

PO-CH/NL/0188

PART E

Chez

Lawson

PART E

CONFIDENTIAL

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notify REGISTRY of movement)



PO -CH /NL/0188



PART E

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

Begin: ~~18/88~~ 30/6/88

Ends: ~~18/12/88~~ 13/9/88 (CONTINUED)

DD: 25 years

6/9/95

8810/NL/0188

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PART E

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Oh, PEM is content, though he suggests we should get a sight of any BP covering letter before it goes. Agree?

FROM: D J L MOORE

DATE: 30 JUNE 1988

SIR PETER MIDDLETON

CC: PS/Chancellor

*30/6
30/6
Agreed*

BP/KIO

BP are under heavy pressure from the MMC to provide firm evidence that they were voicing their concerns over the growing KIO holding at the end of last year.

2. They asked me this morning whether they could give to the MMC immediately, and prior to a hearing later on in the morning, a copy of Walters' letter of 17 December to the Chancellor, copy attached. I refused. I said that I was not greatly worried over the substance. But I did not see why, as in other evidence, they could not simply summarise the evidence rather than supply original documents. We do not want release of this letter to lead to demands for sight of other letters or notes of meetings. Moreover, there was no time to seek the Chancellor's agreement for the release of the letter which I thought was necessary.

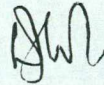
3. I also had in mind that MMC might ask to see the Chancellor's reply. In fact that took the form of a telephone conversation - see Mr Taylor's note of 18 December attached.

4. BP have now come back to me this afternoon to say that following the hearing they feel their credibility is thin unless they can show the letter. I have refused to let them do so immediately, but I have said that I will consider it urgently.

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X | 5. Unless you object I now propose to help them by agreeing. As I say, I see no objection to revealing the substance which demonstrates that we and the company were indeed concerned throughout, for reasons which we have subsequently put to the MMC. I think BP should volunteer that Ministers agreed, in reply to the letter, that the right course was for Walters to speak to the KIO (in fact he did not do so for some time!). If we were asked for our reply we would simply say that it was agreed on the 'phone that Ministers welcomed the idea of Walters pressing the KIO. At the same time Mr Mellor was taking his FCO initiative.

6. Do you agree please? If possible, I would like to tell them tomorrow morning.



D J L MOORE

Repeat

5100

CONFIDENTIAL

SIR PETER WALTERS
CHAIRMAN



BRITANNIC HOUSE,
MOOR LANE,
LONDON. EC2Y 9BU

TELEPHONE
01-920 6091

CHIEF EXECUTIVE	
17	17 DEC 1987
D.J.L. MOORE	
FST, Su P. Middleton	
Mr Monck	
Mrs Brown	
Ms Leahy	

17th December 1987

Dear Nigel,

As you are no doubt aware from briefings from your officials, since the initial discussions with both the Treasury and the Foreign Office on the Kuwait Investment Office's purchase of BP shares, we have taken a jointly well rehearsed public stance on this subject. This was originally to welcome the Kuwait Investment Office as a long term shareholder and to note BP's stated interest in widening its share ownership on an international basis. We have, however, pointed out privately to your officials that any accumulation of stock above the 10% level does raise certain questions of both a commercial and political nature that may have potential negative aspects on the Company.

The Company has of course contacted the Kuwait Investment Office at working level and has offered to discuss the general issue of their shareholding and its strategic implications. To date, the response has been that there are no commercial or financial grounds for dialogue, merely, to use their words, political ones which can only be held at Chairman level. As we have watched the shareholding grow, and indeed now exceed the 15% level, you should be aware that our advisors, Warburgs, were instructed earlier this week to contact the Kuwait Investment Office once again to ensure an understanding of our attitude. This relates particularly to the political and financial implications which follow from a concentration of stock in their hands. These are judgmental issues, but they may well impact on our capacity to compete freely, particularly in the U.S. market. Furthermore, the implications of this shareholding increasing, for instance, to the 20-25% level are not ones which we think are in the best interests of all the shareholders.

.../2

I think it would be helpful if we could review briefly your own reaction to the current and potential situation in order to avoid any conflicting messages. I feel it is in the shareholders' interests that I should speak to the Chairman of the Kuwait Investment Office along the lines of the attached briefing note. I look forward to hearing from you your own reactions to this proposal.

I have copied this letter and attachment to Geoffrey Howe and Cecil Parkinson.

Yours ever,
Peter

Braithwaite 270 2155.

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street,
London SW1 3AG.

BRIEFING NOTE AGREED WITH WARBURGS

IMPLICATIONS OF MAJOR SHAREHOLDINGS IN BP

Until the recent purchases by the Kuwait Investment Office (KIO), the largest holder of BP (other than HMG) had around 2% of the Company's issued share capital. The KIO now owns partly paid shares representing over 15% of BP.

BP is concerned that the prospect of any single shareholder acquiring a holding greater than 10% could have adverse implications for the Company's ability to increase value for all shareholders. KIO, which is associated with a major oil producing country, may represent a particularly sensitive shareholder.

COMMERCIAL

BP is an international company with operations in over seventy countries. It is essential for BP's development that it can compete with the major oil companies on an equal basis.

Any single large shareholder owning 10% or more of stock will be associated, in the minds of important decision makers in many countries of the world, with significant influence in the direction of the Company's affairs.

The existence of a large shareholding with this potential influence will affect the attitudes of the company's customers and suppliers, irrespective of any assurances given by the shareholder or the company.

POLITICAL

Equally, if not more importantly, BP's relationships with foreign governments are fundamental to the continuing success of the Group. The implications of a large shareholder with major political connections could be particularly detrimental to BP's ability to trade freely in all areas where it wishes to do business. This point is particularly relevant in the USA where more than half of BP's assets are located. There are potential complications for such issues as the Special Security Agreement for our structured materials company and also for our resource based operating companies under the conditions of the State Leasing Statutes.

FINANCIAL

Speculation and uncertainty are accentuated when a large block of the Company's shares is held by one investor. This can cause volatility and destabilise the shareholder base. It can create particular difficulties in the acceptability of the company's securities in new issues.

CONFIDENTIAL AND PERSONAL



FROM: J M G TAYLOR
DATE: 18 DECEMBER 1987

cc Mr Brown
Mr W. Williams
Mr Cooley
Mr Burt

cc Sir P Middleton
Mr Monck
Mr D J L Moore

NOTE FOR THE RECORD

Conversation with Sir Peter Walters (BP): KIO

The Chancellor spoke to Sir Peter Walters on the telephone this evening.

2. The Chancellor thanked Sir Peter for his letter of 17 December about BP and the KIO. He thought that the suggestion that Sir Peter should speak direct to the Chairman of the KIO was very sensible. But he thought that the briefing note was rather tentative, and in part said things which BP would not want to say. For example, the briefing note implied that the KIO might have some potential influence. Sir Peter said that this point was well taken, and he would review the briefing note.

3. The Chancellor said he would be inclined to concentrate on the political dimension. Any increase in the KIO holding would be damaging to BP in many countries, and indeed damaging to the KIO. Sir Peter agreed.

4. The Chancellor suggested that Sir Peter Walters might like to press Sir Geoffrey Howe. He was aware that Mr Cazalet had spoken to Mr Mellor yesterday, but he thought that Mr Mellor would only touch lightly on the matter during his tour. Sir Peter said he would speak to Sir Geoffrey Howe as advised.

JT

J M G TAYLOR

CH/EXCHEQUER	
REC.	1-JUL 1988
ACTION	EST
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Prime Minister

11TH ROUND LICENSING ROUND

I am writing to let you know that we intend to make the announcement next Thursday 7 July, which will effectively launch the 11th Offshore Licensing Round. I shall need to lay revised regulations before the House during July as there are a number of points of detail on which licences issued in this Round will differ from those issued in previous Rounds.

The selection of blocks for this Round has been more difficult than in the past. Companies have certainly demonstrated enthusiasm for new exploration acreage but they are much more cautious than they were a few years ago when the oil price was much higher and they have little appetite for high risk frontier acreage. Consequently from a long term point of view we have to 'mark time' by creating licensing opportunities in mature areas which have previously remained unlicensed because of competing uses, and also by including a large number of previously licensed blocks which have been relinquished or surrendered. We have included some frontier acreage although these blocks might not be highly competed for in the present climate. I think in summary that we have managed to put together a package which should result in a successful Round. The block list has already been cleared with officials in interested Departments.

As regards the licence term you will be aware from our E(A) discussion that one of our aims was to induce companies to stop banking acreage they were not using. We have now agreed with the industry a new deal whereby the second term of 11th Round licences will have a break point at the end of 12 years. If they do not have a development under way by then they will, with certain exceptions, be expected to surrender the licence. This new development has been welcomed by British independents.

There was some discussion at E(A) about the possibility that some blocks might be offered for cash tender. I have given this considerable thought and Peter Morrison has discussed it with Peter Lilley. The conditions which E(A) set for inclusion of such blocks have not been met and accordingly I have decided that this Round should be a wholly discretionary one. None of the blocks in the list is of outstanding attractiveness; and the oil price has shown no improvement since we discussed the subject last March. There are also good political grounds for avoiding licensing by cash tender, which is widely perceived in the industry as benefiting the multinationals over the independents. This would not be popular at a time which is difficult for our own British independent sector.

I am copying this minute to Members of E(A) Committee, the Lord President, the Secretary of State for Defence, and to Sir Robin Butler.

C.P.

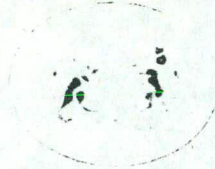
SECRETARY OF STATE FOR ENERGY

1/7 July 1988

CONFIDENTIAL

cc PS/Chancellor AS/FST

MR SCHOLAR MR DJL MOORE
 MR CURPIN MR MCHILLIAMS
 MS GODDARD



Herbert Chamber, Downing Street, SW1P 3AA

[Handwritten signature]

Steve Whiting Esq
 Private Secretary to the Rt Hon Peter Morrison MP
 Minister of State for Energy
 Department of Energy
 Thames House South
 Millbank
 LONDON
 SW1P 4QJ

1 July 1988

Dear Steve

ELEVENTH ROUND OF OFFSHORE LICENSING

The Minister of State for Energy came to see the Economic Secretary yesterday to discuss the Economic Secretary's letter of 24 June, and the Minister of State's of 28 June.

The Economic Secretary said that he accepted that the present was not a very auspicious time to introduce auctions for oil licences, both because of the prevailing level of oil prices, and because of the adverse reaction to the Budget proposals from companies operating in Southern Basin. Nonetheless, E(A) had given a clear remit to consider whether the blocks being made available were particularly attractive. There were considerable difficulties in determining in advance how much a particular block was worth. But it would be a matter for concern if assets were being allocated with no appraisal of their value. The Economic Secretary had expected that Treasury officials might become involved in the process of determining the worth of particular blocks, particularly in view of the extent to which his officials had been prepared to cooperate with the Department of Energy on fiscal matters. He had not necessarily expected anything to come of this process of

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investigation, but he had expected at least to be involved in it. He had therefore been surprised and disappointed when Treasury officials' request for a meeting had been turned down.

The Minister of State said that, partly for reasons that the Economic Secretary himself admitted, he had seen little point in such a meeting. He recognised, however, that the subject of auctions was one on which the Economic Secretary himself felt strongly. It had certainly not been his intention to proceed with the Eleventh Round before consulting the Economic Secretary. Nonetheless, he continued to think that a system of discretionary allocations of licences was preferable to an auction. Under the present system, companies competed for licences not on price but on the work programmes that they offered for the exploration and development of particular areas. This led to a quicker and more extensive exploration of the North Sea than would be achieved by a market mechanism, particularly as companies were encouraged to explore blocks which might otherwise be neglected.

The Economic Secretary said that he had made clear his views on auctions on a number of earlier occasions. But what was at issue here was not so much the intrinsic merits of the two systems, as the involvement of Treasury officials in determining the attractiveness of particular blocks being considered for inclusion in any Round. He had no wish to delay the start of the Eleventh Round, which he knew the Minister of State wished to announce shortly. But he thought nonetheless that a meeting between officials should take place.

The Minister of State said that he was grateful to the Economic Secretary for saying that he did not wish to delay the Eleventh Round, as the Minister of State hoped to announce this by the following Thursday. He continued to doubt whether a meeting between officials would serve any useful purpose. Nevertheless, he was happy to agree to one if the Economic Secretary thought this desirable. The Economic Secretary said that he was grateful to the Minister of State for accepting that Treasury officials should be involved in such discussions. He too thought it unlikely that anything which would impinge on this licence round would arise out of a meeting at this stage, but even so it would be helpful for it to take place.

Yours sincerely
Peter Barnes


P D P BARNES
Private Secretary

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From: S D H SARGENT

Date: 1 July 1988

MR MOORE

cc PS/Chancellor BP/KIO

Sir Peter Middleton was grateful for your minute of 30 June.

2. He shares your view that we should agree to allow BP to show the MMC a copy of Walters' letter of 17 December to the Chancellor. But he thinks that we should ask to see a draft of the covering letter they propose to send to the MMC to ensure that the reference to our response is put in the terms suggested in paragraph 5 of your minute.

S D H SARGENT

Private Secretary

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FROM: J M G TAYLOR

DATE: 1-July 1988

MR D J L MOORE

cc PS/Sir P Middleton

A handwritten signature in blue ink, appearing to be "P. Middleton".

BP/KIO

The Chancellor has seen your minute of 30 June.

2. He is content for you to let BP show the MMC Walters' letter of 17 December to the Chancellor. He agrees with Sir Peter Middleton, however, that we should make sure that the form of words that BP use to describe Ministers' response should be correct.

Handwritten initials in blue ink, appearing to be "JMG".

J M G TAYLOR

FROM: C J JARVIS
DATE: 4 JULY, 1988

1. MR MOORE
2. FINANCIAL SECRETARY

- cc
- Chancellor
 - Chief Secretary
 - Paymaster General
 - Economic Secretary
 - Sir P Middleton
 - Mr Anson
 - Mr Monck
 - Mrs Lomax
 - Mr Beastall
 - Mrs Brown
 - Mr Bent
 - Miss Goodman
 - Mr Gunton
 - Mr Call
 - Mr Gregory T. Sol
 - Mr Messer T. Sol

We would be grateful for your agreement
This week to pressing a further band of
defaulters as proposed in para. 5+6.

It is interesting that there has been
little or no publicity over the action so far taken -
1 MP's letter, no PQs, no press comments of which we
are aware.

JW/4/7.

BP: STOPPED CHEQUES

This submission reports the progress made on legal action against BP defaulters who applied for 2,500 shares or more, and recommends a further stage of action against those defaulters who applied for 1,000 shares or more.

Background

2. Mr Johnson's submission of 16 March explained that letters had been sent to all BP defaulters on 29 February. In the case of those who had applied for less than 2,500 shares the letters were sent from National Westminster Bank reminding them that they remained liable to legal action and would not receive the benefits deriving from the shares they had agreed to buy unless they paid up. In the case of 81 defaulters who applied for more than 2,500 shares Treasury Solicitors wrote threatening legal action unless they paid within 14 days.

3. These letters produced some payments from both groups of defaulters. The current situation is that of the 4845 defaulters who originally stopped their cheques 2614 had paid up before the last letter was sent and a further 712 did so after receiving it. There are currently 1519 defaulters* remaining, and the total amount outstanding is £935,976.

4. Of the 81 defaulters who had applied for more than 2,500 shares, 14 paid up on receipt of the letter. Writs were issued against the remainder, and judgements have now been obtained against almost all of them. Of the defaulters against whom writs were issued all but 37 have now paid up, and over £300,000 has been recovered. The sums outstanding from the remaining cases amount to some £195,000, and the cases fall into two categories: those who could pay up but

* 0.6% of the 270,000 applicants

are continuing to resist; and those who are genuinely unable to pay. The former can usually be dealt with by an examination of their means and by garnishing their bank accounts. In the case of the latter, we can recoup some of our losses by selling their shares, but our chances of recovering the remaining sums are slim. The Treasury Solicitor estimates that about £83,000 will eventually be recovered in full, and that we should be able to recoup about half of the remainder by the sale of the defaulters' shares.

Issues

5. We now need to take a decision about legal proceedings against defaulters who applied for less than 2,500 shares. I attach an annex which gives a breakdown of the remaining shareholders by the number of shares for which they applied. This shows that most of the remaining defaulters applied for 200 shares or less. This means that the total sum that each of them owes is below £250. Treasury Solicitors usually advise, on cost grounds, against suing for a recovery of less than this amount. However, there are still over 700 defaulters who applied for more than 200 shares, with large numbers of defaulters at both the 500 and 1,000 share levels. In particular, we think it worth extending legal proceedings to the 206 defaulters (excluding those against whom proceedings have already been started) who applied for 1000 shares or more. These account for some £318,000 of the outstanding sum, and extension of legal proceedings to them would be seen as a logical extension of the current policy.

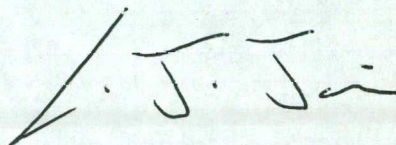
6. If you wish Treasury Solicitors to pursue these cases there is some advantage in advising them of our intention to proceed in the next week. This would enable us to give defaulters 14 days to respond to our letter, as before, and still allow enough time to start proceedings before the courts begin their long vacation. It would also be desirable, to avoid confusion, to begin proceedings before the collection of the second instalment due on the shares begins.

7. As far as defaulters who applied for under 1,000 shares are concerned, they will again be reminded that they are liable to legal action when letters are sent to them requesting payment of the second instalment on the BP shares, due on 30 August. They will be warned that they will not receive interim certificates unless they pay both the first and second calls on their shares. This may prompt some to pay up; those that do not can again be considered for legal action in the Autumn, by when the amount that they owe may have increased sufficiently to justify court action.

Recommendation

8. We recommend that Treasury Solicitors be instructed to send a letter to those defaulters who applied for 1000 shares

or more, advising them that unless they pay up within 14 days legal proceedings will be started against them, and that Treasury Solicitors be instructed to issue writs in the event of non-payment. Consideration of the remaining cases should be deferred until after the second call.

A handwritten signature in black ink, appearing to read 'C. J. Jarvis'. The signature is written in a cursive style with a large initial 'C' and 'J'.

C J JARVIS

pe2.ss/jar/min/2

Annex

BP defaulters

Number of shares applied for	Number of defaulters remaining	Total amount outstanding
80 - 200	753	£119,856
300 - 400	233	£ 93,840
500 - 900	290	£209,040
1,000 - 2,000	206	£318,000
2,500 - 10,000	37	£195,240
	<hr/> 1,519 <hr/>	<hr/> £935,976 <hr/>

RESTRICTED



CH/EXCHEQUER	
REC.	- 4 JUL 1988 ✓ 4/7
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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

4 July 1988

Dear Stephen,

11th OFFSHORE LICENSING ROUND

The Prime Minister was grateful for your Secretary of State's minute of 1 July and has noted that an announcement will be made on Thursday 7 July.

I am sending a copy of this letter to the Private Secretaries to the members of E(A), the Lord President, the Secretary of State for Defence and Sir Robin Butler.

Yours,
Paul

(PAUL GRAY)

Stephen Haddrill, Esq.,
Department of Energy.

RESTRICTED

FROM: H C GOODMAN
DATE: 5 July 1988

1. MR WILLIAMS

2. ECONOMIC SECRETARY

cc. PS/Chancellor
PS/Financial Sec
Mr Scholar
Mr D J L Moore
Mr Culpin
Mr Johns - IR

ELEVENTH ROUND OF OFFSHORE LICENSING

Following your discussion with Mr Morrison last week, we had a meeting with Energy officials to discuss the background to the Eleventh Round. This minute reports on that meeting. You will also have seen that the Prime Minister has now noted Mr Parkinson's proposals for the Eleventh Round which are to be announced on Thursday. I attach the draft, which has been prepared by Energy officials, together with a map of the blocks.

2. When E(A) discussed the Eleventh Round at the beginning of March, it was agreed that the possibility of auctioning some of the blocks should be considered if oil prices improved or if particularly attractive blocks were released. Unfortunately, oil prices have not improved: at the beginning of March, Brent spot prices stood at \$14.50 p.b., today they are at \$14.00 p.b. though, because of exchange rate movements, the starting price has barely changed.

3. The blocks which Energy propose to include in this round are listed in the draft proposal. They made the following points to us about these:-

- (i) Central North Sea and Northern North Sea - The most attractive blocks are in these categories with good seismic results, but the fishing industry will object to further developments. Many part blocks are on offer here, which have been relinquished following previous failure by companies to develop in earlier rounds.

- (ii) Orkney/Shetlands - some good seismic results, but a high risk area, may all be taken by one company.
- (iii) Faroes/Shetland - restrictions on production, because of MoD's interests, will be needed.
- (iv) Hebridean Platform - these are in deep waters (and thus expensive to develop).
- (v) Outer Moray Firth and Forth Approaches - Good seismic results have been achieved by the British Geological Survey, but the companies have shown little interest, so the Department hopes to attract them by inclusion.
- (vi) Irish Sea/Manx Basin - only British Gas have developments here. Further discoveries by them and Esso (which are confidential) could mean they bid here. There will be restrictions because of navigational and environmental concerns.
- (vii) Southern North Sea - This is mostly under licence. Following careful negotiations with the MoD, new areas are being included. There is a possibility of gas at 16,000 ft.
- (viii) Cardigan Bay - Restrictions on the timing and place for drilling have been required by the MoD.
- (ix) English Basin - Environmental and navigational problems may make development difficult and costly, but it is thought that a continuation of the Wytch Farm trend will be found.

4. So overall the picture is mainly one of blocks included where development will be constrained by the interests of the fishing and shipping industries, environmental concerns and MoD's interest, either in the form of firing ranges or submarine lanes. Energy officials have succeeded in persuading the MoD to be more flexible about the areas they need for target practice, which may open up good possibilities also in future rounds. Only the blocks in the already developed areas near the median line do not face such serious problems. But although they are near the mature fields, they have been licenced before and so, despite improvements in seismic techniques, it is becoming less likely that reserves in commercial quantities remain undiscovered here. These would have been the most suitable candidates for auction, but even these are not particularly attractive.

5. For the future, it may be that we should not seek to rest the argument for auctions so heavily on the attractiveness of the blocks. It is likely that further development will be more constrained, in any case licences could be auctioned with conditions attached.

6. One new feature in the Eleventh Round is the proposal to offer more generous terms in deep waters. You will see that the periods allowed for exploration have been extended to 48 years, with a longer initial period of 8 years and surrender only if no development has taken place after 16 years. Given the greater problems and costs associated with deep waters, this is a sensible innovation.

Recommendations

7. Clearly it is now too late to re-open the question of auctioning some blocks in this round. In any case, it would be difficult to show that the criteria agreed at E(A) had been fulfilled. Nonetheless, we now have more information about the blocks on offer. Since this includes some new acreage; blocks expected to be of interest to different sectors of the industry and blocks in a wide variety of geological and commercial situations, we can expect a reasonable spread

of development and a relatively successful licence round. We have no drafting comments on the proposed announcement, and suggest that your Private Secretary telephones Mr Morrison's office to register Treasury agreement. *conurrence.*


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H C Goodman
H C GOODMAN

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FROM: H C GOODMAN

DATE: 7 JULY 1988

PS/CHANCELLOR OF EXCHEQUER 

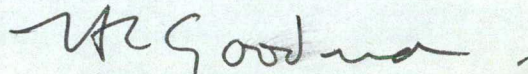
cc

Economic Secretary
 Sir P Middleton
 Mr Scholar
 Mr D A Moore
 Mr M L Williams
 PS - IR
 Mr Johns - IR

ROYALTY OIL

The Chancellor asked (Mr Taylor's minute of 15 June) how long it will take to phase out the participation agreements.

2. Department of Energy officials have now discussed this with OPA. To a large extent on this work they will be in the hands of the oil companies. This makes it difficult to be precise about the timetable. Energy's preliminary view is that the more straightforward task of terminating the option deeds should probably take no more than 4 or 5 months. The other work of preparing initial drafts of deeds of termination of the participation agreement will take longer and it is on this that we will be dependent on the companies. Because we need their cooperation the Department of Energy judges it best not to set target dates. However, the Chancellor should be pleased to know that OPA had already made a start on the work and the bulk of it should be cleared by the end of financial year.


 H C GOODMAN

A B < F C i P O s

Press Association

UK File

on 07-07-88 at 11:34

Mr Davies 35A/B

FIRE Rig Trade

RIG DISASTER DEALS BLOW TO UK TRADE

By Dan Atkinson and Larry Elliott,
Press Association Economics Staff
First City estimates are that the
shutdown of production in the five
fields surrounding the stricken Piper
Alpha platform will decrease output by
14%.

This will cost around £80 million a
month in lost exports.
As the massive international search
for survivors of the North Sea inferno
continued, it became clear that
7+ More 4 Headlines 6+ 00+ < >

✓
MP

Press Association

UK File

on 07-07-88 at 11:34

Britain's deteriorating balance of
payments position has received another
blow.

At a time when Britain's trade with
the rest of the world is already
deeply in the red, the loss of 280,000
barrels of oil a day comes as bad news
for Chancellor Mr Nigel Lawson.

Aside from the loss of exports, the
closure of the fields would lose Mr
Lawson between £300 million and £400
million in tax revenue over a whole
year.

However, with Government finances at
their healthiest for more than 20

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Press Association

UK File

on 07-07-88 at 11:34

years, this will be only a minor irritant to the Chancellor.

The fact that a good deal of routine maintenance work takes place during the summer, when the weather in the North Sea is kinder, means that the loss of production will be less than it would have been at other times.

The price of North Sea oil rose in the wake of the disaster. Brent crude for September delivery stood at 14.95 dollars a barrel, against 14.7 dollars last night.

North Sea oil proceeds have prevented Britain from sinking even further into the red in foreign trade. On average

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Press Association

UK File

on 07-07-88 at 11:34

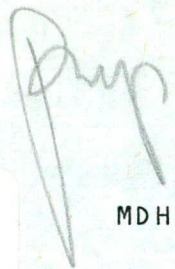
the UK has a £300 million a month surplus in oil, although this is down markedly on the early 80s, due to lower oil prices and a gradual rundown in reserves.

end lp

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035703
MDHIAN 6556

PS/CHANCELLOR OF THE EXCHEQUER
TREASURY



CONFIDENTIAL

FM LAGOS

TO IMMEDIATE FCO

TELNO 754

OF 081445Z JULY 88

INFO PRIORITY DEPARTMENT OF ENERGY, DTI, OPEC COUNTRIES

INFO PRIORITY UKMIS IAEA VIENNA, UKREP BRUSSELS, WASHINGTON

INFO PRIORITY UKDEL OECD PARIS

CALL ON LUKMAN, MINISTER OF PETROLEUM

SUMMARY

1. LUKMAN SAYS HE IS VERY CONCERNED ABOUT THE PRESENT OIL PRICE SITUATION AND IS CLEARLY UPSET BY THE UAE'S RECENT MOVES. HE DOES NOT RULE OUT THE PROSPECT OF AN EARLY OPEC MINISTERIAL MEETING. HE LEAVES FOR VIENNA ON 10 JULY AND EXPECTS TO BE THERE FOR MOST OF THE WEEK. HE MAY RETURN VIA LONDON.

DETAIL

2. I CALLED ON LUKMAN, MINISTER OF PETROLEUM AND OPEC CHAIRMAN, ON 8 JULY TO SOUND OUT HIS REACTIONS TO THE DEVELOPMENTS IN THE OIL MARKET SINCE THE LAST OPEC MEETING. HE WAS PARTICULARLY CONCERNED ABOUT THE UAE'S OVERPRODUCTION. HE SAID OPEC COULD HAVE LIVED WITH THE FACT OF UAE'S OVERPRODUCTION BECAUSE THAT WAS NOT NEW, BUT NOT WITH OTAIBA'S PUBLIC STATEMENT THAT THEY WERE NOT PREPARED TO ABIDE BY THEIR QUOTA. HE SAID HE VIEWED THE CURRENT SITUATION AS VERY SERIOUS AND SAID IT WAS IMPOSSIBLE TO PREDICT WHAT WOULD HAPPEN. HE DID NOT RULE OUT A SUBSTANTIAL DROP IN THE PRICE IF THE OVERPRODUCTION BY THE UAE, BY KUWAIT, AND THE HIGH PRODUCTION LEVELS OF IRAQ CONTINUED (WITH THE IMPACT OF THE UAE BEING THE MOST IMPORTANT). ON THE WHOLE HOWEVER HE THOUGHT THAT THE OPEC PRODUCERS HAD LEARNT THEIR LESSON FROM THE 1986 PRICE COLLAPSE, AND HE THOUGHT THAT RATHER THAN EVERYBODY FOLLOWING THE UAE AND ABANDONING THEIR QUOTAS, THE REST WERE LIKELY TO STAND FIRM AND PUT PRESSURE ON THE OVERPRODUCING GULF COUNTRIES TO COME BACK INTO THE FOLD. HE ALSO SAID THAT IRAQ'S PRODUCTION LEVELS WERE GROUNDS FOR CONCERN. THEY WERE NOW PRODUCING MORE THAN IRAN, WHICH REMOVED THE JUSTIFICATION FOR THE EXTRA NEUTRAL ZONE PRODUCTION, AND SAID HE HAD BEEN PRESSING THIS VIEW ALTHOUGH WITH LITTLE SUPPORT.

3. LUKMAN LEAVES FOR VIENNA ON SUNDAY 10 JULY. I ASKED WHETHER

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MDHIAN 6556

THIS WAS A CONSEQUENCE OF THESE DEVELOPMENTS OR WHETHER HE HAD PLANNED TO GO ANYWAY. HE SAID HE HAD PLANNED TO GO ANYWAY, TO HELP WITH THE HANDOVER TO THE NEW SECRETARY GENERAL, BUT THAT HE FEARED NOW HIS TIME WOULD BE DEVOTED TO SHORING UP THE QUOTA SYSTEM. I ASKED IF HE ENVISAGED THE NEED FOR ANOTHER EARLY MINISTERIAL MEETING. HE SAID HE DID NOT RULE THAT OUT.

4. PREDICTABLY, LUKMAN COULD NOT RESIST THE OPPORTUNITY TO LECTURE ME ON THE NEED FOR THE NON-OPEC PRODUCERS TO HELP OPEC MAINTAIN THE PRICE. HE SAID THAT THERE WAS NOW A VERY REAL DANGER OF A SIGNIFICANT PRICE COLLAPSE TO A LEVEL WHICH WOULD DO GRAVE DAMAGE TO UNITED STATES OIL PRODUCTION AND ALSO TO THAT IN THE NORTH SEA. HE SAID THAT FOR THESE REASONS THERE WERE THOSE IN OPEC ('THE OPEC SHARP-SHOOTERS') NOW ADVOCATING THAT OIL PRICES SHOULD BE PURELY A FACTOR OF MARKET FORCES. THAT COULD TAKE THE OIL PRICE DOWN TO DOLLARS5 PB OR LESS, WHICH WOULD DESTROY MUCH OF THE EXISTING WORLD'S OIL PRODUCTION TO THE BENEFIT OF A FEW OF THE OPEC PRODUCERS. HE SAID THIS COULD NOT BE IN OUR INTERESTS, AND EVEN A MODEST GESTURE OF SUPPORT, SUCH AS THAT MADE BY NORWAY, WHICH HE SAID, CONTRARY TO THEIR STATEMENTS, HAD NOT REALLY CUT PRODUCTION AT ALL, WOULD BE HELPFUL. I SAID THAT WHEREAS I UNDERSTOOD WHAT HE WAS SAYING, HE WOULD APPRECIATE THAT WHILE THE BRITISH GOVERNMENT WAS WELL AWARE OF THESE ARGUMENTS AND HAD STUDIED THEM CAREFULLY, WE WERE OF THE VIEW THAT OIL PRODUCTION LEVELS AND PRICES SHOULD BE DETERMINED BY MARKET FACTORS ONLY WITHOUT GOVERNMENT CONTROL, BUT SAID THAT I WOULD OF COURSE REPORT WHAT HE HAD SAID.

5. WE DISCUSSED BRIEFLY THE LNG PROJECT AND THE OSSO FIELD PROJECT. HE SAID HE HOPED BRITAIN WOULD BE ABLE TO SUPPORT BOTH. I STRESSED THAT ANY INVOLVEMENT BY ECGD WOULD HAVE TO FOLLOW A MORE GENERAL AGREEMENT WITH THE IMF. HE SHOWED IMPATIENCE AT THIS, SAYING THAT THESE PROJECTS AND OTHERS IN THE HYDROCARBON FIELD, SUCH AS THE FOURTH REFINERY AND THE PHASE II PETROCHEMICAL DEVELOPMENT, PROVIDED THE MAJOR PART OF THE ANSWER TO NIGERIA'S ECONOMIC WOES. THEY WERE GUARANTEED TO INCREASE THE COUNTRY'S HARD CURRENCY PAYMENTS AND HE HOPED WE WOULD BE SYMPATHETIC.

