No. 20 of 1970

In the Privy Council

ON APPEAL
FROM THE COURT OF APPEAL
OF NEW ZEALAND

BETWEEN

THE COMMISSIONER OF INLAND REVENUE
Appellant

AND

EUROPA OIL (N.Z.) LIMITED
Respondent

Record of Proceedings

VOLUME 2

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Appellant

A N D EUROPA OIL (N.Z.) LIMITED

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NOTES OF EVIDENCE

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(Case resumed 26/2/69)

MR WHITE OPENS AND CALLS:

WALTER LEWIS NEWTON. I am a consultant on economic problems relating to the petroleum industry. I hold the degree of Bachelor of Arts, University of Cambridge, England, 1942.

I am a director of Petroleum Economics Limited, 1 Argyll Street, London, W. 1. Petroleum Economics Limited provides consultancy services on matters relating to the oil industry and in this respect advises oil companies, oil consumers, governments and international organisations.

I am the author of the following papers and articles:

Current Economic Trends in Location and Size of Refineries in Europe	World Petroleum Congress, Fifth, 1959, New York
(with Dr P.H. Frankel as joint author)	
Profitability of International Oil Companies	The Analysts Journal, November, 1959
(with Dr P.H. Frankel as joint author)	
The State of the Oil Industry	National Institute Economic Review, September 1960.
(with Dr P.H. Frankel as joint author)	
The Economics of Oil Supplies to the Power Industries	World Power Conference, Sixth, Melbourne, 1962
(with Dr P.H. Frankel as joint author)	
Recent Developments in the Economics of Petroleum Refining	World Petroleum Congress, Sixth, Frankfurt, 1963
(with Dr P.H. Frankel as joint author)	
Tanker Availability and Requirements: their effects on the Tanker Market	Petroleum, May, 1961
Refineries in Small Consumer Countries	World Petroleum, January 1964
The Long Term Development of the Tanker Freight Market	Institute of Petroleum, April, 1964
Economics of Petroleum Refining - Present State and Future Prospects	Institute of Petroleum, January, 1968
(with Dr P.H. Frankel as joint author)	

I have been active in the oil industry since 1948 when I joined Manchester Oil Refinery Limited - an independent refining company in the U.K. which, however, had close operational links with other independent refineries on the Continent of Europe. There I was first employed in the market research department and later on the operational side dealing with crude oil purchases, processing agreements, petroleum products sales, tanker chartering, etc. and was thus closely connected with the international oil business. In 1955 I joined Petroleum Economics Limited on its foundation by Dr P.H. Frankel and I have been a director of that company since 1958.

(A) WORLD MARKET CONTROL AND PRICE STRUCTURES

The price structures in the various parts of the world can be understood only if they are seen as being the result of the shape of the oil industry as it has developed over the last fifty years.

It is a matter of historical record that in oil-consuming areas where there is also indigenous production of crude oil there has tended to be a substantial number of enterprises not only in the producing but also in the refining and marketing sectors. Nowadays this however only applies to the U.S.A., the U.S.S.R. and Canada. All other major areas of consumption are bereft of any substantial indigenous oil reserves and are therefore dependent upon supplies from other countries. It would now appear that Australia will prove an exception in the near future.

On the other hand, since the first World War practically all prolific oilfields have been discovered in areas remote from urban civilisation. In these countries the infra-structure of an industrial activity had to be created from scratch. This is a task which only enterprises of some considerable size and staying power could undertake. Also only companies which had already an established market position and/or had the support of their own Government could aspire to go into what was then an intricate and risky business. The fact that thus the unit of operation was very big resulted in the field being de facto reserved to seven or eight large companies, American, British and French. This virtual monopoly of a small number of companies had its repercussions everywhere, but it gained particular significance in areas where for other reasons the stage was already set for the predominance of a limited number of operators.

In areas near crude oil production, especially when its control is split between a number of enterpreneurs, there is scope for small and middle-sized companies in the refining and, more especially, in the marketing sector. If and when, however, supplies have to go by sea, especially over longer distances, a peculiar set of circumstances makes itself felt: ever since the oil industry emerged from its barrel stage (when the unit of operation was small) oil was shipped by tankers and had to be stored in bulk tankage. Thus only large and well-balanced operators could gain access to and maintain themselves in the market, especially in areas where the total turnover was limited. This applied, and to some extent still applies, to practically all points East of Suez, and goes a long way towards explaining the state of exclusivity which a very small number of oil companies, all of them internationally backed and diversified, had attained there. One consequence was that competition, as and when it obtained, inevitably took on what the economists call an oligopolistic character, i.e. the operation of a limited number of marketers obtaining their share by way of investment and advertisement rather than by price competition. Market shares, once acquired, tended to be respected.

It is fair to say that this description applied until the 1950s not only to the areas of the Indian Ocean and further east but also to practically all of Africa. The reasons why in Europe, in spite of the substantial market position of the same big oil companies, their status there was different were roughly as follows:

There were a certain number of old-established local companies which, especially in Germany, developed indigenous crude oil production, making them independent of supply by the international purveyors.

In Sweden one or two domestic companies maintained their identity, strengthened by other activities (e.g. shipping) and political backing, as in the case of the Co-operatives.

In France, however, it was the government which established a climate favourable to the development of French enterprise in the oil sector.

Variants from the French example, which itself was, however, partly the result of French participation in Middle East oil, are provided by the Italian and South American examples.

In Italy, between the wars, the Fascist regime established a state company (AGIP), designed to search for, produce and market oil, but it became effective only after the Second World War.

The main exception to the ubiquitous and predominant operations of the international oil companies outside the U.S.A., Europe, etc., is provided by some of the Latin American republics.

Mexico is a case per se: it is the only country outside the Soviet Bloc where all oil activities are in the hands of a state monopoly. The nationalisation of the oil industry there in 1938 was on the whole a success simply because Mexico happens to be self-sufficient in oil. It can therefore be a law unto itself.

The other Latin American consumer countries, however, are or at any rate have been until recently on the whole importers of petroleum (finished products originally, now mainly crude); therefore they applied their calculated interference at the importation stage. Argentina, Brazil and, to some extent, Uruguay have virtual import monopolies under which supplies, even those eventually reaching the affiliated companies of international enterprises, are mostly channelled through the agency of a state company.

It is an interesting reflection on the general conditions of the oil trade that, other features of such regimes notwithstanding, these countries through buying by way of public tenders have had for a long time a level of foreign exchange cost significantly below that of countries which did not apply these methods.

To sum up:

In the absence of state intervention on the one hand and of effective local entrepreneurs on the other, the oil business in the peripheral regions is almost inevitably in the hands of integrated international operators whose affiliates enjoy all the benefits of belonging to a widespread network but for the same reasons do not develop individual initiative or bargaining power. All through the last decades wherever local enterprises have emerged and have managed to establish themselves in business; there is however an almost fateful tendency for such enterprises either to become affiliated to one of the international networks or to behave as if this were the case.

Consequently, and again inevitably, in the absence of actual negotiations between armslength sellers and buyers, the major international oil networks tended to develop and to apply the concept of world market prices which provide a framework for the supply of their affiliates and for the price behaviour of the latter.

Posted Prices

These must be considered both in relation to crude oil and to petroleum products.

(1) Crude Oil

The expression "posted price" for crude oil, which precedes considerably that for finished products, was first applied to areas outside North America in the late 1940s. The need for posting a crude oil price outside North America arose for governmental and tax reasons. Firstly the authorities administering the U.S. Marshall Plan for Europe needed a reasonably reliable yardstick for the cost of the oil financed by them. Another need for the posting of prices came in the early 1950s when the original royalty agreements between the producer-country governments in the Middle East and the oil companies were converted into 50-50 profit sharing arrangements. The reason why the posting of a price became necessary in this connection was the concern of the producer-country governments that the concession holders would tend to supply their own affiliates at fictitiously low prices in order to transfer profits beyond the producer country's tax jurisdiction. By posting a price which applied to the sale of oil to all potential customers a floor was put under the price because a company which posted a price at a lower level would have exposed itself to the danger of having the oil acquired by its competitors.

The posted price thus became the basis for the sharing of profits on a 50-50 basis between the producer-country governments and the concessionaire companies, the principle being that the difference between the cost of producing the oil and its f.o.b. selling price should be shared equally between the producer-country government and the oil company.

In the early 1950s, when crude oil prices were originally posted, there was a shortage of oil and it was a sellers market. At that time therefore posted prices were effective sales prices and until the 1956/7 Suez crisis the tendency was for posted prices to rise.

When market conditions changed after the first Suez crisis the companies at first attempted to reduce posted prices for crude oil in line with market conditions as they developed. After a second reduction of posted prices for crude oil in 1960 the producer-country governments, however, became alarmed at seeing their revenue eroded and, in order to maintain their tax income, put a veto on any further reduction. Consequently from that time onwards posted prices ceased to be effective market prices for crude oil and became in practice a tax base in producer countries. Actual market prices in armslength transactions were from that time onwards generally expressed in discounts on the posted prices. It must however be added that the largest armslength buyers had enjoyed special terms even before then. In 1958 Mr Wolters, the managing director of the Belgian refining and marketing company Petrofina declared in an interview with the U.S. magazine "Fortune" that only "fools pay the posted price".

[INTERPOLATION: There were two reductions - one in 1959 and the second in 1960. First in 1959 was one of 18 cents per barrel in case of Middle East crude. Second in 1960 was between 8 and 10 cents per barrel depending on different crudes. To give an example - what is generally considered the Middle East Reference Crude Oil i.e. Arabian light crude oil at Ras Tanura was reduced in 1959 from $2.08 per barrel to $1.90 per barrel and then again in 1960 from $1.90 per barrel to $1.80 per barrel. It was at this point that the producer countries became alarmed and organised themselves in OPEC.]

"(2) Petroleum Products

The original fountainhead of product pricing was the U.S. Gulf, justifiably so at a time when the U.S.A. was the universal provider of oil wherever it was needed (roughly until the 1930s).

Originally the market quotations for petroleum products reported in Platt's Oilgram, a generally internationally recognised daily report of petroleum prices, published in the U.S.A., were not what one now calls "Posted Prices" but were meant to be straight market reports, i.e. a reflection of actual armslength transactions. With the gradual change of the domestic U.S. market, and the reduction in the number and significance of these armslength transactions, Platt's quotations increasingly represnted semi-official price lists of companies, but in the U.S.A. they still are not official postings.

Elsewhere, however, they were used by the international oil companies as a basis of world-wide pricing. Therefore when it became obvious that the U.S.A. had become both a net importer of oil and a protected market, whose prices bore little relationship to international supplies, substitute price indicators had to be found. It was in the course of this development that, in the wake of the Suez crisis of 1956, the major oil companies started to "post" prices for products in the Caribbean different from the U.S. Gulf Platt's quotations, and they also posted product prices at the Persian Gulf. These postings were designed to meet the following conditions:

(a) Starting from the posted price of crude oils, and making allowance for the refining costs and desirable refinery margins at the respective refineries, the prices for individual products were meant to give an adequate return, taking into account the demand pattern of the markets to be supplied, from which followed the yield pattern ("product mix") of these refineries.

(b) Posted products prices, for instance, at the Persian

Gulf, could not be set too high in relation to crude oil prices, since if they had been, the incentive to build local refineries, e.g. in India, to cover total local demand would have been overwhelming. On the other hand prices could not be so low as to influence adversedly the prices of products from local refineries where and when they were built by the same companies who had an interest in Persian Gulf refineries. This inter-relationship of prices was inevitable because most countries East of Suez, even once a local refining industry was established there, did have to rely on supplementary imports of some products (e.g. middle distillates in India, light fractions in Australia, and heavy fuel oil in Japan) to meet the local pattern of demand. In other cases surplus products had to be exported.

It can be seen that the posted price system for products fitted into the general international set-up with its supply and competitive patterns: uniform prices sprang from a form of price leadership and were influenced also, as for instance in the case of the Abadan refinery, by tax problems relating to the refinery margin in producer countries."

[INTERPOLATION: In certain areas of the world in the industry certain companies were accepted to be the price leaders. In the Persian Gulf it was generally accepted to be B.P. At any rate until the closure of the Abadan refinery and nationalisation of B.P. Anglo Iranian assets in 1951. But again it was to be noted in 1957 when products prices were first posted it was B.P. which as the price leader took the initiative to post product prices. In Lybia ESSO is recognised as the market leader. The same paragraph deals with tax problems relating to refinery margins - would you comment on that a little more in view of what Mr Todd said? Refinery profits at the Abadan refinery are taxable. In the agreement with the Iranians the companies have to provide a minimum taxable uplift of 5%. This means that the value at posted prices of a composite barrel of products made from a barrel of crude oil must exceed by at least 5% the total of the cost of the crude oil at posted prices (in recent years with minor exceptions) plus cost of refining. This uplift is then taxed by Iran. A similar situation although there is no defined uplift of 5% exists at Ras Tanura. I do not know off hand the exact position in Kuwait and Behrein but would be surprised if there were no taxation of refinery profits there.]

"In actual practice this posted price system for finished products was qualified by deviations explained later.

There are several reasons why the concept of an international price structure for petroleum products has been developed.

(a) Oil is not only traded internationally on a large scale but the main sources of supply to the world have been traditionally confined to a few points (although these points have changed from time to time). Originally the U.S. Gulf was the main source but in the post-war period this role was taken over by the Caribbean and later also by the Middle East (Persian Gulf), and, within a restricted area, by Indonesia. In the past it was thus the practice to adjust petroleum products prices all over the world to those prevailing at the main points of export.

(b) The need for an oil price structure as distinct from oil prices arose from:

(i) the desire of the international oil companies to bring some order into the terms on which they supply their own affiliates and outside customers;

(ii) the need for governments in producer as well as in consumer countries to have an easily recognisable basis for the control they wish to apply to oil exports or imports.

An examination of available published material shows how limited the relevance of any set of finished products prices at overseas centres of refining had become for the pricing of products in consumer countries. Prior to the development of large-scale refineries in consuming areas, these overseas supply points could rightly be considered as the main determinant of any rational system of prices in the consumer countries for which they formed the principal source of supply.

Until the end of the 1940s the U.S. Gulf could properly be considered as the basing point for the price structure for the entire world. This was justified for three reasons: firstly the U.S. oil industry was by far the largest in the world; secondly U.S. exports from the Gulf Coast covered a very large part of the world's demand, when other Western Hemisphere and Middle East supplies as well as refineries in consumer countries were still in the process of development; and thirdly the U.S. Gulf was the principal point where there was an open market sufficiently large to cover any potential requirements.

With the virtual disappearance of the U.S. oil industry as a supplier of crude oil and finished products to the rest of the world, the Caribbean became the main source of supply. Petroleum products prices at Aruba and Curacao were first posted in the early 1950s. In the initial period petroleum products prices f.o.b. Aruba and Curacao tended to be the same as the Low of Platt's quotations at the U.S. Gulf. The principal reason for this was that the U.S.A. constituted an important market for products from these areas, in particular residual fuel oil, and the freight to the U.S. East Coast from Aruba and Curacao was approximately the same as that from the U.S. Gulf.

Since the end of the 1950s, however, petroleum products prices at the Caribbean export centres have ceased to follow those at the U.S. Gulf and have tended to find their own levels. This was, in the first place, the consequence of Venezuelan crude oil prices being reduced in the late 1950s without corresponding reductions in the United States crude oil prices, Caribbean petroleum products prices being inevitably influenced by the price of the crude oil from which they are derived. Secondly the U.S. import restrictions on a mandatory basis were enforced in 1959 and the only product which now moves in large quantities from the Caribbean to the U.S.A. is residual fuel oil. With imports of other finished products into the U.S.A. being restricted to comparatively small amounts, the inter-dependence of the U.S.A. market and Caribbean supplies was greatly reduced.

Until mid-1957 there were no posted prices for petroleum products at the Persian Gulf. Generally speaking f.o.b. prices for petroleum products at Persian Gulf refineries were considered to be about in line with f.o.b. prices in the Western Hemisphere. With the growing importance of exports from the Persian Gulf, B.P. took the initiative in 1957 to post petroleum products prices there. These quotations became relevant in those areas which were nearer to the Middle East than to the Caribbean, such as part of the Mediterranean, the Indian Ocean, South Africa, Australia and Japan. New Zealand, which is marginally better placed in terms of freight costs for petroleum products supplies from the Caribbean, can nevertheless be considered to be situated on the watershed between the Caribbean and the Persian Gulf and thus be able to draw its supplies from whichever source offers the more advantageous terms.

The relevant companies also posted prices f.o.b.

Sungei Gerong and Pulau Bukom (Singapore) for products made in South East Asian refineries from Indonesian crude oil. These postings at Far East export centres have tended to follow those at the Persian Gulf, allowing for differences in freight costs from these two areas to Far Eastern and Australasian destinations.

There is a significant difference between the U.S. Gulf market and those at the Caribbean and at the Persian Gulf. Whereas in the U.S. Gulf market there was originally a substantial number of independent (non-integrated) refiners, practically the whole of the petroleum products supplies originating in the Caribbean or at the Persian Gulf were and are at present controlled by the international major oil companies. The greater part of the products sold from these latter two export centres move within the integrated channels of the major international oil companies.

In 1959 exports of petroleum products from the Caribbean area totalled about 500 million barrels (over 70 million tons). In 1965 exports of petroleum products from the Caribbean area totalled about 700 million barrels (around 100 million tons). In both years over 70% were shipped to other Western Hemisphere countries and about 20% went to Europe. Of the balance of about 6%, less than half went to East of Suez destinations, including New Zealand.

Armslength sales from the Caribbean area of motor gasoline and aviation fuels include those to the U.S. armed forces. There are also some armslength sales to the Panama Canal Authority. In the past there have also been offers in reply to invitations to tender to South American countries but these have become less frequent as a result of the development of refining capacity in these consumer countries. Some gasoline and gas oil sales of an armslength character were also made to European independent buyers. Substantial sales of residual fuel oil take place to third parties in the

U.S.A. where non-integrated companies or public utilities are important buyers on a cargo lot or contract basis.

So far as export sales of petroleum products from the Persian Gulf are concerned, in 1959 these totalled about 230 million barrels (32 million tons) and in 1965 about 330 million barrels (over 45 million tons). Of these totals over 70% remained East of Suez and the rest was exported to West of Suez destinations. The volume of Persian Gulf exports of petroleum products has been less than half of total exports from the Caribbean refineries.

Non-integrated sales of petroleum products from the Persian Gulf have been an even smaller proportion of overall sales than in the Caribbean. Armslength sales of petroleum products at the Persian Gulf fall into two categories:

1. Petroleum products derived from the small proportion of Persian Gulf refining capacity which is not owned by the major international integrated oil companies. This relates to

   (a) the 5% share held by the Iricon Group of U.S. independents in the Iranian Consortium which operates the Abadan refinery. However, when Iricon came into being, all the members of this Group with the exception of Aminoil at that time made an arrangement with the major company members of the Consortium whereby the Iricon companies agreed to exchange their products share from the Abadan refinery against additional crude oil from the major companies.

   (b) The refineries of Aminoil and Getty in Kuwait and the Kuwait/Saudi Arabian Neutral Zone which, since 1958, have been exporting approximately 2.5 million tons per annum of petroleum products, almost entirely naphtha and residual fuel oil. These two refineries thus constitute relevant sources of third party sales from the Persian Gulf.

2. Additionally, there was a limited volume of petroleum products sales to third parties by the international major oil companies. It was recently reported that in the case of Arabian American Oil Co., third party sales amounted to 10%-15% of total sales.

Although the major international oil companies, for reasons of their own, have continued to favour the idea of a unified world market from which a system of prices could be derived, some of them at least have admitted publicly that in recent years this system could no longer be based on quotations in the traditional overseas refining areas. In 1963 Shell stated in a pamphlet entitled "Current International Oil Pricing Problems":

"Since 1950 an increasing amount of product supplies has come from refineries located in consuming areas, the proportion for Europe in 1962 being as high as 85%. Some European countries refined locally practically the whole of their product requirements. In these circumstances it is only to be expected that local product prices will tend to be influenced more by local refining conditions, such as the pattern of consumption, a competitive refining margin, and the competitive delivered price of crude oil, than by relation to products prices at main export centres in producing areas, as hitherto."

Refining capacity in the overall East of Suez area has always been greater than demand. Since 1962 refining capacity in the consuming countries East of Suez, with the exception of East and South Africa, has also exceeded demand in these countries. N. (Table 1). "

[INTERPOLATION: I should add here that refineries are not generally run at 100% of capacity. I think 80 to 85%

is a reasonable average yardstick.]

"The remarks made in the Shell pamphlet regarding Europe can be thus said to apply to an equal extent to most of the consuming countries in the East of Suez area. The Shell statement can be regarded as a confirmation of the idea that the prices in all marketing areas (or countries) now depend mainly on the degree of market competition extant - and, of course, on the governmental regime prevailing in each case.

Posted prices for petroleum products have declined at all export centres. In the period from 1959-1965 posted prices for gasoline (90 octane) have declined in the Caribbean from 10.25¢ per U.S. gallon to 8.4¢ per U.S. gallon and at the Persian Gulf (Abadan) from 10.5¢ per U.S. gallon to 8.4¢ per U.S. gallon. In the case of gas oil (48/52 DI), the reduction at the Caribbean and Abadan has been from 9.375¢ to 6.5¢ and from 9.1¢ to 6.8¢ per U.S. gallon respectively. The Bunker C fuel oil price has gone down from $1.90 to $1.55 per barrel at Abadan and remained at $2.00 per barrel in the Caribbean. The trend in prices in both areas has been much the same, although not uniform in extent, reflecting partly the difference in crude oil and yield patterns and also the emphasis of demand in the various parts of the world."

[INTERPOLATION: At this point as we shall see later the posted prices for these products are not necessarily a full reflection of actual prices. As I mentioned earlier in evidence, the posted prices in particular at Persian Gulf for products as well as for crude oil have a certain relevance for taxation in these countries. Therefore with the posted prices of crude oils being frozen and the need for the companies to show a refining profit for taxation purposes, a certain limitation is imposed on the free movement of petroleum products prices.

Graph starts in 1960? Any index before 1960? No not in this form. In May 1960 a discount on gasoline of 2 cents per U.S. gallon can be calculated from the channel port index. It is most unlikely that these discounts mushroomed to 2 cents per U.S. gallon overnight in May 1960 and I would say that this was a developing trend during the preceding years. Difference between 10.5 and 8.5 at that date? Yes. Other graphs deal with the other products in a similar way.]

(B) EVIDENCE OF PETROLEUM PRODUCTS ARMSLENGTH SALES OVER THE RELEVANT PERIOD

Development of Discounts

The general tendency to grant discounts to armslength buyers of petroleum products in cargo lots became more firmly established during the period 1959-1964, as a result of the competitive conditions which have prevailed in the oil market since the Suez crisis of 1956. It should be pointed out however that during the preceding five years, 1954-1959, competitive pressure in the Persian Gulf sphere was accentuated by the re-opening in 1954 of the Abadan refinery. This provided all the members of the Iranian Consortium, including Gulf, with substantial additional quantities of petroleum products for disposal.

In this connection it is relevant to point out that all the members of the Iranian Consortium had marketing organisations east of Suez capable of disposing of their share of the products obtained from the Abadan refining with three exceptions: The Iricon Group, C.F.P. and Gulf. We have already seen that the Iricon Group exchanged their share of products for more crude oil. C.F.P. at great cost and effort established marketing organisations in some countries East of Suez notably in Australia, South Africa and certain other East African countries; it also made a long term supply contract with the Western India Oil Distributing Company in which discounts on posted prices were granted. Gulf for reasons which will be analysed presently in this evidence chose not to enter East of Suez gasoline markets but preferred an Europa solution. Against this background it appears inconceivable that Gulf should have negotiated during this period a long-term supply arrangement, such as that with Europa, without making any price concession in one form or another.

Despite the fact that discounts on petroleum products sales are not generally publicly announced, sufficient information has become available to make possible some indication of the trend in discounts.

a) West of Suez Area

An indication of the extent of discounts granted to the larger armslength buyers has for some time been given by the offers made in reply to invitations to tender by certain South American government buyers (e.g. ANCAP in Uruguay) as well as the Panama Canal Company. Such reported offers for the period 1960-1964 are shown in N Table 2. Many of these offers are on a c.i.f. basis and it is, therefore, difficult to ascertain the exact level of the discounts. Indications are, however, that discounts of up to 3¢ per U.S. gallon were offered on gasoline as early as 1960 at the Caribbean but these tended to increase to up to almost 5¢ in 1964.

A more readily ascertainable indication of the trend in Caribbean discounts was provided by what has become known as the Platt's Channel Port Index. Platt's began to quote the Channel Port Index for the first time in May 1960. It was calculated by Platt's on the basis of Caribbean posted prices less the last reported discount at the Caribean for the product concdrned, plus the spot tanker freight from the Caribbean to North West Europe. Since the end of 1966 Channel Port Index has been discontinued by Platt's but has been substituted by the twice monthly reporting of discounted f.o.b. prices at the Caribbean.

From the way it was originally constructed, Channel Port Index fluctuated almost from week to week, not only with changes in discounts to the largest armslength buyers but also with variations in spot tanker freight rates, which at times have tended to fluctuate frequently and sharply. About 1965 the spot tanker freight began to be taken on a monthly basis in order to eliminate too frequent changes in Channel Port Index. The discounted f.o.b. prices used for Channel Port Index were those granted to armslength buyers of cargo lots.

As Platt's generally indicated the reason for each change, i.e. whether it was due to a change in the level of freight rates or to a change in the level of discounts, whenever an adjustment in the Channel Port Index was made, it was possible to calculate backwards from Channel Port Index by deducting the freight element, and thus arrive at the discounted price for the particular product at any one time. On this basis a complete trend in the level if discounts for armslength buyers in cargo lots at the Caribbean could be established for the period from May 1960 to the end of 1966. The trend of posted prices and discounted prices at the Caribbean during the relevant period, i.e. 1960-1964, is indicated in the attached N - graphs A - D.

[INTERPOLATION: Have you copies of the documents available? Yes, Photo copies.

TABLE N 3(a) - you referred in evidence to ANCAP - what is that? ANCAP is the State buying company of Uruguay. YPF is State buying company of Argentina. PETROBRAS is State buying company of Brazil. N.A. means Not Available. First page - CFP - Compagnie Francaise des Petroles. Third page - seller AMOCO - is foreign operating company of Standard Oil Company of Indiana which has a joint concession with NIOC - National Iranian Oil Company in Iranian Coastal waters. Crude oil offered in this example was offered jointly by the two companies and comes from that concession.

