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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

IRAN: IRANIAN DEBTS TO THE UNITED KINGDOM

Note by the Secretaries

The attached Note by Officials on Iranian debts to the United Kingdom relates to the 'variety of outstanding claims' to which the Foreign and Commonwealth Secretary referred in paragraph 3 of his minute to the Prime Minister of 26 March about arms supplies to Iran. The note is circulated to the Committee to provide a background for the resumption of their discussion on this general issue, and on the proposed release of the 'Kharg' to Iran.

Signed ROBERT ARMSTRONG  
R L WADE-GERY  
R M HASTIE-SMITH

Cabinet Office

2 April 1981

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BACKGROUND NOTE ON IRANIAN DEBTS TO THE UNITED KINGDOM

Note by Officials

In considering their future policy on the export to Iran of goods requiring an export licence, Ministers may find it useful to be aware of the scale of Iranian debts and the scope for applying pressure to secure their repayment.

2. There are four categories of debt -

a. Debts owed by the Iranian Government and agencies under its control to British Government Departments or to International Military Services Limited (IMS) acting on behalf of the Government or, in some cases, on their own account. Details are set out at Annex A.

b. Debts owed by the Iranian Government and agencies under its control on which ECGD has paid out claims. A list of some of the larger cases involved is at Annex B. ECGD has to date paid a total of £127m in respect of all Iran claims of which some £98m is directly attributable for one reason or another to the Iran Government. Another £26m of claims are currently under examination and further potential losses notified amount to some £106m.

c. Debt to companies not covered by ECGD insurance. The only debts of which the Group is aware under this heading are those incurred by the Iranians in respect of spares and services provided by British Shipbuilders for the 'Kharg' prior to its abandonment by the crew. These amount to £850,000.

d. Debt to banks. Arrears of \$35 million are still outstanding. Most of this sum relates to direct (ie non-syndicated) borrowing by Iranian companies and there are reasonable prospects for repayment of the bulk of the money in due course. But some loans to the Ahlavi (formerly Pahlavi) Foundation are, because of that organisation's close links with the former Shah, unlikely to be repaid. There is no suggestion at present that the banks would wish these bank debts to be the subject of intergovernmental bargaining.

3. The claims are not all one way. Although no totals are available, a number of British firms have received claims from the Iranians in respect of contracts not completed; and it is clear that, once conditions permit serious discussion of UK claims, many Iranian counter claims will also be put forward. Another factor to be taken into account is the existence of performance bonds relating to a number of outstanding contracts. So far the Iranians have not called such bonds capriciously or for political reasons, but there is a risk that they might retaliate in this way to an attempt on our part to apply general commercial leverage by withholding export licences. At present at least £100m million of performance bonds are outstanding of which £40 million are guaranteed by ECGD.
4. The position of other Western countries, the USA apart, is similar to or worse than our own. France has considerably larger claims; West Germany appears to have less than the UK at present but their potential claims are larger; Italy has comparatively few claims; and Japan's position depends largely on the future of one very large petro-chemicals projects. ECGD will keep in close touch with their colleagues in Europe and will consider with them whether there is scope for any concerted action to recover debts.
5. The normal arrangements for debt recovery are
- i. In the case of companies, whatever arbitral or court proceedings are provided for in the contract concerned. However, the malfunctioning of the Iranian administrative and legal system is such that the chances of redress by this means can at present be regarded as negligible.
  - ii. In the case of official organisations, Government to Government negotiation.
6. Once political clearance has been given, IMS and MOD would expect to enter into negotiations with the Iranians. In such negotiations, the Iranians would be reminded of the major importance which we attach to the early clearance of debts, and we would hope to use the possibility of the release of non-lethal military equipment as a lever to persuade the Iranians to clear at least part of their debt. However, it has to be recognised that the extent of the pressure that can be exerted in this way would be limited, particularly as the Iranians

would still not be receiving the lethal items to which they must attach even greater importance in the context of the hostilities with Iraq. The legal and contractual situation underlying this situation would be complex and would have to be considered in the context of the supply requests made and the individual contracts concerned. The Attorney General's opinion is however that it would be lawful for the Government to refuse export licences so long as debts to itself (ie in this case MOD) or DMS (an arm of the Government) were outstanding.

