



SECRETARY OF STATE FOR ENERGY  
THAMES HOUSE SOUTH  
MILLBANK LONDON SW1P 4QJ  
01 211 6402

Miss Caroline Stephens  
10 Downing Street  
LONDON  
SW1

3 September 1982

*Dear Caroline,*

You wrote on 20 August to ask for briefing for the Prime Minister's meeting with Mr Garvin of Exxon on Wednesday 8 September, which I now attach. I apologise for the length of the briefing; I have asterisked the most important briefs in the index.

I am copying this letter to the Private Secretaries to the Secretaries of State for Foreign and Commonwealth Affairs and for Trade.

*Yours sincerely*

*Jeremy Clayton*

JEREMY CLAYTON  
Private Secretary



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A

GENERAL ECONOMIC AND ENERGY BRIEFING

1 Lines to take

1.1 General UK Economic Outlook

- Continued progress is being made towards laying the foundation for sustained economic recovery. In July inflation fell to 8.7%, its lowest level since 1978. Progressive reduction in inflation, both here and in the United States is being facilitated by careful control of public expenditure and borrowing. As a result, interest rates are falling (UK banks base rate now down to 10½%) which will provide stimulus to both consumption and investment.

- The international competitiveness of UK companies is being assisted by the continued substantial rise in productivity - manufacturing output per head has risen over 12% since the end of 1980 and cost competitiveness improved by 10 - 15% during 1981. Continued moderation in pay settlements will further this process.

- Although any recovery of the real economy remains hesitant - most independent forecasts expect a modest 1% growth of output in 1982 followed by 2 - 2½% pa growth over the next 3 - 4 years - partly because of the sluggish growth in world trade, it would be foolish to risk a renewed burst of inflation by artificially boosting demand.

1.2 General UK Energy Outlook

- Currently preparing new long-run UK energy projections, but would be premature to anticipate their detailed conclusions now. [Seems likely that they will contain substantially lower projections of demand than contained in the last published projections (1979), because of lower expected world growth and continued weakness of oil market.]



World Oil demand having fallen 5% in both 1980 and 1981 looks set to fall another 4% to  $44\frac{1}{2}$  mbd this year. OPEC's output this year is likely to be about  $18\frac{1}{2}$  mbd. With a slight increase in demand next year and an end to destocking OPEC output could rise to 20 mbd. The seasonal summer downturn in demand is currently limiting OPEC output to  $17\frac{1}{2}$  mbd and whilst this could rise to nearer 20 mbd by the winter the market will be soft as OPEC's members, especially Iran and Iraq, try to increase their output. The oil cartel's cohesion could be tested over this period.

Longer term

b) Exxon have decided not to publish their annual 'World Energy Outlook' which would have covered the period to 2000. It is suggested that they now foresee lower energy demands and prices in the longer term than previously, when they projected world energy demand rising at about  $2\frac{1}{2}$ % p.a. The Government's planning oil price projections are currently being reviewed, having previously been higher than Exxon's. The outcome is awaited.

2.4 UK Oil Products Supply/Demand

1. The last oil price hike was in 1979. Illustrative UK inland demand figures for 1978, 1981, and confidential PIA\* forecasts for 1986 are as follows:

|                         | 1978 | 1981 | $\frac{1981}{1978}$ % | 1986      | M Tonnes |
|-------------------------|------|------|-----------------------|-----------|----------|
| petrol                  | 18.7 | 18.7 | (same)                | 18.4-19.5 |          |
| fuel oil                | 27.5 | 15.6 | - 43.3%               | 15.3-16.1 |          |
| Total inland deliveries | 84.6 | 66.3 | - 21.6%               | 63.0-68.3 |          |

Petrol demand has not been markedly affected by the oil price explosion; total UK consumption has remained broadly flat. But because of the development of more fuel efficient cars further growth in motor spirit demand is now thought unlikely. Fuel oil demand has been severely hit by recession, conservation and substitution (industry and power stations) and its prospects are still weak.

2 The UK is no longer a net importer of petrol, now that 4 further 'catalytic crackers' - which extract more petrol from a barrel of crude oil - have come on stream.

