

John Walker

Prime Minister

Qa 04254

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To: MR LANKESTER

From: SIR KENNETH BERRILL

I think the idea of forward sales should be vigorously pursued. This will take care of the Chancellor's PSBR problems in 1979/80. For 1980/81, I think we should now consider 'privatisation' of BNOC as an alternative to selling off assets: politically easier and it can bring in as much money.

Disposal of Energy Assets

1. When this item is discussed tomorrow by 'E' Committee I would urge the Prime Minister to pay particular attention to the forward sale of the North Sea oil aspects of this question. This is covered in the Secretary of State for Energy's paper but is not given quite the full attention it deserves - in part because the proposal surfaced only recently and in part because when Mr Howell wrote his paper it was not completely clear that such forward sales of oil would count against the PSBR, but that has now been resolved.

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10/9*

2. We start from the need to obtain £1 billion to help reduce the PSBR in the present financial year, of which £700 m. must come from some combination of BP shares and the North Sea. The whole of £700 m. could be obtained by selling forward a large part (but by no means the whole) of BNOC's 1980 oil from the North Sea. The terms of the forward sale would be that the Government (through BNOC) would be paid for this oil at the beginning of the year rather than for delivery during the year. In exchange for this payment in advance the oil companies concerned would be guaranteed a supply of North Sea oil for their UK refining operations to the value of £700 m. for periods of between 3 and 5 years. At the end of these periods the payment would revert to the normal timing.

3. This is in fact early payment in exchange for security of supplies to the company's UK refineries. Clearly, when the period of each undertaking expires the Government will have to wait awhile before it begins to get paid again. But this problem can be spread over 2 or 3 years by

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varying the timing of the contracts and the problem will be eased by increases in the volume of North Sea oil and by any increase in the price of oil per barrel.

4. From the Government's point of view the advantages of such forward sales are two-fold. Firstly it is the only way in which, in practice, the Chancellor can get £700 m. by next March. The sale of BP shares will raise money within this timescale but the sale of any North Sea assets will take appreciably longer.

5. As has already become apparent, BNOG will be a most unwilling seller and will argue for a high price; the value of the assets will vary from buyer to buyer according to the buyer's corporation tax position; BP are aware that the Government wants to sell only the British company; BNOG wants to sell gas, whereas BP want to buy oil - it all has the makings of a long drawn out and unpleasant operation.

6. But apart from forward sales having the advantage of getting the money into the Chancellor's hands quickly they do provide the alternative of being not just a temporary substitute for the sale of assets, but a complete substitute. Given Minister's' unhappiness at being forced to sell BP shares and the practical difficulties of selling BNOG assets the advantages are great.

7. It is important to realise that since Ministers' first discussed the sale of BP shares and the sale of North Sea assets to BP, the circumstances of that company have greatly changed. A year ago BP was in the comfortable position of having 180 million tons of crude oil worldwide and needing only a 100 million tons for their own refineries. The events in Iran, Kuwait and most recently Nigeria ^{the} have changed this dramatically. BP now have appreciably less than 100 million tons they need and may be forced to pay high prices in the spot market in the coming year to meet their needs.

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8. The market is just beginning to appreciate this position which is likely to affect the BP's ability to purchase North Sea assets on a large scale without a rights issue. Besides having implications for the sale of BP shares and the sale of North Sea assets to BP, this new position makes it very important to try to make any North Sea oil which is surplus to the UK's requirements available to BP for overseas refining so as to help a major British company with its difficulties. This last is not an issue immediately before Ministers but it, together with the reorganisation of BNOC, will be important questions in the immediate future.

9. I am sending a copy of this minute to Sir John Hunt.

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KENNETH BERRILL

10 September 1979