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PRIME MINISTER

Future of BNOC  
(E(79) 20, 21, 22 and E(DL)(79)6)

BACKGROUND

There are no new circulated papers for this meeting, but you will want to read again the Secretary of State for Energy's minute of 18th July; the Chancellor's comment on this dated 19th July; the Chancellor's minute of 20th July reporting discussion in E(DL); and the Attorney General's minute of 20th July. The Foreign and Commonwealth Secretary, who is in Brussels with the Lord Privy Seal, has also recorded his views (minute of 23rd July).

2. Following the discussion in E on 17th July, there have been a number of bilateral talks, and a meeting of E(DL) on 19th July. As a result of the latter, the Attorney General held private talks with BP's lawyers, reported in his minute. The Ministers concerned are meeting again under the Chancellor's chairmanship on Monday afternoon 23rd July. In addition, there was some brief discussion of these points at your Monetary Seminar on 18th July.

3. Decisions are now needed in four related areas:-

- (i) The future role of BNOC, and the first steps on dismantling the Corporation.
- (ii) The sixth round of licensing.
- (iii) Disposal of BNOC assets, this year and later (and possibly also sale of BGC assets).
- (iv) Disposal of BP shares.

HANDLING

4. You might take each of these in turn:-

- (i) The future role of BNOC. Mr. Howell's proposals are set out in E(DL)(79) 6, and in his minute of 18th July. You might take the three main functions in reverse order of difficulty:-



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- (a) Advisory Role. Mr. Howell wants to scrap this, and to remove BNOC from the operating committees. One oil company has recently described BNOC's presence on these committees as 'like having the camp commandant sitting in on the escape committee'. But the Chancellor sees some value in continued BNOC membership. It provides a source of information on pricing; costs; and oilfield development. It is worth remembering that the two proposals do not necessarily hang together. BNOC could lose its role as statutory adviser to the Government and still retain membership of the operating committee if advantage were seen in this course.
- (b) Participation. Assuming at least some reduction in BNOC's up-stream role, continuation of the participation agreements is central to a continued trading role for BNOC. It is argued that this trading role gives the Government greater control over the disposition of oil in an emergency. Your own view so far has been against continuing the participation agreements. It is also relevant that the way in which they were obtained was doubtfully legal under Community Law: although in practice it has never been attacked. However, the majority of the Ministers consulted (notably the Chancellor, the Secretary of State for Energy and I think also the Lord Privy Seal) think this function should continue. Incidentally, although it is alleged that BNOC has compounded our oil supply difficulties by excessive export of oil, BP exported half as much again in the first half of 1979. And BNOC, unlike BP, has rapidly unwound its export commitments, entered into earlier in the interests of getting the best price for the Treasury.
- (c) Upstream. It is common ground that some at least of the upstream equity interests should be sold: the question is one of degree. Mr. Howell argues that to go too far will emasculate the Corporation. It will no longer be a credible trading partner.



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There is a case, which the Foreign and Commonwealth Secretary might have deployed were he present, for retaining some exploration and development capacity for 'strategic' purposes - e. g. to block French ambitions in the disputed South Western approaches, or to explore and then sterilize prospective oilfields in the interests of depletion policy. These arguments would point against a block sale to BP. In addition, some of your colleagues may doubt whether BP could or would play this 'chosen instrument' part. To do so would carry some risk to its credibility as an independent multi-national and the company has always fought shy of identification with the British Government. Moreover membership of the EEC rules out overt direction of BP on oil supply quite apart from the Government's self-denying ordinance in the shape of the Bradbury/Bridges correspondence.

It should now be possible to reach a final decision on these three points, in order to allay uncertainties and allow planning to go forward. In that case, a number of secondary points arise:-

- (d) Establishment of a Subsidiary Company. Mr. Howell proposes this (minute of 18th July) and the Chancellor sees no serious difficulty (19th July). It was originally proposed as a first step towards the introduction of private capital. It would go equally well with a block sale to BP (although it would not help with the 'pre-emption' problem - see below). It would not facilitate, and might slightly complicate, the task of a partial disposal: although presumably a subsidiary company could just as easily sell a limited number of assets as could the parent corporation.
- (e) The Chairman. Lord Kearton has made it clear that he wants to go quickly. Any potential successor will need to know the size of the job he is taking on. It may also affect the appropriate level of salary. (Kearton does not draw his.) It will not be



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possible to announce a new chairman before the Recess: but early steps should be taken about selection. You may want to pursue this separately after the meeting.

- (f) Public Announcement. If agreement can be reached on the main points above, there is every advantage announcing it early. It would help with the presentation of the sixth round decision - see below. It would also provide a framework for the disposals package. But - on the Attorney's advice - it will be important not to announce in advance the destination of the assets.
- (ii) Sixth Round Licenses. If BNOC is to have no major continuing upstream role, it is common ground that it need not be given any further licenses - at least at present. The preferred option is therefore to grant the sixth round licenses which have already been allocated in principle; to let BNOC take up temporarily the rights which these licenses grant them (because this is the basis on which applications have been made, and the Attorney advises that to change them at this late stage would involve retrospection) and to disentangle BNOC from each license separately as soon as possible thereafter. The Chancellor, the Secretary of State for Energy and the Attorney all prefer this course. || The alternative would have been to hold up the allocation of this extra licenses, at some risk of delay to the development of the North Sea. But allocation in this way involves some explanation of why BNOC is still involved. It might be possible to make a holding statement, that BNOC's future role was still under consideration: but it might equally be preferable to put this into a broader context by announcing decisions on the future of the Corporation - as above. || No decision need be taken or announced at this stage about the seventh round, which Mr. Howell mentions (18th July): this will raise important questions of depletion policy to which the Committee should return in the autumn. Similarly his request in a separate minute to you of 20th July to announce a new approach to licensing policy should await the Committee's consideration of depletion strategy.



