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PART B

CHANCELLOR'S PAPERS
ON OIL POLICY INCLUDING
THE PRIVATISATION OF
BRITISH PETROLEUM (BP)

Begin: 22/1/88

Ends: 3/3/88 (CONTINUED)

DD: 25 years

6/9/95

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PART B

CONFIDENTIAL

FROM: D J L MOORE

DATE: 22 JANUARY 1988

- DJM*
- 1. SIR PETER MIDDLETON
2. CHANCELLOR

cc Financial Secretary
Economic Secretary
Sir Geoffrey Littler
Mr Anson
Mr Monck
Mrs Brown
Mr Williams
Ms Leahy
Mr Call

Miss Wheldon TSOL

Thanks. This seems OK, but I will be grateful for updates (are the latest news of the size of the KIO holding). ~~but~~ I would like to have a prior mtg. to discuss tactics, with Mr Parkinson, Sanderson, Sir Peter Glynne, etc.

BP: KUWAIT INVESTMENT OFFICE

With Mr Parkinson, you are meeting Shaikh Ali Khalifa on Thursday, 28 January to discuss the KIO's holding in BP.

2. I attach a brief which we have prepared with Energy, the Foreign Office and the DTI. The other departments are also putting it to their Ministers tonight. It is in the form of an introductory speaking note, supplementary Q and As, and Annexes with some more detailed background briefing.

3. In drafting we have taken account of DTI's concern that nothing should be said which might prejudice the OFT review.

4. You will wish to consider the tactics of whether to open by asking KIO to stick at the present holding or by asking them to go down, in the near future, to around 15%. Alternatively this lower level could be brought into the discussion at a later stage. Either way you will not want to leave any implication that 15%, (or any other particular lower level) is the right and acceptable figure.

5. In drafting supplementary Q6 I have asserted that HMG would not buy any BP shares off the KIO. The problem might be that, if the KIO were ready to make a substantial off loading, it could be difficult to find other buyers at a price at which the KIO would want to sell. The answer could be in BP's hands - I suspect they will be encouraging their friends among

the institutions, here and in the USA, to be ready to buy in the event of an orderly reduction in the KIO holding.

6. BP will also be seeing Ali Khalifa next week, Energy will talk to them on the general line. If BP see him first that could be useful in providing some warning on the Kuwaiti's line.

D.J.L.

D J L MOORE

CONFIDENTIAL

BP: STEERING BRIEF FOR MINISTERIAL MEETING WITH SHAIKH ALI KHALIFA

Aim

To seek agreement that the KIO will not increase its holding in BP, and preferably will agree to reduce it; will not seek any Board membership; and will consult HMG and BP before making any significant sale of their holding to a third party.

To do so mainly by stressing that it is in the Kuwaiti's own interests to agree.

To do so in a way that does not prejudice the use of the Fair Trading Act powers.

Opening remarks

1. We have welcomed the assurance by the Kuwaiti authorities that they have no ambitions to control BP nor any interest in any management role.

2. But as you will have observed from questions in Parliament and comments in the press, there is growing public concern about the KIO's stake in BP and its future intentions. We have done our best to allay this concern in answers and public comments, but we must face the fact that it exists, it is growing, and it is causing the Government grave political difficulties. We do not want this to affect UK/Kuwait relations and our cooperation in the Gulf.

3. The size of the stake has already led the DGFT to begin independent inquiries, which he is bound to do under the law. During the course of his enquiries the DGFT will approach all interested parties and take account of any representations made to him.

4. But the Government cannot simply await the outcome of this process. The public concern is too deep. The political problem for the UK Government is enhanced by the fact that the KIO acquisition has nullified what was always seen as one of the major objectives of disposing of the UK Government's holding in BP - ie the desirability of reducing the direct influence of any Government

on the affairs of the company.

5. The only immediate way that the UK Government can deal with the problems that the KIO acquisition has created for it is, therefore, to be able to make public further assurances about the KIO's intentions.

6. We would therefore be grateful for assurances that

- KIO will not further increase its present holding [and indeed will reduce it in the near future to, say, 15% - there is a tactical question on whether to mention 15% at the outset]
- KIO will not seek Board membership [NB this point has not been put to the Kuwaitis so far]
- Kuwaitis will consult HMG and BP before selling all (or a substantial part) of their stake to a third party.

Annexes

Detailed background briefing is annexed:

- A: table showing buildup of KIO stake
 - B: note by Foreign Office on international aspects of the Kuwaiti holding
 - C: notes by DTI on the Fair Trading Act 1973; Takeover Panel rules on increments in shareholdings; Industry Act 1975; and on the significance of various levels of shareholding
 - D: note by Energy on North Sea licencing arrangements
- NB this would only be likely to be relevant if, contrary to their assurances, the KIO bought one third or more of BP's shares
- E: Transcript of Sir P Walter's remarks on 20 January.

Supplementary and defensive points**1. Why is there public concern given KIO's good reputation and the assurances already given?**

Concern arises because KIO is seen as the arm of a sovereign state. Because major shareholders are assumed in this country to exercise an influence in the affairs of a company, the public perceive BP as now being subject to the influence of a sovereign state, which is bound to look at its interests as a whole. Where the company concerned is the biggest in the UK and a major oil company, and the sovereign state a major oil producer in a very difficult part of the world, concern is intensified. We cannot assume that Kuwait's national interest and BP's commercial interests will always be identical. There could, for example, be differences of view on major upstream investment.

2. Why object to increase up to 29.9%?

- as explained, already widespread concern (damaging to Kuwait Government as well as HMG) over existing holding
- a move to 29.9%, or indeed to any level above the present one, would throw doubt on assurance of no ambitions for control.
- [NB Under Company Law, certain major decisions have to be passed by special resolution, which require a 75% majority. In practice a shareholding of significantly less than 25% could be an effective block, as not all shareholders would attend the meeting.]

3. Asking for less than 18.4%?

- pending the DGFT's enquiries, an early reduction to, say, 15% would ease the presentational problems. [But important not to imply that 15% is the "right" level; something less in due course would be more comfortable]

18 1/2

- the Kuwaitis may claim that Sir P Walters has said BP could live with 18% - see Annex E (his remarks were widely quoted in the press). But it is clear that this was on the understanding that it was a passive holding, and moreover that he was not comfortable with over 10%.

4. Why worried over Board membership?

- for the KIO to seek Board membership now, or later, would provoke further public criticism. It would be seen as a move to an active role in running BP. No one would believe that the KIO Directors would not seek to influence BP in the interest of Kuwait.
- the British Government, having surrendered its own position on the Board, would not wish to see this pass to any other Government (or its agency)

[NB 20% is the level at which, according to City custom and practice, a shareholder could expect to have Board representation. For BP to resist Board representation they would need to be supported in any vote by UK institutional shareholders - who could be put under pressure by KIO]

By no means
purchase possible
(if - now - Mandat of F?)

5. Why should KIO consult on sales of their shares?

- do not want an unwelcome predator to pick up a significant holding

6. Would HMG be willing to buy them?

- No. the purpose of the October sale was to get rid of the Government's stake, to remove the overhang on the share price of a large holding, and to remove any remaining and misplaced notion that BP was Government controlled

- but sure there would be other acceptable investors interested in buying. *Evhu, pmir, Ad itself*

7. **Why no objection to KIO build up during Bank offer period?**

- For figures see Annex A
- the 10% which the KIO had picked up by 19 November was a very sizeable holding but not so high that we wished to question it [NB the Prime Minister on 19 November did not welcome the 10% level in terms. She said that it was not surprising that there should be some international investment in BP]
- our concern rose as the stake increased until, when it reached 15-17%, Mr Mellor spoke to the Kuwaitis on 23 December. Since then concern has continued to mount.

8. **Would BP's US business be adversely affected?**

US energy security has always been a politically sensitive issue, and if an amendment to the draft Omnibus Trade Bill is adopted the Secretary of Commerce will have the right to prevent foreign investment "against national security interests". We shall defend BP's interests vigorously if this becomes necessary. But a large Kuwaiti stake in BP could heighten the risk of hostile action by the Administration, and would be a major complicating factor (for more detail see page 5 of Annex B).

9. **Effect on UK/Kuwaiti relations**

As I said, Britain and Kuwait have good and mutually beneficial relations. But growing public concern about the KIO's stake in BP and its future intentions could affect these, as well as our cooperation in the Gulf. We must both work to avoid this.

0. What if OFT/MMC concluded no threat to the public interest?

- Premature to speculate. The Secretary of State for Trade and Industry will have to consider the DGFT's views/MMC's findings

[NB If the DGFT were to advise against a reference to the MMC the Secretary of State for Trade and Industry could nevertheless still make a reference, having taken account of the DGFT's views. The Secretary of State decides the matter, not the DGFT].

The build up of the KIO's stake in BP

	<u>% of ordinary shares</u>	<u>shares million</u>
19 November	10.06	600
1 December	10.44	622.5
7 December	11.52	687
11 December	13.07	779.5
16 December	15.02	895.75
18 December	16.06	957.5
22 December	17.07	1017.9
30 December	18.03	1075
5 January	18.35	1094
15 January	18.41	1098

2. The KIO has therefore bought almost exactly half of the shares sold in the Government/BP combined offer of 2,194 million shares in October 1987.

*an amount of
pounds £2.2 billion*

ANNEX: INTERNATIONAL ASPECTS OF KUWAITI SHAREHOLDING IN BP

1. This paper covers the bilateral (UK-Kuwaiti) and international aspects of the Kuwait Investment Office (KIO)'s BP share purchases. It contains short sections on:

- A. UK interests in Kuwait
- B. Effect on these interests if relations soured.
- C. BP's relations with HMG.
- D. Kuwaiti oil interests.
- E. Kuwaiti interest in BP.
- F. US attitudes
- G. Legal position of the KIO and its London Office

A. UK Interests in Kuwait

2. Our principal objective in UK/Kuwaiti relations is to promote British strategic, political, economic and commercial interests by maintaining the stability of a pro-Western State in the Gulf region. There is a UK interest in ensuring that the present regime does not fall as a result of Iranian pressure and subversion though this is considered unlikely. This would destabilise the Gulf, and put the revenues from around 10% of OPEC oil production into the hands of a potentially hostile government.

3. Kuwait is our 36th largest export market (visibles less than £300m in 1987). Official Kuwaiti holdings in the UK are believed to be the largest of any country. We have a traditionally strong position as a supplier of military equipment. At the moment there are possibilities of sales of tanks (the Challenger) worth about £800m and armoured personnel carriers worth about £300m. There is a possible future market for minesweepers and fast patrol craft.

4. As can be seen, visible exports are not large but invisible trade is considerable. Kuwait's official investments in the UK are about £4bn, and private investments may amount to a similar figure.

The Kuwaitis also run a substantial portion of their overseas investments from the Kuwaiti Investment Office in London. In the opposite direction, the UK has little invisible export interest in Kuwait.

B. Effect on these interests if relations soured

5. If relations soured because of UK Government action over KIO share purchases in BP, the Kuwaitis' general pro-Western stance would not be affected. At present they need our political support and our protection for shipping we have reflagged. The extent of their reaction would also reflect how far they felt publicly humiliated or deceived.

6. It is however possible that they would act against our interests by not proceeding with military purchases from the UK, the largest element in visible trade. As regards invisibles, the Kuwaitis could move the KIO and their investments out of London, e.g. to Frankfurt. This would be expensive for them, and would not have a great effect on London as a financial centre. Significant disinvestment in British companies, not only BP but others, e.g. Royal Bank of Scotland, could have a depressing effect on the shares of the companies concerned. But it is questionable whether the Kuwaitis would risk potential losses by doing this.

C. BP's relations with HMG

7. If the Kuwaitis were to have a board member, this could complicate the confidentiality of the exchanges between BP and various parts of HMG. The following are examples of areas which could be affected:-

a) HMG currently rely on BP (and Shell) to lift and market the Saudi crude which is being used to pay for a large Tornado export deal with Saudi Arabia. Kuwaiti awareness of the details would be unwelcome to HMG and the Saudis.

b) Discussions on BP's policy towards certain sensitive countries, e.g. Iran would be inhibited.



c) In the likely event of attacks on shipping in the Gulf continuing, Kuwait might seek through BP to put pressure on HMG to assist a larger number of oil tankers and to extend the operations of the Armilla Patrol as far north as Kuwait. HMG have so far eschewed integrated operations with the US Navy which convoys Kuwaiti tankers and have been unwilling to commit more of the RN to the Gulf.

d) BP might pressure HMG to be more forthcoming in our attitude towards discussions between oil producers and consumers. HMG's position vis a vis OPEC, at present supported by the oil companies, is that questions of production and pricing should be left to the market.

e) Government/oil company discussions on contingency planning for oil supply in time of shortage or crisis would be constrained.

D. Kuwaiti Oil Interests

8. Although Kuwait has so far gone along with Saudi efforts to impose a \$18 official selling price, the Kuwaiti Oil Minister, Ali Khalifa, favours lower prices to discourage more expensive non-OPEC production. Kuwaiti oil strategy can be seen as an attempt to benefit from the longer-term effects of OPEC policies, i.e. eventual higher oil price, whilst increasing its involvement both in exploration and production, and in refining and distribution, outside the OPEC area. The Kuwaiti Petroleum Company (KPC), the state owned holding company for all domestic and international oil related activities, has, for some years, been pursuing a campaign of purchases of down-stream refining and distribution outlets, principally in the US and Europe. More recently this has been supplemented by a move into exploration and production activities in the same areas.

9. On the down-stream side the major landmarks have been the KPC purchase in February 1983 of Gulf Oil's refining and marketing interests in Benelux and Scandinavia. This was followed a year later by KPC's purchase of Gulf's Italian refining and marketing

interests. In the UK, KPC entered the down-stream market in 1986 through the acquisition of approximately 800 service stations belonging to the Hay's petroleum chain. In 1987 it purchased Ultramar's marketing operation, doubling its UK market share to approximately 2%.

10. On the up-stream side, KPC overseas activities are divided between two affiliates, Santa Fe International and Kuwait Foreign Petroleum Exploration Company. Santa Fe, a wholly owned US company acquired in 1981, provides KPC with production capacity from fields principally in California and the Gulf of Mexico and also from the North Sea. The Kuwait Foreign Petroleum Exploration Company is responsible for KPC up-stream efforts in developing countries and has large interests in Egypt and Indonesia.

E. Kuwaiti Interest in BP

11. The Kuwaitis have told us that their prime interest in BP is as a sound long-term investment. The KIO's interest in taking a major share in BP can also be seen as a continuation of its oil policy, though at a far more ambitious level than hitherto. The attraction of BP is that it complements KPC's recent acquisitions in both the US and Europe. About 90% of BP's production (1.4 mbd) is from either the North Sea or US. Since BP's acquisition of Standard Oil in 1987, BP accounts for 25% of total UK output and 8% of total US output. BP also owns about 10% of combined UK and US oil reserves. In the US the interests of BP (mainly Alaska) complement those of Santa Fe (mainly in the lower 48 states). In 1982 a joint oil exploration agreement was signed between Standard Oil and Santa Fe, then already a KPC company. Investment in BP could also offer KPC significant refinery capacity and a marketing network, notably in the US and Europe.

12. It is unlikely that KPC expects to enjoy the same degree of control over BP as it has over its smaller acquisitions. For this reason, they might agree to disinvest or accept no board membership/passive board membership, without feeling too much resentment.

13. If however they were to acquire a long-term influence over the management of BP, it is conceivable that at some future stage the Kuwaitis, as members of OPEC, might seek to reduce production and investment in the US and North Sea in favour of their own and OPEC's production. Moreover, even if this were not the Kuwaitis' intention, and they were content to adopt a purely commercial attitude to questions of non-OPEC production, it might be just as prejudicial to BP's interests in that others might suspect the Kuwaitis of such a conflict of interest. Large-scale OPEC involvement in the development of North Sea oil resources could well become a domestic as well as an international political problem.

F. US Attitudes

14. Paragraph 7 has considered the consequences of Kuwaiti influence on BP's relations with HMG. Just as serious could be the consequences for the company's considerable interests in the US, especially during an election year, when energy security and the health of the domestic US industry will be important issues. We know that the US has in the past invoked legislation against companies with large foreign government holdings (the Santa Fe case, where this company, owned by KPC, was initially barred by the Administration from acquiring exploration licences on government-held land). Such difficulties will become greater if the Breaux/Exxon amendment to the draft Omnibus Trade Bill is adopted; this would give the Secretary of Commerce the right to prevent foreign investment "against national security interests". This could affect BP if it tried to acquire Federal land, e.g. in Alaska, which it may well wish to do in the near future as its present reserves there become depleted. Increased Kuwaiti interest in, or control of, BP could heighten the risk of hostile action by the Administration (with an attendant threat to BP's share valuation, a matter of concern to the Kuwaitis too). It would be a major complicating factor in any defence of BP's interests in the US that HMG needed to mount.

15. It is not in the interest either of the UK (or of the Kuwaiti shareholders in BP) to encourage such US protectionist tendencies, which would not only adversely affect the BP share price, but also



the US position on free trade.

G. Legal position of the KIO and its London Office

16. We understand that the KIO is an instrument of the Kuwaiti Government.

17. Whilst the two principal officials of the KIO office in London enjoy diplomatic immunity, the FCO have not accepted the office itself as having any diplomatic status. In certain cases, an overseas government may enjoy immunity under the State Immunity Act, but the FCO's legal judgement is that in practice this would not prevent the British Government from acting under the Fair Trading Act in relation to the KIO's shareholding in BP. Moreover, the Kuwaitis would probably be reluctant to claim immunity, as this would affect their reputation in the financial markets worldwide. Nevertheless, there exists the potential for a bilateral dispute if the Kuwaitis were to seek to do so.

Foreign and Commonwealth Office
22 January 1988

FAIR TRADING ACT 1973

1. The Act gives the Secretary of State discretion, in the light of advice from the Director General of Fair Trading (DGFT), to refer to the Monopolies and Mergers Commission (MMC) any qualifying merger involving a market shares of 25%, or acquisition of assets worth £30 million or more.
2. The Act distinguishes three levels of influence on a company which constitute a qualifying merger - a) the ability materially to influence its policy, b) the ability to control its policy, and c) the acquisition of a controlling interest.
3. The Act does not define material influence or control in terms of percentage shareholding. In practice any acquisition of shares of 10 per cent or more is likely to be examined by the Director General of Fair Trading (DGFT) to establish whether it constitutes a qualifying merger. The DGFT considers each case individually; factors taken into account include the balance of other shareholdings, board representation, and voting rights.
4. The Secretary of State has powers under the Act to prohibit or impose conditions on merger only if the Monopolies and Mergers Commission find that it operates or is expected to operate against the public interest. An adverse report gives the Secretary of State power to seek a reduction in shareholding or divestment of assets, where he considers such action is requisite to remedy the adverse effects specified by the MMC.

TAKEOVER PANEL RULES ON INCREMENTS IN SHAREHOLDINGS

5. A person is prevented under Rule 1 of the Code from acquiring more than 10 per cent of a company's shares (representing voting rights) in any seven day period, if such acquisitions raise his shareholding to 15 per cent or more. A shareholding of more than 10 per cent can be acquired from a single shareholder only if it is the only acquisition in a 7 day period. At 30 per cent the acquiror must make a full bid.

INDUSTRY ACT 1975

6. The Act provides powers to prevent control of important manufacturing undertakings passing overseas. However, the powers do not apply to a level of shareholding below 30%. There could be difficulty in enforcing a prohibition order against a State.

SIGNIFICANCE OF VARIOUS LEVELS OF SHAREHOLDING

- 10% is the level at which the OFT publicly state (in their guide to procedures under the Fair Trading Act) that an acquisition is likely to be considered by the OFT to see whether it may constitute a qualifying merger.
- This is also the level down to which the MMC have recommended divestment following an adverse report on an existing holding.
- 15% is generally the "ceiling" imposed on a shareholding (or on the voting rights, if the shareholding is already larger) as an interim measure after a merger has been referred to the MMC, so as to avoid prejudicing the MMC's enquiry.
- 16.1% is the lowest level of voting rights which has actually been referred to the MMC : (arising from P&O's 20.8% shareholding in European Ferries, referred 17 June 1986).
- 20% is the level at which, according to City custom and practice, a shareholder could expect to have Board representation.
- 25% Under Company Law, certain major decisions have to be passed by special resolution, which require a 75% majority. (In practice, a shareholding of less than 25% is likely to be an effective block, as not all shareholders would attend the meeting).
- 29.9% is the maximum level permitted under the City Takeover Code before a full bid must be made.

SECRETARY OF STATE'S POWERS RELATING TO CHANGES OF LICENCE CONTROL

1. Any change in control of a UK licensee is subject to scrutiny by the Department of Energy. Such changes occur frequently, and the Department has to be satisfied that the change in control does not adversely affect the licensee's ability to fulfil the licence conditions. The definition of "change of control", based on a modified version of that in the Income and Corporation Taxes Act 1970, is someone being able to exercise direct or indirect control over the licensee and in particular possessing or entitled to acquire one third or more of the shares or voting power in the company.

2. In view of the basis of the Secretary of State's powers to grant licences (the 1934 Petroleum (Production) Act), the primary consideration for the Government when a change of control has occurred is the effect on the licensee's exploration and development activities and on the optimum exploitation of the UK's petroleum resources.

3. BP has offshore licences covering 108 blocks (net 8.5% of licensed area), and 79 operatorships. Onshore it has 9.5% of licensed area and 50 operatorships. It has 19.6% of estimated remaining UK oil reserves and 8.9% of estimated remaining gas reserves. Any acquisition of a controlling interest in BP by the KIO would automatically be subject to the Department's scrutiny procedure, and a recommendation made to the Secretary of State on the KIO's suitability to have control of BP's licence interests.

4. Failure to satisfy the Department could result in the Secretary of State's powers to revoke a company's licence being used. These are embodied in licence model clauses. Model clause 39 (3) allows the Secretary of State to revoke a licence where there is a change of control and where a further change is not effected to his satisfaction within three months of his serving notice on the licensee requiring such a further change.

5. This power was primarily aimed at preventing an unsuitable (e.g. financially and/or technically incompetent) company obtaining licences "by the back door" when they would not, under standard licensing criteria, have obtained them in the normal way. It has never been used, the preliminary scrutiny phase having, in all cases so far, been effective in obtaining the changes necessary to satisfy the Department's criteria.

6. Notice would have to be served individually for each licence held by the licensee, and would affect co-licensees also, although the Secretary of State could grant fresh licences to the "innocent" parties. Consideration would need to be given to the specification (or not) of a further change of control, and the terms and mechanics of the transfer.

7. The conclusions D. Energy draw from the foregoing paragraphs are that:

(a) The only certain basis on which we could require a scrutiny of BP's licences would be if the KIO bought one third or more of BP's shares;

(b) It would be very difficult to find sustainable grounds for challenging the KIO's control or revoking the licences simply on grounds of nationality. Moreover, such a divestment would be open to legal challenge by both KIO and BP;

(c) Revocation of the licences would have to take place simultaneously with a request to some other company to take over the licences (and in view of the scale of BP's operations there would be very few possible candidates - probably only the other majors);

(d) Although there is no provision for compensation in the model clauses, the question would almost certainly arise in the context of such a large, forced, divestment.

EXTRACT FROM TRANSCRIPT OF SIR PETER WALTER'S REMARKS TO JOURNALISTS AT HIS PRESS LUNCH ON 20 JANUARY

And so we go then from the disappointment of the sale to the Kuwaiti situation. In some ways I would feel that in a company with an international spread of assets, and this is what I try to put across as the strategic shareholding disposition at the time of the BP sale, I would like to see BP shares held more widely internationally but in proportion to where our assets are based. For that reason we had high hopes of a much greater international shareholding in the United States, that substantially has not come about. We now find that eighteen and a half per cent or so of the company is held by Kuwaiti interests. How do we feel about it? I take it at face value what the Kuwaitis have assured the British Government that their interest in the company is long term, strategic and confined to investment, namely that they do not propose to interfere with the management of this company nor, implicitly, I think, that they are going to launch for the whole of this company. I take that at face value, we are prepared to live with the situation. Of course any shareholding perhaps over 10 per cent in one hands does tend to colour the perception that Governments around the world or customers or competitors might have of that company. I think that in taking the Kuwaiti's assurances at face value what we really have got to demonstrate is that we are still just as independent a company as ever we were that just as for 70 years we lived with a Government shareholding in this country that did not effect commercial aspects and strategy of BP, so that we can live with a Kuwaiti investment in the company for as long as, and I hope that it is long term, they are prepared to put their faith in us. I think they've got an exceptionally good buy in one sense, its a pity that the institutional shareholders where the assets are did not also see the opportunistic situation that the Kuwaitis have filled.



Chy / A.A. 10/11

- see page 3.

JR
25/11

Per letter Law
to retract from
Sir P. Walker's recent
address to the shareholders
in which he referred
to the BP share issue
& ~~that~~ ~~that's~~ his view
of that's contact.
M.

Transcript of Sir R. Walter's remarks at his pre-lunch on 19/1.

Many times, and I don't think Bob Head has been here in each one of his 25 years as City Editor, which must make him the doyen of your assembled company who come here, but for those of you who have been here before welcome again its very nice to have you on our annual occasion, or such as Lucy, who is here on my left, who hasn't been here before, who I think, without betraying her confidence, thought it was going to be a private lunch, but I mean if.... Welcome Lucy and all of you who are joining us for the first time.

I think in 1987 we've done rather well by each other. We've provided you with a lot of good copy, by and large you've done well by us and thank you. I say by and large, because there were some things that were almost libellous, I mean the description of me in one renowned northern paper as being someone, I think addicted to casual suits, suede shoes and pipe, either confused me with Harvey Jones or Michael Hesletine or really took no notice of the day after that we announced the nuclear non-smoking free zone Britannic House and really the Chairman with a pipe! However, I forgive you that, but it just shows that you don't have to believe all that you read in the papers.

1987 actually was a much more significant year for BP than the last three months and the news spread that we got might have indicated. It was significant, I think, because if you can remember way back to July, which is pre-year black-Monday, we then completed on 1st July the acquisition of the minority interest in Standard Oil and frankly that was a land-mark for BP. For a number of years we have looked at the United States as the market where BP wish to have a unified operation and entity. We found that with Standard Oil and the majority shareholding we had on the one hand, and the BP businesses we were rapidly building up under our own name, that we were getting to the point where compared with some of our other competitors, like Shell and Exxon with unified management and coherent corporate strategies, we were in danger of falling between two stools, were either missing opportunities between ourselves and Standard, were perhaps duplicating overheads, were even perhaps colliding in the marketplace where that would normally be unnecessary and so our plans actually for unifying into one corporate entity came to fruition at the middle of last year. And just to remind you, but you don't need any reminding, the United States is the world's largest petroleum market, the world's largest agriculture market, almost by any standards the world's largest everything market with perhaps a slow growing population when you look at GNP growth per head the world's richest discretionary dollar lending market in the world. To see BP established there with something now representing about 50 per cent of the assets of our company is, I think, the major strategic plank of BP's policy of the last 10 years. We made a start at the beginning of last year too, in expanding our nutrition business in the United States with the acquisition of Purina Mills, the largest animal feed producer in the States which puts us very evenly spread in our nutrition business between Europe and the USA, our two dominant agriculture communities. We made a

start too in our strategic advanced materials businesses by going into the United States and acquiring a company called Hitco on the West Coast which is one of the six major US advanced materials suppliers and a business and an industry which we think in the next century will be contributing a very significant cash flow to our company. The acquisition of the Standard Oil minority made us the third largest oil company in the world, not that size in itself is a virtue, but it gave us number one position in production and reserves of oil in the US. We are and have been for some time, the number two company in oil reserves in Europe. Looked at as a whole in the previous five years we have maintained our oil reserves situation. We believe that, even excluding the Britoil situation, about which perhaps a little bit later, for the next five years, based on our current record and appreciation of what we have available, we will be able substantially to maintain our reserves of oil and gas, which is, I think, a source of considerable strength for the company. Last year was not as good as we had hoped in the downstream business of refining and marketing. A situation, of course, that affected all major companies and from which I think BP emerged rather better than some of its competitors. It was however, an exceptionally good year for BP Chemicals who are restricted at the moment only by the fact that they are at about 103 per cent of their capacity utilisation, part of which will be taken care of when we bring onstream two new plants that are building now and which will be available at either the end of this year or early next. A year of almost turnaround for BP Minerals, but certainly this year we will see the mineral business, which has been such a disappointment to us over the last five years, get, we believe into healthy profit, particularly with the commissioning of the new facilities at Bingham Canyon in Utah, where the new modernisation plant is due to come on stream in the middle of the year, and the long awaited commissioning of Olympic Dam, the polymetallic uranium, copper and gold mine which we share with Western mining in Southern Australia. Two very significant events I think for BP Minerals and one which perhaps went slightly unnoticed because it was announced but didn't quite take place in the aftermath of black-Monday was our announced intention of forming BP Gold which is a company which would put together a very substantial part of BP's worldwide gold assets totalling in that case about 26 million ounces and where we announced our intention in November to float a company and sell off ten per cent of that company to the public. We didn't go ahead with it, not because the gold market collapsed, but a general perhaps lack of confidence in the market-place, but we've got that under review. We have got it well-defined and perhaps a pointer for the future of something that we have been turning considerable more attention to which is extracting value from the company for the shareholder.

Two dominant things perhaps in BP's strategy apart from the things which you actually see us doing, making acquisitions or bringing in extensions of existing oil fields or making new finds, an underlying theme of our strategy, two-pronged, is superior performance and critical mass in those businesses in which we are engaged. Now they are not just words, they have

in our operations some well-defined successes where what we'll be looking for is to be better than most in the areas in which we operate, either technologically or in terms of customs service or products that we produce, and also to concentrate geographically and in market sectors to a point where the critical mass of market penetration gives us the added value that if you are extending too widely in any product or in any area detracts from your margin performance, so excellence and critical mass are two very dominant themes, it means expansion in areas that we know well, it means contraction in areas where we are too thinly spread, and we have got quite a few good examples of where that has succeeded.

*for P
Walker
at BP annual
press lunch
a fortnight
ago*

Now all that was lead up for parading before the institutions of the world a marvellous company, which we did, and where in spite of the fact that we were offering some 2 billion shares to institutions around the world and to 6 million potential individual investors in this country, in the first week of October the world could not get enough of the BP shares on offer, the third week of October sadly we saw triumph turn into considerable disappointment. The outcome was in my view the right one, the sale should have gone ahead, I was very pleased though, that there was this temporary lifeboat represented by the Bank of England offer to buy back the partly paid which has now expired and which, as you see, almost no-one took advantage of. There was no disagreement between myself and the Chancellor as to whether the sale should go ahead or not. We are both fairly independent minded people, we have our occasional disagreements on tax rates in the North Sea but I do assure you that there was no disagreement and there is, really no ill-will between the Chancellor and myself. Again if you believe the pipe and the suede shoes you'll believe that there is but I'd ask you not to believe either.

