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MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BNOC: IMPLICATIONS OF DISPOSAL OF ASSETS

Memorandum by the Secretary of State for Energy.

The discussion at E(DL) on 5 July made it clear that colleagues are most anxious to pursue the possibility of outright disposal of at least part of BNOC's upstream assets, and wish if possible to see the assets disposed of to British companies - in particular to BP.

2. Disposal of BNOC's interests in Viking and Statfjord, disengagement from many of BNOC's 5th and 6th Round Licence obligations and the introduction of private capital are important elements in the proposed strategy for BNOC as set out in my paper E(DL)(79)6. As stated, one objective in such disposals would be to secure, as far as possible, that the assets were transferred to British hands.

3. E(DL)(79)7 sets out the particular considerations relevant to the outright disposal of BNOC's assets to BP. The important conclusions from this paper were

(i) Transfer to BP of BNOC's rights under participation agreements, even if feasible, was inconsistent with my proposed policy of securing control for the state of as much of UKCS supply as possible.

(ii) The extent to which outright disposals of BNOC's <u>upstream</u> assets should be sought is a question that needs to be resolved by reference to the future role envisaged for BNOC. (E(DL)79)7 made clear my view that outright disposal of all upstream assets would be inconsistent with the future role for BNOC proposed in E(DL)(79)6 - but there are no overriding legal or practical objections to such a course.)

(iii) If decisions are reached to seek buyers for all or part of BNOC's upstream assets, then BP is an obvious potential purchaser, but a sale exclusively to BP might weaken the Government's negotiating position on price. Moreover there are difficulties in BP taking on all BNOC's obligations under 5th and 6th Round licences, and the other partners in these licences might have serious reservations about BP assuming such a dominant position.

4. This paper examines in more detail the constraints on disposal of BNOC's upstream assets whether in whole or in part, to BP or elsewhere, and the possible timetable for such disposals. I will be reporting separately on my discussions with Sir David Steel on the possible options with regard to disposals to BP.

Need for legislation

5. The Attorney General has advised that legislation will be needed to give me the power to direct BNOC to dispose of any of its major assets. Even if it seemed possible that the Corporation would be willing to co-operate in a disposal programme without a specific direction, the advice of the Attorney General is that we would still need legislation to effect any major disposal. I conclude therefore that as a preliminary to any disposal programme we need to legislate to secure the necessary powers.

6th Round of Licensing

6. This may give rise to particular problems. The concluding stages of the Round have been reached, and we are on the point of confirming the first batch of awards. But I have held this confirmation up pending Tuesday's discussion. This is because announcement of a commitment on the part of the Government to see BNOC's interest in the Round relinquished whether in favour of BP or other companies, coming soon after confirmation of the award of licences could be seen as changing the basis upon which applications had been invited so radically as to invalidate the licences, and possibly leave us open to challenge. This is a point touched on by the Attorney General in his letter of 10 July.

7. Accordingly the problem cannot be solved by delaying the Round at this stage and inviting applicants in due course to accept licences which included BP or any other 3rd party instead of BNOC. We would have to cancel the round and lose a year's or more exploration effort. We would also run the risk of claims by the applicants against the Government for wasted effort and expense incurred in preparing and supporting their applications, and in negotiating work programmes and joint operating agreements. More importantly, cancelling the Round would set back our plans to step up the pace of UKCS exploration activity. Some companies are ready to start drilling.

8. In my view therefore we must press ahead with confirmation of 6th Round awards recognising that, although there are no rights of first refusal for partners of any transfer of interest, nonetheless partners consent to a transfer of interest must be obtained and any relinquishment by BNOC of such interests (whether to BP or elsewhere) will therefore have to be undertaken cautiously on a case by case basis; each case being dealt with in close consultation

with co-licensees, with a view to obtaining their explicit endorsement of whatever arrangements are made. This may mean that we cannot achieve transfer to BP (or any other recipient of our choice) of all BNOC's 6th Round interests, although we should if possible avoid leaving BNOC with any of these interests, if it is to lose all of its other upstream stakes.

Assignment constraints

9. The scope for making sales of individual interests acquired under 1st to 5th Rounds of licensing may be constrained by the provisions of operating agreements between partners. Generally these agreements give partners the right to first refusal of an interest to be disposed of by way of an assignment. Where this provision exists it usually gives partners the right to match an offer for the interest made by a third party. But this provision need not prevent the asset being disposed of to a third party provided that party is willing to pay a competitive price for it. Much would depend on the determination of individual partners to acquire a greater interest. Two general points are relevant

(i) Any assignment requires my consent, and this could be a powerful weapon in steering disposals in a desired direction.

(ii) The assignment provision could be circumvented by arranging that the interest in question is disposed of not by means of an assignment, but by means of sale of shares in a company owning the interest. Thus if it were intended that all or part of BNOC's assets were to be sold to BP, then these assets could be vested in a subsidiary of BNOC, the shares of which would then be sold to BP. This would have important political and commercial implications and would need to be presented in the context of Government policy for the development of our offshore oil resources.