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- (iii) Disposal. There are, as the Chancellor says in his minute of 20th July, three packages available, though they overlap to a degree (e. g. even full disposal to BP leaves a gap to be covered by the sale of BP shares if the full £1 billion is to be obtained).
- (a) Complete Disposal to BP. Sir David Steel has told you that he is prepared to buy the lot. He would like to do so by taking up shares in a subsidiary. But this may have been based on mistaken advice. The Attorney General (letter of 20th July) does not believe this will help resolve the 'pre-emption' problem. There seems little alternative to negotiating away separately the existing rights of some 35 partners, some of whom may very well object to an enlarged role for BP. (Paradoxically, they prefer the less-powerful BNOC as a partner). There would be difficult problems of valuation, though these are not unprecedented. Some form of reference to independent arbitration might be necessary. The net yield could well be less than the purchase price, because of the need to net off the Government's share of any future rights issue: alternatively, the Government would prejudice its ultimate control of BP. The net benefit to the PSBR might be smaller still, because of the effect on BP's tax liabilities: these have yet to be worked out in detail. BP would require a formal reaffirmation of the 'Bradbury/Bridges' relationship, which would be publicly difficult to reconcile with the continued control over disposal of oil. It might not be possible to complete the transaction in the present financial year: but the 'seminar' thought that provided the deal were agreed in principle, and a substantial down-payment made, this need not necessarily matter.



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(b) The smaller disposal package. The fields involved, in order of preference, are Viking, Statjford, Dunlin, Murchison & Ninian (or part). The Attorney has confirmed that all of these raise 'pre-emption' problems. (In the case of Ninian, these do not arise if the disposal is part of a total package: but that does not help much). Still, the chances of negotiating ones way out of the limited number of agreements in a limited time must be better than that of the total package. You might ask whether creation of a subsidiary company would make this route any more difficult? (Probably not). Mr. Howell will also argue that disposal on this scale, while still leaving BNOC with upstream liabilities, will turn it into a loss-maker. This is a question of timing, not of substance: Her Majesty's Government would be bringing forward, in the form of a capital payment, the future cash flow from the fields disposed of: the 'losses' would in fact be BNOC's share of future investment in its continued fields, which would in due course yield additional revenue. In any case, his objection applies with much less force to the sale by BGC of Wytch Farm; you might try to reinstate this in the smaller package. He has argued that BP do not want it (for fear of complicating their relations with BGC) but there is no reason why Shell should not take it on: or it be sold to a city consortium established for the purpose.

Either course needs legislation. The Committee should therefore confirm policy approval for statutory powers to direct BNOC to divest itself of substantial parts of its assets. These clauses can be added to the Industry Bill, being introduced shortly after the Recess. No such powers are needed to direct BGC to sell Wytch Farm.

(iv) BP Shares. Even if the decision has been to risk the 'whole hog' sale to BP, there will still be a short-fall on the Chancellor's original £1,000 million. You will not want to take a final decision at this stage on the extent of the sale of BP shares which may be needed. Equally,

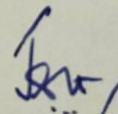


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you will not want, I suggest, to let the chance of selling BP shares go by default. The Bank of England advice is that even a partial sale of the present BP holding will get a better price if payment is received in two tranches at 3-month intervals. Leaving some margin for market manoeuvre, the latest date for the offer is therefore about end-October: and several weeks' preparation are involved. You might be prepared to authorise the Chancellor to proceed, so far as can be done without public disclosure, with the preparation for such a sale. There are then a number of subsidiary questions, about the allocation to existing employees and to small shareholders, which could be left to him and the Financial Secretary: the Committee's general intentions on these points are already well known. If necessary, this Committee, or E(DL) could look again at any remaining problems (e.g. sales to foreign investors) in September, before any public action is needed. You will want to reserve the final decision on the sale for your own consideration.

CONCLUSIONS

5. I suggest you aim to record conclusions on the four main points above:-
- (a) The future role of the Corporation, including its advisory role, its participation/trading role; and the extent of its upstream involvement; the creation of its subsidiary company; the selection of a new chairman and a need for a statement.
  - (b) Sixth round: whether or not to go ahead with the present allocation, and what sort of announcement to make.
  - (c) Disposal: whether to go by the "sale to BP" route, or with the smaller package, and if so, the content of a smaller packet; in either case, confirming policy approval for legislation
  - (d) Keeping open the option of selling BP shares by instructing the Chancellor to proceed with preparations for a possible sale.

  
(John Hunt)

23rd July, 1979