PO-CH/NL/0188

PART D

Chex
Lawson

PART D

SECRET

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notify REGISTRY of movement)

PO -CH /NL/0188

PART D

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

PO -CH /NL/0188
PART D

Begins: 27/4/88
Ends: ~~30/6~~/88 (CONTINUED)

DD: 25 years

6/9/95

53/2/LPD/3765/004

CONFIDENTIAL

FROM: P D P BARNES
DATE: 27 April 1988

NOTE OF A MEETING HELD IN ROOM 51/2, TREASURY CHAMBERS, PARLIAMENT STREET, AT 3.00pm MONDAY 25 APRIL

Those Present: Economic Secretary
Mr M Williams
Miss M Hill
Mr R Reid, Chairman, Shell Oil UK
Sir Archibald Forster, Chairman, ESSO UK

ECONOMIC SECRETARY'S MEETING WITH SHELL AND ESSO

Mr Reid thanked the Economic Secretary for agreeing to see him and Sir A Forster. He asked the Economic Secretary to explain what had been the intention of the changes to the fiscal regime for oil in the Budget.

2. The Economic Secretary said that the Budget measures had been a considered response by the Government to UKOOA's representations that the continuation of royalty, which was a cost-based tax, might hinder marginal developments in the South North Sea. The two previous Budgets had contained oil measures which were favourable for the industry, and which had been taken in the light of industry representations and in response to deteriorating conditions in the North Sea. But this year, the Government had been satisfied with the overall level of taxation in the North Sea. So it had not felt that it would be possible to justify a package that was more than fiscally neutral. The new regime would, however, be more sensitive to the profitability of individual projects. The Economic Secretary stressed that the changes had been undertaken after considering a range of price assumptions higher than those published in the FSBR.

3. Sir A Forster thanked the Economic Secretary for his

explanation. But he said that Shell and Esso, in company with a number of other oil companies, had considerable problems with the Budget. First, he did not think that fiscal neutrality would be the result of the Budget. The Government had not taken sufficient account of the peak shaving problem of the Sean field, the tax position of which depended on when, and in how many chargeable periods, its profits arose. Secondly, the industry appeared to be working on very different price assumptions from those used by the Government. Lastly, the Government had failed to appreciate the extent to which allowing companies to retain the upside on profitable projects would encourage further development and in time would produce more revenue for the Exchequer.

4. But even if the discrepancy in the figures could be resolved, Sir A Forster questioned why the Government should be aiming for fiscal neutrality, which had been no part of the industry's representations and could affect the profitability of some projects undertaken quite recently. It would change cashflow and hence reduce investment capability and flexibility. For example, the decision to proceed with Sole Pit, which had been subject to very tough price negotiations with British Gas, had been taken in the expectation of the abolition of royalty, but the severe reduction in the oil allowance meant that on most scenarios the project would have a lower rate of return than under the present system.

5. Sir A Forster also said that Esso were concerned about the element of "backwardation" in the Budget proposals. The measures would apply not just, as had been the case with the 1983 measures, to a field gaining Annex B after the date of the Budget, but to all existing fields that had gained Annex B after a certain date. Sir Archibald said that, unless the industry could rely on a stable fiscal regime for fields already committed, then it would have to demand even stricter criteria before proceeding with future fields, and this could adversely affect the number of future developments.

6. The Economic Secretary agreed that there were still differences between the industry's figures and the Government's. But apart

from Sean, which would need investigating separately, the discrepancies were substantial only for future fields. He agreed that it was important that these figures should be sorted out. As for "backwardation", the Economic Secretary said that the Government did not see itself as signalling an unstable tax regime for the future. The aim of the Budget had simply been to finance a technical change, made in response to industry representations, to allow a number of otherwise marginal fields to come onstream sooner by abolishing royalties.

7. The Economic Secretary said that he understood Mr Morrison had seen UKOOA the previous week, and he would want to see how Mr Morrison intended to respond before himself considering any formal invitation from UKOOA. But he would be dealing with these matters as the Finance Bill went through Parliament which would probably take at least a couple of months.

PB

P D P BARNES
Private Secretary

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Sinclair
Mr M Williams
Ms Leahy
Mr Cropper

Mr Painter - IR
Mr Johns - IR
Miss Hill - IR
PS/IR

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

CH/EXCHEQUER ✓27/4
REC. 27 APR 1988
ACTION Mr O Moore
COPIES TO PS/FST
Sir P Middleton
Mr Monck
Mr M Williams
Ms Leahy
Miss Wheldon T/501

The Rt Hon Lord Young of Graffham
Secretary of State for
Trade and Industry
1 Victoria Street
LONDON
SW1H 0ET

27th April 1988

Ch/
I understand Ld Young's office that he might like to have a word with you before taking a decision.
Would you like to write along the lines of this letter from MoP?
27/4

Dear David,

BP/KIO

I understand that you have now received or will receive shortly the advice of the Director General of Fair Trading on whether to refer the Kuwait Investment Office (KIO) shareholding in BP to the Monopolies & Mergers Commission for investigation.

My own view, which I first voiced last December, is that the level of the KIO's shareholding in BP does raise questions of public interest. Since then Nigel Lawson and I have attempted to persuade the Kuwaitis that it was in the best interests of both countries that further increase in the holding should be avoided. The Kuwaitis have given assurances that they have no interest in any management role in BP, see their shareholding as a long term investment, would consult HMG on any significant disposal and do not intend for the foreseeable future to seek Board Membership. The shareholding has, however, increased to its present level of around 22% and I understand the KIO have stated that they do not intend in present circumstances to go beyond 22.5%.

I think we all recognise that the heart of the problem here is that the investment has been made by a friendly foreign Government with whom we have long standing relations but whose interests in the oil market differ from our own. While I would support a reference to the MMC if that proves to be the only way of tackling the problem, it does seem to me that it would be right and proper, before taking that step, to make the attempt to secure additional undertakings from the Kuwaitis which would answer the problem. My own officials and the Treasury have suggested to the OFT that these could include:

(a) an appropriate reduction in the shareholding

(b) a commitment to observe a ceiling on the holding at the reduced level; and

SECRETARY OF STATE FOR ENERGY

(c) no Board representation at any time.

It would probably also be appropriate to obtain confirmation of the commitment to consult HMG before making any disposals.

The judgement on how to proceed is, clearly, one that only you can take in the light of all the evidence and advice available to you. But I would urge the merits of offering the Kuwaitis the opportunity of meeting the requirements of the case as you see them and so solving the problem short of putting both Governments through the more public process of the MMC.

I am copying this letter to the Prime Minister, Geoffrey Howe and Nigel Lawson.

Yours Ever,

Cecil

CECIL PARKINSON

3705/1/sh

CONFIDENTIAL

MARKET SENSITIVE

FROM: D J L MOORE

DATE: 27 APRIL 1988

CHANCELLOR

Ch/ Content to write as proposed? (I have separately mentioned to Ld.Y's office that he might like to have a word with you before taking a decision). 27/4

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

Miss Wheldon TSOL

BP/KIO

I attach a copy of Sir Gordon Borrie's submission to the Secretary of State for Trade and Industry. You have also seen Mr Parkinson's letter of 27 April to Lord Young. — flagged, behind

2. Borrie recommends that there should be a reference to the MMC; that the MMC should be given three months to report; and that the OFT should obtain suitable interim undertakings from the KIO to operate during the three months.

3. He advises that for the purposes of the Fair Trading Act there is a merger situation. As explained in paragraph 15 of the annex "it makes no difference that KIO has denied any intention, in present circumstances, of seeking Board representation or actively influencing policy: what matters is that KIO is able materially to influence the policy of BP."

4. In paragraph 16 of his main paper Borrie advises that to remove the danger the KIO holding would need to be below 10%. As the KIO holding was 10% on 18 November he goes on to make the crucial point that the deadline for decision on a reference to the MMC is no later than 17 May (a reference can only be made within 6 months of the event which gave rise to a qualified merger).

5. Paragraph 14 discusses remedies in the event of an adverse MMC finding. He points out the difficulties of a major reduction in the holding and suggests that the general objective would probably be to ensure an orderly disposal over a period while preventing the relevant shares being voted in the meantime.

6. As you will see from his paragraph 15 he is clearly sceptical over the chances of Ministers' securing satisfactory formal undertakings without a reference to the MMC. But if there are futher discussions on these lines the statutory deadline, of 17 May, should not be forgotten.

Mr Parkinson's letter of 27 April

7. In his letter of today to Lord Young, Mr Parkinson urges him to consider the merits of securing undertakings from the Kuwaitis and so avoid an MMC reference. These undertakings include an "appropriate" reduction in the shareholding with, not surprisingly, no recommendation as to what that reduction should be.

8. Lord Young is likely to consider these questions this week. At official level DTI have serious worries over the case for talking to the Kuwaitis further, rather than proceeding straight to the announcement of a reference. They would be faced with the problem of advising Lord Young what would be an appropriate reduction to seek from the Kuwaitis. Given the OFT's views, it is unlikely that they could advise other than a reduction to 10%. It is implausible that the Kuwaitis would willingly undertake to go down to that level. To suggest anything higher, and to fail to secure even that, could prejudice any reference to the MMC that was then made. Irrespective of these worries, it is doubtful whether the Kuwaitis would or could agree to public undertakings in sufficient time. If they were canny, and well advised, they could agree to think about the proposals and then try to play it long until the deadline was passed.

9. I must say I have sympathy for these DTI worries, Nevertheless, given the history of the negotiations, you may wish to write in support of Mr Parkinson. I attach a draft. It makes clear the

perhaps obvious point that the Kuwaitis would have to agree both to the undertakings and to their publication. It also underlines the importance of not letting any discussions with the Kuwaitis cause us to miss the statutory deadline of 17 May.

10. The decision is of course for Lord Young alone. But this would not stop him from talking about the problems to you and Mr Parkinson if he so wished.

DJLM.

D J L MOORE

CONFIDENTIAL Re type final.

DRAFT LETTER FROM THE CHANCELLOR OF THE EXCHEQUER TO:

Rt Hon Lord Young of Graffham
Secretary of State for
Trade and Industry
1 Victoria Street
LONDON
SW1H 0ET

BP/KIO

I have seen Cecil Parkinson's letter of 27 April to you.

I agree with Cecil that, if ~~it were~~ you consider it practicable, it would be preferable to deal with the problem by securing additional and legally enforceable undertakings from the Kuwaitis rather than making a reference to the MMC. The Kuwaitis would of course have to understand that we would make these undertakings public. If you were to have such discussions with the Kuwaitis, it would ~~be~~ of course be absolutely essential for them to be completed in time for you to be able to make a reference to the MMC within the very tight statutory deadline should you then judge that to be the right course.

I am copying this letter to the Prime Minister, Geoffrey Howe and Cecil Parkinson.

[NIGEL LAWSON]

mjd 2/84Jn

CONFIDENTIAL

Financial Secretary
Economic Secretary
Sir P Middleton
Mr Monck
Mr D J L Moore
Mr Williams
Ms Leahy
Miss Wheldon - TSOL

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

28 April 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
1 Victoria Street
London SW1H 0ET

Dear David

BP/KIO

I have seen Cecil Parkinson's letter of 27 April to you.

I agree with Cecil that, if you consider it practicable, it would be preferable to deal with the problem by securing additional and legally enforceable undertakings from the Kuwaitis rather than making a reference to the MMC. The Kuwaitis would of course have to understand that we would make these undertakings public. If you were to have such discussions with the Kuwaitis, it would of course be absolutely essential for them to be completed in time for you to be able to make a reference to the MMC within the very tight statutory deadline should you then judge that to be the right course.

I am copying this letter to the Prime Minister, Geoffrey Howe and Cecil Parkinson.

Yours
Nigel

NIGEL LAWSON

FCS/88/086

CH/EXCHEQUER
REC. 29 APR 1988
ACTION Mr Moore
COPIES TO PS/FST, PS/EST
Sir P Middleton
Mr Monck
Mr M Williams
Ms Lealy
Miss Wheldon TSol

SECRETARY OF STATE FOR TRADE AND INDUSTRY

BP/KIO

1. I have seen a copy of Cecil Parkinson's letter of 27 April to you. I have also received a copy of Sir Gordon Borrie's advice on how to deal with the Kuwaiti shareholding in BP. It is common ground that at about 22% this holding is at a level which adversely affects the national interest.

2. From the beginning of this affair Ministers, and our Ambassador in Kuwait, have tried to negotiate a voluntary arrangement with the Kuwaitis to cut the KIO shareholding to an acceptable level. We made some progress, but not nearly enough.

3. Time for further negotiation is tight. I note that Sir Gordon Borrie advises that any reference to the MMC by you must be made by 17 May, and that an earlier reference would be safer. This is predicated on the view, which we must respect, that KIO acquired the ability to influence BP policy materially when its shareholding passed the 10% mark. It would be a tall order to negotiate enforceable assurances from the Kuwaitis, within the MMC deadline, that they will cut their shareholding down to below 10%.

/4.

4. If you decide for these reasons not to negotiate with the Kuwaitis, but to make a reference to the MMC, I have no reason to believe that Anglo-Kuwaiti relations would be significantly damaged by the process that would then be put in train.

5. I am copying this letter to the Prime Minister, Cecil Parkinson and Nigel Lawson.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
29 April 1988

Pug

CONFIDENTIAL

153414
MDLIAN 4377

PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

CONFIDENTIAL
FM RIYADH
TO PRIORITY FCO
TELNO 251
OF 030630Z MAY 88
INFO PRIORITY OPEC POSTS, DEPT OF ENERGY, WASHINGTON
INFO ROUTINE LUANDA, PEKING, BOGOTA, MOSCOW

MEETING OF OPEC MINISTERS, 28 APRIL TO 1 MAY

SUMMARY
1. SAUDI POSITION EXPLAINED BY A SENIOR DELEGATE (PROBABLY NAZER). SAUDIS DOUBTFUL OF REAL VALUE OF NON-OPEC PROPOSAL, BELIEVING THAT THE KEY LIES IN GREATER OPEC DISCIPLINE ON QUOTAS. KINGDOM NOT PREPARED TO GO BEYOND A MINIMAL CONCESSION, EQUALLY SHARED.

DETAIL
2. A SENIOR SAUDI DELEGATE TO THE OPEC MINISTERIAL MEETING (ALMOST CERTAINLY NAZER HIMSELF) QUOTED IN THE ARAB NEWS OF 2 MAY, SAID THAT THE SAUDI PROPOSAL FOR A BARREL-FOR-BARREL MATCHING BY OPEC OF THE NON-OPEC OFFER TO CUT PRODUCTION BY FIVE PER CENT (ONE HUNDRED AND EIGHTYTHREE THOUSAND BARRELS PER DAY) WAS FAIR SINCE IT EMPHASISED THE SHARING OF RESPONSIBILITY AMONG ALL PRODUCERS. NON-OPEC COUNTRIES WERE PUMPING AT FULL CAPACITY WHILE SAUDI ARABIA OPERATED AT SIXTY PER CENT. ANY CUT IN PRODUCTION NEED NOT (NOT) BE LARGER THAN THE SAUDI PROPOSAL, SINCE STRICT ADHERENCE TO QUOTAS BY OPEC WOULD REMOVE FIVE HUNDRED THOUSAND BARRELS PER DAY OF OVERPRODUCTION BY OPEC AND WOULD CAUSE PRICES TO FIRM AUTOMATICALLY. THE OVERPRODUCTION PROBLEM CLEARLY NEEDED TO BE TACKLED SIMULTANEOUSLY. THE SPOKESMAN ADDED THAT THE CHANGE IN POSITION BY THE SAUDIS AND OTHER GULF PRODUCERS FROM OPPOSITION TO CUTS TO AGREEMENT TO LIMITED CUTS SHOULD BE SEEN AS A GESTURE OF GOODWILL TO THE NON-OPEC PRODUCERS.

3. ON THE QUESTION OF EQUAL REDUCTIONS BY ALL OPEC MEMBERS RATHER THAN PRO RATA REDUCTIONS, THE DELEGATE REFERRED TO SAUDI SACRIFICES IN 1983-85 AND THE FACT THAT OPEC MEMBERS WERE NOT CLASSIFIED AS LARGE OR SMALL PRODUCERS BUT HAD EQUAL RIGHTS AND OBLIGATIONS.

COMMENT
4. HISHAM NAZER'S COMMENT TO THE SECRETARY OF STATE FOR ENERGY

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153414
MDLIAN 4377

ON 13 APRIL THAT ADHERENCE TO QUOTAS BY ALL OPEC MEMBERS WOULD BE SUFFICIENT TO FIRM THE MARKET WAS ECHOED BY KING FAHD IN AN INTERVIEW WITH THE SAUDI PRESS AGENCY ON 28 APRIL. THIS WAS CLEARLY THE SAUDI OPENING POSITION AT THE OPEC MINISTERIAL. THE SAUDI OFFER OF EQUAL CUTS BY OPEC MEMBERS TO MATCH THE NON-OPEC OFFER BARREL-FOR-BARREL SHOULD THUS BE SEEN AS BOTH THE MAXIMUM THEY ARE PREPARED TO ACCEPT AND THE MINIMUM POLITICALLY FEASIBLE RESPONSE TO THE NON-OPEC OFFER.

5. THE SAUDI REFUSAL TO MOVE TO PRO RATA CUTS WITHIN OPEC REFLECTS THEIR CONTINUED REJECTION OF THE SWING PRODUCER ROLE. THE SAUDIS BELIEVE THAT OIL PRICES WILL IN ANY CASE RECOVER AFTER JUNE AS RESTOCKING COMMENCES AND ARE DOUBTFUL ABOUT THE REAL VALUE OF THE NON-OPEC PROPOSAL. THEY MAY SEE LITTLE PURPOSE IN MAKING CONCESSIONS NOW, PREFERRING TO CRACK THE WHIP FOR MORE STRICT ADHERENCE TO OPEC QUOTAS. NOR WILL THEY HAVE BEEN IN ANY MOOD TO MAKE CONCESSIONS TO A CAMP WHICH INCLUDES THE IRANIANS.

EGERTON

YYYY

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MR FAIRWEATHER
SIR D MIERS
MR MAUD

ADDITIONAL 41

OIL

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53/2/LPD/3765/034

CONFIDENTIAL

ECONOMIC SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

The Hon Peter Morrison MP
Minister of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

4 May 1988

Dear Peter

ELEVENTH ROUND OF OFFSHORE LICENSING

As you know, the Prime Minister left open at E(A) the possibility of an auction element for oil licensing in the Eleventh Round if oil prices improved and if particularly attractive blocks were released.

In the light of this, I think it would be helpful if both our Departments were able to come to a common judgment about which blocks under consideration could be considered particularly attractive. It would therefore be useful if my officials could meet yours in the near future to discuss the relevant factors relating to the blocks potentially available, so that they can jointly identify which blocks are in question. Then when the choice of blocks to be offered has been completed, it would be sensible for our officials to have a short round-up meeting to discuss the choices and to talk about any special licence conditions to be imposed on any of the blocks. This would help both our Departments to judge whether there was a case for going back to E(A).

This should not involve unnecessaray effort and would be a natural development of the close co-operation established between our officials over the North Sea fiscal regime. It would also enable us to support you more effectively in discussions with other Departments over the release of sensitive blocks.

I very much hope that you will be prepared to allow our officials to get together at an early stage to go over the necessary ground.

Yours ever

Peter

PETER LILLEY

3705/10/sh

CONFIDENTIAL

PMP

FROM: D J L MOORE

DATE: 4 MAY 1988

Ch/
For completeness - Ld Y mentioned this to you yesterday.

CHANCELLOR

cc Financial Secretary
Economic Secretary
Sir P Middleton
Mr Monck
Mr R I G Allen
Mr Williams
Mr Towers
Ms Leahy

Miss Wheldon TSOL

BP/KIO

DTI announced at 9 am this morning that the KIO holding has been referred to the MMC. I attach a copy of their press notice.

2. We knew that Lord Young was considering the issue yesterday but we were not given any warning of his decision. I understand that a note was sent to Mr Parkinson and to you, informing you of the decision and timed to arrive before the announcement. Your office had not received it at 11 am.

I have complained about this

3. Lord Young apparently decided that it was impracticable to seek and to obtain firm assurances from the KIO by 17 May. I think this was realistic.

4. If press office are questioned about the referral they should rest on the press notice and, if necessary, refer questions to the DTI press office.

5. Energy will be in the lead in preparing evidence to the MMC. We will keep in close touch with them.

D J L MOORE

dti

9.30 am

press notice

88/332

4 May 1988

Press Office
Tel 01-215 4473
Out of Hours
Tel 01-215 7877

ACQUISITION BY THE KUWAIT INVESTMENT OFFICE OF A SHAREHOLDING IN THE BRITISH PETROLEUM COMPANY PLC

Lord Young, Secretary of State for Trade and Industry, has decided, in accordance with the recommendation of the Director General of Fair Trading, to refer the acquisition by the Kuwait Investment Office of a shareholding of some 22 per cent in the British Petroleum Company PLC to the Monopolies and Mergers Commission for investigation and report under the provisions of the Fair Trading Act 1973. The Commission are being asked to make their report within 4 months.

Lord Young considered that the implications of BP coming under the influence or control of a Government with substantial oil interests, and which is a member of OPEC, raised issues of public interest which warranted investigation by the MMC:

The decision to make a reference to the Commission does not in any way prejudge the question whether or not the Kuwaiti Shareholding would be against the public interest. It is for the Commission to report on this after investigation.

NOTES FOR EDITORS

1. The Fair Trading Act 1973 empowers the Secretary of State to refer to the Monopolies and Mergers Commission for investigation and report actual or proposed mergers which create or intensify a 'monopoly' (25 per cent or more of the supply in the UK or a substantial part of the UK of a particular product or service) or involve the takeover of a company with assets exceeding £30m. The Commission are required to investigate and report to the Secretary of State whether the merger operates or may be expected to operate against the public interest.

ENDS

Rw/P

dti

press notice

88/332

4 May 1988

Press Office
Tel 01-215 4473
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ENDS

Ch.

BP/KIO – advisers

I chased EST. His initial response is that he only knows analysts, who are ruled out on propriety grounds, and that he has no other ideas. But he will continue to ponder – if anything emerges later this evening he will let me know.

[initials] 5/5

· Of the S. Bu list, the Robinson one Sylvan best. I would not touch Kam or Lasis; ~~[illegible]~~ Glyn & Posner would be justifiable, in that order; but [illegible]

greatly reform
of Robinson.
No objection to Kennington's
name being added to
the list, but he is
unlikely to get elected on
the old constituency.

M.

26A/1/jno/295/070

Prayer -

FROM: MS P M LEAHY

DATE: 4 May 1988

1. MR D J L MOORE DJLM 4/5.

2. CHANCELLOR

Ch

Content for Mr Kenningham's name to be put forward (para 4, below)? Any other suggestions?

J

cc Fiancial Secretary
Economic Secretary
Sir P Middleton
Mr Monck Mr. Byatt
Mr Scholar
Mr Odling-Smee
Mr M L Williams
Mr McAuslan
Mr B Morris

BP/KIO: MMC REFERENCE

The MMC have told Department of Energy that they intend to appoint a consultant to assist them in considering the KIO stake in BP. They have asked the Department to suggest some names of individuals who are familiar with the oil industry.

2. The Department have come up with the following names:

Dermot Glyn of the National Energy Research Association

John Kay of the London Business School

Mark Lewis of Petroleum Economics

Michael Posner

Sylvan Robinson.

Brokers/analysts have been ruled out because of the commercial sensitivities of the enquiry.

3. The Department have asked if we have any suggestions/comments. John Kay and Michael Posner are of course well known academics. I believe Petroleum Economics have close links with OPEC. I am afraid I know nothing about Dermot Glyn or Sylvan Robinson.

4. Ivor Kennington, who you will remember from the Britoil/BP bid, might be a possibility. Would you be content for us to put his name forward with any others that you or copy-recipients might want to suggest.

5. The Department have to respond to the MMC by Friday.

P M Leahy

P M LEAHY

dti

the department for Enterprise

PWP

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

CONFIDENTIAL AND MARKET SENSITIVE

The Rt Hon Cecil Parkinson MP
Secretary of State for Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET
Switchboard 01-215 7877
Telex 8811074/5 DTHQ G
Fax 01-222 2629

CH/EXCHEQUER
REC. 04 MAY 1988
ACTION MR D MOORE
COPIES TO PS/FST, SIR P MIDDLETON
MR MONCK, MR M WILLIAMS
MS LEAHY
MISS WHELDON . TSOL

VAB

Direct line 215 5422
Our ref DC2ANO
Your ref
Date 4 May 1988

Dear Cecil,

BP/KIO

Thank you for your letter of 27 April about this case. I have also seen Nigel Lawson's letter of 28 April and Geoffrey Howe's minute of 29 April.

I considered carefully your arguments against an immediate reference to the MMC and in favour of another attempt to seek voluntary undertakings from the Kuwaitis. It seemed to me, however, that the odds were stacked against any such renewed approach being fruitful and it would moreover entail serious practical difficulties, not least those of timing. Geoffrey Howe has indicated that he supports this view.

I believe that there are distinct advantages to be gained from handling this case according to the normal procedures laid down in the Fair Trading Act 1973, which provide certain powers in the event of an adverse public interest finding by the Monopolies and Mergers Commission. I have therefore decided to accept the Director General of Fair Trading's advice of 26 April to refer the acquisition to the MMC. The announcement will be made at 9am today, and I enclose a copy of the press notice announcing my decision.

I am also copying this letter to the Prime Minister, Geoffrey Howe and Nigel Lawson.

Yours,
David

dti

press notice

88/332

4 May 1988

Press Office
Tel 01-215 4473
Out of Hours
Tel 01-215 7877

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ENDS

RESTRICTED

165421
MDLOAN 7404

PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

RESTRICTED
FM FCO
TO PRIORITY VIENNA
TELNO 67
OF 051630Z MAY 88
AND TO PRIORITY OPEC POSTS, LUANDA, PEKING, BOGOTA, MOSCOW

FCO TELNOS 53 TO VIENNA AND 20 TO UKDEL OECD: MEETING OF OPEC MINISTERS 28 APRIL-2 MAY

SUMMARY

1. OPEC MINISTERIAL MEETING ENDS WITHOUT AN AGREED RESPONSE TO THE NON-OPEC COUNTRIES' (NOPEC) OFFER. OIL PRICES FALL INITIALLY BUT BEGIN TO RECOVER IN ANTICIPATION OF FURTHER MINISTERIAL MEETING IN JUNE AND RISING DEMAND FORECAST FOR THE SECOND HALF OF 1988. AS WELL AS FRUSTRATING NOPEC'S EXPECTATIONS, FAILURE TO AGREE HAS DEEPENED THE RIFT IN OPEC BETWEEN THE GULF AND OTHER PRODUCERS IN ADVANCE OF OPEC'S REGULAR 8 JUNE MINISTERIAL.

DETAIL

1. AS FORESHADOWED IN TURS, OPEC FAILED TO AGREE A COMMON RESPONSE TO THE NOPEC COUNTRIES' CONDITIONAL OFFER OF A 5 PER CENT CUT IN EXPORTS DURING MAY AND JUNE. INITIAL REPORTS SUGGEST THE MEETING ENDED IN DEADLOCK WITH THE EIGHT NON-GCC MEMBERS OF OPEC PREPARED TO SUPPORT AN ALGERIAN PROPOSAL FOR A RECIPROCAL CUT OF ABOUT 300,000 B/D, DISTRIBUTED AMONG ALL OPEC MEMBERS (EXCEPT IRAQ) IN PROPORTION TO EXISTING PRODUCTION QUOTAS, WHILE THE FOUR GCC MEMBERS (SAUDI ARABIA, KUWAIT, UAE AND QATAR) WOULD ONLY ACCEPT A TOTAL OPEC CUT OF 183,000 B/D (I.E. THE BARREL FOR BARREL EQUIVALENT OF THE 5 PER CENT NOPEC EXPORT CUT). MOREOVER, THE GCC MEMBERS INSISTED THAT THE BURDEN OF CUTS SHOULD FALL EQUALLY ON ALL OPEC MEMBERS (IE ONLY 56,000BD FOR ALL FOUR GCC COUNTRIES).

2. NO COMMUNIQUE WAS ISSUED, WHICH SUGGESTS THE MEETING ENDED ACRIMONIOUSLY. OPEC PRESIDENT LUKMAN IS REPORTED AS SAYING AFTER THE MEETING THAT OPEC WOULD QUOTE IMMEDIATELY UNQUOTE CONTINUE ITS DIALOGUE WITH NOPEC COUNTRIES ON THE NATURE OF THE APPROPRIATE RESPONSE TO THEIR OFFER AND CONSULTATIONS WOULD ALSO CONTINUE WITHIN OPEC BETWEEN NOW AND THE 8 JUNE REGULAR OPEC MINISTERIAL. HE DESCRIBED THE NOPEC OFFER AS A QUOTE STARTING POINT UNQUOTE WHICH WAS BEING CONSIDERED FULLY WITH A

VIEW TO REACHING A QUOTE LASTING ARRANGEMENT UNQUOTE. OPEC WAS NOT INTERESTED IN QUOTE HALF BAKED IDEAS UNQUOTE BUT IN THE MEANS OF ACHIEVING A LASTING RELATIONSHIP.

COMMENT

3. DESPITE TALK OF CONTINUING DIALOGUE, THE SAUDI/GCC POSITION LEAVES LITTLE ROOM FOR MANOEUVER OVER THE ORIGINAL NOPEC PROPOSAL. THE FAILURE OF THE MEETING REFLECTS GENUINE DIFFERENCES BETWEEN OPEC AND NOPEC AND MORE ESPECIALLY WITHIN OPEC ITSELF. THE SAUDIS HAVE REAFFIRMED THEIR UNWILLINGNESS TO RETURN TO THE ROLE OF SWING PRODUCER OR SEE THEIR MARKET SHARE FURTHER ERODED BY HAVING TO MAKE WHAT THEY CONSIDER DISPROPORTIONATE CUTS ON TOP OF THOSE ALREADY MADE. IMPROVING DEMAND PROSPECTS FOR THE SECOND HALF OF THE YEAR APPEAR TO HAVE STRENGTHENED THEIR VIEW THAT FURTHER CUTS NOW, AS OPPOSED TO DISCIPLINE OVER CURRENT QUOTAS AND POSSIBLY A SMALL QUOTA INCREASE AT THE JUNE MEETING, WOULD PUSH PRICES TOO FAR ABOVE THE DOLLARS 18/B TARGET, THUS ENCOURAGING CHEATING WITHIN OPEC AND INCREASED NON-OPEC PRODUCTION. SECONDLY, THE SAUDIS MAY HAVE FEARED A DILUTION OF THEIR INFLUENCE WITHIN OPEC. THE NOPEC COUNTRIES REPRESENTED AT VIENNA SHARE AN INTEREST WITH THE BULK OF THE NON-GULF OPEC MEMBERS IN HIGHER PRICES IN THE SHORT TERM. THE CLEAR MESSAGE OF THE SAUDI STAND IS THAT THEY ARE NOT PREPARED FOR NOPEC TO PLAY MORE THAN A PURELY SUPPORTING ROLE IN OPEC AFFAIRS.

4. THOSE IN OPEC OPPOSED TO THE SAUDI VIEW, LED BY THE VENEZUELANS AND ALGERIANS, APPEAR TO HAVE BEEN PARTICULARLY ANNOYED BY SAUDI INTRANSIGENCE, BELIEVING THAT SOME GOODWILL GESTURE COULD HAVE BEEN MADE IN RESPONSE TO THE NOPEC OFFER, TO BE FOLLOWED IN JUNE BY A MORE DETAILED ATTEMPT TO AGREE LONGER TERM CO-OPERATION. THE NOPEC PARTICIPANTS' VIEW, AS EXPRESSED BY THE MEXICANS, REMAINS THAT, AS THERE IS NO AGREED OPEC VIEW, THEY CANNOT THEY BE EXPECTED TO MAKE A UNILATERAL CUT, WHICH WOULD HAVE HAD LITTLE IMPACT ON THE MARKET WITHOUT THE SUPPORT OF OPEC.

5. ALTHOUGH FAILURE TO REACH AN AGREEMENT WAS WIDELY PREDICTED FOR THE REASONS GIVEN ABOVE, NOPEC APPEARS TO HAVE SERIOUSLY UNDERESTIMATED THE STRENGTH OF SAUDI REACTION, POSSIBLY AS A RESULT OF STATEMENTS BY NAZER IN MEXICO IN EARLY APRIL WHICH APPEARRED TO ACCEPT THE PRINCIPLE OF JOINT PRODUCTION CUTS. AT THE SAME TIME, THE QUOTES TAKE IT OR LEAVE IT UNQUOTE TERMS OF THE NOPEC OFFER FOR MAY AND JUNE - PRESUMABLY DESIGNED TO

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PRE-EMPT OPEC'S DEFERRING A DECISION FOR FURTHER NEGOTIATIONS - WERE CLEARLY UNREALISTIC. ACCORDING TO SOME OBSERVERS HERE, THE SAUDI POSITION MAY HAVE HARDENED CONSIDERABLY IN THE PERIOD IMMEDIATELY BEFORE THE MEETING, WITH THE BREAK IN RELATIONS WITH IRAN AND US OPPOSITION TO AN OPEC/NOPEC AGREEMENT BEING IMPORTANT CONTRIBUTORY FACTORS.

