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CABINET
MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BNOC: PRIVATE SECTOR PARTICIPATION

MEMORANDUM BY THE SECRETARY OF STATE FOR ENERGY

1. At its meeting on 11th March (E(80) 9th Meeting) the Committee considered proposals set out in my memorandum E(80)22 for introducing private sector participation into the upstream operations of BNOC. The Committee agreed that legislation to facilitate private sector participation should be postponed until next session (and an announcement to that effect was made on 25th March), but did not come to any conclusions about the nature, scope and timing of privatisation.

2. This paper set out revised proposals for private sector participation, which have been formulated in the light of continuing developments in the oil world, and in consultation with the Chancellor of the Exchequer, who agrees that in view of the privatisation commitment these should be explored.

PROPOSED SCHEME

3. My proposals in March were for a restructuring of BNOC into separate Trading and Operating arms, with the sale to the public of a majority stake in, and relinquishment of Government control of the Operating arm. However, the passage of time since those proposals

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were formulated has underlined the importance that attaches to the control and influence over oil. While my proposals were structured to enable the Government to retain complete control of BNOC's trading operation and its access to UKCS oil through the participation agreements, the relinquishment of control over the upstream side at a time of evident and increasing political and trading turbulence and uncertainty in the oil markets may be publicly interpreted as lack of Government interest and responsibility in an area of major political and economic importance. Finally, the present world oil scene must make real the risk of challenge to our participation arrangements from the EEC that might arise if we isolated BNOC's trading side.

4. Accordingly I propose that for the time being the trading and upstream activities of BNOC should not be totally separated. I remain convinced, however, that private participation in BNOC is a desirable aim, and we are publicly committed to this. My proposals which follow are therefore designed to allow introduction of private capital while keeping the Corporation as a whole and subject to Government control (and, as such, it would remain within the public sector). In essence I propose first a scheme providing for the sale to the public at large of rights to a specified proportion of BNOC's revenues from its equity oil field interest. Investors would receive regular "dividends" related to the revenue from some or all of those fields, and ultimate repayment of the security at "par" at some specified date. The dividends would therefore be related to the price of oil and to the level of production from the fields.

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5. The proceeds of sale of revenue interests would not reduce the PSBR, but would finance it: it would be an alternative to selling gilts or National Savings to comparable investors, and would have much the same monetary effects. There would be a small effect on the PSBR in subsequent years arising from the difference between interest payments on the conventional instruments and the dividends on the bonds, after allowing for any difference in tax treatment. It would probably slightly reduce the PSBR in early years, and slightly increase it in later ones. In the Treasury's view it would almost certainly be a more expensive form of financing overall.

6. The particular advantages of such a scheme - commonly known as a revenue interest or revenue bond - are as follows:-

- (i) It would simplify the legislation by making a formal splitting of the Corporation unnecessary;
- (ii) the security holders' rights would not impair Government control of the management of the assets or disposal of the oil;
- (iii) it would nevertheless give the holders a direct participation in BNOC's North Sea revenues;
- (iv) there would be no need for BNOC to negotiate with its partners to transfer the upstream assets to a new company as there would be if we introduced equity into BNOC's upstream operation. This would be very complex and time consuming, as we recognised when my original proposals were discussed.

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FORM AND SCALE OF ISSUE

7. I would like the securities to be marketed in a way which catered for the widest spread of investors' interests- not least because it would minimise the risks of subsequent expropriation. I believe there are major and lasting political gains here although care would have to be taken over sales and to the extent that sales are widespread and to smaller investors on a mass scale the price is inevitably affected. I would therefore propose that, if the Committee agrees with the proposal in principle, officials of my Department, the Treasury and the Bank of England should be asked to prepare possible schemes in consultation with ENOC. This study, on terms agreed between the Chancellor and myself should be directed not only to presenting the issue in the most imaginative way to the wider public but also the possible scale and the potential effects of that on the markets and question of timing, methods of issue, tax etc. Factors such as building society inflows and the impact of overseas investors must be taken into account in determining the amount and timing of sales, but we should plan to offer a total amount which can be seen to contribute a significant element of privatisation; I suggest that anything less than £500 million would be inadequate from this point of view, but the sale could of course be spread over more than one year if this/^{is} considered necessary. A final decision on the amount can await our consideration of the study by officials.