6. LUKMAN ALSO MENTIONED THAT AT HIS MEETING WITH MR PARKINSON ON 20 JUNE THERE HAD BEEN MENTION OF THE POSSIBILITY OF MR PARKINSON COMING TO LAGOS, AND ASKED WHEN I THOUGHT HE MIGHT BE ABLE TO DO SO. I SAID THAT I HAD NO INFORMATION ON THAT, BUT THAT I UNDERSTOOD IT HAD BEEN AGREED IN PRINCIPLE (YOUR TELNO 443).

PAGE 2
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CONFIDENTIAL

035703
MDHIAN 6556

7. HE SAID THAT DEPENDING ON WHEN HE COULD GET AWAY FROM VIENNA, HE MIGHT RETURN VIA LONDON. I ASKED HIM TO LET ME KNOW, PERHAPS THROUGH OUR EMBASSY IN VIENNA, IF HE NEEDED ANY HELP (HE IS UNLIKELY TO DO SO: HE TRAVELS THROUGH LONDON FREQUENTLY WHERE SHELL USUALLY LOOK AFTER HIM WELL).

HEAP

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FM OTTAWA
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TELNO 519
OF 082050Z JULY 88
AND TO PRIORITY DEPT OF ENERGY (FOR OSO)

✓

MY TELNO 282: OFFSHORE NEWFOUNDLAND

1. SPECULATION CONTINUES THAT A DECISION IS CLOSE ON DEVELOPMENT OF THE HIBERNIA FIELD OFF NEWFOUNDLAND.

2. AT THE TIME OF THE PRIME MINISTER'S VISIT TO CANADA IN JUNE, THE CANADIAN ENERGY MINISTER TOLD US THAT THE GOVERNMENT'S NEGOTIATIONS WITH MOBIL WERE PROVING DIFFICULT AND THAT MOBIL WERE HOLDING OUT FOR ADDITIONAL FEDERAL SUPPORT OVER AND ABOVE THE ATTRACTIVE OFFER THAT HAD BEEN PUT TO THEM.

3. IN THE LAST FEW DAYS MASSE HAS BEEN QUOTED AS SAYING THAT NOW THAT TALKS BETWEEN THE GOVERNMENT AND MOBIL HAVE REACHED A STAGE WHERE AGREEMENT WAS MORE POSSIBLE, MOBIL HAVE REVIEWED THEIR DEVELOPMENT COSTS WHICH ARE NOW HIGHER THAN EXPECTED. AS A RESULT IT MIGHT STILL BE SEVERAL WEEKS BEFORE ANY ANNOUNCEMENT IS MADE. MOBIL'S COSTS HAVE PREVIOUSLY BEEN ESTIMATED AT BETWEEN DOLLARS 4-5 BILLION. THE SAME REPORT SUGGESTS THAT THE GOVERNMENT'S CURRENT FINANCIAL PACKAGE IS ABOUT DOLLARS 1 BILLION AND INVOLVES A COMBINATION OF SUBSTANTIALLY REDUCED ROYALTY REGIME, LOAN GUARANTEES AND OTHER FORMS OF ASSISTANCE WHICH WILL TAKE EFFECT IF OIL PRICES FALL BELOW DOLLARS 17-18 A BARREL.

WENBAN-SMITH

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MR CARRICK

ADDITIONAL 42

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PAGE 2
RESTRICTED



A large, stylized handwritten signature in dark ink, likely belonging to J. M. G. Taylor.

FROM: J M G TAYLOR
DATE: 11 July 1988

MS GOODMAN

cc PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr D A Moore
Mr M L Williams
PS/IR
Mr Johns IR

ROYALTY OIL

The Chancellor was grateful for your note of 7 July.

A smaller, stylized handwritten signature in dark ink, likely belonging to J. M. G. Taylor.

J M G TAYLOR



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

FROM: JEREMY J HEYWOOD

DATE: 11 July 1988

MR C JARVIS

cc **PS/Chancellor** - 2
Sir P Middleton
Mr Monck
Mr Moore
Mr Beastall
Mr Bent

BP: STOPPED CHEQUES

The Financial Secretary was grateful for your minute of 4 July.

2. You told me that we took action against those defaulters who applied for 1000 Britoil shares. In the light of that, the Financial Secretary is content with what you proposed.

A smaller handwritten signature, likely of Jeremy Heywood, located below the main body of text.

JEREMY HEYWOOD

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FM KUWAIT
TO PRIORITY FCO
TELNO 349
OF 111028Z JULY 88

BP/KIO

1. THE LOCAL PRESS CARRIES A REPORT OF A REUTERS' INTERVIEW WITH THE GOVERNOR OF THE CENTRAL BANK OF KUWAIT IN WHICH SHAIKH SALEM IS REPORTED AS SAYING THAT THE KIO COULD REDUCE ITS SHAREHOLDING IN BP 'IF MARKET CONDITIONS WERE RIGHT'. HE IS ALSO QUOTED AS ADDING THAT 'IT IS A LONG TERM INVESTMENT BUT IF MARKET CONDITIONS ARE OK AND PRICES REASONABLE, I DO NOT THINK THERE IS ANYTHING AGAINST SELLING'.

2. WE WOULD NOT BE INCLINED TO READ TOO MUCH INTO THESE REMARKS ON THEIR OWN. ALTHOUGH SHAIKH SALEM IS ON THE BOARD OF THE KUWAIT INVESTMENT AUTHORITY, IT IS UNLIKELY THAT HE WAS DOING MORE THAN STATING THE OBVIOUS. IT IS STILL SHAIKH ALI KHALIFA WHO CALLS THE SHOTS ON BP.

HINCHCLIFFE

YYYY

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MR BRAITHWAITE
MR MAUD
MR MUNRO
SIR D MIERS

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PS/NO
~~PS/CHANCELLOR~~
MR MOORE, HMT

MR D DAVIS, D/ENERGY
PS/SOS FOR T AND I
MR TREADGOLD, DTI

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MR MONCK, HMT
PS/SOS FOR ENERGY
MR CHIPPERFIELD, D/ENERGY

MS RICHARDSON, DTI SOLS
MR WHOMERSLEY, LEGAL ADVS

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INFO ROUTINE OPEC POSTS

MY TELNO 180: ALGERIAN VIEWS ON OIL MARKET

SUMMARY

1 ALGERIAN ENERGY MINISTER REITERATES CONCERN AT MARKET TENDENCY, AND SUGGESTS EXPLANATION.

DETAIL

2 I WAS ABLE TO SEE NABI TETE-A-TETE ON 11 JULY AND PROBED FURTHER THE VIEWS REPORTED IN MY TUR. HE SPOKE OF A CATASTROPHIC COLLAPSE IN THE PRICE OF OIL IN MUCH THE SAME TERMS AS THE WEEK BEFORE, BUT I WAS ABLE TO GET HIM TO SAY RATHER MORE ABOUT THE POSSIBLE POLITICAL BACKGROUND TO THE ATTITUDE OF THE GULF STATES.

3 NABI STARTED BY WONDERING ALOUD WHETHER AN IMPORTANT ELEMENT MIGHT NOT BE THE AMERICAN PRESIDENTIAL ELECTION CAMPAIGN. HE ARGUED THAT A LOW OIL PRICE WOULD REDUCE THE DEFICIT IN THE US CURRENT ACCOUNT, AND IMPROVED FIGURES WOULD HELP THE REPUBLICAN PARTY. WHEN I POOH-POOHED THIS, POINTING OUT THAT THE INSTABILITY CAUSED BY VERY LOW OIL PRICES WOULD NOT BE IN THE US INTEREST, NABI ACCEPTED MY POINT BUT SAID THAT THE GULF STATES WERE NONETHELESS HINTING STRONGLY THAT IT WAS AT AMERICAN REQUEST THAT THEY WERE EXERCISING DOWNWARD PRESSURE ON THE PRICE.

4 NABI THEN SUGGESTED ANOTHER EXPLANATION WITH RATHER MORE CONVICTION: THE LOWER GULF STATES WERE STILL SUSPICIOUS OF IRAQ AND HAD MANY TIES WITH IRAN. THEY OBJECTED STRONGLY TO IRAQ'S EXEMPTION FROM THE OPEC QUOTA SYSTEM, AND MIGHT BE TRYING TO EXERCISE PRESSURE ON IRAQ TO ACCEPT A REASONABLE QUOTA LIMIT. MEANWHILE OTHERS WERE BEING HURT.

5 NABI ASKED THAT I PASS A MESSAGE OF SINCERE SYMPATHY TO MR PARKINSON IN RESPECT OF THE PIPER ALPHA TRAGEDY. IT WAS AN AWFUL EVENT WHICH MUST SADDEN EVERYBODY IN THE INDUSTRY. HE ENDED BY EXPRESSING THE HOPE THAT MR PARKINSON WOULD BE ABLE TO ACCEPT THE NEW DATES PROPOSED FOR HIS VISIT (MY TELNO 183). THE STATE OF THE

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MARKET MADE ITA VERY GOOD TIME FOR EXCHANGES BETWEEN THEM.

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MR CARRICK

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CONFIDENTIAL

FROM: P N SEDGWICK
 DATE: 14 JULY 1988

SIR P MIDDLETON

cc PS/Chancellor
 PS/Economic Secretary
 Sir T Burns
 Mr Scholar
 Mr Odling-Smee
 Mr Gieve
 Mr Hibberd
 Mr Mowl o/r
 Mr Williams
 Mr Bush
 Ms Goodman
 Mr Owen o/r
 Mr P Davis
 Mr Cropper
 Mr Tyrie
 Mr Call

PIPER ALPHA : ECONOMIC CONSEQUENCES

You and copy recipients might like to see the Department of Energy's assessment of the consequences of the Alpha-Piper accident. We have been asked to assess the estimates of the effects on the current account.

2. I have been sent also a draft of the D. of Energy's press briefing (which has not yet been agreed within the department). Again we have been asked to check the statements on the current account. In my absence Mr Hibberd will organise this.

P.N.J

P N SEDGWICK



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PIPER ALPHA : ECONOMIC CONSEQUENCES

Background : Piper Tartan Area

The Piper field was discovered in January 1973 and oil production commenced in December 1976. Production from the field is now in decline, having produced 111 million tonnes of oil to end of June 1988 and with some 16 million tonnes remaining to be produced.

The Piper Alpha platform was at the centre of a complex oil and gas pipeline system illustrated in Fig.1. Surplus gas from the whole Piper-Claymore-Tartan area is routed through Piper to the Mid-Line Compression platform where it joins the Frigg pipeline to St. Fergus. Oil from other fields is routed through Claymore after which it joins the Piper line to Flotta via a subsea connection. The Piper end of this line will need to be sealed before any oil from these fields can be produced.

Oil Production

2. Piper. It is PED's current view that it is extremely unlikely that any production can be resumed from this field until after 1989. What happens beyond this period is speculative and has therefore not been pursued in this assessment.

Claymore and Scapa. It is still uncertain how long these fields will be out of production. PED's current assessment, which is similar to Occidental's, is that these two fields will be out of production for two months and when brought back into production will remain at half production for a further month.

Tartan, Highlander and Petronella. It is PED's view that these fields could be back at full production in two months time.

3. Chanter and S.Piper. These two small oilfields which were planned to produce via Piper have yet to produce oil. They are unlikely to commence production until after 1989.

14/7



The loss in production is summarised in the following table:

<u>Deferral of oil production in 1988 and 1989</u>		<u>m tonnes</u>	
		<u>1988</u>	<u>1989</u>
a.	Piper	2.5	3.9
b.	Claymore and Scapa	1.05	nil
c.	Tartan, Highlander and Petronella	0.55	nil
d.	Chanter and S. Piper	0.1	0.3
	Total Deferred Production	4.2	4.2

Total UKCS production in 1987 was 123m tonnes and therefore the lost production represents something of the order of 3.5% of total production.

Effect of further delay in bringing Claymore, Tartan, Scapa, Highlander and Petronella into production

4. Each additional month these fields are out of production will result in an additional loss of 0.7m tonnes.

Gas Production

5. The surplus gas sold to British Gas from the Piper/Tartan/Claymore area was expected to be some 65m therms in 1988 and 50m therms in 1989. These volumes are under one tenth of one percent of total UK requirements and therefore will not give rise to any disruption to consumers.

6. A significant proportion of the gas produced by Piper is used for power generation and other oil production purposes within this system of fields. Claymore will need to purchase diesel oil to replace the lost fuel gas and this will add to its costs.

Gross Value of Lost Production

7. The gross value of the production lost in 1988 and 1989 at today's oil prices and exchange rate is put at £300m for each of these years.

Balance of Payments

8. The loss of oil and gas production from these fields could, at today's oil price, lead to a loss to the UK current account of some £250m in 1988 and about £230m in 1989. Each additional month that Claymore, Tartan, etc. are out of production will add to this loss by about £40m per month. Part of the above will be offset by an improvement on the invisible side of the account since a part of the insurance liabilities on Piper Alpha will be met by

(low)

no low level prices in the present.

This includes an offset to the effect on the visible balance of payments

inv 1911 plus 2 foreign owners.



ws. 11 foreigners. We cannot put a figure on this at present, but it could amount to more than one hundred million pounds.

Loss Receipts to the Exchequer

9. The total loss to the Exchequer in terms of royalty, corporation tax and petroleum revenue tax is likely to amount to about £170m in financial year 1988/89 and some £160m in 1989/90. Royalty, which is the responsibility of this Department, is likely to account for about £30m of the above in each of the two years.

10. These figures are based on the assumption that there is no change to the existing tax liabilities and payments of the companies involved. Nor do they take account of tax on any insurance monies received on the damaged platforms.

Employment

11. It is too early to form any reliable estimates of the direct and secondary employment implication following on from this accident.

Wider Oil Market

12. The loss in production of Piper and the fields in the Piper/Claymore/Tartan system is equivalent to only one half of one percent of total free world production. It is therefore unlikely to lead to any tightening in global supply-demand and, once markets have adjusted to the initial impact of the tragedy, to any lasting impact on world oil prices.

Impact on the Oil Industry

13. The licensees of the fields affected by this disaster are listed in the attached Annex. Occidental, with 30% of its world wide production accounted for by Piper and Claymore, is likely to be the company whose cashflow is most significantly effected. This may lead to delays in the development of small oilfields such as Birch and Glenn. Fields affected by this accident account for a much smaller share of the world wide production of Texaco and Union Texas and will therefore not have such a dramatic effect on their cashflow. Apart from a small interest in two other UK oilfields, Thomson's interests are in the Piper area. But as a large company with most of its interests other than in oil, it should not be severely affected.

14. A number of small independents have interests in Claymore : often, this being their only UK production. Any prolonged delay in bringing Claymore back into production could cause serious cashflow and financing problems for these companies. Sovereign and Nedlloyd have interests in the Emerald oilfield and this could make financing of that project more difficult than it already is.



15. Since companies can offset their exploration and appraisal drilling costs against petroleum revenue tax, the loss of production on such tax paying fields as Piper and Claymore is likely to lead to some reduction in the overall level of this activity. Delay in restarting Claymore with its large number of licensees is likely to be more important in this regard.



ANNEX A

Field Licensees

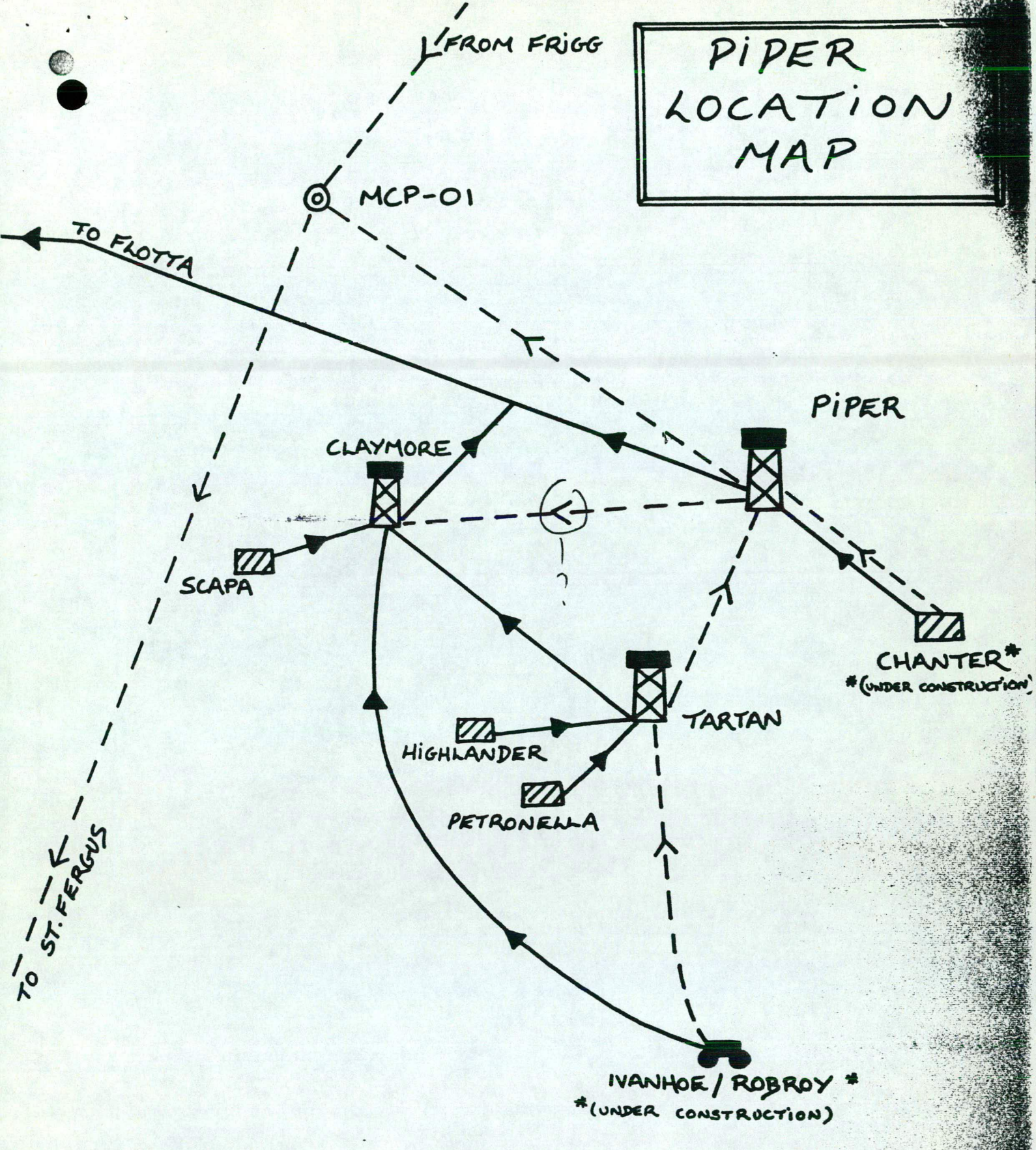
		%
Piper, Scapa and Chanter:	Occidental	36.5*
	Texaco	23.5
	Union Texas	20
	International Thomson	20
Tartan, Highlander and Petronella:	Texaco	100*
Claymore:	Occidental	23.4*
	Texaco	21.2
	Union Texas	20
	International Thomson	20
	AB Exploration	0.5
	AGIP	2.5
	Berkley Resources	0.5
	Coalite Oilex	1.0
	North Sea & General	1.0
	Nedlloyd Energy	5.0
	Pict Petroleum	0.5
	CSX	0.6
	Third Triton	0.5
Transworld	0.8	
Sovereign	2.5	

OPA has 0% share in all the above except Petronella.




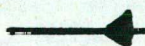
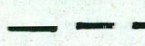
Ivanhoe and Rob Roy	Amerada Hess	38.34*
	Deminex	43.33
	Kerr McGee	10.83
	Pict	3.75
	Whitehall	3.75

* Operator

PIPER LOCATION MAP



KEY:

	PLATFORM		SUB-SEA		FLOATING PLATFORM
	OIL EXPORT LINE		GAS EXPORT LINE		

[THIS IS A DRAFT AND HAS NOT YET BEEN CLEARED WITHIN THE DEPARTMENT]

"PUBLIC POSITION ON ECONOMIC CONSEQUENCES"

Piper Alpha was the only platform on this field and production cannot be restored until new facilities are put in place and this will inevitably take some considerable time. At the time of the accident Piper was producing some 120 thousand barrels of oil per day, which is equivalent to some 5% of total UK production.

A number of fields, Tartan, Highlander, Petronella, Claymore, Scapa and Ivanhoe Rob Roy are tied to the Piper production and transmission system. Oil from these fields is routed via an underwater connection into the Piper-Flotta oil line at a point some 22 miles from Piper Alpha. Once the broken end of this line at Piper Alpha has been sealed, production from these fields can recommence. It is uncertain how long this will take : it could be a few months. Each month's loss of production from these fields amounts to some 0.7 million tonnes.

Since the Piper Alpha platform acted as the gathering point for gas from these fields, offshore gas production will be severely disrupted. The amount of gas from the area sold to BG which is likely to be lost is an exceedingly small proportion of BG's total availabilities and therefore its customers will not be affected. The loss of gas for

offshore processing will affect field economics. There will inevitably be both balance of payments effects and reductions in Exchequer receipts. The reduction in the current account of the balance of payments would amount to a quarter of a billion pounds this year. But a large part of this is likely to be offset by the insurance liabilities on Piper Alpha met overseas. The loss in tax to the Exchequer in 1988 is unlikely to amount to more than about 4% of the total tax receipts on UKCS oil and gas production.

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excise

It is unlikely that the loss of production from these fields will lead to any tightening in global supply-demand and to any lasting impact on world oil prices.

It is too early to comment on what effect this accident is likely to have on activity elsewhere in the UKCS.

CONFIDENTIAL

From: S D H SARGENT

Date: 15 July 1988

MR SEDGWICK

cc PS/Chancellor
PS/Economic Secretary
Sir T Burns
Mr Scholar
Mr Odling-Smee
Mr Gieve
Mr Hibberd
Mr Mowl
Mr M Williams
Mr Bush
Ms Goodman
Mr D Owen
Mr P Davis
Mr Cropper
Mr Tyrie
Mr Call

PIPER ALPHA: ECONOMIC CONSEQUENCES

Sir Peter Middleton was grateful for your minute of 14 July.


S D H SARGENT
Private Secretary



Inland Revenue

Policy Division
Somerset House

FROM M A JOHNS
DATE 18 JULY 1988

- JP 18.7*
1. MR PAINTER
 2. ECONOMIC SECRETARY

PIPER DISASTER: PRT INSTALMENT PAYMENTS: PROPOSED EXTRA STATUTORY CONCESSION

1. The Piper partners have approached us about two issues arising from the Piper disaster:

a. whether they can defer some payments of PRT which are strictly due.

b. whether the law can be changed to prevent an immediate PRT and CT charge on insurance receipts.

2. The latter is a difficult question on which we are awaiting precise proposals and which will need careful thought. We will come back to you when we have fuller information and recommendations to make.

cc Chancellor
Chief Secretary
Financial Secretary
Mr Scholar
Mr Culpin
Mr Williams
Mr Gilhooley
Mr Tyrie
Mr Cropper

Mr Painter
Mr Beighton
Mr Johns
Mr Elliss
Miss Hill
Mr Prescott
Dr Parker
Miss MacFarlane
PS/IR

3. On the former, there is a case for relaxing the strict pattern of payments as it will operate harshly in the unusual circumstances. If we do nothing the companies will have to pay instalments of PRT each month: the instalment on 1 August will be based on the profits for the second half year of 1987; the instalments on 1 September to 1 February will be based on the profits for the first half of 1988. These will therefore not significantly reflect the effect of the fire although current cashflow will be very low. There is provision to cancel instalments where no deliveries are made in the previous month but these provisions will not bite because there was production until the explosion in mid-July and because of the "gas banking" arrangements with the Frigg field. Under these some past Piper gas production was treated as if it came from Frigg and now some Frigg production is treated as if it comes from Piper. This was a device to smooth out the overall profile of gas production to British Gas' requirements. It means that small receipts will be received in any ^{month} year.

4. What the Piper participators want, therefore, is for us not to charge interest if they don't pay instalments. If they get little or no receipts then at the end of the period the liability to the tax in the instalments would effectively be cancelled but interest would be due in strict law. Waiving interest will cost around £3 million.

5. The participators also want us to agree not to pursue any final liability for the first half of 1988 to the extent that it is not covered by instalments already paid. They argue that eventually they will make a loss which will be carried back and so cancel any charge. This would not involve any permanent loss of revenue since the interest on the loss carried back would cancel out the interest on the tax unpaid. But it could defer some £25m of tax from the current tax year until later.

6. As far as the final liability for the first half of 1988 is concerned it would be normal for us to agree to delay enforcing

collection on a company with sudden cashflow problems. Indeed, we have little option short of starting winding-up proceedings. We therefore propose to agree to what they ask subject to review when the figures for the second half of 1988 are available.

7. On the instalments, we had to face a slightly similar problem in 1986 when the oil price fell. Companies were paying instalments which significantly exceeded their eventual liability. Ministers nevertheless decided not to give any relief since the instalments are not an exact instrument anyway and the companies, it was felt, should take the rough with the smooth. This case does, however, seem to us exceptional and not on all fours with that. The law does recognise that instalments should not be paid where there is no production at all; here there has been a sudden catastrophe which has removed all but a tiny proportion of the production. It seems to us reasonable to ignore gas banking and also to allow instalments to be withheld in respect of the month in which the accident took place notwithstanding that there were some deliveries before the accident. We would not suggest going quite as far as the companies would like. They want to stop the payment on 1 August but under the normal rules this is related back to June production which was totally unaffected. They will have received money in July for June deliveries (because of the 30 day credit period). We would propose retaining the linkage to the preceding month but to allow them to withhold the 1 September instalment (relating to July production which was affected by the fire).

8. Were this likely to be a common situation, amending legislation would be appropriate. Given the exceptional nature of the accident, an extra-statutory concession might be felt sufficient. It would only be of significant benefit to the Piper field; but the Claymore field (the only other PRT paying linked field) would be able to benefit in respect of the 1 September payment. For later months the existing rules will anyway let them out. The total cost this year (interest foregone) would be around £3 million; there would be a small cost next year as well.

9. If you are content, therefore, we would propose to write to the companies acceding to their request and to issue a press release announcing the concession as in the attached draft.

M. A. Johns

M A JOHNS

DRAFT PRESS RELEASE

PETROLEUM REVENUE TAX: EXTRA-STATUTORY CONCESSION

Paragraph 3(1) Schedule 19 FA 1982 entitles a participator, on giving notice to the Board, to withhold the instalment due for a month under paragraph 2 of the Schedule if, in the previous month, he did not deliver or relevantly appropriate any of the oil won from the field. By concession a participator is also entitled, on giving notice to the Board, to withhold the instalment for a month if in the previous or an earlier month, oil actually ceased to be won from the field as a result of some sudden catastrophic loss of or damage to production, transportation or initial treatment facilities relating to the field, and has not recommenced.

This concession will be included in the Board's published list of Extra-statutory Concessions (Leaflet IR1) in due course.

NOTES FOR EDITORS

Petroleum Revenue Tax is chargeable in respect of profits from UK oil production for six month chargeable periods ending in 30 June and 31 December. Since 1983 the bulk of the tax has been collected in six equal monthly instalments (based on 75% of the previous six month chargeable period's liability). Under the legislation an instalment may be withheld by an oil field participator if in the previous month he has not delivered or relevantly appropriated any oil from the field. But this condition may not always be satisfied where production from a field has ceased. For example, in the month of the accident there may have been deliveries before the accident which prevent the benefit of the concession being realised. Or it may be that some gas won from the field has been "banked" with a second field and gas from the second field is later treated as coming from the field which has ceased production. In these circumstances where a field suddenly faces a catastrophic loss of production, as happened recently in the case of the Piper field, it will now, ~~concessionally~~, be possible for the participators to withhold any instalments due as if the relevant condition in the 1982 legislation had been fulfilled.

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PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

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FM OSLO
TO PRIORITY FCO
TELNO 134
OF 181140Z JULY 88
AND TO PRIORITY DEPARTMENT OF ENERGY, OPEC POSTS

NORWAY: OIL PRODUCTION CONTROLS

1. THE NORWEGIAN MINISTER OF PETROLEUM AND ENERGY, ARNE OIEN, TOLD REUTERS' CORRESPONDENT HERE ON 14 JULY THAT IF THE MORE MODERATE GULF STATES PUMPED OIL ABOVE THEIR QUOTA, AS HAS BEEN RUMOURED, NORWAY WOULD REASSESS THEIR POLICY ON PRODUCTION LIMITATION. THE REPORT HAS NOW BEEN CARRIED IN THE HELALD TRIBUNE AND OTHER PAPERS, BUT HAS NOT YET SURFACED IN THE NOREGIAN PRESS.
2. THE REUTERS CORRESPONDENT TELLS US THAT OIEN WAS CLEARLY IRRITATED BY THE REPORTS OF EXCESS PUMPING BY SAUDI ARABIA AND SERIOUS IN HIS THREAT TO LIFT PRODUCTION CONTROLS. IMPLICITLY OIEN DID NOT (NOT) INCLUDE UAE IN HIS LIST. BY TELLING REUTERS OIEN APPEARS TO INTEND SENDING A SIGNAL ON THIS TO OPEC.
3. THE NORWEGIAN MEASURE, WHICH KEEPS THEIR PRODUCTION ABOUT 90,000 BPD LOWER THAN IT WOULD OTHERWISE BE, HAS ONLY RECENTLY BEEN RENEWED UP TO END 1988.

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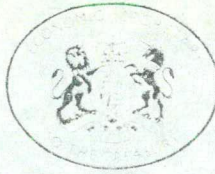
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ADDITIONAL 43

OIL

D/ENGY

NNNN



FROM: P D P BARNES
DATE: 19 July 1988

Handwritten initials

MR JOHNS - IR

cc **PS/Chancellor** ²
PS/Chief Secretary
PS/Financial Secretary
PS/Sir P Middleton
Mr Scholar
Mr Culpin
Mr Williams
Mr Gilhooly
Mr Tyric
Mr Cropper

Mr Painter - IR
Miss Hill - IR
PS/IR

PIPER DISASTER : PRT INSTALMENT PAYMENTS : PROPOSED EXTRA STATUTORY CONCESSION

The Economic Secretary was grateful for your submission of 18 July. The Economic Secretary is content for your to write to the companies agreeing to their request, and to issue a press release as in your draft.

Handwritten initials

P D P BARNES
Private Secretary

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PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

CONFIDENTIAL

FM LAGOS

TO ROUTINE FCO

TELNO 799

OF 191010Z JULY 88

INFO ROUTINE DEPARTMENT OF ENERGY

INFO SAVING KADUNA

MY LETTER OF 18 MAY TO HEAD OF ESSD: BP AND NIGERIA

1. WE HAVE HAD NO FURTHER CONTACTS OR APPROACHES ON THIS SUBJECT. HOWEVER, THE GUARDIAN OF 17 JULY HAS THE HEADING "'BRITISH PETROLEUM BIDS TO RETURN TO NIGERIA'". THE TEXT OF THE ARTICLE IS IN MIFT.

2. THE AUTHOR OF THE ARTICLE, EMEKA OGBEIDE, HAD APPROACHED US WITH A REQUEST TO DISCUSS THE SUBJECT OF BP'S FUTURE IN NIGERIA. ON INSTRUCTIONS FROM THE COUNSELLOR (ECONOMIC AND COMMERCIAL), THE INFORMATION ASSISTANT TOLD HIM THAT THIS WAS PURELY A COMMERCIAL MATTER IN WHICH WE HAD NO INVOLVEMENT AND THAT HE SHOULD ADDRESS HIMSELF TO NNPC. THE "'DIPLOMATIC AND GOVERNMENT SOURCES'" WHICH ARE REFERRED TO IN THE ARTICLE ARE, THEREFORE, NOT THIS HIGH COMMISSION.

3. I IMAGINE BP ARE PLAYING THEIR CARDS CLOSE TO THEIR CHEST BUT YOU MAY WISH TO DRAW THIS ARTICLE TO THEIR ATTENTION.

4. WE ARE REPORTING SEPARATELY BY BAG A SUGGESTION WE HAVE HAD FROM THE BENINESE PETROLEUM AUTHORITIES THAT BP MIGHT BE INTERESTED IN CONCESSIONS IN THE REPUBLIC OF BENIN.