3 For the future the main uncertainties are:

(i) petrol: to what extent, may demand fall because of improved engine efficiency, or diesel substitution.

(ii) middle distillates: how much growth will occur in this sector (eg aviation jet engines, deriv for road use).

\* Petroleum Industry Association



- In shorter-run, to 1985, energy demand likely to continue growing more slowly than GDP, but this itself difficult to forecast with any accuracy. General view of independent forecasters is for 2-2½% pa GDP growth over next 3-4 years (broadly in line with Treasury forecasts.) Oil's share of energy demand likely to fall slightly; the additional nuclear capacity coming into service in next few years will mainly displace coal used for electricity generation.

### 1.3 World Oil Market Outlook

- (i) Short term: The Government's view is that the world oil market will remain soft for the next two or three years. However, there are many uncertainties.
- (ii) Longer term: Department of Energy officials are currently undertaking a review of oil price projections.

### 1.4 UK Oil Products Supply/Demand

- (i) In the next 4 years UK oil products demand is expected to be broadly constant, though perhaps with some further weakening affecting the heavier oil products (which have substitutes);
- (ii) UK a free market in oil products. This provides a framework in which the oil companies can plan on the basis of commercial, not political, uncertainties.

## 2 Background Notes

### 2.1 General UK Economic Outlook

→ The progress of leading indicators has been erratic over recent months reflecting uncertainty over the timing of world recovery and the US Federal Govt. Deficit. The effect on the indicators of falling interest rates has been offset by the pessimism of recent CBI statements and publications.

- growth Despite a recovery in the profits of industrial and commercial companies - up 40% in the year to IQ 1982 - slow demand continues to delay new investment. Capital expenditure in the manufacturing, distributive and service industries fell 3% from 1982 Q1 to Q2. Together with renewed destocking, the immediate prospects for increased activity are not bright and further increases in unemployment, now verging on 3.3 million (UK), seem likely.



- Despite recent improvements in productivity, it will take time for UK companies to recover international markets lost during 1979-80 partly as a result of the high £ exchange rate of that period. Consequently, import penetration could significantly dampen the effects of reviving demand on domestic industry unless there are continued efforts to control production costs. The non-oil current balance of payments deteriorated from a surplus of £1.78 b in 1981 Q1 to a deficit of £0.39 b in 1982 Q2.

## 2.2 General UK Energy Outlook

Long-term projections to be published later this year in time for Sizewell Inquiry. Will contain details of energy demand by fuel and of potential electricity supply. Seems likely that we will be suggesting substantially lower range of energy demands than were contained in our last published projections (1979). New projections place maximum estimate (165 mtce in 2000) of demand for oil close to previous minimum estimate (157 mtce in 2000)

In the short-run, our view of total energy demand very dependent on developments in whole economy; but not unrealistic to assume UK energy demand will grow by average 1-1½% p.a. 1982-5, given a slightly faster growth in GDP.

During this period considerable new nuclear capacity will come into service (increasing nuclear output by one half) as part of Government's long-term programme to expand nuclear power.

Gas is likely to increase slightly its share of total energy demand.

Oil demand is likely to continue reducing slowly from the peak reached in 1973.

Coal will continue to hold an important place in UK energy consumption, but expansion of nuclear capacity inevitably reduces one major source of demand.

## 2.3 World Oil Market Outlook

### a) Short term

|                                       | <u>Department of Energy estimates of oil market balance</u> |      |      |      |            |            | million barrels<br>a day |      |
|---------------------------------------|---|------|------|------|------------|------------|--------------------------|------|
|                                       | 1979  | 1980 | 1981 | 1982 | 1982<br>Q3 | 1982<br>Q4 | 1983                     | 1985 |
| Oil Demand                            |   |      |      |      |            |            |                          |      |
| Industrial countries                  | 40.8  | 37.8 | 35.3 | 33.2 | 31.3       | 34.3       | 35.5                     | 35.2 |
| and OPEC Developing countries         | 10.6  | 10.8 | 10.9 | 11.2 | 11.2       | 11.4       | 11.5                     | 12.1 |
| Total Demand (outside communist area) | 51.2  | 48.6 | 46.2 | 44.4 | 42.5       | 45.8       | 45.0                     | 47.3 |
| Other Supplies                        | 21.6  | 22.7 | 23.2 | 24.6 | 24.7       | 24.8       | 24.9                     | 25.1 |
| Commercial Stockchange                | 1.8   | 0.3  | -0.5 | -1.4 | -0.2       | -1.5       | -0.3                     | -    |
| OPEC Crude Production                 | 30.6  | 26.2 | 22.5 | 18.4 | 17.5       | 19.5       | 19.9                     | 22.4 |