7. Against this background, the question arises whether any Government leverage exists which could secure payment of monies outstanding to companies, the recovery of which would of course be of direct benefit to ECGD. Of the possible approaches, three do not appear to warrant any further consideration.

These are -

i. A generalised settlement of all outstanding debts. This approach stands most chance of success when the debtor has financial difficulty in purchasing goods to meet its current requirements, a situation which does not apply in Iran's case.

ii. Attachment of Iranian assets in the UK. Potential damage to London as a financial centre is equally relevant here. Furthermore this approach would not work because of the difficulty of establishing the precise ownership of Iranian assets in the UK and matching them with the debts of those same organisations.

iii. Freezing Iranian financial assets. Although the United States freezing of Iranian financial assets, triggered by Iran's taking of American hostages, provided a possible means of settling US commercial claims, the arguments which led us to refuse to contemplate that course to help the United States then are no less compelling now in relation to Iran's commercial debts to the UK. The threat to London's role as an international financial centre and to the position of the Bank of England in particular would be totally disproportionate to the amount of money at stake.

8. Officials did however think it worth considering whether it would be possible, once the current political obstacles have been removed, to use the withholding of export licences for military equipment to put pressure on the Iranians to settle



debts beyond what they owe to the Government or IMS. On balance, they did not think this was worth pursuing since the value of the goods we should be withholding is small in relation to the outstanding debt; and although some items (especially spares for Chieftain tanks) are badly required by the Iranians, this would not seem to be an effective lever to apply across the board to the Iranians and could well frustrate the use of such a lever in a more limited context (see para 6 above). The Attorney General has not in any case been asked to consider the legality of withholding export licences as a lever to recover the generality of ECGD guaranteed debts.

CONCLUSIONS

9. Officials conclude that -

a. Iran's outstanding debt to the United Kingdom in respect of amounts due to MOD, IMS and exporters insured through ECGD is substantial (£200 million).

b. On the claims paid at present ECGD estimates that most of the £29 million paid in respect of the Private Sector will eventually have to be written off. On the £98 million already paid in respect of the Public Sector, recovery prospects will depend on the outcome of eventual negotiations which will of necessity be protracted. Taking an optimistic outlook, ECGD would not at present expect to recover more than 50 per cent.

c. As regards sums owing to the Ministry of Defence (and IMS, some of which have been the subject of claims paid by ECGD), use of the Government's discretion to withhold export licences for certain spares requested by Iran (and already paid for) provides some leverage, which it would be lawful to apply.

2 April 1981

DEBTS OWED BY IRAN TO THE MINISTRY OF DEFENCE  
AND INTERNATIONAL MILITARY SERVICES LIMITED  
AS AT 25 FEBRUARY 1981

1. The contracts entered into with Iran prior to the revolution now represent a range of unfinished business for MOD and IMS, and include the following items:

a. Those for which Iran has paid, but for which export licences are being withheld - KHARG, AFV spares and ammunition.

b. Those covered by extant contracts where letters of credit will require revalidation - AFV spares and ammunition.

c. Those under extant contracts yet to be manufactured and where price negotiations are outstanding - AFV spares and ammunition.

d. Those covered by contracts which have been terminated but for which settlements, including termination accounts, have still to be negotiated e.g.

(i) P.4030 MBT Contract.

A total of £307M has been received, and it is expected that all of this will be taken up by the MOD termination claims.

(ii) Other Contracts.

Some £25M of advance payments from Iran are held by MOD and IMS (together), and it is expected that this will need to be utilised in the settlement of termination claims from suppliers and sub-contractors in respect of e.g. ARVs and the Yarrow Support Ships.

e. Those on which debts are owed by Iran to the MOD and IMS. (Paragraph 2 below.)