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TO ROUTINE FCO
TELNO 800
OF 191258Z JULY 88
INFO ROUTINE DEPARTMENT OF ENERGY
INFO SAVING KADUNA

MIPT: BP AND NIGERIA

1. FOLLOWING IS TEXT OF ARTICLE IN THE GUARDIAN OF 17 JULY.

BEGINS:

BRITISH PETROLEUM BIDS TO RETURN TO NIGERIA

BRITISH PETROLEUM (BP) THE COMPANY NATIONALISED IN 1979 BY THE FEDERAL GOVERNMENT FOR DIVERTING NIGERIA'S OIL TO SOUTH AFRICA, IS MAKING RENEWED BIDS TO RETURN TO THE COUNTRY.

DIPLOMATIC AND GOVERNMENT SOURCES HINTED LAST WEEK THAT NEGOTIATIONS BETWEEN BP AND THE NIGERIAN NATIONAL PETROLEUM CORPORATION (NNPC) IN THIS REGARD, HAVE BEEN GOING ON FOR ONE YEAR NOW.

SOME TIME LAST YEAR, FOUR REPRESENTATIVES OF BP MET WITH NNPC OFFICIALS IN BENIN CITY, BENDEL STATE FOR FURTHER TALKS ON AREAS OF DISAGREEMENT, IN WHAT ONE OFFICIAL DESCRIBED AS LONG-DRAWN DISCUSSIONS. THE GUARDIAN LEARNT THAT THE MAIN ISS OF DISAGREEMENT OF BP'S FOR RE-ENTRY BID, IS THE COMPANY'S TRADING LINKS WITH SOUTH AFRICA. THE GOVERNMENT IS INSISTING THAT THE BRITISH OIL COMPANY MUST PRESENT PROOF OF SEVERANCE OF TIES WITH THE RACIST ENCLAVE BEFORE ANY AGREEMENT CAN BE REACHED. BP WITH ASSETS WORTH N2BN IN AUGUST 1979 WAS NATIONALISED BY OBASANJO ADMINISTRATION FOR ATTEMPTING TO DIVERT NIGERIA'S CRUDE OIL TO SOUTH AFRICA. THIS GOVERNMENT FIAT ABRUPTLY ENDED THE COMPANY'S 43 YEARS OPERATION WHICH STARTED AS A JOINT VENTURE WITH ROYAL DUTCH/SHELL GROUP OF COMPANIES. THE GUARDIAN WAS RELIABLY INFORMED THAT BP IS GOING THROUGH DIFFICULT TIMES IN ITS SOUTH AFRICAN TRANSACTIONS AND THAT THE NIGERIAN OIL BUSINESS IS ONE OF THE RECOVERY MEASURES IT EXPECTED TO IMPLEMENT. ACCORDINGLY, RECOMMENDATIONS HAVE BEEN PUT FORWARD TO THE LONDON HEADQUARTERS OF THE COMPANY ' 'TO CONSIDER REVERSAL

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OF ITS POLICY ON SOUTH AFRICA IN PREFERENCE FOR THE MORE VIABLE NIGERIAN OIL BUSINESS''.

BEFORE GOVERNMENT HAMMER DROPPED ON BP IN 1979 , IT WAS PRODUCING 1.02 MILLION BARRELS PER DAY (MBD) OUT OF THE NATION'S 1.7 MBD AT THE TIME. ITS SHARES IN THE SHELL-BP WERE TAKEN OVER BY GOVERNMENT WHICH NOW OWNS 80 PER CENT EQUITY IN SHELL. THIS FIGURE IS 20 PER CENT ABOVE ITS SHARES HOLDINGS IN OTHER OIL PROSPECTING COMPANIES. THE ADDITIONAL SHARES ARE THOSE TAKEN OVER FROM BP. UNDER NIGERIA'S CURRENT ALLOCATION OF 1.3 MBD. SHELL PRODUCES 635,000 BARRELS A DAY OR ABOUT 49 PER CENT OF THE NATIONAL QUOTE. SHELL PRODUCES 400,000 BARRELS PER DAY OF BONNY LIGHT WHICH IS NIGERIA PRIME CRUDE AND 235,000 BARRELS OF FORCADOS.

AFTER THE MEETING IN BENIN LAST YEAR, NNPC MANAGING DIRECTOR GODWIN ARET ADAMS SAID THE DECISION TO HOLD A MEETING WITH BP WAS ''BASED PURELY ON COMMERCIAL AND NOT POLITICAL CONSIDERATIONS''. HE SAID THE ARRANGEMENTS OF SUCH MEETINGS SUCH AS THAT WITH BP WERE ''ROUTINE SINCE NNPC GETS OVERTURES FROM INTERNATIONAL CONCERNS AT LEAST ONCE A WEEK ON THE POSSIBILITIES OF ENTERING INTO OIL EXPLORATION PACTS WITH NIGERIA''.

ACCORDING TO HIM, THE NNPC HAS LOTS OF OIL ACREAGES AND THAT OIL COMPANIES WORLD-WIDE WERE CONTINUOUSLY HOLDING DISCUSSIONS WITH NNPC ON THE POSSIBILITIES OF DEVELOPING THE ACREAGES.

''THE DECISION TO BAN BP YEARS AGO WAS TAKEN AT A HIGH LEVEL AND WE PREFER NOT TO MAKE THE IMPRESSION THAT WE ARE PRE-EMPTING GOVERNMENT DECISION ON THE MATTER.

OUR MOTIVE IS GUIDED PURELY BY COMMERCIAL CONSIDERATIONS, '' HE SAID.

RECOMMENDATIONS ARE NORMALLY MADE TO GOVERNMENT AFTER A SERIES OF MEETINGS HAVE BEEN HOLD WITH OIL COMPANIES THAT SHOW INTEREST IN NIGERIAN CRUDE, MAINLY TO DELIBERATE ON SUCH ISSUES AS INTERPRETATION OF OIL DATA, CONSIDERATION OF TAX REGIMES, EXAMINATION OF KNOWN ACREAGE.

AT THE END OF SUCH DELIBERATIONS, A BASIS IS THEN FORMED FOR A JOINT PARTNERSHIP FOR OIL PRODUCTION WHICH IS FORWARDED TO GOVERNMENT FOR CONSIDERATION.

BP'S QUEST TO RE-ENTER THE NIGERIAN OIL PRODUCTION SECTOR IS SAID TO HAVE GONE THROUGH THESE FORMALITIES BUT THE COMPANY'S DIVERSITURE PROGRAMME FROM SOUTH AFRICAN IS DELAYING FURTHER PROGRESS ON THEIR RETURN. ENDS.

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ADDITIONAL 42

OIL

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From: T L Richardson, ERD

Date: 21 July 1988

cc: PS

PS/PUS

Mr Munro

Mr Bayne

Sir D Miers

Mr Young, MED

Mr Whomersley

Legal Advisers

Mr Carrick

PS/Mr Mellor

BP/KIO

1. I submit speaking notes and background material for the Minister's breakfast meeting tomorrow with Ali Khalifa (PS/Mr Mellor's minute of 20 July).
2. There is a delicate balance to be struck here. The Kuwaitis have made an important offer, which they consider is a true concession, and we do not want to snub them. But the MMC will have to make its own judgment whether the Kuwaiti offer is adequate and acceptable. We cannot preempt the MMC. Equally, the Chancellor and Mr Parkinson will almost certainly not be willing to settle for the present level of KIO shareholding and 15% voting rights, welcome though the third Kuwaiti undertaking undoubtedly is (never to seek board representation). To some extent, we are playing poker with the Kuwaitis. If the MMC were to recommend to Lord Young, for example, that the KIO shareholding should be reduced from its present level, we would not want the Kuwaitis to be in a position to claim that HMG had told them it was content with their new offer, and that Lord Young should therefore override the MMC's recommendations (the Kuwaitis will be well aware that he is entitled to do this).
3. This argues for a polite but temporising reply. The main point to get across to the Kuwaitis is that the MMC enquiry cannot be aborted or preempted, and that HMG cannot give the Kuwaitis any

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reaction to their offer at this stage. There are no statutory powers that would allow the Commission to decide not to report on a merger situation to the Secretary of State for Trade and Industry. It will have to decide whether the Kuwaiti offer is acceptable, and whatever ^{new} it takes it will still have to report to Lord Young by 2 September.

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4. Khalifa may claim tomorrow that Kuwait has done all that HMG asked it to do. This is of course the case as regards board representation. But in the letter to the MMC from the Kuwaitis' solicitors, the latter have alleged that British Ministers "would see no difficulty in the holding if it were limited to 20%." In fact, Ministers have made clear to the Kuwaitis that they would wish to see the KIO holding reduced to levels considerably below 20%. Our request to the Kuwaitis to stop buying at 20% was simply intended to stabilise a situation that was developing alarmingly, and Ministers never disguised their hope that the KIO would settle for a smaller holding. In any case, the question is academic because it is now for the MMC to judge what level of holding, and associated voting rights, is appropriate.

5. The speaking notes have been cleared with MED, Legal Advisers and DTI, the Department of Energy and Treasury officials. I have also discussed the gist of them informally with the MMC. The Commission raised one additional point (not for discussion with Khalifa); namely how any Kuwaiti or KIO assurances could be converted into legally binding form. They suggested that HMG might itself wish to underpin the Kuwaiti Government assurances. My first reaction was that government to government assurances were not the only, nor necessarily the best, solution. They could store up trouble for the future, with damage to our bilateral relations.

6. I recommend that Mr Mellor should not discuss the question of assurances when he sees Khalifa. The Minister will wish to know however, that our Legal Advisers have discussed the point with DTI Solicitors. The only practicable means of making any assurances legally binding would be for the Director General of Fair Trading to seek undertakings from the Kuwaitis under Section 88 of the Fair Trading Act 1973; if such undertakings were broken, the Secretary of

State for Trade and Industry would have the power to make an appropriate order under Section 73(2) of the 1973 Act; however, before this process could be instituted, there would have to be a finding by the MMC that the merger could be expected to operate against the public interest. The solicitors representing the KIO have suggested that the undertakings might be given in a deed under seal ^{but} ~~however~~, the preliminary view of lawyers both in the FCO and DTI is that there would be considerable legal problems attached to such a procedure, not least because it is doubtful if an injunction may be obtained to prevent breach of covenant in a deed under seal. It would not be appropriate for any assurances to be between BP and the KIO, as it is the UK public interest which is involved, and BP may, for good reasons of their own, not wish to enforce the assurances at a particular point in the future. Any assurances would of course, have to be made public.

MR MELLOR'S MEETING WITH SHAIKH ALI KHALIFA, 22 JULY

SPEAKING NOTE

- ~~[We welcome the friendly spirit of this initiative.]~~ As you know, we have always hoped that the problem of the KIO purchases of BP shares would not affect broader Anglo-Kuwaiti relations, which we both want to remain close.
- Given the MMC's procedures, you were right to write to them. They will look at your proposals in the light of other evidence. As you know, the MMC is an independent body. They have a statutory requirement to investigate the implications of your shareholding in BP, and there are no statutory powers that would allow that investigation to be set aside. But in any case the Commission is due to report to Lord Young by 2 September, little more than one month from now. It must examine the implications and reach its own conclusions. The government cannot give you a reaction until the MMC process is concluded.
- Ministers made clear all along that 20% was simply a level above which major political difficulties would be ^{confronted} created and below which political pressures could be contained. Our Ambassador in Kuwait and Ministers also underlined on several occasions that even 20% was a level which was too high and with which we would not be happy in the long term. The question of what size shareholding is suitable is for the MMC to investigate and report on. As you know, the next largest shareholding in BP is only 1½%.

of the greater importance of Kuwaiti
The Chancellor reminded you / *of the greater importance of Kuwaiti* holding below 20%
when he met you on 2nd March

SECRET

FROM: H C GOODMAN
DATE: 21 July 1988

*Am advised as promised
Dear Mr M
Ch. Counselor or wife of Mr Khalifa
I think it is
v. unwise for Mr Mellor to see Khalifa at all. But it is obviously too late to scratch it. The changes to the brief Mr Monck has secured are important.*

Handwritten signature/initials

PS/CHANCELLOR

cc PS/Financial Secretary
Sir P Middleton
Sir G Littler
Mr Monck
Mr Moore o/r
Mr Hyett T/Sol.

BP/K10

Today, the Kuwaitis wrote to the MMC setting out some assurances, which they hope will substantiate their stated intention of not interfering with BP Management. These are:

- (a) Not to exercise voting rights above 15 per cent;
- (b) Not to use their shareholding to nominate any Board Directors and;
- (c) Not to take their shareholding above 22 per cent.

I attach the letter.

2. Tomorrow David Mellor is meeting with Ali Khalifa. It is not clear to us at whose initiative the meeting was set up, but this is one of the items for discussion. I attach also the brief which the Foreign Office have prepared, together with the draft speaking notes for the meeting.

3. Clearly, if the meeting is to go ahead at all, it would be preferable for Mr Mellor to adopt a listening posture. It is most important that the Government is not seen to be anticipating the outcome or compromising the independence of the MMC's work. On the substance we would not wish to give the impression that a K10 holding of 20 per cent would be acceptable.

4. Bearing these points in mind Mr Monck has secured changes to the speaking note:-

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- (i) The deletion of the reference to initiative - which suggests we recognise the Kuwaitis approach and are prepared to do a deal;
- (ii) The deletion of the acceptance of a 20 per cent stake. The final indent now reads:

"Ministers made clear all along that 20 per cent was simply a level above which major political difficulties would become acute. Our Ambassador ... The Chancellor reminded you of the great importance of keeping the holding below 20 per cent when he met you on 2 March. The question ..."

5. DTI and Energy agree with the substance of our comments.

6. It may be a good idea for your Private Secretary to speak to Mr Mellor's office (and be prepared to speak to the Foreign Secretary's) to reinforce these messages.

Given the shortness of time (Mr Mellor is seeing Khalifa at breakfast tomorrow) I take the liberty of doing this off my own bat.

H C Goodman
H C GOODMAN

H C
2/7

SECRET

Stephenson Harwood

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B.R. Gravatt Esq.,
Monopolies and Mergers Commission,
New Court,
48 Carey Street,
London WC2A 2JT.

BY HAND

Dear Mr. Gravatt,

The State of Kuwait/British Petroleum plc

Following the discussion at the second hearing on Friday 15 July the State of Kuwait and the Kuwait Investment Office have given further consideration to whether the assurances already offered by them might be put on a more formal basis, and also whether further assurances might be given.

Our clients wish to repeat that, as stated on their behalf by leading counsel at the hearing, they regard themselves as already completely bound by the assurances that they have given to the British Government and to the Commission about non-interference with the management of BP and non-representation on the board of BP. Our clients regard those assurances as disabling them from exercising any influence that their shareholding might otherwise give them over the policy of BP, and thus consider that there are no grounds for finding a merger situation to exist in this case.

However, if the Commission does consider a merger situation to exist, our clients are anxious to take any reasonable steps to reassure the Commission, and the outside world, that the Kuwait holding in BP is an investment only, and will not result in any effect on BP adverse to the public interest. We therefore set out below the covenants into which our clients are prepared to enter, and the form in which those covenants would be given.

We should however make it fully clear that in offering the covenants set out below the State of Kuwait is not in any way agreeing that a merger situation exists in this case, or that that situation is to be expected to operate against the public interest. Its case in the Reference remains as stated to the Commission. The covenants are however put forward as a means of reinforcing that case and of assisting the Commission to the conclusion

M. Richardson (ERD)

*As foreshadowed in my
minutes on BP/KIO of
20 July*

*cc
PS
Mr. Bogue
Mr. Currie
Mr. Johnson
Mr. King*

Stephenson Harwood is regulated by The Law Society in the conduct of investment business

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Resident Partners:

J.A. Scales P.P. Ruffier

that there is no ground on which the merger can be found to operate against the public interest.

In particular, the State of Kuwait considers, especially after the covenants have been given, that there are no grounds on which it could reasonably be required to dispose of its beneficial interest in any part of its present shareholding.

The assurances offered by our clients are listed below. Our clients will formalise such assurances by giving them by covenant entered into in favour of a third party by deed under seal. It would seem that the appropriate other party to such a deed, who would then be in a position to bring proceedings in the event of any breach of the covenants, would be the Director General of Fair Trading; the practical position in respect of such covenants would then be no different from that of undertakings given to the Director at the conclusion of a Reference. We should emphasise that the drafting of the covenants is entirely open for discussion, if there are any respects in which the Commission regards the drafting as unsatisfactory.

(1) The State of Kuwait and the KIO undertake that they will not, in any vote or poll of the shareholders of BP, exercise voting rights attaching to shares that in total represent more than 14.9 per cent. of the total issued share capital of BP.

Note: Our clients offer this covenant in the context of their desire to demonstrate that the BP holding is indeed regarded by them as an investment only, and that they are only interested in dealing with it as such an investment.

It will be recalled that during the discussions between Kuwait and British ministers that preceded this Reference the British ministers indicated that they had no objection to the Kuwait holding as an investment, and would see no difficulty in the holding if it were limited to 20 per cent. of the issued share capital of BP, with full voting rights up to that limit. Our clients submit that that view could be more than wholly accommodated if the voting powers of KIO or the Kuwait Government were limited to a percentage of the capital of BP in fact something below the 20 per cent. figure discussed; our clients therefore propose to retain voting rights over 14.9 per cent. only of the issued capital of BP. Such an arrangement would enable KIO and the Government of Kuwait to retain the benefit of the holding as investors, whilst clearly providing that any even theoretical power over the policy of BP was restricted substantially below the level indicated by the British Government.

Our clients consider that these arrangements should meet any outstanding concerns that may have been expressed to the Commission. However, they are willing to add to these arrangements by the further covenants set out below.

(2) Neither the KIO nor the State of Kuwait will propose or procure the proposal of any person for election or appointment as a director of BP or of any of BP's subsidiaries.

Note: This assurance was offered and discussed at the hearing, and we do not think that it needs further comment here.

(3) Neither the KIO nor the State of Kuwait will acquire any interest in any of the shareholding of BP if that interest would cause the total shareholding in BP in which the State of Kuwait is directly or indirectly beneficially interested to exceed 21.6 per cent. of the total issued share capital of BP.

Note: This matter was mentioned at the hearing. The effect of the covenant is to limit the State of Kuwait to its present percentage holding in BP, it being understood that, if part of that holding is sold, further shares can subsequently be bought until the total holding returns to the present 21.6 per cent. of the total issued share capital. KIO has made it clear that it wished to be free, as an investor, to buy up to 29.9 per cent. of BP if market conditions were favourable. However, both KIO and the Government of Kuwait have noted the concern expressed by the Commission that, if no adverse finding is made in the present Reference, further purchases of shares could be made. Both KIO and the State of Kuwait are pleased to meet this concern, without expressing any view on its foundation, by entering into a covenant in the present terms to limit their percentage holding to its present level.

We are ready to attend upon the Commission or its advisers at short notice to discuss the matters set out above, and hope that we and our clients will have an opportunity to deal with any comments or observations that the Commission or its advisers may have.

Yours sincerely,

Vivian Robinson

for J.W. Jeffrey

CHEXCHEQUER	
REC.	22 JUL 1988 ✓ 22/4
ACTION	FST
COPIES TO	



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

Copy No 1 of 9

01 211 6402

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

22nd July 1988

Dear Chancellor,

AMERSHAM INTERNATIONAL PLC: SPECIAL SHARE

You will recall that I agreed at your meeting on 28 April that the Special Share in Amersham International should be redeemed at an early date.

My Department has now been in touch with the company, who would welcome an early announcement of redemption at a time of the Government's choosing. I therefore propose to announce by means of a Parliamentary answer next week that the Special Share will be redeemed forthwith.

I should be grateful for your and colleagues' agreement by noon on Tuesday at the latest so that we can set in motion the mechanics for the announcement. In accordance with the Treasury's guidance, we will speak further to Amersham shortly before the announcement is made so that they can discharge their obligations to the Stock Exchange.

I am copying to the Prime Minister, John Moore, David Young and David Trefgarne.

Yours sincerely,
S. A. Parkinson

CECIL PARKINSON

(Dictated by the Secretary of State
and signed his his absence)

PHM

FROM: H C GOODMAN
DATE: 22 July 1988

PS/CHANCELLOR *→*

cc PS/FST
Sir G Littler
Sir P Middleton
Mr Monck
Mr Moore
Ms Wheldon - T/Sol

Ch. Dme
Content for me to
Mr X, over (telephonically)?
25
22/7
JM

BP/KIO

My minute of yesterday reported that Mr Mellor was planning to talk with Sheikh Ali Khalifa about this.

2. Since Mr Mellor met with the Sheik alone there will not be a note of the meeting. However, the Foreign Office intend to circulate at official level an account of the conversation and I will let you see this when it arrives. Obviously it would have been far better if a proper record had been shown to Ministerial colleagues.

3. Foreign Office officials have told me that Mr Mellor used the brief including the Treasury comments. Ali Khalifa's response was that he hoped the MMC produced a report with a solution acceptable to both parties. The Sheikh said he would be in London till 1 August, when he was going to Geneva, but he was available at any time for a further discussion. Mr Mellor is reported to have said he did not think this would be necessary before the MMC had reported.

4. Obviously none of this is very satisfactory. If the Chancellor agrees it may therefore be a good idea for you to let the Foreign Office know that we hope there will be no further meetings at Ministerial or official level with the Kuwaitis before the MMC have reported.

H C Goodman
H C GOODMAN

I agree that we should agree to redemption of the Amersham share now. We need to take the time to answer to precise wording of and in response to questions about other announcements. I have drafted a letter to make this clear.

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

1. MRS M E BROWN
2. FINANCIAL SECRETARY

From: R M BENT
Date: 25 July 1988
cc Chancellor
CST
PMG
EST
Mr Monck
Mr Moore
Mr Ilett
Mr M Williams
Mr Cropper
Mr Call
Mr Tyrie
Ms Wheldon T Sol

[Handwritten signature]

AMERSHAM INTERNATIONAL PLC: SPECIAL SHARE

At the meeting of Ministers which the Chancellor chaired on 28 April to review the various Special Shares, it was agreed that early redemption of the Amersham International special share should be set in hand.

2. In his letter of 22 July, the Secretary of State for Energy proposes an announcement before the recess of the immediate redemption of this special share, and seeks your approval by noon tomorrow.

Issues

3. The removal of the special share, of course, will expose the company to the risk of take-over. However, the management of Amersham International have now had the benefit of a substantial transition period to adjust to life in the private sector, and might reasonably expect to have to put their stewardship to the normal commercial tests.

4. Although the earlier Ministerial correspondence had anticipated an announcement this summer of an intention to redeem the special share perhaps in March of next year, these plans were first formed around the turn of the year when the aftermath of the Stock Exchange crash was still difficult to predict. This timetable has been accelerated in the present DEN proposals.

5. In discussions between DEN and the company, we understand that the latter have been relaxed about the immediate redemption of the special share, in current market conditions. In view of this, we see no reason to object.

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MARKET SENSITIVE

Conclusion

6. I attach a draft reply in this sense.

7. I have also taken the opportunity to stress a point already registered at official level: the news should be disseminated promptly on the Stock Exchange announcements system to prevent false movements in the price of Amersham International shares as a result of information being seen by some market makers and not others.

Sensible

R M Bent.

R M BENT
PE2 Division

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

Draft letter to:

Secretary of State for Energy

Copies to:

Prime Minister
Secretary of State for Social Services
Secretary of State for Trade and Industry
Minister of State for Defence Procurement

AMERSHAM INTERNATIONAL PLC: SPECIAL SHARE

You wrote to Nigel Lawson on 22 July recommending the announcement early this week of the immediate redemption of the Amersham special share.

I am content to proceed on this basis. As you say, it is in line with what was agreed in the recent review of special shares, whose purpose for fledgling companies such as Amersham is to provide a temporary protection against take-over. I should be grateful if your officials would liase with mine to agree the terms of the announcement, and particularly the line to be taken if there are questions about the Government's policy on other special shares.

I can also confirm the need for your officials to liase with the Stock Exchange to ensure that the news is released promptly to all member firms. This will help to ensure that no false market develops at the time of the announcement.

I am copying this letter to the recipients of yours.

NORMAN LAMONT

*One or two
Council for one class
but also all, some of
vires that - GSP over
vires as per
3(i), 3(xi) &
3(a)(ii) -
you
public
M.*

SIR P MIDDLETON

FROM: H C GOODMAN
DATE: 25 July 1988

cc PS/Chancellor -
PS/FST
Sir G Littler
Mr Monck -
Mr Moore - o/r
Mrs Lomax
Mr M L Williams -
Mr Bent -
Ms Wheldon - T/Sol -

BP/KIO

Wain

*OK? (I have some
misgivings about X, unless -
I don't think we should get
down into what was said at private
meetings - but something in these lines
seems unavoidable if we are asked the question)*

25/7

My minute of 21 July set out some new Kuwaiti proposals designed to lessen our concerns about their large BP holding. The MMC have asked for a further hearing on this. I am going with Mr Chipperfield (DEN) and someone from the Foreign Office to give evidence to the MMC at 3 o'clock on Wednesday afternoon. Mr Moore discussed all this with me on Friday and below I set out proposed lines to take on the questions which we are expecting. I would be grateful to have your views by 11 am tomorrow morning, because I am going to a briefing meeting then and it would be most useful if we and Energy would present a united - and agreed - front to the Foreign Office who, as you know, have been most unhelpful over the whole episode.

2. I attach the line which Energy have now cleared with Mr Parkinson. You will wish to note paragraphs 11 and 12 (iii) in particular. Both are true, but they may be more forthcoming than is helpful at this stage.

3. (i) Why are you concerned about the KIO holding?

Because the KIO is effectively controlled by the Kuwaiti Government whose policies on the oil market are very different

from those of the British Government and the holding is so large they could control or influence BP in a manner prejudicial to UK interests

(ii) Why did you agree to the build up of the holding between November and March?

We would not object to a reasonably sized holding. We have been particularly concerned at the scale and rapid-build up of the KIO holding. We informed the Kuwaitis of our concern as early as last November, when it rose from 1 to 10 per cent. We have never accepted any particular level of shareholding.

(iii) Did not the Chancellor accept a 20 per cent holding in a meeting with the Kuwaitis on 2 March?

No. The Chancellor said ^{made clear that} a rise to 20 per cent would not be acceptable. He was speaking when the holding was still below that level.

(iv) Are you prepared to buy back shares?

No. As we have stated repeatedly it is the Government's policy to divest of such assets.

(v) If you believe the KIO holding is too high how should it be reduced?

Yes, the present level is too high. ~~It will certainly be difficult to reduce the holding without pushing down the share price to a degree which could be a problem for all BP shareholders.~~ Some sort of phased disposal might be considered. We hope that ^{divestment} this is one of the issues the MMC will consider taking account of ideas put to them by ^{BB}.

(vi) Would you be prepared to waive the tax consideration if BP were to buy back their own shares?

That is a matter for the Inland Revenue.

Ashted 2/12/72
divestment
buying shares, a way it is a matter of tax (Ph.)

(vii) Why did you not give BP a golden share?

Mr Moore covered this fully in his evidence to you. ^{BP} ~~They~~ did not want one and we considered they were not an "infant" with respect to the private sector. We do not hold golden shares in other large UK companies eg ICI.

(viii) Why did you not restrict the level of shares sold in the foreign market when you sold your holding?

It would not have made any difference. The KIO bought in the secondary market.

(ix) Do you think the Bank of England offer could have been structured to avoid this problem?

The object of the Bank offer was to put a floor under the BP share price. Given the circumstances prevailing, this was judged most important. The Bank price was set at 70p at a time when the share was trading in the low 70's.

(x) Do you think a large divestment now would disrupt the London equity market?

No. Market conditions are quite different. In October and November the market was suffering unprecedented fragility. Our worry was that heavy dumping of shares ^{have} would be very damaging. We do not see such systemic risks now.

(xi) What would be the right level for the KIO holding?

Very difficult to say. Would judge in the light of following factors: BP have said 5% a matter of concern; next largest holding is 1½% and attendance at meetings is usually of shareholders representing only some 10-15% of holdings.

(xii) Will this experience mean you keep golden shares in future?

Judge each case on its merits. Draw a distinction between privatisations and secondary share sales.

(xiii) Would you be satisfied with the KIO's assurances?

(a) not to exercise voting rights above 15%

(b) not to nominate a Board Director and

(c) not to take their holding above 22%?

No. Voting rights of 15% are too high (see (xi) above). A holding of 5% could give control. In any case it is not clear to us how such assurances could be made legally binding, if made before MMC had reported and found there was a public interest/merger problem. Finally an agreement made now would only bind the present Kuwaiti Ministers. If they changed (or if circumstances changed they or) their successors might not feel bound.

(xv) Is not the proposal to put these assurances under seal adequate?

No. Because there is no consideration, it might be difficult to get an injunction to enforce them.

(xiv) What do you think of the proposal to settle the shares to trustees?

[We do not know whether this is an MMC or KIO idea].

We would be very wary of this. It is difficult to see what the objectives of the trust would be other than to protect the interests of the beneficial owners - ie the KIO and that would entail ^{the trustees} doing as the Kuwaitis asked.

(xvii) ..Have Ministers been trying to negotiate with Kuwaitis (recently)?

No. We want the proper MMC/OFT machinery to operate and we told

the Kuwaitis they were running the risk of a referral at the outset .

4. We still have not had a note from the FCO of Mr Mellor's meeting. I would be grateful if the Chancellor's office would insist on this before the Wednesday MMC hearing. I understand the FCO are considering now writing to the Kuwaitis. They should be restrained from doing this also, the only good news on that front is that Mr Mellor is shortly going on holiday.

WMM
No 50.

No!

(to the Department of Health)

H C Goodman
H C GOODMAN

CONFIDENTIAL: MARKET SENSITIVE

1 Mr Chipperfield *SM. J. 24/7*
2 PS/ Secretary of State

cc PS/ Mr Morrison
PS/ PUS
Mr Davis o.r.
Mr Wakely
Mr Brummell
Ms Goodman

BP/KIO

The Monopolies Commission is now turning its attention to the question of possible remedies, if the size of the existing KIO shareholding in BP is found to be against the public interest.

2 They have before them a Kuwaiti proposal which would involve what the KIO's solicitors describe as legally-binding Kuwaiti undertakings to limit the KIO's voting rights to 15% of BP stock, limit the shareholding at current levels (i.e. 21.6%) and commit the KIO never to seek Board representation.

3 It would appear that such undertakings would be predicated on a finding by the Commission that the present KIO shareholding was not contrary to the public interest and would be without prejudice to the Kuwaiti claim that a merger situation does not exist, despite the provisional conclusion in the Commission's public interest letter of 16 June that such a situation did exist. Our legal advice is that it is very doubtful whether, in view of this, these undertakings would in practice be enforceable.

4 Mr Mellor (who has frequent private conversations with Shaikh Khalifa on other matters) has discussed these proposals with the Shaikh and taken the (agreed) line that, while HMG welcomes the spirit of the Kuwaitis' initiative, it is for the MMC to consider it in the light of the other evidence they have received.

5 This Department has been asked to appear again before the Commission, along with representatives of the FCO and Treasury, on 25 July (after BP and before the KIO) to give our views on the Kuwaiti proposal and on the more general issues surrounding the question of possible remedies.

6 So far, we have avoided giving the MMC a view on what specific percentage of BP stock we would feel comfortable for the KIO to retain. We have stressed that it must be for the MMC to decide on this in the light of the evidence they have received from all the interested parties.

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7 However, we have also made clear to the Commission that any remedy must address the particular circumstances of the company - i.e. a shareholder base in which no-one holds more than 2% (except Kuwait) and of which only 10 - 15 % percent has ever actually been voted at General Meetings.

8 We have also pointed out to the Commission that a shareholding at or close to current levels, even if some or all of the voting rights were cancelled, would still give the KIO a potentially dominating position within the company. In the last resort, a threat by the KIO to dump shares on the market could be very powerful. BP have themselves indicated to the Commission that a shareholding over 10% would still give the company serious cause for concern (and even this would be five times greater than any other shareholding in the company)

9 In addition, as indicated in paragraph 2 above, it is not clear that undertakings of the sort proposed could be made legally binding in a practically effective way, or that a future Kuwaiti administration (perhaps of different political sensibilities) would feel itself bound by such undertakings.

10 It is therefore our view that the Kuwaiti proposal, although welcome as a sign of Kuwait's belated recognition of the realities of the MMC process, is inadequate as a legally water-tight, realistic solution to the public interest problems we have described to the Commission.

11 Nonetheless, limitation of voting rights (albeit to a much lower level than that currently envisaged by the Kuwaitis) could be a very useful means of allowing a breathing space of suitable length for a gradual sale of the KIO holding down to a more comfortable level.