B

UK UPSTREAM OIL ISSUES

A. LINE TO TAKE

\* 1. UKCS FISCAL REGIME

- 1.1 Stability of Future regime. The uncertainty that existed during the review is now behind us. We now have a secure and stable regime for the future.
- 1.2 Pipeline tariffs etc - Inland Revenue Consultation Paper. Recognise that this is of particular Importance to Esso because of pipeline tariffs on FLAGS, and emphasise that it is 'green around the edges'.

\* 2. NORTH SEA DEVELOPMENT

- 2.1 Offshore exploration and development activity influenced by many factors (eg Technology, uncertainty as to future oil prices, need to appraise new discoveries).
- 2.2 Exploration and appraisal drilling now at a higher level than in recent years.
- 2.3 20 fields now in production : 6 more under development, and 4 more at pre-development stage.

\* 3. EIGHTH ROUND

- 3.1 This was announced in May. The formal invitation to apply is likely to be issued (as a Gazette Notice) this month, and the closing date is likely to be in January 1983.

4. DEPLETION POLICY

- 4.1 Hope that Exxon will welcome the Government's decision not to impose cuts. But we must keep reserve powers in case of some major change in circumstances.



5. BNOC PRIVATISATION

5.1 The Scheme transferring BNOC's oil-producing business to Britoil came into effect on 1 August. This is a major step forward in the Government's plans to float Britoil later this year, market conditions permitting. The removal of direct state involvement in oil exploration and production should be welcome to the oil industry.

5.2 [Defensive]. The scheme effects an internal re-organisation of BNOC's business, and consequential effects on 3rd parties such as Esso have been kept to a minimum.

6. DISPOSAL OF BGC'S OFFSHORE OIL ASSETS

6.1 BGC are preparing for the disposal of their interests in four N.Sea oilfields.

6.2 [If pressed:] The aim is to complete the disposal as soon as possible, subject to market conditions. But the disposal could not be completed before summer 1983 at the earliest.

B. BACKGROUND NOTES

B.1 UKCS FISCAL REGIME

1.1 The changes announced by the Chancellor on 9 June were:

- (a) no field will pay Advanced Petroleum Revenue Tax (= APRT) for more than 5 years;
- (b) any APRT not set off against PRT within 5 years of the first payment to be repaid then;
- (c) APRT to be allowed as a deduction in calculating the PRT payback period (prolonging the availability of PRT 'uplift' and 'safeguard' reliefs);
- (d) the PRT payment on account due on 1 September 1983 can now be made over 5 monthly instalments;
- (e) backdating by this year of an existing Finance Bill proposal to give quicker Corporation Tax relief on certain North Sea outgoings.





1.2 Pipeline tariffs etc - IR Consultation Paper. Esso (like Shell) are believed to be unhappy about the implications for existing agreements, particularly the Northern and Western legs of FLAGS (= Far North Liquid and Associated Gas System). Inland Revenue (Oil Taxation Office) have the lead.

B.2 NORTH SEA DEVELOPMENT

2.1 Tern Field Shell/Esso advised D/Energy in April this year of their decision to defer this field. They cited "onerous" tax regime as being one of the factors underlying their decision: the companies also mentioned falling oil prices and technical problems, which are arguably more important. There is no evidence that tax by itself would have been reason enough for deferral.

2.2 Figures for the first five months of 1982 show a total of 44 offshore exploration and appraisal well starts, compared with 26 in the corresponding period last year;

B.3 EIGHTH ROUND.

[No background necessary.]

B.4 DEPLETION POLICY

4.1 Some of the main points in SoS/Energy's recent policy statements are:

- no production cuts at least until end-1984;
- regulatory powers to be used to minimise gas flaring;
- reserve powers of intervention to be maintained.