SAMIR - that is Morocco Refinery owned jointly by the

Moroccan Government and by the Italian State Oil Company, ENI. That is a French Government Company - RAP page 3(b) immediately after the Japanese ones.

JALIL is a Pakistan importing agent who supplies to Pakistan International Refinery.]

b) East of Suez Area

There is no such ready-made indicator of discounts in the case of the Persian Gulf as there existed in the form of Channel Port Index for the Caribbean. There is, however, little doubt that discounts on posted prices were also granted at the Persian Gulf. Evidence of this is given in the Report of the Oil Price Enquiry Committee of the Government of India. This Committee was set up in 1960 under the chairmanship of Mr Damle and reported in 1961.

The report indicated that, although the major international companies were at that time not yet in the habit of granting discounts to their affiliates, there was evidence of non-integrated buyers receiving such discounts. On page 30 the Report quoted that Compagnie Marocaine des Carburants, an affiliated company of Compagnie Francaise des Petroles which is generally regarded as a major international company and which had recently acquired a 6% interest in the Iranian Consortium but was short of adequate outlets of its own East of Suez, had made a 10-year contract with the Western India Oil Distributing Company forthe supply of petroleum products and that: "The f.o.b. prices of products are determined on the Low of Platt's at Abadan less discounts, which have been given right from the date of the conclusion of the agreement and have been increased subsequently in the case of some products". It is believed that this agreement was concluded in the mid-1950s. The Report also mentions the purchase of products from the U.S.S.R. by the Indian Oil Company Limited at substantial discounts off Abadan prices.

Furthermore, the Report stated that Caltex confirmed the granting of discounts on fuel oil to Japan, which, however, it is claimed were given to meet competition from other sources of supply, including the United States West Coast.

Although giving no details as to individual contracts, the Commission came to the conclusion that "on the material available to us we notice that discounts generally fluctuate within the range of 10%-15% in the case of kerosene, high speed diesel oil and aviation turbine fuel. In the case of motor spirit and furnace oil, lower rates of discount have been disclosed to us and they vary between 3% to 5%." The Commission then recommended that for the calculation of foreign exchange allocations for the import of petroleum products, the following rates of discount should be taken into account:

Kerosene	10%
Aviation Turbine Fuel	10%
High speed diesel oil	10%
Motor Spirit	5%
Light diesel oil	9.3%
Furnace oil	3%

The Indian Government again investigated oil prices in 1964/5 by means of another Committee under the chairmanship of Mr Talukdar. (Report of the Working Group on Oil Prices, August 1965). With regard to petroleum products prices, this Committee came to the conclusion that the major private oil companies operating in India were wholly-owned subsidiaries of certain international majors and functioned for the purpose of selling the products of the large family of associated companies owned or controlled by the majors. As a result there was no freedom to bargain with parties outside the group and the prices paid were essentially managed ones. The committee then recognised (p.42) that, for the purpose of foreign exchange allocation for petroleum products imports, the following higher discounts should in future be effective:

Aviation spirit	3%
Aviation turbine fuel	15%
Motor Spirit	12%
High speed diesel oil	12%
Kerosenes	12%
Light diesel oil	12%
Furnace oil	10%

Third party sales by major international oil companies also undoubtedly took place at prices below postings as is indicated by an agreement made in the autumn of 1966 between the Arabian American Oil Company and the Saudi Arabian Government. Under this agreement Aramco conceded to the Saudi Arabian Government the calculation of tax on sales to third parties on the basis of posted price instead of realisation and this agreement was made retroactive, as far as petroleum products were concerned, to the beginning of 1963.

Discounts to destinations West of Suez from Persian Gulf refineries were and still are undoubtedly at higher levels than to East of Suez destinations. The explanation for this lies in the fact that the freight to most West of Suez destinations is higher from the Persian Gulf than from alternative sources of supply, and, therefore, such higher freight has to be absorbed in order to dispose of products from Persian Gulf refineries in the West of Suez area.

For the last year or so Platts has also reported the level of discounts in petroleum products armslength sales at the Persian Gulf on a regular basis.

(C) THE GULF-EUROPA AND THE BP-EUROPA ARRANGEMENTS

I have studied the documents referred to in the case stated as -

(1) The 1956 agreements and amendments with Gulf and Associates. Exhibits A - A23.

(2) Agreements in respect of purchases by objector from BP Group. Exhibits A24 and A25.

(3) The 1964 agreements and amendments with Gulf and Associates. Exhibits B - B13.

I confine myself to making an analysis of the three arrangements in oil economic terms and according to what to my best knowledge and belief can be considered to be normal oil industry practice. I do not express an opinion on the tax aspect of the transactions.

(1) The 1956 Agreements

The main features of these agreements were as follows:

(a) A supply agreement (Exhibit A) under which Gulf Iran undertook to supply Europa with all its gasoline and some gas oil requirements in New Zealand. In the case of gasoline the f.o.b. price was the lowest Platt's quotation f.o.b. at the Caribbean or Persian Gulf regardless of loading port; in the case of gas oil the price basis was the same with the exception that a discount of 5¢ per barrel was granted.

(b) Transportation under the supply agreement (Exhibit A) was covered by a contract of affreightment (Exhibit A4) under which Gulf was responsible for the shipment of the petroleum products supplied to New Zealand ports. The contract of affreightment provided for freight at AFRA* rates from Abadan to the New Zealand port of destination nominated by Europa irrespective of the actual port of loading of the petroleum products supplied. A ceiling to the freight cost was set however by a stipulation that if freight on the basis of AFRA exceeded a certain pre-determined level Gulf would cover Europa for such additional costs except for the first £35,000 during the period of the contract. This ceiling proviso was defined in terms of "The Alternative Freight Rates". These were equivalent to Intascale +9%. At the time the contract was signed AFRA was Scale (the predecessor of Intascale) +17%. The Alternative Freight Rates thus gave Europa an advantage of about 7/- per ton.

This became even greater at the time of the 1956 Suez crisis when at one time the Alternative Freight Rates constituted a saving of over £2 per ton as compared with AFRA

* AFRA (Average Freight Rate Assessment) is a weighted average of freight rates calculated at regular intervals (three months at the time the contract was made) by a committee of London tanker brokers.

(c) This direct supply arrangement was supplemented by an arrangement (Exhibit A7) under which a joint company, Pan-Eastern Refining Co.Ltd. (Paneast), was set up with a capital of £100,000 of which £50,000 was subscribed by Europa and £50,000 by Gulf or their respective nominees. Paneast was incorporated in the Bahamas. Furthermore, an agreement (the Third Schedule to Exhibit A7) was entered into between Gulf and Paneast under which Gulf supplied Paneast with sufficient crude oil, at posted price, to meet the gasoline supplies to Europa under (a) above. The crude oil was notionally processed at unspecified refineries provided by Gulf to the following deemed yields:

Gasoline	25%
Kerosene	11%
Distillate	18%
Residual	40%
Processing loss	6%

Petroleum products were purchased back from Paneast by Gulf (Exhibit A7), in the case of gasoline at the lowest Platt's quotation f.o.b. the Caribbean or Persian Gulf. Gulf or its nominee purchased back the quant[illegible] kerosene, distillate and residual fuel oil [illegible] Platt's quotation f.o.b. the Caribbean but this price was subject to adjustment so as to give Paneast a profit which was calculated on the basis of a specific formula before deducting administrative costs and Bahamas income tax. In my view, as the quantity of crude oil supplied to Paneast was linked to the volume of gasoline purchased by Europa under (a) above, Europa's share of the profits of Paneast in practice had the effect of a discount per U.S. gallon of gasoline supplied to Europa which was in direct relationship to the profit per barrel of crude oil made by Paneast. This view is borne out by the correspondence (submitted by Europa) covering the period between 1958 and 1959 when Gulf agreed to grant crude oil discounts to Paneast in order to protect the latter's profit at not less than 2 1/2¢ gallon. The profits to be made by Paneast were subject to certain adjustment if Europa were supplied with gasoline of other than 79 octane quality.

Paneast paid to Gulf 47 1/2¢ per barrel processing fee.

The profit of Paneast on the basis of the formula on which it was calculated would appear to have been subject to fluctuations resulting from changes in the price relationship of crude oil and gasoline. The general trend of posted prices of gasoline was downward throughout the period of the agreement whereas, from 1960 onwards, the posted price of crude oil became in effect, for reasons explained earlier on, a fixed one; consequently on the basis of that formula the Paneast profit per barrel of crude oil, and hence the resulting price concession per gallon of gasoline supplied to Europa, fell well below that which would have applied at the outset of the contract.

Subsequently letters of adjustment (Exhibits A9 - 14, 16, & 17) were issued by Gulf giving Paneast certain discounts on the crude oil supplied. These adjustments were granted retroactively and in practice raised the level of Paneast's profits above that which would have resulted from the strict application of the formula in the 1956 agreement. The indications are that the level of crude oil discount was fixed from year to year so as to maintain a level of profit per barrel from Paneast roughly in line with the position existing at the outset of the contract. In effect it should be pointed out here that the discounts granted on crude oil from year to year (Exhibits A9 - 14, 16 & 17) varied upwards and downwards as required to achieve this objective and were not always in line with the general trend in discounts on posted prices of crude oil during that period. (See N Tables 3(a) and 3(b)). It would therefore appear that the whole object of the creation of Paneast was to provide a discount on the gasoline supplied by Gulf to Europa in the form of Europa's share in Paneast profits. This is borne out by the Preamble to the contract for organisation of Pan Eastern (Exhibit A7) stating: "Whereas the benefits to be secured and enjoyed by Europa by reason of its beneficial interest in the company so to be incorporated and the execution and carrying out by Gulf and Pan Eastern of the Processing contract is a major inducement to Europa to enter into the Petroleum Products Sales Contract ...". The adjustment in the crude oil price was made in order to maintain this inducement to enter the contract which in practice was tantamount to a discount at a steady predetermined level.

To understand the facts underlying the Gulf-Europa contract of 1956 one has to put oneself in the position of the parties involved at the time.

After the War, Gulf Oil Corporation developed substantial crude oil production in Kuwait and later also acquired a 7% participation in the Iranian Consortium. Lacking market outlets of its own in the Eastern Hemisphere it endeavoured to increase its regular and dependable outlets without, however, itself investing on a large scale. An important deal for the duration of the Kuwait concession was consequently concluded between Gulf Oil and Shell; by pooling with Shell the full range of costs and benefits on Kuwait crude oil from the well to the ultimate consumer, for those quantities which Shell took under the contract, Gulf obtained immediate access to Eastern Hemisphere markets, for which it accepted a realisation per barrel, which allowed for a certain margin for Shell, thus giving Shell crude oil at well below posted prices... It is suggested that on a much smaller scale and in a less far reaching way the deal with Europa can in a way be compared with the Shell deal insofar as through the sale of gasoline to Europa, Gulf sold in the New Zealand market without making an investment of its own. For this it was prepared to grant special terms. There is however an important difference. Whereas the price concession which Shell has on the crude oil varies with realization and cost, that granted to Europa would appear to have a minimum attached to it. Moreover, owing to the nature of the Gulf/Shell contract, Gulf had an interest to sell its gasoline in such a way as not to disturb the market as this would have resulted in a lower profitability for Shell which in turn would have had repercussions on the price of the crude oil supplied to Shell. In this respect, too, Europa and the New Zealand market were ideally suitable from Gulf's point of view.

In 1957 and subsequent years Gulf entered into a number of arrangements with Idemitsu in Japan under which, by giving favourable price and other terms, it obtained an enduring and sizeable outlet for its crude oil. Gulf also made other crude oil supply arrangements, e.g. with the Italian state oil company, ENI.

It must be remembered that the profit to Gulf on each barrel of crude oil was substantial as can be seen from the following table:

Costs and Profits on Kuwait Crude

31° APT Crude Oil

$ per barrel

	1956	1959
Posted Price	1.72	1.67
Production and Other Costs	0.15	0.10
	1.57	1.57
Royalty	0.215	0.21
Tax	0.570	0.575
Total Payment to Government	0.785	0.785
Total Cost to Company	0.935	0.885
Profit to Company	0.785	0.785

Even if part of this profit was given away to the buyer of the crude oil or if a sale of gasoline at a low price made the production of additional crude oil possible, the remaining profit to Gulf meant that such a sale was still very attractive and remunerative business.

The prospect of supplying Europa must have been particularly tempting, because it must have been one of the fairly rare opportunities to sell gasoline without the other products made co-jointly in refineries. It was possible (as indeed it was necessary in order to get the business) to provide extraordinary incentives to the gasoline buyer, simply because, in the mid-1950s, the resulting quantities of middle distillates and heavy fuel oil could be disposed of at altogether favourable prices in other markets, whereas gasoline at that time was a surplus product. Such a deal (for gasoline only) could and probably normally would have been organised as a straight sale, but it may well be that at that time both parties preferred not to spell out the real gasoline price.

It is not unusual for a marketer to endeavour to obtain a stake in the refining phase (backward integration) but it would be somewhat farfetched, in oil industry terms, to do so if that marketer in fact needs limited quantities of one product only. Agreements are known in the oil industry under which crude oil is supplied to a refinery but only a certain proportion - but generally the greater proportion - of the refinery output is retained for marketing by the refiner and the balance of the products is bought back by the supplier of the crude oil. Such deals, however, generally relate to specific refineries and definite supply prices for crude oil, and purchase prices for all the products bought back are usually laid down with escalation clauses to take account of changes in market conditions. There are also cases where a processor supplies crude oil to a refinery and receives products yields which are not in line with the actual yields obtained from the crude. Financial adjustment for such deemed or synthetic yields is then generally covered by the processing fee. Again such agreements generally relate to an actual refinery.

Another example which deserves mention is the joint construction of a refinery by an oil company and a petroleum chemical manufacturer of which there are several in recent years. The oil company has a crude oil supply right to the joint refining company at a certain price. This crude is processed at the jointly owned refinery. The chemical company purchases its feedstock and fuel oil requirements from the joint refinery leaving the balance of the products, generally middle distillates, to be marketed by the oil company. In these cases prices of crude oil, feedstocks and petroleum products do however vary at least to some extent with actual market fluctuations.

What I consider to be particularly unusual is for Europa to purchase products for its own marketing not direct from Paneast, but from another subsidiary of Gulf, which itself supplied the crude oil to Paneast. If Paneast sold at least part of the products, e.g. gasoline, direct to Europa and there was no direct sales agreement between Gulf and Europa running parallel with the processing arrangements it could be accepted that, however notional the refining operation Paneast had a genuine crude oil purchase and processing arrangement with Gulf, who would buy back some of the products which Paneast could not directly dispose of to its principal customer, Europa. The fact that there is no direct commercial link between Paneast and Europa, except the corporate link of Europa's shareholding in Paneast, further proves to my mind that the whole Gulf-Paneast processing arrangement is in fact a deal between a number of Gulf subsidiary or affiliated companies and constitutes nothing but a subterfuge to cover up a discount by Gulf to Europa.

I also do not consider it consistent with general industry practice to subsidise the refiner's profit margin by other means because the original agreement did not give the intended result due to the freezing of the crude oil price referred to above. A marketer integrating backwards would be unlikely to be almost entirely shielded from possibilities of losing money by virtue of developments of the refining margin as a whole and of the realisation for the rest of the products.

However, as has been shown, the supplying company at that time had a particular desire to increase its sales in areas where it had no historical position and without making capital investment. Consequently it went out to obtain the business by accepting what, in the overall context of the area, was in the end result a low realization, in order to clear the hurdle with which it was confronted.

Taking into account the climate which prevailed in 1955/6 and in particular bearing in mind the need for Gulf to find an outlet for its products from Abadan, it is evident that the Europa-Gulf-Paneast agreements were designed to give Europa an incentive to purchase its requirements from Gulf.

In this connection it is however also relevent to point out that under its previous long-term supply arrangements with Caltex, Europa had enjoyed a small discount as well as a freight concession. During the period from the date the original agreement was signed, in 1937, until mid-1954 Caltex was not obliged to, and did not in fact, provide transportation for Europa. At the same time Caltex undertook to pay Europa the difference between the freight rate which Europa actually paid for the shipment of products from the loading port to New Zealand ports of discharge, and the "current ocean freight rate", applicable on the date of loading, for the transport of such products from Los Angeles to New Zealand, less 7½%. This was subject to Caltex' prior approval of the charter rate obtained by Europa for the actual transport of products and the products originating from a source other than what was then the Dutch East Indies.

In August 1954 a contract of affreightment was made between Europa and Caltex under which Caltex agreed, from late July, 1954 to 31st December 1955, to provide transport for the petroleum products it sold to Europa. The freight rate applicable was MOT minus 10% (British Ministry of Transport rate was about equivalent to Intascale) or the actual voyage charter rate if less than MOT - 10% or the voyage rate adopted generally for similar trip charters if it should be lower. In this way Europa benefited from a freight rate which was substantially below the AFRA rate.

Reverting to Gulf's interest in concluding the deal with Europa, a particular attraction of the arrangement as far as Gulf was concerned was in Europa's need for motor gasoline only, which was at that time a surplus commodity to Gulf. It was the heavy fractions of oil that were in greatest demand in most parts of the world. This is reflected by the fact that whereas in the period 1956-1960 gasoline demand in the Eastern Hemisphere increased at a rate of 7% per annum, the inland demand for gas/diesel oil and heavy fuel oil rose by almost 15% and 14% respectively. In these circumstances light ends from petroleum refining only had gasoline value when they could be sold as motor fuel. This fact was recognised by an executive of the Italian subsidiary of Shell in December, 1955, i.e. shortly before the Gulf-Europa 1956 agreements were executed, in a pamphlet entitled "Contributo dell 'industria petrolifera italiana al nostro fabbisogno di energia" by S. Somazzi, Shell Italiana S.p.a. December 1955. There he stated:

> "Moreover, when considering gasoline, kerosene or gasoil for burning in liquid form in furnaces, boilers, gas turbines or gasification turbines, we are not dealing with noble use products used as motor fuel or for illumination, but with products coming straight from primary distillation, lead-free and additive-free, where neither octane number or cetane number is of importance, nor are special reforming or other processes necessary.
>
> Therefore, a price differential between these products and fuel oil will reflect solely their greater energy value and their greater efficiency. Consequently the following formula can be evolved:-
>
> y = P.R.x
>
> where y = the price of white products used as liquid fuels
> x = the relative calorific values
> R - the relative efficiency and handling expenses, etc. to be calculated in each case and for individual applications."

In the light of this statement it is not surprising that Gulf should have been glad to sell its surplus gasoline to Europa at a price which in the end result even after allowing for upgrading costs to gasoline was better than the fuel oil equivalent on the basis of the formula of Mr Somazzi quoted above. The saying at the time in the industry was that if you sell a barrel of gasoline you have sold five barrels of crude oil. It therefore made sense to sell gasoline at a low price if other products could be sold at the normal price.

[INTERPOLATION: Gasoline or is it would be in oil industry terms before upgrading naphtha would only have the value of fuel oil plus an allowance for the higher calorific value and handling charges.]

SHORT ADJOURNMENT.

The foregoing analysis must lead one to the conclusion that the Bahamas arrangement can only be considered to be a substitute for a direct price discount.

(2) EUROPA-BP Contracts

At the time of the BP contracts (Exhibits A24 & 25) discounts were undoubtedly available in the Caribbean on the products concerned, as was indicated by the graphs A - D showing discounted prices at the Caribbean based on Channel Port Index. There was also some evidence that discounts were available at the Persian Gulf. This is particularly borne out by the references quoted from the 1961 report of the Damle committee on pages 17/18 of this brief.

In the circumstances a contract involving principally the supply of gas oil can be considered to have qualified for a discount of 10% at the time at which these BP contracts were concluded. Such discount was, however, not incorporated in the direct BP-Europa deal (Exhibit A24) but was paid as a commission to Pacific Trading and Transport, a Europa subsidiary (Exhibit A25).

With regard to the freight agreed in the basic contract (Exhibit A24), a comparison of freight actually charged on the basis of TALFI (a group freight indicator used by BP in some of their contracts) and General Purpose AFRA shows that, taking the period of the contract as a whole, there was very little difference between the application of TALFI and General Purpose AFRA and there is nothing to be said against the use of TALFI.

The freight discount granted under the arrangements made with Pacific Trading and Transport Co.Ltd. (Exhibit A25) amounted at times up to 5/- to 6/- per ton (say 8% - 10%) depending on date of loading and port of discharge although during certain periods of the contract it was much less.

(3) The 1964 Agreements

The 1964 Agreements relating to the position after the Refinery at Whangarei came into operation again consist of two parts.

(a) A supply agreement (Exhibit B) between Gulf Exploration Co. and Europa Refining Company covering Europa for crude oil and other refinery feedstocks, e.g. naphtha and distillate, and such other petroleum products as Europa may need in excess of those becoming available from the processing of crude oil and feedstocks at the N.Z. Refinery to meet its products market requirements. The arrangement regarding the supply of finished products is optional so far as Europa is concerned. Under this agreement Europa purchases crude oil, other feedstocks and finished products at the following prices:

(i) crude oil: at posted prices

(ii) naphtha: at the posted price of Kuwait crude oil plus 2¢ per API^{o} of gravity that the naphtha's API gravity exceeds 31^{o} API, i.e. the gravity of Kuwait crude oil

(iii) gas oil: at the lowest posted price for 53/57 DI gas oil f.o.b. Abadan, Iran

(iv) wide cut distillate: a composite price based on the naphtha and gas oil content and the prices in (ii) and (iii) above

(v) finished petroleum products (motor gasolines, jet fuels, kerosenes and gas oils): at the lowest posted price for each such product f.o.b. Caribbean or Persian Gulf loading ports. These prices have been adjusted by subsequent letters as follows:

(i) crude oil: March 16, 1965 (Exhibit B1) giving discounts of 16¢/bbl on Kuwait and Iranian Heavy crude oil and 20¢/bbl on Iranian Light crude oil retroactively to April 1, 1964; June 30, 1966 (Exhibit B4) increasing these discounts to 18¢/bbl for Kuwait crude oil and 25¢/bbl for Iranian Light crude oil.

(ii) naphtha: March 16, 1965 (Exhibit B2) granting a discount of 29¢/bbl retroactively to April 1, 1964.

(iii) gas oil: March 16, 1965 (Exhibit B3) invoicing at the lowest posted price for 48/52 DI gas oil at Abadan irrespective of gravity or loading port.

(b) Crude oil supply and crude oil, feedstock and petroleum products offtake arrangements between Gulf and Paneast (Exhibit B5). Under this arrangement Gulf supplies to Paneast crude oil sufficient to meet the requirements of crude oil, feedstocks and finished products of Europa under (a) above. Gulf then processes for Paneast a part of the crude oil and purchases back from Paneast the resultant feedstocks and finished products and the unrefined crude oil equivalent to the quantities supplied to Europa by Gulf. These transactions take place at the following prices:

(i) crude oil: Gulf supplies to Paneast at posted price less 15%.

Paneast sells crude oil to Gulf at the same price as Gulf sells to Europa under (a) (Exhibit

B) above, i.e. basically posted price as amended by subsequent letters of adjustment (Exhibits B1 & 4).

Assuming a posted price for Kuwait crude of \$1.59/bbl Paneast therefore buys at \$1.59 less 15% or \$1.35/bbl but basically resells crude to Gulf at \$1.59 making a profit of 24¢/bbl which however has subsequently been reduced to 8¢/bbl and 6¢/bbl respectively.

(ii) naphtha: Gulf supplies naphtha to Paneast at \$1.46/bbl irrespective of gravity covering the costs of related crude oil and processing. This price is designed to escalate with the posted price of Kuwait crude oil.

Paneast sells naphtha to Gulf at the same price as Gulf sells to Europa under (a) (Exhibit B) above, i.e. basically posted price of Kuwait crude plus 2¢ per °API gravity in excess of 31° API as amended by subsequent letter of adjustment (Exhibit B2)

Assuming an API gravity for naphtha of 62° API and a posted price for Kuwait crude of \$1.59/bbl Paneast sells naphtha to Gulf at \$1.59 plus 62¢ = \$2.21/bbl. This means that Paneast makes a profit of \$2.21 less \$1.46 = 75¢/bbl which however has subsequently been reduced to 46¢/bbl.

(iii) gas oil: Gulf supplies gas oil to Paneast at \$2.00/bbl (escalating with the posted price of Kuwait crude oil) covering the costs of related crude oil and processing.

Gulf pays Paneast the same price as it recovers from Europa under (a) (Exhibit B) above, i.e. basically the lowest posted price for 53/57 DI gas oil at Abadan as amended by subsequent letter of adjustment (Exhibit B3).

Assuming posted price for 53/57 DI gas oil at Abadan of 6.7¢ per U.S. gallon or $2.81 per bbl. Paneast would buy the gas oil from Gulf at $2.00/bbl and sell it back to Gulf for $2.81/bbl thus making a profit of 81¢/bbl which however has been subsequently reduced to 73¢/bbl.

(iv) wide cut distillate: the transaction is similar to that in the case of naphtha and gas oil. The actual values both in respect of costs of crude oil and processing on the one hand and the sales price to Gulf from Paneast and from Gulf to Europa depending on the actual components of naphtha and gas oil respectively.

(v) finished products (motor gasolines, jet fuels, kerosenes, gas oils): for these products the price, covering costs of crude oil and processing, at which Paneast acquires these products from Gulf are negotiated annually but escalate in the course of that year with the lowest posted price in the Caribbean or Persian Gulf which is the price at which Gulf sells to Europa and at which Gulf purchases from Paneast. The difference between the Paneast buying and selling price constitutes the Paneast profit on these products.

(c) Transportation for the feedstock to be supplied to Europa is provided for under a contract of affreightment between a Gulf subsidiary Propet and Europa (Exhibit B8). This contract stipulates freight at the AFRA rate for large vessels, i.e. then in the range 45,000 dwt. to 69,999 dwt., although Propet only has the right to use vessels over 45,000 dwt. if Europa agrees. This agreement is supplemented by a further contract (Exhibit B10), between Gulf Oil and Europa, covering Europa in the event that the AFRA for large vessels exceeds Intascale - 45% in the case of feedstock and certain higher rates in the case of petroleum products. The terms provided for transportation under these arrangements are undoubtedly better than those at which Europa could cover itself for its volume of freight on a long-term basis, although it is admitted that occasional opportunities for spot charters, at lower rates, can be expected to have occurred during the period covered by the contract.

