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Your reference

Our reference

Date

17 September 1986

SAUDI ARABIA - YAMAMAH PROJECT

Peter Henley, who I understand is now on leave wrote to me on 29 August seeking agreement at official level to proposed revised arrangements for cover for the Yamamah project. He said that he proposed seeking Ministerial approval for cover on the lines proposed if subsequent negotiations with the banks showed that the terms were acceptable to them.

2. We have had comments from DTI and the Bank of England and I have discussed them with the Foreign and Commonwealth Office.

3. This is a most unsatisfactory state of affairs and one that would hardly have been contemplated if proposed at the outset of a deal. However such is the commitment to this whole deal that we must press on. The absence of a legally enforceable obligation on the part of the Saudis to continue to make oil available to meet all the costs of the project including the financing facility or to pay cash in the event of the oil lift arrangements falling through is most unsatisfactory. The Sharia Law risk is also a major matter of concern. However the size of the borrowing is reduced from the £1.5 billion originally required to \$1.5 billion of which your guarantee would relate only to \$1.1 billion with the risk on the balance being taken in parallel by the banks and BAe. Furthermore you would only be on risk against the Saudis' failure to deliver the oil as agreed. The commercial parties would bear the risk that the proceeds from the sale of the oil may not be sufficient to provide the cash required for this business.

4. We note that you are satisfied that there is an insurable risk here and on that basis we can agree very reluctantly that you may provide the cover as you propose. However this is conditional upon the commercial parties taking the parallel risk on borrowings of \$400 million and to satisfactorily tight drafting of the guarantee particularly over the definition

of the failure to deliver oil. Your maximum horizon should be limited to a shorter period as possible but certainly not to more than 5 years and the proportion of oil deliveries earmarked to pay off the loan and the interest thereon should be as high as possible.

5. I understand that you are still considering suggestions from the commercial parties that you should provide cover for partial as well as for total default on oil deliveries. Amongst other things a partial default would be very difficult to define. There are also suggestions that you should provide cover for the risk that the Saudis may be prevented by war from supplying the oil and also the loss of payments to BAe if the oil flows stop. We would be reluctant to see cover extended in any of these ways and hope that they can be avoided.

Am
Les
R E ADAMS

cc T J H Downing - BOE
P Sullivan - FCO
R A Ludford - ODA
D Jones - MOD
P Curry - MOD (DESO)
J Hibberd - Cabinet Office
W A Pedder - DTI (PEP)
J Bowder - DTI (Air)
W Ricketts - Dept Energy
P Kitcatt - HMT
S Robson - HMT
J Gill - ECGD
D H Twyford - ECGD
G E Breach - ECGD