FUTURE PROSPECTS

6. OIL PRICES FELL JUST OVER DOLLARS 1/B BETWEEN THE START AND FINISH OF THE VIENNA MEETINGS AND HAVE ALREADY STARTED TO RECOVER SLIGHTLY. (JUNE BRENT IS NOW ABOUT DOLLARS 16/B). THEY ARE STILL AT LEAST A DOLLAR ABOVE THEIR MARCH LOW POINT. DEMAND FORECASTS FOR THE SECOND HALF OF THE YEAR SUGGEST PRICES COULD RECOVER TO AROUND THE DOLLARS 18/B TARGET PROVIDED OPEC MAINTAIN CURRENT DISCIPLINE. IN THIS SENSE THE FAILURE TO AGREE JOINT OPEC/NOPEC CUTS MAY NOT PROVE TO HAVE BEEN A MAJOR SETBACK FOR OPEC. IN TERMS OF FUTURE PROSPECTS FOR CO-OPERATION, HOWEVER, THE FAILURE OF THE MEETING MAY HAVE A MORE LASTING EFFECT. OPEC'S REJECTION OF NOPEC'S OFFER IS UNLIKELY TO BE QUICKLY FORGOTTEN EITHER BY NOPEC OR ITS ALLIES WITHIN OPEC. IT MAY ALSO BE MORE DIFFICULT IN FUTURE FOR OPEC COUNTRIES TO BLAME OPEC'S FAILURES ON THE ATTITUDE OF OTHER PRODUCERS. ALTHOUGH ATTEMPTS MAY BE MADE IN COMING WEEKS TO RESURRECT CO-OPERATION, AT LEAST WHILE OIL PRICES REMAIN REASONABLY FIRM, THE CHANCES OF CONCERTED CO-OPERATION ARE SLIM. THE RIFT BETWEEN GULF AND NON-GULF PRODUCERS IS THEREFORE LIKELY TO RESURFACE AT OPEC'S 8 JUNE MEETING AT WHICH THE SAUDIS SEEM DETERMINED TO GET OPEC'S OWN QUOTA RIGHT FOR THE SECOND HALF OF THE YEAR, POSSIBLY TRYING AGAIN TO INCORPORATE IRAQ IN A NEW TOTAL OPEC QUOTA IN THE REGION OF 18.4MBD. (IE ABOUT 750,000 MBD ABOVE CURRENT EFFECTIVE PRODUCTION TOTALS).

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ADDITIONAL 41

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Daily Telegraph
Thursday, May 5, 1988

21 Lord Young adds fat to the BP fire

CITY COMMENT

IN WHAT must be the worst decision since Lord Cockfield sent the bid for Sotheby's to the Monopolies Commission, Lord Young, the present incumbent at the Department of Trade, yesterday ordered an investigation of the Kuwait Investment Office's 22 p.c. stake in BP.

There is no "monopoly" to consider. The nearest that might be found, the chain of Q8 filling stations built up by the Kuwaitis, was not even mentioned yesterday. Instead, worries about BP coming under the influence of Opec provided the justification.

There is no doubt that BP feels uncomfortable with a large, foreign shareholder. It would be naive to pretend that a 22 p.c. holder is just like any other and previously when the Chancellor asked the KIO to stop buying, it took no notice.

Yet the Government seems to have rushed to accept the recommendation from the Office of Fair Trading for an investigation without much thought. Indeed, there were signs yesterday that Lord Young's relationship with the Treasury, already strained over the cost of his 1992 advertising campaign, are worse as a result of the move.

It is hard to see what the commission can do. The KIO has already said it does not intend to bid and it is still free to buy more BP shares. The danger is the same as before—that the Kuwaitis will sell out to a single buyer with different ambitions. The reference makes that more, not less, likely.

There are further dangers. If the commission finds, surprise, surprise, that there is no monopoly to prevent, then the Government cannot overrule it. Only Tony Benn's hated Industry Act—and the market place—would remain as a weapon against an unwanted bidder for BP.

This move also sends out the wrong signals, from a Government supposed to be in favour of market solutions. Officials spoke yesterday of planned changes in competition policy to highlight "reciprocity" provisions for blocking takeovers by companies whose host governments deny British firms the same opportunity.

There has been no rush of British bids for Kuwaiti companies; it is an argument that seems tailor-made for protection from nasty Swiss buyers for Quaker confectionery companies.

Blocking uncomfortable bids would show British hypocrisy at its finest. Last year BP took over Sohio, one of America's largest oil companies, and only a few months ago the Treasury was mighty relieved to see the KIO saving the Government's BP sale from disaster.

If only Nigel Lawson had not shown such machismo by insisting on 70p for the support price, the KIO would surely have been much less keen to pay 90p a share, and the Bank of England might today be BP's biggest shareholder.

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Idiotic

FINANCIAL TIMES

THE LEX COLUMN

Catching up with the Kuwaitis 44

It was not wholly surprising that the market should have taken so badly to yesterday's monopoly reference of Kuwait's stake in BP. The only source of movement in equities these days is bid prattle, with the surge in the day's favourites – yesterday, English China Clays and Pearson – offset by the collapse of favourites from the day before. If the Government became a sudden convert to protectionism, it would threaten not only real bids such as Nestlé's for Rowntree, but also the market's chief source of speculative ramping.

In fact, it would be surprising if the Government's action represented any such coherent response. Throughout the whole BP farce, it has been lumbering along behind the KIO, slamming one stable door after another. The KIO's ceiling of 22.5 per cent is self-imposed – the Government's own limit having been ignored – and the reference seems only a means of setting in train the legal process by which the KIO can be forcibly restrained from changing its mind. Even as things stand, there is nothing at present to stop the KIO buying except the risk of further prejudicing the Government's decision.

Although the KIO could eventually be required to dump all or part of its holding, yesterday's modest drop in the BP price shows that the market takes a less catastrophic view of things.

...Rowntree, the more interesting news yesterday was that Ciba-Geigy's shareholders have followed Sandoz's lead in their docile acceptance of restrictions on stake-building. The issue of Swiss reciprocity could still prove to have wider relevance: the BP issue is merely a one-off governmental disaster.

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APPOINTMENTS IN CONFIDENCE

FROM: J M G TAYLOR
DATE: 6 May 1988

MS P M LEAHY

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr D J L Moore

BP/KIO: MMC REFERENCE

The Chancellor has seen your minute of 4 May.

2. He has commented that, of the Department of Energy's list, Sylvan Robinson is the best bet.

3. He has no objection to Mr Kennington's name being added to the list, but he is not a great expert on the oil industry.

J M G TAYLOR

NH8/24Jo

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FROM: J M G TAYLOR

DATE: 9 May 1988

PS/ECONOMIC SECRETARY

cc PS/Financial Secretary
Mr Scholar
Mr Williams
Miss Leahy
Mr Painter
Mr Johns
Miss Hill
PS/IR

MEETING WITH MR REID, CHAIRMAN OF SHELL UK

The Chancellor has seen Miss Hill's note of 22 April, and your note of the Economic Secretary's subsequent meeting with Shell and ESSO.

2. The Chancellor has noted (paragraph 3 of Miss Hill's note) that the industry argues that British Gas is the main beneficiary of the changes. He has commented that he does not like the look of this.

J M G TAYLOR

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

From: P W Fawcett
Date: 10 May 1988

Financial Secretary

UNION TEXAS PETROLEUM CORPORATION v CRITCHLEY

My minutes of 18 and 28 March explained the background to this case and advised that no legislative action should be taken unless and until we lose in the Courts. You commented that the case presented a serious situation but that there appeared to be nothing that could be done at this stage (Miss Feest's minute of 12 April).

2. Since minuting you we have been taking further legal advice. This advice has not changed our view (or that of our legal advisers) that it would be inappropriate to take legislative action now. However, the advice has brought to light certain consequences, of which you will wish to be aware, of not legislating in advance of any adverse decision of the Courts.

<u>Possible consequences of not legislating now</u>

3. It is possible that difficulties - primarily of a cash flow nature - might arise if at any stage we were to be on the losing end of the Union Texas case and (rather than take pre-emptive action before the decision) Ministers decided after the adverse

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PS/Chancellor
Ms Sinclair

Mr Painter
Mr Millar
Mr Houghton
Mr Cleave
Mr Phalp
Mr Fawcett
Mr Ridd
Mr Critchley IFD
Mr Richardson
PS/IR

court decision to legislate retrospectively to restore the law to its previously generally understood meaning. The problem is that, for the period between losing the Union Texas case and enacting retrospective legislation, we would temporarily be without any legislative cover for retaining the withholding taxes at issue. This period could extend up to a year if we were to lose in the Union Texas case just after the passing of a Finance Bill.

4. It is unlikely that this would be of significance in respect of those claims of Union Texas which are the subject of the legal proceedings, since we would expect those claims to be excluded from the scope of any retrospective legislation. But it could be of significance to Union Texas' claims for other years, and more importantly to claims of other taxpayers.

5. In view of the amounts involved, other taxpayers may ask for our refusal of their claims to be heard by the Commissioners. Unless we could distinguish a claimant's case from the terms of the Union Texas decision (which is extremely unlikely if it arose under the UK/US treaty) the Commissioners would have to follow the decision. With a Commissioners' decision against us in a case, we would have no legal grounds for refusing to repay the withholding tax in that case.

6. Any difficulties would perhaps be most acute if we were to win in the lower courts but lose in the House of Lords (or lose in the Court of Appeal and not receive leave to appeal to the House of Lords). In those circumstances our title to withhold tax in other cases would no longer remain a matter of uncertainty pending the eventual outcome of the Union Texas case; we would have no title to the money unless and until Parliament saw fit to restore it by passing suitable retrospective legislation.

7. To provide some protection to the Exchequer, we would seek to make any repayments on conditions, embodied in a contractual undertaking, to return the money (with interest) if we were to win on appeal or once retrospective legislation was passed. But the Government could be without the use of the money at issue for up to a year. (In the unlikely event that <u>all</u> claimants took their cases to the Commissioners and won, we estimate that the tax at stake would be about £1.2b).

<u>Legislation</u>

8. If other taxpayers were to take their claims to the Commissioners, it would mean that any retrospective legislation would have to overturn Commissioners' decisions in those cases. This would involve the retrospection going wider than that in the Padmore legislation last year. (That legislation let all earlier Commissioners' decisions stand, but as a practical matter the only such decision was the one in the Padmore case). However, providing the decision to legislate retrospectively was announced immediately after any adverse decision in the Union Texas case, other taxpayers going to the Commissioners would know when they did so that the Government's intention was to overturn decisions of the Commissioners where necessary.

<u>Conclusion</u>

9. Our view remains that it would not be appropriate to introduce legislation in advance of any adverse decision. It would be difficult to frame legislation without seeing the terms of the adverse decision. And we are not aware of any precedent for resorting to legislation at the present stage in other cases involving similar circumstances. The circumstances being that we have won before the Special Commissioners; the High Court hearing went well; the decision of the High Court is still awaited; and our legal advice is that we stand a good chance of winning in the Courts.

10. Further, given the inevitable controversy that would follow the announcement of a decision to legislate retrospectively, there is much to be said for not making such an announcement unless absolutely necessary. As there is no certainty that we will at any stage lose the Union Texas case, there is no certainty yet that retrospective legislation will need to be considered.

11. We will of course continue to keep you informed of developments.

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P W FAWCETT

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YOUR TELNO 381 TO TOKYO: BP/KUWAIT INVESTMENT OFFICE (KIO)

1. WE HAVE ONLY LIMITED INFORMATION ON KUWAIT'S INVESTMENT IN ITALY READILY AVAILABLE IN THE EMBASSY OR MILAN CONSULATE GENERAL AND, AS INSTRUCTED IN TELECON GARRETT (ERD)/ELMES, WE HAVE NOT APPROACHED ANY OUTSIDE SOURCE.

2. THE MOST VISIBLE KUWAITI INVESTMENT IN ITALY IS BY KUWAIT PETROLEUM INTERNATIONAL LTD (KNOWN AS Q8) WHICH BOUGHT OUT GULF'S ITALIAN INTERESTS EARLY IN 1984. IN 1987 THESE COMPRISED 1600 FILLING STATIONS AND 3.8 PERCENT OF THE ITALIAN PETROLEUM MARKET. TURNOVER IN 1987 WAS US DOLLARS 725 MILLION WITH A LOSS OF 16.67 MILLION DOLLARS. THIS YEAR Q8 HAS BOUGHT THE LUBRICANTS DIVISION OF ROL, MONTEDISON'S SPECIALISED PETROLEUM PRODUCTS SUBSIDIARY (1987 TURNOVER 64 MILLION DOLLARS), AND A 25 PERCENT STAKE IN CONTINENTALE, A SUBSIDARY OF MONTESHELL (MONTEDISON/SHELL JV). CONTINENTALE OPERATES A LARGE-SCALE PETROLEUM PRODUCTS DISTRIBUTION SYSTEM. Q8 HAVE ALSO FORMED LOGISTICA PADANA WITH THE STATE-OWNED AGIP PETROLI. WE HAVE NO DETAILS ON THE OBJECT OF THIS COLLABORATION APART FROM MANAGEMENT OF AN OIL STORAGE DEPOT AT RHO, NEAR MILAN. Q8'S TOTAL INVESTMENT PROGRAMME 1986-90 IS SAID TO AMOUNT TO LIT. 27 BILLION HAS ALREADY BEEN COMMITTED. IN PRESENTING Q8 ITALIA'S 1987 RESULTS, THE CHAIRMAN RAMINELLA SAID NO FURTHER STRATEGIC ACQUISITIONS WERE FORESEEN FOR THE MOMENT.

3. WE DO NOT BELIEVE THAT THE ITALIAN GOVERNMENT AND POTENTIAL ITALIAN BUSINESS PARTNERS WOULD TURN DOWN OTHERWISE BENEFICIAL COLLABORATION WITH BP BECAUSE OF THE PRESENT SIZE OF THE KIO SHAREHOLDING. THAT SAID, WE THINK THERE WILL BE WIDESPREAD UNDERSTANDING HERE OF THE REASONS FOR THE REFERRAL TO THE MMC. ITALY HAS NO MERGERS LEGISLATION (ALTHOUGH IT IS UNDER DISCUSSION IN PARLIAMENT) BUT STRATEGIC INDUSTRIES ARE MOSTLY STATE CONTROLLED EVEN IF THEY HAVE SOME PRIVATE SHAREHOLDERS. THE ITALIAN GOVERNMENT WOULD BE SURPRISED IF HMG WERE PREPARED TO SEE CONTROL OF SUCH AN IMPORTANT COMPANY PASS INTO POTENTIALLY UNSYMPATHETIC HANDS.

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YOUR TELNO 67 TO VIENNA, AND MY TEL 251 , NEITHER TO ALL :
MEETING OF OPEC MINISTERS, 28 APRIL - 2 MAY.

SUMMARY

1. FURTHER STATEMENT BY SAUDI OIL MINISTER UNDERLINES CONCERN ABOUT OPEC DISCIPLINE. AGREEMENT WITH NOPEC NOT RULED OUT, BUT OF LESS IMPORTANCE.

DETAIL

2. IN A STATEMENT ON 6 MAY, CARRIED BY THE SAUDI PRESS AGENCY, OIL MINISTER NAZER INDICATED THAT THE SAUDI OFFER AT VIENNA OF A BARREL-FOR-BARREL DEAL WITH NOPEC WAS STILL ON THE TABLE. HE DREW ATTENTION AGAIN TO OPEC'S OWN PRODUCTION CUTS SINCE 1980. HE ALSO REPEATED THE RATIONALE BEHIND THE SAUDI CALL FOR EQUAL CUTS WITH OPEC (MY TELNO 251). HE WARNED OPEC MEMBERS TO ADHERE TO QUOTAS, AND ACCUSED FIVE MEMBER STATES WHO VOTED FOR QUOTA REDUCTIONS OF THEMSLEVES OVERPRODUCING. FINALLY, HE CRITICIZED IRAN FOR REFUSING TO ALLOW AN AUDIT OF ITS PRODUCTION AND EXPORTS.

COMMENT

3. SEEN FROM HERE, SAUDI POLICY HAS BEEN CONSISTENT. THEIR MAJOR OBJECTIVE REMAINS TO MAXIMISE REVENUE WHILE AVOIDING A RETURN, IN ANY FORM, TO THE ROLE OF SWING PRODUCER. IN PRESENT MARKET CONDITIONS THIS MEANS ACHIEVING REASONABLE MARKET STABILITY AS CLOSE AS POSSIBLE TO US DOLLARS EIGHTEEN PER BARREL. THEY ALSO WISH TO MINIMISE POLITICAL FLAK FROM OTHER OIL PRODUCERS (ESPECIALLY THE ARABS).

4. WE DO NOT DETECT A HARDENING OF THEIR POSITION IMMEDIATELY BEFORE THE MEETING. THE REPORT OF NAZER'S VIEWS IN MEXICO CITY TELNO 108 MAY HAVE REFLECTED WISHFUL THINKING ON THE

PART OF THE MEXICANS. SO FAR AS WE KNOW, HE HAS SAID NOTHING SIMILAR ELSEWHERE, ALTHOUGH HE HAS SPOKEN IN GENERAL TERMS OF THE MERITS OF COOPERATION. WE DOUBT THAT US PRESSURE PLAYED A SIGNIFICANT ROLE IN SAUDI BEHAVIOUR, AND WE BELIEVE THAT THE BREAK IN RELATIONS WITH IRAN WAS A MINOR FACTOR.

5. WHILE THE SAUDIS CAN NO DOUBT SEE SOME POLITICAL AND PRESENTATIONAL ATTRACTIONS IN CONCERTED ACTION BETWEEN OPEC AND NOPEC PRODUCERS, THEY HAVE ALWAYS BEEN REALISTIC ABOUT WHAT COULD BE ACHIEVED IN PRACTICE. THE SAUDIS HAVE LONG BELIEVED THAT THE MAIN PROBLEM LIES WITH OVER-PRODUCTION BY CERTAIN OPEC COUNTRIES. BY COMPARISON, THE NOPEC OFFER WAS A RELATIVELY MINOR SHORT-TERM MEASURE.

6. NAZER'S STATEMENT SUGGESTS THAT NEGOTIATIONS WITH NOPEC HAVE NOT (NOT) BEEN CONCLUDED. HOWEVER, ANY AGREEMENT WILL HAVE TO BE VIRTUALLY ON SAUDI TERMS: THE SAUDIS CAN EASILY LIVE WITH NO AGREEMENT.

7. LOOKING AHEAD, THE SAUDIS WILL REGARD FURTHER INDISCIPLINE WITHIN OPEC AS THE MAIN RISK TO A RECOVERY IN OIL PRICES LATER THIS YEAR. THERE HAVE BEEN NO INDICATIONS HERE YET OF SAUDI INTENTIONS BUT, IF THEY BELIEVE THAT AN INCREASE IN OPEC PRODUCTION IS INEVITABLE, IT WOULD OBVIOUSLY MAKE SENSE FOR THEM TO INCORPORATE THIS IN AN INCREASE IN QUOTAS, SO THAT THE SAUDIS THEMSELVES MAY OBTAIN A SHARE IN ANY ADDITIONAL REVENUE.

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YOUR TELNO 381 TO TOKYO: BP/KUWAIT INVESTMENT OFFICE (KIO)

1. AS INDICATED IN OUR TELNOS 903 AND ELFU1 THERE HAS SO FAR BEEN LITTLE INDICATION THAT THE KUWAITI HOLDING HAS HAD ANY SIGNIFICANT EFFECT ON US PERCEPTIONS OF BP. BUT THE PROFILE OF THE ISSUE HAS INCREASED SOMEWHAT IN RECENT WEEKS, EVEN BEFORE LORD YOUNG'S 5 MAY ANNOUNCEMENT. CONGRESSMAN BRYANT, FOR EXAMPLE, RECENTLY USED THE KIO'S SHAREHOLDING AS ONE INSTANCE OF FOREIGN INVESTMENT IN ARGUING THE CASE FOR REGISTRATION REQUIREMENTS. BP AMERICA SAY THAT THE POINT HAS ALSO BEEN RAISED WITH THEM WITH INCREASING FREQUENCY.

2. GIVEN THE MMC REFERRAL AND US SENSITIVITY ABOUT FOREIGN INVESTMENT AND ENERGY SECURITY, THE PROFILE OF THE ISSUE, AND HENCE THE RISK FOR BP, MAY WELL INCREASE FURTHER. IN PARTICULAR, WE GATHER THAT THE KUWAITIS, AS WELL AS THE VENEZUELANS AND SAUDIS, MIGHT NOW BE INTERESTED IN TRYING TO BUY A STAKE IN SOME OF TEXACO'S ASSETS. THE ADMINISTRATION SEEM RELAXED ABOUT SUCH A POSSIBLE DEVELOPMENT. BUT IT COULD GIVE RISE TO AN ADVERSE CONGRESSIONAL REACTION WHICH MIGHT IN TURN LEAD TO ALTERED PERCEPTIONS OF BP, OR ATTEMPTS TO PASS NEW LEGISLATION CONTROLLING SUCH FOREIGN INVESTMENT.

3. THE OTHER PERTINENT KUWAITI INVESTMENT WE ARE AWARE OF IS IN SANTA FE INTERNATIONAL CORPORATION WHICH HAS BEEN WHOLLY OWNED BY THE KUWAIT PETROLEUM CORPORATION SINCE 1981 AND ON WHICH WE HAVE PREVIOUSLY REPORTED (LUMLEY'S LETTER OF 20 APRIL TO BRETT). WE DO NOT HAVE ANY INFORMATION ON ANY OTHER KUWAITI HOLDINGS.

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YOUR TELNO 381 TO TOKYO: BP/KUWAIT INVESTMENT OFFICE (KIO).

SUMMARY

1. NO EVIDENCE OF CHANGE IN FRENCH GOVERNMENT PERCEPTIONS OF BP AS A RESULT OF KIO SHAREHOLDING. BUT CHANGE IN ATTITUDE NOT IMPOSSIBLE IF THE ISSUE BECAME POLITICALLY LIVE HERE.

DETAIL

2. WE HAVE NOT SO FAR DETECTED ANY CHANGE IN THE FRENCH AUTHORITIES' PERCEPTION OF BP (FRANCE) SINCE KIO ACQUIRED A 22 PER CENT SHAREHOLDING. RECENT PRESS COVERAGE HAS BEEN LOW KEY AND FACTUAL, WITH NO HINT OF ANY BACKGROUND BRIEFING BY THE AUTHORITIES WHICH MIGHT SUGGEST SOME DISQUIET ON THEIR PART. FURTHERMORE, THE MINISTRY OF INDUSTRY HAVE TOLD US, AT SENIOR OFFICIAL LEVEL (BELLEC) THAT THEY ARE RELAXED ABOUT THE KIO HOLDING AND WOULD REMAIN SO EVEN IF IT WERE INCREASED, PROVIDED THAT KIO WERE NOT ALSO ACQUIRING MAJOR STAKES IN OTHER COMAPNIES. BELLEC ADDED THAT BOTH THE FRENCH MAJORS, ELF ACQUITAINE AND TOTAL, HAVE BEEN IN DISCUSSION WITH INDIVIDUAL OPEC MEMBERS, NOTABLY THE SAUDIS, ABOUT THE POSSIBILITY OF THEIR ACQUIRING A STAKE IN DOWNSTREAM ACTIVITIES - TO WHICH THE FRENCH WOULD HAVE NO OBJECTION IN PRINCIPLE - BUT SO FAR INCLUSIVELY. (ABU DHABI, WITH A 5 PER CENT HOLDING, ARE THE LARGEST SINGLE SHAREHOLDER IN ELF ACQUITAINE AFTER THE FRENCH GOVERNMENT.

3. NONETHELESS, THE QUESTION OF FOREIGN PARTICIPATION IN FRENCH COMPANIES OR (PEARSON/LES ECHOS) FOREIGN COMPANIES OPERATING IN FRANCE REMAINS SENSITIVE. IT IS NOT IMPOSSIBLE THAT FRENCH GOVERNMENT ATTITUDES WOULD CHANGE IF THIS BECAME A POLITICALLY LIVE ISSUE HERE.

4. WE HAVE NOT YET BEEN ABLE TO SPEAK TO BP (FRANCE), BUT WILL REPORT FURTHER IF ANYTHING SIGNIFICANT EMERGES.

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MR MONCK, HMT
PS/SOS FOR ENERGY
MR CHIPPERFIELD, D/ENERGY
MR D DAVIS, D/ENERGY
PS/SOS FOR T AND I
MR TREADGOLD, DTI
MS RICHARDSON, DTI SOLS
MR WHOMERSLEY, LEGAL ADVS

NNNN

CONFIDENTIAL

THE MINISTER OF STATE

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ
Direct Line 01-211 3290
Switchboard 01-211 3000

ECONOMIC SECRETARY

Mr M Williams
PS/CHX PS/FST
Mr Scholar
Miss Sinclair
Ms Leahy
PS/IR

Peter Lilley Esq MP
Economic Secretary
H M Treasury
Parliament Street
LONDON SW1

17 May 1988

Dear Peter.

11TH ROUND OF OFFSHORE LICENSING

Thank you for your letter of 4 May about the possible inclusion of an auction element in the 11th Round. As you know, E(A) accepted Cecil Parkinson's arguments against including such an element in the round and we are preparing our detailed proposals accordingly. E(A) did also decide that the possibility of an auction element was not entirely ruled out, but set two pre-conditions, the first was that discussions with other departments led to the release of particularly attractive blocks. The second was that there should be an improvement in oil prices. Oil prices today are about 2% higher in sterling terms than they were when we submitted our paper at the beginning of March and show no signs of stabilising at a higher level. I am sure you will agree that the inconclusive outcome of last week's OPEC meeting underlines the fragility of the market.

Our discussions with other Government Departments have so far identified only a small number of blocks for inclusion in the round. There is still much work to be done in firming up the list of blocks and my first priority must be to get this work completed within a reasonable period so as to enable us to keep to the timetable we have set ourselves. It seems to me to be premature at this stage to try and determine the most attractive blocks even if E(A)'s other criterion were likely to be met. But I do not believe the improvement in oil prices the Committee was looking for has been achieved or that there is likely to be significant change in the position before we launch the round formally in the next month or two. On this basis, whilst I would not wish to stand in the way of useful discussions between our officials on any topic, I do wonder whether their having contingent discussions about auction blocks would get us very much further. Perhaps we could have a word about this.

I am incidentally very grateful for your offer of support over the release of sensitive blocks by other Departments. We should certainly seek such support from you if we run into difficulties. I will keep in touch.

Peter.

PETER MORRISON

CONFIDENTIAL

3705/33/sh

SECRET

FROM: D J L MOORE

DATE: 18 MAY 1988

CHANCELLOR

cc Financial Secretary

w/o attachments
Sir Peter Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Beastall
Mr Peretz
Mrs Brown
Mr Ilett
Mr Watts
Mr Bent
Mr Devereux
Mr Hurst
Mr Call
Mr Hyett - TSOL

Ch/ Agree with Mr Moore's advice? [illegible] 18/5

OK Subject to PM's views (Alex will judge - I have spoken to her)

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

Earlier this year, you said that as soon as practicable after 30 April we should arrange for the Bank to transfer their BP partly paid shares to us. We would then add them to the shares we retained, but will not need, for bonus purposes. You had it in mind that they would be sold in due course into the UK retail market and could so contribute to wider share ownership objectives.

2. We recommend that the transfer should be made now as set out in the attached minute by Mr Bent. Sir Peter Middleton and Mr Anson agree with this recommendation and with the procedures proposed to put it into effect. A Revised Estimate would be published at the beginning of June to seek approval for funds for the repurchase from the Bank and for the payment of the second instalment on these shares. In preparation for this we propose that you announce your intentions in a Written Answer next week ie, before the Recess.

3. Although we firmly recommend that it is desirable to make the transfer now, it is not essential. This is because it seems most unlikely that we would sell any of our BP shares for some

time:

i. we do not need to do so for proceeds reasons;

ii. If the KIO are to reduce their BP holding, voluntarily or otherwise, BP will be faced with the difficult and delicate task of ensuring the shares are sold in to safe and suitable hands and in a way which does not disturb the share price too much - it would be very unhelpful if we chose to offload our own shares, even if we were aiming for the retail market, while such an exercise was going on.

If there were any serious worries over the presentational aspects of the route proposed we could therefore wait and make the transfer at some later date.

4. But we are satisfied that it is right to make the transfer now. We intend to sell the shares in due course and, before doing so we will have to take them formally from the Bank (unless contrary to present thinking we wished them to tap out the stock). If we wait and make the transfer in 2 years time or later, the Estimate could then be seen as a signal, which we would not want to give, of that intention. Moreover, presentationally it could look worse than now because once all our instalment proceeds are in, the vote would be substantive rather than token.

5. On the other hand, if the transfer is made now we would be taking the first practicable opportunity after 30 April, when the Bank became free to sell the shares if they wished. It could be more readily presented as a straightforward and neutral move and it could be made clear that while the shares will be sold in due course no decision has been taken on the timing.

6. The procedure whereby we make provision to pay to ourselves the second and third instalments on these shares may seem cumbersome. But we recommend that it is preferable to the option (explained in Mr Bent's paragraph 8 (ii)) of refraining from paying them and giving the custodian bank a declaration to that affect in June

1989, as provided for in the Instalment Agreement. The procedure we propose makes the arrangements transparent, in Parliamentary accounting terms; if there were questions it is simpler to explain that the shares are fully paid up in the usual way; and it covers the possibility, however remote, that we might wish to sell before June 1989.

7. Are you content that we should transfer the Bank's partly paid shares now and on the basis proposed? If so we will provide a draft Written Answer to be given next week in preparation for publication of the revised estimate at the beginning of June. We will inform the Bank and BP.

DJM.

D J L MOORE

SECRET

1. MR MOORE

2. CHANCELLOR OF THE EXCHEQUER

From:R M BENT
Date:12 May 1988
cc FST
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax o/r
Mr Peretz
Mrs Brown
Mr Ilett
Mr Watts
Mr Devereux
Mr Hurst
Mr Call
Mr Hyett-T Sol

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

The Bank of England bought back 38,576,002 partly paid BP shares at 70p under the Share Purchase Arrangements which ran until 6 January 1988. These shares could not be resold before end-April at less than 120p per share, but can now be sold at the prevailing market price. Earlier this year, you indicated your preference for the Treasury purchasing these shares from the Bank of England.

2. Independently, the Bank of England has submitted a number of options for the sale of these shares (see Annex A). Under some (for instance, using the shares as a tap stock), it might be beneficial for the Bank to continue holding these shares, because the Bank is best placed to conduct the sale.

3. But we see no great attractions in an early sale. Rather we continue to favour arrangements that will maximise your control over the timing, amount and method of sale, both of the Bank shares and of those held by the Treasury excess to the requirements for bonus shares. Fully paid, both sets of shares together are presently worth some £270m. We therefore recommend that the Bank shares be purchased by the Treasury. While there is no need to repurchase the Bank shares at the first opportunity, it is logical to do so, and we will be able to fund the purchase from within a token Vote.

Method for repurchase

4. It is suggested that a Revised Estimate be presented to Parliament to seek approval for funds to repurchase the BP shares from the Bank, and to provide funds to pay the second instalment on these shares. A transaction of the former kind is not unprecedented. In 1981-82, the Treasury took Vote provision (Class IV, Vote 23) to purchase from the Bank the BP shares it then held.

5. If you approve this proposal, we suggest that you table an arranged PQ prior to the Revised Estimate being published in June to explain your intention. If you agree, we will supply a draft.

6. The Bank of England value the BP shares in their books at the current market price, rather than the 70p at which they were purchased. The Treasury will have to pay this current market price in repurchasing the Bank shares if the note issue is to remain adequately backed by assets held by the Bank. We suggest that funds be sought for a purchase price of up to 85p to give a margin for market movements by the time that the Consolidated Fund Bill is enacted.

Payment of the second call

7. It is something of a nonsense to have to pay to ourselves the second instalment on any partly paid shares bought back from the Bank. But, in the normal course of events, any purchaser of partly paid BP shares in the market is legally obliged to assume responsibility from his predecessors for paying the subsequent calls under the terms of the Instalment Agreement.

8. There are two options for avoiding this commitment, but neither is satisfactory:

(i) In theory, we could seek to negotiate contractual amendments with all the parties to the Instalment Agreement to recognise the Treasury's special position as both vendor and repurchaser of BP partly paid shares. In practice, however, the task would be difficult because each purchaser of partly paid shares is a party to the contract, as well as the Treasury, BP and the custodian bank;

(ii) A second alternative is to refrain from paying either the second or the third instalments, and to give the custodian bank a declaration on 22 June 1989 that the Treasury as vendor is satisfied that the Treasury as purchaser has met its obligations. The date of this declaration is enshrined in the Instalment Agreement, and cannot be advanced. This alternative would mean that the partly paid shares will be in limbo until June 1989, and we will be unable to sell them earlier than this date. In addition, we may create difficulties for ourselves in disciplining any investor who fails to pay either the second or the third calls when required to do so, and who points to the Treasury's own practice in this respect.

9. In short, simplicity suggests that we should plan to pay the two remaining calls (105p in August 1988 and 105p in April 1989) on any partly paid shares in our possession at that time.

Vote provision and the Reserve

10. Neither the cost of the purchase (up to £33m), nor the cost of the second call (£41m), will cause difficulty for the Vote. There will be more than enough sales receipts (£2233m) accruing to be able to appropriate in aid of the Vote sufficient proceeds to offset the expenditure, and to leave a token £1,000 Vote total.

12. Since the effect of the repurchase is to match Treasury expenditure with Bank receipts, and since the effect of paying the second call is to substitute Treasury expenditure for expenditure otherwise incurred by the Bank, there is no net impact on the Reserve.

Residual shareholding in BP

13. The residual public sector shareholding in BP takes three forms:

(i) The Treasury holds £1,000 of BP preference shares which we undertook in the 1987 Prospectus to sell after the offer. There is no particular urgency in conducting this sale;

(ii) The Treasury also retains some 67.7 million *fully paid* ordinary BP shares against a requirement for bonus shares that proved to be only 7 million on application, and which is likely to fall further over the qualifying period to 31 October 1990;

(iii) The Bank of England bought back some 39 million *partly paid* ordinary BP shares, as noted earlier.