2. The breakdown of the debts referred to above is as follows:

	<u>£M</u>	<u>£M</u>
a. <u>MOD Contracts Direct with Iran</u> <u>(Covering Hydrographic Survey,</u> <u>Training and Naval Stores)</u>		7.0
b. <u>MOD Contracts Via IMS:</u>		
(i) AFV Spares		4.6

	<u>£M</u>	<u>£M</u>
(ii) Armoured Recovery Vehicles	1.0	
(iii) Support in Aid of Iranian Ships	<u>1.4</u>	7.0

c. IMS Direct Contracts with Iran

(i) Bandar Abbas Dockyard	32.2	
(ii) Fifth Echelon Workshop	17.1	
(iii) CTT	1.3	
(iv) ICP	11.0	
(v) Yarrow Ships	2.0	
(vi) Support Contracts	<u>2.7</u>	<u>66.3</u>
		<u>80.3</u>

Notes:

- a. The Bandar Abbas figure includes an extra-contractual claim of approximately £2.6M for loss and damage due to breach of contract by delay in performance of obligations by the Iranians.
- b. Against the debts owed to IMS on the Fifth Echelon and CTT contracts, ECGD have, to date, paid the sums of £14.7M and £0.6M respectively to IMS.
- c. The Yarrow Support Ships debt relates only to the IMS input. In addition, Yarrows are owed a further £20M against which ECGD have, to date, paid £13.8M.
- d. The above contain elements owed in Rials, the Sterling value of which will vary according to the exchange rate ruling at the time of settlement.
- e. The above sums exclude further possible termination claims against Iran.

LARGER CLAIMS PAID BY ECOD IN RESPECT OF IRAN GOVERNMENT AND PUBLIC BIDDERS

EXPORTER	BUYER	GOODS/PROJECT	CAUSE OF LOSS	AMOUNT PAID BY ECOD	FURTHER LIABILITY	STATE OF CONTRACT
<u>A COMPLETED CONTRACTS</u>						
RIEC LTD	MIN OF WATER & POWER	SUPPLY AND ERECTION FOR IRAN POWER GENERATION AND TRANSMISSION CO.	GOVT. DEFAULT	£1,371,529.47	NIL	SUPPLY AND WORKS COMPLETED
<u>B INCOMPLETE CONTRACTS</u>						
GFC TURBINE GENERATORS	IRAN POWER GENERATION AND TRANSMISSION CO (TAVANIR)	POWER STATION AHMAZ II	GOVT. DEFAULT	£3,665,394.59	£500,000	CONTRACT TERMINATED. GOODS IN STORAGE IN UK.
TURRIFF TAYLOR	SOCIETE FRANCAISE DES PETROLES D'IRAN (SOFIRAN)	ONSHORE FACILITIES FOR GIBRI ISLAND OIL TERMINAL	WAR	£2,851,653.59	NIL	WORK COMPLETE BUT HOLD UP IN 12 MONTH MAINTENANCE PERIOD
HARRIES HIGHWAY	MIN OF ROADS AND TRANSPORT	ROAD CONSTRUCTION	GOVT. DEFAULT	£20,100,000.00	?	CONTRACT TERMINATED. £5.4K PAID DIRECT TO HARRIES. BALANCE OF £15M PAID TO BANK AGAINST TGF
<u>C MILITARY CONTRACTS (OVER £1M)</u>						
ORG LTD	MIN OF WAR	3 GAS TURBINE GENERATING UNITS	GOVT. DEFAULT	£5,886,280.80	NIL	GOODS WITH OTC. POSSIBLE BEING RESOLD TO GULF CREDIT CO OF RAS AL KHAIMAH
BRITISH AEROSPACE	MIN OF WAR	CONVERSION OF RAPIER MISSILE SYSTEM INTO BLINDFIRE ROLE	GOVT. DEFAULT	£20,068,776.00	£1,159,771 PLUS 2 SMALL CLAIMS	CONTRACT TERMINATED. RECOVERIES FROM RESALE OF PARTS TO ORAN BEING USED TO COVER VALID CLAIMS UNDER RELATED BUYER CREDIT ALSO SUPPLIER CREDIT CLAIM FOR £1,159,771
SHS LTD	MIN OF WAR	5TH BRITISH TANK WORKSHOP	GOVT. DEFAULT WAR	£12,911,185.19 £1,816,311.60	POSSIBLE TERMINATION CLAIM OF UP TO £5M.	CONTRACT TERMINATED
YARROW SHIPBUILDERS	MIN OF WAR	4 LOGISTIC SUPPORT VESSELS	GOVT. DEFAULT	£13,783,046.69	£100K(?)	CONTRACT TERMINATED. ENDEAVOURING TO SELL SHIPS BUT SO FAR WITHOUT MUCH SUCCESS
<u>D MILITARY CONTRACTS (UNDER £1M)</u>						
BRITISH AEROSPACE	MILITARY INDUSTRIES ORGANISATION	SPARES RAPIER SYSTEM	GOVT. DEFAULT	£ 906,594	NIL	CONTRACT COMPLETED
SHS LTD	MIN OF WAR	COMBINED TACTICAL TRAINER	GOVT. DEFAULT	£ 508,076	£500,000	CONTRACT TERMINATED