12 We would therefore propose to take the following line with the Commission next Wednesday:

(i) In D Energy's view, the Kuwaiti proposal is not adequate, as it stands, to deal with the public interest problem;

(ii) Nonetheless, it is a welcome sign that Kuwait recognises there is a problem and that the Kuwaiti authorities are willing to discuss a solution in a spirit of cooperation;

w. 12

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(iii) D Energy's view is that although an undertaking never to seek Board representation would need to be an integral part of any solution, the key problem is the size of the shareholding itself, and a restriction on voting rights would not be sufficient to address the problem. The existence of a block of shares of the current size, whether voted or not, could still face the company with a serious problem in the event of a Kuwaiti decision to sell large quantities of stock;

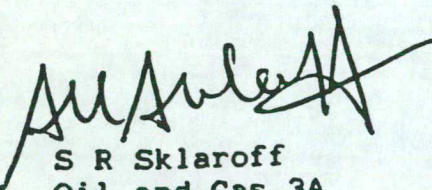
*too friendly?
to Kuwait*

(iv) It is of course for the Commission to consider precisely what level of reduction in shareholding would meet the concerns which have been outlined by the company and the Government. Clearly, any solution must take account of BP's existing shareholder base and the record of voting at recent General Meetings of the company;

(v) Nonetheless, it is in everyone's interests, should the Commission decide that a sale of some proportion of the existing shareholding were necessary, that such a process should take place in an orderly and well-managed fashion with the full cooperation of BP;

(vi) The Commission may therefore feel that a limitation on voting rights for an interim period, albeit covering a significantly greater proportion of the KIO shareholding, would allow such an orderly sale to take place, and would be a sensible way forward.

13 I should be grateful to know if the Secretary of State is content.


S R Sklaroff
Oil and Gas 3A
Room 726
Extn 3781
22 July 1988

CONFIDENTIAL
MARKET SENSITIVE

From: S D H SARGENT

Date: 26 July 1988

MS H GOODMAN

Ch
Sensible suggestions, which complement your own comments (minuted out, behind)

cc PS/Chancellor
PS/Financial Secretary
Sir G Littler
Mr Monck *Mr Schelen*
Mr Moore o/r
Mrs Lomax
Mr M L Williams
Mr Bent

Miss Wheldon - Tsy Sol

✓ M

26/7

BP/KIO

Sir Peter Middleton was grateful for your minute of 25 July. He has the following comments on the proposed line to take in paragraph 3.

- (ii) Introduce new first sentence "We did not agree to anything."
- (v) Delete second sentence and revise the third sentence to read "A phased disposal might be considered."
- (vi) Sir Peter is not sure that we can treat this as simply a matter for the Inland Revenue. We ought to know whether the answer is yes or no if the question is about a legislative change or an ESC. This question was considered earlier in the year and Sir Peter's recollection is that it was decided that we could not change ACT treatment in this and other cases. We do not want the MMC making recommendations about ACT.
- (ix) Delete the second sentence. Revise the third sentence to read "The price was set at 70p in line with the market price at the time."

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MARKET SENSITIVE

(x)

Revise to read as follows:

"No. Market conditions are quite different. In October and November the market had suffered an unprecedented fall. Heavy selling of BP shares would be very damaging to the health of the stock markets both in the UK and overseas. We do not see such systemic risks now."

(xii)

It is unclear whether this answer is directed to the question of whether we will retain our existing special shares or whether we will introduce them in future privatisations.



S D H SARGENT
Private Secretary



FROM: J M G TAYLOR

DATE: 26 July 1988


PS/SIR P MIDDLETON

cc PS/FST
Sir G Littler
Mr Monck
Mr Moore
Mrs Lomax
Mr M L Williams
Mr Bent
Ms Wheldon
MS GOODMAN

BP/KIO

The Chancellor has seen Ms Goodman's minute of 25 July.

2. He has one or two comments on the line to take. First he thinks it essential to omit the second sentence ("It will certainly be difficult... shareholders") from the answer to 3(v). Second, the answer to 3(vi) is wrong - this is a matter of tax law.
3. Above all, however, the Chancellor thinks it vital that none of this - especially our views as set out in 3(i), 3(xi) and 3(xii) - becomes public knowledge.
4. I have spoken to ERD (Mr Garrett) about a note of Mr Mellor's meeting. He has undertaken to provide one.



J M G TAYLOR



FROM: J M G TAYLOR

DATE: 26 July 1988

A large, stylized handwritten signature in blue ink, appearing to be 'JMG'.

PS/FINANCIAL SECRETARY

cc Chief Secretary
Paymaster General
Economic Secretary
Mr Monck
Mr Moore
Mr Ilett
Mr M Williams
Mr Cropper
Mr Call
Mr Tyrie
Ms Wheldon - T.Sol.

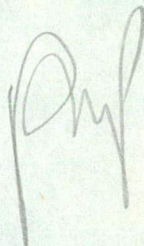
AMERSHAM INTERNATIONAL PLC: SPECIAL SHARE

The Chancellor has seen Mr Bent's submission of 25 July. He agrees with the advice that we should agree to redemption of the Amersham share now.

Handwritten initials in blue ink, appearing to be 'JMG'.

J M G TAYLOR

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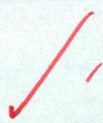


FROM: D J L MOORE

DATE: 27 JULY 1988

SIR PETER MIDDLETON

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



Miss Wheldon TSOL

BP POST MORTEM: TERMINATION CLAUSES

Earlier in the year you agreed that we should take further legal advice on the preparation of a new model termination clause for underwriting agreements. This has taken longer than I had expected - although in operational terms this does not matter. But we now have a draft clause which I attach together with a covering letter for you to send to the Deputy Governor.

2. The draft letter summarises the main features of the new clause and I will not repeat that summary in detail in this cover note. Briefly, we think we have a clause which is undoubtedly in simpler English than its predecessors and which we are advised leaves us, or rather the sponsor department, with fewer constraints on the manner of consultations. In particular, the normal relationship with the Bank should not be compromised. Throughout it would be the vendor department, rather than the Treasury, which was named

3. In looking at the options Counsel agreed with us that it would not be appropriate to exclude a termination clause and to leave the contract to be terminated by mutual agreement or frustrated. In the latter case litigation will probably ensue and it would be left for the courts to decide whether the contract had

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been frustrated. They also agreed that it would be unwise to rely on an automatic and arbitrary trigger for termination in relation to a specified fall on the Stock Exchange.

4. The next step is to take DTI, and Norton Rose (the solicitors to the Steel offer) through the clause and to coach them on the negotiations. It is particularly important that we get it right for Steel because that clause will undoubtedly be the precedent for Water and for Electricity. Treasury Solicitor's Department will work closely with PE on this.

5. Although Counsel, and we, are satisfied that the clause is a marked improvement, any termination discussions will of course have to be conducted with meticulous care. It is worth quoting from the note of the consultation with Counsel on this:-

"Mr Chadwick said that it was extremely important that the Government had an open mind throughout the consultation procedure. If it could be shown that the Government had had a closed mind, the Government would be in breach of contract. There was an implication in an agreement providing for consultations that bona fide consideration would be given to the representations and that the Government would be prepared to change its mind.

The underwriters would bring an action for breach of contract; they would not be able to bring an application for judicial review. This would be less advantageous for the Government as discovery of documents would almost certainly take place. It would therefore be important for the Government to document all the various steps taken and meetings held to show on discovery in the contract action that the contract had been complied with, as bona fide consideration had been given to all the underwriters' representations throughout the consultation procedure."

6. The Agreement provides for either the lead underwriter or the department to initiate termination procedures. This is new (previously ~~any~~^{only the} lead underwriter could take this action). The

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example which comes to my mind in which this clause might conceivably be used is if a stock market crash came on the last day of the offer by which time two or three million small investors had put their applications in. In those circumstances Ministers might wish to pull the offer; though in practice the underwriters might take the initiative anyway if the institutions had not yet come in and therefore some underwriting stick were likely. Although I hope that this clause would never be used I think it worth having in as a precaution.

7. If you are content with all this we will now proceed to consultations with the DTI and with Norton Rose as part of the preparations for the Steel sale. If the Bank have any reservations or points - and I would expect these to be on tactics rather than on substance - we would then feed them in to those discussions.

Mary Brown

cc: D J L MOORE

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DRAFT LETTER FROM SIR P MIDDLETON TO:

Sir George Blunden
Deputy Governor
Bank of England
Threadneedle Street
LONDON
EC2R 8AH

July 1988

BP POST MORTEM: TERMINATION CLAUSE

In my letter of 18 April, I said that I would write to you again when we had further legal advice on a new model termination clause for use in future UK underwriting agreements.

I now attach draft clauses which have been approved by Counsel (Mr John Chadwick and Mr John Mummery) on instructions from the Treasury Solicitor's Department and Slaughter and May. I would be grateful for any comments you have. In the meantime, the Treasury will discuss the clauses with DTI, the sponsor Department for the coming Steel sale, and with Norton Rose the solicitors to the offer. The clauses will then be for negotiation with the UK lead underwriter for the Steel sale who is likely to be appointed at around the end of September and, assuming there are overseas tranches, with the overseas lead underwriters.

The language of the main clause, 8.01, is much simpler than its predecessors and the operation of any termination discussions should not be so constrained as with BP, though they would still be onerous. In particular, we are advised that the clause meets

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our objective that, in consultations with the Bank, there would be no question of the normal advisory relationship with you being put in baulk.

The main points are as follows (and throughout the draft the name of the department responsible for the sale would be substituted for the Treasury);-

i. The lead underwriter may propose termination, with the reasons given in writing. The clause does not attempt to specify what might be appropriate reasons, but it states that there must have been an occurrence of such significance that the underwriters conclude that it would be reasonable for them to be released and discharged from their obligations under the agreement.

ii. The decision whether to proceed rests with the department concerned. They would not be obliged by the clause to give reasons for that decision, although in practice there will obviously be a Ministerial statement, as with BP.

iii. In reaching that decision the department "may conduct such consultation in such manner and with such persons as it thinks appropriate [including with the Bank of England] and with or without reference to the lead underwriter."

The wording in iii. is important. The words "in such manner, and with such persons" are intended to avoid any implication that the

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Government was only under a simple duty to consider the underwriters' representations and not to consult with any other persons. The words "with or without reference to the lead underwriter" overcome the serious disadvantage in the BP consultations where the Treasury had to involve the lead underwriter in its representations to the Bank.

In the opening negotiations with the underwriters there would be no reference to the Bank of England. But it would be explained that the Government would be likely to consult both the Bank and the company, although there was no obligation to consult either of them or, indeed, any third party. If in negotiations it became clear that the underwriters attached great importance to the inclusion of a reference to the Bank, that could be included, as shown in the draft clause, though to avoid the risk of any constraint on our normal relationship there would be no reference to the role in which you were being consulted.

The clause does not give overseas underwriters power to propose the termination of the agreement nor does it make any reference to consultation with them. In practice the Government would expect to consult the lead underwriters and ^{if necessary} they could be advised of this expectation in negotiations. If strongly pressed we could acknowledge this in the clause - "including the lead overseas underwriters". But we are advised to resist giving any legal entitlement for each overseas lead underwriter to propose termination or to take a part in the consultation procedure. This would give each of them the right to sue the Government for breach of contract regarding the consultation procedure, whereas in the

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BP agreement this right only rested with the UK underwriters. Increasing the number of potential litigants against the Government would be a material disadvantage particularly as some of the overseas underwriters come from more litigious jurisdictions.

We must wait to see the reactions of the overseas banks to these proposals but in any negotiations we will be able to point to the fact that each of them, in bidding for appointment to the Steel sale, specifically said that they would abide by the same underwriting arrangements as in previous offers, *even though they would prefer to be included in any consultation process.*

Clause 8.02 provides for the Government to take the initiative in terminating the offer. This is a new provision, which we think it is prudent to have available even though it may be unlikely that we would see circumstances in which the Government but not the underwriters wished to terminate. The remaining clauses are on familiar lines.

P E MIDDLETON

Handwritten: 27 3/8
BP to 2/8

FROM: MRS BROWN
DATE: 28 JULY, 1988

FINANCIAL SECRETARY

cc PS/Chancellor *and*
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Moore
Mr Peretz
Mr Ilett
Mr Watts
Mr Devereux
Mr Hurst
Mr Bent
Mr Gunton - IDT
Mr Dyer - Parly Sec
Mr Call

Mr Hyett T.Sol
Mr Gregory T.Sol

RESIDUAL GOVERNMENT SHAREHOLDING IN BP

We have now reached an agreement with the Bank of England for the purchase of the partly paid BP shares held by the Issue Department of the Bank at the price of 59 pence per share. We cannot actually receive the shares until the Estimate provision for their purchase being voted, and the agreement is therefore conditional on the Consolidated Fund Bill receiving Royal assent. The shares will be exchanged at this point.

Handwritten signature: Mary Brown.

MRS M E BROWN

28
1. MRS M E BROWN

2. Copies attached for:

CHANCELLOR 14/2

FINANCIAL SECRETARY

From: R M BENT

Date: 28 July 1988

cc CST

EST

PMG

Sir P Middleton

Mr Anson

Mr Monck

Mr Moore o/r

Mr RIG ^{Gieve} IDT

Mr Gunton IDT

Ch.
Content?
OK summary
HTS
28/7

BP SECOND CALL: PRESS NOTICES

You will recall that last October's offer price for BP partly paid shares of 330p per share was payable in instalments: 120p per share was paid on application, 105p per share is payable by 3pm on Tuesday 30 August, and a further 105p per share will be payable in April next year. This submission seeks approval to the attached draft Treasury press notices drawing attention to the BP second call at the end of August.

Background

2. In preparing for the second call, we have considered, and rejected, the idea of advertising the call date. Adverts were placed by DEN for the Gas third call in April, but not by DTP for the BAA second call in May. The advice we received from Dewe Rogerson was clear cut. First because most of the shares went to the underwriters rather than to retail investors, and second to avoid press criticism and minimise painful memories of the unhappy experience last Autumn, Dewe Rogerson firmly advised against paid advertising for the second call. We have accepted that advice.

3. We think it important, nonetheless, to secure free press coverage of the date of the second call, given the likelihood that investors will be holidaying sometime during August. We hope to rather persuade investors to pay early to minimise late payments, though we anticipate some element degree of late payment and plan to be lenient (except with the institutions) if investors get their cheques in quickly thereafter. We therefore propose to issue Treasury press notices on suitably newsworthy occasions.

4. The first of these occasions occurs next week when Natwest Bank despatches call notices to investors to remind each of them of the exact amount which has to be paid for their shareholding, and to describe how payment should be made. We therefore suggest a first press notice next Monday (1 August) to coincide with the posting of the call notices.

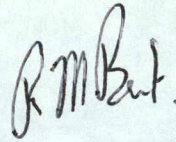
5. The second foreseeable occasion will be just before the call is due. Recognising the other attractions over the Bank Holiday weekend itself, and the fact that Sunday is probably too late late for a final reminder, we are targetting the

second press notice for Wednesday 24 August.

6. If necessary, however, we will still have the option of repeating the message over the Bank Holiday weekend to secure extra coverage in the Sundays, and/or again after 30 August if the element of late payment looks substantial. We can decide the need for this coverage nearer the time.

Conclusion

7. I attach draft press notices for issue on 1 and 24 August. If you are content, we will arrange for their issue on the days targetted.



R M BENT
PE2 Division

DRAFT PRESS NOTICE

[1 August 1988]

SECOND INSTALMENT ON BP PARTLY PAID SHARES NOW DUE

Call notices are being sent today to holders of The British Petroleum Company p.l.c. partly paid shares to remind them that the second payment on their shares is now due. Payment of 105p per share must be received no later than 3pm on Tuesday 30 August. The call notice informs shareholders of the exact amount which has to be paid, and describes how payment should be made.

In order to ensure that the deadline is met, holders of BP partly paid shares should return their payment, together with the complete call notice document, in the pre-addressed envelope provided, as soon as possible.

Any holder of BP partly paid shares who has not received a call notice by 8 August should contact Natwest Bank plc, Registrar's Dept, PO Box 472, Consort House, The Lombard Centre, East Street, Bristol BS99 1NW, on 0272 306666. Lines will be open from 8.30am to 6pm Monday to Friday, and 8.30am to 2pm on Saturdays.

Shareholders who do not meet the deadline for the final payment could lose their shares, and any entitlement to bonus shares.

Friday 19 August is the last date for dealing on the Stock Exchange in BP partly paid shares for which the second instalment has not been paid.

H M Treasury

DRAFT PRESS NOTICE

[24 August 1988]

SECOND INSTALMENT ON BP PARTLY PAID SHARES DUE NEXT TUESDAY

Holders of The British Petroleum Company p.l.c. partly paid shares are reminded that the deadline for payment of the second instalment on their shares is 3pm on Tuesday 30 August.

Shareholders who have not already paid the second instalment of 105p per share should ensure that they do so by 3pm on Tuesday 30 August at the latest. Those who do not meet this deadline for the second instalment could lose their shares, and any entitlement to bonus shares.

Any holder of BP partly paid shares who has any questions about payment of the second instalment should contact Natwest Bank plc, Registrar's Dept, PO Box 472, Consort House, The Lombard Centre, East Street, Bristol BS99 1NW, on 0272 306666. The lines will be open from 8.30am to 6pm Monday to Friday, and 8.30am to 2pm on Saturdays.

H M Treasury

CONFIDENTIAL

FROM: H C GOODMAN
 DATE: 28 July 1988



SIR PETER MIDDLETON

cc: PS/Chancellor
 PS/Financial Secretary
 Sir G Littler
 Mr Monck O/R
 Mr Moore O/R
 Mrs Lomax
 Mr M L Williams
 Mr Bent
 Ms Wheldon - T.Sol

BP/KIO

I went with officials from the Foreign Office and Department of Energy ~~this~~ ^{yesterday} afternoon to give evidence to the MMC.

2. The MMC asked us about the further assurances promised by the KIO of a limitation on their voting rights to 15 per cent; a limit on their holdings of 21.6 per cent and agreement not to seek Board representation. We explained that we saw a legal problem with any assurances agreed before MMC had reported. Mr Chipperfield^(DEn) said that the holding was too large now and that our concern was that the KIO could use the strategy of disposing of it in the market to influence BP. I added that the assurances were not satisfactory, because they would not deal with the perception problem, ie the problem that the parties dealing with BP would still be concerned about Kuwaiti influence and that at meetings 15 per cent of the vote was significant, given that the next largest holding was 1½ per cent and usually only 10-15 per cent of the shareholders attended.

3. Mr Brummell^(DEn) explained at some length the reason why the intentions stated now were not legally binding. He will provide a further note on the problems likely to arise if the KIO shares were put into a trust: namely that the Trustees will have to act for the interests of the beneficial owners, which will not reduce the possibility of a conflict

CONFIDENTIAL

of interests. The note will, with FCO help, also incorporate a section on sovereign immunity and explain why this may also make it difficult to enforce any assurances. Perhaps Ms Wheldon could make contact with Mr Brummell and ensure she is happy with the note before it goes to the MMC.

4. ^{were also asked} We ~~will also ask~~ about the problems of disposing of the shares. I explained that our view was that the effect on the equity market was not likely to be problematic now in the way it had been in the autumn, particularly if the sale of shares was orderly. Our concern with a rapid disposal was that the shares could fall into the hands of the predators. We were asked whether there was some risk that the Kuwaitis might sell the shares to other investors where the problem would be essentially unchanged, eg the Saudis. We said that that risk lasted as long as the Kuwaitis had such a large holding. The Foreign Office said that they did not think the Kuwaitis would dump the shares on the market in such a pique if the MMC reported unfavourably, since that would not be in their financial interest. They expect the Kuwaitis to offer further concessions in the period before the MMC reports.

5. The Chancellor stressed his concern that our views do not become public knowledge (Mr Taylor's minute of 26 July). As I explained to your Private Secretary and his, it is unrealistic to think that the MMC can write a report, particularly if they are to find in our favour, without referring to the arguments which we have deployed, if not to the detail. In practice, I suspect this will not turn out to be a problem for the Treasury. I am attaching a draft chapter entitled "Events Leading Up To The Merger Situation" to be included in the report, which is based on Treasury evidence up to now. It is not problematic. The only point which it might be helpful to insert is that at 23 November the Kuwaiti holding was 10.44 per cent. I am attaching also the draft chapter based on the Department of Energy's evidence.

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6. I would be grateful for any comments by close on
1 August.

Brian Morris

for H C GOODMAN



MONOPOLIES AND MERGERS COMMISSION

New Court 48 Carey Street London WC2A 2JT

Telephone: 01-324 1467

GTN: 3548 0467

Fax: 01-324 1400

D Moore Esq
The Treasury
Parliament Street
LONDON
SW1P 3AG

Direct line: 01-324 1500

27 July 1988

Dear Mr Moore

THE GOVERNMENT OF KUWAIT AND THE BRITISH PETROLEUM CO PLC

Attached are copies of further material which is likely to be included in a section of the report entitled 'Events leading up to the merger situation'. These paragraphs are extracts from a section and do not necessarily run on but have been numbered concurrently for ease of reference.

We should be pleased if you would check the factual accuracy of this material, make any amendments considered necessary and return one copy to me before 3 August.

Yours sincerely

Miss G Booth

cc Sir P Middleton
Mr Rourke - or
Mr Moore - or
Mr A L Williams
Mr Bent

Comments 1/31
to me
by close
on August 1st
please.

AC Goodman.

1. In order to understand the circumstances which had led to the merger situation we have found it necessary to examine the events which led to the Government of the State of Kuwait acquiring 1,315,750,000 shares of ordinary shares in British Petroleum PLC (BP) (held in different forms), equivalent to [22] per cent of all the ordinary shares in issue (or [21.82] per cent if adjustment is made for shares issued as the result of BP's acquisition of Britoil PLC).

2. In October 1987, HM Treasury offered for sale in the United Kingdom and overseas 2,194 million ordinary shares. These shares consisted of 1,735 million ordinary shares being all of HM Treasury's existing 31.5 per cent of BP's shares and 459 million new ordinary shares issued by the company to HM Treasury for sale under the combined offer. Up to 1,369 million of these ordinary shares were made available under a fixed price offer to the general public and existing shareholders of 330p per share, of which 120p was payable immediately, 105p payable on 30 August 1988, and 105p payable on 27 April 1989. Not less than 825 million ordinary shares were also offered to United Kingdom institutional and overseas investors at or above 330p per share payable by instalments on the same dates. The sale was part of the Government's policy of divesting its holdings in private companies.

3

Diplomatic contact was made on 23 November to establish the Government of Kuwait's short-term and long-term intentions. ^{When the KIO holding was} A number of meetings between ministers of both countries took ^{at} place between 23 December 1987 (when the holding was just over 17 per cent) and 2 March 1988. In these exchanges, United Kingdom ministers expressed concern at the continuing purchases of shares while stressing that it was the extent of the holding, and not its fact, that posed problems. The Kuwaiti Government's response was that KIO was free to take the shareholding to 29 per cent, although it was unlikely in fact to go much above 20 per cent. The Kuwaiti Government gave an assurance that KIO had no intention to interfere in the management of BP and would not seek Board representation in the foreseeable future. 10-441

CONFIDENTIAL: MARKET SENSITIVE

✓ *Case 27/17*
1 Mr Chipperfield
2 PS/ Secretary of State

cc PS/ Mr Morrison
PS/ PUS
Mr Davis o.r.
Mr Brummell
Mr Wakely

BP/KIO


The Secretary of State earlier approved the evidence that the Department gave in writing to the MMC and the lines to take that the Department's witnesses should give in response to questions. The MMC have now compressed our evidence and oral answers into the attached draft chapter for their report.

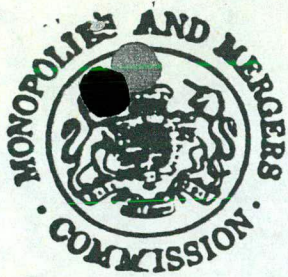
2 The draft is a pretty accurate version of our evidence and we have no reason to challenge it in any substantive way. We intend however to suggest some minor amendments, which are indicated on the attached copy.

3 The MMC have asked for our confirmation that the draft accurately expresses the Department's views. We are bound to give this. The draft does of course put the Department in the forefront of the argument that the KIO holding is against the public interest. But we have always been aware that, if the MMC eventually came to the conclusion that this argument were indeed sound, they would need to be able to refer to the evidence that led to this conclusion. We do not think, therefore, that we could credibly argue that they should not set out the Department's evidence at some length in their report.

4 Theoretically, there is a further opportunity, when the Secretary of State for Trade and Industry receives the report from the Commission, to seek deletions from the published text. But because that would entail the inclusion in the public version of asterisks in place of the deleted passages, such deletions would be likely to cause more problems than they would solve.

5 I should be grateful to know if the Secretary of State is content.


S R Sklaroff
Oil and Gas 3A
Room 726
Extn 3781
27 July 1988



MONOPOLIES AND MERGERS COMMISSION
New Court
48 Carey Street
London WC2A 2JT

Tel: 01-831 6111 Ext }
GTN 2548 }

S Sklaroff Esq
Department of Energy
Thames House South
LONDON
SW1P 4QJ

22 July 1988

M100/5/6

Mr Clippofield cc PS/PJS
Mr Davis
Mr Bruni

Dear Mr Sklaroff

GOVERNMENT OF KUWAIT/BRITISH PETROLEUM PLC

Aut
26/7

I enclose two copies of draft material which the Commission are likely to include in a section of their report on the views of the United Kingdom Government and other parties. The wording used here might not be exactly that which will be used in the final report.

Would you please confirm that the passage accurately reflects your views or make any amendments which you consider necessary. Should you wish in addition to make any representations concerning the Commission's intention to include any of this information in their report, you are invited to do so.

I should like, if possible, to receive your comments by 5 August.

Yours sincerely

Miss G Booth

Department of Energy

- 1 The Department of Energy is responsible for the development of United Kingdom policies in relation to all forms of energy and for international aspects of energy policy. It is the sponsoring department for the British oil industry and has responsibility for the Government interests in the development of oil and gas resources on the British sector of the Continental shelf.

- 2 The Department provided us with information on the oil industry in the United Kingdom and elsewhere, on the oil markets, and on HM Government's policy for oil, particularly in respect of the Continental shelf. We received evidence from them in writing and at a hearing at which HM Treasury was also represented. The Department's evidence was put forward on behalf of HM Government.

Summary of views

- 3 The Department told us that the Government's view was that the 22 per cent KIO shareholding in BP afforded Kuwait the ability materially to influence the policy of BP and that Kuwait might ~~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 United Kingdom.

- 4 The Government's view therefore was that the 22 per cent shareholding was against the public interest and that appropriate steps should be taken to reduce it to a level at which Kuwait's ability to influence BP was no longer on a different scale from that of the company's other shareholders.

Kuwaiti oil interests

- 5 The Department emphasised the importance of oil to the Kuwait economy: its net oil exports accounted for ^{over a third} ~~about one quarter~~ of its GDP compared with 1 per cent for the United Kingdom, ~~and the oil sector as a whole may account for as much as 50 per cent of Kuwaiti GNP (depending on the price of oil) compared with 2 per cent for the United Kingdom.~~ Ownership of all oil reserves was ^{vested} ~~vested~~ in the State and its oil industry was controlled by a state-owned holding company, which was responsible for both domestic and international oil activities. The Chairman of the KPC was also a director of the KIA. HMG's understanding was that although there appeared to be no barrier in Kuwaiti law, there were considerable practical obstacles to the involvement of foreign companies in the development of Kuwaiti oil reserves and no effective way for a foreign company to buy shares in KPC or its subsidiaries.

6 The Department also drew attention to what the Kuwaitis had themselves described as 'aggressive expansion' of its downstream markets in Europe and elsewhere. In this respect, they said, it was of interest to note that BP had substantial downstream assets, and its refining and marketing activities accounted for 70 per cent of BP turnover in 1987. Kuwait was also expanding its foreign exploration and production activities, to complement its overseas downstream assets, through its subsidiary, Santa Fe. Although Santa Fe's production capacity was largely concentrated in California and the Gulf of Mexico, it had a presence on the UK Continental Shelf and a significant interest in the Miller field, operated by BP, which was in the planning stage.

Kuwait and OPEC

L 7 The Department also ^{described} ~~pointed to~~ Kuwait's role in OPEC. OPEC's objective was to set production quotas for its members in order to control the price of oil. [~~As circumstances dictate, Kuwait had observed its quota with varying degrees of rigour.~~] In the early 1970s Kuwait was one of the first to cut back oil production and push up prices. In recent years it ^{has continued to hold output} ~~had, among others, found~~ ^{itself significantly below capacity in} ~~itself under consistent pressure from other members to trim its~~ ^{support of prices.} ~~output in support of prices.]~~

L 8 OPEC member states, the Department told us, had sought to influence other producing states, including the United Kingdom, in favour of controlling production as a means of maintaining the world price of oil at levels consistent with the interests of OPEC

producers. HM Government's position was that questions of production and pricing should be left to the market. It was this view which underpinned the Government's policy of disengaging from detailed intervention in North Sea developments.

KIO and Spain

- 9 The Department said that recent Kuwaiti policy had been to extend its portfolio of investments in Western Europe, with particular emphasis (via the KPC) on the downstream oil and petrochemicals sector. KIO investment in Spain had also followed this pattern, with emphasis given to the acquisition of downstream outlet companies whether in the chemical, explosives or refining sectors.
- 10 The investment activity in Spain also afforded examples of the way in which KIO had sought to influence the policy of companies in which it has a shareholding. These included: encouraging the sale or merger of corporate assets against the will of existing company management (GRT); 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).
- 11 The Department's ^{view was therefore} ~~concluded from this~~ that KIO was prepared to take the sort of ~~any~~ any active shareholding would deem; ~~any~~ action ~~it deemed~~ appropriate if a company in which it had a

controlling shareholding was perceived as not acting in the KIO's interests.

The build up of KIO's shareholding

12 The Department told us that as the KIO stake in BP rose above 10 per cent and rapidly approached 20 per cent, United Kingdom ministers several times impressed on the Kuwait authorities their concern at the increasing size of the holding. The Kuwaitis had assured HMG that they had no ambitions to control BP nor any interest in any management role. They added that for the foreseeable future they did not intend to seek a seat on the BP board. However on the crucial question of the size of the shareholding, the Department said the Kuwaitis had not addressed United Kingdom Ministerial concerns. They had consistently maintained that they could give no undertakings on the level of the shareholding which were not required by law.

Ability to influence

13 The Department pointed out that KIO's shareholding was more than ten times greater than the next single shareholding in BP. Furthermore, the voting record at recent General Meetings showed that the number of shares actually voted had typically amounted to around 10 to 15 per cent. A 22 per cent share placed the holder in a strong, and possibly commanding, position at General Meetings. Such a shareholding, in the Department's view, would enable KIO to influence the policy of BP either by blocking resolutions at shareholders' meetings or by convening such

meetings and then carrying motions unwelcome to the BP board. It would also be in a position to use its voting strength to remove existing directors from the board and, if it so wished to replace them with its own nominees. Even if BP could successfully mount a defence on the first few occasions, it was doubtful whether sufficient votes could be mustered indefinitely. An accommodation with the KIO was the likely outcome of such a situation. An additional source of pressure given the size of the KIO stake, would be the threat of a precipitate sale of part of the shareholding with potentially adverse consequences for the share price.

Public Interest Issues

(a) Influence on BP production and oil field development

14. Given the history of OPEC's efforts to persuade other producing countries to support, via production controls, world oil prices favourable to OPEC members, the Department thought that conditions might arise in which Kuwait would attempt, on her own account, or under pressure from fellow OPEC members, to constrain BP's oil production and development activities in the North Sea, or elsewhere, for example by extending the 'off-season', or by delaying new developments. This would affect not only BP but also its partners in the North Sea. It ^{might} ~~would~~ have considerable adverse effects on UK resources in the medium and long term.

15. In amplification of the above, the Department told us that there had been recent public statements by Kuwaiti Ministers to the

effect that the United Kingdom and other non-OPEC producing companies should cooperate with OPEC in 'stabilizing' oil prices. It was, the Department said, more in the UK interest, than Kuwait's interest, to ensure that the North Sea continued as a significant oil producing province in the foreseeable future and the UK's independence in this matter 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. There were, said the Department, even wider implications. In the longer term, as production from the North Sea declines, the UK might once more become dependent on the Middle East for oil, as it was in the 1970s. ^{Members of OPEC such as} [Kuwait ^{might} would] then be able to exert even tighter control over BP's sales of oil, and on the UK's raw material costs (through oil price).

- 16 We asked the Department for an estimate of the reductions in oil production in the North Sea which might result from extensions of BP's 'off-seasons' for repair and maintenance. They told us that the reductions might conceivably be significantly in excess of 5 per cent of BP's present production. Given that total output from the North Sea is around 2.6 million barrels per day, and that BP (with Britoil) owned roughly 25 per cent of that output, a cut of, say, 5 per cent in BP's North Sea production would amount to about 30,000 barrels per day.

