PO-CH/NL/0648 PART A

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PART. A

CHANCELLORS 1987
BRITISH PETROLEUM
AND OIL PAPERS.

DD's 25 yrs N.A3/3
22-11-96

22-10-87

THIS FOLDER HAS BEEN
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BP PAPERS

85', 86', 8~~7~~8'

Ch/ Do you want a meeting (with Steve) or just talk at your next PEM bilateral? KL 31/5

Permanent Secretary
H M TREASURY

Chancellor,

We need to come to a position on this. I am presently suffering from a positive hail of miscellaneous bits of literature from James Hanson.

Mr Robson's note provides a very useful aide memoire on the possibilities

PM 31/5

Discuss @ next PEM bilateral. N

SECRET AND PERSONAL

FROM: S A ROBSON
DATE: 29 MAY 1985

SIR PETER MIDDLETON

BP

Your minute of 21 May.

2. I am not sure how much analysis you want at this stage so the following is a preliminary assessment. I could easily do more if needed. In addition it also happens I am seeing two of Merrill Lynch's Wall Street energy analysts on June 13 to discuss greenmailing (and BGC) and I may be able to offer more then.

3. This minute examines the broad approach of current oil company raiders, the way this might be applied to BP and the impact of one particular radier, Hanson Trust.

A. <u>Raiders</u>

4. The basic public position of raiders is that oil companies are not looking after their shareholder's interests. They point out :

(a) growth prospects in the oil business have diminished. This is in part cyclical, but in addition the oil intensity of GDP has fallen throughout the industrial world in the last decade;

(b) crude oil is not in short supply and the price of crude looks to have little growth potential for the rest of this decade Even looking further ahead (which is more the timescale of oil company investment) oil price projections are being revised downwards;

(c) despite reduced growth prospects, abundant crude and diminished prospects of increased real oil prices, oil companies continue to spend heavily on exploration;

(d) they also spend heavily on diversification (often unsuccessfully), on fixed assets and on corporate infrastructure;

(e) in addition to all this dubious spending, oil companies are also piling up cash balances for which they can find no use.

5. The raiders say the answer is :

(a) cut exploration, cut capital investment and slim down corporate infrastructure;

(b) sell peripheral assets - which can mean both downstream assets and assets bought in pursuit of diversification;

(c) use the cash realised, plus the cash balances plus cash generated by borrowing, to boost dividends and buy in shares so putting the money into the shareholders pockets.

6. It has to be said that the raiders have never got into a position to put their words into deeds. They usually frighten the oil company management into taking action along these lines

so that the raiders retire from the scene with a healthy capital gain rather than the management problems involved in implementing 5(a)-(c) above.

B. BP

7.BP can be seen as guilty of most of the shortcomings identified above. (The figures below are taken from BP's accounts).

(a) Exploration

8. BP are spending heavily on exploration (£ million) :

1980	1981	1982	1983	1984
355	692	986	1176	1221

It is hard to see what there is in the outlook for oil that would justify a programme increasing at this rate.

9. It is also hard to see it justified in terms of the success of BP's exploration. There is no very easy test of success in the accounts but two measures are ~~instructure~~ instructive. First, BP divide exploration costs into three. Successful exploration expenditure is capitalised, unsuccessful is written off and expenditure which is not yet determined to be successful or unsuccessful is carried forward. The amount carried forward at the end of 1984 was £1852 million. The amounts capitalised or wirtten off in any year therefore relate to prior years' expenditure as well as the current year's but the trend is relevant (£ million) :

	1980	1981	1982	1983	1984
written off	174	413	607	967	903
capitalised	na	na	130	16	30

Another measure of success is the company's proven reserves. Despite the expenditure on exploration, proven oil reserves fell from 5,585 million barrels at the end of 1980 to 4,631 at the end of 1984.

(b) Capital Expenditure

10. BP are spending well in exces of their replacement cost depreciation :

	1980	1981	1982	1983	1984
Capital expenditure	1773	3079	3664	3237	3610
Replacement cost depreciation	1384	1808	1397	1170	1411

(i)figures for 1982 and earlier years include provisions as well as depreciation and may overstate depreciation by some £200 million a year.

11. BP has also been spending money on acquisition, although at a slower rate in recent years (£ million) :

1980	1981	1982	1983	1984
545	1637	96	45	205

12. Unfortunately there are no figures in BP's accounts for the cost of its headquarters operations. But it is hard to see why it needs the large complex of offices around Brittanic House in what is a high rent City position. This may be indicative of a general attitude to overheads.

(c) Cash

13. BP has a cash mountain. The unaudited figures at 31 March 1985 show liquid assets of some £2.6 billion. Of this, £1.4 billion is cash and the balance are financial (as opposed to trade) investments. BP's major corporate strategy issue is how to use this cash; there are signs of more acquisitions ahead.

(d) Overall

14. BP is a company fighting against decline. The main contributions to its operating profit in 1984 breakdown as follows

BP Expro		391
BP Oil Int.		113
Other		117
		1621
Sohio		
	Expro	2189
	Refining	148
	Other	(57)
		2280
Group		3901

In short the profits are heavily concentrated in oil production. Group oil production, in turn, is heavily concentrated in two provinces (North Sea and Alaska) and in three fields - Forties, Prudhoe Bay and Kuparuk. North Sea production in 1984 was rather below the 1980 level. Prudhoe Bay appears to be on plateau. Kuparuk is increasing but is relatively small.

15. In response to this picture of potential decline, raiders would say BP is tending to throw money at the problem (exploration, capital expenditure, acquisitions) but with little success. They would also argue that the existence of BP's cash mountain will encourage further diversification attemps and further wasteful expenditure. This is not in the shareholders' interests. The cash should be returned to the shareholders and not wasted by BP.

D. Hanson Trust

16. It is pretty unlikely that a US company would mount an attack on BP. They would tend to be put off by uncertainty about the political reaction. The US raiders are in any case licking

their wounds after their recent set back in the US courts. We need to look within the UK for a raider and Hanson Trust look the part.

17. Hanson's activities to date are not precisely those of a US corporate raider. Nevertheless thcy come pretty close. Hanson is to a large extent a sophisticated asset stripper. Its growth comes primarily from acquisition rather than from organic activity. It does not dispose of acquired asset with the alacrity (and publicity) of the asset stripper of the early 1970s. Some disposals are made but in addition those retained tend to be run on a very tight rein to generate cash to finance more acquisitions.

18. This is reflected in expenditure on fixed assets. In stark contrast to BP, Hanson's capital expenditure is, if anything, below its replacement cost depreciation. In the last two years (£ milion) :

	1983	1984
Capital expenditure	39.6	49.5
Replacement cost depreciation	37.9	52.5

19. As well as using cash generated internaly to finance acquisitions, Hanson also have fairly frequent rights issue and periodically fairly heavy borrowings (shades of the "junk bonds" approach used by US raiders).

20. What would Hanson do to BP? The first thing that has to be said is that he would find it very difficult to take over. BP is something like seventeen times the size of Hanson in terms of assets employed - before any value is placed on BP's oil in the ground. Where Hanson does score is in terms of the return on shareholder's equity (%) :

	1980	1981	1982	1983	1984
BP	24%	14%	10%	11%	15%
Hanson	21%	21%	22%	15%	31%

21. Hanson would no doubt play on this. He would have to argue that, although the acquisition would be largely financed by borrowing, this would be quickly run down by using BP's liquid assets, by cutting back its capital expenditure, exploration and overhead costs and by disposal of past acquisitions.

21. Against this background the consequences of a successful bid would probably be :

(a) a reduction of possibily 50% in both BP exploration programme and its capital expenditure;

(b) a rundown of its corporate overheads;

(c) the liquidation of its financial investment;

(d) the disposal of fringe businesses - such as BP minerals (ex Selection Trust), BP Nutrition, BP shipping, BP metals (ex Kennecott)

(e) sale or closure of some downstream capacity;

(f) sale of the Sohio shareholding. Hanson might wish to apply the same treatment as in (a) to (e) above to Sohio but he would probably need to realise cash for the shareholding to run down his own borrowing. It is not easy to identify the price Hanson might get for the holding. Sohio bought in some of its own shares in 1984and, at the price of that transaction, BP's holding is worth some £6¼ billion.

(g) a halt to BP's acquisition plans. BP's corporate finance people recently had a session with Hanson's. This was intended to help BP to learn how to mount a successful take over campaign. This may have given Hanson some insight into BP's own plans.

23. In the short term a move by Hanson would be likely to enhance the value of our shareholding in BP (currently worth some £3 billion). In the longer term, if BP managed to defeat the bid, its defence would probably involve some of the moves described in paragraph 20 above. This would boost earnings per share and so probably give a lasting rerating to its shares. We would, of course, have to decide on a stance towards the bid.

SAR

S A ROBSON

Bradbury letter attached.

SECRET AND PERSONAL

NB emphasis for disposal of BP residual

Hanson would reappear on Burmah Board?? (& Govt [illegible] [illegible]??)

From: SIR PETER MIDDLETON
Date: 7 June 1985 shareholding

CHANCELLOR

cc Mr Robson

__BP__

I promised you some further thoughts on BP. The position as I see it is as follows:

(a) the Government believes in letting markets work. Therefore there is a strong presumption that you should not try to stop Hanson;

(b) BP is not obviously using its current assets very effectively. Nor is it likely to do so in future. Its activities are increasingly being driven by a desire to reduce its embarrassing cash mountain. History suggests this will not lead to successful investment;

(c) a successful bid would change all this. There would be a considerable rationalisation of, inter alia, BP's downstream activities. Some of this would have happened anyway. But Hanson is likely to do it much quicker and much more thoroughly. Many jobs in areas of high unemployment would be at risk;

eg.

(d) even an unsuccessful bid would shake up the management and force BP to consider its own activities much more seriously than it does at present;

(e) any bid, successful or not, would therefore raise BP's earnings per share and so its share price;

(f) it would increase the value of the Government's shareholding pari passu.

2. If this was a normal company there would be no doubt about the advice - let the bid go ahead. Let the market decide. Sell the Government's shareholding to the bidder if he gets a majority of the shares available on the market.

3. I doubt myself whether Hanson would actually succeed in his bid any more than T Boone Pickens has with his. But the results could still be good for BP; indeed this might be the most satisfactory outcome.

4. But BP is not a normal company. There has been a long history of Government involvement - as exemplified by the shareholding and the Bradbury/Bridges assurances. I doubt whether these have much relevance today - though we should have to consult the lawyers to be sure. But, for emotional rather than economic reasons, BP is still regarded as an important national strategic asset. And Hanson is widely thought to be a high-class asset stripper. So there is a political dimension which only Ministers can judge. Everyone expects privatisation but can you stand Hanson?

I doubt it. Frankly. But worth putting to the PM.

5. My own inclinations - and those of Mr Robson who is the only official aware of all this - would be to give Hanson the green light to bid for BP in the market and see what happens before deciding whether to sell the Government's shareholding. In view of the political sensitivities you may first wish to get Hanson in and tell him that the Government stance towards

him making the bid depends on a satisfactory explanation of what he intends to say (when making the bid) and do (if successful) about BP's UK downstream activities.

Will he tell you?

6. Another risk is that there could be other bids - probably from overseas. Hanson seems the only likely domestic bidder, but others might emerge.

7. One final point. A bid for BP will be a major event. It could distract a lot of attention in the media and the City from our efforts to market Britoil in the run up to the sale of our holding at the end of July. Against that, a demonstrable readiness by the Government to see BP taken-over could have a beneficial impact on Britoil's own share price. On balance this means we want to see Hanson move before the end of June or not until after the Britoil sale.

PEM

P E MIDDLETON

Thanks. Note (v). I answer with Jim OTO. N.

FROM: H J DAVIES
DATE: 6 FEBRUARY 1986

CHANCELLOR

cc FST
Sir P Middleton
Sir T Burns
Mr Monck
Mr Moore
Mr Cassell
Mr Cropper
Mr Lord

C./ Useful note. Various telexes below.

RS 7/2

BP VIEWS

I had a conversation today with John Browne, the Chief Executive of BP Finance. He made the following points about the oil and foreign exchange markets:

i) BP are internally forecasting some bounce back from the current price level. They were not overly confident about their forecasts, but for what it was worth were expecting the price to stabilise just below $20 a barrel.

ii) The stock market has not fully adjusted yet to lower oil prices. AMOCO and ARCO were the belweather stocks and had not moved as much as one might expect.

iii) This, to BP, indicated the possibility that the foreign exchange market, too, had not yet fully adjusted to a price as low as $16.

iv) The cable rate had so far held up well, because there was great nervousness about holding dollar assets, and the interest rate differential was attractive enough to hold up sterling. But the market was very fragile and BP had not yet made any major adjustments to its currency holdings, but might do so in the face of a further adjustment in oil prices.

v) On the point in the Financial Times Leader, he thought that the average price was still considerably higher than the Brent spot, but that all prices would inevitably come back to the spot level.

They can't expect to recoup it all themselves! What about us?

vi) Margins on domestic retail business were fatter than before. But the additional profit was not enough to compensate for upstream losses.

vii) Some companies operating in the North Sea were worth nothing at all at this oil price. Their stock price was held up by the prospect of dividend cover, but it was not clear how long that could last.

viii) There was market talk of problems in the US banking system. They would not be revealed until 90 days after the end of the first quarter, and he was not taking them too seriously yet.

HJD

H J DAVIES

RT8.11

CONFIDENTIAL

FROM: A W KUCZYS

DATE: 5 March 1986

CHANCELLOR

Thanks. Comments within.

IMPLICATIONS OF LOWER OIL PRICES

Three separate notes are attached.

Oil prices and North Sea oil and gas development

2. The Energy Secretary minuted the Prime Minister on 25 February on the implications of falling oil prices for North Sea development and the offshore supplies industry. Steve Robson put up a draft minute on 28 February, recommending that you resist Mr Walker's proposal to set up an interdepartment study by officials. While agreeing with this conclusion, Peter Middleton and Frank Cassell were concerned that it looked a bit odd against the advice on Mr Walker's later minute (about the impact on the NCB and ESI), which was that we should set up an official group. They felt it was important that you should not, therefore, appear too negative on Mr Walker's first proposal. Steve has now accordingly submitted a revised draft.

Implications of lower oil prices for the NCB and ESI

3. Mr Walker sent a further minute to the Prime Minister on 27 February, about the implications for the coal and electricity supply industries. Here, Steve's advice is that officials should examine the prospects against a range of oil price forecasts.

Fall in oil price: Impact on PRT rules

4. Thirdly, the Revenue's note of 28 February explains how the rules for advance payment of PRT lead to cash flow disadvantages

for companies at a time of falling oil prices. The Financial Secretary's recommendation, subject to your views, is that we should take no action.

AWK

A W KUCZYS

FROM: THE RT. HON. JULIAN AMERY, M.P.

112, EATON SQUARE,
SW1W 9AA
TEL: 01-235 1543
01-235 7409

Pse reply (I will top & tail)

Many thanks for your letter of 7th March and accompanying notes ~~[illegible]~~ about your visit to Saudi-Arabia. ~~[illegible]~~

C/ Worth glancing at record of Yamani meeting

Your talks were clearly very worth while, and I read both notes (although page 6 of the longer one was missing) with much interest.

I hope the Saudis do fully understand that we are not prepared to join them in cutting back production: that is entirely (and genuinely) a matter for the oil companies, and will remain so, and I don't expect the oil companies to cut back, either. If the Saudis believe otherwise, and are still trying to persuade HMG to cut the sea production, they are wasting their time, and basing their policy on a false premiss.

7th March, 1986

Dear Nigel,

You were kind enough to ask me to come and have a talk before I went to Saudi Arabia.

I enclose two notes, one which I sent to Geoffrey Howe and one made by the Commercial Councillor at the Embassy, of a talk we had with Yamani.

The Saudis were very insistent on the psychological impact which a British cut-back in oil production would have. I don't think, however, that they expect it and I think they know perfectly well that it would not have much impact on the market.

They can't lose on oil prices ~~in~~ themselves, since they can produce the cheapest oil in the world. On the other hand I ~~thought~~ think they are worried at the impact on the international banking system in which they are involved and on the effect on the more expensive Arab producers such as Iraq who they are currently subsidising.

Yours ever,

Julian

Julian Amery

The Rt. Hon. Nigel Lawson, MP

CH/EXCHEQUER	
REC.	11 MAR 1986
~~ACTION~~	MR ROBSON
COPIES TO	CST, FST, EST, MST
	SIR P. MIDDLETON
	SIR G. LITTLER
	SIR T. BURNS

MR CROPPER
MR LORD
MR H. DAVIES
MR CASSELL
MR LAVELLE
MR MOUNTFIELD
MR MOORE

✓ 11/3

Reference.......................................

HMA
HofC
1 Sec (L)

SAUDI OIL POLICY

1. I accompanied the group of MPs, led by Mr Julian Amery, to their meeting with Sheikh Ahmad Zaki Yamani at his house on 18 February. The meeting lasted from 1035p.m. to 12.15a.m. and was friendly and informal. The Minister was on his most effective form, speaking in his quiet way with eloquence and intensity; and there were no signs of ill-health or unhappiness with his present position.

2. Sheikh Zaki began by explaining the reason for the change in Saudi oil policy last Autumn. In August 1985 Saudi production had dipped to 2.1mbpd (1.3mbpd export), a cut in Saudi oil earnings of almost two-thirds below their full quota earnings. The Saudi Government had then increased production through net-back deals, with the effects seen. He had read in the British press and elsewhere that Saudi Arabia had thereby forced the world oil price down, but this was not the case. Saudi Arabia had always wanted Opec producers to maintain discipline and non-Opec producers to co-operate. When they did not, Saudi Arabia was left like a man staggering along the road with a heavy load, who reaches the point of exhaustion and drops. So the Saudis could not be given the credit (some would say the blame) for what had happened. It had just happened.

