Ref: A0927

CONFIDENTIAL

PRIME MINISTER

BNOC: Future Structure and Private Sector Participation
(E(79) 80)

BACKGROUND

This will be a continuation of the discussion at the meeting on 26th November (E(79) 15th Meeting) about Mr. Howell's proposals for BNOC. Summing up that discussion, you said that the Committee's first impressions were favourable and invited Mr. Howell to discuss his proposals further in detail with Ministers concerned, and to report back.

2. Mr. Howell favours splitting BNOC into two companies, BNOC (Production) and BNOC (Trading) and selling 75 per cent of the shares in BNOC (Production) to the public, over a 3-year period. BNOC (Production) would become a private sector company with a Government shareholding (held on behalf of Government by BNOC (Trading)).

3. There are really two questions. Does it continue to make sense to pursue the reorganisation of BNOC on the lines proposed by Mr. Howell and hitherto favoured by colleagues? If so, how much of BNOC (Operating) should be sold to the public?

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4. The first question has been thrown into doubt by Sir Ian Gilmour's minute of 3rd December questioning the extent to which the proposed arrangements for BNOC (Trading) are proof against challenge from the EEC. Mr. Howell dismisses this worry in his paper subject to the comments of the Attorney General (which were not available when his paper was written). The Attorney will be present and will be able to advise the Committee.

5. There is however a further point (which Sir Kenneth Berrill may make) about the possible role of a unified BNOC both as an instrument for the effective sale of North Sea oil and for the potential undertaking of Government to Government deals with OPEC countries. This last is of rapidly-growing importance (and in the papers before your meeting last Friday on the IEA Mr. Howell argued for permission to explore the possibilities of such deals).

Provided there are no legal snags (and again the Attorney can advise) they could be a means by which BNOC could help BP (and Shell) over OPEC's shift away from the oil majors. Of course if colleagues were to be convinced that circumstances had changed enough to militate against the splitting of BNOC the contribution it might otherwise have made to the PSBR will have to be found in other ways, e.g. from the sale of physical assets.

6. If colleagues confirm the general framework of Mr. Howell's proposals the question then arises whether the aim should be a sale of 75 per cent of BNOC (Operating) - as Mr. Howell prefers - or of 49 per cent, thus retaining clear Government control. The argument will revolve around option (b) in Annex 1 (75 per cent sale) and option (c) (49 per cent sale). The choice depends both on political attractiveness and on the effect on the Government's finances. The former is a matter of opinion. The second is a matter of arithmetic.

7. Mr. Howell's case for a 75 per cent sale rests on the calculations in the Annex. Although complex in appearance, what they really say is that the more of BNOC is sold the bigger the immediate cash gain and the larger the longer term cash loss. The cash benefits are allegedly compared in paragraph 4 of the Annex and those describing the relative impact of option (a) as against option (b) are soundly based. The comparison with option (c), however, is distorted by the technicality that if only 49 per cent of BNOC (Operating) is sold, the receipts from sale do not reduce the PSBR but increase the funds available to finance it. Mr. Howell, therefore, omits them from option (c) whereas they are included in option (b). The 'missing' receipts could amount to about £600 million over a 3-year period. Bring them into the account and the advantage of option (b) over option (c) becomes clearly negative in net present value terms.

8. Colleagues may feel that despite Mr. Howell's efforts they need further clarification of the financial implications before coming to a decision. If so a working group under Treasury chairmanship with members drawn from Energy, the CPRS and possibly BNOC ought to be able to produce a quick and clear display of the options.

9. Timing. Mr. Howell's proposals will require legislation, which would be controversial. You will want to enquire whether, in the present crowded timetable, it is realistic to expect the legislation to be introduced and passed in this Session.

HANDLING

10. You might open the discussion yourself by pointing to the two basic issues described above - whether to follow Mr. Howell's route at all and, if so, to what extent.

11. You might then ask Mr. Howell to introduce his paper, and seek comments from Lord Carrington, Sir Michael Havers and Sir Kenneth Berrill before inviting others to take part.

12. If the Committee have serious doubts about the wisdom of proceeding by Mr. Howell's general route at the present time the rest of the points at issue fall. The problem then will be to set in hand further work to resolve the doubts or to find a new way forward. The right course would probably be to commission a full-scale inter-departmental study under CPRS (or possibly Treasury) chairmanship. We could let you have specific proposals for this after the meeting.

13. If on the other hand the Committee want to press ahead on the lines indicated by Mr. Howell, there will be one major and several minor issues outstanding. The major point will be the proportion of BNOC (Operating) shares to be sold. Unless a very clear preference emerges you might like to propose an official working group on this issue on the lines of paragraph 8 above. Additional points which will need to be covered are:-

(a) How much access should BNOC(Trading) have to BNOC (Operating)'s oil? This is discussed in Annex B of the paper. Mr. Howell does not seek a decision, but asks for colleagues' views. You might take some discussion on this, but leave the position open for subsequent correspondence. But you should note that if BNOC (Trading) are given a 100 per cent option on BNOC (Production) oil then it may well leave the Company inside the PSBR net (see 3(d) of Annex B). And it would reduce the price obtainable.

(b) What detailed legislative proposals should be agreed? These were discussed in Annex 5 of the previous paper (E(79) 67). They include some tidying up clauses, as well as the main requirements. Colleagues might be asked to deal with these in correspondence.

14. Equally unless the Committee is able to provide a clear view on the timing of legislation you may want Mr. Howell to explore this with the Chancellor of the Duchy of Lancaster and let you have a note on the possibilities and prospects.

CONCLUSIONS

15. These will very much depend on the course of discussion. Paragraphs 12, 13 and 14 above provide a checklist.

RtA

(Robert Armstrong)

11th December 1979