(b) Government planning arrangements

17 The Department told us that HM Government maintained contacts with BP and other oil companies on contingency plans for times of crises, including blockade in time of war. They said that as one of the main companies holding UK national stocks BP was also one of the leading companies with which the Government liaised regularly on the Oil Industry Emergency Committee, which was concerned with planning for war-time. BP was 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. At times of crisis, the company's ability to respond to HMG might be constrained and this would be a particular handicap.

(c) Research and development activities

L 18 The Department told us that it was conceivable that ^{any} a state such as Kuwait with very large low-cost indigenous reserves of oil would be less interested in research and development aimed at improving extraction of oil or at developing oil substitutes than a wholly commercial company like BP. Any reduction in these activities could be against the public interest. We asked the Department for their views on some aspects of this programme, especially those parts relating to the production of oil substitutes and to the exploitation of having crude oil for use in transport and power generation.

19 The Department told us that BP was well in the forefront of United Kingdom-based oil companies in spending on new oil-related technologies. Their programme on the conversion of methane to heavier liquids suitable for use as gasoline was aimed primarily at gaining access to future reserves of natural gas in remote regions. The world's gas reserves were currently estimated to be almost equivalent to the oil reserves but for economic reasons they were at present less extensively developed. Similar research was being carried out by some of BP's competitors.

20 The process which emulsifies heavy oils in water to make them more easily transportable and usable in large industrial boilers and furnaces was at a more advanced stage. A commercial test of the product jointly developed by BP and Petroleos de Venezuela was about to take place and the project might well be on the verge of commercial launch. BP were leaders in this field.

21 Both of these areas of research and development offered, in the Department's view, considerable potential benefit to the North Sea and the UK economy. Neither was of obvious benefit to a Government with extensive conventional resources of its own.

(d) Purchase of Kuwait oil by BP

22 The Department believed that at some future date Kuwait ^{might} wish to increase disposal of its own oil, beyond the capacity of its existing refining and marketing system. KIO might then seek to influence BP to increase the usage of Kuwaiti crude in BP

there were a number of ways in which a producer state such as Kuwait might wish to influence BP's purchasing policy. For example

refineries and/or other downstream facilities, rather than buy on the open market or increase its own output. This would have a clearly adverse impact on BP's ability to take decisions in a commercial way.

(e) Perception of BP by others

23 The Department told us that the decision to sell HMG's holding in BP was taken on the basis that it was no longer appropriate for HMG to retain shareholdings in private sector companies. 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. Investment on a substantial scale by a foreign Government had therefore nullified one of HMG's aims in disposing of its shareholdings in BP. This, and the fact that the Government with a potentially dominant holding was an OPEC members state was almost certain to have an impact on the perception of the company by prospective suppliers, customers and partners, and to cast doubt on BP's ability to behave as a commercial organisation. It could also influence the way BP was regarded by other foreign Governments. The Department told us it was aware of several examples where BP had already encountered difficulties in commercial negotiations overseas as a result of the existence of the KIO shareholding.

24 The Department also thought that BP ^{might} ~~would~~ encounter difficulties over raising capital, particularly with regard to corporate takeovers if it was not seen to be an independent company.

(f) Access to commercially sensitive information

25 The Department considered that Kuwait representation on BP's board would give it access to commercial information on refining and distribution in markets where BP and Kuwait were at present in competition. This would give Kuwait advantages in the European and United States markets which it would not otherwise obtain. The Department added that there were also examples from the recent past where the KIO, having acquired interests in UK downstream assets, had sold them to KPC. There must therefore be some concern that similar rationalisation of some of BP's downstream assets could not be ruled out for the future.

Conclusions

26 For all these reasons, the Department told us, the Government's view was that the KIO shareholding, at its present level, was against the public interest.

MINUTE SHEET:

PWP

No.....

File No.....

CONFIDENTIAL

From Miss J L Wheldon
29th July 1988

Miss H Goodman
H M Treasury

CH/EXCQUEUR	
29 JUL 1988	
10	

cc PS/Chancellor
PS/Financial Secretary
Sir P Middleton
Sir G Littler
Mr Monck (o/r)
Mr Moore (o/r)
Mrs Lomax
Mr M L Williams
Mr Bent

BP/KIO

You copied to me your minute of 28th July to Sir Peter Middleton.

I had already liaised with Mr Brummell about the legal aspects of the Department of Energy evidence and I am content with the note which he proposes to send to the MMC about the suggestion that KIO shares should be put into a trust.

You referred in paragraph 5 of your minute to the Chancellor's concern that the Treasury's views do not become public knowledge. I think it would be worth adding to what you have said that section 83 of the Fair Trading Act 1973 provides the Secretary of State with the power to delete from the MMC report, before publication, any matter in the report which he believes would be against the public interest to publish. As a Department of Energy minute attached to your minute of 28th July says, use of this power results in a line of asterisks in the public version of the report and the powers^{is} used sparingly. Nevertheless, it does offer a basis on which to delete particularly sensitive material.

J L Wheldon
Miss J L Wheldon

OVER

CONFIDENTIAL



cc: Chancellor,
 Sir P. Middleton,
 Mr Anson, Mr Monck,
 Mrs Lomax,
 Mr R. Benk,
 Mrs M.E. Brown,
 Mr O.J.L. Moore,
 Mr Call, Mr Tyrrie,
 Mr Hyett (T.Sol).

Treasury Chambers, Parliament Street, SW1P 3AG

Peter Morrison Esq MP
 The Minister of State
 Department of Energy
 Thames House South
 Millbank
 London SW1

29 July 1988

Dear Peter

I have considered carefully the points in your letter to Alan Clark of 19 July about the eligibility rules for the BT, BGC, BA, BAA and BP incentive arrangements, both from the viewpoint of my direct responsibility for the BP sale, and from my wider remit for coordinating the privatisation programme generally.

The advice we have now obtained from the Law Officers confirms the serious legal implications arising from the interpretation of these five contracts in the circumstances of shareholders who transfer into joint names, and other departments have also identified substantial policy issues which arise if we depart from the practice adopted so far.

I am sure we cannot simply each go our own ways, with one interpretation for Gas and another for BT, BA, BAA and BP. It is essential that all departments should adopt a common strategy, and minimise the risks of legal challenge.

I have reviewed both the legal and the policy issues in the light of your recent letter, and I must say that I agree with the view provisionally reached by officials that the best balance is struck if Gas practice, with effect from 1 July, is brought into line with the practice on the BT, BA, BAA and BP sales.

On the legal issues, I readily acknowledge the complicated situation, and I am conscious of the "better view" expressed by the Law Officers. But I am also aware that they went on to note the severe practical problems that might drive us to want to resist claims, and advised that "it remains open to the Secretary of State to insist upon the strict construction of the prospectuses". So the legal arguments are not one-sided.

On the policy front, the weight of advice is that a substantial administrative task arises if we instruct officials to reverse previous practice. All those investors in the BT, BA, BAA and BP sales who had previously lost entitlement, and who would remain eligible for incentives under your department's interpretation, would need to be identified, and given redress. Very possibly,

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administrative action on its own might not be successful, and advertising for claimants would then be necessary. Leaving on one side the cost and difficulty of dealing fairly with such claims on the basis of inadequate documentation, action of this kind would certainly attract unfavourable publicity for the privatisation programme, and would be bound to increase the pressures for other departures from past practice which we have hitherto resisted.

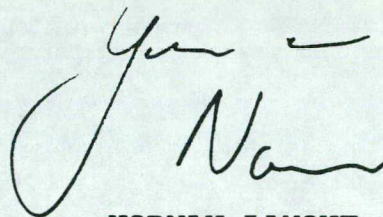
It is also the case that the interpretation and course of action which you favour would in fact fail to protect the entitlement to bonus shares of a surviving widow on the death of the husband, for the reasons I gave in my letter of 18 April. But your suggested interpretation also opens up the possibility of abuse - eg the transfer of shares between wholly unrelated persons via a joint holdin - for which inadequate safeguards exist in the contract because, or course, it was not the draftsman's intention to allow transfers into joint holdings cum entitlement.

There are no easy, or entirely satisfactory, answers to the problem we face. Weighing the possibility of an unhelpful Court decision in the event of a legal challenge against the policy arguments for maintaining the contract as the draftsman intended, I believe that the agreement reached by officials is the best outcome.

I hope you might be able to reconsider your objections to this proposal. The issue has been under consideration for a long time and officials in other departments have been prevented from responding to correspondence with investors meanwhile, so we need to reach a quick decision if we are not to provoke the legal challenge that will expose our conflicting interpretations.

We need a common Government interpretation, it would be most helpful if you felt able to agree, that the interpretation adopted for BT, BA, BAA and BP should even be adopted for Gas as from 1 July.

Copies of this letter go to the recipients of yours.

A handwritten signature in black ink, appearing to read 'Norman Lamont', written in a cursive style.

NORMAN LAMONT

UNCLASSIFIED



FROM: J M G TAYLOR

DATE: 29 July 1988

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

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Gieve
Mrs M E Brown
Mr Gunton
Mr Bent

BP SECOND CALL: PRESS NOTICES

The Chancellor has seen Mr Bent's minute of 28 July. He is content with Mr Bent's advice, subject to any comments which the Financial Secretary may have.

Handwritten initials, possibly "JMGT", in the bottom right area of the page.

J M G TAYLOR

FROM: H C GOODMAN

DATE: 29 July 1988

PS/CHANCELLOR

cc

PS/FST
Sir P Middleton
Sir G Littler
Mr Monck - o/r
Mr Moore - o/r
Mr M L Williams
Ms Wheldon - T/Sol

Ch.
FCO seem to have
gone completely mad. Content
for me to write is suggested (I have
made one or two amendments).

BP/KIO

df 29/7
OK as suggested up.

The FCO have now sent a record of Mr Mellor's meeting with Ali Khalifa ten days ago. Also attached is a draft letter the FCO want to send to the Kuwaitis.

2. It is not a good idea to write now to the Kuwaitis: it may be seen to compromise our position vis a vis the MMC; neither you nor Mr Parkinson wrote previously after meeting the Kuwaitis and finally, Mr Waldegrave has now taken over from Mr Mellor and is not really in a position to record that meeting. I have marked with square brackets the passages which are particularly unhelpful, in particular the last sentence.

3. I attach a draft letter for you to send to Mr Waldegrave's private secretary, if the Chancellor agrees.

H C Goodman
H C GOODMAN

DRAFT LETTER FROM PS/CHANCELLOR TO:

Kim Darroch, Esq.
PS/Mr Waldegrave Minister of State
Foreign and Commonwealth Office

BP/KIO

I understand that your Minister is considering writing to Sheikh Ali Khalifa, following Mr Mellor's recent meeting.

The Chancellor has asked me to convey his ^{strongly-held} view that for Mr Waldegrave to write now would ^{be very unhelpful indeed.} ~~not be helpful~~. Such a move could, ^{among other things,} be misinterpreted as an attempt to circumvent the MMC investigations now underway. ^{He trusts that no letter will issue.}

I am copying this letter to Stephen Haddrill (DEn).

J M G TAYLOR

P- S-



Foreign and Commonwealth Office

London SW1A 2AH

Telephone 01-

270 2680

S Sklaroff Esq
Department of Energy

Your reference

Our reference

Date

28 July 1988

Dear Sir,

BP/KIO

1. When we met on Tuesday in Mr Chipperfield's office I told the meeting that we would like to acknowledge Shaikh Ali Khalifa's approach to Mr Mellor in a polite and temporising letter. I explained why the FCO thought sending such a letter was worth doing.
- / 2. I attach a draft letter to Shaikh Ali Khalifa which I would like to submit to Mr Waldegrave's office for his signature. Before I do I would be glad of any comments/drafting amendments that you would like to propose.
3. I am copying this letter to Helen Goodman at HM Treasury whose views on the draft I would also welcome. I will be happy to take comments by telephone.

John Minors

CJB

C J B White
Economic Relations Department

DRAFT: minute/letter/teleletter/despatch/note

TYPE: Draft/Final 1+

FROM

Mr Waldegrave

Reference

CG1AOZ

DEPARTMENT:

TEL. NO:

SECURITY CLASSIFICATION

TO:

Your Reference

Top Secret

Secret

Confidential

Restricted

Unclassified

Shaikh Ali Khalifa

c/o Embassy of Kuwait

Copies to:

PRIVACY MARKING

SUBJECT:

.....In Confidence

CAVEAT.....

1. You will have heard that David Mellor has left the Foreign and Commonwealth Office to take up a new post at the Department of Health. [I hope that we will soon have an opportunity to meet, so that I can continue the dialogue he had with you on matters of mutual interest.]

2. I have had accounts of David's recent contact with you on the BP issue. Like him, I am keen that the Monopolies and Mergers Commission (MMC) investigation of the KIO's shareholding in BP should remain separate from the broader relationship between the United Kingdom and Kuwait. I would like to thank you for letting us know about the proposal you put to the MMC. I would also like to endorse the point David made to you that we welcome the spirit of your letter to the MMC outlining Shaikh Sa'ad's initiative. I am glad that you broached the issue by putting Shaikh Sa'ad's ideas to the Commission first since they are an independent body. The Commission will

Enclosures-flag(s).....

SECURITY CLASSIFICATION

Top Secret

Secret

Confidential

Restricted

Unclassified

PRIVACY MARKING

.....

In Confidence

now, I am sure, examine the proposals with care and bear them in mind in preparing their report to Lord Young. It will not be long before the MMC submit their report to Lord Young. [We look forward to discussing the findings with you.]

May not be appropriate

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From: N K Darroch

Date: 22 July 1988

cc. PS
PS/PUS
PS/Mr Munro
PS/Mr Bayne
Mr Carrick
Mr Whomersley,
Legal Advisers
Mr Young, MED

Mr Richardson, ERD

BP/KIO: MR MELLOR'S BREAKFAST WITH SHAIKH ALI KHALIFA

1. As Mr Mellor reported orally to you this morning, he had the following exchanges on BP/KIO with Shaikh Ali Khalifa.
2. Ali Khalifa asked for our reaction to the Kuwaiti Government's letter to the MMC. Mr Mellor said that we welcomed the positive spirit that the letter reflected; but he had not considered British Government views to report. The Kuwaiti proposals would be studied by the MMC. This was an independent body and they had no powers simply to set their investigation aside. Ministers could not just "call them off".
3. Ali Khalifa said that his Government felt strongly that it would be better for all concerned if the MMC's report and recommendation were acceptable to all sides. Otherwise there might be difficulties that would spill over into wider bilateral relations. The British Government was bound to be asked by the MMC for its views on the Kuwaiti offer. He hoped that the Kuwaiti Government could also be informed immediately of our considered reaction. He himself would be in London in the first week in August and in Geneva for two weeks thereafter and would be available for any meetings that were thought appropriate.
4. Ali Khalifa added that he hoped that the Kuwaiti offer would be considered properly by Ministers and not left to officials because of the August holiday; and that the Prime Minister would be properly informed and consulted since this was a personal initiative by Shaikh Sa'ad. Mr Mellor gave appropriate assurances.

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Comment

5. Mr Mellor's impression is that this Kuwaiti offer does not quite represent their bottom line; they may have a little more to give. But it is also clearly their wish to cut a deal with us on the sidelines of the MMC enquiry. They imagine that this could then be presented to the MMC as the agreed view of the two governments - and all will be well. As you pointed out this morning, matters may not be quite that simple to arrange.

A handwritten signature in black ink, appearing to read 'N K Darroch'. The signature is written in a cursive style with a large, prominent 'D'.

N K Darroch
PS/Mr Mellor

CONFIDENTIAL

CONFIDENTIAL

From: S D H SARGENT

Date: 1 August 1988



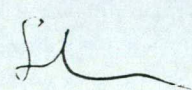
MS H GOODMAN

cc PS/Chancellor
PS/Financial Secretary
Sir G Littler
Mr Monck
Mr Moore
Mrs Lomax
Mr M L Williams
Mr Bent

Miss Wheldon - Tsy Sol

BP: KIO

Sir Peter Middleton was grateful for your minute of 28 July with which he was content.

**S D H SARGENT**

Private Secretary



cc PS/Chancellor
 PS/Financial Secretary
 Mr Anson
 Mr Monck
 Mr Scholar
 Mrs Lomax
 Mr Moore
 Mrs M Brown
 Mr M L Williams
 Mr Bent
 Mr Lyne
 Mr Call
 Miss Wheldon - Tsy Sol

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-270 3000
 Direct Dialling 01-270 4360

Sir Peter Middleton KCB
 Permanent Secretary

CONFIDENTIAL

[Handwritten signature]

Sir George Blunden
 Deputy Governor
 Bank of England
 Threadneedle Street
 LONDON
 EC2R 8AH

1 August 1988

[Handwritten signature: Sir George]

BP POST MORTEM: TERMINATION CLAUSE

In my letter of 18 April, I said that I would write to you again when we had further legal advice on a new model termination clause for use in future UK underwriting agreements.

I now attach draft clauses which have been approved by Counsel (Mr John Chadwick and Mr John Mummery) on instructions from the Treasury Solicitor's Department and Slaughter and May. I would be grateful for any comments you have. In the meantime, the Treasury will discuss the clauses with DTI, the sponsor department for the coming Steel sale, and with Norton Rose, the solicitors to the offer. The clauses will then be for negotiations with the UK lead underwriter for the Steel sale who is likely to be appointed at around the end of September and, assuming there are overseas tranches, with the overseas lead underwriters.

The language of the main clause, 8.01, is much simpler than its predecessors and the operation of any termination discussions should not be so constrained as with BP, though they would still be onerous. In particular, we are advised that the clause meets our objective that, in consultations with the Bank, there would be no question of the normal advisory relationship with you being put in baulk.

The main points are as follows (and throughout the draft the name of the department responsible for the sale would be substituted for the Treasury):

- (1) The lead underwriter may propose termination, with the reasons given in writing. The clause does not attempt to specify what might be appropriate reasons, but it states

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that there must have been an occurrence of such significance that the underwriters conclude that it would be reasonable for them to be released and discharged from their obligations under the agreement.

- (ii) The decision whether to proceed rests with the department concerned. They would not be obliged by the clause to give reasons for that decision, although in practice there will obviously be a Ministerial statement, as with BP.
- (iii) In reaching that decision the department "may conduct such consultation in such manner and with such persons as it thinks appropriate [including with the Bank of England] and with or without reference to the lead underwriters."

The wording in (iii) is important. The words "in such manner, and with such persons" are intended to avoid any implication that the Government was only under a simple duty to consider the underwriters' representations and not to consult with any other persons. The words "with or without reference to the lead underwriter" overcome the serious disadvantage in the BP consultations where the Treasury had to involve the lead underwriter in its representations to the Bank.

In the opening negotiations with the underwriters there would be no reference to the Bank of England. But it would be explained that the Government would be likely to consult both the Bank and the company, although there was no obligation to consult either of them or, indeed, any third party. If in negotiations it became clear that the underwriters attached great importance to the inclusion of a reference to the Bank, that could be included, as shown in the draft clause, though to avoid the risk of any constraint on our normal relationship there would be no reference to the role in which you were being consulted.

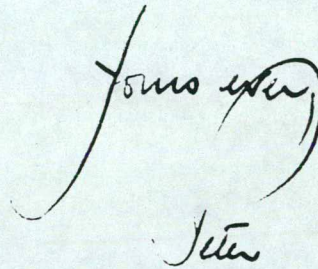
The clause does not give overseas underwriters power to propose the termination of the agreement, nor does it make any reference to consultation with them. In practice the Government would expect to consult the lead underwriters and if necessary they could be advised of this expectation in negotiations. If strongly pressed we could acknowledge this in the clause - "including the lead overseas underwriters". But we are advised to resist giving any legal entitlement for each overseas lead underwriter to propose termination or to take a part in the consultation procedure. This would give each of them the right to sue the Government for breach of contract regarding the consultation procedure, whereas in the BP agreement this right only rested with the UK underwriters. Increasing the number of potential litigants against the Government would be a material disadvantage particularly as some of the overseas underwriters come from more litigious jurisdictions.

We must wait to see the reactions of the overseas banks to these proposals, but in any negotiations we will be able to point to the fact that each of them, in bidding for appointment to the Steel sale, specifically said that they would abide by the same

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underwriting arrangements as in previous offers, even though they would prefer to be included in any consultation process.

Clause 8.02 provides for the Government to take the initiative in terminating the offer. This is a new provision, which we think it is prudent to have available even though it may be unlikely that we would see circumstances in which the Government, but not the underwriters, wished to terminate. The remaining clauses are on familiar lines.

A handwritten signature in cursive script, appearing to read "P. E. Middleton". The signature is written in dark ink and is positioned above the printed name.

P E MIDDLETON

ANNEX B

DRAFT: (GIH) 19.7.88
GIH0014.88T

8. Termination

8.01 If, between the execution of this Agreement and the time when this Agreement becomes unconditional in all respects, there shall have been any occurrence of such significance that the Underwriters conclude that it would be reasonable for them to be released and discharged from their obligations under this Agreement, the Lead Underwriter may, on behalf of the Underwriters, so notify the Treasury. Such notification* shall include details of the occurrence and the reasons why it has led the Underwriters so to conclude. Following receipt of such notification, the Treasury shall determine whether or not the Offer should proceed and shall notify the Lead Underwriter on behalf of the Underwriters accordingly. In reaching such determination the Treasury may conduct such consultations in such manner and with such persons as it thinks appropriate [(including with the Bank of England)**] and with or without reference to the Lead Underwriter.

* See Note at the end of Annex B.

** This phrase in parenthesis in Clauses 8.01 and 8.02 is not to be included in the first draft submitted to the Lead Underwriter.

8.02 If, between the execution of this Agreement and the time when this Agreement becomes unconditional in all respects, there shall have been any occurrence of such significance as to lead the Treasury to contemplate withdrawing the Offer and terminating this Agreement, it shall notify the Lead Underwriter on behalf of the Underwriters. Thereafter the Treasury shall determine whether or not the Offer should proceed and shall notify the Lead Underwriter on behalf of the Underwriters accordingly. In reaching such determination the Treasury shall consider such representations (if any) as the Lead Underwriter may make and may conduct such consultations in such manner and with such persons as it thinks appropriate [(including with the Bank of England)*] and with or without reference to the Lead Underwriter.

8.03 The Offer shall proceed or not proceed, as the case may be, in accordance with the determination made by the Treasury under Clause 8.01 or 8.02.

8.04 If:-

- (a) any of the conditions referred to in Clause 2.01 [e.g listing of the Shares, filing of the Prospectus] is not fulfilled; or
- (b) following any consultation pursuant to Clause 3.10 the Treasury and the Lead Underwriter, on behalf of the

Underwriters, shall agree that the Offer should not proceed;
or

(c) following any notification pursuant to Clause 8.01 or 8.02
the Treasury shall determine that the Offer should not
proceed; or

(d) the Allocation Announcement has not been made either:-

(i) within 96 hours (or such longer period as may be agreed
between the Treasury and the Lead Underwriter, on
behalf of the Underwriters) after the Lead Underwriter
shall have been notified of the number of Ordinary
Shares comprised in Valid Applications; or

(ii) by 6.00 p.m on [specified date - this is usually about
a week after the date when the Agreement is expected to
become unconditional in all respects];

whichever shall be the earlier,

this Agreement (other than Clause 8.05 and the provisions of the
other Clauses referred to in Clause 8.05) shall terminate and the
Lead Underwriter shall notify the Company thereof as soon as
reasonably practicable thereafter.

8.05 In the event that this Agreement is terminated (in the manner and to the extent referred to in Clause 8.04), the parties hereto shall be released and discharged from their respective obligations hereunder or pursuant hereto except for:-

- (a) the liability of the Treasury [and the Company] for the payment of costs, charges and expenses as provided in Clause 5.02 or under the indemnity contained in Clause 7.01;
- (b) the liability of the Treasury [and the Company] to pay the commissions referred to in Clause 5.01 if this Agreement shall terminate in any of the circumstances mentioned in Clauses 8.04(a) (except as a result of the condition in Clause 2.01(c) not being satisfied) or 8.04(d) or shall terminate pursuant to any consultation referred to in Clause 3.10 unless such consultation takes place as a result of an event falling within the provisions of Clause 3.10(c) having occurred or being likely to have occurred; and
- (c) the liability of any party hereto by reason of their[, his] or its antecedent breach of the terms of this Agreement.

8.06 In the event that the Treasury [and the Company] shall be liable to pay the commissions referred to in Clause 5.01 by virtue of Clause 8.05(b), such commissions will be paid in London two business days in London after the date on which this Agreement is terminated.

8.07 If any consultation pursuant to Clause 3.10 does not result in the Treasury and the Lead Underwriter, on behalf of the Underwriters, agreeing that the Offer should not proceed, neither the Treasury nor any of the Underwriters shall thereafter be entitled to rescind or terminate this Agreement or treat the same as discharged solely by reason of any matter which gave rise to the said consultation.

8.08 If following any notification pursuant to Clause 8.01 or 8.02 the Treasury determines that the Offer should proceed, neither the Underwriters nor the Treasury shall thereafter be entitled to give a notice pursuant to such Clauses in relation to any matters which gave rise to the earlier notification unless there has been some material change in circumstances which is itself an occurrence of such significance as to lead the Underwriters or the Treasury (as the case may be) to conclude that a notice should be given.

Note:

All communications between the parties to the Underwriting Agreement would be required to be in writing pursuant to a clause like clause 13.02 of the BP Underwriting Agreement, the text of which is set out below:-

"All communications under this Agreement shall be delivered by hand or sent by telex, telecopier, facsimile copier or other instantaneous electronic method of written communication in any such case marked for the immediate attention of the relevant person mentioned above or communicated by telephone (subject in the case of communication by telex, telecopier, facsimile copier or other instantaneous electronic method of written communication or by telephone to confirmation within 3 hours by hand delivery)."

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[Handwritten signature]

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

1 August 1988

Kim Darroch, Esq
PS/Minister of State
Foreign and Commonwealth Office
London SW1A 2AH

PS/FST
Sir P Middleton
Sir G Littler
Mr Monck
Mr Moore
Mr M L Williams
Ms Wheldon - T/Sol
Ms GOODMAN

[Handwritten signature]

BP/KIO

I understand that your Minister is considering writing to Sheikh Ali Khalifa, following Mr Mellor's recent meeting.

The Chancellor has asked me to convey his strongly-held view that for Mr Waldegrave to write now would be very unhelpful indeed. Such a move could, among other things, be misinterpreted as an attempt to circumvent the MMC investigation now underway. He trusts that no letter will issue.

I am copying this letter to Stephen Haddrill (DEn).

[Handwritten signature]
[Handwritten signature]

J M G TAYLOR
Private Secretary

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Foreign and Commonwealth Office

London SW1A 2AH

8 August 1988

ppp

BF 10/8

Dear Jonathan,

Thank you for your letter of 1 August.

Mr Waldegrave will not be writing to Shaikh Ali Khalifa about this issue for the moment. But I should make it clear that the reasons we proposed writing to Shaikh Ali Khalifa were first, simply to acknowledge his courtesy in informing HMG of the Kuwait Government's approach to the Monopolies and Mergers Commission; second, specifically to maintain the distance between the Commission investigation of the KIO shareholding in BP and the broader relationship between the United Kingdom and Kuwait; and third in so doing precisely to leave the Kuwaitis in no doubt about our views on the independence of the MMC process. Such a letter would not be open to misinterpretation as an attempt to circumvent the current MMC enquiry, nor inconsistent with HMG's wish to solve the BP/KIO problem in a manner which minimises any damage to British interests.

I am copying this letter to Stephen Haddrill (DEn).

*Yours sincerely
N K Darroch*

N K Darroch
PS/William Waldegrave MP

PS/Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

CH/EXCHEQUER	
REC.	10 AUG 1988 ✓ 10/8
ACTION	MR D MOORE
COPIES TO	PFST, SIR P MIDDLETON SIR G LITTLE MR MONCK MR M L WILLIAMS MS GOODMAN

MS WHELDON T SOL

BF 15/8

Pmp

FROM: H C GOODMAN

DATE: 8 August 1988

PS/CHANCELLOR ←

cc PS/FST
PS/Sir P Middleton
Mr Monck - o/r
Mr Moore.- o/r
Ms Wheldon - T.Sol
Mr Bush

BP/KIO

I attach (top copy only) a draft Deed of Covenant which we have been informed the KIO intend to sign today and release to the press tomorrow. It promises that the KIO will not:

- (a) increase their shareholding above 21.68%
- (b) vote more than 14.9%
- (c) seek to nominate a BP director

2 In the confidential evidence we have given to the MMC we have said these 3 limitations do not satisfy our concerns legal advice is that this remains true. There is therefore very little which we can say and in any case we must beware of appearing to undermine the MMC inquiry underway. So I have agreed with Mr Bush that the line to take should be:

Aware of Covenant. MMC inquiry underway; may wish to take

into account in preparing their report. Would not be appropriate for us to comment before they have reported.

H C Goodman
H C GOODMAN



MONOPOLIES AND MERGERS COMMISSION

New Court 48 Carey Street London WC2A 2JT

Telephone: 01-324 1467

GTN: 3548 0467

Fax: 01-324 1400

cc
Miss Goodman.

CONFIDENTIAL MARKET SENSITIVE

Mr David Moore
H M Treasury
Parliament Street
LONDON
SW1P 3AQ

Direct Line : 01 324 1437

4 August 1988

Dear Mr Moore

P1 fax to Mrs. Wheldon.
8/8

KUWAIT/BP

Further to the hearing on 27 July, I attach for information a copy of a letter to the MMC from the solicitors to the State of Kuwait together with a draft Deed of Covenant, an opinion by Richard Buxton QC and a draft press release. As you will see, copies were sent direct to DTI and OFT.

Yours sincerely

A C HUGHES

A H Isaacs
R J Eddis
J G Fleming
C A W Gibbons
D R Armit
M J F T Wilson
J T Bach
P R Belchamber
M R H Baily
E A Manisty
J W Jeffrey
D L Slade
C S Garrett
M F Jennings
D M D McCann
P D Maloney

P J W Alchin
J A Scales
M H Hoddinott
G S Woolf
K W Duncan
J R C Howison
A H Stockwell
J M Fordham
R P N Brown
C J Mackenzie Grieve
J P Rodier
P J M Fidler
R A Light
P J Diss
Sir Henry Rumbold Bt
J D P Carrell

PL Lochner
J A D Watters
R F Olsen
A L Sutch
J G J Copeland
R H Aydon
P W U Corbett
J G Pike
R Gwynne
R M Uffland
R A Partridge
M Walter
M J Wood
D N Phillips
T M John
J S Gale

J S Schwarz
A J Keates
G G Burns
D R C Robertson

Associates
Ann Phillips
Jane Bowden Dan
P J Miller
Jane Harte-Lovelace
A E Pakenham
J P Scrafton

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Telex: 886789 SHSPC G

Fax Groups 2/3: 01 6060822

Word Processor (IBM): 01 3294350

DX No. 64

Our ref 240

Your ref

Date 2nd August 1988

BY HAND

B.R. Gravatt, Esq.,
Monopolies and Mergers Commission,
New Court,
48 Carey Street,
London WC2A 2JT.

Dear Sir,

KIO/British Petroleum

Further to the hearing on 27th July, we now enclose copies of a Deed to be entered into by the State of Kuwait and an Opinion to be given by Mr. Richard Buxton QC dealing with the effect and enforceability of that Deed. As was made clear at the hearing, the State of Kuwait and the KIO consider that it is incumbent on them to make public the terms on which they hold their shares in BP and the limitations that they are under as to future purchases, and a press release will therefore be made on the morning after the Deed is executed setting out its main terms. A copy of a draft of that that press release is also enclosed herewith.

We do not intend to set out in this letter the matters dealt with in the Opinion, or already discussed at the hearing or in our letter of 21st July, but we are instructed to draw the Commission's attention to the following particular points.

Clause (i) of the Deed, which was not foreshadowed in our letter of 21st July, will prevent the State of Kuwait from using its holding in BP to further any interest of the State of Kuwait other than its interest as an investor. In our clients' view, which is shared by ourselves and by counsel, this covenant will fully and effectively deal with the question of "interference with management" that was discussed at the last hearing. It is, we think, accepted that any investor must legitimately be free to protect its interests as such investor. What, as we understand the matter, concerns the Commission, or at least concerns some parties that have given evidence to the Commission, is that the shareholding in BP might at some future date be used for some ulterior motive inspired not by the protection of Kuwait's investment but rather by a desire to promote some commercial or

Stephenson Harwood is regulated by The Law Society in the conduct of investment business

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Trevor Robinson & Co
Howard House, 66-70 Baker Street
Weybridge, Surrey KT13 8AL
Telephone: 0932 859655

Resident Partners

political end of the State of Kuwait. In our view and that of our clients clause (i) will remove that possibility.

Clause (v) will take account of the point mentioned at the hearing that Kuwait would agree not to oppose candidates proposed by the Board of BP for election to the Board of the company, as well as agreeing not itself to propose or procure the proposal of candidates.

