CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

E(79)80
7 December 1979

COPY NO. 56

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BNOC: FUTURE STRUCTURE AND PRIVATE SECTOR PARTICIPATION

Memorandum by the Secretary of State for Energy

The Committee invited me on 26 November (E(79)15th Meeting) to discuss my proposals for BNOC in detail with Ministers concerned and to make a further report to the Committee. I think there was general agreement at that meeting with the principle of a separation of the operating and trading activities, with private capital being introduced into the former. This paper records the points covered in discussion with colleagues and my responses to them. In the light of these discussions I believe that the proposals set out in my earlier paper (E(79)67) should stand.

Points covered in discussion

2. EEC problems. Annex 2 to E(79)67 set out the legal implications with regard to the EEC of my proposals. The Lord Privy Seal has written drawing attention to the risks of challenge. No doubt the Attorney General will be responding shortly. Subject to his comments I am satisfied, however, that Annex 2 fairly sets out the position. There are increased risks; these can to some extent be mitigated by conferring on BNOC an express duty to act on behalf of the Government; and in any event these risks are not very great. These are considerations which I took into account in formulating my proposals. I suggest therefore that we should not be deflected from the proposals if they are otherwise generally acceptable.

3. Another EEC point that came up at the meeting on 26 November was whether we could learn anything from the German/Dutch gas case in relation to EEC attitudes. The case instanced was an attempt by the Dutch Government to restrict export of gas to Germany. The Commission called on the Dutch to reverse their decision and to abolish the power

CONFIDENTIAL

under which they had sought to make the restriction. In the event the Dutch agreed to allow 50% of the gas to go to Germany but maintained the line with the Commission that their power did not in itself contravene the Treaty. The Commission apparently took no further action.

4. PSBR effects. It was noted at the Meeting that the figures set out in Annex 1 to E(79)67 might not accurately reflect the position, due to tax complications. Colleagues will have seen my letter to the Chancellor seeking his agreement to changing the general PRT provisions in relation to successor companies in the 1980 Finance Bill. If he can agree to this then the figures in Annex 1 can be taken as accurately representing the situation - although I am attaching a revised annex incorporating projections somewhat further ahead and a revised presentation allowing for privatisation proceeds spread over 3 years.

5. BNOC (Trading)'s access to BNOC (Operating)'s oil. My paper makes no recommendations on the extent of BNOC (Trading)'s access to BNOC (Operating)'s oil, as it is not necessary to make a decision on this issue now. The Committee discussed two possibilities; either allowing BNOC (Operating) to retain 49% of its oil (some 4m. tonnes in the 1980s) or establishing 100% options - which might depress the privatisation proceeds. There may also be intermediate possibilities. The attached note (Annex B) sets out the main considerations. I would welcome my colleagues views on this question so that I can take account of them in reaching a decision.

Conclusion

6. None of the matters recorded above raise materially new issues which put a different complexion on the proposals circulated in my earlier paper (E(79)67). I therefore recommend my colleagues to endorse the proposals set out in paragraphs 20 to 24 of that paper.

D.A.R.H.

DEPARTMENT OF ENERGY
7 DECEMBER 1979

PSBR EFFECTS OF VARIOUS CASES

ANNEX 1

1. The total public sector take is affected significantly by the size of the capital expenditure programme assumed. The figures in paragraphs 3 and 4 below are prepared on alternative capital expenditure assumptions (see note (v)). The upper lines, (i), are based on BNOC's capital expenditure programme as agreed by Ministers for the PES White Paper, with the assumption that expenditure beyond the survey period will remain constant in real terms. BNOC has however, recently reviewed its capital expenditure projections and, on the assumption that its future programme is limited to upstream operations on existing licences, it now foresees a reduced programme of expenditure, becoming constant from 1982/83 in money of the day terms; this would give rise to the lower line figures (ii).

2. In all three cases PRT and corporation tax would accrue to the Exchequer. BNOC's estimates of total tax take are:

Total tax take:

1980/81	81/82	82/83	83/84	84/85	85/86	86/87
-	-	125	245	250	360	375

Payment of corporation tax is assumed to begin in 1985/86.

3. The net effects on the size of the PSBR of three cases are shown below:

(a) BNOC Status Quo

		1980/81	81/82	82/83	83/84	84/85	85/86	86/87
A. Net cash flow to BNOC after tax and dividend:	(i.)	60	235	180	105	125	55	40
	(ii.)	140	320	240	150	190	95	85
B. Notional Dividend:	(i) or (ii)	-	20	45	60	65	85	85
C. Total public sector take less tax (A and B):	(i.)	60	255	225	170	190	140	125
	(ii.)	140	340	285	215	255	180	170

(b) BNOC(Operating) 25% public owned and counted as a private sector body

The public sector would lose BNOC's net cash flow (line A in option (a)) and 75% of the dividend payment (line B), which would be paid to the private sector. Against this, the public sector would receive the proceeds of privatisation. Assuming proceeds of £960m at 1978/79 survey prices (75% of £1500m at 1 January 1980 prices), spread over three years, the total public sector take, less tax, would be:

		1980/81	81/82	82/83	83/84	84/85	85/86	86/87
25% of dividend:	(i) or (ii)	-	5	10	15	15	20	20
Proceeds of privatisation:	(i) or (ii)	320	320	320	-	-	-	-
Total public sector take: less tax	(i) or (ii)	320	325	330	15	15	20	20

(c) BNOC (Operating) 51% publicly owned and counted as a public sector body

Total BNOC net cash flow (Line A) would be counted as public sector revenue. The public sector would lose 49% of the dividend (line B), which would be paid to the private sector. PSBR would not be reduced by the proceeds of privatisation, but they would help to finance it. The total public sector take, less tax would be:

		1980/81	81/82	82/83	83/84	84/85	85/86	86/87
Net cash flow to BNOC after tax and dividend:	(i)	60	235	180	105	125	55	40
	(ii)	140	320	240	150	190	95	85
51% of dividend:	(i) or (ii)	-	10	20	30	30	40	40
Total public sector take less tax:	(i)	60	245	200	140	160	100	80
	(ii)	140	330	260	180	225	140	125

4. The year-by-year benefit (disbenefit) to the PSBR from exercising option (a) or (c) in preference to option (b) would be:

Net additional PSBR benefits (disbenefits)

		1980/81	81/82	82/83	83/84	84/85	85/86	86/87
Option (a)	(i)	(260)	(70)	(105)	155	175	120	105
	(ii)	(180)	15	(45)	200	240	160	150
Option (c)	(i)	(260)	(80)	(130)	125	145	80	60
	(ii)	(180)	5	(70)	165	210	120	105

Notes

All figures are shown in £m. at 1978/79 Survey prices

The tables are based on the following assumption:

(i) oil prices at $28.50/bbl in April 1980, rising at 10% each January thereafter; $2.10 = £1; UK inflation falling from 14% to 9% a year over the period;

(ii) BNOC estimates of PRT and corporation tax; BNOC (Operating) will retain the allowances of BNOC;

(iii) dividends based on two-thirds of post-tax profits as forecast by BNOC; dividends not paid out until April/May of the year after the profit figures to which they relate;

(iv) the need to repay BNOC's Brit Oil finance during this period is neutral in terms of PSBR;

(v) capital expenditure programmes:

	1980/81	81/82	82/83	83/84	84/85	85/86	86/87
(i)	300	300	280	245	245	245	245
(ii)	215	210	220	200	185	170	155

No estimates are given for the years beyond 1986/87 because of the par cular uncertainties in projecting so far ahead. Under options (a) and (c) there are likely to continue to be some net PSBR benefits from fie already in production or coming on stream. Their size will depend not only on oil price/exchange rate movements but on the future capital ex diture programme, the rate of success in finding and developing new fields and, from the 1990s, the size of abandonment costs on fields reaching the end of their producing lives.

ANNEX B

BNOC (TRADING)'S RIGHTS OVER BNOC (OPERATING)'S OIL

1 The options are:-

(i) 51% of all UKCS oil - as for other UKCS producers;

(ii) 100% of all UKCS oil under all existing and future licences;

(iii) 100% of all UKCS oil under producing fields or existing licences; 51% of all other UKCS oil;

(iv) some intermediate percentage.

2 The gross amount of oil is some 8 mtpa in the eighties; 100% options would keep the full amount under state control; 51% options would give up control over some 4 mtpa.

3 Arguments

(a) Security of supply: clearly (ii) is preferable; the amounts lost by taking 51% only would be over 10% of the oil available for disposal to BNOC and HMG, and about 5% of UK overall demand.

(b) Spot Sales: there is a risk that BNOC (Operating) would consider itself obliged to sell on the spot market if it retained oil. It would be very embarrasing for a company with a substantial Government holding to do this and, although Government pressure could be applied as to existing private sector companies, it would be difficult to guarantee success, especially as the company would be crude long and created in a period when the market was expected to be tight.

(c) Commercial viability of BNOC (Operating): it is argued that BNOC (Operating) must be given the commercial freedom to go downstream on the basis of its own crude, if it is to be successfully privatised. (Shelbourne suggests 100% options would cause a measurable reduction in proceeds.)

(d) PSBR problems; Treasury have argued that 100% options would make it less easy to class BNOC (Operating) outside the PSBR on the grounds that it suggests an unusually close relationship between the two companies.

(e) EEC points: in practice 100% options would not change BNOC's position in the market, and should therefore not increase the risk of successful challenge on the grounds of BNOC holding a dominant position or restraining exports. However it might be argued that the option arrangements could lead to distortion of competition and in this event a 51% option would be less likely to provoke challenge than a 100%.

4 This question does not have to be settled for purposes of framing legislation and I will consider it further in the light of the views of colleagues.