

8 Conclusions

Introduction

8.1. We are concerned in this reference with the acquisition by the Kuwait Investment Office (KIO), an agency of the Government of Kuwait, of some 21.6 per cent¹ in The British Petroleum Company plc (BP). The shareholding was built up during the autumn and winter of 1987-88 in circumstances which are described in Chapter 2.

The terms of reference

8.2. Under the terms of the reference, which was made on 3 May 1988, and the relevant sections of the Fair Trading Act 1973 (the Act) we are required to investigate and report whether a merger situation qualifying for investigation has been created, in that enterprises carried on by or under the control of BP (a body incorporated in the United Kingdom) have, at a time (ie not earlier than six months before the date of the reference) or in circumstances falling within section 64(4) of the Act, ceased to be distinct from enterprises carried on by or under the control of the Government of Kuwait. If we find a merger situation we have to consider whether the creation of the situation operates, or may be expected to operate, against the public interest.

8.3. The reference also includes the condition, specified in section 64(1)(b) of the Act, that the value of the assets taken over (ie BP's) exceeds £30 million. The condition is fulfilled (see Appendix 4.3). The reference excluded from our consideration the market share test in section 64(1)(a).

The merger situation

8.4. It follows from section 65 of the Act that when a person or group of persons (which expressions comprehend the Government of Kuwait) are able, directly or indirectly, to control or materially to influence the policy of a body corporate but without having a controlling interest in that body, enterprises carried on by that person or group of persons and that body corporate may be treated as being under the control of that person or group of persons and cease to be distinct.

8.5. We are concerned with the ability to control or materially influence the policy of BP. For a finding that a merger situation qualifying for investigation has been created, it is not necessary for there to be evidence that control or material influence has been exercised or even whether, at a particular time, it is intended that they should be exercised. Material influence is not defined in the Act; consequently the particular circumstances of each case where it may arise have to be considered.

8.6. Prior to the reference the Government of Kuwait, on behalf of the State of Kuwait, the beneficial owner of the shares held by KIO, gave certain assurances (paragraph 2.6) to the United Kingdom Government (HMG) about KIO's intentions in relation to the shares. We consider the effect of these assurances on the public interest later in this chapter. While we do not doubt the intentions of the Government of Kuwait to carry out its assurances, they have no legal effect. In the circumstances explained in the preceding paragraph, the assurances did not affect the ability of the Government of Kuwait at the date of reference to seek to exercise material influence on BP.

¹ (a) 21.68 per cent at the date of the reference.

(b) The percentage has fallen slightly to 21.61 per cent on 28 July 1988 due to shares issued in association with a share dividend plan and BP's acquisition of Britoil plc.

8.7. We therefore have to determine whether, in the six months ending on 3 May 1988, a merger situation qualifying for investigation was created, by reason of the holding of some 21.6 per cent of BP's shares being sufficient to give the Government of Kuwait the ability, if it so desired, either to control or materially to influence BP's policy. We are satisfied (paragraph 8.1 and Chapter 2) that the holding was built up to that figure during this period. We would add that we are advised and accept that our conclusion as to whether a merger situation has been created should not be affected by developments subsequent to the date of the reference.

8.8. Control or material influence arising from the ownership of shares can be exercised directly through the general meetings of the company or indirectly, by procuring the appointment of directors, or in the case of material influence by the effect of the existence of the shareholding on the Board and management of the company.

8.9. BP told us that in the past United Kingdom institutions had declined to exercise their vote, and the vast majority of non-HMG votes cast in person or by proxy had been by individuals. The size and nature of other holdings is an important factor in assessing the ability of a large shareholder to control or materially to influence the policy of a company. We have examined the composition of shareholdings in BP and the position is summarized in paragraphs 4.13 and 4.14 and at Appendices 4.1 and 4.2. One result of the share offer in October 1987 was a significant increase in the number of separate shareholdings to nearly 660,000. By April 1988 individuals comprised 95 per cent of all shareholders but they held only 18 per cent of the shares. KIO's holding of some 21.6 per cent (1,315.75 million shares) was over 12 times the size of the next largest beneficial shareholding, Prudential Assurance, which has 1.8 per cent followed by HM Treasury which now has 1.7 per cent.

8.10. Another factor to be taken into account in the case of companies with shareholders in a number of countries is the nationality or country of residence of those shareholders. Foreign shareholders are less likely to attach importance to matters which may affect United Kingdom interests. There are large holdings in BP in the name of nominee companies (which include a large proportion of the KIO holding) and the nationality of the beneficial owners behind some of the smaller nominee holdings cannot easily be determined. BP has told us that some two-thirds of its shares are held by United Kingdom residents with the next largest group (apart from KIO) being over 5 per cent held by residents of the United States of America in the form of American Depositary Shares.

8.11. Also to be taken into account is the extent to which shareholders attend company meetings or appoint proxies. BP has provided us with information on attendance and proxy voting at Annual General Meetings and Extraordinary General Meetings over recent years. This indicates a low personal attendance and an average proxy pattern in the years 1984 to 1987 prior to the restructuring of capital in October 1987 of some 13 to 14 per cent (excluding HMG) of the total eligible votes. At the April 1988 AGM, after the restructuring, the votes represented by proxies given related to approximately 700 million out of a total of just over 6,000 million issued shares, or about 12 per cent. KIO attended the 1988 AGM but did not submit proxy forms; had it done so it is clear that its votes at 1,315.75 million would have been nearly double all other proxies submitted and it would have had around 65 per cent of the total proxy vote.

8.12. Under BP's Articles of Association KIO as the holder of more than 10 per cent of the total voting rights, would be able to require a poll in relation to any resolution put to a general meeting. KIO would also, if it wished, by virtue of its holdings of over 10 per cent of voting capital, be able to requisition Extraordinary General Meetings. In view of the recent restructuring of BP's capital we have only limited evidence of current voting patterns but it appears that on the basis of the historic proxy count patterns, set out in the previous paragraph, KIO with some 21.6 per cent of the shares would have a substantial majority of the proxy votes typically submitted to general meetings. This would give the

Government of Kuwait a substantial degree of power. It would, in practice, have the near certainty of an ability to defeat Special Resolutions which require a minimum of 75 per cent of the votes cast, and, on the basis of past practice, carry its own Special Resolutions with the support of a third of the other proxy votes. Ordinary resolutions require a simple majority of votes cast and Kuwait would be in a very strong position to have its way in relation to all such resolutions (including those it proposed). In addition the existence of the holding would at all times create uncertainty for the Board of BP and give the Government of Kuwait significant negative power.

8.13. It was put to us by HMG and BP that KIO's voting powers, if they were used, would have considerable effect on the ability of the Board of BP to manage the company. We understand that KIO's powers would enable it to block resolutions relating among other things to the approval of dividends, alterations to borrowing powers, increases in share capital, the approval of substantial acquisitions, the adoption of accounts and the appointment of directors. The voting power would also enable the Government of Kuwait to procure the appointment of directors of its choice.

8.14. Kuwait told us that it considered the historic voting pattern did not provide a reliable indicator of the position that would arise if, despite its assurances, it attempted to exercise its voting rights in a way that was contrary to the expressed views of the management of BP. In these circumstances Kuwait suggested the BP Board could expect to obtain much more support from other shareholders and this would enable the Board to command the requisite majority.

8.15. We believe that, in the particular circumstances of BP, it is probable that its Board could obtain support from some United Kingdom shareholders to oppose actions which could be seen to be possibly contrary to the interests of the United Kingdom. But it is doubtful whether the level of support could be sustained over the longer term. It is also unlikely that BP's Board would wish to allow its management to be subject either to the pressure of a large shareholder such as Kuwait, or to the uncertainty that would follow disagreement between Kuwait and the Board of BP. It is probable, therefore, that at some point in time the pressure and uncertainty would lead BP to seek some form of accommodation with Kuwait or its representatives.

