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E(DL)(79) 4th Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

SUB-COMMITTEE ON DISPOSAL OF PUBLIC SECTOR ASSETS

MINUTES of a Meeting held in the
Large Ministerial Conference Room
on THURSDAY 19 JULY 1979 at 4.30 pm

PRESENT

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
(In the Chair)

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry

The Rt Hon Peter Walker MP
Minister of Agriculture,
Fisheries and Food
(Item 1)

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment

The Rt Hon John Nott MP
Secretary of State for Trade

The Rt Hon David Howell MP
Secretary of State for Energy

The Rt Hon John Biffen MP
Chief Secretary, Treasury

Mr Nigel Lawson MP
Financial Secretary, Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Sir Ian Gilmour MP
Lord Privy Seal
(Item 1)

The Rt Hon Sir Michael Havers QC MP
Attorney General

The Rt Hon George Younger MP
Secretary of State for
Scotland

Lord Strathcona
Minister of State,
Ministry of Defence
(Items 2-4)

Sir Kenneth Berrill
Head of the Central
Policy Review Staff

SECRETARIAT

Mr P Mountfield
Mr G D Miles
Mr A S D Whybrow

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1. DISPOSAL OF BNOC ASSETS

The Sub-Committee's discussion and the conclusions reached are recorded separately.

2. BRITISH SHIPBUILDERS: SALE TO THE PRIVATE SECTOR

The Sub-Committee considered a memorandum on this subject by the Secretary of State for Industry (E(DL)(79) 11).

THE SECRETARY OF STATE FOR INDUSTRY said that there was a manifesto commitment to offer to sell British Shipbuilders back to private ownership. British Shipbuilders were currently running at a loss. A severe contraction of the industry was inevitable and it would require very large Government subsidies in the short term. In these circumstances he saw no prospect in selling shares in a company created to carry on the whole of British Shipbuilders' business, and virtually none of doing so in any individual merchant shipbuilding or mixed merchant/warship-building yard. However, 5 of British Shipbuilders' subsidiaries all engaged wholly or mainly on work for the Royal Navy, were profitable. He had considered the possibility of directing British Shipbuilders to sell some or all of these, which would require legislation. He had concluded that it would be best not to take the necessary powers of direction, at least for the present. The effect of selling the warship-building companies would probably be to increase the public sector borrowing requirement (PSBR) not to reduce it as might have been expected. This was because at present British Shipbuilders as a whole enjoyed the benefit of £86 million of payments in advance of work done by the warship-building companies. If those companies were sold, this amount would have to be paid over to them, and it was likely to exceed the proceeds of the sales. Announcement of a proposal to sell off the warship-builders also carried the risk of exacerbating the industrial action which was likely to arise from further contraction, with adverse financial consequences as a result. He recognised that if the Government did not take immediate action, many of its supporters would be disappointed, and it might be more difficult to find a suitable opportunity later. But he regarded these consequences as a lesser evil than the adverse consequences of taking action now. He therefore recommended that action on the de-nationalisation of British Shipbuilders should be deferred, with the possible exception of any voluntary sales that British Shipbuilders might be willing to undertake, and that the legislation to be introduced this year to introduce public sector finance into British Aerospace should make provision to enable the Government to compel British Shipbuilders to sell off the warship-builders. This proposal had the attraction that a Bill confined to Aerospace

would be more coherent and shorter than a bill covering Aerospace and Shipbuilding, and that the Government could be seen to be acting rapidly where action was likely to prove fruitful. He would make clear to the Government's supporters that the Government intended to return to the de-nationalisation of British Shipbuilders when it had a more definite idea of their size, structure and prospects, and when the market picked up.

THE CHANCELLOR OF THE EXCHEQUER, summing up a brief discussion, said that the Sub-Committee agreed with the proposals which the Secretary of State for Industry had made.

The Sub-Committee -

Took note, with approval, of the Chancellor of the Exchequer's summing up of their discussion, and invited the Secretary of State for Industry to be guided accordingly.

3. FINANCING OF BRITISH AIRWAYS

The Committee had before them a memorandum from the Secretary of State for Trade E(DL)(79) 4 and a letter from the Secretary of State to the Chancellor of the Exchequer dated 15 July, which requested clearance for the terms of an announcement on the financing of British Airways.