Having outlined the 1964 Agreements I should like to make the following comments:

(a) At the time these contracts were negotiated substantial discounts on the Middle East crude oils covered by the Gulf-Europa contract (Exhibit B) were available to armslength buyers. Examples of such discounts are given in Table 3. This shows that the discounts generally granted at that time were about in line with or higher than those granted to Paneast under the Gulf-Paneast arrangements (Exhibit B5). It is therefore inconceivable that Europa should have entered into a crude oil supply arrangement without a discount on the posted price at least in an indirect form. Such a discount in effect was provided by means of the Paneast arrangements and this is substantiated by the fact that when direct discounts were granted to Europa (Exhibits B1-4) the profit of Paneast was automatically reduced by the full extent of those direct discounts (Exhibit B6) leaving the Paneast profit to be shared between Gulf and Europa at a much reduced level.

(b) Although refiners sometimes engage in the exchange of crude oil it is not usual for a refining company to trade in crude oil. But even assuming that it did, commission payable on what would have to be regarded as a brokerage business, i.e. the purchase of crude oil from one party and its sale to another without any physical change taking place in the crude oil, would normally amount to about 1% or 2% of the sales price of the crude. It would never amount to 15% (Exhibit B5). It would also be unusual for a broker to buy from and re-sell to the same party.

(c) The prices, covering related costs of crude oil and processing, at which naphtha and gas oil are transferred to Paneast of $1.46 per bbl and $2.00 per bbl respectively are prices at which spot sales might take place or have taken place. I have no knowledge of other <u>long term</u> contracts for these feedstocks being concluded at such low prices and consider it unlikely that any have taken place.

(d) The arrangements for the sale of finished products under the 1964 agreements are based on a similar principle to that of the 1956 agreements. Paneast selling to Gulf and Gulf to Europa at lowest posted prices. What is not defined is the transfer price, covering costs of crude oil and processing, at which Paneast acquires the finished products from Gulf and hence the Paneast profit on these products. I would, however consider it unlikely that Europa's share of the difference between the buying and selling price of Paneast would be any different from the discount obtainable by Europa on the open market. If it were otherwise Europa would presumably exercise its option to buy these products elsewhere. Hence the profit to Paneast can be expected to be, as before, such as to allow for a certain level of discount to Europa on the prices of the products supplied by Gulf.

Indeed there is some evidence that the supply of such finished products to Europa continues to take place within the framework of the 1956 agreement. This is borne out by Exhibit A17 granting a discount by Gulf to Paneast of 35¢ per bbl on Light Iranian crude in respect of crude oil sold in 1965, i.e. after the coming into operation of the N.Z. Refinery and after the termination of the 1956 Agreements (Exhibits A2 & 15). It is incidentally of interest to note that this discount is out of line with that granted for the year 1965 for the same crude oil to Europa of 20¢ per bbl (Exhibit B1) and to Paneast under the 1964 Agreement of 15% or 26.7¢ per bbl (Exhibit B5). This would further suggest that the discount granted to Paneast in respect of crude oil relating to finished products supplied was brought up to a level to give Paneast an assured profit which would allow for the intended discount to Europa on the products supplied by Gulf.

<u>Addendum to Brief of Evidence of Mr W.L. Newton</u>

Since my arrival in New Zealand I have been shown the Caltex offer of 27 May 1955 and the agreements between Europa and Gulf and Paneast of 1962 which were replaced by the 1964 agreements. On these two documents I should like to comment as follows:-

1. <u>Caltex offer of 27 May 1955</u>. This agreement has some similarities with the Gulf Agreements. It also provides for a processing arrangement via a Bahamas Company. The offer is however less realistic than the Gulf deal of 1956 in the way it relates the volume of crude oil to be processed under the arrangement to the volume of gasoline sold to Europa. Whereas the Gulf deal provides for a quantity of crude oil to be processed which is realistic in terms of refining yields in relation to the quantity of gasoline supplied to Europa. The Caltex offer by basing the quantity of crude oil on the value of Europa's offtake would reflect a gasoline yield of about 60% which is technically unrealistic on the basis of Middle East crude oils available to Caltex which were clearly intended to be used.

On the other hand the Caltex offer was more realistic than the Gulf deal in certain other respects. In particular it relates to a specific refinery - the Bahrein refinery. It also provides for a refinery profit varying in line with actual changes in prices of crude oil and products with a time limited guarantee of a profit margin of not less than one quarter than that which would have prevailed on 28 February 1955. If the profit was to reflect a discount per gallon of gasoline it was therefore not a fixed one.

One further interesting point about the Caltex offer is Clause J on p.14. This refers to the discontinuation of "present discounts, and payments including pre-emptive payments" which suggests that there were such discounts and payments under the contract with Caltex then in operation.

Contracts of 1962 with Gulf & Paneast

These follow largely the agreements signed in 1964. There are however two significant variations.

With regard to the contract of affreightment Clause 6 of the 1962 contracts provides for AFRA freight whereas the 1964 agreement stipulates "the best market freight rate obtainable by Propet at the time of the voyage". Furthermore in the 1964 contract (Exhibit B.8) provision is made for the Alternative Freight Rates which are fixed at Intascale - 45% for the duration of the contract. No such provision is made in the 1962 agreement. Instead this freight concession was incorporated in the Processing Contract with Pan East. In Clause 5 provision is made for Pan East to charter from Gulf the tonnage needed for Propet to supply Europa. The rate laid down is the same as that of the Alternative Freight Rates of the 1964 Contract. Additionally the transportation profit of Pan East was then intended to be doubled to give the full benefit of the Alternative Freight Rates to Europa via Pan East. This was to be effected by adding to the price of the products not required by Europa and disposed of by Gulf an amount equal to the freight benefit. In other words under the 1962 Agreements the benefit of the Alternative Freight Rates, if any, and they are likely to have been considerable, would have gone to Pan East instead of direct to Europa.

Also of interest is Clause 4.03 of both the 1962 and the 1964 Processing Agreements. The 1962 Agreement shows an example suggesting a price for gasoline of 7.4 cents per US gallon for 93 octane and 5.3 US cents per US gallon for 83 octane quality. These example prices happen to be 2.5 cents per US gallon less than the f.o.b. posted prices at the date of the 1962 contract and would therefore suggest a discount of this magnitude. The example has been omitted from the 1964 Agreement.

CONCLUSION OF WRITTEN EVIDENCE

Additional points arising from evidence of Mr Todd - I refer first to Notes of Evidence page 2058 line 28 - reference to typical Europan refinery having about five days' storage of crude - would you comment on this? The storage in European refineries has always been and is well above five days. Indeed not only in France as Mr Todd suggested but in all main European countries there is now a legal requirement to hold a total of 65 days of stocks either in the form of crude oil or petroleum products. In some countries the stipulation is even higher. U.K. is a secret but I know and we know from Suez crisis - it is well known U.K. is at least three months storage. In any event, even apart from the regulations which may be in force it is just technically not possible for refineries to operate on 5 days storage because crude oil is nowadays being delivered in Europe in tankers of 200,000 tons size. Even for a 5 million ton refinery 200,000 ton tanker would mean about two weeks supplies and a refinery will never have its tanks empty - they will always have a certain buffer stock to allow for say the delay in arrival of a tanker because of bad weather. Therefore I think there will be no refinery with a storage capacity of less than three weeks crude. I have made enquiries in last few days with regard to the position at the New Zealand refinery and from information given to me and on a basis of an annual through put of 2½ million tons storage capacity for feed stocks including naphtha is something of the order of thirty days.

Page 2071, line 13 - "At the time of the 1956 negotiations Europe and Japan were each on the threshold of a vast increase in automobiles - motor cars. And we felt that in those markets the demand for gasoline which had been relatively low in previous years would show a sharp increase and prospects were for a relative improvement in the price of gasoline compared with other products."? It is correct what Mr Todd said in evidence that Europe and Japan were on the threshold of a considerable expansion of automobile demand and hence gasoline. But this in my view is only half the story. This expansion in gasoline demand is part of the overall industrial and economic expansion of these areas and this expansion brought with itself an even greater expansion in the demand for the heavier parts of the barrel. This position if I may quote an example from my own experience as a consultant was already clear to Doctor Frankel and myself at the end of 1955, shortly after we had formed our consultancy firm. We were at that time an adviser to British Celanese now a subsidiary of Cortaulds who had a factory for the manufacture of snythetic fibres in England and they came to us and consulted us about their feed stock and on what conditions and terms they should purchase. They were at that time using a middle distillate feed stock - a gas oil feed stock - and they told us they could alternatively use a naphtha feed stock. We looked at the time at the overall supply position of both these types of feed stocks. And we came to the conclusion that where as middle distillates were moving into a position of shortage naphtha was moving into one of surplus. We advised them to switch to the naphtha feed stock and they followed that advice and they at that time got a much better supply agreement with I believe it was ESSO Standard Oil, New Jersey than they would have got for middle distillates.

Passing now to discounts which is referred to at page 2104 of the Notes, line 28. [Reference to Exhibit 2 - Examples of Armslength Sales and Offers of Petroleum Products 1955-1959]. And then page 2153 in re-examination at line 11 - Those sales to military or canal company are all Government sales? Yes. Do you regard Government sales as a reliable guide to market sales? No" etc. Would you comment on those two matters? That is not a table prepared by you? No, table prepared by Inland Revenue and shown to me here. My comment - it looks as if the Inland Revenue have followed the same system of analysis as in Table II of my brief. With regard to the offers made to the U.S. Military authorities and to the Panama Canal Company these are made in reply to public tenders and there is strong competition between the companies to obtain this business. I must therefore regard them as of relevance so far as short term sales of these products are concerned and I do know that Platts do take them into consideration as one of the factors which they consider in reporting first the channel port index and now in their reports on the level of discounts in the Caribbean. It is one of the factors of several. As for the item relating to German prices I have been shown that particular issue of Platts oilgram since I arrived here. It is a general report on border prices as revealed by the import statistics of the German Customs Authorities. And it compares the position in 1962 the date of the particular Platts oilgram with the import prices reported by the same German Customs authorities in 1955, I believe also in 1956 and 1959. I believe that these prices are not a true reflection of the German market at the time which certainly in 1955-56 was generally based on import parity from the Caribbean area.

Passing now to reference on page 129 line 34 "The reason for Europa not buying gasoline direct from Pan-Eastern is based upon the principle which flows throughout these contracts of availability of products supplies to Europa from global sources." Would you comment on this reason? I do not think that this is a valid reason. Mr Todd in his evidence has referred to the system of product exchanges which exist between oil companies all over the world. And I should have thought that if there had been a processing agreement of Paneast with a particular Gulf Refinery say the Abadan refinery, and if under the set up the gasoline were supplied direct by Paneast to Europa and if for one reason or another it had not been found convenient for Gulf who would have been handling the processing to make these quantities available out of the Abadan refinery I think in such circumstances it would have been perfectly feasible for Europa to make one of these exchanges with Gulf and off take from another more conveniently located Gulf refinery.

TO BENCH: But if general insurrection in Middle East? If that happened it would presumably have been possible for Gulf and Europa to agree to transfer processing arrangement to another Gulf refinery - Caribbean or United States.

TO COUNSEL: What you have said is consonant with a guarantee from Gulf of supply? Yes.

I now refer to page 147of the Notes of Evidence - 1964 contract - "They were particularly concerned as being one of the largest crude oil sellers in the world and particularly with vast contracts for crude in Japan, not to make any decision regarding the discount for invoicing into New Zealand until the matter had been carefully examined with all these considerations which lay behind the problems. And that is how the matter rested at that time." Comment on that? Gulf had at that time and had had for some years from about 1957, 1958 a crude oil supply contract with Japanese Refining Company, Idemitsu - and it is well known that under that agreement Idemitsu not only had a substantial discount but also a substantial loan at a very favourable interest rate - loan from Gulf. I refer to Table 3(b) which relates to year - one relating to Japan, 1964/65. Gulf 1965 and this was additional sale to original agreement which is also known to have had discount and is borne out by the fact that date of loan of 1962. Fourth table from the end, last line on page. Gulf gave Idemitsu a 14 cent discount on Kuwait crude but this although previous deal had not been reported was an additional sale believed to have been made on same terms as the main deal. Main deal was first done about 1957/58. And it was then re-negotiated and discount increased about the time this 30 million dollar loan was made in 1962. This 30 million dollar loan was given at an interest rate of 4½% which is well below the level of interest rates ruling in Japan at that time. I believe that to have been something in range of eight if not ten per centum. It has for some time been the habit of oil companies to give low interest loans to Japanese companies for their refining expansions and these low interest loans provided an additional discount in an indirect form to such Japanese refineries. And explains to some extent why discounts to Japan and I mean here direct discount, were lower than those granted to European independent refineries. The security provides that that refinery is tied to the lender? Yes, by long term crude oil supply contract. Also gave oil company security of outlet for a long time.

There have been comparisons made between New Zealand Whangarei Refinery and the Paneast set up - would you comment on the comparisons? Relating to your analysis?

To my mind there are two fundamental differences between the processing arrangements at Whangarei and the set up under the Pan-Eastern deals. In the first place in the case of Whangarei you have a definite refinery where actual processing takes place instead of what must be regarded as purely notional refinery in Pan Eastern set up. Secondly, as far as I can see although for convenience of running the refinery what are in effect changes of products take place between the individual companies processing at Whangarei basically the refining company never becomes the owner of either the crude oil or the petroleum products. These as far as I can see remain the property of the processing company all the time. In the case of Pan Eastern however the crude oil becomes the property of Pan Eastern which then processes and sells the products back to Gulf and Gulf then in turn sells them to Europa at least as far as Gasoline is concerned. Whangarei is a joint refinery and as far as I can see the method of operation there is entirely in line with industry practice at other joint refineries.

Now you are aware and have seen charts put in under heading of Actual and Notional not prepared by you? No. We had in our London office when trying to understand the flow of oil under these arrangements drawn up some charts of our own in London to help our understanding. These charts are not those. I have seen and examined them and regard them as correctly portraying Actual and Notional positions according to my interpretation. It is proper to indicate that you were doing that in London - is your firm consulted by New Zealand Government? Yes. We are general advisers to Ministry of Industries and Commerce on all matters relating to the petroleum industry on which that Department cares to seek our advice. Including New Zealand Refinery, any advising capacity there? No direct advisory capacity with New Zealand Refining

Company. Naturally when the Government discussed matters relating to the refinery with the companies, they from time to time seek our advice on particular points relating to the refinery.

And it has been suggested that crude discounts are included in posted prices of products? Discounts on crude are included in posted prices of products? No, that is not so. Because as I earlier explained, owing to the problem of taxation of refinery profits in producer countries, the posted prices for products have to be maintained at a certain level in order to give the uplift for taxation purposes.

TABLES N. 1 to N.3(b) and GRAPHS N-A to N-D follow.

Development of East of Suez Demand and Refining Capacity

Million Tons

rea.	1950 Demand	1950 Refining Capacity	1955 Demand	1955 Refining Capacity	1960 Demand	1960 Refining Capacity	1962 Demand	1962 Refining Capacity	1964 Demand	1964 Refining Capacity
ustralasia	7	1.0	9	8.1	13	12.1	14	15.7	18	20.9
efining Capacity % of Demand		14		90		93		112		116
apan	2	3.7	10	8.5	31	34.2	48	54.9	74	92.8
efining Capacity % of Demand		185		85		110		114		125
ther Asia (Excluding Middle East)	15	11.7	27	19.0	29	25.2	34	35.9	39	44.8
efining Capacity % of Demand		78		70		87		106		115
ast and South Africa	8	2.5	10	3.5	12	5.9	16	7.8	20	16.5
fining Capacity % of Demand		31		35		49		49		83
ddle East	9	42.5	12	58.4	26	67.0	29	74.2	32	77.8
fining Capacity % of Demand		472		487		258		256		243
tal East of Suez	41	61.4	68	97.5	111	144.4	141	188.5	183	252.8
fining Capacity % of Demand		150		143		130		134		138

Products 1960-1964

Source of Information	Country	Buyer	Seller	Product	Quantity	Selling Price (1) f.o.b.	Selling Price (1) c.i.f.	Posted(1) Price	Discount on f.o.b. basis	Discount on c.i.f. basis with freight at: (1) AFRA(2)	Discount on c.i.f. basis with freight at: (1) Intascale -50%
A. WEST OF SUEZ											
Platts Pricegram											
10.5.60	Panama	Panama Canal Company	Sinclair	87 Gasoline	N.A.	-	7.95	10.125(CA)	-	2.9	2.665
10.5.60	Panama	Panama Canal Company	Sinclair	96 Gasoline	N.A.	-	9.3	11.575(CA)	-	3.0	2.765
20.10.60	Panama	Panama Canal Company	Mobil	87 Gasoline	N.A.	-	7.65	10.125(CA)	-	3.2	2.965
20.10.60	Panama	Panama Canal Company	Mobil	96 Gasoline	N.A.	-	9.03	11.5 (CA)	-	3.195	2.96
7.12.60	France	(at Donges)	Gulf	83 Gasoline	50 mll.galls.	-	6.93	9.625(CA)	-	3.875	3.305
13. 4.61	U.S.A.	Military Authorities	Shell	115/145 Av. Gasoline	21 mll.galls.	13.0	-	16.0 (CA)	3.0	-	-
20. 6.61	Uruguay	ANCAP	Sinclair	83 Gasoline	126,000 bbls.	6.76	-	8.5 (CA)	1.74	-	-
20. 6.61	Uruguay	ANCAP	Gulf	83 Gasoline	126,000 bbls.	5.75	-	8.5 (CA)	2.75	-	-
20. 6.61	Uruguay	ANCAP	Shell	83 Gasoline	126,000 bbls.	-	7.6	8.5 (CA)	-	2.14	1.57
20. 6.61	Uruguay	ANCAP	Esso	83 Gasoline	126,000 bbls.	-	6.8	8.5 (CA)	-	2.95	2.375 (3)
20. 6.61	Uruguay	ANCAP	Texaco	83 Gasoline	126,000 bbls.	-	8.5	8.5 (CA)	-	1.24	0.65
19.10.61	U.S.A.	Military Authorities	Shell	115/145 Av. Gasoline	31.5 mll.galls.	12.8	-	15.5 (CA)	2.7	-	-
12. 4.62	Panama	Panama Canal Company	Gulf	90 Gasoline	N.A.	-	6.33	9.3	-	3.6	3.46
12. 4.62	Panama	Panama Canal Company	Gulf	99 Gasoline	N.A.	-	8.34	11.6	-	3.89	3.75
29. 6.62	Uruguay	ANCAP	Esso	48-52 Gas Oil	25,000m3	-	8.6	8.1 (CA)	-	0.93	0.266
29. 6.62	Uruguay	ANCAP	Esso	Kerosene	25,000m3	-	9.73	9.3 (CA)	-	0.91	0.29
21. 9.62	Panama	Panama Canal Company	Gulf	90 Gasoline	N.A.	-	5.88	9.2 (AB)	-	3.94	3.81
21. 9.62	Panama	Panama Canal Company	Gulf	99 Gasoline	N.A.	-	8.08	11.6 (CA)	-	4.14	4.01

For Footnotes see Overleaf

2050

[illegible]

Source of information	Country	Buyer	Seller	Product	Quantity	Selling Price (1) f.o.b.	Selling Price (1) c.i.f.	Posted (1) Price	Discount on f.o.b. basis	Discount (1) on c.i.f. basis with freight at: AFRA (2)	Discount (1) on c.i.f. basis with freight at: Intascale -50%
9. 3.63	Panama	Panama Canal Company	Texaco	90 Gasoline	N.A.	-	5.7	8.9 (CA)	-	3.9	3.69
9. 3.63	Panama	Panama Canal Company	Texaco	99 Gasoline	N.A.	-	7.4	11.2 (CA)	-	4.4	4.29
9. 9.63	Panama	Panama Canal Company	Gulf	90 Gasoline	N.A.	-	5.4	8.6 (PG)	-	3.8	3.69
9. 9.63	Panama	Panama Canal Company	Shell	99 Gasoline	N.A.	-	7.3	11.2 (CA)	-	4.5	4.35
5. 3.64	Panama	Panama Canal Company	Texaco	90 Gasoline	62,500 bbls.	-	5.336	8.9 (CA)	-	4.117	4.054
5. 3.64	Panama	Panama Canal Company	Texaco	99 Gasoline	67,500 bbls.	-	7.049	11.2 (CA)	-	4.764	4.641
0. 8.64	Panama	Panama Canal Company	Texaco	99 Gasoline	N.A.	-	7.05	11.2 (CA)	-	4.69	4.64
. EAST OF SUEZ											
9. 8.60	Pakistan		Standard-Vacuum	79 Gasoline	(4)	8.2 (PG)	-	8.2 (AB)	Nil	-	-
9. 8.60	Pakistan		Caltex	Diesel Oil	(4)	7.9 (PG)	-	7.7 (AB)	Nil	-	-
9. 8.60	Pakistan		Burmah-Shell	Furnace Oil	(4)	$1.55 (PG)	-	$1.55 (AB)	Nil	-	-
1.10.60	Egypt	General Petroleum Authority	Shell	Gas Oil	N.A.	-	8.57(5)	7.9 (AB)	-	0.63	0.05
2. 1.62	Japan		N.A.	Bunker C	1 Cargo	$1.59 (PG)	-	$1.65 (AB)	0.06(S)	-	-
2. 1.62	Japan		N.A.	Bunker C	8 Cargoes	$1.69 (PG)	-	$1.75 (RT)	0.06(S)	-	-
2. 1.62	Japan		N.A.	Bunker C	7 Cargoes	$1.75 (PG)	-	$1.75 (RT)	Nil	-	-
2. 1.62	Japan		N.A.	Bunker C	11 Cargoes	$2.20 (PB)	-	$2.10 (PB)	Nil	-	-
6. 9.62	Egypt	General Petroleum Authority	Esso	53.57 Gas Oil	120,000 tons	7.5 (5)	-	8.2 (CA)	0.7	-	-

For Footnotes see Overleaf

Examples of Armslength Sales and Offers of Petroleum Products 1960–1964

Source of Information	Country	Buyer	Seller	Product	Quantity	Selling Price (1) f.o.b.	Selling Price (1) c.i.f.	Posted (1) Price	Discount on f.o.b. basis	Discount (1) on c.i.f. basis with freight at: AFRA (2)	Discount (1) on c.i.f. basis with freight at: Intascale -50%
6. 9.62	Egypt	General Petroleum Authority	Esso	48–52 Gas Oil	30,000 tons	7.4 (5)	-	8.1 (CA)	0.7	-	-
P.I.W. 30.11.64	Korea	Korean Oil Corporation	Gulf	Gas Oil	N.A.	5.3	-	7.1 (AB)	1.8	-	-
30.11.64	Korea	Korean Oil Corporation	Gulf	Fuel Oil	N.A.	$1.45	-	$1.55(AB)	$0.10	-	-

(1) Fuel oil in $ per bbl. all other products in ¢ per U.S. gallon
(2) Handy size AFRA operative at the time of sale or offer
(3) c.& f. quotation, insurance included in discount
(4) Not a particular sale, but the general price level of imports into Pakistan
(5) Sale or offer includes a buy-back arrangement

N.A. – not available
(CA) – Caribbean
(PG) – Persian Gulf
(AB) – Abadan
(RT) – Ras Tanura
(PB) – Pulau Bukom
(FE) – Far East
P.I.W.– Petroleum Intelligence Weekly

N - Table 3(a)

Examples of Armslength Sales and Offers of Middle East Crude

West of Suez

Source of information*	Country	Buyer	Seller	Crude	Posted Price	Selling Price f.o.b.	Discount on f.o.b. basis**	Selling Price c.i.f.	Discount on c.i.f. basis - Freight at Intascale -50%**	Remarks
					$/bbl.	$/bbl.	¢/bbl.	$/bbl.	¢/bbl.	
i) South America										
latt's 11.11.55	Argentina	YPF	B.P.	31°Kuwait	1.72	1.63	9	-	-	Price indicated is for sale of up to 13.2 million bbls.; for between 5-6.5 million bbls. price quoted was $1.66/bbl. and for under 5 million bbls. $1.69/bbl.
etroleum Week 3. 7.58	Argentina	YPF	Gulf	31°Kuwait	1.85	-	-	2.30	18	
etroleum Week 2. 4.60	Uruguay	ANCAP	Gulf	31°Kuwait	1.67	-	-	2.06	21	Quantity - one cargo
etroleum Week 7.10.60	Brazil	Petrobras	N.A.	34°Arabian	1.80	-	-	2.20	17	Sale of 2 million barrels
nk of London S. America ortnightly eview 22.10.60	Uruguay	ANCAP	N.A.	36° Iraq	2.21(1)	-	-	2.40	31	Offer to supply crude oil to the value of $40 million over 3 years
do.	Uruguay	ANCAP	CFP	41° Qatar	1.95	1.74	21	-	-	Offer to supply crude oil to the value of $40 million over 3 years
att's 13. 2.61	Uruguay	ANCAP	Gulf	31° Kuwait	1.59	-	-	2.00	19	Contract to supply 1,010,000 m³ over 3 years