3. Saudi Arabia's next move had been to look to Opec for a fair market share. How could that be calculated? Iraq was fighting a War, and she could not be asked to produce below her full capacity. Nigeria was hungry; the UAE Sheikdoms could not be disciplined. Equador was poor. So an Opec production total of 16mpbd was no longer a valid figure. As for non-Opec producers, how could Mexico survive without high production? Everyone was suffering. The situation could easily be controlled, but it needed the co-operation of everyone to do it. Otherwise market forces prevailed. This was an unprecedented development: always in the past the market had been controlled either by the oil companies or by the producers.

4. He said that he himself did not subscribe to the view that the UK would benefit from lower prices. There were certainly positive consequences, but the negative ones were serious for banks, oil companies, North Sea production and exploration, the coal industry and the balance of payments. Consumption of oil would increase while reserves dropped. In the further future, a new energy crisis would develop, once again created by the mistakes of producers and consumers. The oil companies precipitated the 1973 crisis; the Iranian revolution and some factors he still did not fully understand generated the 1979 price rise. It was strange at that time how consumption went down but demand went up, taking prices with it: it had to be explained by oil company speculation and stocking. Now the consumers were making the same mistake in reverse. The price was being forced down by a glut, but it would just as suddenly shoot up again. It had to be remebered that oil could not be treated like any other commodity, because of the long lead time needed to change production patterns. As for the future, his crystal ball was broken. Anything could happen. The price could go down to $10 or below, or there could be a sharp increase if anything dramatic happened in the Gulf War. It made economic planning a miserable job.

....../5.

5. Mr Amery said that it was clear that the old market system was now broken. Saudi Arabia was lucky to have such a great production capacity, but even the Saudis might not be able to influence the market, any more than the Federal Reserve Bank could influence the price of the U.S dollar. Certainly the UK could not play more than a marginal part. How could the market now be controlled? Sheikh Zaki said that he underestimated the role of the UK: the British were definitely the key. Their power was beyond the imagination of anyone in this respect. Mr Amery was wrong to say that Opec's power was broken: the organisation was weak, but it would come back. Mr Amery and he would live to remember that. He reminded the group that he had been right in saying in 1979 that the price would come down, when everybody assumed that it would still go up further; he was right in 1981 in saying that Saudi production would eventually come down from 10mbpd to 4mbpd. On both occasions people had thought he was mad. Today the oil price drop was another mirage and in due course there would be a further sharp increase in the oil price.

6. Asked again to explain how the UK could exert influence, Sheikh Zaki said that the whole of Opec was now ready to control production. The British Government might think that controlling the market was a sin, but what was expected from the UK was more than from Oman or Venezuela. The Soviet Union had told him that it would curtail its production, and he believed them. The only country not prepared to discuss the subject was the UK. It was their right: he respected that. But he would not accept that the UK did not have the power to intervene. Indeed, her power was greater at the moment than Saudi Arabia's. Only three hours previously he had been sitting on the same seat talking to the Saudi Ministers of Finance and Planning about how they could stem the serious draining of Saudi financial reserves. Oil was everything to Saudi Arabia, which was a poor country without it. The Government was therefore desperate to find a way of preventing the reserves from running out.

7. Mr Amery said that oil production represented no more than six or seven percent of the UK's gnp. Moreover, the small amount by which, in theory, we might curtail production would have no effect on the market. Mr Brown asked whether the Saudis had taken the effect of conservation measures in the industrialised world into account. Sheikh Zaki said that they had. There had been a structural change in demand which had brought it down. Electricity generation was one factor, energy conservation was another. But that was a one-off process, which was now completed. Buildings had been insulated and cars would not get any smaller. In fact the trend was the other way. He had thought that the immediate impact of the present drop in prices would be zero, but it was already apparent that the effects were considerable. Fuels used for power generation were changing; already the Australian coalmines had been affected. Oil companies were going out of business and the first US Bank had just collapsed. He had no doubt at all that the consequences would affect more than just 6% of the UK's economic activity.

8. Mr Aitken said that he agreed that many people in the UK were concerned about developments. He had talked with British oil executives who were worried. But how would it work if the UK cut production? Opec had failed before to agree amongst themselves, and now the Minister was talking about a worldwide agreement. It seemed no more feasible for the oil price to be controlled than for foreign exchange rates to be managed. Sheikh Zaki said that he was sure that central banks did influence exchange rates. As for oil, he knew that the UK had the legal power to intervene on production levels if the Government wished, even with BNOC dispanded (Mr Amery agreed on this point). Second, whereas Opec discipline looked hopeless up to last November, it was now very different. Everyone had begun to see where their real financial interests lay. Mexico was prepared to lower production, so was Oman. Egypt and Malaysia had already done so.

......./Producers

producers were coming to him and asking how much he wanted them to cut. They saw the correlation between lower production and higher income. So should the UK. He had made calculations for those who might not be prepared to cut, eg. Venezuela and Nigeria. But order could still be restored with the UK and Norway. The members of Opec were frightened: and the UK held the key.

9. Mr Deakins asked how great a UK cut would be necessary. Sheikh Zaki said that as soon as the UK agreed to discuss oil price levels informally, it would affect the market. If the answer was that the UK would benefit from a lower oil price, and would not discuss co-operation, that was fine. But he was a friend of the UK - his second home was there - and he was telling the UK that the negative impact would be far greater than people thought. Mr Bell said that he could see the effect already in his North Sea coast constituency. These matters needed to be debated thoroughly. Sheikh Zaki said that he implored the MPs not to use publicly what he was now saying to them. He could not be seen to be talking against policies of his own Government. He was speaking personally and as a friend. The UK would be hurt. The marginal costs of producing in the North Sea were not as low as the press said: maintenance, debt servicing, the drilling of extra production wells all had to be accounted for in the North Sea, and were expensive. Fresh money had to be injected constantly. If the market continued like this for a year it would be really alarming for the oil companies; and the impact on the banks would be hard. The first US bank was already going under. The UK was still a world leader and recognised that she had world responsibilities.

10. Mr Amery said that a potential banking crisis was the real point. But preventing that was much more than the UK could manage. Sheikh Zaki said no doubt the UK wanted to punish Opec for providing the money to the banking system in the first place for their expensive loans. Saudi Arabia was against a sharp increase in price in the 1970s and was against a sharp drop now. In a few years time, people would look back and see that the Saudis were right. The philosophy of non-intervention in markets only went as far as people wanted it to go: look how President Reagan and the group of five had knocked down the value of the dollar by as much as 25%. Where was laissez-faire Reagan in that?

11. Mr Brown asked whether he was saying that a sign from the UK could affect the psychology of the market enough to push oil prices back up. Sheikh Zaki said that he did not yet know who had been behind the forcing down of the oil price. Perhaps the UK had been involved, but he doubted it. The UK's productivity was lower than her main industrial competitors, and the French, Germans and Japanese would reap a greater advantage from an era of lower prices. So he could not believe that the UK had helped orchestrate the drop. It had to be remebered that the Middle East was not a relaxed piece of real estate: the price would rise again rapidly in due course. That was his strong feeling; and it was against the UK's interest in the long run to help bring the price down. If nothing serious happened in the Gulf War, the price would fall below $10.

12. Mr Aitken asked whether he could see Saudi Arabia producing at a very high level again, if necessary. Sheikh Zaki said that it would, if necessary. But he had always fought against a policy of that kind.

13. Mr Heathcot-Amory pointed out that the Minister had been highly selective in naming the countries who would suffer from a drop in oil prices. Many countries in the world with financial problems would now benefit, eg. Poland, Turkey, Argentina, Brazil. It would not be all bad for the banks. Sheikh Zaki said that if he put one of his feet into a pot of boiling water and the other into a pot of freezing water, it might be said that his feet were comfortable on average. But in truth, of course, they were not.

J Q GREENSTOCK

cc: HMCG, Jedda
Chanceries: Opec Posts, Moscow

FROM: THE RT. HON. JULIAN AMERY, M.P.

112, EATON SQUARE,
SWIW 9AA

TEL: 01-235 1543
01-235 7409

7th March, 1986

Dear Geoffrey,

I was in Saudi Arabia from 15th - 19th February with a small delegation from the British Saudi Arabian Parliamentary Group. Jonathan Aitken, Robert Cranborne, John Browne and David Heathcote-Amory came from our side. Eric Deakin, Stuart Bell, Kilroy-Silk and Home Robertson from the Labour Party. St. John Armitage, Secretary of the British-Saudi Arabian Group and ex FCO, also came with us. We all got on very well with each other, and to the best of my knowledge, nothing was done to cause offence to our Saudi hosts. On the contrary I think the Saudis were really glad to see us. Certainly the warmth of our welcome increased day by day.

Thanks to Jonathan Aitken's remarkably wide range of contacts with Saudi leaders both from the older and the younger generations and to St. John Armitage's long experience of Saudi Arabia we saw a very wide range of personalities in the five days we were in the Kingdom. I derived some personal reflected glory from the fact that I had known King Abdulaziz as long ago as 1943. I attach a note of our programme which will give you some idea of the ground we covered.

Our delegation was briefed by the Foreign Office before we left and we had a further and fuller briefing from Sir Patrick Wright who has also written notes of the main meetings we held and at which he or someone from his office was present. I attach a few additional notes of things which struck me personally and which you may like to glance at.

Yours ever,

Julian.

Julian Amery

Rt. Hon Sir Geoffrey Howe, MP

FROM: THE RT. HON. JULIAN AMERY, M.P.

112, EATON SQUARE,
SWIW 9AA
TEL: 01-235 1543
01-235 7409

NOTES:-

SAUDI RESENTMENT OF THE BRITISH PRESS

The Minister of information devoted more than an hour to discussing with us what the Saudis allege to be the unfriendly attitude of much of the British press towards them. He explained both at the meeting - and again in a private talk with me - that he was acting on the express instructions of the King. This was emphasised by the fact that our talk was taped and videoed so that the whole conversation could be sent to the King who was resting in the desert!

The main Saudi grievance concerns a well informed article which appeared in the Economist written, I think, by Miss Duncan. This was by no means unfriendly but did have some rather uncomplimentary remarks about the King and other members of the Royal Family.

The Minister also expressed the hope that we would find a way of persuading the press not to link the impending trial of Prince Mansur on drug charges too closely with the Saudi Royal Family as a whole.

. I did my best, as did my colleagues, to explain the very strict limits within which we can hope to influence the British press and pointed out that London was also an Arab capital and that journalists in London were naturally fed a good deal of information from Arab sources which might be unfriendly to Saudi Arabia. I took the opportunity to point out, gently, that the Editor of Sharq Al Jadid not only wrote in London but was on the Saudi diplomatic list. The Minister took the point.

I do not know that there is much we can do about all this. The only suggestion that occurs to me is that the Department might build up a small file of the more scurrilous press attacks in the British press on members of our own Royal Family and let the Saudis see it as evidence of how little influence we can exert on our press.

I think the more sophisticated Saudis understand the position perfectly well. They are, however, afraid that their less educated public opinion might interpret attacks on their rulers in the British press as inspired by HMG.

THE OIL PRICE

The Saudis have been wise in their own generation in spending the oil money while the going was good. They seem to have appreciated that the price which had leaped from $3 a barrel to $36 a barrel in five or six years could not stay at that peak. They accordingly spent as hard as they could on modernising the infrastructure of the country; roads, harbours, airfields, hospitals, schools, housing, petro-chemical projects etc. This programme has been, so they say, virtually completed. They are now left with the much cheaper problems of maintenance and getting the right people to man the permanent jobs created.

Much of the weight of the recession has been absorbed by the expatriates - both expert and unskilled - whose numbers have been drastically cut down. There has also been ~~by~~ some reduction in the ludicrously extravagant standard of living to which the Saudis had got used e.g. having five or six cars per family - and this in a country where women are not allowed to drive. Rents and houses and land prices have dropped substantially. There is, of course, no direct taxation so any hardship produced by the currect recession has been relative - expectations disappointed rather than real losses, though there have been some of these

We had a meeting with the Governor of the Saudi Monetary Fund - the nearest thing to their Central Bank. He was the soul of discretion but left us with the impression that they had drawn further on their overseas reserves than they liked to admit. A chance remark of Sheikh Yamani seemed to confirm this.

We also had a very relaxed after dinner talk with Sheikh Yamani. His main purpose was to try to persuade us to cut back production in the North Sea.

Sheikh Yamani knows perfectly well that we are not big enough producers to influence the price of oil to any serious extent especially when larger producers in the OPEC cartel are cheating blatantly. He argued, however, that a British cutback in production would have a psychological effect out of all proportion to its material effect. The commercial councillor's note of this conversation is both detailed and accurate.

The Saudis are in an impregnable position where oil is concerned. They produce the cheapest oil in the world and have virtually unlimited reserves. They can always find a market for their oil. Their concern arises rather from anxiety over the international banking system in which they are deeply involved and with the impact of lower oil prices on other Arab producers such as Iraq, Egypt and Algeria. The cost to them of subsidising the Iraq war will rise in proportion to the fall in the oil price.

SECURITY AND SUBVERSION

The Saudi leaders were remarkably frank and open both at formal meetings and in private talks. I am inclined therefore to believe them when they say - and they include the Minister of the Interior, the Deputy Governor of Riyadh and the Governor of the Eastern Province - that they have seen no evidence of organised Communist or Fundamentalist subversion. The total absence of cafes or bars makes it difficult for people to get together and conspire outside the circle of the family and intimate friends, and the authorities keep a pretty vigilant eye on the comings and goings both of Saudis and of expatriates. Compared with most other countries in the area Saudi Arabia would seem to remain an island of internal stability.

to some extent from their principal Western ally, the United States, and from the West as a whole. They are, of course, scared of the Palestinians in their midst and terrrorism generally and pay a good deal of Danegeld to keep it away; and it is important where their public opinion is concerned. But as the Deputy Minister of Foreign Affairs and the former Ambassador to London, now Minister of Health, made it pretty clear they know this is something they have got to live with for a long time. It is by no means at the top of the agenda. 9

GENERAL

I have a number of friends among the older generation of Saudi leaders and Ministers but I had not previously had the chance of meeting the new generation of young Princes and Ministers, mostly graduates from American and a few from British universities, who are beginning to take over at a lower level. I was very impressed by the way in which they appear to combine respect for traditional values and a pretty sophisticated understanding of the modern world.

I suspect that, like their fathers, but perhaps with more discretion, they recognise that it is their self-interest to behave according to strict Islamic principles when at home and rely on their holidays to give them an opportunity to follow the mores they may have learned in the West.

It is, I think, very much our interest to cultivate them when they come to Britain and do what we can to steer them towards friends and families who's society and interests they might enjoy.

***

JULIAN AMERY

6.3.86

Ali Nasser's movements since then are still not very clear. He seems to have gone first to his own tribal area Abiyan then to Ethiopia where he was the guest of Mengistu - with Soviet approval? Then to Sanaa. The Saudis still seem to regard him as the legitimate Government and if he were in the country and had somehow gathered Resistance behind him, would be tempted to give it support. For the moment, however, their policy seems to be to wait and see.

I would suggest that we do the same. When Abdul Nasser overthrew the Imam of North Yemen in 1962 we very nearly made the mistake - at U.S. insistence - of recognising the puppet Republican regime set up by the Egyptians. Luckily for us, we waited and presently saw that there was a substantial Resistance movement. We were thus able to continue recognising them as the legitimate Government and so - as now in Afghanistan - to give them support without international embarrassment.

THE IRAN-IRAQ WAR

There was a clear current of anxiety about the outcome of the war but no panic that I could detect. The Saudis seem confident that as long as the Iraqis had superior air power it was unlikely that the Iranians could break through to Basra. Their nightmare would, of course, be the declaration of an Islamic Republic of Basra. They didn't seem too concerned that this would happen.

Equally ~~un~~realistically they are frightened of a collapse of Iran and ~~a~~ the possibility of the Russians taking advantage of this.

As they pay the Syrians a great deal of subsidy they seem to be doing their best to work on the Syrians to persuade the Iranians to come to terms and at any rate to stop the Syrians taking advantage of the situation against the Iraqis.

I was struck by how little the Saudis spoke favourably

THE ADEN REVOLUTION

The following analysis is based on talks with Prince Sultan the Minister of Defence, Prince Naif the Deputy Minister of Interior, the Deputy Minister of Foreign Affairs and Prince Abdurrahman bin Yahya ~~the~~, uncle of the Imam of the Yemen.

It would appear that President Mohammed Ali Nasser of the South Yemen republic found the economic going increasingly hard as the recession of the last few years began to bite in the Middle East. Since the Soviets could not provide him with the necessary economic and financial aid he resolved to seek some support from his more moderate neighbours. In the process he strengthened relations with North Yemen, established diplomatic relations with Oman and made overtures to Saudi Arabia.

It is thought that the Soviets did not object to these initiatives but rather encouraged them as paving the way for the establishment of their own diplomatic relations with Oman and the U.A.E. It may be, however, that they thought there was a danger of Ali Nasser going too far in a pro-western direction. Abdul Fateh Ismail was accordingly sent back to Aden; and here opinions differ as to whether this was to act as a brake on Ali Nasser or to supplant him.

Ali Nasser, however, seems to have come to the conclusion that Abdul Fateh Ismail's objective was to overthrow him and accordingly decided on a pre-emptive strike. Hence the invitation to Abdul Fateh Ismail and his friends to a Politburo meeting where Ali Nasser's men tried to bump them off with only partial success.

The Soviets do not seem to have been prepared for this which rather suggests that they were not planning a coup at any rate at that particular time. When the crunch came, however, they decided to support the Army against Ali Nasser.

PPS PSL

FROM: THE RT. HON. JULIAN AMERY, M.P.

112, EATON SQUARE,
SWIW 9AA

TEL: 01-235 1543
01-235 7409

Personal

20th March, 1986

Dear Nigel,

Thank you for your letter of 17th March about my visit to Saudi Arabia. Here is the missing page although I am not sure it is of great interest.