Sale of the remaining HMT/Bank shares

14. A note by the Bank of England is attached.

15. Although the sale of excess bonus shares in general gives an opportunity for the Government to pursue its wider share ownership objectives, an early public offer of BP shares is likely to meet with consumer resistance following the adverse publicity last Autumn. Nor is there any need for an early sale, though if one were required the choice probably lies between a placing with institutions and an experiment with tapping the shares out over a period of time. We have some sympathy for the Bank suggestion that residual shares be used as a tap stock to see whether this approach might add to our marketing options, but there is a special sensitivity about the use of BP shares given past Kuwait Investment Office (KIO) purchases when the share price has fallen. We believe this argues against a tap stock experiment with the Bank shares.

16. On balance, a later sale seems desirable. It is possible, for instance, that the KIO may reduce its holding in BP around the time that further instalments are due on the partly paid shares. If so, we should want to assist the company in arranging the orderly disposal of KIO shares by staying out of the market ourselves. In any case, we are looking separately at arrangements to sell the Government's residual shareholdings in Gas, BA and BAA, and will wish to coordinate any sale of BP shares, both fully and partly paid, with this wider programme.

17. In summary, we see no need to take swift decisions on the sale of the Government's residual shareholding in BP.

Recommendation

18. We recommend that Vote provision be sought to enable the Treasury to purchase from the Bank the 39 million partly paid BP shares bought by them under the Share Purchase Arrangement, and to pay the second instalment on these shares. This consolidation will facilitate your decisions on the timing, amount and method of sale of the Government's residual shareholding in BP.

R M Bent

R M BENT
PE2 Division

SECRET

BP: SALE OF THE REMAINING HMT/BANK SHARES
(Note by the Bank of England)

1 Since the Share Purchase Arrangements ended early in January, BP shares have moved moderately firmer, helped by signs of investment demand from the US, by the firmer oil price and, until last week, by the moderate recovery in the equity market as a whole. But the rise has not been particularly robust and there is therefore probably no pressing case for disposal of the remaining BP shares held by HMT and the Bank in the immediate future. In their partly-paid form, moreover, the shares offer a high yield. It may, however, be useful to set out the main options available as a basis for discussion in due course.

HMT/Bank shareholding

2 As a result of the Share Purchase Arrangements, the Bank holds just under 39 million shares, acquired at 70p for £27mn. The Treasury holds 68 million shares to cover share bonuses; few of these shares may now be required. The total combined shareholding of 107 million shares represents 1.8% of BP's share capital and, at the current market price of 73p, is worth £78mn.

3 Under the terms of the Share Purchase Arrangements the Bank undertook not to sell its shares prior to 30 April 1988 except at a price above 120p; but from 30 April we are free to sell at any price. As far as we are aware, there are no restrictions on sale of HMT's shareholding, provided sufficient shares are retained to cover the share bonuses.

Possible means of disposal

4 Various different approaches to disposing of this small shareholding are possible, but they can perhaps be grouped into five main alternatives:

(i) a public offer;
(ii) a placing;
(iii) negotiated sale direct to one or a few buyers;
(iv) tap sale;
(v) sale of debt convertible into BP shares.

These alternatives are reviewed below in turn.

5 A public offer (eg, by tender or auction), with the need for full UK (and probably US) documentation, looks an unduly cumbersome and costly route for a small shareholding, though the offer, at around £250mn in fully-paid terms, would not be particularly small by comparison with ordinary company issues. A further public offer so soon after last October's operation might not be particularly well received by investors; and although in principle applications by KIO could be weeded out, the dampening effect on the price might provide them with a further buying opportunity in the market. This does not therefore look a particularly attractive approach.

6 A placing would be a less high profile operation, though it would still be a public event, and might have less dampening effect on the market than a public offer; and it could be achieved without full documentation. It could also be directed away from Kuwait's hands. A placing could, within limits, be directed as broadly or narrowly as desired, and confined to London or extended abroad (eg, in the US) as desired. It would probably be necessary to concede a discount to the market price, and possibly also a placing commission, but if skilfully handled it should be possible to achieve a clean-cut sale with relatively little market disturbance.

7 Alternatively, it may be possible to discover one or a few institutions who would be willing to buy the shares by direct

negotiation. BP themselves might know of interested parties and might see advantage in facilitating such a deal (the company might conceivably be interested in buying the shares itself); and the buyer might be persuaded to pay up to some degree for the benefit of obtaining a block of shares in one go. Provided the buyer, or buyers, were acceptable to HMG and BP and proved to be firm holders, this approach could offer all the advantages of a placing with the minimum of market disturbance, though a negotiated deal of this nature might be awkward to defend publicly (eg, in Parliament).

8 As an alternative to selling the shares in a single discrete operation, it would be possible to tap the shares out over a period of time. The mechanics would need to be planned carefully, but the essential tactic would be to aim to tap into periods of relative strength, adjusting the price upwards to ride up with the market and holding off in bouts of weakness. Given the small size of the shareholding, knowledge of the tap, if operated in this manner, would be unlikely to be a significant brake on the share price. This approach could offer the best chance of maximising proceeds: it takes advantage of the fact that, unlike most privatisations, there is no need to dispose of the shares by any particular deadline. Costs would be minimal since no special documentation or fees would be necessary.

9 In a wider context, selling this small BP shareholding by tap might be a useful experiment to test whether this approach could be used on a more regular basis in future Government sales of residual shareholdings (eg, BT).

10 The final alternative would be to direct the share sale away from the straight equity market and aim to link the shares with some form of debt issue. There are many possibilities: the security could take the form of debt convertible into BP shares (at a premium above the current market price), or the debt could be sold with accompanying detachable warrants which (if detached) would trade separately: both forms are common in the euromarket. The debt element could be a gilt-edged stock; or, if it was desired to target the operation towards the small investor, a National Savings instrument (though this might require

a full prospectus to be produced); or a foreign currency bond. In whatever form, the coupon would be reduced as against that required for straight debt, to reflect the value of the equity element. The main attraction of this route would be the possibility of selling the shares at a price above the current market price, if conversion were exercised, with HMG no worse off if conversion were not exercised and the shares, in consequence, reverted to its hands. The drawback is that the HMT/Bank shareholding is probably too small for an operation of this type in any size.

Bank of England
28 March 1988

RESTRICTED

Ch.

Some interesting points here.

FROM: D J L MOORE

DATE: 18 MAY 1988

SIR PETER MIDDLETON

Persona[l] to PB/PEM

copy attached for: Chancellor
Financial Sec.

cc: Mr Anson
Sir A Wilson
Mr Monck
Mr C D Butler
Mrs Lomax
Mrs Brown
Mr M Williams
Mr R Bent
Ms Leahy
Mr Lyne
Miss Huleatt-James

Miss Wheldon - TSOL

Mr Moore is right to point up Rothschilds strengths. I only saw them in their shell shocked period. They were certainly in a difficult position. But I should not fancy having them in a leading role when things get rough. Not much imagination and fr[illegible] in those conditions. PM 23/5

NOTED. I am cautious by [illegible] 31: we cannot allow this to happen again.

BP SALE: ORGANISATION AND RESOURCES

I attach another chapter in the BP post mortem. It looks at your question on the adequacy of the resources committed to the sale. I have set out our impressions in some detail, for our records and as a source for planning later sales. In summary the main points are as follows.

2. The sale turned out to be far more complicated than we had expected. All of us were heavily stretched. But, although there are a number of lessons learned, we believe that we were keeping on top and that but for the Black Monday crash the sale would have been successful.

3. All of our team had the highest regard for Rothschilds' performance, and it would be a pity if their strengths and their commitment were forgotten because of the events when they were forced to the opposite side of the table in their role as lead underwriters representing the case for pulling the sale.

4. Slaughters were also first class. Dewe Rogerson were stretched but fully committed to the sale. Wood Mackenzie were fine as second

56.

brokers. There were no problems with the overseas advisers. Hoare Govett let us down and were the weak link.

5. The Treasury team were pushed to the limits and there are lessons here for runnning the BT secondary sale which is a possibility for next summer - see paragraphs 27-33.

DJM,

D J L MOORE

RESTRICTED

BP SALE

This note discusses the question whether the resources committed by the main advisers to the sale, and by the Treasury, were adequate and properly organised and co-ordinated.

2. We put in place at an early stage a formal organisation with the aim of allocating responsibilities clearly and ensuring co-ordination. The chart is annexed. It is on the now familiar lines for all sales.

3. In general the organisation was delivering the goods and, had it not been for the October crash, we believe that we would have had a successful and efficient sale. But within the organisation there were weaknesses and some lessons for the future which are noted below.

4. There is no doubt that the sale turned out to be more daunting and demanding than we had expected. It was the world's largest equity sale and we were introducing the major innovation of an international tender. Moreover, the decision to have a combined offer, with BP raising £1½ billion, led to complexity with which we coped but which took up a lot of time and resources.

BP

5. In many ways BP's commitment to the sale was admirable and much of their contribution, in particular in the presentation of themselves as a company, was of a very high quality.

6. The trouble was that they were at times over enthusiastic and over ambitious. In particular they chose to equate their £1½ billion with the overseas tranche and bid hard to take over the running of the overseas side. There were proud men in their number who were always quick to remind us that they were a large international company with great financial experience and not some duff nationalised industry. In fact, although they were highly professional and widely experienced, they had not raised equity on anything remotely approaching the scale of a major privatisation.

7. As in any sale, this was not a situation in which we could ride roughshod over the company. We needed their full commitment and co-operation, and they knew it. But we insisted in holding the important reins in our hands and, in particular, in keeping charge of the overseas offer. But we did make two concessions which we later regretted.

8. First, we let them, rather than Rothschilds, chair the prospectus committee. But it turned out that they needed a great deal of guidance from the Treasury (Mr Lyne) and from Slaughter and May. They did not always bring to the committee people of sufficient seniority to take decisions - and BP is a very hierarchical organisation.

9. Secondly, in refusing to let them chair the main overseas committee we had to chair it ourselves rather than let Rothschilds do it as we would have wished. We also put BP in charge of the territorial subcommittees. This did not work particularly well because they did not chair them at a sufficiently high level with the result that Rothschilds, who could have handled things much better if they had been in overall charge, were frustrated.

10. The main conclusions here are that:

i. a combined offer is workable - and indeed essential if the company intends to raise money at around the time of the Government sale - but the conduct of a sale will be much easier without it;

ii. although it is essential to be sensitive to the wishes of the company, and the key personalities within the sale, the aim should be for HMG, or its advisers, to chair all the main working groups.

Rothschilds

11. Up to the October crash, Rothschilds put in a first class performance. As in Gas, they provided us with a very strong commitment of resources, in number and in quality. This is crucial in any major sale and it is important to remember the perhaps obvious

point that the merchant bank adviser is not only advising us but carrying out a wide range of executive functions which we do not have either the resources or the expertise to deal with.

12. At the top level, Rothschilds had their Managing Director of Corporate Finance, Michael Richardson, and two directors, Tony Alt and Simon Linnett. These were supported by four staff at Assistant Director/Manager level. All seven of them had worked on the Gas sale. They knew what they were about and they gave us a very good combination of different talents and experience. All, apart from Michael Richardson, were working virtually full time on the sale. Richardson himself was always readily available to us, as were his staff. We could not fault them on their commitment to the sale and their enthusiasm (though when the heat was on they could have done with one more junior member on the overseas side). We doubt whether many other merchant banks provide the same in depth top level support.

13. They gave us excellent backing in keeping a firm grip on the organisation of the sale. Their experience enabled them to make good weaknesses elsewhere - eg, on the part of Hoare Govett, and on the marketing campaign when Dewe Rogerson became badly stretched. They were innovative and we believe that the two tier structure would have been highly successful had it not been for the stockmarket crash.

14. We would like to stress the strength of Rothschilds' performance to balance the impression they gave during the termination procedures when they were operating as lead underwriter rather than our advisers. They were then under great pressure from the UK and the overseas underwriters. If they had put a foot wrong they were liable to be sued. Their relationship with us was broken off. In these circumstances Richardson was deeply unhappy, tense and far from his best.

15. For the future we hope we have removed this structural problem by separating the roles of financial adviser and lead underwriter. So far as PE are concerned, we would be happy to employ Rothschilds again as our advisers.

Slaughter and May

16. Again we went for experience and it paid off. Giles Henderson, who must be the most experienced City lawyer on privatisation, was supported by two other partners (Colin Hall and Mark Horton) also working full time, and they had a strong supporting cast. Their experience enabled us to guard against the weakness of Hoare Govett's contribution and, of course, they were our only adviser once termination procedures had started.

17. Good as they were, they were very heavily stretched by the complexities of the sale, and by the task they set themselves of combining all the overseas territories in one underwriting agreement, subject to UK law, rather than having several separate agreements. They were slow off the mark in putting sufficient resources into the marketing side, where the legal input to documentation is very important. Rothschilds thought that they were late in drafting some of the legal agreements, though Slaughters argued that this was because they had to wait for crucial policy decisions. Whatever the rights and wrongs here, it is crucial in any sale to be satisfied that all the legal agreements are coming along on time. This should be done either through the co-ordinating group or through a formal legal group, which Slaughter and May resisted in the BP sale against the wishes of Rothschilds.

18. We remain convinced that it is essential for a major sale, and particularly one with a large overseas element, to employ a major firm of solicitors with privatisation experience.

Hoare Govett and Wood Mackenzie

19. We appointed Hoare Govett as the lead broker, with Wood Mackenzie as number two. The appointment of two brokers is a good device. It does not add to costs as the agreed fee is divided between them. Subject to our approval, they then allocate the work between them. Particularly in dealing with potential institutional investors, there is more than enough work to go around on a large sale. The arrangement has the futher advantage that if one of the two is weak the other can be a counterweight.

20. Hoare Govett were very disappointing. Their team were affable but lacking in good leadership and in quality. Their strength is said to be in their placing power and their muscle, and had the sale gone ahead as planned this could have shown to advantage when the institutions were being encouraged to come into the tender. As it was, they did not have the chance to shine here and their performance was weak on the preparatory work. Richard Westmacott offered little by way of ideas and Robert Norbury of Wood Mackenzie was much more lively.

21. Although Hoares were helpful in providing additional broking facilities in Glasgow, they generally did badly in the recruitment of regional brokers. Those responsible disappeared on leave at the same time leaving a mess which Rothschilds then had to cope with (and here Richardson's broking background and general wide contacts were put to good effect). They dismally failed to complete their UK paying in arrangements in good order and to anticipate problems arising from the underwriting stick. This led to a formal complaint from Sir Peter Middleton (letter of 18 December). Rothschilds and Slaughters fiercely criticised them for this succession of failures.

22. As a result of their performance on BP, Hoares' appointment as brokers to the Water sale was re-considered and they lost the job in a beauty competition. In addition, their general standing seems to have slipped in recent months. It remains to be seen whether they will recover now they are 100% owned by Security Pacific and much more under their direct control.

<u>**Dewe Rogerson**</u>

23. They were responsible for PR advice and for flotation advertising (Saatchis did the corporate advertising). There is a worry that DR are too much a one man team - Tony Carlisle. But this said, they are very experienced, very committed and were always available to us.

24. But they had limited resources to deal with flotation advertising, and we were worried that they were overstretched; this pressure also put a strain on their abilities to handle the

PR side of the sale - the same staff were often coping with both jobs. Rothschilds thought that the standard of the newspaper adverts was below that of the TV adverts. We felt that they did not have the capacity to produce TV alternatives for us.

25. Thus, while we have no major reservations about their PR advice and their commitment, we would need to be convinced in future that they should take on flotation advertising as well. A better division for BP might have been DR for PR advice and Saatchis on both corporate and flotation advertising. But it would have been a bad mistake, and a recipe for rows and confusions, if we had brought in a third company to do flotation advertising.

The overseas advisers

26. Our lead advisers, jointly appointed with BP, for the four main territories were Goldman Sachs (US), Daiwa (Japan), Wood Gundy (Canada) and Swiss Bank Corporation (Europe). All were enthusiastic, Goldman Sachs notably so, and all gave us a very full commitment of their resources. SBCI gave us particularly good written advice.

Treasury

27. Our team was me; Mrs Brown (Grade 5); at Grade 7 Ms Leahy and Mr Bent (with some HEO(D) support); Mr Johnson EO; Mr Lyne (Price Waterhouse partner on secondment); Miss Huleatt-James (Deloittes manager on secondment).

28. Nearly all of us were already familiar with privatisation work and in several cases had been on privatisation teams before. This meant the responsibility could be more readily delegated. It enabled us to work with a relatively small team and free from a cumbersome organisation.

29. But we were working on this sale from March to October and for periods, particularly after the summer holidays, we were stretched to the limits. The sale turned out to be more complex than we had supposed. We were all continuing with work other than on BP, and this inevitably suffered to some extent when we had

to give BP priority. Had any of us fallen ill we would have been in a mess.

30. The decision to bring in Miss Huleatt-James from CA to work in support of Mr Lyne on the important and time consuming prospectus and related overseas documentation was very successful.

V. Sad

31. Although we pressed them hard EOG could not find us adequate clerical support until late in the day, by which time the sale documentation had suffered badly. In an exercise in which we were deluged with paper and badly stretched this was unacceptable.

32. The next sale to be run from PE will be a BT secondary which could be in June 1989. Some of our BP team will have moved on by then and we are bound to have a team with less breadth of experience. The BT sale may be less complicated if, as we currently understand, the company are not raising any money themselves at the same time. But it will still be a major undertaking to sell a company which in many way looks far less attractive than BP.

33. The lessons I would draw from BP experience for the BT sale are:

i. we must start in good time, as indeed we did for BP - certainly no later than January for a June sale;

ii. we must ensure that most key members of the team are free to concentrate virtually, or entirely, full time on the sale;

iii. we should again use one of the accountants on secondment to CA as well as Mr Lyne's successor;

iv. we must have adequate clerical support in place throughout the sale;

v. we should have a team of advisers who all have adequate privatisation experience in large UK and international sales. To the extent that we had to take on newcomers, or we were lumbered with lame ducks, Treasury resources will come under even more pressure than will be the case anyway. I repeat the point that we depend on the advisory team for an enormous amount of executive work in addition to the advisory function. We must be satisfied that they have the experience and the resources to carry this out.

35. We have already registered in our work programming returns, the need for more resources when the BT sale takes place. CA's planning takes account of the need to give us additional accountancy support when necessary.

DJLM.

D J L MOORE

BP - ORGANISATION STRUCTURE

Steering Group
(Chair: Tsy)

Co-ordinating Group
(Chair : NMR)

A	B	C	D	E
Prospectus (BP)	Overseas (Tsy)	Logistics (NMR)	UK Marketing (NMR)	Legal (S&M)
Prospectus Drafting BP	USA BP	Instalments NMR	Roadshows (UK) ~~BP~~ NMR	
Verification S&M	Japan BP	Post offer trading NMR	Advertising ~~NMR~~ DR.	
	Europe BP	Receiving Bank NMR	Financial PR NMR	
	Canada BP	Registration BP	SIO NMR	
	(Australia BP)	Fraud Tsy	Institutions (UK) NMR	
	Overseas roadshows BP	(Incentives NMR)		
		(Employees BP)		

26A/1/jno/4032

CONFIDENTIAL

FROM: MS P M LEAHY

DATE: 20 May 1988

1. MR D J L MOORE DJLM 20/5.

2. CHANCELLOR

Thanks. Content.

2. I am concerned that the MMC report, when published, will be critical of HMG for having allowed this situation to have occurred: i.e. either the issue should have been pursued, or the Bradshaw/Burden agreement should not have been terminated, or some other safeguard should have replaced the golden share. I should be grateful for DEn's advice on how this might be avoided [illegible] [illegible] relevant [illegible] the MMC [illegible].

cc
Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mrs Lomax
Mr MacAuslan
Mr M L Williams
Mr Hirst
Ms Wheldon - T Sol

BP/KIO: EVIDENCE TO THE MONOPOLIES AND MERGERS COMMISSION (MMC)

I attach, for information, drafts of Department of Energy and FCO evidence to the MMC. These are being put to Department of Energy and FCO Ministers tonight.

2. We have already commented on the drafts at official level. You will notice some duplication between the DEn and FCO papers. This is inevitable as the MMC asked the Departments to answer similar questions.

3. Paragraphs of particular relevance to the Treasury are;

(i) paragraphs ~~3.3~~ 3.5 of the DEn paper. This sets out the basis of the Government's relationship with BP and the reasons for the 1987 sale.

(ii) the last paragraph of the FCO paper. This discusses the possibility of a withdrawal of Kuwaiti investment from the UK. As you will see the FCO regard this as unlikely. We have not added in anything about the possible impact of this on the economy. EA division have suggested that the impact on the balance of payments would probably be manageable. Any significant disinvestment might however have an adverse impact on stock markets. It would be odd however for the Kuwaitis to precipitate a crisis as they would also be likely to suffer significantly.

4. The MMC have asked the Treasury (Mr Moore) to be available to give oral evidence on the morning of Tuesday 2 June when they take the DEn paper. The FCO paper will be taken that afternoon. You will recall that the MMC have been asked to report by the beginning of September.

P M LEAHY

CONFIDENTIAL: MARKET SENSITIVE

DRAFT 20/5/88: DEPARTMENT OF ENERGY MEMORANDUM TO THE MONOPOLIES AND MERGERS COMMISSION ON THE KUWAIT INVESTMENT OFFICE'S SHAREHOLDING IN BP

CONTENTS

NOTE

A few passages in this memorandum and its appendices contain information which is classified Confidential, either because it was provided to the Department on a Commercially Confidential basis or on grounds of sensitivity of source. The passages concerned have been clearly marked and the Department would be grateful it it were consulted before such material were divulged to any of the parties concerned.

CONFIDENTIAL: MARKET SENSITIVE

1. INTRODUCTION

(i) Overview

1.1 This memorandum describes the Kuwait Investment Office's shareholding in BP, HMG's attitude towards it and the background against which this has been formulated. Topics covered include the relationship of the KIO to the Kuwaiti Government, that Government's interests in the oil market, HMG's policy towards the oil market and how this differs from Kuwait's, and the manner in which Kuwait might, via the KIO shareholding, seek to influence BP in ways which would conflict with the company's commercial interests and HMG's policy for the oil sector.

1.2 The North Sea oil province, in which companies are constrained by HMG neither on production levels (beyond the requirements of good oilfield practice) nor prices, has been able to attract a very high level of UK and foreign investment. This has produced concomitant economic benefits for the UK in terms of contribution to the Gross National Product, to UK industrial investment (particularly in the offshore supplies sector) and tax revenue. In 1987, these amounted to around £10 billion, 12% and £5 billion respectively.

1.3 HMG believes that there are grounds for concern, described below, that the existing KIO shareholding in BP will affect the ability of BP, a company currently responsible for around a quarter of the UK's oil reserves and production, to continue to operate in a commercial manner and that this may have adverse consequences for the UK's national interest.

(ii) The importance to the Kuwaiti economy of oil reserves and production

1.4 Kuwait is a major oil producer for which oil is a significant component of the economy (most recent figures show that Kuwait's net oil exports account for about a quarter of GDP compared with 1% for the UK - the oil sector as a whole may account for as much as 50% of Kuwaiti GNP compared with 2% for the UK) and with significant national interests in oil production, distribution and in the wider market context within which these activities are carried out.

1.5 Kuwait's oil industry is controlled by a 100% state-owned holding company for both domestic and international oil-related activities, the Kuwait Petroleum Corporation (KPC). Ownership of all oil reserves is vested in the State. HMG's understanding is that although there is no barrier in Kuwaiti law which expressly forbids the involvement of foreign companies in the development of Kuwaiti reserves, there would be considerable practical obstacles to such a development. There is no effective way for a foreign company to buy shares in the KPC or its subsidiaries. (The general Kuwaiti attitude to foreign investment is indicated by the 1965 law providing protective tariffs and priority in Government contracts so that any Kuwaiti firm tendering to the Kuwaiti government is allowed a 10% margin over foreign competitors).

1.6 The original foreign shareholding in the Kuwait Oil Company, held by BP and Gulf, was bought out in the mid-1970s. The Aminoil concession was nationalised and compensation paid after international arbitration. Two foreign companies currently hold concessions in areas which are or used to be part of the Neutral Zone (Arabian Oil of Japan in the offshore Neutral Zone and Getty Oil in the Kuwaiti sector of the onshore Divided Zone, formerly part of the Neutral Zone).

1.7 The KPC, originally the Kuwait Petroleum Authority, was incorporated by Amiri decree in 1980 and is managed by a Board of directors under the Chairmanship of the Oil Minister, Shaikh Ali Khalifa al-Sabah, who is also a member of the Board of directors of the Kuwait Investment Authority to which the Kuwait Investment Office (KIO) is responsible. The KPC took over ownership of the previously separate national oil companies, including the Kuwait Oil Company (responsible for domestic production), the Kuwait Oil Tankers company, the Kuwait National Petroleum Company and the Petrochemicals Industries Company.

1.8 In world terms, Kuwait owns over 10% of known petroleum reserves (92 billion barrels), and was responsible for nearly 2% of total world production in 1987, or 1.1 million barrels per day (mb/d). (Up to the mid-1970s, Kuwait was producing between 2.5 and 3 mb/d. By 1980 it had curbed production to about 1.25 mb/d in order to preserve its reserves for the future)

1.9 By comparison, the UK Continental Shelf produced 2.6 mb/d in 1987, or 5.4% of the world total. UK proven reserves are of the order of 5.2 billion barrels or 0.6 % of the world total. BP owns (worldwide) about the same proportion of world reserves as the UK (around 5 billion barrels) and the company is responsible (with Britoil) for about 2.5 % of total world production (around 1.6 million barrels per day). In terms of transport capacity, BP has about 1.7% (4 mdwt) of total world capacity while Kuwait has about 0.4%. (1 mdwt)

1.10 On the UKCS, BP accounts for around 0.46 mbpd of production and Britoil for about 0.15 mbpd, i.e. about 24% in total. BP has around 1.7 billion barrels of UK reserves and Britoil around 0.4 million barrels, giving an aggregate figure of 2.1 billion barrels or 40% of proven and 22% of proven plus probable UK reserves. (The figures quoted in paragraphs 1.8 to 1.10 are the most recent available and are derived variously from the following: the BP Annual Report and Accounts 1987; the Britoil document issued in response to BP's bid; the 1988 Department of Energy "Brown Book"; the James Capel upstream database for 1987; and the 1988 IEA Annual Oil Market Report)

Kuwaiti downstream interests

1.11 The KPC has recently embarked on an extensive programme of downstream expansion in the US, Continental Europe and the UK via its marketing arm, Kuwait Petroleum International (KPI). This has at times been carried out via the KIO's acquisition of assets and the subsequent transfer of those assets to the KPC. An example of this was the KIO's purchase, in 1985, of the UK Hayes Group of companies. In October 1986 the KPC bought the Hayes group from the KIO. Subsequently, in April 1987, the KPC directly acquired the marketing arm of Ultramar plc (Ultramar Golden Eagle Petroleum Ltd) and later in 1987 the Nafta chain of petrol stations. The KPI's UK petrol stations are currently being rebranded under the "Q8" brand name. [**Confidential:** About 50% of Kuwait's UK sales at present is accounted for by distillate, DERV and gasoil.]

1.12 The KPC have also taken over Gulf's marketing operations in Denmark and Sweden, where they now have 20% of the market, and have expanded into Italy (also via Gulf) and the Benelux countries. They have plans to move into France, Germany and the USA.

1.13 The KPC strategy is eventually to run all their UK downstream companies through Kuwait Petroleum GB ltd. [**Confidential:** The KPC currently supplies 1,274 petrol stations in the UK (of which they own 58) giving them a current market share of 2-3% as against a declared target of 5%. By comparison, BP's existing share of the UK retail petrol market is 12%.]

1.14 In a recent speech, the President of KPI, Mr Nader Sultan, stated that the KPI was keen to continue its policy of "aggressive expansion" to increase its downstream markets in Europe and elsewhere, but that as result of the limits on Kuwaiti production imposed by OPEC quotas, he did not foresee output exceeding its current level of around 1 m b/d. Future plans for downstream expansion would therefore have to involve the acquisition of additional manufacturing facilities. **(Appendix 4)**

1.15 During a press briefing given by the Kuwaiti Oil Minister, Shaikh Khalifa, in December 1986, he said that as a country with an integrated upstream and downstream capacity, Kuwait was better able than other OPEC members to cope with the adverse effects of the OPEC fixed price system. Other member states not in this position could come under great pressure.(**Appendix 4**)

1.16 Shaikh Khalifa also explained that Kuwait exchanged North Sea oil for its own production in order to improve the economics of certain of its European refineries. In September 1987, in a statement to the Kuwaiti paper al-Qabas, Shaikh Khalifa said that Kuwait had had to resort to purchases in the spot market to supply its European refineries as a result of its "respect for its obligations and duties towards OPEC". On the same occasion, the Assistant Managing Director for Supply at the KPC said that the KPC was buying 120,000 bpd of North Sea crude to supply its refineries at Rotterdam and Golfhavn in Denmark, and "Kuwait could supply KPC with these quantities instead of buying them from the North Sea or elsewhere but refused to do so in order not to exceed its quota."(**Appendix 4**)

1.17 It is clear that Kuwait has a continuing interest in the expansion of its downstream interests. In this respect, it is of interest that BP is an integrated producing and marketing company with substantial downstream assets. BP's results for 1987 show that 70% of turnover was accounted for by refining and marketing (i.e. "downstream") activities. BP's total world-wide refining capacity is almost three times Kuwait's, at around 2 million barrels per day or 2.7% of the world total, compared with Kuwait's of 0.7 million barrels per day or 0.9% of the world total. [**Confidential:** BP has around 10% of the UK's total refinery capacity. At present Kuwait has no interests in the UK's refinery capacity.]

Kuwaiti Upstream Interests

1.18 The KPC has also been expanding its foreign exploration and production activities to complement its extensive overseas downstream assets. The KPC's upstream activities are divided between Santa Fe (a wholly owned US subsidiary acquired in 1982) and the Kuwait Foreign Petroleum Exploration Company (KFPEC). The KFPEC is responsible for Kuwait's oil production interests in developing countries and has large interests in Egypt and Indonesia.

1.19 Santa Fe's production capacity is largely concentrated in California and the Gulf of Mexico. However, it does have a presence on the UK Continental Shelf where it holds interests in 24 offshore production licences, including shares in 2 producing fields - Thistle and Deveron. These fields are operated by Britoil (now owned by BP). [**Confidential:** Santa Fe's share of North Sea production amounts to about 10,000 barrels per day.] Santa Fe has interests in 7 UK onshore production licences, following the acquisition of Denholm Exploration in 1987. Santa Fe also has a significant interest (just under 12%) in the UK Miller field, operated by BP, which is currently in the planning stages.

1.20 Naturally, the Government of Kuwait takes an interest in those North Sea fields in which it has a stake. For example, in a recent speech to the Conference on Cash and Futures in New York, Shaikh Ali Khalifa expressed satisfaction that the "very painful process of removing the fat" from companies' exploration and production budgets had resulted in a substantial reduction in the estimated development costs for the Miller project. **(Appendix 4)**

(iii) Kuwaiti policy with regard to the world oil market and how this has differed from that of the UK

1.21 Kuwait, unlike the UK, is a member of the Organisation of Petroleum Exporting Countries (OPEC). OPEC describes itself as

> "A permanent intergovernmental organisation created at the Baghdad Conference of Sept 10 -14 1960 by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. Its objective is to co-ordinate and unify petroleum policies among Member Countries in order to secure fair and stable prices for petroleum producers; an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on capital to those investing in the industry."

1.22 At present the organisation comprises the five founding members, plus eight other full members; Qatar, Indonesia, Libya, the United Arab Emirates, Algeria, Nigeria, Ecuador and Gabon. As circumstances dictate, OPEC operates by means of agreement on production quotas which are then observed with varying degrees of rigour by individual members. Saudi Arabia has been prominent in recent years as swing producer, i.e. disproportionately reducing production, compared with other members, in order to support prices. Kuwait, among others, has found itself under consistent pressure from other members over recent years to trim its output in support of prices.

1.23 There are divisions of various sorts within the organisation, one being between the arab members and the rest. Another is between countries such as Kuwait with very high reserves, in relation both to population and current production, and other member states such as Indonesia and Algeria with far lower reserve ratios.

1.24 Both in 1973 and 1979, OPEC took advantage of the rise in oil consumption throughout the industrialised world to increase oil prices dramatically. Higher oil prices encouraged the development of non-OPEC sources of supply and also reduced world-wide oil demand. In turn, this had the effect of sharply reducing OPEC's market share. The prospect of a continuing reduction in OPEC market share exacerbated the division between countries such as Saudi Arabia and Kuwait with extensive reserves, which felt they were unfairly bearing the brunt of the fall in demand for OPEC oil, and the others. During a press briefing (**Appendix 4**) given by Shaikh Ali Khalifa in December 1986, he said that the Gulf members of OPEC had taken more than their fair share of production cuts in 1983/84. The Gulf states had as a result been forced to readjust the balance, so precipitating the 1986 falls in the price of oil.

1.25 In the early 1970s, the UK imported virtually all of its oil from OPEC sources. Difficulties began when Libya (an OPEC member) cut back oil production and caused a large increase in prices. Kuwait was the first among the Gulf states to follow suit and an OPEC resolution was subsequently passed demanding further price increases.