8.16. Having considered the factors previously set out in this chapter and the arguments of the parties, we are satisfied that at the date of the reference the shareholding of some 21.6 per cent gave the Government of Kuwait the ability to exercise material influence on the policy of BP. Influence at the level of a 21.6 per cent shareholding falls short of the ability to control policy. We believe the shareholding would have been sufficient to allow the Government of Kuwait in the future to procure or influence the appointment of directors to the Board. We consider that a shareholding of 21.6 per cent would, in the absence of any other large shareholdings, have been sufficient to allow the Government of Kuwait to ensure that the Board of BP and its senior management would have regard to the interest and wishes of Kuwait before finalizing any major decisions. The extent of influence would have been likely to ensure that in the future on many matters BP's policies would reflect those indicated as desirable by the Government of Kuwait. Its holding would have put it in a very strong position to tip the balance if differences arose between shareholders.

8.17. We therefore conclude that in the terms of section 65(3) of the Act, enterprises carried on by or under the control of BP and of the Government of Kuwait ceased to be distinct from each other and that consequently a merger situation qualifying for investigation has been created.

The background to the merger situation

8.18. We have been concerned in this reference with an unusual merger situation concerning two major participants in the international oil market. In order for us to consider the public interest issues it has been necessary for us to take account of their history, the Government of Kuwait's intentions in relation to its shareholding and the present state and foreseeable future of the oil market.

8.19. BP was founded in 1909 to exploit the first discovery of oil in Iran. In partnership with another oil company it discovered oil in Kuwait in 1938 and production was started in 1945. For many years BP was a major producer of crude oil from the Middle East but as the host governments, including Kuwait, nationalized BP's interests, its involvement in the Middle East was reduced. Over 90 per cent of BP oil is now produced outside the Middle East, largely in the United States and the United Kingdom. BP is the largest producer of oil and holder of oil reserves in both the United Kingdom and United States.

8.20. BP has significant downstream activities in the United Kingdom and elsewhere in the world; it has diversified into many other activities including chemicals and minerals, and it claims to be the largest animal feed producer in the world.

8.21. Kuwait has a long history of association with the United Kingdom, but during the period of the British Protectorate from 1899 to 1961 was responsible for its own internal government. For many years the revenue from oil exploitation has been a fundamental feature of the Kuwait economy. Kuwait told us that it has always been concerned that its oil revenue should be used in a responsible way for the benefit of present and future generations of its citizens and in particular to ensure that the country continues as a modern state when, eventually, domestic oil reserves are exhausted. To this end at least 10 per cent of the State's revenues, including those from oil, must be paid each year into a 'Fund for Future Generations'. No distribution can be made from the fund until a special law is passed permitting such distribution, and Kuwait told us it is not intended to pass such a law until at least the beginning of the next century.

8.22. Most of the investments of the State of Kuwait are handled by two investment agencies, the Kuwait Investment Agency (KIA) located in Kuwait, and the Kuwait Investment Office (KIO) located in London. The current value of the investments is unknown; it is understood to be well in excess of £50 billion. The revenue from the investments, which is largely reinvested, is now of considerable importance to Kuwait. Given the current relatively low price of crude oil and Kuwait's present low level of production, Kuwait's investment revenues are at least equal to its oil revenues. Although KIO is subordinate to KIA it appears to have a significant degree of autonomy (paragraphs 3.16 to 3.20), and Kuwait told us that, from its London base, KIO invests in all parts of the world and manages large international investments.

8.23. Kuwait was a founder member of the Organisation of the Petroleum Exporting Countries (OPEC) and has taken, and continues to take, a major part in the deliberations of that organization and in its pricing and quota arrangements (paragraphs 5.22 to 5.24, 5.31 and 5.32). In addition to its own domestic oil production Kuwait, through its state-owned oil company, the Kuwait Petroleum Corporation (KPC) (paragraphs 3.4 to 3.13), has growing interests in crude oil production and downstream activities on a world-wide basis.

8.24. We are therefore concerned with two parties which, after close historical connections, are now both major participants in the oil industry as producers of oil and in downstream activities. Since BP's concession in Kuwait was nationalized in the 1970s, and following the ending in 1979-80 of supply contracts between the parties, there has been only limited commercial contact.

**The circumstances
surrounding the merger
situation**

8.25. We have explained in Chapter 2 the events that led up to the present situation. The sale of HM Treasury's shareholding in BP shortly after the collapse of the stock markets in October 1987 provided the opportunity for KIO to acquire a large number of BP shares at prices which, KIO told us, it considered to be advantageous for long-term investment.

8.26. During later stages of the period when the shares were being acquired there were a number of contacts between representatives and Ministers of the United Kingdom and Kuwait Ministers. From the accounts we have received of these meetings it appears that HMG did not question the principle of the acquisition of the shares but, as the size of the holding that was being built up became evident, it indicated its concern at the number of shares that were being acquired. For its part, the Government of Kuwait, while it gave assurances that it would neither seek to influence BP's management save in a quite exceptional case nor immediately to procure the appointment of Directors to the BP Board, would not give any assurances on the level of shares that were to be acquired and did not exclude the possibility of purchasing up to 29.9 per cent of the share capital.¹

8.27. BP told us it had hoped and expected that as a result of the arrangements that were made for the sale of HM Treasury's shares to a very wide range of shareholders in the United Kingdom and abroad, no single shareholder would exceed 5 per cent, and BP was therefore very concerned at the build-up of shares by KIO. This concern does not appear to have been expressed directly to the Government of Kuwait or to KIO. BP explained that in its public pronouncements it had to be concerned to reassure its shareholders and staff, rather than indicate strong opposition to the shareholding.

8.28. We are satisfied, however, that the Government of Kuwait could have been in no doubt that the increasing size of its holding was unwelcome to the United Kingdom Government.

8.29. We are therefore considering a merger situation in which the investment arm of a sovereign state, which is a major oil producer, actively and increasingly involved in all areas of the oil industry, took the opportunity provided by market circumstances to acquire a significant share in one of the world's largest oil companies. The shareholding continued to be built up despite the expressed concern of the United Kingdom Government which had sold its own large shareholding partly in order to release BP from any possibility that it could be perceived as being under the influence of government and not completely free to act in a commercial manner.

**Kuwait's intentions towards
the shareholding**

8.30. Kuwait explained that although BP operated in the oil industry, in which Kuwait has substantial interests (principally through KPC), the BP shareholding was not bought for that reason. The shareholding was bought because it was regarded as a valuable investment which, because of the circumstances surrounding the sale of HMG's share, was available at a low price and enabled a significant holding to be acquired without affecting the market price. The officers of KIO who made the decision had no responsibility for or connection with the oil interests of Kuwait. Kuwait explained that the majority of the KIO investments were purely portfolio investments. There were, however, a few other investments where, because of special circumstances or because of the relative size of its shareholding, KIO took an active part in the management of the company. These it described as direct investments. Kuwait told us that the shareholding in BP was a portfolio investment and therefore would not be used in order to further any policy or interest of Kuwait or any competitive interest of KPC.

8.31. The Government of Kuwait repeated to us the assurances given to HMG; it would seek neither to interfere with the management and policies of BP nor to procure the appointment of directors to the BP Board.

8.32. Towards the end of our inquiry the Government of Kuwait told us that, while it regarded itself as already completely bound by the assurances it had given to the United Kingdom Government and the Commission, it was anxious to take any reasonable steps to reassure the Commission and the outside world that the holding in BP was only a portfolio investment and would not result in any effects on BP which would be adverse to the public interest. The State of Kuwait therefore executed a Deed on 8 August 1988 which is set out in full in Appendix 7.1.

