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PRIME MINISTER

Introduction

You are meeting Sir David Steel on 16 July with the Chief Secretary and myself. I was asked at E(DL)3rd meeting to explore with Sir David Steel his reaction to a number of options whereby BP might take an interest in or take over BNOC's upstream assets.

... I have had two meetings with Sir David, and attach a copy of the note which he prepared as the basis for our second discussion.

You will want this.

... 2 I am also attaching by way of background the papers on the future strategy for BNOC which I have circulated to colleagues for discussion at E Committee on 17 July. The two points I would like to emphasise as background to our discussion with Sir David Steel, which are covered in these papers are:

- (i) the essential contribution that a state oil trading operation with access to the oil available under participation agreements can make to securing our oil supplies;
- (ii) the options for BNOC's upstream operation which range from a preliminary slimming down, prior to introduction of private capital, to outright disposal of all its upstream assets.

3 The options which are covered by Sir David Steel in his note show ways in which BP might help us in meeting our objectives for

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BNOC's upstream side with minimum disposal to foreign owners depending on the policy decisions which may be taken about BNOC's future.

BP's views

4 As you will see BP's clear preference is for outright acquisition by BP of all of BNOC's upstream assets, and it is the implications and feasibility of this approach that the note concentrates on, and which I have developed in my discussions with him. I have not thought it necessary at this stage to probe closely BP's reasons for preferring this option, nor the implications of the other options, although if in subsequent consideration of the matter with colleagues we come to the view that the outright disposal of all BNOC's assets to BP is unacceptable, then we are still at liberty to pursue the other options with BP, and Sir David has expressed himself ready to do so at any time.

5 I think we should be quite clear that if BP's preferred solution were to be accepted as being consistent with the future role which we envisage for BNOC, its execution would be a very high risk course, and would give rise to a number of difficult problems. You may wish therefore to concentrate discussion with Sir David on the problems that might arise from his preferred option, and I note these below together with my comments in the light of my discussions with him:

- who?
- a) Price: Negotiation of an agreed price is accepted by BP as likely to take time - in BP's view hanging mainly on our respective views of future oil prices. BP suggested this might take 2-3 months. This may be a

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serious under-estimate; the oil price is only one of a number of important parameters that will have to be considered including estimates of recoverable reserves, production profiles and BP's tax position. (There is no point in getting a good price out of BP if the Inland Revenue simply foots the bill). It is essential that we should be able to demonstrate publicly that we have realised the full value of BNOC interests, and that BP have not got anything on the cheap. It is equally important that BP accept that their interests too would not be served by an apparently very favourable deal, since this could expose them to future political pressures.

- b) HMG's relationship with BP: BP would want the Government's traditional non-interference in BP's commercial affairs to be reaffirmed. With such a large stake in the UKCS accruing to BP (including BNOC's interest approaching 22% of reserves and 24% of licensed territory) I doubt whether in practice the sort of arms length relationship that BP has sought to maintain could or should be continued at least in respect of UK oil operations.
- c) Partner pre-emption rights: BP accept that if assets are transferred to BP by the assignment route, BNOC's partners rights of first refusal could make for extremely protracted negotiations lasting as much as a year. BP suggest that the assets are vested in/<sup>a</sup>BNOC subsidiary whose shares are then acquired by BP. This certainly

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disposes of the pre-emption rights, but such a move should expose HMG to criticism that we had used a transparent device to circumvent the contractual rights of BNOC's partners.

- d) 6th Round Licences: None of these licences has yet been confirmed. BP's view was that partners would welcome BP instead of BNOC (this may well not be true of small companies in particular). Nonetheless BP would not wish to take on the benefit of the various carried interest provisions which applicants had offered BNOC. I remain dubious about pressing ahead with transferring these licences to BP on the grounds that the substitution of BP for BNOC in the licences almost simultaneously with their issue, could be regarded as invalidating the licences. I think we would have to seek the specific agreement of BNOC's partners case by case.
- e) BNOC staff: BP confirmed that it saw no problem in absorbing management all the way to heads of operational divisions and would say so at the start. The top management would be more problematical. BP accepted that the period of uncertainty between announcement of the plan and completion should be kept to a minimum and that we should try to settle the main lines of the deal before announcement. This would probably mean deferring an announcement until October (which would also mean deferring an announcement about our plans for future licensing, with a further risk to North Sea momentum.)

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/f) Finance:



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(f) Finance: BP's preference is for a rights issue to raise the bulk of the necessary finance; this would involve us in either reducing our holding in BP, or using a major part of the proceeds of sale of assets to take up our rights. Whatever financing package emerged BP think a rights issue raising a minimum of £500 m would be needed.

(g) Timing and Legislation: BP would be willing to start work on detailed negotiations as soon as HMG had declared its intentions. Any deal would have to be conditional on the passage of the necessary legislation. This would need to be introduced as soon as Parliament reassembles. If BP's suggestion for avoiding pre-emption right difficulties ( (c) above) is adopted then BP think there should be no problem in securing proceeds of sale by end March 1980. If not there would have to be a large payment in advance.

6 You may wish to probe BP on all these points. I should add that while BP may consider that from its point of view there should be no difficulty in disposing of all the problems outlined above within the timescale envisaged, the same problems may prove much more difficult for us to overcome from our side, especially where solutions may be politically sensitive. In this context I am ... attaching a note prepared by my officials which examines the problems

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that we will have to overcome. Perhaps none of these problems is insurmountable. But there is a serious risk of chaos if anything goes wrong.

7 A copy of this note goes to the Chief Secretary.

*D.A.*

SECRETARY OF STATE FOR ENERGY

5 July 1979