeing the details with Ministers involved, and bring a complete Bill to L as quickly as possible (this is his own preferred course).

11. I doubt there will be sufficient consensus at this meeting to allow of course 3 which gives Mr. Howell almost a free hand. In that case, I think that course 1 is the best, even at the risk of setting back the legislation slightly.

CONCLUSIONS

12. In that event, your conclusion might simply be to invite Mr. Howell, in consultation with the Ministers concerned, to formulate worked out proposals, or options, in the light of the Committee's discussion, and to bring a fresh paper to the Committee just before Christmas. [This means a meeting after your return from the United States on 18th December.]

RtA

(Robert Armstrong)

23rd November 1979