¹ 30 per cent is the level of holding beyond which a full offer is required by the rules of the Stock Exchange.

8.33. The provisions of the Deed are somewhat wider than previous assurances. They can be summarized as follows:

- (a) the State of Kuwait holds and will hold any interest that it now has or may acquire in the issued voting share capital of BP for investment purposes only and will not use any interest in BP's issued share capital to further any interest of the State of Kuwait other than its interest as an investor;
- (b) the total interests of the State of Kuwait in BP will not exceed 21.68 per cent of the issued voting share capital of BP;
- (c) if the State of Kuwait disposes of any of its present holding it will not acquire any further interest in the issued share capital of BP which would take its total to more than 20 per cent;
- (d) at any general meeting of BP the State of Kuwait will not vote more than 14.9 per cent of the total voting rights of all the members of BP having a right to vote at such meetings; and
- (e) the State of Kuwait will not propose nor procure the proposal of any person as a director of BP or vote against the election as such director of any person who is proposed for election by the Board of BP.

We should also say that, very late in the inquiry, after the execution of the Deed, a further undertaking was put forward, that the State of Kuwait was prepared to say that, if the Commission found that KIO's holding in BP did not operate against the public interest, then the State of Kuwait would elect for cash rather than the share alternative on the occasion of each of the company's dividends, and would decline to take up its rights to any other shares offered by BP, until such time as (and to the extent required that) KIO's holding fell below 20 per cent. We were asked to take this proposal into account in reaching our conclusions and have done so.

8.34. The Deed was expressed to be made between the State of Kuwait and the Secretary of State for Trade and Industry but was executed only by a representative of the Government of Kuwait.

8.35. The Department of Trade and Industry, on behalf of the Secretary of State, were informed, by the solicitors acting for the Government of Kuwait, of the terms of the proposed Deed. In reply, the Department explained that, in view of the Secretary of State's statutory powers and duties and his wider parliamentary responsibilities, he had been advised that he could not accept any legally binding undertakings proffered by a party under investigation by the Commission at a time when the reference was still in progress and before the report was to hand; the Secretary of State had also been advised that the efficacy in law of what was proposed was not entirely beyond doubt. Following the execution of the Deed on 8 August, the Department indicated to the solicitors that the Secretary of State, while acknowledging the bona fides of the State of Kuwait and making no judgment on the merits of the individual covenants contained in it, felt unable to accept and formally disclaimed the Deed.

8.36. The Government of Kuwait informed us that in the event of the Commission relying on the covenants in any conclusions in the report it would remake the Deed.

8.37. We believe that the provisions of the Deed and the statement in the preceding paragraph represent a genuine attempt by the Government of Kuwait to set out its present intentions in relation to its shares in BP, and we have borne this in mind in considering our conclusions. However, while fully accepting the good faith underlying the Deed's execution we feel that we can give it only the weight which attaches to an indication of present intent on the matters provided for in it. Quite apart from any question of the Secretary of State's willingness or unwillingness to accept any obligations under the Deed (or a future Deed), we are advised and consider that there would be substantial legal and practical difficulties as regards its enforceability and enforcement, if this should ever prove necessary, a contingency which we are bound to consider in respect of the longer term. We have had to take this aspect into account in considering the public interest issues below and we refer to this further in paragraph 8.119.

8.38. This is not to suggest that we in any way doubt the intentions of the present Government of Kuwait to abide by the provisions of the Deed, whether or not they are enforceable. But circumstances and times do change and sovereign states have very wide interests and considerations to take into account. At some time in the future a different Government of Kuwait under different conditions could well, we believe, see its responsibilities in a way which would be inconsistent with continued compliance with those provisions. We return to this point more specifically below but it is one which, in conjunction with the question of enforceability, we regard as relevant in considering our approach to the Deed or the future Deed which has been suggested.

8.39. As a general matter (but not one which we have taken into account in reaching our conclusions) we question whether, apart from problems such as have been mentioned above, it can be wholly satisfactory for arrangements, intended to be taken into account by the Commission in a current inquiry while being enforceable in the indefinite future, to rest on an instrument executed without reference to or prior negotiation with the person who is intended to be in a position to enforce this instrument. The approach is to be contrasted with the process of consultation with relevant parties which is contemplated, in another context, in section 88 of the Act, where the Director General of Fair Trading is requested to obtain undertakings from them.

**Kuwait's investment policies
and practices**

8.40. As we have explained, Kuwait is investing in two ways: through KIA and KIO in a widely diversified range of companies in many parts of the world; and directly in the oil industry through KPC. Our examination of the investment practices of KIO and KIA was somewhat handicapped by the reluctance of the Government of Kuwait to provide us with much information on its present investments (paragraph 3.18). From what is publicly known, and from information which was provided by Kuwait, it appears that in relation to those of its investments, known as portfolio investments, KIO adopts a low profile with minimal or no interference in the company's affairs.

8.41. Apart from the portfolio investments KIO has a few shareholdings in companies where it has taken an active role in the management. These include, in the United Kingdom, the St Martins Property Corporation, perhaps the best known non-oil company wholly owned by KIO, and The Hays Group, in which it holds a 25 per cent interest, which sold its bulk petroleum distribution operation to KPC, and which has been responsible for the building of a large office complex near London Bridge financed by KIO.

8.42. KIO has recently made a number of investments in Spain including a 45 per cent holding in a manufacturing company, Torres Hostench SA which in turn has significant interests in other companies. KIO told us it has taken a much more active and entrepreneurial role in Spain than in the United Kingdom. It told us it had done this because of its perception of the needs of the Spanish economy and the preconditions for successful investment there.

8.43. The Department of Energy and BP drew parallels between the activities of KIO in Spain and its acquisition of shareholdings in BP. We considered this but do not think that any useful comparison can be made.

8.44. From the information made available to us, it would appear that the scale of KIO's investment in BP is very much larger than the value of any of the other of its portfolio investments and may be the largest single investment ever made by Kuwait or KIO. It is by far the largest quoted investment held by KIO in the United Kingdom and is, we believe, more than 15 times the size of its next quoted investment.

8.45. Kuwait also told us of large investments made, not through KIO, in other companies. These included three major German companies, Daimler Benz, Metalgesellschaft and Hoechst AG. In these companies Kuwait told us it was represented on the supervisory (not management) boards.

8.46. The question we have to address is whether Kuwait's role in relation to its shareholding in BP will be mainly passive or if at some time in the future, as HMG and BP have contended, Kuwait will seek to exercise its material influence with adverse consequences to the public interest.

8.47. Before examining the individual public interest issues we consider the position of Kuwait and whether changed circumstances may cause a future Kuwait Government to decide to use the ability, which we have found that its shareholding in BP gives it, to exert material influence over the policy of BP.

Kuwait's strategic interests

8.48. Kuwait, one of the Gulf states, has a population of less than two million. At present it accounts for just over 2 per cent of world crude oil production but it has very substantial oil reserves amounting to perhaps 10 per cent of the world total. In the past it has produced at more than twice its present level of output and it has the largest reserve to production ratio of any major oil producer (Table 5.4).

8.49. Kuwait's state petroleum company, KPC, in addition to acting as the selling agent for Kuwait's crude oil, has interests in exploration, drilling, oil production and downstream activities in other parts of the world including the United Kingdom, some interests in the UKCS and a retail distribution network (see paragraphs 5.15 and 5.44).

