Prime Minister

The Foreign Secretary and Lord Privy Seal would, of course, be able to attend. There is an FCO interest. Can Mr Ridley come instead?

Yes MT 10/9

Ref: A0197

CONFIDENTIAL

PRIME MINISTER

BNOC Disposals (E(79) 36)

Although I have bracketed this on the Agenda with the Chancellor's paper (E(79) 31), you will probably find it convenient to take the BNOC paper first. If you can secure agreement on the Energy proposal, you can then score £400 million safely before moving on to discuss the Chancellor's proposals for raising the rest of the money.

BACKGROUND

1. Earlier discussion on this subject stretched over several meetings of E and E(DL) and resulted in an instruction to Mr. Howell to go away and find £400 million in the current financial year, from disposal of assets rather than by any other financial device. He has since had extensive talks with BNOC and BGC, and with BP (and some of this has leaked into the Press). You discussed this with him last week, with results reported in your Private Secretary's letter of 5th September; you might also look again at the note from the Chancellor's Private Secretary of 7th September. The net position is that the Secretary of State can find his £400 million, but not necessarily in the current year; that (subject to detailed checking) the Chancellor is prepared to accept this, provided that the shortfall could be made good temporarily in the present year; but that the sale of BNOC assets will be quite difficult and has some nasty side effects.

HANDLING

2. I suggest you ask the Secretary of State for Energy to introduce his paper, and then, before too many general comments from other Ministers, try to structure the discussion around these questions:-

(a) Can the £400 million be found by sales of Viking and Statfjord? - OK.

The BGC option has dropped (though perhaps Mr. Howell is unduly conscious of Sir Denis Rooke's susceptibilities). So he proposes to raise the whole of the money from sale of Viking, Gas. and associated developments, and of Statfjord. (N.B. this is the BNOC interest on the British side of the line, but because the field is unitized, this requires the agreement of all the partners, among whom Phillips is the predominant one). There are four main problems:-

(i) BNOC's declared opposition. There is no doubt that the Corporation will lose staff, and quite possibly some Board members if this sale goes through. Since it is now agreed Government policy to keep BNOC in being, on a reduced scale, this is a factor: but Mr. Howell is prepared to accept the risks.

(ii) The chances of getting a good price. BNOC themselves regard these as sub-commercial deals, and will say so. They will require a direction. This is a political issue. There will be a major Parliamentary row (see Mr. Callaghan's remarks at the week-end): but this may be tolerable.

(iii) Timing. It is pretty clear that a transaction of this scale could not be completed in the current year notably because of the uncertainties about the gas interests associated with Viking, and about Statfjord. So the acceptability of the package turns on the acceptability of the bridging operation - see below.

(iv) The role of BP. The Committee was strongly inclined, last time, to make sure that these assets ended up with BP. It will not necessarily follow that the Government can control the oil as effectively: BP exports more oil than BNOC and will continue to do so. But the bulk of the planned disposals are of gas, which has perforce to land in this country. More serious is the net effect on the PSBR: any purchaser would offset the purchase cost against tax liabilities, but because BP's profitibility is currently so high, the tax loss would be particularly great. You might probe the Chancellor's views on this. (It may be that the interest saved by having £400 million in cash will largely offset the loss of revenue.)

The device proposed for ensuring that BP pays a fair price is also questionable, but should be all right. You might see whether the (Mr Ridley) Lord Privy Seal (in the Foreign Secretary's absence) is content.

(b) Is there a viable alternative i.e. by selling oil forward?

Mr. Howell touches on this in paragraph 10, but does not specifically recommend it in paragraph 13. However, BNOC are pressing hard in private for a series of forward oil sales as a permanent alternative to the disposal of assets. They argue that it will have the same effect on the PSBR, without involving loss of control or of future profitibility. You might see whether Mr. Howell wishes to pursue this point seriously. If so you will need to check with the Lord Privy Seal about the possible impact on OPEC practice - see the Chancellor's Private Secretary's letter of 7th September.

(c) Is the forward sales device useable as a short term bridging operation?

Subject to the same OPEC point the forward oil sale device might be considered as a temporary bridging operation even if it is not acceptable as a permanent solution. The Chancellor's provisional view (which needs to be confirmed after work by officials) is that if BNOC sells its own oil forward, the proceeds will help to reduce the PSBR; whereas if the Government sells its royalty oil, this will not. Provisional CSO advice confirms this. The real point however is that if permanent asset sales cannot be achieved this financial year and if the forward oil sales device is not acceptable, then either the Chancellor has to abandon the £1,000 million target for this year (with the consequences pointed out in his own paper) or something else has to be sold, probably more BP shares.

CONCLUSIONS

3. The most likely outcome of the discussion seems to be that the £400 million worth of assets should be sold, in the way proposed by the Secretary of State for Energy (paragraph 13(i) and (ii)); and that the PSBR target in 1979-80 should be temporarily bridged in the method proposed at paragraph 13(iii).

4. In any case, the Committee should take note that the Secretary of State will be making further proposals about a new capital structure for BNOC.

(John Hunt)

10th September 1979

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