

PO-CH/NL/0188

PART F

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PART F

SECRET

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PART F

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

PO -CH /NL/0188

PO -CH

PART F

Begins: 19/9/88

Ends: 18/12/88



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

CH/EXCHEQUER	
REC.	19SEP1988
ACTION	EST
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The Rt Hon Nigel Lawson MP
 Chancellor of the Exchequer
 Treasury Chambers
 Parliament Street
 LONDON
 SW1P 3AG

*now clear what this
 is of damage that
 happened for (a) Piper
 1988 & (b) calendar 1989.
 for calendar 1989.*

September 1988

Dear Nigel,

PIPER ALPHA: ECONOMIC CONSEQUENCES

In my report to Cabinet on 28 July where I dealt with the wider economic consequences of the Piper Alpha disaster, I indicated that the operator, Occidental, was revising its views on the amount of oil production likely to be lost in 1988 and 1989. (NB All references are to calendar years). Occidental has now informed my Department that it intends with Texaco, the operator for the Tartan field, to install emergency shutdown valves in all the oil and gas pipelines servicing the Tartan, Claymore and other fields associated with Piper. Occidental also intends to conduct a full review of the operations and safety systems on its Claymore field.

The effect of these changes is to increase the overall loss of oil production in 1988 to 6.6 million tonnes (previously 4.2 million tonnes): the estimated loss in 1989 remains as previously at 4.2 million tonnes. My economists estimate that the gross value of oil lost in 1988 is likely to amount to some £450 million and that the loss to the balance of payments and in Exchequer receipts over the whole period to end 1989 could amount to £500 million and £415 million respectively. These estimates take no account of insurance claims by licencees: such claims are likely to reduce both the tax and balance of payments losses indicated above. The oil lost in 1988 and 1989 is likely to be fully recovered later on in field life (including Piper which we expect eventually to be redeveloped).

It is much too early for my Department to provide any reliable estimates of the wider implications for production and costs likely to arise from changes in safety procedures until after the Public Inquiry. But I recognise that you need to take account of the possibility of such consequences in your Autumn assessment of the economy. My petroleum specialists and economists have therefore given some careful thought to the sort of 'ball-park' figures which it would be appropriate to include in your North Sea forecast. Their assessment is that a further 4 million tonnes of oil could be lost over the period 1989 and 1990 due to



fields extending their maintenance period or having to cease production whilst installing emergency shutdown valves or similar isolation facilities. It is thought that this lost oil will probably be recovered by 1992. The capital costs of these measures is, at present, equally uncertain. My officials current best estimate is for a cost of £600 million spread over the period 1989 to 1992, with peak expenditure in 1990.

My officials will be pleased to explain to your economists the details and background thinking behind these numbers which should be used only for internal HMG purposes.

*Yours Sincerely,
Cecil Parkinson*

CECIL PARKINSON

FROM: D J L MOORE
DATE: 20 SEPTEMBER 1988
cc: PS/Chancellor
Mr Monck
Mr Scholar
Miss Wheldon TSOL

SIR PETER MIDDLETON

Handwritten initials in red ink

MMC REPORT ON BP/KIO

DTI officials have recommended Lord Young to publish the report on Tuesday 4 October. They have explained why we do not want Wednesday 28 September and that the Foreign Office do not like Thursday or Friday. It is the Kuwaiti weekend and therefore more difficult for our Ambassador to soothe and smoothe.

2. Lord Young will not respond before Thursday.

Handwritten signature
D J L MOORE

chex.md/jt/27

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FROM: J M G TAYLOR
DATE: 21 September 1988

Handwritten initials

PS/SIR P MIDDLETON

cc Mr Monck
Mr D J L Moore
Mr Scholar
Miss Wheldon TSol

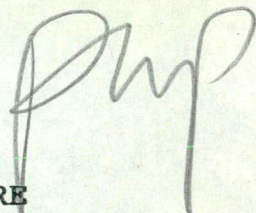
MMC REPORT ON BP/KIO

The Chancellor has seen Mr Moore's minute of 20 September. He has commented: "Fine".

Handwritten initials

J M G TAYLOR

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FROM: D J L MOORE
DATE: 23 SEPTEMBER 1988

MR PERETZ

cc: PS/Chancellor
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Monck
Mr Scholar
Mr Lankester
Mrs Lomax
Mr Gieve
Miss O'Mara
Mr Williams
Ms Goodman or
Mr Call

Miss Wheldon TSOL

MMC REPORT ON KIO STAKE IN BP

BZW asked Miss O'Mara yesterday if they could talk to the Treasury of behalf of the KIO. Energy had a similar approach from one Steven Stacey representing a consultancy firm called GJW acting on behalf of KIO lawyers. They wanted to elaborate on the unfortunate consequences which they claimed might follow if the findings were adverse to the KIO.

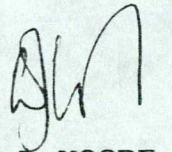
2. As others could be lobbied I am copying fairly widely this note of what I said to you.

3. There is no question of any discussion with the Treasury before the report is published (and the timing of publication and the decision on the MMC's findings is a matter solely for the Secretary of State for Trade and Industry). If they want to say anything to the DTI that is up to them.

4. If BZW or anyone else wanted to get in touch with us us after publication there is nothing to stop them doing so. But we should

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not give any commitment now that we will see them then. If the Secretary of State were to decide that action should be taken the next step would be for the Director General of Fair Trading to negotiate undertakings with BP and KIO to give effect to that decision. We would need to be careful not to have parties making representations to us when they should be making them to the DG. We would not want to make his task any more complicated. It may nevertheless be that there are some matters on which we could reasonably listen to representations and it will be easier to judge the situation when the report is out and the Secretary of State has announced his decision.



D J L MOORE

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FROM: FINANCIAL SECRETARY

DATE: 21 September 1988

CHANCELLOR

Economic Secretary
 Sir G Littler
 Mr Scholar
 Mr Culpin
 Mr Gilhooly
 Miss Hay
 Mr Tyrie

Parliamentary Council
 Mr Fawcett - IR
 PS/IR

Ch. Content with proposed approach?
JK
2/1/89
OK

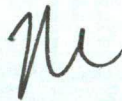
UNION TEXAS PETROLEUM CORPORATION V CRITCHLEY

Mr Fawcett's minute of 6 September sets out the implications of the recent High Court judgement in the Union Texas case. In essence, we won on the main point of principle (for which over £1 billion was at stake); but lost on a subsidiary point as a result of the judge's interpretation of a phrase in the UK/US double taxation convention which covered the computation methodology for the withholding tax on dividends. The effect of this is to give Union Texas an additional tax credit payment of about £1 million. Claims by other companies covering the last 6 years could increase that to some £68 million, and there could be a further ongoing cost of some £15 million a year if the decision were applied in the future.

The Revenue intend to appeal against the decision on the subsidiary point. However, there is a fair chance that they would lose, even though the current method of calculating the withholding tax was generally agreed, and was in fact expressly spelt out in the technical memorandum which accompanied the convention in its passage through Congress (a system which we don't have). If the High Court ruling were upheld, it would provide claimants other than the company which had initiated the court action with a windfall gain at the expense of the general body of taxpayers, which is clearly unreasonable. The Revenue have therefore suggested that we prevent this by announcing by way of a Parliamentary Answer that we will legislate in next year's Finance Bill to clarify the position of the tax deduction from tax

credit payments in respect of dividends paid to US companies, putting it beyond legal doubt that the calculation should always have followed (and will do so) past Revenue practice. The legislation would have retrospective effect. Provision would be made to allow Union Texas to keep the fruits of victory, but not any other company currently making a claim.

I believe we should legislate in this case, and I have therefore asked the Revenue to draw up the necessary PQ and (short) draft Clause. It is necessary to act quickly. The PQ is intended to cut off claims in the pipeline. Once these claims are heard by the Special Commissioners, then successful appellants would have a case for claiming similar "protective" treatment to that proposed for Union Texas. You will recall that we adopted the same position in the Padmore case, which required a similar retrospective Clause in order to put the law into the position everyone had thought it to be. We will obviously have to handle the presentation to the US authorities very carefully if we are to avoid accusations of "treaty override". But the explicit nature of the technical memorandum means that there should be no problem here; we have a very good case.



NORMAN LAMONT



FROM: J M G TAYLOR
DATE: 22 September 1988

A handwritten signature in dark ink, appearing to be 'pmf', located to the right of the date.

MR ODLING-SMEE

cc PS/Economic Secretary
Mr D J L Moore
PS/IR

PIPER ALPHA: ECONOMIC CONSEQUENCES

You are providing advice on Mr Parkinson's letter of 19 September to the Chancellor.

2. The Chancellor has commented that it is not clear from the letter what current account damage the Piper Alpha disaster implies for (a) calendar 1988 and (b) calendar 1989. He would be grateful if you could deal with this in your submission.

A handwritten signature in dark ink, appearing to be 'JMG', located below the main body of text.

J M G TAYLOR



FROM: J M G TAYLOR
DATE: 22 September 1988

A handwritten signature in dark ink, appearing to be "JMG".

PS/FINANCIAL SECRETARY

cc Economic Secretary
Sir G Littler
Mr Scholar
Mr Culpin
Mr Gilhooly
Miss Hay
Mr Tyrie

Parliamentary Counsel
Mr Fawcett IR
PS/IR

UNION TEXAS PETROLEUM CORPORATION V CRITCHLEY

The Chancellor has seen the Financial Secretary's minute of 21 September. He is content to proceed along the lines proposed.

A handwritten signature in dark ink, appearing to be "JMG".

J M G TAYLOR



THE MINISTER OF STATE

The Rt Hon John Wakeham MP
Lord President of the Council
& Leader of the House of Commons
Privy Council Office
68 Whitehall
LONDON SW1

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DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ

Direct Line 01-211 3290
Switchboard 01-211 3000

23 September 1988

PETROLEUM ROYALTIES RELIEF BILL

In your letter of 15 April to Cecil Parkinson you agreed to the expansion of the Continental Shelf (Amendment) Bill to include provisions dealing with the abolition of Royalty in the Southern Basin of the North Sea. You urged that the Bill should be ready for introduction at the very beginning of the next Session.

We now have both sections of this Bill at an advanced state of readiness and I will wish to submit it to the first meeting of Legislation Committee called to consider Bills for the next Session with a view to introducing it as soon as possible.

Negotiations with the Irish are going well and there is every prospect that they will be completed in time. However I have made it clear to our negotiators that I would not permit any delay in reaching agreement with the Irish to hold up the introduction of the very urgent Royalty provisions and that, if it should become necessary, I would strike the Continental Shelf provisions from the Bill and proceed with the Royalty Relief provisions on their own. I hope you can agree to this approach.

I am copying this letter to the Prime Minister, the Chancellor of the Exchequer, my opposite numbers in other Departments, Members of QL, Sir Robin Butler and First Parliamentary Counsel.

PETER MORRISON

CONFIDENTIAL

Personal



✓
✓

cc. PS/Cancellor
Sir P Middleton
Mr March
Mr Sedlat

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- see in particular
2, 10-18

To

SECRETARY OF STATE FOR TRADE AND INDUSTRY

COPY NO

JW 23/9.

From

Director General of Fair Trading

23 September 1988

REPORT BY THE MONOPOLIES AND MERGERS COMMISSION ON THE ACQUISITION BY THE KUWAIT INVESTMENT OFFICE OF A 21.6 PER CENT SHAREHOLDING IN THE BRITISH PETROLEUM COMPANY PLC

In this submission I advise under Section 86(1) of the Fair Trading Act (the Act) on the above report. The Monopolies and Mergers Commission (MMC) have concluded that the 21.6 per cent shareholding of the Kuwait Investment Office (KIO) in the British Petroleum Company Plc (BP) gives the KIO the ability materially to influence the policy of BP and that this merger situation may be expected to operate against the public interest. To remedy this situation the MMC recommend divestment of the shareholding down to not more than 9.9 per cent of BP's issued ordinary share capital, and that this should take place over a period of some twelve months, if an orderly disposal can be achieved in that time in the prevailing market conditions.

2 I recommend that you accept the MMC's conclusions and that you invite me to consult the KIO with a view to obtaining an undertaking to divest its shareholding down to 9.9 per cent. I propose to consult and advise you further on the timetable that should be set.

THE REFERENCE

3 When I recommended reference of this merger in April, my concerns were that BP could come under severe pressure which eventually compelled it to seek some form of accommodation with the Government of Kuwait enabling the latter to influence its policy in directions contrary to British interests. It appeared moreover that BP's commercial interests in third countries might be damaged by a perception there that BP was no longer a fully independent company. There was also the possibility that at times of emergency HMG would not have full freedom of action in respect of assets controlled by BP.

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THE MMC'S CONCLUSIONS AND FINDINGS

4. The MMC had first to consider whether the shareholding gave the Government of Kuwait the ability materially to influence the policy of BP. Taking into account the size of KIO's shareholding relative to that of other holdings in BP, the rights which attach to a shareholding of 10% or more under BP's Articles of Association, and the voting patterns at past shareholder meetings, they concluded that the Government of Kuwait had the ability to exercise material influence, including the ability to procure or influence the appointment of BP directors. The size of the KIO holding would in itself be liable to make BP directors and management have regard to Kuwait's interests on major policy issues. There was therefore a merger situation for the purposes of the Act.

5. Second the Commission had to consider how this merger situation affected the public interest. In its evidence to the MMC, KIO stated that its concern as a shareholder in BP was only to protect its investment and not to further any interest of the State of Kuwait. The MMC accepted this statement as reflecting in good faith the intentions of KIO and the Government of Kuwait at the present. But against the background that British and Kuwaiti national interests in matters concerning the oil industry were likely to diverge increasingly as non-OPEC oil reserves were used up, they believed they had to consider not merely the present but the indefinite future: and that in the end a government's actions must be expected to be driven by its national interests. They therefore considered that with changing times and circumstances it could be expected that KIO would seek to use its shareholding to influence the policy of BP in pursuance of the national interests of Kuwait. The MMC considered that the future of BP's commercial activities and the way in which these activities were carried out were themselves matters affecting the public interest. They concluded that there was likely to be conflict in certain respects between on the one hand the national interests of Kuwait and on the other the interests of BP and HMG.

6. The Act requires the MMC, in finding against a merger, to specify the particular effects, adverse to the public interest, which in their opinion the merger may be expected to have. Any remedies have to be directed towards these adverse effects. The broadest adverse effect specified by the Commission is that (para 8.117) there is a high degree of probability that sooner or later situations will arise in which Kuwait's national and international

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interests conflict with BP's and HMG's; and that in such situations Kuwait will be able and willing to use its ability to influence the policy of BP in ways that may be expected to operated against the UK public interest.

7. The Commission also identify the following further and more detailed adverse effects:-

- (i) it could be expected that BP would be constrained from acting independently and competitively in the world market for oil (para 8.68);
- (ii) it could be expected that the level of BP's investment in exploration and in the development of new oil production facilities would be affected adversely (8.73);
- (iii) it was likely that BP would come under pressure to change the priorities of its research and development programme (para 8.81);
- (iv) the Government of Kuwait would have the opportunity to interfere with BP's capital-raising operations and any substantial acquisitions (para 8.101);
- (v) the Government of Kuwait through KIO would be able to procure the appointment of a Director to the BP Board and this would lead to a damaging conflict of interest (para 8.98); and
- (vi) BP's future operations were likely to be adversely affected in some third countries where there might be reservations about a company under the influence of the government of an OPEC member (para 8.94).

8. Summing up all these adverse effects of the merger situation, the Commission conclude that "taken individually and viewed as a whole", they provide sufficient grounds for concluding "that the merger situation may be expected to operate against the public interest".

9. To remedy the adverse effects which they identified the MMC considered two possibilities: a reduction in voting rights and divestment. They rejected the first of these because of the uncertainty that would remain for BP's Board, and concluded that divestment was the only satisfactory remedy.



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13. As to the extent of divestment, the MMC have argued that the shareholding should be reduced below the level required to requisition company meetings or call for a poll, ie to less than 10 per cent. This is also the level of holding that the BP Board has stated it would not be concerned about. I agree with the MMC that it would be sufficient remedy for the adverse effects to reduce the KIO shareholding to 9.9 per cent. I also agree that, in the unique circumstances of this case, there is no need to fear that this forced divestment would damage the reputation of London as an international capital market. But see my comments below on timing.

14. The period for divestment is not one on which I am yet able to give you firm advice. The MMC make clear that, in suggesting a period of some 12 months, they recognise your need for flexibility to obtain an orderly disposal in the light of market conditions. The shareholding to be disposed of is very large. If the KIO were compelled to release it onto an unwilling Stock Market, this would be damaging to the market and unjust to the KIO, who might then have to accept distress prices. I accept that there could be damage to London's reputation as an international capital market if the KIO was seen to be treated with greater harshness, and to suffer greater financial loss, than the needs of the situation required. I therefore need to take expert advice, and to consult the KIO, before I can advise you on the most appropriate deadline for disposal. Even then, a deadline set in advance might need to be open to revision in the light of experience and of developments in the Stock Market. In advising you further I shall have regard to the MMC's suggestion of a 12-month deadline.

RECOMMENDATIONS

15. I therefore recommend that you accept the findings of the MMC that a merger situation qualifying for investigation exists and that the merger situation may be expected to operate against the public interest.

16. I further recommend that you instruct me to consult the KIO with a view to obtaining an undertaking to divest its shareholding to not more than 9.9 per cent of the ordinary issued share capital over a period to be determined, and in the meantime not to vote more than that number of shares. I would advise you as to an appropriate timetable for disposal after consulting as in paragraph 13 above.



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17. Until this definitive undertaking has been obtained, I further recommend you to instruct me to procure an extension of the existing interim undertaking which the KIO agreed pending the Commission's enquiry, and which failing extension will expire 40 days after publication of the report.

18. Failing satisfactory undertakings on any of these points, I would advise you further as to the need for an Order under Section 89 of the Act.

A handwritten signature in cursive script that reads "Gordon Borrie".

Gordon Borrie



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PS/PARLIAMENTARY UNDER SECRETARY OF STATE FOR CORPORATE
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Prof

FROM: D J L MOORE

DATE: 26 SEPTEMBER 1988

SIR PETER MIDDLETON

cc: PS/Chancellor
PS/Financial Secretary
Mr Monck
Mr Scholar
Mrs Lomax
Mrs Brown
Mr Gunton
Mr Bent

BP: FINANCIAL TIMES

David Lascelles of the Financial Times is chasing me for an interview of an hour or so on the BP issue and all that. I attach a letter he has now sent. Unless you feel it would be damaging I propose to continue to turn him down.

2. On the history of the events I would not want to go beyond the Chancellor's statement of 29 October 1987 or to be drawn into discussion of Rothschilds/Bank/Treasury relations at the time. Although Ian Plenderleith was not present, he understands that Lascelles did not see the Deputy Governor on the BP issue exclusively and that he was not given any insights to it.

3. On lessons for the future I can refer him to the Financial Secretary's statement on the division of the role between adviser and underwriters. The position of the foreign underwriters and the new termination clause will be negotiated with the lead underwriter to the Steel sale. The Steel agreement will be an important precedent and we do not want to debate it in advance with journalists.

4. I would be grateful if Mr Bent would check whether the chronology is factually correct.

DJM.

D J L MOORE



20 September 1988

Mr. David Moore,
Head of Public Enterprises Group,
Room 100/1,
Treasury Chambers,
Parliament Street,
London SW1P 3AG

Dear Mr. Moore,

I gather Michael Gunton of your Press Office has already told you of my interest in seeking a meeting with you. I am writing to you directly to explain why in a bit more detail.

We shall be marking next month's anniversary of the market crash with a number of articles looking back at the event and examining some of the implications.

I am working on a piece which looks specifically at the BP issue. It will try to ^{re-}construct the events of the week following the crash and analyse some of the lessons which both the City and the Government learnt from it.

I have already interviewed a number of merchant banks to hear their story, and I also had a session with the Deputy Governor to talk about the Bank of England's role. To complete the picture, I am naturally quite anxious to hear the Treasury's side as well.

There are two broad areas I wanted to talk to you about. The first is the actual sequence of events. I attach a chronology which I have prepared to give you an idea of the structure I am working on. The second is the effect which the BP issue has had or is likely to have on future government sales: role of underwriters, position of foreign underwriters, handling of "force majeure" situations, and so on.

I hope you will be able to find time to see me. I expect an hour would be enough.

Yours sincerely,

David Lascelles
Banking Editor

Enc.



269

The market crash and BP

Synopsis

April 14: N.M. Rothschild appointed to advise Govt on BP

July 21: Lamont says BP issue will be in autumn.

Aug 21: sale campaign begins.

Sept 27: draft prospectus

Oct 14: am: NMR meeting at Treasury to agree pricing. pm:
underwriting arranged with 17 underwriters at NMR.

Oct 15: price announced at 330p vs market price of 347p.
deal sub-underwritten

Oct 16: sharp falls on Wall Street. London market
disrupted by storm.

Oct 19: the Big Crash: BP shares fall 33p to 317p.

Oct 20: prospectus published. Govt pulls TV advertising as
BP shares fall to 285p.

Oct 22: shares fall to 282p. Treasury says no extension.

Oct 23: NMR summons meeting of underwriters to discuss
postponement. Meeting inconclusive.

Oct 24/25: comings and goings over the week-end.

Oct 26: shares fall to 266p. more than 30,000 irrevocable

invoke force majeure to halt issue.

Oct 27: meeting between Treasury and underwriters.

Oct 28 offer closes. estimated 250,000 applications received. shares down to 254p. Canadian finance minister appeals for halt. NMR and Treasury fail to agree on force majeure, and call on the Bank to make its assessment.

Oct 29: am: Bank hears Treasury and underwriters' cases.

pm: Bank delivers its assessment. 10pm Chancellor announces go-ahead with safety net arrangement.

Oct 30: dealings begin. part paid close at 85p. NMR says 270,000 applied for 17.7m shares.

Nov 3: Underwriters deliver issue proceeds to Treasury.

Nov 5. Bank starts buying in.

SECRET

BANK OF ENGLAND
LONDON EC2R 8AH

26 September 1988

A C S Allan Esq
Private Secretary to
The Chancellor of the Exchequer
H M Treasury
Parliament Street
London SW1P 3AG

Dear Alex

BP AND THE KIO

As you may know, the Bank was invited by the Director-General for Fair Trading to comment on some of the market implications of the recommendation by the MMC that the KIO be required to reduce its holding in BP to 9.9%. We have prepared and sent to the DGFT a short paper setting out our concerns about the consequences for the financial markets, for BP and for commercial relations with Kuwait. The paper also describes some ways in which these effects might be made more manageable, and as such we felt that it should be made available to those likely to be most closely concerned with the consequences of any decision arising from the report. A copy is enclosed, and I am also sending a copy for information to Neil Thornton (DTI).

Yours

John.

J R E Footman
Private Secretary
to the Governor

KUWAIT SHAREHOLDING IN BP: THE MMC'S RECOMMENDATION
(Paper by the Bank of England)

1 The MMC's recommendation - that Kuwait should be required to divest down to 9.9% over 12 months - will undoubtedly come as a shock to both the Kuwaitis and the outside world and could have damaging repercussions on UK interests in a number of areas to an extent that may not be fully appreciated. This paper sets out the Bank's concerns and considers whether there are courses of action open to the Government which would reduce the risks which we see.

