cc A Duguid
A Walters
J Vereker

Energy 1

Prime Minister
You have already agreed in principle to these proposals. The Chancellor, Flag A Foreign Secretary (C) and Sir Keith Flag B also support them, though the Chancellor and Foreign Secretary have a few caveats. Can I tell other members of E that you are content for the Howell to proceed?

NB I M 9/7

M. 17/7

Yes MT

PRIME MINISTER

BNOC: SALE OF SHARES

As you know, I believe the time is ripe to press ahead with plans to privatise the oil-producing business of the British National Oil Corporation (BNOC).

It fits squarely into our wider strategy. There is a strong political demand for it. We have the full co-operation of the Chairman of BNOC, Mr Shelbourne.

M. 27/7

I attach a memorandum seeking colleagues' agreement to my proposals and to an announcement of our intentions when the Petroleum and Continental Shelf Bill to which we are committed as a high priority is given a Second Reading next Session.

I understand that you would like this matter, which we have already discussed thoroughly on a number of occasions, to be cleared by correspondence out of Committee.

I am accordingly circulating this minute and my memorandum to other members of E Committee, Sir Robert Armstrong and Mr Robin Ibbs, and would be grateful for early approval of my proposals. The timetable for this major exercise is very tight.

DH

Secretary of State for Energy
July 1981

MEMORANDUM BY THE SECRETARY OF STATE FOR ENERGY

BNOC: SALE OF SHARES

1. I propose that we should press ahead with plans to privatise the oil-producing business of the British National Oil Corporation(BNOC).

DECISIONS SO FAR

2. We have already decided:

a. that BNOC's oil-trading activities should remain in the public sector: E(79) 6th meeting. Its participation agreements with oil companies, which give access to 51 per cent of North Sea oil, are essential to our policies on oil-pricing and security of supply.

b. that statutory powers should be taken to enable us to privatise BNOC's upstream operations: E(79) 6th and E(80) 32nd meetings. Legislation has been deferred twice because of pressure on the Parliamentary programme. The Petroleum and Continental Shelf Bill, now published, contains these powers and we are committed to its reintroduction next session as a high priority.

c. that North Sea Oil Bonds linked to revenues from BNOC's oil should be launched this autumn: E(80) 32nd meeting. These national savings certificates, designed to give the small investor a chance to share in our North Sea wealth, will be complementary to privatisation but no substitute for it.

3. We now need to decide the main features of the scheme to be implemented, so that preparatory work (which is complex) can go ahead and I can explain our plans when the Bill has its Second Reading. Unless we reach decisions, privatisation of BNOC in the lifetime of this Parliament will not seem credible either to our supporters or our opponents when the Bill is reintroduced.

PROPOSED APPROACH

4. The legislation envisages the transfer of BNOC's oil-producing operations to a subsidiary company formed under the Companies Acts in which shares are then sold to the public. This will establish a lively new British oil company, relatively small by multi-national standards but with good prospects, free to

by participation agreements. BNSO would retain commercial freedom to dispose of the rest of its oil (likely to be about 4 million tonnes a year).

12. Secondly, I would want BNSO to be proof against unacceptable changes in control which might prejudice its character as an independent British oil company. The possibility of it passing into foreign hands will be particularly sensitive in Parliament. Although discrimination against nationals of other EEC Member States would breach the Treaty of Rome the advice of merchant bankers is that the necessary safeguards can be secured without infringing our international obligations by giving BNOC certain passive reserve powers in BNSO's Articles which could be used in time of crisis, together with the right to appoint up to two directors. The conditions attached to offshore production licences would also give me relevant powers, for instance if there was a change in the control of BNSO or the location of its central management or if there was a disposal of its licence interests to a third party. See Annex B.

13. Thirdly, it would be desirable if BNSO could retain the "flagship" quality of a national oil company in its overseas dealings, particularly in developing countries but also in Europe. This quality should largely be ensured by BNSO's origins, name and minority BNOC (or Government) shareholding, but it is also envisaged that there should be a supporting provision in the Company's Articles and Memorandum.