The Commission will appreciate that once the Deed has been entered into it will be binding on the State of Kuwait irrespective of the conclusions of the Commission or of the Secretary of State as a result of the Reference. The State of Kuwait respectfully submits to the Commission that the limitations on the freedom of the State of Kuwait to be confirmed by the Deed will make it clear that no effects adverse to the public interest are to be expected to arise from the holding of the State of Kuwait in BP.

Yours faithfully,

Stephenson Harwood

cc: DTI
OFT

DEED

THIS DEED is made between

THE STATE OF KUWAIT, acting by His Excellency Sheik Ali Khaleifa Al-Sabah, Minister of Oil in the Government of the State of Kuwait and

THE SECRETARY OF STATE FOR TRADE AND INDUSTRY

By this Deed the State of Kuwait covenants with the Secretary of State for Trade and Industry in relation to its holding of the issued share capital of British Petroleum plc ("BP") as follows:

(i) The State of Kuwait holds and will hold any interest that it now has or may hereafter acquire in the issued share capital of BP for investment purposes only and neither the State of Kuwait nor any of its agencies will use any interest in the issued share capital of BP to further any interest of the State of Kuwait or of its agencies other than its interest as an investor in the issued share capital of BP.

(ii) Neither the State of Kuwait nor any of its agencies will acquire any interest in any of the issued share capital of BP that causes the total interests of the State of Kuwait and its agencies in the issued share capital of BP to exceed 21.68 per cent. thereof.

(iii) In the event of the State of Kuwait disposing of any of its present holding in the issued share capital of BP neither the State of Kuwait nor any of its agencies will thereafter acquire any further interest in the issued share capital of BP if the effect of such acquisition would be to cause the State of Kuwait and its agencies to be interested in total in more than 20 per cent. of the total issued share capital of BP.

It is stipulated that for the purpose of clauses (i)-(iii) inclusive hereof and in relation to the covenants given in the said clauses the State of Kuwait or its agencies shall be deemed not to have an interest in such of the issued share capital of BP as is owned by (a) a person or company that is not a subsidiary of, and whose policy is not controlled by, the State of Kuwait or any of its agencies; or (b) any pension fund or similar fund that is associated with but not under the control of any of the agencies of the State of Kuwait.

(iv) Neither the State of Kuwait nor any of its agencies will at any general meeting of BP exercise in person or by proxy voting rights representing more than 14.9 per cent. of the total voting rights of all the members of BP having the right to vote at such meeting.

(v) Neither the State of Kuwait nor any of its agencies will propose or procure the proposal of any person for election or appointment as a director of BP or vote against the election as such director of any person who is proposed for election by the Board of BP.

It is stipulated that for the purpose of clauses (i)-(v) inclusive hereof and in relation to the covenants given in the said clauses

(a) The agencies of the State of Kuwait shall be deemed to include any company which would if the State of Kuwait was a holding company be a subsidiary company thereof, the expressions holding company and subsidiary company having the meanings ascribed to them by Section 736 of the Companies Act 1985;

(b) The issued share capital of BP means the issued share capital of BP carrying rights to vote in all circumstances at general meetings of BP.

(vii) The State of Kuwait hereby consents to the giving of relief against it by way of injunction or order for specific performance for the enforcement of the covenants contained in clauses (i)-(v) above in any case where the High Court of Justice of England and Wales or any court on appeal therefrom determines that the only reason why such relief should otherwise not be granted is the provision contained in section 13(2)(a) of the State Immunity Act 1978 or any re-enactment thereof.

This Deed shall be construed according to the law of England.

IN WITNESS of which the State of Kuwait, acting by H.E. Sheik Ali Al Khaleifa Al-Sabah its Minister having the authority of the State of Kuwait to act in this matter has sealed this Deed at _____ on _____

SIGNED by the said Sheik Ali Al Khaleifa as a Minister of the State of Kuwait

In the presence of

RE:A DEED OF THE STATE OF KUWAIT

OPINION

1.1 I am asked to advise the State of Kuwait as to the status and effect in law of a Deed to be entered into between the State of Kuwait and the Secretary of State for Trade and Industry ("the Secretary of State").

1.2 I am instructed that the objective of the Deed is to implement the desire of the State of Kuwait to be bound in law, in terms that can be enforced in the English courts by the Secretary of State, to the undertakings that are set out in the Deed. To achieve that aim, two possible courses could be adopted (see Halsbury's Laws (4th edition), vol. 9, paragraph 209). First, a simple contract for nominal consideration could be entered into between the State of Kuwait and the Secretary of State. Second, the State of Kuwait can bind itself by a deed under seal. I am instructed that the State of Kuwait has decided to adopt the latter form because it wishes to bind itself immediately and without the delay that might be occasioned by the formation of a simple contract.

2.1 The Deed is in the form of a deed poll: that is to say, it is the unilateral act of the State of Kuwait, and the deed has not been subscribed or sealed by the Secretary of State. There is however no doubt that such a deed binds the party whose deed it is immediately upon execution by him, and irrespective of whether the deed has also been subscribed or sealed, or indeed agreed to in any way, by the other party to it: see Halsbury's Laws (4th edition) vol. 12, paragraph 1353, and also *Lady Naas v Westminster Bank Ltd* [1940] A.C. 366 at pp. 374, 375 in the House of Lords, and also per Sir Wilfrid Greene M.R. in the Court of Appeal at [1938] 3 All E.R. p. 657 F.

2.2 As Sir Wilfrid Greene points out, a deed thus operates whether it is expressed to convey property or to bind the grantor by covenant. Promises made in a deed poll, even if no consideration is given for them, are thus binding on the promisor as a matter of contract, and can be enforced by anyone who is named as the other party to the deed and thus is a beneficiary of the covenants contained in it: Halsbury's Laws (4th edition) vol. 9, paragraph 210 and volume 12, paragraph 1357, n.1.

2.3 The effect of the Deed is, therefore, that the covenants contained in it will bind the State of Kuwait, and will continue to bind the State of Kuwait unless and until those covenants are released by agreement with the other party, that is, the Secretary of State. Although the obligation is undertaken unilaterally, it is not possible, once that obligation is effectively undertaken, to escape from the obligation other than by agreement inter partes. And since the covenants have the effect described above they are enforceable by the Secretary of State as if they were contained in a contract for consideration made with him.

2.4 It is, of course, open to the Secretary of State to disclaim the Deed (that is to say, to reject the benefit and power of enforcement that the Deed confers to him: Halsbury's Laws (4th edition), vol. 12, paragraph 1370). It is also open to the Secretary of State, in any particular case of breach, to decide not to take enforcement action. It would, however, seem most unlikely that the Secretary of State would either completely disclaim the Deed or decline to act in the case of a particular breach; unless of course he judged in a particular case that the breach involved no detriment to the U.K. public interest. The covenants will form part of the evidence considered by the Monopolies and Mergers Commission in relation to possible damage to the public interest emanating from the State of Kuwait's holding in BP. I am instructed that it is the State of Kuwait's confident belief that the covenants will fortify the Commission in finding that that holding cannot be expected to have effects contrary to the public interest. If the Commission were to conclude that the covenants were relevant to such a finding, the Secretary of State can be presumed to be in a position to enforce such covenants should they ever be broken in the future.

3.1 The most obvious mode of enforcement would be by injunction proceedings. Kuwait, as a sovereign state, would normally be immune from relief by way of injunction, but by clause (vi) of the Deed the State of Kuwait has consented to the use of injunctive relief to enforce the covenants contained in the rest of the Deed. In my opinion the terms of clause (vi) fulfill the requirements of section 14 (3) of the State Immunity Act 1978, and therefore in any future injunctive proceedings brought to enforce the covenants contained in the Deed the State of Kuwait will not be able to rely on any immunity that would otherwise spring from its being a sovereign state.

4.1 I have dealt above with the effect of the Deed. I now comment on its form. The Deed is expressed to be sealed by the State of Kuwait, the seal having been placed thereon by H.E. Sheik Ali Al Khaleifa Al Sabah, a Minister of the Government of Kuwait authorised to seal the Deed. The State of Kuwait is not, in English law terms, to be characterised as a corporation or corporate body, and thus neither has what would in English law be recognised as a corporate seal nor is bound by the rules developed in English law for sealing the documents of corporations. That does not, however, in my view prevent the State of effectively sealing a Deed according to the general mode recognised by English law, as has been done in this case.

4.2 The State of Kuwait, like any entity that is not an individual, must act through the physical instrumentality of an individual, H.E. Sheik Ali having authority to act in this case. I do not, however, consider that H.E. Sheik Ali will himself be making the Deed as agent of the State of Kuwait, so as to bring into operation the principle that an agent cannot execute a deed unless he is himself appointed by power of attorney (see *Powell v London & Provincial Bank* [1893] 2 Ch. 555 at p. 563). Rather, the Deed is, and is with authority expressed to be, that of the State itself, with the individual concerned being

merely the instrument through which the State physically acts in the execution of the Deed.

4.3 My opinion is, therefore, that the Deed is in a form that effectively binds in law the State of Kuwait, and that accordingly the consequences set out in paragraphs 2-3 above follow from it. If, however, any objection is expressed as to the form of the Deed, the objectives of the State of Kuwait can be equally achieved by simple contract (see paragraph 1.2 above), and I am instructed that the State of Kuwait is ready to enter into such contract if requested to do so. Since, as I am instructed, there is no suggestion in the present Reference that the undertakings of the present Government of Kuwait cannot be relied on, the Commission should in my view conclude that any indication on its part that it is relevant for its conclusions for the State of Kuwait to bind itself by contract would be equally effective as the present Deed, and would be equally effective to remove any need or justification for an adverse finding in the Reference.

5.1 In my opinion, however, such considerations are unnecessary, since the State of Kuwait is already effectively bound, in a form that can be enforced by injunction in an English court, by the covenants contained in the Deed. So that there is no misunderstanding on the point I should emphasise that (i) the rules of law that lead to the State of Kuwait being bound are general rules of English law and do not depend at all on any provision of the Fair Trading Act or any powers conferred on the Secretary of State or on the Monopolies Commission by that Act; and (ii) the State of Kuwait will be so bound with effect from its execution of the Deed and will continue to be so bound irrespective of the conclusions of the Commission on the Reference or any action taken by the Secretary of State as a result of the Commission's Report on the Reference. It is the fact that the State of Kuwait will be bound in the terms set out in the Deed that, as I understand it, leads the State of Kuwait to submit to the Commission that the terms of the Deed are an important piece of evidence leading to the conclusion that a finding adverse to the State of Kuwait would not be justified in the Reference.

(017A)

Draft/PRESS RELEASE

KUWAIT LIMITS ITS HOLDING IN BP

The State of Kuwait announced today that it had entered into a Deed of Covenant to make legally enforceable various assurances that it has already given to the British Government and during the current investigation by the Monopolies Commission in relation to the holding of the Kuwait Investment Office (KIO) of 21.68% of the issued share capital of British Petroleum plc (BP).

The State of Kuwait has always made clear that the KIO holding is held as an investment only and therefore will not be used in any way that could affect the public interest of the United Kingdom or the interests of BP. The State of Kuwait has fully cooperated with the Monopolies Commission in its present enquiry, and has been advised by its advisers that even without the covenants into which it has now entered there is a very strong case for the Commission to find that the KIO holding in BP is not contrary to the public interest.

However, in order to put beyond doubt that it regards itself as bound by the assurances already given the State of Kuwait has entered into binding covenants, that will be enforceable by the British Government in the British courts, that confirm that its interest in BP is that of an investor only.

It should be stressed that the covenants have been entered into by the State of Kuwait entirely on its own initiative and without any request for such covenants having been made either by the Monopolies Commission or by the British Government. The covenants are binding on the State of Kuwait in perpetuity, and irrespective of the outcome of the Monopolies Commission reference.

The main points covered by the covenants are as follows:

- (a) Kuwait will use its interest in BP only to protect its investment, and not to further any other commercial or political interest of Kuwait.
- (b) Kuwait will not increase its interest in BP beyond the present level of 21.68 per cent. of the share capital of BP, and in the event of Kuwait disposing of any of its shares it will in future limit its interest in BP to 20 per cent. of the share capital of BP.
- (c) Kuwait will, whatever the level of its shareholding, limit its voting rights to 14.9 per cent. of the share capital of BP.
- (d) Kuwait will not seek representation on the Board of BP, and will not oppose the election to the Board of any candidate proposed by the Board.

The Monopolies Commission has been informed of these covenants and they will form part of the evidence considered by the Commission in the current merger reference.

Press enquiries: Mr. J.W. Jeffrey or Mr. M. Walter
(Stephenson Harwood, Solicitors to the
State of Kuwait)

Tel No.: 01-329-4422

(016A)

pel.jo/hcg/minute 5

BC

FROM: H C GOODMAN

DATE: 11 August 1988

PS/EST

cc

Chancellor
Sir P Middleton
Sir T Burns
Mr Lankester
Mr Monck
Mr Scholar
Mr H P Evans
Mr Sedgwick
Mr D J L Moore
Mr Mountfield
Mr Odling-Smee
Mr S J Pickford
Mr S W Mathews
Mr M L Williams
Mr Houston
Mr D Owen
Mr B Morris

✓

OIL PRICES

There has been considerable activity in the oil market in recent weeks and we thought you might find the attached summary and indication of prospects helpful before the summer.

H C Goodman
H C GOODMAN

DEVELOPMENTS IN THE WORLD OIL MARKET

Demand and Supply

THE IEA Secretariat's latest figures for the world oil balance in 1987 and 1988 are shown in Table 1 below:

TABLE 1: WORLD OIL DEMAND AND SUPPLY*

	mbd			forecast for 1988			
	<u>Q1</u>	<u>1987 Q2</u>	<u>Year</u>	<u>Q1</u>	<u>1988 Q2</u>	<u>IAE Secretariat</u>	<u>June WEP</u>
<u>Demand</u>							
OECD	36.3	34.3	35.7	37.5	35.0	36.4	
non-OECD	<u>13.0</u>	<u>12.5</u>	<u>13.0</u>	<u>13.3</u>	<u>12.8</u>	<u>13.3</u>	
Total demand	49.3	46.8	48.7	50.8	47.8	49.7	49.5
<u>Supply</u>							
non OPEC	28.4	28.4	28.9	29.0	29.1	29.2	29.3
OPEC: crude	15.6	16.9	17.7	17.5	18.5) 20.2
OPEC: NGLs	<u>1.7</u>	<u>1.7</u>	<u>1.7</u>	<u>1.7</u>	<u>1.7</u>) <u>20.2</u>
Total supply	<u>45.7</u>	<u>47.0</u>	<u>48.3</u>	<u>48.2</u>	<u>49.2</u>		<u>49.5</u>
Stock change	<u>-3.6</u>	<u>+0.2</u>	<u>-0.4</u>	<u>-2.6</u>	<u>+1.5</u>		<u>. 0.0</u>

* World outside centrally planned economies

2. The IEA has revised upwards by 1.1 per cent its estimate of oil demand in 1988 Q1, this represents an increase of 3 per cent over 1987 Q1. Growth was particularly high in N America and the Pacific but was partially offset by a reduction in European demand due to the mild winter. Demand for 1988 Q2 is expected to be more "normal" and for 1988 as a whole the IEA forecast is 2 per cent higher than 1987. Supply for 1988 is also expected to be up by 2 per cent on 1987.

3. Stock draw for OECD estimated at 1.9 mbd for Q1 1988, this is lower than usual. Preliminary estimates for 1 July show that existing stock levels amount to 99 days forward consumption (an increase of 2 days on 1987) and such levels are not normally realised until late summer. Ironically weak prices now may encourage stock build, which puts further downward pressure on prices later in the year..

OPEC developments

4. The June ministerial conference, as expected failed to agree any reduction in quotas, instead, the current quota system was extended for a further six months. The other main discussion at the June meeting concerned definitions, of condensates and NGLs, OPEC production of these has been steadily increasing since 1983 to the extent that they now amount to about 1.7 mbd of liquids production which is outside, and therefore undermining, the quota system. The meeting failed to decide whether this production should be included in the quotas but instructed a committee of experts to submit proposals on this issue at the next full conference, scheduled for November, where it is bound to provoke further controversy.

5. In July the United Arab Emirates unilaterally announced that it was increasing its quota from 1 to 1.5 mbd. This provoked a price fall to below \$14 pb and ^{provoked} the General Secretary into organising a price monitoring meeting on 3 August. No decisions were taken, but it was acknowledged that OPEC production of 19 mbd was some 2 mbd above the level needed to sustain prices at the

official level of \$18 pb. after the meeting prices which had strengthened to \$ 15.50 pb fell back.

End to the Gulf War

6. The series of announcements on this since Iran accepted the Security Council Resolution No 598 have boosted oil prices, though other factors (described above) have pulled them down intermittently.

7. The immediate effect of the ceasefire will be to raise production and exports, thus:

	<u>Production</u> <u>Q2 88</u>	<u>Capacity</u>	<u>Quota</u>	<u>mbd</u> <u>Expected Rise</u>
Iran	2.2	3	2.3	0.8
Iraq	2.6	4	[2]	0.4

Despite this prices have risen, because of the expected rapprochement between Iran and Saudi Arabia. Renewed political commitment to OPEC may enable it to operate more effectively in the medium term. The ending of the war will also mean the question of formalising Iraq's quota - in practice 2 mbd - is tackled, which may have knock-on effects on other members, in particular Venezuela. At the extreme, boosts in output could lead to an overt battle for market share that might quickly bring prices down. This might be tolerated by Iran and Iraq for whom scope for higher production is easiest. Oil analysts' views over the price outlook for the next 6 months differ widely, but the market is fundamentally weak. Spot Brent prices are standing around \$15 pb which makes the June WEP forecast of \$16 pb for the second half of 1988 a little on the high side.

8. The Piper Alpha disaster is not expected to have any discernable effect in the medium term as lost production is more than offset by OPEC increases.

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FM KUWAIT
TO ROUTINE FCO
TELNO 341
OF 290835Z AUGUST 88

AMENDED DISTRIBUTION 30 AUGUST

MY TELNO 384: BP/KIO

1. WHEN I SAW THE HEAD OF THE KUWAIT INVESTMENT AUTHORITY ON 28 AUGUST ON OTHER BUSINESS, I TOOK THE OPPORTUNITY TO CHECK THAT THE KUWAITIS WERE NOT PUT OUT BY THE WAYS IN WHICH WE HAD DEALT WITH THEIR COVENANT. FAHED AL RASHID SAID THAT THEY QUITE UNDERSTOOD WHY WE HAD ACTED AS WE DID. THEY WERE NOT AT ALL UPSET.

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MR MUNRO
SIR D MIERS

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PS/CHANCELLOR

D MOORE, HMT
MR WHOMERSLEY LEG ADV

NNNN

mp

FROM: C J JARVIS
DATE: 31 AUGUST, 1988

MR FLITTON

cc P/S Chancellor
P/S Financial Secretary
P/S Sir Peter Middleton
Mr Monck
Mr Peretz
Mr Moore
Mrs Brown
Mr Bent OR

BP SECOND INSTALMENT

I attach a line to take and background note for possible press questions on the collection of the BP second instalment.

C. J. Jarvis

C J JARVIS

COLLECTION OF SECOND INSTALMENT ON BP SHARES: LINE TO TAKE
FOR PRESS OFFICE, 31 AUGUST, 1988

Q. How much of the money due for the BP second instalment has been collected?

A. About 98% of the money due has been collected. We expect to receive over half of the remaining sum today.

Q. Will you accept late payments?

A. Late payments will be accepted if they are sent in straight away. Interest may be charged on late payments at the Government's discretion. If any holders of partly paid shares need more information they should call National Westminster Bank on 0272 306666.

IF PRESSED

Q. How many shareholders have so far failed to pay their second instalment?

A. We have not yet received payments from about 25,000 shareholders (almost all smaller shareholders). Some payments may be delayed by the postal strike, and we will take the strike into account in deciding when to stop accepting late payments.

BACKGROUND NOTE

The total sum due on the BP second instalment is some £2,232 million. Of this some £1,874 million was due from holders of partly paid shares yesterday. The total received so far is £1,853 million.

2. A further £358 million is due to be paid today by Morgan Guaranty, in respect of sums collected from holders of ADRs.

3. The total sum still outstanding is therefore around £21 million. National Westminster Bank have already been notified by some large holders that they expect to make payment, with interest, on over half of this sum in the course of today.

4. There may also be some press interest in adverts placed by Guaranty Nominees in some newspapers. PE should be consulted on any questions about this. The general line is that this is a matter for Guaranty nominees, but there may be some questions which we should answer ourselves.



Inland Revenue

Policy Division
Somerset House

FROM: P W FAWCETT

DATE: 6 SEPTEMBER 1988

1. MR HOUGHTON *Me 6/9.*
2. MR ISAAC *AL.*
3. FINANCIAL SECRETARY

*BF 8/9*UNION TEXAS PETROLEUM CORPORATION V. CRITCHLEY

1. We minuted Ministers on 18 and 28 March and on 10 May about the case of Union Texas Petroleum Corporation v Critchley on which we have been waiting for a decision from the High Court for over two years. Judgment was given on 31 August (exceptionally in the vacation because of the delay, we believe). The Revenue won on the main point (which involved in this case some £23 million) but lost on a subsidiary computational point (which involved in this case about £1 million). Costs were awarded against the Revenue. I attach a copy of an article in the Financial Times of 1 September on the case.

The facts of the case

2. I set out the background to the case in my minute of 18 March. The facts are very briefly as follows.

c PS/Chancellor
PS/Financial Secretary
PS/Economic Secretary
Sir Geoffrey Littler
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Tyrrie
Parliamentary Counsel

Mr Isaac
Mr Miller
Mr Houghton
Mr Johns
Mr Cleave
Mr Bush
Mr Phalp
Mr Fawcett
Mr Alderman
Mr Steele
Mr Richardson
Mr Bolland
PS/IR

3. Under our interpretation of the UK/US double taxation convention a US company which controls 10% or more of the voting stock of a UK company is entitled to payment of half the tax credit that a UK resident individual would receive from a UK company less 5% of the aggregate of the dividend and the half tax credit. Individuals resident in the US and other US companies are entitled to payment of the full tax credit less 15% of the aggregate of the dividend and the tax credit. There is no doubt that this was the basis on which the convention was negotiated and this interpretation was accepted by the US authorities.

4. Union Texas - a US corporation - controls more than 10% of the voting stock of a UK subsidiary Union Texas Petroleum Limited and challenged our right, when making payment, to deduct 5% tax from the dividends and the half tax credit in respect of the dividends paid to it by Union Texas Petroleum Limited. We won the case before the Special Commissioners in March 1985 and Union Texas' appeal against this decision was turned down by the High Court on 31 August. This was the main point to which I referred in paragraph 1 of this minute.

5. The subsidiary point on which we lost turned on the wording of the convention: the UK/US convention refers to 5% of the aggregate of the dividend and the half tax credit paid to companies and the Judge said that the Revenue operated this provision on the footing that paid meant payable. The result of this was that Union Texas was getting a rather smaller tax credit payment (about £1 million) than it was entitled to.

6. As of now, we propose appealing against the decision on the subsidiary point but will make a final decision when we know whether Union Texas are appealing on the main point.

Other cases

7. I mentioned in earlier minutes that we had received 300 protective claims to payment from other taxpayers, and also some writs. The first of these cases is to go before the Special

Commissioners in November when the latter will be bound to follow the High Court judgment.

8. We estimate that the total tax involved in this matter is some £1.2 billion on the main and subsidiary points together, of which some £68 million relates to the subsidiary point alone. This is a cumulative total to date and the future annual cost on the subsidiary point could be in the region of £15 million a year.

Remedial action on the subsidiary point

9. Our present intention (subject to the appeal decision of Union Texas) is to appeal against the decision on the subsidiary point, although our Solicitor advises that we have perhaps less than a 50-50 chance of winning. The potential loss to the Exchequer on this point is some £68 million to date plus an extra £15 million a year. It is clearly right that Union Texas should keep any fruits of victory they may ultimately win but we believe that there is no case for other taxpayers who have joined the bandwagon getting a windfall gain of this kind. In addition, we think that the Judge's formula for calculating the payment is complicated, and we believe that it would create unnecessary problems for both taxpayers and Revenue.

10. One option would be to approach the US with a view to renegotiating the convention (the wording on which we lost the subsidiary point is peculiar to the US convention - the US convention was the first convention with such a dividend article). We are frankly extremely reluctant to do this because our experience with the US suggests that, although we would be merely seeking to restore the position to what it was understood to be by both the UK and the US, the US would almost certainly try to exact some price for this in the form of concessions in other fields. Also, a renegotiated agreement would not restore the position retrospectively without Finance Bill legislation.

11. The situation we are in is therefore not very different from that of a couple of years ago with the Padmore case. Ministers

agreed to legislate in that case, because of the substantial windfall tax at stake. We would, again, ordinarily wish to exhaust the legal remedies, going if necessary to the House of Lords, before seeking legislation to repair a possible defect exposed by a decision of the High Court. However, in all the circumstances we would advise Ministers to make an announcement by Parliamentary Answer as soon as Parliament returns (and before the first other case comes before the Special Commissioners in November) to the effect that the Government proposed to put the position beyond doubt with retrospective effect in the next Finance Bill. Any legislation would need to cover cases where 15% was deducted also (see paragraph 3 above).

12. We considered whether a statement of intention to legislate in the event that the Revenue ultimately lost on the point but without a definite date for such legislation might be sufficient, given that if Union Texas were to win on the main point in the higher Courts, it might be necessary to have a second lot of "Union Texas" legislation in a later year. We would however recommend against this on the grounds that any announcement of this kind - on the embarrassingly stark terms that the Government intended to legislate if it lost in the Courts - would be seen as holding a gun at the Courts.

13. We would imagine, subject of course to the views of Parliamentary Counsel, that the legislation would be fairly short, probably less than half a page.

Objections to legislation

14. The main objections to legislation would be retrospection and treaty override.

15. On retrospection, Ministers could argue that the position was on all fours with the Padmore legislation, and that it was unreasonable that claimants other than the company which initiated the court action should have a windfall gain at the expense of the general body of taxpayers.

16. On treaty override, Ministers could argue that the legislation was merely restoring the position to what it was thought to be by the two parties to the treaty when it was negotiated. The difference from the Padmore legislation is that that legislation affected only UK taxpayers whereas this legislation would affect US taxpayers. We would, of course, need to explain to the US what we were doing at the time of the announcement. We are presently engaged with other OECD Members in a paper on treaty override but we believe we could defend our action in that forum.

Conclusion

17. We therefore seek your agreement to an announcement by Parliamentary Answer, as soon as Parliament returns, that the Government intends to bring forward legislation in next year's Finance Bill to clarify the position of the tax deductible from tax credit payments in respect of dividends paid to US companies, following the decision in Union Texas in the High Court. We further recommend that the legislation should have retrospective effect (paragraphs 9 and 11). We expect that it would occupy no more than half a page (paragraph 13).

18. We are, of course, at your disposal if you would like to discuss.

P W F

P W FAWCETT

Union Texas loses £23m appeal over tax

By A.H. Hermann and Richard Waters

18

THE INLAND Revenue won an important tax case in the High Court yesterday when Union Texas International Corporation lost its appeal against tax deductions from dividends paid to it by its UK subsidiary.

The US company's claim in respect of deductions made in the period 1981 to 1985 amounted to about £23m.

However, the potential threat to the Inland Revenue was much greater. A successful appeal would have been followed by similar claims by other US companies which, according to official estimates, could have exceeded £1bn.

However, Union Texas won its argument that the calculation of withholding tax was wrong and was awarded £1.3m. This has opened the door for similar claims totalling about £50m from US corporations in a similar position.

Inland Revenue officials seemed pleased with the decision. Clifford Chance, the London firm of solicitors acting for Union Texas, could not say whether there would be a further appeal.

The decision, which turned on the interpretation of the UK-US double tax agreement, took Mr Justice Harmond two

years to reach.

He said he changed his mind several times during the hearings in July 1986 and during the two years he considered the judgment. He reached a conclusion during the court's summer recess and interrupted his holiday to read his reserved judgment.

The difficulty of the case appears to have been purely of linguistic nature.

The double tax agreement combines the drafting techniques of the two delegations which produced it.

It does not lend itself easily to the strictly logical, grammatical interpretation usually applied to the UK's finance acts.

The Union Texas claim, presented by Mr C.R. Bretten, QC, relied on the literal, strictly logical interpretation of the agreement.

The term "tax credit" was given more than one meaning in the agreement and the taxpayer could be assessed for tax only on the basis of the plain meaning of the statute.

Therefore Mr Bretten argued that the term "tax credit" could not be taken as meaning tax credit within section 86 of the 1972 Finance Act and that,

consequently, no authorisation for deduction from the dividends to the US company could be found either in the agreement or in the finance acts.

The judge rejected this method of literal interpretation as Union Texas was neither a UK taxpayer nor a British subject.

"The life of the law was not logic, but experience," he said.

The interpretation given to the agreement by the counsel for Union Texas would make its provisions relating to tax credits meaningless.

It was better for a clause to have effect than to be interpreted in a way which made it void, the judge said.

In addition to removing the threat faced by the Revenue in this case, the purposeful method of interpretation - trying to follow parliament's intention rather than the draftsman's text - adopted by the judge creates an interesting precedent for future cases involving double tax agreements.

While Union Texas lost on the main point, its appeal was allowed on a second minor claim concerning the calculation of the 5 per cent deduction from the sum of dividend and

tax credit paid.

It was found that the Revenue had deducted about 0.2 per cent more from dividends paid to the US than was provided for in legislation - totalling £1.3m in Union Texas's case. This means that the Revenue could be forced to repay 0.2 per cent of all dividends which have been paid by UK subsidiaries to their US parents since 1982, amounting to an estimated £50m.

Tax advisers said US clients which had received substantial dividends from the UK had been waiting anxiously for the decision.

The amount at stake would have been far larger had companies been allowed to reopen assessments for tax years where agreement had already been reached with the Revenue.

Section 33 of the Taxes Management Act provides for cases to be reopened where an error or mistake has occurred.

However, this does not apply in cases where a tax return was made on the basis of practice generally prevailing at the time. This is thought to rule out any reopening of assessments under the Union Texas judgment.

1/9



The 2 KIO stamps
are well worth
reading. ~~Read~~

The first one, in particular,
tho' no doubt inaccurate
in parts, contains a great
deal more info relevant
to the KIO/BOP affair
than has been used for
HM Ambassador's or the FCO.
POM SLJ was it.

XL

chex.ps/aa/19

UNCLASSIFIED



FROM: A C S ALLAN *pyg*

DATE: 9 September 1988

MR D J L MOORE

cc Sir P Middleton
Sir G Littler
Mr Monck
Ms Goodman

KIO AND KIA

The Chancellor saw the two attached articles in Institutional Investor for August 1988, which he thought were well worth reading. The first one, in particular, though no doubt inaccurate in parts, contains a great deal more information relevant to the KIO/BP affair than we ever received from HM Ambassador or the FCO.

ACSA

A C S ALLAN -

The struggle over Kuwait's money machine

Kuwait's oil and finance ministers are bitterly at odds over how the Kuwait Investment Office should be managed. At stake: \$100-plus billion.