10. Annex A examines in detail each of the individual BNOC assets available for disposal, and any constraints there may be on disposing of them. The broad conclusion from this detailed examination is that the main part of the Thistle interest is the only one not subject to some partners pre-emptive rights.

Other practical constraints

11. Any disposal programme would need to be so devised as to avoid leaving BNOC with a group of unsaleable assets with major unfulfilled exploration obligations (i.e. 5th and 6th Round licences). It would also need to ensure that any sale of assets for which BNOC is operator (e.g. Thistle, Beatrice, 30/17b) should not prejudice the continuing efficient management of the fields in question.

Timing

12. The timing of a disposal programme will depend on the scale, the range of potential buyers considered, their interest in acquiring assets and the willingness of partners to forego their rights of first refusal to assignments. In the case of sale of a small number of field interests negotiation over terms could possibly be completed within 6 months provided a willing buyer was found. This could proceed in parallel with early introduction and passage of the legislation needed to secure the powers to dispose of assets. Such powers would be incorporated in the Industry Bill planned for introduction after the summer recess.

13. Sale of all the assets to BP would be a much more laborious and complicated process, the timing of which would need to be handled with great care. We would need to avoid announcing our intention to sell to BP until BP was in effect committed to the deal otherwise our negotiating position with BP would be severely weakened. This suggests that similarly we should defer introducing legislation until BP's commitment had been secured. Negotiation of price for all the assets concerned could be protracted taking us into 1980/81. An alternative approach to securing BP's irrevocable commitment might be to reach a binding agreement to negotiate or if unable to agree to refer to an independent expert. Negotiation of such an agreement would also be complicated - in that it would have to set out very closely defined terms of reference for the arbitrator; but it could probably be completed within this financial year. We would insist on BP making a major downpayment on signature, in order to achieve some realisations in 1979/80, although BP would probably resist paying much above half the probable final sum (say half of £1000m), and might insist on the legislation being enacted before making any such payment. Whatever route chosen negotiations would require a major commitment of manpower resources from the Department supplemented by the use of outside advisers, e.g. merchant bankers and lawyers.

Summary

14. (i) Legislation will be needed to enable BNOC to dispose of assets whether to BP or elsewhere.

(ii) Partners pre-emptive rights to assignments where they exist, may slow the process of disposal down, but need not inhibit sale to chosen buyers.

(iii) It may be necessary to proceed cautiously with disengagement from 6th Round interests to avoid invalidating the Round.

(iv) BP is an obvious purchaser for major acquisition from BNOC, but exclusive negotiations with BP may depress the price, and there are difficulties in relation to BNOC's 5th and 6th Round interests.

(v) Sale of Viking and Statfjord could possibly be achieved in 1979/80 provided the legislative powers were taken as part of the Industry Bill. Total disposal to BP within that timescale would be more problematical, although an early downpayment could probably be secured.

Recommendations

15. I ask my colleagues to

(a) take note of these points, in considering both the future strategy for BNOC, and the scope for disposal of assets

(b) endorse the confirmation of 6th Round awards on the basis set out in para. 8.

D.A.R.H.

Department of Energy.

13 July 1979

ANNEX 1

Table 1 attached sets out the valuations of BNOC's main field interests. The following sections describe BNOC's relationships with partners in these fields and in its other licence interests.

Beatrice

BNOC is operator for this field which lies in block 11/30. Its partners are Kerr McGee, Hunt (both US companies), Deminex (West German) and P & O. BP has agreed terms to acquire P & O's 15% stake. First oil is expected in 1981 and the estimated recoverable reserves of the field are 21 million tonnes of which BNOC's share could be about 5 m. tonnes. The operating agreement does not require partners to be given first refusal of assignments.

Dunlin

This field extends into 2 blocks, 64% in block 211/23 held by Shell and Esso, and 36% in block 211/24 held by BNOC, Gulf and Conoco. Shell is the operator. Production started in August 1978. Recoverable reserves are presently under re-assessment but they could be of the order of 80 m. tonnes of which BNOC's share could be about 13 m. tonnes. The combined effect of BNOC's operating agreement with Gulf and Conoco, and the Unitization Agreement covering all the participants in the field, is that BNOC must secure the consent of all participants to an assignment of its interest, and must offer Gulf and Conoco first refusal.

Murchison

This field extends over the median line into Norwegian territory. About 84% is on the UK side held by BNOC, Gulf and Conoco, and about 16% is on the Norwegian side. Conoco is the operator. First oil is expected in 1980 and the estimated recoverable reserves of the UK sector of the field are about 43 m. tonnes of which BNOC's share could be some 14 m. tonnes. Under the Northern Waters Operating Agreement between BNOC, Gulf and Conoco, BNOC must offer its partners first option to acquire its interests on assignment.

Ninian

This field extends into two blocks; 74.04% in block 3/3 held by Chevron, BNOC, ICI, Murphy and Ocean (both US companies) and 25.96% in block 3/8 held by BP, Lasmo Scot (a British consortium) and Ranger (Canadian). Chevron is the operator. Production started in December 1978 and recoverable reserves are estimated to be 155 m. tonnes of which BNOC's share might be about 34 m. tonnes.