14. Finally, arrangements for the carrying on of BNOC's trading activities, including transitional arrangements, will need further consideration.

TRANSFERRING BNOC'S ASSETS

15.. Transferring BNOC's upstream business to a subsidiary will be a major task because of the complexity of the many legal agreements governing these activities.

16. In earlier discussions we assumed that the separation would be achieved by negotiations with BNOC's partners, a process expected to take at least a year or more but not regarded as insuperable. BNOC now consider however that because of the delay in the legislation it is not certain that privatisation could take place in the lifetime of this Parliament if we follow this route.

17. It is difficult to quarrel with this conclusion given the complexity of the agreements and the risk that oil companies would seek to exploit the tight timetable for negotiations. I therefore propose that the provision in the Bill enabling BNOC to transfer interests to the upstream subsidiary for the purposes of disposal should be expanded to enable BNOC to make a scheme for that transfer which, subject to my approval, would bring about a statutory vesting of those interests, thereby cutting out the negotiations with BNOC's partners. There will still be problems to be overcome but this should greatly shorten the timetable whilst enabling us to keep the Bill very much in its present form.

TIMETABLE

18. Merchant bankers advise that we should aim to float the new Company, BNSO, in the course of next year and that the sooner we can do so after Royal Assent the better the prospects for a successful launch. An illustrative timetable is in Annex C.

19. Timing will depend on world oil and stock market conditions but the legislation should be enacted as soon as possible, to keep our options open. Apart from the modification in paragraph 17, a further minor adjustment on which I shall be consulting colleagues shortly and detailed drafting changes, the Bill is now ready. I shall be seeking agreement that it should be reintroduced as soon as practicable in the new Session. Preparations for setting up and floating the Company will need to go ahead in parallel with the passage of the Bill.

FINANCIAL IMPLICATIONS

20. BNOC's merchant bankers have valued the upstream Company at £1,500 million or more, so that the sale of a 51 per cent holding if carried out in one tranche could raise £750 million to the benefit of the PSBR in 1982/83. There will be a loss of surplus cash of £60 million in 1983/84 but the Corporation expect to have a positive requirement for external finance from 1984/85 onwards. So the loss of cashflow over the next few years is not significant compared with the potential benefits to the PSBR from the sale. Indeed the main benefit of BNOC to the Exchequer in this period is through the tax system and this will not be affected.

CONCLUSIONS

21. Privatisation of BNOC's upstream operations will be the largest exercise of its kind that we undertake as well as the most complex. Time is short and the work must go ahead now.

22. I seek agreement to the proposals in this paper and to an announcement of our intentions when the Petroleum and Continental Shelf Bill is given a Second Reading next Session.

DH

July 1981

INDEX OF ANNEXES

Note

Further background material and discussion of relevant issues are in earlier papers for the Committee including:

E(DL)(79)6
E(79)67 and E(79)80
E(80)22, E(80)80 and E(80)95

BACKGROUND INFORMATION ABOUT BNOC

1. BNOC was established on 1 January 1976 under the Petroleum and Submarine Pipe-lines Act 1975.

UPSTREAM ACTIVITIES

2. BNOC began its upstream operations in 1976 when it took over the North Sea assets of the National Coal Board and Burmah Oil Company. Since then it has acquired other extensive licence interests, both by purchasing interests from third parties and through the 5th, 6th and 7th licensing rounds. The 5th and 6th rounds both gave BNOC a 51 per cent interest in all licences.

3. As a result of its acquisitions BNOC has equity interests in the following North Sea fields:-

	BNOC Share %	
Thistle	18.9	in production
Dunlin	9.8	"
Ninian	20.8	"
Statfjord (UK sector)	33.3	"
Murchison (UK sector)	33.3	"
Viking (gas field)	50.0	"
Beatrice	28.0	under development
Brae	20.0	"
Hutton	20.0	"
Clyde	51.0	awaiting development

4. In all the Corporation has interests in over 150 offshore blocks which comprise about 17% of currently licensed acreage. It is operator for more than 40 of these blocks. By comparison, BP and Shell each have interests in about 8% of licensed acreage and Texas Eastern, a major US company, 1%.