BY KEVIN MUEHRING

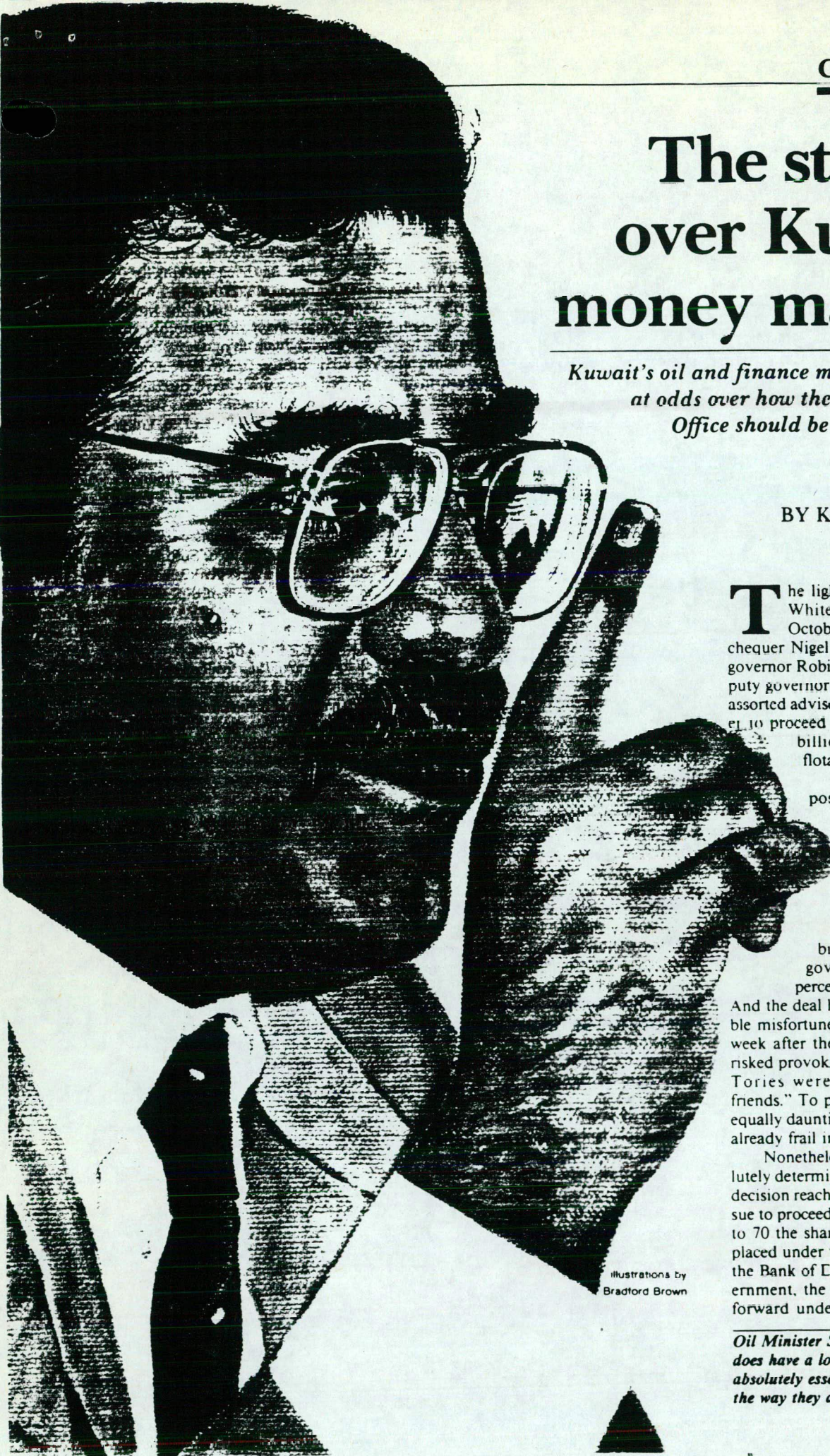
The lights were burning bright in Whitehall late into the evening October 29. Chancellor of the Exchequer Nigel Lawson, Bank of England governor Robin Leigh-Pemberton and deputy governor George Blunden as well as assorted advisers were deliberating whether to proceed with or postpone the £7.2 billion British Petroleum Co. flotation.

Theirs was not an enviable position. The U.K.'s largest ever privatization — and the centerpiece of Prime Minister Margaret Thatcher's campaign to promote participatory capitalism — the BP offering involved some 2.2 billion shares representing the government's remaining 31.8 percent stake in the oil company. And the deal had suffered the unimaginable misfortune of being scheduled for the week after the crash. Yet to postpone it risked provoking opposition cries that the Tories were bailing out "rich City friends." To proceed, however, posed the equally daunting prospect of undermining already frail investor confidence.

Nonetheless, the chancellor was absolutely determined to go ahead. The crucial decision reached that night allowing the issue to proceed was to lower from 90 pence to 70 the share-support scheme, or floor, placed under the 120 pence issue price by the Bank of England. For the British government, the momentous decision to go forward under these terms appeared, at

Illustrations by
Bradford Brown

Oil Minister Sheikh Ali: "Yes, the KIO does have a lot of autonomy. But it is absolutely essential for them to operate the way they do and as well as they do"



first, to have turned a potential financial debacle into a political triumph.

For Sheikh Fahd Mohammed al-Sabah, chairman of the Kuwait Investment Office, meanwhile, the adoption of the 70 pence support level triggered an equally momentous decision of a quite different sort. "Can you tell me when the shares of a major company were for sale at such a depressed price?" asks Sheikh Fahd's general manager at the KIO, Fouad Jaffar, recalling the meeting at which the KIO chairman divulged his idea of buying, and buying big, in BP.

It took Sheikh Fahd and Jaffar all of fifteen minutes to decide to proceed. The pair then embarked on one of the most spectacular raids ever staged in the international equity markets. With hardly a pause in the four months following that fateful October 30 meeting, the KIO relentlessly pursued its target, lifting entire blocks of unwanted shares from shell-shocked underwriters and steadily snapping up more partly paid BP shares in the open market. The KIO, ignoring successive British government intimations of "discomfort," finally halted its buying binge in late March, having by then amassed a £3.8 billion, 22.5 percent stake in Britain's premier company and the world's third-largest oil company.

Raging debate

This breathtakingly bold maneuver was to have unintended consequences of a global import: It soon embroiled the ordinarily low-profile KIO in a major political and diplomatic uproar — and raised questions both abroad and in Kuwait about exactly what the KIO perceived its mission to be. Embarrassed Tory officials — "Don't let BP become KP," the Labour Party's shadow chancellor, John Smith, had exhorted to great effect — and extremely nervous BP executives worried over the ramifications of the KIO's investment: Were the Kuwaitis merely passive investors or were they hard-bitten arbitrageurs planning to put the shares into play by selling their block to the highest bidder, perhaps a rival oil company?

Even worse, might the KIO be a stalking horse in what would turn out to be the biggest and most brazen takeover ever attempted by the Kuwait Petroleum Corp.? Furious at the Ku-

Finance Minister

al-Kharafi: "We must be careful that our investments are based on a system, not personal whims. If there is a difference, then there will be a war"



waitis for ignoring a series of diplomatically coded warnings to stop their purchases well below the 20 percent level. Her Majesty's government determined that an issue of public interest was involved and referred the KIO stake to the Monopolies and Mergers Commission on May 4.

The British were not alone in seeking to unmask the KIO's true intentions. Many in Kuwait, including the KIO's purported masters, were wondering about them as well. Indeed, the BP raid, the subsequent referral of the stake to the monopolies commission and, to a lesser extent, the KIO's massive foray into Spain (see page 57) added fuel to a heated dispute back home over who has ultimate authority over Kuwait's vast investment portfolio — estimated at some \$100 billion-plus. Though the disagreement has assumed many shapes and forms, at its core is the remarkable autonomy of the KIO from its ostensible overseer, the Kuwait Investment Authority, and the rivalry between Finance Minister Jasem al-Kharafi, the KIA's chairman, and Oil Minister Sheikh Ali Khalifa al-Sabah, its deputy chairman. How this central policy issue is eventually decided — much will depend on how Kuwait fares in the BP matter before Britain's Monopolies and Mergers Commission — is bound to have a major impact on the KIO's investment policies and thus on the many companies and countries in which it invests.

Impulsive soloist

"The KIA manages, on behalf of the Kuwaiti government, all its surplus funds," asserts KIA managing director Fahd al-Rashed. "The final and ultimate authority over all investments lies with the board of directors of the Kuwait Investment Authority. And the board of directors is responsible for setting policy, priorities and investment strategies." And the KIO, he adds, reports to the KIA.

Nevertheless, as the BP raid so dramatically established, the KIO does not play anything remotely resembling the passive role in managing Kuwait's foreign investments that al-Rashed implies. The KIO's Sheikh Fahd and Jaffar pumped nearly a tenth of Kuwait's Western assets into a single stock without ever bothering to receive a green light from the KIA — or even bothering to ask for one, for that matter. Throughout the BP affair, al-Rashed and KIA chairman al-Kharafi were kept at the margins by the KIO, according to a well-placed Kuwaiti source, the pair first heard about the BP stake more than a week after the share buying began, when Sheikh Fahd called them a few hours before the British newspapers reported market rumors of a KIO stake nearing 5 percent. "The KIA still has authority with local investments and those in the Arab world," contends Jasem al-Sa'adoun, head of the al-Shall Economic Consultancy. "But as far as the foreign in-

vestments are concerned, the real power and authority is with the KIO."

Essentially three things enable the KIO to behave in its high-handed manner: its relative longevity (it actually predates the KIA by some two decades); a phenomenal investment track record; and, many Kuwaitis assert, the behind-the-scenes patronage of Sheikh Ali. "Yes, the KIO does have a lot of autonomy," conceded Sheikh Ali during an interview at the last OPEC meeting in Vienna. "But it is absolutely essential for them to operate the way they do and as well as they do. We do not want to be making all their decisions for them."

Indeed, Sheikh Ali belatedly learned of the KIO's BP stake the same afternoon as al-Kharafi and al-Rashed. And though he may in fact have begun to mull over the possibilities of a Kuwaiti stake in BP well before that, to suggest that he ordered the KIO to buy into the British oil company mistakes his relationship with the KIO's Sheikh Fahd. It is based on mutual admiration and a common philosophy, not on the fealty due a superior by a subordinate. "We are 100 percent independent of the [Kuwait Petroleum Co.]," insists Jaffar. "Frankly, though, we would have been worried if Ali was not in favor of the deal." Adds another Kuwaiti who knows both Sheikh Ali and Sheikh Fahd well: "Ali would have never simply called Fahd and said, 'Do this.' As a point of pride, Fahd would have told him to go to hell."

The oil minister is comfortable delegating authority to those whom he trusts and admires, and that select group includes the KIO's Sheikh Fahd and Jaffar. Indeed, their move into BP is exactly the type of decisive action that would appeal to Sheikh Ali, for his own style is to act boldly, untempered by self-doubts. "Ali is very able, very intelligent, but he is also very impulsive. He is a soloist who would never accept playing in the orchestra," suggests a former Kuwaiti minister who knows him well. Sheikh Ali's intellectual grasp of both the oil and financial markets is unparalleled in Kuwait, which may help explain why he has a penchant for encroaching on the territories of other ministers. His more extreme inclinations, say critics and even many supporters, need to be checked.

Multilayered conflict

In the case of Kuwait's foreign investments, that check is likely to take the form of Finance Minister al-Kharafi, who makes a formidable political adversary for Ali. "We must be careful that our investments are based on a system, not personal whims," al-Kharafi remarked during an interview in his third-floor office suite at the Finance Ministry. To the finance minister, the KIO is not an independent entity at all but very much "an arm of the KIA." As one of the authority's earliest promoters, he believes strongly in this. Accord-

ingly, al-Kharafi says, he will henceforward play a more prominent role in overseeing the KIO, providing "a conservative anchor" to its foreign investment policies. "It is a matter of principle, not personalities," he says in a thinly veiled reference to Sheikh Ali. "If there is a difference, then there will be a war."

Al-Kharafi's comment notwithstanding, it would be easy to dismiss the pair's dispute as a personality clash between ambitious, strong-willed politicians, and certainly there's an element of that present. But their differences go much deeper, into the very texture of Kuwait's delicately balanced, multilayered society. Theirs, after all, is also a clash between a member of the al-Sabah family (Sheikh Ali), which has ruled over Kuwait for more than 200 years, and a member of one of Kuwait's wealthiest merchant families, which have long vied for power and influence over Kuwait's economic and financial affairs. Fundamentally, too, the two ministers' rivalry reflects a power struggle between their respective ministries — finance and oil.

The stakes in Finance Minister al-Kharafi's "war" are not insignificant. Although OPEC's great surpluses have steadily declined because of shrinking oil revenues and ambitious spending on development and welfare projects, astute investing by Kuwait — notably an aggressive push into the world equity markets — has caused its paper wealth to mushroom to \$94 billion, according to semiofficial estimates by the National Bank of Kuwait. And even that mind-boggling sum considerably understates the riches' true value. As one KIA official points out, most of the real estate holdings are booked at cost rather than their current market value; moreover, Kuwait's extensive holdings of convertible bonds and of bonds with warrants are recorded at their nominal value rather than that reflecting the value of the underlying equity.

A more accurate tally of Kuwait's financial assets would put them closer to \$116 billion, according to a well-placed Kuwaiti source. Even an estimated \$5 billion in paper losses in October's crash hardly shrank the pile. (The KIO was both reasonably liquid and in defensive stocks at the time. "We decided the stock markets around the world were top heavy," says Jaffar. "So we were net sellers of equity in 1987.")

Kuwait's \$100 billion-plus nest egg is split unevenly between two main accounts. The first, the State General Reserves, totals about \$34 billion, and only about one fifth of that — some \$6 billion — is invested in the West. It's mostly managed directly by the KIA or through Western banks reporting to it. The great bulk of the wealth has remained at home, much of it invested in such illiquid assets as Kuwait Airways, the Kuwait Petroleum Corp., the Kuwait Fund for Arab Eco-

conomic Development and a handful of other government organizations. In addition, Kuwait has placed some of the state reserves on deposit with Kuwaiti banks and made cash loans to Iraq and other Arab countries.

Tax-free

It is the second of the two accounts that constitutes Kuwait's glittering prize. That is the \$86 billion Reserve Fund for Future Generations, which is invested almost entirely in the industrialized economies and mostly managed by the KIO in London. Established at the instigation of Sheikh Jaber al-Ahmed al-Sabah, the present emir, the RFFG was endowed with \$3 billion in 1976 and every year since has been the beneficiary of at least 10 percent of the country's oil revenues. In the petro-boom years of the early 1980s, the fund was topped up with an extra \$3 billion in oil revenues above and beyond the decreed 10 percent. Even as the investment income of the state general reserves and \$7 billion of that account's assets were being liquidated to help Kuwait meet budget shortfalls, the RFFG was rising steadily in value, from \$37.1 billion in mid-1984 to more than \$60 billion (by grossly understated official estimates) this summer. "Legally, the reserve fund cannot be touched," explains Sheikh Salem Abdul Aziz al-Sabah, governor of the central bank and a member of the KIA board. "Ten percent of the oil revenues, regardless of the [government's] deficit, and all dividend and capital gains must be reinvested in the fund until the year, I think, 2001."

Equity forms "the core" of the RFFG's portfolio, comprising "just over half" the total, according to the KIO's Jaffar. The approximate sum in stocks: \$47.3 billion. Other reliable estimates put some \$25.8 billion of the remaining RFFG funds (which are in both KIO and KIA accounts) in bonds, convertibles and warrants, a further \$4.3 billion in cash and about \$8.6 billion in direct or property investments. Only one third — some \$28.3 billion — is invested in the U.S. and Canada (counting U.S. and Canadian dollar Eurobond holdings). Japan accounts for one fifth, or \$17.2 billion. It's followed by the U.K., with \$16 billion; Germany, with \$8.6 billion — the Kuwaitis began selling their German assets in 1985, according to a KIA board member; and Spain, with \$2 billion, all of it invested since 1986. The remainder — some \$13.9 billion — is in Kuwait, with some funds scattered around Southeast Asia, the rest of Europe and the Arab world.

The evolution of Kuwait's foreign investments and the decision-making process that shapes its strategy provides a clue as to why Sheikh Ali and al-Kharafi are at odds. For most of the decade following the first oil price hike in 1973 (Kuwait's annual surplus soared from \$300 million to

\$6 billion by 1974), the country's foreign investments were largely managed by Khalid Abu Su'ud, the Palestinian-born, trusted adviser to Emir Jaber, and by the minister of finance and oil, Abdul Rahman al-Ateeqi. But they allowed considerable discretion in supervising investments to Sheikh Fahd and Jaffar at the KIO, which had been formed roughly ten years before out of the old Kuwait Investment Board. (The KIB had been managed by Khalid al-Ghanim, the former Kuwaiti ambassador to Britain, and by Jaffar's father; because it, and subsequently the KIO, evolved from the £200 million personal bank account at the Bank of England of the then-emir, Sheikh Abdulla, the KIO to this day is allowed to use nominee accounts — and is exempted from U.K. dividend and capital gains taxes.)

Prior to 1974, most Kuwaiti investments were in safe, low-yielding gilts and U.S. Treasuries. Only occasionally would the Kuwaitis dabble in equities or non-sterling or -dollar assets through international investment trusts managed from London. Abu Su'ud and al-Ateeqi, however, began that year to steer more Kuwait foreign investment into dollars and deutsche marks — for instance, the Kuwaitis spent Dm1 billion for a 24 percent stake in Daimler-Benz in 1974. More money was also channeled into equities and property. In London, meanwhile, the KIO became more aggressive, making what Jaffar calls its "first public act": a successful £400 million battle against Commercial Union for St. Martins Property.

Diversification

By early 1982 slightly less than two thirds of Kuwaiti investments were still in the U.S., a wide scattering of equity stakes in major companies mostly kept below the 5 percent level that would have required disclosure. But the Kuwaitis had already begun diversifying out of dollars into deutsche marks and, especially, into yen. Soon after the second

oil price escalation, in 1979 and 1980 the KIO began taking sizable stakes in most of the leading Japanese companies, such as Hitachi, Toshiba, Mitsubishi and several pharmaceutical concerns. The KIO restructured its Japanese portfolio in 1986. "We have stayed in yen, but we got out of the stock market last year, moving into bonds or defensive stocks, such as companies with strong domestic sales," reports Jaffar.

Gathering political forces inside Kuwait, meanwhile, were to effect changes in the decision-making process by 1982. Influential National Assembly deputies felt the KIO was far too secretive and, moreover, that the RFFG, in particular, should be held more accountable to the body designated to represent the Kuwaiti public — that is, the National Assembly. At the same time, Kuwait's then-new finance minister, Abdul Latif al-Hamad, the Harvard-educated scion of one of the great merchant families, was anxious to "modernize" the ministry's procedures and coordinate oversight of Kuwait's disparate investments. Though the KIO itself handled the bulk of the reserve fund's investments out of London, major portfolios were then being handled by a dozen or more fund managers in all the major markets. Among them: Citicorp, Bank of America, Chase Manhattan, Commerzbank, Deutsche Bank and Union Bank of

Former finance minister al-Hamad: His attempt to impose order on Kuwait's ad hoc investment approach — and exert control over the KIO — fell victim (as did he) to the souk al-manakh crisis



"As far as the foreign investments are concerned, the real power and authority is with the Kuwait Investment Office."

Switzerland. Other than having to work within broad guidelines as to acceptable risk — and keep Kuwait out of the headlines — managers were pretty much on their own, subject only to loose review. Kuwait's central bank, the Finance Ministry's own investment department and government-controlled investment banks were also investing abroad for their own account.

Unacceptable accountability

To bring coherence and control to this essentially ad hoc system, al-Hamad and the four parliamentary deputies reached a compromise and united to win cabinet approval for establishment of the KIA in late 1982. Investment activities were to be consolidated under the KIA, which would be chaired by the finance minister. Though he was to have considerable discretion in managing investments, he was to be directly accountable to Parliament in money matters. The dean of the faculty of commerce, economy and political science at Kuwait University and a former deputy director general at the Social Security office — Fahad al-Rashed — was named to a four-year term as the KIA's managing director. "There [had been] a lot of duplication and a lack of coordination," al-Rashed explains. "We wanted to improve and enhance cooperation and coordination for the sake of better performance."

There was tacitly a limit, however, to how much the KIA could hope to tinker with the KIO's decision making. For a start, Sheikh Fahd and Jaffar were never particularly impressed with their new overseer and put up determined resistance through bureaucratic foot-dragging when the KIA sought to meddle too obtrusively in the KIO's affairs. Meanwhile, bureaucratic inertia set in at the Finance Ministry, where staff members chafed under al-Hamad's wrenching, American-style management upheavals. And, within the cabinet, forceful arguments against the KIA's exercising too much authority over the KIO were being put forward by Sheikh Ali. "Ali just never accepted the idea of accountability to the Parliament," says one former cabinet member. "Sometimes I think Ali will feel insulted if you ask him the time of day." In any event, the minister was hardly persuaded by the more radical deputies' demands that Kuwait shift its investments out of the "imperialist West" into the Arab "brother" states, the third world and the East Bloc.

Whatever countervailing pressure al-Hamad might have brought to bear to bring the KIO within the KIA orbit was nullified by the *souk al-manakh* crisis,

which finally boiled over in the summer of 1982. The calamity preoccupied the finance minister, eventually costing him his job. As it happened, he was succeeded by KIO-booster Sheikh Ali, who combined the oil and finance portfolios. He lost little time in loosening the links between the KIO and the KIA, creating tensions between the two institutions that persist to this day.

The bad feelings have been considerably exacerbated by more recent events, however. When Sheikh Ali left the Finance Ministry in late 1985, he was succeeded by al-Kharafi — who had been one of the four parliamentary deputies who had helped al-Hamad shape the law establishing the KIA. He plainly still feels the KIO needs to be brought to heel.

Over at the KIO, meanwhile, there is disdain for what is seen as a grave lack of professionalism at the KIA. It's an opinion many outsiders share. "The KIA are nice people, but they are not in the same league as the KIO," says one British official well acquainted with both organizations. The KIO is more comfortable with market risk and smarter about market timing; no doubt the fact that the KIO vests decision-making authority in typically two and never more than five managers helps account for this market savvy.

"Our London arm"

The KIO's more flexible, market-tuned style can strain against the KIA's broad top-down asset-allocation approach, which relies on collective decision making. "The most important and relevant overall issue today is the allocation of the assets, be it in cash, bonds or the equity of the various countries, as well as currency considerations. It is primary; everything else is secondary," says KIA managing director al-Rashed. At least once a month an investment committee consisting of al-Rashed, the heads of the KIA's seven investment departments, one or two outside advisers and the KIO's Jaffar reviews market trends, investment recommendations and asset-allocation models.

Once it settles on its recommendations, the committee submits them to an executive board of the KIA and on to the KIA's board of directors, whose nine members include chairman al-Kharafi and deputy chairman Sheikh Ali. Central Bank governor Sheikh Salem also sits on the board, as does Finance Ministry undersecretary Abdul-Mohsen al-Hunaif, the KIA al-Rashed and KIO chairman Sheikh Fahd. Three members from the private sector round out the complement. The board usually meets monthly (at the very

least quarterly) in a small office next door to al-Rashed's office, from which then emanate instructions on risk parameters and diversification guidelines for twenty or so Western fund managers — and, asserts al-Rashed, for "our arm in London, the KIO."

Such an arrangement works well for the most part. But the KIO's Jaffar clearly believes there can be, and are, exceptions to the rule. "We are not so rigid," he says of the KIO's own style. "What are you going to do when a great investment comes along? Say 'gee, that is a good investment, but, oh dear, I will have to wait until our next quarterly meeting.' Yes, we have a broad plan, but we will take an opportunity when it arises." That, of course, was nowhere more apparent than with the BP raid.

But just as the KIO's relationship to the KIA is a sensitive issue, so is Sheikh Ali's relationship to the KIO. It certainly extends beyond his role as KIA deputy chairman, for the oil minister's association with the KIO is undeniably a close and fond one. He and Jaffar are good friends — Jaffar's brother, Faisal, used to work with Sheikh Ali at the Oil Ministry, and KIO general manager Sheikh Fahd is a first cousin.

Perhaps more important, the three share a common style and a guiding philosophy. Sheikh Ali admires the KIO's impressive record of performance and trusts its senior officers' independent judgment. "You better be able to justify a decision, but you have to do so only after, not before, the fact," he says. He does not harbor the same sort of admiration for al-Kharafi and the KIA.

The feeling is assuredly mutual, and in al-Kharafi's case the low regard is tinged with mistrust. The finance minister still suspects ulterior motives on the part of Sheikh Ali and the KIO in the BP share purchase. In fact, the underlying logic of the deal may go well beyond that of a mere investment, as al-Kharafi suspects. BP needs long-term access to crude oil, and Kuwait has plenty of it. The Kuwaitis, in turn, need the sort of excess refining capacity and direct distribution in the main consuming countries that BP possesses; a fundamental goal of KPC's long-term oil diversification policy is to go "downstream" from production into refining and distribution.

Indeed, oil analysts see the Kuwaiti move downstream as a long process toward a reverse integration of the oil industry in which a handful of oil producers (the Saudis and Venezuelans are embarked on the same course) will once again control the industry from the well-

Ali is very able, very intelligent, but he is also very impulsive. He is a soloist who would never accept playing in the orchestra."

head to the gas station in the style of the Seven Sisters. As it is, Kuwait can pump its entire 980,000 barrel-per-day OPEC production quota without cutting its posted prices or offering discounts because a third of the production is distributed through its own network and another third as refined products, which are outside the bounds of the OPEC agreements.

Profit strategy

The Kuwaitis' strategy — a so far successful one — is to capture the profit margins on both downstream and upstream ends of the oil market. "When you are making a lot of money upstream, it usually means the margins downstream are pretty thin. And of course the reverse tends to be true," notes Sheikh Ali.

Nonetheless, he is adamant in insisting that "there is no link whatsoever" between Kuwait's diversification into refining, direct marketing and distribution and its investment portfolio, which is to provide the state with income after the oil is gone. "The two are parallel but unrelated," he stresses.

That may be crystal clear in Sheikh Ali's mind, but it does not appear to be in Finance Minister al-Kharafi's. Already uneasy over the KIO's \$2 billion foray into Spain, al-Kharafi felt the KIO had definitely overstepped its mark with BP. That such a large stake was committed to a single stock — and to an oil company no less — not only undercut his credibility as KIA chairman, he seems to believe, but also challenged the fundamental principles behind the founding of the reserve fund. "Diversifying out of oil is the most important aspect of our foreign financial investments," al-Kharafi argues. "It doesn't mean that we should not concentrate on our downstream policies — I agree with my colleagues on that point. But the Kuwait Petroleum Corp. has its own investments. The RFFG should not participate in oil market investments, because it was put there as an alternative to oil to reduce our dependence on it."

Sheikh Ali, in the course of a broad-ranging conversation, dismisses this argument, suggesting that al-Kharafi bases it on a misunderstanding of the memorandum establishing the RFFG. It did not forbid investments in the oil industry. Sheikh Ali contends, only in oil operations *inside* Kuwait. "It would be impossible for the investments in the reserve fund not to be affected by the oil market because *everything* is impacted by such a basic commodity," maintains the oil minister.

Still, many Kuwaitis offer the opinion that the British decision to refer the BP

stake to the monopolies commission and, to a lesser extent, the adverse publicity surrounding Kuwait's Spanish investments may just provide the political ammunition for al-Kharafi to squelch the KIO's go-it-alone stance. The need for him to do so, they add, is all the more pressing now that there's been a discernible shift of power away from the Finance Ministry to the central bank under the astute Sheikh Salem (*Institutional Investor*, July 1988). "Jasem [al-Kharafi] needs the KIA," says one Kuwaiti. "Without it, the Finance Ministry is left only to disburse the checks." To reassert his power, he adds, al-Kharafi will have to take on the formidable Sheikh Ali, and that will be no easy task.

At the *diwaniah* (a traditional gathering held by prominent Kuwaiti families to discuss politics and business) of a wealthy merchant family in May, the talk ranged from J.R. Ewing to football hooliganism but soon came around to Sheikh Ali. Almost to a man, the guests used the word "brilliant" to describe the oil minister. He is widely acknowledged to be Kuwait's most skilled and influential technocrat of recent decades. The hard-working Sheikh Ali has skillfully negotiated Kuwait's interests through the labyrinthine and mind-numbing twists of OPEC geopolitics, serving as the perfect counterfoil to former Saudi oil minister Ahmed Zaki Yamani within OPEC (he provided the intellectual groundings to complement Yamani's skilled diplomacy).

Contrasts

Today Sheikh Ali has no real equal among OPEC ministers. As chairman of the board of Kuwait Petroleum, he supplied the vision and leadership behind the company's drive into downstream oil markets. He also served as chairman of Gulf International Bank. More recently, Sheikh Ali played a key role in lobbying the U.S. Congress as part of Kuwait's adroit manipulation of superpower rivalry to inveigle the American Navy into the Gulf to protect eleven reflagged Kuwaiti oil tankers. "Sheikh Ali is the youngest, the brightest and the most dynamic member of the Kuwaiti cabinet," attests one U.S. State Department official.

A friend who years ago boarded with him at Victoria College, a British-style boy's school in Alexandria, recalls that he was "always hard working." True, Sheikh Ali was known to carouse the back streets and cafés of the city with the rest of the school, but he was also "a serious student, enthralled with mathematics," his friend says. Sheikh Ali went on to pursue his intellectual interests at the University of

California, Berkeley, in the late 1960s, ignoring the political upheavals of the period. He later attended London University, returning to Kuwait after graduating in 1973 and taking his first job, at the Finance and Oil Ministry. Within five years he'd been named oil minister.

Sheikh Ali can dominate a room through sheer self-confidence or a conversation through sheer breadth of knowledge. He exudes an aura of auliority that makes him seem larger than his medium stature. And he is, of course, a sheikh.

Though his shock of black hair and precisely trimmed mustache are now flecked with gray, Sheikh Ali has lost none of his youthful arrogance or impatience, especially with those whom he suspects of being his intellectual inferiors, which includes just about everybody. Temperamental and restless, he is plainly very ambitious as well. "Ali can be combative when he feels he is right and often doesn't see the point of debate if he already has the solution," says one acquaintance. "Ali likes a good fight, he likes the challenge of it all, the opportunity to prove himself right." Says another Kuwaiti, noting that Sheikh Ali often finds himself embroiled in controversy, "Some people just like to make big decisions."

In stark contrast to Sheikh Ali stands al-Kharafi. "Ali and Jasem are like night and day," notes former finance minister al-Hamad, who knows each well. Where Sheikh Ali is comfortable working an OPEC meeting or lobbying the U.S. Congress or holding a one-on-one with Nigel Lawson, al-Kharafi is more accustomed to the narrow habitat of Kuwaiti politics, whose inner workings he knows intimately. His formal education never went beyond Kuwaiti schools. Older than Sheikh Ali, al-Kharafi is portly, with a long face and broad nose. He has somewhat the appearance of former U.S. president Lyndon Johnson — if one can imagine the Texan in a white *thobe*. Indeed, if al-Kharafi had been an American, he might well have become an old-style pol working smoky back rooms to cut deals.

Born into one of Kuwait's wealthiest families, al-Kharafi eschewed the eldest son's traditional path of entering his father's business and instead gave in to his passion for politics. First elected to Kuwait's National Assembly in 1976, he currently represents the suburban neighborhood of Shimaya al-Shuwaikh. Before being selected finance minister in 1985, al-Kharafi had risen to the powerful post of chairman of the assembly's Finance and Economy Committee. Regarded as honest and diligent, he takes his responsibilities seriously, almost grimly so. More cautious

“What are you going to do when a great investment comes along? Say ‘Oh dear, I will have to wait until our next quarterly meeting?’”

than Sheikh Ali, al-Kharafi is an attentive listener who favors a pliable approach, always keeping a sharp eye out for a compromise resolution that will appease each side to a dispute. In KIA meetings, he often plays the role of mediator to Ali's testy advocate. Says a fellow board member: “Jasem listens and does not impose his views. He does not have the ego of some others.”

Falling out

Ironically, he and the oil minister used to be fast friends. Sheikh Ali is even said to have helped al-Kharafi win election as the parliamentary deputy for Shuwaikh in early 1985 by using his influence in other districts to ensure that support flowed al-Kharafi's way. Sheikh Ali also strongly supported al-Kharafi's appointment to the Finance Ministry and, in al-Kharafi's first few months in office, made himself continually available for advice and assistance.

Even today Sheikh Ali and al-Kharafi are cordial, even warm toward one another in KIA and cabinet meetings. But it is clear enough that al-Kharafi distrusts Sheikh Ali's intentions and resents his staunch support for the KIO's autonomy. For his part, Sheikh Ali seems to have lost patience with al-Kharafi for the same reasons so many other people have fallen out of his favor: They don't measure up to his own high intellectual standards. In fact, al-Kharafi lacks the oil minister's financial expertise. And that shortcoming has been used against al-Kharafi in councils of power. Still, the finance minister is a skilled bureaucratic infighter who can deliver the political goods when and where they count. “If he is in a corner, he will fight back,” says a friend at one of the banks. “Jasem is not a quitter.”

Sheikh Ali, on the other hand, enjoys the confidence of the emir, which can be crucial in winning high-level policy disputes. When he was finance minister, he was bitterly attacked in the National Assembly over the government's Kd1 billion share-support scheme for *souk al-manakh* investors and was accused of selectively helping out debtors close to the al-Sabah family. But he earned the emir's gratitude by standing firm against the parliamentary onslaught; eventually, he won broader respect for the way he deftly handled the deputies. Personal attacks against Sheikh Ali contributed to the emir's decision to dissolve the assembly in the summer of 1986. The oil minister has always been especially close to Sheikh Sa'ad, the crown prince and prime minister, but he also has been aligning himself more closely with Sheikh Sabah Ahmed, foreign minister

and full brother to the emir, who is vying with Sheikh Sa'ad to succeed Sheikh Jaber as emir.

But for all his talents and royal patronage, Sheikh Ali can push too hard, antagonizing important people. “Ali made so many enemies for no reason by fighting so many battles at the same time,” asserts one Kuwaiti. Critics have long felt that Sheikh Ali is simply too ambitious and resent his encroaching on the traditional prerogatives of the merchant class; critics see in his actions a systematic attempt to break down the old order.