THE SECRETARY OF STATE FOR TRADE said that the earlier discussion in the Sub-Committee on 5 July (E(DL)(79) 3rd Meeting) had endorsed the principle of introducing private capital into British Airways, and had given authority for appropriate legislation to be prepared. In order to take this work forward he now needed to consult with a much wider group of people, and it was therefore necessary to announce intentions in general terms. The crowded Parliamentary timetable before the Recess implied that a statement should be made on Friday 20 July. The proposal was to convert British Airways into a Companies Act company with the Government holding all the shares, and then subsequently to dispose of part of this shareholding. Although it was envisaged at present that only a minority of shares would be sold, the size of the residual shareholding was not important in determining the Government's future relationship with the new company. The aim would be to disengage completely from the management of the company, except insofar as the Government was a shareholder. The pattern was well-established in the relationship between the Government and BP, whose terms were defined by the 'Bradbury and Bridges letters' the Treasury had a status analogous to that of any other major shareholder, but it was clear that the company acted in the light of its commercial interests, and was not an arm of Government energy or other policy. If a similar relationship was established for British Airways, then whether or not the Government retained the majority of the shares, the company would fall outside the public sector, and sales of shares would contribute to reducing the Public Sector Borrowing Requirement (PSBR), while future borrowing would not count against the PSBR. Since circulating his draft announcement with the letter of 15 July, he had received comments from colleagues, and he would take account of these in preparing a revised statement.

THE CHANCELLOR OF THE EXCHEQUER summing up a brief discussion said that the Sub-Committee were agreed on the principle of the method of introducing private capital into British Airways, and with the Government's intention to stand aside from the commercial management of the company, except insofar as it had an interest as a shareholder. The statement should not give any assurance that the Government would retain a majority shareholding, but neither need it give a commitment to a majority sale. This question should be left open. Because it was important that the change in status of British Airways should result in a reduction in the PSBR, the Secretary of State for Trade should agree the terms of his new draft statement with the Financial Secretary, Treasury. With that proviso the Sub-Committee agreed that the statement could go ahead as planned.

The Sub-Committee -

Took note, with approval, of the summing up of their discussion by the Chancellor of the Exchequer, and invited the Secretary of State for Trade and the Financial Secretary, Treasury to be guided accordingly.

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4. BRITISH AEROSPACE: SALE TO THE PRIVATE SECTOR

The Committee had before them a memorandum from the Secretary of State for Industry E(DL)(79) 8 which discussed the possibilities for introducing a private shareholding with British Aerospace.

THE SECRETARY OF STATE FOR INDUSTRY said that this proposal met a manifesto commitment to sell back to private ownership the recently nationalised aerospace concerns, while giving their employees the opportunity to purchase shares. The principle of the proposal was analogous to that for British Airways; an initial conversion into a Companies Act company, with 100 per cent Government shareholding, followed by a sale of part of the shares. The legislation should provide for the conversion of the whole of the present business of British Aerospace into a company, but should also leave scope for future sales to apply to only part of that business, for example the Dynamics Group, if that seemed more appropriate at the time. The Government would relinquish control over the affairs of the new company, except in respect of its generalised powers as a shareholder. The precise relationships, particularly in respect of access to Government finance would need careful examination, in view of the expected large cash requirements of the aircraft side of the organisation over the next few years. He asked for agreement in principle to this method of introducing private capital into British Aerospace, and approval for drafting the necessary legislation, for which there was already a place in this session's programme. He also asked approval that he should make an announcement in general terms before the Summer Recess. He would circulate this in draft.

THE CHANCELLOR OF THE EXCHEQUER, summing up a brief discussion, said that the Sub-Committee accepted the principle of the proposals, provided satisfactory agreement could be reached on the definition of the future relationship between the Government and the company, which would ensure that disposals would contribute to the reduction of the PSBR. The Sub-Committee approved the preparation of legislation along the lines proposed. The

Sub-Committee agreed in principle that a statement should be made before the Recess; that the Secretary of State for Industry should circulate this in draft; and that he should in particular obtain the agreement of the Financial Secretary, Treasury, to its terms, before it was made.

The Sub-Committee -

Took note, with approval, of the summing up of their discussion by the Chancellor of the Exchequer, and invited the Secretary of State for Industry and the Financial Secretary, Treasury, to be guided accordingly.

Cabinet Office
20 July 1979

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COMMITTEE

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

SUB-COMMITTEE ON DISPOSAL OF PUBLIC SECTOR ASSETS

LIMITED CIRCULATION ANNEX
E(DL)(79) 4th Meeting Minute 1

THURSDAY 19 JULY 1979 at 4.30 pm

SECRET

DISPOSAL OF BNOC ASSETS

Previous reference E(DL)(79) 3rd Meeting and E(DL)(79) 5th Meeting - Item 6.

The Sub-Committee resumed discussion about the disposal of assets of the British National Oil Corporation (BNOC). They had before them a series of memoranda by the Secretary of State for Energy (E(DL)(79) 6 and 7, and E(79) 20, 21 and 22).

THE CHANCELLOR OF THE EXCHEQUER said that the purpose of this meeting was to examine the feasibility of possible methods of disposing of BNOC assets in the current year. The choice among the possible options would be a matter for E Committee to consider at their meeting on 24 July.