5. The Corporation is estimated to have access to oil from its equity holdings of some 6 million tonnes this year, representing about 7% of total UKCS production, rising to over 7 million tonnes in the mid-1980s. By comparison BP's share of total production is presently about 25% and Texas Eastern's just over 1%.

6. BNOC is also beginning a gradual expansion in its overseas activities. It already has an equity interest in an exploration venture in Dubai and is seeking an interest offshore France. It is also exploring the possibility of becoming involved in waters offshore the Republic of Ireland, Denmark and perhaps Indonesia. It has also provided management services to Petronas, the Malaysian state oil company, and has seconded staff to Malaysia and Venezuela.

TRADING ACTIVITIES

7. BNOC is the largest trader of UK Continental Shelf (UKCS) crude oil, mainly by virtue of its right through participation agreements with other oil companies to purchase 51% of most of the oil produced on the UKCS, and the Corporation's role as agent for the Government in taking 12½% royalty-in-kind.

8. In 1981 BNOC will be responsible for the disposal (after selling oil back to producing companies under the terms of some participation agreements) of some 35 million tonnes of oil, about 40% of total UKCS production. BNOC presently disposes of about 50% of its oil to UK companies, with the balance going to companies in Europe and N America.

9. The Corporation also started trading in certain oil products during 1980, and subject to Ministerial agreement, will have access to increasingly significant quantities of Natural Gas Liquids (NGLs) for disposal over the next decade or so through participation agreements. The proposed Gas Gathering Pipeline would greatly increase the availability of NGLs.

STAFF

10. BNOC has over 1900 staff of which 900 are based in Glasgow (where the Corporation's headquarters are located), nearly 800 in Aberdeen (BNOC's operational base) and the remainder in London. Only about 60 staff are engaged in trading activities.

FINANCIAL POSITION

11. The Corporation's financial requirements were met initially from the NLF. But since 1976 BNOC's capital investment has been financed from three main sources;

a. royalty receipts in the National Oil Account (NOA);

b. the proceeds of the Britoil Forward Oil Purchase Agreement (a financing agreement with a consortium of US and UK banks) some of which was used to repay borrowings from the NLF; and

c. more recently, its own internally generated resources.

12. The Corporation has been self financing since 1979. Its development over the past five years is illustrated by the following table:

All figures £m out-turn except where stated

	1976	1977	1978	1979	1980
Equity sales volumes (million tonnes)	-	-	0.5	3	4
Equity sales revenues	-	-	53	265	511
Profit (loss) before tax	(32)	(30)	(26)	77	309
Net profit (loss)	(16)	(15)	(15)	21	88
Capital Expenditure	387	169	190	226	216

	1976/7	1977/8	1978/9	1979/80	1980/81
External financing requirement	218	192	269	(27)	(217)

13. BNOC's EFR forecast for 1981/82 amounts to -£220m, after payment of nearly £140m by way of Supplementary Petroleum Duty.

14. Since 1976 the Corporation has invested over £1,200 million on the UKCS, of which about £900 million is represented by fields now under production. Much of the present capital expenditure is devoted to three fields now under development but expected to produce oil within the next 2/3 years.

15. The Corporation expects to continue to generate cash surpluses in the next two financial years, though at a much reduced level (around £60 m pa) as it begins to pay PRT. On current forecasts, however, it foresees a positive requirement for external finance by 1984/85. Its latest five-year forecasts are summarised in the table below.

SUMMARY OF BNOC FIVE YEAR FORECASTS

£m outturn	1981/82	1982/3	1983/4	1984/85
Equity sales	907	986	1216	1412
Total internal resources (after tax)	589	501	572	620
Capital expenditure	(363)	(454)	(503)	(670)
External financing requirement	(221)	(60)	(62)	57
Forecast profit after tax and interest	52	67	81	101

BRITISHNESS

1. My Department and BNOC have sought merchant bank advice on ways of safeguarding BNSO against unacceptable changes in control after privatisation, taking account of the need:

a. to comply with the Treaty of Rome and stock market procedures;

b. to establish the commercial independence of the Company;

c. to avoid reducing the price at which shares are sold or their transferability;

d. to keep proposals simple so that investors will understand and accept them.