1.26 During the 1970s, the distinction betwen the Arab members of OPEC and the others became more important. The Arab - Israeli war of October 1973 saw the imposition of an arab oil embargo. The UK was assured by the Arab Governments of "preferred customer" status (in contrast to the USA and other customers thought to be more favourably disposed towards Israel) but actual supplies reaching the UK did not reflect this. In May 1979 the Organisation of Arab Petroleum Exporting Countries (OAPEC) threatened to suspend or reduce crude oil supplies to any developed country which refused to buy arab refined products.

1.27 Kuwait's attitude during the early 1970s was in many respects more hostile than that of its OPEC partners. Kuwait chose to impose production cuts from a baseline 250,000 barrels per day lower than that prescribed by OPEC. Kuwait was then the first OPEC country to decide not to redistribute the oil held back as a result of the embargo, aimed at the USA and the Netherlands, amongst the non-embargoed importing countries.

1.28 Subsequent OPEC cuts prescribed that exports to "friendly" countries should not be reduced below their average levels for the first 9 months of the year. Kuwait failed to nominate any "friends", and insisted that the oil companies supply all previous customers "without discrimination" - i.e. breaching the OPEC guidelines to the detriment of all importing countries including the UK.

1.29 Kuwait's attitude to the UK was thus initially noticeably less helpful than that of other major producers such as Saudi Arabia and Abu Dhabi. [**Confidential:** This was the case despite approaches at high level from HMG reminding Kuwait of the close and friendly relations between the two countries and the various practical ways in which the UK had supported Kuwait over the years.] Eventually, Kuwait changed its position and instructed the oil companies to send their "full contract volume" of oil to certain countries including Britain.

1.30 As the UK became an oil producer in its own right, the question of introducing a special pricing regime for UK oil was considered and rejected by HMG. Recent UK government policy has been that the oil companies are themselves best placed to make decisions on exploration and production levels on commercial grounds and that the price of oil should not be set by governments. The Government believes that the UK national interest, as both producer and consumer of oil, is best served by allowing a free market in oil to operate on the UKCS.

1.31 OPEC member states have, over the years, sought to influence other producing states, including the UK, in favour of controlling production as a means of maintaining the world price of oil at levels consistent with the interests of OPEC producers. HMG's position, in common with most Western Governments, is that questions of production and pricing should be left to the market. It is this view which underpinned the Government's policy of disengaging from detailed intervention in North Sea developments via the British National Oil Corporation, whose equity oil interests were privatised in 1982 as Britoil plc and whose trading functions were wound up and residual agency functions transferred to the Oil and Pipelines Agency in 1985.

(iv). The KIO - history, relationship to the Kuwaiti Government, investment policy and recent activities elsewhere in the world

1.32 The Kuwait Investment Office is an organisation which invests on behalf of the Kuwaiti Government. It is responsible to the Kuwait Investment Authority (KIA), established by Kuwaiti Law 47 of 1982 as

> "a public authority of independent nature ... to be attached to the Minister of Finance... The aim of the authority will be to take up the management and investment, in the name of Kuwait and to her account, of the state reserve."

The KIA is run by a Board of Directors, headed by the Minister of Finance, and including the Oil Minister, Shaikh

Khalifa. The KIO describes itself as a Department of the Government of Kuwait.

1.33 The KIO has extensive investments in many parts of the world. In the USA, it has shareholdings of 2 to 3 % in three US oil companies; Atlantic Richfield, Conoco and Phillips. It also owns 100% of the small Andover oil company. The KIO has a 24% shareholding in the German Hoechst chemicals company. Among other countries in which the KIO has significant investments are Singapore, the Netherlands, Belgium, Italy, Luxemburg, Greece and Spain.

1.34 Recent Kuwaiti policy has been to extend its portfolio of investments in Western Europe, with particular emphasis (via the KPC) on the downstream oil and petrochemicals sector. In the UK, the KIO has stressed the passivity and long-term nature of their investments, and in particular the shareholding in BP.

1.35 The recent history of KIO investments in Spain is of interest in this regard. KIO activity in Spain has included a hostile takeover bid for Spain's largest sugar company (Ebro) and a variety of investments in the industrial and commercial banking sector, leading to public discussion by the Spanish government of the possibility of new legislation ensuring that individual investors cannot purchase more than 15% of the share capital of the Spanish commercial banks. (see **Appendix** 1)

1.36 The Spanish experience is relevant to the KIO shareholding in BP in a number of ways. Firstly, it is an example of the emphasis, in recent Kuwaiti investment decisions, given to the acquisition of downstream outlet companies, whether in the chemical, explosives or refining sectors. BP has, too, extensive oil processing and marketing assets.

1.37 Secondly, it affords examples of the way in which the KIO, in practice, has sought to influence the policy of companies in which it has a shareholding. These include: encouraging the sale or merger of corporate assets against the will of existing company management (ERT); using a significant shareholding as a lever to obtain board representation (ERT, Banco Central); calling an Extraordinary General Meeting in order to overturn existing management policy (Banco Central); the rapid sale of a shareholding despite a declared policy of long-term investment (Banco de Vizcaya); and a hostile takeover bid (Ebro). (**Appendix 1**)

1.38 [**Confidential:** Other recent KIO investments abroad include a 20% stake in Hong Kong's Dao Heng Bank, acquired in 1984 and more recently raised to 44%. Since being a shareholder, the KIO has been represented on the boards of both the Dao Heng holding company and the bank. After the KIO's shareholding was raised to 44% in 1987, Mr Faoud Jaffar (Deputy Chairman of the KIO) was elected Deputy Chairman of both companies and the KIO is now consulted on all major policy matters and transactions.]

1.39 In general, it is clear that the KIO is prepared to take any action it deems appropriate if a company in which it has a controlling shareholding is perceived as not acting in the KIO's interests. This accords with the recent comments of Mr Faoud Jaffar on UK television. **(Paragraph 1.45)**

(v). The build-up of a KIO shareholding in BP

1.40 The Kuwait Investment Office (KIO) began purchasing shares in BP after HM Government's offer for sale in October 1987. On 19 November, when the KIO's holding stood at just over 10%, the Prime Minister was questioned about it in the House by the Leader of the Opposition and said that it was not surprising that there should be a considerable number of overseas investors in BP. At various times since then, concern has been expressed in Parliament over the shareholding. Copies of the relevant extracts from the Official Report are attached at **Appendix 3.**

1.41 Since November, as the KIO stake rose above 10% and rapidly approached 20%, UK Ministers have several times impressed on the Kuwaiti authorities their concern at the increasing size of the Kuwaiti holding in BP. As Ministers have informed Parliament (see **Appendix 3**), the Kuwaitis have assured HMG 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.

1.42 In further discussions, the Kuwaiti authorities indicated [**Confidential:** that they would consult HMG if they were contemplating any significant disposal of their shareholding and] that, although it was their long-term intention to work towards board representation, they did not intend to seek a seat on the BP board <u>for the foreseeable future.</u>

1.43 However, on the crucial question of the size of the shareholding and the ability this confers on the KIO to influence BP, the Kuwaitis have not addressed Ministerial concerns. The Kuwaiti authorities have consistently maintained that they could give no undertakings on the level of the shareholding which were not required by law. HMG's understanding of the Kuwaiti position has been that they could not accept that a shareholding at current levels was too high and that although a limit below 29.9% might be contemplated, a 25% holding was necessary to protect Kuwaiti interests. If the matter were eventually referred to the MMC, they would use all means legally available to protect their shareholding, including the invocation of sovereign immunity.

1.44 On 11 March, the KIO made a public statement that it had acquired an interest of 21.25% in BP, and that it would be increasing the stake to approximately 22.5%. Later the same day, the KIO announced that it did not intend to take its stake beyond 22.5%, and repeated that it looked on its stake in BP as a long-term holding and that it did not propose to seek representation on the BP Board.

1.45 On 13 March, during a television interview, the Deputy Chairman of the KIO, Mr Faoud Jaffar, reiterated the KIO's intention not to go above 22.5% but said that this could alter if the situation changed. He said that if the KIO felt that the management of BP were acting contrary to the interests of shareholders, the KIO would have to look at the situation and take a decision at that time, but the KIO had every confidence in the management of BP and so this was hypothetical and unlikely. If there were cooperation between BP and the KPC, this would not be as a result of the KIO stake in BP but because there was some industrial and commercial logic for it.

2. Kuwait's ability, via the KIO shareholding, to influence the affairs of BP

2.1 The KIO shareholding in BP currently stands at just under 22%. This is more than ten times greater than the next largest single shareholding in BP. The voting record at recent General Meetings of BP shows that the number of shares actually voted has typically amounted to around 10 - 15% of the total ordinary shares in the company. It is not yet known how the pattern of attendance and voting at General Meetings will settle following the disposal of HMG's remaining shares. But a 22% share of the equity places the holder in a strong, and possibly commanding, position at General Meetings.

2.2 Such a shareholding would enable the KIO to influence the policy of the company either by blocking resolutions at shareholders' meetings or by convening such meetings and then carrying motions unwelcome to the BP board. The KIO is in a position to use its voting strength to remove existing Directors from the Board and, if it so wished, replace them with its own nominees. Recent experience of KIO investments in Spain is relevant (**Appendix 1**). Even if BP could successfully mount a defence on the first few occasions the KIO chose to attempt to influence a General Meeting, it is doubtful whether sufficient votes could be mustered indefinitely. An outcome involving an accommodation with the KIO would be quite likely in these circumstances.

2.3 If the KIO achieved Board representation, this would considerably reinforce the position described in the previous paragraphs, and substantially alter the character of the BP Board and the way it was perceived by customers, suppliers and the market.

3. The manner in which Kuwait might wish to influence BP, and the possible consequences for the company and the UK

(i) The Perception of the Company in the marketplace

3.1 The UK Government's policy towards the oil sector is that oil companies should be free to operate in a commercial manner in response to market conditions. In this context, BP's policy has been that of any commercial organisation, i.e. to maximise its return on investment in the long term.

3.2 The policy of the Government of Kuwait, however, is likely to be influenced by a wide variety of non-commercial pressures. Their interest is in maintaining oil prices at a level consistent with Kuwait's long-term national advantage. There is therefore a real possibility that Kuwait will seek to influence the policy of BP in directions different from those the company would have pursued for commercial reasons.

3.3 HMG had a significant shareholding in BP for many years and had special powers over the company. BP was however always managed and operated as a private business enterprise. The basis of the Government's relationship with BP was a contract signed in 1914 between HMG and BP and the company's Articles of Association. The Bradbury and Bridges letters of 1914 and 1951 respectively (copies attached at **Appendix 5**) made it clear that HMG had no intention of intervening in the administration of BP as a commercial concern. Successive Governments re-affirmed that intention. The 1914 agreement was terminated when HMG disposed of substantially all its shareholding in the company in late 1987. The Articles of Association were changed at the same time.

3.4 The decision to sell HMG's holding in the company was taken on the basis that it was no longer appropriate for HMG to retain shareholdings in private sector companies. It was part of the Government's policy of selling residual shareholdings as and when the circumstances of the companies and market conditions permit. Moreover the decision to sell the shareholding had the benefit of putting it beyond doubt that the company was free to operate in a fully commercial manner. BP welcomed the Government's decision when the sale was announced.

3.5 KIO's shareholding in BP is held on behalf of the Government of Kuwait. Investment on a substantial scale by a foreign Government has therefore nullified one of HMG's aims in disposing of its own shareholding in BP. Not only has a potentially dominant Government shareholding been reintroduced, but in this case the Government is that of an OPEC member state. This is almost certain to have an impact on the perception of the company by prospective suppliers, customers and partners and to cast renewed doubt on BP's ability to behave as a commercial organisation. The identity of the Government concerned is also a potential influence on the way BP is regarded by other foreign Governments in parts of world in which, hitherto, it has operated unhindered.

3.6 [**Confidential:** Even without any overt pressure having been exerted by Kuwait on the company, there is already some evidence that prospective partners in other countries are viewing potential business arrangements with BP in different light. (**Appendix** 2)]

(ii) Ways in which Kuwait might seek to influence BP

Disposals of Kuwaiti oil via BP

3.7 At some future date, Kuwait may wish to increase disposals of its own oil, beyond the capacity of its existing refining and marketing system. Under these circumstances, the KIO might seek to induce BP to increase the usage of Kuwaiti crude in BP refineries and/or other downstream facilities, so displacing BP's own production or alternative cheaper sources of supply which BP would otherwise have contracted.

3.8 This would have a clear adverse impact on BP's ability to take decisions in a commercial way, and hence on the company's ability to plan sensibly for the future.

Transfer of BP downstream assets to Kuwait

3.9 Given Kuwaiti ambitions to expand further downstream, it also possible that at some stage BP might be encouraged to dispose of part of its refining and marketing network to the KPC or another arm of the Kuwaiti government, under circumstances where this was not in the best commercial interests of the company. Kuwait would thereby further increase its ability to influence the oil market both upstream and downstream.

Utilisation of BP production in Kuwaiti downstream faciltities

3.10 Another option for Kuwait, if existing constraints on its own production were to be maintained, would be to divert some of BP's production into its own downstream system rather than purchasing North Sea crude on the open market as at present. The Kuwaiti Oil Minister, Shaikh Khalifa, in a recent speech to the Conference on Cash and Futures in New York, said that although Kuwait had the capacity to produce much more oil than it did, it often bought other countries' crude oil, including some from the North Sea, to use in its refining and marketing outlets. (**Appendix 4**) There would be clear advantage for Kuwait if it were able to obtain some or all of these extra supplies from BP under favourable terms not available to other consumers. Under such circumstances, BP's ability to treat all its customers in a uniform commercial manner would be seriously compromised.

Kuwaiti influence over levels of BP production, exploration and development

3.11 BP (including Britoil) accounts for about a quarter of oil production and a similar proportion of reserves in the North Sea. Given the history of OPEC's efforts to persuade other producing countries to support, via production controls, world oil prices favourable to OPEC members' domestic circumstances, conditions may occur in which Kuwait would attempt, on her own account or under pressure from fellow OPEC members, to constrain BP's oil production in the North Sea (or elsewhere) at non-commercial levels.

3.12 It is relevant that BP, in common with most other major oil companies operating on the UKCS, exploits its UK licensed acreage in consortia with many other companies, governed by joint operating agreements. Kuwaiti influence over BP's exploration and development policy would therefore have immediate repercussions for many of BP's partners in the North Sea.

3.13 Kuwaiti influence over BP's activities in the North Sea could be exercised in other ways. One of these would be to influence the pace of current exploration and development activity via extensions of the "off-season" for North Sea work. [**Confidential:** HMG has in fact received recent approaches from both Saudi Arabia and Oman requesting this sort of extension.] Another would be to reduce the size and scope of BP's future exploration and development programme, which would have serious effects on the company's future levels of oil production. Either development would also have considerable adverse effects on UK revenues in the medium and long term.

3.14 Any of these circumstances could have serious commercial effects on BP. The Government is also, however, concerned that the UK's policy of encouraging oil companies operating on the UK Continental Shelf to behave in a commercial manner, free from Government interference, is likely to be thwarted by the influence, over a company with about a quarter of UK output under its control, of a foreign Government with quite different national aims and which controls 10% of the world's oil reserves.

Kuwaiti attitudes to the North Sea

3.15 Several recent public statements by Kuwaiti Ministers demonstrate the Kuwaiti attitude towards the North Sea (**Appendix 4**). In February 1986, in a UK television interview, Shaikh Khalifa called on the UK to cut its North Sea output by more than 300,000 bpd as part of a global effort to stabilize the oil price. At that time, Shaikh Khalifa's view was that OPEC alone would be unable to stabilize oil prices without the cooperation of countries such as the UK. In response to questions, Shaikh Khalifa said that he did not accept that HMG would find difficulty in cutting back oil production because of the UK's policy on the operation of a free market in oil. In his view, some of the cut-back at least should be absorbed not by the Government via reduced royalty in kind, but by the oil companies operating in the North Sea. This is, of course, directly opposed to established UK policy.

3.16 In April 1986, Shaikh Khalifa held a press conference during which he expressed the opinion that the oil price fall had so damaged the North Sea that he was no longer concerned to continue the attempt to influence UK government policy. He expanded on this theme in May during an interview with the Kuwaiti newspaper al-Anba, when he said that the effects of lower oil prices on non-OPEC exploration and production has been "very good" and "much greater than expected". Shaikh Khalifa expressed the view that the UK was only harming itself by its continued refusal to participate in stabilizing the oil market. By August, he was of the view that "North Sea oil is something we do not have to worry about for too long a period. Production is already declining." He believed that Department of Energy figures on reserves and future production levels were optimistic and that Britain's role as a net exporter would decline dramatically in the early 1990s. (**Appendix 4**)

3.17 The North Sea is an important contributor to competition in the world oil market. As has been indicated above, it cannot be assumed that it will always be in Kuwait's interests for the North Sea to continue as a significant oil producing province for the forseeable future, whereas it is definitely in the UK's interest that this should be so, as is likely to be the case if current policy in the North Sea is maintained. The UK's continuing independence from OPEC pressures of the kind experienced in the 1970s would be threatened by a Kuwaiti ability to influence the exploration, development and production policy of a company which owns a quarter of the UK's own oil reserves.

3.18 There are also wider implications. Since the UK became technically self-sufficient in oil in 1981, the kind of dependency on Middle Eastern sources of production which existed at the time of the oil crisis of 73/74 has not existed. In the longer term, as production from the North Sea declines, such dependency might begin to arise again. If Kuwait were subsequently to emerge as a major influence over one of world's largest oil companies (and the UK's largest company of any sort) with extensive downstream assets, it would be in a position to exert an even tighter control, both over BP's sales of oil to the UK and elsewhere and on the UK's raw material costs (via the oil price) than was the case in the early 1970s. For a Gulf oil state with 10% of the world's reserves to be in a position to influence about 25% of UK reserves during this period could have serious consequences for the UK.

(iii) BP's tanker fleet

3.19 BP's tanker capacity is four times the size of that of Kuwait. The opportunity to influence the deployment of BP's tanker fleet could be of use to Kuwait in a variety of circumstances. [**Confidential:** BP has, for example, been involved in certain export deals between HMG and other Middle Eastern countries where payment for UK goods has been made via bartered oil, transported in BP tankers.]

3.20 Kuwait's attitudes to barter deals is revealed in comments made by Shaikh Khalifa to the press in December 1986. "We in Kuwait have conistently refused to make barter deals. I hope they will be eliminated." Knowledge of or influence on BP's involvement in this type of operation could therefore be seriously damaging to the company's reputation as an impartial participant in such deals in the future.

(iv) HMG's confidential exchanges with oil companies on contingency planning arrangements.

3.21 HMG maintains contacts with BP and other oil companies on contingency plans for times of crisis, including blockade in time of war. BP is one of the main companies holding UK national emergency stocks (an EC requirement). It is also one of the leading companies with which the Government liaises regularly on the Oil Industries Emergency Committee, which is concerned with planning for war-time. BP is very actively involved in such planning and involvement in or detailed knowledge of its affairs by a foreign Government could seriously impair the company's future ability to maintain this role.

4. Conclusions

4.1 This memorandum has described the way in which Kuwait, via the existing KIO shareholding in BP, is in a position to influence the policy of the company in a variety of direct and indirect ways.

4.2 Kuwait's interests as an Arabian Gulf oil producer and OPEC member have been described, along with the contrasts between Kuwaiti and UK oil market policies. In particular, the Kuwaiti aim of supporting oil prices via production controls has been highlighted and compared with HMG's policy of allowing companies the freedom to choose commercially sensible levels of production in the context of market prices.

4.3 Kuwait's interest in the North Sea as a competing oil province has also been described, and a number of ways in which Kuwaiti policy might lead to pressure on BP to take decisions on non-commercial grounds with adverse consequences for the UK.

4.4 The memorandum has been drawn up on the assumption that the Kuwaiti regime will remain broadly similar in outlook for the foreseeable future. If this situation were to change, for instance in the direction followed by Iran since the overthrow of the Shah, the Government's fears over Kuwait's potential influence on BP's policy would be even greater.

4.5 In summary, the Government's view is that the present KIO shareholding in BP affords Kuwait the ability materially to influence the policy of BP and that Kuwait may be expected, in due course and as circumstances dictate, to use this ability in ways consonant with its own national interest, to the detriment of the North Sea as a source of competitive pressure in the world oil market, and in conflict both with the commercial interests of BP and the national interests of the UK.

4.6 It is therefore the Government's view that the KIO shareholding, at its present level, is against the public interest and that appropriate steps should be taken to reduce it to a level at which Kuwait's ability to influence the company is no longer on a different scale from that of BP's other shareholders.

APPENDIX 1

Recent KIO investment policy overseas

(i) KIO investment in Spain began in 1981 in the paper marketing industry. The KIO acquired controlling interests in two paper companies, Papiera Riera and, in 1984, Incapsa.

(ii). However, the KIO has become very much more active over the last 18 months, and its Spanish investments have grown from $ 0.4 billion to $ 2.4 billion over this period. In August 1986, the KIO took a 24% stake in Torras Hostench, the second largest Spanish paper maker. Stakes were also acquired in a number of Spanish property companies at the same time.

(iii) In October 1986, the KIO acquired a 5% share in Banco Central, Spain's largest commercial bank, so becoming the largest single shareholder in the bank. Banco Central itself already possessed a 15% stake in Spain's largest private oil refining company Cepsa.

(iv) In June 1987 the KIO made an unsuccessful attempt to purchase 15% in Cepsa directly, which would have given them Board representation.

(v). In July 1987, Torras took a 20% interest in Union Explosivos Rio Tinto (ERT), a leading Spanish chemicals group. To finance this purchase, Torras made the largest ever Spanish rights issue, which was undersubscribed. The KIO itself acquired the residuum, so taking its stake in Torras to 37%. This was subsequently raised to 45% by direct purchase. Torras then became the principal route for further KIO investments in Spain.

(vi). The KIO acquired a 22% stake in S A Cros (another chemicals company), stakes in two commercial banks (including 2% in Banco Central), and in Empresa Nacional de Celulosas (another paper company), as well as a media company and (in what is reputedly Spain's first hostile takeover bid), in the sugar company Ebro. A meeting between Ebro and the KIO allowed a truce in the takeover proceedings but the KIO appear to have restarted purchases.

(vii) Having established Torras as the principal route for further Spanish investments, the KIO turned its attention to reorganising ERT by selling off its explosives division and merging its fertiliser operations with S A Cros.

(viii) This was not welcomed by the ERT Chairman and a public battle ensued, which was finally resolved when ERT's creditor banks switched their support to the KIO and the Spanish Government reportedly applied pressure on ERT to acquiesce. The result was that board representation at ERT was agreed for Cros representatives. A special committe of ERT has now been formed to consider hiving off the defence divisions of the company as a separate entity.

(ix) Despite the KIO's familiar posture as a long-term investor, KIO/Torras then began to sell off certain acquisitions. In October 1987, after only 3 months ownership, Torras sold its interest in Banco de Vizcaya and at the same time the KIO sold a long-standing 30% holding in a Spanish hotel chain.

(x) At the end of last year, the KIO and the Spanish construction group Conycon set up a holding company, Cartera Central, (48.8% KIO owned) to administer the KIO holdings in Banco Central.

(xi) Conycon obtained 5.25% of the bank's stock; the KIO already had a direct investment of 4.95% and a further 2% via Torras, producing a combined stake of over 12%. This enabled Cartera to press legally for Board representation.

(xii) Banco Central opposed this, claiming that only 1% of Cartera's holding had been registered in time for the EGM which was called to consider the matter and that the KIO had reneged on an earlier undertaking to give the bank first refusal if they disposed of their interest (This is an arguable point as the KIO could claim that an intra-group transfer had taken place rather than a sale). In the event, Cartera obtained four representatives (all Spaniards) on an enlarged 22-man Board.

(xiii) The Spanish response has been to attempt to tighten up the banking legislation by introducing a new Banking Bill. This would give the Bank of Spain the right to block anyone seeking more than 15% in a commercial bank.

CONFIDENTIAL: MARKET SENSITIVE

APPENDIX 2

Recent BP experience overseas

(i) [**Confidential:** In Japan, it is believed that a potential oil sector partner of BP's has become concerned at the prospect of entering a joint venture with BP if BP's policy may in some way be influenced by a Middle East shareholder.]

(ii) [**Confidential:** Similar considerations arose in Venezuela, where BP encountered difficulties in confidential discussions with the state petroleum company PDVSA partly as a result of the Kuwaiti shareholding. The shareholding was regarded by the Venezuelans as an unhelpful factor in negotiations with BP.]

(iii) An area of particular sensitivity for BP is the USA, where Santa Fe encountered problems over licences to develop federal land, after being taken over by Kuwait. Given that BP's US holdings are largely in Alaska, whereas the KPC's US assets are in the remainder of mainland USA, there is a good fit between the two, illustrated by the 1982 joint exploration agreement between Standard Oil (operators of the Alaskan holdings acquired by BP in 1987) and Santa Fe, subsequently acquired by the KPC. Collaboration between the two companies following the KIO's acquisition of a controlling interest in BP could serve to deepen suspicion further in the USA and lead to commercial difficulties for BP on other fronts.

(iv) A substantial Kuwaiti Government shareholding in BP might, for instance, lead the US authorities to invoke legislation (designed to protect strategic assets) against BP's North American holdings. BP's ability to borrow in the US market may also be affected. The KIO shareholding in BP has recently been raised in Congress where it was given as an instance of foreign investment for which, it was argued, registration should be required. Possible KIO interest in Texaco may also raise the profile of the shareholding in BP with adverse consequences for the company.

(v) Potential difficulties in the USA could have serious commercial consequences for BP given the company's extensive holdings there. Even were litigation against BP to be unsuccessful, as in the Santa Fe case, a protracted legal battle of any sort in a region which accounts for 32% of turnover and 23% of profits would be very serious.

(vi) The long-term consequences for BP, which operates in more than 70 countries world-wide and has more than half its assets overseas, of a mistrust of a company potentially under the control of the Kuwaiti government, are potentially serious.

CONFIDENTIAL: MARKET SENSITIVE

APPENDIX 3

PARLIAMENTARY EXCHANGES ON THE KIO SHAREHOLDING IN BP

Received from PB 22/2.88

on average families in order to provide more. Every service will have to live within a budget and, because of our rate of growth, we have been able to make increasing provision for the Health Service. As we have a record rate of growth this year—much bigger than growth in the rest of the European Community — there will be increased provision for the Health Service next year of about £800 million. That was previously announced by my right hon. Friend.

Q3. **Mr. Patrick Thompson:** To ask the Prime Minister is she will list her official engagements for Thursday 19 November.

The Prime Minister: I refer my hon. Friend to the reply that I gave some moments ago.

Mr. Thompson: Will my right hon. Friend find time during her busy day to take note of the fact that the figure for those out of work in my constituency of Norwich, North has fallen by over 15 per cent. during the last 12 months? Bearing in mind that in Norwich and the surrounding area there is still a shortage of skilled manpower, will my right hon. Friend and her colleagues press on with programmes that give more emphasis to training and to incentives to work, such as those announced yesterday by the Secretary of State for Employment in his excellent statement?

The Prime Minister: I am sure that most hon. Members are delighted with the reduction in the unemployment figure, which has fallen by 445,000 over the last year. That is very welcome. I agree with my hon. Friend that the new training programme announced by the Secretary of State for Employment is excellent and will help many more people to get jobs as more and more people in our work force will require an increasing number of skills.

Mr. Kinnock: Clearly, everybody is glad about any fall in unemployment. We have only 2 million more to go and we shall be back where the Prime Minister started in 1979. Up to 45 per cent. of Jaguar, 20 per cent. of Rolls Royce and 15 per cent. of British Areospace have been bought by foreign interests. Now that 10 per cent. of BP has been bought by the Kuwaiti Government, will the Prime Minister tell us whether this is what she meant when she talked about encouraging wider share ownership?

The Prime Minister: As our own overseas assets, including portfolio investments, are very considerable and contribute enormous sums to our balance of payments, I would hardly think that the right hon. Gentleman would want to do without them. Moreover, as British Petroleum owns many assets and oilfields overseas, it is not surprising that there should be some international investment in BP.

Mr. Kinnock: The claims that the right hon. Lady makes for returns on overseas investments constitute less than half of the deficit that she has run up on manufacturing trade. She should put the matter in perspective. If the idea of Kuwaiti Government involvement in British Petroleum is so good, will she tell us why she has not taken 10 per cent. of the shares, or must we rely on the Kuwaitis to nationalise BP again in order to give it proper security?

The Prime Minister: The right hon. Gentleman's questions are absurd. BP has great international assets, thank goodness. It is not surprising, therefore, that there should be a considerable number of overseas investors in BP. That is good. It seems to me that the right hon. Gentleman forgets that this is a global economy and that there is global trade. He wants to treat this country as some sort of Albania.

Mr. Kinnock: The Prime Minister knows a great deal more about the Albanian form of government than I do. I am glad that she is delighted about the strength of BP. Does it strike her as ironic that it used to be British strength in BP, and that now it belongs to everybody else? When will she stop re-flagging Britain?

The Prime Minister: It is because I am aware of the kind of government and attitude in Albania that I accuse the right hon. Gentleman of it.

Dr. Michael Clark: During her busy day will my right hon. Friend find time to study the Central Electricity Generating Board's statement, recommending that, when privatisation takes place, electricity generation should be kept together as a whole and controlled by the board? Does she further agree that, when privatisation takes place, there should be competition in generation and that, whatever it might cost to break up generation, the savings would be far greater than any costs?

The Prime Minister: I am aware that there will be many representations before the Bill on electricity privatisation is presented to the House in the next Session. I think it would be best to wait and see what that Bill contains, but my right hon. Friend the Secretary of State for Energy is very interested in the representations being made.

Mr. Maclennan: Will the Prime Minister say — *[Interruption.]*

Mr. Speaker: Order. The hon. Gentleman has not yet asked a question.

Mr. Maclennan: Will the Prime Minister say what contingency plans she has to protect the economy in the event of the United States authorities failing to agree measures to deal with their deficit problem? In particular, will she say how much she proposes to rely on a fiscal and how much on a monetary boost?

The Prime Minister: As the hon. Gentleman should be aware, if the United States Congress and President do not agree, Gramm-Rudman takes effect on Friday. During that time a number of alternative policies can be put forward, but, in any event, there must be a reduction in the budget. It is not for us to have contingency plans, but there must be some cuts in the United States' budget.

Mr. Boswell: Will my right hon. Friend find time in her busy day to go to Wandsworth to study the benefits to the nation of the sale of 10,000 council houses by competitive tendering, thus reducing costs by 25 per cent., so that it has the lowest rates in the Metropolis?

The Prime Minister: I do not think I can go down today but I congratulate Wandsworth, under Conservative local government, on the excellent results it has achieved both in the sale of council houses and in holding down rates.

Q4. **Mr. Cox:** To ask the Prime Minister if she will list her official engagements for Thursday 19 November.

The Prime Minister: I refer the hon. Gentleman to the reply that I gave some moments ago.

Mr. Cox: Does the Prime Minister recall that last winter there was very severe weather, which caused enormous problems for the elderly and disabled in being

Annex

THE APPROACH OF THE GOVERNMENT OF KUWAIT TO THE ORGANISATION OF PETROLEUM EXPORTING COUNTRIES (OPEC)

Kuwait was a founder member of OPEC in 1960. The Organisation's stated objectives are "to co-ordinate and unify petroleum policies among member countries in order to secure fair and stable prices for petroleum producers; an efficient, economic, and regular supply of petroleum to consuming nations; and a fair return on capital to those investing in the industry." In practice OPEC operates openly as a cartel. It fixed a high price in the 1970s when demand exceeded supply. It has sought to limit production to maintain a high price in the 1980s when the supply/demand ratio moved against the cartel. Kuwait has cooperated fully with OPEC's policy of using its market position to keep prices up, (though it has not always respected its detailed OPEC pricing/production obligations). Kuwait has made no secret of its wish that the UK, as a significant oil producer, would abandon its policy of leaving market forces to determine the price and production levels of North Sea oil, and instead operate controls in sympathy with OPEC.

Kuwait has the highest reserve to production ratio in OPEC. At current production levels (roughly 1mbd, for the time being in line with her OPEC quota), proven reserves should last over 200 years. For OPEC as a whole the equivalent figure is 69 years. By contrast non-OPEC/OECD reserves would last only about 10 years at current production levels (and the US and UK about 7.5 years). Kuwait, therefore, has an interest as a high reserve, low cost producer in ensuring a long term demand for her oil, and in fixing the price at a level which discourages the development of alternative energy sources as well as maintaining revenue.

As early as 1972, Kuwait was to the fore in efforts by some OPEC members to limit production in order to conserve oil reserves and exploit the favourable market situation as demand rose to exceed supply. It set a ceiling on its own production of 3mbd. It was also a leader within OPEC in the drive for progressive nationalisation of foreign oil assets, leading to full Kuwaiti nationalisation in 1975, (and expropriation of BP's interests in Kuwait for a sum which, with hindsight, can be seen as very low compared with the revenue subsequently derived by Kuwait from these expropriated assets).

In 1973, Kuwait, along with other Arab oil producers in OAPEC (Organisation of Arab Petroleum Exporting Countries), embargoed crude supplies to the US and Netherlands and imposed percentage cuts on supplies to all Western customers. Because Kuwaiti cuts were applied on the basis of her earlier self-imposed output ceiling, they were more severe than those of other producers or than OAPEC resolutions strictly required. When OAPEC cuts were relaxed at the end of 1973, however, Kuwait allowed a degree of preferential treatment to so called "friendly" countries, including the UK and France. In 1979/80, following the loss of Iranian oil as a result of the Revolution, Kuwait was amongst those OPEC countries which cut their production further, in contrast to the Saudis who increased production to moderate the price effects of the shortfall.