And so we go then from the disappointment of the sale to the Kuwaiti situation. In some ways I would feel that in a company with an international spread of assets, and this is what I try to put across as the strategic shareholding disposition at the time of the BP sale, I would like to see BP shares held more widely internationally but in proportion to where our assets are based. For that reason we had high hopes of a much greater international shareholding in the United States, that substantially has not come about. We now find that eighteen and a half per cent or so of the company is held by Kuwaiti interests. How do we feel about it? I take it at face value what the Kuwaitis have assured the British Government that their interest in the company is long term, strategic and confined to investment, namely that they do not propose to interfere with the management of this company nor, implicitly, I think, that they are going to launch for the whole of this company. I take that at face value, we are prepared to live with that situation. Of course any shareholding perhaps over 10 per cent in one hands does tend to colour the perception that Governments around the world or customers or competitors might have of that company. I think that in taking the Kuwaiti's assurances at face value what we really have got to demonstrate is that we are still just as

independent a company as ever we were that just as for 70 years we lived with a Government shareholding in this country that did not effect commercial aspects and strategy of BP, so that we can live with a Kuwaiti investment in the company for as long as, and I hope that it is long term, they are prepared to put their faith in us. I think they've got an exceptionally good buy in one sense, its a pity that the institutional shareholders where the assets are did not also see the opportunistic situation that the Kuwaitis have filled.

Now Britoil, you all presumably want to know more about Britoil than the Offer document contains and whether there have been any further developments. I really can't tell you any more than the Offer document contains I think it sets out very well why we are bidding for Britoil, the fit that it has with the BP situation in the North Sea, the technological expertise that we believe we can bring to the development of Britoil's assets, perhaps more quickly and for the betterment of the nation than Britoil could. They've got long assets but they are relatively a small company, I think that with our diversity of spread of income from sources that do not necessarily go down or considerably up with the price of oil alone we can offer, as we've said in the document, a more consistent approach to the development of Britoil's assets. We believe we have made an offer that is fair in relation to the value of those assets, its fair for the Britoil shareholder. My other constituency of course is that any offer has to be fair to the BP shareholder and I think that we have pitched it in this situation at the right level. We'll have to wait and see. But I can't really tell you any more and at the moment there are no further developments.

Looking ahead now to 1988, much, of course, as it has for the last 3 years, depends on the oil price. Just two years ago at this lunch I welcomed the new approach led by the Saudi's towards a stability based on an 18 dollar barrel. I rationalised at that time that if anyone could pick a price that was fair to or fair enough to producers, consumers and enabled the oil industry to get ahead with development of sources outside OPEC, was very necessary to stop the obviously ultimate world dependance, particularly on the OPEC countries in the Gulf then you couldn't do better than to pick 18 dollars a barrel. I still take that view I am perhaps slightly reinforced in still taking that view by the fact that those 18 dollars aren't quite worth as much as they used to be. That must weigh very heavily I think, in the minds of the producers, the OPEC producers. They are going through some fairly testing times as they look at the new quotas, at what appears also to be Saudi's refusal any longer to act as the swing producer and to ensure that everybody who has a quota sticks to it. I think they've got to emerge through that their budgets in fact necessitate it. If they come through the next testing 2 to 3 months, I think that we'll all be basing our plans on a continuance of 18 dollars more or less. I think 1987 shows that you can't actually get 18 dollars, sometimes it will be above, sometimes it will be below. But, given seasonal swings and roundabouts, I think that another period of relative stability is in store for us.

CONFIDENTIAL

FROM: D J L MOORE

DATE: 25 JANUARY 1988

- JM*
1. SIR PETER MIDDLETON
 2. CHANCELLOR

copies attached for: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary

cc Mr Anson
Mr Monck
Mr R I G Allen
Mrs M E Brown
Mr M L Williams
Ms Leahy
Mr Bent
Mr B O Dyer
Mr S B Johnson
Mr Call

Ch / Content?
Jr 25/1 *OK -*

Miss Wheldon TSOL

BP: BRITOil/KIO

Line for press briefing and for PM's Questions.

I suggest that our line in dealing with press queries should be:-

'It remains the position that the powers of the Special Share will be used for so long as it is in the national interest to do so. We are keeping developments under very careful review. If BP, or any other bidder, became certain to acquire a majority of Britoil's ordinary shares, we would discuss the situation with them and with the Britoil Board. We cannot say anything further at this stage.'

2. This is a variant of the holding line approved by the Chancellor for use if and when BP had acquired a majority holding (Mr Taylor's note of 21 January). It reflects the fact that while BP very probably will get a majority they have not yet done so.

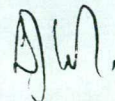
3. It is still open to Arco to accept a higher bid from elsewhere if one emerged. But they could at any time announce a firm decision (rather than their present intention) to accept BP's revised offer of £5. If they did so, under the Takeover Code requirements the shares would not actually pass to BP before 4 February, the closing date of the present offer. Thus, there could be an interval during which a BP majority holding was certain but not yet in place.

4. BP expect to post their revised offer this Wednesday or Thursday. This offer has to remain open for 14 days. We should therefore assume a closing date of around 12 February.

5. I also attach briefing notes for PM's Questions tomorrow. The note on Britoil expands the previous one to take account of the line recommended above.

6. The KIO note is as before with the insertion of the second question on whether the Chancellor is meeting Ali Khalifa. This meeting has already been reported by Platt's Energy Services, apparently following a leak by the Kuwaitis. Although we do not want any spotlight on this meeting it seems to me better not to deny it. We need a line for the press office anyway.

7. When the notes for PM's Questions have been approved I suggest that Mr Taylor sends copies to Energy, FCO and DTI.



D J L MOORE

BP BID FOR BRITTOIL

Line to take

Her Majesty's Government's position was outlined to the House by the Chancellor on 11 January when he explained the powers of the Government's Special Share in Britoil:

- in present circumstances the Government intend to use their Special Share in Britoil to prevent any bidder from gaining control of the Britoil Board
- the powers of the Special Share will be used for so long as it is in the national interest to do so.

Now that BP has made a formal offer for the whole of Britoil's ordinary shares, 71C of the Articles of Association comes into effect.

If BP, or any other bidder, became certain to acquire a majority of Britoil's ordinary shares, my Rt Hon friend would discuss the situation with them and with the Britoil Board. The situation is still developing and I cannot say anything further at this stage.

Notes

1. BP have revised their cash offer from 450p to 500p. This offer has to remain open for 14 days after they post their revised bid later this week.

2. Arco have declared an intention to sell their 24% Britoil holding to BP who already have 29.8%. But Arco have not yet announced a firm decision and they are still free to sell to a higher bidder if one emerged.

KIO AND BP

Assurances by the Kuwait Authorities

As the Treasury announced on 8 January, the Kuwait authorities have assured us that they have no ambitions to control BP nor any interest in any management role, and that the KIO holding in the company is intended as a long term investment.

Meeting with Kuwaiti Ministers

[NB For use only if ^{esud} proceed]

My Rt Hon Friends the Chancellor and the Secretary of State for Energy expect to see Shaikh Ali Khalifa the Kuwait Oil Minister and acting Finance Minister, when he is in London this week. Normal for opposite numbers to meet. Not practice to give details.

Possibility of reduction in present holding

They have said that it is a long term investment. Any reduction would be a matter for their commercial judgement.

[NB on 22 January KIO announced an increase in their holding from 18.41% to 18.88%]

Possibility of sale of KIO's BP shares to a purchaser unacceptable to HMG

I am confident that they would not make a sale unacceptable to us and that they would consult us if they were contemplating any significant disposal.

Acceptability of present level

As I said on 19 November it is not surprising that there should be a considerable number of overseas investors in an international company like BP. [It is unrealistic to lay down precise figures

as to what is an acceptable level of investment.] But in the case of the KIO what is important is the very firm assurances the Kuwait authorities have given.

Acceptability of up to 29.9%.

As the Chancellor told the House on 11 January, an increase up to 29.9% would seem inconsistent with the assurances given that the KIO has no intention at any time of seeking to exercise control over BP.

Role of Office of Fair Trading and MMC

If there had been any question of the KIO proceeding to a full bid for control the situation would have been examined under the Fair Trading Act in the normal way.

The KIO's current holding is being considered as a matter of course by the Director General of Fair Trading who will advise the Secretary of State for Trade and Industry whether there may be a merger situation qualifying for investigation and, if so, whether it should be referred to the MMC.

[Note To preserve the Secretary of State's position nothing should be said which indicate that HMG has already concluded that the present KIO holding either is or is not acceptable.]

Timing of Kuwaiti assurances and of Treasury's statement

Assurances were given to Mr Mellor on 23 December. Made public on 8 January in response to enquiries following misleading statements in the press.

Collusion between HMG and Kuwaitis to boost BP share power (Independent story)

No truth in this whatsoever.

And no truth in claims that Mr Mellor discussed the KIO holding with the Kuwaitis on 4 December.

BP's views

For them to say.

The KIO bought into BP cheaply as a direct result of the Government's foolishness in going ahead with the BP sale

Always possible for someone to buy shares cheaply after a fall in share prices. The Bank support operation meant that the Kuwaitis had to pay more than they would have otherwise.

CONFIDENTIAL

[Signatures of 12] (complete agreement)

FROM: N MONCK

DATE: 25 January 1988

SIR P MIDDLETON

cc Chancellor
Financial Secretary
Economic Secretary
Mr D Moore
Ms Leahy

Miss J Wheldon, T.Sol

V. Atkinson v. I.S.S. also
to groups to Mr. H's
address JAMES
or nuisance
value
APR 1988
CWA 1
complaint
by a
holder.
2-1 S.S. like to
business all this
@ K. Home
mtg.
M

MR KENNINGTON'S ADVICE ON BRITTOIL

I attach a letter and a note by Mr Kennington which I received this morning. His proposals are designed for a situation in which BP get all the Britoil equity or have the right to do so, and Ministers regard it as acceptable for BP to play an active role in Britoil and its management. He proposes:

- (a) that a deal with BP should take the form of a shareholders' agreement to which Britoil would also be a party. In return HMG would undertake not to vote its Special Share (unless the rights of the Share were effected) and not to requisition General Meetings. The Special Share would be reactivated if BP lost its independence;
- (b) he does not attempt to define the content of the deal. But he sees advantage in one feature of it in relation to KIO, viz that the agreement would permit BP to move assets into Britoil and would prevent Britoil from disposing of them. Subject to shareholder consent, this could enable BP to construct its own "poison pill" against unwelcome predators.

Comment

2. I have discussed this with PE and Miss Wheldon. If the Government decided it wanted a deal with a successful bidder, a shareholders' agreement is certainly one possible form it could take. But we would first need to decide whether we wanted any such deal to have a precise legal form or not. No judgement could be made until we knew what kind of agreement we wanted and what could be negotiated. Mr Kennington rightly draws attention/to the need to define "the national interest factors", which would need to be agreed collectively.

3. One element in his note which strikes me as right is that at least initially

the Government's proposition would be to deny itself the use of the Special Share's voting power provided the bidder's side of the deal is honoured. This seems a better negotiating posture than offering at an early stage to redeem the Special Share.

4. So far as (b) is concerned, it probably is not worth considering the potential advantages in relation to KIO unless it is clear that other approaches are running into trouble. We thought it was doubtful whether the significance of a ploy of this kind could be kept quiet for long.



N MONCK

35/146

19 Deepdale,
Wimbledon,
London, SW19 5EZ.

Tel: 01-946 8729

23rd January, 1988.

CONFIDENTIAL

N. Monck, Esq.,
H.M. Treasury,
Parliament Street,
London SW1P 3AG

Dear Ned

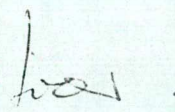
As I mentioned in the course of our telephone conversation on Friday I have been giving some thought and prepared a note relating to the position of the Special Shareholder if BP wins its bid and Britoil becomes BP's wholly owned subsidiary. I now enclose the original and four copies of this note. The suggestions in it may appeal to Ministers.

The note was prepared before Friday evening's news of ARCO's agreement to accept BP's increased bid. That news makes the note of greater relevance. Whilst it does not rule out another third party offer, it makes it very unlikely in my opinion. I should emphasise that the proposal contained in the note is not intended to be applicable to a situation in which BP declares its bid unconditional with a significant minority shareholding left outstanding. I do not regard this possibility as being very likely but if it were to ensue it would require a different solution which I would be happy to discuss with you.

Events could move fairly fast after BP receives ARCO's acceptance of BP's offer. At the time of writing I have not seen details of the precise contractual position between BP and ARCO and in particular do not know the specified date by which ARCO has committed itself to accept the BP offer if no higher offer is on the table.

Would you kindly pass copies of my note to Sir Peter Middleton and Ministers. I shall be interested to learn your reaction to the suggestion. Please let me know if any points want clarification. If of interest there is preparatory work to be done.

Yours sincerely,



I.G. Kennington.

who? limit / 13028
address, PC,
tel. no

22nd January, 1988

To: N. Monck, H.M.Treasury

From: I.G.Kennington

BRITTOIL - SPECIAL SHARE STRATEGY

1. This note outlines a strategy for HMG in responding to a Britoil bid outcome in which:-

i) an offer from BP becomes unconditional in all respects;

ii) BP obtains 100% of the Britoil equity (or has the Companies Act right to do so and intends to use it);

iii) Ministers decide that it is not in the national interest to permit Britoil to redeem the Special Share or to give up permanently the special powers under the Articles of Association at this time; and

iv) Ministers regard BP as an acceptable party to play an active role in Britoil and its management.

2. In an earlier note (10th January, 1988) I advised that a contractual arrangement between HMG and a sole equity owner of Britoil - with or without the back up of Special Share powers - was a more appropriate and effective way of protecting the national interest, e.g. if Britoil was under 100% BP equity ownership. A Special Share with fully adequate powers under the Articles of Association remains the preferable route for a listed company with public shareholders.

PROPOSAL

3. Ministers and BP may find the following proposal of interest which I believe can be successfully structured:-

i) the Special share in Britoil remains in being with its special voting powers in place under Article 71(C) and with all other Articles remaining substantially unchanged;

ii) BP is invited to enter into a Shareholders' Agreement with H.M.Treasury (to which Britoil PLC would also be a party) under which BP undertakes to procure that Britoil acts or refrains from taking certain actions (to be defined) in order to provide the essential national interest protections for HMG; in particular the agreement would permit BP to move additional assets into Britoil and would restrain disposal by Britoil of any material part of its existing assets;

iii) in consideration of BP and its subsidiary, Britoil, entering into the Shareholders' Agreement, HMG undertakes:-

- a) not to vote its Special share at General Meetings of shareholders (other than on resolutions to change the Articles which could affect the rights of the Special Share) and
- b) not to requisition meetings of shareholders,

all for so long as:-

- c) no party owns or controls more than 50% of the equity or voting rights of BP or of any intermediate parent company of Britoil, and
- d) both BP and Britoil comply with their obligations under the Shareholders' Agreement.

It is envisaged that the essential national interest constraints in the agreement would be relatively few. They require further study and are not identified in this note.

ADDED ADVANTAGE

4. An important element of the proposal is that the Shareholders' Agreement presents the BP board with the opportunity to inject existing assets of BP into its subsidiary, Britoil, in the knowledge that BP would not be restrained from exercising continued management control over the assets through the enlarged Britoil for so long as BP remained an independent company. In the event of BP losing its independence, the Special Share powers in Britoil would automatically be reinstated and would operate over an enlarged Britoil. It is for consideration by Ministers whether they would wish to be seen overtly to be offering the BP Board this opportunity of increasing the chance of BP retaining its own independence. Should the BP Board find this protection of interest it would be a decision of the BP Board alone whether or not to implement

it. Ministers would have created the environment in which the national interest could be better protected and on a wider scale than within the existing Britoil. There is no need for any attention to be drawn by Ministers and BP to this possibility as only the BP board can initiate the potential protection. On the other hand Ministers may regard it as appropriate to be seen as having offered BP this opportunity. Under the City Code on Take-overs and Mergers BP could not move assets into Britoil after a bid for BP was seriously in prospect without first obtaining BP shareholders' approval.

END RESULT

5. The result achieved would, therefore, be:-

i) Britoil remaining in existence as a separate company under British control;

ii) no termination or loss of the Special Share powers, albeit they would be held by The Treasury in abeyance for so long as BP remained an independent company and both BP and Britoil complied with the Shareholders' Agreement;

iii) the offering of a lifeline to the BP Board by providing BP with some additional protection against a bid;

iv) BP obtaining day to day management control of Britoil through a Britoil board subject to continuing

- compliance with the terms of the Shareholders' Agreement and to BP remaining independent;
- v) HMG not being seen to surrender any of its Special Share rights at a time when BP's own independence may be in question;
 - vi) protection of HMG's position in Britoil in the event of a bid for BP;
 - vii) HMG acknowledging BP's de facto equity ownership and control position after defining the parameters within which the Britoil/BP management can operate; and
 - viii) removing much uncertainty which will otherwise arise among Britoil's staff and assisting in retaining or recruiting management to Britoil.

BENEFITS TO BP

6. The attractions to BP which might induce it to enter into an arrangement along these lines are:-

- i) BP is seen not to be in conflict with HMG;
- ii) elimination of uncertainty with its adverse effect on Britoil staff morale;
- iii) BP obtains a lifeline whereby it can construct its own "poison-pill" against unwelcome predators;
- iv) BP and Britoil management obtain clearly pre-defined parameters within which they can operate e.g. the extent to which BP can move assets in or out

of Britoil;

v) a structure which enables BP to obtain the advantages of operating BP's and Britoil's North Sea assets together in Britoil with BP management control for so long as BP remains an independent company.

HMG'S POSITION

7. The attractions to HMG are considerable and would be achieved without climbdown or loss of face. In reality the Special Share rights are strengthened through the Shareholders' Agreement. The conditional suspension of the enhanced voting rights for so long as BP remains an independent company is entirely consistent with the concept of the Special Share's powers being reserve powers only. The likely level of interest from BP in the proposal will depend on the extent and nature of the minimum national interest protections inserted in the Shareholders' Agreement.

NEXT STEPS

8. This note does not address the timing or form of any HMG announcement. If the proposal is of interest to Ministers, preparatory work needs to be carried out at the earliest opportunity to define the national interest factors for incorporation in the Shareholders' Agreement.

mjd 2/93Jn

CONFIDENTIAL



FROM: J M G TAYLOR
DATE: 26 January 1988

PS/SIR P MIDDLETON

cc PS/Financial Secretary
PS/Economic Secretary
Mr Monck
Mr D J L Moore
Ms Leahy

Miss J Wheldon T.Sol

MR KENNINGTON'S ADVICE ON BRITOil

The Chancellor has seen your minute of 25 January and Mr Kennington's enclosed note.

2. He has commented that this is very interesting. He would also be grateful for Mr Kennington's advice as soon as possible on the nuisance value of HMG's 1% holding of Britoil Ordinary (which he understands cannot be compulsorily acquired by a bidder). I should be grateful if Mr Monck could arrange this.

A handwritten signature in black ink, appearing to be 'JMG'.

J M G TAYLOR

CONFIDENTIAL



FROM: J M G TAYLOR
DATE: 26 JANUARY 1988

MR D J L MOORE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr R I G Allen
Mrs M Brown
Mr M Williams
Ms Leahy
Mr Bent
Mr B Dyer
Mr S Johnson
Mr Call

Miss Wheldon
T Sol

BP: BRITOIL/KIO

The Chancellor has seen your minute of 25 January. He is content with the line proposed and with the briefing notes.

A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR

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CONFIDENTIAL

FM RIYADH

TO PRIORITY FCO

TELNO 49

OF 260530Z JANUARY 88

INFO ROUTINE GULF POSTS, OPEC POSTS

PS. TO CHANCELLOR OF THE EXCHEQUER,
TREASURY.

SAUDI OIL POLICY

SUMMARY

1. SAUDIS NOW ACCEPTING SOME REDUCTION IN PRODUCTION (PERHAPS 0.5MBD) PROVIDED OTHERS PLAY THEIR PART. AN UNDERSTANDING WITH IRAQ. ABU DHABI ON SIDE, PERHAPS TEMPORARILY. AIM IS TO STABILISE PRICES UNTIL THE MARKET IMPROVES, HOPEFULLY IN APRIL. A DELICATE PERIOD.

DETAIL

2. HEAD OF CHANCERY CALLED ON DEPUTY MINISTER OF OIL ON 25 JANUARY FOR A TOUR D'HORIZON. ABDUL AZIZ TURKI SAID THAT THE VIENNA OPEC MEETING HAD BEEN DIFFICULT. IN RETROSPECT, IT HAD BEEN A MISTAKE TO SET A RELATIVELY LOW CEILING IN JUNE 1987. AS SOON AS THE MARKET HAD TIGHTENED THE PRODUCERS HAD LOST DISCIPLINE. THIS HAD TO BE RESTORED. AS REGARDS PRICE, THE SAUDIS WOULD, ON PURELY NATIONAL GROUNDS, PREFER A LONGER TERM PRICE CLOSER TO THE THERMAL EQUIVALENT OF US DOLLARS 15 BUT HAD COMPROMISED AT US DOLLARS 18. ANY HIGHER PRICE WAS OUT OF THE QUESTION.

3. TURKI AGREED BROADLY WITH THE MARKET OUTLOOK DESCRIBED IN PARA 3 OF YOUR TELNO 204 TO VIENNA. IT WAS, HOWEVER, IN EVERYONE'S INTEREST TO SUSTAIN THE OIL PRICE. HE BELIEVED THAT THE IRAQIS ALSO UNDERSTOOD THIS. HE 'HAD THE IMPRESSION' THAT THERE WAS AN UNDERSTANDING (BUT NOT AN AGREEMENT) THAT IRAQ WOULD HOLD PRODUCTION TO THE SAME LEVEL AS THE IRANIAN QUOTA. THIS WOULD, IN PRACTICE, ACHIEVE THEIR POLITICAL OBJECTIVE WITHOUT UNDULY STRAINING THE MARKET. (TURKI CONFIRMED THAT KUWAITI AND SAUDI ARRANGEMENTS FOR WAR RELIEF CRUDE HAD BEEN RESUMED BUT THE OIL COULD ONLY BE SOLD AT THE OFFICIAL PRICE. AT PRESENT, HE BELIEVED THAT THE TOTAL VOLUME WAS ONLY ABOUT 200,000 BD. AMOUNTS UNSOLD COULD BE SOLD LATER. HE POINTED OUT THAT HISHAM NAZER HAD NOT MADE PUBLIC THE TOTAL BUT HE DID NOT DENY THE FIGURE OF 310, 000 BD WHICH HAS APPEARED IN THE SPECIALIST PRESS.)

PAGE 1
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4. TURKI REMARKED THAT ABU DHABI WAS, AT LEAST FOR THE PRESENT, HOLDING STRICTLY TO QUOTA AND TO OFFICIAL SELLING PRICES. AS FOR THE SAUDIS, THEY HAD BEEN PRECISELY ON QUOTA IN DECEMBER 1987 BUT EXPECTED TO BE 4 TO 5 HUNDRED THOUSAND BARRELS BELOW QUOTA IN JANUARY. AT PRESENT, THE PROSPECTS WERE FOR STILL LOWER OFFTAKE IN FEBRUARY. TURKI INDICATED THAT THE SAUDI OBJECTIVE WAS TO SUSTAIN THE PRICE UNTIL THE MARKET IMPROVED IN APRIL BUT THEY WERE ONLY PREPARED TO MAKE SACRIFICES IF OTHER OPEC MEMBERS STAYED WITHIN THEIR QUOTAS. THE COOPERATION OF NON-OPEC MEMBERS WAS ALSO ESSENTIAL EACH, AS HE PUT IT, IN THEIR OWN STYLE. THE CURRENT POSITION WAS DELICATE BUT THE SAUDIS WERE PREPARED TO WORK FOR STABLE PRICES SO LONG AS OTHERS PLAYED THEIR PART.

COMMENT

5. ACCORDING TO LOCAL INDUSTRY SOURCES THE SAUDIS HAVE WHAT IS EFFECTIVELY A MARKET PRICE ARRANGEMENT WITH THE ARAMCO PARTNERS AND ARE DISCOUNTING TO ONE OR TWO OTHER US COMPANIES. THEY ARE REFUSING TO DISCOUNT TO OTHER FOREIGN FIRMS, APPARENTLY READY TO ACCEPT SOME CONSEQUENTIAL REDUCTION OF LIFTINGS.

EGERTON

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ADDITIONAL 41

OIL

NN NN

From: The Rt. Hon. John Smith, Q.C., M.P.



HOUSE OF COMMONS
LONDON SW1A 0AA

cc: FST
PEN
NRMK
DZLM

26 January 1988

CI
100 bynd...
100...
100... also...

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Gt George Street
LONDON SW1

demand.
AA
WA
Galloway

Nigel Lawson

BRITOIL

I would be most grateful if you could agree to meet myself, Donald Dewar, Bruce Millan and George Galloway (Constituency Member) to discuss the situation at Britoil in the light of recent developments.

If you are agreeable perhaps our offices can arrange a suitable time and place.

John Smith

JOHN SMITH



FROM: D J L MOORE
DATE: 27 JANUARY 1988

CHANCELLOR

cc Financial Secretary
Sir P Middleton
Mr Monck
Mr Williams
Ms Leahy

BP/BRITTOIL: TIMETABLE

BP's revised offer will be posted today. It has to stay open for at least 14 days ie to 11 February. BP could revise the offer further if they wished.

2. Arco could at any time convert their intention into a firm commitment to sell their 24% to BP at £5. BP would then have 54% of Britoil.

3. But BP cannot acquire Arco's shares before 4 February, the date on which BP's present offer closes.

4. It therefore seems unlikely that Arco will declare their hand before 3 February. And if a white knight does emerge they could delay until 11 February - or, of course, later if the BP offer were extended.

5. Britoil expect to issue a defence document before 29 January. If Arco commit to sell out to BP they will have to issue further advice to the minority shareholders.

6. If the offer has not gone unconditional by 25 February shareholders will be able to withdraw their acceptance.

7. The offer has to close by 14 March unless a competing bid is put in.

8. On these assumptions we must be ready to act by Thursday 4 February ie to be ready to talk to BP and to Britoil and, presumably, to make some further statement in the House, even if only a holding statement.

D J L MOORE

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A large, stylized handwritten mark or signature in the top right corner of the page.

FROM: J M G TAYLOR
DATE: 28 JANUARY 1988

MR D J L MOORE

cc PS/Financial Secretary
Mr Monck
Mr Williams
Ms Leahy
Miss Wheldon - TSOL

BP AND BRITOIL: OFT

The Chancellor has seen your minute of 28 January to Sir Peter Middleton.

2. He notes your comment that the sooner we can speak about our ideas to the Scottish Office the better it will be. He has commented on this that Mr Rifkind already knows the broad approach we have in mind, though not the details.

A handwritten signature, likely of J M G Taylor, consisting of stylized initials.

J M G TAYLOR

CONFIDENTIAL

SIR PETER MIDDLETON

FROM: D J L MOORE
DATE: 28 JANUARY 1988

cc PS/Chancellor
PS/Financial Secretary
Mr Monck
Mr Williams
Ms Leahy

Miss Wheldon TSOL

BP AND BRITOL: OFT

As you know we, Energy and the Scottish Office have been asked by OFT for our comments on the BP bid.

2. Energy are advising that they see no argument for referring the BP bid to the MMC on grounds of competition or other public interest. We agree with that. The question to the Treasury was in relation to the Special Share. I attach a copy of my reply.

3. I also attach a copy of the letter from the Scottish Office, Officials did not discuss this with us because they said it was essentially a matter for their Secretary of State. Mr Taylor told me that Mr Rifkind had told the Chancellor on Monday evening that the Scottish Office were deliberately saying very little and nothing new and that they were keeping a low profile. Their letter, however, is not particularly low profile since it hopes for a reference to the MMC.

4. Their point that Sir P Walter's statements on Glasgow are not included in the offer itself strike me as rather silly - the letter is incorporated in the offer document. But their main point, which is fair enough, is that BP's undertakings lack precision; and they hope that the outcome of a reference to the MMC would have the effect of binding BP to its commitments to Scotland.

*Re X. M. Rifkind
also known
to be
approach
we have in mind,
this is the
details.*

5. This wish for greater precision and for binding commitments is of course in line with our own thinking, which I am setting out further in a note which I will be putting to you later today. This reinforces the thought that the sooner we can speak about our ideas to the Scottish Office the better it will be.

DJL.

D J L MOORE



CONFIDENTIAL: MARKET SENSITIVE

COPY

New St Andrew's House
Edinburgh EH1 3TA

Telephone 031-556 8400
ext

GTN 2034

Telex 727301

Industry Department for Scotland

A G Atkinson Esq
Assistant Director
Mergers Secretariat
Office of Fair Trading
Field House
15-25 Bream's Buildings
LONDON
EC4A 1PR

26 January 1988

Dear Mr Atkinson

BP/BRITTOIL AND ARCO/BRITTOIL

Thank you for copying to me your letter of 19 January to David Moore. You asked for Scottish Office views on whether BP's bid for Britoil should be referred to the MMC for investigation.

Britoil is of course a major Scottish-based company; and as such has an important place within the Scottish economy, both in terms of the jobs supported and (perhaps as significantly) the contribution which the Britoil headquarters functions located in Glasgow make to the range, depth and diversity of the Scottish economy. We would very much regret the loss of Britoil's independence both because this would reduce the number of oil companies operating in the North Sea and because of the loss of its headquarters functions from Scotland.

As regards the maintenance of jobs, BP state (paragraph 9 of their offer) their "expectation" that overall employee numbers in Glasgow and Aberdeen, taking BP and Britoil together, would not fall as a result of the acquisition. This is clearly some way short of an undertaking of any kind regarding the future level of employment. As regards the maintenance of headquarters functions, the letter of 14 January from Sir Peter Walters to Britoil ordinary shareholders states that "following successful completion of the acquisition, Glasgow would become the business headquarters and decision centre of the combined UK oil and gas exploration and production business of BP and Britoil. The Chief Executive of that business and his staff would be based in St Vincent Street in Glasgow. Aberdeen would continue as an operation HQ"; but nothing to this effect is included in the offer itself although these statements are repeated in paragraph 5.1 of BP's submission of OFT.

In any event, the loss of Britoil's headquarters functions could be only partially replaced by the transfer of exploration and production functions of BP since BP's overall decision making would remain firmly in London. Moreover, the statements made by BP, whether in the submission to OFT, the letter to shareholders or indeed in the offer itself, are not binding on

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CONFIDENTIAL: MARKET SENSITIVE

BP; and nor can they be made so by the MMC. We understand that the only firm undertakings which can be extracted from any company are those negotiated by the Secretary of State for Trade and Industry following both reference and an adverse finding by the MMC.

You may take it therefore that we would support a reference to the MMC with the primary objective of ensuring that Britoil remains an independent North Sea operator with headquarters and decision making functions based in Scotland. At the very least, we would hope that the outcome of reference to the MMC would be to bind BP to its commitments to Scotland.

Copies go to Derek Davies, David Moore and Sidney Treadgold.