2 Specifically, we think there are five areas of UK interest where the MMC's recommendation, if implemented as it stands, could have damaging repercussions. These are -

- (i) the sale of some 12% of BP shares by Kuwait will not necessarily result in a more satisfactory shareholding structure in BP if it went to any equally unwelcome buyer;
- (ii) the potential damage to commercial and diplomatic relations with Kuwait;
- (iii) the potential impairment to international confidence in the UK as a home for overseas investment;
- (iv) the potential impact on financial markets and the strains this could place on the Government's monetary policy;
- (v) disturbance to the Government's future privatisation programme.

These five areas of concern are discussed in turn in the following sections.

(i) BP shareholding structure

3 We are concerned that divestment on the scale required by the MMC could fail to deliver the result that the Government wants in terms of securing a more acceptable and stable shareholding structure in the company. The Kuwaitis will presumably be free to sell to whom they wish. Given the likelihood of a hostile reaction from them, there is then at least a risk that they will sell the shares as a block to a buyer (or to a small number of buyers) just as unwelcome as significant shareholders in BP as the Kuwaitis themselves. Little would then have been achieved to the considerable embarrassment of both the Government and the company.

(ii) Impact on relations with Kuwait

4 The Kuwaitis can be under no illusion that their stake of 21.6% in BP is unacceptable to HMG. They have been warned, with increasing vigour and clarity, that they should not exceed 20% and invited by the Prime Minister to reduce their shareholding to 15%. But a requirement to go below 10% within a relatively short period - necessarily involving them in a very substantial financial loss - is likely to cause bitterness. Ministers, including the Prime Minister, publicly welcomed the Kuwaiti investment in BP when it already exceeded this level.

5 It is difficult to predict how the Kuwaitis may react if they feel that their action in buying into BP, which was initially welcomed by HMG and which has been entirely correct in market terms, is now to be subject to what they may see as punitive sanctions and, in terms of the proposed divestment, perhaps even a breach of faith. Rejection of undertakings by the Kuwaiti authorities, notwithstanding their proper observance of market codes, is also likely to cause resentment. The holding has already declined sharply in value and is likely to depreciate further in a forced sale. Losses on disinvestment, amounting at present prices to more than £200mn on a reduction to 9.9%, will rebound particularly on the ruling al Sabah family, which has been very closely involved in the whole operation.

6 Commercial and diplomatic relations generally could clearly become seriously strained. In the narrower financial sphere, while self-interest may make it unlikely that Kuwait would react violently with wholesale liquidation of their very substantial sterling assets, they may well comment adversely on the UK as a reliable home for investment with possibly serious repercussions on wider international confidence in investment here.

(iii) Impairment of international confidence in investment in the UK

7 The scale of the penalty which HMG is prepared to impose on an overseas investor in relation to shares bought openly over a period in the market will undoubtedly attract adverse attention in the outside world, even without an aggressive reaction by the Kuwaitis. We are not aware of any precedent for action of this severity outside wartime. The criticism from overseas investors which followed the recent forced disposal of excess overseas shareholdings in Rolls Royce indicates how sensitive investors can be on this score, and that was in circumstances in which there was a clear warning in advance, in the terms of the offer, that there was a ceiling on the size of overseas' investors shareholdings and that it would be enforced. In the present case, it will be widely believed that HMG gave no indication at the outset of any objection to Kuwait's build up of its shareholding, at any rate until after the ending of the share repurchase arrangements in January (when Kuwait's shareholding had already reached 18.35%).

8 Our concern is that HMG's action may be felt to be not only heavy-handed but vindictive. We fear that this may significantly dent overseas confidence in the UK as a country in which investment may be undertaken within a reasonable and reliable market framework.

(iv) Impact on markets and implications for monetary policy

9 Divestment to reduce Kuwait's current shareholding to 9.9% would require Kuwait to dispose of shares worth something over £1 billion, with a requirement on the buyers to pay the final call of another £3/4 billion next April. This on its own would be a substantial disposal, even with 12 months to achieve it.

Disinvestment on this scale is not expected, so that it would be bound to weaken the BP share price and have a depressing effect on the equity market as a whole.

10 Potentially more serious however are the risks: of a more aggressive reaction by Kuwait of the kind described in paragraph 6 above; of other investors, who probably believe that Kuwait's sterling assets are very much larger even than they in fact are, anticipating such a reaction by Kuwait; or of the more general damage to the confidence of investors in the UK of the kind described in paragraphs 7-8 above. Any of these effects, coming at a time when sterling is already vulnerable because of the trade deficit, could cause the exchange rate to weaken to the point where we were pressured to raise interest rates when our clear preference would be to hold the present level until we can see the impact of the recent deliberate tightening of policy.

(v) Interference with the privatisation programme

11 The weakening in the equity market which may follow a Government announcement to implement the MMC recommendation will not be helpful in the run-up to the privatisation of British Steel in November; and the disturbance would be the greater if there were wider repercussions on the financial markets and on monetary policy of the kind described in paragraph 10. There would be likely to be continuing effects of this sort for as long as the uncertainties arising out of the prospective Kuwaiti disposal remained.

Possible action to mitigate these potential effects

12 In thinking through the possible repercussions on UK interests in these five areas, we have become concerned that the cumulative potential for damage may be more extensive than is appreciated if each area is looked at in isolation. We therefore felt it right to set out our concerns in this paper. It may of course be that in at least some areas the luck will run our way and the outcome will not be too uncomfortable. But there can be no assurance of this. The degree to which we are vulnerable to unforeseen events turning the outcome against us, and the

SECRET - MARKET SENSITIVE

cumulative damage that could then result to UK interests in so many different areas, has led us to reconsider whether it is really prudent to proceed with the MMC recommendation as it stands.

13 In many of the areas an important unknown is the degree of hostility with which Kuwait may react. One way of deflecting Kuwait from a hostile reaction might be to try to engage them, and BP, in a constructive discussion designed to find an orderly way of reducing their shareholding on a basis acceptable to both sides. For HMG and BP this would presumably mean finding acceptable long-term shareholders. The Kuwaitis for their part would no doubt look to achieve in this process a better price than they would achieve by forced disposal. Ideally, all this would be done before any publication of the MMC recommendation, so as to avoid having a period of acute uncertainty in the market. If, as we understand it, that is not possible, publication would have to be accompanied by the announcement of HMG's intention to hold such discussions, and followed as soon as possible by the decision.

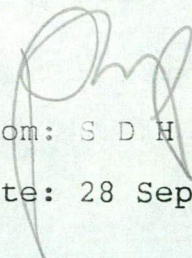
14 Other ways in which the risks might be reduced either in the context of such a discussion, or by HMG's independent decision, would be -

- (i) Extending the period for disposal might help in some degree. It is doubtful whether extending to 18 months would make much difference to the Kuwaitis' attitude, though an extension to, say, two years might help make to HMG's decision seem less confrontational, particularly if it was accompanied with indications that HMG would be ready to discuss with the Kuwaitis ways in which the disposal could be handled in an orderly manner. But extending the period could also work against us: a longer period of overhang might make markets increasingly jumpy about how and when the disposal would be effected, and could affect sentiment during the run-up to other major privatisation exercises.
- (ii) We feel more confident that reducing the size of divestment, say to 15% rather than 9.9%, would

significantly reduce the risks. 15% is a level that the Kuwaitis had reason to believe, from UK statements at the time of the build-up in their shareholding, might be acceptable to HMG; and it is a level that would not come as a complete surprise to the market. It would also put fewer BP shares into play and thus reduce the risk of Kuwait selling so sizeable a stake to an equally unwelcome shareholder; and it is the level that has been set as the ceiling on any single shareholding in a number of recent privatisations. We recognise that a 15% shareholding would not achieve protection for BP against Kuwait calling an EGM; but, if this protection is considered essential, it might be possible to achieve it by other means, eg, by negotiation with the Kuwaitis or by changing BP's constitution.

15 Finally, some of the risks in the equity market (but not the potential wider repercussions) could be avoided if the Government itself were to offer to buy the excess Kuwaiti shares at their market value, probably again through the Issue Department, allowing HMG to control their subsequent disposal. The case for such action is clearly weaker than it was in the context of the stock market crash last October, and there would be obvious presentational arguments against this course. But we think it would merit consideration if the other approaches were excluded.

September 1988


From: S D H SARGENT

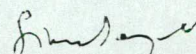
Date: 28 September 1988

MR MOORE

cc PS/Chancellor
PS/Financial Secretary
Mr Monck
Mr Scholar
Mrs Lomax
Mrs M Brown
Mr Gunton
Mr Bent

BP: FINANCIAL TIMES

Sir Peter Middleton was grateful for your minute of 26 September. He strongly agrees that you should turn down Mr Lascelles' request for an interview on the BP issue.



S D H SARGENT
Private Secretary

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PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

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FM FCO
TO ROUTINE VIENNA
TELNO 180
OF 281800Z SEPTEMBER 88
AND TO ROUTINE OPEC POSTS, MADRID

OPEC PRICE COMMITTEE MEETING: MADRID 25-26 SEPTEMBER

SUMMARY

1. MEETING TAKES NO ACTION OTHER THAN TO CALL FOR JOINT MEETING WITH LONG TERM STRATEGY COMMITTEE, WHICH WOULD INCLUDE IRAN AND IRAQ. FAILURE TO CALL EXTRAORDINARY MINISTERIAL CONFERENCE SHOWS OPEC STILL SOME WAY FROM AN AGREEMENT TO CURB OVERPRODUCTION AND REVISE QUOTAS. FOLLOWING THE MADRID MEETING BRENT CRUDE PRICE FALLS BELOW DOLLARS 13/8, THE LOWEST FOR TWO YEARS

DETAIL

2. OPEC'S COMMITTEE ON PRICE, COMPOSED OF OIL MINISTERS FROM ALGERIA, INDONESIA, NIGERIA, SAUDI ARABIA AND VENEZUELA PLUS OPEC SECRETARY-GENERAL SUBROTO MET IN THE INDONESIAN AMBASSADOR'S RESIDENCE IN MADRID ON 25 AND 26 SEPTEMBER. THE COMMUNIQUE ISSUED AFTERWARDS SAID THE MEETING HAD STUDIED A REPORT BY SUBROTO ON HIS RECENT VISITS TO VARIOUS OPEC COUNTRIES. IT EXPRESSED CONCERN AT THE FALL IN OIL PRICES SINCE THEIR LAST MEETING ON 3 AUGUST (OUR TELNO 141 TO VIENNA) AND SAID THE 'SHARP DECLINE' WAS 'MAINLY DUE TO A SIGNIFICANT OVERPRODUCTION BY SOME OPEC MEMBER COUNTRIES AS WELL AS NON-OPEC PRODUCERS'. THE COMMITTEE CONCLUDED THAT PROMPT ACTION TO REVERSE FALLING PRICES WAS NEEDED BUT THAT A REVIEW OF STRATEGY WAS NECESSARY BEFORE ANY EXTRAORDINARY MINISTERIAL CONFERENCE COULD BE HELD. FOR THIS PURPOSE IT CALLED FOR A JOINT MEETING OF THE PRICE COMMITTEE AND THE LONG TERM STRATEGY COMMITTEE. THIS WOULD MEAN A MEETING OF THE FIVE COUNTRIES REPRESENTED IN MADRID PLUS IRAN, IRAQ AND KUWAIT

3. OIL PRICES FELL ABOUT 60 CENTS ON THE DAY FOLLOWING THE MEETING TO AROUND DOLLARS 12.60 (BRENT). THIS FOLLOWS A DECLINE FROM DOLLARS 14.5/8 SINCE EARLY AUGUST. THE IEA'S PROVISIONAL ESTIMATE OF

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OPEC PRODUCTION FOR SEPTEMBER IS AROUND 19.6 MBD (EXCLUDING NEUTRAL ZONE) WITH PRODUCTION SIGNIFICANTLY ABOVE QUOTA BY THE UAE (1.8 MBD), KUWAIT (1.4 MBD), SAUDI ARABIA (4.8 MBD) AND NIGERIA (1.6 MBD), IRAQ'S PRODUCTION IS ESTIMATED AT 2.6 MBD AND IRAN'S 2.0 MBD.

COMMENT

4. IT HAS BEEN REPORTED THAT THE SAUDIS WERE OPPOSED TO A FURTHER PRICE COMMITTEE MEETING AND THAT ONLY A HIGH LEVEL APPEAL BY THE ALGERIANS PERSUADED THEM TO ATTEND. INITIAL ATTEMPTS TO MAINTAIN SECRECY ABOUT THE MEETING SUGGEST OPEC'S LIMITED EXPECTATIONS OF ITS PROSPECTS. THE DECISION NOT TO CONVENE A FULL EXTRAORDINARY MINISTERIAL CONFERENCE CONFIRMS THAT OPEC IS STILL FAR FROM REACHING AGREEMENT ON OUTPUT QUOTAS TO RESTORE PRICES. IN PARTICULAR THE QUESTION OF QUOTAS ACCEPTABLE TO IRAQ AND IRAN REMAINS UNRESOLVED FOLLOWING SUBROTO'S VISIT TO THE TWO COUNTRIES AT THE START OF SEPTEMBER AN EXTRAORDINARY MINISTERIAL CONFERENCE THAT FAILED TO SOLVE THE QUOTA ISSUE WAS PROBABLY SEEN AS MORE DAMAGING TO OPEC CREDIBILITY AND OIL PRICES THAN A FURTHER ATTEMPT TO PREPARE THE GROUND AT LOWER LEVEL. MEANWHILE OVERPRODUCTION BY INDIVIDUAL OPEC MEMBERS CAN BE EXPLAINED BOTH IN TERMS OF MAINTAINING REVENUES IN THE FACE OF FALLING PRICES AND CHEATING BY OTHERS AND ESTABLISHING BARGAINING POSITIONS AHEAD OF ANY POST-WAR RENEGOTIATION OF QUOTAS

5. NO DATE HAS YET BEEN SET FOR THE COMBINED PRICING/LONG TERM STRATEGY COMMITTEE MEETING BUT IT WILL PROBABLY BE BEFORE THE END OF OCTOBER. WHETHER IT WILL THEN LEAD TO A FULL EXTRAORDINARY MINISTERIAL CONFERENCE BEFORE THE NEXT SCHEDULED ONE ON 21 NOVEMBER MAY LARGELY DEPEND ON WHETHER AGREEMENT ON QUOTAS FOR ALL OPEC MEMBERS INCLUDING IRAN AND IRAQ SEEMS ATTAINABLE. A FURTHER FALL IN PRICES, WHICH CURRENT OVERPRODUCTION AND STOCK LEVELS COULD PRODUCE MAY HELP TO CONCENTRATE OPEC MINDS ON ACHIEVING SUCH AN AGREEMENT.

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From: SIR PETER MIDDLETON

Date: 28 September 1988

CHANCELLOR

CC Mr Moore
(without attach.) Miss Wheldon - T Sol

*Thanks.
Weston
Solat*

BP AND THE KIO

... I attach the Bank's paper on BP and the KIO. The DTI are consulting the Attorney General about the issues raised by the copy sent to the Secretary of State; he will not be shown it unless the Attorney so advises. I do not think that affects your position, especially as the Bank go into some wider issues. However, it is essential that the paper is not discussed with the DTI, and it would be best not to discuss it outside the department at all - even with the Bank - till we have the Attorney's advice.

P E MIDDLETON

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PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

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FM ABU DHABI
TO PRIORITY FCO
TELNO 264

OF 290700Z SEPTEMBER 88

INFO ROUTINE DEPARTMENT OF ENERGY, DTI, OPEC POSTS, BANK OF ENGLAND

MY TELNO 253 : UAE OIL POLICY

SUMMARY

1. UAE OIL MINISTER MAINTAINS THE UAE'S STANCE ON OPEC QUOTA BUT THE EVIDENCE INDICATES THAT HE IS NO LONGER IN CONTROL OF PRODUCTION LEVELS. UAE APPEARS NOW TO BE PRODUCING IN EXCESS OF 2 MBPD.

DETAIL

2. I CALLED ON DR MANA AL OTAIBA ON 27 OCTOBER. HE TOLD ME THAT, WHATEVER THE OIL PRICE PRESSURES, THE UAE CONTINUED TO REJECT ITS FORMER OPEC ALLOCATED QUOTA AND REGARDED ITS RIGHTFUL QUOTA AS 1.5MBPD. HE ADDED IN CONFIDENCE THAT FOR THE FORESEEABLE FUTURE ABU DHABI, BY ITSELF, WOULD MAINTAIN PRODUCTION LEVELS AT ABOUT 1.5 TO 1.6 MBPD.

3. BUT I UNDERSTAND THAT, WHEN VISITING OIL MEN ASKED HIM RECENTLY FOR PRODUCTION DETAILS, HE HAD IGNOMINIOUSLY TO REFER THEM TO SUHAIL MAZROUI, GENERAL MANAGER AT ADNOC. FURTHERMORE, THE FIGURE OTAIBA GAVE ME IS NOT BORNE OUT BY EVIDENCE FROM OTHER SOURCES. SOMETHING NEARER 1.75MBPD FOR ABU DHABI IS SEEN AS A MORE REALISTIC FIGURE FOR CURRENT OUTPUT. A WELL PLACED OIL SOURCE HERE BELIEVES THAT EVEN THIS FIGURE COULD BE EXCEEDED IF THE PRACTICALITIES OF PRODUCTION ALLOW.

4. THERE IS COLLATERAL TOO FOR THIS HIGHER FIGURE FROM THE GAS PRODUCTION SIDE OF THE INDUSTRY. THE ABU DHABI GAS LIQUEFACTION COMPANY (ADGAS) WHICH PROCESSES ASSOCIATED GAS FROM THE ADMA-OPCO OIL FIELDS, IS AWASH WITH GAS AND IS URGENTLY TRYING TO FIND BUYERS FOR ITS LNG. THE GAS PRODUCTION LEVELS ARE CONSISTENT WITH THE ADMA-OPCO FIELDS PRODUCING AT MAXIMUM CAPACITY OF OVER 350,000 BPD. WE BELIEVE THAT ADCO HAS BEEN PRODUCING UP TO 1.2 MBPD. THESE FIGURES COMBINED WITH THE PRODUCTION LEVELS OF ZADCO AND THE SMALLER OPERATING COMPANIES WOULD BRING LEVELS UP TO CLOSE TO 1.75 MBPD FOR ABU DHABI. WE UNDERSTAND THAT DUBAI AND THE NORTHERN

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EMIRATES CONTINUE TO PRODUCE SOME 400,000 BPD GIVING THE UAE AN OVERALL TOTAL IN EXCESS OF 2 MBPD.

COMMENT

5. ABU DHABI IS CLEARLY TAKING ADVANTAGE OF THE GENERAL BREAKDOWN IN OPEC PRODUCTION RESTRAINT TO MAXIMISE ITS OIL PRODUCTION IN ORDER TO TOP UP ITS COFFERS WHILE THE PRICE STILL HOLDS.

6. OTAIBA'S STYLE HAS LOST A GOOD DEAL OF ITS EASY CONFIDENCE AND HE UNCHARACTERISTICALLY QUALIFIED A REPLY TO ONE OF MY QUESTIONS WITH THE CAVEAT ''SUBJECT TO THE VIEW OF MY TWO BOSSES (SHAIKHS ZAID AND KHALIFA) AND IF I AM STILL OIL MINISTER...''. ALTHOUGH IT IS BY NO MEANS CERTAIN THAT HE WILL LOSE HIS JOB AS UAE OIL MINISTER, IT SEEMS CLEAR THAT HE HAS ALREADY LOST ALL CONTROL OVER PRODUCTION LEVELS.

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DEPT OF ENERGY
DTI

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FROM: ROBERT CULPIN
DATE: 30 September 1988

FINANCIAL SECRETARY

cc: Chancellor
Sir Geoffrey Littler
Mr Scholar
Mr Gilhooly

V. sensible.

*dr
39/1*

I agree.

UNION TEXAS PETROLEUM CORPORATION V CRITCHLEY

You will remember that - to put it very starkly - you have agreed to announce by PQ that you will legislate in the Budget to override retrospectively the letter (though not of course the spirit) of a double taxation treaty with the United States, in a way which will adversely affect some US taxpayers. Your minute to the Chancellor of 21 September says that "we will obviously have to handle the presentation to the US authorities very carefully".

2. We asked how the Revenue intend to do this. Mr Fawcett's note of 29 September says simply that he will write to his counterpart in the US Treasury when the Parliamentary announcement is made.

3. I do not think this is good enough. What Mr Fawcett suggests may very well be sensible. The Revenue have been confident all along that there will be no trouble with the Americans, and they may well be right. We certainly seem, on the face of it, to have a good case; the issue at stake is relatively trivial; and I have no reason to doubt the Revenue view. But the fact remains that they have not consulted our Embassy in Washington, except very informally; still less has anyone checked with any of the US authorities. And with the best will in the world, the Revenue in London are simply not sufficient authorities to decide on their own how to deal with the Americans. Ministers need properly considered advice.

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4. I have shown the papers both to Tim Lankester and to Richard Allen. Both advise that we should ask the Embassy to check with the US authorities before any announcement. For example, is their interpretation of the IRS Technical Notes unequivocally the same as the Revenue's?

5. At the very least, I think you should get a submission on handling from the Embassy before this goes any further. If the Embassy agrees with the Revenue, fine. If not, Ministers need to see both views, and decide between them.

6. We have already suggested to the Revenue that they send the papers to the Embassy. But if you agree, it would be helpful if Mr Satchwell could send out a note saying that you would like the Embassy's written advice on how best, as you put it, "to handle the presentation to the US authorities very carefully".



ROBERT CULPIN

Ch

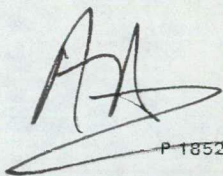
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Bank's letter has not been shown to Lord Young or to officials dealing with BP/KIO - I don't know if the Bank knows this yet.

Reasoning behind the Attorney's advice is that receiving late representations from the Bank would place Lord Young in a v difficult position since he had been advised not to receive representations from the Ministers etc.

The decision (which will be expected) will be announced at 9AM tomorrow (Tuesday).

✓



MINUTE SHEET:

No.....

File No.....

CONFIDENTIAL

Principal Private Secretary

FROM: Miss J L Wheldon
T Sols

DATE: 30 September 1988

c c PS Sir P Middleton
Mr Moore

*Confidential
work up*

BP/KIO

I attach a copy of a letter from the Law Officers Department, recording the Attorney General's advice that the Bank of England's letter of 26 September should not be shown to the Secretary of State or to DTI administrators. It follows of course that no one in the Treasury should discuss the letter with the DTI. From the legal point of view it would, I think, be simplest if, like the DTI, the Treasury do not respond to the Bank's letter; but if a reply is thought to be necessary we can look at this again.

J L Wheldon

Miss J L Wheldon

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01-405 7641 Ext.

*Communications on this subject should
be addressed to*

THE LEGAL SECRETARY
ATTORNEY GENERAL'S CHAMBERS

ATTORNEY GENERAL'S CHAMBERS,
LAW OFFICERS' DEPARTMENT,
ROYAL COURTS OF JUSTICE,
LONDON, W.C.2.

CONFIDENTIAL

Miss Jane Richardson
Solicitor's Office
Department of Trade and Industry
10-18 Victoria Street
LONDON S W 1

30 September 1988

Dear Jane

BP/KIO

I refer to your letter of 28 September.