It has been stressed that tax is not an instrument of depletion policy.

4.2 Esso benefit to a limited extent from the decision on production cuts and should welcome the new clarity and certainty given to depletion policy (although they might prefer general assurances and would undoubtedly prefer royalty banking - leaving the Government's royalty share in the ground which means it bears the whole cost-as the depletion instrument).

B.5 BNOc PRIVATISATION

5.1 The Oil and Gas (Enterprise) Act 1982 gives powers to introduce private capital into the oil-producing business of BNOc and into parts of BGC, notably its offshore oil business. A Scheme made under the Act, transferring BNOc's oil-producing business to Britoil, was approved by the Secretary of State for Energy and came into effect on 1 August 1982. In order to substitute Britoil for BNOc on licences, operating agreements and certain other legal documents, the Scheme imposed some changes; on third parties including licence partners such as Esso. So far, there has been a limited reaction from the oil industry to these changes; but it is important to avoid any substantial opposition to the Scheme, since one aggrieved oil company resorting to litigation could seriously hold up the timetable for flotation.



B.6 DISPOSAL OF BGC'S OFFSHORE OIL ASSETS

6.1 On 6 August, directions were issued to BGC, under the Oil and Gas (Enterprise) Act 1982, requiring them to:

- (i) prepare, by end-November, a scheme to transfer their interests in the 4 oilfields to 4 new subsidiaries owned by a new holding company;
- (ii) engage an independent petroleum consultant to prepare an evaluation of the interests by end-February 1983;
- (iii) Prepare accounting information on the interests.

These requirements have been designed to preserve flexibility as to the ultimate disposal method.

DEPARTMENT OF ENERGY  
OPH DIVISION

2 SEPTEMBER 1982



## THE UK REFINING AND PETROCHEMICALS INDUSTRIES

### Line to Take

- (i) Both the UK (and West European) refining and petrochemicals industry have substantial excess capacity (about 30%) exacerbated by low market growth and weak prices;
- (ii) in the UK refining industry, re-structuring led to 2 refinery closure decisions in 1981, and a further closure - BP's Belfast refinery - was announced in August 1982: but about 30% over-capacity will remain, so further closures cannot be ruled out;
- (iii) re-structuring of the UK petrochemicals industry began in 1980. The latest BP/ICI announcement on closures and portfolio exchanges is to be followed shortly by a decision by Shell on the future of the Carrington (Manchester) complex;
- (iv) [defensive] despite ICI's litigation, HMG is confident that S. 134 of the Finance Act 1982 - the so-called 'Mossmorran amendment' - is consistent with the Treaty of Rome.

### Background

1. Esso have 2 UK refineries: a large and modern 'showpiece' refinery at Fawley (Southampton), which is currently benefiting from a large investment programme, and a smaller one at Milford Haven. At the time of the BP Belfast refinery closure announcement in August there were press reports that Esso are keeping the future of their Milford Haven refinery under review.
2. On the petrochemical side Esso, with Shell, are constructing a large (0.5 mtpa) ethylene cracker at Mossmorran. Esso's intention is to take their half share of the Mossmorran ethylene to their derivatives plant at Antwerp, so displacing some of their existing ethylene capacity on the Continent. To date £103 m has been spent, and a further £182 m has been committed in orders. ICI's litigation on S. 134 of the Finance Act, even if ultimately unsuccessful, meanwhile introduces an element of uncertainty into the tax valuation of Mossmorran ethane. In July Mr Ed Holmer, the head of Esso Chemical world-wide, warned D/Industry that if the ICI action were to succeed and the tax valuation of their feedstock increased substantially they would not operate the cracker, even if it were built.
3. The background on the 'Mossmorran amendment' is that it removes an anomaly (it does not provide a subsidy). It will permit inter-affiliate deals in ethane for petrochemical use to be valued, for tax purposes, on the same ('formula') basis as arm's length sales. ICI claim that the amendment 'in principle or in implementation' constitutes a state aid to industry, contrary to Article 92 of the Treaty of Rome. The case is likely to be heard in the UK courts in 1983, and may well then go to the European Court.