8. Although we are proposing to keep the Corporation within the public sector I believe it would be wrong to deny ourselves the opportunity to sell some equity in an operating subsidiary of the Corporation holding the oilfield assets, at a later date, if we so wished, when the Government

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financial needs, the world climate and the public mood might make it very desirable. A moment could arrive when such a move could be politically attractive and timely. We also need to bear in mind that an element of private equity ownership, however limited, would act as an important impediment in the way of any future moves under a different Government, towards using the operating company purely for political objectives, such as the expansion of state ownership into petrochemicals and other oil-connected industries.

LEGISLATION

9. We are already committed to legislation next session to sever ENOC's connection with the NOA and to end ENOC's statutory advisory duty. Work on this and a number of non-ENOC amendments to petroleum legislation is already in hand following drafting approval given last January. I now propose to include in this legislation specific provisions for ENOC to undertake the issue of revenue interests, to allow the Government to control the exercise and to allow for possible future sales of equity. We may also need additional powers to handle the trading in securities if we decided that this should be other than through the normal stock exchange channels, as seems likely.

TIMING

10. I plan to introduce legislation as soon as possible next session. The timescale within which such securities could be ready for issue will depend on the details of the scheme, and the state of the market, but an issue should be possible in 1981/82 if we so wish it. I propose to put details of the proposed scheme to the Committee as soon as possible after the Summer recess.

ANNOUNCEMENT

11. We are not yet finally in a position to make an announcement

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specifying the size, or precise nature or timing of the proposed revenue bond scheme. But there is very strong public speculation about our plans and their implications for the structure of BNOC. The fact that legislation is being prepared allowing a form of private capital involvement will leak. It is therefore best to announce our broad objective forthwith. BNOC anyway will have to be told what is needed - so whether we announce now or not it will come out. It is therefore in my view pointless to delay making an announcement before the recess, though I understand the Chancellor has doubts about this. A draft announcement is annexed which does not commit us to anything except the basic principle of our plans.

RECOMMENDATIONS

12. I seek the Committee's agreement that:-

- (i) private participation in BNOC should for the time being be limited to a sale of revenue interests, with the widest possible distributions, although powers to sell equity should also be sought;
- (ii) the necessary legislative provisions should be introduced as soon as possible next session as part of the legislation already approved for the ending of BNOC's statutory advisory duty, the severing of the NOA connection and the various amendments to the legislation summarised in Annex 5 to E(79)67;
- (iii) the Chancellor and I should bring before the Committee as soon as possible detailed proposals formulated in the light of a report by officials from my Department,

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the Treasury, Inland Revenue and the Bank of England, together with BNOC and appropriate professional advisers who should examine further all the possible schemes, having in mind the considerations referred to in paragraph 7;

- (iv) announcement should be by way of the annexed draft before the Summer recess.

D A R H

Department of Energy

30th July 1980

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DRAFT ANNOUNCEMENT

ANNEX

As previously announced the Government plans to give the public the chance to participate directly in BNOC's oil producing business. We consider that the best way to start this process is through the sale of revenue securities, although the Government may also wish to authorise a limited sale of equity shares in the upstream interests of the Corporation at a date judged appropriate. Holders of revenue securities would have a right to a specified proportion of BNOC's revenues from defined oil field interests. We plan to make such securities accessible to the widest possible spread of potential investors. This type of security will provide a direct participation in the risks and fortunes of the North Sea oil producing business, while at the same time being capable of widespread distribution. As foreshadowed in my announcement of 25th March I plan to introduce just as soon as possible the legislation providing powers for these changes, and ending BNOC's statutory duty to advise and its access to Government finance through the National Oil Account..

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