8.50. Kuwait was a founder member of OPEC whose stated objectives include the co-ordination and unification of the petroleum policies of its members. Kuwait is also a member of the Organisation of Arab Oil Exporting Countries (OAPEC) which was formed in 1968 by Kuwait, Libya and Saudi Arabia. Although the effectiveness of OPEC as a cartel has varied during its lifetime the OPEC countries, individually and collectively, have exercised a significant influence in oil markets in recent years. In the early 1970s OPEC members sought and achieved major price rises by limiting production at a time of rising demand. In 1973 certain countries including Kuwait and other OAPEC members acted together in the imposition of an embargo on supplies of crude oil to the United States and the Netherlands at the time of the Arab-Israeli war.

8.51. In the early 1980s OPEC pursued a policy of production quotas to maintain the high price levels which followed cut-backs in Iranian production in 1979-80 at the time of the Iranian revolution. Kuwait supported and participated in these policies. Although recently it has taken action with Saudi Arabia to bring oil prices down, Kuwait's production is still subject to an OPEC agreed quota and is well below the level achieved in the early 1970s.

8.52. In recent years OPEC's share of world supply has fallen as new sources of supply, including the UKCS, have been opened up. At present OPEC accounts for about one-third of world production. However, the OPEC countries contain three-quarters of the world's proven reserves and with non-OPEC production expected to reach a peak and possibly decline over the next decade, OPEC oil is likely to be of increasing importance in meeting a growing world demand (paragraphs 5.34 to 5.38). In the longer term OPEC production is likely to be concentrated in a small number of Gulf states of which Kuwait is one. Although Kuwait told us that it was a moderating influence within OPEC the possibility that OPEC, and in particular its leading producers, may in future be in a strong position to act successfully as a cartel is a factor that must be taken into account in any consideration of the acquisition by an OPEC member of a large shareholding in a major non-OPEC oil company.

8.53. It is also possible that in future Kuwait may come under pressure from its larger neighbours to join them in a more aggressive approach to the oil market. Moreover a future Government of Kuwait may be less well disposed towards the United Kingdom or the West. Such a government may feel under no obligation to abide by the statements of intent which have been made in respect of the shareholding in BP. It could even feel compelled to abandon them in the overriding interests of its own country.

8.54. Kuwait, however, put it to us that, even if for reasons which it considered to be very remote and unlikely, the present Government of Kuwait was to act in support of more aggressive OPEC policies or was replaced by another Government, it would be unlikely to use its shareholding in BP to seek to influence BP's management in ways that might be adverse to the United Kingdom public interest. In the first place Kuwait suggested that actions of this kind would be readily identified as being against the interests of BP and the United Kingdom and therefore could and would be resisted by BP's management. Secondly, Kuwait suggested, if it was seen to be using its shareholding in a way that would be adverse to the United Kingdom's interests, HMG would then take action to neutralize the effect of the shareholding.

8.55. Thirdly, Kuwait suggested, the size and importance to its economy of its overseas investments would make it reluctant to use its influence in relation to BP.

8.56. We accept the good faith and present intentions of the Government of Kuwait. There are, however, existing and potential conflicts of interest between the national interests of Kuwait as a sovereign state and member of OPEC on the one hand and the interests of BP as an international oil company and the United Kingdom as a consumer and as a non-OPEC oil producer on the other.

8.57. We accept that before seeking to use its influence in BP, the Government of Kuwait would take into account its position as a major international investor. But, for example, at a time of a major crisis in oil supply or for powerful political reasons, we believe the Government of Kuwait would feel obliged to put tangible benefits to its oil and political interests before a potential risk to its investments.

8.58. We have therefore concluded that where it is appropriate in our consideration of the public interest, we must take into account the expectation that Kuwait would at some time in the future, in support of its national interest, seek to exercise the material influence that results from its shareholding in BP. We have, therefore, to consider whether such exercise of influence operates or may be expected to operate against the public interest.

Public interest issues

The status of BP

8.59. We considered that it was important to determine whether the future of BP's activities and the way in which these activities are carried out are matters of public interest.

8.60. HMG told us that as the United Kingdom's largest company and a major contributor to the success of the economy, BP's continued ability to operate successfully in a commercial manner, unconstrained by interference by any government, was important to the economy as a whole. HMG considered two of the sectors in which BP operated, petroleum extraction and trading, to be of strategic significance in both the economic and political senses. In these circumstances for both general economic reasons and for specific reasons of oil market policy and related United Kingdom interests HMG's view was that BP's continued prosperity and independence were in the public interest.

8.61. Kuwait told us that, although it agreed in general terms that BP's status in the United Kingdom and the importance of its contribution to the United Kingdom did make its activities a matter of public interest, the fact that BP was a very large company did not mean that it was of dominating importance in the oil market. It could not therefore be assumed that actions affecting BP would significantly affect the whole of that market. BP's status and importance could not justify the Commission taking a different approach from that generally required in merger cases.

8.62. We accept that size, which can be measured in a number of ways, should not be an overriding factor in our considerations. We must, however, take account of the strategic importance of BP to the United Kingdom economy, its role in the UKCS and as a producer and trader in oil, as a company which contributes to the technological base of the United Kingdom's economy, the assets it owns abroad and its contribution to tax revenues. A merger situation which affected the ability of a company of this size and importance to operate independently and free from external governmental influence is likely to have implications for the United Kingdom's public interest. We have therefore concluded that the future of BP's commercial activities and the way in which these activities are carried out are matters affecting the public interest.

The maintenance of a competitive world market for oil and oil products

8.63. HMG told us that it takes the view that the price of oil should be determined by free market forces, and that the public interest is best served by this policy. The North Sea has at times been an important source of competitive pressure and it was in the national interests of the United Kingdom that this should be maintained. There had been in the past a wide divergence in policy towards the oil market between HMG and OPEC of which Kuwait is a leading member. The Department of Energy told us that there had been recent public statements by Kuwaiti Ministers to the effect that United Kingdom and other non-OPEC producing countries should co-operate with OPEC in stabilizing oil prices, (paragraph 6.16).

8.64. BP told us that as a result of its investment in oil exploration in non-OPEC areas, its recent acquisition of Britoil and its entrepreneurial role it made a positive and significant contribution to the competitiveness of the world-wide oil market. Much of BP's crude oil production is sold to third parties and it purchases crude oil for use in its own refineries. In addition it is actively involved in the New York and London oil futures markets. As a result BP is one of the largest active traders in the world crude oil markets and is also a major trader of oil products. BP told us that its activities as an extra-marginal supplier of oil and oil products outside the OPEC cartel was of very great value to the United Kingdom economy and to its public interest.

8.65. Kuwait told us that it was wholly incorrect to think that unilateral action by BP or even combined action by BP and Kuwait could significantly prevent or impair the maintenance of the competitive market for oil. Although BP and Kuwait are very important participants, neither of them was in any way dominant or even a very significant participant in global terms. As to the suggestion that Kuwait's membership of OPEC would affect the issue, this was not relevant. Kuwait told us its membership of OPEC does not affect and is not relevant to any of the State of Kuwait's interests outside Kuwait including its investment interest in BP.

8.66. In considering this issue we accept that neither BP nor Kuwait alone has a dominant position on a world scale. Nonetheless we do regard BP and Kuwait as significant participants in the world oil market. In recent years their contributions to the market have been different. Kuwait has cut back its production substantially in support of OPEC policies and has built up its downstream activities. BP has been involved in major developments of new sources of oil in non-OPEC countries and has become a major trader in crude oil and refined products. We regard BP's activities in the markets as being broadly pro-competitive, in contrast to OPEC's policy of restricting production.