SUPPLIER	LENDER	BUYER	PROJECT	CLAIM PAID	RECOVERED	CURRENT PRINCIPAL O/S	NEXT REPAYMENT	FINAL REPAYMENT	REMARKS
<u>1 BUYER CREDITS:</u>									
BRITISH AEROSPACE	LEASARDS	MIN OF WAR	BLINDFIRE	£ 4,866	£ 3,975	£20,334,826	20 APRIL 1981	20 APRIL 1983	TERMINATION CLAIM OF £4,05M OFFSET AGAINST DELIVERATIONS FROM OMAN.
PLATT SACO	MIDLAND	POUSHESH IND	TEXTILE PLANT	£3,360,299	NIL	£ 2,905,328	28 FEBRUARY 1981	28 FEBRUARY 1984	BUYER UNDER CONTROL OF GOVERNMENT JOINT GUARANTEES AND NATIONALISED BANKS.
CEMENTATION INT	MORGAN GIBB	GAA TEHRAN	LUXURY FLATS	£ 510,894	£87,051	£ 2,400,000	30 APRIL 1981	31 OCTOBER 1984	GUARANTOR IS EMBK OMAN NOW PART OF HELIAY.
PROJECT LOC	LLOYDS	SHAHPUR CHEMICAL CO	CHEMICAL COMPLEX	£ 626,413	£625,844	£ 3,000,000	31 JANUARY 1981	31 JULY 1984	

<u>2 FRESHMENT FINANCE</u>									
HARPLES BIDWAY	-	MIN OF ROAD AND TRANS-PORT	ROAD CONSTRUCTION	£6,221,445	NIL	-	-	-	POSSIBLE TO BE OFFSET AGAINST BASIC CLAIMS

<u>3 INVESTMENT INSURANCE PAYMENTS</u>									
INVESTOR	CLAIM PAID	CAUSE OF LOSS	REMARKS						
BRITISH BANK OF MIDDLE EAST	£1,292,445.90	EXPROPRIATION	POSSIBLE ADJUSTMENT TO BE MADE ON RECEIPT OF UP TO DATE ACCOUNTS.						
BRITISH IND PLASTICS LTD	£ 175,058.65	EXPROPRIATION	TAKEN OVER BY REVOLUTIONARY COMMITTEE. STILL IN TOUCH.						
HAAGER SIDOLEY GROUP LTD	£ 433,800	EXPROPRIATION	HAD TO PHYSICALLY HAND OVER SHARES TO REVOLUTIONARY COMMITTEE.						
STANDARD CHARTERED BANK LTD	£3,392,189.51	EXPROPRIATION	POSSIBLE ADJUSTMENT TO BE MADE ON RECEIPT OF UP TO DATE ACCOUNTS.						
BHILAN LTD	£ 647,535.30	WAR	TAKEN OVER BY REVOLUTIONARY COMMITTEE. STILL IN TOUCH.						
STANDARD CHARTERED BANK LTD	£ 56,176.84	WAR	FULLY RECOVERED IN NET PAYMENT OF £3,392,189.51 FOR EXPROPRIATION.						