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CABINET
MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BNOc DISPOSALS

Memorandum by the Secretary of State for Energy

At E Committee 5th meeting I was asked to arrange in consultation with ENOC, BGC and BP for the sale of assets realising a net £400m in 1979/80.

2. As I have indicated at previous discussions and in correspondence I do not propose to seek to achieve any disposals from BGC in 1979/80. My reasons for this are:

(i) From preliminary soundings of BGC it is quite clear that any attempt to induce it to sell oil assets this year would meet with strong opposition.

(ii) Thus even a limited disposal operation would call for a direction, which would be fiercely contested.

(iii) Without the willing cooperation of BGC there is no prospect of achieving any disposals in 1979/80.

(iv) It is not sensible to embark on what would be a major row with BGC with the prospect of an extremely difficult winter for gas supplies calling for the utmost cooperation from BGC.

(v) It would make no sense to sell Wytch Farm at this precise moment when its valuation is so uncertain.

3. This paper therefore sets out the ways in which £400m might be realised by disposing of BNOC assets, and the alternative ways in which a similar benefit to the PSBR might be achieved.

BNOC's Position

4. I have had a number of discussions with BNOC. I think colleagues should be aware of two important points which BNOC has emphasised to me:

(i) it regards any disposal as a bad business decision, as it does not expect to realise values reflecting the very large cash inflows which will accrue to these assets in future years.

(ii) the full values of these assets can only be realised if the field of purchasers is unrestricted and there is no fixed deadline. In particular BNOC would have serious reservations about accepting a depressed offer from a nominated British purchaser; and would require a direction to establish that the financial responsibility for such a deal rested with the Government.

A possible package

5. From my discussions with BNOC I consider that £400m could be raised by asset disposals as follows:

- (i) BNOC's gas interests in the Viking area:
 - (a) Gas already contracted to BGC is estimated as worth £65m.
 - (b) There are significant quantities of gas (as yet uncontracted to BGC) in nearby accumulations, which could be produced through the Viking facilities. If BGC were willing to contract for this gas at the same price as for Brent gas, these assets might be worth £70m.
 - (c) Other proven uncontracted gas producible through Shell's existing facilities, on the same basis worth £15m.

It makes sense for BNOC to dispose of its gas interests. It is however highly unlikely that the full value of the uncontracted gas can be realised by 31 March 1980. Clearly we would want to avoid a

disposal to the private sector at a price which allowed for a windfall gain on subsequent sale of the gas to BGC. I am pursuing this with BGC. Given that BGC will anyway be buying the gas, I suggest we need not insist on a British buyer for these assets.

(ii) BNOC's interest in Statfjord - estimated value £250m. (BNOC value this at £250 - £300m). This has been chosen because the net cash inflow lost between 1980/81 and 1982/83 is insignificant. I would want this to go to BP, who is actively interested, but suggest that BNOC is encouraged to invite bids from elsewhere including foreign companies - but with the clear understanding between ourselves and BNOC that if BP is prepared to offer a competitive price it will go to BP. Gulf and Conoco will anyway have to be involved as they have rights of first refusal to this asset under their partnership with BNOC. It might be advantageous to bring in an independent valuer in the event that agreement cannot be reached on price and to protect us from criticism that we had let the asset go too cheaply.

(iii) The above assets between them should, given time, realise the full £400m. I have discussed with Lord Kearton what other asset he would sell if the £400m target could not otherwise be met and he has indicated Dunlin, although with great reluctance. This could realise £150 - £170m.

6. We have made our best assessment of the consequential effects on the PSBR in subsequent years from tax and loss of net revenues. Tax consequences will not materialise until 1980/81 at the earliest, and the exact effects will depend on the method of sale and on the purchaser. The table below notes the loss of net revenues in the 3 years 1980/81 to 1982/83 and the estimated maximum tax at risk, over the same period:

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<u>Asset</u>	<u>Valuation</u>	<u>Loss of Cash flow</u>	<u>Tax at risk</u>
		£m.	
Viking	65	70	30
Statfjord	250	nil	30
Other gas	85	negative	nil
Dunlin	160	150	30

7. The valuations placed on these assets are based on the assumption that any constraints on the sales, either with regard to timing or purchasers do not prejudice negotiations or prices. We cannot rely on this because:

(i) the process of negotiating sales is complex and time consuming (Annex I illustrates this). It may not prove practicable for BNOG to complete the necessary deals by 31 March. In particular the realisation of the full value of the gas interests will not be possible in this timescale. Some flexibility on timing is therefore essential.

(ii) confining buyers to a narrow group of British purchasers against a fixed and tight deadline is bound to depress prices.

8. It is hardly possible to speed up the process of disposal by resorting to outside help. BNOG with its experience of this sort of transaction will be in the best position to push sales through as quickly as possible; any outsider (e.g. an independent arbitrator, or merchant bank) would almost certainly require more time to familiarise himself with the situation. This underlines the need for BNOG's cooperation. There is a risk that we might not get this if the constraints on timetable and purchaser make the £400m unattainable without also selling Dunlin. In this situation the whole timetable could be seriously set-back if BNOG would not proceed without a specific direction. This would mean no progress until passage of the Industry Bill which is unlikely before end January at the earliest. This reinforces the case for flexibility as to timetable and purchasers.

BP's Position

9. I am satisfied from discussions I have had with BP that it is potentially interested in all the assets mentioned in paragraph 5.