The Attorney General considers that the best course to adopt in relation to the Bank of England's letter is for the Secretary of State not to see it. It follows that it should not be shown to his administrators either. The Attorney questions whether it is necessary for any response at all to be made by the DTI to the Bank's letter. It was not addressed to the Department. He would prefer that no response be made.

I am copying this letter to Miss Wheldon.

Yours ever

Just

Justin Greig

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TO PRIORITY FCO

TELNO 557

OF 021120Z OCTOBER 88

INFO PRIORITY DEPT OF ENERGY, DTI, OPEC POSTS

FROM H OF C, IN ABASSADOR'S ABSENCE -IN EASTERN PROVINCE

YOUR TELNO 180 : OPEC : SAUDI OIL POLICY

SUMMARY

1. DEPUTY OIL MINISTER ACKNOWLEDGES SAUDI OVER-PRODUCTION, CLAIMS SAUDI AIM IS RESTORATION OF DISCIPLINE IN OPEC.

DETAIL

2. I CALLED ON DR ABDUL AZIZ AL TURKI ON 2 OCTOBER. I SAID THAT IT SEEMED NOW TO BE GENERALLY BELIEVED THAT SAUDI ARABIA HAD PRODUCED AT A RATE OF 4.8 MBD IN SEPTEMBER I.E. 450,000 BPD ABOVE ITS OPEC QUOTA. WHAT LAY BEHIND SAUDI OVER-PRODUCTION ?

3. AL TURKI ACKNOWLEDGED SAUDI OVER-PRODUCTION, THOUGH HE DECLINED TO CONFIRM SPECIFIC FIGURES. OTHERS HAD BEEN CHEATING FOR A LONG TIME, WITH THE EFFECT THAT PRICES HAD SUNK AND SAUDI ARABIA'S REVENUES WERE DOWN. ACCORDINGLY HISHAM NAZER HAD MADE IT CLEAR AT THE OPEC PRICE COMMITTEE MEETING ON 25/26 SEPTEMBER THAT SAUDI ARABIA NO LONGER REGARDED ITSELF AS BEING BOUND BY THE OPEC QUOTA.

4. I DREW THE PARALLEL WITH 1986, WHEN SAUDI ARABIA HAD RAISED PRODUCTION DRAMATICALLY. AL TURKI SAID THAT THERE WERE SIMILARITIES BUT THE PARALLEL WAS NOT EXACT. THE SAUDIS WERE NOT THROWING AWAY ALL RESTRAINT. BUT THEY DID HOPE THAT THEIR ACTION WOULD BRING OTHERS TO THEIR SENSES, AND CONTRIBUTE TO A RESTORATION OF DISCIPLINE.

5. AL TURKI ACKNOWLEDGED THAT SAUDI ARABIA HAD NOT BEEN ENTHUSIASTIC ABOUT THE HOLDING OF LAST WEEK'S PRICE COMMITTEE MEETING. THEY HAD PREDICTED THAT THE COMMITTEE WOULD ACHIEVE NOTHING AND THAT PRICES WOULD AGAIN FALL. THIS PREDICTION HAD PROVED CORRECT. THE DECISION TO HOLD A MEETING OF THE STRATEGY

PAGE 1

CONFIDENTIAL

COMMITTEE MADE MORE SENSE. THE RIGHT COUNTRIES WERE INVOLVED (IE INCLUDING IRAQ AND IRAN) AND OPEC NEEDED TO WORK OUT A NEW STRATEGY. BUT IT WOULD TAKE TIME AND A GREATER DEGREE OF COOPERATION THAN WAS CURRENTLY APPARENT. THE MINISTERIAL SCHEDULED FOR 21 NOVEMBER WOULD BE A VERY DIFFICULT ONE. AL TURKI SAID NOTHING TO SUGGEST THAT HE REGARDED AN EMERGENCY MINISTERIAL BEFORE THEN AS LIKELY.

6. I ASKED AL TURKI WHETHER HIS REMARKS ABOUT THE NEED FOR A NEW STRATEGY IMPLIED THAT SAUDI ARABIA BELIEVED THAT THE PRESENT QUOTAS AND THE DOLLARS 18 A BARREL PRICE TARGET WERE FINISHED. HE SAID THIS WAS NOT NECESSARILY THE CASE. THE MARKET HAD SUSTAINED A PRICE OF DOLLARS 18 PER BARREL FOR A TIME IN 1987, WHEN OPEC MEMBERS HAD SHOWED GREATER DISCIPLINE. SAUDI ARABIA WAS NOT SEEKING A HIGHER QUOTA FOR ITSELF, NOR DID IT BELIEVE THAT OTHERS SHOULD RECEIVE HIGHER QUOTAS. THE INEVITABLE CONSEQUENCE OF INCREASING QUOTAS WOULD BE A FURTHER DROP IN THE PRICE.

7. I ASKED ABOUT IRAQ. WAS IT NOT UNLIKELY THAT THE IRAQIS, IN THEIR PRESENT MOOD WOULD ACCEPT ANY REDUCTION IN OUTPUT ? AL TURKI SAID THE SAUDIS CONTINUED TO THINK PARITY BETWEEN IRAN AND IRAQ AT THE PRESENT IRANIAN QUOTA LEVEL A SENSIBLE GOAL, THOUGH HE ACKNOWLEDGED THAT THE IRAQIS SHOWED FEW SIGNS OF INTEREST IN SUCH AN ARRANGEMENT. SAUDI ARABIA'S ABILITY TO WIN THE IRAQIS (AND THE UAE) ROUND BY PERSUASION SHOULD NOT BE OVERESTIMATED. IN RESPONSE TO ANOTHER QUESTION, AL TURKI SAID THAT CONTINUATION OF THE NEUTRAL ZONE ARRANGEMENT WAS A MATTER FOR THE KING. THE AMOUNT OF OIL INVOLVED WAS NOT IN ANY CASE VERY GREAT IN RELATION TO THE TOTAL OVERHANG IN THE MARKET AT PRESENT.

8. I SAID THAT I ASSUMED THAT WIDER QUESTIONS OF QUOTA AND PRICE WOULD DOMINATE THE NEXT OPEC MINISTERIAL, AND CONDENSATES AND RELATIONS WITH NOPEC WOULD THEREFORE RECEDE INTO THE BACKGROUND. AL TURKI SAID ANY AGREEMENT WITHIN OPEC WOULD HAVE TO COVER THE CONDENSATES ISSUE. WITHOUT AGREED DEFINITIONS, QUOTAS WERE MEANINGLESS. HE PLACED LESS EMPHASIS ON THE OPEC/NOPEC ISSUE. THE DEAL OFFERED BY NOPEC HAD CONTAINED FEW IF ANY ATTRACTIONS. NONETHELESS IT MUST BE RECOGNISED THAT ALL OIL PRODUCERS WERE IN THE SAME BOAT, AND WOULD SUFFER FROM A PRECIPITATE FALL IN PRICES. EVERYBODY, INCLUDING THE UK, HAD AN INTEREST IN STABILITY. HE HAD NOT HEARD OF OMANI INTEREST IN REOPENING OPEC/NOPEC DIALOGUE (MUSCAT TELNO 390) BUT SAUDI ARABIA WAS NOT OPPOSED IN PRINCIPLE. THERE WAS TO BE A GCC OIL MINISTERS MEETING ON 16 OCTOBER.

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FROM: J M G TAYLOR
DATE: 3 October 1988

PS/FINANCIAL SECRETARY

cc Sir G Littler
Mr Scholar
Mr Gilhooly

Handwritten initials, possibly 'JG', in the top right corner of the page.

UNION TEXAS PETROLEUM CORPORATION V CRITCHLEY

The Chancellor has seen Mr Culpin's minute of 30 September. He agrees that we should, in the first instance, get a submission on handling from the Embassy before this goes any further.

Handwritten signature of J M G Taylor.

J M G TAYLOR

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PS/CHANCELLOR OF THE EXCHEQUER
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1ELNO 563

OF 041155Z OCTOBER 88

INFO PRIORITY DEPT OF ENERGY, DII, OPEC POSIS

MY 1ELNO 557 : OPEC : SAUDI OIL POLICY

SUMMARY

1. SAUDI GOVERNMENT WARN OTHER OPEC MEMBERS THAT THEY WILL NOT TOLERATE OVERPRODUCTION OR QUOTA INCREASES BY OTHERS AT THEIR EXPENSE. WARNINGS ALSO TO OIL CONSUMERS AND NON-OPEC PRODUCERS. IRAQI OIL MINISTER VISITED THE KINGDOM THE DAY THE SAUDI STATEMENT WAS ISSUED.

DETAIL

2. IN A STATEMENT ISSUED AFTER ITS MEETING ON 3 OCTOBER THE SAUDI COUNCIL OF MINISTERS SAID THAT THE KINGDOM WOULD ABIDE BY ITS OPEC PRODUCTION QUOTA IF ALL OTHER MEMBERS AGREED TO RETURN TO THEIRS AND PLEDGED TO ABIDE BY THEM. OTHERWISE THE KINGDOM COULD NOT ACCEPT THAT SOME MEMBERS SHOULD ENJOY PRODUCTION ADVANTAGES WHILE OTHERS DID NOT.

3. THE STATEMENT REAFFIRMS THAT RETURNING TO FIXED PRODUCTION QUOTAS IS THE BEST WAY TO RESTORE BALANCE IN THE UNSTABLE MARKET. THE KINGDOM DID ENOUGH FOR OPEC BY REDUCING ITS PRODUCTION FROM 10 MBD TO 4.3 MBD. THIS HAD RESULTED IN A LOSS OF MORE THAN DOLLARS 109 BILLION IN OIL REVENUES IN RECENT YEARS. THE SAUDI GOVERNMENT WOULD NOT ACCEPT ANY ADDITIONS TO THE QUOTAS OF OTHER MEMBERS AT SAUDI EXPENSE, NOR ALLOW ITS PRODUCTION TO BE FROZEN WHILE OTHERS CONTINUED TO ADD TO THEIRS. THAT WAS NOT A ROLE THE KINGDOM WISHED TO REPEAT.

4. THE STATEMENT REMINDS OPEC MEMBERS OF THE BENEFITS WHICH ACCRUED WHEN THEY ABIDED BY THE DECEMBER 1986 QUOTA AGREEMENT. AS A RESULT A BALANCE BETWEEN SUPPLY AND DEMAND HAD BEEN REACHED, AND SPOT MARKET PRICES ROSE TO DOLLARS 20 PER BARREL. OPEC MEMBERS WERE NOW SUFFERING LOSSES CAUSED BY THE DETERIORATION IN THE MARKET AS A RESULT OF CONTINUOUS AND PERSISTENT VIOLATION OF PRODUCTION QUOTAS. THIS WAS DAMAGING TO

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THEIR OIL INDUSTRIES. THEY SHOULD CONFRONT THEIR PROBLEMS INSTEAD OF TRYING TO CIRCUMVENT THEM, GIVE INVESTORS A GENUINE SIGNAL THAT OIL PRICES WOULD REMAIN STABLE FOR SEVERAL YEARS AND THEREBY CALM THE OIL MARKET.

5. TURNING TO THE POLICIES OF OIL CONSUMING COUNTRIES, THE STATEMENT SAYS THAT THE EFFORTS OF INDUSTRIALISED NATIONS TO LIMIT THE USE OF OIL HAD "EXCEEDED NATURAL LIMITS" AND REACHED A LEVEL AT WHICH THEY DAMAGED THE VITAL INTERESTS OF THE OIL PRODUCERS. THE HARM OIL PRODUCERS WERE SUFFERING WOULD AFFECT MANY DEVELOPING COUNTRIES IN THE THIRD WORLD, GIVEN THE DIVERSE ECONOMIC LINKS BETWEEN THEM AND OPEC COUNTRIES. IF THIS CONTINUED, IT WOULD SHAKE THE BANKING SYSTEMS IN THE INDUSTRIALISED NATIONS THEMSELVES.

6. THE STATEMENT ALSO URGES OIL PRODUCING COUNTRIES OUTSIDE OPEC TO TAKE THE SITUATION SERIOUSLY, AND REACH AN UNDERSTANDING WITH OPEC MEMBERS. IT CAUTIONS THEM NOT (NOT) TO BELIEVE THAT THEY ARE IMMUNE FROM THE PROBLEMS BEING SUFFERED BY OTHER PRODUCERS GIVEN THEIR IRREGULAR PRODUCTION AND HIGH PRODUCTION COSTS.

7. THE IRAQI OIL MINISTER, CHALABI, VISITED SAUDI ARABIA ON 3 OCTOBER FOR TALKS WITH THE SAUDI OIL MINISTER, HISHAM NAZER, ON THE OIL MARKET. CHALABI DESCRIBED HIS MEETINGS AS USEFUL, ADDING THAT HE HAD EXCHANGED VIEWS ON COORDINATING POLICY AND BOOSTING THE STABILITY OF THE OIL MARKET. CHALABI WELCOMED THE MEETING OF THE OPEC LONG-TERM STRATEGY COMMITTEE TO BE HELD ON 20 OCTOBER, AND SAID THAT IRAQ WOULD PARTICIPATE IN A POSITIVE AND OBJECTIVE WAY.

COMMENT

8. THIS IS THE FIRST CLEAR PUBLIC STATEMENT OF SAUDI OIL POLICY SINCE THEIR PRODUCTION WAS RAISED ABOVE QUOTA. WHILE CONFIRMING THAT THE SAUDI AIM IS TO BRING OPEC BACK TO A STRICT QUOTA ARRANGEMENT, IT WARNS THAT THEY INTEND TO HOLD ON TO THEIR MARKET SHARE IF OVERPRODUCTION CONTINUES, AND ARE PREPARED TO FACE THE CONSEQUENCES. WHILE THE STATEMENT COULD BE SEEN AS THE SAUDI ANSWER TO THE OPEC SECRETARY-GENERAL'S WARNING LAST WEEK THAT OIL PRICES COULD FALL TO DOLLARS 5 PER BARREL IF SAUDI ARABIA CONTINUED TO OVERPRODUCE, ITS COINCIDENCE WITH THE VISIT BY THE IRAQI OIL MINISTER IS UNLIKELY TO BE AN ACCIDENT. THE SAME MESSAGE IS LIKELY TO BE RELAYED TO OTHER GULF OVERPRODUCERS, EITHER DIRECTLY OR INDIRECTLY. IN CONTRAST, THE WARNING TO NON-OPEC

RESIRICIED

163525
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COUNTRIES TO EXERCISE RESIRRAINT IS RELATIVELY MUTED. THIS, AND THE REFERENCE TO THE POLICIES OF OIL CONSUMERS, MAY HAVE BEEN ADDED TO GIVE SOME BALANCE TO AN OIHERWISE ROBUST ATTACK ON FELLOW OPEC MEMBERS. THE DEPUTY OIL MINISTER DID NOT LAY MUCH EMPHASIS ON NON-OPEC PRODUCERS WHEN HEAD OF CHANCERY SAW HIM ON 2 OCTOBER (MY IUR).

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MR FAIRWEATHER
SIR D MIERS

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OIL

NNNN

CONFIDENTIAL

FROM: TONY DOLPHIN
DATE: 5 October 1988

CHANCELLOR

cc: Sir P Middleton
Sir T Burns
Mr Lankester
Mr Monck
Mr Scholar
Mr Evans
Mr Mountfield
Mr Odling-Smee
Mr Sedgwick
Mr Matthews
Mr O'Donnell
Mr M L Williams
Ms Goodman
Mr McLaren

*Thanks.
At the present time,
the Saudis are down
from down to the
access to the
back to the
1986.*

OIL PRICES

Oil prices have been very weak recently and we thought you might like a short note setting out our views on recent developments. Next week Mr Sedgwick will be circulating a report on the latest Treasury forecasting exercise. As usual, this will cover the implications of the oil price forecast for the UK's current account and public finances.

2. The following table shows developments in the Brent spot price since the beginning of 1988.

Table 1: Brent blend spot price in 1988, \$ per barrel

January	16.7
February	16.1
March	14.9
April	16.6
May	16.5
June	15.7
July	14.9
August	14.3
September	13.4
October 3	11.6

Prices are now at their lowest levels for almost two years. The average price of OPEC crude has fallen below \$11 per barrel, compared to an official reference price of \$18 per barrel.

3. The recent fall in prices has arisen largely because of reports of large scale over-production by many OPEC members, including some that previously had abided by their quotas. But the drop in prices to below \$12 per barrel is attributable to a statement made last Friday by OPEC's secretary-general, Dr Subroto, that prices could collapse to \$5 per

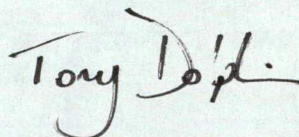
barrel if Saudi Arabia continues to increase output.

4. Iran and the UAE have been ignoring for some time the quotas set for them at last December's OPEC Ministerial meeting (and later re-affirmed at the June meeting) while Iraq has refused to accept any quota. Now Saudi Arabia has warned that it will not allow over-producers to profit at the expense of other OPEC members and has stepped up its own production. The result is that OPEC production in September is estimated to have been close to 20 million barrels a day, compared to a total quota of just over 15 mbd (excluding Iraq where production is just under 3 mbd). This has led some oil market experts to suggest that the existing OPEC agreement is beyond repair and that prices will remain weak until a new agreement, including all OPEC members, can be reached.

5. It is now quite likely that world oil prices in real terms (deflated by the price of exports of manufactured goods) will fall to the same low point in 1988Q4 as they did in 1986Q3 - see attached chart. But real prices would still be above levels prior to the first oil price shock in 1973/74.

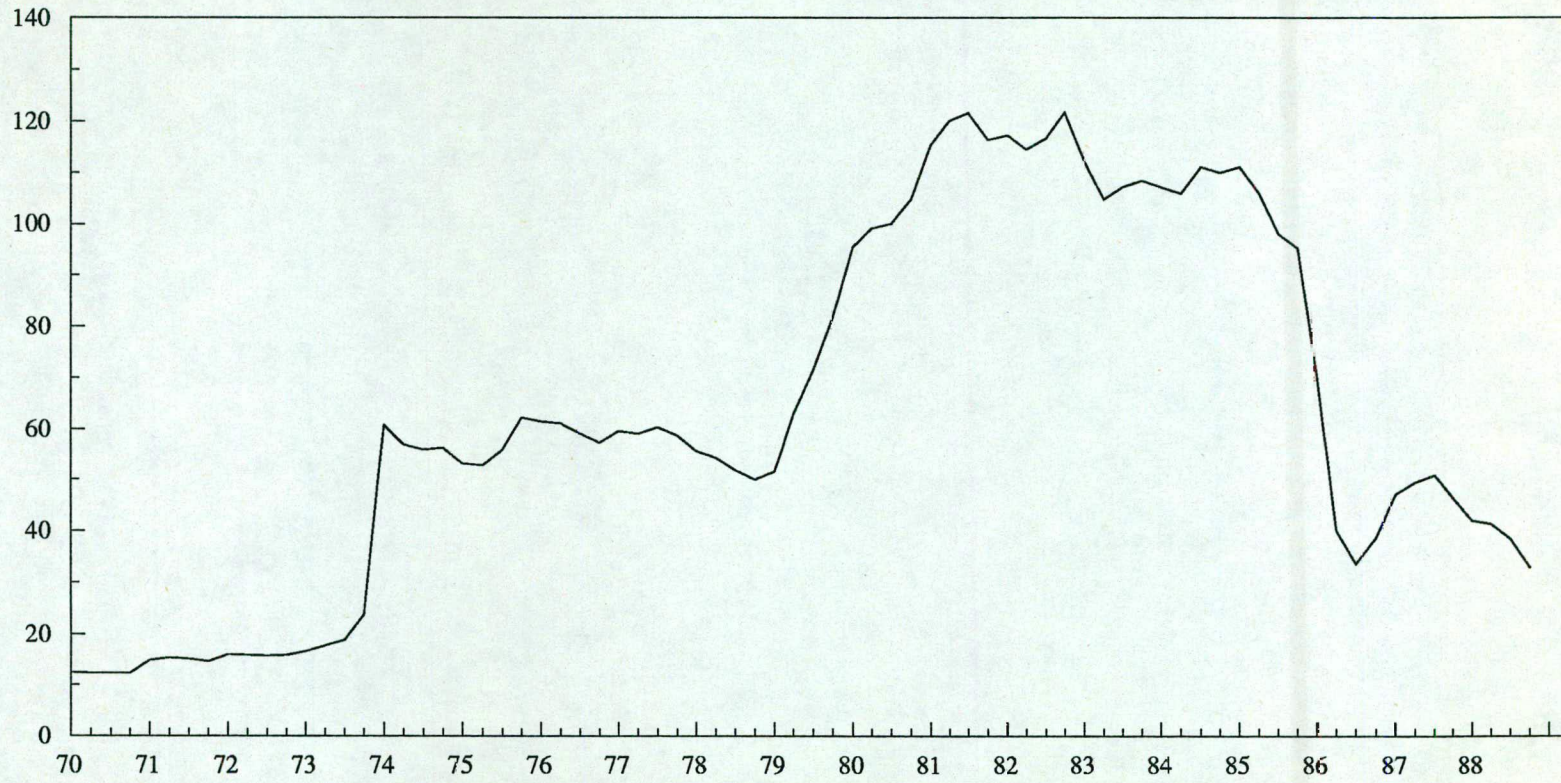
6. Some experts have argued that there is a floor to the oil price around \$10 - \$11 per barrel, but a recent survey by Petroleum Intelligence Weekly found the industry more sanguine now about the prospect of sustained low prices than in 1986. In particular, it seems that production costs have been reduced considerably since then. The main effects of low prices are likely to be felt in the United States. Over 1 million barrels a day of stripper well production has already been removed since 1986 and a further 0.3-0.4 mbd of production would be immediately threatened by prices below \$12 pb. But the major potential casualty of low prices is Alaska (and, therefore, British Petroleum). Because of high production and delivery costs, the break-even point for Alaskan oil is around \$12 pb, though Alaskan producers would be prepared to run at a loss for some time because of the high shutting in and opening up costs. Thus, although pressure for higher prices might come from the US if the oil price remains below \$12 pb for any length of time, the main factor likely to underpin the oil price is pressure on the finances of some OPEC members if revenues are badly hit, as they were in 1986. This could force them into a production agreement.

7. This means 1989 is likely to be another year of oil price volatility. Prices could range from \$10 pb to \$18 pb, though the upper end of this range will only be reached if OPEC can put together a credible production deal.



TONY DOLPHIN

REAL OIL PRICE 1980=100





FROM: MISS M P WALLACE

DATE: 6 October 1988

Handwritten initials 'MP' in black ink.

MR DOLPHIN

cc Sir P Middleton
Sir T Burns
Mr Lankester
Mr Monck
Mr H P Evans
Mr Mountfield
Mr Odling-Smee
Mr Sedgwick
Mr Matthews
Mr O'Donnell
Mr M L Williams
Ms Goodman
Mr McLaren

OIL PRICES

The Chancellor was most grateful for your note of 5 October. He has commented that at the present time, the Saudis are driving prices down to try to reassert authority and teach a lesson. It is highly reminiscent of 1986.

Handwritten signature of Moira Wallace in black ink.