Yours sincerely

J F LAING

Heather Parker

CONFIDENTIAL: MARKET SENSITIVE

CONFIDENTIAL



H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-270 3000
Direct Dialling 01-270 4440D J L Moore
Under SecretaryA G Atkinson Esq
Mergers Secretariat
Office of Fair Trading
Field House
15-25 Bream's Buildings
LONDON
EC4A 1PR

26 January 1988

Dear Atkinson

BP/BRITTOIL

Thank you for your letter of 19 January.

You asked what were the Treasury's views on how the Government's Special Share affects any public interest issues raised by the BP takeover bid.

We cannot at this stage add to what the Chancellor told the House on 11 January on how the Government intends to use their Special Share in Britoil. I attach a copy of the Hansard extract.

But we see the considerations relating to the Special Share as distinct from your remit.

The Department of Energy and the Scottish Office will be replying to you separately. I am sending copies of this letter to Derek Davis and to Hamish Laing, and also to Sydney Treadgold in DTI.

Yours sincerely
David Moore

D J L MOORE

SECRET

FROM: D J L MOORE

DATE: 28 JANUARY 1988

- 1. SIR PETER MIDDLETON
- 2. CHANCELLOR

cc attached for Financial Secretary
Economic Secretary

cc

- Mr Anson
- Mr Monck
- Mr Williams
- Mr Lyne
- Ms Leahy
- Mr Call
- Miss Wheldon TSOL

Brady contact, thought one or two queries possible. 2 - Ben Lohy to refer to M.M. via a minute to help (changed with Sir 10.15)

BRITTOIL AND BP

I attach a note initially for our own use but in a form suitable for passing to Energy, Scottish Office and DTI.

2. I think we should bring these other Ministers into the discussions as soon as possible now. We need their agreement to the proposed approach and their help in developing our ideas. In particular we need to get the Scottish Office on side - I sent you earlier today their letter to the OFT seeking an MMC reference. From what they say in that letter, I think they could be comforted by our ideas for seeking firmer commitments.

3. I do not think we should spend much time yet on the form of an agreement. We first need to agree on what are the objectives and where possible to sharpen them up. We then need legal advice - and Mr Kennington is not a lawyer - on how best to put them into effect and to what extent they can be legally binding. Miss Wheldon would like to show the present note to Richard Sykes QC, I agree with this. We need to be warned of any pitfalls in good time.

4. We will deal separately, following further advice from Miss Wheldon, with the question of the relevance of HMG's small

SECRET

holding (0.096%) and how best to deploy it. I do not think we need to burden the note for other departments with this.

5. I have also asked Miss Wheldon to consider your question whether, if we insist on some of these conditions, we run any risk of becoming responsible for Britoil or BP debts etc.



D J L MOORE

SECRET

BRITTOIL AND BP

This note sets out a possible approach for negotiation if BP acquire most or all of Britoil's shares.

2. In summary, the aim would be to negotiate with BP and with the Britoil Board a set of arrangements and undertakings, which among other things would underwrite BP's commitments to Scotland. These would be made public and incorporated in some form of agreement.

3. On the basis of these arrangements BP would be allowed ~~representatives~~ on the Britoil Board, which would continue as ~~an independent plc~~ with, at the least, its present assets. The Special Share would remain in place ^{provision} with no time limit set for its redemption, but with the Government free to redeem it once it had been satisfactorily demonstrated that BP were honouring the assurances given. If BP were to backtrack on these assurances their Britoil Board representatives would be removed under the powers of the Special Share.

to appoint a chief executive and other directors

4. BP and the Britoil Board would thus have certain, specific objectives agreed with the Special Shareholder against which to operate. (These objectives would be limited in number and scope and in no sense would HMG be laying down comprehensive objectives as for a nationalised industry.) This should help to answer the charge that the split of ownership and of control would lead to confusion in the management of Britoil and, as claimed by Mr John Smith MP, "a crisis of authority within the company". It should reduce uncertainty and poor morale among Britoil staff. And it would give effect to the Chancellor's assurance, on 11 January, that the powers of the Special Share would be used for so long as it was in the national interest to do so.

5. If BP obtained 100% of Britoil's equity these arrangements might be incorporated in a Shareholders' Agreement. The form

SECRET

If this Agreement (whether in a memorandum of understanding or an exchange of letters having contractual force) would be settled later and we would need legal advice. It would depend, in part, on the assurances negotiated and the extent to which these were of sufficient precision and clarity to be made legally binding. We would want to avoid the risk of a long running dispute in the courts as to whether the obligations of BP and Britoil had been breached in a particular case.

6. Whatever the form of the agreement, and whether or not BP had 100% of Britoil's equity or some lower majority holding, the main features, which are explained in more detail below, would be as follows:

i. Britoil plc would be restrained from disposing (without the agreement of the Special Shareholder) of any material part of its North Sea assets

ii. though not necessarily made public or incorporated in the Agreement, BP would be free to move some of its own assets into Britoil which they would undertake to keep in sound financial condition

iii. BP would undertake to carry out their commitments, as outlined in their submission to the OFT:

a. to Scotland, but with more precision, ^{at least} on timing

b. on North Sea exploration and development, but with more precision on financial commitment and on timing

iv. BP would be allowed to nominate ~~some~~ ^{Executive} Directors to the Britoil Board including, ~~probably,~~ the Chief Executive, but not the non-executive Chairman.

7. In return for BP and Britoil entering into a Shareholders' Agreement, or giving some form of assurances, the Government would undertake:

*Duplicate
Page 3
to some
extent*

i. not to vote its Special Share at General Meetings of shareholders (other than on resolutions to change the Articles which could affect the rights of the Special Share) and

ii. not to requisition meetings of shareholders, all for so long as:

iii. no party owns or controls more than 50% of the equity or voting rights of BP and

iv. both BP and Britoil comply with their obligations under the Shareholders' Agreement.

It has to be recognised that if, contrary to expectations, the rights of the Special Share had to be reactivated and the BP Directors removed, it could prove much more difficult to run Britoil independently after a period in which its management and operations had been closely enmeshed with those of BP.

8. The following paragraphs discuss some of these proposals in more detail.

Independent Britoil plc keeping its present assets

9. Sir Peter Walters has said (page 9 of BP's first offer document) that "following the successful completion of the acquisition, Glasgow would become the business headquarters and decision centre of the combined UK oil and gas exploration and production business of BP and Britoil. The Chief Executive of that business and his staff would be based in St. Vincent Street in Glasgow."

10. This needs clarification in any event. But obviously it would be unacceptable if BP were proposing to take away Britoil's main North Sea assets and sweep them into BP itself (to which the Special Share does not apply). It is essential to guard against this and, for so long as the Government kept the Special Share, for Britoil to remain in existence and to continue to keep its

Problem: if this is possible, we can look in it for from 1910 perhaps better.

present assets, indeed possibly more rather than less. (Alternatively, and if necessary, a new combined company might be set up to which the Special Share applied.)

BP to be free to move some of its own North Sea assets into Britoil

11. BP should be free - though the decision would remain with their Board - to move additional assets into Britoil. This would make commercial and operational sense if BP are to run the two businesses as outlined by Sir Peter Walters and, as is essential, Britoil's assets are kept with the ongoing independent Britoil plc. We may, however, find in discussions with BP that they see problems with this, possibly for accounting and tax reasons, but mainly because of the power of the Special Shareholder to remove BP Directors from the Britoil Board. They could, therefore, propose that while the assets should remain with the two legally separate companies, these assets could be managed together. These possibilities require further discussion.

12. A further possible advantage of this course to BP, which would no doubt be noted by commentators watching the Kuwaiti holding, is that it would give them protection against any possible predator seeking full control of BP. If BP were free, or able, to put their key assets into Britoil plc the predator would then be faced with the Special Share.

13. If BP were to move assets into Britoil we need to guard against the possibility (however unlikely) that they did so in a way which substantially weakened Britoil's financial position and, therefore, HMG's hand in operating the Special Share, (eg by transferring assets for a high cash value, thereby causing a large increase in gearing, and possibly making Britoil overdependent on BP loans). Rather than lay down detailed conditions we provisionally think it sufficient to make a general requirement that BP should ensure Britoil is maintained in sound financial condition. (NB this is an example of a condition which would probably not have sufficient precision to be made legally binding.)

Assurances on Scotland

14. BP have set out their present intentions most clearly in paragraph 5.1 of their submission to the OFT - see extract attached. The aim would be to sharpen up these assurances. The commitment to build up activities in Glasgow, and to continue Aberdeen as an operation centre, could be given more precision and in particular the plans for Glasgow should be supported by an agreed timetable. The remaining BP expectations on employment would be noted, though it would be unreasonable to require a firm commitment to particular numbers.

Assurances on North Sea exploration and development

15. These were also set out in BP's submission to the OFT - see paragraph 6.5 in the attached extract. Here the objective would be to back up the proposals with a timetable and, if possible, to agree to a commitment from BP to a stated amount of annual expenditure which was demonstrably higher than the total of any undertakings given by Britoil together with previous North Sea expenditure by BP itself. The assurances under this head would be less important than those on the commitments to Scotland and, if necessary, might be dropped or traded for something else in the negotiations.

Britoil Board membership

16. Britoil are required to have at least 7 Board members. The opening proposal to BP would be that the majority of the Britoil Board members, including the Chairman, should be independent and acceptable to the Special Shareholder. By independent, we mean that they would not be BP employees, present or past, and would not have a known strong link with BP. The remaining Board members would be BP's own nominees and might include the Chief Executive. The new independent Chairman, who would succeed Sir Philip Shelbourne who is due to retire in April, would be a part-time non-executive with no known BP connections, ^{and perhaps Scottish} This would give further credibility to the claim that for the time being Britoil was operating as ^{a separate} ~~an independent~~ company and in accordance with published objectives against which BP were to be judged.

SECRET

7. But if BP were to be interested in moving some of their present assets into Britoil it is unlikely that they would be content to do so without a majority on the Britoil Board. Even then they would face the risk that HMG could claim a breach of the Agreement and vote the BP Directors off the Board. We must, however, be ready to consider this possibility in the course of the negotiations.

HM TREASURY
28 January 1988

5.1 This commitment to Scotland will be increased with the acquisition of Britoil; BP has announced that it will ensure that the rights, including pension rights, of the existing 1,800 employees of Britoil will be fully safeguarded. In the event of a successful bid:-

(i) Glasgow will become the business headquarters and decision centre of BP's UK oil and gas exploration and production business. The chief

executive of that business and his staff will be based there.

(ii) Aberdeen will remain as the operations centre, as is presently the case for both BP's and Britoil's exploration and production activities.

(iii) BP does not expect that overall employee numbers in Glasgow and Aberdeen, taking BP and Britoil together, will fall as a result of a successful bid.

(iv) Britoil employees will be treated, as a matter of policy, on an equal footing with existing BP staff as far as career opportunities are concerned.

6.5 Far from having adverse consequences for the public interest, BP maintains that the merger will bring about positive benefits. Discovery and subsequent development of the North Sea's resources will in future

become increasingly challenging, for example in the deeper water frontier exploration areas. New fields will be harder to find and are likely to be smaller than those discovered to date. Economic maximisation of national resources in the overall context of the changing UK hydrocarbon province will require the appropriate combination of managerial, financial and technical strengths. The application of BP's financial strength together with its technical and commercial expertise will permit more effective management of Britoil's assets; following the merger, BP intends to:-

(a) explore acreage licensed to Britoil more fully and faster, reversing the sharply declining trend in Britoil's UK exploration activity;

(b) undertake an active programme of technical and commercial appraisal of Britoil's discoveries, to ensure their timely development; and

(c) apply its production engineering and reservoir management expertise to Britoil's producing fields, seeking to improve recoverable reserves from these fields.

SECRET

IS THIS THE ONE?



I have written the 1st 1/2 of the minute to the PM - also the 2nd 1/2.

FROM: D J L MOORE

DATE: 29 JANUARY 1988

CHANCELLOR

cc Financial Secretary
Sir P Middleton
Mr Monck
Ms Leahy

I have revised the draft note to take in your amendments (Mr Taylor's minute of today). I have dropped 7 iii. - the reference to the possibility of BP being taken over - but picked up the point at the end of paragraph 12.

2. I attach a draft minute to the PM, which would cover the revised note.

3. You wish it to be cleared with Energy first and I attach a draft Private Secretary letter to them. It could also go to the Scottish Office if you thought that would help.

4. I am assuming that (either at Ministerial or Official level) we would discuss the negotiating note urgently with Energy and the Scottish Office before going into action with the companies.

D J L MOORE

SECRET**Draft Private Secretary letter to Energy****BP/BRITOIL**

Following Arco's formal acceptance of BP's offer we must be ready to move quickly to discussions with BP and with Britoil on the operation of the Special Share.

I attach a draft minute which, subject to any comments from your Secretary of State, the Chancellor wishes to send to the Prime Minister as soon as possible. Unless you have any major points of principle on the more detailed note attached to it, this can be discussed and developed further before any meetings with BP and Britoil.

[J M G TAYLOR]

DRAFT LETTER FROM CHANCELLOR TO:

PRIME MINISTER

BP/BRITTOIL

Following Arco's formal acceptance of BP's offer for their 24% holding, BP have nearly 54% of Britoil's shares.

2. Subject to David Young's decision, in the light of advice from the OFT, on whether the offer should be referred to the MMC, we must assume that BP will acquire most or all of Britoil's shares. We therefore need to discuss with them and with the Britoil Board the implications of our powers under the Special Share for operating the company.

3. ~~Accord~~ I attach a note setting out a possible approach for negotiation. In brief it provides for the powers of the Special Share to remain in place for the time being but to be dormant provided BP continue to honour agreed and defined commitments to ~~operations in~~ Scotland and to the ~~development of their own~~ ^{development of} and Britoil's North Sea assets. I shall want to develop these ideas further in consultation with Cecil Parkinson and with Malcolm Rifkind. I believe that potentially they offer a basis for a defensible deal with ^{clear} positive attractions for Scotland and for ^{the successful develop of} the North Sea. ^{both}

4. ~~We do not of course know~~ ^{It is ~~impossible~~ too soon to say} how BP or the Britoil Board will react to these ideas and no doubt they will be developed and modified in discussion. In the meantime, in answering questions

in the House and to the press, we will need to rest on the fact that discussions are taking place.

~~S. I have discussed this approach to~~

~~A.~~ I am sending copies of this minute to Cecil Parkinson, Malcolm Rifkind and David Young.

[Nigel Lawson]



FROM: J M G TAYLOR
DATE: 29 January 1988

A handwritten signature in green ink, appearing to be 'JMG'.

MR D J L MOORE

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Williams
Mr Lyne
Ms Leahy
Mr Call
Miss Wheldon - T.Sol.

BRITTOIL AND BP

The Chancellor has seen your submission of 28 January, enclosing a note setting out a possible approach for negotiation.

2. The Chancellor is broadly content with the note, though he has made a few amendments. These are:

Paragraph 3. First two sentences to read: "On the basis of these arrangements BP would be allowed to appoint a Chief Executive and other Executive Directors to the Britoil Board, which would continue as a separate PLC with, at the least, its present assets. The Special Share would remain in place, probably with no time limit set for its redemption, but with the Government free to redeem it once it had been satisfactorily demonstrated that BP were honouring the assurances given. If BP ...".

Paragraph 6, (iii)a. To read: "to Scotland, but with more precision, at least on timing"

Paragraph 6, (iv). To read: "BP would be allowed to nominate Executive Directors to the Britoil Board including the Chief Executive, but not the non-executive Chairman". (The Chancellor has commented that this duplicates paragraph 3 to some extent.)

SECRET



Paragraph 10. Second sentence to read: "But obviously it would be unacceptable if BP were proposing to take away Britoil's main North Sea assets and sweep them into BP itself (to which the Special Share does not apply)."

Paragraph 16. Fifth and sixth sentences to read: "The new independent Chairman, who would succeed Sir Philip Shelbourne who is due to retire in April, would be a part-time non-executive with no known BP connections, and preferably Scottish. This would give further credibility to the claim that for the time being Britoil was operating as a separate company and in accordance with published objectives against which BP were to be judged."

3. He has also commented that paragraph 7(iii), if published, would give the appearance of our fearing KIO control. This sub-paragraph would perhaps be better omitted.

4. He suggests that the best way to inform other Ministers may be via a minute to the Prime Minister. This should be cleared in draft with the Department of Energy beforehand.

A handwritten signature in black ink, appearing to be "J M G TAYLOR".

J M G TAYLOR

CHANCELLOR ANNOUNCES OUTCOME OF THE BP SHARE SUPPORT SCHEME

Rt Hon Nigel Lawson, Chancellor of the Exchequer, today announced the outcome of the BP share support arrangements:

"The BP share support scheme which I announced in the House of Commons on 29 October closed yesterday. It has resulted in the Issue Department of the Bank of England purchasing a total of approximately 39 million BP partly-paid shares at a cost of about £27 million. This represents a repurchase by the public sector of less than 2 per cent of the 2,126 million BP shares that were sold in the ~~Treasury's offer which closed on 28 October.~~ ^{Government's} offer for sale."

The arrangements I announced on 29 October have thus fully achieved their objectives. They have secured virtually the full proceeds of the sale for the taxpayer, in exceptionally difficult circumstances, while avoiding a disorderly market in BP partly-paid shares, which are now trading above the 70p buy-back price."

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG
01 270 5238

2/88

Notes to editors

The BP share issue support arrangements were announced by the Chancellor on 29 October 1987. On 5 November, the Chancellor announced that the scheme would end no later than 3.30 pm on Wednesday 6 January.

The combined offer for sale on 15 October was for a total of 2,194 million partly-paid shares. Of these;

1,735 million were the Treasury's holding of 31.5% of the company's equity

459 million came from the rights issue which was part of the combined offer.

Of the 2,194 million shares, 68 million were retained by the Treasury to meet bonus entitlement claims by small shareholders and were consequently not underwritten. So (2,194m - 68m) ie 2,126 million shares were underwritten and actually sold. Of these, the Bank of England Issue Department has now bought about 39 million, which represents 1.8% of shares actually sold. Together, the Bank's recent purchases and the Treasury's shares retained to meet bonus entitlements represent 1.8% of BP's ordinary share capital, which compares with the 31.5% of BP which the Treasury held before its Offer for Sale and the related rights issue.

The sale price in the offer was 330p per share, of which 120p was payable immediately, and 105p on each of 30 August 1988 and 27 April 1989. The total proceeds of the sale to the Exchequer in instalments spread over 3 years before expenses and net of purchases by the Bank of England can be calculated as follows:

Total shares sold less rights issue:

(2,126m - 459m) ie 1,667m at 330p = £5,501m

Less shares purchased by the Bank

39m at 280p (70p for first

instalment, 105p for second and

third instalments)

= £ 109m
£5,392m

This represents proceeds per share sold and not bought back of (£5,392m ÷ 1,628m) ie 331p; and proceeds per share originally sold of (£5,392m ÷ 1667m) ie 323p - to which can be added in due course the proceeds of the shares which the Bank has bought back.

BP SUPPORT OPERATION: PRESS OFFICE BRIEFING ON CLOSING STATEMENT

POINTS TO MAKE

Support operation a success. Chancellor set out objectives when scheme announced on 29 October - to secure the ~~full~~ proceeds of the sale for the taxpayer, to ensure an orderly aftermarket in BP shares, and that the sale did not add to existing difficulties in world markets. These objectives have been achieved.

DEFENSIVE

Expenses of the support operation

The expenses have not yet been finalised. They will be accounted for on a Treasury Vote in the usual way, like the costs of the rest of the BP sale. The extra expenses incurred by the taxpayer in setting up the support operation will in any event be negligible compared to the benefits the taxpayer has received from the sale proceeding as planned.

Expenses of the sale

These have not yet been finalised. Final figures will be announced to the House of Commons as soon as possible.

Kuwait/Britoil etc

[On substance, no change to existing press line.] Without the support operation the KIO could have bought its shares cheaper.

Why did price of partly-paid BP shares rise sharply on 5 and 6 January?

Market demand for a sound investment.

When will the Bank sell its shares?

No decision has been taken. The terms of the share purchase arrangements are that the Bank will not sell shares purchased in the offer before 30 April 1988 unless it can do so at a price in excess of 120p per share.

Will the Bank transfer its shareholding to the Treasury?

This is a possibility, but no decision has been taken. The Treasury retained 68 million shares to meet bonus entitlements to small shareholders in the offer. Most of these shares will not be needed for that purpose. The Treasury will sell them in due course but no decision has been taken on the method or timing of sale.

PSBR effects

Negligible (same as impact on privatisation proceeds).

Impact on privatisation proceeds

Privatisation proceeds will be reduced by £27 million in 1987-88. The impact in future years depends on when the shares are sold again by the Government. ~~If the Government has not sold the shares by 1989/90, the total impact of the Bank scheme would be to reduce privatisation proceeds by £109 million (£27m in 1987/88, £41 million in both 1988/89 and 1989/90).~~

How many people sold to the Bank?

Approximately 11,000 acceptances were received.

Why are the Bank's figures only "approximate"?

A few applications to sell need further checking; some of the forms have not been filled in correctly; and some applications handed in over bank branch counters may have been delayed in transmission. But the final outcome is expected to be close to the figures announced today.

Government remarkably lucky

The objective of the buy back scheme were made clear by Chancellor when scheme announced (see points to make). These objective has been achieved. Always accepted that this might result in Bank having to buy back some BP shares, but judgement was that support operation would give market time to absorb the offer. This judgement has been proved correct.

stat
But even without an further sale of BP shares by 1991/92, privatisation proceeds from BP would be £2.6 billion in 1987/88, £2.2 billion in 1988/89, and £2.2 billion in 1990/91.

As number of shares sold

QUESTION

To ask the Chancellor of the Exchequer, if he will make a statement on the closure of the Bank of England's arrangements for the purchase of partly-paid shares in British Petroleum.

ANSWER

The Bank of England's share purchase arrangements closed as planned on 6 January. The Bank has made disbursements in respect of approximately x million shares at an approximate cost of fy million. The precise figures will be available when the processing of acceptances has been completed. Under the terms of the arrangements, the Bank will not dispose of any of its holding before 30 April 1988 except at a price in excess of 120p.

The arrangements have as envisaged in my statement to the House on 29 October 1987 secured virtually the full proceeds of the sale for the taxpayer in exceptionally difficult circumstances whilst avoiding a disorderly market in BP partly-paid shares. Before the sale and the associated rights issue, the Government held 31% of BP. The outcome of the sale and of the support scheme which made it possible is that the public sector now holds only a% [1.8%] of the enhanced share capital of BP, of which b% [0.67%] represents the Bank's recent acquisitions and c% [1.14%] the shares retained by the Treasury to meet bonus entitlements. [ASSUMING 40m SHARES BOUGHT BACK]. The net effect is that we have sold [1627 million] shares, and raised [5.4 billion] or 331p per share.

The PSBR effect of the arrangements will be x in 1987-88; the effect in subsequent years will depend on when the Bank sells its shares [FOR USE IF "Y" IS SMALL but will not exceed y in 1988-89 and 1989-90 in any event].



AA

Lentworth
was for
BP annual
N.

Statement by Mr. C. H. / O. X on the outcome of
the BP share support scheme

The BP share support scheme which I
announced in the House of Commons on 29 October
closed ~~on 15 October~~ yesterday. ~~Under the~~ It has
resulted in the issue department of the Bank of England
purchasing a total of approximately [40] million BP
~~shares~~ ^{partly-paid} shares at a cost of about
£[28] million. This represents ^{a repurchase} less than 2 per cent
of the 2,300 million BP shares that were ~~offered~~
~~for sale~~ underwritten and offered for sale on 15 October.

The arrangements I announced on 29 October
have thus fully achieved their objectives. ~~They have~~
~~the result of~~ They have secured virtually
the full proceeds of the sale for the taxpayer, in
exceptionally difficult circumstances, while avoiding
a disorderly market in BP ^{partly-paid} shares,
which are now trading at above the top ~~of~~
buy-back price.

[Notes for Editors to fill out the background &
provide the calculation @ X below]

STATEMENT BY THE CHANCELLOR OF THE EXCHEQUER ON THE OUTCOME OF THE
BP SHARE SUPPORT SCHEME

"The BP share support scheme which I announced in the House of Commons on 29 October closed yesterday. It has resulted in the Issue Department of the Bank of England purchasing a total of approximately [40] million BP partly-paid shares at a cost of about £[28] million. This represents a repurchase by the public sector of less than 2 per cent of the 2,300 million BP ^{shares} that were underwritten and offered for sale on 15 October.

The arrangements I announced on 29 October have thus fully achieved their objectives. They have secured virtually the full proceeds of the sale for the taxpayer, in exceptionally difficult circumstances, while avoiding a disordering market in BP partly-paid shares, which are now trading above the 70p buy-back price."

[Notes for editors to fill out the background, and provide the calculation at X below.]

Ch
Something on these
lines? AA

The Chancellor of the Exchequer announced this afternoon that the Bank of England had purchased about [40] million BP partly-paid shares, at a cost of about £[28] million, under the share purchase arrangements which closed yesterday. He said:

(Notes) — The support arrangements for BP partly paid shares have been successfully concluded. The arrangements have fully achieved the objectives I set out in my statement to the House of Commons on 29 October: they have ensured orderly after-markets in BP shares; and have made sure that the BP sale did not add to difficulties in world markets which had emerged in October. Share prices in all the major markets have stabilised since October, and BP partly-paid shares are now trading above 70p.

X Before the sale and the associated rights issue, the Government held 31 per cent of BP. The public sector now holds only [1.8] per cent of the enhanced share capital of BP, of which [0.7] per cent represents the Bank's recent acquisitions and [1.1] per cent the shares retained by the Treasury to meet bonus entitlements. The net effect of the sale and the support scheme is that the Government has sold [1627] million shares and raised £[5.4] billion, or 331p per share, in instalments spread over three years."

QUESTION

To ask the Chancellor of the Exchequer, if he will make a statement on the closure of the Bank of England's arrangements for the purchase of partly-paid shares in British Petroleum.

ANSWER

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The arrangements have as envisaged in my statement to the House on 29 October 1987 secured virtually the full proceeds of the sale for the taxpayer in exceptionally difficult circumstances whilst avoiding a disorderly market in BP partly-paid shares. Before the sale and the associated rights issue, the Government held 31% of BP. The outcome of the sale and of the support scheme which made it possible is that the public sector now holds only a% [1.8%] of the enhanced share capital of BP, of which b% [0.67%] represents the Bank's recent acquisitions and c% [1.14%] the shares retained by the Treasury to meet bonus entitlements. [ASSUMING 40m SHARES BOUGHT BACK]. The net effect is that we have sold [1627 million] shares, and raised [5.4 billion] or 331p per share.

The PSBR effect of the arrangements will be x in 1987-88; the effect in subsequent years will depend on when the Bank sells its shares [FOR USE IF "Y" IS SMALL but will not exceed y in 1988-89 and 1989-90 in any event].

SECRET



10 DOWNING STREET
LONDON SW1A 2AA

2/2

CH/EXCHEQUER	
REC.	02 FEB 1988
SECTION	Mr D Moore
COPIES TO	BS/FST
	Sr P Middleton
	Mr Manck

From the Private Secretary

1 February 1988

pmf

Dear Alex,

BP/BRITOL

The Prime Minister was grateful for the Chancellor's minute and attached paper of today's date, which was discussed when they met earlier today.

The Chancellor explained that he felt it necessary in starting discussions with BP to set out a tough opening position. The Prime Minister commented that excessive conditions should not be imposed on BP which would hamper the effective management of the company. Rather, it was essential to focus on and secure the Government's main objectives in relation to the Golden Share. She also commented that in considering candidates for the new Chairman the key requirement was to identify the right person for the job and not to prejudice this by setting overly-restrictive criteria for selection.

I am copying this letter to Stephen Haddrill (Department of Energy), David Crawley (Scottish Office) and Alison Brimelow (Department of Trade and Industry).

*Yours
Paul*

(PAUL GRAY)

Alex Allan, Esq.,
H.M. Treasury.

SECRET

Scottish
Development
Agency

4/2

CH/EXC/NEQUER	
REC.	04 FEB 1988
ACTION	Mr. D Moore
COPIES TO	PS/FST
	Sir P Middleton
	Mr Mouck

120, Bothwell Street
Glasgow G2 7JP
Telephone 041 248 2
Telex 777600
Fax 041 221 3217

Sir Robin Duthie c/o
Chairman

CONFIDENTIAL

The Rt Hon Malcolm Rifkind QC MP
Secretary of State for Scotland
Scottish Office
New St Andrew's House
EDINBURGH EH1 3SX

*A v. useful letter. @ the end of
I had hope that, with Sir R D
the day, we could get
to welcome - probably - no
outcome, as soon
good for Scotland.
PS AW
what
etc X
D. G.?*

1 February 1988

It now looks likely that BP will soon own the majority of Britoil shares and that, subject to the offer not being referred to the Office of Fair Trading, its offer will go unconditional in the near future. The Government will therefore no doubt be considering as a matter of urgency how, if at all, to exercise their rights in terms of the Golden Share. The Agency believes that, unless the Government decide to exercise their right to maintain Britoil as an independent oil company, then it is legitimate in the interests of the Scottish and UK economy for the Government to seek a number of very important commitments from BP about its future operations in Scotland.

The BP Exploration and Production Company falls into three major parts: the first with responsibility for UK onshore and offshore exploration and production activities; the second exercising a similar function in respect of overseas interests; and the third providing the engineering, field development and other service support activities for the other two functions (indeed last year BP relocated around 300 of its engineering staff in that third function from Aberdeen to London). The Chairman of BP has publicly indicated his intention to locate the "headquarters and decision centre" of the first of these functions in Scotland but beyond understandably low key commitments to preserving employment at broadly similar levels to the present there has been no indication of the future location of either support services or of Britoil's expanding overseas activity.

Given BP's/



Given BP's existing position in the oil industry, and its place as one of the largest employers in Scotland, if this takeover does go through it will undoubtedly re-emphasise BP's position as the leader in the North Sea. The Agency therefore believes that the Government should seek to secure from BP the maximum possible commitment to the further strengthening of its technological base in Scotland, to the deployment of all the necessary services to achieve that end and indeed to the expansion of the operation for example in oil field developments to create a truly integrated Scottish based enterprise. Britoil proved that oil field development can be carried out very successfully within Scotland when it brought on the Clyde Field within time and cost.

BP also has an important exemplar effect as dominant partner in many of the oil field developments. By committing the location of the necessary technology and development staff to Scotland BP would influence others towards a Scottish location thus building up the infrastructure necessary to secure Scotland's position as an offshore centre. This could be further strengthened were the Department of Energy for example to consider relocating their Petroleum Engineering Directorate to Scotland. Such infrastructure would go a long way towards helping the Scottish offshore service and supply industry develop its technological base for expansion into major export markets thereby securing a long-term future for an industry which employs well over 50,000 people in Scotland.