(1) Eastern Mediterranean

*/** For Footnotes see overleaf

Examples of Reported Sales and Offers of Middle East Crude

West of Suez

Source of Information*		Country	Buyer	Seller	Crude	Posted Price	Selling Price f.o.b.	Discount on f.o.b. Basis**	Selling Price c.i.f.	Discount on c.i.f. Basis - Freight at Intascale -50%**	Remarks
						$/bbl.	$/bbl.	¢/bbl.	$/bbl.	¢/bbl.	
Platt's	24. 3.61	Brazil	Petrobras	Texaco	34° Arabian	1.80	-	-	2.10	27	Agreement to supply 2 million bbls. in April and May 1961
Platt's	7. 8.61	Uruguay	ANCAP	Esso	41° Qatar	1.95	1.75	20	-	-	Offer to supply 600,000 bbls. over 5 months
P.I.W.	17. 9.62	Uruguay	ANCAP	Gulf	31° Kuwait	1.59	-	-	2.00	18	Offer to supply 1 million bbls. p.a. over 4 years
Platt's	12. 3.63	Uruguay	ANCAP	CFP	41° Qatar	1.95	1.52	43	-	-	Offer to supply 100,000 m^3
Platt's	12. 3.63	Uruguay	ANCAP	Arabian Oil	28° Khafji	1.42(2)	1.33	13(3)	-	-	Offer to supply 100,000 m^3
P.I.W.	10. 6.63	Brazil	Petrobras	Esso	34° Arabian	1.80	-	-	2.09	26	Sale of 5 million bbls. to be delivered during summer
P.I.W.	4.11.63	Brazil	Petrobras	B.P.	34° Agha Jari	1.78	-	-	1.92	43	Deliveries of trial cargoes
P.I.W.	24. 2.64	Brazil	Petrobras	B.P.	35° Basrah	1.72	-	-	2.00	29	Contract to supply 27,000 b/d
Platt's	21. 1.65	Uruguay	ANCAP	B.P.	31° Kuwait	1.59	1.29	30	-	-	Offer to supply 18.3 million barrels over 3 years
Platt's	21. 1.65	Uruguay	ANCAP	Texaco	29° Saudi Arabian	1.55	1.39	16	-	-	Offer to supply 18.3 million barrels over 3 years
Platt's	21. 1.65	Uruguay	ANCAP	Shell	34° Iranian	1.78	1.55	23	-	-	Offer to supply 18.3 million barrels over 3 years
Platt's	21. 1.65	Uruguay	ANCAP	Gulf	31° Kuwait	1.59	1.44	15	-	-	Offer to supply 18.3 million barrels over 3 years

(2) Posting for 26° API crude

(3) Adjusted for gravity difference

*/** For Footnotes see Overleaf

West of Suez

Source of Information*	Country	Buyer	Seller	Crude	Posted Price	Selling Price f.o.b.	Discount on f.o.b. basis **	Selling Price c.i.f.	Discount on c.i.f. basis - Freight at Intascale -50%**	Remarks
					$/bbl.	$/bbl.	¢/bbl.	$/bbl.	¢/bbl.	
Platt's 21. 1.65	Uruguay	ANCAP	Standard of California	(34°Arabian	1.80	1.54	26	-	-	Offer to supply 18.3 million bbls. over 3 years (4)
				(27°Safaniya	1.47	1.26	21	-	-	
Platt's 21. 1.65	Uruguay	ANCAP	CFP	35°Basrah	1.78	1.31	47	-	-	Offer to supply 18.3 million bbls. over 3 years
Platt's 21. 1.65	Uruguay	ANCAP	Amoco/NIOC	34°Iranian	1.63	1.35	28	-	-	Offer to supply 18.3 million bbls. over 3 years
Platt's 26. 4.65	Argentina	YPF	Esso	34°Agha Jari	1.78	-	-	2.19	19	Offer to supply 500,000 m^3
Platt's 26. 4.65	Argentina	YPF	Esso	34°Arabian	1.80	-	-	2.19	19	Offer to supply 500,000 m^3
Platt's 26. 4.65	Argentina	YPF	Mobil	34°Arabian	1.80	-	-	2.10	28	Offer to supply 500,000 m^3
Platt's 26. 4.65	Argentina	YPF	Mobil	34°Agha Jari	1.78	-	-	2.08	30	Offer to supply 500,000 m^3
Platt's 26. 4.65	Argentina	YPF	Mobil	38°Murban	1.86	-	-	2.19	25	Offer to supply 500,000 m^3
Platt's 22. 7.65	Argentina	YPF	Shell	34°Agha Jari	1.78	-	-	2.07	31	Offer to supply 700,000 m^3 over 3 months
Platt's 22. 7.65	Argentina	YPF	Shell	39°Murban	1.88	-	-	2.15	31	Offer to supply 700,000 m^3 over 3 months
Platt's 22. 7.65	Argentina	YPF	Mobil	34°Agha Jari	1.78	-	-	2.09	29	Offer to supply 700,000 m^3 over 3 months
Platt's 22. 7.65	Argentina	YPF	Atlantic	34°Agha Jari	1.78	-	-	1.98	40	Offer to supply 700,000 m^3 over 3 months
Platt's 22. 7.65	Argentina	YPF	Atlantic	31°Gach Saran	1.63	-	-	1.98	25	Offer to supply 700,000 m^3 over 3 months

(4) 50% of each

*/** For Footnotes see Overleaf

Table 3 Continued (a)

Examples of Armslength Sales and Offers of Middle East Crude

West of Suez

Source of Information*	Country	Buyer	Seller	Crude	Posted Price	Selling Price f.o.b.	Discount on f.o.b. basis**	Selling Price c.i.f.	Discount on c.i.f. basis - Freight at Intascale -50%**	Remarks
					$/bbl.	$/bbl.	¢/bbl.	$/bbl.	¢/bbl.	
Platt's 22. 7.65	Argentina	YPF	Signal	34°Iranian	1.78	-	-	2.04	34	Offer to supply 700,000 m^3 over 3 months
Platt's 22. 7.65	Argentina	YPF	Esso	34°Agha Jari	1.78	-	-	2.07	31	Offer to supply 700,000 m^3 over 3 months
Platt's 22. 7.65	Argentina	YPF	Esso	36°Basrah Zubair	1.74	-	-	2.04	31	Offer to supply 700,000 m^3 over 3 months
Platt's 22. 7.65	Argentina	YPF	Esso	40°Murban	1.90	-	-	2.18	30	Offer to supply 700,000 m^3 over 3 months
Platt's 22. 7.65	Argentina	YPF	Mobil	40°Murban	1.90	-	-	2.31	17	Offer to supply 700,000 m^3 over 3 months
Platt's 28.10.65	Argentina	YPF	Shell	39°Murban	1.88	-	-	2.10	36	Offer to supply 1,365,000 m^3 over 4 months
Platt's 28.10.65	Argentina	YPF	Shell	35°Basrah	1.72	-	-	2.00	33	Offer to supply 1,365,000 m^3 over 4 months
Platt's 28.10.65	Argentina	YPF	Mobil	34°Arabian	1.80	-	-	2.10	28	Offer to supply 1,365,000 m^3 over 4 months
Platt's 28.10.65	Argentina	YPF	Mobil	35°Basrah	1.72	-	-	2.08	25	Offer to supply 1,365,000 m^3 over 4 months
Platt's 28.10.65	Argentina	YPF	Esso	35°Basrah	1.72	-	-	2.13	20	Offer to supply 1,365,000 m^3 over 4 months
Platt's 28.10.65	Argentina	YPF	Esso	34°Agha Jari	1.78	-	-	2.16	22	Offer to supply 1,365,000 m^3 over 4 months
Platt's 28.10.65	Argentina	YPF	Standard of California	34°Arabian	1.80	1.50	30	-	-	Offer to supply 1,365,000 m^3 over 4 months
Platt's 14. 3.66	Argentina	YPF	Mobil	34°Arabian	1.80	-	-	1.95	43	Offer to supply 700,000 m^3 over 2 months

*/** For Footnotes see Overleaf

Table 3(a) Continued

Examples of Armslength Sales and Offers of Middle East Crude West of Suez

Source of Information*	Country	Buyer	Seller	Crude	Posted Price	Selling Price f.o.b.	Discount on f.o.b. basis*	Selling Price c.i.f.	Discount on c.i.f. basis - Freight at Intascale -50¢**	Remarks
					$/bbl.	$/bbl.	¢/bbl.	$/bbl.	¢/bbl.	
Platt's 14. 3.66	Argentina	YPF	Mobil	34°Iranian	1.79	-	-	1.95	43	Offer to supply 700,000 m^3 over 2 months
Platt's 14. 3.66	Argentina	YPF	Esso	35°Basrah	1.72	-	-	2.07	26	Offer to supply 700,000 m^3 over 2 months
Platt's 14. 3.66	Argentina	YPF	CFP	35°Basrah	1.78	-	-	2.02	37	Offer to supply 700,000 m^3 over 2 months
Platt's 14. 3.66	Argentina	YPF	Shell	34°Agha Jari	1.79	-	-	2.06	32	Offer to supply 700,000 m^3 over 2 months
Platt's 14. 3.66	Argentina	YPF	Shell	35°Basrah	1.72	-	-	2.06	27	Offer to supply 700,000 m^3 over 2 months
Platt's 14. 3.66	Argentina	YPF	Atlas	34°Agha Jari	1.79	-	-	1.915	47	Offer to supply 700,000 m^3 over 2 months
Platt's 14. 3.66	Argentina	YPF	Atlas	34°Basrah	1.70	-	-	1.915	40	Offer to supply 700,000 m^3 over 2 months
(ii) Europe and North Africa										
Platt's 8.12.61	Italy	ENI	CFP	(36°Iraq (36°Iran	2.21(5) 1.78	1.71 1.38	50 40	- -	- -	(Sale of 1 million tons for (delivery in 1962
Platt's News 5.2.62	Morocco	SAMIR	B.P.	36°Iraq	2.21(5)	-	-	2.00	34	Sale of 100,000 tons for SAMIR refinery
Platt's 28. 6.62	Morocco	SAMIR	CFP	36°Iraq	2.21(5)	-	-	1.96	38	Sale of 150,000 tons for SAMIR refinery
P.I.W. 25.11.63	Tunisia	Government	CFP	36°Kirkuk	2.21(5)	-	-	1.86	48	Sale of 100,000 tons for new refinery
P.I.W. 9.12.63	Tunisia	Government	Texaco	34°Arabian	1.80	-	-	1.88	33	Sale of 100,000 tons
P.I.W. 30. 3.64	Morocco	SAMIR	Standard of California	34°Arabian	2.17(5)	-	-	2.00	35	Unspecified quantity for SAMIR refinery

(5) f.o.b. Eastern Mediterranean * Platt's references are from the Pricegram ** Excluding additional financial advantages granted through favourable credit terms and other means.

Examples of Armslength Sales and Offers of Middle East Crude
East of Suez

Date of Sale(s)	Seller	Buyer	Crude	Posted Price* $/bbl.	Selling Price f.o.b.** $/bbl.	Discount** ¢/bbl.	Date of Loan	Amount of Loan $ mill.	Repayment Period Years	Repayment Deferment Period Years	Rate of Interest %	Remarks
(i) Japan												
1961-65	CFP	Asia Oil	35°Zubair	1.72	1.52	20	July '60	5.0	$5\frac{1}{2}$	2	5.0	Sale of 23 million tons over 9 years
1961-65	Unoco	Maruzen	31°Kuwait	1.59	1.45-1.43	14-16	(Aug. '60	5.0	$6\frac{1}{2}$	-	5.0)	Sale of 5 million tons over 5 years. Since 1963
1964-65	Unoco	Maruzen	31°Gach Saran	1.63	1.47-1.45	16-18	(Dec. '61	15.0	$7\frac{1}{2}$	2	6.0)	Unoco has had a 33% holding in Maruzen
1964-65	Esso	Asia Oil	31°Gach Saran	1.63	1.48-1.43	15-20	Sep. '61	5.0	3.3	3.3	5.5	
1961-65	Stanvac	Toa Nenryo	35°Zubair	1.72	1.52-1.50	20-22	(Oct. '61	10.0	5	3	5.0	Esso and Mobil have 25%
1961	Stanvac	Toa Nenryo	31°Kuwait	1.59	1.44	15	(					interest each in Toa Nenryo
1961-65	Stanvac	Toa Nenryo	27°Safaniya	1.47	1.32	15	(July '64	5.0	$4\frac{1}{2}$	2	5.0	Made by Mobil alone
1964-65	Stanvac	Toa Nenryo	31°Gach Saran	1.63	1.47-1.43	16-20	(					
1964-65	Stanvac	Toa Nenryo	34°Agha Jari	1.78	1.59	19	(July '64	5.0	$4\frac{1}{2}$	2	5.0	Made by Esso alone
1964-65	Gulf	Nippon Ming.	31°Kuwait	1.59	1.44	15	(Oct. '61	15.0	9	3	4.5	
1965	Gulf	Nippon Ming.	34°Agha Jari	1.78	1.53	25	(					
1964-65	Esso	Idemitsu	31°Kuwait	1.59	1.45-1.43	14-16	(Nov. '61	6.0	-	6	4.0	
							(Sep. '62	15.0	$1\frac{1}{2}$	$8\frac{1}{2}$	5.0	
							(Aug. '63	5.0	1	$8\frac{1}{2}$	5.0	
1965	Gulf	Idemitsu	31°Kuwait	1.59	1.45	14	1962	30.0	10	N.A.	4.5	It is believed that part of this loan was actually made by the Bank of America on behalf of Gulf

* The posted price of $1.78/bbl. on Agha Jari is that at Bandar Mashur; the posted price since Nov. '65 is $1.79/bbl. at Kharg Island. If this is taken the discounts given on Agha Jari would be 1¢/bbl. higher.

** Where two selling prices (and therefore two discounts) are given for the same crude the first figure relates to the earlier sale, the second to the most recent.

N.A. = Not available.

Table 3(b) Continued

Examples of Armslength Sales and Offers of Middle East Crude East of Suez

Date of Sale(s)	Seller	Buyer	Crude	Posted Price * $/bbl.	Selling Price f.o.b.** $/bbl.	Discount** ¢/bbl.	Date of Loan	Amount of Loan $ mill.	Repayment Period Years	Repayment Deferment Period Years	Rate of Interest %	Remarks
964-65	Getty	Mitsubishi	31°Kuwait	1.59	1.41	18	(Mar.'62	5.0	-	7	5.0	Loan in name of Getty, and sale in name of Tidewater. Tidewater holds a 50% interest in Mitsubishi
964-65	Getty	Mitsubishi	31°Gach Saran	1.63	1.43	20	(					
964-65	Getty	Mitsubishi	24°Wafra	1.48	1.27	21	(					
965	Getty	Mitsubishi	35°Zubair	1.72	1.50	22	(					
964-65	Gulf	Toa Oil	31°Kuwait	1.59	1.44	15	(Apr.'62	10.0	7	3	4.5	
964	Gulf	Toa Oil	31°Gach Saran	1.63	1.43	20	(					
964-65	CFP	Daikyo Oil	35°Zubair	1.72	1.50	22	(Apr.'62	10.0	6	2	5.0	
965	CFP	Daikyo Oil	34°Agha Jari	1.78	1.49	29	(					
965	Esso	Nichimo Oil	34°Agha Jari	1.78	1.59	19	Jul.'62	2.0	5	2	5.0	
965	Mobil	Nichimo Oil	34°Agha Jari	1.78	1.59	19	(Jul.'62	2.0	5	2	5.0	
965	Mobil	Nichimo Oil	31°Gach Saran	1.63	1.43	20	(					
965	B.P.	Kyushu Oil	31°Gach Saran	1.63	1.44	19	Oct.'62	19.6	8	3	5.5	
964-65	Esso	General Oil	35°Zubair	1.72	1.50	22	(Nov.'62	2.0	5	2	5.0)	Esso has a 50% interest
964-65	Esso	General Oil	34°Agha Jari	1.78	1.59	19	(Nov.'63	15.0	8	3	5.0)	
965	Esso	General Oil	27°Safaniya	1.47	1.32	15	(				)	
965	Esso	General Oil	31°Gach Saran	1.63	1.43	20	(				)	
964-65	Shell	Showa Oil	31°Kuwait	1.59	1.44-1.43	15-16	(May '63	6.3	10	-	5.5-7.0	Shell has a 50% interest
964-65	Shell	Showa Oil	31°Gach Saran	1.63	1.47-1.43	16-20	(Mar.'64	5.32	11½	2½	5.5	
965	Caltex	Koa Oil	31°Gach Saran	1.63	1.43	20	Jan.'64	3.5	6½	3	5.5	Caltex has a 50% interest
965	CFP	Nippon Ming.	35°Zubair	1.72	1.52	20	Mar.'64	5.0	6½	3½	5.0	
965	Mobil	Asia Sekiyu	31°Gach Saran	1.63	1.47	16	May '65	11.0	3	3	N.A.	

* The posted price of $1.78 per barrel on Agha Jari is that at Bandar Mashur; the posted price since November 1965 is $1.79 per barrel at Kharg Island. If this is taken the discounts given on Agha Jari would be 1¢ per barrel higher.

** Where two selling prices (and therefore two discounts) are given for the same crude the first figure relates to the earlier sale, the second to the most recent.

Examples of Armslength Sales and Offers of Middle East Crude East of Suez

Source of Information	Country	Buyer	Seller	Crude	Posted Price $/bbl.	Selling Price f.o.b. $/bbl.	Discount on f.o.b. basis ¢/bbl.	Selling Price c.i.f. $/bbl.	Discount on c.i.f. basis Freight at Intascale –50% ¢/bbl.	Remarks
(ii) Other East of Suez Areas										
Platt's 6/11/64	India	Madras Refinery	Standard of Indiana /NIOC	34°Darius	1.63	1.35	28	–	–	Contract to supply 20 million tons over ten years. Platt's Oilgram 10/11/65 reports the quantity the Madras Refinery would purchase will be increased to 42 million tons if Standard of Indiana agrees to finance a fertilizer project at Madras.
P.I.W. 30/11/64	Korea	Korean Oil Corporation	Gulf	31°Kuwait	1.59	1.41	18	–	–	(Agreement to supply requirements of the (Ulsan refinery (capacity at end 1964 (1.75 million tons p.a.) over 15 years. (Gulf has a 25% equity interest in the (refinery and has provided the necessary (finance for its construction. This (accounts for the apparent low discounts (offered.
P.I.W. 30/11/64	Korea	Korean Oil Corporation	Gulf	31°Gach Saran	1.63	1.43	20	–	–	
P.I.W. 30/11/64	Korea	Korean Oil Corporation	Gulf	34°Agha Jari	1.78	1.56	22	–	–	
P.I.W. 10/5/65	Pakistan	National Refinery Ltd.	Standard of Indiana	30°Darius	1.55	1.31	24	–	–	Contract to supply 13 million tons within 10 years.
P.I.W. 10/5/65	Pakistan	Eastern Refinery Ltd.	RAP	34°Agha Jari	1.78	1.60	18	–	–	Contract to supply half the Chittagong refinery's requirements (planned capacity 1 million tons p.a.) for 10 years. RAP has a 30% equity interest in the refinery and provides finance. This accounts for the apparent low discount offered.

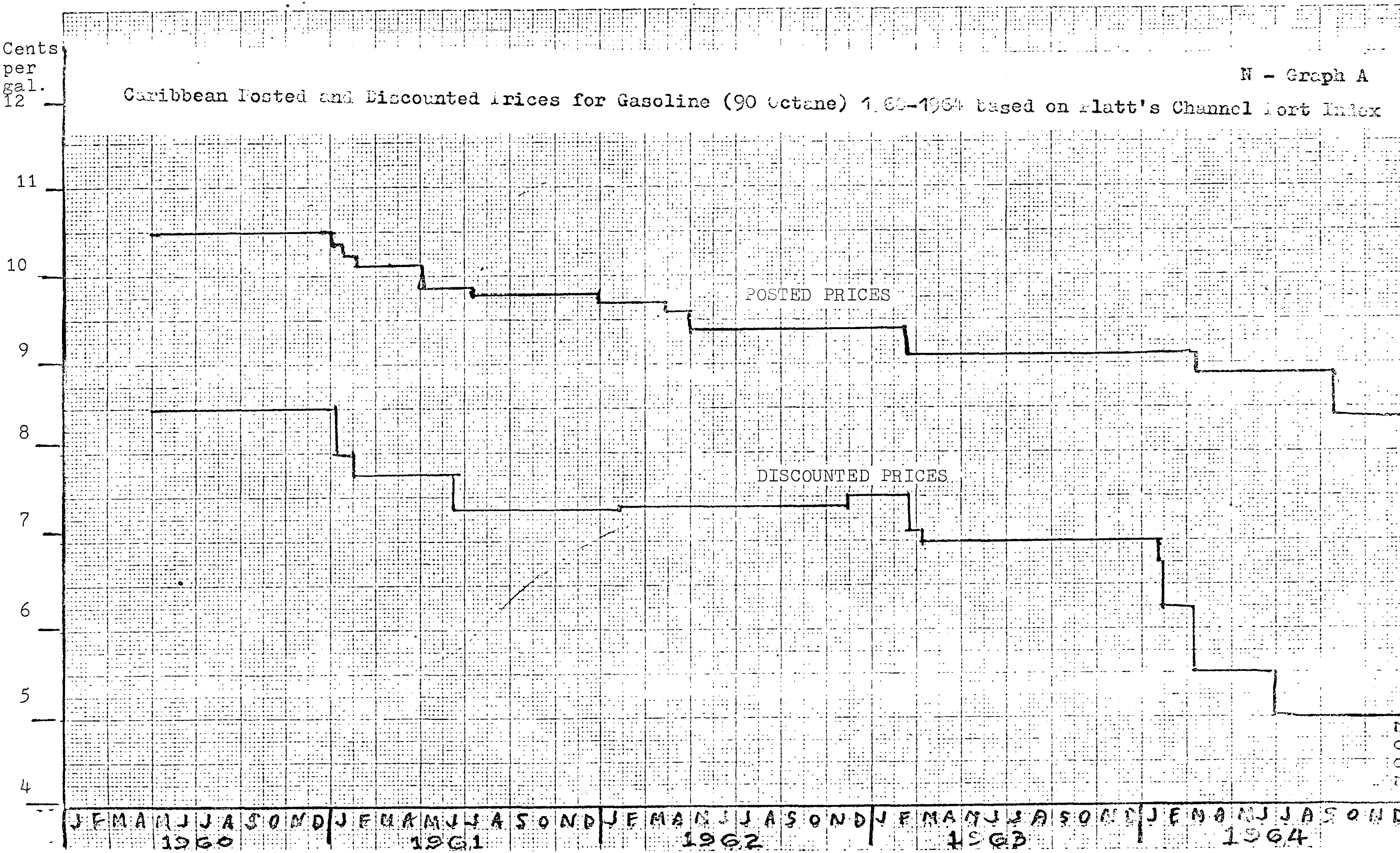
Table 3(b) Continued

Examples of Armslength Sales and Offers of Middle East Crude East of Suez

Source of Information	Country	Buyer	Seller	Crude	Posted Price	Selling Price f.o.b.	Discount on f.o.b. basis	Selling Price c.i.f.	Discount on c.i.f. basis, freight at Intascale -50%	Remarks
					$/bbl.	$/bbl.	¢/bbl.	$/bbl.	¢/bbl.	
P.I.W. 16/8/65	India	Cochin Refineries Ltd.	Phillips	Agha Jari	1.78	1.48	30	-	-	A renegotiation of the contract to supply 2.5 million tons p.a. over 15 years at a discount of 21¢/bbl., reported in P.I.W. 24/2/64. Phillips purchases that crude from Standard of California.
P.I.W. 15/11/65	Pakistan	Jalil	CFP	50% Agha Jari, 37½% Abu Dhabi offshore, 12½% Murban	1.82 1)	1.33	49			An offer to supply 2.4 million tons p.a., or 7.2 million tons over 3 years.

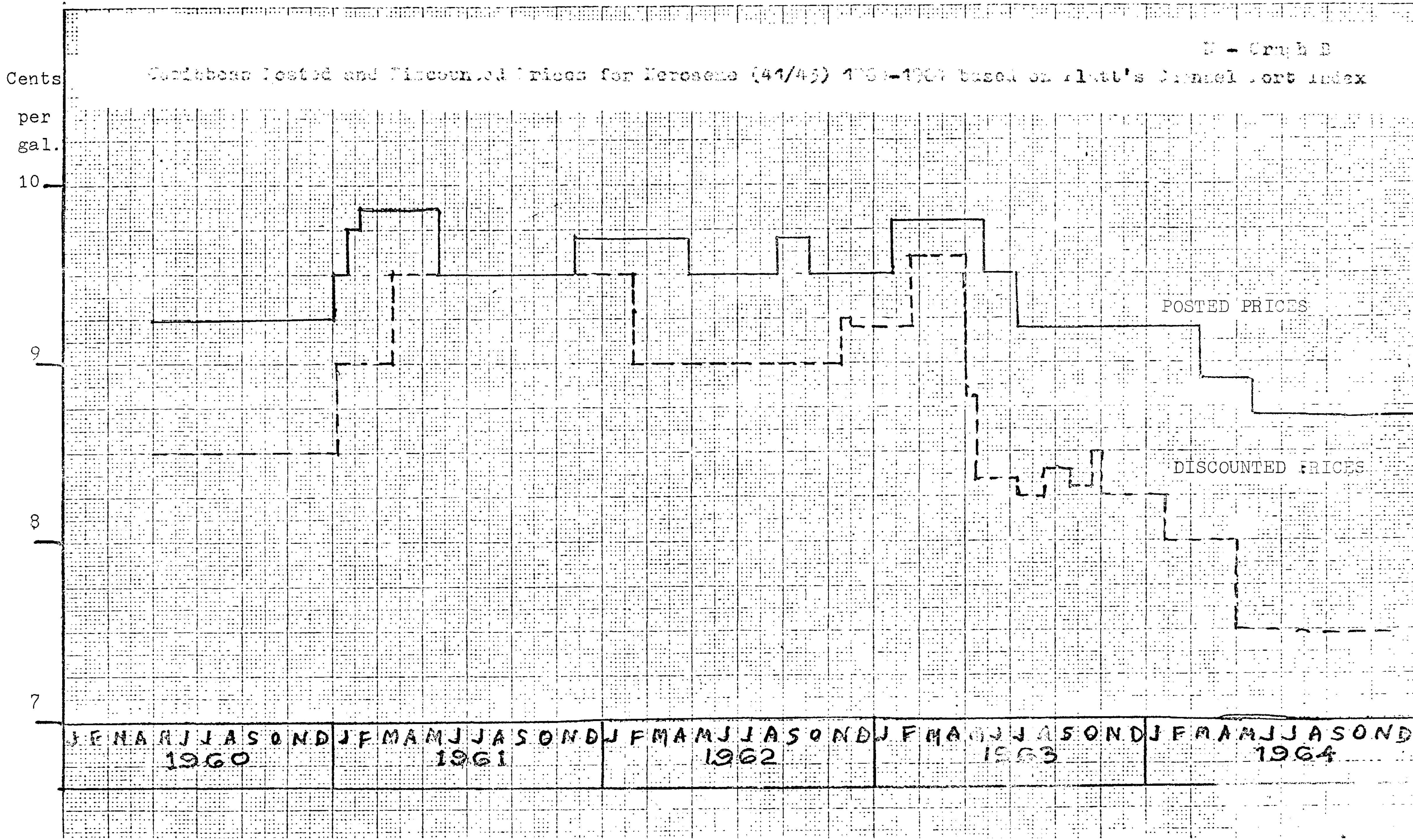
1) Weighted average of the posted prices of the three crudes.

