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- cc PS/MFT
- PS/Sir B Hayes
- Mr Roberts DTI
- Mr Titchener "
- Mr Everett "
- Mr Gill ECGD
- Mr Henley "

PS/Secretary of State for Trade

**£5bn DEFENCE DEAL WITH SAUDI ARABIA
(LETTER FROM GEORGE YOUNGER)**

Issue

1 The arrangements for a special £1.5bn overdraft facility from Lloyds Bank to the Kingdom of Saudi Arabia ("KSA") relating to the £5bn Tornado sale, as outlined in Mr Channon's letter of 25 March to Mr Lawson, proved unacceptable to the Saudi Arabian side. Mr Younger is therefore proposing an alternative scheme which differs essentially in that:-

i the Saudi Arabians would not be the direct borrowers under the facility (but would still have responsibility for eventual repayment and for the fees incurred), and

ii the amount of oil to be dedicated to the deal should be increased as necessary.

2 An urgent decision is required as MOD would wish to resume negotiations at the weekend so that if they are acceptable to the Saudi Arabian side the agreement could be signed during Mr Younger's visit to Saudi Arabia on Tuesday next.

Recommendation

3 I recommend that the Secretary of State should reply to Mr Younger in the terms of the attached draft, confirming that he is content that ECGD support should still be provided despite the change in the structure of the arrangements on the condition that the contractual provisions are not further diluted.

Argument

4 As Mr Younger's letter states the arrangement previously agreed by Ministers (although most reluctantly by Mr MacGregor and Mr Walker) proved unacceptable to the Saudi Arabians, because of their dislike of sovereign borrowing and their insistence that the deal was set up on the basis that it would be paid for in oil or cash. However they have accepted the advantages of an overdraft facility in smoothing out any mismatch between oil receipts and the cash requirements of BAe and they are prepared to pay the costs of such a facility. The arrangements now proposed ~~which~~ involve an overdraft facility from Lloyds Bank to BAe for £1.5bn (of which £1bn would be guaranteed by ECGD.) Thus there has been no increase in the total amount of the ECGD involvement but the contractual arrangements with the KSA are much more tenuous. Reliance will now

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be placed on some fairly rudimentary clauses to be inserted in a new exchange of letters to be signed by Mr Younger and Prince Sultan. Nevertheless we have strengthened these sufficiently to ensure that there is a binding obligation on the part of KSA to pay either in oil or in cash by certain specific dates. Should they fail to do so there would be no recourse to BAe but we and Lloyds Bank would seek to pursue the KSA. Under these circumstances the MOD would have the right to terminate their contract and suspend further deliveries. We consider that the amended contractual arrangements are acceptable but we are worried that during the negotiations the MOD will try to water them down further to meet Saudi Arabian sensitivities.

5 The other major change is one which we consider favourable. This has been to stiffen up the arrangements for the provision of oil so that the volume will be adjusted in order to meet the amount needed to keep within the maximum £1.5bn overdraft facility and eventually to repay BAe for their supply. Thus it is envisaged that there will be an immediate increase in the volume of oil (and on the basis of a worst case price of \$10 bpd MOD propose to ask for the commitment to be raised from 300,000 bpd to 600,00 bpd). There are also revised proposals for a review procedure which will ensure that further adjustments will be made each 6 months throughout the contract period. No doubt apprehensive of Mr Walker's reaction, I note that Mr Younger does not mention the proposed doubling of the oil offtake. From our viewpoint, however, this is a satisfactory development as it fulfils the original concept of the deal and ensures that the overdraft facility will be tapped at £1.5bn. Although the banks still appear to be ready to accept £500m on their own account, we have always been apprehensive that if £1.5bn proved insufficient then ECGD would be asked to make up the difference.

Background

6 Please see Mr Henley's detailed note of 18 March. The overdraft facility is needed because of the certain mismatch between receipts of oil sales and payments due to BAe. The main change since the round of correspondence between Ministers initiated by Mr Channon's letter of 25 March, is that it is now envisaged that the overdraft facility will now be given to BAe (instead of KSA). However, repayment of it (including the payment of fees and premium) is to be the responsibility of the KSA. The loan and the additional revisions of the new exchange of letters will be governed by English law. No other changes in the scope or amount of the contract are envisaged at the present time, and we are not aware of any developments regarding the counter-trade proposal to which Mr Clark was averse.

S. H. Twyford

D H TWYFORD
Under Secretary, ECGD
C640: Ext 7043
1 May 1986

*Not change
in KSA? This
is another one of
several...*