From 1982 to 1985 Kuwait supported OPEC production restraint designed to keep prices at a higher level than was economically sustainable. In early 1986 oil prices fell sharply following Saudi Arabia's decision to stop single-handedly cutting output to maintain prices. Kuwait, which like Saudi Arabia had large unused production capacity, joined the Saudis in pushing production well above quota and helping to force prices down to their low point in mid-year. The intention was that other producers would be taught a lesson from the resulting fall in prices, and join in making concerted output cuts. A subsidiary hope may have been that low prices would quickly start to close down high cost output in the North Sea and US. In the event, this did not happen but the Saudi/Kuwait strategy engineered a price fall, sufficiently severe that the OPEC cartel was forced to agree new output quotas in the second half of 1986 to help restore prices.

Kuwaiti policies in OPEC in the early 1980's, directed at sustaining an increasingly unrealistic oil price, bore no obvious relation to Kuwait's interest in keeping oil prices low enough to preserve demand in the longer term. But since prices fell in 1986, Kuwait has allied itself closely with the Saudis and other high reserve countries in OPEC (principally its Gulf Co-operation Council (GCC) partners, Saudi Arabia, UAE and Qatar). This group of countries has supported the $18/barrel objective agreed in late 1986 as a way of striking a reasonable balance between short term revenue needs, encouraging long term demand for OPEC oil and discouraging the further development of high cost non-OPEC reserves such as the North Sea and US. These policies of the high reserve Gulf producers contrast with the short term, high price policies of the majority of non-GCC members of OPEC, led by Algeria, Iran and Libya. The differences between these two groups have become marked in meetings of the OPEC Ministerial Council during 1987 and 1988.

The Kuwaitis have also been active in pressing the case for cooperation in restraining output by both OPEC and non-OPEC producers. The Kuwaiti Oil Minister, Sheikh Ali Khalifa, stated in 1987 (when oil prices where around $20/barrel) that OPEC should not give non-OPEC producers the idea that the cartel alone would bear the burden of price support, thus encouraging the development of expensive non-OPEC oil such as that in the North Sea. In the past 18 months, Kuwait has shown a willingness to produce above her OPEC quota when prices have gone above the $18 a barrel target, but has been prepared to impose quota discipline when prices have dipped much below this level. These actions have been prompted by revenue needs, but also by a desire to show other oil producers that they too must share the burden of output restraint.

THE GOVERNMENT OF KUWAIT, OPEC AND BP

An important consideration in Kuwait's current oil strategy has been to ensure that the long term pursuit of OPEC objectives through price and production discipline does not lead to any loss of market share to other OPEC and non-OPEC producers. For this reason, the Kuwait Petroleum Company (KPC), the state- owned holding company for all oil related activities, has for some years been building up refining capacity at home and purchasing downstream refining and distribution outlets, principally in Western Europe and the US. This has also been supplemented, prior to the BP purchase, by relatively modest moves into up stream exploration and production activities in the same areas (the acquisition of the US company, Sante Fe, being the largest single example). This diversification has reduced Kuwait's exposure to OPEC crude pricing rules and also the risk of Kuwait being unable to sell its output because of OPEC restrictions.

Kuwait's concern to develop secure outlets for its oil through investment outside OPEC and at the same time to maintain revenues at an oil price dictated by OPEC which does not encourage high cost non-OPEC production are both relevant to KIO's interest in BP.

BP's refining and marketing operations, particularly in Europe but also in the US and third world, are, at roughly 2.2mbd, well in excess of its own crude production. This excess downstream capacity could be useful to Kuwait in its unilateral objective of securing market outlets.

The link with BP, assuming it involved Kuwaiti influence over the management of the company, would also provide Kuwait with a major entry into exploration and production activities within an integrated oil company operation in the main high cost, non-OPEC area of production. (About 90% of BP's production of 1.4mbd is from either the North Sea or US). Such a stake could also provide Kuwait with the possiblity of influencing the company in a way that could support its own and/or OPEC objectives. Since BP's major upstream assets are in high-cost and unregulated production areas which Kuwait and OPEC have consistently regarded as a threat to OPEC's prospects, the possibility cannot be excluded that at some future stage the Kuwaitis might seek to influence BP in order to reduce (or at least not increase) production and investment in favour of their own and/or OPEC's production. (Some recent statements by Sheikh Ali Khalifa relevant to these points are attached at Annex).

As the history of Kuwait's relations with OPEC has shown, Kuwait has been capable of great tactical flexibility over the years in the pursuit of its long term aims. Past events have also shown, however, that circumstances can arise under which the political pressures on Kuwait to act irrespective of its immediate economic self-interest have been decisive. Even if it is Kuwait's intention to regard its stake in BP as a profit generating investment and to refrain from interfering in BP's non-OPEC production, it could still prove prejudicial to BP's interests either now or at some stage in the future if potential shareholders, partners or countries in which it had assets were to suspect the company of being subject to the sort of conflict of interest suggested above.

RECENT STATEMENTS BY THE KUWAITI OIL MINISTER, SHAIKH ALI KHALIFAH

1. Interview on Channel 4 Business Programme, 9 February 1986 (MEES 10.2.86) (Oil price then below $20/b and falling).

Q. To what extent do you want (the UK and other non OPEC producers) to curb production?

A. It is not a question of wanting the UK to curb production. In order to be able to maintain a given price level we all have to co-operate by reducing production. We do not ask the UK to reduce production just because we do not like the UK. It is just that if the UK continues with its current production policy, we all - all of us oil producers - will be hurt. The amount, I would think, would not be too great a sacrifice for the UK, especially since it will also be gaining in terms of a higher oil price, which constitutes a large percentage of government revenue....

Q. Could we look specifically at the position of the UK? Clearly it is not as easy for the UK as it is for some other countries to cut production. We don't now have a national oil corporation of the kind other countries have. Do you accept that it is not easy for the British to cut back production in the way it is for a country like Kuwait?

A. No, I do not accept that at all, because the government decides on depletion policy. The Prime Minister said as much in a TV interview not long ago. And I know, being a producer in the North Sea, or having a share of production in the North Sea, that the UK Government does have the authority to decide on depletion policy....

Q. You would like the British Government to co-operate on production. How far would you like to see it cutting back?

A. I think it is in the long-term interest of Britain to cut back for depletion purposes, if nothing else. But the range I would think it should cut would be something better than 300,000 b/d....

2. Press Conference, Geneva, 21 April 1986 (MEES 28.4.86) (with prices below 15/b and no OPEC quota agreement.)

Q. Several ministers in the past have attempted talks with the UK. Are there any new developments here?

A. This initiative has not been completely abandoned. But great damage has already been done to the North Sea prospects, so perhaps OPEC worries about the North Sea may be smaller than in the past.

3. Interview with Kuwaiti daily al Anba 21 May 1986 (MEES 26.5.86).

In conclusion Shaikh 'Ali warned that the UK was only harming itself by its continued refusal to participate in stabilizing the oil market. "Britain's lack of co-operation with OPEC", he said, "has led to an increase in the influence of psychological factors on prices, with the result that many projects in the North Sea have been postponed. Therefore in the end the main loser from this non-cooperation is Britain itself."

4. <u>Press Conference, Geneva, 5 August 1986 (MEES 11.8.86) (Following OPEC agreement to re-introduce output quotas).</u>

Q. Have you had any indication of any possible co-operation by the UK with this OPEC agreement?

A. I have not talked with any British official and I am aware of no contacts with the British Government. I think North Sea oil is something we do not have to worry about for too long a period. Production is already declining. If the price level remains even in the high teens the decline will be steeper. Perhaps by the early nineties Britain will be a net importer rather than an exporter. Even if one takes the Department of Energy figures it would not be much of an exporter. I believe they are optimistic and I think Britain's role as a net exporter will decline dramatically.

5. <u>Speech at Oxford Energy seminar, 11 September 1987 (MEES 21.9.87).</u>

We in OPEC also gave a wrong signal to the market in the sense that we are again encouraging the development of expensive oil outside OPEC. Today, in the UK North Sea, at least three major new oil development projects are being considered. This is being made possible on the assumption that the 13 developing countries grouped in OPEC will bear the responsibility of price support. This, of course, is not a matter of right or wrong. The real question is: can we or can we not do it? And my frank opinion is that we cannot do it if the situation continues in this manner.

What is the solution? We would like stable prices. We would like increasing prices, if possible. But the responsibility for ensuring such an increase in prices would have to be shouldered not only by the 13 developing countries of OPEC but also by a large number of producers.

An idea - which I have still not thought through very clearly, and by no means represents the policy of my country - occurred to me recently. This would be to tie the price of oil in some way to demand for OPEC oil. Instead of saying we will support a price of $ 18/B just like that, we would say something like, for the sake of example: we will support a price of $18/B if the call on OPEC crude oil is 18mn b/d; if the demand for OPEC crude rises to 20mn b/d, we will maintain a price of $20/B; if it falls to 16mn b/d, we support a price of $16/B; and so on. It would really transfer some of the responsibility for prices to the non-OPEC producers whether they like it or not. Basically, it would be up to them to choose the level of demand they will leave for OPEC to supply. So, in a fundamental sense, it would be their choice on production that would determine the price.... It would not be a case of OPEC deciding on the price, and the non-OPEC producers applauding and benefiting from this while continuing to act as they please on production.

ANGLO-KUWAITI RELATIONS

1. We have considered the possible effects on Anglo-Kuwaiti relations of the hypothetical possibility of the Government of Kuwait being asked to divest or perhaps give up voting rights in shares in BP. Our bilateral relationship with the Kuwaitis is long established and very good. Kuwait does not regard itself as beholden to us, but does recognise areas of significant mutual interest. One such is access to the London financial market. Kuwait has been an active participant in the City for many years. Kuwaitis are used to operating within the framework of laws and regulations which apply in England, and can be assumed to be well briefed on the functions and powers of the OFT and the MMC.

2. In presenting their case to the MMC the Kuwaitis will not be deterred by any embarrassment which they may cause HMG. Nor will any differences between Kuwait and HMG on this issue change our perception of Kuwait. It is a pro-Western state in a sensitive area of the Gulf, in whose continued stability and prosperity the UK has a strong interest. Up to 1961 the UK was responsible for Kuwait's defence and foreign relations. In that year British forces were deployed to Kuwait to deter an invasion from Iraq. We no longer have any commitment to the defence of Kuwait. But, as we have done for the past 25 years, we continue to provide a team of British servicemen to assist in military training in Kuwait. The defence relationship has been strengthened over the years by major sales of equipment and the provision of allied training.

3. The Kuwaitis probably know that the MMC investigation of the Kuwaiti shareholding in BP is unlikely to cause HMG to reduce our interest in the security of Kuwait under the rule of the Al Sabah. We want to limit as far as possible the instability caused in the Gulf by the Iran/Iraq conflict. We have an interest, as do the Kuwaitis, in the freedom of navigation in the Gulf. So we will not allow any disagreement over the Kuwaiti shareholding in BP to assume exaggerated importance in our bilateral relationship. We would not, for example, withdraw our military training team nor refuse to sell

the Kuwaitis new military equipment. So Kuwait is unlikely to be deterred from reacting sharply to any unfavourable MMC decision by the fear of Britain withdrawing cooperation in any of these fields.

4. The Kuwaiti reaction to an outcome to the MMC investigation which obliged them to divest, or to limit their voting rights, would not necessarily be hostile. The Kuwaitis accept the correct and non-discriminatory application of our laws and regulations as the backdrop to their trading operations in the UK. Any possible backlash would be minimised if the Kuwaitis were convinced that an adverse judgment based on the concept of "public interest" was not motivated by anti-Arab discrimination. They suspect that reference to the MMC is part of a process of political manipulation in this case. It would also help maintain the bilateral relationship in good order if any divestiture recommendation recognised that the Kuwaitis will be most reluctant to take a loss on that part of their shareholding they may be asked to divest. They may be willing to cooperate with HMG in agreeing upon a divestment schedule over a period of time. This would limit the risk of a sharp loss in value of their shareholding, which might occur if they had to divest rapidly, and of damage to the market's perception of BP. On the other hand a recommendation on divestment (or to limit their voting rights, though this might seem less drastic to them) that was not accompanied by suggestions on how to manage the divestment in an orderly manner could provoke a hostile reaction.

5. If this were the case they could retaliate by damaging British commercial interests by actively denying large contracts to British suppliers, or by using the pretext of a row over BP to justify a decision not to buy British which they would have taken on other grounds. This in turn could lead to sharp criticism of HMG by disappointed British suppliers. The best target for any Kuwaiti displeasure would be a defence contract. Kuwait is currently evaluating offers to supply new tanks. The British Challenger tank is believed to be the favourite. The value of the deal is around £800 million. (Our annual exports to Kuwait currently run at around about £300 million). Other offers of defence equipment being considered by the Kuwaitis are for armoured personnel carriers, minesweepers, helicopters and aircraft. It is normal Kuwaiti

practice, in addition to paying close attention to price, quality and delivery dates, to distribute large contracts among the major arms supplying countries in order to retain the goodwill of all. The UK has been the traditional supplier of tanks. An MMC decision unfavourable to Kuwait could contribute to loss of a defence sales order. On the other hand it would do the UK long-term overall defence sales effort no service if it was thought that the UK could be blackmailed by the fear of losing such orders into suspending or bending its normal statutory procedures for investigating monopoly or other undesirable commercial activity.

6. The Kuwaitis could also signal their displeasure by moving investment out of the UK or discriminating against the UK in invisible trade. Official Kuwaiti holdings in the UK are estimated to amount to about £4 billion, and private investments are considerable as well. We believe that this aspect of Anglo-Kuwait relations is unlikely to be affected both because the Kuwaitis need to maintain a wide international spread of investments of which a proportion will continue to be attracted to the UK, and because shifting their investments for no good market reason would involve not only inconvenience but financial losses as well. But their willingness to cut off their nose to spite their face cannot be ruled out entirely, though we assess the likelihood as low.

42/2.BTW.4376/32

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: MISS S J FEEST
DATE: 20 May 1988

MR P FAWCETT IR

cc PS/Chancellor
Miss Sinclair
PS/IR

UNION TEXAS PETROLEUM CORPORATION v CRITCHLEY

The Financial Secretary was grateful for your minute of 10 May 1988 and has noted its contents.

Susan Feest

SUSAN FEEST
(Assistant Private Secretary)

UNCLASSIFIED

CHANCELLOR OF THE EXCHEQUER

PMP

FROM: J M G TAYLOR
DATE: 23 May 1988

MS LEAHY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mrs Lomax
Mr D J L Moore
Mr MacAuslan
Mr M L Williams
Mr Hurst
Ms Wheldon T.Sol

BP/KIO: EVIDENCE TO THE MONOPOLIES AND MERGERS COMMISSION (MMC)

The Chancellor was grateful for your minute of 20 May, and is content with the enclosed Energy and FCO drafts.

JT

J M G TAYLOR

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Ch

For word with Lord Young i margins of Cabinet. Sidney Lipworth is the man who is heading this investigation

AS

I will spk to him

NH8/56Jo

CONFIDENTIAL

FROM: J M G TAYLOR

DATE: 23 May 1988

PS/SIR PETER MIDDLETON

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

BP/KIO: MMC

The Chancellor is concerned that the MMC report, when published, will be critical of HMG for having allowed this situation to have occured. For example, they may say that either the issue should have been pulled, or the Bradbury/Bridges agreement should not have been terminated, or some other safeguard device should have replaced it.

2. The Chancellor would be grateful for Sir Peter's advice on how this might be avoided (since it is not really relevant to the issue the MMC has to decide).

J M G TAYLOR

Sidney Lipworth

Ch

V early days, but seems likely that could accommodate £95m in 1988-89 without too much risk of PSBR overshoot

Delaying six months means using up some of next year's fiscal adjustment – and announcement in November (? in AS) could be tricky in relation to public expenditure decisions / announcements – Not v attractive

– RB 2/x –

AA

26A/1/jno/4032/049

CONFIDENTIAL

8/72

FROM: H C GOODMAN

DATE: 24 May 1988

25.5

1. ~~MR M L WILLIAMS~~

2. ~~CHANCELLOR OF THE EXCHEQUER~~

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Mowl
Mr Fox
PS/IR
Mr Johns - IR

Thanks. I wish to go ahead without delay. L

ROYALTY OIL

You decided after the autumn statement that you would like to consider a change from royalty in kind (RIK) to royalty in cash (RIC) before the end of June. This note sets out the main arguments and considers in particular the question of timi[ng] of any change. An important new factor is that for the fir[st] time the Department of Energy are themselves wishing to review the future of RIK with an open mind.

2. You will recall that a change can only be made on 1 July or 1 January and that the oil companies must be given 6 months notice. This means that if a change is to be made from 1 January 1989, an announcement will be needed before the end of June.

3. The main arguments for and against the change remain much as stated previously. They are:-

In favour:-

(a) the desirability in principle of cutting back on public sector involvement in trading, which could equally well be undertaken by the private sector;

(b) the consequent savings of agency fees and expenses paid to OPA ((£1.8 million in 1988-89) and of 2 staff in the Department of Energy;

(c) the avoidance of the risk of future trading losses by OPA,

(d) the benefit to the industry's cashflow from existing fields (which might be presented as a quid pro quo for the recent Budget changes about which they have complained).

Against

4. (a) assuming a June announcement, the one-off adverse impact on the PSBR this financial year is now estimated to be about £95 million (arising since the proceeds of sale of RIK come some four months earlier than would cash royalties), and the continuing annual cost (arising from the need to borrow earlier, offset by lower claims for relief against corporation tax) estimated to be £18 million. These figures assume oil prices of $17pb; an exchange rate of $1.79 and real interest rates of 8 per cent;

(b) the information flow to the Inland Revenue from OPA concerning both their own transactions and what is happening in the market would end. The Revenue use data from OPA to establish, from daily figures, monthly market values of North Sea crude, needed in the new valuation legislation. OPA data is more reliable than that obtained from the companies, because integrated producers can always transfer crude within the group at adminstered prices, rather than disposing of it on the market, (BP's takeover of Britoil removes another source of such information); OPA has a large market share and in some circumstances the companies would have an interest in presenting lower figures. Furthermore both the Revenue and Department of Energy find OPA a useful sounding board on specific issues, Assume: my [illegible] write all above [illegible] MFT!

such as the application of the Financial Services Act and on the anti-spinning legislation: it was information volunteered by OPA which in part alerted the Revenue to the problem. In other words, without OPA's market knowledge the possibility of tax loopholes going unseen and the tax base being eroded would be greater. (Up until the second half of last year the difference between RIK actually realised and the deemed value receivable under an RIC system was positive. In the second half of 1987 a small loss was apparent, possibly because of the effectiveness of the anti-spinning legislation. This removes one plank of Department of Energy's resistance to the change.)

(c) OPA might not be able effectively to exercise its participation powers without actively trading in the market since the government would no longer have any influence over the disposal of 10 per cent of production. The Participation Agreements include the right to purchase up to 51% of production, so that participation could be activated if Ministers decided that was necessary to protect security of UK Oil supplies. This is essentially a presentational argument in dealing with concerns in the House about security of supply – concerns which extend to royalty oil as well as participation agreements.

Department of Energy Review

5. Notwithstanding the disadvantages, the Department of Energy seem to have been persuaded that a move to royalty in cash should now be considered. They are taking the opportunity for a general overhaul of OPA. This review has the full support of their Ministers?

6. As well as collecting Royalties in Kind, OPA manages the operation of the Government Pipeline and Storage System (GPSS) and maintains the legal framework for participation. Discussions are underway with the MoD about their taking over responsibility for the GPSS. But the other policy questions are still under review and Treasury and Revenue officials are being consulted before advice is submitted to Energy Ministers. What this means, in effect is that the future of OPA as a whole is being re-appraised. So the main question to resolve now is whether a change to the RIK should be announced now or in six months time.

Timing

7. You indicated previously that you would prefer to make the change from 1 January. This avoids the issue being used by the department in considering any changes to the North Sea fiscal regime next year, and as stated in paragraph 3(d), may ease pressure for making changes to this year's Budget. (Though for maximum effect it would need to be announced by the Finance Bill clause debate on 16 June. Given that Mr Parkinson is abroad at the beginning of June, this would not leave much time to sort out the connected issues). The margins of error on the PSBR forecast for 1988-89 are at this stage very large, but the published forecast was cautious and the fiscal position could be more difficult next year.

8. At official level the department have argued for making the change from 1 July 1989 with an announcement in November. This is because a decision to take royalty in cash would effectively mean an end to OPA and the Department wish to make further progress with their review of OPA's other responsibilities and negotiate an orderly run-down once all decisions have been taken, including a suitable redundancy package for the staff. Energy fear an announcement on RIK alone would risk losing revenue in the final chargeable period as trading staff left. If this could be delayed and a complete announcement on the future of OPA made at the same time, there would be an opportunity to agree terms, which might mitigate this. The staff point does not appear very strong; whenever the announcement is made there will be a tendency for staff to leave before the end of OPA's trading activities. On the other hand there is a risk that an early announcement would put back the negotiations with Defence over the GPSS, since they would not wish to be presented with a rump OPA and have to deal with the problems of run-down.

Conclusion

9. In balancing the considerations the main points seem to be:-

(1) by waiting 6 months, there is every prospect that

Mr Parkinson will agree to the change (with luck, without taking advantage in the fiscal regime negotiation of the £100 million benefit to the industry). It can be managed on an orderly manner, together with the possible wind-up of OPA. We would however lose the opportunity of taking the sting out of the present attack by the industry on the Budget measures;

(ii) Mr Parkinson would probably resist an early announcement; there would also be problems in managing the transition within OPA; it could dealy MoD's takeover of the GPSS.

10. In the circumstances you may wish to delay for 6 months. If not, we will let you have a draft to send early next week.

H C Goodman.

H C GOODMAN

NH3/37AL

SECRET

BF 25/5
pugs

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

24 May 1988

Paul Gray Esq
10 Downing Street
Whitehall
LONDON SW1

Dear Paul,

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

As you know, the Bank of England bought back some 40 million partly paid BP shares under the support scheme announced in October. The prospectus for that scheme said the Bank would not sell these shares before 30 April at less than 120p per share. The Treasury itself also holds shares we retained, but will not now need, for bonus purposes. Fully paid, both sets of shares together are worth some £270 million.

We have no plans for an early sale of these shares, but intend in due course to sell them into the UK retail market as a further contribution to wider share ownership. To give us greatest flexibility, we propose to purchase the Bank's shares, which will enable us to combine both blocks in a single holding. (The shares are held by the Issue Department, so the 'purchase' is in effect a transfer, with no net impact on public expenditure or the PSBR.)

The Chancellor feels it would be most sensible to make this transfer now, taking the first available opportunity after the limitations under the Bank's Share Purchase Arrangement ran out. We would need to publish a Revised Estimate at the beginning of June to seek Parliamentary approval for the funds for the purchase from the Bank, and would plan to announce this in a written answer this week. This procedure was the one we followed in 1981-82 when we purchased from the Bank the BP shares it then held.

The Chancellor feels that doing the transfer now has the advantage that we will be able to present it in a low-key way as being a routine arrangement which we were doing at the first available opportunity; and it will come at a time when the wider issue of the KIO holding is in baulk pending the outcome of the MMC's investigation.

The Chancellor would be grateful to know if the Prime Minister is content that we should proceed in this way.

Yours
Alex

A C S ALLAN
Principal Private Secretary

CONFIDENTIAL

PPS. P1.

FROM: D W OWEN
DATE: 24 MAY 1988

SIR P MIDDLETON

cc PPS
Sir T Burns
Sir G Littler
Mr Monck
Mr Scholar
Mr Sedgwick
Mr Mowl
Mr Hibberd
Mr P Davis

KIO INVESTMENT IN BP

In reply to your letter to Sir Brian Hayes of 12 April, which indicated our opposition to the reclassification of KIO investment in BP from 'portfolio' to 'direct', DTI promised to circulate a technical note on the issue. However, the attached letter from Peter Stibbard to John Kidgell (CSO) reports that DTI have now decided to postpone any decision on reclassification until after the Monopolies and Mergers Commission has reported on the KIO investment. This means the issue will probably not be reconsidered until the autumn, in time for the Q3 Balance of Payments figures to be published in December. Until then the published figures will continue to show the KIO holding as portfolio investment.

2. John Kidgell's reply, which is also attached, makes some helpful points which support the line you took in your letter to Sir Brian Hayes.

David Owen

D W OWEN
EA2

dti
the department for Enterprise

Mr J Kidgell
Central Statistical Office
Room 58/2
Great George Street
London

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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01-215 7877

Telex 8811074/5 DTHQ G
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Direct line 01 215 4872
Our ref 8182
Your ref
Date 19 May 1988

Dear John,

KIO INVESTMENT IN BP

1 The recent reference by the DTI Secretary of State of the investment by the Kuwait Investment Office in British Petroleum to the Monopolies and Mergers Commission (MMC) has implications for the appropriate treatment of this transaction in the balance of payments accounts.

2 Pending the outcome of the investigation, we have postponed further consideration of whether this holding should be reclassified from 'portfolio' to 'direct' investment. It has been agreed with the Bank of England that this item will continue to be treated as portfolio investment in the balance of payments for Q1 1988.

3 Given these developments, there is little point at present in circulating the technical note referred to in Sir Brian Hayes' letter of 25 April to Sir Peter Middleton (which was copied to Jack Hibbert). The situation will be reviewed once the MMC has reported. It has been asked to report by early September; this will probably be just too late to feed anything into the Q2 1988 balance of payments figures, should that be necessary. So we will have to reconsider this again for the Q3 figures before they are compiled in November and published in December.

4 Copies of this go to [redacted] (Treasury) and Peter Bull (Bank).

Yours sincerely

Peter Stibbard

P J STIBBARD

339/5

DTI Copies:

PS/Sir Brian Hayes
Mr Liesner
Mr Treadgold CP
Mr Richardson S2C

B013

CABINET OFFICE

Central Statistical Office

Great George Street, London SW1P 3AQ Telephone 01-270 6040

23 May 1988

Dear Peter,

KIO INVESTMENT IN BP

Thank you for your letter of 19 May.

I note that you and the Bank are agreed that KIO's transactions in BP shares will be treated as portfolio investment in the balance of payments accounts for the first quarter, and probably in the second quarter of 1988. Treatment will be reconsidered in the autumn in the light of the MMC's report, hopefully in time for the publication of Q3 figures.

You should know that our current view is that these transactions (and their earnings) should remain in portfolio investment, on the grounds that the KIO will not, on its own declaration, exercise management influence over BP. Although the 20 per cent ownership rule is a useful general guide, the issue of management cannot be entirely ignored. The IMF Manual refers to having "an effective voice in the management of an enterprise" as an important criterion in defining direct investment and your questionnaire refers to being "in a position to exercise a significant influence over the UK company". But, no doubt, we shall all have the opportunity to contribute to this debate when the MMC has reported.

I am copying this letter to Peter Sedgwick (Treasury) and to Peter Bull (Bank).

Yours sincerely

John

J E KIDGELL

P J Stibbard Esq
Department of Trade and Industry
Room 260
1 Victoria Street
London SW1H 0ET

366/3

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MDLIAN 9975

PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

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FM ABU DHABI
TO PRIORITY FCO
TELNO 132
OF 250941Z MAY 88
INFO ROUTINE OTHER GULF POSTS, BAGHDAD, WASHINGTON, VIENNA

U A E OIL POLICY.

SUMMARY

1. U A E OIL MINISTER GIVES AN ACCOUNT OF HIS RECENT VISIT TO RIYADH AND VISITS TO THE UAE BY IRANIAN MINISTERS. SHAIKH ZAID HAD TAKEN A MUCH TOUGHER LINE WITH THE IRANIANS THAN HITHERTO. WHILE THIS SEEMS TACTICALLY WISE, IT INVOLVES SOME OBVIOUS RISKS.

DETAIL

2. I CALLED ON DR MANA AL OTAIBA, UAE OIL MINISTER ON 24 MAY, JUST BEFORE HE SAW OFF AQAZADEH, THE DEPARTING IRANIAN OIL MINISTER AND BEFORE HE HIMSELF LEFT FOR RABAT AND ALGIERS WITH A MESSAGE OF CONGRATULATION FROM SHAIKH ZAID TO THE HEADS OF STATE CONCERNED AND AN OFFER OF ZAID'S SERVICES IF MEDIATORY EFFORTS WERE REQUIRED FURTHER TO ADVANCE THE RECONCILIATION. OTAIBA INTENDS THEN TO GO ON TO LONDON, WHERE HE WILL LIE LOW UNTIL THE 8 JUNE OPEC MEETING.

IRAN AND THE UAE

3. OTAIBA SAID THAT HE HAD FOUND THE TALKS WITH AQAZADEH DIFFICULT. THE LATTER'S OBJECTIVES WERE, PREDICTABLY, TO GET THE U A E TO REDUCE ITS OUTPUT AND TO DEMONSTRATE THAT IRAN, WITH ITS CONTACTS WITH THE UAE, OMAN, ETC, WAS NOT ISOLATED EITHER POLITICALLY OR IN THE FIELD OF OIL DIPLOMACY. AQAZADEH'S LINE WAS THAT THE ONLY PROBLEMS FACING OPEC WERE OVER-PRODUCTION BY IRAQ AND THE UAE. AS THE IRAQIS WERE IMPOSSIBLE, IRAN INTENDED TO FOCUS DISCUSSION AT THE NEXT OPEC MEETING ON THE UAE'S PERFORMANCE. OTAIBA WARNED HIM THAT, IF IRAN DID THIS, HE WAS UNDER FIRM INSTRUCTIONS TO WALK OUT OF THE OPEC MEETING. HE COMMENTED TO ME THAT TO DO SO WOULD CAUSE HIM NO DISTRESS : ''OPEC NOWADAYS WAS HARDLY A RESPECTABLE ORGANISATION''. HE HAD GONE ON TO TELL AQAZADEH THAT, IF HE DID WALK OUT, THE UAE WOULD FEEL AT LIBERTY TO FOLLOW THE EXAMPLE OF OTHERS ROUND THE GULF WHO PURSUED THEIR INTERESTS WITH TOTAL DISREGARD FOR OPEC CONSIDERATIONS. AQAZADEH MODIFIED HIS ATTITUDE, SAYING THAT, AFTER PRESENT PROBLEMS HAD BEEN RESOLVED, THE BIG FIVE OIL RESERVES HOLDERS, SAUDI, IRAN, IRAQ, KUWAIT AND THE UAE,

SHOULD WORK TOGETHER FOR A COMMON POLICY REFLECTING THEIR COMMON INTERESTS. HE THEN LAPSED BACK INTO THE STANDARD IRANIAN LINE ON IRAQ.

4. AQAZADEH HAD CALLED ON SHAIKH ZAID AND THE DISCUSSION HAD LEFT OTAIBA FEELING DISTINCTLY UNCOMFORTABLE. SHAIKH ZAID HAD TAKEN THE OFFENSIVE AND HAD FOLLOWED UP HIS EARLIER BERATING OF BESHARATI DURING THE LATTER'S VISIT HERE ON 1-2 MAY WITH A HIGHLY CRITICAL ANALYSIS OF IRANIAN ATTITUDES. ZAID HAD REPEATED HIS INSISTENCE ON A CEASE FIRE AND ARBITRATION, WHICH HE SAW AS THE OBVIOUS, AND INDEED THE ONLY, WAY TO BRING THE WAR QUICKLY AND FAIRLY TO AN END.

5. IN OTAIBA'S VIEW, AQAZADEH'S ATTITUDE HAD SHOWN CONSIDERABLY LESS CONFIDENCE THAN IN THE PAST, WHICH HAD LED HIM TO TAKE A MORE AGGRESSIVE LINE IN RESPONSE TO ZAID'S CRITICISMS. IN HIS OWN DEALINGS WITH AQAZADEH, OTAIBA HAD BEEN MORE EMOLLIENT AND HAD COUNSELLED AQAZADEH, WHO HAD BEEN MUCH LESS AGGRESSIVE WITH HIM THAN IN THE PAST, NOT TO TAKE ZAID'S HARSH WORDS TOO MUCH TO HEART.

SAUDI ARABIA AND THE UAE

6. DURING OTAIBA'S RECENT VISIT TO RIYADH ON 14 MAY, HISHAM NAZER HAD BROUGHT HIM UP TO DATE ON THE RECENT VIENNA MEETING AND THEY HAD TRIED TO WORK OUT A LINE FOR JUNE. NAZER'S POLICY WAS UNCHANGED : OPEC COUNTRIES SHOULD CONTINUE TO RESPECT CURRENT QUOTAS. OTAIBA WAS KIND ABOUT NAZER AS A COLLEAGUE BUT SAID THAT HE WAS IN THE UNFORTUNATE POSITION OF HAVING TO CLEAR EVERY DETAIL OF WHAT HE SAID IN OPEC BY TELEX WITH RIYADH. A MARKED CONTRAST TO YAMANI'S FREEDOM OF MANOEUVRE.

UAE OIL PRODUCTION

7. ON HIS RETURN TO THE UAE FROM SAUDI ARABIA, OTAIBA HAD FOUND THAT HIS STAFF HAD RAISED ABU DHABI PRODUCTION FOR A WEEK OR SO TO ABOUT 1.1 MILLION BPD. HE HAD IMMEDIATELY ORDERED IT TO BE REDUCED BY 170,000 BPD SO AS TO REMAIN WITHIN WHAT HE SAW AS HIS OWN QUOTA. HE WAS CONCERNED TO PRESERVE A REASONABLE RECORD FOR THE RUN-UP TO THE OPEC MEETING.