MOIRA WALLACE



[Handwritten signature]

CH/EXCHEQUER	
REC.	10 OCT 1988 ✓ 10/10
ACTION	EST
COPIES TO	

FCS/88/168

LORD PRESIDENT OF THE COUNCIL

Petroleum Royalties Relief Bill

1. I have only just seen a copy of Peter Morrison's letter of 22 September recording his wish to drop from the Bill provisions, relating to dedesignation of certain areas of our continental shelf, if agreement with the Irish were not reached in time for the whole Bill to be introduced at the very beginning of the next Session of Parliament.

2. Since Peter wrote, agreement has been reached at official level by our negotiators with the Irish, ad referendum to Ministers on both sides. I shall be circulating a paper to OD shortly, recommending acceptance of the agreement. Our officials are endeavouring to ensure that Irish ministerial approval is forthcoming in the right timescale, and they are optimistic that this will be possible: they have certainly left their Irish counterparts in no doubt about the implications of delay.

3. I accept nevertheless that, should our hopes be misplaced and there is a delay, the continental shelf provisions should be struck from the Bill as Peter Morrison proposes, and that he should proceed with the Royalty Relief provisions on their own.



4. I am copying this letter to the recipients
of Peter's.

A handwritten signature in black ink, consisting of several fluid, connected strokes that form a stylized representation of the name 'Geoffrey Howe'.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
7 October 1988



Inland Revenue

International Division
Somerset House

FROM: P W FAWCETT

DATE: 14 OCTOBER 1988

- 1. MR ISAAC *14.0*
- 2. FINANCIAL SECRETARY

Ch. Though this submission makes extraordinarily heavy weather of things, its proposed approach (para 12) seems sensible.

UNION TEXAS PETROLEUM CORPORATION v. CRITCHLEY

1. The Chancellor was content to proceed along the lines you proposed in relation to the case of Union Texas Petroleum Corporation v Critchley, that is that the Government should introduce legislation in the next Finance Bill to clarify the position of tax deductible from tax credit payments in respect of dividends paid to US companies; and that the legislation should have retrospective effect (your minute of 21 September and the Chancellor's of 22 September).

2. Mr Satchwell's note of 3 October indicated your concern about the US authorities' possible sensitivity to our proposed course of action on this matter and asked for the advice of our Embassy in Washington about whether to notify the US authorities in advance of the announcement in the UK.

Free: 9/6
13/10
JM
B/ST

- cc PS/Chancellor
PS/Economic Secretary
Sir Geoffrey Littler
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Tyrie
Parliamentary Counsel
Mr Pratt (Washington Embassy)

- Mr Isaac
- Mr Miller
- Mr Houghton
- Mr Johns
- Mr Cleave
- Mr Bush
- Mr Phalp
- Mr Fawcett
- Mr Alderman
- Mr Steele
- Mr Gray
- Mr Bolland
- Miss McFarlane
- PS/IR

3. In reply to that note you have had the Embassy's views in favour of such notification (telno 2429 and 2433 of 7 October). Yesterday I discussed the matter in some detail in Somerset House with Richard Pratt from the Embassy who happens to be in the UK this week. The Revenue recommendation, and that of Mr Gilhooly (FP), to whom I have spoken, is that we follow the Embassy's suggested line of approach.

Next Steps

4. The Embassy advice would involve Richard Pratt in an informal meeting with my counterpart in the US Treasury, to give him advance confidential notification. He has already made a provisional arrangement for such a meeting next Tuesday, 18 October. He would broadly follow the line set out in the Embassy telegram, that is to make clear to US officials that the proposed UK legislation would no more than restore the original intention of the convention and that no US company would be worse off than when the treaty was signed and ratified in the US.

5. We have prepared additional detailed written material, including a letter from myself to my counterpart in the US Treasury setting out the background and what we see as the justification for the legislation, together with some suggested defensive briefing which the US Treasury could use if US companies complained to them following the announcement. (We expect US companies to be the main critics of this course of action: UK taxpayers are not directly affected and the point concerns the amount of UK tax deductible from the tax credit paid to US companies by their UK subsidiaries and affiliates.) Depending on the US Treasury response this additional material could be handed over at the meeting or kept back for later, as necessary.

6. Richard Pratt himself will be away from Washington elsewhere in the US for the rest of next week, after Wednesday morning, but will be back again on Monday, 24 October. He will tell the US Treasury that, if they wish for any further clarification, they can, in the meantime, contact me direct in London.

7. It is, of course, difficult to predict the US Treasury's reaction. We cannot perhaps realistically expect them to be better than neutral on our behalf in this matter. We would hope that they will not be outright hostile, but there is of course a possibility that they will seek a quid pro quo of some kind from us. We will just have to wait and see.

Timing of Parliamentary Announcement

8. An appeal, on a similar claim to that of Union Texas, by another US company, is listed for hearing before the Special Commissioners on 2 November. The Parliamentary announcement therefore needs to be made before then to prevent any other company from benefitting from any decision of Commissioners or Courts after the date of the announcement. If all goes according to plan Tuesday, 25 October may be a suitable day for the announcement. I attach a draft Press Release, including the suggested answer to an arranged PQ on the matter, for your approval. Although the court case was specifically concerned with the UK/US convention we feel that it is important, and indeed preferable presentationally, to clarify the point for the purposes of the UK's double taxation conventions generally: we would therefore hope - subject, of course, to the views of Parliamentary Counsel - that it will be possible to draft the legislation in general terms.

Legislation to cover the other point in the Union Texas case

9. The specific point on which we lost before the High Court concerned the method of calculating the UK tax deductible from the UK tax credit payable and this is the point we wish to clarify in the legislation.

10. On the major point of the appeal, the UK's right to make any deduction for tax, the High Court found in our favour. However, in his judgement, Mr Justice Harman said:

"The points raised by the Appeal are in some senses short but I have found them of very great difficulty to determine and my mind has changed several times in the course of argument and of consideration

Given this uncertainty, and the fact that very substantial sums of UK tax revenue are at stake (our note of 10 May 1988 put the total revenue at stake in the appeal at perhaps £1.2 bn, most of which relates to this major point) we think that there would be an advantage if the legislation could be clarified in this respect as well. It makes sense not to run any risk at all here, not least having to legislate a second time.

11. We suggest, therefore, that the proposed legislation include a provision confirming our right to make the tax deduction provided for in the agreement. The precise wording would of course be a matter for Parliamentary Counsel but we would not expect this to be a long or complicated provision. We have included a reference to this proposed further provision in the final paragraph of the Notes to Editors of the Press Release.

Conclusion

12. We would be grateful for Ministers' agreement -

- (i) to our giving advance confidential notification of the proposed legislation to the US Treasury, at the meeting provisionally arranged for next Tuesday, 18 October; formal written notification and additional written material could be handed over as necessary (paragraph 4-7),
- (ii) to the answer in the attached Press Release to an arranged PQ to announce the legislation, to be given provisionally on 25 October (paragraph 8), and
- (iii) for the proposed legislation to cover both points dealt with in the Union Texas case, that is, the UK's right to make a deduction from the UK tax credit payable, as well as the method of calculating the amount of tax deductible (paragraph 9-11)

13. We would be glad to have Ministers' agreement as soon as possible. In view of the opportunity that Richard Pratt has to see the US Treasury as early as Tuesday, it would be helpful if you could agree to at least (i) above by close of play on Monday.

P. W. Fawcett

P W FAWCETT



**INLAND
REVENUE**

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 6692 OR 6706

[x]

TAX DEDUCTIBLE FROM TAX CREDITS PAID TO NON-RESIDENTS

The Financial Secretary to the Treasury, the Right Hon. Norman Lamont MP, today announced that the Government is proposing legislation to clarify the amount of UK tax that is deductible from UK tax credits to which non-residents may be entitled under a double taxation convention.

In response to a Parliamentary Question, the Financial Secretary said:

"The Government propose bringing forward legislation in the 1989 Finance Bill to make clear the amount of UK tax that is deductible from UK tax credits to which non-residents may be entitled under the terms of a double taxation convention. The legislation follows the recent decision in the case of Union Texas Petroleum Corporation v Critchley and its purpose would be to do no more than restore the position to what it was intended to be. It will apply so as to prevent claims to payment of additional tax credit for past years, but will not affect the decision of any Commissioners or Court given before today".

Notes for Editors

1. Under certain of the UK's double taxation conventions non-resident companies receiving dividends from UK companies in which they have a significant holding are entitled to payment of half the tax credit to which a UK resident individual would be entitled less 5% of the aggregate of the dividend and the half tax credit. Other investors are entitled to the full tax credit less 15% of the aggregate of the dividend and the tax credit.

2. In the case of Union Texas Petroleum Corporation v Critchley a US company receiving dividends from a UK subsidiary company claimed that the UK had no right to make the 5% deduction from the dividend and the half tax credit. The company further argued that, even if such a deduction were permitted, the wording of the UK/US double taxation convention required such a deduction to be calculated on the aggregate of the dividend and half tax credit paid, and not as the convention has been operated to date, on the half tax credit payable. This revised method of calculation would result in less UK tax being withheld. The High Court, on 31 August 1988, found for the Inland Revenue on the first point, but for the US company on the further point.

3. The proposed legislation would ensure that the UK tax deductible will continue to be based on the aggregate of the dividend and tax credit payable. As the purpose of the legislation would be only to restore the law to what it was intended to be, it will apply for all years currently in date. This will ensure that no tax advantage is obtained through payment of amounts of tax credit, in respect of past dividends, additional to amounts paid under the terms of the convention as it was intended to operate.

4. The High Court decision concerned the specific terms of the UK/US double taxation convention and it is not thought that the same point arises in the case of the UK's other double taxation conventions. But, for the avoidance of doubt, the legislation will confirm the UK's entitlement to make such a deduction and the way in which the deduction should be calculated for the purposes of the UK's double taxation conventions generally.

Bf 15/10

(+ adding minute of today)

FROM: B S MORRIS

DATE: 14 October 1988

- W*
17.10
1. MR WILLIAMS
 2. CHANCELLOR

cc Chief Secretary
Mr Anson
Mr Monck
Mr Moore
Mr Robson
Mr Turnbull
Mr Fox
Mr Macauslan
Mr Denison
Mr Knight
Ms Goodman

GOVERNMENT PIPELINE AND STORAGE SYSTEM

The Secretary of State for Energy wrote to the Prime Minister on 11 October seeking her agreement to the proposed transfer of responsibility for the Government Pipeline and Storage System (GPSS) from the Department of Energy to the Ministry of Defence from 1 April 1989.

2. The initiative for this proposal came originally from the Treasury. As a strategic defence asset the GPSS should be MoD's responsibility; DEN have no interest in the system. The two departments have largely been left to sort out the transfer between themselves on the understanding that there could be no question of a claim on the Reserve. The transfer is to be neutral in public expenditure terms as it will merely involve transfer of DEN's PES provision to MoD. It should, as Mr Parkinson says, be uncontentious and there is no need for you to comment on his minute.

3. If, as expected, the Prime Minister agrees to the transfer it will be formalised as an Order in Council and considered by the Privy Council on 15 November.

Brian Morris

B S MORRIS

FROM: GUS O'DONNELL

DATE: 14 OCTOBER 1988

CHANCELLOR

cc: Chief Secretary
 Financial Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Sir T Burns
 Mr Scholar
 PCC
 MEG
 Mr Odling-Smee
 Mr Edwards
 Mrs Lomax
 Mr Luce
 Mr Moore
 Miss Peirson
 Mr Riley
 Mr S Davies
 Mr Grice
 Mr Hibberd
 Mr Matthews
 Mr Melliss
 Mr Mowl
 Mr Hibberd
 Mr O'Donnell
 Mr Pickford
 Mr Williams
 Mr Dolphin
 Ms Goodman
 Ms Turk
 Mr McLaren
 Mr Tyrie
 Mr Call

PS/Inland Revenue

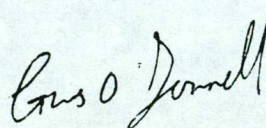
Mr Calder) I/R
 Mr Parker)

PIPER ALPHA : ECONOMIC CONSEQUENCES

1. Mr Parkinson wrote to you on 19 September giving his latest estimates of the consequences of the Piper Alpha disaster. A copy of the letter is attached. His officials have now provided us with more detailed information on changes to North Sea oil production and investment which have been incorporated in the attached paper on the effects of the Piper Alpha disaster. The paper takes into account the

Insurance and extra safety investment effects mentioned at the end of Mr Parkinson's letter. As a result of this and other changes described in the paper, the losses in government revenues and on the current balance are different from those originally given by the Department of Energy (D.En). (The adverse effects on the current account are now estimated at £300 million in 1988 and £390 million in 1989.) D.En have not as yet had the chance to approve these figures.

2. In his letter Mr Parkinson says that the figures he has provided are for "internal HMG purposes only". D.En are anxious that detailed estimates of the safety-related losses are not made public as the figures are subject to particularly wide margins of error and they do not want to appear to be prejudging the results of the various inquiries into the disaster. I think that we will almost certainly have to be ready to provide some estimates of Piper Alpha effects at the time of the Autumn Statement, though not necessarily in the text of the Industry Act Forecast. It would be worthwhile reminding Mr Parkinson of this, and this is the main purpose of the attached draft reply to his letter.



A T O'DONNELL

THE EFFECTS OF THE PIPER ALPHA DISASTER

1. This note outlines the economic consequences of lost production and increased investment as a result of the Piper Alpha disaster. Latest estimates of production losses and increased investment have been supplied by the Department of Energy (D.En) which, combined with the latest Treasury forecast of oil prices, have allowed Inland Revenue to calculate the effect on government revenues. Figures for the effect on the balance of payments are also shown.

2. These latest estimates differ from those originally given by D.En for the period to end. This is due to an assumed lower oil price and the effects of probable extra safety measures and insurance payments.

Production and Investment Effects

3. The oil production losses are expected to decline steadily while the expenditure to replace Piper Alpha and to improve general safety in the North Sea is predicted to be greatest in 1990 and 1991. (The loss of gas production is expected to be negligible as the useful output from the affected fields is almost entirely oil.) The production losses are much greater, and last longer, than originally expected by D.En, partly because they now expect increased safety measures to cause further reductions in output. Piper Alpha is presently expected to resume production in 1992.

TABLE 1 : EFFECTS OF PIPER ALPHA ON NORTH SEA PRODUCTION AND INVESTMENT

	1988	1989	1990	1991	1992	Total 1988-92
OIL production (millions of tonnes)						
Loss from Piper Alpha	-6.6	-4.2	-2.8	-2.1	-0.5 or less	-16.2
Contingencies for reduced production due to safety measures	-	-2.0	-2.0	-	-	-4.0
<u>Total</u>	-6.6	-6.2	-4.8	-2.1	-0.5 or less	-20.2
INVESTMENT (£mn)						
Piper Alpha replacement	-	+30	+110	+150	+90	380
Extra safety work	-	+100	+250	+150	+100	600
<u>Total</u>	-	+130	+360	+300	+190	980

4. The information in Table 1 (which can be split down field by field) has been incorporated in the current forecasting exercise. It is therefore possible to give up to date estimates of the effects of the disaster on the current account and government revenues from the North Sea. Our calculations assume that the average North Sea oil price rises from its current level of around \$12½ per barrel to \$14 by mid-1989 and then remains at this level until 1991.

(i) North Sea Revenues

5. Table 2 shows estimates of the revenue foregone as a result of the lost production and increased investment to replace Piper Alpha and improve safety. The size and, particularly, the timing of the estimated increases in investment are subject to wide margins of error.

TABLE 2 : EFFECTS OF THE PIPER ALPHA DISASTER ON GOVERNMENT REVENUES

(£ million, (-) denotes less revenue)

	1988/89	1989/90	1990/91	1991/92	1992/93	1988/89 to 1992/93
Due to lost production	-160	-200	-140	-70	0	-570
Due to Piper Alpha insurance/investment	250	-20	-30	-70	0	+130
Due to extra safety measures	-	-150	-220	-60	-60	-490
TOTAL	+90	-370	-390	-200	-60	-930
(D.En estimate		-415	to end of 1989)			

6. Table 2 includes the impact of possible receipts of insurance claims. The companies are likely to receive substantial payouts in this financial year on Piper Alpha insurance policies and tax on these receipts, under existing legislation, will be payable immediately at a very high marginal rate. Having spoken with the oil companies involved, Inland Revenue estimate that an extra £¼ billion of PRT may be received in 1988/89. Hence, paradoxically, North Sea revenue could be on balance some £90 billion higher this year as a result of the disaster. However, the increase in receipts from insurance payments in 1988/89 will be more than offset in later years as extra (tax-deductible) investment on rebuilding Piper Alpha and on extra safety measures reduces taxable income and, in turn, government receipts.

ii) Effects on current account

7. Table 3 shows our estimates of the effects on the current account of the lost Piper Alpha production at the oil prices used in the current forecast (see para 3). The current account effect is defined as:

(a) the value of lost production (which reduces exports and/or increases imports),

less (b) an estimate of the change in profits due abroad to oil companies.

TABLE 3 : CURRENT ACCOUNT EFFECT OF THE PIPER ALPHA DISASTER

	(£ million)					Total
	1988	1989	1990	1991	1992	1988-92
(a) Value of lost production	-400	-380	-300	-140	-30 or less	-1250
(b) Change in profits due abroad (=-improvement in invisibles balance)	-100	+10	+140	+120	+30	+200
Total current account effect ((a)-(b))	-300	-390	-440	-260	-60 or less	-1450

(D.En estimate: -500 to end 1989)

8. The estimates do not take account of either the import content of the extra investment or the extent to which the insurance claims will be met by UK companies (ie the figure above assumes that Piper Alpha was insured with overseas companies who did not reinsure with UK companies). Exact details of the insurances and possible reinsurance arrangements are not known. To the extent that the claims are met by UK companies the effect on the current account would be worse than is shown in Table 3.

9. As you would expect, the disaster results in a fall in profits due abroad in 1988. In later years, however, foreign companies net of tax profits are expected to be higher than they would have been. This is because increased capital flows, which finance the extra investment needed, generate additional tax allowances while much of the value of the lost production is offset by lower PRT payments. Overall, the adverse effect after 1988 on the current account is greater than the value of lost production.

Conclusion

10. It is worth emphasising again that most of the figures given in this note are subject to quite wide margins of error, both in size and timing. This is particularly true for extra safety investment in the North Sea where D.En are guessing the outcome of a public enquiry. Having said that, it is clear that over the forecast period losses will be suffered both in government revenues and on the balance of payments as a result of the Piper Alpha disaster. Most of these losses will be made good in the long run, as oil-field lives are extended, and are relatively small in comparison with the present forecast of current account deficits and gross revenue receipts.

DRAFT LETTER TO MR PARKINSON

PIPER ALPHA: ECONOMIC CONSEQUENCES

1. Thank you for your letter of 19 September 1988 describing the likely economic consequences of the Piper Alpha disaster. I would appreciate being kept up to date with any new or revised figures on the effects of the disaster.

2. I note that you say that the figures you provide of the effects on Piper Alpha are for internal HMG use. We will, however, have to be prepared to give some estimates of the effects when I publish a new Industry Act forecast at the time of the Autumn Statement. My officials will as usual show the relevant sections of the Industry Act forecast and our briefing to your officials nearer the time.

[N.L]

ECONOMIC SECRETARY

19 SEP 1988

~~Mr Odling-Smee~~

~~RS/KHK RS/EST~~

~~RS/EST RS/PNG~~

~~Sir P Middleton~~

~~Mr Scholer~~

~~Mr Moore~~

~~Ms Goodman~~

RS/IR

Mr Sedgwick

Sir T Burns

Mr Byatt

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

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



EST

19 September 1988

Dear Nigel,

PIPER ALPHA: ECONOMIC CONSEQUENCES

In my report to Cabinet on 28 July where I dealt with the wider economic consequences of the Piper Alpha disaster, I indicated that the operator, Occidental, was revising its views on the amount of oil production likely to be lost in 1988 and 1989. (NB All references are to calendar years). Occidental has now informed my Department that it intends with Texaco, the operator for the Tartan field, to install emergency shutdown valves in all the oil and gas pipelines servicing the Tartan, Claymore and other fields associated with Piper. Occidental also intends to conduct a full review of the operations and safety systems on its Claymore field.

The effect of these changes is to increase the overall loss of oil production in 1988 to 6.6 million tonnes (previously 4.2 million tonnes): the estimated loss in 1989 remains as previously at 4.2 million tonnes. My economists estimate that the gross value of oil lost in 1988 is likely to amount to some £450 million and that the loss to the balance of payments and in Exchequer receipts over the whole period to end 1989 could amount to £500 million and £415 million respectively. These estimates take no account of insurance claims by licencees: such claims are likely to reduce both the tax and balance of payments losses indicated above. The oil lost in 1988 and 1989 is likely to be fully recovered later on in field life (including Piper which we expect eventually to be redeveloped).

It is much too early for my Department to provide any reliable estimates of the wider implications for production and costs likely to arise from changes in safety procedures until after the Public Inquiry. But I recognise that you need to take account of the possibility of such consequences in your Autumn assessment of the economy. My petroleum specialists and economists have therefore given some careful thought to the sort of 'ball-park' figures which it would be appropriate to include in your North Sea forecast. Their assessment is that a further 4 million tonnes of oil could be lost over the period 1989 and 1990 due to



fields extending their maintenance period or having to cease production whilst installing emergency shutdown valves or similar isolation facilities. It is thought that this lost oil will probably be recovered by 1992. The capital costs of these measures is, at present, equally uncertain. My officials current best estimate is for a cost of £600 million spread over the period 1989 to 1992, with peak expenditure in 1990.

My officials will be pleased to explain to your economists the details and background thinking behind these numbers which should be used only for internal HMG purposes.

*Yours Sincerely,
Cecil Parkinson*

CECIL PARKINSON

Mr X, /
Prime Minister

CH/EXCHEQUER	
REC.	11 OCT 1988
ACTION	Ms GOODMAN
COPIES TO	CST, SIR P. MIDDLETON, Mr ANSON, Mr MANCK, Mr ROSSON, Mr MOORE, A. M. L. WILLIAMS, Mr A. A. WHITE, Mr WATLER.

✓
11/10

TRANSFER OF RESPONSIBILITY FOR THE GOVERNMENT PIPELINE AND STORAGE SYSTEM TO THE MOD

This minute seeks your agreement to the transfer of responsibility for the Government Pipeline and Storage System (GPS) from my Department to the Ministry of Defence.

The GPSS consists of around 1,000 miles of oil pipeline with 27 storage sites in the southern half of England. It was built at the beginning of the second world war to deliver the large amounts of fuel required by military bases, and has been much extended since to military specifications. The System is linked to a further 300 miles of MOD-owned pipelines serving 23 RAF and USAF bases. It was used to store Government stocks of fuel up to the early 1980s when they were sold. Since then, my Department has had no direct interest in the System.

The MOD-owned pipelines are wholly dependent on the GPSS run by my Department. The combined system now meets the entire USAF and around 80% of the RAF need for aviation fuel. In peacetime this accounts for only 20% of the System's throughput and the remaining 80% is hired out to commercial users on a repayment basis. But in time of tension or war the whole system would be cleared of commercial products and made available for the movement of aviation fuel for the two Air Forces.

In 1988/89 the total revenue of the System is estimated to be £25.7 million and the replacement cost of the assets approximately £450 million. The system makes a healthy cash surplus each year but a loss in Current Cost Accounting terms.