THE SECRETARY OF STATE FOR ENERGY said that he believed there was general assent from his colleagues that the role of BNOC as an oil trading company, and their access to 51 per cent of UKCS oil through participation agreements, should be retained to Government, albeit perhaps through an organisation different in some respects from that of the existing BNOC. Thus the disposal discussions related only to the "upstream" side of BNOC activities. There were then several options, ranging from a total sale to a single company (BP), a sale of part of the assets to chosen buyers, (again preferably BP), and his own preferred choice, which would be to retain a substantial slice of the assets in a new Companies Act company, which might be called BNOC (North Sea) Limited, in which shares could be sold to the public and employees. All of these proposals presented problems of timing, if cash was to be obtained during the current financial year. He recommended that the best starting point for all options would be to create a subsidiary company to hold all the BNOC upstream assets. This would not require legislation, although power would be needed to direct the disposal of assets from the subsidiary, and appropriate clauses could be added to the Industry Bill. There was an additional problem because of the need for an early announcement about intentions on the 6th Round licences, in which BNOC was involved as a partner. Deferring the announcement until BNOC could be extricated would cause serious delay to exploration in the North sea.

The Chairman of BP had made it clear to him that even if BP were to take over all BNOC upstream assets, they would be content to forego any BNOC rights in the 6th Round. Thus it seemed that the 6th Round licences could be issued with BNOC identified as a partner, and that subsequently individual negotiations could be conducted with the partners for each block, to extricate BNOC from the agreements. He felt that continuing uncertainty would be very damaging to the future exploitation of the North sea, and that it was essential that some statement of Government intentions about the future of BNOC should be made before the Summer Recess.

The Committee discussed first the possibility of a complete take-over of BNOC upstream assets by BP. There were 35 other companies in partnership with BNOC in existing commercial fields, and under the agreements they would have pre-emptive rights to purchase the BNOC share. Unless BP were willing to outbid them in each case, it seemed unlikely that a complete takeover could be obtained. The Sub-Committee noted that in the opinion of BP, who naturally had great experience in these matters, the creation of a subsidiary of BNOC, holding all the assets, which was then taken over in toto by BP, would prevent other companies from exercising pre-emptive rights in the sale. On the other hand it was argued that this route would be seen as a device, to deprive companies of their rights, and as such would be open to serious risk of challenge in the Courts. Although similar transactions were common, on a smaller scale, in the oil world, it seemed likely that a change which would further strengthen BP's already dominant position in North Sea oil, would be unwelcome to BP's competitor companies. Since this was crucial to the question of the feasibility of the total takeover, the legal arguments should be further explored, in consultation with BP lawyers.

The Sub-Committee then considered the possibility of sales of only part of the upstream assets. Here the possibility of ensuring that sales went to BP, would depend very much on the attitude of the individual partners in the field concerned. It was difficult to speculate about this, and clear conclusions could only be reached after consultations with them. It would not be practicable to rely on the Secretary of State's power of consent in assigning interests, because this power could only be legally exercised in the manner of a partner: for example in relation to the technical or financial suitability of a potential assignee. Once a general announcement about

future policy had been made, individual consultations could take place, but their outcome would naturally be uncertain, the proceeds of the sale could not be ensured during the current financial year.

In further discussion the Committee noted that any substantial purchase of BNOC assets by BP would involve a rights issue. If the Government did not take up its option, the Government's proportion of the BP shareholding would be diluted. If Burmah were successful in their current litigation, they might subsequently claim that they had suffered loss because the Government had failed to take up the option on behalf of their shareholders. On the other hand, if the Government did take up the option, the contribution of the sale to the £1000 million required by the budget strategy would be reduced. There was also a need for a close examination of the BP tax situation, since this could have a considerable effect on Government revenue.

THE CHANCELLOR OF THE EXCHEQUER, summing up the discussion, said that the Sub-Committee were agreed on the desirability of the statement on future policy with respect to BNOC before the Summer Recess. The proposal to place all BNOC upstream assets in the hands of a subsidiary would not pre-empt decisions about the disposal of those assets, and the Secretary of State for Energy could include this in his statement if it seemed desirable. Legislation should be prepared for incorporation in the Industry Bill, to allow the Secretary of State to direct the sale of BNOC assets. There was agreement that announcement of the 6th Round licences could proceed, with the presumption that BNOC interests would be extricated later on an individual basis. The Attorney General, in consultation with the legal advisers of the Department of Energy, should hold urgent discussions with BP lawyers, in strict confidence, to elucidate the possibility of achieving a complete takeover of a BNOC subsidiary by BP, without risk of legal challenge. He would himself report to the Prime Minister on the discussions in the Sub-Committee, in preparation for the meeting of E Committee on 24 July.

The Sub-Committee -

Took note, with approval, of the summing up of their discussion by the Chancellor of the Exchequer, and invited the Secretary of State for Energy, and the Attorney General to be guided accordingly.

Cabinet Office
20 July 1979