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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BRITISH GAS CORPORATION - DISPOSAL OF OIL ASSETS

Memorandum by the Secretary of State for Energy

At E(80)30th we agreed that I should consult the British Gas Corporation (BGC) to secure their agreement either to the sale of their interest in the Wytch Farm oil field or to my proposals, as set out in paragraph 8 of E(80)81, for the disposal of a majority holding in their oil interests.

2. BGC's initial reaction (Annex A) was predictably hostile. They argued that the performance of the Corporation's statutory duties would be seriously impaired by either proposal, and that in the circumstances they would not be able to obtain a proper price for the assets.

3. I did not accept these arguments and asked them to reconsider their position (Annex B).

4. After further consultation (Annex C) and discussions with my officials the Corporation have now commissioned Lazards to advise how they could meet our objectives whilst satisfying themselves that they were meeting their statutory responsibilities. Lazards have agreed to produce an outline report as soon as possible. The Corporation have said that they will be able to give me their proposals by the end of the first week in October, although they have stressed that even if their response is positive detailed

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implementation of what will be a complex process will inevitably take some time.

5. This is at last a welcome move by BGC and I believe we must allow them this time. Otherwise, we would only exacerbate an already difficult position and we would at best forfeit BGC's co-operation in some of the other difficult problems that lie ahead (EFL, pay, gas gathering, MMC report). Furthermore, I believe that disposal of a majority stake in their oil assets with BGC's co-operation would raise more than the sale of Wytch Farm alone as well as being consistent with our policies of increasing public participation in the nationalised industries.

6. I and my officials have, however, make it clear that in the absence of a positive response from the Corporation we will proceed with the necessary consultations for issuing a direction under Section 7(2) of the Gas Act 1972 for disposal of BGC's holding in the Wytch Farm oilfield. The draft direction and the letter formally consulting the Corporation have been prepared. It should therefore be possible to allow them time to prepare proposals yet in the absence of a positive response to complete the necessary consultations and lay the direction if justified soon after the House reassembles on 27th October.

7. I therefore recommend to my colleagues that :-

- a) We allow BGC until the end of the first week in October to consider and make proposals to me;
- b) failing a positive response I proceed with necessary consultations for issuing a direction under Section 7(2) of the Gas Act 1972 for disposal of their interests in the Wytch Farm oilfield.

Department of Energy
10 September 1980

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ANNEX A

BRITISH
GAS

23 July 1980

The Rt Hon David Howell MP
Secretary of State for Energy
Thames House South
Millbank
London
SW1P 4QJ

Sir Denis Rooke CBE FRSE FENG
Chairman

PERSONAL TO ADDRESSEE

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OIL INTERESTS

You met Jack Smith and Bill Jewers on 4 June and, following a discussion on EFL matters, referred to the Government's policy to reduce the public sector. In the case of British Gas the proposal was that the Corporation agree to set up a company embracing what are loosely described as the offshore oil interests, from which the Corporation would dispose of a proportion of the equity and retain, in view of the PSBR implications, only a minority interest. The majority interest would be sold in some way, preferably by the issue of shares through the stock market.

When we met on 15 July I was able to inform you that the Board of the Corporation had before it a paper detailing the information necessary to a consideration of the proposals and would be doing so on the following day, the 16th.

The Board's consideration of the problem fell into two main areas. First, the extent to which the proposed disposal of interests bore on the Corporation's performance of its statutory duties. And second, irrespective of the first consideration, how far disposal could be achieved on proper commercial terms. In this connection the Board had to bear in mind that it was not a case where any supporting argument could be made out for a more efficient use of assets by restructuring, refinancing or bringing in new management.

It would, I think, be helpful to note that the interests under consideration are the Corporation's rights and obligations, which are of a minority or non-controlling nature, in a series of joint ventures with various producers, mainly US companies, namely Amoco, Amerada, Texas Eastern, Mobil, Esso, Shell and Gulf. The joint venture agreements require - to put it broadly - a high degree of unanimity between the venturers to enable effective exploration and development, and they presuppose a high degree of operational knowledge and the technical expertise to service and enhance such knowledge.

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Let me now deal with the first consideration - the extent to which the Corporation's performance of its duties may be affected. It will be readily accepted that it is not technically feasible for the Corporation to perform its duty to supply gas by confining its activities to natural gas. Gas and oil co-exist in varying degrees and the Gas Act 1972 gave recognition to this fact by conferring upon the Corporation power to get petroleum found in the course of searching, boring for or getting natural gas. Furthermore it is difficult to define whether certain fields are to be treated as gas or oil-fields and there are all the complications of gas caps in oil-fields and of condensate fields. The technology of the whole spectrum is relevant, and the knowledge gained from handling liquid hydrocarbons is an essential part of the engineering and financial know-how necessary to find and distribute gas. It must be stressed that the Corporation's direct knowledge of the oil industry in all its many facets through its interests is viewed as an essential element in its operations.