Caribbean Posted and Discounted Prices for Gasoline (90 octane) 1960 - 1964 based on Platt's Channel Port Index



2062

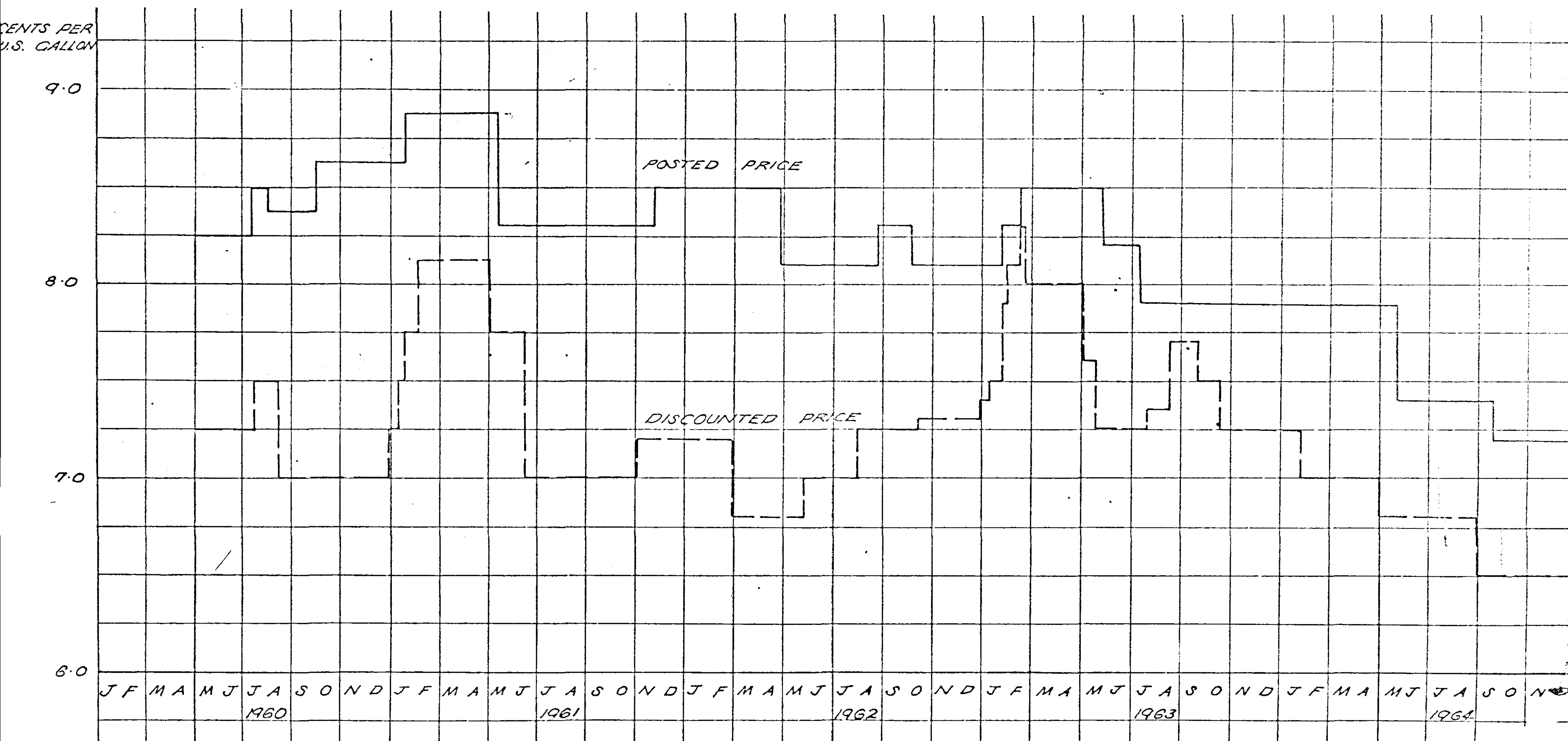
Caribbean Posted and Discounted Prices for Kerosene (41/43) 1960 - 1964 based on Platt's Channel Port Index



CARIBBEAN POSTED AND DISCOUNTED PRICES FOR GAS OIL (48/52 D.I.) 1960-64 BASED ON FLATT'S CHANNEL PORT INDEX.

N - Graph C

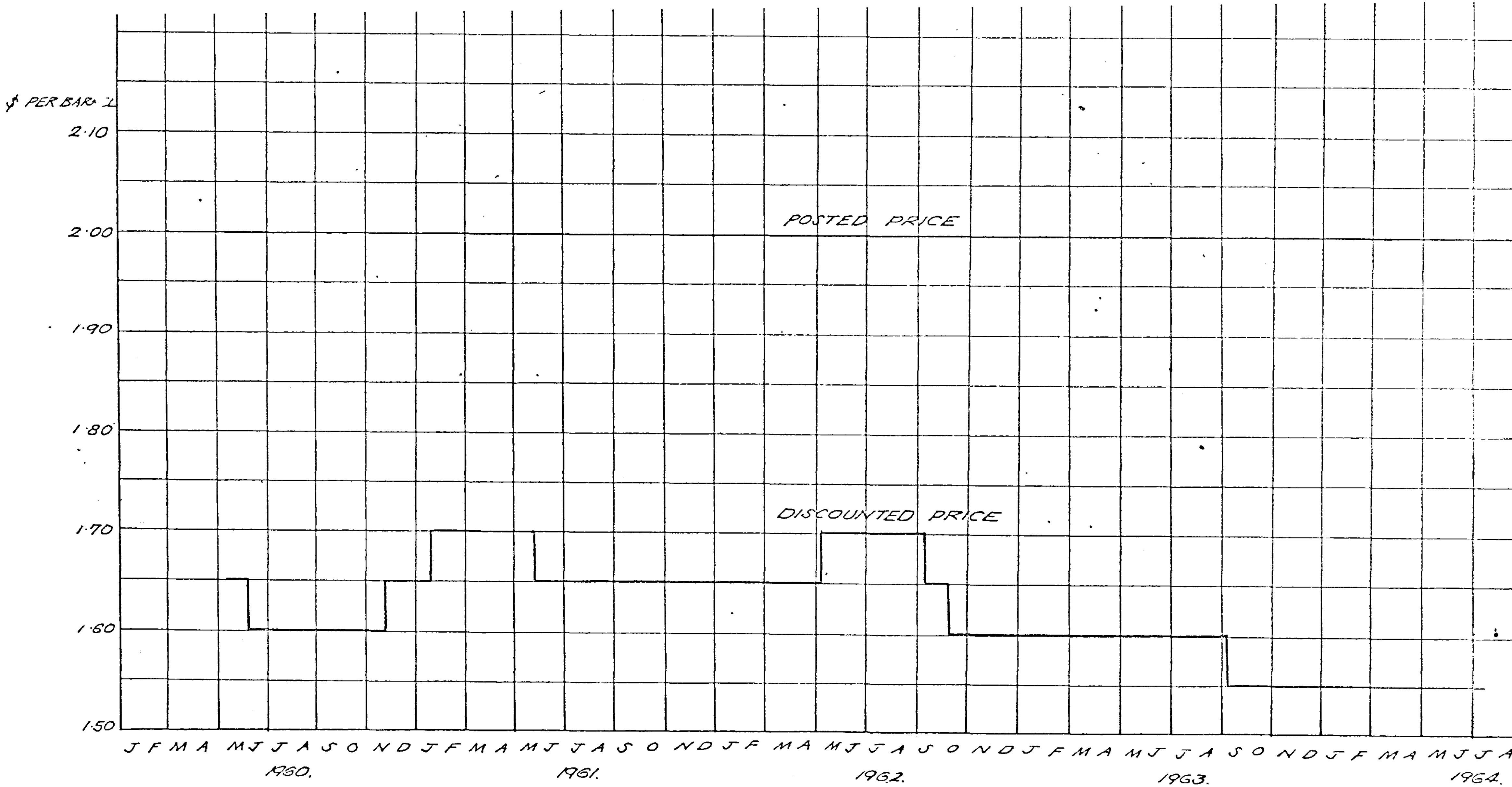
Caribbean Posted and Discounted Prices for Gas Oil (48/52 D.I.) 1960-1964 based on Platt's Channel Port Index



CARIBBEAN POSTED AND DISCOUNTED PRICES FOR BUNKER C FUEL OIL 1960-64 BASED ON PLATT'S CHANNEL PORT INDEX.

Graph D

Caribbean Posted and Discounted Prices for Bunker C Fuel Oil 1960-1964 based on Platt's Channel Port Index



XXN:

You said that you disagreed with Mr Todd's opinion that in the Middle East areas where there is no tax on refining profits - Mr Todd said did he not he thought there was something called a lifting tax? He referred to the uplift which is required by Iranian authorities for instance, to be taxed - if he referred to that then there would be no disagreement between us. And the tax in effect is 5% of refining margin? It is - the uplift must be minimum 5%. That 5% is based on - it must be as I explained the cost of crude oil, plus refining cost plus 5%. And that 5% which is in effect the net margin of refinery is then subject to tax. At what rate? I believe at the same rate 50%. So it is only a minimal tax? I was not commenting on the size of the tax. That will depend entirely on the posted prices of products, posted prices of crude and the refining costs. When gross refinery margin was substantial such as $1 and the tax on processing cost about half that amount and there was a net margin of 50 cents and on 50 cents a 50% profit the taxation would have been 25 cents a barrel. Now margin is less as Mr Todd pointed out - from my own writings at least in some areas, and consequently the tax has become less. But companies only have to declare not less than 5% margin of profit? They have to declare a minimum of 5%. And they pay tax on what they declare? Yes. They pay tax on what they declare although I believe lately the Iranians have insisted on a minimum of actual whichever is highest. Of course the company so handles the posted prices of products that the realisation on the composite barrel does not give an uplift which is in excess of the 5%.

Coming to the position of Europa - I take it you understand its position as independent marketer in this country?. Yes. You know it is in competition with subsidiaries of International companies? I do. And you accept it must have long term supply contracts with security of supply? I appreciate that. Will you also accept that Europa must if it can get a global source supply contract? Yes. I believe that it is of benefit to Europa. And are you aware that it is a feature of the original Caltex contract as well as of the 1956 Gulf contracts? Yes. So that with the global source contract the supplies cannot be imperilled by force majeur? Yes. Do you know Mr Snodgrass referred to by Mr Todd? I have met him several times both when he was resident of London and I have also met him in other places when we happened to have been elsewhere at the same time. Is he an independent oil refining consultant? He is an independent consultant. I think his activities are not necessarily confined to refining but also cover other technical fields in the oil industry. He is well known consultant, retained as adviser to Government of Iran? I do not know that. But I accept that if you say so. And you have heard in evidence that he prepared a refinery project for Mr Todd in 1954? Yes. And you heard the document read out to you that represented the notes of Mr Todd's and Mr Tyler's interview on 21 February 1963 when Mr Snodgrass' name was mentioned? I do not believe I was in Court. EXHIBIT BB?

COURT ADJOURNED 1 p.m.

CASE RESUMED 2.15 p.m.

XXM: (continued)

I asked you to look at EXHIBIT BB? Yes, I have done so. It recorded there Mr Todd told Mr Tyler the advice Mr Snodgrass had given him in 1954? Yes. That Mr Snodgrass said it was not necessary to own a refinery to be in that business? I agree with that. That Mr Snodgrass also said that however you would have to be careful about being caught in the refiner's squeeze? I take it you agree with that? I agree that being in the refining business can mean that one can get involved in a situation where the refiner margin can either go up or down. I would say that if one does not want to take a chance with regard to the refiner margin going down and if one does not have to get into the refining business the best thing to do would be to keep out of the refining business. And if a company in the position of Europa with certain required gasoline volume and without market for heavy ends, then if it got into a refinery operation it would have to be on terms that someone else took care of the heavy ends? Yes.

You know Mr Snodgrass did a project for Mr Todd? Yes. And any such project would of course have to take into account the particular market that Europa would have? It would.

Would you look at your statement of evidence (page 3). I am quoting from nearly half way down - "Thus only large and well-balanced operators could gain access to and maintain themselves in the market, especially in areas where the total turnover was limited. This applied, and to some extent still applies, to practically all points East of Suez, and goes a long way towards explaining the state of exclusivity which a very small number of oil companies, all of them internationally backed and diversified, had attained there. One consequence was that competition, as and when it obtained, inevitably took on what the economists call an oligopolistic character, i.e. the operation of a limited number of marketers obtaining their share by way of investment and advertisement rather than by price competition. Market shares, once acquired, tended to be respected." You there refer to characteristics of the oligopoly and are pointing out the tendency to try and improve the market position by means other than price competition? Yes. I quote from Mr Hartshorn's book, 1962 edition - are you familiar with it? I have read it and know the author. It is a recognised textbook? Yes, it is a recognised text book. Page 131, bottom - "Moreover, the international groups had even less incentive than integrated companies operating in the United States to compete in ways that would push down the general level of prices in final markets. They were, clearly, in a situation of 'oligopoly' - that is, of competition between a few sellers, as distinct on the one hand from single-firm monopoly and on the other from the 'perfect competition' of many sellers in the market. Smaller independent operators existed; but at no stage of the integrated world oil trade were these as important as they were in the oil industry of the United States. Each major group, moreover, sold oil in many places; could press, but equally was vulnerable, on many fronts. Under conditions of oligopoly, action to alter price or rates of output by any one of them was certain to affect the general balance of the market for all the others. Each international group had to consider that if it cut the price of oil, its competitors would almost certainly match the cut and possibly cut further; so its initial decisions involved deciding how to react to the reactions that its move would be likely to provoke. This situation of oligopoly is frequently present in oil marketing. But for the international companies it existed on a wider than national scale. Price cutting to put pressure on a competitor in one market might bring pressure in return in some other part of the world where that competitor happened to be better placed." You are in general agreement? Yes, I am in general agreement with that statement - but this does not apply in all cases and in my opinion would not apply in the particular circumstances in which Gulf and Europa found themselves in 1955. Europa was an established market and therefore a sale to Europa at below posted price would be unlikely to have resulted in pulling the market down. Because as I have also stated in my brief, some independents in time either get bought up by the international majors, or they behave like one. I think that Europa in the New Zealand market in fact behaved exactly like the international major companies. It was unlikely to cut prices even if I believe the particular conditions in New Zealand had enabled Europa to do so. Therefore, in selling to Europa and to the New Zealand market at a lower price, in my opinion Gulf was not running the risk of pulling the whole structure down. Perhaps this gives me an opportunity if I may say this to bring up one other point. In Europe conditions similar to those which prevailed much longer in East of Suez markets were also in existence in the immediate post war period and I would say until the middle 1950s. Although there is no direct comparison of a company like Europa in the European market set up, it is well known that to certain independent companies who at that time were known not to be price cutters special terms were granted by the major companies in the supply of admittedly crude oil and not petroleum products, because relevant companies had their own refineries, when crude oil was supplied on special terms under long term contracts. I refer in particular to the deal which the BP Company had with Petrofina. The terms of this contract have never been published but from information which has leaked I have reason to believe that Petrofina did not buy at a posted price. I believe that there was a kind of sliding scale agreement that the greater the purchase the lower the price would become. In other words, as quantities went up the price would decline. Similarly, the BP Company which had a crude oil surplus at the time and still has, concluded special arrangements with the Italian State Company, AGIP, under which a joint refinery was supplied with crude oil on what are believed to have been special terms and at the same time as long as that agreement was running the BP Company did not market in Italy and it was only when that agreement had expired and was not renewed that BP entered the Italian market. I think I have elaborated on the other deals which although not published are known in general terms of the industry to indicate that in special circumstances and for long term contracts there have always been exceptions to the rule, especially when it did not involve a general disturbance of the market.

Are you suggesting that in 1955 Gulf Oil would have invoiced gasoline into this country for a period of ten years at a discount which was between 25 or 30 per cent. off posted price: do you suggest that? I am not saying that they would have done that. And I am not really concerned as to where and how the special terms would have been granted. I do however believe that in the circumstances of being able to market the one product which they had the greatest difficulty in marketing, and at the same time being able to do so without selling the rest of the barrel for which they had a market, they would have made special concessions and wherever and however and in whatever form these concessions would have been given they would have been tantamount to a discount. But there would be no possibility in the world of Gulf in 1955 invoicing gasoline in to New Zealand under the terms of this contract at a discount of 25 to 30 per cent.

off posted prices? I would say that Gulf would have been reluctant to do that.

I ask you to take it further - neither Gulf nor Caltex in 1955 would ever consider going to such a length? I would say that the Caltex position is slightly different from Gulf. Caltex was a marketer in New Zealand and if Caltex had given a discount to Europa it would have created precedent for their own affiliates. In the case of Gulf this particular consideration did not apply. So you suggest now that Gulf would have invoiced gasoline into New Zealand at these excessive discounts off posted prices? I am not in a position to say what they would or would not have done. I think they would have been reluctant to do so, but their position is not exactly comparable with that of Caltex. Is it possible they might have entered into such a discount arrangement? I would say in the circumstances of 1955 it is probably on balance unlikely.

And I refer you to page 1012 of your evidence - "Oil is not only traded internationally on a large scale but the main sources of supply to the world have been traditionally confined to a few points (although these points have changed from time to time). Originally the U.S. Gulf was the main source but in the post-war period this role was taken over by the Caribbean and later also by the Middle East (Persian Gulf), and, within a restricted area, by Indonesia. In the past it was thus the practice to adjust petroleum products prices all over the world to those prevailing at the main points of export.

b) The need for an oil price structure as distinct from oil prices arose from:

(i) the desire of the international oil companies to bring some order into the terms on which they supply their own affiliates and outside customers;"

Assume you agree that that type of consideration must have been in minds of Gulf in 1955? Yes. It probably was, but again I would say that Gulf's position was not quite the same as that of the other International major companies, because it was not a direct marketer. What about the effect of Gulf/Shell agreement to share the whole profits from production down to marketing? Do you consider Gulf would undercut Shell in this market area? As I have pointed out in my brief, the sale to Europa at a lower price would have been just one of the few things which Gulf could have done without having repercussions on profitability to Gulf of the Gulf/Shell agreement. What you say is that actual Gulf contracts that were made were one of the few things that would not affect profitability of Gulf/Shell agreement? That is so. Because Gulf had surplus of top grade? No, the Gulf/Shell deal was based on the sharing of cost and profits by Gulf and Shell at all stages from well to the gasoline pump and the price which Gulf got for its Kuwait crude oil was dependant on the realisation of Shell on that crude. Therefore, Gulf would have been reluctant to do anything which would have affected the profitability of Shell and which therefore would have had repercussions on the return to Gulf on the crude oil sold to Shell. The agreement went further. It provided for penalties that if Shell could prove that if by any action of Gulf it had lost market in any of the relevant markets Shell had a right to reduce the crude oil offtake in proportion. I do however come back to the point I made earlier in my brief - that the sale to Europa would be one of the few if not the only one of the things which Gulf could do to sell gasoline without in any way affecting its deal with Shell. But it would affect the deal with Shell by invoicing gasoline into New Zealand at under posted price? It would have only affected the deal with Shell if Europa had taken advantage of that lower price to cut the price of gasoline in the New Zealand market, which I believe Europa could not have done in any case under Government regulations. Therefore, sale at lower price to Europa if Gulf had been prepared to invoice at such a price, which one cannot be sure about as I said earlier, would have been likely to result in an increased profitability for Europa in New Zealand. Depending upon the price controls of petrol in the country? Yes. And on the marketing policy of Europa.

Now would you tell me if you agree with these points - there was a finding by the Commonwealth Tax Board of Review of Australia that as at 1954, 1955, 1956, listed product prices in Persian Gulf reflected market prices for products? Are you in general agreement? Yes, generally speaking. Then in the paper prepared by yourself and Doctor Frankel produced in evidence, are you not quoting posted prices of products East of Suez, up as far as 1959? Yes. Then in the Damle, the paper was as you rightly say based on posted prices. The paper was however not a statement of market conditions at one particular moment. It was an analysis of trends in refiner's margins. Obviously with a very limited armslength market and with little individual evidence of sales below posted prices such an analytical paper could not base itself on anything but posted prices. I would not like however to say here it should be taken as evidence that there were never any discounts in posted prices before 1959. But your calculations show refiner's margin in 1959 that was being earned? On the basis of posted prices. Refiner's margin was being earned on the bases you were setting up? I was giving in that paper an analysis of the position on the basis of posted prices. I agree that the bulk of the sales took place on posted prices at that time in East of Suez area with very limited exceptions. Therefore any discount which was being granted at that time was affecting a comparatively small volume so as to make an insignificant impact on the picture given on the basis of posted prices. In other words, you treated profitability of refining East of Suez in 1959 on the basis there was no discount on posted prices of products? Yes largely because of high proportion of sales that take place in integrated operations of major International companies which at that time East of Suez generally took place at costed prices.

Now the Damle report of 1961 recommended in India that 5% ought to be available by way of discount off motor gasoline as from 1961? That is so. I would add that the Indians were more concerned with the discounts on middle distillate products such as kerosene and gas oil which were and are the main products of which India has a deficit and which have to be imported. Imports of gasoline into India are of marginal significance.

Your statement of evidence (page 2112 line 18) - "Until mid-1957 there were no posted prices for petroleum products at the Persian Gulf. Generally speaking f.o.b. prices for petroleum products at Persian Gulf refineries were considered to be about in line with f.o.b. prices in the Western Hemisphere. With the growing importance of exports from the Persian Gulf, B.P. took the initiative in 1957 to post petroleum products prices there. These quotations became relevant in those areas which were nearer to the Middle East than to the Caribbean, such as part of the Mediterranean, the Indian Ocean, South Africa, Australia and Japan. New Zealand, which is marginally better placed in terms of freight costs for petroleum products supplies from the Caribbean, can nevertheless be considered to be situated on the watershed between the Caribbean and the Persian Gulf and thus able to draw its supplies from whichever source offers the more advantageous terms."

With reference to that last sentence, you agree that in the Europa supply contract of 1956 there was that alternate price provision? Yes I agree. And that provision was in conformity with the principles set out here? Could be.

Now turning to page 2115 / of your evidence, you say towards bottom of that page "Refining capacity in the overall East of Suez area has always been greater than demand. Since 1962 refining capacity in the consuming countries East of Suez, with the exception of East and South Africa, has also exceeded demand in these countries." And you refer there to capacity greater than demand? Yes. This does not mean does it that an International company will simply have surplus stocks of gasoline? No. It means it may have surplus capacity to produce gasoline? Yes, but if it has crude oil available, which as shown in my brief the margin was substantial - and if it could sell the rest of the barrel of products then the temptation to use that refinery capacity even if one product such as gasoline has to be sold at a lower price than the going posted price, is great.

Now page 2117 / under heading "D". You refer to cargo lots not long term contracts? Because generally the conditions of the spot and short term market would not be identical with the sales terms under a ten or twenty year agreement. The terms of such long term contracts could be either better or worse as the case may be according to the circumstances of the parties than short term sales. Anyhow you are only talking of 1959 onwards? That applies at any time - it would apply 1947, 1957 and 1967. Your reference to tendency to grant discounts here is related to 1959 onwards? Yes.

Now going to page 2122 /, here you discuss Gulf/Europa contract? Yes. At the end of paragraph (a) on page 20 you refer to discount of 5 cents a barrel off gas oil?

Yes. You heard Mr Todd's evidence about that? This was written before he gave his evidence. So you would not attach the same significance now? This very small discount is a very marginal significance in the whole set up.

And then at page 2024 / under paragraph (c) you refer about half way down the paragraph to crude oil being mostly processed at unspecified refineries provided by Gulf? I do. This again is the aspect of Global source obligation of Gulf? This is what we have been told in evidence. As I said this morning I believe that if this had been a deal in terms more generally in line with the normal practice of the oil industry the agreements could have easily provided for a specific refinery if necessary with provision for the transfer of the processing deal to another specific refinery or refineries should special circumstances arise. And you say that if that had been done you would have no general criticism of these contracts that were made? I would not go quite as far as that. Perhaps I may be permitted to state what I would consider taking the circumstances of Gulf and Europa to have been the minimum conditions which to my mind would have made a processing deal acceptable in what I consider to be general industry practice - at the moment. As I take it you have two general objections to this deal that was struck between Gulf and Europa. One that it would be more usual to have a specific refinery? Yes. Two, the sale of gasoline by Pan-East back to Gulf Iran instead of direct to Europa? Yes. Those are your two main objections? Third one - that in the arrangements it appears as the result of the letter granting crude oil discounts Europa is completely shielded from a refinery loss and therefore takes no refining risk and for that reason in my mind it cannot be considered to be in the refining business in the accepted industry sense. First, it would be usual to have a specific refinery? Yes. You understand that Europa would never have agreed to long term supplies from a specific refinery because the supply contract could be frustrated by force majeur? I believe that this could have been covered by means of an adequate force majeur clause and/or some kind of guarantee by Gulf. Force majeur clause could have stated that if in the event of force majeur Gulf is prevented from putting the refining facilities at the disposal of Pan-Eastern Gulf will offer to Pan-Eastern alternative processing facilities at another of its refineries. Is that not in effect what this contract contains. Gulf had to procure a refinery at its peril didn't it? Yes, but it could be refining capacity under this agreement not even at one of Gulf refineries. And point one - in all my knowledge of the industry and I do not pretend to know of every contract or of habits of all companies, but in all my over twenty years' experience in the industry, either in business or as a consultant, I have never come across processing agreement not related to a specific refinery until I had seen this.