Two points about Yamani's attempted pressure on us to cut back North Sea oil production may be worth repeating.

A. A leading Omani Arab who knows Yamani well came to see me yesterday. I asked him if he thought that Yamani really believed that a cut back in North Sea production would have more than a cosmetic effect on the oil situation. He said that Yamani knew perfectly well that it would not have any far reaching effect. The Saudi Royal Family had been threatened physically by the Libyans and Algerians who held them responsible for the fall in the oil price; and Yamani was trying to shift the blame on to other shoulders. It was mainly a public relations operation.

B. I had a visit some time ago from John McKinley, the chairman of Texaco, who seemed inclined to favour a cut back in North Sea oil production. ~~and~~ His top man in London followed this up with a visit yesterday. He showed much less interest in a cut back. I said, that as far as I knew, we had no intention of leaning on the companies and that as far as I knew there was no expressed wish on their part to cut back production. In reply he went on to some technalities which I couldn't quite follow but which suggested that if the companies cut back at Government request they would want some kind of compensation! He went on to say that if the American companies cut back to limit~~ed~~ North Sea production they might well be in breach of the anti-trust laws in the U.S.

Perhaps you would keep the details of this exchange with Texaco and myself, private. I don't want to make any bad blood between them and the Department of Energy.

../.

The Rt. Hon. Nigel Lawson, M.P.

As I am writing may I say how much I admired your Budget and the way in which it was delivered. You made a remarkable number of bricks with precious little straw. But what really matters is the direction in which you have pointed the economy. The drop in the oil price seems to me the best news for a long time and despite the loss of revenue for us it is really the biggest disinflationary development which could have taken place and takes away some at least of the need for high interest rates. You would know much better but my own guess is that the drop in American long-term bonds is directly related to this.

Yrs ever,

Julian.

Julian Amery

The Rt. Hon. Nigel Lawson, MP.

[missing Page 6 of notes referred to in letter of 7th March '86 from Julian Amery to Nigel Lawson – re. Saudi Arabian Visit.]

of King Hussein. They never in my presence criticised him but the absence of positive support - though not ~~to be~~ unexpected - was noticeable.

THE GULF CO-OPERATION COUNCIL

In all our talks the Saudis expressed their support for this and their general feeling that it was making progress.

Different conversations, one of which is reported in the Ambassador's account ~~in~~ of our talk with the Deputy Minister of Foreign Affairs, left me with the impression that the Saudi border with Oman and indeed Abu Dhabi is still a matter of some concern to them. They are not satisfied with the present situation.

In view of the Tornado and other interests we have with Saudi Arabia I thought it wiser not to investigate this too closely.

THE PALESTINIAN PROBLEM

The discussion of the Peace Process and the Palestinian problem occupied a quantity of time which I would judge to be an inverse ration to the actual importance they attach to it. Al Tuwaijari, for example, the Crown Prince's right-hand man, devoted an hour and a half to it (admittedly with translation). Before our dinner with Prince Faisal bin Turki, the Chief Commissioner for Yanbu and Jubail, ~~We~~ we also had something like a debate on the Palestinian problem. When we got down to details, however, such as the failure of the Palestinian delegates to London to sign the communique or the position of Arafat, there was a determined refusal to deal with these particular points. My own guess is that this is an affair of the heart rather than the mind. Intellectually the Saudis are much more concerned with the Iran Iraq war and what goes on in Aden, than with the Peace Process. The Palestinian issue, however, gives them a good card to separate themselves

WITH COMPLIMENTS

Lord Hanson

Why BP needs to spend its cash

BY JUDI BEVAN

THE stock market has got a bee in its bonnet about BP's cash mountain — £2·6 billion at the last count and rising. So far this year, there have been rumours that BP was about to buy Midland Bank, Northern Foods, its own shares, a tranche of Government-held shares, 49 per cent of Britoil, Rowntree Mackintosh, a stake in British Gas and Johnson Matthey. As yet BP has confirmed serious interest only in the last and even that seems to have subsided now.

City pundits have long tired of speculating on Lord Weinstock's hoard of around £1.5 billion at GEC and no one ever seems to ponder what those tight-lipped men at Royal Dutch Shell might do with their princely stash of £6 billion.

So why the fascination with BP's spending plans? As ever with the City, it has novelty value. After a decade and a half of life on the breadline, BP has money pouring out of its ears—it has even formed a quasi-bank to manage it properly and to study various potential homes for it.

BP chairman Peter Walters: pondering an encore

Finding oil, as the oil companies never tire of telling us, is an expensive business. BP spent £436 million on exploration alone in 1984 out of a total capital expenditure for the group of £3·8 billion. In the 1984 accounts, £10·5 billion is authorised for future exploration. Meanwhile, the oil price is falling.

During the late 1960s and early 1970s BP had a string of exploration successes starting with the fabulous Forties taking in the giant Prudhoe Bay and Kaparuk fields in Alaska and ending with magnificent Magnus in the North Sea in the summer of 1974.

In the last ten years or so there has been a noticeable dearth of big finds. The best thing has been the Miller Brae discovery in 1983 reckoned to be about 300 million barrels, but still be half the size of Magnus and a sixth of Forties.

All through the 1970s BP's problem was how to get enough cash to bring these finds on stream. Now it has an embarrassment of riches as all these discoveries are pumping out oil and there are less major developments to spend money on.

BP has been trying hard—in Alaska's Mukluk and in China with a notable lack of success. It is partner with Lasmo in Indonesia but the scale of finds to date have more significance to a £400 million company like Lasmo than a £10 billion giant like BP.

So while it is nice to have the money, BP would rather see some prospect of rising oil production in the 1990s. Most analysts reckon that BP's production is due to peak from 1988 and begin to trend slowly downwards from then on.

That is one reason why it is unlikely that BP will use the money to diversify into food or banking proper, although it has clearly thought about moving into financial services sector. But the priority is replacing its oil and gas assets.

Coming across big oil fields has become increasingly rare world-wide and discovering small oil fields increasingly expensive. Finding and producing oil from a small North Sea field these days costs over $15 a barrel.

It can be a lot cheaper to buy it in, as Shell proved on Wednesday, buying half Occidental's 1.3 billion barrel find in Colombia for $1 billion — or around $4 a barrel after allowing for costs. That is the sort of deal BP would love.

But BP is unlikely to follow Shell's lead with Shell Oil and buy in the 45 per cent minority of its American subsidiary Sohio. Rather it is encouraging Sohio to buy in its own shares, thus increasing its own percentage gradually.

Instead it is in the happy position of being able to watch the weak, debt - burdened oil companies like Chevron, Texaco, Mobil and Phillips get frailer as the oil price slides towards $20 a barrel.

Some of these companies are already selling off assets. Phillips has its Dutch acreage up for sale, as does the smaller Placid, where Enterprise is said to be sniffing.

Chevron is selling off bits of Gulf and Atlantic Richfield is going in for a very serious rationalisation. These are highly attractive situations for BP.

There is no immediate pressure for BP to spend its money, especially with real interest rates of 5 per cent plus. Meanwhile it can nibble away at specialist chemicals acquisitions and small deals in minerals, coal and nutrition.

But within the next 18 months, BP will have to buy some sizeable oil assets. It has coveted Britoil since it was still part of BNOC but the Government remains committed to selling shares to individuals and there is an unwritten law that BP stays clear of other British oil companies.

A piggy bank worth £2·6 billion is nice to have around, but as always, the price of success is that everyone wants to know what you are doing for an encore.

Sir Peter Middleton.

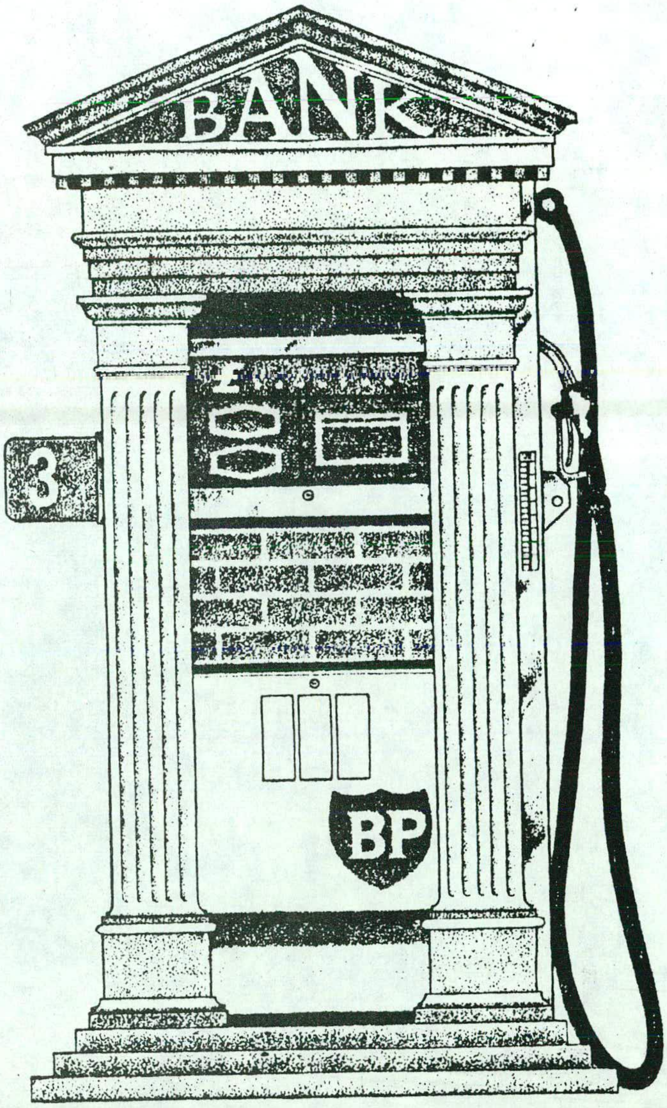
Help!

ANCIAL TIME

BP goes into the banking business

When a company turns into a bank as well . . .

David Lascelles reports on the implications of multinationals managing their own finances 18



Michael Dale

SIR PETER WALTERS, chairman of British Petroleum, was in Hong Kong last week attending the International Monetary Conference—an exclusive event to which only bankers are usually invited.

But Sir Peter had a special claim to be there: apart from being a big banking customer, BP is now in the banking business itself. In January it launched its own in-house bank, initially to handle the huge oil group's finances but maybe later on to offer banking services to outsiders as well.

If the bank evolves as planned, its balance sheet will consist of virtually the entire financial assets of BP, over £10bn, which would put it among the 100 largest banks in the world, and create a formidable competitor to established banking institutions.

The apparent novelty of BP's move was re-inforced in April when Volvo, the Swedish car manufacturer, also unveiled plans for an in-house bank that would rank among the largest financial institutions in Sweden, and again challenge the borders of the conventional banking business.

Despite the publicity both companies received, neither was actually breaking new ground. ICI, Dow Chemical and even the Co-operative Wholesale Society have nurtured banks which evolved over time to stand on their own feet. And coming as BP and Volvo did in the wake of the near collapse of one of the most notorious industrial company-owned bank of all, Johnson Matthey Bankers, they could also have been better timed.

Nonetheless, the initiative by these companies indicates two things: the close resemblance that the treasury departments of large multinationals have to banks these days, and the attraction of the financial services market as an extra profit-making outlet for an industrial company's financial strength and skills, which can be considerable. Both Volvo and BP have huge cash resources and turn over billions of dollars in the foreign exchange markets each year, all of it needing tight co-ordination to avoid waste.

Most large companies are already in the banking business to some extent, particularly if they are active in the $250bn U.S. commercial paper market, which is where corporate treasurers trade their IOUs directly, without going through banks. Some people believe that companies will also start trading directly in other financial instruments normally handled by banks, like interest rate and currency swaps, and options.

Whether a company need go the extra step and set up a bank with its own capital and staff depends on other considerations. And many financially strong companies have chosen not to get too deeply involved in the esoteric and highly regulated world of banking.

Most large U.S. corporations, for example, have confined themselves to finance subsidiaries, like General Motors Acceptance Corp or General Electric Credit Corp whose main function is to raise finance in the markets for their parents rather than handle their banking relationships or deal in foreign exchange.

General Electric Co of the UK, an obvious candidate with its £2.6bn cash mountain, has chosen to plough some of its surplus resources into new companies instead. Last month it launched GEC Finance as an investment vehicle, though a move into banking services later on has not been ruled out.

An important motive for creating a bank is the expectation that a well-defined banking operation with its own staff and profitability targets will yield something extra.

The classic example is Dow Banking Corp, the Swiss bank set up in 1965 by Dow Chemical of the U.S. to handle the $23m it had accumulated in overseas earnings and peddle some of its international financial expertise. Twenty years later after some ups and downs, Dow still owns 75 per cent of the bank. But it has matured into an extensive international banking network under a new subsidiary established last year, Dow Financial Services, which also owns 52 per cent of Dow Scandia and is about to participate in the City revolution through its stake in Arbuthnot Latham, the merchant bank, and Savory Milln, the London stockbrokers.

What started as an in-house bank has become, for Dow, a diversification into financial services from which it now reaps dividends.

At BP, the idea of a bank had been under consideration for some time. The group has an annual cash flow of $40bn, a

8/3

2153/45

CONFIDENTIAL

b/f with further notes

FROM: J J HEYWOOD
DATE: 20 OCTOBER 1986

PS/CHANCELLOR

cc Mr Monck
Mr Scholar
Mrs Lomax
Mr Ilett
Miss Sinclair
Mr Neilson

1978 PROFIT SHARING LEGISLATION: RELEASE DATE RELAXATION

Further to your note of 14 October, the Financial Secretary has asked the Revenue to approach, informally, a handful of companies operating 1978 profit-sharing schemes to sound them out about release date requirements. The Revenue will also have a word with the Wider Share Ownership Council.

J.H.

JEREMY HEYWOOD
Private Secretary

CONFIDENTIAL

1252/38

SECRET

FROM: A ROSS GOOBEY
DATE: 14 JANUARY 1987
(rec'd 15/1)

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Scholar
Mr Moore
Mr Peretz
Mrs M Brown
Mr Culpin
Mr M Williams
Ms Leahy
Mr McIntyre

Ch
I think you have already ruled out anything on the lines Alastair suggests
AWK 15/1

BP SALE: TIMING OF ANNOUNCEMENT

Mr Moore's note of 14 January.

2. There is the option of announcing the sale in the Budget, where it would fit naturally and not draw as much attention.

3. Has a decision been made to use BP as a deeper share ownership issue? If the proposed sale is to raise between £½-1 billion, this would be less attractive since so little is likely to go to all the applicants (up to 3 million individuals might apply), let alone institutions.

4. The sale of the shares opportunistically by a "bought deal" would possibly add to the flexibility of the issue and maybe even the proceeds.

5. Such a method would not require appointment of a merchant bank, merely the notification to the market that we were amenable to bids from time to time.

ARG

A ROSS GOOBEY

SECRET

3678/014

Thanks. The answer is para 19 is yes.

SECRET & PERSONAL

yes psc ditto

Ch

Invite Sir P Walters for a drink?

FROM: D J L MOORE
DATE: 14 JANUARY 1987

CHANCELLOR (see 'x' in para. 13)?

cc: Financial Secretary
Sir Peter Middleton
Mr Monck

AWK 14/1

BP SALE

I met David Simon, the Finance Director of BP, on 9 January to exchange preliminary views on the broad approach to the sale. I made clear that I was not committing you in any way and that you had not taken any firm decisions. Simon was speaking on the authority of Sir Peter Walters.

2. As I explain below, BP want the sale to be mainly in international markets rather than the UK and they show little or no interest in wider share ownership. I recommend that you should see Walters reasonably soon to bring home to him your objectives for the sale. I was also given details of a likely major acquisition in the Spring and asked of the possibility of financing that through BP shares bought from us. I do not think it a runner but I undertook to take soundings. The reference to this is the main reason for the very limited circulation of this minute. I am minuting you separately today on whether you should announce the BP sale before or shortly after the Buget.

3. Simon said that BP's primary concern was that the impact of the timing and the method of sale should not be damaging to the value of existing shareholdings. They want a robust position post-sale. I see no objection of principle to this generalisation, particularly as the Government will be concerned with the after-market for new shareholders.

Timing

4. I explained that we were thinking in terms of the Autumn, and of October rather than November (to avoid Autumn Statement disclosure problems). This was acceptable to Simon. Near, or in, the winter is a good time for a BP sale as all oil prices are firmer then. For that reason November would be marginally better than October but this was not vital. They would have been worried had we wanted a sale in a Spring. This is something we will have to bear in mind if for any reason it is not possible to do BP in the Autumn.

Method of Sale

5. BP want the sale to lead to a good spread of shareholdings with the greater part in international markets. They would like to match the spread of their shares much more to the location of their assets. They see themselves as a global enterprise. They are getting a listing on the Tokyo stock exchange. They are being much more active in the USA: until recently about 1½% of the total of BP shares was held there but they have now got it up to 5-6%.

6. Ideally they would like to see roughly up to 30% of our shares sold in the UK; around 30% in the USA; the greater part of the remaining 40% in Japan; and the rest in Continental Europe (up to a maximum of £600-£700 million). Later in discussion he referred to up to 40% in the UK (NB: at yesterday's price of 756p the gross value of our holding has gone up to nearly £4.5 billion, though we would have to sell with some discount to the market price).

7. He explained that they had reached these broad judgments after listening to the pitches of various overseas banks (and there is no doubt from the overtures to us that there is an enormously keen interest among the overseas banks in the possibility of a BP sale). He said that the UK institutions were already well fed with BP stock and anything

substantially more would be at the expense of the price. ? BP did not see themselves as a British Gas or a BT. They were a high risk/high reward share. They had no enthusiasm for UK road shows.

8. In response, I explained that, following the pattern of recent major sales, I would expect the shares to be sold in the main overseas markets they had mentioned, including possibly Canada. But I would not expect Ministers to want the total available in these markets to be more than 20% and indeed that would be subject to clawback (i.e. as in the other recent sales). Quite apart from broad political worries over selling more than 20% abroad there was the major objective of wider share ownership in the UK, a factor which did not seem to come into BP's thinking.