The Agency believes that the maximum benefit for Scotland's economy would accrue if the Government were able to secure the following objectives in its discussions with BP:

- 1 most importantly, the creation in Scotland of an integrated exploration and development operation for the whole of the UK as promised, but expanded to include the maximum amount of back up services including engineering and field development;
- 2 the location in Scotland of the technology and engineering services staff required to provide that integrated framework;
- 3 the location in Scotland of the necessary administrative and other support staff to support these functions not just for the UK activities but also if possible for the activities of the whole exploration and development company worldwide.

The more we can concentrate central engineering and support functions within Scotland the more confident can we feel about the permanence of the operation.

We have been/

We have been keeping in close touch with BP over the past few weeks and we believe that the company is highly sensitive to the Scottish case. We believe that it is worthwhile to secure this higher level of BP commitment going as it does beyond the assurances provided by the company in its offer document. We also believe that the creation of such an integrated operation by BP in Scotland supported as appropriate by its own engineering and development services and drawing on substantial Scottish tradeable services could be one of the most significant influences that Government could bring to bear in terms of the development of Scotland's position as a leader in offshore technology markets. There are in our view sound business reasons for carrying out these activities near to the scene of operations with all the spin-off benefits that will accrue from creating a better infrastructure to support the oil industry.

We would therefore urge you to consider these points in any discussion with your colleagues and BP.

Yours age.
John



cc PS/Financial Secretary
Sir P Middleton
Mr Monck
Mr D J L Moore
Ms Leahy

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PLP

PRIME MINISTER

BP/BRITTOIL

Following Arco's formal acceptance of BP's offer for their holding, BP now have a majority of the ordinary shares in Britoil. We therefore need to discuss with them and with the Britoil Board the implications of our powers as holder of the Special Share.

We have two options before us: confrontation and negotiation. The former would imply using the Special Share to deny BP any representation on the Britoil Board and thus any role in the Company's management. It would effectively divorce ownership from control. This would be highly unsatisfactory for BP, but it would be almost as unsatisfactory for HMG, and it is difficult to see how it could be in the long-run interest of Britoil either. The alternative route, of negotiation, is in my view clearly preferable. The essence would be to allow BP to secure effective control of Britoil, in return for certain firm undertakings concerning in particular the nature of BP's commitment to Scotland. I have discussed this with Cecil Parkinson, and he agrees.

Accordingly, I attach a note setting out a possible approach for negotiation. In brief, it provides for the powers of the Special Share to remain in place for the time being but to be dormant provided BP continue to honour agreed and defined commitments both to Scotland and to the development of Britoil's North Sea assets. I shall want to develop these ideas further in consultation with Cecil Parkinson and with Malcolm Rifkind. I believe that

SECRET



potentially they offer a basis for a defensible deal with clear attractions for Scotland and for the successful development of the North Sea.

It is too soon to say how BP or the Britoil Board will react to these ideas and no doubt they will be developed and modified in discussion. In the meantime, in answering questions in the House and to the press, we will need to rest on the fact that discussions are taking place.

I am sending copies of this minute to Cecil Parkinson, Malcolm Rifkind and David Young.

ACS Allan

PP N.L.

1 February 1988

(approved by the Chancellor and signed in his absence).

SECRET**BRITTOIL AND BP**

This note sets out a possible approach for negotiation if BP acquire most or all of Britoil's shares.

2. In summary, the aim would be to negotiate with BP and with the Britoil Board a set of arrangements and undertakings, which among other things would underwrite BP's commitments to Scotland. These would be made public and incorporated in some form of agreement.

3. On the basis of these arrangements BP would be allowed to appoint a Chief Executive and other Executive Directors to the Britoil Board, which would continue as a separate PLC with, at the least, its present assets. The Special Share would remain in place, probably with no time limit set for its redemption, but with the Government free to redeem it once it had been satisfactorily demonstrated that BP were honouring the assurances given. If BP were to backtrack on these assurances their Britoil Board representatives would be removed under the powers of the Special Share.

4. BP and the Britoil Board would thus have certain, specific objectives agreed with the Special Shareholder against which to operate. (These objectives would be limited in number and scope and in no sense would HMG be laying down comprehensive objectives as for a nationalised industry.) This should help to answer the charge that the split of ownership and of control would lead to confusion in the management of Britoil and, as claimed by Mr John Smith MP, "a crisis of authority within the company". It should reduce uncertainty and poor morale among Britoil staff. And it would give effect to the Chancellor's assurance, on 11 January, that the powers of the Special Share would be used for so long as it was in the national interest to do so.

5. If BP obtained 100% of Britoil's equity these arrangements might be incorporated in a Shareholders' Agreement. The form of this Agreement (whether in a memorandum of understanding or an exchange of letters having contractual force) would be settled later and we would need legal advice. It would depend, in part, on the assurances negotiated and the extent to which these were of sufficient precision and clarity to be made legally binding. We would want to avoid the risk of a long running dispute in the courts as to whether the obligations of BP and Britoil had been breached in a particular case.

6. Whatever the form of the agreement, and whether or not BP had 100% of Britoil's equity or some lower majority holding, the main features, which are explained in more detail below, would be as follows:

i. Britoil plc would be restrained from disposing (without the agreement of the Special Shareholder) of any material part of its North Sea assets

ii. though not necessarily made public or incorporated in the Agreement, BP would be free to move some of its own assets into Britoil which they would undertake to keep in sound financial condition

iii. BP would undertake to carry out their commitments, as outlined in their submission to the OFT:

a. to Scotland, but with more precision, at least on timing

b. on North Sea exploration and development, but with more precision on financial commitment and on timing

iv. BP would be allowed to nominate Executive Directors to the Britoil Board including the Chief Executive, but not the non-executive Chairman*.

7. In return for BP and Britoil entering into a Shareholders' Agreement, or giving some form of assurances, the Government would undertake for so long as BP and Britoil comply with these obligations:

i. not to vote its Special Share at General Meetings of shareholders (other than on resolutions to change the Articles which could affect the rights of the Special Share) and

ii. not to requisition meetings of shareholders.

It has to be recognised that if, contrary to expectations, the rights of the Special Share had to be reactivated and the BP Directors removed, it could prove much more difficult to run Britoil independently after a period in which its management and operations had been closely enmeshed with those of BP.

8. The following paragraphs discuss some of these proposals in more detail.

Independent Britoil plc keeping its present assets

9. Sir Peter Walters has said (page 9 of BP's first offer document) that "following the successful completion of the acquisition, Glasgow would become the business headquarters and decision centre of the combined UK oil and gas exploration and production business of BP and Britoil. The Chief Executive of that business and his staff would be based in St. Vincent Street in Glasgow."

10. This needs clarification in any event. But obviously it would be unacceptable if BP were proposing to take away Britoil's main North Sea assets and sweep them into BP itself (to which the Special Share does not apply). It is essential to guard against this and, for so long as the Government kept the Special Share, for Britoil to remain in existence and to continue to keep its present assets, indeed possibly more rather than less. (Alternatively, and if necessary, a new combined company might

be set up to which the Special Share applied.)

BP to be free to move some of its own North Sea assets into Britoil

11. BP should be free - though the decision would remain with their Board - to move additional assets into Britoil. This would make commercial and operational sense if BP are to run the two businesses as outlined by Sir Peter Walters and, as is essential, Britoil's assets are kept with the ongoing independent Britoil plc. We may, however, find in discussions with BP that they see problems with this, possibly for accounting and tax reasons, but mainly because of the power of the Special Shareholder to remove BP Directors from the Britoil Board. They could, therefore, propose that while the assets should remain with the two legally separate companies, these assets could be managed together. These possibilities require further discussion.

12. A further possible advantage of this course to BP, which would no doubt be noted by commentators watching the Kuwaiti holding, is that it would give them protection against any possible predator seeking full control of BP. If BP were free, or able, to put their key assets into Britoil plc the predator would then be faced with the Special Share. The conditions on the operation of the Special Share (paragraph 7 above) would need to be drawn up so as not to prevent use of the Special Share powers to deal with these circumstances.

13. If BP were to move assets into Britoil we need to guard against the possibility (however unlikely) that they did so in a way which substantially weakened Britoil's financial position and, therefore, HMG's hand in operating the Special Share, (eg by transferring assets for a high cash value, thereby causing a large increase in gearing, and possibly making Britoil overdependent on BP loans). Rather than lay down detailed conditions we provisionally think it sufficient to make a general requirement that BP should ensure Britoil is maintained in sound financial condition. (NB this is an example of a condition which would probably not have sufficient precision to be made legally binding.)

Assurances on Scotland

14. BP have set out their present intentions most clearly in paragraph 5.1 of their submission to the OFT - see extract attached. The aim would be to sharpen up these assurances. The commitment to build up activities in Glasgow, and to continue Aberdeen as an operation centre, could be given more precision and in particular the plans for Glasgow should be supported by an agreed timetable. The remaining BP expectations on employment would be noted, though it would be unreasonable to require a firm commitment to particular numbers.

Assurances on North Sea exploration and development

15. These were also set out in BP's submission to the OFT - see paragraph 6.5 in the attached extract. Here the objective would be to back up the proposals with a timetable and, if possible, to agree to a commitment from BP to a stated amount of annual expenditure which was demonstrably higher than the total of any undertakings given by Britoil together with previous North Sea expenditure by BP itself. The assurances under this head would be less important than those on the commitments to Scotland and, if necessary, might be dropped or traded for something else in the negotiations.

Britoil Board membership

16. Britoil are required to have at least 7 Board members. The opening proposal to BP would be that the majority of the Britoil Board members, including the Chairman, should be independent and acceptable to the Special Shareholder. By independent, we mean that they would not be BP employees, present or past, and would not have a known strong link with BP. The remaining Board members would be BP's own nominees and might include the Chief Executive. The new independent Chairman, who would succeed Sir Philip Shelbourne who is due to retire in April, would be a part-time non-executive with no known BP connections, and preferably Scottish. This would give further credibility to the claim that for the time being Britoil was operating as a separate company and in accordance with published objectives against which BP were to be judged.

17. But if BP were to be interested in moving some of their present assets into Britoil it is unlikely that they would be content to do so without a majority on the Britoil Board. Even then they would face the risk that HMG could claim a breach of the Agreement and vote the BP Directors off the Board. We must, however, be ready to consider this possibility in the course of the negotiations.

5.1 This commitment to Scotland will be increased with the acquisition of Britoil; BP has announced that it will ensure that the rights, including pension rights, of the existing 1,800 employees of Britoil will be fully safeguarded. In the event of a successful bid:-

(i) Glasgow will become the business headquarters and decision centre of BP's UK oil and gas exploration and production business. The chief

executive of that business and his staff will be based there.

(ii) Aberdeen will remain as the operations centre, as is presently the case for both BP's and Britoil's exploration and production activities.

(iii) BP does not expect that overall employee numbers in Glasgow and Aberdeen, taking BP and Britoil together, will fall as a result of a successful bid.

(iv) Britoil employees will be treated, as a matter of policy, on an equal footing with existing BP staff as far as career opportunities are concerned.

6.5 Far from having adverse consequences for the public interest, BP maintains that the merger will bring about positive benefits. Discovery and subsequent development of the North Sea's resources will in future

become increasingly challenging, for example in the deeper water frontier exploration areas. New fields will be harder to find and are likely to be smaller than those discovered to date. Economic maximisation of national resources in the overall context of the changing UK hydrocarbon province will require the appropriate combination of managerial, financial and technical strengths. The application of BP's financial strength together with its technical and commercial expertise will permit more effective management of Britoil's assets; following the merger, BP intends to:-

(a) explore acreage licensed to Britoil more fully and faster, reversing the sharply declining trend in Britoil's UK exploration activity;

(b) undertake an active programme of technical and commercial appraisal of Britoil's discoveries, to ensure their timely development; and

(c) apply its production engineering and reservoir management expertise to Britoil's producing fields, seeking to improve recoverable reserves from these fields.

**CONFIDENTIAL
MARKET SENSITIVE**

FROM: MS P M LEAHY *PLP*
DATE: 2 FEBRUARY 1988

1. MR D J L MOORE *DJL 2/2*
2. CHANCELLOR

cc Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr McAuslan
Mr M L Williams
Mr Wynn Owen

MERGERS PANEL: BP/BRITOil, HANSON/GEORGE ARMITAGE

As you know the Mergers Panel met yesterday to discuss BP's bid for Britoil and Hanson's bid for George Armitage and Sons.

BP/Britoil

2. The Panel concluded that there were no significant competition issues arising out of the bid and that there was no case for a reference on energy policy grounds. The Panel recognised that there was a serious concern about the implications for Scotland. (The Scottish Office argued very strongly for a reference.) But they thought that the powers of the Special Share should enable the Government to satisfy itself that BP's assurances would be honoured. The Panel therefore expected the Director General of Fair Trading to recommend against the Secretary of State for Trade and Industry referring the bid to the MMC. (The Secretary of State usually follows the DGFT's advice but he has the discretion to do otherwise.)

3. DTI and the OFT are aiming for the Secretary of State to announce his decision on Thursday morning. *Before markets open at 9am.*

Hanson Trust/George Armitage

4. The Mergers Panel paper on this concluded that there were no significant competition issues at stake. Most of the representatives at the meeting argued against a referral although

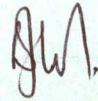
many thought it was a borderline case. After discussion the Chairman concluded that the degree of concentration in some regional markets that would result from a merger combined with difficulties in entering the industry justified a reference to the MMC.



P M LEAHY

BP expect to have today or tomorrow formal confirmation that Arco have title to all ^{the} shares that make up their 24%. The delay is over Salomon's confirming some of their more recent purchases on behalf of Arco.

When BP have the confirmation the offer will be declared unconditional as to acceptances.



D J L MOORE



I think, on
balance,
I will take
the Wakeham
line.

Ch

John Wakeham's view is
that if you see the
delegation from Labour Party,
Speaker would be more likely
to concede ANQ from Salmon.

His suggestion is that you
should write to Smith saying
you do not think it would be
appropriate for you to see the
team, but — though you have
nothing new to say beyond
what you have said in public —
you could be ready to see
Smith on his own. over

Do you want to do that?
Or could simply say nothing
new to say and will of
course let the House know
as soon as you have.

AA



fwp

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

2 February 1988

The Rt Hon. John Smith QC MP
House of Commons
LONDON SW1A 0AA

John Smith

Thank you for your letter of 26 January about Britoil. Having answered your private notice question in the House yesterday, together with supplementaries from Bruce Millan and George Galloway, I do not think a meeting would serve any useful purpose. I shall of course make sure that the House is informed of the outcome of the Government's discussions with Britoil and BP.

*Yours
Nigel*

NIGEL LAWSON



HOUSE OF COMMONS
LONDON SW1A 0AA

3 February 1988

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Great George Street
LONDON SW1

Ch. To be aware. (We are seeking advice. CBTs reply to APEX, behind, think about a meeting with them).

HS 5/2

Dear Nigel.

I understand that you are holding discussions about the future of Britoil with the management of BP and of Britoil. I hope very much that you will include in your discussions the Union representing the employees of Britoil, namely APEX. I know that they are anxious to meet you and have requested an opportunity to do so.

I write to you because there may be some urgency and I think it would be astonishing if the employees who are very directly affected by any decision will not be consulted.

Yours sincerely,
John Smith

JOHN SMITH

*APPEX to Union strike on
APPEX "12 union approach
no for by an of Britoil?"
in a way. I then
want to talk to you
over as talk to
BP. or*



Treasury Chambers, Parliament Street, SW1P 3AG

Roy A Grantham Esq
General Secretary
Association of Professional, Executive,
Clerical & Computer Staff
22 Worple Road
SW1A 4DF

5 February 1988

A handwritten signature in cursive script, appearing to read "Roy A Grantham".

You wrote to the Chancellor of the Exchequer on 13 January and 1 February about BP's bid for Britoil shares.

I understand the importance of this issue to your members employed by Britoil.

I attach a copy of a statement which the Chancellor made to the House of Commons on 1 February in reply to a question from Mr John Smith, MP. As you will see the Government intend, in discussing the issue with BP and with Britoil, to take fully into account what is best for Scotland and for the development of the North Sea.

I am afraid I cannot say anymore at this stage and must therefore decline your request for a meeting with the Chancellor.

A handwritten signature in cursive script, appearing to read "Norman Lamont".
NORMAN LAMONT

Britoil

3.31 pm

Mr. John Smith (Monklands, East): (*by private notice*): To ask the Chancellor of the Exchequer if, following the acquisition by BP of the majority shareholding in Britoil, he will make a statement on how he proposes to use the special share to preserve the independence of the company.

The Chancellor of the Exchequer (Mr. Nigel Lawson): The Atlantic Richfield Company, Arco, has now formally agreed to sell its 24 per cent. holding in Britoil to BP. Taken with its existing holding of 29.8 per cent., this would give BP nearly 54 per cent. of Britoil's ordinary shares. How many more shares it acquires depends on the response to its increased offer.

In the circumstances which have now arisen, the Government will be discussing the situation with BP and with Britoil. These discussions will, of course, be without prejudice to the decision by my right hon. and noble Friend, the Secretary of State for Trade and Industry, in the light of advice to him from the Director General of Fair Trading, on whether the acquisition should be referred to the Monopolies and Mergers Commission.

The House will understand that in advance of these discussions it would not be sensible for me to give details of the outcome which I have in mind. But I can reaffirm that the powers of the special share will be used for so long as it is in the national interest to do so. We shall, of course, take fully into account what is best for Scotland and for the development of the North sea.

Mr. Smith: Is it not clear to everyone that BP now has effective control of Britoil, and that unless the Government use the special share Britoil will cease to be an independent company?

Does the Chancellor recollect, when he was Secretary of State for Energy, saying:

"The very existence of these powers"—
—the special share—

"will act as the most formidable deterrent to anyone who tries to take over control of the board, of the company or of the majority of its shares, and who the Government consider to be unacceptable." [*Official Report*, 31 March 1982; Vol. 21, c. 334.]

Will the Chancellor describe how BP was affected by that "formidable deterrent", as, in pursuit of Britoil, it has acted as if the Chancellor's specially devised protection simply did not exist?

Will the right hon. Gentleman give a straight answer to the question: is BP acceptable or unacceptable to the Government?

Does he recollect another assurance that was given to the House by the then Minister of State, now Lord Gray of Contin, who said:

"The articles will contain effective safeguards for Britoil's independence and the safeguards will be triggered if there is an attempt to take over voting control of the company or to control the Britoil board or its composition." — [*Official Report*, 1 April 1982; Vol. 21, c. 450.]

In the light of those assurances given by and on behalf of the Chancellor, what will he now do to honour them? Surely his only course is to say now, emphatically, that he will use his special share to maintain Britoil as a wholly independent company, as independent in every way as it was before the BP bid was lodged. If the right hon. Gentleman does not do that, but produces some cobbled-together deal garlanded with more assurances, he will have

engaged in a dishonourable retreat from specific guarantees given to the House. If that happens, will it not prove that, once again, privatisation leads to the bolstering of monopoly?

Does the right hon. Gentleman appreciate that this company is the largest publicly quoted company in Scotland and that the obliteration of its independence would be a severe blow to the west of Scotland and to the dispersal of corporate headquarters throughout the country? Is it not time that the Chancellor cleared the whole matter up and made it crystal clear that the special share will be used to achieve the national objectives which he advertised some years ago?

Mr. Lawson: I have made the position crystal clear. I am glad that the right hon. and learned Gentleman has quoted from what I said nearly six years ago on Report on the Oil and Gas (Enterprise) Bill and I am especially glad that he quoted column 334. I point out that Britoil has enjoyed complete independence for some five years since it was privatised.

I shall again read—the House should pay attention—the quotation from *Hansard*, accurately read by the right hon. and learned Gentleman, when I said:

"The very existence of these powers will act as the most formidable deterrent to anyone who tries to take over control of the board, of the company or of the majority of its shares, and who the Government consider to be unacceptable." I shall read two further quotations, since the right hon. and learned Gentleman is interested. I said:

"We wanted to create effective safeguards which would enable the Government to prevent any unacceptable change in the future control of the company". I said:

"We have given, as has BNOG and its advisers, considerable thought to the articles to ensure that they are an effective means of protecting Britoil's independence against unacceptable changes in control." — [*Official Report*, 31 March 1982; Vol. 21, c. 333-4.]

It was quite clear from the beginning that the possibility of an acceptable change in control existed.

The right hon. and learned Gentleman asked me whether control by BP would be acceptable. That depends on the outcome of the discussions which we shall have. That is precisely what they are about.

It is strange to have the right hon. and learned Gentleman treating BP as though it were some kind of pariah. I should like to read what he said in the House on 29 October 1987, barely three months ago, about the share offer and BP. The right hon. and learned Gentleman said:

"Is it not the case that the first victim will be BP, Britain's largest company? . . . Is it not clear that BP will suffer . . . I regard it as a matter of grave seriousness for BP and this country.

The interests of BP have been cast aside". — [*Official Report*, 29 October 1983; Vol. 121, c. 541.]

The right hon. and learned Gentleman's schizophrenia is such as to make his remarks today totally valueless.

Mr. Dennis Skinner (Bolsover): Tell us about the Kuwaiti's nationalisation.

Mr. Speaker: Order. The hon. Member must not keep interrupting from a sedentary position.

Sir Michael Shaw (Scarborough): Is not the outcome, so far, of this affair entirely satisfactory? The foreign bidder has been deterred and Britoil remains British. Is that not the object of the exercise?

Mr. Lawson: My hon. Friend makes a very important and pertinent point.

Mr. Bruce Millan (Glasgow, Govan): Why can we not have straight answers to our questions? Is BP unacceptable, or not? It is certainly wholly unacceptable to the staff and management of Britoil. Why does not the Chancellor say that, as part of his objectives in any discussions—about which we are suspicious—that he may have with BP, at the very least he wants Britoil to remain an independently managed company and the head office and corporate functions to remain in Scotland, in Glasgow?

Mr. Lawson: I very conscious, as I mentioned in my earlier answer, of the Scottish dimension. It is important to consider the best interests of Scotland in all this.

The right hon. Gentleman may not find BP an acceptable company, but the right hon. and learned Member for Monklands, East (Mr. Smith) showed the greatest solicitude for BP's welfare some three months ago, so he clearly regards it as an acceptable company. Whether the change of control to BP will be acceptable will depend on the outcome of the discussions which will be taking place, as I informed the House.

Mr. Tim Smith (Beaconsfield): Will my right hon. Friend confirm that the original objective of the special share was to deter a foreign takeover rather than to protect the independence of Britoil in perpetuity? As that is now not contemplated, surely there is no need to use the special share?

Mr. Lawson: I have listened carefully to what my hon. Friend has said. I know—I recall well—that at the time of the debates that we had in 1982 the concern of the Opposition was that there might be a foreign takeover of Britoil. That was their concern, and nothing else. However, I do not think that it is right now to give up the special share. It is necessary to maintain the special share to ensure a satisfactory outcome and to ensure that whatever is agreed is adhered to.

Mr. Malcom Bruce (Gordon): Will the Chancellor acknowledge that BP's takeover of Britoil is its revenge on the Government for the Government going ahead with the sale of shares last November, and that BP is now in direct confrontation with the Government's interests on this matter? Will he not accept that the existence of Britoil as an independent company is vitally necessary, not just for Scotland, but for the healthy development of exploration activity in the North sea, and that in those circumstances, the loss of Britoil's corporate headquarters from Scotland, and the loss of Britoil as an independent company, would set that course back? Does he not acknowledge that BP is transferring people from Aberdeen to London? How does that square with it keeping its corporate headquarters in Scotland?

Mr. Lawson: If the hon. Gentleman is bidding for the leadership of the new party, he will have to do a little bit better than that.

I specifically mentioned the best interests of the development of the North sea, and especially Britoil's assets in the North sea, in my reply. As for the hon. Gentleman's suggestion that there is any difference between BP and myself over the question whether the BP share issue should go ahead, which the hon. Gentleman has alleged and which was alleged earlier by the right hon. and learned Member for Monklands, East (Mr. Smith),

that, of course, is totally untrue. I should like to read briefly from what the chairman of BP, Sir Peter Walters, said at the annual BP press lunch a fortnight ago. He said:

"The outcome was in my view the right one, the sale should have gone ahead. I was very pleased though that there was this temporary lifeboat represented by the Bank of England offer to buy back the partly paid which has now expired and which, as you see, almost no one took advantage of. There was no disagreement between myself and the Chancellor as to whether the sale should go ahead or not."

Mr. Anthony Beaumont-Dark (Birmingham, Selly Oak): Does my right hon. Friend accept that many of us believed that it was right for there to be a big foreign interest in the North sea but that no one in this House contemplated the chance of virtually the whole of our oil industry in the North sea being controlled by foreign interests? Is he aware that many of us think that the wisest decision that the Government made was to keep a golden share and keep some control in our hands? Is he also aware that Nomura Securities of Japan is bigger than all our banks put together and that it could take over Prudential Assurance and have that as only petty cash? Is it not right that we must make it clear what we wish to control and what we are willing to sell out to other people?

Mr. Lawson: I note very carefully what my hon. Friend, who is an expert in all these matters, has said. Of course, it is not a matter for me but I would have thought that if there were—I realise that this is purely hypothetical—to be a bid by Nomura Securities for the Prudential, there must be a strong chance that that would be referred to the Monopolies and Mergers Commission.

Mr. Tony Benn (Chesterfield): Does the Chancellor recall that as Liberal First Lord of the Admiralty Winston Churchill took control of the Anglo-Persian oil company which became BP, in 1914, because oil was so important to the British Navy and to Britain; that the establishment of BNOG gave us further control; that Britoil also gave us control and that when Burmah Oil company went bust, BP acquired its shares to strengthen British control and influence? Does he also realise that both as Secretary of State for Energy and Chancellor, he will be the man who threw away our control of the oil resources and the revenues accruing from them?

Mr. Lawson: I have answered that question many times before at greater length than I propose to do now, although it is always good to see one of my predecessors as Secretary of State for Energy in his place when we discuss these matters. The plain fact is that times have changed. It is no longer necessary for the British Government to own shares in BP and indeed, BP believes that it is far better off without the British Government. Furthermore, I must remind the right hon. Member for Chesterfield (Mr. Benn) that he presided over the first sale of BP shares.

Mr. Ian Gow (Eastbourne): Since it was the primary purpose of the special share to prevent the unacceptable takeover of Britoil, will my right hon. Friend confirm that the indignation—however synthetic—of the Opposition would be much more justified if there had been an unacceptable acquisition?

Mr. Lawson: I suspect that my hon. Friend, as usual, is correct. Certainly, although the special share was put in, as I said at the time, to prevent unacceptable change of control, I remember very clearly the debates that we had

at that time. All the Opposition were talking about was the risk of the foreign takeover of Britoil. That was all that they were concerned about.

Mr. Ted Rowlands (Merthyr Tydfil and Rhymney): The right hon. Gentleman is remembering the numerous debates that we had on those issues. Does he remember the numerous times that he said that the whole point and purpose of privatisation and the creation of Britoil was to create a bright, independent British oil company in the North Sea? What price now that independence? Is it not the case that BP's interests now appear bigger than the national interest and bigger than the Government's wishes?

Mr. Lawson: I remain anxious to have the best possible development of the United Kingdom continental shelf and I know that that concern is shared by the hon. Gentleman. However, I do not believe that it necessarily follows that that has to be secured by Britoil remaining unconnected with BP. We shall have to see what can result from the discussions that we shall have with BP.

Mr. Jonathan Aitken (Thanet, South): Does my right hon. Friend envisage that the Government's forthcoming discussions with BP will be in the nature of a vigorous wrestling match or tea and sympathy? I urge my right hon. Friend to adopt the friendly approach, which I believe is suggested by his tone this afternoon. Unless the Government are suddenly adopting the blinkers of Scottish nationalism surely it is inconceivable that BP's ownership would be contrary to national interest.

Mr. Lawson: I believe that discussions will take the form of hard negotiations conducted in an amicable atmosphere.

Mr. George Galloway (Glasgow, Hillhead): The Chancellor of the Exchequer has brought weasel words to the House this afternoon. The golden share was to be a shield to protect the independence of the independent oil-producing and oil-exploring sector, but it has proved to be no more formidable than a piece of silver paper.

Much has been made by the Chancellor of the unacceptability issue. The board and the staff of Britoil—highly skilled staff at the top of their profession—to a man and woman, find the BP takeover proposals to be completely unacceptable. One of the things that has been said concerns the Britishness of BP. How British is BP? Will BP be BP with a billion shares owned by the Kuwait Government through the Kuwait Investment Office? Unless the Government stiffen their back and offer some resistance to the proposals this will represent another well-heeled kick in the face of Scotland and the oil-producing sector.

Mr. Lawson: BP is most certainly British and will remain so. The acceptability issue is extremely important. As the hon. Gentleman reminds the House and as I did earlier, we specifically took the power to prevent any unacceptable change of control. [HON. MEMBERS: "Independence."] The whole thing must be read in context. I said that on no fewer than three occasions in that one column of *Hansard* alone. That is what is at issue now. The discussions are designed to ensure that if there is to be—I said if—any change of control, it will take place in an acceptable manner. It is the responsibility of the Government, acting in the national interest, to decide what is acceptable.

Several Hon. Members rose—

Mr. Speaker: Order. I remind the House that this is an extension of Question Time.

From: S D H SARGENT

Date: 5 February 1988

NOTE OF A MEETING HELD AT 5.30 PM ON THURSDAY 4 FEBRUARY 1988 IN
SIR PETER MIDDLETON'S ROOM, HM TREASURY

Those present:	Sir Peter Middleton	Treasury
	Mr Moore	
	Miss Wheldon	Treasury Solicitor
	Mr Henderson	Slaughter and May
	Mr Tindale	Britoil
	Mr Walker	
	Mr Richardson	Rothschilds
	Mr Walker-Arnot	Herbert Smith

*Two Assurances in
the British press:
(i) He cannot promise anything
solely in respect of share No
higher than the price for
British's shareholders
(ii) If BP were to go for
100% that would be v. helpful
a matter for the British
Government to consider
Mr*

BRITTOIL: BP OFFER

Sir Peter Middleton noted that the Secretary of State for Trade and Industry had now decided not to refer the BP bid to the Monopolies and Mergers Commission. The background to the meeting was Arco's decision to sell its holding to BP. The Chancellor had made three main points in the House of Commons on 1 February.

- (i) He reaffirmed that the powers of the special share would be used for so long as it was in the national interest to do so.
- (ii) The Government would take fully into account what is best for Scotland and for the development of the North Sea.
- (iii) This did not necessarily require that Britoil should remain unconnected with BP. That would depend upon the outcome of discussions to be held with BP.

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At a meeting on 5 February, the Government would be seeking assurances from BP in the areas outlined by the Chancellor. The Treasury could not say anything further of substance at this stage.