8.67. We accept that Kuwait has not always fully supported OPEC policies, most notably when it joined with Saudi Arabia in 1986 in the move away from official prices. However, the relative weakness of OPEC in recent years will not necessarily continue. As we have explained in Chapter 5, the known non-OPEC reserves of oil are relatively small and it is reasonable to assume that within a decade, and almost certainly by the end of the century, the world will be once more relying increasingly on the supply of oil from the Middle East. In these circumstances, as has happened in the past, the OPEC cartel is likely to be able to

control the levels of production of oil to achieve higher prices. Some producers may also wish to use the supply of oil to achieve political aims. As a member of OPEC Kuwait would be likely, as it has been in the past, to support OPEC's objectives.

8.68. In these circumstances the approaches of Kuwait and BP towards competition in the oil market would be in conflict and we believe Kuwait would seek to influence BP's policies in its own interest. We consider that the contribution to competitiveness which BP has made through its exploration and development and through its active involvement in day-to-day trading in oil has positive benefits to the United Kingdom public interest. We expect that Kuwait would in the long term exercise influence over these policies and constrain BP from acting independently and competitively. We consider this may be expected to operate against the public interest.

**The possibility of a cut-back
in BP's exploration and oil
production programme**

8.69. The Department of Energy told us that given OPEC's efforts to support, via production controls, world oil prices favourable to OPEC members, conditions might arise in which Kuwait would attempt, on its own account or under pressure from fellow OPEC members, to constrain BP's oil production and development activities in the North Sea, or elsewhere. This might have considerable adverse effects on United Kingdom resources in the medium and long term.

8.70. BP told us that a substantial commitment to long-term exploration and development projects had been essential to the success of BP and its contribution to the United Kingdom oil industry. BP's major fields in the North Sea, Forties and Magnus had reached maturity as had the Prudhoe Bay field in Alaska (the largest field in the Western world of which BP owns approximately 50 per cent). It was expected that the production capacity of the Prudhoe Bay field would decline at the rate of about 10 per cent per annum from the end of 1989. In order therefore to maintain reserves and levels of production substantial investment was necessary in exploring new provinces, developing existing fields and improving methods of recovery and developing substitutes for conventional crude oil. BP considered that the importance of investment in non-OPEC oil production was likely to become more critical as the power of OPEC and particularly the Gulf states including Kuwait increased in the late 1990s. Non-OPEC production would have reached a plateau and might begin to decline, the amount of oil released by the Soviet Union was likely to fall and the importance of the production of non-Gulf OPEC states would decline. BP therefore considered there were substantial conflicts of interest between its commitment to long-term exploration and development in the North Sea, Alaska and elsewhere and Kuwait's likely objectives as an OPEC nation with access to immense low-cost oil reserves.

8.71. Kuwait maintained as it did on other issues that on the basis of its assurances there would be no attempt to influence the management or policy of BP and suggested that in any case there was really no scope for any action which it might attempt to be successful. It would not be possible for BP to make any significant alterations to its oil production programme. In the United Kingdom legislation and Government control and the influence of BP's partners made such alterations impossible. Kuwait also drew the Commission's attention to the fact that KPC and its subsidiary Santa Fe 'had been in no way limited in their exploration and production outside Kuwait' by the Government of Kuwait. Indeed since its acquisition by KPC Kuwait told us that Santa Fe had been enabled to increase its exploration activities.

8.72. We have looked at the possible effect of material influence on the production levels of existing wells and on exploration and future production. From the evidence we have received the effect of any material influence of Kuwait on the level of production of existing wells would be small and would have only a marginal effect on the overall availability of crude oil and prices.

8.73. On the other hand the extent of exploration and the longer-term decisions on the provision of production facilities are matters on which a large shareholder with material influence could expect to affect BP's policies. The capital cost of production of oil in the North Sea (and in areas such as Alaska) is high and involves great risk and commitment. The scope for intervention by HMG in relation to exploration and new production is less than in the case of existing production facilities. Kuwait has available very large reserves of oil which can be produced at prices much lower than in the North Sea. The view could be taken, or be advanced, that the profitability of BP would increase in the short term, if the level of investment was reduced. A reduction in exploration and in the development and construction of production facilities would serve OPEC's and Kuwait's interests in reducing long-term non-OPEC supplies of oil and increasing demand for their own oil. We would expect therefore that, over a period of time, the Government of Kuwait would seek to influence BP on the level of investment in exploration and in the development of new production facilities and that this would be adverse to the United Kingdom public interest.

Conflict of interest at a time of emergencies

8.74. We have been told by HMG that BP plays an important role in assisting the Government in planning for civil emergencies and war situations.

8.75. BP told us that it considered that its contribution to a number of national and international arrangements related to oil contingency planning would be put at risk by the Kuwaiti shareholding. Kuwait told us that while it might have a different view from BP as to how crises should be regulated, it was impossible that a conflict of interest between them could result from the existence of the holding. Even if it was considered that the Government of Kuwait may have some ability materially to influence the policy of BP in some respects and in some circumstances it was inconceivable that a 21.6 per cent shareholder could materially influence the policy of BP at a time of public crisis. It was equally inconceivable, Kuwait suggested, that it would try to use its shareholding to prevent BP from co-operating with emergency arrangements made by the United Kingdom Government or other organizations such as the International Energy Authority (IEA). Subsidiaries of KPC had always fully co-operated with the activities of the IEA and its affiliates throughout Europe were in fact playing a full part in certain present activities of the organization.

8.76. We consider that given the extent of regulation of the oil industry it is difficult to conceive of circumstances in which the current level of shareholding by Kuwait would materially affect the ability of BP to take part in the various emergency planning organizations. It is of course possible that if Kuwait were able to procure the appointment of directors to the BP Board such directors could gain knowledge of the contingency planning. But we doubt whether such directors would be prepared to risk prosecution by revealing information on national security to Kuwait. We do not therefore give this particular issue much weight in our consideration of the public interest.

The research and development activities of BP

8.77. BP told us that it is committed to a high level of expenditure on research and development. In 1987 this amounted to £232 million, equivalent to some 17 per cent of the group's net profit for the year. Amongst the research projects was one which was targeted at converting methane (the main component of natural gas) into liquids suitable for use in gasoline. Another concerned a method which could be used to overcome the problems in the production and transportation of heavy oil by converting the heavy crude into an oil and water emulsion. The emulsion was suitable for burning in power stations and might be capable of processing in refineries. In both these projects, BP claims to be in the forefront, if not ahead, of world developments.

8.78. The Department of Energy confirmed the importance of BP's research, and particularly the two projects mentioned above. It explained that a number of heavy oil discoveries have already been made in the UKCS and the success of BP's process would bring real benefit to the United Kingdom.

8.79. Kuwait told us that it was inconceivable that it would engage in any attempt to limit research into extraction techniques or into the development of oil substitutes. KPC's wholly-owned subsidiary, Santa Fe, was itself engaged in research, and had retained expertise in the area of oil shale processing even though research had been discontinued as it was currently considered to be uneconomic.

8.80. As the availability of non-OPEC supply of oil declines it could well be in OPEC's interests to restrict research and development work which will bring forward alternative non-OPEC supplies or develop substitute products. Kuwait, as a major investor in BP and one which has extensive crude oil reserves which it will not want to see displaced by such work, may in these circumstances seek to influence the direction and scale of BP's research programme. Research and development is very expensive, and its curtailment by raising profit in the short term could be put forward as being in the interests of other shareholders. The United Kingdom's interests are very different. Continuing research into methods of transportation of heavy crude oil, which would enable the reserves of such oil in the UKCS and elsewhere to be used, or into methods for converting natural gas into liquid petroleum products are of considerable long-term strategic and financial interest to the United Kingdom.

8.81. We believe that it is likely that at some time in the future Kuwait, for totally understandable reasons of national interest, would use its material influence, which it possesses by the present level of shareholding, to seek to influence BP to change the priorities or reduce the level of its research and development programme. We believe this would be detrimental to the United Kingdom public interest.