9. It is important to bring home to BP that this sale, with the major part of it in the UK, could have considerable attractions to them and I went on to point out:

(i) A major sales campaign in the UK should provide BP with a great deal of good publicity.

(ii) In particular there would be scope for promoting the notion of customer shareholders which could be good for their own retail sales marketing campaigns.

(iii) Over the last year the BP share price has done remarkably well against the background of a collapse in the oil price. This demonstrates its strength and robustness as an integrated company. While it might be riskier than the shares of some of the privatised utilities it is nevertheless a share which could well appeal to the new breed of shareholder.

10. Simon acknowledged there was some force in these points. But it was clear to both of us that the gap between us was large. Simon has later confirmed that Walters remains firmly in favour of an international sale with only a minority of the shares being sold in the UK.

11. I am clear that we are not going to get any further on this fundamental point at official level. It is of course not impossible that when we have our advisers on board a case might emerge for doing rather more than usual in international markets in order to get a good price. But in the meantime, and in order to put our dealings with BP on the right footing, it is essential to clarify your broad objectives at an early and formative stage of work on the sale. I recommend therefore that you should talk to Walters as soon as possible.

12. On some other points:

(i) BP now appear to be assuming that we intend to sell all of our shares. Some in the BP camp have previously talked about the desirability of our holding on to a small stake.

(ii) Simon did not raise the question of a Special Share. This is bound to come up in due course. I see it as a bargaining point which provides us with something we might concede to BP in return for something from them.

(iii) At my request they are considering the possibility of a share split. This could be important in helping to meet a UK wider share-ownership objective. For that reason it may not appeal to them.

An Acquisition

13. With the agreement of Walters, Simon told me in strictest confidence that BP hope to make a major acquisition overseas this Spring. (I can give you more precise details orally). They have not yet decided how to finance this. One possibility would be a combination of cash and BP shares. If they did it this way, they would be attracted by the idea of buying some of our shares for the purpose rather than facing the complications of a new stock issue. They want to know whether we would be interested in this. They are talking in the order of 90 million shares which would be worth nearly £700 million today. They would give us a good price though the details would have to be negotiated. The transaction would be in March.

X|

14. I agreed to take soundings as requested. But I warned that the probability was that the offer would be found unattractive, not least because it was in conflict with the objectives of wider share ownership which I had explained to them.

15. This provisional judgment is of course fully in line with your very firm decision before Christmas that you did not want to entertain the possibility of selling, say, £200-£250 million BP shares to ensure delivery of our £4¾ billion target in 1986-87. Your reasons were that you were relaxed over some shortfall on the target and that you wanted to reserve the BP shares for a wider share ownership sale.

16. The only difference now is that the sale could be made in response to a BP initiative rather than on our initiative. But I take it your objections stand and indeed that they are 3 times stronger to the sale of up to £700 million worth. If that is so I suggest I tell Simon forthwith and in advance of any meeting with Walters. Simon would not be surprised

and would prefer to get that point out of the way so that they can plan accordingly for financing their acquisition and there would be no distraction to the main issues in any discussion between you and Walters.

17. If this acquisition does go ahead it is helpful that it will be out of the way well in advance of an Autumn sale. But the fact that it is in around March leads BP to say that they would prefer not to have the intention of the main sale announced in March, rather than later. This is relevant to my other minute on the timing of that announcement. Since I believe it is already pretty self-evident that we do intend to sell BP in 1987-88 I do not regard BP's objection as decisive. I have not asked them but it might be easier for them if your announcement was in February rather than March.

Summary

18. I recommend that you see Sir Peter Walters soon to discuss the broad objectives of the sale. Until these can be clarified it is going to be difficult to make useful progress at official level. Now that these matters have been raised, the sooner Walters is put straight the better.

19. Do you wish me to tell Simon that we are not interested in the possibility of selling them some of our BP shares for use in financing their proposed acquisition?

DJLM.

D J L MOORE

SECRET & PERSONAL

FROM: D J L MOORE
DATE: 26 JANUARY 1987

CHANCELLOR

cc: Financial Secretary
Sir Peter Middleton
Mr Monck

BP SALE

You are meeting Sir Peter Walters on 28 January. The main aims are:

(i) to establish your broad objectives for the sale - mainly in the UK and going for wider/deeper share ownership, rather than a primarily international sale as BP would like;

(ii) to secure his full personal commitment to a sale which requires a good deal of top level BP time;

(iii) to persuade him to put a resolution to the AGM on 30 April to provide for a share split;

(iv) to discuss the timing of the announcement of the sale;

(v) to discuss the implications of a possible major acquisition by BP.

2. The following advice takes account of further discussion with David Simon, the Finance Director, after my note of 14 January. I find Simon friendly and helpful.

793p tonight.

3. The price on Friday was 784p (compared with a recent high of 805p and a 1986-87 low of 518p). This would yield £4.5 billion gross. One of the issues will be how much discount is necessary. But we are clearly talking of a sale of £4 billion plus.

OBJECTIVES

Timing of Sale and Instalments

4. BP are content with an Autumn sale. I have explained the need to avoid the Autumn Statement period and they would accept October rather than late November; though the latter would be our fallback if there were an early Autumn Election.

5. Assuming sale of all our shares and proceeds of £4 billion plus, instalments are inevitable, even though this means partly and fully paid shares trading alongside. We are thinking of two instalments with the second in late Spring/Summer 1988. But this is for firm decision later.

BP's Objectives

6. BP want 60% or so of the shares sold in international markets (i.e. £2.4 billion plus): up to 25% of the total in the USA, another large tranche in Japan, and the balance in mainland Europe.

7. From their point of view this is reasonable. They are aiming to establish themselves as a global enterprise, with the spread of their shares better matched to the spread of their assets. They are already building up their presence in the USA - from 1½% of total shares to 6% recently. They get their Tokyo listing in July.

8. It also looks practicable. They are advised that there is strong demand in the USA with institutions currently underweighted in oil stocks. Japan is also light on international energy stocks, and BP are major energy suppliers to Japan. In Europe they judge there could be demand for up to £700 million. This assessment ties in with what we have heard independently from the overseas

banks who suggest that total international demand for BP stock could be $3 billion plus.

9. In answer to the charge that this ignores deeper/wider share ownership objectives, BP argue that the retail investor should be cautious over oil stocks. They do not want a Sid sale with BGC razzamataz.

10. They further argue that the UK institutions are well weighted with oil stocks. A UK dominated sale could therefore be at the expense of proceeds. This would cut across their concern that the price should hold up for existing shareholders.

Treasury Objectives

11. I have explained that, on the precedent of previous sales, I would not expect Ministers to want more than 20% to be sold in international markets, and even that would be subject to clawback. The rough figures on a £4 billion total, and the measure of the possible gap between us, would then be:

	UK	International
Treasury	3.2	0.8
BP	1.6	2.4

I have pointed out that in addition to any broad political objection to more than 20% overseas, BP have to recognise the objective of wider shareownership (NB: they have about ¼ million shareholders).

12. Points you could make to Walters are:

(i) With well orchestrated marketing there should be good UK demand, institutional and retail. If overseas appetite is unsatisfied, they can buy in London which will help the aftermarket.

(ii) The performance of the BP price in 1986 demonstrates the robustness of BP as an integrated oil company; an important point for the retail investor.

(iii) There should be marketing advantages to BP in a major UK campaign. Scope for capitalising on the customer/shareholder. May be riskier than a utility, but should still appeal to the new breed of shareholder.

(iv) Even on BP's assumption the UK tranche would be £1.6 billion. That is a major sale by any standards and a major UK campaign is essential.

13. You could consider reassuring him by saying that while 20% would be your aim for the international ceiling you would keep this under review in the light of work by the advisers. (Kleinworts suggested to me that 30-35% would be an acceptable minority in City if not political eyes).

Share Split and AGM

14. £7 plus is high for a UK share and even partly paid could be unfamiliar to small shareholders. I have therefore asked them to consider a share split.

15. If this is to be done they will have to put a resolution, which requires time to prepare, to their AGM which is on 30 April. I recommend you to press Walters on it.

Special Share

16. This has not been mentioned in my discussions with Simon, and I suggest you should not raise it with Walters. But if he wanted it, we would have a card to play in getting their cooperation on other fronts.

Steering Group for the Sale

17. I have explained to Simon that I would expect there to be a Steering Group which I would chair supported by a small Treasury team and HMG's advisers who would be appointed after a beauty contest. BP would attend with their advisers (Warburgs).

18. Simon seemed content with this. But it is essential that Walters recognises that it is in HMG's and BP's common interests for BP top management to be ready to commit a good deal of time to the sale, the planning and the road shows etc.

TIMING OF ANNOUNCEMENT

19. You have provisionally decided to announce the sale on 23 March. I have not of course mentioned that date to Simon but I have sounded him out on a February/March announcement. He was at first strongly in favour of no earlier than late April. But he now seems persuaded to March because:

(a) he accepts that it is becoming increasingly obvious that to meet the £5 billion target for 1987-88 we are planning a BP sale and that the City is widely assuming it;

(b) if BP go ahead with their major acquisition in the Spring, and if they finance it in part with BP shares (see below) it will be necessary to reveal HMG's intentions.

20. But you will want to ensure that Walters is comfortable with a March announcement and perhaps to sound him out on particular dates, which will be relevant to the acquisition.

THE ACQUISITION

21. BP are considering the possibility of a major acquisition in the USA. They will discuss it at their mid-February Board and decide by mid-March. Walters will want to consult you on the options for financing it.

22. If they went ahead the cost would be in the order of £4 billion. They could finance this by a straight cash purchase. They would run down their cash mountain (£3 billion plus); borrow, using existing credit facilities; and then replace the new borrowing from asset sales. They would offer a price for the acquisition and this would be open for 20 days.

23. Alternatively they could finance it by a combination of cash and BP shares. This would be much more complicated. The issue of new shares for the purpose would require shareholders' approval. To meet SEC requirements the offer would be open for around 8 weeks. Nevertheless Walters is apparently keen on this route. He may be thinking of a package including more than the 100 million shares (£750-£800 million) that Simon has in mind.

24. BP had hoped that you would have provisionally agreed to selling them a tranche of HMG's shares. They would then cancel and reissue them for use in the acquisition. The total of BP shares in issue would therefore be the same. I have reported your decision against this route.

25. This leaves them with the option of issuing new shares for the purpose. Walters is likely to want to sound you out on the implications for the share price of a combination of this move and your announcement of the HMG sale.

26. From a few informal soundings, I doubt whether the announcement of HMG's sale alone would make a significant impact on the share price. The market has probably discounted it already. And by announcing it in March we leave good time for the news to be digested.

27. But it is more difficult to assess the impact on the share price of £750 million plus new shares for a company with a market capitalisation of £14.3 billion. The fact that there were more shares to service should be offset by the market's assessment of the benefits to flow from the acquisition. In the case of an all cash acquisition the market would be putting into the equation its assessment of the impact of reduced cash in hand and (temporarily) increased gearing.

28. Looking at it from another angle, currently the USA could probably absorb £750 million BP shares. But there must be a high risk that there would not then be much unsatisfied appetite left for our shares in the Autumn. This could be damaging, whatever the aims for the level of a USA offering.

29. My own view, without the benefit of any professional advice, is that the all cash route runs less risk for the share price, and our prospects for proceeds, and also avoids overfeeding the USA markets with BP shares. But if BP wanted to press the point they would do well to sound out their own advisers, Warburgs and Goldmans.

30. Since the issue of new shares requires the approval of the shareholders Walters would need your agreement if he were to press ahead.

Summary

31. The key points to establish are those listed in paragraph 1.

DJLM.

D J L MOORE

~~BUDGET~~: CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD
DATE: 27 January 1987

PS/CHANCELLOR

cc Mr Monck
Mrs Lomax
Mr Scholar
Miss Sinclair
Mr Prescott IR
Miss Green IR
PS/IR

OK

1978 PROFIT SHARING LEGISLATION: RELEASE DATE RELAXATION

In your note of 14 October to me you recorded the Chancellor's comment that this idea needed to be looked at further.

2. Miss Green's note of 23 January reports on the Revenue's approach to 9 companies operating FA 1978 schemes. In the light of Miss Green's note and Mr Farmer's original submission of 14 October, the Financial Secretary is not attracted to an advancement of the release date from 5 to 3 years.

3. Is the Chancellor content with this conclusion?

J.H.

JEREMY HEYWOOD
Private Secretary

3682/006

SECRET & PERSONAL

FROM: D J L MOORE
DATE: 18 FEBRUARY 1987

CHANCELLOR

Thanks. I like the idea of a joint operation!

cc: Financial Secretary
Sir Peter Middleton
Mr Monck

BP SALE

This is to report some further developments which Sir Peter Middleton and Sir Peter Walters discussed yesterday.

2. Proposals on the (Sohio) acquisition will be put to the BP Board tomorrow. If things go to plan the terms of the bid will be announced on Monday, 23 March. This is the day you intend to announce our sale. Nearer the time we will need to consider what reference, if any, you should make to the bid and the line to be taken by BP and ourselves in Press briefing.

3. BP realise there is the risk of a leak of their intentions before 23 March. They will therefore have Press briefing on the acquisition ready. This need not affect our plans for announcing our sale.

4. If the response to the bid is acceptable BP would seek shareholders' approval at an EGM in April. We would need to give our formal approval then. We see the acquisition as a matter for BP's commercial judgment which we cannot sensibly second-guess.

5. The cost of the acquisition is likely to be £4 billion plus. Initially BP would finance this from their cash reserves, and from commercial paper and bank credit lines in the USA.

6. But they estimate that the effect would be to raise their gearing from 31% to around 47% in 1987 falling to 38% in 1988. To keep their present credit ratings they want to get down to around 33% in 1988.

7. If forced to, they could do this by a combination totalling £1.5 billion of capital expenditure cuts and asset sales. But they believe their interests would be best served by raising £1 billion new equity.

8. BP's preference would be a rights issue in May or June. They were not surprised when we said that an issue in advance of our sale was very unlikely to be acceptable.

9. On this assumption their front runner is an Autumn issue concurrently with our sale - i.e. making it around £5.5 billion in total rather than £4.5 billion. They agree that a decision does not have to be taken before May on whether or when there should be an equity issue in 1987. They would, however, probably want to tell the credit rating agencies in confidence that they intended to raise equity in 1987 or 1988.

10. This approach to the timing of the decision is helpful to us. It means that we can appoint our advisers in April and then take their minds on the options and the following main questions. Is there anything to be said, despite our doubts, for a summer rights issue? Should we make them wait until after our sale? - very probably not since any intention to raise further equity in 1987 would have to be made known when we sold. How would a joint offer be best handled?

11. If we do go for a joint offer we will need to look at the UK/international balance. If it were solely our sale, and it was worth £4.5 billion, we would be looking for UK sales of at least £3.6 billion (i.e.80%) with £0.9 billion offered internationally. If there were a £1 billion rights issue on top most of that would be on offer to UK shareholders. But if we wished we could still aim for around £3.6 billion in total in the UK with most or all of the balance on offer internationally. This would no doubt appeal

to BP but it is one of the main points we will need to consider with the advisers.

Conclusions

12. Subject to any markers you wish to put down, we do not need to act on these questions yet. But it looks as though the probability is an Autumn sale coupled with BP raising £1 billion equity. An advantage of a joint operation is that it would add to BP's commitment to the sale.

13. A firm decision on this can wait until we have our advisers on board. Our aim is to advertise the beauty competition on Tuesday 24 March (i.e. immediately after your announcement) and to make the appointment by mid-April.

D J L MOORE

3683/014

SECRET & PERSONAL

FROM: D J L MOORE
DATE: 6 MARCH 1987

CHANCELLOR

OK. FST can announce in his 'wind-up' speech 18/3.

cc: Financial Secretary
Sir Peter Middleton
Mr Monck

BP

Following further discussion with BP on their proposed acquisition, I should be grateful to know whether you would be willing for the BP sale to be announced on Wednesday or Thursday, 18 or 19 March, rather than in your Budget Debate wind-up speech on the evening of Monday 23 March.

2. The purpose would be to keep clearly separate the Government's sale announcement and BP's announcement of their intentions for the acquisition.

3. BP are now definitely going ahead with the bid. Sir Peter Walters is meeting directors of the target company on Monday 9 March. BP hope that this will lead to detailed negotiations on the weekend of 21/22 March.

4. If a deal were firmly clinched that weekend it would be necessary to announce it in New York when markets open first thing on the morning of Monday 23 March i.e. early afternoon here and a few hours before your announcement, as currently planned.

5. Alternatively, the deal might not be clinched until Monday and it would be announced on Tuesday morning, 24 March, in New York i.e. less than 24 hours after your statement.

6. Either way the two announcements would come out very close to each other. If it were acceptable to you, Sir Peter Walters would prefer to widen the gap. If this were done, the markets and the press could first absorb the Government's news of the sale. Then, after the weekend, they would have BP's news. Sir Peter feels that on this time-table there is less chance of confusion over the two major messages.

7. I agree with this. Although we know that two announcements on or around 23 March would be coincidental, they could lead to sharper questions than otherwise on whether HMG and BP had got their acts together in a sensible way. Moreover, if a BP announcement at midday on Monday 23 March rocked the share price that afternoon it could be more difficult for you in handling the sale announcement in the evening. The markets and the press could also find it difficult to digest on Tuesday a BP announcement following the Monday evening news.

Ch FST's Budget Debate speech? AWK

8. I recommend, therefore, that in line with BP's preferences, your announcement should be on 18 or 19 March, either in a Written Answer or in a Treasury Minister's speech if there is one in this period. If this is provisionally acceptable to you, the timing could be confirmed by the end of next week in the light of any further intelligence from BP on their opening talks with the target company. Even on this time-table we must be ready to answer the question, when the acquisition is announced, of whether we knew of it. The short answer is that we knew of the intention but that the timing and details were a matter for BP. I will be discussing further with BP how we handle this.