The System is currently managed by the Oil and Pipelines Agency (OPA) acting as agent of the Secretary of State. Day-to-day operation is in the hands of a number of private pipeline contractors, also acting as agents of the Secretary of State but reporting in practice to OPA.

It has been agreed by my Department, MOD and the Treasury that the GPSS should pass to MOD on 1 April 1989. This will enable the MOD to run the combined pipeline system as a single entity. The present arrangement is inefficient, not least because it inserts my Department as an unnecessary extra tier of management in an area unconnected with its objectives. Accordingly, I should be grateful for your agreement that the GPSS should be transferred to the Ministry of Defence.

Only two staff in my Department work full time on the System. They will not transfer with the work; the Ministry of Defence has agreed to provide its own staff. We have also agreed with the Ministry of Defence and the Treasury that there will be a transfer of the public expenditure provision covering the System such that neither Department will be better or worse off. The precise amount will be worked out and agreed by the Departments involved when the transfer takes place. There will be no increase in public expenditure.

If you agree the transfer, there will need to be an Order in Council under the Ministers of the Crown Act 1975 to formalise it, and I would aim to submit this to the meeting of the Privy Council on 15 November to allow for a planned and orderly transfer of responsibilities on 1 April 1989. Parliament was informed in June that we have been discussing a possible transfer with the Ministry of Defence. I would also propose to make an announcement by an arranged written Parliamentary Question (copy attached) as soon as Parliament re-assembles. It should not be controversial.

I should add that the proposed transfer has implications for OPA. Apart from managing the GPSS, the Agency's role to date has been to collect and sell North Sea oil taken as Royalty in Kind and to maintain arrangements for state participation in UK oil production. As you know, we decided in June that royalty oil would cease to be taken with effect from 31 December this year, and that the participation arrangements would be terminated. (The announcement

is recorded in Hansard for 16 June 1988, column 182). The winding down of most of this work will be completed within a few months, after which OPA's only role will be as managing agent for the GPSS. X The Ministry of Defence will need to decide over the coming year or two whether or not to retain the Agency for this purpose.

I also propose to take this opportunity to put right an anomaly in connection with petroleum production licences. Energy matters were the responsibility of the Secretary of State for Trade and Industry between 1970 and 1974. When my Department was established in early 1974, rights and liabilities under some 200 licences then in force were not transferred. They have remained in the name of the Secretary of State for Trade and Industry, although they have been exercised by my Department. It would be convenient to include these rights and liabilities in the transfer order. The additional provisions needed for this purpose would be quite short.

I am copying this to Nigel Lawson, George Younger, David Young and Robin Butler.

C.P.

SECRETARY OF STATE FOR ENERGY

11 October 1988

DRAFT ARRANGED PQ ANNOUNCING GPSS TRANSFER

PQ

To ask the Secretary of State for Energy, what progress has been made concerning the transfer of the Government Pipeline and Storage System to the Ministry of Defence.

Draft Reply

My Rt Hon Friend the Secretary of State for Defence and I have agreed, with the approval of the Prime Minister, that his Department will take over the Government Pipeline and Storage System from 1 April 1989. An Order in Council will be laid before the House as soon as possible; this, subject to Parliamentary approval, will formally effect the transfer.



FROM: J M G TAYLOR
DATE: 17 October 1988

A handwritten signature in ink, appearing to be 'JMG Taylor', located to the right of the header information.

MS. GOODMAN

cc Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Robson
Mr Moore
Mr Williams
Mr White
Mr Waller

TRANSFER OF RESPONSIBILITY FOR THE GOVERNMENT PIPELINE AND STORAGE SYSTEM TO THE MOD

The Chancellor has seen Mr Parkinson's minute of 11 October to the Prime Minister.

2. He has noted that the Ministry of Defence will need to decide over the coming year or two whether or not to retain the Oil and Pipelines Agency as managing agent for the Government pipeline and storage system. He has commented that he cannot see any reason why MOD should retain the agency: is there one? If not, it would be best to wind it up.

A handwritten signature in ink, appearing to be 'JMG Taylor', located below the main text.

J M G TAYLOR

CONFIDENTIAL



FROM: R C M SATCHWELL
 DATE: 17 October 1988

MR FAWCETT - IR

cc

PS/Chancellor
 PS/Economic Secretary
 Sir G Littler
 Mr Lankester
 Mr Scholar
 Mr Culpin
 Mr Gilhooly
 Mr Tyrie

Mr Pratt - Washington
 Parliamentary Counsel
 PS/IR

UNION TEXAS PETROLEUM CORPORATION V CRITCHLEY

The Financial Secretary was most grateful for your minute of 14 October. This minute confirms what I told you on the phone, namely that;

- the Financial Secretary is content for Mr Pratt to give the U.S Treasury advance confidential notification of the proposed legislation at the meeting arranged for tomorrow. Mr Pratt may also hand over detailed written material and defensive briefing as necessary; you agreed to clear these in advance with FP.
- you would reflect, in the light of that meeting, whether the draft Written Answer and press release should include a specific reference to the fact that we had consulted the U.S authorities in advance. The Financial Secretary was otherwise happy with the content and timing of the Written Answer.
- The Financial Secretary did not believe that it was necessary for the proposed legislation to deal with the major point in the Union Texas case, given that the company had appealed to the House of Lords for a definitive answer. The last sentence of the notes to editors should therefore be deleted.

R.C.M.S.

R C M SATCHWELL
 Private Secretary



Handwritten initials: PPB, PT

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 2111/3

Handwritten initials: PJP

MO 10/2L

18th October 1988

CH/EXCHEQUER	
REC.	21 OCT 1988
ACTION	Ms GOODMAN
COPIES TO	CST
	Sir P. MIDDLETON
	Mr ANSON
	Mr MONCK
	Mr ROBSON
	Mr MOORE
	Mr WILLIAMS
	Mr WHITE, Mr WALGER

Handwritten: ✓ 21/10

Handwritten notes: "Wagon: there some advice from PE on the Parkinson letter?"

Dear Charles

My Secretary of State has seen the Energy Secretary's minute of 11th October requesting the Prime Minister's formal approval to the transfer of the Government Pipeline and Storage System from the Department of Energy to the Ministry of Defence on 1st April 1989.

The minute reflects the agreement reached between the MOD and the Department of Energy, with the concurrence of the Treasury, and my Secretary of State is therefore content to assume responsibility for the Government Pipeline and Storage System as proposed, together with the appropriate transfer of public expenditure provision.

I am copying the minute to Alex Allen (HM Treasury) and Stephen Haddrill (Energy) and To Trevor Woolley (Cabinet Office).

Yours sincerely
Stan Metcalfe
(S MCCARTHY)
Private Secretary

Charles Powell Esq
10 Downing Street



CH/EXCHEQUER	
REC.	20 OCT 1988
ACTION	EST
COPIES TO	

20/10/88

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

19 October 1988

Dear Cecil,

PETROLEUM ROYALTIES

Peter Morrison wrote on 23 September proposing that, if agreement with the Irish were not reached in time for the continental shelf provisions to be introduced at the very beginning of next Session, those provisions should be dropped from your Bill and that you should proceed instead with a truncated measure confined to the abolition of royalty in the Southern Basin of the North Sea. I have also seen Geoffrey Howe's letter endorsing that proposal but indicating that agreement has now been reached at official level with the Irish and that everything possible was being done to ensure that final agreement was secured in time for the continental shelf provisions to be ready at the start of the Session.

From a business management point of view, it would obviously be unfortunate if separate Bills were to be required for these two matters. I should be grateful, therefore, if you and Geoffrey could continue to ensure that all possible steps are taken to try to secure agreement with the Irish in time for the continental shelf provisions to be included in the Bill. I agree with Peter and Geoffrey, however, that, if this cannot be achieved, the Bill should be confined to the royalty relief provisions. In that event, there could be no presumption that there would be room for a separate Bill later in the Session and you would need to put forward a fresh bid in the usual way.

There is, of course, a risk that some Opposition members will seek to use the Bill as a vehicle for raising points about safety on oil rigs. While it remains essential that the Bill should be available right at the beginning of the Session, we shall need to consider precise timings a little later in the light of the likely response of the Opposition.

My Business Manager colleagues and I will certainly do our best to secure the passage of the Bill by the end of February, but, as you will appreciate, this is a very tight timetable and its achievement is dependent on the House of Lords being prepared to give the Bill a fair wind. I am sure it would be prudent, therefore, to ensure that you have a contingency plan against the possibility that Royal Assent cannot be achieved on this timetable.

I am copying this letter to the Prime Minister, other Cabinet colleagues, members of QL, Sir Robin Butler and First Parliamentary Counsel.

JOHN WAKEHAM

The Rt Hon Cecil Parkinson MP
Secretary of State for Energy

CONFIDENTIAL



10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

CH/EXCHEQUER	
REC.	21 OCT 1988
ACTION	Ms Goodman
COPIES TO	CST Sir P. Middleton Mr Anon Mr Monck Mr Robson, Mr D Moore Mr M Williams, Mr White Mr Waller
21 October 1988	

TRANSFER OF RESPONSIBILITY FOR THE GOVERNMENT PIPELINE AND STORAGE SYSTEM FROM DEPARTMENT OF ENERGY TO THE MOD

The Prime Minister has seen your Secretary of State's minute of 11 October seeking her agreement to the transfer of responsibility for the Government Pipeline and Storage system from the Department of Energy to the Ministry of Defence; and for the transfer of rights and liabilities under about 200 petroleum production licences from the Department of Trade and Industry to the Department of Energy.

The Prime Minister is content for both these transfers of function to go ahead, and for your Secretary of State to announce the changes along the lines he proposes. She hopes the Secretary of State for Defence will be able to dispense with the Oil and Pipelines Agency when alternative arrangements can be made.

I am copying this letter to the Private Secretaries to the Chancellor of the Exchequer, Secretary of State for Defence, Secretary of State for Trade and Industry and Sir Robin Butler.

N. L. WICKS

Stephen Haddrill, Esq.,
Department of Energy.

CONFIDENTIAL



Inland Revenue

International Division
Somerset HouseFROM: P W FAWCETT
21 OCTOBER 1988

1. MR HOUGHTON *Mr N/w*
2. MR ISAAC *21.10*
3. FINANCIAL SECRETARY

UNION TEXAS PETROLEUM CORPORATION v CRITCHLEY

1. Your Private Secretary's note of 17 October.
2. Mr Pratt of our Washington Embassy duly saw my counterpart in the US Treasury (Mr Terr) on 18 October about the proposed legislation and told me on the telephone afterwards that Mr Terr raised no difficulty about the proposal. I understand that he readily agreed that the US interpretation of the UK/US double taxation convention on the point at issue corresponded with ours. Mr Pratt has been elsewhere in the US since 18 October but will return to Washington on Monday, when he will make a final check with Mr Terr and discuss with him any defensive briefing the latter may need. Mr Pratt will hand over an

cc PS/Chancellor of the Exchequer
PS/Economic Secretary
Sir Geoffrey Littler
Mr Lankester
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Tyrie
Mr Dyer
Parliamentary Counsel
Mr Pratt (Washington Embassy)

Mr Isaac
Mr Miller
Mr Houghton
Mr Johns
Mr Cleave
Mr Bush
Mr Phalp
Mr Fawcett
Mr Alderman
Mr Steele
Mr Gray
Mr Bolland
Miss McFarlane
PS/IR

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Explanatory letter (which has already been cleared with FP) and the Press Release on Tuesday (the day of the Parliamentary Answer).

3. You asked whether the draft Written Answer and Press Release should include a specific reference to the fact that we had consulted the US authorities in advance. I discussed this with Mr Pratt, who advised against this. He feels, and we agree, that it would unnecessarily highlight the US dimension. It is true that only the US double taxation convention is involved, but the proposed legislation - for which Parliamentary Counsel has now given us a first draft - will be in general terms.

4. You thought that it was not necessary for the proposed legislation to deal with the major point in the Union Texas case, and we have accordingly deleted the last sentence of the Notes to Editors in the Press Release. I have made two other small changes (sidelined) to the Notes for Editors to reflect comments from FP. I attach a revised draft Press Release for your approval.

5. To sum up then, we are now on course for the Written Parliamentary Answer and issue of the Press Release on Tuesday, with an explanatory letter and copy of the Press Release going to the US authorities on the same day. I would, therefore, be grateful for your final approval of the Press Release attached by close of play on Monday.

P.W.F.

P W FAWCETT



**INLAND
REVENUE**

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 6692 OR 6706

[x]

TAX DEDUCTIBLE FROM TAX CREDITS PAID TO NON-RESIDENTS

The Financial Secretary to the Treasury, the Right Hon. Norman Lamont MP, today announced that the Government is proposing legislation to clarify the amount of UK tax that is deductible from UK tax credits to which non-residents may be entitled under a double taxation convention.

In response to a Parliamentary Question, the Financial Secretary said:

"The Government propose bringing forward legislation in the 1989 Finance Bill to make clear the amount of UK tax that is deductible from UK tax credits to which non-residents may be entitled under the terms of a double taxation convention. The legislation follows the recent decision in the case of Union Texas Petroleum Corporation v Critchley and its purpose would be to do no more than restore the position to what it was intended to be. It will apply so as to prevent claims to payment of additional tax credit for past years, but will not affect the decision of any Commissioners or Court given before today".

Notes for Editors

1. Under certain of the UK's double taxation conventions non-resident companies receiving dividends from UK companies in which they have a significant holding are entitled to payment of half the tax credit to which a UK resident individual would be entitled less 5% of the aggregate of the dividend and the half tax credit. Other non-resident investors are entitled to the full tax credit less 15% of the aggregate of the dividend and the tax credit.

2. In the case of Union Texas Petroleum Corporation v Critchley a US company receiving dividends from a UK subsidiary company claimed that the UK had no right to make the 5% deduction from the dividend and the half tax credit. The company further argued that, even if such a deduction were permitted, the wording of the UK/US double taxation convention required such a deduction to be calculated on the aggregate of the dividend and half tax credit paid, and not, as the convention has been operated to date, on the half tax credit payable. This revised method of calculation would result in less UK tax being withheld. The High Court, on 31 August 1988, found for the Inland Revenue on the first point, but for the US company on the further point.

3. The proposed legislation would ensure that the UK tax deductible will continue to be based on the aggregate of the dividend and tax credit payable. As the purpose of the legislation would be only to restore the law to what it was intended to be, it will apply for all years currently in date. This will ensure that no advantage is obtained through claims for payment of amounts of tax credit, in respect of past dividends, additional to those made under the terms of double taxation conventions as they were intended to operate.

4. The High Court decision concerned the specific terms of the UK/US double taxation convention and it is not thought that the same point arises in the case of the UK's other double taxation conventions.

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TO ROUTINE VIENNA
TELNO 207
OF 251700Z OCTOBER 88
AND TO ROUTINE OPEC POSTS, MADRID

OPEC JOINT PRICE AND LONG TERM STRATEGY COMMITTEE MEETING:
MADRID 20-22 OCTOBER

SUMMARY

1. MEETING DISCUSSES THE NEED FOR A PRODUCTION AGREEMENT ACCEPTED BY ALL 13 MEMBERS, BUT MAKES NO SPECIFIC RECOMMENDATIONS. ISSUE OF QUOTAS FOR IRAN AND IRAQ REMAINS UNRESOLVED. PRICES FALL BACK TO NEAR DOLLARS 12/B. A FURTHER JOINT COMMITTEE MEETING TO BE HELD ON 17 NOVEMBER, 4 DAYS BEFORE THE NEXT FULL OPEC CONFERENCE, AT WHICH AGREEMENT ON NEW QUOTAS COULD STILL BE REACHED.

DETAIL

2. OPEC'S JOINT PRICE AND LONG TERM STRATEGY COMMITTEE MEETING MADE UP OF OIL MINISTERS FROM SAUDI ARABIA, ALGERIA, INDONESIA, VENEZUELA, NIGERIA, IRAN, IRAQ AND KUWAIT PLUS SECRETARY-GENERAL SUBROTO MET IN MADRID FROM 20-22 OCTOBER. IN A PRESS RELEASE ISSUED AFTERWARDS, THE COMMITTEE'S MEMBERS EXPRESSED CONCERN OVER THE CONTINUED EROSION OF THE OIL PRICE STRUCTURE. THEY NOTED THE POSITIVE CONTRIBUTION MADE BY ALL PRESENT WHICH ENABLED THEM TO ACHIEVE QUOTE PROGRESS TOWARDS AN OPEC PRODUCTION AGREEMENT TO BE ACCEPTED AND SIGNED BY ALL 13 MEMBERS OF OPEC UNQUOTE. THEY NOTED THAT ANY QUOTE PRODUCTION CEILING THAT COULD PRESERVE THE PRICE STRUCTURE HAS TO CREATE THE RIGHT CONDITIONS FOR ALL MEMBER COUNTRIES TO PROPERLY IMPLEMENT (IT) AND TO STRICTLY ABIDE BY THEIR NATIONAL PRODUCTION LEVELS UNQUOTE. BEFORE PRESENTING FINAL RECOMMENDATIONS ON A PRODUCTION AGREEMENT THE COMMITTEE MEMBERS CALLED FOR FURTHER CONSULTATIONS AND AGREED TO MEET AGAIN IN VIENNA ON 17 NOVEMBER.

3. AFTER THE LAST JOINT COMMITTEE MEETING ON 25-26 SEPTEMBER (OUR TELNO 180 TO VIENNA) PRICES FELL FROM AROUND DOLLARS 13/B (BRENT) TO JUST ABOVE DOLLARS 11/B IN EARLY OCTOBER. IN THE 10 DAYS LEADING

UP TO THE LATEST OPEC COMMITTEE MEETING THEY RECOVERED TO ABOVE DOLLAR 13/B AS TRADERS COVERED THEMSELVES AGAINST THE POSSIBILITY OF OPEC REACHING AGREEMENT. IN PARTICULAR THE 16 OCTOBER GCC OIL MINISTERS' MEETING (RIYADH TELNO 597) WHICH PROPOSED IRAQ RETURN TO THE QUOTA SYSTEM AT PARITY WITH IRAN, HELPED BOOST PRICES. PRICES HAVE FALLEN BACK AGAIN FOLLOWING THE INCONCLUSIVE MADRID MEETING TO NEAR DOLLARS 12/B. OPEC'S CURRENT OUTPUT IS THOUGHT TO BE AT LEAST 21MBD, WELL ABOVE EXISTING QUOTAS, WHILE DEMAND FOR OPEC CRUDE MAY BE LESS THAN 19MBD, SUGGESTING A SIGNIFICANT STOCKBUILD IS TAKING PLACE.

COMMENT

4. OPEC'S PRESS RELEASE PLACES GREAT EMPHASIS ON THE NEED FOR AN AGREEMENT EMBRACING ALL MEMBERS. THE 6 OTHER COUNTRIES PRESENT IN MADRID APPARENTLY SAW ANY NEW QUOTA AGREEMENT THAT EXCLUDED IRAN OR IRAQ AS UNACCEPTABLE. CONSIDERABLE DIFFERENCES APPARENTLY REMAIN BETWEEN THE TWO FORMER BELLIGERENTS. OTHER ISSUES, SUCH AS THE UAE'S QUOTA AND THE DEFINITION OF CONDENSATES ALSO REQUIRE RESOLUTION. HOWEVER THE FACT THAT IRAN AND IRAQ WERE PREPARED TO NEGOTIATE SERIOUSLY COULD PAVE THE WAY FOR AN AGREEMENT. IRANIAN STATEMENTS BEFORE THE MEETING REJECTED IRAQ'S RETURN TO THE QUOTA SYSTEM AT PARITY. THE IRANIAN OIL MINISTER IS REPORTED TO HAVE SUGGESTED AT THE MEETING THAT INSTEAD IRAN AND IRAQ BE GIVEN EQUAL EXPORT QUOTAS. GIVEN IRAN'S LARGER DOMESTIC CONSUMPTION THIS WOULD MEAN THEIR OVERALL OUTPUT WOULD BE ABOUT 0.4MBD HIGHER THAN IRAQ'S. THE IRAQIS ARE REPORTED NOT TO HAVE REJECTED THE IRANIAN PROPOSAL OUTRIGHT. EVENTUALLY HOWEVER THE IRANIANS MAY HAVE TO ACCEPT IRAQI PARITY. THIS COULD LEAD TO A SETTLEMENT BASED ON THE GCC FORMULA OF EXISTING QUOTAS, PLUS A PRO RATA INCREASE FOR ALL, PERHAPS WITH SOME ADDITIONAL FINE TUNING FOR PARTICULAR COUNTRIES, GIVING AN OVERALL TOTAL AROUND 18.5 OR 19MBD.

5. IT IS NOT CLEAR WHETHER ANY AGREEMENT CAN BE REACHED. IF THE FINAL OUTCOME ENDORSES A TOTAL OF 18.5-19MBD, PRICES MIGHT NOT RISE MUCH BEFORE THE SECOND OR THIRD QUARTER OF 1989. THE OPEC SECRETARIAT APPARENTLY FORECASTS AVERAGE DEMAND FOR OPEC OIL IN 1989 AT 19.5MBD. THIS COULD ITSELF PROVE OPTIMISTIC AND THE CURRENT STOCKBUILD MAY LEAD TO A SIGNIFICANT STOCKDRAW IN THE FIRST PART OF 1989, DEPRESSING ACTUAL DEMAND FOR OPEC OIL WELL BELOW THIS FIGURE.

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6. IN THE SHORT TERM, IF THE MARKET SENSES THAT AN AGREEMENT AT THE 21 NOVEMBER CONFERENCE IS POSSIBLE, PRICES MAY HOLD NEAR CURRENT LEVELS. IF IT TAKES A MORE PESSIMISTIC VIEW, WHICH THE RELATIVELY LONG GAP BEFORE THE NEXT JOINT MEETING, AND CONTINUED HIGH OUTPUT LEVELS MAY ENCOURAGE, PRICES COULD FALL. IRONICALLY THE LATTER OUTCOME MIGHT HELP OPEC OVERCOME ITS INTERNAL DIFFERENCES MORE QUICKLY.

HOWE

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AND TO ROUTINE JEDDA, DOHA, ABU DHABI, BAHRAIN, MUSCAT
AND TO ROUTINE KUWAIT, BAGHDAD, ALGIERS, TEHRAN, MEXICO CITY
AND TO ROUTINE CARACAS, LAGOS, JAKARTA, OSLO, PARIS
AND TO ROUTINE UKDEL OECD PARIS, UKREP BRUSSELS, BONN, ROME
AND TO ROUTINE LUXEMBOURG, ATHENS, DUBLIN, COPENHAGEN
AND TO ROUTINE THE HAGUE, TOKYO, CAIRO, OTTAWA, WASHINGTON
AND TO ROUTINE LIBREVILLE, BANDAR SERI BEGAWAN, KUALA LUMPUR
AND TO ROUTINE BRAZZAVILLE, QUITO, SANA'A

UKCS PRODUCTION

1. ESTIMATES FOR UKCS PRODUCTION FOR THE THREE MONTHS ENDING JULY 1988 INDICATE THAT PRODUCTION WAS AS FOLLOWS:-

FIGURES IN MBD

		1988	1987
JUNE	X	2.17	1.97
JULY		2.18	2.54
AUGUST	X	2.22	2.47

(X = PROVISIONAL)

2. THE FIGURES ABOVE INCLUDE NGLS AND SOME ONSHORE OIL, FACTORS NORMALLY OMITTED FROM UKCS STATISTICS. EXCLUDING THESE, ESTIMATED AVERAGE PRODUCTION LEVELS WERE AS FOLLOWS (MBD):-

		1988	1987
JUNE		2.08	1.88
JULY		2.09	2.42
AUGUST	X	2.13	2.36

(X = PROVISIONAL)

3. THE FIGURES FOR AVERAGE UKCS PRODUCTION IN Q2 1988 WAS 2.42 MBD (INCLUSIVE OF NGLS AND ONSHORE PRODUCTION). THIS FIGURE IS PROVISIONAL.