COMMENT

8. SHAIKH MOHAMMED BIN ZAID HAD TOLD ME ON 22 MAY THAT SHAIKH ZAID HAD RAISED THE LEVEL OF HIS VOICE AND HIS ACERBITY WITH BESHARATI IN THE MEETINGS WHICH HAD TAKEN PLACE IN ABU DHABI AFTER THE IRANIAN ATTACK ON MUBARAK. THIS IS CONSISTENT WITH THE LINE TAKEN WITH AQAZADEH. I CONCLUDE THAT ZAID HAS DEFINITELY DECIDED

THAT APPEASEMENT IS A BAD POLICY TO DEPLOY WITH THE IRANIANS AND THAT HE SHOULD, IF NOT TOUGH IT OUT WITH THEM, AT LEAST REACT REASONABLY AGGRESSIVELY TO ANY PROVOCATION.

9. ZAID REMAINS OBVIOUSLY AWARE OF THE CONTINUING NEED FOR THE UAE ITSELF TO AVOID PROVOKING THE IRANIANS BUT HAS PROBABLY BEEN ENCOURAGED TO TAKE A FIRMER LINE BY FAO, THE US NAVAL STRIKES, AND THE SATISFACTORY OUTCOME, FROM HIS POINT OF VIEW, OF HIS REASONABLY ROBUST RESPONSE TO THE IRANIAN ATTACK ON ABU AL BUKHOOSH IN 1986. SO FAR HE HAS JUDGED THE IRANIAN TEMPER WELL BUT, IN ADOPTING A HARSHER LINE WITH THEM, HE COULD BE OPENING UP A GAP BETWEEN HIMSELF AND THE DUBAI SHAIKHS AND WIDENING THE CONSIDERABLE GAP WHICH EXISTS BETWEEN HIMSELF AND THE RULER OF SHARJAH, WHOSE WIDELY KNOWN PREFERENCE IS FOR A VERY MUCH MORE CONCILIATORY APPROACH.

TAIT

YYYY

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ECD (I)	MR MAUD
NENAD	

ADDITIONAL 42

OIL

NNNN

MARKET SENSITIVE

FROM: J M G TAYLOR

DATE: 25 MAY 1988

MR BENT

cc Financial Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr D J L Moore
Mr Peretz
Mrs Brown
Mr Ilett
Mr Watts
Mr Devereux
Mr Hurst
Mr Gunton - IDT
Mr Dyer - Parly
Mr Call
Mr Hyett - T.Sol

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

The Chancellor has seen your minute of 25 May.

2. He is broadly content with the draft Question and Answer. He would, however, prefer the last part of the answer to read: "... the Treasury should purchase these shares from the Issue Department of the Bank, at the prevailing market price. Her Majesty's Government have no immediate plans to resell these shares though it is their intention to do so at some time in the future. A Revised Estimate ..." (continue as drafted)".

3. He would be grateful if the Financial Secretary would scrutinise the press briefing. If the Question is to be Press Released it should be accompanied by a "Note to Editors" reading: "The purchase from the Bank represents an intra-public sector transfer, and the payments of the second instalment substitutes a Treasury obligation for a Bank obligation. Thus there is no addition to public expenditure."

4. He is not happy with the figure of £73.295 million for the subhead provision in the Revised Estimate. He would prefer this to be a round £70 million. (He has commented that the price high of 83p a share was a false, KIO inspired level).

J M G TAYLOR

* subject to addition of NAO & Bank

MARKET SENSITIVE

1. MR MOORE RW 25/5.

2. CHANCELLOR OF THE EXCHEQUER

From: R M BENT
Date: 25 May 1988
cc FST
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Peretz
Mrs Brown
Mr Ilett
Mr Watts
Mr Devereux
Mr Hurst
Mr Gunton IDT
Mr Dyer Parl
Mr Call
Mr Hyett-T Sol

Content with PQ & answer* but do further work on supplementaries for press briefing. I am not, however, at all happy with the extraordinary figure in ¶ 4. Where does £750 m. come from?

Ch/ No 10 are content with the arrangements (Mr Craig's letter of 25/5, behind).

Content with PQ (& the suggestion on the Press briefing). JFS 25/5

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

This is to supply a draft arranged Parliamentary Question to announce the intention to buyback the 39 million shares repurchased by the Bank of England. Draft supplementaries for the press office are also attached.

2. Since the Revised Estimate will be released to the Treasury Committee over the Whitsun recess, we recommend that the arranged PQ be tabled today for answer tomorrow.

3. Since BP is a listed company, and since the PQ constitutes material information, we also recommend that IDT make arrangements to notify the Stock Exchange of the contents of the PQ as soon as it is answered. We suggest that this notification be sent soon after 3.30pm tomorrow.

4. We have cleared the draft answer with the Bank, and we have warned BP.

R M Bent

R M BENT
PE2 Division

MARKET SENSITIVE

Issuing Department No

DRAFT

Q: To ask Mr Chancellor of the Exchequer, if he will make a statement about the partly paid BP shares repurchased by the Bank of England.

A: Under the terms of the BP share support scheme which were announced on 29 October and which closed on 6 January, 38,576,002 partly paid BP shares were repurchased by the Bank of England. These shares could not be sold by the Bank, unless at a price in excess of 120p per share, before 30 April 1988. Now that this date has passed, I propose, subject to Parliamentary approval of the necessary Revised Estimate, that the Treasury should purchase these shares from the Bank, at the prevailing market price. ~~We~~ Her Majesty's Government have no immediate plans to resell these shares though it is ~~our~~ their intention to do so at some time in the future. A Revised Estimate will be presented shortly, and will provide for the costs of purchase and of paying the second instalment on the purchased shares.

Notes to Editors

[X from 2nd page of supplementaries]

MARKET SENSITIVE

PRESS SUPPLEMENTARIES

Why buyback ?

So Government can resell shares at some time in future. Will be able to coordinate sale of both partly paid shares now held by Bank, and fully paid shares held by the Treasury in excess of requirements for bonus shares.

Some 68 million fully paid shares were retained for the bonus issue, but the number of individuals applying for shares in the offer suggests that those likely to qualify for bonus shares by buying in the offer and holding continuously until 31 October 1990 will require at most 7 million bonus shares.

Cost of buyback

Uncertain. Depends on market value of partly paid shares by the time that the Consolidated Fund Bill is enacted.

Profit/loss to the Bank

No. The Issue Department bought the part paid shares at 70p per share and will sell them to the Treasury at the prevailing market price. The resulting profit or loss will affect the profits of the Issue Department, all of which are paid into the National Loans Fund (and do not remain with the Bank of England).

Why pay the second call ?

All the shares sold to the public partly paid were subject to a contractual requirement, binding on subsequent purchasers of the shares, to pay the second and third instalments on the shares. The second instalment of 105p per share is due in August 1988. The third instalment, also of 105p per share, is due in April 1989.

Vote provision

Y

Subhead provision of £73.295 million will be made in the Revised Estimate for the costs of purchasing and of paying the second instalment on these shares: this expenditure will be offset by proceeds from the second instalment appropriated in aid. The Vote total remains a token £1,000.

[Not For Use: an astute observer will deduce that this Vote provision is equivalent to 85p per share for the purchase, plus 105p per share for the second instalment. The current market price for partly paid BP shares is 66p per share, but the price has been as high as 83p per share (3 March), and so it is prudent to provide for the possibility of a cost per share of up to 85p].

Market analysts are bound to pick this up. Shldn't we have a defensive line e.g.

Why are you allowing up to 85p for the cost per share?

For good housekeeping only. No implied prediction of ~~likely~~ likely movements in the share price.

a false response

K10 - price

MARKET SENSITIVE

Public expenditure

X The purchase from the Bank represents an intra-public sector transfer, and the payment of the second instalment substitutes a Treasury obligation for a Bank obligation. ~~No net effect on~~ public expenditure.

Future intentions

As PQ emphasises, no immediate plans to resell the shares. Simply transfer of shareholding within the public sector.

addition to

There is thus no

SECRET

pup

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

25 May 1988

Dear Alex,

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

Thank you for your letter of 24 May, which the Prime Minister has seen. She is content for the transfer of the Bank's shares to be handled in the way proposed.

Yours,

Paul

(PAUL GRAY)

CH/EXCHEQUER

REC.	25 MAY 1988
ACTION	
COPIES TO	

Alex Allan, Esq.,
HM Treasury.

SECRET

42/2/DCG/4370/10

RESTRICTED

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD
DATE: 25 May 1988

SIR P MIDDLETON

cc PS/Chancellor
Mr D J L Moore

BP SALE: ORGANISATION AND RESOURCES

The Financial Secretary has seen Mr Moore's minute of 18 May and your manuscript note of 23 May.

2. The Financial Secretary agrees with your view that Rothschilds did not perform well during the termination procedures. But he also agrees with Mr Moore that before that period - when the Financial Secretary saw them once or twice a week - they put up a first-class performance. The Financial Secretary does not think we should allow ourselves to be too influenced by their "shell-shocked period".

J J HEYWOOD
Private Secretary

From: S D H SARGENT

Date: 25 May 1988

MR D W OWEN

cc PPS
Sir T Burns
Sir G Littler
Mr Monck
Mr Scholar
Mr Sedgwick
Mr Mowl
Mr Hibberd
Mr P Davis

KIO INVESTMENT IN BP

Sir Peter Middleton was grateful for your minute of 24 May.

S D H SARGENT
Private Secretary

Bent 4777

MARKET SENSITIVE

1. MR MOORE

2. CHANCELLOR OF THE EXCHEQUER

From: R M BENT
Date: 26 May 1988
cc FST
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Peretz
Mrs Brown
Mr Ilett
Mr Watts
Mr Devereux
Mr Hurst
Mr Gunton IDT
Mr Dyer Parl
Mr Call
Mr Hyett-T Sol

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

This is to confirm that we have no objections to the amendments you proposed yesterday to the draft arranged Parliamentary Question to announce the intention to buyback the 39 million shares repurchased by the Bank of England.

2. I attach a revised version of the PQ and press briefing.

3. I further understand that the Question was not tabled in time to meet yesterday's deadline, and that it will therefore have to be laid today for answer at noon on Friday. Would Mr Gunton please note the change in timing for the release of the information to the Stock Exchange.

R M Bent.

R M BENT
PE2 Division

472
62.

MARKET SENSITIVE

DRAFT

Q: To ask Mr Chancellor of the Exchequer, if he will make a statement about the partly paid BP shares repurchased by the Bank of England.

A: Under the terms of the BP share support scheme which were announced on 29 October and which closed on 6 January, 38,576,002 partly paid BP shares were repurchased by the Bank of England. These shares could not be sold by the Bank, unless at a price in excess of 120p per share, before 30 April 1988. Now that this date has passed, I propose, subject to Parliamentary approval of the necessary Revised Estimate, that the Treasury should purchase these shares from the Issue Department of the Bank, at the prevailing market price. Her Majesty's Government have no immediate plans to resell these shares though it is their intention to do so at some time in the future. A Revised Estimate will be presented shortly, and will provide for the costs of purchase and of paying the second instalment on the purchased shares.

MARKET SENSITIVE

NOTE TO EDITORS

The purchase from the Bank represents an intra-public sector transfer, and the payment of the second instalment substitutes a Treasury obligation for a Bank obligation. Thus, there is no addition to public expenditure.

MARKET SENSITIVE

PRESS SUPPLEMENTARIES

Why buyback

So Government can resell shares at some time in future. Will be able to coordinate sale of both partly paid shares now held by Bank, and fully paid shares held by the Treasury in excess of requirements for bonus shares.

Some 68 million fully paid shares were retained for the bonus issue, but the number of individuals applying for shares in the offer suggests that those likely to qualify for bonus shares by buying in the offer and holding continuously until 31 October 1990 will require at most 7 million bonus shares.

Cost of buyback

Uncertain. Depends on market value of partly paid shares by the time that the Consolidated Fund Bill is enacted.

Profit/loss to the Bank

No. The Issue Department bought the part paid shares at 70p per share and will sell them to the Treasury at the prevailing market price. The resulting profit or loss will affect the profits of the Issue Department, all of which are paid into the National Loans Fund (and do not remain with the Bank of England).

Why pay the second call

All the shares sold to the public partly paid were subject to a contractual requirement, binding on subsequent purchasers of the shares, to pay the second and third instalments on the shares. The second instalment of 105p per share is due in August 1988. The third instalment, also of 105p per share, is due in April 1989.

Vote provision

Subhead provision of £70 million will be made in the Revised Estimate for the costs of purchasing and of paying the second instalment on these shares: this expenditure will be offset by proceeds from the second instalment appropriated in aid. The Vote total remains a token £1,000.

[Not For Use: an astute observer will deduce that this Vote provision is equivalent to some 75p per share for the purchase, plus 105p per share for the second instalment. The current market price for partly paid BP shares is 65p per share, but the price has been as high as 83p per share (3 March), and so it is prudent to provide for the possibility of a cost per share of up to 75p].

MARKET SENSITIVE

Public expenditure

The purchase from the Bank represents an intra-public sector transfer, and the payment of the second instalment substitutes a Treasury obligation for a Bank obligation. No net effect on public expenditure.

Future intentions

As PQ emphasises, no immediate plans to resell the shares. Simply transfer of shareholding within the public sector.

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PS/CHANCELLOR OF THE EXCHEQUER
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INFO ROUTINE CAIRO, CARACAS, DOHA, DUBAI, JAKARTA, KUALA LUMPUR
INFO ROUTINE KUWAIT, LAGOS, LIBERVILLE, BAHRAIN, JEDDA, MEXICO CITY
INFO ROUTINE OSLO, UKDEL OECD, QUITO, RIYADH, VIENNA, WASHINGTON
INFO ROUTINE TOKYO, OTTAWA, SANA'A

OPEC/NOPEC DIALOGUE

1. WHEN I SAW THE SULTAN ON 25 MAY IT WAS EVIDENT THAT HE HAD TAKEN PERSONAL CONTROL OF DECIDING WHETHER OMAN SHOULD WORK FOR THE CONTINUATION OF TALKS OR NOT. HE SAID THAT HE SAW LITTLE POINT IN A FURTHER MEETING IN JUNE (OR INDEED ANY OPEC MEETING AT THIS JUNCTURE) UNLESS THERE WAS A REASONABLE GUARANTEE OF A SUCCESSFUL OUTCOME, WHICH CLEARLY COULD NOT BE BASED ON THE SAUDI POSITION WHICH WAS MANIFESTLY UNJUST TO SMALLER OPEC PRODUCES. HE WAS NOT CLEAR WHAT THE SAUDI BOTTOM LINE REALLY WAS AND PROPOSED TO SEND QAIS ZAWAWI (DEPUTY PRIME MINISTER FOR FINANCE) WITH A MESSAGE TO KING FAHD NEXT WEEK. HIS PERSONAL ADVISER, SAYYID HAMAD BIN HAMOUD WOULD GO TO THE UAE AT THE SAME TIME. IF IT PROVED THAT THERE WERE STRONG OVERTONES OF THE PRESENT SAUDI/IRANIAN RIFT IN THE WAY THE SAUDIS WERE LOOKING AT THE OIL ISSUE IT WOULD BE BEST TO PAUSE NOW. OTHERWISE THE EXERCISE COULD BECOME COUNTER PRODUCTIVE.

COMMENT
2. THIS APPROACH IS VERY MUCH AT ONE WITH HIS VIEWS ON THE BROADER GULF SITUATION (MIPT NOT TO ALL). HE CLEARLY BELIEVES THAT IN THE NERVOUS PERIOD BETWEEN NOW AND THE HAJ THERE IS LITTLE PRACTICAL PROSPECT OF PROGRESS ON ANY ISSUE INVOLVING THE SAUDIS AND IRANIANS.

ALSTON

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AND TO PRIORITY: UKDEL IMF/IBRD WASHINGTON
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INFO SAVING KADUNA

ALLEGED NIGERIAN OIL EXPORTS TO SOUTH AFRICA

SUMMARY

1. THE FEDERAL GOVERNMENT MAY INVESTIGATE ALLEGATIONS THAT TWO OIL COMPANIES OPERATING IN NIGERIA, AMONG OTHERS, HAVE BEEN SELLING OIL TO SOUTH AFRICA.

DETAIL

2. THERE HAS BEEN A PRESS REPORT TO THE EFFECT THAT FOLLOWING ALLEGATIONS IN THE US CONGRESS THAT CERTAIN OIL COMPANIES ARE INVOLVED IN INDIRECT TRADING WITH SOUTH AFRICA, NIGERIAN GOVERNMENT OFFICIALS HAVE SUGGESTED THAT AN INVESTIGATION INTO THE COMPANIES CONCERNED MAY BE ORDERED. THE TWO NIGERIAN COMPANIES HAVE NOT BEEN IDENTIFIED, BUT PRESUMABLY ARE NIGERIAN SUBSIDIARIES OF MULTI-NATIONAL OIL COMPANIES. COMPANIES ALLEGED BY THE PRESS TO HAVE INDIRECT TRADING LINKS INCLUDE SHELL, B P, MOBIL, TOTAL AND CALTEX (CHEVRON AND TAXACO). THEY ARE SAID TO BE SELLING CRUDE BOUGHT MAINLY FROM OPEC COUNTIRES THROUGH SUBSIDIARIES TO SOUTH AFRICAN AT A PRICE ABOVE THE OPEC BENCHMARK.

3. THE PRESS REPORT COMMENTS THAT OIL COMPANIES OPERATING IN NIGERIA ACT LARGELY AS MARKETING COMPANIES, SELLING CRUDE OBTAINED FROM NNPC. THEY SELL OIL TO THEIR PRINCIPALS, BUT HAVE NO CONTROL OVER HOW THEIR PRINCIPALS THEN DISPOSE OF THE OIL.

HEAP

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MR BRAITHWAITE

ADDITIONAL 42

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42/2.BTW/4372/21

MARKET SENSITIVE

FINANCIAL SECRETARY TO THE TREASURY

PMP

FROM: J J HEYWOOD
DATE: 26 May 1988

MR BENT

cc PS/Chancellor
Mr D J L Moore
Mr Gunton

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

The Financial Secretary has seen the Question and Answer briefing attached to your minute of 26 May and thinks that it is fine.

pp JForst

JEREMY HEYWOOD
Private Secretary

ps3/76T

CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 27 May 1988

MS H C GOODMAN

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Mowl
Mr Fox
Mr M L Williams
Mr Johns - IR
PS/IR

ROYALTY OIL

The Chancellor was grateful for your minute of 24 May.

2. The Chancellor wishes to go ahead with the change from royalty in kind to royalty in cash without delay. I should be grateful for a draft letter.

J M G TAYLOR

26A/1/jno/4032/060

FROM: H C GOODMAN

DATE: 27 May 1988

1. M L WILLIAMS

2. PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Moore
Mr Sedgwick
Mr Mowl
Mr Fox
Miss Sinclair
Mr Johns- IR
Miss Hill - IR
PS/IR

Ch, Content? (I have amended somewhat). JT 27/5

I have ~~[illegible]~~ amended it rather more drastically!

ROYALTY OIL

Your minute of today recorded that the Chancellor wishes to go ahead with the change from royalty-in-kind to royalty-in-cash now. I attach a draft letter for him to send to the Secretary of State for Energy.

H C Goodman

H C GOODMAN

I suggested that you keep Mr Parkinson's office in touch. He will be returning to the office briefly on 1 June before going to the Far East for 2 weeks.

27.5

26A/1/jno/4032/061

DRAFT LETTER FROM THE CHANCELLOR TO:

Secretary of State for Energy

27 May 1988

ROYALTY OIL

Peter Walker

~~In March 1985 the Prime Minister asked me and your predecessor to consider a move to taking North Sea royalty in cash rather than in kind. For a number of reasons, including the possible impact on the PSBR, we have delayed making this change, but I understand your officials are now reviewing the situation again.~~

put this matter to one side,

Replace with (A)

of switching to royalty in cash was that it would have helped us

to resist

~~In 1985 we saw one of the main advantages in the context of the pressures from OPEC countries to support the oil price by reducing UKCS Production and foregoing royalty oil was seen as a possible route. The other important advantage, and in my view now the main one, flows from our commitment to reduce the role of the public sector and restrict it to activities which cannot be undertaken by the private sector. The sale of oil, and OPA-related trading activities are best undertaken by the private sector.~~

This is now less important. The and more still holds good. That is that switching to royalty in cash would allow us further

Could not

Work towards our objective of restricting it

particularly

I believe that now would be a good time to make the change. ~~As you know~~ Some of the oil industry has, as you know, been critical of the effect ~~on them~~ of it of the budget changes, and Peter Morrison discussed with Peter Lilley ~~earlier~~ last this week whether to table an amendment to the Finance Bill making some concessions. An early announcement of a decision to switch to royalty in cash could greatly lessen the pressures from the industry — and ~~(indeed~~, to maximise the tactical advantage we should make an announcement before the Committee Stage debate expected on Thursday 16 June). The change would take effect from 1 January 1989, and the once-off PSBR costs of some £95 million would fall in ~~falling into~~ this financial year, ~~I should be very grateful if you could see your way to doing this. I recognise that~~ which I wd greatly prefer.

New para

I recognise that

it will require officials to move quickly to complete the necessary arrangements, but I hope this can be done. In the meantime I am content that the work you have put in hand on OPA's other functions should continue as planned.

~~I am copying this letter to the Prime Minister.~~

[NL]

~~cc Prime Minister~~

ps3/81T

MARKET SENSITIVE

FROM: J M G TAYLOR
DATE: 27 May 1988

MR R M BENT

cc PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr D J L Moore
Mr Peretz
Mrs Brown
Mr Ilett
Mr Watts
Mr Devereux
Mr Hurst
Mr Gunton - IDT
Mr Dyer - Parly Sec
Mr Call
Mr Hyett - T.Sol.

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

The Chancellor has seen your minute and enclosures of 26 May, and is content.

J M G TAYLOR

26A/1/jno/4029/056

DWP

FROM: MS P M LEAHY

DATE: 27 May 1988

PS/FINANCIAL SECRETARY

cc PS/CHANCELLOR
PS/EST
Sir P Middleton
Mr Anson
Mr Monck
Mr D J L Moore
Mr R I G Allen
Mrs M E Brown
Mr M L Williams
Mr Bent
Ms Goodman
Mr Hyett - T.Sol

1985 BRITOIL SALE: MULTIPLE APPLICATIONS

This minute is for information only.

2. You should be aware that a Mr Michael Dixon is being brought to trial in October for making multiple applications in the 1985 Britoil sale and in the British Gas sale. Mr Dixon is disputing the charges made against him.

3. I have been called as a witness by the prosecution and will be expected to attend (even though I will be on secondment at the time)

P M Leahy

P M LEAHY

pn?

CHANCELLOR OF THE EXCHEQUER

Ch

£ oil price

	FSBR QII	Latest
$ oil price (NS)	14.00	16.25
$/£ XR	1.79	1.86
£ oil price	7.8	8.7

Thanks ...

AA

RESTRICTED

PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

003347
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FM RIYADH
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MY TELNO 270 : SAUDI OIL POLICY

SUMMARY

1. SAUDIS UNREPENTANT ON NOPEC: THEY WILL STICK TO THEIR GUNS. OBJECTIVES FOR JUNE MINISTERIL INCLUDE BETTER DISCIPLINE AND IMPROVED DEFINITIONS. THEY WOULD LIKE TO SEE IRAQ INCLUDEF WITH A QUOTA EQUAL TO IRAN, BUT ARE NOT (NOT) OPTIMISTIC. SPECULATION ABOUT ALTERNATIVE CEILINGS DEPENDING ON PRICE DEVELOPMENTS.

DETAIL

2. ON 30 MAY HEAD OF CHANCERY CALLED ON DEPUTY MINISTER OF PETROLEUM TO SEEK A SAUDI VIEWPOINT ON THE RECENT OPEC MEETING IN VIENNA AND THE FORTHCOMING MEETING ON 8 JUNE.

3. ABDUL AZIZ TURKI SAID THAT SAUDI ARABIA HAD LONG BELIEVED IN THE PRINCIPLE OF COOPERATION WITH NON-OPEC STATES. THEY FELT THAT ALL OIL PRODUCERS HAD A RESPONSIBILITY TO HELP SUSTAIN PRICES AT A LEVEL THAT WAS IN THEIR COMMON INTEREST IN THE MEDIUM AND LONG TERM. HOWEVER, THE NOPEC COUNTRIES HAD BEEN RATHER FEW AT VIENNA AND THE SAUDIS HAD NOT BEEN CONVINCED THAT THEIR OFFER OF PRODUCTION CUTS WERE GENUINE. (CURIOUSLY, HE EXEMPTED MEXICO FROM THIS STRICTURE.) NOR DID THE SAUDIS ATTACH ANY GREAT WEIGHT TO THE SO-CALLED POLITICAL IMPORTANCE OF REACHING AGREEMENT. THERE HAD BEEN OTHER SUCH DISCUSSIONS PREVIOUSLY AND WOULD NO DOUBT BE MORE IN THE FUTURE. HE FULLY EXPECTED THAT THE POLICY OF SAUDI ARABIA AND HER GULF ALLIES WOULD BE UNCHANGED AT THE FORTHCOMING OPEC MEETING. THERE WAS NO EFFECTIVE POLITICAL PRESSURE ON THEM TO CHANGE POLICY, AND THEY HAD NO (NO) INTENTION OF DOING SO.

4. TURNING TO THE 8 JUNE MEETING, ABDUL AZIZ TURKI REAFFIRMED THAT THE CHIEF SAUDI OBJECTIVE WOULD BE THE RESTORATION OF SOME ELEMENT OF DISCIPLINE TO OPEC. HE REMARKED THAT SAUDI

ARABIA WAS ONE OF THE FEW COUNTRIES TO KEEP THEIR QUOTA. AT PRESENT, NOBODY WAS SELLING AT THE OFFICIAL PRICE: SAUDI ARABIA INTENDED TO SELL HER FULL QUOTA, AND WOULD FOLLOW PRICE MOVEMENTS AS NECESSARY IN ORDER TO DO SO. THEY, LIKE OTHERS, NEEDED THE REVENUE.

5. GREEN ENQUIRED ABOUT THE SCOPE FOR PERSUADING OVER-PRODUCERS TO CUT BACK. TURKI SAID THAT SAUDI ARABIA WAS TRYING WITHIN OPEC TO GET IRAN TO ACCEPT THAT IRAQ SHOULD HAVE A QUOTA EQUAL TO IRAN. THIS WOULD BE IN THE IRANIAN INTEREST SINCE THE IRAQIS WERE CURRENTLY PRODUCING 2.6 MBD AND, OF NEUTRAL ZONE PRODUCTION, 120,000 BARRELS WERE SOLD ON IRAQI ACCOUNT (AND 70,000 ON SAUDI ACCOUNT). IN THEORY, THEREFORE, THE IRANIANS WOULD ACHIEVE A 0.5 MBD REDUCTION IN IRAQI PRODUCTION. HOWEVER, HE RECOGNISED THAT THEY WOULD FACE VERY SEVERE POLITICAL DIFFICULTIES IN CONCEDING THE PRINCIPLE OF EQUAL QUOTAS.

6. TURKI ACKNOWLEDGED THAT ABU DHABI HAD RECENTLY MAKE A CUT IN THEIR PRODUCTION, BUT THE UAE AS A WHOLE WAS STILL 0.3 MBD OVER QUOTA. HE DID NOT SEEM OPTIMISTIC ABOUT THE PROSPECTS OF PERSUADING THEM TO REDUCE FURTHER, REFERRING VAGUELY TO THEIR BUDGETARY DIFFICULTIES.

7. SAUDI ARABIA WILL ALSO BE SEEKING PROGRESS ON THE QUESTION OF DEFINITIONS. THE SAUDIS INCLUDED BOTH REFINERY LOSS AND OIL CONSUMED BY THE PETROCHEMICAL INDUSTRY WITHIN THEIR QUOTA. OTHERS SHOULD DO THE SAME. THE QUESTION OF CONDENSATES WOULD ALSO BE DIFFICULT.

8. TURKI DID NOT DISSENT FROM THE THOUGHT THAT THE MARKET MIGHT IMPROVE LATER IN THE YEAR. STRESSING THAT HE WAS SPECULATING, HE SAID THAT THERE MIGHT BE A CASE FOR ALTERNATIVE CEILINGS TO BE AGREED FOR AUTUMN 1988. THE CEILING ADOPTED WOULD DEPEND ON THE OUTTURN FOR DEMAND. IF THE PRICE ROSE FOR A SUSTAINED PERIOD IT WOULD AUTOMATICALLY TRIGGER A HIGHER CEILING. THIS IDEA HAD BEEN REJECTED IN 1987 WITH THE RESULT THAT, WHEN THE PRICE HAD REACHED US DOLLARS TWENTY, THERE HAD BEEN A RUSH OF PRODUCTION WHICH IT HAD NOT PROVED POSSIBLE TO CONTAIN. HE HOPED, WITHOUT MUCH CONFIDENCE, THAT WISER COUNCILS WOULD PREVAIL THIS TIME.

COMMENT

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9. IT IS CLEAR THAT THE POLICY GUIDELINES HAVE NOT CHANGED (MY TUR), ALTHOUGH THE SAUDIS WILL NO DOUBT ADJUST THEIR TACTICS IN THE LIGHT OF DEVELOPMENTS.

EGERTON

YYYY

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ADDITIONAL 42

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cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Moore
Mr Sedgwick

CONFIDENTIAL

Mr Mowl
Mr Fox
Miss Sinclair
Mr M L Williams
Mr H C Goodman
Mr Johns - IR
Miss Hill - IR
PS/IR

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

1 June 1988

PWP

The Rt Hon Cecil Parkinson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1

Dear Cecil

Since 1979 a proportion of North Sea royalty has been taken in kind rather than in cash. This benefited the PSBR in the first year since receipts in kind arrive some four months earlier than receipts in cash.

The matter was reviewed in 1985, when BNOC was abolished and the much more modest OPA set up in its place. It was clearly consistent with that decision to transfer the business of selling oil and the accompanying OPA-related trading activities to the private sector. However, for a number of reasons, not least the immediate adverse impact on the PSBR, it was decided that no action should be taken for the time being.

I understand your officials are now reviewing the situation once again. I am sure this is sensible. The policy argument for switching back from taking royalty in kind to taking it in cash remains a powerful one, while the PSBR can no long be held to require any artificial assistance.

Indeed, I believe that now would be a particularly good time to make the change. The oil industry has, as you know, been critical of the effect of some of the Budget changes, and Peter Morrison discussed with Peter Lilley last week whether to table an amendment to the Finance Bill making some concessions. An early announcement of a decision to switch to royalty in cash could greatly lessen the pressures from the industry - and to maximise the tactical advantage we should make an announcement before the Committee Stage debate expected on Thursday, 16 June. The change would take effect from 1 January 1989, and the one-off PSBR costs of some £95 million would fall in this financial year, which I would greatly prefer.

I recognise that it will require officials to move quickly to complete the necessary arrangements, but I hope this can be done. In the meantime, I am content that the work you have put in hand on OPAs and other functions should continue as planned.

Yours
Nigel

NIGEL LAWSON

THE MINISTER OF STATE

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ
Direct Line 01-211 3290
Switchboard 01-211 3000

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

BF 7/6 ~~[illegible]~~ [illegible]

3 June 1988

Dear Nigel.

Thank you for your letter of 1 June to Cecil about the taking of Royalty in Kind. I am replying as he is now in the Far East.

I welcome your agreement that we should now review the future of OPA and the policy of taking Royalty in Kind (RIK). It is also helpful to know that you do not regard the once-for-all adverse impact on the PSBR as an obstacle to ending RIK if that should be our conclusion.

This year

I doubt very much, however, whether the ending of RIK would be taken by the oil industry as a significant concession in the context of the Southern Basin budget changes. The balance of companies concerned is, of course, different, and the interest savings to the industry are fairly modest. I am afraid that an announcement on the eve of Committee Stage would be taken by the industry as a sop which demonstrated that we had not taken their representations seriously.

??

One of the points that I made to Peter Lilley on the Budget is that we should either make a concession that would be judged by the industry to show that we had listened to their points or that we should make none at all. My own view is that there is a lot to be gained by giving just enough to restore confidence. But I have made it clear that I defer very much to Peter's judgement and that he has my full support for going ahead as announced if that is his final conclusion. He has asked officials to study the merits of the case that the industry have put and I agree that that should be our next step.

I am sure you are right that the ending of RIK would be regarded as a favourable development by the oil industry. If we eventually decide to make no concession on the Budget then an announcement later this year, after the dust has settled, would do something to restore relations. I think it would be much better received than it would be next week.

But even if the ending of RIK would have helped in the context of the Budget and unusually for me, since I generally prefer to do everything yesterday, I think it would be a mistake to rush the decision. The taking of RIK, the future of OPA, and our future policy on participation oil as security are all closely related issues. There would be a serious risk of a muddle, which I would be most reluctant to take, in making an announcement on RIK before we had taken decisions on the other issues that flow from it and put in place the necessary arrangements for implementation.

For this reason I would much prefer to follow the course that we have set. This is to complete the transfer of responsibility for OPA's Government Pipeline role to MOD as quickly as possible while pressing ahead with our reviews of the wider issues. Depending on the conclusions that were reached this should put us in a position to make a comprehensive announcement in November, at which time (if OPA was to be wound up) we would have agreed a management plan for the Agency through to June 1989 when the last RIK would be taken.

I hope you can agree that this is the most realistic approach.

PETER MORRISON

3701/18/sh

CONFIDENTIAL

FROM: D J L MOORE

DATE: 3 JUNE 1988

SIR PETER MIDDLETON

cc PS/Chancellor
PS/Financial Secretary
Mr Monck
Miss Goodman

MMC: KIO HOLDING IN BP

I was up before the MMC yesterday together with Energy officials who had prepared the submission and who took most of the questions.