D

## GAS ISSUES

### 1. Lines to Take

#### 1.1 WYTCH FARM

The sale of BGC's 50% interest in Production Licence 089 (which includes the Wytch Farm oil field) is already in progress. The sale is being conducted by British Gas, not the Government.

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#### 1.2 NORWEGIAN SLEIPNER GAS

BGC are genuinely interested in obtaining the gas at the right price. Our feeling is that it is not for governments to get involved at this stage and we will await the outcome with interest.

☐ If the possibility of selling the gas partly to the UK and partly to the Continent is raised:

- Clear that BGC are interested in obtaining all the gas, but sure that they would be happy to consider other options<sup>7</sup>.

#### 1.3 NORTH SEA GAS: GAS EXPORTS

The UK is willing to consider the question of gas exports if sufficient new discoveries of gas are made as a result of the impetus given to exploration by the freeing of the market through the Oil and Gas (Enterprise) Act. However, it must be remembered that, at present, we still have to import a quarter of our gas requirements from Norway.



## 2. Background Notes

### 2.1 WYTCH FARM

The sale is being carried out by inviting tenders from specialist bidders for the licence interest and associated assets. The present timetable envisages initial bids being received in October, with the sale being completed towards the end of January 1983, although this could vary, depending on the interest shown by prospective bidders.

### 2.2 NORWEGIAN SLEIPNER GAS

The Sleipner field is estimated to hold more than 200 billion cubic metres of recoverable gas (about the same size as Frigg) and the Norwegians are now in a position to offer it for sale. The UK faces an opening supply/demand gap in the early 1990s with the decline of both the Southern Basin fields and imports from Frigg as reserves are depleted. BGC therefore need to find large quantities of gas over the next few years, and Sleipner would therefore be interesting: however, we should not give the impression that BGC are weak buyers.

At a recent meeting with BGC the President of Statoil made it clear that he recognised that, following the passage of the Act, companies other than BGC would be able to buy the gas for landing in the UK. He undertook to inform BGC if Statoil were talking to other UK buyers.

### 2.3 OUTLOOK FOR THE PRIVATE SECTOR IN THE BRITISH GAS MARKET

The British market for natural gas has, to date, been the monopoly preserve of the British Gas Corporation. The climate of supply has, however, now been changed by the passage of the Oil and Gas (Enterprise) Act, which became law last June. This removes the Corporation's monopoly buying privileges over North Sea gas, and its sole right to supply large and medium sized customers in Great Britain (representing 37% of the total gas market, at present). Private sector companies wishing to compete with British Gas in the market are now able to negotiate access to the Corporation's integrated transmission and distribution network, with the right to appeal to the Secretary of State if necessary. These new measures create opportunities for the private sector which have not existed hitherto. We hope Exxon will be amongst those seeking to compete with British Gas.



E

THE SIBERIAN GAS PIPELINE

Line to Take

1. Most concerned at the worsening transatlantic rift over President Reagan's measures. Believe this has only benefited Russians. We must sort it out as quickly as possible.

2. We object strongly to the US Government's measures. I know of the concern in some circles in Washington about Western Europe's possible future over-dependence on Soviet energy supplies. But I know our European partners have done their sums and believe no suitable alternative supply exists. Doubt if they will agree to slow construction of pipeline. We must look ahead constructively. For the moment, both sides must damp down the dispute as much as possible. As you know we have taken minimum action to protect our companies' interests.

Background Note

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1. Following President Reagan's measures of 29 December and 18 June, Americans last week imposed orders 'temporarily denying export privileges' to two French companies - Creusot-Loire (a main contractor for the pipeline) and Dresser-France (a French registered US subsidiary which has begun shipment of compressors). John Brown (which with three other UK companies was prohibited by HMG on 2 August from complying with the American regulations) has begun shipment of the first six of 21 turbines ordered by the Russians. Americans have now restricted scope of measures against the French to oil and gas equipment, and intend that John Brown will be similarly treated. German and Italian companies are also expected to begin turbine deliveries in next few weeks.