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MR FAIRWEATHER
SIR D MIERS
MR MAUD
MR REEVE

ADDITIONAL

43

OIL

NNNN

CONFIDENTIAL

FROM: R P KNIGHT
DATE: 28 OCTOBER 1988

PS/CHANCELLOR

cc Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Robson
Mr Moore
Mr Williams
Mr Fox
Mr White
Mr Walker
Miss Barber
Ms Goodman

NOTED

TRANSFER OF RESPONSIBILITY FOR THE GOVERNMENT PIPELINE AND STORAGE SYSTEM TO THE MOD

Your minute of 17 October to Ms Goodman asked whether there is any reason why MOD should retain the Oil and Pipeline Agency (OPA) as managing agents for the Government Pipeline and Storage System (GPSS).

2. Mr Wick's minute of 21 October also notes that the Prime Minister raised the question of the future use of OPA by MOD when giving her approval for the transfer of responsibility for the GPSS to MOD from 1 April 1989.

3. We understand MOD are currently studying possible alternatives to the continuation of OPA as managing agents and they hope to report to their Minister on the options in a few months time.

4. Under the existing agreement with OPA, which MOD will take over from D Energy, MOD will be obliged to give 12 months notice to OPA of termination of the agreement. The MOD study is intended, in part, to identify the possible financial obligations on MOD arising out of termination. There is also the possibility of Treasury retrieving some of OPA's commencing capital if OPA is wound up.

5. We will keep track of MOD's progress on this issue.

R P Knight

R P KNIGHT

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PS/CHANCELLOR OF THE EXCHEQUER
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FM CARACAS
TO ROUTINE FCO
TELNO 234
OF 281835Z OCTOBER 88
INFO ROUTINE VIENNA

YOUR TELNO 207 TO VIENNA: VENEZUELA AND OPEC

SUMMARY

1. VENEZUELAN OIL MINISTER EXPRESSES OPTIMISM ABOUT PROSPECTS FOR AGREEMENT AT OPEC MINISTERIAL MEETING. MEANWHILE HE CLAIMS VENEZUELA HAS BEEN CUSHIONED FROM EFFECTS OF PRICE DECLINE BY PATTERN OF ITS MARKETING ARRANGEMENTS.

DETAIL

2. THE VENEZUELAN OIL MINISTER, CESAR JULIO GIL, TOLD ME THIS MORNING THAT HE THOUGHT THERE WAS A GOOD CHANCE THAT AGREEMENT WOULD BE REACHED AT THE MINISTERIAL MEETING BEGINNING ON 21 NOVEMBER BOTH AS REGARDS QUOTAS FOR IRAQ AND IRAN AND A NEW OVERALL OPEC PRODUCTION CEILING. HE SAID THAT IRAN'S INABILITY TO INCREASE PRODUCTION MEANT THAT THE IRANIAN BARGAINING POSITION WAS WEAK AND HE THOUGHT THAT THE PRESSURE ON THEM TO REACH AGREEMENT WOULD BE STRONG. HE ALSO THOUGHT AGREEMENT WAS POSSIBLE ON AN OVERALL OPEC CEILING OF BETWEEN 18 AND 19 MILLION BARRELS PER DAY, THOUGH VENEZUELA WOULD PREFER A FIGURE AT THE LOWER END OF THIS RANGE.

3. GIL CLAIMED THAT THERE WERE SIGNS ALSO THAT THE NOPEC PRODUCERS WERE MORE READY THAN PREVIOUSLY TO HELP OPEC STABILISE THE MARKET. HE MENTIONED IN PARTICULAR MEXICO AND THE SOVIET UNION SEMI COLON HE SAID THAT THE LATTER HAD FOR THE FIRST TIME MADE PLAIN RECENTLY TO OPEC ITS CONCERN ABOUT THE CURRENT LOW OIL PRICE.

4. AS TO VENEZUELA'S POSITION, GIL SAID THAT VENEZUELA HAD TO SOME EXTENT BEEN PROTECTED FROM THE FULL CONSEQUENCES OF THE RECENT DROP IN THE OIL PRICE BY THE FACT THAT A RELATIVELY LARGE PROPORTION OF ITS OIL WAS EXPORTED AS PRODUCT AND ALSO BECAUSE IT CONTROLLED SUBSTANTIAL REFINING CAPACITY BOTH IN EUROPE, THROUGH ITS STAKE IN VEBA, AND IN THE UNITED STATES.

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5. GIL SHOWED NO DISPOSITION TO QUESTION THE WISDOM OF CONTINUED VENEZUELAN MEMBERSHIP OF OPEC SEMI COLON INDEED HE WENT OUT OF HIS WAY TO REITERATE THE TRADITIONAL POSITION THAT OPEC MEMBERSHIP WAS ESSENTIAL TO HIS COUNTRY.

FITZHERBERT

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ADDITIONAL 43

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FROM: J M G TAYLOR
DATE: 3 November 1988

A handwritten signature in ink, appearing to be "JMG".

MR R P KNIGHT

cc Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Robson
Mr Moore
Mr Williams
Mr Fox
Mr White
Mr ~~W~~alter
Miss Barber
Ms Goodman

**TRANSFER OF RESPONSIBILITY FOR THE GOVERNMENT PIPELINE AND STORAGE
SYSTEM TO THE MOD**

The Chancellor has seen and noted your minute of 28 October.

A handwritten signature in ink, appearing to be "JMG".

J M G TAYLOR

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FM CARACAS

TO PRIORITY FCO

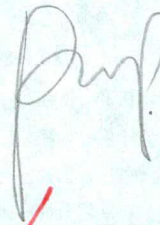
TELNO 239

OF 041838Z NOVEMBER 88

AND TO PRIORITY DTI, DEPT OF ENERGY, BANK OF ENGLAND

AND TO PRIORITY HM TREASURY

INFO ROUTINE UKDEL IMF/IBRD WASHINGTON



VENEZUELA ECONOMY

1. FINANCE MINISTER HURTADO HAS SAID THAT VENEZUELA PLANS TO MEET PART OF ITS 1988 BALANCE OF PAYMENTS DEFICIT WITH US DOLLARS 1 BN TO BE RAISED BY AN INDIRECT MARKET OPERATION IN THE US. THE FUNDS BORROWED ARE TO BE REPAID OUT OF FUTURE OIL PRODUCTION.

2. THE EXACT DETAILS OF THE SCHEME ARE NOT YET CLEAR, AND DISCUSSIONS BETWEEN THE VENEZUELAN GOVERNMENT AND THE OTHER PARTIES INVOLVED HAVE APPARENTLY STILL TO BE COMPLETED. HOWEVER, IT APPEARS THAT TWO US-BASED OIL COMPANIES (CITGO AND CHAMPLIN, IN WHICH THE VENEZUELAN STATE-OWNED OIL COMPANY PDVSA HAS HOLDINGS OF 50% AND 100% RESPECTIVELY) WILL ISSUE BONDS FOR US DOLLARS 1 BN IN THE US INSTITUTIONAL CAPITAL MARKET. THE BONDS ARE TO BE PLACED BY THE BANK OF AMERICA AND SALOMON BROTHERS. THE PROCEEDS WILL GO TO THE VENEZUELAN CENTRAL BANK. INTEREST WILL CAPITALISED AT THE RATE FOR US TREASURY BONDS, PLUS AN UNDISCLOSED SPREAD. VENEZUELA WILL REPAY BOTH PRINCIPAL AND INTEREST BEGINNING IN 1991, OVER A PERIOD OF FIVE YEARS, BY SUPPLYING OIL TO THE TWO BORROWING COMPANIES AT NO CHARGE. THE VALUE OF THIS OIL WILL BE DETERMINED BY THE THEN-PREVAILING MARKET PRICE, NOT (NOT) BY ANY PRICE FIXED IN ADVANCE.

3. ESSENTIALLY, VENEZUELA PLANS TO USE TWO CAPTIVE AND CREDIT-WORTHY US OIL COMPANIES AS A MEANS TO RAISE MONEY ON THE US CAPITAL MARKETS: SOMETHING WHICH, AS A LATIN AMERICAN SOVEREIGN BORROWER, IT WOULD HAVE DIFFICULTY DOING ITSELF. THE VENEZUELAN AUTHORITIES HOPE THAT THE US DOLLARS 1 BN RAISED WILL ENABLE THEM TO MAINTAIN INTERNATIONAL RESERVES AT THE LEVEL OF US DOLLARS 8.5 BN THIS YEAR, WITH OPERATIVE RESERVES AT US DOLLARS 2.2 BN. IT WILL ALSO AVOID, OR AT LEAST DELAY, THE POLITICALLY-DIFFICULT DECISION TO BORROW FROM THE IMF.

4. HURTADO HAS SAID THAT PDVSA WILL BE REIMBURSED BY THE VENEZUELAN CENTRAL BANK, IN BOLIVARES, FOR THE LOSS OF OIL REVENUE THE SCHEME WILL ENTAIL AFTER 1991. IT REMAINS TO BE SEEN WHETHER THIS IN FACT HAPPENS. USING PDVSA AND THE CENTRAL BANK AS THE CHANNEL FOR THE LOAN FROM THE TWO US COMPANIES, AND REPAYING IT WITH OIL SUPPLIES, GETS ROUND THE PROBLEM THAT UNDER THE PRESENT DEBT RESCHEDULING AGREEMENT ANY GUARANTEE (SUCH AS OIL OR GOLD) GIVEN FOR NEW LOANS MUST ALSO BE EXTENDED TO EXISTING LOANS. IF OIL HAD BEEN USED SIMPLY TO GUARANTEE A NEW LOAN TO VENEZUELA THE GOVERNMENT WOULD EITHER HAVE HAD TO OBTAIN ALL CREDITORS' PERMISSION TO GIVE SUCH A GUARANTEE, OR EXTENDED IT TO ALL PAST LOANS. BOTH OPTIONS WOULD HAVE BEEN DIFFICULT TO ACHIEVE. HOWEVER, THIS NEAT SCHEME ON THE PART OF VENEZUELA IN UNLIKELY TO HELP ITS FUTURE RELATIONS WITH ITS CREDITORS.

5. AT LUNCH WITH EC AMBASSADORS YESTERDAY HURTADO GAVE CONTRADICTORY ACCOUNTS OF THE EXTENT TO WHICH THE ARRANGEMENT DESCRIBED ABOVE WAS A FAIT ACCOMPLI. HE ADMITTED THAT PDVSA DID NOT LIKE IT AT ALL. IT MAY WELL THEREFORE TURN OUT THAT IT IS NOT YET IN THE BAG, THOUGH NEGOTIATIONS CLEARLY ARE WELL ADVANCED.

FITZHERBERT

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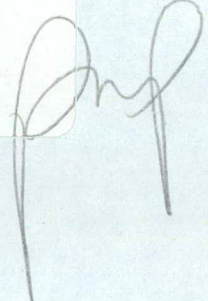
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PS/CHANCELLOR OF THE EXCHEQUER
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TO ROUTINE FCO
TELNO 788
OF 240820Z NOVEMBER 88
INFO ROUTINE OVERSEAS TRADE DIVISION DTI, ECGD



IRAQ: OILFIELD DEVELOPMENT.

1. WE HAVE REPORTED BY EISER THE AWARD TO MANNESMANN (FRG) OF A USD 200 MILLION CONTRACT TO DEVELOP THE SADDAM OILFIELD NEAR TIKRIT. THE CONTRACT INCLUDES DEGASSING STATIONS, PROCESSING PLANT AND 500 KM OF PIPELINE NETWORK. THE FIELD IS SCHEDULED TO PRODUCE 45,000 BARRELS OF OIL AND 300 MILLION CUBIC FEET OF GAS A DAY IN 21 MONTHS.
2. IT IS OF INTEREST THAT MANNESMANN OR, MORE LIKELY, A THIRD PARTY, IS TO ACCEPT PAYMENT IN OIL. WE UNDERSTAND, HOWEVER, THAT IT IS LIKELY TO BE THE LAST DEAL OF ITS KIND. THE IRAQIS HAVE NEVER FAVOURED THE USE OF THEIR OIL AS CURRENCY AND HAVE STRUCK SUCH DEALS, EG FOR BRAZILIAN CARS AND FOR IPSA 2 ONLY OUT OF NECESSITY. THESE EXISTING ARRANGEMENTS, TOGETHER WITH FORWARD SUPPLY OR DEBT REPAYMENT COMMITMENTS TO SUCH COUNTRIES AS TURKEY AND YUGOSLAVIA AND FRG ITSELF, COULD ALSO MEAN THAT IRAQ IS REACHING THE POINT WHERE THERE IS LITTLE CAPACITY LEFT TO USE IN COUNTER-TRADE.

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SYSTEM SUPERVISED BY THE SECRETARY GENERAL REPORTS WILL BE MADE AT WEEKLY INTERVALS. HE CONFIDENTLY EXPECTED OPEC PRODUCTION, CURRENTLY RUNNING IN EXCESS OF 20 MBD TO FALL TO 18.5 MBD BY JANUARY.

4. PRESS AND OTHER OBSERVERS SEE THE AGREEMENT, WHICH INCLUDED IRAQ FOR THE FIRST TIME IN YEARS AS BEING A TRIUMPH FOR THE ORGANISATION. THE IRANIAN MINISTER, AGHAZADEH, DESERVED CREDIT FOR REACHING AN ACCORD WITH IRAQ. OPEC APPEARS TO HAVE DONE ITS HOMEWORK BETTER THAN IT WAS PREVIOUSLY GIVEN CREDIT FOR AND BOTH LUKMAN AND SUBROTO HAVE INCREASED THEIR STOCK CONSIDERABLY.

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ADDITIONAL 44

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FM VIENNA
TO PRIORITY FCO
TELNO 281
OF 291739Z NOVEMBER 88
AND TO PRIORITY DEPT OF ENERGY
AND TO ROUTINE OPEC POSTS

PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

(OIL)

OPEC CONFERENCE: 21 - 28 NOVEMBER 1988

SUMMARY

1. THE 84TH MEETING OF THE OPEC CONFERENCE UNANIMOUSLY AGREED TO SET PRODUCTION LEVELS AT A TOTAL OF 18.5 MBD FOR THE FIRST SIX MONTHS OF 1989. COMMITTEES WERE FORMED TO MONITOR PRICE EVOLUTION AND TO MONITOR PRODUCTION LEVELS OF MEMBER COUNTRIES. FURTHER CONTACT WITH NON-OPEC PRODUCERS TO BE UNDERTAKEN.

DETAIL

2. FOR THE FIRST TIME IN YEARS THE AGREEMENT TO SET PRODUCTION LEVELS WAS UNANIMOUS, DESPITE A LAST MINUTE PROPOSAL BY THE SAUDIS TO SET A MINIMUM PRICE OF US DOLLARS 15 PER BARREL WHICH THREATENED TO WRECK ANY AGREEMENT. PRODUCTION LEVELS AGREED ARE AS FOLLOWS: ALGERIA 0.695, ECUADOR 0.230, GABON 0.166, INDONESIA 1.240, IRAN 2.640, IRAQ 2.640, KUWAIT 1.037, LIBYA 1.037, NIGERIA 1.355, QATER 0.312, SAUDI ARABIA 4.524, UNITED ARAB EMIRATES 0.988, VENEZUELA 1.636. THE CONFERENCE DECIDED TO FORM A MINISTERIAL MONITORING COMMITTEE (ALGERIA, INDONESIA, IRAN, IRAQ, KUWAIT, NIGERIA, SAUDI ARABIA, VENEZUELE) TO MONITOR PRICE EVOLUTION, SUPERVISE PRODUCTION LEVELS AND TO PREPARE LONG-TERM STRATEGIES. EMPHASIS WAS AGAIN PLACED ON THE NEED FOR NON-OPEC OIL PRODUCERS TO PLAY THEIR PART IN HELPING TO RESTORE STABILITY TO THE MARKET. CONTACT WITH NON-OPEC OIL PRODUCERS WILL BE UNDERTAKEN BY HEADS OF DELEGATION OF ALGERIA, INDONESIA, KUWAIT, NIGERIA, SAUDI ARABIA AND VENEZUELA UNDER THE DIRECTION OF THE SECRETARY GENERAL, SUBROTO.

3. IN THE PRESS CONFERENCE WHICH FOLLOWED, LUKMAN DEFINED QUOTAS AS INCLUDING PRODUCTION, DOMESTIC CONSUMPTION AND SALES FROM STOCK (IN HIS WORDS QUOTE ALL STORAGE FLOATING OR SINKING). NEUTRAL ZONE PRODUCTION WILL IN FUTURE BE INCLUDED WITHIN THE OVERALL QUOTA. HE ADMITTED THAT THE AUDIT HAD NOT HELPED VERY MUCH MAINLY BECAUSE OF THE DELAY IN RECEIVING REPORTS, UP TO TWO MONTHS LAG. UNDER THE NEW

~~CONFIDENTIAL~~



FROM: S M A JAMES
DATE: 25 November 1988

MR PRESCOTT - IR

cc: PS/Chancellor
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Williams
Mr Tyrie
Mr Jenkins (Parly Counsel)

PS/ir
Mr Beighton - IR
Mr Johns - IR

PIPER DISASTER : TAX TREATMENT OF INSURANCE RECEIPTS

The Economic Secretary was grateful for your minute of 18 November.

2. As you are aware, he would be grateful for a 'stand firm' reply.

S M A JAMES
PRIVATE SECRETARY

RESTRICTED

FM FCO

TO PRIORITY VIENNA

TELNO 242

OF 301239Z NOVEMBER 88

AND TO PRIORITY OPEC POSTS

YOUR TELNO 281: OPEC CONFERENCE, VIENNA, 21-28 NOVEMBER

SUMMARY

1. AGREEMENT ON NEW OUTPUT CEILING OF 18.5MBD FOR ALL 13 MEMBERS, INCLUDING IRAQ SEEN AS A SUCCESS FOR OPEC. FAILURE TO REACH AGREEMENT COULD HAVE RESULTED IN A PRICE COLLAPSE. OIL PRICES ROSE FROM AROUND 12.5 DOLLARS PER BARREL (BRENT) BEFORE THE MEETING TO OVER 14 DOLLARS PER BARREL FOLLOWING THE AGREEMENT BUT HAVE FALLEN BACK AGAIN SLIGHTLY SINCE. GIVEN CURRENT HIGH STOCK LEVELS AND LIKELY UNDERLYING DEMAND, EVEN FAIRLY STRICT QUOTA ADHERENCE, ITSELF NOT CERTAIN, COULD SEE FURTHER PRICE WEAKNESS IN EARLY 1989 AND IS UNLIKELY TO BRING A RETURN OF 18 DOLLARS PER BARREL OIL IN THE FIRST HALF OF THE YEAR.

DETAIL

2. ON THE EVE OF THIS OPEC MINISTERIAL MOST ANALYSTS PUT ITS CHANCES OF SUCCESS AT ONLY 50/50. BOTH THE GCC OIL MINISTERS' MEETING ON 17 OCTOBER AND OPEC AT THEIR 20 OCTOBER COMMITTEE MEETING IN MADRID (FCO TELNO 207 TO VIENNA) HAD PROPOSED AN AGREEMENT THAT WOULD INCLUDE ALL 13 MEMBERS, THUS EFFECTIVELY PRECLUDING THE OPTION OF SIMPLY CONTINUING TO EXCLUDE IRAQ. THE APPARENTLY IRRECONCILABLE DEMANDS OF IRAN AND IRAQ (IRAN DEMANDING A LARGER QUOTA THAN IRAQ, IRAQ DEMANDING PARITY) PROVED AS EXPECTED, THE MAIN OBSTACLE TO A SOLUTION.

3. IRAN'S FINAL ACCEPTANCE OF PARITY DEPENDED ON CERTAIN CONDITIONS:

A) EXPLICIT MENTION OF AN 18 DOLLARS PER BARREL REFERENCE PRICE: ALTHOUGH THE FINAL COMMUNIQUE DOES NOT CALL FOR IMMEDIATE RESTORATION OF OFFICIAL PRICES AT THIS LEVEL IT DOES TALK ABOUT ACHIEVING THIS PRICE QUOTE AS SOON AS POSSIBLE UNQUOTE. THE LAST MINUTE SAUDI ATTEMPT TO INSERT A CALL FOR A

15 DOLLARS PER BARREL FLOOR PRICE WAS OVERCOME BY OTHER OPEC MEMBERS, THEIR FEAR APPARENTLY BEING THAT ANY REFERENCE TO SUCH A PRICE MIGHT LEAD THE MARKET TO SETTLE AT THIS LEVEL. SAUDI CLAIMS THAT THE PROPOSAL WAS DESIGNED TO HELP KEEP PRICES ABOVE 15 DOLLARS PER BARREL MAY HAVE BEEN SLIGHTLY DISINGENUOUS. THE SAUDI INTERVENTION COULD HAVE BEEN IN PART AN ATTEMPT TO SHOW IRAN IT WAS NOT GOING TO HAVE EVERYTHING ITS OWN WAY.

B) MAINTENANCE OF IRAN'S MARKET SHARE AT 14.27 PER CENT (AS IMPLIED BY THE 1986 OPEC AGREEMENT): ACHIEVEMENT OF THIS INVOLVES AN INCREASE IN IRAN'S QUOTA BY ABOUT 270,000B/D AND IN IRAQ'S BY 1.1MBD (FROM THE NOMINAL 1.54MBD WHICH IT HAD NEVER ACCEPTED). THE REMAINING 11 MEMBERS OF OPEC BETWEEN THEM ONLY RECEIVE 533,000B/D DISTRIBUTED ON A PRO RATA BASIS.

C) OUTPUT FROM THE NEUTRAL ZONE TOTALLING 300 TO 400,000B/D TO BE INCLUDED IN SAUDI ARABIA AND KUWAIT'S OPEC QUOTAS AND NONE OF ITS PROCEEDS TO GO TO IRAQ AS QUOTE WAR RELIEF UNQUOTE: ALTHOUGH NOT MENTIONED IN THE COMMUNIQUE THIS PART OF THE AGREEMENT WILL APPARENTLY COME INTO FORCE FROM THE START OF 1989.

4. THE COMMUNIQUE DOES HOWEVER SAY THAT UNANIMOUS AGREEMENT WAS REACHED ON A SET OF DEFINITIONS FOR QUOTAS AND CONDENSATES BUT GIVES NO DETAILS. IT REMAINS TO BE SEEN IF THIS ISSUE HAS BEEN FINALLY RESOLVED.