The operating agreement relating to block 3/3 provides that BNOC must offer its partners first refusal for any assignment proposal unless the assignment is part of a disposal of all or substantially all the party's UKCS assets. However the Unitization Agreement which governs relations between the two groups of participants in the blocks in which Ninian lies does not oblige partners to be offered first refusal. It is not clear whether or not the Unitization Agreement cancels the assignment provisions of the operating agreement, but partners may well consider that it does not, and hence that the rights still exist.

Statfjord

This field extends over the Norwegian median line. About 11% is on the UK side in two blocks (211/24 and 25) held by BNOC, Gulf and Conoco; about 89% is on the Norwegian side. Mobil is operator. First oil is expected this year and the estimated recoverable reserves of the UK sector of the field are about 45m. tonnes of which BNOC's share could be some 15 m. tonnes. BNOC's agreement with regard to assignments is exactly the same as for Murchison above.

Thistle

This field for which BNOC is operator extends into two blocks. Most of the field is in block 211/18 held by BNOC, Deminex, Burmah, Santa Fe (US) Tricentrol, Charterhouse and Ultramar; and the remainder in block 211/19 held by BNOC, Gulf and Conoco. Production started in February 1978 and estimated recoverable reserves are about 73m. tonnes of which BNOC's share might be some 14 m. tonnes. There is no obligation on BNOC to offer its partners first refusal of a transfer of its interest through block 211/18. However the operating agreement for 211/19 does require BNOC to offer first refusal of this interest to Gulf and Conoco, and even though the Unitization Agreement covering the two blocks makes no such provision it seems likely that Gulf and Conoco would consider that the provisions of the operating agreement still obtained. (Similar to the Ninian situation).

Viking

This is a gas field. Conoco holds the other 50%. The gas is committed to BGC on a long-term contract providing for the price to be related to the price of oil and the UK Wholesale Price Index. Production started in 1972 and is now running at over 5000 million cubic metres/year which is equal to about 4m t.o.e/year and about 15% of total UK gas production.

The operating agreement requires a partner wishing to assign to a third party, to give its existing partners first right of refusal.

Hutton

This field, which is presently under appraisal, lies across the licence boundary between block 211/28d held by BNOC, Conoco and Gulf and 211/27 held by Amoco, Gas Council and Mobil. Conoco is the potential operator. First oil is expected in 1983/84 and on initial estimates the field could have 40 m. tonnes of recoverable reserves of which BNOC's share might be 8 m. tonnes. The terms of the operating agreement with regard to assignments in block 211/28 are identical to those for Murchison above.

Brae

Pan Ocean is the potential operator for this field, presently under appraisal, which lies in block 16/7d. The Pan Ocean Group comprises BNOC, Pan Ocean, Ashbrae Finance Ltd., LL and E (all US companies), Bow Valley, Canadian Ashland and Sunningdale (Canadian) Saga (Norway) and Siebens (UK). First oil is expected is 1983/84 and on initial estimates the field could have 35 m. tonnes of recoverable reserves of which BNOC's share might be some 7 m. tonnes. The draft operating agreement does not require partners to be given first refusal of assignments.

30/17b

This is a BNOC-operated, Fifth Round discovery (under appraisal) on block 30/17b held by BNOC, Shell and Esso. First oil is expected in 1984/85 and on initial estimates the field could have 30 m. tonnes of recoverable reserves of which BNOC's share might be just over 15 m. tonnes. The terms of the operating agreement require BNOC to offer first refusal of assignment to other partners.

Other Licence Interests

Of the 62 1st to 4th Round blocks not included in fields presently under development or in production 17 are covered by the Northern Waters Agreement which requires BNOC to give its partners first refusal of assignments. There are similar provisions in agreements covering a significant number of the remaining 1st to 4th Round blocks.

In general, under the 5th Round Joint Operating Agreements, BNOC's licence partners have first option to take up any interest which BNOC seeks to assign, except where the assignment would otherwise be to BGC (or to a BNOC subsidiary or affiliate), and so long as they are willing to meet the terms negotiated with any other prospective assignee, 6th Round JOAs do not include this provision: BNOC's license partners do not have first option and only need to be satisfied of the financial capacity of any proposed assignee.

TABLE 1

BNOC'S UPSTREAM ASSETS

1. BNOC's main field interests are:

Field	% Interest	Net present value £m	Figures to 1984 only: Capex outstanding £m	Net Revenue foregone £m
Beatrice	23	12 - 45	55	85
Dunlin	16	115 - 150	20	150
Murchison (UK)	33⅓	75 - 160	80	190
Ninian	22.12	360 - 450	110	530
Statfjord (UK)	33⅓	40 - 100	60	105
Thistle	18.94	145 - 175	30	180
Viking	50	48 - 50	n.a.	n.a.
Hutton	20	0 - 30	75	5
Brae	20	0 - 12	95	35
30/17b	51	0 - 60	160	120

The NP values shown represent the range of prices which might be achieved, on the basis of two cases: (a) the lower price case is based on an oil price constant in real sterling terms, and taking a discount rate of 15%. (b) The higher price case is based on an oil price rising at a real rate of over 4% a year in the long run, taking a discount rate of 10%.