BP as a potential purchaser of Kuwaiti crude oil

8.82. It was suggested to us by HMG and BP that at some time in the future Kuwait might use its material influence to arrange that BP should purchase oil from Kuwait rather than, as at present, on the international oil markets or from its own production.

8.83. Kuwait stressed that it was inconceivable that its holding would be used by Kuwait to attempt to exert any pressure on BP to buy Kuwaiti crude, and equally inconceivable that such pressure would be successful. Moreover, it could not see any situation in which it would be to the advantage of Kuwait to induce BP to purchase Kuwaiti crude.

8.84. We understand that Kuwaiti crude oil contains significant quantities of sulphur. For environmental reasons this requires special refining equipment. BP has not purchased significant quantities of Kuwaiti crude for its own refineries for many years, and its refineries no longer have sufficient suitable equipment to remove the sulphur. On the other hand, if BP could be induced to increase its trading in Kuwaiti crude, this might at some time in the future be of benefit to Kuwait, but might result in a reduction in BP's freedom to compete in the market. We do not attach much weight to this possibility.

Petrol retailing

8.85. In the United Kingdom the only area in which BP and the Kuwaiti oil company, KPC, are in direct competition is in the retailing of petrol. BP is the third largest petrol retailer in the United Kingdom supplying some 2,150 outlets. The KPC is building up a petrol distribution network in the United Kingdom and other parts of Europe under the trade name Q8. It now distributes from 1,270 outlets in the United Kingdom. However, BP's and KPC's market shares taken together are not sufficient for the merger situation to have any appreciable effect on the level of existing competition in the United Kingdom retail market.

Third party perception

8.86. BP suggested that it could reasonably be expected that, where the policies of the Government of Kuwait, whether they are political and diplomatic or economic and commercial, run counter to the commercial policies of BP, the Government of Kuwait will exercise the ability materially to influence the policy of BP and to promote the Government of Kuwait's interests. The Department of

Energy told us that investment on a substantial scale by a foreign government would introduce an element of uncertainty in respect of BP's freedom and would therefore nullify one of HMG's principal aims in disposing of its shareholdings in BP. This and the fact that the government with the shareholding was an OPEC member state was almost certain to have an impact on the perception of the company by customers and parties and to cast doubt on BP's ability to behave as a commercial organization.

8.87. In support of the contention that the perception of BP had already changed after the acquisition of shares by the Government of Kuwait, BP put to us certain material which it claimed showed that companies and government agencies in Abu Dhabi, Iran, Japan and Venezuela had already indicated their concern and the possibility that it would affect future commercial relationships with BP.

8.88. Kuwait denied that its shareholding would in any way harm BP's future commercial activities by adverse third party perception. It suggested that the evidence BP had provided, which for commercial reasons could not be made fully available to Kuwait, was unreliable and provided its own evidence which indicated that the KPC and Kuwait were acceptable commercial partners in Abu Dhabi, Iran, Japan and Venezuela and that BP with a Kuwait shareholding would be equally acceptable.

8.89. The evidence we have received from BP and Kuwait, which it has not been possible for us to test by direct contact with those concerned, tends to indicate that at the present time, while there may be differing views as to the effect of Kuwait's shareholding, there would appear to be little harm to BP's existing contracts.

8.90. However, Kuwait has only been a shareholder for a short while and we are concerned with the future. Even without a further oil crisis or major market upheaval, while large companies and countries may be content to have BP and KPC working with them, the existence of an influential shareholding in BP by the Government of Kuwait will be a factor taken into account when future work is under consideration. Whatever undertakings are given by the Government of Kuwait we believe BP will become known as an oil company with an influential shareholding by a state which is a leading member of OPEC. It seems to us that in these circumstances there could well be an adverse effect on BP's business opportunities. We must also take into account, having regard to past events and the political uncertainties of the Middle East, that at some time in the future the ability of OPEC to influence the supply and price of oil may again become an economic and political issue and that Kuwait is, as in the past, likely to play a significant role as a member of OPEC and one of the Gulf nations which control the bulk of OPEC reserves. We consider that these factors are likely to affect BP's future operations adversely in at least some third party countries where government agencies or companies may prefer to deal with independent companies with interests in non-OPEC oil-producing countries.

8.91. We have considered in particular the situation in the United States of America where BP is the largest oil producer, with major oilfields in Alaska, and has been developing by a policy of acquisition downstream activities in many of the individual states. KPC is also, but to a much lesser extent, involved in oil production and other activities in the United States through a subsidiary company, Santa Fe International Corporation, which has both oil and natural gas interests.

8.92. We consider that the position of BP in the United States and its ability to continue to grow in competition with other companies including KPC is a matter of considerable importance to the United Kingdom public interest. A major part of BP's income is derived from its activities in the United States and the company has many United States shareholders. As in other countries, we believe it is probable that there will be no immediate detriment by reason of Kuwait's shareholding. BP's position in the United States as the largest producer of oil is, however, rather different from that in any other overseas country. It is vital for BP's continued prosperity and growth in the United States that there are no impediments, legal or otherwise, to it being able to obtain exploration and production rights and licences and to continue to grow in downstream areas.

8.93. At present, as Kuwait pointed out to us, it is considered as a friendly nation by the United States and has received considerable political support from the United States recently in the Middle East, and there is no legal impediment to granting of licences for exploration or production to KPC's subsidiaries. We must, however, take into account the possibility of political change in the Middle East. The changes that have taken place in the relationship between Iran and the United States over the past decade illustrate the problems that can arise between friendly states.

8.94. As we explained in paragraph 8.91, BP is a much larger and more important company in the United States than KPC's subsidiary Santa Fe. We believe that BP's prosperity and growth in the United States depend upon it continuing to be seen as a company totally committed to the West and free of interests adverse to those of the United States. Should any conflict of interest arise between the United States and Kuwait, the perception of BP by the United States could change and BP's vital interests could be harmed. It is very difficult to evaluate this risk. The probability of it arising might be small, but the effect on the company could be very great.

**The risk to commercially
and politically sensitive
information**

8.95. BP told us that it was its policy to involve its executive and non-executive directors in all aspects of the groups' activities. All directors have, therefore, access to a considerable amount of sensitive material. BP suggested that it would be highly detrimental if the information which was available to its non-executive directors became routinely available to Kuwait through representation on BP's Board. Kuwait was a major commercial competitor of BP in both its upstream and downstream activities, and it would clearly be damaging for such commercially important information to fall into the hands of a major competitor which is also an influential member of the OPEC cartel. BP was also of the view that, since KPC was a competitor for many of BP's trading partners, Kuwaiti Board representation would inhibit discussions on relationships with those partners.

8.96. For its part, the Government of Kuwait considered that, in order for this issue to affect the United Kingdom public interest, it would be necessary for the Government of Kuwait, in direct contravention of its assurances, to seek representation on the Board of BP; to succeed in that aim, and for the individuals so appointed to act in breach of their fiduciary duties by informing the Government of Kuwait or KPC of matters confidential to the members of the Board.

8.97. It is not unusual for non-executive directors to find that they are involved in matters which are under consideration by their Board. The normal practice in such matters is for the director to declare his interest and to absent himself from any discussions of that subject. Because Kuwait, with KPC and BP, are in competition across the whole oil market, this would clearly be impracticable in the case of any Board member appointed by KIO on behalf of Kuwait.

8.98. We consider that, in view of the conflict of interest that may be expected to arise between BP and the State of Kuwait, it would be against the public interest for the Government of Kuwait to be able to procure the appointment of a director to the Board of BP.