5. THE PROSPECT OF SEEING IRAQ REINTEGRATED INTO THE QUOTA SYSTEM PROVED TOO GOOD FOR OPEC TO MISS AND OVERCAME MOST COUNTRIES' MISGIVINGS ABOUT IRAN'S DEMANDS, PARTICULARLY OVER MARKET SHARE. OPEC'S HOPE MUST BE THAT IRAQ WILL NOW FIND IT HARDER TO JUSTIFY PRODUCTION INCREASES NEXT YEAR. FOR THE SIX MONTHS THIS AGREEMENT COVERS IRAQ MAY STAY NEAR HER NEW QUOTA ANYWAY. HOWEVER WITH NEW PIPELINE AND PORT FACILITIES LIKELY TO COME ON STREAM IN THE LATTER HALF OF THE YEAR AND A SHORT TERM PRODUCTION POTENTIAL OF PERHAPS 4MBD, IRAQ COULD WELL PRESS FOR A QUOTA INCREASE AT THE NEXT SCHEDULED OPEC MINISTERIAL IN JUNE OR SIMPLY CHEAT OR DO BOTH.

6. THE UAE PRESENTS A MORE IMMEDIATE PROBLEM. HER OIL MINISTER IS ALREADY REPORTED AS SAYING HER NEW QUOTA OF 988,000B/D IS NOT OFFICIAL. IN JUNE THE UAE UNILATERALLY ADOPTED A QUOTA OF 1.5MBD. CURRENT OUTPUT COULD BE UP TO 1.9MBD. SOME ANALYSTS BELIEVE OPEC HAS TACITLY ACCEPTED

ASSURANCES THAT THE UAE WILL IN FACT NOW CUT OUTPUT TO ABOUT 1.3MBD.

7. NON-OPEC PRODUCERS' REACTION TO THE AGREEMENT IS LIKELY TO BE ONE OF WAIT AND SEE. IF THE AGREEMENT STARTS TO UNRAVEL, MOST ARE LIKELY TO SAY IT IS UP TO OPEC TO RESTORE INTERNAL DISCIPLINE FIRST BEFORE THEY TAKE ANY ACTION TO CUT OUTPUT. IF OPEC SUCCEED IN BOLSTERING PRICES THE INCENTIVE FOR NON-OPEC PRODUCERS TO CO-OPERATE WILL BE LESS IN ANY CASE. SINCE THE MEETING, NORWAY HAVE CONFIRMED HOWEVER THAT THEY WILL CONTINUE WITH THEIR 7.5 PER CENT RESTRAINT ON PLANNED PRODUCTION INCREASES. THEIR OUTPUT MAY NEVERTHELESS RISE BY 250,000B/D DURING 1989.

8. OPEC OUTPUT CURRENTLY PERHAPS 22.5MBD, IS LIKELY TO CONTINUE AT HIGH LEVELS UNTIL THE NEW AGREEMENT TAKES EFFECT ON 1 JANUARY, PARTLY BECAUSE OF CONTRACTS ALREADY SIGNED, BUT ALSO BECAUSE SOME OPEC MEMBERS MAY WANT TO PUMP ALL THEY CAN BEFORE THE DEADLINE. GIVEN CURRENT HIGH STOCK LEVELS THE FIRST QUARTER OF 1989 COULD SEE A SIGNIFICANT STOCKDRAW DEPRESSING ACTUAL DEMAND FOR OPEC CRUDE PERHAPS TO 17.5MBD OR LESS. EVEN IF OPEC COME NEAR TO QUOTA ADHERENCE, PRICES COULD THEREFORE STAY NEAR CURRENT LEVELS OR EVEN FALL SLIGHTLY. IF OPEC KEEP THEIR NERVE, THE SECOND QUARTER MIGHT SEE SOME RECOVERY. HOWEVER A RETURN TO 18 DOLLARS PER BARREL STILL LOOKS UNLIKELY IN THE FIRST HALF OF 1989.

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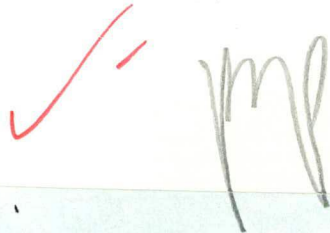
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PS/CHANCELLOR OF THE EXCHEQUER
TREASURY



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TO PRIORITY FCO

TELNO 802

OF 301005Z NOVEMBER 88

INFO ROUTINE DEPARTMENT OF ENERGY, OVERSEAS TRADE DIVISION DTI,
INFO ROUTINE OPEC POSTS, VIENNA

VIENNA TELNO 281 TO FCO. OPEC AGREEMENT: REACTIONS.

SUMMARY

1. IRAQI AND UAE OIL MINISTERS EXPRESS SATISFACTION WITH THE NEW OIL PRODUCTION QUOTA AND PRICING AGREEMENT.

DETAIL

2. ACCORDING TO LOCAL PRESS REPORTS, THE IRAQI OIL MINISTER, ISSAM ABDUL RAHIM AL CHALABI, TOLD A PRESS CONFERENCE HERE ON 29 NOVEMBER THAT HE WAS HAPPY WITH THE NEW AGREEMENT ON PRODUCTION QUOTAS AND PRICES. HE IS QUOTED AS SAYING THAT OPEC MEMBERS HAD SHOWN A GOOD UNDERSTANDING OF IRAQ'S POSITION ON QUOTAS. HE DESCRIBED THE VIENNA MEETING AS AN HISTORIC ONE.

3. THE UAE MINISTER OF OIL AND MINERAL RESOURCES, DR MANA SA'EED OTEIBA, WHO IS VISITING BAGHDAD AND WAS PRESENT AT THE PRESS CONFERENCE, TOLD REPORTERS THAT THE NEW AGREEMENT WAS BOUND TO HAVE A POSITIVE EFFECT ON OIL PRICES AND ON THE STABILITY OF THE OIL MARKET. HE SAID THAT THE GULF WAR CEASEFIRE HAD HELPED MEMBERS REACH AGREEMENT AND HE NOTED THAT THIS WAS OPEC'S FIRST UNANIMOUS AGREEMENT SINCE 1983, ADDING THAT IT WAS DISAGREEMENT IN 1983 WHICH FORCED PRICES DOWN FROM THEIR EARLIER USD 35 PRICE. OTEIBA SAID 'WE PIN GREAT HOPES ON THIS QUOTA AGREEMENT. THE ACCORD WILL CERTAINLY REDRESS IMBALANCES IN THE OIL MARKET AND RAISE PRICES TO USD 18''. HE SAID THAT ALL OPEC MEMBERS WERE COMMITTED TO THE NEW AGREEMENT THIS TIME AND THAT IT HAD THE SUPPORT OF NON-OPEC OIL PRODUCERS WHICH SENT REPRESENTATIVES TO VIENNA. HE ADDED THAT 4 US OIL PRODUCING STATES AND CANADA SENT ENVOYS AND EXPRESSED THE DESIRE TO CO-OPERATE WITH OPEC AND NON-OPEC PRODUCERS.

4. OTEIBA IS REPORTED TO HAVE STRESSED THAT THE NEW AGREEMENT EXPRESSES THE DETERMINATION OF ALL MEMBER COUNTRIES TO DEFEND OPEC MARKETING POLICIES AND OVERCOME DIFFERENCES. FINALLY, HE SAID THAT THE UAE IS FULLY COMMITTED TO THE AGREEMENT.

5. IT IS NOT CLEAR FROM TUR WHETHER NEUTRAL ZONE PRODUCTION IS TO BE INCLUDED IN IRAQ'S QUOTA OR THOSE OF SAUDI ARABIA AND KUWAIT. GRATEFUL IF VIENNA COULD THROW ANY MORE LIGHT ON THIS POINT.

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FROM: D J L MOORE
DATE: 5 DECEMBER 1988

CHANCELLOR

cc Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr R I G Allen
Mrs M E Brown
Mr M L Williams
Ms Leahy
Mr S B Johnson

Ms Wheldon - TSOL

Ch/Content?
OK as heard you.
5/1

**LETTER TO SECRETARY OF STATE FOR FOREIGN AND COMMONWEALTH AFFAIRS
ABOUT BP**

I attach a draft letter on the lines discussed yesterday. As Walters has so far not taken up your suggestion that he should speak to Sir Geoffrey, I have not mentioned it in the draft.

2. He also failed to fix up a meeting with the Chairman of the KIO. He will try again when he is back next week.

*Walters' conduct is
inadvisable -
must suggest to
Cockfield*

DJM.
D J L MOORE

Be type final

minute

DRAFT ~~LETTER~~ TO

The Rt Hon Geoffrey Howe MP
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Whitehall
LONDON
SW1

FOREIGN SECRETARY

5 January 1988

BP AND THE KIO

*I continue to be concerned about the build-up of the KIO
holding in BP, also which we spoke of before Christmas.*

I spoke to Peter Walters before Christmas about the KIO's purchases
in response to
of BP shares and the issues raised in his letter of 17 December, *and*

also

I encouraged him to speak directly to the Chairman of the KIO
(signature James)
and to emphasise that any increase in the KIO holding would be
damaging to BP in many countries, and *possibly thus* indeed to the KIO, *too.* He
He has not yet done so, but I understand plans to arrange a
has not yet been able to arrange a meeting.
meeting next week.

I have now seen telegram 459 about David Mellor's discussions
with Fahd Al Rashid and Shaikh Ali Khalifa, and also
Cecil Parkinson's comments in his Private Secretary's letter
of 29 December (copied to you).

Bankelle,

While the assurances given to David Mellor, *(offer some comfort,*
they do not go far enough and I remain concerned that the Kuwaitis
might not realise that the Government would be strongly opposed
to a KIO holding of over 20 per cent in BP; indeed, even this
level of holding is a potential problem to the company, as
Peter Walters points out in his letter. *Majority,* While it is probably
right that KIO would not suddenly dump large quantities of BP
shares on the open market, the real worry is that they could

could at any time sell New States to

~~make a deal with a predator interested in bidding for BP. Such a deal could make good financial sense for the KIO but be highly *While it is true that HMG previous rights under BP's articles of association could have proved* damaging to BP. It would also lay the Government open to criticism *an unstable takeover of BP, and that it was at BP's* that it had stood back and effectively allowed BP to fall into *express request that these rights were transferred with* foreign hands, and, as Cecil Parkinson points out, this could *No October sale, no fact remains that any such* be contrasted with our approach to Britoil. (In fact, it was *takeover, particularly by an overseas predator,* at BP's own request that there is no Special Share in the Company *company, would be against no national interest - and even* and that all HMG's previous rights under the Articles of *No purport of it would be politically highly favourable.* Association were terminated with the October sale.) *Indeed, no opposition as already made a major issue of this.*~~

A holding greater than 20 per cent would exacerbate these problems and call into question the Kuwaitis own intentions. Although they have said that they have no ambitions to control the company, nor any interest in any management role, their attitude could change - particularly if we appeared to be unconcerned about such a possibility.

I therefore urge you to speak to the Kuwaitis to make our position and concern clear beyond any doubt. *We would not wish to see* ~~It ought to be possible to do this without causing unnecessary offence.~~

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

from him
~~we should *not* secure an instalment (a) that no ~~takeover~~ KIO could not remove its stake in BP beyond 20 per cent and (b) that they would not dispose of such stake to anyone seeking to secure control of BP, at least ~~without~~ *first* ~~to HMG.~~ *ensure that no potential purchaser can acceptably update their assurance to David Molla that they themselves will at no time seek to exercise any control over BP, nor any management role in the company.*~~

NIGEL LAWSON

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PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

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INFO PRIORITY OPEC POSTS, UKREP BRUSSELS, DEPT OF ENERGY

YOUR TELNO 242 TO VIENNA: OPEC

SUMMARY.

1. SAUDI VIEWS ON OPEC AGREEMENT AND FUTURE PROSPECTS.

DETAIL.

2. IN A STATEMENT ISSUED AFTER YESTERDAY'S REGULAR SAUDI COUNCIL OF MINISTER'S MEETING, THE KING IS QUOTED AS EXPRESSING SATISFACTION AT THE LATEST OPEC AGREEMENT, AND THE COMMITMENT BY ALL OPEC MEMBERS TO ABIDE BY THEIR NEW QUOTAS. THE COUNCIL LOOKED FORWARD TO A STRENGTHENING OF THE OIL PRICE AS A RESULT OF THE AGREEMENT. SAUDI ARABIA WOULD BE THE FIRST TO ABIDE BY THE NEW QUOTAS.

3. HEAD OF CHANCERY CALLED ON THE DEPUTY MINISTER OF PETROLEUM ON 6 DECEMBER. AL TURKI SEEMED PLEASED WITH THE AGREEMENT ACHIEVED IN VIENNA, BUT SAID THAT ONLY TIME WOULD TELL HOW WELL IT WOULD HOLD.

4. PLUMBLY ENQUIRED ABOUT THE SAUDI PROPOSAL FOR A 15 DOLLAR PER BARREL TARGET, WHICH HAD BEEN REJECTED BY SAUDI ARABIA'S OPEC PARTNERS. HAD THIS REFLECTED DOUBT ABOUT THE 18 DOLLAR REFERENCE PRICE, OR SAUDI ARABIA'S LONG TERM INTEREST IN A SLIGHTLY LOWER PRICE? AL TURKI SAID THAT THE PROPOSAL HAD BEEN WIDELY MISUNDERSTOOD. HE CLAIMED THE SAUDI INTENTION HAD MERELY BEEN THAT 15 DOLLARS PER BARREL SHOULD BE A FLOOR BELOW WHICH A QUOTA REDUCTION WOULD BE TRIGGERED. IT WAS TRUE THAT SAUDI ARABIA'S LONG TERM INTEREST MIGHT BE BEST SERVED BY A RELATIVELY LOW PRICE, BUT THIS CONSIDERATION HAD TO BE BALANCED AGAINST IMMEDIATE BUDGETARY CONCERNS. HISHAM NAZER HAD MADE THESE POINTS CLEARLY IN AN INTERVIEW TO MEES, WHICH WE HAVE NOT YET SEEN (BUT SEE PARA 10 BELOW).

5. AL TURKI CONFIRMED THAT NEUTRAL ZONE OIL WOULD BE INCLUDED IN SAUDI/KUWAITI QUOTA. THE SAUDI POSITION HAS ALWAYS BEEN THAT OIL GIVEN AS AID COUNTED AGAINST THE RECIPIENT'S QUOTA, AND IT

PAGE 1
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WAS RIGHT TO DEDUCE THAT SAUDI ARABIA WOULD NO LONGER BE SUPPLYING THIS OIL TO IRAQ. THE IRAQI'S WOULD NOT HAVE WANTED THE OIL IF IT HAD TO BE COUNTED AGAINST THEIR OWN QUOTA. THEIR OWN WAS OF HIGH QUALITY. PLUMBLY ASKED WHETHER THIS MEANT AN EXTRA US DOLLARS 1 BILLION PER ANNUM FOR THE SAUDI TREASURY. AL TURKI HEDGED SLIGHTLY: IT MIGHT, BUT THE WIDER QUESTION OF FINANCIAL ASSISTANCE FOR IRAQ WAS NOT ONE FOR HIS MINISTRY.

6. AL TURKI WAS UPBEAT ABOUT THE LIKELIHOOD OF IRAQ ABIDING BY ITS NEW QUOTA. HE KNEW THE PERSONALITIES WELL. THEY SEEMED GENUINELY CONVINCED THAT IRAQI INTERESTS WERE BEST SERVED NOW BY DISCIPLINE IN THE MARKET. AL TURKI DID NOT THINK THEY WOULD CHEAT WHEN THEIR NEW FACILITIES CAME ON STREAM, AND GOD WILLING THERE MIGHT BE A LITTLE EXTRA DEMAND AROUND AT THAT TIME TO ALLOW FOR A QUOTA INCREASE.

7. PLUMBLY MENTIONED RUMOURS THAT THE NEW UAE QUOTA DID NOT INCLUDE DUBAI PRODUCTION, OR THAT THERE MIGHT BE AN UNDERSTANDING WHEREBY THE UAE WOULD BE ALLOWED OUTPUT UP TO AROUND 1.3 MBD (PARA 6 OF TUR). AL TURKI DID NOT EXPLICITLY ACKNOWLEDGE THE EXISTENCE OF SUCH AN AGREEMENT, BUT SAID THAT PRODUCTION BY THE UAE AT SUCH A LEVEL WOULD BE UNDERSTANDABLE. THEY HAD A REAL REVENUE PROBLEM. THERE WAS, HE THOUGHT, SOME SLACK IN THE AGREED QUOTAS IN THAT ONE OR TWO COUNTRIES EG ALGERIA MIGHT BE UNABLE TO PRODUCE UP TO QUOTA.

8. AL TURKI SPOKE AS IF THE CONDENSATES ISSUE HAD BEEN FINALLY RESOLVED. A COMPLEX FORMULA HAD BEEN AGREED. ITS DIRECT EFFECT ON SAUDI ARABIA WOULD HOWEVER NOT BE GREAT.

9. AL TURKI DID NOT SEEM MUCH FOCUSED ON NON-OPEC PRODUCTION GENERALLY, BUT WAS SHARPLY CRITICAL OF THE NORWEGIANS. HE HAD SEEN THEM IN THE MARGINS OF THE VIENNA MEETING. THEY WERE FULL OF FINE WORDS, BUT THEIR PROMISED 7.5 PER CENT RESTRAINT ON PRODUCTION HAD MEANT NOTHING IN PRACTICE (THERE HAS BEEN AT LEAST ONE ARTICLE IN THE SAUDI PRESS ON SIMILAR LINES CONCERNING THE NORWEGIAN PERFORMANCE).

10. PLUMBLY ASKED WHAT AVERAGE OIL PRICE THE SAUDIS WOULD BE USING AS A BASIS FOR THEIR NEW BUDGET, WHICH IS DUE TO BE ANNOUNCED AT THE END OF THIS MONTH. AL TURKI SAID THAT THIS WAS A MATTER FOR THE FINANCE MINISTRY BUT GAVE IT AS HIS PERSONAL VIEW THAT THEY WOULD BE IMPRUDENT TO GO FOR A FIGURE IN EXCESS OF 15 DOLLARS A BARREL. ASKED ABOUT

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PROSPECTS FOR AN UPTURN IN THE OIL MARKET IN THE LONGER TERM, TURKI WAS NON-COMMITAL. THE UPTURN MIGHT NOT NECESSARILY COME IN THE EARLY 1990S (THE TIME OFTEN CITED HERE IN CONVERSATIONS.) A GREAT DEAL WOULD DEPEND ON THE RATE AND SUCCESS OF EXPLORATION CARRIED OUT BY NON OPEC PRODUCERS.

11. AL TURKI SAID LITTLE ABOUT SAUDI DOWNSTREAM OPERATIONS, WHICH DO NOT FALL WITHIN HIS AREA OF RESPONSIBILITY. BUT HE CONFIRMED - AS HAS HISHAM NAZER IN SEVERAL PUBLIC STATEMENTS RECENTLY - THAT MOVEMENT DOWNSTREAM WAS VERY MUCH THE TREND, IN THAT IT OFFERED THE KINGDOM A MEASURE OF REVENUE STABILITY. TALKS WERE IN TRAIN WITH JAPANESE, FRENCH AND ITALIAN COMPANIES, THOUGH IN NONE OF THESE CASES WERE THEY YET ANYWHERE NEAR A TEXACO-TYPE DEAL.

COMMENT

12. ON NEUTRAL ZONE OIL, THE US EMBASSY BELIEVE THAT SAUDI ARABIA WILL INDEED STOP THE OIL ARRANGEMENTS BUT WILL CONTINUE TO GIVE IRAQ AID IN OTHER WAYS.

13. MOST OF THE ABOVE WAS CONFIRMED BY MANIATO POULOS (ENERGY DIRECTORATE, EUROPEAN COMMISSION) AT A COMMUNITY BRIEFING FOLLOWING CALLS ON THE KUWAITI OIL MINISTER AND AL TURKI. MANIATOPOULOS ADDED THAT HE HAD RECEIVED THE IMPRESSION FROM HIS INTERLOCUTEURS THAT THERE EXISTED AN UNDERSTANDING BETWEEN THE MAJOR GULF PRODUCERS (IE EXCLUDING BOTH IRAN AND IRAQ) NOT ONLY THAT THEY WOULD INCREASE PRODUCTION IN ORDER TO MAINTAIN THE TARGET PRICE IF THE OIL PRICE ROSE ABOVE DOLLARS 18 PER BARREL, BUT ALSO THAT OPEC MEMBERS OR INCREASED PRODUCTION BY NON-OPEC COUNTRIES WOULD BE PUNISHED BY FLOODING THE MARKET IF THE PRICE FELL BELOW AN (UNSPECIFIED) LEVEL. THE AIM IN THE LATTER CASE WOULD BE TO MAINTAIN GULF OIL REVENUES.

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ADDITIONAL 43

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Ch,

I have confirmed with Sir PEM that he is content that this does not set a dangerous precedent. (DTI have from time to time answered questions along these lines).

OK
JF
21
M.

SECRET AND PERSONAL

CHANCELLOR

FROM: D J L MOORE

DATE: 6 DECEMBER 1988

cc Financial Secretary
Sir P Middleton
Mr Monck

PQs ON BP/BRITOLL FROM MR ALEX SALMOND MP

We have put forward to Parliamentary Section today draft Answers to a group of Questions from Mr Salmond aimed at finding out when we knew of BP's intention to buy shares in Britoil and, in effect, what advance knowledge we had of this.

2. Our drafts rest on the fact that we did not know of the BP Boards' intention before Tuesday 8 December when they made their dawn raid. While I am satisfied with this line, it could be probed subsequently and I would like to remind you of those discussions which did take place beforehand.

3. In the previous week BP spoke separately to me and to the Department of Energy. They wanted to know if we could say what would be the Government's attitude to their taking, initially, a non-controlling interest - say 10-20% - and then going on to bid for a controlling interest. These were hypothetical questions in that nothing had been put to the BP Board at that stage and no decisions had been taken as to whether they wanted to go ahead in that way.

4. On Thursday 3 December I discussed this first with Mr Gregson and Energy officials and then with Sir Peter Middleton. I reported the situation to you that evening.

5. On Friday 4 December you spoke to Mr Parkinson. Alex Allan told me that you had agreed that BP should be told that a) that it was up to them whether they went for a non-controlling interest and b) Ministers had not formed any view on the hypothetical question of what would be the Government's attitude if BP, or anyone else, tried to take a controlling interest.

1 am quite with Alex Allan (X with Mr Monck's background explanation) Salmond has no doubt set in motion this info on BP's intentions. Mr Salmond will confirm this to Mr.

6. I spoke to Mr Simon of BP accordingly on the morning of Monday 7 December. He took note. The BP Board was meeting that afternoon to decide what action, if any, to take.

7. The next we heard was on the morning of Tuesday 8 December when BP told us they were the dawn raider. They made this public at about 4.45 pm that day.

8. They announced their intention to make a full bid on the morning of 18 December. I told Simon of the Government's statement on the use of the Special Share immediately after it was released from here.

9. Against this background I am satisfied that we are fully justified in saying that we did not know of the BP Boards' intention before 8 December. I am also satisfied that while we knew of the possibility of their moving on Britoil there was no substantive discussion with BP.

pp

D J L Moore
D J L MOORE

FRIDAY 18 DECEMBER 1987

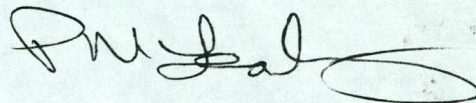
TREASURY

Scot Nat - Banff and Buchan

No. **MR ALEX SALMOND** : To ask
Mr Chancellor of the Exchequer, when he was first informed
of BP's intention to purchase shares in Britoil.