9. If the sale were announced earlier, one further - but not overriding - advantage is that we could announce the beauty contests immediately afterwards and then run a slightly more generous time-table than that in my minute of 4 March to the Financial Secretary - though still, of course, aiming for appointments before Easter.

DJLM

D J L MOORE

CONFIDENTIAL

FROM: F CASSELL
16 March 1987

MR A C S ~~ALLAN~~

cc PS/Financial Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr H P Evans
Mr Mountfield
Mr Scholar
Mr Sedgwick
Mr Bottrill
Mr M L Williams
Ms Leahy

Ch
Re-draft OK?
AA

OK

OIL PRICE ASSUMPTION: GUIDANCE TELEGRAM

The amendments suggested in your minute to me of earlier today are being incorporated in the telegram.

However, we heard late this evening that the FCO had put an alternative version of the 'Line to Take' to Sir Geoffrey Howe - one that in their view had greater "conviction". Sir Geoffrey, who is in Brussels today, has not yet responded.

I spoke to Roderic Braithwaite this evening and explained that some parts of this version were not acceptable. We agreed the attached redraft. I think that this makes the points we want to make, and adopts the style that Briathwaite prefers.

We are both putting it forward as the recommended text.

F CASSELL

FCO behaved v badly.

They did not put the drafts to Sir G Howe until this morning, when he was in Brussels, and did not tell Frank what they were up to till late today.

AA

CONFIDENTIAL

LINE TO TAKE

i) The dollars 15 figure is a planning assumption only. It is required for the purpose of drawing up a Budget, specifically in order to estimate government revenues for the year ahead. The same figure was used throughout last year.

ii) The figure is not a forecast of oil prices for the year. HMG are not well placed to forecast oil prices, and have never claimed to be. They are however concerned about oil market volatility and take care to avoid any action which might add to it. It follows that HMG have no interest in talking prices down.

iii) OPEC's December agreement on prices and production has clearly had an impact on the market. But in the light of the recent fluctuation of the oil price the Chancellor concluded that it would be prudent to stick to the now conventional assumption of dollars 15 a barrel.

[If pressed]

iv) We believe that we are not alone in adopting this approach to estimating oil revenues and that several OPEC States have used broadly similar figures.

3684/015

CONFIDENTIAL

18

FROM: Ms P M LEAHY
DATE: 19 MARCH 1987

1. MR D J L MOORE

2. FINANCIAL SECRETARY

I agree that we should accept BP's proposal. They have gone a long way to meet us. With instalments the price per share should be very manageable. 19/3.

cc: Chancellor
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mrs M E Brown
Mr McIntyre
Mr Lyne
Mr Ross Goobey
Mr Hyett - T.Sol.

BP SHARE SPLIT

Tony
Phoned to PS/FST
Alex thought best not minute out as recommendation was not to do this.

As you know we have been discussing the idea of a share split with BP for some time. Sir Peter Walters told the Chancellor at their meeting of 28 January that he had no objections to a share split and would look into it.

2. BP have now concluded that they would prefer to do this through a two-for-one bonus issue i.e. capitalisation of £916 million of the £940 million share premium account into the Ordinary share account (currently standing at £458 million). This would increase the number of shares threefold to 5,400 million and reduce the value of each share to a third. At a share price of 800p this would mean a reduction to about 267p.

3. Another alternative they would accept, but which would be a little more cumbersome administratively, would be to split the existing 25p shares into 5p shares and then consolidate them to 10p shares. At a share price of 800p this would lead to a share price of 320p.

a ridiculous suggestion

4. We have pressed BP to consider the alternative of a split into 5p shares leading to a share price of 160p at a starting price of 800p. Conventional wisdom is that the lower the share price the better for a retail marketing campaign. BP were very much against this (rationally or not), as it would take them out of line with their major

competitors. BP were only considering a share split to be helpful to us. They saw no reason therefore to go outside the parameters they felt comfortable with.

5. BP would like to introduce the share split in an EGM which would be convened immediately after the AGM on 30 April. Only 14 days' notice needed to be given to shareholders. The Board are however probably going to consider the principles tomorrow.

6. We see no advantage in arguing with the Company over this. Ideally we would have liked a price in the £1 range for marketing reasons. But a price in the range which would be brought about by BP's preferred option is acceptable. This will at least allow the minimum application to be in 3 figures.

Conclusion

7. We recommend that you agree to BP's idea of a two-for-one bonus issue to reduce the share price to a third at the 30 April meeting.

P M LEAHY

3685/001

SECRET & PERSONAL

FROM: D J L MOORE
DATE: 23 MARCH 1987

CHANCELLOR

cc: Financial Secretary
Sir Peter Middleton
Mr Monck

BP

Yes [illegible]

My latest information on the acquisition is that BP will announce it either first thing Thursday morning 26 ~~April~~ May or on Wednesday 1 April. Although this is slightly later than earlier expected things seem to be going well. They will keep me in close touch with the timing.

March

Ch/ You will want to vet this closely
AWK

2. The day before the announcement I will provide Question & Answer notes for Treasury Ministers and for sending on to No 10 and Energy. They do not know anything of it yet and, given the market sensitivities, I think it should remain that way until as late as possible.

Ch/ In fact, you authorised Alex to let David Norgrove know — but Energy are still in the dark
AWK

3. Once it is announced, our main line will be that it was their commercial decision which they came to independently of your decision on the sale. But we will have ready defensive briefing on the interaction between the two.

DJLM

D J L MOORE

I take it this is March. But I still [illegible]

Personal

Minister of State, Treasury

Ch

!!

AA.

Chancellor

The MST/PMG asked me to send you a copy of this letter to Robert Malpas of BP.

(The dividend was not that due on the shares he used to hold!)

PMG

SPS 15/6

Many thanks for letter re amount. (Computers are only human)

HOUSE OF COMMONS
LONDON SWIA OAA

14 June 1987

Dear Bob

This is a most belated thank you for a delicious lunch in late April, which I much enjoyed, but I am for once in the unusual position of being able to manipulate the waters so as to return the bread you cast upon it, after many days.

You will remember I mentioned that, because of GDN, I had felt obliged to sell my BP stock because of Scicon and the remote possibility of a change of a conflict of interest. You will be entertained (or, I suppose, possibly not)

×(B.P.)

to hear that you[×] have since then inadvertently credited me with a dividend for approaching a quarter of a million pounds. It has its ironies, in the light of my own punctiliousness. You did it on May 7th, to the tune of £229,484.80, and it has from that day to this sat in a non-interest bearing current account, as I knew nothing of it till I opened my May bank statement for the first time today, after the election.

You (BP) have not been in touch with my bank or with me, so I assume either it has not been missed or you have not been able to trace it. I will gladly return it immediately once I know where you would like it

2/

to go — I am assuming it should go somewhere where its return can be flagged up: you may wish also to indicate if any particular wording should accompany the transfer or whether it should be marked for anyone's attention.

Duty and prudence suggest I ought to mention this contretemps to the Chancellor, not for any ~~positive~~ action but in case the episode ever saw the light of day, against the coincidence of my other responsibility. Should you or someone want to have a word, my Treasury number is 270-4350.

Yours sincerely

Peter Brooke

3755/022

COMMERCIAL IN CONFIDENCE

ECONOMIC SECRETARY TO THE TREASURY

FROM: P D P BARNES
DATE: 24 June 1987

PS/CHANCELLOR

cc Sir P Middleton
Mr Cassell
Mr D J L Moore
Mr M L Williams

BRITOIL

The Economic Secretary has seen Mr Cassell's submission to the Chancellor of 23 June.

2. The Economic Secretary thinks that the removal of the Britoil Golden Share will create political problems for all future privatisations and should be ruled out on that ground.

PB

P D P BARNES
Private Secretary

Sir P Middleton's views on economic [illegible] stem from a misunderstanding of the Britoil Golden Share. That Share empowers us to prevent a change of control — it does not oblige us to do so. That will depend on our view of the specific proposals at the time. (a) Should we decide to allow a change of control, which [illegible], then there can be a case for cancelling the golden share. (b) But there can be no question of cancelling the golden share in other circs.
NL

COMMERCIAL IN CONFIDENCE

3757/045

Tony

UNCLASSIFIED

FROM: P D P BARNES
DATE: 6 July 1987

MR JOHNSON

cc PS/Chancellor 2
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Williams
Miss Leahy

Mr Pitts - IR
Miss Hill - IR
Mrs Hubbard - IR
PS/IR

PS/Customs & Excise

Mr Cassell

Pse let me have a quick note on the case for moving from RIK to RIC. [illegible] given how [illegible] PSBR [illegible] this FY?

ECONOMIC SECRETARY'S LUNCH WITH ESSO UK PLC

The Economic Secretary had lunch today with Sir Archibald Forster, Chairman and Chief Executive, Esso UK Plc. Also present were Dr Keith Taylor, Managing Director, Upstream; Mr David Clayman, Managing Director Downstream; and Mr Walter Arzonetti, Finance Director. The Economic Secretary was grateful for your briefing.

2. The following were the main changes sought by Esso:-

(i) A higher crossfield allowance. Esso said that the 10 per cent crossfield allowance introduced in the Finance Act 1987 made a difference of only around 1-1.5 per cent in the net rate of return on projects, which would often not be sufficient to sway a decision in favour of going ahead with a borderline project. They were seeking a crossfield allowance of between 15 and 20 per cent.

(ii) Elimination of the fiscal differential in the Southern Basin. Esso said that many new developments in the Southern Basin required deeper drilling. Present development activity in the Southern Basin was merely a reflection of projects prepared and planned some

UNCLASSIFIED

years earlier and new development was likely to fall off unless an undifferentiated tax regime was introduced.

(iii) Relief from royalty for existing fields. Esso suggested that royalties, being based on revenue rather than on profits, might lead their company to abandon otherwise viable fields earlier than they would in normal circumstances.

(iv) PRT relief for incremental investment. Esso argued that it was anomalous that investment needed to extract a given amount of oil from an existing field should not attract PRT relief when a similar investment on a new field would do so. Esso feared that this might lead to fields still yielding significant amounts of oil being abandoned. They had discussed and would accept a time trigger for relief on such investment.

(v) Mossmoran. Esso said that they felt somewhat bitter that a project they had undertaken on the clear understanding of an agreement with the Government should subsequently have been vitiated by a decision of the courts. They suggested that the Government should introduce legislation to restore the status quo ante as they had understood it if the Revenue come up with an unsatisfactory price.

(vi) PRT safeguard and deferred expenditure claims. Esso expressed concern at the delaying tactics of the Revenue in preventing Esso from a legitimate exercise of their tax rights on the North Cormorant field.

(vii) Non-leaded petrol. Esso said that the Government would need to introduce a higher fiscal differential between the cost of leaded and unleaded petrol if it was to encourage consumers to buy the latter.

The 5p differential meant that unleaded petrol cost the same as four star petrol, although the latter was a far superior product because of its greater efficiency of octane conversion. Esso said that they had considerably more stations offering non-leaded petrol than the industry average.

PB

P D P BARNES
Private Secretary

3824/022

CONFIDENTIAL

FROM: M L WILLIAMS
DATE: 10 July 1987

1. MR CASSELL
2. CHANCELLOR

The answer to your question is at 'X' (overleaf)

cc Chief Secretary
Financial Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Mowl
Ms Leahy
PS/IR
Mr Pitts - IR

ROYALTY OIL

You asked for a quick note on a possible switch to taking royalty oil in cash, rather than in kind.

The main argument for taking royalty oil in cash is to cut-back public sector involvement in activities which can equally well (or better) be undertaken by the private sector. This is the case for the sale of oil and OPA-related trading activities. A decision to take royalty in cash would effectively mean an end to OPA, but there is a prospect of resource benefits as a result. The savings, over and above our fees to OPA of some £2 million a year, are difficult to judge; they would depend on OPA's trading efficiency in practice. If OPA was disbanded, however, alternative arrangements would be needed to manage the GPSS.

The main costs of the switch are the once-off costs to the PSBR of about £130-150 million in the year in which it occurred, and the continuing costs of servicing the additional borrowing of about £15 million a year. (These figures are subject to checking.) There are further presentational and political disadvantages. Once the switch was made it would be difficulty quickly to build up the ability to take royalty in kind again. This in turn could lead to doubts about security of supply, although that essentially depends on access to refined products, rather than crude. In the past, royalty in kind as also been justified by the weakness in the PRT pricing and valuation rules.

This weakness as now been mitigated, but at least for the moment there is still something in the argument that sales by OPA are useful as a check on the success of the new rules.

Notice of a move to royalty in cash has to be given 6 months in advance of the chargeable period for which the switch would come into affect. The chargeable period begins on 1 July and 1 January. This means that we would now have to wait until 1 July 1988 before making a change, ie giving notice before the end of December this year. The change would then affect the 1988-89 PSBR. Since royalty in cash would be paid in just 2 months of the financial year the receipt profile would be made more lumpy than at present, when royalties are received in an even flow.

There is a further potential problem that is likely to be relevant were you to want to negotiate this change with Department of Energy. They are likely to question whether the benefits justify the once-off PSBR and financing costs. The cash flow benefit falls primarily to the oil companies operating the larger fields. Were you willing to accept the PSBR cost DEn would probably argue that it should be channelled to the oil industry through more precisely targetted tax reliefs.

M L WILLIAMS

MR 2/30

CONFIDENTIAL

1. ~~Alex~~
2. b/f with response (or 13/7) p

FROM: A W KUCZYS
DATE: 10 July 1987

MR CASSELL

cc: PS/CST
PS/FST
Sir P Middleton
Sir T Burns
Mr Scholar
Miss Sinclair
Mr M Williams

NORTH SEA OIL: ROYALTIES

We spoke. The Chancellor would be grateful for a quick note on the case for moving from royalty in kind to royalty in cash. If notice were given now, would the PSBR cost fall in this financial year?

A W KUCZYS

CONFIDENTIAL

PPS

b/f PEM bilateral

FROM: P D P BARNES
DATE: 13 July 1987

MR WILLIAMS

cc PS/Chancellor
Mr Cassell
Mr Scholar

Mr Pitts - IR
PS/IR

ROYALTY OIL

The Economic Secretary has seen your submission to the Chancellor of 10 July. The Economic Secretary thinks it odd that payment in kind should be more onerous to companies than payment in cash. He wonders whether they have complained.

PB

P D P BARNES
Private Secretary

CONFIDENTIAL

MR 2/35

CONFIDENTIAL

b/f 14/7
(PEM bilateral)

FROM: A W KUCZYS
DATE: 13 July 1987

MR CASSELL o/r

cc: PS/CST
PS/FST
Sir P Middleton
Sir T Burns
Mr Scholar
Mr M L Williams

ROYALTY OIL

The Chancellor has seen Mr Williams' note of 10 July. He has asked why this proposal was not put to him immediately after the General Election, so that we could have got in in advance of 1 July?

2. However, it still may well be worth doing. The arguments set out in Mr Williams' note are Department of Energy red herrings.

AWK

A W KUCZYS

CHANCELLOR OF THE EXCHEQUER

1. ~~Alex~~

2. Chancellor

See note below.

Do you agree with Frank Cassell that the letter to Mr Parkinson shd not go 'til <u>after</u> the Autumn Statement?

AK
23/7

I will, as FC suggests, write after the AS. But the right time to take a decision is June; & - however - unless there June - I will probably wait until June.

N

CONFIDENTIAL

FROM: M L Williams
DATE: 22 July 1987

1. MR CASSELL
2. CHANCELLOR

I am extremely sorry that we did not give you the opportunity of considering this change when it could still take effect in 1987-88. My own advice would have been — and still is — against making the change just yet, largely for the reasons given in para 4 below. I do not see much point in writing to Mr Parkinson now — better, I think, to wait until after the Autumn Statement.
[initials] 23.7.87

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Mowl
Ms Leahy
PS/IR
Mr Pitts IR

ROYALTY OIL

I apologise for not putting the proposed switch to taking royalty oil in cash to you immediately after the election (Mr Kuczys minute of 13 July). I am afraid that the failure was mine in not arranging for the papers to be brought forward at the right time.

2. You thought that the change was still worth making. The target is now 31 December. Although there is no need to put the proposal immediately to Mr Parkinson, you may think it worth writing while he is still receptive to new ideas; and I know that DEn officials have been asked to review the role of OPA. I therefore attach a draft letter. I have tried to avoid being too bullish about the PSBR in 1988-89 in case that rebounds in the public expenditure round. I also attach (you only) a copy of the exchange of letters with Mr Walker last year; I see no need to rebut all his arguments when you are essentially relying on Mr Parkinson's fresh mind.

3. It may be helpful to clarify some points in my previous minute:

1) The PSBR cost in 1988-89 would be about £120 million, assuming an oil price of $18 and an exchange rate of $1.60/£, with an implied continuing PSBR cost of nearly £20 million a year from higher interest costs, net of

extra CT receipts from the companies;

2) I see no way of judging OPA's performance, ~~unless~~ ie. the benefits (or costs) of the change to set against the debt interest cost. OPA have in the past consistently disposed of their oil at a price greater than that at which it would have been valued had it been taken in cash; but that discrepancy largely reflccts the weakness in the tax rules, not OPA's expertise. That weakness we hope has been corrected for tax purposes by the Revenue's nomination scheme, and these rules would likewise run for royalty in cash purposes. OPA have earned profits on their ancilliary trading activities (£5.7 million last year) but again they have some flexibility in timing their liftings, and we have no way of knowing whether they performing more or less efficiently than would a private sector equivalent.

4. As well as acting in the short term as a check on the success of the new pricing and valuation rules, OPA has a continuing usefulness to the Revenue. First it provides - on an informal basis - price information which feeds into the valuation data base; second OPA acts as an independent and unbiased source of advice and information about what is usually happening in the market.