Point two - you would think it more usual if Pan-Eastern sold gasoline direct to Europa? Yes. But is not that question practically the same as Point one - that by Gulf Iran buying back the gasoline it left itself free, did it not, to supply the equivalent quantity from any point? Yes, that may be so, but then by Europa having no direct contact with the refinery, or with even a number of refineries, Europa to my mind cannot claim to be in the refining business. Your second objection - by Gulf Iran buying back at the refinery the gasoline, can then at its own convenience supply that gasoline or can get another oil company on exchange deal to supply the same quantity ex the other company's refinery? Why cannot Europa do the exchange deal. You suggest Europa would then have to get into exchange deals not only with Gulf but with some other company? I am sure if these circumstances had arisen Gulf would within the overall arrangements have undoubtedly been very helpful in coming to such exchange arrangements. By providing Gulf Iran buy the gasoline, the onus is on Gulf - Europa does not need to start dickering with exchange deals does it? Still it does not - this may be the effect - but it does not answer my criticism that it is not a normal processing deal because Europa has no contact with the actual refinery except through the indirect shareholding in PanEast. What you say is that if Pan Eastern sold direct to Europa that would be normal? Europa would then have contact with the refining business. And yet you can see the practical reason for Gulf Iran buying gasoline from Pan-East? I see that there may be from Gulf's point of view certain practical reasons. As far as Europa is concerned it is not a processing deal. Your point three, letter variations of discounts - that was a contract variation made afterwards, wasn't it? I agree. And if Gulf had not met Europa in its difficulty it might not have got the 1964 feed stock contract? That was long before feed stock contract was even being considered. But I correct you - the letter variation arrangements were completed 1959? And in 1959 it was known that New Zealand refinery was going to be built with New Zealand companies participants and the contracts were signed with Gulf in 1962? Three years after 1959

BRIEF ADJOURNMENT 3.30 p.m.

Now look at page 2025 / of your evidence statement - last paragraph? Yes. "What I consider to be particularly unusual is for Europa to purchase products for its own marketing not direct from Paneast, but from another subsidiary of Gulf, which itself supplied the crude oil to Paneast. If Paneast sold at least part of the products, e.g. gasoline, direct to Europa and there was no direct sales agreement between Gulf and Europa running parellel with the processing arrangements it could be accepted that, however notional the refining operation Paneast had a genuine crude oil purchase and processing arrangement with Gulf, who would buy back some of the products which Paneast could not directly dispose of to its principal customer, Europa." You say there that one main objection in your view is the requirement that Gulf Iran buy back gasoline? It is one; I would not say the main. I say at least. You say it could be accepted if it had not been for that etc.? I go on in next paragraph - next sentence of same paragraph - "The fact that there is no direct commercial link between Paneast and Europa, except the corporate link of Europa's shareholding in Paneast, further proves to my mind that the whole Gulf-Paneast processing arrangement is in fact a deal between a number of Gulf subsidiary or affiliated companies and constitutes nothing but a subterfuge to cover up a discount by Gulf to Europa." Somewhere else in your evidence (page 29, bottom) you refer to this as a subterfuge: do you still stick to that term "subterfuge"? What I mean by subterfuge - I mean camouflage for a discount. And you say that what you call discount would be a rebate between 25 and 30 per cent. off posted price in 1955? In the form in which this has been done for the reason of the very special circumstances in which Gulf found itself at the time I refer to the profitability of crude oil production, its availability of refining capacity, and the possibility to sell the rest of the barrel other than the gasoline. And the reluctance of Gulf to grant a discount off posted price, as you said yourself? I believe I said Gulf would have been reluctant to invoice a direct discount into New Zealand. This is something entirely different from covering up the arrangement in another form. Can't you see any connection between reluctance on the part of Gulf? I was referring to invoicing of direct discount into New Zealand. And you said before the adjournment that a direct discount would not affect Shell/Gulf discount provided that Europa did not lower the New Zealand selling price - now is not your firm oil pricing consultant for New Zealand Government? Now but not in 1955. Are you not aware that it is the price at which gasoline is landed which through the Motor Industry Spirits Pool must affect landing cost of the other companies? I have not been involved or consulted in the matter relating to the Pool. I was under the impression that there was a price control in New Zealand which set the price, both minimum and maximum price, retailing. I have not been involved in matter of Pool and do not know details of operations. I have not been confronted with this problem. Mr Tyler did not tell me about it. Did he consult Doctor Frankel? May be.

Bottom of page/ 2033 for your evidence - this arrangement would be a substitute for direct price discount?

Turning to the 1964 agreement (page 31) and turn to page 2034 of your evidence statement - and I refer to paragraph (a) at page 2038 - you say there that the contract ought to contain provisions for crude discounts? Yes. And that crude discounts were available at that time? Yes. I believe it is generally accepted. But in Mr Todd's evidence on this he said that Gulf undertook to grant whatever were the going discounts but wanted to go to the OPEC conference first and wanted to ensure that they did not upset the Japanese customs? Yes, I heard him say that. And then you are aware that after OPEC Conference Gulf granted discounts of 16 cents up to May 1966, and 18 cents after that? Yes. In your Table 3 of Exhibit 10 you refer to Japanese discounts of 14 and 15 - 14 and 16 cents? In 1965 plus a loan with low interest which is significant addition and are generally estimated by the industry to be worth roughly 6 to 8 or 9 cents per barrel. But it depends on what the loans are and their terms? Well, look at Table 2(d) you will see interest rates. Interest rates are not only terms - what about length of the loan? Length of these loans - this was a ten-year one Table 3(b). Length are given in some cases, one year right up to ten. And you can assume that the length of the supply contract generally related to repayment period of the loan.

TO BENCH: Take the first example - CFP to Asia Oil - the repayment period is 5½ years and contract is sale of 23 million tons over 9 years? They are different periods there? Yes, but generally loan would not exceed the length of the contract.

TO COUNSEL: Your philosophy - if a biscuit manufacturer lends to a biscuit retailer in some other city some money to help him out in business and interest rate is under market rate, then the difference in interest rates is discount off the price of biscuits? I think the biscuit example perhaps is not entirely relevant, and not comparable. If I may quote another example of oil industry. That relates to the system of tying up service stations to a particular brand of petrol by long-term agreements which are linked with loans to the owner of the petrol station to improve his station, and these loans are also given in England at low interest rates. I think that this kind of thing -

TO BENCH: It is part consideration for the tied house? Yes.

TO COUNSEL: Part consideration for long term deal? Yes. But I think the oil company in making such a loan would consider it part of the terms of the supply price per gallon for the petrol.

TO BENCH: It is partly done to get the extra trade? Exactly what I would suggest Gulf did in the case of Europa.

TO COUNSEL: Now you say then that Europa should have got higher discounts than 16 to 18 cents? I think Europa - if you compare - take Japanese loans - they got a better deal than Europa. If you take the Japanese discounts and the loans into account, then the discounts granted to Paneast on crude oil of 15% cannot be considered excessive.

You realise the difference in volume of crude oil supply to Paneast on the one hand and Japanese on the other? There are some differences - undoubtedly the purchases of IDEMITSU are immeasurably greater than Paneast because crude oil purchase by Paneast is four times gasoline purchase by Europa. Difference between crude oil supply to Europa is about 250 to 1? To whole Japanese market? Gulf's supply to Japanese market? It is hard to say exactly what IDEMITSU contract is, but early 1960s it was about 3,000,000 tons a year. I am told quantity to IDEMITSU is 250,000 barrels a day? Now but not then. Europa 1,000 barrels a day? You say we should have done better than the discount we got? No, I have never suggested that, not in my brief either. I said discounts were generally at the time were in line with or higher than those granted under the Gulf/Pan-Eastern arrangement. By saying that (page 2038 / of my evidence statement) I realise that buyers like IDEMITSU would get a higher discount - that is why I say that discounts were about what Pan Eastern got or higher, but I have nowhere in my brief suggested that at that time in 1964 the discount which was granted to Pan Eastern on crude oil was either too high or too low.

Bottom of page 2040 /, last complete paragraph -

"On the other hand the Caltex offer was more realistic than the Gulf deal in certain other respects. In particular it relates to a specific refinery - the Bahrein refinery. It also provides for a refinery profit varying in line with actual changes in prices of crude oil and products with a time limited guarantee of a profit margin of not less than one quarter than that which would have prevailed on 28 February 1955. If the profit was to reflect a discount per gallon of gasoline it was therefore not a fixed one." You say that a profit guarantee is realistic whereas you said the Gulf profit guarantee is unrealistic? A ceiling or a floor limit, to prices which presumably in a way reflect margins, are quite common in escalation clauses, under supply contracts to the oil industry. I know many contracts which give a basic price and this basic price then fluctuates with certain escalation clauses, but that within these escalation clauses an upper and a lower limit is set for the price. In order not to make the contract too onerous for either party. It is as something like that that I would understand the guarantee as to profit margin offered by Caltex. Was that not just what the formula did in the 1956 Gulf contract? Yes if the contract has been allowed to operate in their original form but they were not. Margin was brought back to a certain level by variation letters. Brought back to a minimum? Yes. But in your view in the formula as drafted in 1956 contract would be a realistic form of profit assessment? I would not say realistic; I would say more realistic and it would have at least involved Europa in some risk on the refining side which subject to the other qualifications I have mentioned would have put some different light on the whole deal.

In Hartshorn's book there is some description of the way international oil companies which is wholly integrated will have different phases of operations done by different subsidiary companies? Yes. And it is correct to say that the practice in all those companies is to keep those subsidiary activities in watertight compartments? Yes. And this may be for jurisdictional and taxation matters and other reasons? Could be, yes. In certain circumstances.

And are there not oil companies and other international trading companies which as practice locate the appropriate subsidiaries in the Bahama Islands? Yes. And in other jurisdictions with similar tax advantages? Yes. I should like to say here I am not a taxation expert. It is a commonplace thing? It is done - I think partly done for all sorts of reasons. Exchange reasons sometimes? Yes. One reason I think is that some of these companies for instance Californian Texas Corporation operates over a large number of countries and they find it convenient to have a holding company in, say, Bahamas, or Bermuda, but of course individual subsidiaries exist in all the countries where Caltex is operating and they would have their own budget, own accounting and would be liable to taxation in the countries in which they exist.

REXN: Notes of evidence (p.165) you had started to answer - "Perhaps I may be permitted to state what I would consider taking the circumstances of Gulf and Europa to have been the minimum conditions which to my mind would have made a processing deal acceptable in what I consider to be general industry practice."? I would have thought that if Europa wanted to genuinely get into refining business, the deal in roughly the following terms could in my opinion be considered reasonable industry practice. Europa and Gulf form a joint subsidiary - let it be called Paneast - which enters into a refining contract, i.e. a processing agreement - with a specific refinery either of Gulf or for that matter of another oil company. The joint company purchases crude oil from Gulf at let us say the market price, posted in 1955, a discounted price, today. Whilst this oil is being processed it remains the property of the joint company and the resulting products also belong to the joint company. The joint company then sells the gasoline to Europa and the balance of the products to a Gulf subsidiary at clearly laid down prices which would vary with development in world market conditions. This could be supplemented if so desired by exchange deals between Europa and Gulf or at least for the provision of these, and possibly some kind of letter of guarantee, not as to price but as to holding Europa covered for supplies by Gulf.

COURT ADJOURNED 4.30 p.m.

Case Resumed 27/2/69

RICHARDSON CALLS: WAYNE ALVIN LEEMAN. I am Professor of Economics of the University of Missouri. I have prepared a statement of my evidence, which I now read.

"... I hold the following degrees: Bachelor of Arts, Univerisy of Wissonsin, 1948; Doctor of Philosophy, University, 1950. I teach at the University of Missouri - Comparative Economic Systems, Advanced Analysis of Economic Systems. I am author of the following Papers and Books: Papers - "An Evaluation of Organized Speculation" Southern Economic Journal, Vol. XVI (October, 1949); "The Status of Facts in Economic Thought" Journal of Philosophy, Vol. XLVIII (June 21, 1951); "The Guaranteed Annual Wage, Employment and Economic Progress" Industrial and Labor Relations Review, Vol. 8 (July 1955); "The Limitations of Local Price-Cutting as a Barrier to Entry" Journal of Political Economy, Vol. LXIV (August, 1956); "Crude Oil Prices in the United States at the Gulf Coast", Journal of Industrial Economics, Vol. V (July 1957); "The Reduction of Queues Through the Use of Price", Operations Research, Vol. XII (September-October, 1964); "Property in Capitalism and Socialism: The Right of Decision", New Individualist Review, forthcoming; "Syndicalism in Yugoslavia", "Economic Development and Cultural Change", forthcoming.
Books: The Price of Middle East Oil (Ithaca, Cornell University Press, 1962); (Editor) Capitalism, Market Socialism, and Central Planning: Readings in Comparative Economic Systems (Boston, Houghton Mifflin 1963).

From June 1957 to August 1958 I travelled in U.S.A., London and all the oil countries of the Middle East doing research for my book "The Price of Middle East Oil". I had many interviews with Government officials and oil company officials. The book went into a second printing and sales have been 50-50 domestic and foreign. It is being translated into Japanese and has been translated into a pirated Arabic edition.

In April, 1963 I gave a paper, "The Future Structure of the Market for Middle East Oil" during a conference at Princeton University.

In late March of this year I will testify before the U.S. Senate Subcommittee on Antitrust and Monopoly, on the subject of U.S. oil import quotas. The paper I present to the Subcommittee will be published in the proceedings of the Senate hearings.

I have been approached on several occasions to act as consultant, by the U.S. Government and others, but as I wished to continue research in the field I preferred to remain free of any ties. As my main interest has latterly been focussed on another area I was willing to advise New Zealand Government.

<u>The 1956 Agreements (Before Amendment by Letter)</u>.

In my opinion the Pan-Eastern Refining Co. Ltd. cannot properly be regarded as a refining venture.

I shall start out by listing the properties of a normal or typical refining business and state after each whether Pan-Eastern possessed this property.

(a) A refining enterprise usually owns a plant for converting crude oil into products. Consequently it risks physical loss of this plant (a risk which can be covered by insurance) and it risks a decline in value of the plant, caused by a rise in the price of inputs or a decline in the price of outputs.

Pan-Eastern does not own a refinery, hence faces no risk of a physical loss and no need to insure against such loss, and faces no risk of a decline in plant value.

(b) A refining enterprise usually owns inventories of crude oil and products. Consequently it risks (insurable) physical loss of stocks and risks a decline in their value.

Pan-Eastern does not own inventories, hence faces no risk of a physical loss of stocks and no risk of a loss in their value.

(c) A refining enterprise usually operates a refinery, runs the risk that profits will be cut if costs of operation are excessive, and makes gains when operating costs are reduced.

Pan-Eastern does not operate a refinery, gets its refining done by Gulf on a processing contract at a fixed charge per barrel, runs no risk on unexpectedly large costs of operation, and makes no gains from reductions in operating costs.

(d) A refining enterprise usually enters into contracts to purchase crude and sell products. When, as is usually the case, these are not fixed-price contracts but contracts which tie purchase and sale prices to posted prices the refining enterprise runs a risk of changes in posted prices.

Pan-Eastern does have such contracts and does run risks that posted prices of crude oil and gasoline will change (but runs no risks with regard to the prices of products other than gasoline).

(e) The net earnings of a refining enterprise usually are a function of (i) the price of crude oil or other refinery feedstocks, (ii) the unit costs of refining the crude, (iii) the prices of the various products of the refinery - such as gasoline, kerosene, distillate, residual oil - and (iv) the output of the different products of the refinery.

The net earnings of Pan-Eastern are not calculated in this fashion. In order to show how Pan-

Eastern profits are calculated I submit Memorandum L1. Looking at equation 2 we observe that when Europa buys 79 octane gasoline the net earnings of Pan-Eastern are a function of only three variables: notional output of gasoline (N), the price of gasoline (B), and the price of crude oil (A). The net earnings of Pan-Eastern are not a function of the prices of products other than gasoline, not a function of output of products other than gasoline, and not a function of the cost of refining.

The profits per barrel of gasoline in a refining enterprise usually change by 100% of a change in the price of gasoline. A $1.00 per barrel reduction in the price of gasoline would reduce profits by $1.00 per barrel of gasoline output.

Looking at equation 1 we observe that Pan-Eastern profits per barrel of gasoline change by 126% of a change in the price of gasoline (see the coefficient of B). A $1.00 per barrel reduction in the price of gasoline would reduce profits by $1.26 per barrel of gasoline output. Thus we see that when Europa buys 79 octane gasoline neither the net earnings of Pan-Eastern nor its profits per barrel of gasoline are calculated as they would be in an ordinary refinery.

When a refining enterprise increases the octane of the gasoline it turns out, its profits per barrel of gasoline incrdase by 100% of the difference between the prices of the two octanes less the cost per barrel of raising the octane rating. Looking at equation 3, we observe that Pan-Eastern profits per barrel of gasoline increase by only about 26% of the difference in prices between the octanes (see the coefficient of

B-B') and that there is no reference to the costs of increasing the octane rating. Thus we see that when Europa buys higher than 79 octane gasoline, Pan-Eastern profits per barrel of gasoline are not calculated as they would be in an ordinary refinery.

Of the five properties of a refinery which we discussed, Pan-Eastern has only one, the fourth, and that only partially. (It runs the risk that the price of gasoline will change, but does not run such a risk with regard to the prices of other products.)

Pan-Eastern buys refining services from Gulf and has never been more than a shadow of a refinery.

What I have said about inventory risk is brought out by a comparison of inventories carried at risk in refining, on the one hand, and in shipping, on the other. While Pan-Eastern is explicitly freed of all risk with regard to inventories of crude oil supplied and processed by Gulf (Processing Contract, 1956, Exhibit A7, Third Schedule, Paragraphs III and V), Europa explicitly assumes the risks associated with products shipped by Gulf under the Contract of Affreightment, Exhibit A4, Paragraphs I, VI(a), XIII(b), XIV(a)(b), XVI, XVIII(b)(c). In the matter of stocks owned or carried at risk, Europa, under the 1956 contracts, is more definitely in the shipping business than it is in the refining business.

The Pan-Eastern arrangements might be described as an odd "processing deal" between Gulf Oil and Europa. In an ordinary processing deal a marketing firm buys crude oil from a company, pays it a refining fee to process the crude, and sells back to it unwanted products. But the Pan-Eastern deal is odd because Europa does not buy crude oil, does not itself pay a refining fee to Gulf, and does not sell unwanted products to Gulf. In any case, however, entry by Europa (?P.E.) into a processing deal does not put it into the refining business. The processing deal does not have the properties of a refinery discussed earlier.

I think that Pan-Eastern (before amendments by letter) can best be described not as a refining enterprise but as a somewhat peculiar trading venture. It is essentially a venture in trade because it seeks the profits of trade (through the purchase of crude and the sale of products) and it may take some risks of trade. It does not manufacture nor take the risks of manufacture. Pan-Eastern is a peculiar trading venture for two reasons:

(a) Unlike an ordinary trading venture when profits would be related to all products sold, the formula in the Processing Contract relates profits only to the prices of gasoline and crude oil. The prices of other products are adjusted arbitrarily in order to ensure that actual Pan-Eastern profits equal formula profits.

(b) Pan-Eastern owns no inventories and takes no risks of inventory loss. It is a trader in crude and products but it never takes a position in the goods in which it trades.

This trading company pays for some refining activity, but that does not put it in the manufacturing business. The Pan-Eastern processing contract with Gulf is exactly analogous to the contract a trader might have with a transportation company. Suppose a trader buys cattle in St. Louis and sells them in Kansas City, paying a truck line a fixed price per pound for transportation. One would not say that the cattle trader was in the transportation business. Nor would it seem reasonable to say that Pan-Eastern is in the refining business on grounds that it has a contract with Gulf to refine the crude oil it buys.

Europa describes the Pan-Eastern arrangements as vertical integration. The usual reason for vertical integration backward is to achieve security of supply. Europa, however, achieved security of supply in the Petroleum Products Sales Contract (Exhibit A): the creation of Paneast did not enhance its security of supply.

[INTERPOLATION: Do you have a further comment you wish to make? In this paragraph I described what happened in Pan-Eastern set up. But actually a company which wanted to go into the refining business as an independent refinery would expect to be tied to a single refinery. It would expect to take risks associated with ownership of a single refinery.]

I believe that the Pan-Eastern trading business is a substitute for a discount. Had Europa not been permitted to buy into Pan-Eastern for £50,000, it is highly probable that it would have gotten a fixed amount or fixed percentage discount on products from Gulf. Now there is no reason to doubt that some sort of alternative inducement would have been given to Europa. The benefits to be obtained from the Pan-Eastern venture are described in the fourth recital of the Contract for Organisation of Pan-Eastern Refining Company (Exhibit A.7 page 2) as "a major inducement to Europa to enter into the Petroleum Products Sales Contract and the Contract of Affreightment". This suggests that if Gulf had not offered Europa these benefits, it would have had to offer her other inducements in order to sell products. Moreover, given the anticipated and actual profits of Pan-Eastern, the £50,000 purchase price of stock in Pan-Eastern paid by Europa appears to be exceedingly low. One looks for additional value provided by Europa. The question we must ask is this: What reason do we have for believing that the alternative to the trading venture would have been a concession in price? The answer is very simple: While established oligopolists avoid price competition, a new entrant is likely to employ this very sharp weapon.

The Pan-Eastern contracts appear to be a substitute for a <u>gasoline</u> discount. The Petroleum Products Sales Contract (Exhibit A, para. 2.01) provides for the sale by Gulfiran to Europa of all Europa's requirements of gasoline and, at the option of Europa, some gas oil. By paragraph 11.02 Gulfiran has the option of supplying Europa's requirements of lubricating oils, crude oil and other products. The price for gas oil is that fixed in Platt's Oilgram less 5 cents a barrel. As for lubricating oils, crude oil and other products Gulfiran must meet the best offer available to Europa. This might well involve some discount from Platt's Oilgram prices. I can, however, find no evidence of possible discounts on gasoline in the Petroleum Products Sales Contract. All I observe is that the price for gasoline is by paragraph 5.01 the lowest quotation in Platt's Oilgram under the headings "Caribbean and Far East" and "Persian Gulf". For all products other than gasoline there is a possibility of discounts. This suggests to me that the Pan-Eastern arrangement was intended to provide a concession to Europa in respect of gasoline.

To be sure, relatively few outright price discounts on petroleum products were obtainable before 1960. That some open discounts were granted can be seen in Exhibit 13 (replacing Exhibit 2), Examples of Arms Length Sales and Offers of Petroleum Products, 1955-59. During this period however, firms seeking new outlets or seeking to hold existing outlets usually cut prices indirectly, through freight concessions, loans at below-market interest rates, and the like. An example of the latter is the Gulf Oil Corporation loan to Union Oil Company of California. Gulf arranged to purchase $120,000,000 of convertible debentures maturing in twenty-five years and carrying an interest rate of 3¼%. In describing the deal, the New York Times stated that "As part of the transaction, Union Oil will get access to Gulf's crude oil production at the market price." (New York Times, 5 April 1956, p.41). In commenting on the deal Melvin G. de Chazeau and Alfred E. Kahn, Integration and Competition in the Petroleum Industry, 1959, p.366n, assert that "though reported as an 'investment', the low terms suggest that Gulf may be 'buying' an advantageous market outlet for its Middle East crude ....."

Moreover, Gulf Oil Corporation had a particularly strong reason for offering concessions to Europa. It had unlimited lifting rights in Kuwait (where it is in partnership with British Petroleum). And then Europa was a purchaser of gasoline which was generally in surplus when the 1956 agreement was concluded. Since middle distillates and heavy fuel oil could be readily disposed of at the time, the sale of gasoline to Europa meant that Gulf could increase its production of crude oil. Hence Gulf would have been eager to obtain an outlet in New Zealand.

Finally, Gulf had just acquired a seven percent interest in the Abadan refinery at a time when it lacked marketing outlets East of Suez. Thus, Gulf would have been particularly anxious to secure an outlet for gasoline, and is likely to have been prepared to sell at a reduced price.

THE REFINER'S MARGIN

Consider two propositions:

(i) If Gulf Oil could not sell light ends as gasoline and at posted price, it could not get a $1.00 refiner's margin.

(ii) If, on the contrary, Gulf could sell its gasoline at posted prices and realize the $1.00 refiner's margin, then we must ask why Gulf cut Europa in on its refiner's margin (for an insigificant investment of £50,000).

It seems probable that under the circumstances Gulf found itself in (a 7% share in the Abadan refinery while without a previously developed market for gasoline East of Suez) Gulf could not realize a $1.00 refiner's margin. I believe that to dispose of its gasoline as gasoline (and not as fuel oil) Gulf gave Europa about $0.25 of the refiner's margin through Pan-Eastern, so that Europa's share of Pan-Eastern profit is what Gulf otherwise would have had to give as a gasoline discount.

[INTERPOLATION: Would you explain how you arrive at the figure of 25 cents in that paragraph? It has been generally agreed that the refiner's margin at the time was $1.00. If we take from that one dollar the refining fee of $47\frac{1}{2}$ cents, round the $47\frac{1}{2}$ off to 50 cents, so if we take from the $1.00 50 cents, we have 50 cents left. Europa's share of that 50 cents was 25 cents. That is the 25 cents I believe is conceded to Europa. In order to sell the gasoline. We can arrive at the 25 cents by another route. A barrel of gasoline has 42 gallons. A quarter of that would be $10\frac{1}{2}$. Round that off to 10 cents - to 10 barrels. 10 barrels times $2\frac{1}{2}$ cents per barrel which is the discount I believe was involved, 10 barrels at $2\frac{1}{2}$ cents a barrel is 25 cents.]

THE 1956 AGREEMENTS AS AMENDED BY LETTER.

The letter amendments (Exhibits A.9 - A.14, A.16 - A.17) are extraordinary and cannot be described as a normal discount to a refinery.

The Exhibit B.14 materials which resulted in these letter amendments substantially change the nature of Pan-Eastern. From a somewhat peculiar trading venture, Pan-Eastern is made into a repository for an assured discount to Europa. The communications (see particularly those of 10 July 1958, 19, 20 and 21 August 1959, Exhibit B.14) clearly establish that Pan Eastern (Europa) is to receive a minimum of 2.1/3% per gallon of gasoline purchased by Europa, for the duration of the contract. They show that the statement in the letters ... "action in this respect ...

is made without prejudice to any of our rights to insist that the price provisions be strictly adhered to in the manner and in accordance with the terms specified in the aforementioned Third Schedule" does not represent the true situation with regard to the post-correspondence contracts.

That is the correspondence we can read "Europa" whenever it says "Pan Eastern" can be seen in Mr Bryan Todd's letter to Gulf Oil of 10 July 1958. In a discussion of Pan Eastern's return, Mr Todd speaks of the Formula return moving from 2.50¢ per U.S. gallon up to 2.87¢. But it was Europa's (and Gulf's) return which started at 2.5¢; Pan Eastern's return began at 5.0¢. It seems clear that Europa and Gulf had gotten into the habit of speaking of Pan Eastern when they meant Europa. (See also Paton to Todd, 4 March 1958).