2. Mr Tindale said that the Britoil Board were concerned to protect the interests of their staff and shareholders. As far as the shareholders were concerned they clearly felt that the existence of the special share had depressed the price offered by BP. This effect could be demonstrated by the fact that the price offered by BP represented a lower percentage of the company's asset value than the price Arco were paying for Tricentrol. The Britoil Board were therefore anxious to obtain an improved offer for the shareholders. The Board felt that its only remaining bargaining chip was its ability to deliver a unanimous recommendation to shareholders to accept an improved BP offer. But to make this sufficiently attractive to BP it would need to be backed by an agreement that the Government would not make use of its special share. Mr Richardson added that it was unlikely that BP would obtain a 100% shareholding in Britoil without a unanimous Board recommendation in favour of their offer. If a minority shareholding remained, the Government would find itself in the awkward position of having to become involved in a struggle between BP and the minority grouping. It would in practice be very difficult for the company to operate in such circumstances.

3. Sir Peter Middleton said that the Government certainly had no desire to play an active role in the day to day running of the company. It would be seeking assurances from BP along the lines indicated by the Chancellor, and these assurances would be backed up by the continued existence of the special share. Mr Richardson asked whether, if agreement was reached with BP, the Government might be willing to redeem the special share. Sir Peter Middleton replied this would not be the intention, at least in the first instance, but the objective would be to ensure that it was unnecessary for the special share to be used. Mr Tindale said that it should be possible for the Government to obtain bankable assurances from BP; this was in everybody's interests.

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4. Mr Walker said that if a minority shareholding remained he would carry on, as now, running the company in the interests of all its shareholders. This would involve continuing competition with BP who would therefore need to be kept at arm's length. If however BP obtained a 100% shareholding the position would be much simpler. In either case there would be organisational problems to be resolved in terms of the relationship between Britoil and BP. The plans outlined so far by BP suggested that there would be no organisation with real teeth remaining in Glasgow. It was relevant that BP had only recently moved their exploration staff from Aberdeen to London. It was also unclear how BP would deal with Britoil's engineering department in Glasgow. On the other hand there was no apparent problem over R&D since the two companies' present arrangements were largely complementary. Mr Walker said that he hoped that the existence of the special share would mean that he would have the opportunity to discuss with BP how the two organisations could be melded together, rather than simply having a new organisation imposed by BP. He was concerned to retain quality staff and to ensure a career structure for them. It was important not to lose Britoil's present partners. There were no reason why such discussions should result in an outcome that was detrimental to BP's own interests.

5. Mr Walker-Arnot pointed out that the Britoil Board were obliged to help their shareholders by providing adequate information about the BP offer, and they would like to write to their shareholders advising them on whether it should be accepted. The Board would inevitably come under pressure to write to shareholders before the offer's present closing date of 12 February and would certainly need to do so well before 26 February. The more information the Treasury was able to provide, the easier the Board's task would be. One key question of interest to shareholders was whether BP would be permitted to nominate a majority of the Board. Sir Peter Middleton said that the Britoil Board's position in relation to its shareholders was well understood. However he could not at this stage add to what the Chancellor had told the House of Commons on 1 February. The question of Board membership was clearly one that would have to be discussed with BP. Mr Richardson said that it would be extremely helpful if Britoil could have further

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discussions with the Treasury early next week following the meeting with BP. After that they would want to talk to Schrodgers who were advising BP. Mr Walker added that he would like to talk direct to BP at that stage about staffing issues. Sir Peter Middleton replied that he would aim to hold a further meeting with Britoil early next week. However it was by no means certain that he would have anything further to say at that stage; this would depend upon what progress was made with BP.

6. It was agreed that those present would not make any public comment beyond saying that discussions were taking place.

Ha!



S D H SARGENT
Private Secretary

Circulation:

PPS —
FST
EST
Mr Moore

Miss Wheldon - Tsy Sol

Mr Henderson - S&M

Mr Gregson - Department of Energy

*pmf*

FROM: J M G TAYLOR
DATE: 5 February 1988

MR D J L MOORE

cc PS/Financial Secretary
Sir P Middleton
Mr Monck o.r.

BRITOIL: LETTER FROM SIR ROBIN DUTHIE (SCOTTISH DEVELOPMENT AGENCY)

The Chancellor has seen a copy of Sir Robin Duthie's letter of 1 February to Mr Rifkind.

2. He has commented that this is a very useful letter. He would hope that, at the end of the day, we could get Sir Robin Duthie to welcome - publicly - the outcome, as being good for Scotland.

JG

J M G TAYLOR

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A handwritten signature in the top right corner of the page.

FROM: J M G TAYLOR

DATE: 8 February 1988

PS/SIR P MIDDLETON

cc PS/Financial Secretary
PS/Economic Secretary
Mr D J I. Moore**BRITTOIL: BP OFFER**

The Chancellor has seen your note of Sir Peter Middleton's meeting with Britoil on 4 February.

2. He has two observations on the Britoil position:

- (i) It cannot possibly be HMG's sole objective to secure the highest possible price for Britoil's shareholders;
- (ii) If BP were to get less than 100 per cent that would be very helpful in ensuring that Britoil remains an independent entity.

A handwritten signature, likely of J M G Taylor, located above the typed name.

J M G TAYLOR



Br next
PEM
Whatever!
my

Ch.

Your questions, behind.

(i) the "independent Chairman" was touched on - see final minutes (at back of string), esp. footnote on page 2. This needs to be resolved later (see first part of para 7).

(ii) the Scots are in close touch - for example they are getting copies of these minutes. No present plans actually to invite them to the meetings, but they are being kept on board as the situation develops.

8/2

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py

From: S D H SARGENT
Date: 8 February 1988

DRAFT

NOTE OF A MEETING HELD IN SIR PETER MIDDLETON'S ROOM, HM TREASURY AT
3.00 PM ON FRIDAY 5 FEBRUARY 1988

Those present:	Sir Peter Middleton Mr Moore	Treasury
	Mr Gregson	Department of Energy
	Miss Wheldon	Treasury Solicitor's Dept
	Mr Henderson	Slaughter and May
	Sir Peter Walters Mr Simon Mr Butler	BP

BRITTOIL: BP OFFER

Sir Peter Middleton said that the Chancellor had announced in the House of Commons on 1 February that the Government would be holding discussions with BP and with Britoil following Arco's agreement to sell its holding to BP. He had made clear that in those discussions the Government would take fully into account what was best for Scotland and for the development of the North Sea. The Secretary of State for Trade and Industry had now decided, in accordance with the recommendation of the Director General of Fair Trading, not to refer the proposed BP takeover to the Monopolies and Mergers Commission, and a meeting had been held with Britoil on 4 February. Sir Peter Middleton said that the purpose of the present meeting was to put some flesh on the framework which the Chancellor had set out for the future of Britoil. The Government did not propose to make any further public statement until there were any further developments to announce.

2. Sir Peter Walters pointed out that the BP offer was now unconditional as to acceptances. He saw no particular difficulty



Permanent Secretary
H M TREASURY

Myx *Ch* You will want
to see. *8/2*

I attend a drop note *8/2*
of Friday's meeting with BP
which I am clearing with
Gregory. ~~-----~~

Simon 8/2
PSM *colateral.*
2. I see no use in
best of the indep. -
Chair of Antall. Can
be handled?
3. At what stage
is it controlled
by the
Switz
Office?

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for BP in meeting the Government's concerns regarding Scotland and the North Sea. BP had said at the time of their initial bid that there would be no overall loss of jobs in Glasgow and Aberdeen, taking BP and Britoil together. More generally there could be no doubt about BP's wider commitment to Scotland; an investment package worth £60 million had been announced in the previous week. As for the North Sea, the aim of the takeover was not simply for BP to hold Britoil's assets into the 1990s, but to exploit them more effectively. With effect from 1989 BP would expect to increase the Britoil exploration programme and accelerate Britoil's planned development programme.

3. Sir Peter Walters said that as far as the post-acquisition organisation was concerned, BP would propose to integrate Britoil's relatively small international organisation fully with BP's. BP also proposed to put a Chairman and Chief Executive on to the Britoil Board and bring the management of Britoil's North Sea activity together with BP's own. If however the Government wished to insist upon keeping the Britoil and BP organisations separate, it would be possible to delay integration and use joint ventures in the North Sea for an initial period. Sir Peter Middleton replied that the Government would like to see the Britoil and BP North Sea activities brought together, but within a continuing Britoil organisation. The retention of Britoil was essential if the special share was to remain effective. The special share would not be used by the Government to interfere in the day-to-day running of the organisation, but clearly the Government required an effective sanction to ensure that whatever agreement was reached was properly implemented. If the two North Sea organisations were to be integrated, the Government would like BP to move some of its own assets into Britoil. If however the organisations were kept separate the Government would not be willing to see BP appointing the Britoil Chairman or Chief Executive or even nominating a majority of the Board. Sir Peter Walters said that he was not concerned about having a majority on the Board, and would also be content for there to be suitable Scottish representation on it. His main concern was to ensure that the new organisation could operate effectively. However he saw difficulties with the suggestion of moving BP assets into Britoil

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while the special share remained in existence. If this was to be done, there would need to be an agreed expiry date for the special share within the lifetime of the present Government. He added that the existence of the special share might inhibit tax consolidation within the BP group. Mr Simon explained that the problem was to do with the definition of control for tax purposes; it might be difficult for BP to demonstrate that it had control of Britoil even with a majority shareholding if the special share remained in existence. But if the special share was simply a veto, with management left free to operate from day to day, the position might be acceptable.

4. Mr Gregson pointed out that there would be concern if the proposed integration of BP took place too far down the line. It was essential that an operation of real substance dealing with good quality work should remain in Scotland. Mr Butler explained that BP's worldwide exploration effort was divided into three parts; one dealing with the US, another with UK, Norway and Ireland, and a third with the rest of the world. BP proposed that the division dealing with the UK, Norway and Ireland should take over Britoil's North Sea activity, although it was possible that exploration in Norway would hive-off. The new organisation would be moved to Glasgow, where engineering and support work would also be based. Operating offices would be retained in Aberdeen where BP already had several thousand employees, despite the much publicised move of some 300 to London. As for the quality of work the new organisation would have genuine autonomy. BP were already in the process of moving accountability and responsibility down the line within their organisation worldwide. Mr Gregson asked whether it would be possible to keep Britoil's overseas activities separate from BP's. Sir Peter Walters said that this would be extremely anomalous. Britoil's overseas effort was concentrated in areas where BP already had their own organisation. The Britoil presence abroad was small and of doubtful quality. Integration would take a little while to achieve but clearly made sense.

5. Sir Peter Middleton said that a further Government requirement was for an assurance from BP that Britoil would be kept in a sound

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financial condition. Mr Simon commented that clearly it would be necessary to talk in more detail at a later stage about the appropriate funding arrangements, but BP envisaged that Britoil would be able to borrow on its own behalf as other BP subsidiaries were able to do, within limits set by the parent company.

6. Mr Gregson said that the Government would need to demonstrate that any agreement reached with BP was clearly in the national interest. A crucial element in this related to the North Sea development, where the encouraging intentions expressed so far by BP needed to be firmed up. The Government would be looking for an assurance that BP would be able to improve on Britoil's own plans for drilling, appraisal and development. Mr Butler replied that for 1988 BP would undertake to do at least as much as Britoil had planned to do. However, BP were prepared to give a commitment that by 1990 they would be doubling the exploration effort planned by Britoil, without any change in the rest of their own forward programme. This commitment would be subject to change only if there was a major upheaval in the overall environment. It was not possible to say at this stage precisely where drilling would take place; and the size of the development programme would of course depend upon how successful the exploration was, but the intention would be to move forward as fast as possible. Mr Gregson said that BP's proposals were encouraging. Given that BP could not at this stage be fully conversant with the assets they would be acquiring from Britoil, it might be appropriate for the Government to reach a broad understanding with BP initially, to be refined once BP had had the opportunity to appraise the position more fully. He enquired about BP's plans for research and development, pointing out that the Government would wish to see Britoil's existing effort maintained in both quality and quantity. Mr Butler commented that BP, like Britoil, already funded a substantial amount of research and development in Scottish universities. There would be no reduction in the combined BP and Britoil effort from its present level. Sir Peter Walters added that he would see no difficulty in stepping up the present quantity of research carried out through the Scottish universities.

7. Sir Peter Middleton said that the meeting had been useful. The next stage was to work up a more detailed set of proposals

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and to look further, in the light of those proposals, at the appropriate Board structure for the new organisation. Mr Gregson added that he would like to see Britoil retained as a distinctive entity looking after BP's upstream operations, and playing a role within BP analogous to that of Shell UK. Mr Moore said that BP's proposals should put specific targets on their increase in activity in Glasgow and also say something about the quality of work to be carried out there. Mr Simon said that in setting out their proposals BP would want to address the question of how the special share might be used. Sir Peter Walters said that he saw no real problems for BP in meeting the Government's needs. Mr Butler added that BP were conscious that they had a problem of "hearts and minds" to address; they were anxious to retain the goodwill of Britoil's existing staff.

S D H SARGENT
Private Secretary

Circulation:

PPS
Financial Secretary
Economic Secretary
Mr Monck
Mr Moore

Miss Wheldon - Tsy Sol
Mr Henderson - S&M
Mr Gregson - Department of Energy

Sir Alex Fletcher

bf. 12/2
pnp

Tel: 01-245 6377

4a William Street
Knightsbridge
London SW1X 9HL

Our Ref: AMF/kma/L

8 February 1988

PRIVATE & CONFIDENTIAL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
The Treasury
Whitehall
LONDON SW1

10/2. Post copy to Britoil lab.

CH/EXCHEQUER	
REC.	10 FEB 1988
ACTION	Mr DJL Moore
COPIES TO	PS/FST, Sir P Middleton Mr Manckoff Mrs ME Brown Miss Wheldon Tsel

Nigel

You will recall our conversations last year about the Guinness affair and my concern about its impact on the Scottish economy. BP's control of Britoil, although happily dissimilar as to how it has come about, does raise some similar issues, and as the presence of the Golden Share gives the Government a proper locus in this case, I would like to emphasise some of the points which I believe the Treasury should consider in the current discussions with BP.

First, the creation in Scotland of an integrated exploration and development organisation to control these BP activities, not only in the UK but also overseas. Second, to maintain the maximum possible links with the services sector in Scotland and to build on those created by Britoil. In this respect I am referring to taxation and treasury management, fund management and financial services generally. Third, to control the purchasing function for the exploration and development operations in Scotland. And finally, to require the senior management to be located in Scotland.

If your negotiations with BP were concluded along these lines, then I believe that this would be seen in Scotland as a very positive Government initiative towards maintaining corporate headquarters in Scotland.

*Yours
Alex*

CC: FST
Sir P Middleton
Mr Monck
Mr D J L Moore
Ms Leahy



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

A handwritten signature in black ink, appearing to be 'P. Middleton'.

10 February 1988

The Rt Hon John Smith QC MP
House of Commons
LONDON SW1A 0AA

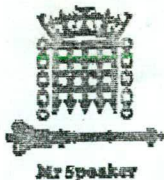
A large, stylized handwritten signature in black ink, likely 'John Smith'.

Thank you for your letter of 3 February asking that APEX should be consulted on the future of Britoil.

Any discussion directly with Britoil staff, or with APEX who represent them, is clearly a matter for the management of Britoil.

A handwritten signature in black ink, appearing to be 'Nigel Lawson'.

NIGEL LAWSON



Speaker's Office House of Commons London SW1A 0AA

PRIVATE NOTICE QUESTION

Brian Millan MP

To ask The Chancellor of the Exchequer if he will make a statement on the discussions he has had with Britoil and BP on the BP takeover bid for Britoil and in particular the intentions of the Government as to its use of the special share.

CH
Predictable, especially in view of today's unhelpful press reports. We are resisting.
20/2

10th February 1988

From: The Rt. Hon. John Smith, Q.C., M.P.



HOUSE OF COMMONS
LONDON SW1A 0AA

A 20/2/88

11 February 1988

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Great George Street
LONDON SW1

CH/EXCHEQUER	
REC.	12 FEB 1988
ACTION	MR D MOORE
COPIES TO	FST, Sir P Middleton
	Mr Monck
	Mr M Williams
	Ms P Leaky
	Mr Cropper
	Mr Call

Dear Nigel,

Thank you for your letter of 10 February from which it is clear that you are not prepared to meet APEX to discuss the future of Britoil although they have requested such consultation.

The interests of the employees of the company are clearly a very important factor in any consideration of the future of the company and I find it extraordinary that you are not prepared to meet the union who represent them, although you are presumably meeting the management of Britoil and BP. Is it really necessary for the Government to demonstrate its prejudice against trade unions by totally ignoring their legitimate and reasonable concerns?

Yours sincerely,
John Smith

JOHN SMITH

CONFIDENTIAL

FROM: S B JOHNSON

DATE: 12 February 1988

- 1. MR D J L MOORE *DJM 12/2*
- 2. FINANCIAL SECRETARY

- cc
- Chancellor
 - Chief Secretary
 - Paymaster General
 - Economic Secretary
 - Sir P Middleton
 - Mr Anson
 - Mr Monck
 - Mrs Lomax
 - Mr Beastall
 - Mr R I G Allen
 - Mrs M E Brown
 - Mr Bent
 - Ms Leahy
 - Mr Lyne
 - Mr J D R Shore
 - Mr Call
 - Miss Wheldon T.Sol
 - Mr Gregory T.Sol
 - Mr Messer T.Sol

Handwritten notes in red ink:
 FSI
 Granting of shares with 10% down
 with 10% down (x 4) a little.

BP: STOPPED CHEQUES

Mr Heywood's
My ~~Haywards~~ minute of 22 January recorded your agreement to the:

- i. Treasury Solicitors Department writing to all defaulters who applied for 2,500 shares or more demanding payment (ie 120p per share) failing which we will sue;
- ii. NatWest writing to all other defaulters pointing out that unless they honour their obligation to pay they remain liable to legal action, and until they pay they will not receive the benefits deriving from the shares they have agreed to buy.

2. The draft letters attached have been settled by Counsel - Mr John Mummy. Variants of the two main types of letter are needed to cover situations where, for example, an RLA was sent to a defaulter and has not been returned, or where the drawer of the cheque is not the same person as the applicant. Drafts of the letters to be sent by the Treasury Solicitors Department are attached at Annex A and a draft to be sent by NatWest is attached at Annex B.

Handwritten: 290/144

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3. In drawing up the interim rights register NatWest have included one holding on the register entitled "Balancing Account - Unpaids" representing the aggregate of the shares applied for by defaulters. Dividends, notices of meetings and other communications will not be passed on to any defaulter so long as he has failed to pay. Counsel has confirmed that these arrangements are acceptable.

4. We should be grateful for your approval to send these letters. We hope to be able to do this by the end of next week.



S B JOHNSON

Draft (2): GIH/AGB
112.88

Letter 2/3

Form of letter to be sent to applicants who applied for more than 2,000 shares and whose cheques, which were drawn by the applicant, have not been honoured.

[This letter should not be sent to any applicant who was sent an RLA which has been renounced or transferred.]

[Letterheading of the Treasury Solicitor]

[Name and address of applicant]

[Date]

Dear Sir/Madam,

The British Petroleum Company p.l.c.
Offer for Sale of Ordinary Shares of 25p each

I
~~We~~ have been instructed to write to you in connection with your application for Ordinary Shares in BP and the cheque which accompanied that application. You have already been sent letters by the receiving bank which dealt with your application explaining that the application was accepted in full. This means that you are legally bound to purchase the shares you applied for and to pay, in instalments, the full purchase price for those shares.

The cheque for the first instalment which accompanied your application was not honoured on first presentation. This, in itself, means that you are in default of the terms and conditions agreed to by you when you submitted your application. The receiving bank has written to you on two occasions giving you the opportunity of arranging for the cheque to be honoured when it was re-presented. The cheque, however, was not honoured on either occasion when it was re-presented.

The register of persons who agreed to purchase shares in the Offer for Sale has now been compiled. Your interest has been recorded in this register on the basis that your rights are subject to payment of the first instalment. If you pay the first instalment ~~we~~ ^{H.M. Treasury} will (unless you have transferred your rights) arrange for your name to be unconditionally included in the register so that you can, in accordance with the terms of the Offer for Sale, receive the benefits deriving from the shares you have agreed to buy.

[Until you have paid the first instalment you should regard the renounceable letter of acceptance which you have received as held on behalf of H.M. Treasury and you should not deal with the rights represented by it.]*

X In view of your continuing default in honouring the cheque which accompanied your application ~~we~~ have been instructed by BP Share Offer (the payee of the cheque) to institute proceedings against you for the recovery of the amount due. Interest on that amount for the period since the due date and amounts in respect of legal and other costs will also be claimed. Unless payment is received by ~~us~~ ^{the Treasury Solicitor} in the meantime, these proceedings may be taken against you without further notice at any time after [seven] days following the date of this letter.

Yours faithfully

* This paragraph should only be included in the letters sent to applicants who were sent, and who have not returned, an RLA.

AGB0009.88T

Draft (2): GIH/AGB
11.2.88

Letter 6

Form of letter to be sent to the drawers of the dishonoured
cheques which accompanied applications of more than 2,000 shares
where the drawer was not the same person as the applicant.

[Letterheading of the Treasury Solicitor]

[Name and address of drawer]

[Date]

Dear Sir/Madam,

The British Petroleum Company p.l.c.
Offer for Sale of Ordinary Shares of 25p each

I
We have been instructed to write to you in connection with a cheque drawn by you which accompanied an application for Ordinary Shares in BP made by [] of []. The applicant has already been sent letters by the receiving bank which dealt with the application explaining that the application was accepted in full. This means that the applicant is legally bound to purchase the shares applied for and to pay, in instalments, the full purchase price for those shares.

The cheque for the first instalment which was drawn by you and which accompanied the application was not honoured on first presentation. The receiving bank wrote to the applicant on two occasions giving him the opportunity of arranging for the cheque to be honoured when it was re-presented. The cheque, however, was not honoured on either occasion when it was re-presented.

In view of the continuing default in honouring this cheque we have been instructed by BP Share Offer (the payee of the cheque) to institute proceedings against you for the recovery of the amount due. Interest on that amount for the period since the due date and amounts in respect of legal and other costs will also be claimed. Unless payment is received by ~~us~~ ^{the Treasury Solicitor} in the meantime, these proceedings may be taken against you without further notice at any time after [seven] days following the date of this letter.

Yours faithfully

AGB0013.88T

Draft (2): GIH/AGB
11.2.88

Letter 7/8

Form of letter to be sent to applicants who applied for
2,000 or fewer shares and whose cheques
have not been honoured

[This letter should not be sent to any applicant who was sent
an RLA which has been renounced or transferred]

Nathwest
[Letterheading of ~~Receiving~~ Bank]

[Name and address of applicant]

[Date]

Dear Sir/Madam,

The British Petroleum Company p.l.c.
Offer for Sale of Ordinary Shares of 25p each
[from Bank]

We refer to ~~our~~ previous letters to you concerning your application for Ordinary Shares in BP and the cheque which accompanied that application. Your application was accepted in full, which means that you became legally bound to purchase the shares you applied for and to pay, in instalments, the full purchase price for those shares.

The cheque for the first instalment which accompanied your application was not honoured on first presentation. This, in itself, means that you are in default of the terms and conditions agreed to by you when you submitted your application. ~~We~~ *[from Bank]* have written to you on two previous occasions giving you the opportunity of arranging for the cheque to be honoured when it was re-presented. The cheque, however, was not honoured on either occasion when it was re-presented. Your continuing default means that legal proceedings, or other steps, could be taken against you.

The register of persons who agreed to purchase shares in the Offer for Sale has now been compiled. Your interest has been recorded in this register on the basis that your rights are subject to the payment of the first instalment.

You remain liable to pay the first instalment. If you do this now you will avoid the possibility of legal action being taken against you in respect of your non-payment. Payment may be arranged by informing us that if your cheque is re-presented it will be honoured. We will then re-present it and, if it is honoured, we will (unless you have transferred your rights) arrange for your name to be unconditionally included in the register referred to above so that you

can, in accordance with the terms of the Offer for Sale, receive the benefits deriving from the shares you have agreed to buy.

[Until you have paid the first instalment you should regard the renounceable letter of acceptance which you have received as held on behalf of H.M. Treasury and you should not deal with the rights represented by it.]*

Yours faithfully

* This paragraph should only be included in the letters sent to applicants who were sent, and who have not returned, an RLA.

AGB0010.88T



FROM: J M G TAYLOR
DATE: 15 February 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Beastall
Mr D J L Moore
Mr R I G Allen
Mrs M E Brown
Mr Bent
Ms Leahy
Mr Lyne
Mr J D R Shore
Mr Johnson
Mr Call
Miss Wheldon - T.Sol
Mr Gregory - T.Sol
Mr Messer - T.Sol

BP: STOPPED CHEQUES

The Chancellor has seen Mr Johnson's minute of 12 February. He would be grateful if the Financial Secretary would consider lengthening the seven day period (last sentence of the draft letters) a little.

A handwritten signature in black ink, appearing to be 'J M G TAYLOR'.

J M G TAYLOR



FROM: J J HEYWOOD
DATE: 16 February 1988

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Beastall
Mr D J L Moore
Mr R I G Allen
Mrs M E Brown
Mr Bent
Ms Leahy
Mr Lyne
Mr J D R Shore
Mr Johnson
Mr Call
Miss Wheldon T.Sol
Mr Gregory T.Sol
Mr Messer T.Sol

Ch
Content?

JP
16/2

Content.

BP: STOPPED CHEQUES

The Financial Secretary has seen your minute of 15 February.

2. The Financial Secretary agrees that the normal seven day period should be lengthened in this case. He suggests that a fourteen day period would be more appropriate.

3. Treasury Solicitors are content with this, but advise that any further lengthening of the period might lead to letter-recipients simply ignoring the threat of legal action.

4. Is the Chancellor content with this?

9-1/2

JEREMY HEYWOOD
Private Secretary



A handwritten signature in the top right corner of the page.

FROM: J M G TAYLOR

DATE: 17 February 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Beastall
Mr D J L Moore
Mr R I G Allen
Mrs M E Brown
Mr Bent
Ms Leahy
Mr Lyne
Mr J D R Shore
Mr Johnson
Mr Call
Miss Wheldon - T.Sol
Mr Gregory - T.Sol
Mr Messer - T.Sol

BP: STOPPED CHEQUES

The Chancellor has seen your minute of 16 February. He is content that the period should be extended to fourteen days, and no more.


A handwritten signature of J M G Taylor.

J M G TAYLOR

PMP

FROM: D J L MOORE

DATE: 18 FEBRUARY 1988

- 
1. SIR PETER MIDDLETON
 2. CHANCELLOR

cc attached
for FSTcc Mr Monck
Ms Leahy
Miss Wheldon TSOL**BP/BRITOIL**

I attach the latest drafts of the BP/Treasury exchange of letters. Mr Parkinson and Mr Rifkind have already been given copies. I understand that Mr Rifkind is generally content with the approach, subject to one or two points noted below.

2. Both we and BP need to check carefully through the details of the draft and a number of amendments will no doubt be made. But we believe that it is sufficiently near a final draft to form a basis for discussion on the main issues tonight.

The Treasury letter (penultimate page)

3. The Treasury letter provides that if BP honour the assurances the Special Share will remain dormant. The Government will not intervene in day to day management of the company.

4. The wording of paragraph 4 of the Treasury letter avoids stating when the Special Share might be redeemed. But the implication is that it will not be early, ie in 1988, and there is flexibility on timing. (As you know, provisionally we think redemption in 1990 might be about right; by then it should be clear whether the assurances are being met).

The work programme (paragraphs 6-9)

5. The assurances on the work programme, were negotiated by Energy. They give substance to the very generalised promises made by BP at the time of the Offer.

Scotland (paragraphs 11-18)

6. For the main Scottish package we have similarly tied BP down as far as possible on timings and numbers.

7. 40-60 senior BP staff will be moving to Glasgow including the current Chief Executive of BP's upstream activities in the UK, Norway and Ireland. The inclusion of Norway should be a helpful prestigious point for Glasgow.

8. We pressed BP hard to provide something new for Scotland. They have offered - middle of paragraph 11 - the transfer of management of a high technology research and development project.

9. They have also offered to endow a Chair at a Scottish university and to fund associated research activities (paragraph 16). Though not reflected in the draft they would be willing, as an alternative, to endow research fellowships via the Royal Society of Edinburgh. On second thoughts they think that this would be a more effective way of spreading around support for research. They do not want to wrong foot themselves with the Scottish Office by appearing to withdraw the offer of a Chair but you might ask Mr Rifkind (I have spoken to his officials).

10. Paragraph 16 says that BP will enhance the university research commitments of BP and Britoil. Mr Rifkind wants a commitment that they will maintain the community support levels given by both companies. I will discuss this with BP.

11. Not surprisingly, BP are not willing to transfer major group functions to Glasgow. It would be impracticable to move their main R & D function from Sunbury. They are not willing to remove their international exploration activities. I asked about pensions but they want to leave themselves with the option of contracting out this work.

Britoil Board structure and management (paragraphs 18-25)

12. They have agreed (paragraph 18) that there should be a new non-executive Chairman with no BP connections. He will be someone

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acceptable both to HMG and to BP. Sir Peter Walters has suggested we should look for a Glaswegian or a West Coast Scot. Does Mr Rifkind have any suggestions?

13. Mr Rifkind finds the last sentence of paragraph 20 vague and alarming in that it suggests loss of key jobs. If it cannot be improved he would like it deleted.

14. Paragraph 23 means that BP cannot transfer Britoil assets to themselves or, in any substantial way, to anyone else. (This meets the point made at your meeting on Monday that we must be able to show that we have guarded against the possibility of disposal of assets or shares to foreigners or others.)

15. Paragraph 24 deals with the other legal points. Although you do not need to explain it to your colleagues, the plan is to deal with the EGM quorum problem by an assurance in the letter that BP will procure a quorum backed by a formal and binding undertaking from them that they will amend the Articles of Association, as necessary, once they get 100% - see the draft letter at the end of the papers. On this basis we would expect to transfer to them, in a squeeze out, all of our ordinary Britoil shares.

The Majority Percentage Case (paragraphs 26-31)

16. Although BP seem completely confident that they will get 100%, the outcome will not be known for certain at the time of your statement and so we need to cater for a lesser percentage.

17. The present draft is generally satisfactory except that we want to have another go at BP on paragraph 31. As drafted it brings out too starkly that this is a comparatively much less attractive deal. This could be awkward in presenting your statement.

18. Ideally we and Energy would like the first sentence to stop in the third line at "minority shareholders". If necessary it

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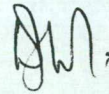
might go on to read "Glasgow will remain Britoil's business headquarters and BP will determine an appropriate timetable for re-locating the centre of its own UK upstream business to Glasgow."

Timing

19. If colleagues agree to the proposals tonight we will complete tidying up the drafts tomorrow. I will then give you a draft of a note to go to the Prime Minister for the weekend which would cover the drafts of the letters.

20. Subject to her approval, Sir Peter Middleton could show Britoil the final versions on Monday. These would be offered for information rather than debate. I assume that Sir Peter would sign the Treasury letter.