2. The Chairman, Sydney Lipworth, was particularly interested in establishing why the public interest was at risk from a holding of 22½% by a company which had declared that it wished to hold the investment long term, but not to intervene in management. If this were so, why worry and how much real substance was there in the possible situations envisaged by Energy? The KIO might propose some things which make could commercial sense for BP and so there would be no problem in that. But if they made proposals against BP's interests, and those of other shareholders, the BP Board ought to be able to resist them. If the KIO were forced to divest some of their shareholdings, might not the USA, for example, take the opportunity to promote a protectionist policy against UK companies investing there.

3. Our main line was that it was crucial to recognise that the KIO were no ordinary foreign company investing here, but that they were an arm of a foreign government whose policies on oil differed from those of HMG. There could be no certainty that their interests would remain passive, and damaging developments could follow. It is difficult to be certain how MMC responded to this, and they have yet to see BP and the KIO. But our impression was that they saw force in our concerns.

4. I had a number of questions put to me. I explained why there had been no Special Share: the company had not wanted one and we

thought it reasonable that a longstanding private sector company should rely on no more than the Fair Trading Act regime. I acknowledged that we had recognised that there was a risk of a predator - though we had not expected to see the KIO at 22% - but that this was only one of a number of factors which the Chancellor took into account in making his decision to go ahead with the sale.

5. I said that I did not think that we could rely on a situation over the long term in which institutional holders and the Treasury voted in support of BP against an aggresive KIO. Our own and the institutional holdings were individually small and we could not assume that the institutions would all wish to continue voting against the KIO.

6. Encouragingly, the last part of the session was on the theme of what type of recommendation the MMC might make if they found that the holding was indeed contrary to the public interest. We declined to be drawn on a figure for what might be an appropriate level of holding and politely suggested that was for the Commission to advise or decide upon.

7. Sam Wainwright (ex Giro) put it to me that the Treasury had done very well out of the KIO, who had affectively stopped the shares being left with the Bank, and that we could not now expect them to sell at a loss. Were we considering setting up some support arrangements to stop this happening? I said that we were not, and that the Government had no intention of buying any of the KIO's holding. We had not minded some Kuwaiti buying but we had certainly not welcomed or encouraged anything near 22%. I suggested that the aim should be for an orderly run down in the holding so as to avoid a damaging fall in the price. I pointed out that there could well be considerable interest from other overseas investors in taking over the holding eg, in the States.

DJLM.

D J L MOORE

M

PWP

To: A.D.MURRAY (DTN009)
From: M.S.D.GRANATT (DTN010) Delivered: Mon 6-June-88 19:40 BST Sys 10
7 ([redacted])
Subj[redacted]t: OIL QUOTE FROM SOS AND COMMENTS
Mail Id: IPM-10087-880606-177071143

"Obvious" seems a bit strong.

SOS PRESS CONFERENCE, JAKARTA, MINISTRY OF ENERGY, 6 JUNE

Q. WHAT DO YOU EXPECT FROM THE OPEC MEETING?

A. It's very difficult to predict what the outcome of Opec meetings will be. But I think there is a general agreement, and I have met the ministers from virtually all the Opec countries...there is very general agreement everybody stands to gain from stable prices...the Opec members, the non-Opec members, even the users in many ways, prefer stable prices, rather than wildly fluctuating ones. So I think that if the meeting was to be successful, then it would probably have to result in the Opec members accepting the offer of the non-Opec members to reduce their production by 5 per cent if the Opec members will. I think the aim would be to try to stabilise the price at around the 18 dollar mark. That is what is the ambition, that is what the Saudi minister has said to me. I know that is what other Ministers in Opec would wish. That's what they'll be trying to achieve. And we support that as an objective.

[Glad to add explanation, but [illegible] [illegible] spoke in a way that [illegible] unsurprising [illegible]]

MY COMMENT. The references are obvious to anybody who knows the oil scene.

"Non-Opec" refers to the group of non-members who have been discussing production levels. UK is not one of them. Our position is well known, and we were not even invited to join in.

"And we support that objective", refers to oft-made statements by UK ministers supporting a stable, rather than a "wildly fluctuating" price. The UK Goverment has made it clear that it does not seek a particular price; it believes that prices are best determined by the market, and that North Sea production must be determined by the operators on a commercial basis. Oil is only 2 per cent of our GDP, and while a rise in the price increases oil revenues, falls in the price benefit our industries. The effects are therefore broadly neutral.

So, there is nothing new in what Mr Parkinson said, and nothing that contradicts our long-held and well-understood position. Secretary of State also pointed out that the UK believes market forces should determine the level of production.

MSDG

[illegible] [illegible] [illegible]

SW

Chancellor's Office 12/2

* Don't like any of this.

UK ENERGY MINISTER SUPPORTS OPEC 18 DLR OIL TARGET NRAT

JAKARTA, JUNE 6, REUTER - BRITAIN SUPPORTS THE ORGANISATION OF PETROLEUM EXPORTING COUNTRIES' AIM OF STABILISING OIL PRICES AROUND 18 DLRS A BARREL, BRITISH ENERGY MINISTER CECIL PARKINSON SAID ON MONDAY AFTER MEETING WITH INDONESIA'S PRESIDENT SUHARTO.

Ch??

ON A FOUR-DAY VISIT TO OPEC-MEMBER INDONESIA, PARKINSON SAID ALTHOUGH BRITAIN WAS OUTSIDE OPEC, IT WAS EFFECTIVELY AIDING EFFORTS TO BRING OIL PRICES BACK UP TO THE 18 DLR REFERENCE PRICE AS ITS OWN OUTPUT WAS GRADUALLY FALLING AS PRODUCTION FROM ITS MAJOR NORTH SEA FIELDS GO INTO DECLINE.

U.K. OUTPUT PEAKED AT 2.757 MLN BPD IN JANUARY 1986 BUT HAS NOW FALLEN BACK, AND IS CURRENTLY RUNNING JUST BELOW 2.6 MLN.

AAMM 1330 GERMAN NET CURRENCY RESERVES FALL 3.4 BILLION MARKS TO 95.9 BILLION IN WEEK

CONTINUED ON - NRAU

P

DUTCH STOCKS-OFFN 1434

UK ENERGY MINISTER =2 JAKARTA NRAU

"THE MAIN WAY THAT OPEC IS TRYING TO STABILISE THE PRICE IS BY REDUCING PRODUCTION. AS I SAY, WE ARE REDUCING PRODUCTION INEVITABLY BECAUSE OUR BIG FIELDS ARE NOT PRODUCING AS MUCH AS THEY DID," PARKINSON TOLD REPORTERS.

"WE ARE NOT INCREASING OUR PRODUCTION WHILE OPEC IS REDUCING IT. OUR PRODUCTION IS IN FACT REDUCING NATURALLY. SO OUR POLICY IS RUNNING IN PARALLEL WITH OPEC. AND WE THINK IN SOME WAYS WE ARE BETTER MEMBERS OF OPEC THAN SOME OF THE MEMBERS WHO PROMISE TO REDUCE PRODUCTION AND DON'T.

"WE AREN'T MEMBERS, BUT WE ARE REDUCING PRODUCTION," HE STATED.

06-JUN-1257. MON544 MONC

CONTINUED FROM - NRAT CONTINUED ON - NRAV

P

DUTCH STOCKS-OFFN 1434

UK ENERGY MINISTER =3 JAKARTA NRAV

THE U.K. GOVERNMENT HAS ALWAYS REFUSED REQUESTS FROM OPEC TO INTERVENE TO REDUCE ITS OIL OUTPUT TO SUPPORT PRICES, ARGUING OUTPUT LEVELS ARE THE RESPONSIBILITY OF THE OIL COMPANIES.

PARKINSON, WHO ARRIVED IN JAKARTA ON SUNDAY FROM BURMA, DISCUSSED BRITISH INVESTMENT OPPORTUNITIES AS WELL AS PROSPECTS FOR OPEC'S JUNE 11 CONFERENCE WITH INDONESIAN OIL MINISTER GINANJAR KARTASASMITA, AND WILL MEET WITH SIX OTHER MINISTERS.

PARKINSON SAID A KEY TO THE SUCCESS OF THE FORTHCOMING OPEC VIENNA MEETING WAS WHETHER THE GROUP COULD RESPOND POSITIVELY TO AN OFFER BY SIX NON-OPEC PRODUCERS TO LIMIT THEIR CRUDE EXPORTS TO HELP UNDERPIN SAGGING OIL PRICES.

06-JUN-1259. MON549 MONC

CONTINUED FROM - NRAU CONTINUED ON - NRAW

P

DUTCH STOCKS-OFFN 1434

UK ENERGY MINISTER =4 JAKARTA NRAW

"THERE IS A VERY GENERAL AGREEMENT THAT EVERYBODY STANDS TO GAIN FROM STABLE PRICES ... SO I THINK IF THE MEETING WAS TO BE SUCCESSFUL, THEN IT WOULD PROBABLY HAVE TO RESULT IN THE OPEC MEMBERS ACCEPTING THE OFFER OF THE NON-OPEC MEMBERS TO REDUCE THEIR PRODUCTION BY FIVE PCT IF THE OPEC MEMBERS WILL," HE SAID.

PARKINSON SAID, "I THINK THE AIM WOULD BE TO TRY THE STABILISE THE PRICE TO AROUND THE 18 DLR MARK. THAT IS WHAT IS THE AMBITION, THAT IS WHAT THE SAUDI MINISTER HAS SAID TO ME. I KNOW THAT IS WHAT OTHER MINISTERS IN OPEC WOULD WISH. THAT'S WHAT THEY WILL BE TRYING TO ACHIEVE, AND WE SUPPORT THAT AS AN OBJECTIVE."

06-JUN-1302. MON554 MONC

CONTINUED FROM - NRAV ENDS

P

DUTCH STOCKS-OFFN 1434

2

26A/1/jno/300/028

CONFIDENTIAL

FROM: H C GOODMAN

DATE: 6 June 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr D L Moore
Mr Sedgwick
Mr Mowl
Mr M L Williams - o/r
Mr Fox
PS/IR
Mr Johns - IR

yes

Ch/
Somewhat fence-sitting advice, but there is a steer towards acquiescing with Mr Morrison.
If you agree, I will arrange for a draft to be prepared
JT 6/6

Ch
A word cut Mr Morrison on lines deal is "accept now or all lets off"?
AA

ROYALTY OIL

Peter Morrison has now responded to your letter of 1 June to Cecil Parkinson, arguing against announcing a change from Royalty in Kind to Royalty in Cash (RIC) this month.

2. There will of course be another opportunity to make this change in six months time. Mr Morrison argues that, in any case, a switch to RIC is not an appropriate response to the industry's concerns over the budget changes to the Southern Basin regime, since there would be a mismatch between the gainers and losers. The Revenue, will of course, be submitting to the Economic Secretary later in the week on the question of making a concession on the Southern Basin, but it is not-able that the Department's concern over relations with the industry does not extend to seeing the earliest possible RIK/RIC switch.

3. Whenever an announcement is made it will be necessary to make arrangements for the Revenue to get information on market prices from alternative sources and to agree a redundancy package for the oil traders to ensure that trading capacity for the last 6 months is not depleted to a harmful degree, while being acceptable

CONFIDENTIAL

on cost grounds. There are now only ten days left before the Committee Stage debate on Southern Basin expected on 16 June. As you know Mr Parkinson is currently in the Far East, so in order to get these conjunctural issues sorted out, if you wanted to press the point, you would probably have to speak personally to Mr Morrison as soon as possible.

H C Goodman

H C GOODMAN

CONFIDENTIAL

PMP

From: S D H SARGENT
Date: 6 June 1988

MR MOORE

cc PS/Chancellor
PS/Financial Secretary
Mr Monck
Miss Goodman

MMC: KIO HOLDING IN BP

Sir Peter Middleton was grateful for your minute of 3 June.

SL

S D H SARGENT
Private Secretary

CONFIDENTIAL

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr D J L Moore
Mr Sedgwick
Ms H C Goodman
Mr Mowl
Mr M L Williams
Mr Fox
PS/IR
Mr Johns - IR

PMP

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

PRIME MINISTER

ROYALTY OIL

Since 1979 we have taken a proportion of our royalties from North Sea oil in kind rather than in cash.

We reviewed this arrangement in 1985, when BNOC was abolished and replaced by the more modest OPA. It was clearly consistent with that decision to transfer the business of selling oil and the accompanying OPA-related trading activities to the private sector. We decided, however, that no action should be taken at that stage - primarily because of the immediate adverse impact on the PSBR, since receipts in kind are paid some four months earlier than receipts in cash.

I have now considered the matter again in consultation with Peter Morrison. The argument for switching to royalty in cash remains as strong as ever. And we are now in a position where the one-off effect on the PSBR - some £95 million - could be accommodated this year. The change could be set in the context of a minor concession on the oil allowances which I propose to make in the Finance Bill, to meet the strong representations which the industry has made about the Budget proposals.

I have concluded, therefore, that we should now press ahead with the change. The change can only be made on 1 July or 1 January, and the oil companies must be given six months notice. This means that an early announcement is essential if we are to make the change in

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this financial year. I propose that the Department of Energy should announce the change by Written Answer on 16 June. Peter Morrison is content with this.

I am copying this minute to Peter Morrison.

NL

[N.L.]

9 June 1988

Chancellor's Office 12/6

KUWAIT SUSPENDS BP SHARE BUYING PENDING INQUIRY OIGV
LONDON, JUNE 9, REUTER - THE KUWAIT INVESTMENT OFFICE, AN ARM OF THE KUWAIT GOVERNMENT, HAS AGREED NOT TO ADD TO ITS AROUND 22 PCT STAKE IN BRITISH PETROLEUM CO PLC (BP.L) PENDING THE OUTCOME OF A U.K. MONOPOLIES COMMISSION INQUIRY.
THE KIO STAKE IN BP WAS REFERRED TO THE COMMISSION ON MAY 3, AND THE GOVERNMENT ASKED THE PANEL TO REPORT WITHIN FOUR MONTHS.
A STATEMENT FROM THE DEPARTMENT OF TRADE AND INDUSTRY, DTI, SAID IT HAD RECEIVED KIO UNDERTAKINGS THAT KUWAIT WOULD NOT BUY ANY MORE BP SHARES OR SEEK REPRESENTATION ON THE BP BOARD DURING THE INQUIRY.

09-JUN-0809. MON506 OILC

CONTINUED ON - OIGW

P

REUTER MONITOR 0844

KUWAIT SUSPENDS =2 LONDON OIGW
KUWAIT ALSO UNDERTOOK NOT TO BUY ANY BP ASSETS DURING THE INQUIRY, EXCEPT "IN THE ORDINARY COURSE OF BUSINESS", AND NOT TO REQUISITION A SPECIAL MEETING OF BP SHAREHOLDERS.
THE DTI SAID IT WAS NORMAL PRACTICE TO SEEK SUITABLE INTERIM UNDERTAKINGS FROM THE PARTY BUYING SHARES WHENEVER A REFERENCE WAS MADE TO THE MONOPOLIES COMMISSION.
INDUSTRY SOURCES SAID THE COMMISSION'S HEARINGS HAVE ONLY RECENTLY BEGUN. THE KIO HAS STARTED MAKING SUBMISSIONS, BUT THE COMMISSION HAS STILL TO HEAR ARGUMENTS FROM BP.
SPECULATION IN THE MARKET CENTRES ON WHETHER THE KIO MAY BE REQUIRED TO LIMIT ITS STAKE TO PERHAPS 20 PCT OR EVEN 10 PCT.
09-JUN-0847. MON518 OILC

CONTINUED FROM - OIGV CONTINUED ON - OIGX

P

REUTER MONITOR 0844

KUWAIT SUSPENDS =3 LONDON OIGX
INDUSTRY AND BROKERAGE SOURCES SAID BP BECAME PROGRESSIVELY UNHAPPY OVER THE KIO'S STAKE-BUILDING EXERCISE WHICH GOT UNDER WAY IN THE AFTERMATH OF THE UNSUCCESSFUL 7.5 BILLION STG BP SHARE ISSUE LAST OCTOBER.
THE KIO WAS ABLE TO TAKE ADVANTAGE OF THE COLLAPSE OF BP'S SHARE PRICE TO ACQUIRE A SIGNIFICANT MINORITY HOLDING. THE U.K. GOVERNMENT'S OFFER FOR SALE OF ITS REMAINING 31 PCT STAKE IN BP COINCIDED WITH THE WORLDWIDE STOCK MARKET CRASH.
BP IS INEVITABLY WORRIED THAT ITS FUTURE DEVELOPMENT PLANS COULD BE HAMPERED IF THE COMPANY WERE SEEN TO BE PARTLY CONTROLLED BY A GULF STATE MEMBER OF OPEC.
09-JUN-0928. MON589 OILC

CONTINUED FROM - OIGW ENDS

P

REUTER MONITOR 0844

CONFIDENTIAL

/EXCHEQUER ✓13/6

REC 13 JUN1988

ACTION Ms H. C. Goodman

COPIES TO CST, EST
Sir P. Middleton
Sir T. Burns
Mr Scholar Mr Culpin
Mr D L Moore Mr Sedgwick
Mr M Cowl Mr M. L Williams
Mr Fox
PS/IR Mr Johns I/R

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

13 June 1988

Dear Alex,

ROYALTY OIL

The Prime Minister has seen the Chancellor's minute of 9 June, and is content for the proposed switch to royalties in cash to be made.

I am copying this letter to S.J. Whiting (Minister of State's Office, Department of Energy).

Yours,

Paul

PAUL GRAY

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

CONFIDENTIAL

26A/1/jno/300/068

CONFIDENTIAL

FROM: H C GOODMAN

DATE: 14 June 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr D L Moore
Mr Sedgwick
Mr Mowl
Mr Fox
Mr M L Williams
PS - IR
Mr Johns -IR

Ch – Content for me to say "content"? (The answer looks all right to me). JS 14/6

Content. But [illegible] how [illegible] participation agreements?

ROYALTY OIL

Mr Morrison has written to you today with a draft written Parliamentary question and answer to announce the change from Royalty in Kind to Royalty in Cash, which he wishes to make on Thursday.

2. In addition to covering the change from RIK to RIC, which the Prime Minister agreed to, Mr Morrison proposes stating that he intends to phase out the participation arrangements with the oil companies. The justification for the parcipation arrangements is of course that in a time of crisis they could be used to secure oil supplies. However, it is doubtful whether they would be effective, and there are other defences such as compulsory stocking arranged by the IEA and EC so to retain the particapation arrangements simply for presentational purposes seems somewhat pointless and, in any case, as with oil trading, they extend the role of the public sector. There may be some criticism of this decision, but since the Department of Energy judge that the presentation of ending participation will be better if they do not appear on the defensive, we see no reason to object to this.

3. Mr Morrison has asked for any comments by 10 o'clock tomorrow morning. Perhaps your Private Secretary could telephone saying that the Treasury has none.

H C Goodman

H C GOODMAN

CONFIDENTIAL

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ

Direct Line 01-211 3290
Switchboard 01-211 3000

THE MINISTER OF STATE

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

CH/EXCHEQUER
REC. 14 JUN1988
ACTION Ms H C GOODMAN
COPIES TO CST, EST, SIR P MIDDLETON, SIR T BURNS, MR SCHOLAR, MR CULPIN, MR D L MOORE, MR SEDGWICK, MR MCCOOL, MR M L WILLIAMS, MR FOX, PS/IR, MR JOHNS IR

14 June 1988

Dear Nigel.

ROYALTY OIL

Following our discussion last week and your minute of 10 June to the Prime Minister, I have prepared the announcement which I would propose to make by way of written answer this Thursday 16 June.

Announcement of our decision on RIK will necessitate making clear our intentions about the future of state participation in oil production. This seems to me the right opportunity for us to take credit for what we intend on this front rather than be pressed to do so in the aftermath. I have also indicated a sentence on the GPSS, where we can expect to be pressed similarly along the lines of my letter of 10 June to Ian Stewart.

It is of course essential that we keep OPA's traders in place over the final period until the last of the royalty oil has been sold. I am therefore asking the Board to prepare a suitable retention package along the lines of that offered in similar circumstances during the wind-up of BNOC.

I am copying this letter to the Prime Minister and to the Secretary of State for Defence. I would be grateful for any comments by 10.00 am tomorrow (Wednesday) at the latest.

PETER MORRISON

CONFIDENTIAL

Q To ask the Secretary of State for Energy whether he intends to review the role of the Oil & Pipelines Agency and if he will make a statement.

A The Oil and Pipelines Agency (OPA) is responsible for collecting royalty in kind, for maintaining the arrangements for state participation in oil production in the UK Continental Shelf and for managing the Government Pipeline and Storage System (GPSS). Following review, the Government has decided to cease taking royalty in kind. Notice is being given to the companies concerned that the final chargeable period for royalty in kind will run from 1 July to 31 December 1988 and that from 1 January 1989 all royalty will be taken in cash. With the ending of the trading activities of OPA, it will be my intention to phase out the participation arrangements with the oil companies. We shall be discussing with OPA and the industry the best means of achieving this. My Hon Friend, the Minister of State for the Armed Forces, has agreed in principle that responsibility for the GPSS should be transferred to his Department.

NH8/6Jo

CONFIDENTIAL

67 4/7 67 23/6

J
Before Wednesday
this week
Sarah

Pse chase

FROM: J M G TAYLOR

DATE: 15 June 1988

Pse chase

MS H C GOODMAN
4783

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr D L Moore
Mr Sedgwick
Mr Mowl
Mr Fox
Mr M L Williams
PS/IR
Mr Johns IR

BF 8/7

J
DEn are having a
Meeting on friday and
nothing can be done before
that so hopefully early
next week
Sarah

ROYALTY OIL

The Chancellor has seen your minute of 14 June. He was content for me to telephone Mr Morrison's office to say that we had no comments, and I have done so.

2. The Chancellor has asked how long it will take to phase out the participation arrangements. I should be grateful for advice.

J M G TAYLOR

CONFIDENTIAL

3709/29

Passed on to PS/PM

FROM: D J L MOORE
DATE: 22 JUNE 1988

I would rather like to delete the last sentence.

SIR PETER MIDDLETON

cc PS/Chancellor
PS/Economic Secretary
Mrs Lomax
Mr Ilett
Miss Goodman

BP/KIO

The MMC have asked Energy for written answers to a number of supplementary questions. One of them falls to us:-

> Whether findings in relation to this inquiry which result in divestment or restrictions in respect of the holdings of the Government of Kuwait will have adverse effects on the international standing of the City of London as a capital market?

Subject to your views I propose we answer:-

> No. It would be recognised that the decision applied to one holding in one company and had been reached in the light of special and unusual circumstances. ~~Moreover, the UK domestic equity market is only a part of the City's international activities.~~

D J L MOORE

FROM: S P JUDGE
DATE: 24 June 1988

MR D J L MOORE

cc PS/Chancellor (*)
PS/Financial Secretary (*)
PS/Sir Peter Middleton
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Miss O'Mara
Mr Culpin
Mr Cropper
Mr Tyrie
PS/Inland Revenue (*)
Mr Bryce - IR (*)
(* without attachment)

SOVEREIGN IMMUNITY: KIO AND BP

Thank you for your+ help on Tuesday with this. I thought you might like to see the Paymaster's response during the debate on the Opposition's amendment.

S P JUDGE
Private Secretary

+ and Miss O'Mara's

Covering CONFIDENTIAL

FROM: D W OWEN
DATE: 28 JUNE 1988

1. MR SEDGWICK Approved i draft

2. CHANCELLOR

Thanks. [Must give a good deal more time for PM mtg on 5/7]

cc Sir P Middleton
Sir T Burns
Mr Scholar
Mr Odling-Smee
Mr S Davies
Mr Gieve
Mr Grice
Mr Hibberd
Mr Pickford
Mr Allum
Mr Brooks o/r
Mr P Davis

RECENT TRENDS IN NON-OIL VISIBLE TRADE

I attach a note which discusses our analysis of recent trends in non-oil trade. In particular, it examines the extent to which other data - notably on output - are consistent with the disappointing figures for the early months of the year, and looks at trade performance by sector within manufacturing industry.

2. This work was done before and during the past forecast round. The conclusions are summarised in paragraphs 17-18 (for exports) and 21 (for imports).

David Owen

D W OWEN
EA2

CONFIDENTIAL

RECENT TRENDS IN NON-OIL VISIBLE TRADE

The non-oil visible trade deficit rose through 1987 and widened further in the first quarter of 1988, to £4.9 billion. The deterioration during the year to 1988Q1 is more than accounted for by volume movements - recorded export volumes fell by 2 per cent while import volumes rose by 13 per cent. The non-oil terms of trade improved by 2½ per cent over the same period, as the exchange rate appreciated.

Table 1 : Visible trade balance

	Visible balance	of which oil	non oil	Non oil volumes Exports	Imports	Ratio	Non oil terms of trade
		(£ billion)			(1980=100)		(1980=100)
1986	-8.5	4.1	-12.5	115.4	141.0	81.8	99.8
1987	-9.6	4.2	-13.8	123.6	152.9	80.8	101.0
1987 1	-1.2	1.2	-2.4	121.2	140.0	86.6	99.0
2	-2.3	1.0	-3.3	120.1	149.5	80.3	101.7
3	-3.1	0.9	-4.0	125.8	160.1	78.6	101.4
4	-3.0	1.1	-4.1	127.3	161.9	78.6	101.5
1988 1	-4.0	0.9	-4.9	118.6	158.2	75.0	101.4
Dec	-1.0	0.3	-1.4	127.8	162.8	78.5	101.5
Jan	-1.6	0.4	-1.9	117.1	162.3	72.2	100.9
Feb	-1.5	0.3	-1.8	116.1	157.9	73.5	100.9
Mar	-1.0	0.2	-1.2	122.6	154.6	79.3	102.4
Apr	-1.2	0.3	-1.5	129.0	167.9	76.8	101.9
May	-1.7	0.2	-1.9	125.0	170.8	73.2	100.9

Export volumes

2. The volume of exports grew strongly between the first and second halves of 1987 but fell sharply in the first quarter of 1988. The falls in early 1988 occurred in all categories but were particularly marked for manufactures. In the year to 1988Q1 exports of manufactures fell slightly but the largest falls were in exports of non manufactures, especially basic materials which were temporarily boosted by carousel trade in olive oil in early 1987.

Suspicions

What is this?

!

What market

Table 2 : Export volumes

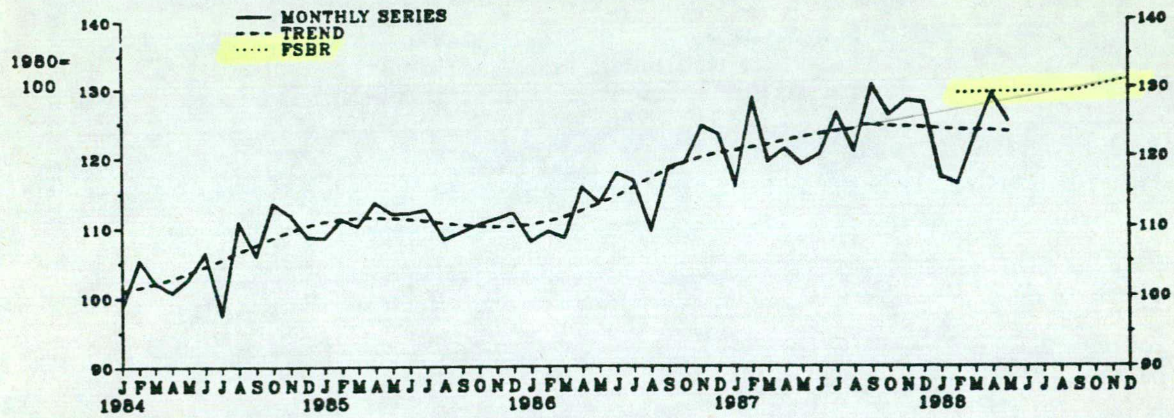
BOP basis, £ billion, 1980 prices

	Manufactures	Fuel	Non-manufactures*	Total	Total less oil
1986	39.9	11.3	7.0	58.2	47.3
1987	43.2	11.1	7.1	61.5	50.7
1986 4	10.5	2.9	1.9	15.3	12.5
1987 1	10.5	2.9	1.9	15.3	12.4
2	10.5	2.7	1.7	14.9	12.3
3	11.0	2.6	1.8	15.4	12.9
4	11.3	2.9	1.7	15.9	13.1
1988 1	10.4	2.8	1.7	14.9	12.2
% change 1988Q1 on					
- previous quarter	-7.6	-5.0	-2.0	-6.5	-6.8
- a year earlier	-0.8	-5.8	-8.9	-2.7	-2.2

* excl. fuel

3. Chart 1 shows recent published monthly figures and a representation of the trend. This is a much smoother representation than used by DTI in their monthly assessments, and removes the seasonal peaks and troughs evident in their trend lines. But it is still quite heavily weighted towards recent observations and shows a small fall in early 1988. The recent observations are clearly well below the figures underlying the FSBR forecast.

Chart 1 : Trend in the volume of non-oil exports.



4. The fall in recorded exports could reflect a combination of:

- distortions in the timing of recorded exports as a result of the introduction of new Customs procedures on 1 January

- a rise in general underrecording of exports, perhaps also related to Customs '88

- residual seasonality - exports also fell in the early months of 1986 and 1987 but recovered strongly in the second half of each year

- possibly a genuine slowing in underlying export growth.

These issues are discussed in turn. We have more general worries about possible under-recording of exports relative to imports over a longer period, when the compromise adjustment and residual error have been rising. However, this could not possibly explain the scale of the short-term deterioration since mid-1987.

Timing of distortions

5. The evidence so far, on the effect of Customs '88 on the timing of recording of exports, suggests that:

(i) the submission of documents was accelerated and/or the shipment of goods was brought forward in December, so that a larger proportion than usual of non-oil December shipments were recorded in the December month of account - 64 per cent compared to the previous average of 56 per cent.

(ii) new SAD documents were submitted more slowly than usual in January and, to a lesser extent, February so that recording of exports in this period may have been delayed.

(iii) recording appeared to return broadly to normal in March and April, but it is too soon to be sure that the figures are now free of distortions.

6. The main implication is that some exports which would normally have been recorded in January were brought forward into the December figures and some delayed until February. This would help explain the fall in recorded exports in January (see Table 1), but the extent of distortions within the first quarter cannot yet be estimated. However, on present evidence, the very low export figure for February cannot easily be accounted for by timing distortions.

7. For the purposes of the forecast we were only concerned about the quarterly figures, so to help analyse trends we made tentative adjustments based on estimates of the value of recorded exports brought forward into December. From a more detailed analysis of figures of the sort given in (i) above, DTI conclude that an appropriate adjustment would be 5 per cent of normal monthly exports, or £300 million (£250 million at 1980 prices).

Table 3 : Adjustments for timing distortions to exports

£ million

		Published series	Adjustment	Adjusted series
Monthly	Nov	6881		6881
	Dec	6817	-300	6517
	Jan	6209	+300	6509
	Feb	6176		6176
	Mar	6441		6441
Quarterly	Q4	20500	-300	20200
	Q1	18826	+300	19126

8. The new documentation is unlikely to have affected the recording of oil exports significantly, so the adjustments were allocated proportionately between manufactures and non-manufactures (excluding fuel).

Underrecording

9. Customs conduct regular surveys of underrecording of those exports recorded under post shipment procedures (which allow traders to ship goods under skeleton pre shipment forms and submit full statistical documentation within 14 days). These account for 15 per cent of exports. For the remainder, Customs assume underrecording is negligible. Surveys during 1987 showed slightly less underrecording than in previous years, and the overall allowance for underrecording in the figures was reduced from around 1½ per cent to just 1 per cent.

10. It is possible that under-recording has risen following the introduction of the SAD. Maybe the number of those not bothering to complete the documentation rose as the new form was introduced, and - perhaps - as the realisation spread that non-compliance didn't always lead to Customs and Excise chasing them up. If under-recording has risen, this should be revealed by the latest Customs survey, conducted in March 1988, the results of which will be available in July. Evidence so far, however, shows

no rise in the number of pre shipment advices unmatched by post shipment statistical forms. Another possibility is that underrecording is more widespread than previously considered by Customs. We have asked Customs to look into this, but we will not get a response before Sir Peter Middleton's meeting on balance of payments statistics on 5 July. At this stage, therefore, we are probably not in a position to make any allowance for additional underrecording in 1988.

Seasonality

11. We have been convinced for some time that the published figures for both exports and imports contain residual seasonality. It appears that the seasonal pattern is evolving over time and, possibly because of this, it is not being removed completely by DTI's seasonal adjustment procedures. Our work suggests the following seasonal factors.

Per cent

	Q1	Q2	Q3	Q4
Adjustment to volume of non oil exports	+0.77	+0.08	+0.13	-0.98

12. Table 4 shows the recent quarterly pattern of the volume of manufactured exports and the proposed adjustments for timing distortions and seasonality. The implication is that, after making these adjustments, the underlying level of manufactured exports still appears to have fallen since the third quarter of 1987, though only by 3 per cent.

