PRIME MINISTER

THE FUTURE OF BNOC

The Chancellor of the Exchequer and I have been considering the future of BNOC in the light of the discussion in E Committee on 13 March (E(80)9th Meeting, Item 2). The Committee felt unable then to endorse our proposals to establish an independent company owning all BNOC's North Sea assets in which the general public would have the majority share. We would now like to discuss with you the next steps.

Our officials have produced the paper attached which sets out the options, including the option of leaving the present arrangements (other than the changes already announced of ending BNOC's special access to Government finance through the National Oil Account, removing its statutory role as adviser to the Government and abolishing its privileges vis-a-vis other oil companies). The paper is long, but it is a useful assessment of all the likely schemes. It also discusses BNOC's own ideas set out in a letter from their former Chairman, Mr Utiger, also attached.

Against the background provided by the paper we think the choice is between the following schemes:

Scheme C - a new independent upstream company in which BP would have a substantial interest (for which they would pay the Government in shares), 25-33 per cent of the shares in the new company would be sold to the general public with the public sector retaining 25-33 per cent.

Scheme E - a revenue interest scheme under which BNOC stays as a public corporation but the public are given the opportunity - through oil production bonds or similar instruments - to share in a percentage of the oil revenues from some or all of BNOC's fields.

Scheme G - the sale of say 75 per cent of shares in a company owning a part of BNOC's oil field assets (with perhaps BP taking a substantial interest in that company as in C). This would produce a smaller version of the independent upstream company in C, but an integrated though smaller BNOC would be retained; it would be up to us to decide how much smaller.

The status quo.

The main considerations

We think that the main considerations governing the choice of scheme are:

(i) The need for national control over oil at a time of evident and increasing political and trading turbulence and uncertainty in the oil markets. The Chancellor feels that this is the message coming from the Summit. In practice under schemes C and G control would not be relinquished over much oil (only 4m tonnes under C and less under G) since the BNOC participation agreements would still give access. But would people understand this or would they simply resent it as "selling our oil"?

(ii) There is also the question of whether we wish to split trading from upstream operations. The integrated pattern wo uld be lost under scheme C, but retained completely under E and to a lesser extent under G. The Chancellor considers that it is only as long as BNOC retains an integrated capability that HMG can be reasonably sure of using BNOC as an effective lever in negotiations about North Sea oil policy (including tax) with the big oil companies, many of them foreign, whose interests understandably do not always coincide with Government's.

(iii) The very difficult PSBR problems, particularly in 1981-82 would be helped by a sizeable contribution from BNOC privatisation. Schemes C and G could be devised to produce a reduction in the PSBR of some £400m in 1981-82. Further reductions would depend on the timing and extent of sale by the Government of BP shares and - in the case of G - on which BNOC assets were put into the new upstream company. All such reductions would be at the expense of increases in the PSBR in later years. Scheme E would finance, not reduce, the PSBR; it could be used to raise anything between £200m to well over £1bn. But any of these schemes could prove over the longer term to be an expensive way of raising money for the Government compared to a conventional fixed interest gilt issue. A £ raised under all three schemes has very broadly the same effect on the money supply.

(iv) Scheme E is in accord with my firm statement to introduce private capital into the Corporation, except that the private capital would not be in the form of shares in a Companies Act company. It would also allow the private interests to be very widely spread. Schemes C and G would privatise a substantial element of the Corporation's business. Retention of the status quo could not be reconciled with the public commitment to private involvement.

Our conclusions

If BNOC is to stay as a wholly public corporation, my strong preference is for option E rather than the status quo. E fulfils our political commitment and retains an integrated company although I would wish to see the two 'halves' made more distinct within it. If we go for an independent upstream company, I would on balance favour G (with a BP element) before C. The Chancellor accepts it could be politically difficult to withdraw from our commitment to introduce private capital into the Corporation; although the political attractions of that position might not be very durable if the passage of legislation coincided with a major upheaval in oil supplies. He has, however, real PSBR difficulties, particularly in 1981-82 which make it desirable to proceed with at least one of the options if possible. If asked to choose he would prefer G to C, but would be willing to settle for a limited issue under E if it was judged necessary to do something and yet maintain Government control over the Corporation and its full capability as an integrated company. His only question is whether even this last option might prove difficult to defend in the face of developing political concern about control of oil in a volatile world.

Timing of announcements

Subject to the wider political considerations I would see much advantage in announcing our decision to Parliament as soon as possible and certainly before the Recess.

We should be glad to discuss all this with you.

I am sending a copy of this minute to the Chancellor of the Exchequer.

DH

SECRETARY OF STATE FOR ENERGY
4 JULY 1980