**Constraints on the ability of
BP to obtain capital or to
make large corporation
acquisitions**

8.99. As we have explained, a shareholding of some 21.6 per cent would give the Government of Kuwait the ability to block resolutions at BP shareholders' meetings. This could effectively constrain BP's ability to raise capital by rights issues, or vendor placing or to make substantial acquisitions that require approval by shareholders.

8.100. Kuwait suggested that KIO would only contemplate using its shareholding in this way if it considered it necessary in the financial interests of all shareholders, and such circumstances would in practice only arise when other

large, institutional investors were equally concerned about BP's policy. It was misconceived, therefore, Kuwait told us, to suggest that it might use its shareholding simply to harm BP or to place it under any other constraints.

8.101. BP and Kuwait, together with KPC, are competitors in all parts of the oil market and it may be expected that at some time there will be conflicts of interest in relation to policies or even a particular acquisition in which BP and KPC may be competitors. In these circumstances, we believe it would be clearly detrimental and against the public interest for the Government of Kuwait to have the opportunity to use its material influence to interfere with BP's capital operations and its ability to complete acquisitions.

Potential adverse effects on the international standing of the City of London

8.102. The Government of Kuwait suggested to us that a finding to restrict the shareholding made after receiving evidence on the status of the investment and the intentions in relation to it of the Government of Kuwait would give rise to great concern as to the freedom and security with which investors, particularly investors from abroad, could use the facilities of the London capital market.

8.103. We disagree with this view. We believe that investors will recognize the unique nature of the investment by a foreign government which is an oil producer and member of OPEC in a large international oil company which is of great importance to the United Kingdom's production and supply of oil. In these circumstances and with the concern of HMG about the build-up of KIO's investment being widely known it should be evident to investors, including those from overseas, that any decision which may restrict the Government of Kuwait's shareholding in BP relates to these special circumstances and in no way affects the normal workings of the London stock markets.

Possible benefits to BP from the merger situation

8.104. It was suggested by a few of those who gave evidence that the association of BP with a major crude oil producer with extensive reserves might result in long-term benefits for the company. Kuwait also said that if there was any perception at all, the effect was likely to be beneficial. It added, however, that as its holding was purely an investment there could be no question of any transactions being entered into between Kuwait and BP that would not occur in the absence of the shareholding. While, as we have referred to previously, we believe it is possible that at some time in the future BP might be induced to trade in Kuwaiti oil, this would if anything be primarily for the benefit of the State of Kuwait. It has not been established that any significant benefits are likely to result to BP from this merger situation.

CONCLUSIONS AND RECOMMENDATIONS

The legal situation

8.105. In reaching their conclusions the Commission must have particular regard to two provisions of the Fair Trading Act. These are:

- (a) section 69(1)(b) which requires the Commission to investigate and report on the question of whether the creation of the merger situation 'operates or may be expected to operate against the public interest'; and
- (b) section 72(2), which requires the Commission, in a case where they find that the creation of a merger situation operates or may be expected to operate against the public interest, to 'specify in their report the particular effects, adverse to the public interest, which in their opinion the creation of that situation . . . have or may be expected to have'.

8.106. The question we have to determine is whether the merger situation operates or may be expected to operate against the public interest. In many of the cases before us, when we identify adverse effects they can clearly be related to detriments to competition which may be expected to arise from the effects of the

merger in reducing the number of competitors or in some way impeding existing or future prospects for competition in the particular market. In this case the detriments we are concerned with relate to potential restraints on the policies and management of a company and on the effects that third parties' perception of the merger situation may have on that company at some time in the future. Section 84 of the Act makes it clear that:

In determining for any purposes to which this section applies whether any particular matter operates, or may be expected to operate, against the public interest, the Commission shall take into account all matters which appear to them in the particular circumstances to be relevant . . .

8.107. A number of legal arguments were put forward on behalf of Kuwait and these are summarized in paragraphs 7.45 to 7.47. Attention was drawn to the view set out by the Commission in their report on the Berisford/British Sugar reference¹, part of which (paragraph 9.40) is set out below:

The question we have to consider is not only whether there is a possibility that the merger will operate against the public interest. If only a possibility were required, hardly any merger could ever be allowed to proceed, for it is very rarely that such a possibility can be quite excluded. The question is whether the evidence creates an expectation that the merger will operate against the public interest. To put the matter colloquially, the required conclusion is not, 'This may happen', but 'We expect that this will happen'.

8.108. Kuwait suggested therefore that the Commission had to determine the question of whether the merger situation operated or may be expected to operate against the public interest, not in general terms, but by reference to the particular effects of the situation and, in this case, the Commission must be able to say that any such particular effect may be expected to arise from the situation. If the Commission were considering a possible chain of future events leading to a consequence or effect that might be against the public interest, the Commission must be able to say that they expect each step in the chain to occur before they can say that the effect that follows at the end of the chain is to be expected. Moreover, the Government of Kuwait suggested that the Commission could not rely in law on a combination of possibilities of serious adverse effects. The Commission, it was suggested, have to be able to say that at least one specific effect adverse to the public interest may be expected to occur.

8.109. While we endorse the principles in the Berisford report (set out in paragraph 8.107), we do not accept the suggestions, made by Kuwait, as to the way in which we should reach our conclusions in the present reference. We are advised and ourselves consider that, in determining whether the creation of a merger situation qualifying for investigation may be expected to operate against the public interest, it is proper for us to look at the situation as a whole. In considering, in this connection, what may be expected to happen, or in what way, our approach should be based upon reasonableness; it should represent our reasonable expectation, having taken into account all the factors which we consider relevant, among them the risk of serious adverse consequences for the public interest. In so doing, as we have been advised that we may do, we would think it right to have regard to the position where, although the risk of an event occurring might be relatively small, the adverse consequences to the public interest would be serious.

8.110. Looking at the merger situation as a whole in this way, we may contemplate a number of consequences of it (including risks such as are mentioned in the preceding paragraph), any one or more of which we expect to arise and, if so, to operate against the public interest, without our necessarily being able to identify which of these consequences specifically would arise and when. It would nevertheless, in our view and in accordance with the advice we have been given, be open to us to find that the merger situation as a whole may be expected to operate against the public interest.

¹ S & W Berisford Ltd and British Sugar Corporation Ltd, a report on the proposed merger, HC 241, 25 March 1981.

Conclusions

8.111. In considering whether the merger situation may be expected to operate against the public interest the Commission have looked at individual issues and the situation as a whole. As we have indicated, the sheer size of the Government of Kuwait's shareholding means that it could be used to defeat ordinary and special resolutions at general meetings either alone or in combination with other shareholders.

8.112. The mere existence of a holding of this size would create difficulties for BP's management and would influence it to take decisions and actions different from those it would take without the existence of that shareholding. BP's actions could be influenced either by the threat of a sale or through actual sales, or by the placing of shares on the market at an inopportune time or a threat to place the shares with unfriendly buyers. The Government of Kuwait's ability to make known its intentions to vote in particular ways or to support the proposals of other shareholders would also be likely to influence BP's Board as would Kuwait's promise of support on some issues or abstention on others. There is a great difference between the interventions of numbers of ordinary and institutional investors each having a relatively small percentage of the share capital and the existence and possible intervention by a block of some 21.6 per cent of the shareholding owned by a foreign government which is a major producer of oil and a competitor in downstream activities in the oil market.

8.113. The Government of Kuwait and its agency, KIO, are not bound by the same considerations as most other investors. Even on strictly investment grounds the Government of Kuwait's considerations, having regard to the long-term nature of its investments, the size of its holdings and its revenues, are unlikely to be the same as other investors. Even if the Government of Kuwait were to be effectively bound by undertakings to vote as an investor and not to further any political or other interests of the state, it would be difficult to establish its motivation for taking a particular approach on individual issues or whether any particular action or attitude falls within the terms of any undertaking.