DRAFT REPLY

BP informed the Government of their intention to purchase
shares in Britoil on Tuesday 8 December.



P M LEAHY



D J L MOORE

MR ALEX SALMOND

BACKGROUND NOTE

This is one of a number of related questions about the Government's discussions with BP and other companies about Britoil.

The answer is self-explanatory.

FRIDAY 18 DECEMBER 1987

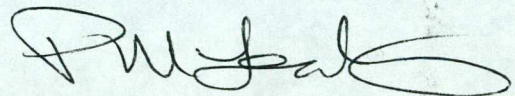
TREASURY

Scot Nat - Banff and Buchan

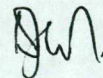
No. **MR ALEX SALMOND** : To ask
Mr Chancellor of the Exchequer, what discussions his Department
had with BP concerning that company's intention to purchase
shares in Britoil, prior to 8th December.

DRAFT REPLY

None.



P M LEAHY



D J L MOORE

MR ALEX SALMOND

BACKGROUND NOTE

This is one of a number of related questions put down by Mr Salmond.

BP did not tell the Treasury that it intended to buy shares in Britoil until 8 December when it made a dawn raid.

FRIDAY 18 DECEMBER 1987TREASURY

Scot Nat - Banff and Buchan

No. **MR ALEX SALMOND :** To ask Mr Chancellor of the Exchequer, what discussions his Department has had with private companies about the Government's policy towards using its special rights preference share in Britoil; and on what dates such discussions took place.

DRAFT REPLY

Ministers and officials have frequent contacts with private companies. It is not usual practice to give details of the timing or subject matter of such meetings.

The Government has publicly stated that in present circumstances it intends to use its Special Share in Britoil to prevent any bidder from gaining control of the Britoil Board.

P M LEAHY

D J L MOORE

MR ALEX SALMOND

BACKGROUND NOTE

This is one of a number of questions Mr Salmond has asked about Government discussions with companies about Britoil.

There have been a number of discussions in person and on the telephone between Treasury officials and BP and Britoil on this subject. But the answer assumes Ministers will not want to give away detailed information.

FRIDAY 18 DECEMBER 1987

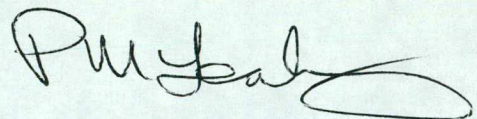
TREASURY

Scot Nat - Banff and Buchan

No. **MR ALEX SALMOND** : To ask
Mr Chancellor of the Exchequer, when he was first informed
of the intention of the Atlantic Richfield Company of Los
Angeles to purchase shares in Britoil.

DRAFT REPLY

The Government first learned of the Atlantic Richfield
Company's intention of purchasing shares in Britoil on Friday
11 December when a press release was issued.



P M LEAHY



D J L MOORE

MR ALEX SALMOND

BACKGROUND NOTE

This is one of a number of related questions put down by Mr Salmond about the Government's discussions with companies about Britoil.

The Government only found out that Arco intended purchasing shares in Britoil when a press notice was put out on the morning of Friday 11 December.

FOURTH DRAFT FOR FINAL APPROVAL

BP PRESS OFFICE

QUESTIONS AND ANSWERS RELATING TO BID

1) BRITTOIL - BACKGROUND

- Q1 What fields currently in production does Britoil have a share in?
- A1 Britoil has interests in 13 producing North Sea fields plus interests in the onshore **Humbly Grove** oil field (7.5 per cent) and the **MARGAM** gas/condensate field in Dubai (33.3 per cent). The producing North Sea fields are:- **Thistle** (oil, operator, 18.41 per cent), **Murchison** (oil, 25.9 per cent), **Deveron** (oil, operator, 15.95 per cent), **Statfjord** (oil, 5.3 per cent), **Dunlin** (oil, 9.77 per cent), **Ninian** (oil, 21.37 per cent), **Hutton** (oil, 22.17 per cent), **South Brae** (oil, 20 per cent), **Beatrice** (oil, operator, 28 per cent), **Clyde** (oil, operator 51 per cent), **Viking** (gas, 50 per cent), **Victor** (gas, 25 per cent) and **Sean** (gas, 25 per cent). Britoil's average daily UK oil production in 1986 was 172,000 barrels (7 per cent of UKCS production) as compared with BP's 484,000. UK gas production for 1986 was 247 million cubic feet per day in 1986 (6 per cent of UKCS production) compared with BP's 242 million.
- Q2 What fields does Britoil currently have under development?
- A2 Britoil currently has interests in three fields under development - **Audrey** (gas, 17.5 per cent), **V. Fields** (gas, 43.4 per cent) and **North Brae** (gas/condensate, 20 per cent). Britoil is also operator of the **Amethyst** field which has not yet reached Annex 'B' stage.
- Q3 What reserves does Britoil have? What exploration acreage will you gain access to?
- A3 All figures are 1986. Britoil had 578 million barrels. This compares with BP's 1,231 million UK reserves and 3,427 in the rest of the world.

Britoil had 2,835 billion cubic feet of gas reserves in the UK. BP has 3,456 billion cubic feet of UK gas with 5,009 billion elsewhere.

Britoil's net acreage in the UKCS was 7,513 square kilometres compared with BP's 7,967 (minor changes in 1987 due to UKCS relinquishments and additional licence awards). In the rest of the world Britoil had

*Ms Leahy
This is BP's Q & A brief,
See Q26 and 27 for the Special
Share,
Section 6 and Q29 on
Scotland is interesting.*

JW 18/12.

*cc PS/Chancellor
R/PST
R/PMC
R/EST
Sir P Middle
Mr Menck
Mr R/G Allen
Mr Williams
Mr Brown
Miss White*

some 27,995 sq kms compared with BP's 314,410, which includes all BP's interests in the USA.

2) CORPORATE

Q4 What is BP's view of the oil price over the medium and long term?

A4 BP still believes \$18 to be a price which both producers and consumers can live with. Following the recent OPEC meeting we expect volatility in the market. However, we would still hope for a \$18 average to be maintained over the medium and long term.

Q5 BP is already highly exposed to oil price fluctuations - won't the takeover of a pure upstream company merely add to your exposure?

A5 BP has a highly resilient upstream business where we have a good balance of assets. Our Alaskan production is sensitive to oil prices but our North Sea production is far less so. Moreover, BP has a sound downstream business which offers a substantial cushion against fall in earnings upstream.

Q6 Doesn't this move to buy reserves suggest that you have been less than successful at adding to reserves through exploration?

A6 This is not the case. BP is the third largest holder, amongst the oil majors, of proved oil and gas reserves in the world (as at end-1986). Over the last five financial years BP has virtually replaced its production through an active exploration programme and the level of our estimated net proved reserves of oil has not changed significantly while our reserves of natural gas, excluding undeveloped Alaskan gas, has increased substantially - up from 5,616 billion cubic feet in 1982 to 8,465 billion cubic feet in 1986 - mainly as a result of discoveries in the North Sea. BP has a major exploration programme worldwide and is currently exploring in 25 countries. Worldwide exploration spending last year totalled £624 million, of which £204 million was spent in the North Sea.

Q7 Is your pro-active move to acquire Britoil not partly an attempt to improve your standing in the financial markets and therefore help the Government out of a hole as far as the safety net is concerned?

A7 We are bidding for Britoil because we think it would be a good strategic acquisition. We made it abundantly clear during the recent Government Share Sale that we have a strategy of deepening our existing business portfolio through selective acquisitions. This move is simply an expression of that strategy. If the market sees the move as evidence of a strong, vigorous BP engaging 'in business as usual', that is an incidental benefit.

Q8 Is this the end of the British independent sector?

A8 Certainly not. Even without Britoil a strong and entrepreneurial independent oil sector will remain.

Q8 Are you intending to mop up any of the other independents?

A8 In the recent prospectus issued for the Government's BP share sale we said: "The current intention is to deepen rather than broaden the existing business portfolio through organic growth supplemented by acquisitions". Our current bid for Britoil is in keeping with this strategy. Let us acquire Britoil first before we think of further moves.

Q9 Is it not odd that this bid comes at the same time as the KIO's purchase of a large stake in BP and that you decided to announce the good news yesterday of higher Alaskan reserves?

A9 The KIO's holding in BP is a long-term investment of an institutional nature. There is no connection of any kind with our bid for Britoil. As to the Alaskan reserves, we have an obligation to disclose revisions of this kind and the timing of our announcement was coincidental.

Q10 Bearing in mind that the KIO is such a large shareholder, can you really call yourself a British company in the context of this bid?

A10 The KIO has substantial holdings in a large number of British companies, including, for instance, The Royal Bank of Scotland. These are institutional investments which do not alter the nature of the companies involved.

3) COMMERCIAL

Q11 What is the price per barrel BP will be paying for Britoil's reserves under this offer?

A11 On the basis of Britoil's annual report for 1986 the cost per barrel of oil equivalent would be in the region of £2.00 at the bid price of £4.50. But there are so many variable factors in this area that such a crude calculation is largely meaningless.

Q12 After saying that you were making only a 29.9 per cent investment, why are you now making a full bid?

A12 Circumstances and market conditions have changed since we announced our intention to acquire 29.9 per cent. It would not be ideal for us to sit with a large investment in a company in which a competitor also had a substantial holding. The proposed purchase of Britoil is in line with our long-term strategy which, in the upstream area, is to add to reserves by acquisition as well as through exploration. We believe that, at the price we are

offering, the addition of Britoil's assets to our portfolio is a sensible step.

Q13 Have you had any communications with Britoil since you informed them of your 14.9 per cent shareholding?

A13 As we said in our press release announcing our 14.9 per cent holding, we have asked for discussions with Britoil. But so far no talks have been held.

Q14 Why, in detail, do you consider Britoil's assets are a good fit with yours?

A14 Britoil's assets would considerably strengthen BP's gas position in the southern North Sea. In the northern North Sea, Britoil would bring more oil production in an area where we are comparatively under-represented. Britoil has over 20% in the undeveloped Bruce field which BP operates, with a similar stake. Britoil has a wide spread of UKCS exploration acreage which complements BP's (Britoil - 7,513 sq km, BP - 7,967 sq km). In summary Britoil's assets would strengthen BP's gas reserves and production and complement existing UKCS oil production. The large UKCS exploration acreage held by Britoil would enable BP to pursue an active programme of exploration over a wider area of prospectivity.

Q15 Why do you think you can bring more value to Britoil's assets than its present management which seems to have negotiated a very beneficial deal with ARCO?

A15 BP has great financial strength in the international market and has a proven and successful record of finding and developing oil and gas reserves. Being a fully integrated oil company with extensive downstream interests BP has proven itself capable of riding the oil price fluctuations without having to adopt a stop-go approach to its North Sea exploration and development programme. This ability to ride the peaks and troughs and stay on course pursuing an active exploration programme can best be illustrated by the industry's reaction to the dramatic fall in oil prices during 1986.

BP spent £204 million on UKCS exploration and appraisal in 1986 compared with £178 million in 1985. In contrast, on a similar amount of acreage Britoil was forced to cut its UK exploration and appraisal budget from a high of £156 million in 1985 to £87 million in 1986 - this was a direct result of the company's exposure to low oil prices and the consequent effect on cash-flow. Further cutbacks have been made this year. It would be BP's intention to pursue a more vigorous exploration programme on the acreage it acquires at a level more appropriate than that pursued by Britoil. In 1986 Britoil was operator for eight exploration and appraisal wells on its acreage compared with BP's 20 exploration and appraisal wells. We would expect this increase in exploration expenditure, coupled with the track record and financial and

operational strength of BP, to result in a more effective exploitation of Britoil's assets.

- Q16 Would the acquisition of Britoil extend your production profile - if it does not, why are you buying?
- A16 BP regards the acquisition as good business and a good strategic fit which adds to current production and future reserves. We would obviously hope that our proposed increase in exploration activity on the Britoil acreage would lead to development projects.
- Q17 Why are you buying more production in what is a high-cost area, ie the North Sea?
- A17 BP has a well-balanced portfolio of reserves. However, it is generally acknowledged that most of the large fields in the North Sea have already been discovered. However, BP still continues an active exploration programme in the area as we believe it to be a highly prospective and politically stable, albeit mature oil and gas province. There are no 'low cost' oil provinces outside the Middle East but BP has a good track record of making so called 'high cost' provinces commercial. Britoil has a balanced spread of reserves and acreage which would be mid-way in terms of development costs but not the highest by any measure.
- Q18 What makes you think that you could bring Britoil's discoveries into production more speedily and efficiently than they can?
- A18 BP has the management structure, financial strength and technical expertise to optimise Britoil's discoveries without the delays imposed by cash flow and cash shortage problems which have curtailed the company's development programme in the past.

The following is an extract from Britoil's 1986 Annual report which talks about the 'corrective action' taken in response to the oil price fall:-

"Your company (Britoil) remains in the Exploration and Production sector of the market and was not able to take advantage of an increase in profits in the downstream area. We could, therefore, only confine our corrective actions to our upstream activities. Firstly, every attempt has been made to cut overhead expenses. In particular, it has made us implement our plan more quickly to reduce over-manning. one third of the staff have been made redundant, including many good men and women, who will be greatly missed. I would like to pay tribute to the excellent work that they did for us and I am glad to say that we have heard that many have obtained worthwhile alternative employment. Owing to the payment of compensation, these economies will not be felt until 1987. Secondly, exploration expenditure was cut from £214 million in 1985 to £115 million in 1986. While

further economies should not be made on the same scale in future years, in the serious circumstances through which we passed in 1986 conservation of cash became of over-riding importance."

BP is an integrated oil company less exposed to oil price fluctuations. Constraints such as these listed by Britoil will not be of such importance in deciding the speed and type of developments pursued.

Q19 How does your recent North Sea exploration spending compare with Britoil's?

A19 BP's UKCS exploration and appraisal capital expenditure for 1986 was £204 million compared with £178 million in 1985.

Britoil's was £87 million compared with £156 million in 1985. Both companies have roughly the same amount of UKCS acreage.

Q20 Britoil's lack of success in the US has been mentioned by some commentators - but hasn't BP also experienced huge write-offs in the US in 1985 and 1986?

A20 What Britoil bought in the US was mainly production which the company later sold at a substantial loss. The US write-offs you refer to in connection with BP related to exploration acreage and were in fact made by Standard Oil before BP bought out the Standard minority and gained effective control of the company.

Q21 Do you believe, as some commentators have suggested, that Britoil lacks the experience to develop as an international oil company?

A21 Some 95 per cent of Britoil's assets are currently in the UK so we believe that the company's stated intention to have half its assets overseas by the year 2000 looks rather ambitious. Bear in mind that in its earlier annual reports Britoil expressed the hope of realising this ambition by 1990.

Q22 Was not Britoil as quick and effective as BP in its reaction to the fall in the oil price in 1985-86?

A22 As a pure upstream company, Britoil's reaction to the oil price drop was, of necessity, sudden and severe. Many other companies had to act similarly. Staff was reduced by a third, total worldwide exploration spending fell from £214 million in 1985 to £115 million last year (North Sea: £156 v £87) and the company said that further conservation measures were necessary. BP, by contrast, reduced its exploration spend worldwide from £986 million in 1985 to £624 million in 1986 but increased its North Sea spend from £178 million to £204 million. Plainly,

therefore, the oil price drop had a more dislocating effect on Britoil than on BP.

4) ARCO

Q23 Are you going for a full takeover at this time because of ARCO's intervention, or would you have made a bid anyway?

A23 Clearly, the intervention of ARCO was a factor in the decision to bid at this time.

Q24 Is not this apparent battle between BP and ARCO merely an elaborate facade to cover a carve-up of Britoil between the two of you?

A24 Absolutely not. There has been no collusion whatever between ourselves and ARCO.

Q25 Why has ARCO come in as a white knight?

A25 That is a question you must ask them.

5) GOLDEN SHARE

Q26 Have you asked, or are you asking, for the golden share to be removed?

A26 We plan to enter into discussion with the government on the future role or status of the golden share in the event of our offer being successful. It would be wrong to speculate further at this stage.

Q27 What happens if you acquire all the equity and the golden share is not removed?

A27 That is a hypothetical question - let us wait and see.

6) SCOTLAND/JOBS

Q28 What will happen to the Britoil board if your bid is successful - will you invite any of them to join BP?

A28 That is a matter that we will consider if the bid is successful.

Q29 What are your plans for Britoil and its Glasgow headquarters?

A29 If the bid succeeds, Glasgow will become the business headquarters and decision centre of BP's entire UK oil and gas exploration and production business. The chief executive of that business and his staff will be based in St Vincent Street in Glasgow. Aberdeen will continue as operations HQ.

In our exploration and production business we do not expect that overall employee numbers in Glasgow and Aberdeen - taking BP and Britoil together - will fall as a result of the acquisition.

Q30 You have just made a general statement of your intentions - can you please spell out your plans for Britoil and its staff in more detail?

A30 At this early stage, when all we have done is to announce a bid, we cannot give precise answers to questions like this because we do not know enough about Britoil's detailed organisation and resources to say how it would be integrated into BP.

As a matter of policy, Britoil employees who join BP Exploration will in no way be regarded as second class citizens but will be treated on an equal footing with existing BP staff as far as career opportunities are concerned.

Q31 Will you recognise APEX in the new Glasgow centre?

A31 BP works with numerous trade unions. However, it is too early to talk in detail yet but we would approach relations with APEX on the same basis as we do with other trade unions.

Q32 If you decide to make Glasgow your UK centre for BP Exploration does this make economic sense - are you not just doing it for political reasons?

A32 We would not be making this acquisition if it did not make economic sense. In this overall context, establishing Glasgow as our UK oil and gas production headquarters and decision-making centre is logical. The acquisition of Britoil's assets puts BP's UK operations into a different activity league which requires a separate headquarters with a separate identity. This is what the Glasgow headquarters will provide.

Q33 How would your London staff react to moving to Glasgow, especially since some 300 of them are still in the process of moving from Aberdeen to London?

A33 At this stage it has not been decided which BP staff would move to Glasgow, but they would most likely be professional and technical staff who expect to move about frequently in the course of their careers.

Q34 Won't the move to Glasgow create all kinds of communications problems for you?

A34 We are an international oil company used to communicating around the world. Communicating with Glasgow should cause no problem.

Q35 What is BP's commitment in Scotland at present?

- A35 BP has been firmly established in Scotland since 1919 when the Anglo Persian Oil Co. acquired Scottish Oil Ltd. Today BP employs over 6,000 people in Scotland and has assets representing an investment of well over £6,000 million in today's money over 75 per cent of which is tied up in oil and gas development.

All of BP's major business streams are represented in Scotland with Exploration and Production activities employing some 3000 people, refining and marketing with some 1,550, Chemicals with some 1,250 and Detergents, Nutrition, Scicon, Minerals, Shipping and BP Ventures employing the rest. BP has its major UK refinery at Grangemouth where it also has a major chemicals plant. More than 48,000 tonnes of bulk blended detergent products are produced at the company's Pumpherston works whilst a £3 million plant at Invergordon produces fish feed for the growing fish farming industry.

BP also maintains a small office in Edinburgh which ensures the Scottish dimension of BP's activities is fully recognised and understood throughout the group. The office is also responsible for initiating and co-ordinating a large part of BP's community programme in Scotland, including education and community project work, sponsorships and donations. The company plays an active role in supporting education and the arts and in encouraging local community and enterprise projects.

- Q36 If you are so committed to Scotland and its economy why are you in the process of moving some 300 highly skilled jobs from Aberdeen to London?
- A36 BP decided to move these staff purely for operational reasons and to create a technical centre in order to increase efficiency and enable it to bring a number of North Sea prospects through to development at a quicker pace than would otherwise have been the case. Over the next few years BP hopes to develop two major North Sea fields - Miller and Bruce. Both of these will create jobs and increase activity in the Aberdeen area.

7) FINANCIAL

- Q37 Can you spell out details of BP's performance, relative to Britoil's, over the period since it became a public company, ie share growth, dividend, p/e ratios etc?
- A37 In terms of share price, since the end of 1982 when Britoil was floated, BP has outperformed the All-share Index by 15 per cent while Britoil has under-performed it by 55 per cent.

If you look at earnings per share, Britoil has shown a drop of 81 per cent from 1983-1986 (inclusive) while BP has fallen six per cent over the same period. In both cases the fall in earnings per share occurred in 1986

over 1985 - Britoil was down 87 per cent, compared with a BP fall of 49 per cent - a reflection of the oil price drop which had a bigger impact on Britoil as a pure upstream company.

As for dividend growth, BP has shown an increase of 46 per cent over the four years 1983-1986, compared with minus 20 per cent for Britoil.

- Q38 Do you think it fair to compare BP's performance with that of a company which became public only in 1982 and whose share price has clearly been held back by the existence of a golden share?
- A38 We think it is perfectly fair for shareholders to compare the performance of companies in the same sector. The effect of the golden share is a matter of opinion.
- Q39 Won't BP's gearing increase to unacceptable levels if you acquire Britoil - and will you consider doing a rights issue to bring it down?
- A39 No, our gearing will remain at a level which we consider acceptable - much lower, for example than the level reached following the acquisition of Standard Oil. We do not intend making a rights issue in connection with the Britoil acquisition.
- Q40 The market is suggesting that your offer price of 450p per share undervalues Britoil's assets - how do you respond to that?
- A40 We consider this to be a very reasonable offer.
- Q41 Why are you now prepared to pay 450p a share when your recent tender offer represented only £3 a share?
- A41 We are offering 450p a share because that is what we believe we need to offer to acquire the company.
- Q42 Will you increase the offer price or vary its terms?
- A42 No comment. (Note: Under no circumstances must any comment be made on the possibility of increasing the price or varying the terms, since any such comment would jeopardise our position with the Take-over Panel.)

8) POLITICAL

- Q43 Won't this takeover, if successful, lead to too great a concentration of North Sea assets in the hands of BP?
- A43 If the assets were combined BP/Britoil UKCS reserves would be 1809 million barrels of oil and 6291 billion cubic feet of gas, based on end 1986 reserve figures. We will still not be the largest holder of reserves in the UKCS nor the largest producer.

In exploration acreage terms the BP/Britoil total would be some 15,480 square kilometres which represents c.15 per cent of the total UKCS licenced acreage.

Q44 Do you really consider that your acquisition of Britoil would advance the national interest?

A44 As we say, BP believes it can explore for and develop the Britoil reserves quicker and more effectively than they can. Such accelerated activity will enable BP to maximise resources and create employment and opportunities in the support sectors and the Scottish economy as a whole.

Q45 Do you expect your bid to be referred to the Monopolies and Mergers Commission - if it is, how will you respond?

A45 Oil is demonstrably an international business, with the UK North Sea representing less than five per cent of world production and BP and Britoil combined accounting for just 20 per cent of UK output. If it were to be referred, we would, of course, co-operate fully with the MMC.

Q46 What happens if it is referred?

A46 If it is referred, then the offer will lapse.

Q47 What is the Department of Energy's attitude to the concentration of assets in the North Sea?

A47 You must ask the Department of Energy. But the combining of these assets will bring many benefits for North Sea development enabling a more active exploration and accelerated development programme.

Q48 What will you do if there is Scottish devolution?

A48 BP already has the bulk of its UK assets in Scotland, so even without the Britoil assets devolution would be a relevant issue if it arose. In general, BP works within the political environment which prevails in each of its operational areas - the same would be true of a devolved Scotland.