2. There is clear evidence that the Americans are seeking a way to extricate themselves from the impasse. But it remains to be seen what price they will demand from the Europeans, in terms of further implications on East/West economic relations, and whether our European partners will be prepared to pay the price demanded.

Department of Energy/FCO  
3 September 1982



\* The Exxon Corporation

The Exxon Corporation is the world's largest corporation and operates in the United States and nearly 100 other countries. Their principal business is energy, including exploration for and production of crude oil and natural gas and petroleum products, exploration for and mining and sale of coal and uranium and fabrication of nuclear fuel. Exxon Chemical Company is a major manufacturer and marketer of petrochemicals. Exxon had a turnover in 1981 of \$115.1bn (1980 - \$110.4bn) and made a profit of \$5.4bn (1980 - \$6.2bn). They have recently reported a 35% drop in earnings in the first half of 1982 from \$3.43bn to \$2.13bn. The results reflect the depressed economic environment, reduced demand for oil and petrochemical products, the large surplus of processing plant, the falling value of oil production and the high cost of financing stocks and investments. Exxon are attempting to reduce their staff worldwide by 180,000; they have also been cutting back investments in alternative energies (notably the production of oil from shale).

\* Esso Petroleum Company

The Esso Petroleum Company (EPCO) is an integrated oil company involved in exploration and production, refining, distribution and marketing. Although it is the UK subsidiary of Exxon - Esso enjoys a large degree of autonomy and has always placed a great deal of emphasis on its "Britishness".

Two other Esso companies operate in the UK: Esso Chemicals, whose operations are limited to this country in the same way as EPCO; and Esso Europe which, rather by chance, has its headquarters in London but has a co-ordinating role for all Esso's European companies.

In the North Sea EpcO has interests in the Auk, Brent, Cormorant, Dunlin, Forties and Fulmar Fields, as well as the Leman Bank gas field. In the past all Esso's exploration and production activity has been conducted in equal partnership with Shell; while this relationship is continued in some licences awarded to them under the Seventh Round; Esso also became an operator for the first time in partnership with smaller companies.

Approximately half Esso's refinery throughput in the UK is UKCS crude; Esso are an Aramco partner, and the remainder of their UK refinery throughput is mainly Saudi Arabian. The company operates two refineries in the UK: Fawley and Milford Haven. Fawley, near Southampton is the largest refinery in the UK and is now 30 years old. Milford Haven is more recent but only half the size. Together they have a crude distillation capacity of around 25m tonnes per year although the current state of the product market means that much less is actually being run.

Esso sell all of the major oil products used in the UK and have around 20% of the market, as do Shell and BP.

Esso's net revenue increased in 1981 from £3,219m to £4,199m to give a pre-tax profit of £805m compared with £205m in the previous year.

\* Esso Chemicals Ltd

Esso Chemicals is an affiliate of the Exxon Corporation, and began operations in the UK in 1966 where it is now the fourth largest petrochemical company. The Head Office is in Southampton, with the principal manufacturing site at Fawley, adjacent to the Esso Petroleum refinery. Esso Chemical's turnover in 1981 was £271m (1980 - £232m) and their pre-tax profit was £19m (1980 £8m)



CLIFTON C. GARVIN JR.

Chairman of the Board and  
Chief Executive Officer

Exxon Corporation

Holds master's degree in chemical engineering from Virginia Polytechnic Institute. Joined Exxon Company, U.S.A. in 1947; elected President, Exxon Chemical Company, in 1965; to Exxon Board in 1968; President in 1972; Chairman in 1975. Chairman and Director, American Petroleum Institute; past Chairman, the Business Roundtable. Director, Citicorp and Citibank, N.A.; PepsiCo Inc; Sperry Corporation. Board of Governors, National United Way of America. Vice-chairman, The Conference Board. Board of Trustees, Sloan-Kettering Institute for Cancer Research. Trustee, Committee for Economic Development; Teachers Insurance and Annuity Association Stock. Member, The Business Council; College Retirement Equities Fund; National Petroleum Council; Business Committee for the Arts; American Institute of Chemical Engineers. Board of Trust, Vanderbilt University. Honorary Doctor of Commercial Science, New York University; Honorary Doctor of Engineering, Stevens Institute of Technology.