5. In these circumstances, the justification for the change is essentially the need to cut back public sector involvement in activities which can equally well be taken by the private sector; and I have emphasised that in the draft letter.

6. The Economic Secretary asked whether companies had complained at having to pay royalty oil in kind, rather than in cash, given that it is more onerous for their cash flow. The short answer is: not recently. Royalty in kind goes back a long way and the companies seem to be used to the system. Department of Energy tell me that occasionally one of the companies grumbles, but there is certainly no concerted campaign. The fall in the oil prices has, of course, meant that the cost to companies' cash flow is now very much less (although arguably more important).

M L WILLIAMS

CONFIDENTIAL

DRAFT LETTER FROM THE CHANCELLOR TO SECRETARY OF STATE FOR ENERGY
cc Prime Minister

ROYALTY OIL

In March 1985, the Prime Minister asked me and your predecessor to consider a move to taking North Sea royalty in cash rather than in kind. For a number of reasons, including the possible impact on the PSBR, we have delayed making this change. However I believe that the time is now ripe for making the switch at the next available opportunity, ie 1 July 1988, which would require notification to the companies before the end of this calendar year.

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

The disadvantages in making the change have now largely fallen away. The weakness in the PRT pricing and valuation rules, which meant that cash receipts based on tax prices and valuations may have been less than obtainable in the market, have been removed by the series of changes introduced in the last Finance Act. Our power to take royalty in oil in kind would be preserved, which should meet any (misplaced) criticism in the House that we were jeopardising security as a result of the switch. If we can decide now to make the change, I will be able to take it into account in planning the PSBR for 1988-89. We would also have time to consider properly the impact of this change on OPA and the arrangements for discharging its other duties.

I am copying this minute to the Prime Minister.

ps3/28K

CONFIDENTIAL

b/f ~~23~~/11 17 (P)

FROM: A W KUCZYS
DATE: 24 July 1987

MR M L WILLIAMS

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Mowl
Miss Leahy
Mr Pitts - IR
PS/IR

ROYALTY OIL

The Chancellor was grateful for your minute of 22 July. He will, as Mr Cassell suggested in his manuscript comment, review the position after the Autumn Statement, rather than write to Mr Parkinson now. But he thinks the right time to take a decision is June; and - having missed this June - he will probably wait until next June.

x1

AWK

A W KUCZYS

2200/23

CONFIDENTIAL

Much improved. But I am not clear about X (which looks a bit like an own goal): from BP's pt of view, the alternative is no pressure for us to arrange [illegible] thus Autumn: to do own sale & Rev to go ahead with Rev [illegible] next Autumn. It would be for Rev to take new shares pro rata out of each instalment for combined offer, or [illegible] £100m [illegible] basis.

FROM: MRS M E BROWN
DATE: 29 July 1987

SIR PETER MIDDLETON

cc PS/Chancellor
PS/Financial Secretary
Mr F E R Butler
Mr Monck (o.r)
Mr Culpin
Mr Moorc (o.r)
Mr Lyne (o.r)
Mr Bent (o.r)
Ms Leahy

Ch/
Content with the simpler explanation at Annex A?
25/7
30/7

BP SALE: POOLING OF PROCEEDS

1. You commented in your minute to the Chancellor of 15 July that a simpler explanation was needed of the price which the Government will pay for BP's new shares. The Chancellor agreed with this.

2. A draft is attached at Annex A. It is due to be discussed with Mr Moore and others in PE when they return from leave. It has been prepared as a brief for use after the sale.

3. We will also need an agreed line to take before the sale, when the basis of the subscription arrangement is made public. A speaking note, in Q and A form, is at Annex B.

4. At the latest, the pricing agreement will be revealed in the pathfinder prospectus on 25 September. It is probable, however, that BP will need to explain the precise terms of the agreement when they write to their shareholders seeking authority for the subscription arrangement as a whole. The date of the circular is still under discussion, but it is likely to be at the end of August or the very beginning of September, so that the requisite Extraordinary General Meeting can be held before pathfinder day in the week beginning 21 September.

Mary Brown

MRS M E BROWN

BP: THE PROCEEDS POOLING ARRANGEMENTS

Under the subscription arrangement, HMG agreed to subscribe for new BP ordinary shares on a fully paid basis and to sell them, together with its existing shares, in a combined offering. Payments under the combined offering would be in three instalments. The total pool of shares (BP's and the Government's) were to be offered at two prices: an international price determined by national banking syndicates, and a UK retail offer price for individual investors. BP shareholders were able to purchase the proportion of BP's new issue to which they would have been entitled under a normal rights issue, at the UK retail price.

As part of these arrangements, the Government needed to determine what price it would pay to BP for the new shares. The arrangement had to recognise the respective advantages to both sides:

- to BP, the fact that they would receive their £1.5 billion straight away, out of the proceeds from the first instalment of the sale. This benefit was quantifiable, representing an interest cost of some £100 million;

- to HMG, the fact that it was able to sell all the shares in the combined offering by instalments, which was a key consideration in meeting the Government's objective of widening share ownership. By reconciling the two parties' different cash flow requirements, it also ensured that the two issues took place at the same time. The alternative would have been for BP to go ahead with its new issue in advance of the Government's share sale, on a fully-paid basis. These advantages to HMG were not precisely quantifiable.

In assessing the specific price to be paid, the Government had to take into account the price which BP could have received had it issued its new shares alone. The company had shareholders' authority to issue at least [£800 million] other than by way of rights; and it argued forcefully that it would in fact have issued the full £1½ billion by means of an overseas placement, subject in part or whole to clawback for UK shareholders. In other words, the company believed it could have raised the money at a very narrow discount to market price. The Government also took into account the fact that, by including the BP new shares in the total offering, a higher proportion of the offer was available overseas than would otherwise have been the case. These shares were, of course, sold at the higher, international, price. These two factors pointed to paying BP a nominal price close to the current market price, subject to a deduction for financing costs.

But the Government also took into account the advantages which BP derived from selling its shares in conjunction with Government, and the fact that its shareholders would benefit from participating in the lower, retail, element of the offering.

Accordingly, it was considered equitable to both sides that BP should receive the higher of:

> <u>either</u> the nominal retail price: this would ensure that the company received no less, on a fully-paid basis, than its shareholders paid for their shares;
>
> <u>or</u> the international price less 10 per cent: this would ensure that BP had an incentive to promote the success of the international element of the sale; and would have some protection if the Government (for wider share ownership reasons) set the retail price at a particularly deep discount to the prevailing market price.

Under either approach, BP received a considerably lower price than that which it believed it could receive by going ahead with its new issue alone. The arrangement was reached after protracted negotiations, in which each side was conscious of the need both to secure a justifiable settlement in financial terms, and to ensure that a workable basis for the joint offering could be found.

ANNEX B

Q. How was the pricing arrangement determined?

A. The combined share offer is being sold at two prices: the fixed "retail" price; and the higher "international" price. The Government had to decide what was a fair price at which it would subscribe for BP's new shares.

It took into account three main considerations. First, the fact that BP's shareholders will pay for their rights entitlements at the retail price. These entitlements cover some 68 per cent of BP's new shares, or just over £1 billion. Secondly, the Government will sell about a third of the total offer (new and old shares) at the international price. Thirdly, BP will receive the £1½ billion payable for its new shares straight away, whereas the Government's proceeds will be spread over three instalments. The price paid to BP must clearly reflect the financing benefit of this arrangement to the company.

The agreement reached means that BP will receive no less than their shareholders pay for their rights entitlements. It also ensures that, if there is a wide differential between the international price and the retail price, BP will receive some benefit from the international price, but no more than 90 per cent.

COMMERCIAL IN CONFIDENCE

PWP

Ch/ Deputy Chairman.
AS 6/8

FROM: F CASSELL
4 August 1987

Thanks

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Mr D J L Moore
Mr M L Williams

Thanks - PSR remind me of this point re T/O panel

BRITOIL

I understand from the Department of Energy that Sir Philip Shelbourne's departure as chairman of Britoil is likely to be announced fairly shortly. This move, as I reported to you in June, follows a series of board room rows. The final decision, I gather, was taken at the board meeting last Friday, but Sir Philip will remain chairman until after the Queen has opened the new Clyde field on 7 August.

F CASSELL

CONFIDENTIAL

Re this and the submission below

(i) Bearing in mind the Sums provision, I think I shd take the pricing mtg, with the FST present of course

(ii) The FST shd do the Impact Day Press Conf. etc @ Lancaster Ho, but I wd be available for Radio & TV in order to put this in the context of the Govt's wider political objectives etc.

(iii) I wd like to leave open @ this stage whether I take the 30 Oct mtg (with the FST present) or whether he takes it & communicates with me by telephone.

L.

FROM: MRS M E BROWN
DATE: 17 SEPTEMBER 1987

PS/FINANCIAL SECRETARY

cc PPS
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Moore
Mr Culpin
Mr Lyne
Mr Bent
Ms Leahy
Mr M Call

How much do you want to be involved in the BP launch? The "pathfinder" Press conference will take place while you are away, so will be for FST. But would you like to chair the meetings at (a) + (c) below? And, in particular the Impact Day press conference ((b), below)? 21/9

BP: KEY DATES

This is just to confirm that you should keep the Financial Secretary's diary clear on the following dates for the key pricing and allocation decisions and announcements. Ms Leahy has already advised you of a number of specific engagements during the same period.

(a) Wednesday 14 October: retail offer pricing meeting(s)

(b) Thursday 15 October: Impact Day

Wednesday 28 October: Offer closes: visit Receiving Bankers (NB closing time not yet finalised)

Thursday 29 October, pm: preliminary pricing and allocation meetings

(c) Friday 30 October, am: allocation and pricing meeting for international offer; allocation meeting for retail offer, pm: dealings commence.

Prospectus

2. The Financial Secretary asked to see this. I enclose a copy of the (16th) draft.

Mary Brown

MRS M E BROWN

UN ASSOCIATION
UN CHILDREN'S FUND

3696/003

CONFIDENTIAL & MARKET SENSITIVE

FROM: D J L MOORE
DATE: 12 OCTOBER 1987

FINANCIAL SECRETARY

cc: PS/Chancellor
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mrs M E Brown
Mr Bent
Ms Leahy
Mr Lyne
Mr Call

A further [illegible] for 80 mn app. rather than 70! At this price, it would be v. difficult to hope we go below 340 for the PP price — a 6.1% discount.

BP: FIXED PRICE OFFER

At your meeting at 4.00 p.m. tomorrow, Tuesday, with us and the advisers the main items will be:

(i) the fixed price:
(ii) underwriting allocations in the international offer;
(iii) any points on the Impact Day arrangements.

(i) will be in preparation for the Chancellor's meeting at 11.00 a.m. on Wednesday 14 October when the fixed price will be decided. (ii) has to be decided by Tuesday night so that the allocations can be incorporated in the various legal documents.

Fixed Price

2. You have already discussed Rochschilds' letter of 5 October which suggested a discount of up to 7% after allowing for a 5p fall overnight in the share price as it goes ex rights.

3. I now attach a paper by Wood Mackenzie, under cover of a letter of 9 October from Hoares. This comes to effectively the same conclusion as Rothschilds - see conclusions on page 6. In particular they are concerned with offer period risk - see (ii) on page 2. As the price has fallen from 377p a week ago to 362p this morning we would be unwise to ignore this risk. But there is a counter-argument that after such a fall some of the risk has shaken out, and we could afford to be nearer to 5%.

4. We are discussing this further with the advisers later today. We are also taking BP's and Warburgs' views. It is not for them to decide. But it will be useful to get another angle. I will report further tomorrow.

Underwriting Allocations

5. We are discussing this further with BP later today. The demand from each of the overseas territories is very strong. BP are continuing to press for a higher underwriting allocation to the USA than looks practicable. There will probably be a row. We - and if necessary you - may have to overrule them.

6. The decision has to be taken by Tuesday night. While underwriting allocations are an indication of distribution they do not determine it; the outcome will turn on the bids made.

D J L MOORE

Enc:

3974/48

CONFIDENTIAL

FROM: P J CROPPER
DATE: 15 October 1987

PS/CHANCELLOR

cc Mr A Tyrie
Mr M Call

BP

Would it be thought very tiresome if the advisers were to ask guidance on whether or not they ought to apply for BP?

Refers: DJL Moore, 7 September, attached.

P J CROPPER

CONFIDENTIAL

FROM: D J L MOORE
DATE: 7 SEPTEMBER 1987

MRS M E BROWN - copy each

MR LYNE

Ms LEAHY

cc: (**For action**):
PPS
PS/FST
PS/Sir Peter Middleton
Mr F E R Butler
Mr Monck Mr Cassell
Mrs Lomax
Mr Peretz
Mr Scholar

Ms Wheldon - T.Sol.

Ms A Beaton - D/Energy

cc: (**For information**):
PS/CST
PS/EST
PS/Paymaster General
Mr C D Butler
Mr Culpin
Mr M L Williams
Ms Pelham
Mr Cropper
Mr Tyrie

PURCHASE OF SHARES IN PRIVATISATION SALES

On 21 October 1986, I circulated a copy of ON(General)(85)112 which gives advice on the rules for dealing in shares in those sales on which we have inside information not available to the public and on which we give or see advice.

2. As the BP sale approaches it is timely to repeat this guidance. You and your staff see papers giving information which could be relevant to the value of BP shares and you should not buy those shares in the privatisation offer or deal in BP shares from now until 12 months after the offer (this 12-month requirement is in line with that we have imposed on our advisers).

3. I enclose a list of those whom I believe to be affected by this bar. I would be grateful if you would show this minute to each of your staff involved in the sale, and **confirm by 15 September** that each of them has seen this note. It would be helpful if Ms Pelham (x.4778, rm.29/1) could be informed of any additions to the list (including any new

staff who join us before the sale) and, equally, anyone who will not be seeing relevant papers and can be removed from the list. In order to keep the list as brief as possible I have asked for separate divisional floats of BP papers to be compiled, and circulated only to those on the list.

4. I believe that copy recipients under the "For action" heading will all see price-sensitive information on this sale. I would be grateful if they could show this note to those of their supporting staff who also see relevant papers and **let Ms Pelham have by 15 September** a list of those concerned.

5. I think that "For information" recipients will not see price-sensitive information on BP. But if I am wrong, either now or later, they should regard the note as applying to them **and let Ms Pelham know** the names of the staff involved.

6. I should be grateful if Mr Sanders would consult on whether the ban should apply to all PCC members, and not solely to those we have named. I do not regard it as necessary, but I recall that last year there was some feeling in PCC that they should all be caught.

DJLM

D J L MOORE

Enc:

SA6.008.SS

ANNEX

PE AND PEAU STAFF

Mr Moore
Mrs Brown
Mr Lyne
Mr Bent
Ms Leahy
Ms Pelham
Ms Huleatt-James
Mr Johnson
Miss J Willson
Mr Clark
Mrs Lane
Miss Kinahan
Mrs Pritchard
Miss Nelson
Miss Simon

3696/018

Passed on to DJLM, PS/FST. 19/10

CONFIDENTIAL

FROM: D J L MOORE
DATE: 19 OCTOBER 1987

CHANCELLOR

Oh/Contact?

cc: PS/FST
Mr RIG Allen
Mr Towers

Contact.

BP SALE

In reply to any questions on whether the BP offer is to be pulled we recommend that Press Office should say:

> "The Government are <u>not</u> considering terminating the BP offer. The offer has been fully underwritten".

agreed

It is essential that this message gets out immediately. Otherwise it looks as though we are in doubt.

D J L MOORE

CONFIDENTIAL

FROM: CATHY RYDING

DATE: 20 October 1987

CHANCELLOR

BP

The Financial Secretary has pulled all the television advertisements for the next 48 hours. The Lawyers said there was a danger of the Government being accused of breaching the criminal law for misleading people. And there was a greater danger of a civil suit. On underwriting, there is nothing written down to suggest a particular level of advertising, but the underwriters are likely to say there were implicit agreements which have been broken. The advice is that our case is probably strong enough to resist any such claims from the underwriters - but it is rather a gray legal area.

2. On posters - all the existing posters are to be left but no new posters are to be put up. The only press advertising will be printed prospectuses.

3. Dew Rogerson are working up a new toned down purely factual advertisement for television to be used at the end of the week if it seems appropriate.

4. The Financial Secretary would like a word with you on the phone immediately you get back from lunch.

CATHY RYDING

RENSBURG
MEMBERS OF THE STOCK EXCHANGE
SILKHOUSE COURT TITHEBARN STREET, LIVERPOOL L2 2NH.
TELEPHONE: 051-227 2030
TELEX: 51242

OUR REF MJPC/gaw
YOUR REF

The Right Honourable Norman Lamont M.P.
Financial Secretary to the Treasury
The Treasury
Parliament Street
LONDON SW1

cc. Chancellor
Economic Secretary
Sir P Middleton
Mr. FER Butler
Mr. Monck
Mr. DJL Moore
Mr. Brown
Mr. Dent
Mr. Call.

PERSONAL AND PRIVATE

(Fax No: 01-839-2019)

20th October 1987

Dear Norman

Our notes enclosed as promised. I have sent a copy to Mr. Nicholas Wrigley at N.M. Rothschild.

Yours sincerely

M J P Cooke

Spoke D Moore

M J P Cooke

Enc

X is a pt I have overlooked: if BP is left with the underwriters, we get all the proceeds in 1987-88. I would raise @ the 3pm mtg. M

Broadway House,
9 Bank Street, Bradford BD1 1HJ.
Telephone: 0274-729406

RENSBURG

MEMBERS OF THE STOCK EXCHANGE

BROADWAY HOUSE,
9 BANK STREET, BRADFORD BD1 1HJ.
TELEPHONE: 0274 729406

11 PARK SQUARE EAST, LEEDS LS1 2NG.
TELEPHONE: 0532 434631

SILKHOUSE COURT
TITHEBARN STREET, LIVERPOOL L2 2NH
TELEPHONE: 051 227 2030

The BP Offer for Sale

We are writing this as regional co-ordinators and hence having responsibility for the retail marketing in our area. At the outset we recognise that with the issue underwritten the Government could say that they have no further interest in the BP share price and could walk away from the problem. Indeed they could be congratulating themselves on the fact that they will receive the proceeds of the issue sooner rather than later. However, we believe that present conditions are so unusual that exceptional actions must be taken.