21. You could then make your statement on Tuesday, preferably, or on Wednesday.



D J L MOORE

DRAFT LTR PBPB 18.2.88
Ref: PB28.prt

CONFIDENTIAL

FROM: BP
TO: THE TREASURY

BRITOIL plc

1. We write with regard to our offer to acquire the whole of the issued ordinary share capital of Britoil plc not already owned by the BP Group and to set out various assurances as to our post-acquisition strategy.
2. As at [] valid acceptances had been received by us in respect of approximately x million Britoil ordinary shares which, when combined with the y million ordinary shares previously purchased by BP in the market, amounted in total to some z% of the Britoil issued ordinary share capital.
3. As you know, the offer period has been extended to [] 1988 and we hope shortly to declare the offer unconditional in all respects.
4. Our primary purpose in acquiring Britoil is to exploit Britoil's UKCS assets more effectively and to ensure that the combined operations of the two companies are managed to better effect than would be possible under separate control. This will be of benefit not only to our shareholders but to the nation as a whole and Scotland in particular.
5. Our objective is to acquire all of the Britoil ordinary shares as soon as possible. As at the date of this letter, however, the final level of acceptances is still unknown. We therefore set out our position firstly in the context of our having acquired 100% of the Britoil ordinary shares (the "100% Case") and then in the context of a lesser controlling percentage (which, for convenience, we refer to below as the "Majority Percentage Case"). It is, of course, possible that we would commence with the Majority Percentage Case and then move to the 100% Case at some later, as yet undefined, time.

References in this letter to "BP" and "Britoil" include where appropriate references to each company's respective subsidiaries.

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A: 100% CASE

WORK PROGRAMME

6. BP will honour all Britoil's existing commitments in relation to the UKCS. In addition, BP offers the following assurances with regard to the manner in which it will manage Britoil's and BP's UKCS and certain other assets and interests.

Production

7. Production from UKCS fields operated by Britoil (Thistle, Beatrice, Deveron and Clyde) will be maintained and where possible extended through the application of BP's proven and highly successful reservoir management skills. BP will undertake an immediate and rigorous technical evaluation of these fields and present its conclusions to the Department of Energy within 9 months of BP's offer for Britoil becoming wholly unconditional. The objective will be to apply BP's worldwide technical expertise in identifying additional reserves, maximising economic recovery and extending field life. Through this process, BP would seek to achieve an increase in recoverable reserves of at least 5% from these fields. BP will also exercise its influence and experience with the aim of achieving the same objective in relation to other UKCS fields in which Britoil has a share.

Exploration

8. Exploration activity, the best indicator of commitment to the future, will for 1988 be maintained at least at the levels already planned by Britoil and BP, and will thereafter be increased. BP will undertake a geological review of Britoil acreage and also review the scope for drilling unexplored acreage licensed to BP and Britoil in earlier rounds. Subject to there being no major deterioration in economic conditions, and depending on drilling costs, in particular rig rates, BP would expect to spend some £300m. to £325m. on combined BP/Britoil UKCS exploration by 1990. This represents a substantial increase in expenditure, particularly for Britoil, given that BP's existing exploration activity, is already considerably greater than Britoil's on a comparable acreage. The result will be an enhanced level of activity in the UKCS and a significant increase in the number of wells drilled. It is likely that by 1990 BP will on current assumptions be participating with partners in up to 90 wells per annum drilled in the UKCS.

Development

9. Development follows successful exploration. BP will develop as fast as practicable all UKCS discoveries which can be shown to be economic from the combined BP/Britoil portfolio and which result from the proposed increase in exploration activity. In particular, subject to detailed evaluation, BP intends to

proceed with or as the case may be give its support to those field developments, operated by Britoil or its partners, currently under discussion with the Department of Energy.

SCOTLAND AND EMPLOYEES

Staff Numbers

10. BP will ensure that overall employee numbers in Aberdeen and Glasgow, taking BP and Britoil together, will not fall as a result of the acquisition. It is BP's wish that skilled Britoil management and staff are retained, as they will be needed to implement the proposed increased activity.

Glasgow and Aberdeen

11. On or as soon as reasonably practicable after completion of the acquisition, Britoil's Glasgow office will become the business headquarters for the combined BP/Britoil upstream business in the UK (see paragraph 22 below). Related functions residing in Glasgow will include the management of:

oil and gas exploration;
field appraisal;
development planning;
field development work;
associated procurement activity; and
support functions including commercial, technical, personnel and administrative services.

BP will also transfer to Glasgow the management of its high technology Diverless Subsea Production System (DISPS) research and development project. The successful development and deployment of advanced sub-sea production systems is vital for the future exploitation of the deeper waters particularly of the UKCS. BP's objective is to have a proven system in place on the UKCS by the mid 1990s. The technology also has substantial export potential.

Aberdeen will remain the operational centre for BP's and Britoil's day-to-day petroleum exploration, appraisal and production activities in the north and central sectors of the UKCS.

BP will maintain the current procurement policies of the two companies directed from Glasgow and continue to give UK firms full and fair opportunity to bid for orders.

12. BP plans to move its pre-project and project development teams to Scotland as soon as practicable, which is expected to be not later than March, 1989.

The total number of BP personnel involved in moving to Scotland will include not less than 40-60 senior executives and other highly qualified technical graduate staff.

13. The current Chief Executive of BP's upstream activities in the UK is also responsible for such activities in Norway and

Ireland. BP proposes that the Chief Executive of the combined BP/Britoil UK upstream business should likewise be responsible for these Norwegian and Irish interests. The Norwegian activities in particular are substantial and maintenance of co-ordinated management and technical approach of and to the interests in these three countries is essential. The existing locally based management, staff and structures in Norway and Ireland will remain in place. The Chief Executive of the combined activities will be relocated to Glasgow shortly after completion of the acquisition.

Employee Rights and Other Issues

14. To the extent that any functions maintained by Britoil are not required, there may be a few surplus personnel (taking present BP and Britoil staff together) as a result of combining functions. BP will use all reasonable efforts to relocate such staff elsewhere in the BP Group. Redundancies will be avoided where redeployment, voluntary retirements and natural wastage can achieve the desired staffing levels. BP does not expect there to be any redundancies among Britoil staff in the first year following the acquisition but if and to the extent any arose during that period and redeployment efforts were unsuccessful it would be BP's intention to give the affected staff the benefit of Britoil's severance terms. Britoil's Board structure and management are dealt with below.
15. BP will ensure that the rights, including pension rights, of all employees of the Britoil Group are fully safeguarded. As a matter of policy, Britoil employees who join the BP Group will be treated on an equal footing with existing BP Group staff as far as career opportunities are concerned.

Other Implications for Scotland

16. As the UKCS matures as a hydrocarbon province its successful exploitation demands increasingly sophisticated technologies. In meeting these technological challenges, BP is, as explained above, committed to making the fullest possible use of existing Britoil staff. BP will maintain, and is confident that it will be able to enhance, the existing commitments of BP and Britoil (at the level in the case of BP of some £1.2m. in 1987) to conducting UKCS orientated research at Scottish universities. BP is also to endow a Chair at a Scottish University and fund associated research activities. The Chair will have close linkages with BP's research programmes at its corporate research centre in the area of engineering or earth sciences. BP's other substantial business activities in Scotland and its support for the community (the latter totalling £659,000 in 1987) will continue undiminished. BP's determination to increase activity in relation to Britoil's assets will be of significant benefit to the Scottish offshore industry.

Implementation

17. To devise the best organisation to give effect to the assurances in paragraphs 6 - 16 above, BP intends to set up task forces, jointly staffed by BP and Britoil.

BRITOIIL BOARD STRUCTURE AND MANAGEMENT

18. BP accepts that there should be a new non-executive Chairman of Britoil, not at present employed by or affiliated with BP, whose appointment will be agreed by HM Government and BP. There will also be a new Chief Executive, who will be a senior BP employee, and three executive directors (one or more of whom could be existing Britoil Board members): these will be nominated by BP. In addition BP proposes that there should be seven non-executive directors, thereby keeping the Britoil Board at the same size as now. Four of these non-executives would be persons not employed by or affiliated with BP and at least one of them would be a person or persons acknowledged for their affinity to Scottish interests and commitments to the Scottish community. The appointment of the four would be agreed by HM Government and BP. The remaining three non-executive directors would or could be BP personnel.
19. The Board size, composition and arrangements for appointments would be maintained for so long as the Special Share remains in place.
20. Britoil will be managed and operated in similar fashion to other major wholly owned subsidiaries within the BP Group. It will be managed as an integrated operation within the BP Exploration Business; its annual plans and budgets will require BP Group review and approval but its Board will have substantial financial authority (of up to \$20 million) for specific investments. ~~The financing, treasury and other corporate service functions of Britoil will be managed in a co-ordinated way with those of BP.~~
21. BP's wish is to combine the management of its own and Britoil's UK assets as swiftly and as fully as practicable in order that they can be operated in the most efficient and co-ordinated manner. Some transfers of title of existing BP interests into Britoil may be feasible but tax, joint venture consent and other considerations may inhibit such action. BP does not believe a corporate structure in which there are different legal owners of the assets will have any material impact on the unified management of those interests. A number of UK and international exploration interests of BP Exploration have been or are held for tax, legal, historical and other reasons, by separate BP companies, not all of which are necessarily subsidiaries of BP Exploration Company Limited: they are nevertheless successfully managed in a co-ordinated manner.
22. BP will implement the combination of responsibilities referred to above by transferring the management of its UK upstream interests and assets to Britoil. The management of BP's Norwegian and Irish upstream activities will be co-ordinated

through the new Chief Executive of this combined BP/Britoil UK upstream business and the management of Britoil's international (i.e. non UK, Norwegian and Irish) interests and assets will be transferred to BP Exploration's international business.

23. (a) BP will procure that Britoil will not except in the ordinary course of trading (i) transfer to BP the ownership of any of Britoil's assets or interests, or (ii) otherwise dispose of the whole or any substantial part of Britoil's assets or interests either by a single transaction or by a series of transactions whether related or not; and
 - (b) BP will not dispose of any shares in Britoil, and will procure that Britoil will not allot or issue any shares, to any third party.
24. The Britoil name will be kept in place. Britoil will remain a public limited company and its Memorandum and Articles of Association will remain unaltered. BP will procure a quorum at any General Meeting of Britoil while the Special Share remains in place.

Financial Viability

25. BP will ensure that Britoil is adequately funded in terms of ability to meet capital commitments, working capital requirements and other liabilities in relation to the matters set out above. It will maintain a sound balance sheet for Britoil.

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B: THE MAJORITY PERCENTAGE CASE

Board Structure and Management

26. Paragraphs 18 and 19 above will apply.
27. Britoil will continue to be managed and operated as a separate and independent subsidiary in the interests of the company and all its shareholders with most if not all of its own corporate and operational functions. Some arm's length technical and other support by the majority shareholder may be possible and desirable.
28. BP intends
- (a) to co-ordinate the management of Britoil's and BP's UK, Norwegian and Irish interests and assets to the maximum extent practicable; and
 - (b) to transfer the management of Britoil's international (i.e. non UK, Norwegian and Irish) interests to BP Exploration's international business, having regard to obligations owed to Britoil's minority shareholders.
29. Paragraphs 23 and 24 above will apply.
30. The Board of Britoil will retain a large measure of responsibility for the company's financing arrangements but, to the extent agreed by BP, will have access to BP credit whether by means of BP parent company guarantees or otherwise. Some advisory and co-ordinating financial assistance may be available from time to time from BP Finance International, as agreed with the Britoil Board.

Other Assurances and Arrangements

31. There will be as stated in paragraphs 6 - 17 to the extent consistent with paragraph 27 and the obligations owed to Britoil's minority shareholders, provided that Glasgow whilst remaining Britoil's business headquarters would not at this stage become the centre also for BP's UK upstream business. Fewer BP senior executives and other staff would be likely to be relocated to Scotland although as in the 100% Case the new Britoil Chief Executive would be based in Glasgow.

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LETTER FROM TREASURY TO BP

BRITTOIL PLC

1. You have set out in your letter of [] February your assurances on the operation of Britoil, including your proposals for the Board structure and management of the company, depending on whether you acquire either 100% of the Britoil ordinary shares (the 100% Case) or some lesser controlling percentage (the Majority Percentage Case).
2. The Government accepts your assurances which will not be modified without its agreement as Special Shareholder.
3. In both the 100% Case and the Majority Percentage Case, the Government will retain for the time being its Special Rights Preference Share of £1 (the "Special Share") in the capital of Britoil and all rights under it. The Government does not, however, intend to exercise any of those rights so long as BP is, in the opinion of the Government, complying with the assurances given in your letter of [] February.

5. After a period of time, the Government will review, in the light of the way these assurances have operated, when the Special Share should be redeemed.

4. *In the meantime,*
The Government will not, as Special Shareholder, intervene in the day to day management of Britoil.

DRAFT PBPB/ 18.2.88 S
Ref: PB610

From: BP
To: HM Treasury

Britoil plc

We refer to our letter of [*] February, 1988, setting out various assurances as to our post-acquisition strategy in relation to Britoil plc.

We hereby agree that upon attainment of the 100% Case as defined in that letter, we shall, as requested by you, procure the amendment of Article 71 of Britoil's Articles of Association by the insertion at the end of such Article of the following provision:

"At any Meeting convened pursuant to paragraph (c) of Article 71 the presence of the Special Shareholder in person or by proxy shall constitute a quorum at such Meeting and he shall be entitled to propose any resolution which may be put to the Meeting."

*Khalifa cannot
have the same way -
maintain the KIO is
a common asset
with the UK (see his remarks @ Kuwaiti Sov
& the UK enjoys immunity.)*

105165
MDHOAN 9043

CONFIDENTIAL
FM FCO
TO IMMEDIATE KUWAIT
TELNO 57
OF 181700Z FEBRUARY 88

BP/KIO

1. THANK YOU FOR YOUR ACCOUNT OF YOUR MEETING WITH ALI KHALIFA. THERE IS A MEETING HERE ON 19 FEBRUARY TO DISCUSS RECENT DEVELOPMENTS. WE SHALL ALSO LOOK AT KHALIFA'S PROPOSAL OF A QUOTE COMPROMISE UNQUOTE.

2. KHALIFA WAS JUMPING THE GUN WHEN HE SAID THAT THERE WAS NO QUESTION OF A MERGER SITUATION. SHOULD THIS CLAIM BE MADE AGAIN, EG BY KHORAFI, YOU SHOULD REPLY THAT QUOTE THIS IS PRECISELY WHAT THE DGFT IS CURRENTLY CONSIDERING UNQUOTE.

3. ON THE POINT OF SOVEREIGN IMMUNITY. UNDER THE UK'S STATE IMMUNITY ACT 1978, A STATE (WHICH INCLUDES A GOVERNMENT AND A GOVERNMENT DEPARTMENT) ENJOYS CERTAIN IMMUNITIES FROM THE JURISDICTION OF THE UK COURTS. THIS WOULD APPLY TO KUWAIT, AND TO THE KIO, AS IT WOULD SEEM TO BE PART OF THE KUWAITI GOVERNMENT. HOWEVER, UNDER SECTION 3 OF THE 1978 ACT, A STATE DOES NOT ENJOY IMMUNITY IN RESPECT OF A QUOTE COMMERCIAL TRANSACTION UNQUOTE, A TERM WHICH IS WIDELY DEFINED. THE VIEW OF OUR LEGAL ADVISERS IS THAT IT IS UNLIKELY THAT KUWAIT WOULD IN FACT BE ABLE TO MAKE OUT A CLAIM OF SOVEREIGN IMMUNITY IN THE COURTS IF THE SECRETARY OF STATE FOR TRADE AND INDUSTRY WERE TO MAKE AN ORDER AS A RESULT OF AN MMC REPORT REQUIRING THE KUWAITIS TO DIVEST ALL OR PART OF THEIR SHAREHOLDING IN BP.

4. HOWEVER, UNDER SECTION 13 OF THE 1978 ACT, NEITHER AN INJUNCTION NOR AN ORDER SPECIFICALLY REQUIRING PERFORMANCE OF A PARTICULAR ACTION CAN BE ORDERED AGAINST A STATE. THIS MIGHT CAUSE DIFFICULTY IN START UNDERLINE ENFORCING CEASE UNDERLINE SUCH AN ORDER BY THE SECRETARY OF STATE.

5. WE WOULD OBVIOUSLY NOT EXPECT YOU TO DEBATE NICE POINTS OF LAW, BUT YOU MIGHT SAY, IF THIS POINT IS RAISED WITH YOU AGAIN, THAT THE QUESTION OF WHETHER THE KUWAITIS MAY CLAIM SOVEREIGN IMMUNITY IS ONE FOR THE UK COURTS (ALTHOUGH INCIDENTALLY THE VIEW OF OUR LAWYERS IS THAT THEY CANNOT MAKE A CLAIM). BUT IN ANY EVENT WE WOULD TRUST THAT THE KUWAITIS, HAVING TAKEN ADVANTAGE OF

THE OPEN CHARACTER OF THE LONDON MARKET, WOULD NOT SEEK TO AVOID OBLIGATIONS IMPOSED UPON THEM BY UK LAW THROUGH RELYING UPON IMMUNITY.

HOWE

YYYY

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PS/NO 10 DOWNING ST	PS/SEC OF STATE FOR T AND I
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MR MOORE, HMT	GOVERNOR, BANK OF ENGLAND
MR MONCK, HMT	MR T SMITH, BANK OF ENGLAND
PS/SEC OF STATE FOR ENERGY	MR WHOMERSLEY, LEGAL ADVISERS
MR WAKELY, DEPT OF ENERGY	

NNNN

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Many Thanks. One omission, we have checked as an amendment (Statement) repeated in the Lords, I'm glad. Mr.

FROM: D J L MOORE

DATE: 19 FEBRUARY 1988

copy attached for FST

Mr Monck
Ms Leahy
Mr B O Dyer
Miss Wheldon TSOL

Em 19/2.

- 1. SIR PETER MIDDLETON
- 2. CHANCELLOR

Phaekis confirms that Bare Content both in terms of the words in the memorandum and BP/BRITOL the member

I attach a draft minute to the Prime Minister, covering the revised draft letters. We will need to check again on the details but there should not be any further significant changes.

2. Paragraph 16 provides for funding research through the Royal Society of Edinburgh, rather than endowing a Chair, and for continuing community support at BP and Britoil levels. The last sentence of 20 in the previous draft is dropped. There are other minor drafting changes.

3. Paragraphs 31, in the majority holding section, is shortened as we wished, with some harmless additional words to refer to 27 and to the fact that in this situation there will probably have to be 2 separate Chief Executives. BP have accepted that whatever the outcome the staff go to Scotland as promised.

Thanks/ 4. I will have a draft statement on Monday morning and I will prepare Q and A briefing.

5. You will need to decide whether the statement should be repeated in the Lords. The PNQs were not repeated and I hope that can be a precedent - mainly for the no doubt unacceptable reason that it would add to the briefing burden!

6. On the day of the statement I will warn the Clerk to the Energy Committee, as they are showing interest. Otherwise I take it that Mr Taylor and Mr Dyer will handle the procedural points.

DJM
D J L MOORE

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DRAFT MINUTE FROM THE CHANCELLOR TO THE PRIME MINISTER

PRIME MINISTER

BP/BRITTOIL

In my minute to you of 1 February I set out our approach to negotiations with BP and ~~Britoil~~ on the operation of the Government's Special Share in a situation where BP have all or most of Britoil's shares.

2. We have now ^{satisfactorily} completed our discussions with BP, and the outcome is set out in the attached draft letters between BP and the Treasury. The Department of Energy and the Scottish Office have been closely involved in this work, ^{both} and Cecil Parkinson and Malcolm Rifkind are well content with the outcome.

3. If you agree, we ~~will~~ ^{will inform} brief Britoil ^{of} on the position on Monday and I will then make a statement to the House, preferably on Tuesday 23 February, ^{during the} or on Wednesday. At the time of my statement copies of the letters will be placed in the Library. ~~telegraph it~~

4. The Treasury letter provides that ^{while} ~~if~~ BP honour their assurances the Special Share will remain dormant. The Government will not intervene in any way in the day to day management of the company. After a period of time, the Government will review, in the light of the way these assurances have operated, when the Special Share should be redeemed. This gives us freedom to decide when redemption should take place, but the wording implies that we do not expect it to be ~~early~~ (ie this year).

would obviously be convenient if the Britoil board were to recommend their shareholders to accept the BP offer (over 80 per cent have already done so), but I believe that should go ahead whether they do or not.

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5. BP have given, in paragraphs 7-9 of their letter, ^{specific} useful assurances on production, exploration and development, ^{The Dept of Energy are satisfied that these} which give substance to the very generalised promises ~~they~~ ^{BP} made at the time of the offer, ~~The Dept of Energy are satisfied that~~ ^{and indeed go further in many ways.}

6. Their undertakings on Scotland and employment are in paragraphs 10-17. They will transfer to Britoil the management of not only their UK upstream assets but also their Norwegian and Irish activities. ^{Between 40 - 60} ~~Not less than 40-60~~ ^{BP} senior executives and other highly qualified technical graduate staff will move to Scotland.

7. In addition, BP will transfer to Glasgow the management of their high technology Diverless Subsea Production System research and development project. They expect to enhance the existing commitments of BP and Britoil in support of UKCS research at Scottish universities and they will fund further research through the Royal Society of Edinburgh. They will continue their support for community activities at no less than the present levels for BP and Britoil combined.

8. The proposed Board structure is set out in paragraph 18. BP have accepted that the new ^{non-executive} ~~Chairman~~ of Britoil should have no BP connections, which ~~we think~~ is important in the presentation of the package. He will be someone acceptable both to BP and to the Government and I am sure that between us we can find a suitable Scottish candidate.

9. BP are confident that they will secure 100% of Britoil's shares and most of the letter is written on that assumption. But

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it is possible that in the short term, or even for a longer period, they could be left with a minority holding. This possibility is covered by paragraphs 26-31 of their letter. The arrangements would need to have regard to the obligations owed to any minority shareholders and it may be necessary ^{in these circumstances} to have separate Chief Executives for the BP and Britoil interests. But BP have ~~today~~ accepted that whatever the percentage shareholding and the arrangements the proposed staff movements to Scotland will take place.

10. I ^{consider} think that this ^{is} a ^{very} highly satisfactory outcome in which the Special Share has enabled us to negotiate a very good deal for Scotland and for our North Sea interests, ^{which does not form British control.} BP are already a large employer in Scotland, with an excellent reputation there. This, together with the assurances we have secured for both the quantity and the quality of jobs in Scotland, should mean that the deal is well received.

11. I am sending copies of this minute to Cecil Parkinson, Malcolm Rifkind and David Young.

[NL]

[NIGEL LAWSON]

CONFIDENTIAL
and MARKET SENSITIVE

*Thanks.
AA: W. Spence*

FROM: D J L MOORE

DATE: 22 FEBRUARY 1988

CHANCELLOR

cc Financial Secretary
Economic Secretary
Sir P Middleton
Mr Monck
Mr Williams
Mr R I G Allen
Mr B O Dyer
Mr Tyrie
Miss Wheldon TSOL

*Ch.
Content? (One or two
Suggestions by
Mr Dyer).
22/2*

BP/BRITTOIL

I attach a draft statement which I have cleared with Sir Peter Middleton and with Energy officials.

2. As soon as there is an approved version, Mr Taylor should send copies to the other Ministerial Offices concerned.

3. I also attach the very near final drafts of the letters which will be signed tomorrow before your statement. There are no significant differences except that the minimum total staff going to Scotland is now 50-75 - see paragraph 14.

Q and A will follow.

D.J.L.

D J L MOORE

BRITOil

1. Mr Speaker, with permission I wish to make a statement.

2. On 1 February I told the House that, following the acquisition by BP of the majority of Britoil's ordinary shares, the Government would discuss with the two companies how we would use the Special Share. I reaffirmed that the powers of the Special Share would be used for so long as it was in the national interest to do so. I undertook that, in the discussions, we would take fully into account what was best for Scotland and for the development of the North Sea.

3. ~~We have now completed those discussions.~~ *Those discussions have now been completed, and an acceptable arrangement has been reached with BP.* The details are set out in an exchange of letters between BP and the Treasury, and ~~copies are now available in the House Libraries.~~

I am placing copies in the Library of the House.

4. ~~BP now have approximately 80% of Britoil's ordinary shares. Their aim is to acquire all of them. Whether they do so depends on the decisions of the remaining shareholders. In the meantime, they have set out in their letter assurances which would apply if they had either 100% of Britoil's shares or a majority of them.~~ *(or not)*

The undertakings BP have given about their management

4.5. I will deal first with ~~BP's plans for managing~~ *BP's plans for managing* Britoil's North Sea assets on the UK Continental Shelf. ~~BP aim to achieve an increase of at least 5% in total production from Britoil's North Sea oil fields. They will also substantially increase exploration - and this is the best indicator of commitment for the future.~~ *BP will seek to achieve an increase of at least 5% in total production from Britoil's North Sea oil fields. They will also substantially increase exploration - and this is the best indicator of commitment for the future.* By 1990 BP ~~expect~~ *plan* to spend between £300 and £325 million a year on ~~combined BP and Britoil~~ *combined BP and Britoil* North Sea exploration. ~~It will lead to a big increase in the number of wells drilled. BP will develop as fast as is as practicable all economic North Sea discoveries in the combined BP and Britoil portfolio including those resulting from the increased exploration programme.~~ *This represents a substantial increase in exploration and will lead to a big increase in the number of wells drilled. BP will develop as fast as is as practicable all economic North Sea discoveries in the combined BP and Britoil portfolio including those resulting from the increased exploration programme.*

implies

All this implies

5.6. ~~The outcome, Mr Speaker, will be a faster and more effective development of assets in the North Sea. This increase in activity should give a welcome boost to the UK offshore industry.~~

So far as Scotland is concerned, ~~have undertaken to~~

6. 7. ~~On employment in Scotland, BP will ensure that the overall numbers of employees in Aberdeen and Glasgow, taking BP and Britoil together, will not fall as a result of the acquisition. But the Government was concerned with the quality of the jobs as well as the numbers. [Honourable Members] will be pleased to know that BP have undertaken that Britoil's Glasgow office will become the business headquarters for the management not only of BP's and Britoil's combined UK upstream assets but also of BP's Norwegian and Irish interests, In addition, BP will transfer to Glasgow the management of a high technology research and development project for the exploitation of the deeper waters of the UKCS and elsewhere. As a minimum, between 50 and 75 senior executives and other highly qualified technical graduate staff, will move to Scotland.~~

and that the overall numbers of employees in Aberdeen & Glasgow will not fall as a result of the acquisition.

8. BP expect to increase the existing commitments of both companies in support of UKCS-related research at Scottish universities. In addition they will endow a number of BP Research Fellowships for post graduate research work in Scottish universities. Both BP and Britoil have an excellent reputation for support for the Scottish community and BP have undertaken that this will be continued at ~~no less than~~ ^{at least} the present levels for the two companies.

8. 9. The Board of Britoil will be ~~under~~ ^{headed by} a new non-executive Chairman who will be ~~someone~~ without any previous BP connections and whose appointment will be agreed ~~by~~ ^{between} the Government and BP. Of the rest of the Board, the Chief Executive and the executive members will be nominated by BP, ~~and~~ ^{but} the appointment of a majority of the non-executives will be agreed ~~by~~ ^{between} the Government and BP.

9. 10. ~~If BP, end up with a majority, but not a 100%, shareholding, the same assurances and arrangements will apply, to the extent consistent with the obligations owed to Britoil's minority shareholders. In particular, the proposed staff movements to Scotland will still take place though, with a majority holding, Britoil will be managed and operated as a separate independent subsidiary and will have its own Chief Executive.~~ ^(which currently own some 80 per cent of Britoil's admin shares)

have told BP that, in return for these

10.
11. The Government has accepted these assurances. We have told BP that the Special Share will be retained for the time being but that the Government does not intend to exercise any of the rights under it, so long as we are satisfied that BP are complying with the ^{them,} assurances they have given. ~~In the meantime, the Government will not, as Special Shareholder, intervene in the day to day management of Britoil.~~ ^{the Government does not intend to exercise any of the rights attached to the Special Share.} After a period of time the Government will review, in the light of the way that these assurances have operated, when the Special Share should be redeemed.

11.
12. Mr Speaker, the existence of the Special Share has enabled the Government to secure from BP these wideranging, valuable and ~~published~~ ^{public} assurances. BP have a high reputation, both internationally and also as a major employer in Scotland, and I am sure that ^{the House} ~~[Hon. Members]~~ will share my confidence that they will honour the assurances they have given.

12.
13. ^{I believe this outcome} ~~The outcome~~ is good for Scotland, ~~It is~~ good for the efficient exploitation of our North Sea assets, and ~~it is~~ good for the future of the two companies and ~~of~~ their employees.

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AMP

10 DOWNING STREET
LONDON SW1A 2AA

22 February 1988

From the Private Secretary

Dear Jonathan,

BRITOLIL AND BP

The Prime Minister has seen the Chancellor's minute and attachments of 19 February concerning the negotiations with BP on the operation of the Government's special share. The Prime Minister is content with the outcome of these discussions, as reflected in the draft letters, and for the Chancellor to make a statement to the House on either Tuesday or Wednesday of this week.

I am copying this letter to Stephen Haddrill (Department of Energy), David Crawley (Scottish Office) and Alison Brimelow (Department of Trade and Industry).

Yours,

Paul.

Paul Gray

CH/EXCHEQUER	
REC.	22 FEB 1988
ACTION	MR D MOORE
COPIES TO	FST
	SIR P. MIDDLETON
	MR MONCK
	MS LEAHY
	MR DYER
	MISS WHELDON

23/2

T/SOL

Jonathan Taylor Esq
HM Treasury.

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CONFIDENTIAL
and MARKET SENSITIVE

*A few changes -
our gut
Mr. also to give as
to transfer to Mr. Spring
show to 500
Ch/
Content?
22/2*

FROM: D J L MOORE
DATE: 22 FEBRUARY 1988

CHANCELLOR

cc Financial Secretary
Economic Secretary
Sir P Middleton
Mr Monck
Mr Williams
Mr R I G Allen
Mr B O Dyer
Mr Tyrie
Miss Wheldon TSOL

BP/BRITOL

I attach Q and A briefing. Numbers in brackets refer to paragraph numbers in the BP letter, although Opposition spokesman will not see the letter until after your statement.

2. It would be helpful if your approved version could be sent to other Ministerial Offices.

D J L MOORE

BP/BRITTOIL

A. GENERAL

1. What if BP renege?

The Government would be free to exercise all its rights under the Special Share and could replace some or all of the Board. But I am confident that BP will honour the assurances they have given to me and, through me, to this House.

2. Is it a legally binding contract with BP?

No. The arrangements leave HMG free to exercise its rights under the Special Share immediately in the unlikely event that BP are not honouring the assurances.