Another form of asset disposal

10. A possibility which I have asked my Department and BNOC to pursue is the selling of BNOC's oil forward in such a way as to bring receipts into 1979/80 and assist the PSBR. This idea could also apply to HMG's Royalty oil. Under the arrangements that we are examining oil (whether BNOC's or the Government's) would be sold on a forward basis to British refiners. The purchasers would be committed to pay on March 31st 1980 for a minimum of one year's future oil supply. The scheme could possibly be structured to bring in advance payments for more than a year ahead. Treasury and my Department need to examine the scheme in detail, and to consider the full PSBR implications. But at first sight it would appear that this could help the PSBR in 1979/80, (especially if BNOC were the vendor and on a normal commercial basis). The scheme does not suffer from the inevitable disadvantages of outright asset disposals (loss of cash flow and tax), and could thus act as a cushion in 1979/80 in the event our asset disposal programme cannot be achieved in time without seriously prejudicing our negotiating position; it could also avoid some of the inevitable disadvantages of outright asset sales.

Alternatives to asset disposals

11. Various possibilities have emerged for private sector investment in BNOC's operations, mainly as alternatives to outright asset sales, but which could also have the effect of introducing private capital into the Corporation. These include:

(i) Notes linked in some way to eventual sales receipts in identified exploration and production interests of BNOC - suitable for institutional investors.

(ii) bonds entitling the holder to a share of the revenues from identified established production interests - suitable for small investors.

(iii) equity in a subsidiary company. (In line with our initial thinking).

Wider public ownership of BNO

12. I will be urgently drawing up proposals to my colleagues for a new capital structure for BNO which will allow for the introduction of private capital, and the ideas referred to in paragraph 11 can be considered in this context. (Even if acceptable on policy grounds they could not be implemented in time to have an effect on the 1979/80 PSBR). As my colleagues know I attach great importance to widening the ownership of BNO and if possible to provide an opportunity for the public as a whole to have a stake. My objective will be to do this in a way which helps to reduce the PSBR, when we have passed the necessary legislation to reform BNO.

Conclusions

13. (i) £400 million could be realised by sale of BNO's Viking and other gas field interests and its interest in Statfjord.

(ii) To achieve the best prices we should adopt a flexible approach to both purchasers and timetable. Completion of sales by 31 March 1980 may not be achievable. We should aim to secure British purchasers, in particular BP in the case of Statfjord.

(iii) Selling oil forward may assist the PSBR in 1979/80 and give us greater flexibility in our programme of asset disposal.

(iv) It is important that BNO's future capital structure for its upstream operations should be settled quickly and in a form which allows private participation. I shall be making separate proposals on this.

14. I invite my colleagues to agree that I should proceed on the above basis.

D.A.R.H.

DEPARTMENT OF ENERGY
7 SEPTEMBER 1979

STEPS NEEDED IN NEGOTIATING SALES

- 1) In disposing of any assets it will be necessary:
 - (i) to identify potential purchasers
 - (ii) to give them time to assimilate the vendors information, their own tax and financial position and,
 - (iii) to negotiate the best possible deal from among those possible purchasers.

In addition, potential purchasers will, at some stage, require the opportunity to evaluate in detail (e.g. reservoir engineers' report) the assets being acquired, together with such experts, accountants and lawyers as they may require. The pre-emption provisions which apply in both Viking and Statfjord, will, themselves, necessitate either negotiating a waiver or a time-consuming process of going through the strict requirements of the agreements involving reaching agreement with purchaser and offering first refusal to partner.

- 2) Any transaction involving assets such as this, will have a complex structure to take account of taxation considerations, (both corporation tax and Petroleum Revenue Tax - the latter gives particular problems in the case of producing interest and causes lengthy delays because the assets to be disposed must remain "associated" during the remainder of PRT periods which end on 30th June and 31st December). Both stamp duty and VAT considerations also impose complications.

- 3) Financing considerations will apply to both the Vendor and potential purchasers. So far as BNOG, as Vendor, is concerned, a disposal of material interests in its present fields will necessitate renegotiations with the BritOil banking consortium. This particular negotiation may become difficult or, indeed, impossible if taken in advance of negotiations to resolve what is to replace the NOA arrangements. So far as the purchaser is concerned, transactions of this magnitude may necessitate forming banking syndicates or, indeed, issuing or placing in the market securities to produce cash for the purchaser. SEC registration is likely (eg BP) imposing further delays and perhaps bringing a prior investigation by the rating agencies.

- 4) Various consents will be required apart from the BritOil banks:-

- (i) PSP consents;
- (ii) Oil Taxation Office Clearances
- (iii) Licence consents from SOS and licence partners,
- (iv) consents of associated parties in pipelines, terminals, crude oil refining, and joint operating, exploration and other agreements or relationships.

- 5) In the case of Statfjord and Dunlin the Unit equity determination is yet to be finalised and until this takes place, valuation will be impossible and any contract in advance will necessitate complex detailed negotiation of a formula to deal with this. Later redeterminations of units may provide equal difficulties for negotiation.

- 6) Investments in Viking or Sullom Voe pipeline and terminal facilities have to be protected, both in relation to the uncontracted reserves and future entrants to the system.
- 7) If licence interests as opposed to the specific field interests are sold, complex formulae will need to be negotiated to preserve BNOCC's interests in subsequent exploitation of non-field reserves, and perhaps neighbouring acreage.
- 8) Oil, participation-type provisions will need to be negotiated with purchasers, to safeguard access to oil.
- 9) Full audits of all past costs, overhead allowances and so on have to be carried out to verify estimates and net worth of corporate situations.