1. The aim of the BP Offer for Sale, the largest equity offering ever, is to widen and deepen share ownership, not to leave 100% of issue with institutions. In marketing terms to proceed with the launch of any product when the customers are unlikely to buy seems crazy.

2. If a large proportion of issue is left with the underwriters then up to £7.5bn of liquidity will be withdrawn from the UK market. Overseas institutions will certainly duck it and coming on top of the massive cash calls on the insurance companies this will absorb the majority if not all institutional liquidity. The traditional buyers of stock will not therefore be prepared to provide support for the market - the catastrophic falls will continue, and business failures will occur.

3. If the market falls substantially further the whole of the Government's continuing privatisation programme looks in jeopardy. Interest rates will rise sharply and this will have adverse influences on UK plc. The amended Eurotunnel projections will be such that it will not be able to raise the necessary private sector finance and completion could be delayed for years.

4. In such a volatile and illiquid market it seems to us essential that the Government should take any action possible to ensure liquidity is not 'unnecessarily' extracted. In political terms less face would be lost by postponement (the opposition don't like privatisations!) than by proceeding and seeing Joe Public avoiding the issue or applying and taking an immediate loss.

5. As one of the largest private client stockbrokers in the UK we deal on a day to day basis with thousands of Joe Publics. He will see his other privatisation holdings falling sharply and will duck the BP issue and will congratulate himself on his sagacity as he consigns his Blue Preferential form to the waste bin. Alternatively, and we have already had evidence of this, he will apply and then stop his cheque if he does not like the outlook next week.

Conclusion

In our view the Treasury and N.M. Rothschild should announce the postponement of the issue as soon as possible.

20th October 1987

857/23

MR TOWERS

FROM: MRS M E BROWN
DATE: 20 October 1987

cc PPS
PS/Financial Secretary
Sir P Middleton
Mr Lyne
Mr Bent
Ms Leahy
Ms Huleatt-James
Ms Pelham
Mr Johnson
Ms Wheldon (T Sol)

BP: ADVERTISING

The Wall Street Journal asked you today whether BP advertisements were being withdrawn or toned down. This is to record that, following consultation with Rothschilds and Slaughter and May, we advised you to say that

> Advertising schedules are always under review. Some readjustment in the advertising is taking place.

2. Tony Carlisle of Dewe Rogerson subsequently telephoned to say that he had received a large number of similar queries, and had been saying:

> The view has been taken that it is inappropriate and unnecessary to run more than prospectus and share application form advertising.

The Dewe Rogerson line goes further than Treasury's. I think it is aceptable for it to came from them. But we should continue to say as little as possible.

B. Keneshan

p.p MRS M E BROWN

RC6.41

CONFIDENTIAL

FROM: CATHY RYDING

DATE: 20 October 1987

CHANCELLOR

BP

The Financial Secretary has pulled all the television advertisements for the next 48 hours. The Lawyers said there was a danger of the Government being accused of breaching the criminal law for misleading people. And there was a greater danger of a civil suit. On underwriting, there is nothing written down to suggest a particular level of advertising, but the underwriters are likely to say there were implicit agreements which have been broken. The advice is that our case is probably strong enough to resist any such claims from the underwriters - but it is rather a gray legal area.

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3. Dew Rogerson are working up a new toned down purely factual advertisement for television to be used at the end of the week if it seems appropriate.

4. The Financial Secretary would like a word with you on the phone immediately you get back from lunch.

CR

CATHY RYDING

MINUTE SHEET:

No...............................   File No..................................

SECRET

I favour play it safe. [illegible]

Sir Peter Middleton   cc PS/Chancellor
                                                        Mr D Moore
H M Treasury   Mrs M Brown

[illegible]

BP AND THE AUTUMN STATEMENT

Note behind

Following your meeting this morning I have discussed the options further with Giles Henderson (Slaughter & May).

2. We assume, in line with this morning's discussion, that there will be nothing in the Autumn Statement which bears particularly on BP or indeed which is expected to have a significant adverse effect on the market, including the BP share price.

3. The most relevant legal obligation on HMG is clause 3.12 of the UK Underwriting Agreement, which provides that the Treasury must consult Rothschilds (and BP) about any public announcement which is material in the context of the offer "so far, and as soon, as it is practicable and so far as it is proper on the part of H M Government so to do".

4. The underwriters would have a strong argument that the Autumn Statement, and the public expenditure totals which would normally form part of that Statement, are material within the meaning of clause 3.12. We believe that the underwriters would have a much less good argument as to the materiality of an announcement restricted to the date of the Autumn Statement.

5. In circumstances where the BP offer had been under-subscribed and the underwriters were obliged to take up shares (which they would know by 29th October) they might look for an escape route under the Underwriting Agreement. They are at present expecting all

OVER

MINUTE SHEET:

No.............................. File No..................................

announcements about the Autumn Statement to come after the underwriting period and there may be recriminations about an earlier date. Against this background, the legal preference (always assuming that the Autumn Statement decisions must now be taken by Cabinet on the morning of 29th October) is for an announcement restricted to the issue of the timing of the Autumn Statement. If HMG were to take the other option and make an announcement on 29th October about the public expenditure totals, the underwriters could argue, if they thought this was to their advantage, that HMG had breached clause 3.12. They could argue that, even if it was improper to consult about the contents of the announcement, HMG should still have consulted them about the bare fact that a potentially material announcement was being made on Thursday afternoon. This legal risk could be eliminated by informing the underwriters in advance of the fact of the announcement but in practice this would no doubt provoke a vigorous attempt by the underwriters to find out the contents of the announcement and questions about the necessity of making the announcement at that time.

6. In the event that there was, contrary to expectation, a severe adverse reaction to any statement the underwriters could of course seek to trigger the termination clause in the Underwriting Agreement (although they would not have an absolute right to termination in these circumstances).

7. It may well be that the underwriters, if given the choice, would themselves choose the more broad-ranging statement on Thursday afternoon but this [does] not affect the legal analysis.

Jill Wheldon

Miss J L Wheldon
20th October 1987

OVER

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859/9

Passed on to PB/PSF 21/10

MR TOWERS

FROM: MRS M E BROWN

DATE: 21 October 1987

cc PPS
PS/Financial Secretary
Sir P Middleton
Mr Monck
Mr Moore
Mr Bent
Ms Leahy
Ms Pelham
Mr Johnson

Ms Wheldon - T Sol

This is v. tricky: We are going to say this. I assume, under the terms of the underwriting agreement & our obligations to the ~~[illegible]~~ underwriters, [illegible] is receiving a guaranteed [illegible] of wholly underwritten public offer.

BP: CAN APPLICATION FORMS BE WITHDRAWN?

Rothschilds and Hoares are receiving a number of calls from members of the public asking whether they can withdraw their applications.

2. We have agreed with Rothschilds, BP and Dewe Rogerson that the following answer should be given:

> The sale is proceeding and, under the terms of the offer, applications may not be withdrawn.

3. This is agreed by Slaughter and May.

B. Wheldon
pp MRS M E BROWN

3369/26

SECRET

Many thanks. Re X, I understand the lawyers have not ... remains the position, we have put new 'non-hard' sell, BP ... positions on top of them. Is this not legally problematic, as well as politically insensitive? 2. I note the points in para 21. Re (ii), further work should be done on this (but no-one outside must know). ~~A Stag~~ Is late payment on the option [illegible] the cases?

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD

DATE: 21 October 1987

PS/CHANCELLOR

cc Sir P Middleton
Mr Monck
Mr D J L Moore
Mrs Brown
Ms Leahy
Mr G Henderson - S&M
Mrs. Lomax
Mr. Call

Sp. Mission on this (2HH minute)

BP: MEETINGS WITH ADVISERS

The Finan[ci]al Secretary had meetings this evening with Dewe Rogerson, Rothschilds and then with Giles Henderson of Slaughters to discuss the latest developments on BP.

Meeting with Dewe Rogerson

2. Tony Carlisle reported the latest research findings drawn from polling completed on 19 and 20 October (a sample of 2000 people).

3. The main figures were:

Awareness 73%
Interest 28%
Certainty to Buy 2.6 million

4. Mr Carlisle's interpretation was that the excellent press coverage immediately after Impact Day had boosted all the figures, and from weekend peaks they were now on a downward trend. However he felt that there was a strong presumption among a core of perhaps 2 million people that BP was still basically a good investment - these people had declared themselves "certain to buy" several months ago.

5. His appraisal was that if the markets picked up and the press wrote favourable stories over the weekend and early next week, we could still expect a fairly good response from the retail sector, particularly from the less sophisticated investors who felt somewhat distanced from the "games" played by the City. More fundamentally, Dewe Rogerson had picked up no sense of the public's being turned off share-ownership as a result of the events of the last few days.

6. On the marketing strategy, the Financial Secretary told Dewe Rogerson to cancel tomorrow's TV advertising and all press advertising except the bare publication in newspapers of the prospectus details and application forms (the latter being a requirement of the Underwriting Agreement). The Financial Secretary agreed with Dewe Rogerson that posters which were of the wrong tone or which had thusfar only been patched over should be discreetly removed overnight.

7. It was agreed that the position would be reviewed again tomorrow, by which time the new toned-down TV advert would be available for the Financial Secretary to see. The Financial Secretary was not sure that even this would be suitable and wanted Dewe Rogerson to explore the possibility of a completely factual advert (not drawing on existing footage) which might simply consist of a shot of the prospectus with an explanatory voice-over.

<u>Meeting with Rothschilds, Hoare Govett and Wood Mackenzie</u>

8. Michael Richardson, Richard Westmacott, John Chiene and Robert Norbury joined the meeting.

9. Mr Richardson started by reporting that the Senior Partner of Goldman Sachs had telephoned the Chairman of Rotshchilds to say that the securities system in the US was under a great deal more pressure than anybody in the UK realised. The firm view of Goldman Sachs was that this was not the right time to go ahead with the issue. They would be making the same point to David Moore tomorrow when officials met the overseas underwriters in a series of meetings.

10. Mr Richardson said that he did not think that Goldman Sachs would be prepared to hold on to their underwriting allocation (some £500m of stock at a price of 330p) beyond 30 October, the date on which they would have to pay HMG for the shares. Given other pressures on them they could not afford to tie up $1 billion of capital. There was, therefore, a clear prospect that a large chunk of the US stock would be dropped onto the market on 30 October.

11. As far as the UK was concerned, Mr Richardson reported that the sub-underwriting had been widely spread, and none of the sub-underwriting institutions was in acute difficulties. He thought that Rothschilds and the brokers would be able to coordinate an orderly selling exericse on or after 30 October. He said that with the market rally today there had been little pressure from the UK underwriters or sub-underwriters: most were facing the situation "fairly robustly".

12. Mr Richardson did re-emphasise, however, that the situation was markedly different in the US and the other overseas markets where underwriters did not pass the risk down to a wider spread of institutions and correspondingly took very large chunks of shares in what effectively amounted to a "bought deal". The major problem was in the US: the Europeans and Japanese were not complaining too loudly, and the Canadians were taking their cue from the US. Mr Chiene suggested that the position in New York ought to influence our decision about "what to do".

13. As far as the markets were concerned, the BP price was hovering between 310p and 290p: it did not seem to be able to break through the 310p barrier for technical reasons. The brokers felt that further substantial falls before the end of the week could not be ruled out. Confidence had not returned to the market although it was looking better today than earlier in the week.

14. The Financial Secretary asked what Mr Richardson felt about the position on TV advertising. Mr Richardson said that the decision to pull the advertising for 48 hours had been absolutely

right: it was not correct to encourage people in with the price as it was now. His advice would be to cancel the advertising for a further 24 hours and then to look at it again. Mr Chiene and Mr Westmacott agreed with this.

15. Mr Richardson said that his lawyers (Freshfields) had advised that Rothschilds might not have an indemnity from HMG against the possibility of being sued for issuing adverts which were considered to be misleading. Mr Henderson said that he would reflect on Rothschilds' position.

16. The question was raised of the 20,000 people who by noon today had already submitted applications. If these people cancelled their cheques they would be acting illegally. The Financial Secretary agreed that Treasury, Rothschilds and BP should, if asked, say that under the terms of the offer applications could not be withdrawn.

17. Mr Richardson said that he felt that the problem the Government were up against was one of time. If the offer period could be extended by one week the issue could yet be a success. He thought that the underwriters might agree to this. Neither Hoare Govett or Wood Mackenzie were attracted to this idea at all, however, and Mr Richardson withdrew it.

18. Mr Westmacott suggested that the Government might wish to reduce the size of the offer to £2½ billion (the amount which would be brought in by the first installment in 1987/88). This would help the share price and benefit the wider privatisation programme. The Financial Secretary said this was not an attractive idea to the Government. Mr Richardson said that he thought they were slightly clutching at straws.

19. It was agreed that the Financial Secretary would speak to Rothschilds again on Friday.

Meeting with Giles Henderson

20. The Financial Secretary reflected on some of these issues

with officials and Mr Henderson (Slaughter and May).

21. The Financial Secretary would like to draw the following points to the Chancellor's attention:

(i) In the event that Goldman Sachs defaulted on the underwriting commitment, the other 3 US underwriters would have no liability to meet Goldman Sachs' commitment though they would have continuing liability for their own commitments (liability is "several" rather than "joint and several" as in Japan). HMG would retain the 150 million or so shares underwritten by Goldman Sachs in the event of default, and would have the right to sue.

(ii) The US underwriters' difficulties were particularly accute because in this sale (as in Gas but in no other sale), they would have to pay HMG for their shares on 30 October, <u>not</u> at the point when they had themselves sold on the shares.

(iii) A clear possibility which would have unwelcome implications for the aftermarket was that Goldmans and others would simply dump stock on the market. They could not hold on because of their liquidity position.

(iv) 20,000 people had already come in to the offer. Dewe Rogerson believed that over a million people might yet apply, whatever the market did. The question, therefore, arose of how to deal with theprospect of thousands of small investors making a loss (at least in the short term) on their shares. Mr Henderson suggested that one possibility would be for HMG to consider, <u>after</u> the sale, making refunds to applicants. This, of course, was not something to be decided now and would have to be examined very carefully.

22. The Financial Secretary has communicated most of these points to the Chancellor orally already. I thought nevertheless that they were worth recording.

a.H.

JEREMY HEYWOOD
PRIVATE SECRETARY

BRIEFING FOR PRIME MINISTER'S QUESTIONS, 22 OCTOBER

The Treasury issued the following press notice this morning:-

22 October 1987

BP SHARE OFFER

HM Treasury wish to make clear that there is no intention to extend the BP share offer period beyond the date of 28 October set out in the prospectus.

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
LONDON SW1P

66/87

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Inland Revenue

Policy Division
Somerset House

FROM: M A JOHNS
DATE: 22 OCTOBER 1987

1. MR PAINTER

The delay in bringing the question of valuation for tax to a conclusion is intensely frustrating for everyone involved, including, I fully realise, Treasury Ministers. But we have to get a reasoned answer to the hypothetical question set by the Court which takes account of such, now indirect, evidence as is available. The risk of further judicial review (paragraph 16) simply underlines the point.

TJP

2. ECONOMIC SECRETARY

MOSSMORRAN

1. This minute:

a. brings Ministers up to date with current developments following the ICI case; and

b. seeks your agreement to our sending the attached briefing to the Scottish Office, for use by the Secretary of State when he sees Shell at the end of this month.

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cc PS/Chancellor
Sir P Middleton
Mr Cassell
Mr Scholar
Mr M Williams
Miss Sinclair
Mr Cropper

Mr Battishill
Mr Painter
Mr Pollard
Mr Johns
Mr Cleave
Mr Elliss
Miss Hill
Mr Ridd
Mr Kuczys
PS/IR

At the same time, the minute is intended to meet a request from Sir P Middleton (to Mr Williams) for a report on where the Mossmorran issue now rests, and to brief him for a forthcoming meeting which Bob Reid (Shell) and Archie Forster (Esso) have requested.

2. We last reported on this subject in the briefing for the Chancellor's lunch with Esso on 16 September. Since then, we have had a meeting between the Oil Taxation Office and the tax specialists of Shell and Esso. And the companies seem to have embarked on a round of lobbying - Shell briefly raised the subject with the Minister of State, Scottish Office (Ian Lang) recently, and with the Minister of State, Department of Energy (Peter Morrison) last week; they are seeing the Scottish Secretary at the end of the month; and now they and Shell have asked for a meeting with Sir P Middleton (arranged for Thursday 29 October). So this seems a good time to take stock.

Background

3. The full background was set out in Mr Pitts' minute to you of 25 June (copy attached) and Mr Williams' minute of 26 June. In brief, ICI successfully challenged in Court the approach the Revenue said it would adopt in determining the market value of ethane for PRT purposes under Section 134 of the Finance Act 1982. That legislation had been introduced following representations from Shell and Esso about the Brent ethane they intended to use in the Mossmorran cracker, and ICI had opposed it from the start, on the grounds that it would give ethylene produced at Mossmorran by Shell and Esso an unfair competitive advantage over ethylene produced (from naphtha) by ICI at Wilton.

4. The Courts found no problem with the legislation as such, but ruled that the <u>way</u> the Revenue said it would apply the 1982 PRT rules to the Mossmorran situation, in determining the alternative fuel value of ethane, fell foul of the definition of an arm's length sale price in the 1975 legislation. Further, if the Revenue applied a valuation on that basis, it would be

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conferring a "state aid" (contrary to the Treaty of Rome) on Shell and Esso. Leave to appeal to the House of Lords was refused.