APPROACH

2. In the light of these discussions I propose that BNSO's Articles and Memorandum should incorporate the safeguards set out below. These safeguards will be passive reserve powers for use only in times of crisis where there is a real prospect of an unacceptable change in control, regardless of the nationality of the parties involved. What would constitute such a change in control would need careful definition but in essence it would be any change which if it went ahead would alter the character of BNSO as an independent British oil company based primarily on the North Sea with a wide spread of ownership and sufficient standing to help promote competition in the oil industry.

SAFEGUARDS

3. First, the Articles should provide for BNOC's shares to carry a temporary majority of votes (50 per cent plus one vote) in the event of a takeover bid. The takeover bid would trigger the provision. BNOC could not initiate the circumstances in which it obtained this temporary majority.

4. Secondly, to help detect the situation where two or more shareholders were acting in concert with a view to bringing about an unacceptable change in control, the Articles should specifically include powers (in line with the Companies Bill) to enable the directors - two of them appointed by Government - to discover the identity of beneficial owners of the Company's shares or failing that to disenfranchise the shares.

5. Thirdly, to frustrate attempts by shareholders acting in concert to gain unacceptable control of the Board, the Articles should give BNOC a purely negative power to prevent the passing of any resolution in general meeting to appoint, re-elect or remove any director; and the Articles would also limit the power of the Board to co-opt any Director. This would be a passive power of veto, not appointment, designed to underpin the independence of BNSO.

6. Finally, the Articles should provide BNOC, regardless of its size of shareholding, with a power of veto over any resolution in general meeting:

a. to alter the key provisions of the Memorandum and Articles of Association; and

b. to wind up the Company.

OTHER POWERS

7. There are other more general powers which could be relevant in the event of a change in control of the Company. The conditions attached to offshore production licenses, for instance, could be important:

a. I have power to revoke a production licence if a company which is a licensee ceases to have its central management and control in the United Kingdom;

b. I also have power if there is a change in control of a company which is a licensee to serve notice requiring a further change in control to take place within three months or, failing that, to revoke the licence;

c. my consent is required if a licensee wishes to assign licence interests to any third party.

EFFECT ON SALE OF SHARES

8. My Department's merchant bank advisers, S G Warburg, would not expect provisions on these lines to have any detectable adverse effect on the valuation of the company on flotation.

15 July 1981

ANNEX C

ILLUSTRATIVE TIMETABLE FOR FLOTATION

Warburgs and Rothschilds have both given very similar advice, summarised below, on the timetable leading up to an offer for sale of 51 per cent of the upstream company.

July, 1981	Main policy decision to proceed with privatisation taken.
July/Aug/Sept/Oct 1981	Draft of Scheme prepared. Vesting clause and schedule to Petroleum and Continental Shelf Bill drafted. Drafts prepared of all Contracts between Secretary of State/BNOC/the Company. Decision taken on interests to be transferred to the Company under fifth and sixth round licences. Negotiation with Inland Revenue concluded.
November, 1981	Petroleum and Continental Shelf Bill reintroduced in Parliament.
December, 1981	Petroleum engineers instructed to produce report for prospectus.
31st December 1981	BNOC's financial year ends.
January, 1982	Reporting Accountants instructed to produce long form report.
March, 1982 (or later)	Royal Assent to Bill.
April, 1982	Accountants to have produced long form report based on 31st December 1981 balance sheet. Draft Scheme finalised, including capital structure of Company. Secretary of State invited to approve Scheme. BNOC's Accounts to 30th December 1981 published.
by 30th April 1982	Petroleum Engineers' report available. Draft Prospectus to be available based on 31st December 1981 position. Employee Share Scheme in final form.