8.114. The size of the Government of Kuwait's shareholding is such that it could be used to influence the policy of BP on many matters including research into and the development of substitute or alternative sources of energy or oil products, the exploration for oil or the development of new or marginal existing oilfields or acquisitions.

8.115. Furthermore, we believe that in future the perception in some third party countries, including the United States of America, of this influential shareholding by a member of OPEC is a factor which could have adverse effects on BP's activities.

8.116. Although accepting the Government of Kuwait's present intentions, we consider that it may be expected in the future to exercise its influence in one or more of the ways we have indicated previously in this chapter. The important fact to bear in mind is that we are looking at the long term—the indefinite future. In the future, circumstances are certain to change, and sovereign states may be expected to adapt to changing circumstances and on occasions to place their national interests ahead of their interests as investors. In this respect we have to bear in mind that oil is a most important strategic commodity and it is a product of fundamental importance to Kuwait. Moreover Kuwait, which is currently producing well below its capacity, is a member of OPEC and it has been OPEC's policy for years and it is likely to be its policy in the future to control the supply of oil as a means of influencing its price. OPEC's policy is fundamentally different from that of HMG and BP which is to leave prices to market forces and not to attempt to control supply. Another factor to which we must have regard is the turbulent history of the Middle East and the possibility that in the future it could again be the centre of regional or wider conflicts. Kuwait, as a sovereign state with large oil reserves which are relatively cheap to exploit, must be involved in the politics of the area. This difference in policies and the uncertainties of the politics

of the Middle East become even more important in the context of a situation where non-OPEC oil reserves and production are on a plateau and may decline in the next decade. In these circumstances there is bound to be a basic conflict of interest between the countries of the Gulf with vast reserves of oil that are, and will remain, cheap to extract and oil-consuming countries including those countries with dwindling reserves of oil that will become more difficult and costly to extract.

8.117. Taking all these factors into account, while it is not possible to predict the future of the oil markets or of the Middle East, we believe that there is a high degree of probability that sooner or later situations will arise in which Kuwait's national and international interests will come sharply into conflict with BP's and HMG's interests. Such conflicts of interest would be even more likely to occur if a future government in Kuwait was less well-disposed to the West and the United Kingdom. We consider that if and when these conflicts occur Kuwait will seek, and be able, to use its shareholding to influence BP in the ways we have set out previously in this chapter and that this may be expected to be detrimental to, and will operate against, the United Kingdom public interest.

8.118. We have already concluded in paragraphs 8.59 to 8.62 that the future of BP's commercial activities and the way in which these are carried out are matters which affect the public interest. We now conclude, having regard to the matters previously set out in this chapter, taken individually and viewed as a whole, that the merger situation may be expected to operate against the public interest. The particular effects adverse to the public interest which the situation may be expected to have are that in the future the Government of Kuwait may be expected to respond to conflicts of interest, in relation to the oil market, between the State of Kuwait and the United Kingdom and the State of Kuwait and BP by exercising its ability materially to influence BP in the respects specified in paragraphs 8.68, 8.73, 8.81, 8.98, and 8.101, and further that adverse perceptions of BP could arise in third party countries (paragraphs 8.90 and 8.94).

8.119. We should add that, in considering the public interest issues and our conclusions, we have taken into account the provisions of the Deed to which we have referred in paragraphs 8.32 to 8.39. However, even in the absence of the difficulties as to enforceability and enforcement which, as there mentioned, we believe would exist in respect of the Deed—or even if a further Deed, in the same form, were to be executed by the Government of Kuwait, and were capable of enforcement by the Secretary of State—we do not consider that it would go far enough. The exercise of voting rights of 14.9 per cent of the issued capital (some 16.1 per cent of the effective voting rights after taking into account the non-voting element) would still leave the Government of Kuwait with a dominating shareholding at general meetings. In our view Kuwait would still be able to defeat, or make it difficult to pass, ordinary or special resolutions of which it disapproved, particularly in combination with other shareholders. Further, the total size of the holding—21.6 per cent—would continue to dwarf all other holdings, and would be one that could be a constant distraction for the management of BP.

8.120. An undertaking not to vote shares is in our view unsatisfactory in the long term. The prospect of a sale of a large block of non-voting shares overhanging the market would have a depressing effect on the share price and would restrict the management's freedom of action at times when it wanted to raise capital or issue shares for acquisitions. Moreover, even if the undertakings in relation to the way in which the shares would be voted were enforceable by the Secretary of State, they would nevertheless constitute undertakings whose effect would be dependent for their enforcement upon positive intervention and the discretion of the court. It would always be difficult to establish the precise reasons why voting occurred in a particular way, particularly where shareholders may take different views on the capital costs and risks involved in particular proposals.

Remedies 8.121. We are required by section 72(2)(a) of the Act to consider as part of our investigation what action (if any) should be taken for the purpose of remedying or preventing the adverse effects that have been identified and may include in our report recommendations as to such action.

8.122. We have given careful consideration to the question of remedies. We first looked at the matters that were set out in the Deed. While the Secretary of State's disclaimer of the Deed ended any possibility that its provisions could be enforced, we bore in mind that a further Deed may be executed. We also considered whether the subject matter of the provisions themselves, apart from their inclusion in the Deed, might form the basis of undertakings which we could recommend. However, for the reasons indicated in paragraphs 8.119 and 8.120, we have not found the Deed of assistance as regards the consideration of remedies.

8.123. In these circumstances we consider that the only effective remedy is for the shareholding to be reduced to a level at which it could be expected not to exert material influence. We consider that the maximum level of shareholding should be 9.9 per cent,¹ ie just below the 10 per cent level at which it could requisition company meetings or call for a poll. We therefore recommend that the Government of Kuwait should be required to divest its holding of BP shares to 9.9 per cent of the issued ordinary share capital of BP.

8.124. In reaching this conclusion we took account of the problems that may arise from a sale of some 12 per cent of BP's stock. We therefore considered whether it would be possible to recommend the retention of 5 per cent of BP's stock by the Government of Kuwait in a form which, while in its ownership, carried no-voting rights. We decided against such a proposition. Even if it were possible to make suitable arrangements for the long-term holding of stock on a non-voting basis, the existence of such a block of shares would be a continued source of uncertainty for BP's Board and in certain circumstances might provide the Government of Kuwait with a degree of material influence in BP's affairs.

8.125. We believe, however, that in order to maintain and promote an orderly market in BP's shares, the divestment should be carried out over a period of time of some 12 months which should be subject to some flexibility in the light of market conditions. In the meantime, it would be advisable if the Government of Kuwait's voting rights were to be restricted to those applicable to 9.9 per cent, after taking account of the shares to be divested, of the share capital of BP and that there should be consultation before any disposals of the shares. In making these recommendations, and particularly in suggesting a 12-month period for divestment, we do not wish to be seen to be inhibiting the flexibility of the Secretary of State in the light of market conditions to promote an orderly disposal of the shareholding.

Summary of conclusions and recommendations

- 8.126. (a) We have concluded that a merger situation qualifying for investigation exists between the Government of Kuwait and BP (paragraph 8.17), and that the merger situation may be expected to operate against the public interest (paragraph 8.118).
- (b) We recommend that the Government of Kuwait be required to divest its shareholding in BP to not more than 9.9 per cent of the issued ordinary share capital (paragraph 8.123).
- (c) We recommend that, in order to promote an orderly market in BP's shares, the divestment should take place over a period of some 12 months.

¹ We have taken no consideration of preference shares.

M S LIPWORTH (*Chairman*)

F E BONNER

A FERRY

J D KEIR

S MCDOWALL

S WAINWRIGHT

S N BURBRIDGE (*Secretary*)

2 September 1988