5. For reasons of confidentiality, the Revenue did not disclose in Court (or subsequently) whether Shell and Esso (or any company) had actually made elections under the 1982 rules, and the case was therefore argued on a hypothetical basis. But the Court decision meant that any elections that had been made and accepted on the unlawful basis now had to be reconsidered by the Oil Taxation Office, in the light of what the Court said. This does not necessarily mean that these elections have to be rejected, with the result that tax is assessed on higher valuation figures. The end result could be that the price formulae specified in the original elections are found to be acceptable; or that we end up with valuations sufficiently close to the original ones that Shell and Esso can live with them. It is all a case of establishing precisely where the Court's declarations and required hypothesis take us. Interpretation of the declarations is itself a contentious issue.

6. In any case the Revenue's judgment on all this is not necessarily a final one. In the event that the figures which emerge from this reconsideration process require the elections to be rejected, the companies have the right of appeal to the Special Commissioners. The Commissioners would of course be equally bound by the Court decision, but it is always possible that they would draw rather different conclusions from the evidence put before them.

Recent developments: the valuation route

7. Over the past 18 months the Oil Taxation Office has been trying to carry out the valuation exercise set for them by the Court: this involves establishing the price which would have been paid for Brent ethane for fuel (as opposed to petrochemical) use in 1981 in a contract which does not breach the arm's length rule. As was expected, this has proved to be a very difficult,

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hypothetical, exercise. In practice the only customer for gas for fuel use would have been BGC (as it then was). Most of the gas from Brent - mainly methane - was already contracted to BGC under a contract made in 1975, but, for the purposes of determining what BGC would have paid for the remaining Brent ethane, the Court ruling requires us to <u>ignore</u> the commercial relationship between Shell/Esso and BGC represented by this pre-existing contract - the only firm evidence we have.

8. In fact, of course, this ethane is not used for fuel, but for petrochemical purposes at Mossmorran. The gas is very much richer than gas normally put into the national grid and this raises very difficult questions about how BGC would have approached the hypothetical purchase, bearing in mind its concern for safety and other factors. A reasonably conclusive answer to these questions required expert advice, on what BGC's pricing policy would have been at the relevant time in the appropriate hypothetical circumstances. The obvious place to go for this information was British Gas itself or, as very much a second best, a former employee of BGC with experience of their approach to gas purchasing at the relevant time. We have pursued both avenues vigorously, but this summer concluded that we could get no further down either road. In the case of British Gas there may have been some reluctance to get involved in this sensitive area: they have important trading relationships with Shell and Esso, <u>and</u> with ICI. But in any case the question set by the Court is completely hypothetical and, though we did everything we could to persuade them, it is perhaps not surprising that British Gas, and their former expert employee whom we also approached, have said they have found it too difficult to advance a view on the answer.

9. In the absence of such direct expert advice on these issues, the OTO have now been forced to pursue a more indirect approach - still arriving ultimately at the answer to the original question. This indirect approach involves establishing what specification (ie calorific value, safety factors etc) would have been acceptable to BGC, what price they would have paid for that, and

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what it would have cost to reform the ethane stream to meet the specification.

10. There are still some uncertainties involved in such an approach - and Shell/Esso have not yet signed up to it - but with appropriate technical advice the OTO believes it can reach a view on these questions. We already have some information from British Gas, one of its former employees and other sources. But this is not sufficient to form a firm judgment on the various costs involved, such as in reforming the gas - certainly not of the sort that could stand up to a possible further challenge from ICI. So the OTO is seeking further expert technical evidence, and this will necessarily take a little more time.

11. ICI themselves have continued to take an active interest in this matter. We have told them that the valuation of any particular company's gas - or whether it needs to be valued at all - is a confidential matter, but have nonetheless not sought to discourage them from submitting evidence which they think might be relevant to gas valuation questions, including evidence on the kind of costs referred to above.

12. On 28 September the OTO held a meeting with representatives from Shell and Esso. The office explained where it had got to in the effort to obtain expert advice, discussed the likely timetable from now on, and put to the companies the further questions about the costs of reforming, etc. The companies agreed to provide the information we had requested (this may involve them in some considerable work) with a view to establishing their case. But they were concerned that the work of the past 18 months had proved, to some extent, to have been a blind alley (although a necessary one); and there was a hint that they would find it difficult to reassure their top management, who were expecting a quicker solution and would not look narrowly to the Inland Revenue for it.

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The Legislative and Public Expenditure Routes

13. Since the valuation process was always bound to take time and the outcome was uncertain, the senior management of Shell and Esso have made representations to Ministers and to Sir Peter Middleton asking for the same overall result to be achieved by other means. They have always viewed the matter not as a narrow dispute with the Inland Revenue about the interpretation of tax law, but as a broader issue between the companies and HMG. They argue that the decision to proceed with the whole Mossmorran project in 1981 was a marginal one, which had depended crucially on assurances of government assistance - including commitment to securing a satisfactory basis for tax valuation of the ethane, given by the then Scottish Office Minister of State (Alex Fletcher) in a letter. They hint that Ministers should honour those commitments - presumably through legislation to overturn the Court of Appeal decision, or through some public expenditure route. (In this broader context the companies also complain about the rates payable on the Mossmorran plant.)

14. Treasury Ministers have, of course, given thought to these alternative possibilities. However, any legislation to nullify the Court decision would risk being judged a "state aid" in EC terms, and would give ICI another opportunity to mount a legal challenge. The Chancellor therefore decided last December not to pursue this option. The same objections would seem to apply to the public expenditure route - quite apart from the usual considerations about adding to public expenditure. So, whether or not the companies see it this way, it is probably in their own best interests, as well as the Government's, to continue the discussions with the Oil Taxation Office.

Companies' current thinking

15. This subject was, predictably, raised by Sir Archie Forster at a lunch Mr Painter and I attended on 20 October. He understood the Revenue's problems and the reasons for the delay in arriving at an answer but emphasised the pressures on their side for an early resolution:

- if the Revenue's valuation was not acceptable to the companies then the situation would be very serious. Esso had a commitment from a sovereign Government and there was too much money at stake for this to be let go by default.

- while Esso had not ruled out appeal to the Special Commissioners they saw objections to it. They felt the more bodies (Courts, Revenue, Commissioners) found against them, the more difficult it would be for them to take alternative action. The sums at stake were too great to be put at risk by a gamble before the Commissioners.

16. In response, Mr Painter and I said that Ministers would almost certainly want to be satisfied that Esso had exhausted the existing route up to and including appeal to the Special Commissioners before being asked again to consider exploring alternatives, and even then the alternatives were likely to look very unpromising. It was unusual for the Special Commissioners to find a result even more unfavourable for the taxpayer than the Revenue's proposals: so it was not clear what Esso had to lose from the "gamble", apart from time. Mr Painter also stressed that we in the Revenue had to carry out the remit the Court had given us: we could not take account of extraneous factors such as the economics of Mossmorran. (It is all the more important to take this approach - and be seen to do so - since we cannot entirely rule out the possible further scope for fresh judicial review.)

Sir Peter Middleton's meeting

17. When Sir Peter Middleton last saw Forster and Reid in January, he made clear (Mr Saunders' minute of 20 January) that:

- if it was not possible to get an expert from British Gas, advice would have to be sought from elsewhere; but that

- nevertheless this route was better than the legislative one, which ran into serious problems of EC competition law and opened up the possibility of further legal challenge from ICI. There was no practical alternative but to stick to the present course.

18. That remains the line, except that it is now clear that we cannot get any further with British Gas (short of a subpoena at the Special Commissioners stage). As before, Sir Peter Middleton will not be able to discuss the companies' tax affairs, but on the way the Revenue are handling them he could assure them that:

- the Revenue are as disappointed as they are that it has not been possible to arrive at a direct answer to the valuation question. But, as the companies know, the Revenue are pressing ahead as quickly as possible. The companies will appreciate that the Court ruling raises difficult and essentially hypothetical questions on which it is difficult to find independent evidence.

- the discussions with the Revenue may yet reach a conclusion which is satisfactory to Shell and Esso. But even if they do not there are the usual avenues of appeal: the Special Commissioners would be bound by the Courts' ruling on the law, but would be free to take a rather different view of the evidence.

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Conclusion

19. This minute is mostly for information. But we should be grateful for your agreement to our sending the attached brief to the Scottish Office for Mr Rifkind's use when he sees Shell on 28 October.

pp M A JOHNS

MOSSMORRAN: BRIEFING FOR SECRETARY OF STATE FOR SCOTLAND

Subject

1. Mr Bob Reid (Chairman & Chief Executive, Shell UK) and Mr Peter Everett (Managing Director, Shell UK Exploration & Production) are coming to see the Secretary of State, at their request, at 10.00am on 28 October, "to discuss ethane". We assume this is a reference to the Mossmorran project, in which Shell are partners with Esso UK. The companies certainly have a problem with the valuation of their own Brent ethane for tax purposes, which is the subject of this brief. But it may be that they want in addition to discuss other issues, eg the availability of sufficient ethane to continue to fuel Mossmorran once the Brent ethane has run out. Shell and Esso also have a complaint about the rates payable on the plant. These last two issues are not covered here.

Background

2. The Mossmorran plant was built in the early 1980s by Shell and Esso, to manufacture ethylene from ethane from the companies' Brent field. The companies say that the project was a marginal one for their parent companies, and only went ahead on the basis of Government assurances. In particular, the companies made representations about the valuation of the ethane for tax purposes. Up to 1982, any ethane requiring valuation for petroleum revenue tax (PRT) purposes would have been valued under the same rules as crude oil. These rules assume the existence of a short-term market. In the light of the Shell/Esso representations, the Government accepted that it would be wrong in principle to apply these rules to

ethane, because of the long-term basis on which ethane would be sold at arm's length.

3. Accordingly the 1982 Finance Act introduced provisions giving a choice to a company which has ethane which is to be used for petrochemical purposes and requires tax valuation. Either it could allow the ethane to be valued under the general rules, or it could elect for an alternative long-term basis to apply, specifying a price formula to cover the period of the election (up to 15 years). This would typically take the form of a base price and escalator, from which "market values" for each period covered by the election could be derived. In testing whether an election can be accepted, the Revenue is required to determine whether the "market values" resulting from the company's price formula would differ materially from arm's length long term contract prices. The latter is the best price which could have been obtained in the market, not necessarily for petrochemical use of the ethane, but (if that is higher) for fuel use as well.

4. ICI made known their opposition to the 1982 legislation as soon as it was announced on the ground that it would give Shell and Esso an unfair competitive advantage (ICI had a competing plant at Wilton which produced ethylene from naphtha: ethane had not previously been used as a feedstock). Failing to block the legislation being enacted, they then took the Government to Court, claiming that the legislation, and the way the Revenue proposed to implement it, were contrary to the "state aid" provisions of the Treaty of Rome. In the event, the High Court ruled that the legislation itself, properly applied, did not constitute a state aid: in the Court of Appeal ICI dropped this argument. But both the High Court and the Court of Appeal ruled that the way the Revenue said it would apply the rules was unlawful. (For confidentiality reasons, the Revenue did not disclose -

and has not disclosed - whether any elections had in fact been made. The case was therefore argued on a hypothetical basis.)

5. In particular, the Courts ruled against the approach the Revenue said it would adopt to establish what price a fuel purchaser would pay for the Brent ethane used at Mossmorran, which proceeded on the basis that the ethane would have been sold to BGC at a price which was influenced by a pre-existing (1975) contract between Shell/Esso and BGC. Following the Court of Appeal decision, in February 1986, any elections made by Shell and Esso will now have to be reconsidered by the Oil Taxation Office to take account of what the Court said.

6. Because of the difficult technical issues involved which may well mean seeking advice from outside experts, and obtaining and examining a lot of information from the companies, all this inevitably takes time. Were it finally to result in a valuation which was unacceptable to the companies, the normal appeal avenue would be of course open to them.

7. The companies have argued that an adverse result on valuation would make Mossmorran uneconomic; and that they only went ahead with Mossmorran on the basis of Ministerial (in particular Scottish Office Ministers) assurances. They may contend that the Government should legislate to overturn the Court Appeal decision (leave to appeal to the House of Lords has been refused), or should in some other way restore the companies' financial position to what it was previously thought to be. Treasury Ministers' view is that neither course seem feasible - either would be likely to contravene EC law on "State aids" and both would give ICI another opportunity to mount a legal challenge of the Government's actions.

Continuing discussions with the Inland Revenue seems the best option for the companies.

Present position

8. The rules of confidentiality prevent us from revealing details of discussions between the Revenue and Shell. But representatives of the companies met the Revenue recently, and were told exactly how matters are now progressing on the valuation issue. The Minister of State (Mr Ian Lang) met Shell on 5 October.

Line to take

Want to see continuing viability of Mossmorran assured. Question to be resolved - ethane valuation - is, however, a tax matter, for companies (Shell and Esso) and Inland Revenue. Companies should continue dialogue with Revenue. Hope a satisfactory conclusion can be reached.

Defensive

["HMG should honour earlier undertakings to Shell and Esso by legislating to overturn Court of Appeal decision/by compensating them for any additional tax payments".]

Premature to consider alternative options while discussions with Inland Revenue have not reached conclusion. That is likely to be much the best route.

["Talks with Inland Revenue proceeding slowly/not making progress".]

A matter for Treasury Ministers. But have Treasury's assurance that the issue is being treated as a matter of urgency. Will convey your comments to Treasury colleagues.

GOVERNMENT EYES ONLY

BP SHARE SALE

The briefing material below has been cleared with all parties to the sale, as is required by the terms of the Underwriting Agreement. But our lawyers have rightly advised us to stress the importance of the Health Warning given the BP share price and the uncertain state of world stock markets. This note, which is not being given a wide circulation, amplifies the Health Warning as follows:-

X PRESS OR PUBLIC ANNOUNCEMENTS (SAVE IN PARLIAMENTARY PROCEEDINGS IN ANSWER TO ANY QUESTION OF WHICH PRIOR NOTICE HAS NOT BEEN GIVEN) SHOULD RECEIVE THE PRIOR CLEARANCE OF ROTHSCHILDS (ON BEHALF OF THE UNDERWRITERS) AND BP.

ANY PRESS OR PUBLIC ANNOUNCEMENT OR COMMENT MADE BY A MINISTER OF THE CROWN WHICH IS NOT SO CLEARED AND WHICH IS MATERIAL IN THE CONTEXT OF THE OFFER CAN LEAD TO THE UNDERWRITERS SEEKING TO TERMINATE THE UNDERWRITING AGREEMENT.

R M Bent

R M BENT
H M Treasury

Ch

I hesitate to suggest amendments! But I do not like one of the answers (marked) at all (NB X above, but I am sure we should try to get any revisions fully cleared). AA

I don't like the much either, but don't think it's worth the hassle of going all through the clearance palaver.

PRIME MINISTER'S QUESTIONS

BP SHARE SALE

HEALTH WARNING: ANYTHING SAID ABOUT THE OFFER, BP OR BP'S TRADING ENVIRONMENT MUST BE FACTUAL, ACCURATE AND FAIR, AND SHOULD BE CONSISTENT WITH THE PROSPECTUS. NO OPINION SHOULD BE EXPRESSED AND NO PREDICTION MADE ABOUT THE PROSPECTS FOR THE SHARES OR FOR BP'S BUSINESS OR ABOUT BP'S COMPETITORS OR THE OIL INDUSTRY GENERALLY. NO STATEMENTS SHOULD BE MADE WHICH COULD BE INTERPRETED AS AN INDUCEMENT OR RECOMMENDATION TO BUY, OR NOT TO BUY, BP SHARES.

Line to take

I can confirm that the Government is not considering terminating the offer. It is fully underwritten.

The [Rt] Hon Member will understand that there are limits to what more I can say while a public offer is underway.

Details of the offer are set out in the Prospectus, a copy of which has been placed in the Library. Copies of the Prospectus are being sent to all those who have registered their names with the BP Share Information Office, and are now publicly available.

Investors must decide for themselves whether or not to apply. They have until 10 am on 28 October to make up their minds and to deliver a completed application form to whichever primary receiving centre is appropriate for their particular surname.

Supplementaries

Should small investor apply?

The offer is priced at £3.30, payable in three instalments. Investors must decide for themselves whether to apply, taking account of the offer terms set out in the Prospectus and current market prices.

Position of those who have applied already?

Once applications have been made they cannot be withdrawn.

Government prepared to modify terms of offer?

Terms of offer are as set out in the Prospectus. No change is contemplated.

Wider share ownership in tatters?

Not so. Hon Member must wait and see what happens on BP share sale. Implementation of Government's wider share ownership policies has been highly successful.

Shareholders buying into earlier Government sales always knew that share prices could go down and well as up. They have a continuing stake in the success of British enterprise.

Will the offer be left with the Underwriters?

That depends on the number of applications received when the offer closes at 10 am on 28 October.

Collapse of City institutions under weight of underwriting?

X [Hon Member is presuming outcome of the BP share sale, and casting doubt on strength of City institutions. Do not share his concerns.]

Advertising and marketing costs wasted?

Right and proper to advertise share sales. Can give no estimate of costs of BP sale at this stage.

Cutback in offer advertising?

Some readjustment is being made to the offer advertising. Advertisements setting out the terms of the Prospectus and/or supplying an Application Form are being published according to plan.

Limit on foreign ownership of partly paid shares?

Not appropriate. The issued ordinary share capital of the company is already listed on the stock exchanges in London, Tokyo, Paris, Geneva, Basle, Zurich, Dusseldorf, Frankfurt and Hamburg and is traded in the form of depositary receipts on the stock exchanges in New York and Amsterdam. Foreign share ownership is welcomed by the company.

How many foreign shareholders expected?

That depends on the outcome of the offer.

Underwriters voluntarily took on these risks, in return for a fee. We do not yet know how much of the offer – if any – will be left with the underwriters, nor do we know what the subsequent market price will be. [There is no reason to suppose any firms will have difficulty meeting their commitments].