Al-Kharafi's power flows largely from his perceived role as a counterweight to Sheikh Ali. But the finance minister also draws clout from his recent successes — a steadier economy and breakthroughs in dealing with the banking system's bad debts and the government's borrowing.

Handicaps

But al-Kharafi does have more than his fair share of vulnerabilities. During this year's holy fasting month of Ramadan, he was rumored to be in political hot water over the tragic Kuwait Airways hijacking. The reason: There was no sky marshal on the hijacked flight because Kuwait Airways, which is owned by the Finance Ministry, wanted the Interior Ministry to pay for Kd80,000 worth of tickets for the flying policemen. The letter to the interior minister demanding the sum bore al-Kharafi's signature. One Kuwaiti with close parliamentary sources also thinks al-Kharafi has lost much of his support within the merchant families, which is crucial in amassing enough political weight to win steady access to the emir and crown prince. Al-Kharafi is said to have made the rounds of the *diwanahs* to make amends.

A more lastingly debilitating political handicap for the finance minister is the accusation that he has practiced excessive nepotism. The joke going the rounds of the *diwanahs* was that “Jasem is turning the KIA and Finance Ministry over to Shuwaikh,” his parliamentary district. Critics charge that the finance minister has been filling plum positions at the KIA and Finance Ministry and on the boards of companies under the ministry's authority with influential voting residents of the district against the day when the assembly is reconvened and he must stand for reelection. Some say al-Kharafi tried to pack the KIA board with friends or colleagues from his assembly days.

However, former finance minister al-Hamad, among others, dismisses the contention out of hand. “I know [the appointees],” he says. “Nobody can push them

around.” In any case, adds another Kuwaiti, the selections must be approved by cabinet, making it immensely difficult to stack the deck. For his part, al-Kharafi dismisses the carping with a wave of his hand. “I am not bothered by these criticisms,” he says. “Three quarters of all the people I have put in as new members of the various boards of directors I do not even know.”

Ultimately, the dispute between al-Kharafi and Sheikh Ali over the KIO's future may have to be resolved by the emir himself. Though he rarely intervenes directly in cabinet affairs, the emir was rumored in late June to be mulling a decree to transfer either the KIA or the KIO out of the Finance Ministry back to the Emiri Diwan, his own office. “If the emir ever became involved so directly, there would be no more dispute,” one Kuwaiti says, perhaps wistfully. “Before the emir, you have only opinions, not decisions.” But one prominent Kuwaiti who is very close to the emir says flatly that a decree is out of the question: “I can assure you 100 percent that this will never happen. Such a move would require a change in the Kuwaiti constitution. It would be far easier to change a minister instead.”

In any event, the battle over the KIO promises to be a protracted one. One factor, though, could weigh crucially in favor of one faction or the other: the decision of the U.K.'s monopolies commission. If it renders a favorable verdict — say, upholds the Kuwaitis' contention that the share-buying was purely for investment purposes and thus requires no formal sanctions — then the KIO could emerge stronger, and more independent, than ever. In effect, it would have been cleared in many Kuwaitis' eyes to pursue investments of the BP variety with its customary aggressive, opportunistic zeal. But if the decision goes hard against Kuwait — say, if the KIO is forced to divest part of its stake or its voting rights are “disenfranchised” in a manner that is politically embarrassing to Kuwait — al-Kharafi may have just enough of an edge to demand that the KIO toe his line. In that case, the organization will assume a more cautious stance and certainly endeavor to stay out of the headlines. And if the National Assembly is reconvened, the KIO could well find itself more susceptible to political pressures in making investment decisions.

Curiously, the British referred the BP stake to the commission on what is perhaps the weakest and least likely scenario for legally rebuilding the KIO: that the Kuwaitis would try to use the stake to pressure BP to help OPEC prop up oil prices

Ali likes a good fight, he likes the challenge of it all, the opportunity to prove himself right."

or at least force the oil company toward long-term oil contracts when its best interests — and those of British consumers — require it to purchase crude on the cheaper spot market. "It doesn't have to be a merger or a monopoly," explains one British official somewhat sheepishly of the referral. "I mean, after all, when a foreign government, and a member of OPEC, takes a fifth of the country's largest oil company, surely there are questions of public interest involved." BP officials imply that the Kuwaitis early on sought that first step in wielding influence — a board seat. But that is flatly denied by Jaffar in an interview earlier this summer. Kuwait Petroleum acquired BP's Danish operations last year, he points out, so "KPC doesn't need us to know BP. The board seat debate was in everyone's imagination."

In fact, a bald takeover of BP by the KIO (as agent for the KPC) or even a heavy-handed effort by the Kuwaitis to make the British oil company accede to OPEC policies was never a credible threat. And, in any case, it may well be made moot as an issue by a predicted tightening of oil supplies in the mid-1990s: if that indeed occurs, it will be BP knocking at the

Kuwaitis' door begging for supplies of crude.

A more likely motive for the referral was offered by an oil company executive observing the most recent OPEC meeting: "BP does not want to work with such uncertainty hanging over its head. No one likes to have a single large shareholder that is so secretive, whether an OPEC member or the man from Mars." The possibility that the KIO may not want a board seat, now or ever, actually adds credence to the worst-case scenario from BP's perspective — that the Kuwaitis intend simply to sell the stake to some more predatory bidder. "No one in their right mind will say forever," Jaffar blandly remarks.


Contradiction

Moreover, while a Kuwaiti bid for BP could undoubtedly be blocked on political grounds, one by Royal Dutch/Shell or Exxon Corp., say, would be awkward for the British to reject outright, particularly since BP was itself allowed to snap up Standard Oil Co. and become the single largest holder of American oil reserves. An oil analyst at Kleinwort Gneveson in London figures it would take a gargantuan \$40 bil-

lion to make a reasonable run at BP. A big number, but if the takeovers of the past few years teach anything, it is that size provides no safety. "If that chap Icahn can put together \$14 billion for his bid for Texaco, ask the Wall Street houses if Exxon or — run down the list — the next five oil companies could not put together the financing for a bid for BP," muses one merchant bank adviser very close to BP. The KIO's 22 percent stake would make a convenient starting point.

"The British are the biggest foreign investors in the world, so they have got to be careful about getting nationalistic," cautions a high-level Kuwaiti official. "You cannot be nationalistic and internationalistic at the same time. It is a contradiction." Nor, it might be said, can you be a passive investor and an assertive one at the same time. That glaring contradiction in the current Kuwaiti approach to managing the country's multibillion dollar foreign portfolio — personified in the struggle for the soul of the KIO between Sheikh Ali and al-Kharafi — has yet to be resolved. One way or another, the outcome cannot help but have a major impact on the world's markets. ■

The announcement appears as a matter of record only. February, 1988




PARK LANE HOTELS
HONG KONG
has acquired

THE CHURCHILL HOTEL
LONDON


for a cash consideration of

£110,000,000



بنك الكويت الوطني
The National Bank of Kuwait S.A.K.

has arranged this transaction and acted as Financial Advisor




BRIERLEY INVESTMENTS OVERSEAS N.V.

US\$50,000,000
MEDIUM TERM LOAN

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The National Bank of Kuwait S.A.K. (agent bank)
The National Bank of Kuwait S.A.K. (agent bank)
The Commercial Bank of Kuwait S.A.K.
Kuwait Foreign Trading, Constructing & Investment Co. (S.A.K.)
The Gulf Bank S.A.K.
The National Bank of Kuwait S.A.K. (agent bank)
The Commercial Bank of Kuwait S.A.K.
Kuwait Foreign Trading, Constructing & Investment Co. (S.A.K.)
Bank Al-Jahli S.A.K.
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Republic of Finland

Kuwaiti Dinars 20,000,000
7 1/2 % Bonds due 26th May, 1994

The National Bank of Kuwait S.A.K.

Al Ahi Bank of Kuwait E.S.C. Bahraini Kuwait Investment Group
Bank of Bahrain and Kuwait B.S.C. Kuwait
The Bank of Kuwait and the Middle East B.S.C. Borgan Bank S.A.K.
Commercial Bank of Kuwait S.A.K. The Gulf Bank E.S.C.
Gulf Investment Corporation The Industrial Bank of Kuwait E.S.C.
International Financial Advisors E.S.C.
Kuwait Foreign Trading, Constructing & Investment Co. (S.A.K.)
Kuwait International Investment Co. S.A.K.
Kuwait Investment Company (S.A.K.)
Kuwait Real Estate Bank S.A.K. Securities Group S.A.K.




International Bank for Reconstruction and Development

Kuwaiti Dinars 30,000,000
7 1/2 % Bonds of 1987, due July 27, 1994

The National Bank of Kuwait S.A.K.

Kuwait Foreign Trading, Constructing & Investment Co. (S.A.K.)
Kuwait International Investment Company S.A.K.
Al Ahi Bank of Kuwait E.S.C. Bahraini Kuwait Investment Group
Bank of Bahrain and Kuwait B.S.C. Kuwait Branch
The Bank of Kuwait and the Middle East B.S.C. Borgan Bank S.A.K.
The Commercial Bank of Kuwait S.A.K. The Gulf Bank E.S.C.
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The KIO's new high profile

When you're a multibillion behemoth — and increasingly inclined to throw your weight around — it's hard to keep from being noticed, or resented.

BY STEPHANIE COOKE

The large, wood-paneled door at the entrance to 150 Cheapside looks inviting until visitors realize it doesn't have a handle. In fact, it's not a door at all. The *real* door is to the left. Made of thick glass, it slides inaudibly into a marble wall to let callers — some still trying to figure out how to get through the wooden door — in as far as the manned security desk. There a somber guard directs visitors to the mezzanine on elevators that go no farther without keys. Ask him about the phony door and he'll explain, "Oh, it's just a fire door."

"With a peephole?"

In reply, he half-chuckles and quietly clears his throat. It's a strange place for a fire door, but that isn't the only thing strange about St. Vedast House, Cheapside, London. On the elevator, beside a

row of keyholes, buttons indicate floor numbers one through four. A fifth, unnumbered keyhole presumably sends the lift to the executive suites, but visitors to the lower reaches are left to wonder.

Those who are privileged enough to visit the fifth floor are led away from the mezzanine's array of security screens, enclosed in a darkened alcove, beyond the main elevator to another, smaller lift. An escort first inserts a magnetic identity card into a slot, then slides a key into place. At last the elevator climbs to the offices of the general management of the Kuwait Investment Office. From this bewildering fastness, three Kuwaitis (including two members of the royal family), two Scotsmen and an Englishman oversee the disposition of, by conservative reckonings, some \$80 billion of Kuwait's money.

*Jaffar of the KIO:
"We adapt our policy according to the local environment. But that doesn't mean we'll be so sensitive that we'll let people ride roughshod over us"*

*De la Rosa, the KIO's man in Spain:
The Kuwaitis' binge on the bolsa, he claims, got "everybody buying without any analysis, any research, and I have been obliged to say many times in the past, 'Be careful, [the price] is too high' "*



Tribuna

To the outside world, St. Vedast House (the name is taken from the thirteenth-century Anglican church next door) is just another drab, concrete London building. But to City brokers it is the source of telephone orders that send a frisson through markets worldwide: "The KIO is dealing." Those inside 150 Cheapside call their looking-glass world simply "The Office."

Behind its peepholes and drawn curtains, employees are sworn to secrecy by contract. Their tongues are legally bound. Those brokers and dealers who receive KIO orders to buy or sell are silenced by less tangible but equally effective means: the fear of losing *big* business. The occasional caller is cowed into reticence by the secrecy implicit in false doors and unnumbered floors, in taciturn guards, unsmiling

"The one thing I hate is to see our name in print, but as you get larger you can't help but attract publicity."

receptionists and batteries of monitoring devices. A fairly frequent visitor to St. Vedast House says that the feeling of disorientation is intentional. "At times I've felt that the lift runs at an angle," he says. "It's all security, deliberately made that way, and it's quite understandable."

But in its third decade, the KIO has reached such elephantine proportions — it is among the world's largest investment organizations — that it can no longer hide behind curtains, peepholes or the marketplace. That became painfully clear last spring and summer when massive investments in Spain set off an explosion that rippled from Madrid's tiny *bolsa* to the highest levels of government. Shortly thereafter, the U.K.'s stubborn postcrash privatization of British Petroleum Co. left millions of shares unsold as investors fled the reeling market. When the government attempted to reassure investors by offering a guaranteed buyback price, the KIO handily scooped up a full 22 percent of Britain's largest company.

The two incidents set off highly charged political rows in both countries. The heretofore secretive KIO had suddenly stumbled in front of the news media in a way it could imagine only in its worst nightmare. Government leaders were forced into publicly demanding clarification of the KIO's intentions, and, worse, the KIO was made to offer public reassurances. "The one thing I hate is to see our name in print," says Fouad Jaffar, deputy chairman and general manager. "As you get larger you can't help but attract publicity."

As a government agency, the KIO is no stranger to domestic political pressure; indeed, it is currently the focus of a fierce power struggle between Kuwait's oil and finance ministers (see page 44). Overseas, though, where it has cultivated the image of a low-key, adaptable and highly secretive investor to almost mythical proportions, the scale of the furor unleashed in Europe in the last year was discomfiting. For an organization accustomed to quietly sprinkling billions around the globe — in U.S. skyscrapers, Malaysian rubber plantations and German factories — on a largely tax-free basis with little notice, the politics of investing is something new. By overstepping its traditionally low profile in Spain and the U.K., the KIO was forced outside the safety net of the marketplace — where money did the talking — and into the more dangerous ground of political and public opinion. The men behind the peepholes finally had to consult PR experts in an attempt to win allies among Europeans suddenly more worried about the prospect of domination by Arab economic bullies than tempted by

coffers full of petrodollars. Between politics and PR, The Office is getting squeezed. More than 30 years after Sheikh Abdullah turned his Bank of England account into the KIO's forerunner, the secretive Arab investors now have more money than they can hide.

Contrarians

For all its might, the KIO remains a small organization — 133 people at last count, of whom about 40 actually oversee investments — that intentionally clings to the fringes of the financial establishment. Like the Gulf nation of traders that created it, the KIO puts a high degree of emphasis on the ability of its employees to bargain quickly, quietly and effectively. It also gives them a fair degree of autonomy and encourages independent thinking. It is therefore not surprising that it chose Scotsmen in the U.K. and Catalans in Spain as its local managers. Both areas are known as much for their denizens' individualism and occasional contrariness as for their sharp business skills. "Catalan is viewed by the rest of Spain as Scotland is from London — stingy with money," says a Madrid investment banker.

But being an outsider — and something of a contrarian — has its advantages. When the establishment says sell, the KIO buys. Where bankers fret over mounting debts, the KIO marvels at opportunity. Last year when markets were peaking, the KIO was a net equities seller. "It's not a bad thing to underperform if you understand why you're underperforming," Jaffar says. "When it comes to the nitty gritty, you've got to evaluate constantly. If you have to do a 100 percent somersault, you do it."

Somersaults are dependent, of course, on speed. Around The Office, fund managers count on their outside contacts' giving them wind of big deals early — or else their business goes elsewhere. Once they begin to play, they use their powerful financial muscle to create diversions — buying and selling the same shares simultaneously, for instance, to keep the price in check. The small staff assures that major investment decisions involving sums as large as the total assets of a medium-to-large U.K. pension fund often are made by one or two people. "What's good about them is they're very responsive to ideas," says one broker. "Procrastination's the thief of commissions."

Perhaps the quintessential KIO acrobat was Peter Defty, a tall, lean whiz kid who served as the U.K. market's sole KIO liaison for the seven years before his unexpected departure last December to purchase a Spanish investment firm—and operate an amusement park in Barcelona.

City brokers were surprised by his resignation: KIO employees, especially highfliers like Defty, rarely desert The Office.

Admired and feared, intensely liked or disliked, Defty had a style that was pure KIO. Shrewd at playing both ends against the middle and extremely well informed, according to a top City broker, Defty threw the KIO's weight around with little regard for who might get crushed. "Let's say you offer a client one-quarter-million shares at 2.99, a half at 3.00 and the whole lot at 3.01," he says, illustrating Defty's technique. "Most would say, 'Start with the quarter million.' Defty would say, 'One million at three and you can do it in ten minutes or don't come back.' If you didn't have the stock, you had to find it, and the market maker didn't know if he'd go to someone else. Also, you never knew whether there'd be a takeover bid three minutes after he'd dealt. I don't think you'll find anyone who likes him. He was bloody rude and very aggressive." An admirer admits, "He wasn't everyone's cup of tea."

But the frenetic Kuwaiti pace under Defty was not all bad for the City, another broker insists. "He made a lot more people in London a bit more professional at their jobs." Defty, now expanding the amusement park into a full-blown leisure company with cash injections from two Spanish investors, including the KIO's principal Spanish associate, and the Swiss bank Lombard, Odier & Cie., with whom the KIO is often closely associated, is unfazed by the criticism. "It's of no consequence," he sniffs. "Maybe if you have a large amount of money to look after, you have to adopt a different attitude."

Harm's way

Slowly but surely, the more aggressive KIO posture in the market began to attract attention outside the offices of frazzled brokers. In a now-characteristic high-speed deal, the KIO pulled a 24-hour turnaround on the shares of Exco, the U.K. money broker. The Office netted more than £9 million profit on a £113 million investment, according to Jaffar, but Exco fired its brokers, de Zoete & Bevan, reportedly accusing them of misrepresenting the KIO as a long-term investor. City observers wondered who had misrepresented what to whom. Another deal, involving the printing industry takeover of McCorquodale by Norton Opax, in which KIO held stakes on both sides, was referred to the Takeover Panel. The KIO had begun to sail conspicuously. Soon it would sail in harm's way.

The KIO passed irrevocably out of the mists and onto the front pages with its massive buy-up of BP privatization

When you're trading like ants, you can help, but you can also disrupt or destroy, parts of the economy."

If the buying was purely KIO inspired, as the Kuwaitis insist, they should have perceived that, whatever the eventual profits, they were headed toward political shoals. Great Britain is not an OPEC member, yet here was an OPEC-based investment firm buying the lion's share of the country's largest oil producer and biggest corporation. Adding to that provocation was the way in which the buy-up was conducted — not in the quiet, diffuse fashion of the old KIO, but in a highly visible, centralized manner.

Instead of farming out small pieces of the action to hide its hand as it had done in the past, the KIO apparently worked through a single broker, Marshall & Co. (a subsidiary of Lombard Odier), to buy shares it did not buy directly from the beleaguered underwriters. Jaffar insists that several firms were used, but market makers who sold to the KIO dispute his denial. "It was such a public and high-profile way of dealing. I think it was the only way to do it. You can't hide trades of 9.9 million shares on the trade ticker," says one. Marshall's deputy chairman, Duncan Duckett, one of a handful of brokers who can claim a friendly relationship with Defty, dating back to Duckett's days with James Capel & Co., adds: "Being an agency broker means we have quite a lot of flexibility. When it comes to transactions, if you've got the cooperation of the market some of these deals can be done smoothly."

Gulf "sharks"

If the BP deal was something of a daredevil act, the Spain blitz was akin to an elephant crashing a lawn party. It started simply enough. In 1984 the KIO targeted Spain as fertile ground for investment, and when Spanish banks sought to unload a small debt-ridden paper company called Inpacs, the KIO was interested. Then another impoverished, but larger, paper company, Torras Hostench, approached the Kuwaitis and suggested they buy into Inpacs. Jaffar recalls: "We said, 'Why don't we buy Torras?' By offering to clear the debts, we got it. You've got to be opportunistic, but according to a plan." The plan was to turn Torras into a vehicle for further massive buying in Spain, making it a conglomerate of paper, food, chemical and banking interests.

In 1986 the KIO also took the uncharacteristic step of hiring a public relations firm, Madrid-based Agencia A, rightly calculating that its long-term plan would encounter a rough ride in the local press. By last summer, the KIO had acquired enough of a stake in Torras to take control. It's next move was to appoint former banking executive Javier de la Rosa, the man who introduced it to its

first Spanish investments, to head Torras's hunt for industrial assets. With Spanish companies at bargain prices, there was lots to pick from. Armed with the proceeds from the Spanish stock market's biggest-ever rights issue, Pts56 billion (half subscribed to by the KIO), Torras started to home in on its targets. Spain was suddenly abuzz with talk about the "sharks" from the Gulf, and Madrid's *bolsa* was rife with speculation. "This time last year they started hitting the headlines," recalls an English broker now working for a Spanish firm. "I came down last May and people kept saying, 'Buy Torras.'"

Indeed, brokers around Madrid say speculation in Torras shares began a full three months before the KIO actually increased its shareholding from 24.99 percent to 36.4 percent in July. To hear the locals tell it, cab drivers talked more about the stock market than about their favorite soccer teams. By the end of July the once-bedraggled papermaker's share price had more than doubled. "Everyone knew KIO was buying Torras, so everyone was buying Torras," says the broker.

The real fireworks went off in mid-summer. Torras scooped up 15 percent of Explosivos Rio Tinto, Spain's huge chemical conglomerate, and announced to chairman José Escondrillas its wish for a controlling interest. About that time Torras added another 2 percent to the KIO's directly held 5 percent stake in Banco Central, Spain's largest bank, and took a 5 percent stake in Banco de Vizcaya. Later, in an effort to win Bank of Spain approval for upping its Banco Central holding, Torras teamed up with "Los Albertos," the reclusive cousins who head one of Spain's largest construction conglomerates, to form Cartera Central. Then, to round off Torras's romp on the *bolsa*, the new partnership took a full 13 percent in Banco Central. Spain was in play.

"There was one helluva lot of institutional speculation because of takeover mania created by KIO," says a broker at Benito & Monjardin International. Brokers lucky enough to land KIO business caught the envious eye of colleagues. One in particular, Antonio Morenes, the brother of two partners in Beta Capital, an investment firm now half-owned by Torras, is still watched as a bellwether of KIO dealings. "You can see him on the floor doing a lot of transactions, and very large ones," says a member of a rival firm.

De la Rosa says the speculation got so out of hand that he issued warnings to investors. "Everybody was buying without any analysis, any study, any research, and I have been obliged to say many times in the past 'Be careful, [the price] is too high.'" Madrid brokers, however, say that

they don't recall such warnings. And the speculation didn't stop the KIO from buying. In all, the KIO spent at least \$1 billion acquiring stakes in more than 30 Spanish companies either directly or through Torras, according to Jaffar.

Dark hints

While the Madrid stock market was turning into a casino as a result of the KIO's presence, the Kuwaitis and Torras found that resistance was stiffening in the boardrooms. Escondrillas was firmly opposed to a takeover of ERT, Banco de Vizcaya was less than thrilled by its new shareholder, and Banco Central was distinctly uneasy over the steadily escalating KIO stake in its stock. Indeed, in a move to keep their new shareholders at bay, Banco Central announced a merger with Spain's second-largest bank, Banesto, this spring. Torras and its new partners responded by buying Banesto shares.

More worrisome for the KIO, key members of the Spanish government were becoming alarmed, including officials of the Bank of Spain. Since Spanish banks own a large part of the country's industry through elaborate cross-holdings, the KIO was, in effect, penetrating the core of the national economy. The government was concerned by the enormity of the KIO-Torras onslaught and was unsettled by the presence of de la Rosa at the head of the capital invasion. De la Rosa, whose investment firm, Quail España (recently renamed Diagonal Investment), is putting up money for Defty's leisure company expansion plan, also attracted unfavorable publicity. He had fallen into obscurity after the collapse of a Barcelona bank he once ran, the Banesto subsidiary Banco Garriga Nogues. The Spanish financial establishment had hinted darkly that the bank's loans were worse than bad — they were incomprehensibly unwise.

The Spanish government moved. The Kuwaitis appeared to have miscalculated, or overlooked, the political repercussions of purchasing control in ERT, one of Spain's principal defense contractors. Defense Minister Narcis Serra loosed broadsides against ERT's ending up in non-NATO hands. Jaffar says that the KIO realized from the outset the delicacy of the situation and promised to spin off the defense interests subject to government approvals. The press implied that the promise came only as a result of Serra's objections, largely ignoring KIO protests that it was never interested in the defense holdings. Further fueling anti-KIO sentiment were reports of a NATO document advising the government against letting the KIO into ERT's explosives and armaments division. The KIO also had to

"Spain is a bloody country — full of envy and jealousy."

acquiesce to Madrid's plans for restructuring the fertilizer industry, which meant having Torras buy an apparently unplanned stake in Cros, the company with which ERT was supposed to merge. Finally, it had to combat objections to Torras's stake in ERT's oil refinery.

One Madrid analyst reckons that a deal that was to have taken two months and cost Pts30 billion ended up consuming a year and Pts80 billion. The only outright winners were ERT's bank creditors, which were able to use the ever-lengthening government negotiations and Torras purchases to unload all but Pts10 billion of the Pts35 billion ERT debt. "The length of the process and the cost were much higher than both the KIO and the government thought," says Ignacio Montejo, research director for F&G Inversiones Bursátiles.

If anything, the Kuwaitis were less lucky with Banco de Vizcaya. The Bank of Spain informed Torras that its bank holdings should be discussed. The result of the "discussions" was an immediate decision to sell Banco de Vizcaya shares — only a few months after Torras had purchased them.

The sudden reversal woke the fevered Madrid *bolsa* to the cold reality of what happens when a giant investor suddenly decides to unload. "When you're trading like an elephant with ants, you can help, but you can also disrupt or destroy, parts of the economy," says one broker. Banco de Vizcaya ended up having to buy the Torras shares because the market simply lacked the liquidity to absorb them, he adds.

Questionable judgment

But rather than the KIO lowering its profile after these setbacks, it made the battle for ERT a curtain-opener for Torras's next move: a hotly contested bid for control of Ebro, one of Spain's leading sugar producers. As with previous acquisitions, Torras bought up "creeping control" of Ebro, circumventing Spain's 25 percent disclosure rule by organizing multiple surrogate shareholders to achieve boardroom dominance with minimum investment. "Formally, they were okay," says Montejo. "But the finance minister or the *bolsa* should have looked to see if it was legal. It was a problem of lack of experience."

This time, however, the target fought back. Ebro hired M.M. Lazard Frères, which had already locked horns with Torras and de la Rosa as an adviser to ERT. Lazard, in turn, promptly hired a public relations firm to assure that Ebro's case received a full hearing among Spanish voters, who were growing increasingly con-

cerned about the KIO's burgeoning role in the economy. Ebro, Lazard and the PR men publicly challenged de la Rosa on every conceivable technical aspect of the takeover and even sent a telegram to the emir alerting him to the fact that Ebro produces alcohol. In the end, the appeal to fervent Muslim teetotaling proved futile. Torras's offer price was so high that Ebro was unable to find a white knight. "Nevertheless," says Lazard general partner Remmert Laan, "we basically forced him to make an offer for the whole company."

The Ebro donnybrook strained more than the KIO's cash reserves. De la Rosa's past failure with the Banco Garriga Nogues — even his father's involvement in a multimillion-dollar fraud and subsequent departure for Brazil — were dredged up and splashed across headlines. Cartoonists portrayed the Kuwaitis as marine monsters: octopuses with tentacles throttling the Spanish economy or sharks gorging on Spanish corporations. Once, the KIO had been secrecy personified; now it was beholden to advice from a PR firm. And Agencia A's work for both KIO and Torras seemed in vain. "It was a disaster," de la Rosa says of the publicity effort. He does not blame Agencia A, however. "This is a bloody country — full of envy and jealousy." For his part, Jaffar defends the KIO's Spanish operative. "We're used to having our people being constantly attacked," he says. "You judge people not as others find them, but as you find them."

Still, there is little doubt that the KIO has been damaged by the questionable political judgment evident in its Spanish dealings and the BP affair. Even its heretofore unimpeachable investment instincts have been challenged in the wake of deals that generated more heat than they demonstrated clear logic. "I'm not sure what the KIO wants to achieve with Cros and ERT," says analyst Stuart Walmsley of Morgan Stanley & Co. Adds Montejo: "How are they going to manage a food company and diversify into a sector like chemicals where all the multinationals are well established? They're spread too thin and they've antagonized a lot of people in Spain."

Onlookers now wonder if the KIO has moved into a new phase in its development and — on the evidence of the Spanish and British controversies — whether its master investment strategists are equipped to handle the political and public repercussions of playing so active a role on a larger stage. One investment banker notes that, in the past, the KIO limited itself mainly to passive investments (and smaller-scale direct investments), but in Spain, it appeared to have

broken with the tradition to take clear control and move into management on a broad scale. This direct involvement opened the KIO to scrutiny wider than it had faced previously. "Is that special to Spain?" the banker asks. "Or is it the beginning of a change in worldwide policy?"

More wisdom

Jaffar's reply is both evasive and revealing. "We adapt our policy according to the local environment," he says. Then he bristles and exclaims: "But that doesn't mean we'll be so sensitive that we'll let people ride roughshod over us." One thing is clear, however: The KIO no longer shrivels in the public gaze. Even its activities in the City have become more transparent. Last summer, sensing the markets' approaching limits, it unloaded huge blocks of stock and gave its placements to single houses, accepting the red flag over its trading that single-house dealing represents. "In the past they have split orders between brokers and market makers," notes James Capel chairman Peter Quinnen. "It didn't improve their image."

Puzzling as the KIO's forays into direct control and management are, it could be that the Kuwaitis have at last recognized that their coffers are now simply too big to hide. Disclosure rules are tightening up across Europe — a process that will be accelerated by the EC's move to a unified market in 1992 — and in the U.S. growing protectionism could flush out its nonmarket holdings, notably in real estate. In the wake of press fever over the BP holding, meanwhile, the KIO has come under further press scrutiny because of its sovereign immunity from investment taxes. "I think it's a realization that they just simply can't keep a low profile any longer given the position they hold in the investment community both here and abroad," Quinnen says.

Jaffar, whose father oversaw the KIO's birth and ran it more than two decades ago, insists that the organization is merely evolving with the times. "We are now 30 years old," he says. "Therefore everything we do should be much better, because we have that much more wisdom behind us."

Thirty years older, 30 years richer, perhaps indeed 30 years wiser, the KIO is certainly 30 years bigger. "I hope after a month or two we can disappear and people forget about us for a while," says Jaffar. "That's my wish." It may be one wish even Kuwaiti money can't buy. The KIO is now an investment behemoth too big to ignore. As it learned in England and Spain, an elephant goes nowhere without being seen. ■

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MY TELNO 508: OPEC: SAUDI OIL POLICY

SUMMARY.

1. THE KING BELIEVES THAT PRESENT OIL SITUATION VINDICATES EARLIER SAUDI INSISTENCE ON ADHERING TO QUOTAS. BUT NO EXPLICIT CRITICISM OF OVERPRODUCERS.

DETAIL.

2. ACCORDING TO THE SAUDI PRESS AGENCY, THE KING, AT THE COUNCIL OF MINISTERS MEETING ON 12 SEPTEMBER, SAID THAT SAUDI ARABIA HAD WARNED OF THE LIKELIHOOD OF A DECLINE IN OIL PRICES, WHEN IT CALLED ON ALL OPEC MEMBERS AND THOSE OUTSIDE THE ORGANISATION TO COOPERATE JOINTLY TO MAINTAIN PRODUCTION CEILINGS AND QUOTAS ALLOCATED AT THE DECEMBER 1986 MEETING AND THE AMENDMENTS MADE SINCE. HE EXPRESSED THE HOPE THAT OPEC AND NON-OPEC PRODUCERS WOULD WORK TO STABILISE THE SITUATION AND STOP PRICES FROM SLIDING FURTHER.

COMMENT.

3. THE KING'S COMMENTS ARE NOT UNEXPECTED. BUT, PERHAPS SIGNIFICANTLY, THEY OMIT THE USUAL EXPLICIT CRITICISM OF OPEC OVER-PRODUCERS. THE TONE OF THE COMMENTS SUGGESTS THAT CURRENT SAUDI OVER-PRODUCTION MAY BE A WARNING TO OTHER OPEC PRODUCERS THAT THEY SHOULD RETURN TO THE FOLD OR FACE THE CONSEQUENCES. THIS IS THE VIEW OF OUR OIL INDUSTRY CONTACTS HERE. OIL MINISTRY CONTACTS ARE HOWEVER STILL PROVING ELUSIVE.

4. ACCORDING TO REUTERS IN BAHRAIN, SAUDI PRODUCTION HAS BEEN BELOW QUOTA AT THE BEGINNING OF SEPTEMBER, BUT THAT THIS CAN BE ATTRIBUTED TO LOW LIFTINGS BY THE ARAMCO PARTNERS PENDING THE OUTCOME OF NEGOTIATIONS ON PRICE. WE HAVE HEARD SEPARATELY FROM BP ABOUT ARAMCO DISSATISFACTION OVER TERMS.

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