You will know that we regard our achievements in the exploration field with some pride, as an example of initiative by a nationalised industry resulting in a direct benefit to the nation. But this benefit would not have accrued unless our partners had been satisfied, not only with our competence, but also with our determination to carry through in association with them and in full technical partnership, long-term programmes of exploration and development. The joint venture agreements were constructed on the basis of promoting a long-term association and discouraging disposals of interest simply because of the degree of mutual trust on which the conduct of operations with a high inherent degree of risk depends. We believe that a major change in our current arrangements would make participation in future exploration work difficult, and the knowledge that the Corporation could not retain oil interests incidental to its search for gas would lead to uncertainties concerning the Corporation's standing as a joint venturer.

For these reasons the Board felt that the Corporation's performance of its duties would be seriously impaired by the disposal of the interests.

On the second point - the ability to effect a disposal on proper commercial terms - it also seemed to the Board that considerable problems arose.

Any valuation depends upon assumptions about the reserves. The buyer would presumably have to be a fairly experienced operator associated with one and would have to satisfy the other joint venturers of his ability to perform under the joint venture agreement.

However, under the terms of the joint venture agreements, in the event of disposal to a company in which the Corporation does not have a majority the Corporation is bound to offer the interests in each case to its joint venture partners to enable them to have their right of last refusal. It is felt that in the present

conditions with access to oil so important, it is inconceivable that our partners, mainly US companies as already noted, would not exercise their rights to acquire the oil interests. At the best of times the valuation of oil properties, including as they do further potential for exploration, is a difficult task and the securing of realistic offers to purchase an exercise fraught with uncertainty. In the context of a forced sale, with the additional complication of overriding rights for co-venturers, the prospects look even poorer. Frankly, the Corporation do not feel that a proper price could be obtained for assets sold under these conditions.

A further consideration is that cash flows generated by the interests are far more valuable over a 5-year period to the Corporation and therefore indirectly to Government, than any once-for-all purchase price could match in present circumstances. The financial details can be amplified if necessary, but briefly we estimate that under the restricted conditions outlined we should be fortunate to achieve £200 million as the proceeds of the sale, whereas the market value on the basis of future cash flow is at least £600 million. Furthermore, we estimate that even without taking account of real price increases of oil, the PSBR over a period as short as 5 years would be some £200 million worse off if the assets were to be sold in toto.

With these considerations in mind the Board could not but conclude that the proposals as put to Jack Smith are against the interests of the Corporation in many important ways. The Members, both Part-Time and Full-Time, all felt that it was inconsistent with their responsibilities under the Gas Act to consent to the proposal.

The question whether the Members should agree to a sale of assets is one which has been approached solely with the pragmatism of the prudent businessman. But I should emphasise that the Board, which as you know comprises Members with a wide range of different experience and attitudes, is unanimous in its view; nor is that view one which is achieved on a delicate balance of pros and cons.

It is hoped that Government will give full consideration to the position of British Gas and agree that this is a case where a disposal of assets would be against the interests of the Corporation and the country.

Jan 20,
 J. S.

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ANNEX B

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14 August 1930.

Sir Denis Rooke CBE, FRS,
Chairman,
British Gas Corporation,
Rivermill House,
152 Grosvenor Road,
London SW1V 3JL.

De Denis

OIL INTERESTS

It is clear from your letter of 23rd July that the BGC Board at present feel unable to agree with my proposal to set up a company embracing BGC's offshore oil interests and disposing of a majority share therein to the private sector of the economy. The case against doing so is argued on the grounds of both statutory duties and commercial considerations.

Frankly, I am not convinced by these arguments. BGC, as you rightly say, is in a minority or non-controlling position so far as the offshore fields are concerned, and in no case is it an offshore operator. In these circumstances, it is difficult to see what would be lost to BGC in terms of knowledge or the technology concerned, or of the oil industry more generally, by participation through a minority holding in a separated company as compared with the present position; or indeed why BGC's knowledge and experience should not be fed into joint ventures through the proposed new company much the same as at present.

On commercial considerations, I accept that there are problems to be resolved. I can see in particular that assumptions about reserves would be an important aspect of valuation, although insofar as potential reserves were thought to be far larger than current estimates, it is surely not impossible for the Corporation to devise a form of contract to take account of that eventuality. Nor would I have thought it impossible to devise means of securing realistic offers, despite the pre-emptive rights you mention, or of countering attempts to prevent the formation of a true market price if need be. Indeed it is not inconceivable that in the end shares could be sold to the public at large with the possibility of a premium price.

