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PRIME MINISTER

BNOC: SALE OF SHARES

I have seen David Howell's recent minute to you proposing that we should press ahead with plans to privatise BNOC's oil-producing business. I too believe that the time is ripe for a decisive step in this direction. Not only is there a strong political case for action, but I am convinced that if BNOC's oil producing business is to prosper, it is more likely to be able to do so in the private sector.

2. BNOC's oil-producing business is in an anomalous position in the public sector: now that the Corporation is established, there is evidence that it is finding it hard to form coherent and convincing corporate objectives. The Corporation would benefit from the financial discipline of exposure to the private market, in place of the administrative and bureaucratic constraints of the public sector. I share David's view that, but for the present Corporation's oil trading business, there is no convincing role for BNOC's oil-producing business in the North Sea which requires it to remain in the public sector. I therefore fully agree with the intentions of his memorandum, that he should be ready to present fully thought-through proposals to the House when the re-introduced Petroleum and Continental Shelf Bill is given a Second Reading next Session.

3. Against this background, I am broadly content with the approach to privatisation set out in the memorandum attached to David's minute. There is clearly much work to be done, and my officials will continue to be associated with the working up of the proposals including questions of timing. There will doubtless be questions which David and I will want to look at further together as the proposals are developed,

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but there are one or two points which I should like to make at this stage.

4. The memorandum makes it clear that the privatised company, BNSO, should be "moved right out of the public sector and the PSBR, by selling a majority of shares and by making it clear from the outset that it will be free from Government control". I fully endorse that objective. But with nearly half the shares held at the outset by the public sector, acceptance of BNSO as a private sector firm will depend on acceptance that it was not being controlled by its principal shareholder - whether that was the Government or BNOC. Unless such independence can be established, it would be necessary to consider BNSO as a public sector company. I therefore favour a firm commitment to disposing of substantially more than 51 per cent of BNSO, and reducing to a minimum the public sector's role in the Company, even if market conditions did not permit a larger initial disposal. There would need to be clear statements in the House, and ultimately in the prospectus, about the way in which the residual shareholding would be used. We should need to demonstrate that the Boards of the Company and Corporation were truly independent of each other (ruling out for example, the Chairman of either being a member of the other). These measures together with a declaration at the outset that we intend to reduce the public sector shareholding well before 49 per cent would provide the market with the reassurance that BNSO was a private sector company.

5. I am content to leave for later consideration the question of who holds the residual shareholding to BNSO. But the arguments for the Government holding the shares should not be overlooked. It is quite as important that BNSO should be independent of BNOC as to be independent of Government: the rest of the oil sector would after all be rightly concerned if there was any question of BNSO having undue inflation with BNOC, and therefore over the disposition of royalty and

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participation oil. A statement that the Government as shareholder did not intend to use its shareholding to control the company or intervene in day to day commercial decisions might be more convincing than one by the Corporation in equivalent circumstances. I should incidentally also wish to reflect further on the need for Government-or BNOC - nominated directors on BNSO.

6. I note that it is now proposed to transfer the relevant assets of BNOC to BNSO through a statutory vesting power. I see the advantages that this holds, in avoiding protracted negotiations with BNOC's partners. The absence of such negotiations should not, however, encourage us to pass on to BNSO assets which we know their private sector competitors would regard as appropriate only to a public sector oil corporation. For example, even had we not already decided that it was appropriate to retain the participation agreements within the public sector because of the benefits they bring to national security of supply, I doubt whether it would have been appropriate to pass these obligations, through a vesting power, to BNSO - in effect giving one private sector company disproportionate rights over the assets of the rest of the oil sector. There may be other similar rights and privileges which it would not be appropriate to pass through to BNSO in this way.

7. Another question which I should like to see explored more fully before accepting it is the concept that BNSO should retain the character of a "flagship" national oil company. If we are to put BNOC's upstream operation firmly into the private sector as an independent British oil company, free of Government obligations or intervention, there is surely no question of the Government automatically discriminating in favour of BNSO in relations with overseas Government, in preference say to BP?

8. Lastly, it is important to ensure that the oil trading

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Corporation which remains in the public sector is fully viable. As we know from recent experience over North Sea price levels, the rump oil trading Corporation will face a difficult task, without the financial and other resources of the upstream operation behind it. I am conscious that individuals in the present Corporation may tend to identify with BNSO, both in terms of the advice they give during the coming months, and in terms of individual careers. Careful separate consideration will clearly need to be given to the obligations, resources and financial structure of the remaining Corporation.

9. I have mentioned a number of points which we see needing careful thought over the coming months. But I would not expect overwhelming difficulties to emerge, and none of my comments detract from my view that it is now time to end the uncertainty over BNOC's future and proceed broadly on the lines proposed in David Howell's minute.

10. I am sending copies of this minute to other members of E Committee, to Sir Robert Armstrong, and with a copy of David Howell's to Norman Fowler since the prospect of a BNSO launch next year could have an impact on the timing of his privatisation measures.

(G.H.)

24 July 1981