Europa's letter profit per gallon added to its formula profit per gallon gives it a discount on gasoline purchased by Europa from Gulf. This can be seen, first of all, in the telegram of August 19, 1959, in which Todd states his understanding of how the formula profit will be adjusted each year. He says that "in each year in which Pan-Eastern (Europa) profits are below 2½ cents you will pay by way of crude discount to Pan-Eastern difference between processing contract formula and 2½ cents." Then the gasoline discount is revealed by a calculation of Europa's formula profit per gallon of gasoline notionally refined by Pan-Eastern, Europa's letter profit per gallon, and total Europa profit per gallon. I submit Memoranda L 1a through L 1f in which formula profit is calculated for the years 1960 through 1965. I also submit Memorandum L2 which shows formula profit and letter profit per gallon of gasoline imported by Europa. We observe that from 1960 through 1965 as Europa's share of Pan-Eastern profits calculated in accordance with the formula declines, Europa's share attributable to the amendments by letter rises. The result is to give Europa 2½ cents per gallon "profit" which without doubt is really a discount on gasoline purchased. (Memorandum L2a shows how Europa's gasoline discount is inserted in Pan-Eastern as a crude oil discount.)

A conservative interpretation of the B.14 materials and the amendments by letter would be that they converted a substitute for a discount into an outright discount. A less conservative interpretation would be that the B.14 materials and the letters reveal that the original 1956 agreements were simply a facade for a discount. In either case, the existence of the letters, I believe, makes it possible to characterize Europa's share of Pan-Eastern profits as a discount on gasoline purchased by Europa from Gulf.

THE BP CONTRACTS

BP letter to Pacific Trading and Transport Co. Limited (Exhibit A.25) asserts that a commission will be paid to P.T.T. but in my opinion this alleged commission can be regarded only as a discount of 10% off posted prices on the products concerned (gas oil, lighting kerosene and fuel oil) plus a discount of TALFI rate minus 5-year time charter rate for defined standard tankship. My reasons are -

(a) The parties to the Contract (Exhibit A.24), BP (New Zealand) Ltd. and Europa had found each other and entered into the contract before P.T.T. had come into existence. Therefore P.T.T. cannot have performed a brokerage service. (The date of the contract is 18 December 1961 and the date of the incorporation of P.T.T. was 22 March 1962).

(b) A normal brokerage fee would be about 1%, not 10%.

(c) There is considerable evidence that discounts were available in the products covered in the months preceding the contract. See Newton Brief of Evidence, Graphs B, C, and D.

THE 1964 CONTRACTS (BEFORE AMENDMENTS BY LETTER)

Under the Feed Stock Supply Contract (Exhibit B) Gulfex agrees to sell feedstocks and finished products to Europa. Under the Processing Contract (Exhibit B.5), Gulf sells crude oil to Pan-Eastern and Gulf processes part of this crude oil for Pan-Eastern; Gulf also buys the unprocessed crude back from Pan-Eastern and it buys feedstocks and finished products from Pan-Eastern.

The prices at which these various transactions take place give Europa some outright discounts. These discounts arise in crude oil and naphtha:

(i) CRUDE OIL (Exhibit B.5 para. 4.01)

(a) Pan-Eastern pays Gulf posted price less 15% (assume a posted price of $1.59. Then Pan-Eastern pays $1.59-0.24 (15%) = $1.35.

(b) Pan-Eastern received from Gulf posted price (say $1.59).

(c) Europa pays Gulf the same price for crude as Gulf pays Pan-Eastern, namely, posted price.

(d) The difference (say $0.24) between (a) and (b) above is doubled (para. 5.02) so that Europa's one-half of Pan-Eastern profits gives it a discount equal to the difference between (a) and (b) (that is, $0.24).

(e) Thus Europa received a discount of 15%. This purchase and resale of crude oil is not the sort of activity a refinery would ordinarily engage in.

(ii) NAPHTHA (Exhibit B.5, para. 4.02(a))

(a) Pan-Eastern pays Gulf for crude oil and for processing it into naphtha a base price of $1.46 per barrel, this price escalating cent for cent with any increase or decrease in the posted price of Kuwait crude above or below $1.59 per barrel. (For an example here, say $1.46).

(b) Pan-Eastern receives from Gulf for the naphtha the posted price for Kuwait crude (say \$1.59) plus \$0.02 for each degree of gravity by which the gravity of the naphtha is above 31.0° API (say \$0.70), (the final price being, say, \$1.59 + 0.70 = \$2.29).

(c) Europa pays Gulf the same price for the naptha as Gulf pays Pan-Eastern (see (b)).

(d) The difference (\$2.29 - 1.46 = \$0.83) between (a) and (b) above is doubled (para. 5.02) so that Europa's one-half of Pan-Eastern profits gives it a discount equal to the difference.

(e) Since the price Pan-Eastern pays escalates with the price it receives, the discount remains fixed (here it is \$0.83).

The prices at which transaction involving gas oil and wide cut distillate take place involve Pan-Eastern and Europa in some risk.

(i) GAS OIL. (Exhibit B.5, para. 4.02(b))

(a) Pan-Eastern pays Gulf for crude and for processing it into gas oil a base price of \$2.00 per barrel, this price escalating cent for cent with any increase or decrease in the posted price of Kuwait crude above or below \$1.59 per barrel (for an example here say \$2.00).

(b) Pan-Eastern receives from Gulf for the gas oil the posted price of 53/57 D.I. gas oil at Abadan (say \$2.94).

(c) Europa pays Gulf the same price for the gas oil as Gulf pays Pan-Eastern (see (b)).

(d) The difference (\$2.94 - 2.00 = \$0.94) between (a) and (b) is doubled (para. 5.02) so that Europa's one-half of Pan-Eastern profits gives it a return equal to the difference.

(e) The profits of Pan-Eastern might decline with a rise in the posted price of crude oil or a decline in the posted price of gas oil, when these prices do not move together.

(f) With respect to gas oil, Pan-Eastern and Europa take some risk that profits will not be so great as expected, though with so large a margin to start with ($0.94) the risks of actual losses are small. They do not take the risks (which an ordinary refinery takes) that the cost of refining will rise, since the refining fee is in the base price and there is no provision for increasing this price if refining costs rise.

Incidentally, for Europa to pay the price of finished gas oil (53/57 D.I.) when they take delivery of a raw gas oil for feedstock is most unusual (see Feedstock Supply Contract, 1964, para. 7.01, Exhibit B, where gas oil is listed amongst the feedstocks).

(ii) <u>WIDE CUT DISTILLATE</u> (Exhibit B.5 para. 4.02(c))

(a) Pan-Eastern pays Gulf for crude and for processing it into wide cut distillate a composite price based on the naphtha and gas oil content thereof.

(b) Pan-Eastern receives from Gulf for the wide cut distillate a composite price based on the naphtha and gas oil content thereof.

(c) Europa pays Gulf the same price for wide cut distillate as Gulf pays Pan-Eastern.

(d) Pan-Eastern receives a composite profit which has in part the properties of the income on naphtha (i.e. a fixed discount) and in part the properties of the income from gas oil (i.e., a profit).

The prices at which transactions involving motor gasolines, jet fuels, kerosenes and gas oils (Exhibit B.5, para. 4.03) take place appear at first glance to involve Pan-Eastern and Europa in some risks. Prices and profits in these products are determined as follows:

(a) Pan-Eastern pays Gulf for crude oil and for processing it into these products a base price negotiated each year and escalating during the year with a reference price equal to the lowest price for any given product posted in the Caribbean or Persian Gulf.

(b) Pan-Eastern receives from Gulf the lowest price for any given product posted in the Caribbean or Persian Gulf.

(c) Europa pays Gulf the same price as Gulf pays Pan-Eastern for the products (see (b) above).

(d) The difference (if any) between (a) and (b) above is doubled (para. 5.02) so that Europa, which receives one-half of Pan-Eastern profits, receives a return equal to any difference between (a) and (b).

It appears that Europa is taking the risks of trade in connection with motor gasolines, jet fuels, and kerosenes, since Pan-Eastern profits decline if the (posted) price it receives for these products decline or if the annually negotiated base price it pays for crude oil and for processing rises. But Europa has the option of taking or not taking motor gasolines, jet fuels, and kerosenes from Gulf, and if Europa does not buy these products from Gulf, then Pan-Eastern does not process crude oil into these products. It seems probable that if posted prices on products seriously decline or if the parties cannot agree on a suitable base price, Europa will order its motor gasolines, jet fuels, and kereosenes from another supplier than Gulf so that its notional refinery will not turn out these products. Hence there is little risk for Europa in connection with the production of motor gasolines, jet fuels and kerosenes.

Of the five properties of a refinery listed earlier (p.4-6) Pan-Eastern in the 1964 contracts does not have the first three. It has the fourth, but only with respect to gas oil and wide cut distillate, and it has some measure the fifth.

The net earnings of Pan-Eastern are a function of (i) the prices at which crude oil is purchased from and sold to Gulf Oil, (ii) (a) the prices of crude oil and the costs of processing it into feedstocks and finished products, crude oil and processing for which payment is made to Gulf, (ii) (b) the sales prices for feedstocks and finished products sold to Gulf and (iii) the quantities of crude oil purchased from and sold to Gulf Oil, the quantities of crude oil purchased from Gulf Oil and processed into Feedstocks and finished products, and the quantities of feedstocks and finished products sold to Gulf. The earnings of Pan-Eastern, unlike an ordinary refinery, are not a function of the cost of refining naphtha, gas oil and wide cut distillates (the profits of Pan-Eastern do not change if these costs change).

The method of doubling the profits of Pan-Eastern deserves attention (1964 Processing Contract, para. 5.02, Exhibit B.5). Gulf agrees to purchase additional petroleum products so as to return to Pan-Eastern an amount of money equal to the profits Pan-Eastern makes on the purchase of crude oil and the sale of crude oil feedstocks and finished products in accordance with the earlier clauses of the contract. The prices at which these additional products are purchased may be far from prevailing market prices. Suppose Europa, under the Feedstock Supply Contract, were to buy in products a large part of the composite barrel, then large profits would have to be inserted into Pan-Eastern under the Processing Contract and doubled. To double these large profits, high and unrealistic prices would have to be placed on the small remainder of the barrel not purchased by Europa.

I conclude, therefore, that Pan-Eastern under the 1964 contracts is not in substantial degree a refinery.

The unamended Pan-Eastern 1964 arrangements, however, can be described in part as outright discounts (on crude oil and naphtha) and in part as a substitute for a discount (with respect to gas oil and wide cut distillate).

(i) The profit on gas oil and wide cut distillate can be viewed as a substitute for a discount because Europa had still made no contribution beyond the initial insignificantly small £50,000.

(ii) Gulf, no doubt, had to offer discounts and attractive profit opportunities (which I call substitutes for discounts) because discounts were widely available prior to the signing of the 1964 contracts. For evidence of these discounts see Newton Brief of Evidence, Graph C and in Table 3a the following entires:

Date	Buyer
10.vi.'63	Petrobras
4.xi.'63	Petrobras
24.ii.'64	Petrobras
25.xi.'63	Govt of Tunisia
9.xii.'63	Govt of Tunisia

THE LETTERS OF AMENDMENT (EXHIBITS B1, B2, B3, B4) TO THE (1964) FEED STOCK SUPPLY CONTRACT (EXHIBIT B.)

The letters of amendment do not substantially alter the contracts and do not lead me to change my conclusion that the 1964 arrangements can be described as a substitute for a discount.

The 16 March 1965 letters give Europa an outright discount on its purchases from Gulf of crude oil, naphtha, and gas oil effective 1 April 1964. Since Gulf pays to Pan-Eastern the same price it receives from Europa, the price paid by Gulf to Pan-Eastern is correspondingly reduced. (See the 16 March 1965 letter to Pan-Eastern, Exhibit B6).

In effect, the 16 March 1965 letters convert part of what I have called a substitute for a discount into an outright discount or into a simple price reduction. Before the letters, Pan-Eastern paid Gulf for Kuwait crude posted price less 15% (say \$1.59 - 0.24 = \$1.35) and received from Gulf posted price (say \$1.59). Europa paid posted price for crude (\$1.59). After the 1965 letters, Pan-Eastern pays the same price for crude but receives posted price less \$0.16 (say \$1.59 - 0.16 = \$1.43). Europa now pays posted price less \$0.16 (that is, \$1.43). In this example, Pan-Eastern temporarily retains \$0.08 of the original \$0.24 discount while Europa gets \$0.16 of it. After the letters, Europa pays \$0.29 less for naphtha, say \$2.00 instead of \$2.29. This is an outright discount. The remainder of Europa's share of Pan-Eastern profit (\$0.83 - 0.29 = \$0.54 in our earlier example) continues to be what I have called a substitute for a discount. The letter concerned with gas oil reduces the price which Europa pays for this feedstock. Under the Feedstock Supply Contract Europa paid for gas oil irrespective of gravity the lowest price for 53/57 D.I. Gas Oil f.o.b. Abadan. According to the letter Europa is to pay for all gas oil the lowest posted price for 48/52 Gas Oil D.I. f.o.b. Abadan. The difference in price between these two gas oils throughout 1965 was 0.2¢ per gallon or \$0.084 per (42 gallon) barrel. The letter, therefore, lowers the price to Europa by \$0.084 per barrel, and, while the final profitability of Europa is unchanged, the letter increases by \$0.084 per barrel of gas oil the direct profit of Europa and reduces by the same amount the profit Europa derives through its half share in Pan-Eastern.

A question which must be asked is this: Why were not the discounts which were given by letter to Europa given to her a year earlier in 1964 when the Feed Stock Supply Contract was entered into, in view of the fact that discounts were available at this time? (See discounts in Newton

Brief of Évidence referred to on pages 29-30 of this Brief.) The fact that outright discounts were not given to Europa in 1964 at a time when discounts were generally available supports my contention that the Pan-Eastern arrangements were a substitute for a discount.

The 30 June 1966 letter (Exhibit B4), like the letters of 16 March 1965, converts part of what I have called a substitute for a discount into an outright discount. Only crude oil is covered in this 1966 letter and the outright discount on crude is somewhat larger than in the 1965 letter concerned with crude oil.

THE 1962 CONTRACTS

The 1962 Contracts are like the 1964 contracts with two interesting differences -

(i) Pan-Eastern purchases marine transportation from Gulf Oil Corporation and then sells it back to Gulf (or companies designated by Gulf). The quantity of transportation is that required to carry the quantities of feed stocks, other refinery charge stocks and finished stocks purchased by Europa from Gulfex under the Feed Stock Supply Contract. The purchase prices paid by Pan Eastern are generally Intascale minus 45% adjusted in a designated manner for changes in British marine labour costs and changes in the price of bunker fuel oil at Ras Tanura. The sale prices received by Pan Eastern are generally the AFRA rate for large vessels. The difference between the prices paid by Pan Eastern for marine transportation and the prices received for this transportation is doubled in the same curious way as in the 1964 contracts. In effect these arrangements give Europa a discount on marine transport supplied by Gulf and the discount is put through Pan Eastern. It would not be surprising to see a refinery buy marine transportation but it is odd to see a "refinery" purchase transport from a company and then sell it back to the company, with the amounts of transport involved in the transactions related to the transport which is actually supplied by the company to a third party.

(ii) Examples of the base amount per gallon of gasoline which might be agreed upon are inserted in the contract. For both 93 and 83 octanes the example prices suggested give Pan Eastern (Europa) a 2.5¢ discount.

	93 octane	83 octane
Lowest posted price December 1962 (in cents)	9.9	7.8
Example prices of 1962 contract (in cents)	7.4	5.3
Differences (in cents)	2.5	2.5

Had no discount to Europa been contemplated it seems probable that the actual posted price prevailing at the time of the contract would have been used for the example of the base price. It is, of course, significant that the 2.5¢ of the examples is the same as the 2.5¢ which much other evidence suggests is the discount on gasoline Gulf gave to Europa.

There is evidence that gasoline discounts were available in the open market in the period preceding the 1962 contracts. See Newton Brief of Evidence, Table 2, first page, deliveries to Uruguay and Panama. These are, to be sure, purchases by governmental agencies. Occasionally government purchases are decided by political considerations, but much, if not most, of the time government purchasing agencies, like business enterprises, have as their objective the purchase of supplies at the lowest possible price. Hence, purchases by government agencies usually can be treated as ordinary commercial transactions. Indeed it seems most probable that purchases by an agency like the U.S. Panama Canal Company are purely commercial."

(conclusion of written evidence)

EXAMINATION-IN-CHIEF (Mr Richardson)

Continuation of Evidence of WAYNE ALVIN LEEMAN

A question arising from yesterday's evidence: you were present during that? Yes. My friend Mr Mahon asked Mr Newton whether he was suggesting that in 1955 Gulf would have been prepared to involve Europa for gasoline at a discounted price of 25 to 30 per cent. below posted prices under a ten-year contract? If Gulf had wanted to give Europa an outright price concession it could have done so in many ways other than actual invoice. For example, it might simply have deposited funds to an account in say London. As was done in the case of the P.T.T. Or it might have given a freight concession or a promotional allowance, and so forth. As for the question of whether Gulf would have been prepared to grant an outright price discount, it should be realised that Gulf is an American Company, that in America price competition is actively encouraged, and that while Gulf would have been reluctant to use this very sharp weapon it is entirely conceivable that under the circumstances in which it found itself it would have offered a direct price discount. Perhaps however it would not have been the full 25-30% mentioned.

When you refer to the American environment encouraging price competition, are you referring to the business policies of the American companies or to Government policy as expressed in the Anti-Trust law? I am referring to both. I am referring to United States Government policy of actively encouraging competition and I believe that this kind of environment induces business men more often to engage in price competition. In travelling in Europe when doing my study of Middle East oil I was struck by the difference in outlook both amongst Government officials and amongst oil company people. Government officials in Europa do not really want competition very much. They are afraid of the unstabilising consequence of price competition. I had the impression that many European officials felt that the price structure could come tumbling down if any substantial amount of competition were introduced. European oil men also were very reluctant to think in terms of competition. But as I have indicated the outlook of both Government officials and oil men in the United States is quite different.

MEMORANDA L1 to L3 follow.

MEMORANDUM L 1

The Computation of Pan-Eastern Profits

Since the Third Schedule, Processing Contract (Exhibit A7), paragraph 6.04 tells us that the prices paid by Gulf to Pan-Eastern for kerosene, distillate, and residual are to be adjusted upward or downward in order to ensure that the net earnings of Pan-Eastern are determined in accordance with paragraphs 7.01 and 7.02, I shall analyze these two paragraphs.

1. Formula Applicable When Europa Buys 79 Octane Gasoline (para.7.01)

Let P be Pan-Eastern profits in U.S. dollars per barrel of gasoline sold by Gulf to Europa.

Let B (as in the contract) be the posted price in U.S. dollars per barrel of 79 Octane gasoline.

Let A (as in the contract) be the posted price in U.S. dollars per barrel of 34.0^{0}-34.9^{0} crude oil.

Then:

$$P = 2\left[\left(\frac{2.145\ A + B}{2}\right)(0.256) + \left(B - \frac{2.145\ A + B}{2}\right)\right]$$

$$= (2.145\ A + B)(0.256) + 2\ B - (2.145\ A + B)$$

$$= (0.256)(2.145\ A) + 0.256\ B + 2\ B - 2.145\ A - B$$

$$= 0.54912\ A - 2.145\ A + 0.256\ B + 2\ B - B$$

$$= -1.59588\ A + 1.256\ B$$

$$P = 1.256\ B - 1.59588\ A \qquad \text{(Equation 1)}$$

Let E be net earnings of Pan-Eastern in U.S. dollars

Let N be the number of barrels of gasoline which Gulf Iran is required to deliver to Europa under the Petroleum Products Sales Contract

Then:

$E = NP$

or

$E = N\,(1.256\ B - 1.59588\ A)$ (Equation 2)

2. Formula Applicable When Europa Buys Gasoline of Octane Higher than 79 (para. 7.02)

Let B (as in the contract) now be the posted price in U.S. dollars per barrel of the (higher than 79 octane) gasoline actually purchased.

Let B' now be the posted price in U.S. dollars per barrel of 79 octane gasoline.

Other symbols are defined as before.

Then:

$$P = 2\left[\left(\frac{2.145\ A + B}{2}\right)(0.256) + \left(B - \frac{2.145\ A + B}{2}\right) - \left(\frac{B - B'}{2}\right)\right]$$

$$= (2.145\ A + B)(0.256) + 2\ B - (2.145\ A + B) - (B - B')$$

$$= (0.256)(2.145\ A) + 0.256\ B + 2\ B - 2.145\ A - B - (B - B$$

$$= 0.54912\ A - 2.145\ A + 0.256\ B + B - (B - B')$$

$$= -\ 1.59588\ A + 1.256\ B - (B - B')$$

$$= 1.256\ B - 1.59588\ A - (B - B')$$

$$= 1.256\left[B' + (B - B')\right] - 1.59588\ A - (B - B')$$

$$= 1.256\ B' + 1.256\ (B - B') - (B - B') - 1.59588\ A$$

$$P = 1.256\ B' + 0.256\ (B - B') - 1.59588\ A \quad \text{(Equation 3)}$$

$$E = NP$$

or

$$E = N\left[1.256\ B' + 0.256\ (B - B') - 1.59588A\right] \quad \text{Equation 4}$$

Equation 4 Simplified for Computational Purposes

$$E = N\left[1.256\ B' + 0.256\ (B - B') - 1.59588\ A\right] \quad \text{Equation 4}$$

$$N\left[1.256\ B' + 0.256\ B - 0.256\ B' - 1.59588\ A\right]$$

$$N\left[B' + 0.256\ B - 1.59588\ A\right]$$

$$E = N\left[0.256\ B - 1.59588\ A + B'\right] \quad \text{Equation 5}$$

It turns out that this formula which in the contract is applicable when Europa buys higher than 79 octane gasoline also can be used for computation when the gasoline is 79 octane. For in the case of 79 octane gasoline, B' in equation 5 is the same as B (both being the price of 79 octane gasoline). Hence equation 5 becomes

$$E = N\ (0.256\ B - 1.59588\ A + B)$$

or

$$E = N\ (1.256\ B - 1.59588\ A)$$

which is equation 2, the equation applicable when Europa buys 79 octane gasoline.

In the calculations which follow Equation 5 is used in all cases, both when 79 octane and when higher than 79 octane gasoline is involved.

Memorandum L 1a

PAN-EASTERN PROFIT CALCULATED WITH FORMULA

1960

79 Octane

Quarter ending 31 iii '60

B = 3.696 (8.8¢/gal. = $3.696/bbl.)
A = 1.86
B'= same as B

E = 206,731 [(0.256) (3.696) - (1.59588) (1.86) + 3.696]
= 206,731 [0.94618 - 2.96834 + 3.696]
= 206,731 [1.67384]
= 346,035

Quarter ending 30 vi '60

B = 3.696
A = 1.86
B'= same as B

E = 332,253 [(0.256)(3.696) - (1.59588)(1.86) + 3.696]
= 332,253 [1.67384]
E = 556,138

83 Octane

Quarter ending 30 ix '60

B = 3.570 (8.5¢/gal. = $3.570/bbl.)
A = 1.78
B'= 3.444 (8.2¢/gal. = $3.444/bbl.)

E = 199,489 [(0.256)(3.570) - (1.59588)(1.78) + 3.444]
= 199,489 [0.91392 - 2.84067 + 3.444]
= 199,489 [1.51725]
E = 302,675

Quarter ending 31 xii '60

B = 3.486 (8.3¢/gal. = $3.486/bbl.)
A = 1.78
B' = 3.36 (8.0¢/gal. = $3.36/bbl.)

E = 247,740 [(0.256)(3.486) - (1.59588) (1.78) + 3.36]
= 247,740 [0.89242 - 2.84067 + 3.36]
= 247,740 [1.41175]
E = 349,747

93 Octane

Quarter ending 31 xii '60

B = 4.158 (9.9¢/gal. = $4.158/bbl.)
A = 1.78
B' = 3.36

E = 10,078 [(0.256)(4.158) - (1.59588)(1.78) + 3.36]
= 10,078 [1.06445 - 2.84067 + 3.36]
= 10,078 [1.58378]
E = 15,961

Pan-Eastern Formula Profit, 1960 (Sum of E's)

$ 346,035
556,138
302,675
349,747
15,961
$1,570,556

Memorandum L 15

PAN-EASTERN PROFITS CALCULATED WITH FORMULA

1961

03 Octane

Quarter ending 31 iii '61

B = 3.402 (8.1¢/gal. = $3.402/bbl.)
A = 1.78
B' = 3.276 (7.8¢/gal. = $3.276/bbl.)

E = 236,035 [(0.256)(3.402) - (1.59588)(1.78) + 3.276]
= 236,035 [0.87091 - 2.84067 + 3.276]
= 236,035 [1.30624]
E = 308,318

Quarter ending 30 vi '61

B = 3.402
A = 1.78
B' = 3.276

E = 428,536 [(0.256)(3.402) - (1.59588) (1.78) + 3.276]
= 428,536 [0.87091 - 2.84067 + 3.276]
= 428,536 [1.30624]
E = 559,771

Quarter ending 30 ix '61

B = 3.402
A = 1.78
B' = 3.276

E = 174,511 [(0.256)(3.402) - (1.59588)(1.78) - 3.276]
= 174,511 [1.30624]
E = 227,953

Quarter ending 31 xii '61

B = 3.36 (8.0¢/gal. = $3.36/bbl.)
A = 1.78
B' = 3.192 (7.6¢/gal. = $3.192/bbl.)

E = 285,618 [(0.256)(3.36) - (1.59588)(1.78) + 3.192]
= 285,618 [0.86016 - 2.84067 + 3.192]
= 285,618 [1.21149]
E = 346,023

[illegible]

Quarter ending 31 iii '61

B = 4.074 (9.7¢/gal. = $4.074/bbl.)
A = 1.78
B' = 3.276

E = 187,301 [(0.256)(4.074) - (1.59588)(1.78) + 3.276]
= 187,301 [1.04294 - 2.84067 + 3.276]
= 187,301 [1.47827]
E = 276,881

Quarter ending 30 ix '61

B = 4.158 (9.9¢/gal. = $4.158/bbl.)
A = 1.78
B' = 3.276

E = 26,293 [(0.256)(4.158) - (1.59588)(1.78) + 3.276]
= 26,293 [1.06445 - 2.84067 + 3.276]
= 26,293 [1.49978]
E = 39,434

Quarter ending 31 xii '61

B = 4.158
A = 1.78
B' = 3.192

E = 73,260 [(0.256)(4.158) - (1.59588)(1.78) + 3.192]
= 73,260 [1.06445 - 2.84067 + 3.192]
= 73,260 [1.41578]
E = 103,720

Pan-Eastern Formula Profit 1961 (Sum of E's)

308,318
559,771
227,953
346,023
276,881
39,434
103,720

1,862,100

Memorandum L 1c

PAN-EASTERN PROFIT CALCULATED WITH FORMULA

1962

83 Octane

Quarter ending 31 iii '62

B = 3.36 (8¢/gal. = $3.36/bbl.)
A = 1.78
B'= 3.192 (7.6/gal. = $3.192/bbl.)