3. When will the Special Share be redeemed?

When the Government is satisfied that the arrangements I have outlined have been implemented and have the start to work satisfactorily for a reasonable period the Special Share will be redeemed.
~~Not before it has been demonstrated that the assurances have been put into effect. I have therefore deliberately not set a time. [But it certainly will not be this year.]~~

4. What does this imply for other Special Shares?

Nothing. [The Enterprise Special Share will be redeemed at the end of 1988. Apart from Jaguar (1990) the rest have no time limit].

5. How will you monitor the assurances?

I would expect BP, and the Chairman of Britoil, to report from time to time on progress on the assurances in the letter. The Department of Energy has of course a close continuing relationship with BP. Within 9 months BP will report to the Department on its technical evaluation of Britoil's fields.

6. What happens to the assurances when the Special Share is redeemed?

They remain in place.
Look at that question when the time comes. But the Special Share would not be redeemed unless the Government was satisfied the assurances had been met and would continue to be met in substance.

7. What meetings with Britoil? Are they satisfied?

The Treasury held meetings with representatives of the Britoil Board who have been advised of the terms of the letters. It is for them to decide how to advise their shareholders.

8. Is a 100% holding by BP better than a lesser majority?

Not a matter for me.
It would be wrong for me to comment on that. Britoil shareholders must make up their own minds, having heard what BP and the Britoil Board have to say to them. Either way, staff movements to Scotland will take place.

[Note to be able to get 100% BP need to get 90% of the outstanding shares it did not own when it launched the bid, ie it needs 93% before it can compulsorily acquire the rest.]

9. Will the Government operate the Special Share to protect minority shareholders against BP?

Minority shareholders would enjoy no full protection of the Companies Acts.
~~The assurances are not taken specifically for the benefit of minority shareholders. The Britoil Board must of course act in the interests of the company and its shareholders as a whole.~~

10. Why is it necessary to amend the Articles?

This is a technical point. It is desirable to provide, at the stage when the Government no longer holds any ordinary shares in Britoil, for the Special Shareholder on its own to be able to constitute a quorum at any EGM should that be necessary.

[There would be no such amendment before compulsory acquisition of the minority shareholdings].

What is para 25?

1. Are there any side agreements?

No, apart from the arrangement in paragraph 25 of BP's letter. [See also Q10.]

(requested by HMG) which refers to an amendment in Britoil Memorandum and Articles of Association to ensure

12. What will HMG do with its ordinary shares in Britoil?

a quorum at any General Meeting of Britoil

[We still have approximately 480,000 shares which had been retained for handing out as loyalty bonuses.]

We will be guided by the response of other Britoil shareholders. If BP secure sufficient acceptance & acquire compulsory, then HMG will voluntarily accept in respect of its own 0.01% holding. HMG, etc.

[Do not concede by implication that HMG is bound by these procedures. It will transfer the shares voluntarily].

13. What about small Britoil shareholders who may still be eligible for loyalty bonus shares held by HMG?

Applications for these should have been made by January 1986. Someone who establishes that he should have been given Britoil bonus shares will not be entitled to them if BP acquires 100%. But he may have a claim for financial compensation.

B WORK PROGRAMME (BP letter paragraphs 6-9)

See Department of Energy briefing annexed.

C EMPLOYMENT (paragraphs 10-18)

14. How many extra jobs to Scotland?

BP have undertaken (paragraph 14) that not less than 50-75 senior executives and other highly qualified technical staff will move to Scotland.

These are minima and when BP have had the opportunity to look in detail at the possibilities there could be more.

Functions in Glasgow include the management of exploration, appraisal, development, procurement and support activities (11).

15. How many redundancies?

There may be a few surplus staff but not necessarily redundancies.

BP say in their letter (15) that they do not expect any Britoil redundancies in the first year but if there were any, and redeployment was not possible, BP would give the staff concerned the benefit of Britoil's severance terms.

The rights, including pension rights, of all Britoil employees are fully safeguarded (16).

16. Which Britoil functions will be lost?

I understand that financing and treasury functions, for example, will be integrated with those of BP. But there will still be people working on these matters in Glasgow. The exact organisation and deployment is a matter on which BP and Britoil will be working together.

17. Why did you not meet the Britoil unions?

It is for BP and Britoil to talk to the staff concerned and to the unions.

8. What about the 100 technical staff in Aberdeen waiting to move to London?

This is a matter for BP and these plans were laid well before the acquisition. I understand that BP are currently reviewing the situation but no decision to change the plans has yet been made. They will want to look further at the best organisation to implement the assurances.

D BOARD STRUCTURE AND MANAGEMENT (19-25)

19. Who will the new Chairman be? (19)

Not chosen yet. Someone acceptable to both HMG and BP. [Yes, I would be very happy to see a good Scotsman fill the post].

20. When will the new Board take over?

Cannot be certain yet. A matter for BP and Britoil.

21. Why are BP allowed a majority on the Board?

[Of 12 members, BP can nominate 7.]

They own ^{the vast} a majority of the shares. But the Chairman will not have BP connections and, in the last resort, if the assurances were not honoured the Government could use the Special Share to remove Board Members.

22. What if BP transferred ownership of Britoil assets to itself or to anyone else?

They have undertaken not to do so, except in the ordinary course of trading (24a).

Nor will they sell their shares in Britoil (24b).

23. Can BP move its assets into Britoil and under the Special Share?

They could do. But in practice they expect to transfer management

but not ownership of their UKCS assets to Britoil (22).

24. **What of Britoil's international assets?**

Their management (but not ownership) will be transferred to BP Exploration's international business.

E KIO AND BP**Assurances by the Kuwait Authorities**

[As the Treasury announced on 8 January] The Kuwait authorities have assured us that they have no ambitions to control BP nor any interest in any management role, and that the KIO holding in the company is intended as a long term investment.

Meeting with Kuwaiti Ministers on 28 January

Together with the Secretary of State for Energy I met Shaikh Ali Khalifa the Kuwait Oil Minister and acting Finance Minister, when he was in London at the end of January. He reaffirmed the assurances already given by the Kuwaiti authorities. Normal for opposite numbers to meet. Not practice to give details.

Possibility of reduction in present holding (nearly 20%)

They have said that it is a long term investment. Any reduction would be a matter for their commercial judgement.

Possibility of sale of KIO's BP shares to a purchaser unacceptable to HMG

I am confident that they would not make a sale unacceptable to BP and to the Government and that they would consult us if they were contemplating any significant disposal.

Acceptability of present level

As the Prime Minister said on 19 November it is not surprising that there should be a considerable number of overseas investors in an international company like BP. ~~[It is unrealistic to lay down precise figures as to what is an acceptable level of investment.]~~ But in the case of the KIO what is important is the very firm assurances the Kuwait authorities have given.

Acceptability of up to 29.9%

As I told the House on 11 January, an increase up to 29.9% would ~~seem~~ inconsistent with the assurances given that the KIO has no intention at any time of seeking to exercise control over BP. 65

KIO Directors on BP Board

[NB Kuwaitis have not given any assurance they will not press for Board representation]

~~If this question arose it would be~~ This is) a matter for the BP Board, and the KIO.

Role of Office of Fair Trading and MMC

If there had been any question of the KIO proceeding to a full bid for control the situation would have been examined under the Fair Trading Act in the normal way.

The KIO's current holding is being considered as a matter of course by the Director General of Fair Trading who will advise the Secretary of State for Trade and Industry whether there may be a merger situation qualifying for investigation and, if so, whether it should be referred to the MMC.

[Note To preserve the Secretary of State's position nothing should be said which indicate that HMG has already concluded that the present KIO holding either is or is not acceptable.]

BP's views

I am sure that BP would not wish to see KIO with
~~They have said they are not comfortable with as much as 20%.~~
to go on longer; but that is a matter for them.

The KIO bought into BP cheaply as a direct result of the Government's decision to go ahead with the BP sale

Always possible for someone to buy shares cheaply after a fall in share prices. The Bank support operation meant that the

Kuwaitis had to pay more than they would have otherwise.

Have the KIO been involved in discussions on BP/Britoil?

Certainly not. KIO is an institutional investor in BP. It has no management input. It was not consulted in relation to any aspect of the agreement.



FROM: J M G TAYLOR
DATE: 22 February 1988

A handwritten signature in black ink, appearing to be 'JMG'.

MR D J L MOORE

cc PS/Financial Secretary
Sir P Middleton
Mr Monck
Ms Leahy
Mr B O Dyer
Miss Wheldon - T.Sol.

BP/BRITOIL

The Chancellor was most grateful for your minute and enclosures of 19 February.

2. The Chancellor wrote to the Prime Minister along these lines, and she has now approved the planned course of action. I have spoken to the Lord President's Office. They are now consulting with the Business Managers, with a view to the Chancellor making a statement tomorrow.

3. The Chancellor thinks that the statement must be repeated in the Lords.

A handwritten signature in black ink, appearing to be 'JMG'.

J M G TAYLOR

CONFIDENTIAL

FROM: D J L MOORE

DATE: 26 FEBRUARY 1988

SIR PETER MIDDLETON

cc

PS/Chancellor
 PS/Financial Secretary
 Mr Anson
 Mr Monck
 Mr Scholar
 Mrs Lomax
 Mrs Brown
 Mr Williams
 Mr Bent
 Ms Leahy
 Mr Lyne
 Mr Call

Miss Wheldon TSOL

**BP POST MORTEM: FINANCIAL ADVISERS AND LEAD UNDERWRITERS;
 UNDERWRITING AGREEMENTS**

You asked me in your minute of 3 December to review the lessons to be learned from the BP sale. You agreed that I could answer your questions in instalments.

2. I have dealt first with the problems of having the one merchant bank as financial adviser and lead underwriter, and of the termination clause. I have had considerable help on this from Miss Wheldon and Mr Henderson (Slaughter & May) and from Mrs Brown and Mr Bent. We also talked to Rothschilds.

3. I attach a paper in which I summarise our conclusions in paragraphs 1-3. We recommend the appointment in future of a separate financial adviser and lead underwriter, and a simpler termination clause which leaves the decision to the Government and gives no formal role to the Bank. If you agree with this approach our legal advisers will attempt to draft a new model termination clause.

4. I have not consulted the Bank and I suggest that, subject to any amendments, you should now send the the paper to the Deputy Governor. As I understand it, you and he agreed that in future

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the Bank should not have any role as independent assessor. But, as pointed out in paragraph 24, this would not stop the Bank giving us advice and passing on representations made to them. Indeed they could do so more freely and effectively because they would not be in a Clause 8 strait-jacket.

5. I should also like to send the paper to the other departments dealing with privatisations. Although I do not expect any problems, it is important in particular to carry DTI with us as BSC is the next sale. I shall make clear that the departments may draw on the paper in talking to their advisers but they may not give it to them - Section III says a number of things about options for negotiation on the termination clause.

6. We have now made some progress on the other questions and, with this paper completed and BP/Britoil out of the way, we will now get on with them. In doing so, we will take account of points arising from the privatisation seminar and from papers some of the banks are volunteering to us.

DJM.

D J L MOORE

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Financial Advisers, Lead Underwriters and Underwriting Agreements
- lessons from the BP sale

I SUMMARY

The market collapse, shortly after the announcement on 15 October 1987 of a 330p fixed price in the BP offer, led the underwriters to ask for the issue to be pulled. We were then faced with two major problems.

i. In a crisis situation we could no longer use our merchant bank financial adviser since they were the lead underwriter charged with making formal representations to us on behalf of the UK underwriters.

ii. The operation of the termination clause in the Underwriting Agreement put into baulk our normal relationship with the Bank of England, who assumed the role of independent assessor. It was complex and time-consuming and the clause was open to dispute over interpretation.

2. In summary our recommendations for avoiding, or at least reducing, these problems in future Government sales are as follows:

i. We should appoint separate financial advisers and lead underwriters

ii. We should have a simpler termination clause which would allow for the underwriters to make representations for whatever reason. It would make clear that the decision whether or not the offer should proceed should continue to rest with the Government. It would not give any role to an independent assessor, either the Bank or anyone else. It should continue to deny the overseas underwriters the right to make direct representations to HMG (though we may well come up against pressure for some change).

3. These recommendations, and the reasons we make them, are discussed in more detail below. We propose to proceed in the BSC sale on the basis of (i.). We will ask the Treasury Solicitor and Slaughter and May to draw up a new, model clause on the lines of (ii) and, in doing so, to obtain the advice of Mr John Mummery QC and of Mr John Chadwick QC, who was closely involved in the BP discussions. Before any such clause was finalised, we would consult the legal advisers to the other departments with privatisations in the offing.

II FINANCIAL ADVISER AND LEAD UNDERWRITER

The problem

4. The practice of appointing a merchant bank to be both financial adviser and lead underwriter is standard in privatisations and in private sector issues. It has two disadvantages. As was shown in the BP sale, the vendor loses his principal adviser in a crisis where the underwriters call for the issue to be pulled. Crises apart, it is questionable whether a vendor can be confident of getting fully impartial advice from a merchant bank which is itself at risk because it is an underwriter and may also have some sub-underwriting commitment. It is partly because of this conflict of interest that it has been felt necessary to appoint an additional, independent financial adviser in some previous sales.

5. Although we may well not be faced again with a problem on the BP scale it would not be defensible to work on that assumption and to continue with previous practice. We have therefore looked at some options.

An option

6. It was suggested to us that there were disadvantages in totally splitting the role of financial adviser and lead underwriter. There could be extra work and negotiation arising from conflicts between the two banks. There might be some loss of the "aura of confidence" surrounding a transaction

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if the bank which had advised and operated throughout did not lead the underwriting. Because of these doubts, and because the probability was that a BP situation would rarely occur, the following arrangements were proposed.

7. If termination discussions became necessary, HMG should be able to turn to an alternate financial adviser for wholly independent financial advice, while the main adviser/lead underwriter was effectively confined to its underwriting role. A leading bank with a good knowledge of the UK and international equity markets would be selected, say, at Pathfinder to act as this alternate adviser. It would be given, for information only, a briefing paper and draft underwriting documentation. It would be consulted on two issues only:

a. pricing: where, irrespective of whether the termination clause was invoked, it would act as an independent pricing adviser (though this would not mean that the main bank would not have a major role in the pricing discussions);

b. if they arose, termination discussions: where it alone would provide financial advice to the Government.

This second bank would not be an underwriter but would receive a fee, to be increased if it were used as in (b) above, and perhaps mention in the prospectus.

8. We firmly advise against this. It seems perverse that in a crisis HMG should lose its main adviser, which would be better informed on the sale than any other city institution, to the underwriters sitting on the other side of the negotiating table. The alternative of keeping our financial adviser and asking the remaining underwriters to appoint a new lead would not work. No merchant bank would be likely to take on this rôle, for which there would no longer be the prize of good publicity, and which would carry a serious risk of litigation from fellow underwriters, UK and overseas, over any shortcomings in performance.

Our recommendation

9. We recommend instead that in future sales the vendor department should appoint first a financial adviser and then, later and separately, a lead underwriter. As a result, we must expect advisory fees to be somewhat higher because the financial adviser cannot look to anything from underwriting or from sub-underwriting fees.

10. But in return for a relatively small increase in costs we would avoid the BP risk. And, perhaps more important in practice, we would have independent pricing advice, even though financial advisers may still tend to err to the cautious. This should remove - or at least reduce - the need for appointing an additional and independent pricing adviser which is not always easy. Most merchant banks are ruled out because they want to be in the underwriting group. Retired experts - such as Mr Godfrey Chandler - may well do a good job but they are in short supply and not always available. And, however good the retired expert, it is arguably better to have the full resources of a merchant bank on tap.

11. A further advantage of splitting the roles is that the Government adviser can then support the department in negotiating the detail of the various underwriting agreements. At present this task is undertaken by the department alone because of the conflict of interest when the adviser is also lead underwriter.

12. We do not believe that the splitting of roles would significantly reduce confidence in the sale. The reasons for the split could be readily explained and, following the BP sale, should be well understood. There is no reason why the name of the financial adviser should not continue to feature prominently in the prospectus. The lead underwriter will itself be a prominent bank, will have been involved for some weeks before Impact Day, and by signing the underwriting agreement will itself be implicitly and publicly endorsing the soundness and attractiveness of the offer for sale.

13. Samuel Montagu, who are advising DTI on the BSC sale, have already been told to assume they will have no primary or sub-underwriting role. We need to consider further, and in consultation with them and with DTI, when the lead underwriter should be appointed by competition and on what terms. The aim would be to present the lead underwriter with firm proposals for the structure of the offer and the underwriting agreement. If they persuaded us there were strong grounds for making fundamental changes, we would of course make them. But at the time of appointment it would be made clear that it would not be open to the lead underwriter to redesign the structure as it wished or to rewrite the agreement; if they fundamentally objected, without very good reasons, another bank would be offered the appointment.

14. The financial adviser to the company would not be appointed as lead underwriter, though there may be no objection to their having some underwriting, perhaps at the average percentage established by competition.

III UNDERWRITING AGREEMENT TERMINATION CLAUSE

15. A copy of Clause 8.01 of the BP Underwriting Agreement is at Annex A. A majority in number of the UK underwriters to the BP sale formed the opinion that since 15 October 1987 there had been:

- a. an adverse change in national or international financial, political, industrial or economic conditions or currency exchange rates or exchange controls;
- b. which was of such magnitude and severity as to be material in the context of the Offers or the Fixed Price Offer; and
- c. which should not be regarded as a proper underwriting risk in the context of the Offers of the Fixed Price Offer.

16. The Treasury considered the representations made by Rothschilds on behalf of the underwriters, and separately consulted with BP as to the action which they considered should be taken. Subsequent to those discussions the Treasury and Rothschilds did not agree on whether or not the Offers should proceed. They therefore jointly consulted the Bank of England who, after a meeting, gave its assessment to both the Treasury and to Rothschilds. The Chancellor of the Exchequer, having taken full account of the Bank of England's assessment, announced on 29 October that the Offers would proceed. Under the terms of the underwriting agreements, the four groups of overseas underwriters did not have the right to make formal direct representations to the Government, although their views were made known.

17. Clause 8.01 was basically the same clause which had been in most earlier privatisation underwriting agreements. In the BP sale, it enabled the Government to withstand the best efforts of the UK and foreign underwriters to be relieved of their obligations. Even so we are not aware of anyone involved on either side in the October 1987 negotiations who would argue for it to live on in its present form. We have therefore looked at the options for a new approach.

Options

18. Just as the Government has learnt lessons from the BP sale so, no doubt, have the underwriters. Negotiations of the termination clause on the next sale might be difficult. We have looked at several options.

19. First, potential underwriters might point out that in some private sector agreements underwriters have discretion to pull the offer. But this option would be wholly unacceptable in a Government sale and we have dismissed it as a possibility.

20. Second, we could have no termination clause in the underwriting agreement. This would mean that the contract could still be terminated by mutual agreement or frustrated (see Slaughter

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& May's note on the law of frustration at Annex B). This approach would, however, have the following serious disadvantages:

i. It means that the ultimate decision on whether the Offer proceeds could be taken by the Courts rather than by the Government.

ii. It must be uncertain whether the Courts would be able or willing to decide what was bound to be a difficult case in the very short time that would be available.

iii. If there was any delay in receiving the Court's decision, the underwriters' natural inclination would be simply not to pay on the due date, pending the Court making its decision.

21. Third, the ideal option from the Government's point of view would be a termination clause which so far as possible ousted the doctrine of frustration and under which the underwriters were bound to take up their shares, without the need for any formal consultation procedure, unless the Government itself wished the offer to be pulled. This however is probably an unrealistic negotiating objective.

22. Fourth, it has been suggested that the area for dispute would be reduced greatly or even eliminated if there were provision for the Government to accept automatically a request for termination when markets fell by more than X per cent over a given period. Between 14 and 20 October there was an unprecedented fall of nearly 29% on the London Stock Exchange. Given the Government's decision to go ahead in these circumstances with the BP offer, the presumption must be that, other things being equal, the Government would not pull any future sale because of a fall of up to 30%. It would be possible to write in a trigger at a higher level of, say, 35% or 40%. But such a level would be seen as very cold comfort by the underwriters and they would, therefore, probably press for termination to be triggered in a range of other circumstances which would not necessarily be

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easy to express with sufficient precision to provide a basis for automatic termination. Moreover, it is not clear that the principles which underlay the Government's decision on BP should automatically be over-ridden in the circumstances of a somewhat higher market fall than in October 1987. Nevertheless, while we are not attracted by this option, we recommend that some further work should be done on it by our legal advisers for use as a fallback if the course we recommend below runs into difficulty.

Recommendation

23. A more practical proposition than the third option above would be a clause on these lines:

i. if for any reason the underwriters consider that events have occurred since the date when the agreement was executed such that they should be released from their obligations, they may make representations through the lead underwriter to the Government.

ii. the Government would merely commit itself to consider these representations in good faith

iii. the clause would make clear that the final decision as to whether or not the offer should proceed would rest with the Government

iv. it would provide that if the Government considered that events had occurred leading it to wish to terminate the agreement it would notify the underwriters and consider any representations they wished to make; again the final decision would be for the Government.

24. This should reduce the number of formal procedural steps which would need to be taken if the underwriters wished to pull the issue. In particular there would be no provision for an independent assessor, whether the Bank or anyone else. This would deal with the crucial problem in the BP sale that normal

discussions between the Treasury and the Bank were put in baulk. But this need not stop the underwriters from making their views known to the Bank, outside the legal framework of the underwriting agreement. Indeed, this possibility might ease the presentation of the new arrangements to the underwriters.

25. This should be a considerable improvement on Clause 8. But it would not necessarily solve all the problems which arose on BP. An obligation to consider representations in good faith brings in the sort of considerations which frequently cause trouble on judicial review applications. The Government would be vulnerable if it had a closed mind at the time when representations were made to it and would need to show that it had fully considered the representations in question. This is likely to lead in practice to a fairly formal procedure. Moreover, there may be room for argument about the extent to which such a clause has ousted the doctrine of frustration in a particularly extreme situation.

26. Our legal advisers need to give further thought to the extent to which these problems can be eliminated or minimised. Accordingly we recommend that the Treasury Solicitor and Slaughter & May should draft a clause along the lines of paragraph 23 and consult counsel on it. At the same time, Counsel should consider the option in paragraph 22, for an automatic termination provision. While there are objections to this, it might reduce the problems noted in paragraph 25 and might therefore be worth looking at as a possible fallback.

Overseas underwriters

27. As seen by the four groups of overseas underwriters, a further problem in the BP sale, was that they were precluded from making direct representations to the Government. We also suspect that this added to the problems of the UK underwriters, and particularly the lead underwriter who was liable to be sued by the overseas underwriters for any failure in vigorously making the case for termination to the Government.

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28. On the other hand, from the Treasury's point of view the arrangements had advantages. In practice we were well aware of the overseas underwriters' opinions because we held a meeting with each of the four groups before the termination procedures were invoked, and subsequently each of them sent letters setting out their views clearly and in detail. But we were not obliged to have continuing and formal meetings with them, as with the UK lead underwriter, and this undoubtedly reduced the burden on us when we were already under enormous timing pressures and constraints.

29. We would, therefore, strongly prefer to continue with these arrangements and to deny the overseas underwriters the right to make formal, independent representations direct to the Government. In addition:

- i. all overseas underwriting agreements would continue to be governed by English law as in BP
- ii. the other provisions, first established in the British Gas agreement, to ensure that all the underwriting agreements stood or fell together should be maintained.

**PE GROUP
TREASURY
FEBRUARY 1988**

8. Termination

8.01 If between the execution of this Agreement and the time when this Agreement becomes unconditional in all respects there shall, in the reasonable opinion of the Treasury or a majority in number of the Underwriters, have been:-

- (a) any adverse change in national or international financial, political, industrial or economic conditions or currency exchange rates or exchange controls; or
- (b) any press or public announcement or comment concerning BP or any of its subsidiaries (or the Offers or the Fixed Price Offer or the International Offer (including the Overseas Offerings)), or any agreement or arrangement or act or thing which would require any such press or public announcement or comment to be made, in the United Kingdom or elsewhere by or on behalf of BP falling within the restrictions imposed by Clause 3.11 which has not, insofar as such approval is required, been approved by the Treasury and Rothschilds prior to its release or (as appropriate) prior to the agreement or arrangement being entered into or the act or thing being done or (where BP is required to do so by any applicable law or regulation or by any stock exchange on which Ordinary Shares (or depositary receipts relating thereto) are listed) which has been made, entered into or done without prior consultation with the Treasury and Rothschilds; or
- (c) any press or public announcement in the United Kingdom or elsewhere about the Offers or the Fixed Price Offer by or on behalf of any Minister of the Crown;

which, in the reasonable opinion of the Treasury or a majority in number of the Underwriters, is (or in the case of any such announcement, comment, agreement, arrangement, act or thing the effect of which is) of such magnitude and severity as to be material in the context of the Offers or the Fixed Price Offer, and which (in the case of an opinion formed by a majority in number of the Underwriters) should not, in the reasonable opinion of a majority in number of the Underwriters, be regarded as a proper underwriting risk in the context of the Offers or the Fixed Price Offer, the Treasury and Rothschilds on behalf of the Underwriters (after consulting with BP) shall consult as to what action shall be taken in relation thereto, and if the Treasury and Rothschilds on behalf of the Underwriters shall not agree whether or not the Offers should proceed the Treasury and Rothschilds shall jointly consult the Bank of England, and shall before reaching a decision take full account of the Bank of England's assessment.

H.M. Treasury/Underwriting Agreements

Law of Frustration

Under the doctrine of frustration, a contract may be discharged if after its formation events occur making its performance impossible or illegal, or which would result in the performance of radically different obligations from those envisaged. There is no definition of frustration. Whether an event will constitute a frustrating event sufficient to bring the contract to an end and release the parties from their obligations is a question of law, and also of fact. As a result, it will be difficult accurately to predict a court's decision in any given case, unless it is directly comparable with a decided case, but it is possible to set out the tests which have been applied.

1. The test for frustrating events

The formulation of the test now accepted by the Courts is whether the obligations under the contract have become something "radically different" from what the parties contracted to do. This test has been recently restated as follows "Frustration of a contract takes place when there supervenes an event ... which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual ... obligations from what the parties could reasonably have contemplated ... that it would be unjust to hold them to the literal sense of [the contract's] stipulations in the new circumstances ...".

This test looks potentially broad, but is qualified in its application. The steps a court must go through are to look at the obligations under the contract both before and after the supervening event alleged to frustrate the contract. Then a court must compare these obligations to decide whether the new obligation represents a radical or fundamental change from the original obligation; it is not simply a question of whether there has been a radical change in the circumstances. In addition, a court will always bear in mind that "the doctrine is not lightly to be invoked to relieve the contracting parties of the normal consequences of imprudent commercial bargains".

Other relevant factors are:-

(i) Bad bargains

The fact that one or both of the parties find themselves contracted to perform a bad bargain has never been sufficient to amount to a frustrating event, even where there has been an exceptional change in circumstances. This includes "a wholly abnormal rise or fall in prices" or "a sudden depreciation of currency" (The British Movietonews case [1952]).

(ii) Foreseen and foreseeable events

Subject to certain exceptions, foresight or foreseeability of the supervening event in question prima facie excludes the operation of the doctrine of frustration. However, it is ultimately a question of construction of the contract, where the parties actually foresaw the possibility of the event in question but left the contract silent on the matter, whether the parties intend the contract to continue or relevant legal rules (such as the doctrine of frustration) to apply, particularly in the latter case if the contract provides for these rules to apply. Certainly, a clause in a contract intended to deal with the event which has occurred will normally preclude the application of the doctrine of frustration.

(iii) Risk

Frustration tends to be limited in scope where risk is clearly on one party. Thus under a contract for the sale of goods, risk passes with ownership, so that destruction of the goods does not frustrate the contract. Losses fall on the party with whom the risk rests when the losses are incurred.

It would seem logical that where the purpose of the contract is to allocate risk, the doctrine of frustration is less likely to apply. This contention appears to be borne out by the dearth of cases where an insurer has sought to apply frustration to an insurance contract itself.

2. Effect of frustration

The effect of a frustrating event is that the parties are automatically released from their obligations under the contract. Where payments have already been made or losses incurred by one or both parties, this may give rise to inequality of losses.

Under the Law Reform (Frustrated Contracts) Act 1943, the court has a wide power to allocate such losses between the parties. It is interesting to note that this Act expressly excludes from its ambit contracts for insurance. Under common law, the doctrine of frustration only brings the contract to end releasing the parties from further performance of their obligations; it does not rescind the contract ab initio. Thus, the parties to an insurance contract will usually have to follow the old common law rule that losses lie where they fall.

Slaughter and May
(GIH/CMH/JCXS)
7.1.88

40/236

cc

PS/Financial Secretary
Sir P. Middleton
Sir G Littler
Monck
Mr Moore
Mrs Brown
Ms Leahy



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

3 March 1988

Stephen Haddrill Esq
PS/Secretary of State
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Ken Stepton

k - BR / K10

KIO

... I attach a record of the meeting which the Chancellor and your Secretary of State had with Shaikh Ali Khalifa yesterday.

I am copying this letter and enclosure to Paul Gray (No.10), Robert Culshaw (FCO), Stephen Ratcliffe (DTI), and John Footman (Bank of England).

Yours sincerely

J M G Taylor

J M G TAYLOR
Private Secretary

40/236



NOTE OF A MEETING HELD AT NO. 11 DOWNING STREET AT 1.30PM ON 2 MARCH 1988

Present: Chancellor of the Exchequer
Secretary of State for Energy
Sir Peter Middleton
Mr Gregson

Shaikh Ali al Khalifa al Sabah (Kuwait Oil Minister)
HE Mr al Rayes (Kuwait Ambassador)
Shaikh Fahad al Sabah (Kuwait Investment Office)

.....

BP: KIO HOLDING

The Chancellor began by emphasising the confidentiality of the discussion. Khalifa agreed. The Chancellor, continuing, said that the concern which had been expressed at the earlier meeting on 28 January about the size of the KIO holding in BP was still very much present. Indeed, it had if anything increased following the reports we had received of the meeting between Khalifa and Mr Mellor last week, where mention had been made of an increase in the holding above 20 per cent, and of a possible KIO seat on the BP board at some time in the future. He had to speak plainly. This was not something we would find acceptable. Nor did he think that BP, with whom we were in close contact, would find it acceptable. The Chancellor stressed that political pressures were building up. He recalled that, after his recent statement on Britoil, the Opposition spokesman had immediately raised the subject of the KIO's holding. These political pressures could only be contained if the holding were kept below 20 per cent. Anything at or above this figure would create major political difficulties. There would certainly be Parliamentary debate,



at which remarks hostile to the Kuwaitis would inevitably be made by the Opposition. There would also be pressure outside Parliament, and the Government could be forced to take action.

2. The Chancellor said that the OFT process had been raised at the meeting with Mr Mellor. The OFT was, of course, an independent body and he did not know what it might recommend. But, in this context, sovereign immunity had been raised. Our legal advice was that sovereign immunity did not apply to this case, and that in any event it was irrelevant in the context of the Fair Trading Act. Khalifa had also mentioned the possible disposal of KIO's holding at his meeting with Mr Mellor. Any decision of this sort would be entirely for the KIO, though a reduction in the holding would of course be helpful to HMG. But this was something for the KIO to discuss with BP; there could be no question of HMG itself buying the shares. The Chancellor concluded by expressing his wish that BP/Kuwait relations should continue to be excellent; we attached importance to this. But he also stressed the great importance to HMG of the KIO keeping its holding below 20 per cent.