Table 4 : Manufactured exports

BOP basis, £ million, 1980 prices

		Published series	Adjustments for timing distortions	Adjustments for seasonality	Underlying series
1986	4	10505		-110	10395
1987	1	10479		+85	10564
	2	10487		+10	10497
	3	11030		+15	11045
	4	11250	-215	-110	10925
1988	1	10398	+215	+85	10698

Independent evidence on manufactured exports

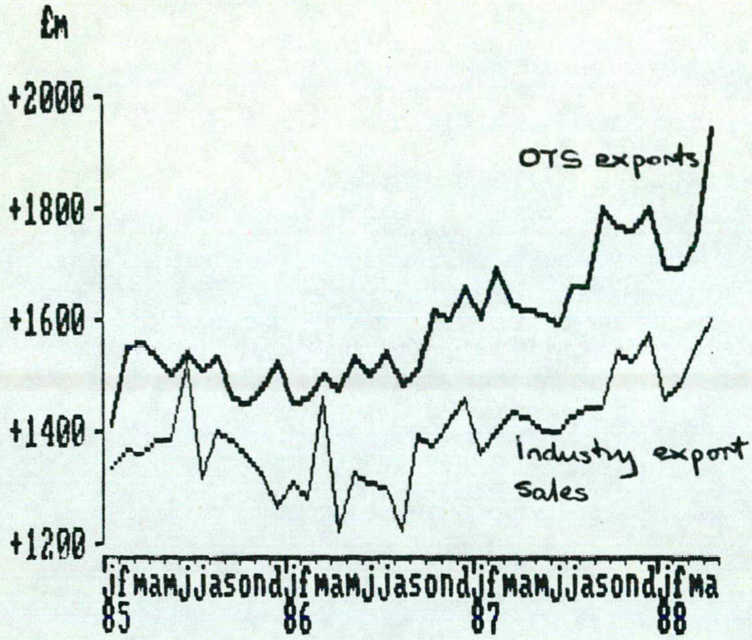
13. Some support for the view that manufactured export growth has, indeed, slowed is provided by the industrial analysis below, which shows some correlation across industries between the size of recorded falls in exports and output in the first quarter of 1988. Large output falls between Q4 and Q1 in engineering industries, particularly electrical engineering and motor vehicles, are associated with large falls in exports. Smaller falls, or rises, in output in chemicals, mechanical engineering and textiles are associated with smaller falls in exports. Metals is an exception to this pattern - the discrepancy between changes in output and exports of metals over the past year is particularly striking.

Table 5 : Industrial analysis of recent changes in exports and output
(Percent change)

Categories of industrial output (weights in brackets)	1988Q1 on 1987Q4 Output	1988Q1 on 1987Q4 Exports (OTS)	1988Q1 on 1987Q1 Output	1988Q1 on 1987Q1 Exports (OTS)
Metals (25)	+3.6	-6.0	+10.1	-5.3
Chemicals and man-made fibres (68)	-0.1	-5.1	+5.1	3.5
Engineering and allied industry (325)	-2.4	-8.7	+4.9	0.0
of which : mechanical (106)	+2.1	-4.3	+8.0	-1.1
electrical (95)	-4.0	-7.9	+1.3	+5.6
motor vehicle and parts (42)	-7.9	-9.6	+ 9.8	0.0
Textiles clothing and footwear (52)	-1.2	-3.5	+1.0	+3.3
Total manufacturing (736)	-0.0	-7.7	+5.9	0.0

14. The BSO collects separate data for home and export sales of the engineering sector, for use in the index of production. Chart 2 compares this with the Customs figures for engineering exports. These independent data show a remarkably close monthly correlation, and the sales data appear to confirm a substantial drop in exports in the first two months of 1988. Over the past few years the OTS series has tended to grow faster than the sales series, so this also provides no evidence of increasing underrecording of exports.

Chart 2 : Engineering exports (seasonally adjusted)



15. Charts A1 to A6 in the attached annex compare UK exports to various European countries with those countries' estimates of their imports from the UK. The monthly figures are generally quite highly correlated and, with the possible exception of Belgium, they tend to confirm the sharp fall in UK exports in January. French and Irish imports from the UK closely follow the pattern of UK exports through the first four months of the year. As a result of problems with the SAD, Germany, Holland and Belgium have not yet published figures for months after January.

NB

16. Recent CBI evidence on exports is summarised in Table 6. There has clearly been a sharp deterioration in export optimism in early 1988, but in principle the CBI question relates to expectations for the next 12 months, not to recent trends. It is possible, though, that firms really report what has already happened to them when they respond to the survey. Export deliveries have continued to rise strongly so far in 1988. Export orders have also risen, though arguably at a slower rate than in mid 1987. As a result export order books (relative to 'normal') have fallen back a little from their peak in July, but remain at a high level by historical standards. This evidence may be consistent with some slowing in growth but does not suggest that any significant fall in export growth has occurred yet.

Table 6 : CBI survey data on exports

Percentage balances, seasonally adjusted

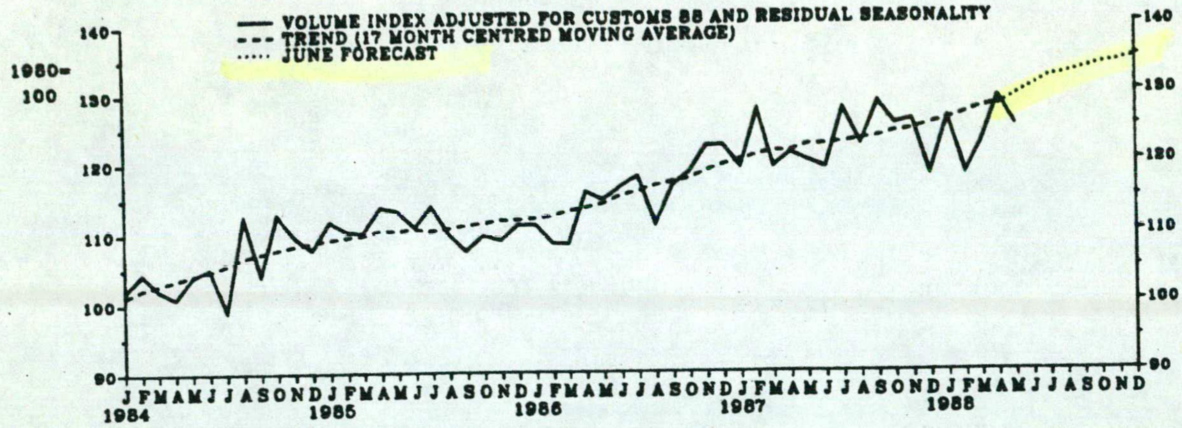
		Export optimism	Trends in export orders Last 4 months	Trends in export orders Next 4 months	Trends in export deliveries last 4 months	Trends in export deliveries Next 4 months	Export order book relative to 'normal'
1986	Jan	-2	-3	5	4	3	-15
	Apr	5	-12	15	-2	17	-19
	Jul	-5	-9	0	-7	1	-26
	Oct	14	-3	16	1	13	-15
1987	Jan	18	9	19	7	20	-9
	Apr	17	4	18	8	19	-4
	Jul	29	24	20	23	24	8
	Oct	17	16	17	19	23	8
1988	Jan	-8	16	5	22	10	9
	Apr	-11	8	7	13	8	4
	June						0

Conclusions

17. Much of the recorded fall in exports in Q1 can probably be attributed to temporary distortions and problems with seasonal adjustment. There probably has been some slowing of export growth since the autumn - this is supported by the industrial evidence and is consistent with the deterioration in cost competitiveness over the past year. Nevertheless the apparent fall in the underlying level, shown in Table 4, seems hard to reconcile with the emerging evidence of very strong world trade growth over this period and the CBI evidence. Possible explanations are that the seasonal pattern has changed, or that there has been a rise in underrecording following the introduction of the new Customs procedures, but we are unlikely to have further evidence to test these theories for several months.

18. For the forecast we have assumed that the upward trend in exports has slowed in recent months, but that part of the weakness in exports, evident even after making the adjustments discussed above (see Table 4) reflects these measurement problems or, simply, erratic factors. The forecast therefore shows a recovery in exports in second quarter, broadly in line with the latest monthly figures (Chart 3).

Chart 3 : Trends in volume of non-oil exports (after adjustment for Customs 88 and seasonality)



Import volumes

19. Non-oil import volumes also dipped in the first quarter of 1988 but remained nearly 13 per cent higher than a year earlier, reflecting very rapid growth in the second and third quarters of last year. Growth over the past year was concentrated in manufactures. A commodity breakdown is shown in Table 7.

Table 7 : Import volumes

£ billion, 1980 prices, BOP basis

	Manufactures	Fuel	Food, drink & tobacco	Other non manufactures*	Total	Total less oil
1986	43.7	6.3	6.9	4.8	61.6	56.4
1987	47.9	6.2	6.9	5.1	66.2	61.1
1986 4	11.5	1.8	1.7	1.3	16.3	14.7
1987 1	10.8	1.5	1.7	1.3	15.3	14.0
2	11.7	1.5	1.7	1.3	16.2	14.9
3	12.6	1.7	1.7	1.3	17.3	16.0
4	12.8	1.6	1.8	1.2	17.5	16.2
1988 1	12.5	1.5	1.8	1.2	17.0	15.8
% change 1988Q1 on -previous quarter	-2.5	-7.2	-1.5	-1.5	-2.8	-2.3
- a year earlier	15.6	-2.6	5.4	-3.8	11.1	13.0

* Mainly basic materials

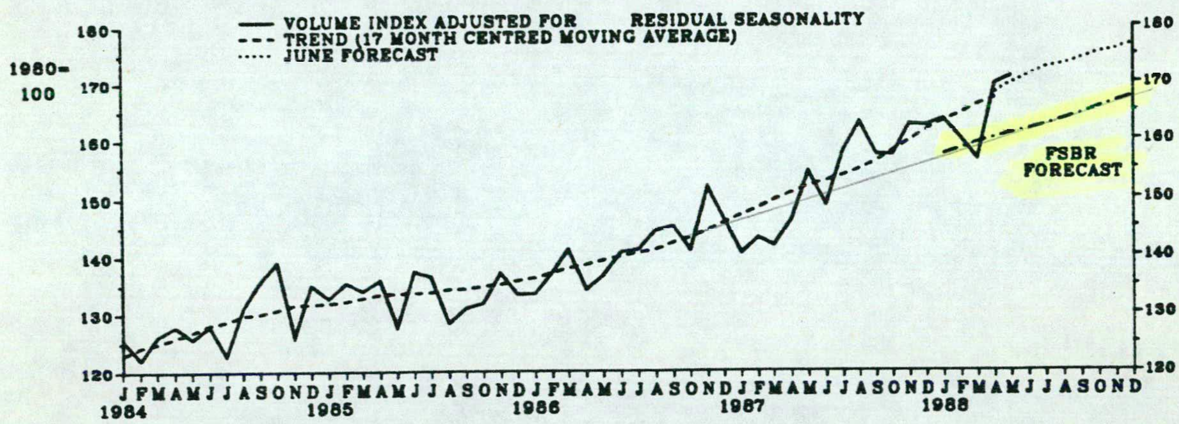
20. Evidence on residual seasonality suggests that the seasonal factors may be larger for imports than exports. In this case the main problem is that imports tend to be high in Q3 and Q4 and low in Q1. Our estimates suggest the following seasonal factors:

Per cent

	Q1	Q2	Q3	Q4
Adjustment to volume of non-oil imports	+1.19	+0.29	-1.03	-0.45

21. After adjusting for residual seasonality, the trend in non-oil imports seems to have been strongly upwards over the past two years, with little hint of a recent slowdown, as shown in Chart 4. The forecast shows this trend slowing through 1988 as domestic demand growth eases.

Chart 4 : Trend in volume of non-oil imports (after adjustment for residual seasonality)



<u>Manufactured imports</u>

22. The rise in imports of manufactures over the past year has been spread across all categories, but particularly large increases were recorded for semis (excluding chemicals), intermediate and capital goods, all consistent with rising industrial output and investment. (Table 8). Imports of consumer goods other than cars rose relatively slowly. The rapid growth in imports of passenger cars over the past year partly reflects an erratically low figure for the first quarter of 1987 while the figure for the first quarter of 1988 was boosted by the Ford strike. Nevertheless there is now evidence that, in response to the deterioration in competitiveness, Ford and Vauxhall are switching some production back to continental plants - a reversal of the trend which saw UK producers gain an increased market share in 1987.

Table 8 : Manufacturing production, capacity and trade

	Percentage change 1988Q1 on a year earlier Production	Exports (OTS basis)	Imports	Capacity*
Chemicals	5.1	3.4	6.3	16
Other Semis		1.8	16.8	
Motor vehicles	9.8	7.1	31.4	34
Consumer goods	5.6	-3.6	8.6	27
Intermediate goods	n/a+	0.0	18.2	28
Capital goods	4.1	4.4	17.4	40

* Percentage of firms working below capacity, CBI survey, April 1988.

+ Published figures for output of intermediate goods include non-manufactures.

23. The table above compares changes over the past year in exports and imports by broad economic category with output growth and capacity in approximately comparable industrial sectors. Imports of consumer goods (other than passenger cars) have grown more slowly than most other categories, reflecting strong growth in production by consumer goods industries and, perhaps, some switching of supply from export to domestic markets. Strong demand has led to rapid growth in import of capital goods, though UK producers of these goods appear to have more spare capacity than other sectors and have increased their exports over the past year. Despite evidence of high capacity utilisation, the net trade performance of the chemicals industry has been particularly good.

ANNEX: **COMPARISON OF UK EXPORTS WITH RECORDED IMPORTS FROM UK TO VARIOUS EUROPEAN COUNTRIES**

Chart A1 COMPARISON OF UK EXPORTS TO GERMANY WITH GERMAN IMPORTS FROM UK

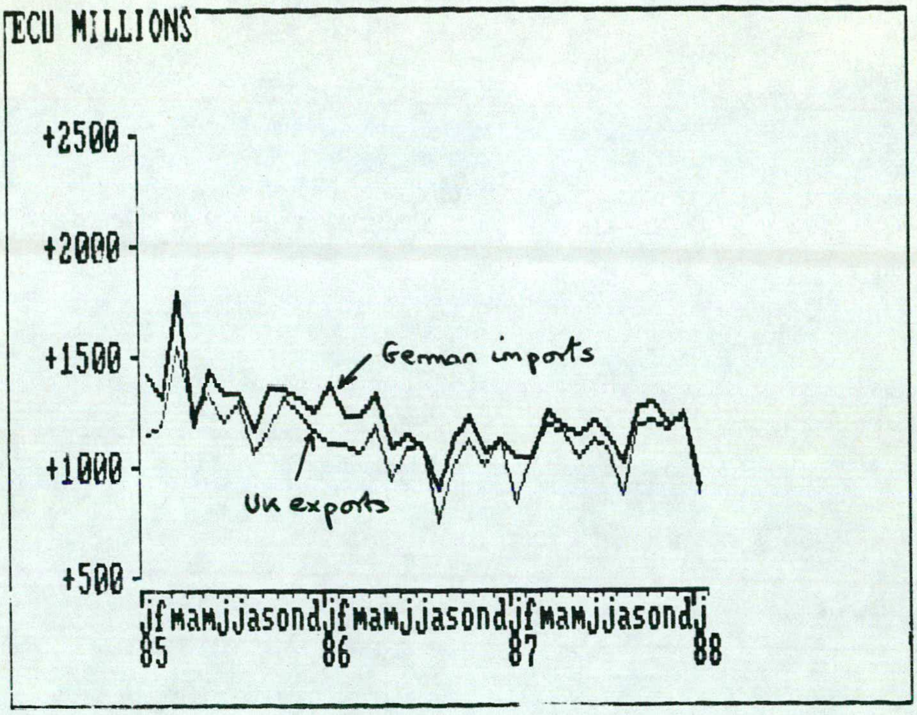


Chart A2

COMPARISON OF UK EXPORTS TO FRANCE WITH FRENCH IMPORTS FROM UK

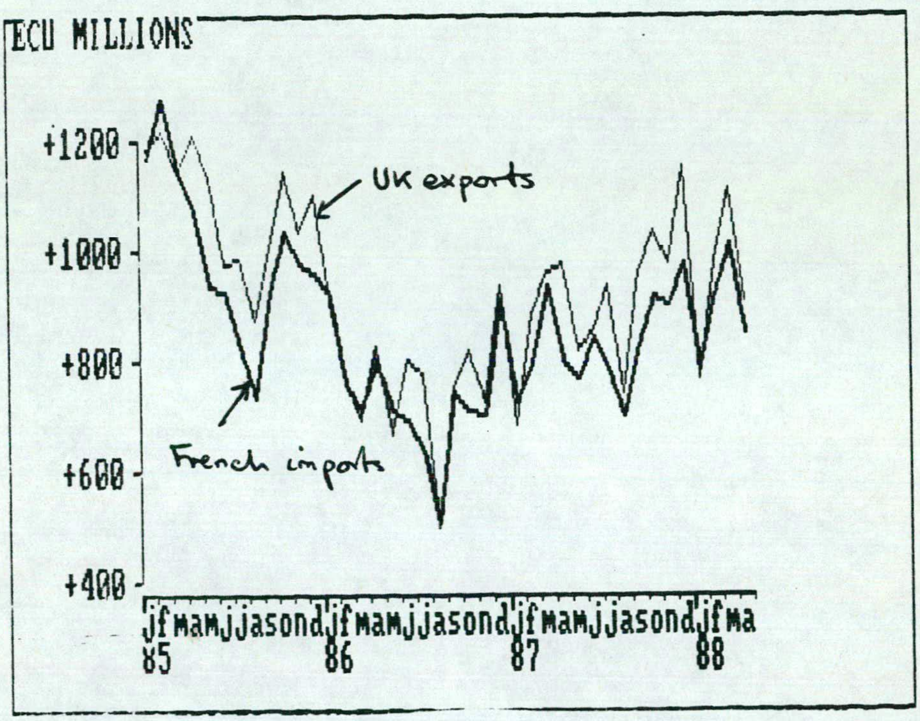


Chart A3

COMPARISON OF UK EXPORTS TO ITALY WITH ITALIAN IMPORTS FROM UK

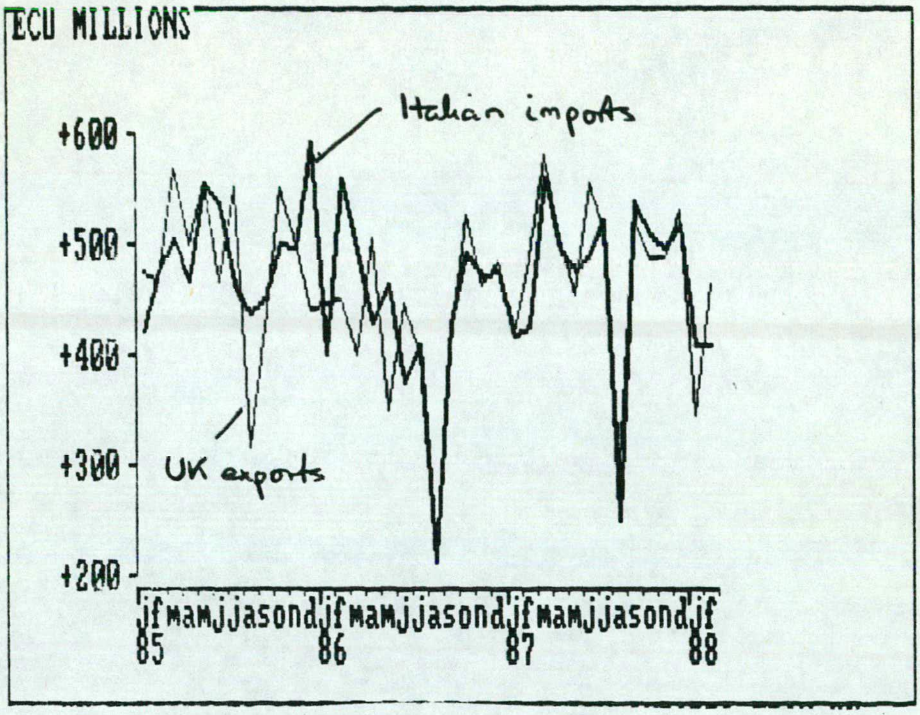


Chart A4

COMPARISON OF UK EXPORTS TO HOLLAND WITH DUTCH IMPORTS FROM UK

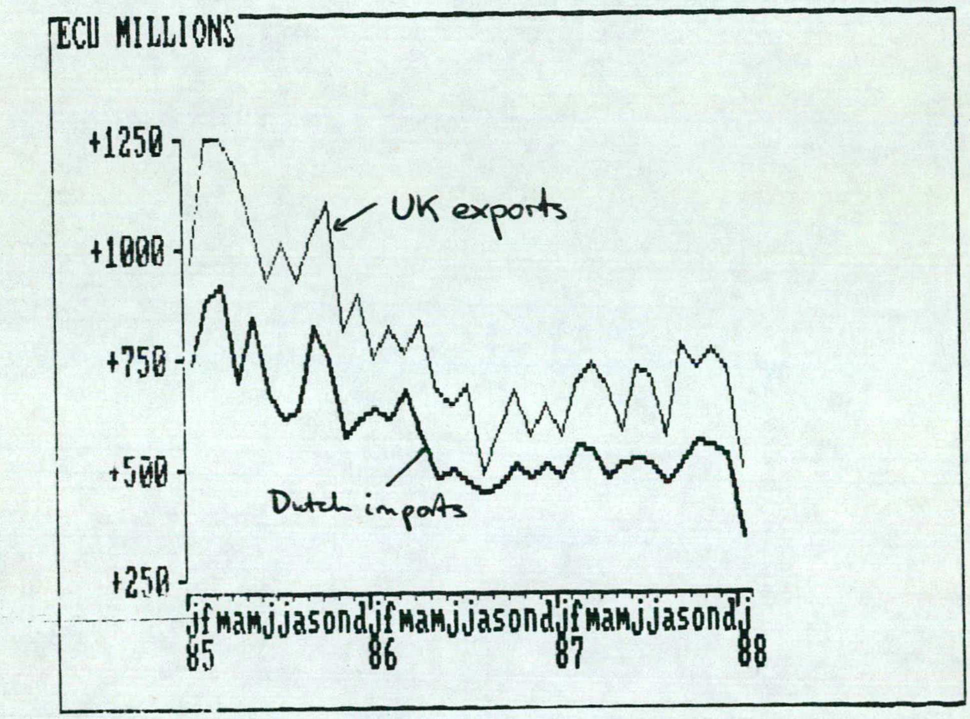


Chart A5

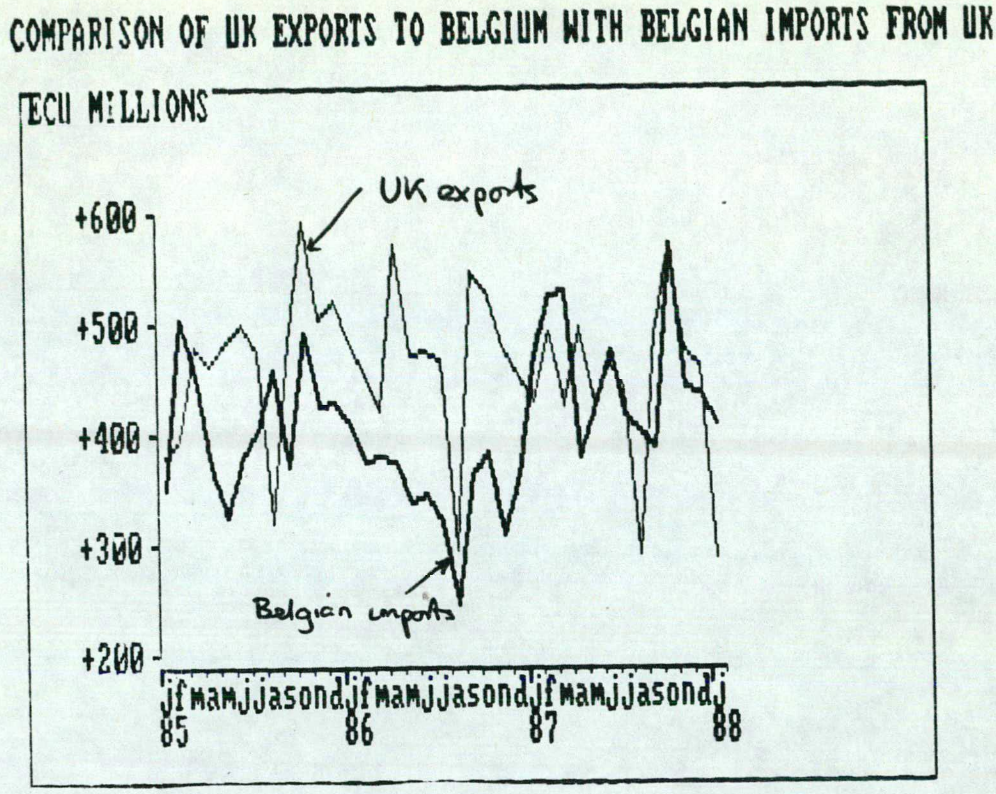
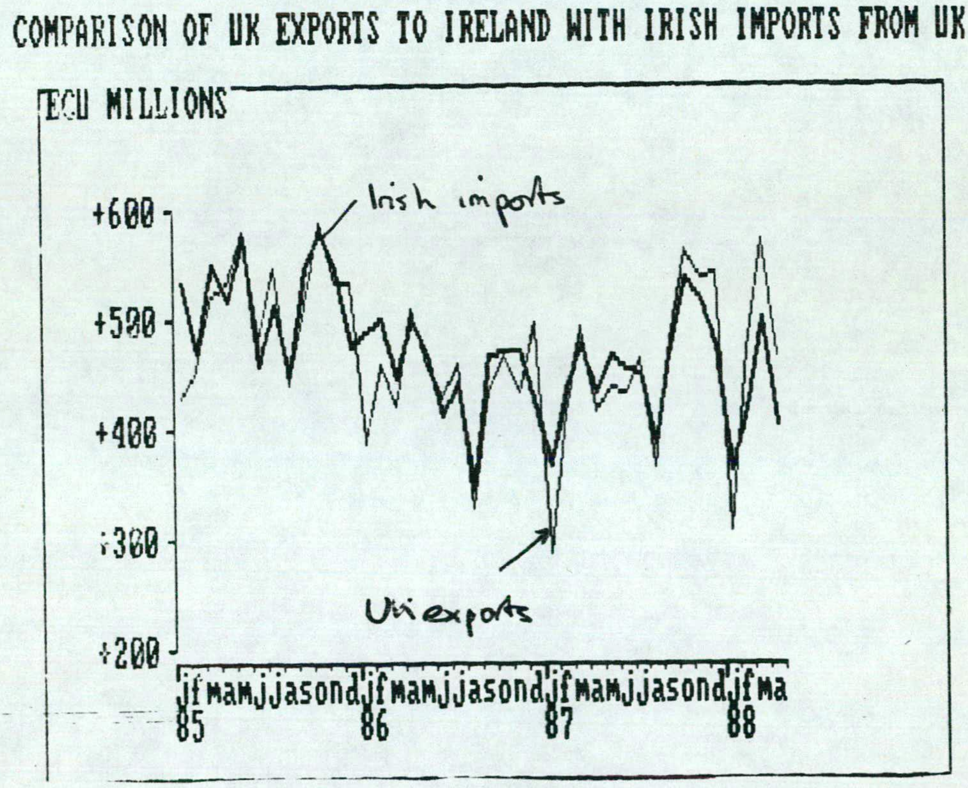


Chart A6



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UAE OIL POLICY

SUMMARY

1. UAE OIL MINISTER CONFIRMS THAT UAE IS CONTINUING TO PRESS ITS DEMAND FOR A 1.5 MBPD OPEC PRODUCTION QUOTA. HE CLAIMS THAT HIS PERSONAL POSITION HAS NOT BEEN MUCH AFFECTED BY THE REORGANISATION OF THE DECISION-MAKING HIERARCHY ON OIL MATTERS IN ABU DHABI.

DETAIL

2. I DROPPED IN ON MANA AL OTAIBA AT GHANTUT ON 28 JUNE. I HAD ABOUT AN HOUR AND A HLAF WITH HIM AND HE WAS IN REASONABLE, IF NOT EXUBERANT, FORM. HE HAD RETURNED BRIEFLY TO ABU DHABI, PRIMARILY TO DISCUSS OIL MATTERS WITH SHAIKH MOHAMMED BIN RASHID AL MAKTOUM BEFORE GOING BACK TO ACCOMPANY SHAIKH ZAID IN RABAT.

UAE OIL QUOTA

3. I ASKED ABOUT HIS RECENT STATEMENT (MY TELNO 160) THAT THE UAE WAS INSISTING ON ITS RIGHT TO A QUOTA OF 1.5MBPD. HAD THERE BEEN ANY ADVERSE REACTIONS FROM OTHER OPEC MEMBERS? OTAIBA REPEATED THE BRIEF HISTORY OF THE UAE QUOTA AND SAID THAT AN ARRANGEMENT WHICH HAD BEEN REACHED AT SAUDI REQUEST FOR THREE MONTHS HAD NOW LASTED 63 MONTHS AND THE UAE HAD GROWN IMPATIENT. AS FAR AS HE WAS CONCERNED, THE UAE QUOTA WAS NOW 1.5MBPD AND HE HAD BEEN TO CALL ON SHAIKH MOHAMMED BIN RASHID IN DUBAI TO SUGGEST THAT THE TWO SHAIKHDOMS SHOULD TOGETHER OBSERVE THE NEW QUOTA LIMIT. WITH DUBAI PRODUCING ABOUT 400,000 BPD, ABU DHABI WOULD HAVE A PRODUCTION LIMIT OF ABOUT 1.1 MBPD. SHAIKH MOHAMMED'S REPLY HAD BEEN VAGUE, BUT REASONABLY ENCOURAGING. OTAIBA HOPED THAT THEY WOULD BE ABLE TO AGREE ON A WORKING UNDERSTANDING.

4. OTAIBA SAID THAT SHAIKH ZIAD HAD BEEN IRRITATED BY THE

SUGGESTIONS BEFORE THE LAST OPEC MEETING FROM SEVERAL OPEC MEMBERS THAT THE UAE SHOULD BE CAST AS THE WHIPPING BOY FOR GENERAL NON-COMPLIANCE WITH OPEC QUOTAS. THIS ATTITUDE SHOWED TOTAL DISREGARD FOR THE CIRCUMSTANCES UNDER WHICH THE UAE HAD AGREED TO A TEMPORARILY REDUCED ALLOCATION. OTAIBA SAID THAT THE ONLY CRITICISM OF HIS RECENT STATEMENT, WHICH HE HAD HEARD OF, WAS FROM AN UNIDENTIFIED SPOKESMAN FOR THE SAUDI OIL MINISTRY, WHO HAD COMMENTED IN A MILDLY ADVERSE WAY TO THE EFFECT THAT THE SAUDIS COULD NOT RESPOND TO THE UAE'S APPEAL TO THEM FOR AN INCREASED QUOTA AS THIS WAS QUESTION FOR OPEC, NOT FOR INDIVIDUAL STATES.

UAE OIL SCENE

5. I ASKED ABOUT THE RECENT RESHUFFLE IN THE ABU DHABI OIL HIERARCHY, WHICH GAVE THE IMPRESSION, AT LEAST ON PAPER, THAT OTAIBA'S POSITION HAD BEEN WEAKENED (MY TELNO 145). OTAIBA REPLIED THAT HE WAS WELL SHOT OF THE DEPARTMENT OF PETROLEUM AFFAIRS, WHICH HAD BEEN AN INEFFICIENT ORGANISATION FILLED WITH PALESTINIANS. HE CLAIMED TO HAVE BEEN ADVOCATING FOR SOME YEARS THE ESTABLISHMENT OF A SUPREME COUNCIL FOR PETROLEUM AFFAIRS SIMILAR TO THOSE WHICH HE SAID HAD EXISTED IN KUWAIT AND SAUDI ARABIA. HE THOUGHT HIS POSITION WOULD BE IN PRACTICE UNAFFECTED. HE STILL ENJOYED A CLOSE PERSONAL RELATIONSHIP WITH SHAIKH ZAID AND HE WOULD REMAIN WELL PLACED TO INFLUENCE OIL POLICY, WHICH WOULD BE DECIDED IN THE FUTURE, AS IN THE PAST, AFTER CLOSE CONSULTATION WITH SHAIKH ZAID AND SHAIKH KHALIFA. IF HIS JOB LOST IS CONTENT - AND THE CRITERION FOR THIS WAS HIS ABILITY TO INFLUENCE PRODUCTION LEVELS - HE WOULD NOT WISH TO CONTINUE.

6. THE REAL LOSERS IN THE RESHUFFLE WERE, HE SAID, THE BANI MOHAMMED, SEVERAL OF WHOM HAD LOST APPOINTMENTS: THE MOST IMPORT DOWNGRADING BEING THE REMOVAL OF SHAIKH TAHNOUN FROM THE CHAIRMANSHIP OF ADNOC. THE BANI MOHAMMED HAD MET RECENTLY IN AL AIN TO DISCUSS THEIR GRIEVANCES.

COMMENT

7. NOTWITHSTANDING HIS OPTIMISTIC ACCOUNT OF DEVELOPMENTS, I RECEIVED A VERY CLEAR IMPRESSION FROM OTAIBA'S RESTRAINED MANNER THAT HE HAD BEEN BADLY SHAKEN BY THE DETERIORATION IN HIS POSITION. I THINK THAT HE REALISED THAT HE HAS BEEN TOO HIGH-HANDED IN HIS ATTITUDE TOWARDS SHAIKH KHALIFA IN THE PAST

AND HE BAS BEEN TRYING HASTILY TO MEND HIS FENCES. HIS FRIENDSHIP WITH SHAIKH ZAID REMAINS HOWEVER A VERY STRONG CARD. ALTHOUGH I HAVE HEARD FROM THE ARCHITECTS OF THE CHANGES, AHMED SUWAIDI AND MOHAMMED HABROUSH, THAT ONE OF THEIR PRINCIPAL OBJECTIVES WAS TO MARGINALISE BOTH OTAIBA AND SHAIKH TAHNOUN, OTAIBA IS, IN TERMS OF INFLUENCE, DOWN BUT NOT OUT.

TAIT

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RECENT TRENDS IN NON-OIL VISIBLE TRADE

The Chancellor was most grateful for your extremely interesting analysis of recent trends in non-oil trade.

ACSA

A C S ALLAN