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I would therefore ask the Board to consider whether on further thought the difficulties of meeting the Government's wish to reduce the public sector through the part sale of oil assets are necessarily as great as they at first seemed. I hope that on reflection the Board would feel it could act within its own powers to co-operate with the Government in the sale of a majority holding in a separated oil company. If, however, the Board should decide otherwise then, given the difficulties cited, I will proceed with the necessary consultations for issuing a direction under section 7(2) of the Gas Act 1972 for the disposal of BGC's holding in the onshore Wytch Farm oilfield as an immediate contribution towards the Government's purposes.

I would, however, far prefer that the Board should feel there is sufficient scope to co-operate with the Government (as indeed has been the case with other nationalised industries) without the need for a statutory direction. I hope that this matter can be discussed further at the Board's meeting next week, and would welcome an early reply.

D A R Howell

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ANNEX C

BRITISH GAS

Sir Denis Rooke CBE FRSE FENG
Chairman

DER/BH

27th August, 1980.

PERSONAL TO ADDRESSEE

The Rt. Hon. David Howell, MP,
Secretary of State for Energy,
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Millbank,
London, SW1P 4QJ.

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Jan Paul

OIL INTERESTS

I acknowledge receipt of your letter of the 14th August which has now been considered by the Board of the Corporation at a recent meeting.

The Board felt that your letter indicated some misunderstanding of their position, particularly in its final paragraph where you refer to the scope for cooperation with the Government and the extent of this in other nationalised industries. We would wish to assure you that the general proposal you have put forward has received consideration of the deepest and most serious kind. We do not, of course, know the details of the other cases under consideration but we do believe that there is a fundamental difference in respect of most, if not all, other nationalised industries; that is, that British Gas is not in a borrowing position and would not, as we see it, be in a position to make effective use of additional money resources which would accrue from a major sale of oil assets.

The Corporation is naturally committed to the disposal of unused assets, but in this case it would appear, as far as the proposals are understood at present, that you wish us to part with productive assets without any real commercial justification so far as the Corporation is concerned. This does not seem to the Corporation a rational way to conserve its assets, the more so because over a short period of years the revenue which the Corporation could expect to recover from those assets would (in its view) much exceed the capital sum that could be raised from sale. Furthermore, the proceeds of sale would increase the cash flow of the Corporation in the year of disposal and pass back through the 'Reverse NLF' mechanism to earn a rate of interest discounted in favour of the Treasury.

/The Corporation ...

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The Corporation is fully conscious of its general duty, as a State industry, to cooperate in achieving the declared objectives of the Government of the day. The foregoing considerations, however, make it a matter of extreme difficulty for its members to reconcile with this duty of assisting the Government, their duty, which they believe is implicit in their statutory function, to deal with their assets in accordance with the highest standards of commercial prudence and good sense. Although the Board feel that at this level of generality they could have reached no other conclusion, they are conscious that it is the detailed nature and extent of Government's proposals and their precise bearing on the future operations of the Corporation which is crucial. There is scope for discussion and understanding here.

For example, we feel there is a good deal of room for discussion of the implications of the minority nature of the existing rights and obligations of the Corporation in the various joint ventures. We have no control of these ventures and, indeed, ourselves feel that in this respect our holdings could be classified already as being outside the public sector. Even if that were not to be so, it does not seem necessary to dispose of a majority share of the various oil interests to ensure that they could be so classified.

You will recall that we have drawn attention already to the particular difficulties which arise from the terms of the joint venture agreements in the event of disposal of the British Gas interests to a company in which the Corporation does not have a majority. It does not seem sensible to us for the Government to take on the burden of all these extra difficulties if, in any event, the assets in question could genuinely be classified as falling outside the public sector already because of the total absence of direct control of any single joint venture, or surely would be so in the event of a minority disposal.

You suggest that there would be no loss of knowledge to the Corporation if it were a minority shareholder in a public company, as compared with the present position. If the overall effect of Government's proposals is that the Corporation (and its subsidiaries) should cease to be regarded as a satisfactory co-venturer by oil companies then there would certainly be a loss of knowledge in the future because it would become impossible to enter into new arrangements for further exploration and development. Everything depends upon the specific nature of the proposals.

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May I refer to Wytch Farm, which the Board were surprised to see mentioned in this context. We had thought that you had virtually accepted the bearing of this asset on the Corporation's exploration activities. The identification of major new exploration targets both offshore in the Channel as well as onshore, is wholly due to the original thinking and perseverance of the Corporation's staff against the strong trend of traditional oil industry thinking and Wytch Farm therefore has a unique morale value. Furthermore, it is the only location where we can train and develop new staff in various exploration and development techniques onshore prior to deploying them in offshore roles. The future of Wytch Farm is thus of critical importance in our exploration and production activities.

I can assure you that the Corporation is anxious to give full effect to Government policies bearing in mind its duties; it is conscious of Government's wish to reduce the public sector; but it is equally conscious of Government's concern to create and encourage sound business. We believe that a constructive step would be for an early meeting with your officers to examine more precise details of your proposal and to discuss the implications in order to reach a solution.

*Jan w.
A. King*

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