3. Khalifa thanked the Chancellor for his frankness. He understood our political problems. He was willing to be flexible about representation on the BP Board. If this caused BP and HMG embarrassment, the KIO would not seek it for the foreseeable future. The KIO could also contemplate a limit to its holding some way below the legal maximum. But the KIO was entitled to fair treatment, and a 20 per cent ceiling was not fair. The KIO had also sought legal advice on sovereign immunity: its advisers had said that while sovereign immunity did not apply to the Fair Trading Act, and that the OFT could suggest a reference to the MMC to the Secretary of State, this did not mean that the KIO would ultimately be forced to sell its holding. As far as reducing the holding was concerned, the KIO would not be willing sellers. It had bought the holding with a view to a long term investment. If the shareholding



was unwelcome to BP, then it might consider selling. But in this event it could find its own buyers.

4. Khalifa hoped that an accommodation between the KIO and HMG could be found. But this could not be one-sided. The KIO was prepared to forgo board representation and to consult before selling its holding. HMG could not expect it also to hold to a limit of below 20 per cent. The KIO had legitimate fears about the future of its own investment, which would be allayed if it were allowed to go beyond 20 per cent. He concluded by affirming that relations between the UK and Kuwait remained very good. He hoped that, if a disagreement over the BP holding arose, this would not disrupt these wider good relations.

5. The Chancellor was grateful for Khalifa's remarks in relation to the BP board. This was not a true concession, since the KIO had no right to board membership, but it was helpful. Similarly, although it was helpful that the KIO would consult HMG before selling its holding, this was also not a true concession. Rather, it was confirmation of the normal practice between friendly governments. On the size of the holding, we had in fact already made a concession. We had become anxious when the holding had reached 15 per cent - as had BP - but had decided not to press the matter at that stage. (Khalifa interjected that it would have been helpful if BP had made clear its anxiety to the KIO at that stage.) The Chancellor made clear that our anxieties would have been the same had any other country - eg Japan - taken a holding of this size in BP. He stressed again the political difficulties which would arise should the holding go to 20 per cent or beyond. He shared the hope that these would not have a wider effect on Anglo/Kuwaiti relations. But if the problem became very large, there must inevitably be a risk of this happening.



6. The Secretary of State for Energy recalled the great problems with Anglo/Saudi relations which had been caused by the "Death of a Princess" affair. He was anxious that no risk should be run of a similar xenophobic backlash arising from the KIO holding in BP. HMG had no wish to see the holding become the subject of political trouble. But if it went beyond 20 per cent, the Opposition spokesmen and backbenchers would certainly create trouble.

7. Khalifa said he was aware that Opposition MPs sometimes made inflammatory remarks. The Kuwaitis would recognise that such remarks did not represent HMG's views, and they should not affect Anglo/Kuwaiti relations. There were, from time to time, attacks on the UK in the Kuwaiti Parliament: these did not mean that the Kuwaiti Government wished ill of the UK. The Kuwaitis would, in any event, react much more calmly than the Saudis had done.

8. Khalifa said that he had talked with six Conservative MPs in Kuwait. They had been very supportive of the KIO holding. One had said that, provided the KIO waited six months, political interest in the holding would die down. He also thought that the Press would be supportive of the KIO's position: "Lex" had made favourable comments recently. BP middle management, to whom he had spoken also supported the KIO holding; indeed he was baffled by the lack of enthusiasm for it at the top of BP given the KIO's assurances. The Chancellor said that BP was in a special position. It was the United Kingdom's largest company, and had a far bigger interest in the UKCS than any other company, especially since its acquisition of Britoil. BP's top management were more wary of the KIO holding because, like HMG, they were aware of the political dimension. The Press and others including BP middle management would become critical if the holding increased in size.

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9. Khalifa said that his investment advisers had said that for the KIO to give an assurance that it would not increase its holding beyond 20 per cent would put its investment at considerable risk. He would not be able to justify this risk to his Ministerial colleagues. Pressed on the nature of the risk, Fahad said that the KIO needed to be able to deal regularly in the markets to protect its investment. An assurance of the sort we wanted, which the Chancellor would have to make public, would affect the prices which the KIO could secure in the market for BP shares. The Chancellor said that, in that case, he would be prepared to accept Khalifa's word that the KIO would not take its holding to 20 per cent or beyond without making this public. Khalifa then said that he would have to make it public. The Secretary of State for Energy pointed out that the Kuwaitis had indicated that they were prepared to accept a limit to their holding. Hence there seemed no logical reason why they should not accept ours. The Chancellor added that the only thing which in other circumstances might adversely affect the share price would be a bid limit which ruled out a bid - but this had already been explicitly ruled out by the KIOs assurance that it was not seeking control. He could see no reason why a ceiling should put the investment at risk.

10. Khalifa regretted that it had not proved possible to reach agreement. He could not give an assurance on the basis of a 20 per cent figure. He could give an assurance on a different figure. But he could not put the 20 per cent figure to his own Government; that would mean that he had "given in" on all three assurances.

11. The Chancellor urged Khalifa to reflect on what he and the Secretary of State had said. The Kuwaiti Government should be very pleased: it had secured a substantial stake in an important company at a very good price. It should be satisfied



with that. Khalifa said he would definitely reflect further. He hoped that dialogue between Kuwait and the UK on this matter would continue. But he hoped that the Chancellor and the Secretary of State could also appreciate his own position, and reflect on what he had said.

A handwritten signature in dark ink, appearing to be "JMG".

J M G TAYLOR
Private Secretary

3 March 1988

The draft answers to the questions are being drafted by me para @ X. See BT

PWP
K B / E J

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FROM: M L Williams
DATE: 3 March 1988

ECONOMIC SECRETARY

cc Chancellor
Financial Secretary
Sir P Middleton
Mr Monck
Mr Scholar
Mr Moore
Mr Odling-Smee
Ms Leahy
Mr Johns IR

ENERGY SELECT COMMITTEE ENQUIRY INTO UK INDEPENDENT OIL SECTOR

The Energy Select Committee are conducting a short enquiry into the UK independent oil sector. You may like to see the attached memorandum that the Department of Energy propose to send in answer to a number of questions from the Committee.

2. The Department's memorandum has been discussed with Treasury and Revenue officials. Its main thrust, with which we agree, is that, although the government is content to see a thriving independent sector, there is no reason to interfere in market processes and give any special protection to independents as against other oil companies. You will be particularly interested in the replies to question 7 (on which the Treasury took the drafting lead; it deals with the Britoil special share) and to questions 6 and 8 which refer to the North Sea fiscal regime.

3. The memorandum has been approved by Department of Energy Ministers, minor drafting changes apart. It will shortly be sent to the Committee. If you wished to make any comments, it would be helpful to know on Friday.

MLW

M L WILLIAMS

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DRAFT (3)

MEMORANDUM TO SELECT COMMITTEE ON ENERGY ENQUIRY INTO THE UK INDEPENDENT OIL SECTOR

INTRODUCTION

The Clerk of the Committee's letter of 15 February requests the Department to provide certain information, and offers the opportunity to comment on other matters as is felt to be appropriate. The replies to the questions put by the Committee are set out below, but it may be helpful first to set out the general background to the involvement of the independent oil sector on the United Kingdom Continental Shelf ("UKCS").

BACKGROUNDHistory

From the outset of UK offshore licensing in the 1960s, the priority has been to encourage exploration, over as wide an area as possible. Initially this entailed reliance being placed substantially on the largest oil companies, as there were far fewer British or foreign independents than now with the technical knowledge and financial resources needed to undertake the task. The independent sector has grown substantially over the years, with the result that they have been able to participate more actively offshore. In the First Offshore Round there were 11 UK and 8 overseas independents involved in the awards.* By

* There is no consistent definition of independent oil companies. For this memorandum UK independents are taken to be all those companies (see Annex 1) whose predominant interest is in oil and gas exploration and development activities; that is to say all UK owned licensees except BP, British Gas, and Shell (which is regarded as part Netherlands, part UK owned). Records are not kept of the predominance, or otherwise, of exploration or development activity for overseas companies. For the purposes of this memorandum, overseas independents have been taken as all those foreign-owned companies operating on the UKCS except those which are affiliates of multi-national oil companies or state owned corporations, or which have downstream activities in the UK. A list of companies which have been classified as overseas independents in preparing this memorandum is at Annex 2.

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contrast, the figures for Ninth Round awards were 39 UK and 30 overseas independents; and in the somewhat smaller Tenth Round, 21 and 16 respectively.

The decline in the number of independents is commented on in the reply to Question 2. In brief, there are a number of influences, which have differing effects on the various companies. The fall in the oil price has discouraged some companies and their shareholders, but other company managements with shareholders, ready to take a longer view, have seen an opportunity to acquire portfolios of interesting territory of a size they could not expect to receive under individual Rounds of licensing. There has thus been a ready market for both sellers and buyers. In general, the tide has run against independents, but UK and foreign independents have in some cases been amongst the buyers.

Policy approach to independents

It is the view of the present Government that independent oil exploration companies have a useful contribution to make, and should be provided with equal opportunity to participate in offshore and onshore exploration as other parts of the oil industry.

HMG's principal concern has consistently been that the UK's offshore oil and gas reserves should be exploited expeditiously and efficiently, and to see that the fiscal system strikes the right balance between the return to the companies and the return to the Exchequer. To assist this, the UK has established a licensing system which does not discriminate on grounds of nationality. It has thus been possible to draw on the resources and expertise of both foreign and UK companies (including majors and independents alike). The requirement on all licensees to abide by licence conditions ensures the UK's essential interests are protected.

HMG is keen to encourage competition for offshore licences and is thus happy to see competent new UK independents launched and established. Many of the present UK independents have proved to be innovative, and have made a full contribution to activity offshore. But unless there are overriding issues of national interest, the Government sees no reason to interfere in the market process so as, in effect, to treat independents as a protected species. It is essential that they stand on their performance and ability to sustain the interest and

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involvement of their shareholders. Government intervention would constrain shareholders' ability to buy or sell as they saw fit and would thus work against their interests: that in turn would tend to discourage the creation of, and future investment in, new independent oil companies.

Although all UK offshore production licences include a provision enabling the Secretary of State to intervene where there has been a change of control of a licensee company, it has not been found necessary to use this power. The Department has been able in discussion with the intending purchaser to satisfy itself in all cases that the competence, attitude and plans of the company make it an acceptable party to take over from the previous controlling company; as a result there has been no significant effect on the national interest.

Question 1 "Please provide figures to show for (i) UK independent and (ii) overseas independent oil companies (a) the numbers operating in the UKCS (b) the net licensed acreage held (c) the number of wells drilled for each quarter since 1 January 1984"

	(i) UK independents	(ii) Overseas independents
(a) Number Operating on the UKCS	39	58
(b) Approximate net acreage* held, and % this represents of offshore licensed area.	15,700 sq kms (16%)	13,700 sq kms (14%)

* Net acreage = size of block x % interest held.

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(c) ¹ Exploration wells spudded each quarter	(1)		(11)		Total number of wells
	UK independents ⁺		Overseas independents ⁺		
	Net ⁺⁺ Wells	Gross ⁺⁺⁺ Wells	Net ⁺⁺ Wells	Gross ⁺⁺⁺ Wells	
1984 Q1	6	15	3.1	11	
Q2	13.3	29	7	18	
Q3	9.6	22	6.3	16	
Q4	<u>8.7</u>	<u>20</u>	<u>3.1</u>	<u>12</u>	
	<u>37.6</u>	<u>86</u>	<u>19.5</u>	<u>57</u>	<u>106</u>
1985 Q1	4.4	9	1.5	6	
Q2	6.8	19	3.6	12	
Q3	7.1	21	3.8	14	
Q4	<u>8.6</u>	<u>23</u>	<u>4.7</u>	<u>16</u>	
	<u>26.9</u>	<u>72</u>	<u>13.6</u>	<u>48</u>	<u>93</u>
1986 Q1	6	14	4.8	14	
Q2	5.1	13	2.2	6	
Q3	3.9	12	1.3	5	
Q4	<u>2.6</u>	<u>11</u>	<u>1</u>	<u>2</u>	
	<u>17.6</u>	<u>50</u>	<u>9.3</u>	<u>27</u>	<u>73</u>
1987 Q1	0.2	1	0.4	1	
Q2	4.3	13	3.1	10	
Q3	3.7	14	3.2	9	
Q4	<u>6.8</u>	<u>18</u>	<u>3</u>	<u>9</u>	
	<u>15.0</u>	<u>46</u>	<u>9.7</u>	<u>29</u>	<u>69</u>

* These figures include as independents those companies which at the relevant time fell into that category. Thus Charterhouse Petroleum's contribution to drilling in 1984 and 1985 is taken under UK independents; for the period thereafter, following its acquisition by Petrofina, it does not appear as an independent.

** Net wells is the addition of the percentages contributed to drilling costs.

+++ Gross wells is the number of wells in which one or more independents were involved, irrespective of their percentage interest.

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(a)2 Appraisal wells spudded each quarter	(1) UK independents*		(11) Overseas independents*		Total number of wells
	Net** Wells	Gross*** Wells	Net** Wells	Gross*** Wells	
1984 Q1	2.9	9	3.1	9	
Q2	3.1	12	2.2	6	
Q3	3.5	12	3.1	11	
Q4	<u>5</u>	<u>12</u>	<u>2.9</u>	<u>11</u>	
	<u>14.5</u>	<u>45</u>	<u>11.3</u>	<u>37</u>	<u>76</u>
1985 Q1	2.5	8	2	6	
Q2	3.8	9	1.7	6	
Q3	3.4	6	1.3	4	
Q4	<u>7.3</u>	<u>20</u>	<u>4.1</u>	<u>9</u>	
	<u>17.0</u>	<u>43</u>	<u>9.1</u>	<u>25</u>	<u>64</u>
1986 Q1	3.4	10	2.5	12	
Q2	3.7	8	0.9	4	
Q3	2.7	5	0.8	4	
Q4	<u>0.2</u>	<u>3</u>	<u>1.0</u>	<u>4</u>	
	<u>10.0</u>	<u>26</u>	<u>5.2</u>	<u>24</u>	<u>40</u>
1987 Q1	1.2	5	1.9	5	
Q2	1.9	7	2.3	8	
Q3	1.2	5	2.4	5	
Q4	<u>4</u>	<u>15</u>	<u>3.7</u>	<u>13</u>	
	<u>8.3</u>	<u>32</u>	<u>10.3</u>	<u>31</u>	<u>63</u>

* These figures include as independents those companies which at the relevant time fell into that category. Thus Charterhouse Petroleum's contribution to drilling in 1984 and 1985 is taken under UK independents; for the period thereafter, following its acquisition by Petrofina, it does not appear as an independent.

** Net wells is the addition of the percentages contributed to drilling costs.

*** Gross wells is the number of wells in which one or more independents were involved, irrespective of their percentage interest.

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Question 2 "What have the most important factors been in the decline in the UK independent oil sector since 1984? What implications does this have for a) the concentration of holdings in North Sea and b) competition for future licence area c) future oil discoveries?"

There are a number of contributory factors. The fall in the oil price is one such factor. Another is the tendency of some shareholders to look for short term returns on their investments, and the better opportunities in some sectors outside the oil and gas sector for achieving this. While oil prices were high, this factor was probably to some extent offset by the chance of higher profits notwithstanding the greater risk and longer term investment pay off. But with the fall in the oil price compounding the wish for early profits, investors in the oil and gas sector became more ready to sell at the earliest reasonable opportunity. The main remaining contributory factor is the availability of buyers. Where shareholders are content to take a longer term view of their investments, the managements of the relevant companies are able to place a higher value on oil and gas assets. They will in general welcome the opportunity to acquire portfolios of worthwhile assets, as this provides a much quicker way of building up a stock of licence interests, than by securing a few awards under each Round of licensing. With willing buyers and sellers, the market is acting efficiently, transferring the assets from those who do not want the assets to those that do.

The implications of the decline are likely to be that (unless oil prices were to rise substantially, with the prospect of that increase continuing):

- (a) There will be a greater concentration of UKCS assets in the hands of fewer companies. An increasing proportion of these companies will be subsidiaries of major companies primarily involved in the energy sector. However it is likely that there will continue to be a range of size of companies involved in the UKCS.
- (b) If the smaller number of companies competing for licences were the only relevant factor, the conclusion must be that the intensity of competition for new licences would be reduced. However this factor must be viewed against the background that the oil industry continues to search for opportunities to acquire exploration territory in what they perceive as the politically more stable parts of the world. Mature areas such as the UKCS are thus unlikely to decrease in

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competition for licences from independents, although on a reduced scale, will still be significant. It is also expected that, if shareholders are satisfied that no hindrances will be placed in the way of disposing, as and when they wish, of their shares in independent companies, they will be more rather than less likely to invest in the creation of new independents.

- (c) The Department has no evidence to suggest that the number of oil and gas discoveries will fall significantly because of any reduced involvement by independents. The key to the number of discoveries is the prospectivity of and the availability of resources to explore and appraise the licensed area, rather than the type of company involved. The work programmes included in the award of new licences should enable the Department to ensure that the licensed areas are thoroughly explored. It may be that some small prospects will be less enthusiastically pursued, either at the exploration or appraisal stages, because the larger companies with a number of discoveries in hand have a different scale of priorities than would small companies, with just one or two. All companies will however be mindful that future licensing decisions are likely increasingly to take account of the applicants' performance in pursuing all reasonable exploration opportunities.

Question 3 "What has been the impact of the independent sector at the exploration stage? Has the total amount of exploration been greater due to existence of independent companies? Is there evidence to show that independent companies have been able to offer a beneficial variety of geological interpretations of oil plays?"

Independents have made a substantial contribution to offshore exploration, both as operators - they operate in the order of 20% of all offshore blocks - and as partners. It is also worth noting that they have a substantially larger role in oil and gas licences onshore. The clear impression is that the amount of exploration has been greater because independents have supplied or helped to define ideas within partnerships. More specifically, proposals put to the Department by independents in the context of the Ninth and Tenth offshore rounds provided in a significant number (over 20%) of cases for more comprehensive exploration than those of competing larger companies. A small number of blocks

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9 | (about 10) were applied for only by independents; and without those applications the blocks would not now be under exploration.

It is appropriate to make two general comments in this context. First, the major contribution to offshore exploration has come from, and can be expected to continue to come from, the largest companies. Second, independents can be expected to continue to play a valuable role in offshore exploration, notwithstanding the current reduction in their numbers.

Question 4 "What national advantages have been gained by the UK through access to overseas exploration rights by the independent companies?"

These are seen as being (a) the expansion of geological and geophysical knowledge which provides new lessons to be applied to the UKCS and (b) exposure to different techniques of operation. In addition, where successful, companies have been put in a stronger position in relation to their UKCS activities. For the longer term there could be advantage in independents establishing themselves abroad to guard against the day when exploration opportunities on the UKCS become more limited.

Question 5 "What evidence is there that small companies have held up developments in the past - ie the so-called "partner drag?"

Partner drag occurs when some co-licensees wish to undertake specific exploration or development work but cannot secure the agreement of the remaining co-licensees. This is undoubtedly a problem in some cases and it is generally related to different perceptions between companies as to the technical promise of exploration acreage or of a discovery, or conflicting priorities for or lack of resources at a particular time. We know of no evidence that partner drag is attributable more to the independent than to any other category of company. As a general comment, we would expect small companies to be enthusiastic about making progress. Their portfolios will often be confined to a small number of UKCS licence interests and their opportunities for satisfying their shareholders with their performance will arise less frequently than for bigger companies, which have a large world-wide portfolio and need to choose between several

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projects competing for support simultaneously. On the other hand it will often be the case, particularly after the oil price fall, that the small independents will find it more difficult than the majors to secure the resources necessary to make progress.

Question 6 "What has been the impact of (a) licensing and (b) fiscal policy on the independent sector? Is there a satisfactory co-ordination of policy between the Department of Energy and the Treasury? To what extent have licensing and fiscal policies been found to work against each other eg with licence awards providing opportunities for the independents but with fiscal policy favouring companies with production and tax shelter?"

The responsibility for UKCS taxation rests with Treasury Ministers. The Department of Energy has responsibility for royalties. Inland Revenue, Treasury, and the Department of Energy work closely together on all aspects of the UKCS fiscal regime.

The Government's objectives in both licensing and North Sea taxation are to create the most favourable conditions for economic exploitation of our petroleum resources while securing for the taxpayer a fair share of their value. There is no conflict between the licensing and fiscal regimes. The Government's policy is that oil companies of all kinds, whether majors or independents, should have the fullest opportunity to participate in the development of the UKCS.

X It is inevitable that the UKCS tax regime has different effects on particular companies depending on their individual tax positions. There is, of course, no necessary correlation between those companies with tax shelter and particular categories of companies: some independents have substantial production. The main reasons for the recent reduction in the number of independent oil companies active in the UKCS have been outlined above. Recent acquisitions have included companies with mature fields in the UKCS. Lack of production was clearly not a consideration in these cases.

The fiscal regime is kept under constant review and if the Government came to the conclusion that it was discouraging economic investments by either the major companies or the independents it would take that into account. In general this has not been the case but the Government did, for example, in 1987 advance repayment of some £300 million of Advance PRT in recognition of the cashflow problems facing smaller and medium-sized companies in the wake of the oil price collapse.

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Question 7 "Why has the special share in Britoil held by the Treasury not been sufficient to protect that companies' independence? Is this mechanism deficient? What implications does this have for the special share in Enterprise?"

The Special Share was aimed at protecting Britoil's independence against unacceptable changes in control. As the Chancellor of the Exchequer explained in his statement in the House of Commons on 23 February 1988, the Government regards the change in control resulting from BP's acquisition of shares in Britoil as acceptable in the light of the assurances given to the Government by BP.

The Government does not consider that the recent developments have any implications for the Special Share in Enterprise which will be automatically redeemed by the company at the end of 1988 unless the Secretary of State's voting rights have been activated and are in force at that date.

Question 8 "What other mechanisms, if any, would be appropriate to foster the UK independent sector? What fiscal changes are required? Is there a case for broadening tax incentives for drilling expenditure to place companies without PRT shelter at less of a disadvantage? Is there a case for a UK equivalent of US drilling funds?"

The Government's North Sea policies are not designed to favour any one group of companies over another. The Government welcomes the contributions that the independents and the majors have made to the development of the UKCS. However, the ultimate balance between companies of different kinds is something that the market, and the shareholders in the companies themselves, will decide. Under the existing PRT regime companies can set exploration and appraisal expenditure against their taxable earnings from any of their existing fields. To go further and provide an analogous benefit for companies which do not pay tax would inevitably involve an element of direct subsidy, which the Government does not believe would be justified. More generally, fiscal incentives intended to benefit the independent sector selectively would be at the expense of the tax payer and would not serve the best interests of the nation through the economic development of the UKCS.

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Question 9 "What is the strategic case for supporting oil exploration by independent oil companies?"

HMG sees its objective as being to encourage oil exploration, by providing opportunities for all types and categories of companies. The particular strength and contribution of independent oil exploration companies is that they can bring different perceptions and priorities to offshore exploration and development. Thus the greater the number of different exploration teams, the more likely that additional oil and gas prospects will be identified; and that a large number of these will be drilled quickly. The need for independents, particularly the smaller independents, to retain shareholder satisfaction provides a spur of greater urgency to pursuing exploration and development opportunities. They can be a helpful stimulus to keeping the very largest oil companies active and involved. The key is that the independents themselves must be conscious of the stimulus of market conditions. To treat them as a protected species would remove this spur. They must survive and prosper on the basis of their performance and their ability to sustain the interest and involvement of their shareholders.

FROM: A M DOLPHIN
DATE: 3 March 1988

1. MR SEDGWICK
2. CHANCELLOR

cc: Sir P Middleton
Sir T Burns
Mr Scholar
Mr Odling-Smee
Mr Bottrill
Mr Davies
Mr Hibberd
Mr Matthews
Mr Mowl
Mr Williams
Mr Owen

seen in draft
*I think we should restrict
Judgment on this for a
few more days.*
CA
*You were minded to
say "around current levels"
& use \$14.* *AA*

OIL PRICES: PROSPECTS TO MID-1989

In the light of the recent fall in oil prices you might welcome a note on oil market developments and our latest view of prospects.

2. In the January internal forecast we projected the average North Sea oil price at \$17 per barrel throughout 1988 and the first half of 1989. This represented about a \$1 pb fall from the fourth quarter of 1987. In fact prices in January and early February were probably a little below the forecast level, and in the last two weeks spot prices have fallen by more than \$2 pb, with about half this fall occurring in the last two days. Spot Brent for March closed yesterday at \$13.8. This is consistent with an average North Sea price - the price we use in Industry Act forecasts - of around \$13½ per barrel when no special factors - such as tax spinning - affect the structure of North Sea prices.

Oil price (\$pb)

	Brent	Average N. Sea*
1985	27.5	27.3
1986	14.4	14.3
1987	18.4	
1987 Q1	17.9	16.6
Q2	18.6	18.0
Q3	19.0	18.7
Q4	18.0	n.a
1988 January	16.8	
February	15.8	
2 March	13.8	

* Only quarterly data available.

3. The weakness of oil prices in the first few weeks of 1988 was not wholly unexpected by market analysts following the larger than usual build up in stocks in the major industrial countries during 1987. But the recent weakness in oil prices has taken most commentators by surprise. It seems to have been generated by three factors:

- i. Rumours that OPEC production in February was above January levels and above the quota agreed at December's OPEC Ministerial meeting: these rumours have been strenuously denied by leading OPEC Members and today's FT contains an estimate (source not given) that OPEC production in February was between 17 and 17½ million barrels a day - just below quota.
- ii. Reports that Saudi Arabia and Kuwait have sanctioned new discounts in the price of Neutral Zone oil sold to Japan.
- iii. A growing awareness that the mild winter in Japan and Europe means that stock drawdown has been less than usual at this time of year, so that high stocks in these countries will dampen demand in the next few months.

Taken together, however, these are hardly sufficient to explain the extent of the present weakness of spot prices.

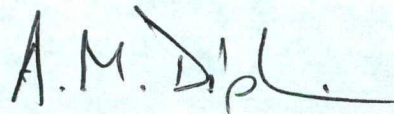
4. Our current view is that prices could remain weak until the middle of the year, unless OPEC production is cut back sharply (and visibly). In the second half of this year, when demand is expected to be boosted by seasonal stockbuilding, prices could recover somewhat - perhaps to the \$17 per barrel we were projecting in the January internal forecast if OPEC maintains some discipline over production. But the uncertainties remain great.

5. In these circumstances a \$15 per barrel average North Sea oil price for 1988 (implying a Brent price of \$15¼-15½ pb in normal circumstances) remains a defensible assumption for the FSBR forecast. This has been the average price over the last three

weeks. Recent events have, however, turned this assumption into a central estimate, rather than a prudent assumption. The summary in the latest draft of Chapter 3 of the FSBR states:

"As last year [the forecast] assumes that North Sea oil prices will average \$15 a barrel over the year ahead".

We do not recommend any change.

A handwritten signature in black ink that reads "A.M. Dolphin". The signature is written in a cursive style with a long horizontal stroke at the end.

A M DOLPHIN



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

APPOINTMENTS - IN CONFIDENCE

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

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CH/EXCHEQUER	
REC.	04 MAR 1988
CC	PS/FST
COPIES TO	Sr P Middleton
	Mr Monck
	Mr O'Moore

*All v. work
Mtn, no doubt; but
let well know a
Scott who knows he
on Admin
3 March 1988
Perhaps! Sr D.
Prattland?*

Dear Nigel,

BRITOIIL CHAIRMANSHIP

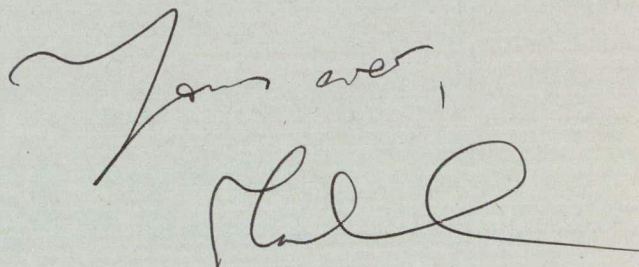
One of the more immediate follow-up actions on the BP/Britoil case is of course to identify candidates for the non-executive Chairmanship of the "new" Britoil. You invited me to feed in any names and I am very happy to do so.

A strong candidate - and my first choice for the post - would be Dr Graham Hills (61) Principal and Vice Chancellor of Strathclyde University, whom I recently appointed as a part-time member of Scottish Development Agency. A physical chemist by background, he is an extremely lively and energetic man and full of ideas. He came to Strathclyde in 1980 and quickly established himself in the public eye in the West of Scotland as someone firmly committed to his University but also to wider economic interests of the area. He has for example involved himself both in the local promotional activities of Glasgow Action and in the attraction of inward investment to Scotland through his participation in seminars in North America organised by Locate in Scotland. His University has a very strong technology base and plays an important role in industrial and commercial life in the region. I recognise that Dr Hills does not have direct business experience but he is a man of real stature and style who would make a convincing job of the chairmanship, who would ask the right questions and whose appointment would be well received in Scotland.

My second choice would lie between Peter Balfour and George Mathewson, leading personalities in the Scottish business community. Mr Balfour (66) is the senior figure of the two, with a solid record of business achievement. A former Chairman and Managing Director of Scottish & Newcastle Breweries, he is now Vice Chairman of the Royal Bank of Scotland and Chairman of Charterhouse. He was also for many years Chairman of the Scottish Council (Development and Industry). His family and business roots are in the East of Scotland rather than the West, but in Scottish terms he is genuinely a national rather than a local figure. His integrity and his standing in Scotland are unquestioned.

Dr Mathewson (47) is now Director of Strategic Planning and Development in the Royal Bank of Scotland and was until recently Chief Executive of the Scottish Development Agency where he had a very considerable success both in sharpening up the activities of the Agency and in giving it a new sense of direction and a strong commitment to the support of private enterprise in the Scottish economy. His background is as an engineer and then as a merchant banker, primarily with the ICFC. He may still be seen by many as a tough "hands-on" senior executive but given his breadth of experience at the Agency and his record of success I am clear that he has the qualities to be successful as a Chairman and that his appointment would be very acceptable throughout Scotland. I hope the Royal Bank would feel able to release him for the time needed to undertake the appointment but this would of course have to be checked.

I am of course copying these suggestions to Cecil Parkinson since HMG's ongoing relationship with BP under the Special share will now be through him. Obviously, given the sensitivity of the appointment, I would be very interested to have an opportunity to comment on any other candidates you or he are able to identify.

A handwritten signature in dark ink, appearing to read 'Yours ever, Malcolm Rifkind'. The signature is fluid and cursive, with a long horizontal stroke at the end.

MALCOLM RIFKIND