E = 178,328 [(0.256) (3.36) - (1.59588) (1.78) + 3.192]
= 178,328 [0.86016 - 2.84067 + 3.192]
= 178,328 [1.21149]

E = 216,043

Quarter ending 30 vi '62

B = 3.276 (7.8¢/gal. = $3.276/bbl.)
A = 1.78
B'= 3.108 (7.4/gal. = $3.108/bbl.)

E = 350,319 [(0.256) (3.276) - (1.59588) (1.78) + 3.108]
= 350,319 [0.83866 - 2.84067 + 3.108]
= 350,319 [1.10599]

E = 387,449

Quarter ending 30 ix '62

B = 3.276
A = 1.78
B'= 3.108

E = 239,070 [(0.256) (3.276) - (1.59588) (1.78) + 3.108]
= 239,070 [1.10599]

E = 264,409

Quarter ending 31 xii '62

B = 3.276
A - 1.78
B'= 3.108

E = 215,150 [(0.256) (3.276) - (1.59588) (1.78) + 3.108]
= 215,150 [1.10599]

E = 237,954

93 Octane

Quarter ending 31 iii '62

B = 4.158 (9.9¢/gal. = $4.158/bbl.)
A = 1.78
B'= 3.192

E = 79,507 [(0.256) (4.158) - (1.59588) (1.78) + 3.192]
= 79,507 [1.06445 - 2.84067 + 3.192]
= 79,507 [1.41578]

E = 112,564

Quarter ending 30 vi '62

B = 4.158
A = 1.78
B'=3.108

E = 42,986 [(0.256) (4.158) - (1.59588) (1.78) + 3.108]
= 42,986 [1.06445 - 2.84067 + 3.108]
= 42,986 [1.33178]

E = 57,248

Quarter ending 30 ix '62

B = 4.158
A = 1.78
B'= 3.108

E = 60,410 [(0.256) (4.158) - (1.59588) (1.78) + 3.108]
= 60,410 [1.33178]

E = 80,453

Quarter ending 31 xii '62

B = 4.158
A = 1.78
B'= 3.108

E = 76,008 [(0.256) (4.158) - (1.59588) (1.78) - 3.108]
= 76,008 [1.33178)]

E = 101,226

Pan-Eastern Formula Profit 1962 (Sum of E's)

$216,043
387,449
264,409
237,954
112,564
57,248
80,453
101,226
1,457,346

Memorandum L 1d

PAN-EASTERN PROFIT CALCULATED WITH FORMULA 1963

83 Octane

Quarter ending 31 iii '63

B = 3.15 (7.5¢/gal. =$3.15/bbl.)
A = 1.78
B' = 2.982 (7.1¢/gal. = $2.982/bbl.)

E = 222,439 [(0.256)(3.15) - (1.59588)(1.78) + 2.982]
= 222,439 [0.80640 - 2.84067 + 2.984]
= 222,439 [0.94773]
E = 210,812

Quarter ending 30 vi '63

B = 3.15
A = 1.78
B' = 2.982

E = 180,965 [(0.256)(3.15) - (1.59588)(1.78) + 2.982]
= 180,965 [0.94773]
E = 171,506

Quarter ending 31 ix '63

B = 2.94 (7.0¢/gal. = $2.94/bbl.)
A = 1.78
B' = 2.772 (6.6¢/gal. = $2,772/bbl.)

E = 177,128 [(0.256)(2.94) - (1.59588)(1.78) + 2.772]
= 177,128 [0.75264 - 2.84067 + 2.772]
= 177,128 [0.68397]
E = 121,150

Quarter ending 31 xii '63

B = 2.94
A = 1.78
B' = 2.772

E = 273,148 [(0.256)(2.94) - (1.59588)(1.78) + 2.772]
= 273,148 [0.68397]
= 186,825

93 Octane

Quarter ending 31 iii '63

B = 4.074 (9.7¢/gal. = $4.074/bbl.)
A = 1.78
B' = 2.982

E = 65,186 [(0.256)(4.074) - (1.59588)(1.78) + 2.982]
= 65,186 [1.04294 - 2.84067 + 2.982]
= 65,186 [1.18427]
E = 77,198

Quarter ending 30 vi '63

B = 4.074
A = 1.78
B' = 2.982

E = 108,374 [(0.256)(4.074) - (1.59588) (1.78) + 2.982]
= 108,374 [1.18427]
E = 128,344

Quarter ending 31. ix '63

B = 3.864 (9.2¢/gal. = $3.864/bbl.)
A = 1.78
B' = 2.772

E = 115,424 [(0.256)(3.864) - (1.59588)(1.78) + 2.772]
= 115,424 [0.98918 - 2.84067 + 2.772]
= 115,424 [0.92051]
E = 106,249

Quarter ending 31 xii '63

B = 3.864
A = 1.78
B' = 2.772

E = 166,114 [(0.256)(3.864) - (1.59588)(1.78) + 2.772]
= 166,114 [0.92051]
E = 152,910

Pan-Eastern Formula Profit, 1963 (Sum of E's)

$210,812
171,506
121,150
186,825
77,198
128,344
106,249
152,910

$1,154,994

MEMORANDUM L 1e

PAN-EASTERN PROFIT CALCULATED WITH FORMULA

1964

83 Octane

Quarter ending 31 iii '64

B = 2.94 (7¢/gal = \$2.94/bbl.)
A = 1.78
B'= 2.772 (6.6¢/gal = \$2.772/bbl.)

$$E = 272{,}026 \left[(0.256)(2.94) - (1.59588)(1.78) + 2.772\right]$$
$$= 272{,}026 \left[0.75264 - 2.84067 + 2.772\right]$$
$$= 272{,}026 \left[0.68397\right]$$

$$E = 186{,}058$$

Quarter ending 30 vi '64

B = 2.94
A = 1.78
B'= 2.772

$$E = 44{,}674 \left[(0.256)(2.94) - (1.59588)(1.78) + 2.772\right]$$
$$= 44{,}674 \left[0.68397\right]$$

$$E = 30{,}556$$

Quarter ending 31 ix '64

B = 2.94
A = 1.78
B'= 2.772

$$E = 77{,}501 \left[(0.256)(2.94) - (1.59588)(1.78) + 2.772\right]$$
$$= 77{,}501 \left[0.68397\right]$$

$$E = 53{,}008$$

Quarter ending 31 xii '64

B = 2.94
A = 1.78
B'= 2.772

$$E = 35{,}697 \left[(0.256)(2.94) - (1.59588)(1.78) + 2.772\right]$$
$$= 35{,}697 \left[0.68397\right]$$

$$E = 24{,}416$$

93 Octane

Quarter ending 31 iii '64

B = 3.864 (9.2¢/gal. = $3.864/bbl.)
A = 1.78
B'= 2.772

E = 189,167 [(0.256) (3.864) - (1.59588) (1.78) + 2.772]
= 189,167 [0.98918 - 2.84067 + 2.772]
= 189,167 [0.92051]

E = 174,130

Quarter ending 30 vi '64

B = 3.78 (9.0¢/gal. = $3.78/bbl.)
A = 1.78
B'= 2.772

E = 97,484 [(0.256) (3.78) - (1.59588) (1.78) + 2.772]
= 97,484 [0.96768 - 2.84067 + 2.772]
= 97,484 [0.88901]
= 87,639

95 Octane

Quarter ending 31 ix '64

B = 4.032 (9.6¢/gal = $4.032/bbl.)
A = 1.78
B'= 2.772

E = 51,515 [(0.256) (4.032) - (1.59588) (1.78) + 2.772]
= 51,515 [1.03219 - 2.84067 + 2.772]
= 51,515 [0.96352]

E = 49,636

Quarter ending 31 xii '64

B = 4.032
A = 1.78
B'= 2.772

E = 101,306 [(0.256) (4.032) - (1.59588) (1.78) + 2.772]
= 101,306 [0.96352]

E = 97,610

Pan-Eastern Formula Profit, 1964 (Sum of E's)

$186,058
30,556
53,008
24,416
174,130
87,639
49,636
97,610
$703,053

Supreme Court
No. 2
Commissioner's evidence
W.J. [illegible]
Examination

Memorandum L 1f

PAN-EASTERN PROFIT CALCULATED WITH FORMULA

1965

83 Octane

Quarter ending 31 iii '65

B = 2.94 (7.0¢/gal. = $2.94/bbl.)
A = 1.78
B' = 2.772 (6.6¢/gal. = $2.772/bbl.)

E = 240,233 [(0.256)(2.94) - (1.59588) (1.78) + 2.772]
= 240,233 [0.75264 - 2.84067 + 2.772]
= 240,233 [0.68397]
E = 164,312

95 Octane

Quarter ending 31 iii '65

B = 4.032 (9.6¢/gal. = 4.032/bbl.)
A = 1.78
B' = 2.772

E = 44,774 [(0.256)(4.032) - (1.59588)(1.78) + 2.772]
= 44,774 [1.03219 - 2.84067 + 2.772]
= 44,774 [0.96352]
E = 43,141

Pan-Eastern Formula Profit, 1965 (Sum of E's)

$164,312
43,141

$207,453

MEMORANDUM L2

EUROPA'S SHARE OF PAN-EASTERN PROFIT

	1960	1961	1962	1963	1964	1965
Deemed yield (gals. of gasoline imported by Europa).	41,844,222	59,285,268	52,154,676	54,968,676	36,513,540	11,970,294
Pan-Eastern profit calculated with formula in dollars	1,570,556	1,862,100	1,457,346	1,154,994	703,053	207,453
Pan-Eastern profit from letters, in dollars	518,071	1,072,781	1,192,107	1,596,709	1,112,794	399,010
Pan-Eastern formula profit, in cents per gallon (b ÷ a x 100)	3.753	3.141	2.794	2.101	1.925	1.733
Pan-Eastern letter profit, in cents per gallon (c ÷ a x 100)	1.238	1.810	2.286	2.905	3.048	3.333
Pan-Eastern total profit, in cents per gallon (d + e)	4.991	4.951	5.080	5.006	4.993	5.066
Europa's share of total profit, in cents per gallon (f ÷ 2)	2.496	2.476	2.540	2.503	2.486	2.533

MEMORANDUM L2a

CALCULATION OF CRUDE OIL DISCOUNT IN AMENDMENTS BY LETTER

	1960	1961	1962	1963	1964	1965
Gallons of motor gasoline imported by Europa	41,844,222	59,285,268	52,154,676	54,968,676	36,513,543	11,970,294
Target profit, or discount, for Europa, in cents per gallon	2.50	2.50	2.50	2.50	2.50	2.50
Target profit for Pan-Eastern, cents per gallon (2 x b)	5.00	5.00	5.00	5.00	5.00	5.00
Target aggregate profit for Pan-Eastern, in dollars (a x c ÷ 100)	2,092,211	2,964,263	2,607,734	2,748,433	1,825,677	598,515
Pan-Eastern profit in dollars, calculated with formula (Memoranda L1a - L1f)	1,570,556	1,862,100	1,457,346	1,154,994	703,053	207,453
Additional profit in dollars to be introduced into Pan-Eastern with letter discounts on crude (d - e)	521,655	1,102,163	1,150,388	1,593,439	1,122,624	391,062
Crude oil in barrels used by Pan-Eastern, given the deemed yield (a ÷ 42 x 4; crude oil figure used in letter)	3,985,164	5,646,216	4,967,112	5,235,112	3,477,480	1,140,028
Additional profit, in cents per barrel of crude oil (f ÷ g x 100)	13.1	19.5	23.2	30.4	32.3	34.3
Actual discount, in cents per barrel of crude oil, in letters	13.0	19.0	24.0	30.5	32.0	35.0

MEMORANDUM L3

PRICE ADJUSTMENT FACTOR, 1960 - 65

Supreme Court
No. 2
Commissioner's eviden
W.A. Leeman
Examination

Factor Used to Adjust Posted Prices of Kerosene, Distillate, and Residual in Order to Reach Formula Profit.

In percent until second quarter 1963 and a simple multiplier thereafter. Number in parenthesis is the voucher number).

Year	Quarter			
	1	2	3	4
1960	107.285710 (4 - 3)	107.285890 (7 - 2)	110.484805 (4 - 1 '61)	106.946827 (4 - 1 '61)
1961	102.864449 (5 - 3)	104.411531 (7 - 1 '62)	103.301048 (12 - 4 '62)	103.933748 (7 - 1 '62)
1962	103.348861 (3 - 1)	100.800554 (7 - 1)	100.734506 (10 - 1)	102.6126611 (1 - 2)
1963	99.9977 (4 - 7)	100.223665 (7 - 1)	1.01458 (10 - 1)	1.016340 (12 - 5)
1964	1.0129011 (4 - 2)	1.0259735 (10 - 3)	1.052412 (10 - 2)	1.0072467 (1 - 2)
1965	1.1008901 (3 - 5)			

Source: Pan-Eastern Vouchers, 1960 - 65.

XXM: [illegible].

You seem to have changed your views of the reluctance of international companies to price cut? I don't think so.

We produced as EXHIBIT T the journal containing a paper given by you at Fifteenth Annual Near East Conference, April 25/26, 1963? Yes. On page 37 you are quoted as follows :-

"The oligopoly is made up of the seven international oil companies which control most of the really low-cost oil in the world. Each of these companies is slow to seek larger output by reducing prices because each expects price cuts to be matched by the others.".

The seven internationals referred to include Gulf? Yes. Then on page 39 -

"Probably the international oil companies feel that their own control of world markets exercised through implicit understandings with one another (through "conscious parallel action") provides all the stability that is desirable or all that is attainable."

Do you still hold those views? Yes. And do you say to His Honour that Gulf in 1956 would have invoiced gasoline to this company at a heavy price cut under other internationals? If necessary to win the business. So that are you aware what would happen in New Zealand if the landed cost of these gasoline imports was reduced? Price control provisions - I have not made a complete study of these provisions but it is my understanding that under them prices are not automatically reduced when landed costs are reduced. It is my understanding that the matter is taken under review but that the reduction of

retail prices does not automatically follow. We are talking about fractional differences arising from freight? Fractional alterations of landed costs arising from freight variations? My knowledge of these provisions is not so complete that I can say whether they are confined only to fractional reductions in freight rates.
(MR RICHARDSON OBJECTS TO QUESTIONS).

But if the invoicing of gasoline to this country at up to 30% of posted price was going to cause a serious reaction against other internationals marketing in this country, do you suppose Gulf would take that action for one moment? Yes the difference I believe is between an established oligopolist in an established market. Under these circumstances of course the oligopolist would be exceedingly reluctant to cut prices. But when it is an oligopolist seeking to win an exceedingly attractive account it is possible that he would use the sharp weapon of price reduction. And the reaction in all countries east of Suez to this departure from posted price would be severe? Might be. And are you saying Gulf would risk all those repercussions? Where a very large prize is to be won, I believe that Gulf would be prepared to take considerable risk. Including the risk of knocking the props out from posted price structure east of Suez? That would be a risk. And you think Gulf would take that risk to get Europa contract? Yes. You approach this as a practical problem or theoretical? As a scholar my interests are of course primarily theoretical, but I believe that good theory should be closely related to facts of the real world. In my many months and years of interviews with oil men and Government officials I have attempted to achieve a knowledge of practical realities of the oil industry. You said to Mr Richardson that whilst Gulf might not give 25/30 per cent.

discount they might have given a lesser direct discount? Yes. So you now say that they would be prepared to lose more money - that they were prepared to grant Europa a greater benefit under processing deal than they would have to grant on a direct invoice discount? They might have been. That is a fact if what you say is right? They might have given open discount, might have been smaller. But if that is so it goes to show their great reluctance to give a direct discount? Yes; I am willing to concede that they would be reluctant. You suggest that could have got away with less by direct discount? Yes.

Short Adjournment.

A substantial part of your evidence was devoted to showing Pan-Eastern is not a refinery? Correct. Who suggested that Pan-Eastern was a refinery? It was my understanding that Mr Todd felt he had gone into the refining business when he participated in the establishment of Pan-Eastern. In other words, Pan-Eastern was a company that had processing agreements which involved actual refineries, owned by or procured by Gulf? That is the correct interpretation of the arrangement? Owned by Gulf or procured by Gulf - insofar as owned by Gulf, Gulf took the risk. That is the short statement of what Pan-Eastern processing agreement is? That actual refining is performed by Gulf, yes. So that no-one could claim Pan-Eastern is a refinery? I wouldn't think so. You know of the Australian Company, H.C. Sleigh Limited? Yes. That is an independent Australian marketer of Gasoline and other products which buys crude oil and has it processed under agreement at refineries in Australia that it does not own? Would you call H.C. Sleigh Limited a refiner? No. You know the Murco Company in the United Kingdom? I have heard the name. If that company buys crude oil and has it processed by agreement in a refinery it does not own, would you call Murco a refinery? No. You also referred to a notional refinery in your evidence - "It seems probable that if posted prices on products seriously decline or if the parties cannot agree on a suitable base price, Europa will order its motor gasolines, jet fuels, and kerosenes from another supplier than Gulf so that its notional refinery will not turn out these products." Where did you get the expression notional refinery from? I do not recall. Was not the term one which the Inland Revenue people here used in their instructions to you on this matter? The Inland Revenue people instructed me to develop my own analysis of the matter. They may have used this term in discussing the matter with you? Yes, they may have used the term but not in connection with instructions. Because the products refined for Pan-Eastern are refined in an actual refinery, are they not? Correct.

Now another topic - I take it you understand Europa's position in New Zealand as an independent marketer? Yes. In competition with international marketers? Yes. You accept that Europa must have a long term supply contract with security of supply? I would consider it most advantageous that it have such a contract. Is it not essential to have that contract? I would not think essential, but highly desirable. Why do you say not essential? Because the company might have survived without absolute security of supply. You mean by spot purchases of gasoline? I suppose they are thinking of situation when Europa had contract with Russians - supplies were said to be unreliable.

TO BENCH: It must have a reliable source or sources of supply? I am hesitating only in regard to the word "necessity". I take it you have not had to deal in the market place itself for oil? No. I take it you also accept that it is most desirable for Europa to have a global source of supply if they can get it? I accept that.

TO COUNSEL: Coming to this discount question, do I take it from your evidence that the only evidence that you can point to of discounts of gasoline in 1955/56 period is in EXHIBIT 13 dealing with West of Suez? In addition I pointed to the Gulf loan to Union Oil which I believe to be an example of the sort of concessions that were being made during this period. This was April 1956. A loan of $120,000,000? Yes. You know anything about the details of that? No, I know only Time reference and the reference in the book mentioned in my earlier evidence. Don't know if it was not first step in a takeover bid by Gulf? My recollection - Gulf denied allegation it was an attempt to take over Union Oil. But was asserted that this was really a takeover? At least there was that speculation.

Your evidence of discounts on products at 55-56 comprises Government agency purchases west of Suez? Would you agree West of Suez market is and always has been an independent market from East of Suez? No, I would not agree with that statement. You say then that it is part of the same market? New Zealand is in the fortunate position of being almost on a water shed for supplies - from Persian Gulf and the Caribbean. As a consequence it can usually draw on supplies from both sources and as a matter of fact in terms of freight costs it has been slightly closer to the Caribbean than to the Persian Gulf. So I believe that discounts in the Caribbean are significant. In other words in 1955 Europa ought to have been enquiring into contractual terms between various oil companies in the Panama Canal zone? Yes. And contractual terms between various oil companies and United States military authorities? Yes. I notice that these West of Suez Government transactions do not seem to have influenced Australian Board of Review Shell Case 1963 or the Damle Report in 1961? I suppose so, I have not myself an intimate knowledge of the two reports. I think I can at least explain the Damle report. India I presume has not access to the Caribbean so I would not have expected them to take it into account. As for Australian authorities I believe it must have been an omission on their part.

And these sales to Government agencies, am I right in thinking the Canal Company and the United States military authorities will often have their own storage facilities? Yes. Their own pumping facilities? In all likelihood. Canal Company would have them? Yes. Is it not well known that tenders will produce lower prices to these authorities with special facilities for handling gasoline? Yes. But I doubt that the storage and pumping facilities could explain a very large part of the discount obtained. Are not contracts between oil companies and Government agencies often influenced by political considerations? I would prefer to say "sometimes". So that you say therefore that Mr Todd in 1955/56 when he says he did not know of discounts at that time should have looked into West of Suez market? Yes. American phrase "Monday morning quarter back"? I have heard that. A man who can say on Monday how the game ought to have been played on Saturday? Yes. I suppose that is what I was actually asked to do.

Looking at this Pan-Eastern deal - in 1956 the contract contemplated posted prices of crude oil, and at that time crude oil prices were hardening? I believe at that stage yes. And then the agreement provided for posted prices of products, at a time when there were no discounts on products east of Suez? As far as I know at that time there were no postings for prices East of Suez. And without posted prices I presume there can be no discount.

TO BENCH: You mean posted prices East of Suez came in after that? In 1957. And every contract prior to that would be by special arrangement to price? Yes or tied to United States Gulf posted prices; prior to 1957 United States Gulf were base prices in many cases.

TO COUNSEL: Posted price in United States Gulf? Yes. In Persian Gulf up to 1957 listed prices? I would not call them listed prices. A list price is a published price and therefore posted prices are list prices. Posted price being merely an oil industry term for what is usually called list prices. Well, quoting again from Australian decision on Shell Company prices in Australia, paragraph 89 of that decision, it says: "On the evidence we find that the posted prices of Middle East crude oil and the listed prices for petroleum products for the calendar years 1954, 1955 and 1956 represented prevailing f.o.b. prices in a market which at that time had established itself as a market independent of the other world oil markets at the U.S. Gulf and the Caribbean." You see where there is a reference to listed price, 1954/56, are they not the equivalent of the posted prices which began in 1957? If the prices described there as listed were in fact published and known to all buyers, then they were the equivalent. But it is my understanding that such prices were not available in the Middle East prior to 1957. Not available to casual enquirer? Not published. But a person in the industry could find out? If a person in the industry asked for a schedule of prices and was handed a list then we would have the equivalent of posted prices. But it is my understanding that such published prices were not available prior to 1957. So that going back to Pan-Eastern contract, it involved posted prices for crude and products? Crude and gasoline. It involved payment of processing fee 47.5 cents? Yes. And that would be around the conventional price? Yes. They budgeted for expected refiner's margin of one dollar U.S. per barrel crude? Yes. So what they ---ted to derive in hands of Pan-Eastern was the conventional refiner's margin that you would get at that time? Correct. So that Gulf then were cutting Europa in on a conventional refinery margin? Yes. And isn't this the way that you are putting it - that because Gulf would be reluctant to give a discount on invoice prices of gasoline, in order to get the contract they really had no alternative but to cut Europa in on the refiner's margin? They had an alternative but it was less preferred. They preferred alternative of cutting Europa in on refiner's margin? Yes. I suppose I don't really know what Gulf's preferences were. I just know what they did. But you could understand them adopting the alternative they did under the existing conditions? Yes.

So what Europa was going to get out of Pan-Eastern was equivalent to half a conventional refiner's margin? Equivalent to a quarter. If conventional refiner's margin is $1.00, then Europa would expect to get about one quarter. But their earnings bearing in mind processing fee payable by Pan-Eastern had a direct relationship with a conventional refiner's margin? I believe so. On the other hand the Europa earnings ex Pan-Eastern had no relationship to any known discount East of Suez? You mean exact relationship, No.

There is no evidence of any discounts of gasoline 1955/56 East of Suez? No. And if Europa's benefit with Pan-Eastern was equivalent to between 25% and 30% off the posted price of gasoline, then that benefit bears no relationship in quantity to any discount East of Suez right up to 1960's? Correct.

Coming to something else - page 2097 of your statement of evidence, four lines from the top: "It seems clear that Europa and Gulf had gotten into the habit of speaking of Pan Eastern when they meant Europa" and you refer to a letter. Then - "Europa's letter profit per gallon added to its formula profit per gallon gives it a discount on gasoline purchased by Europa from Gulf. This can be seen, first of all, in the telegram of August 19, 1959, in which Todd states his understanding of how the formula profit will be adjusted each year. He says that "in each year in which Pan-Eastern (Europa) profits are below $2\frac{1}{2}$ cents you will pay by way of crude discount to Pan-Eastern difference between processing contract formula and $2\frac{1}{2}$ cents."" You are not quoting that telegram correctly, are you? I think it is correct. (Exhibit B.14 in Case Stated). 19th August 1959. In the fourth line below $2\frac{1}{2}$ cents - obviously that means Pan-Eastern formula profits? Could be. Once you accept that reading then your comment on page 18 is not right? My comment still is correct. I mean comment at top of page 18? But the fact is that he was not talking about as you suggest Europa profits below $2\frac{1}{2}$% - he was referring to formula profits? Europa's formula profits. "The formula profits"? My interpretation was Europa's formula profits.

And then turning to page 2098 / your statement of evidence: you speak about B.P. contracts. Do you know or have you heard Mr Todd's explanation in evidence of that 1961 contract? I have heard it and believe I recall it. B.P. would not invoice into this country 10% off posted price when its own subsidiary here was importing at posted prices? Yes. And you do not see anything extraordinary in that attitude on the part of B.P.? No, but when I prepared this analysis I had not heard Mr Todd's explanation. You were asked to look at the contracts as they stood? Yes.

Look at page 2101 / now of your statement of evidence. Under paragraph (f) of that page - "With respect to gas oil, Pan-Eastern and Europa take some risk that profits will not be so great as expected, though with so large a margin to start with ($0.94) the risks of actual losses are small. They do not take the risks (which an ordinary refinery takes) that the cost of refining will rise, since the refining fee is in the base price and there is no provision for increasing this price if refining costs rise." Now you are aware that the gas oil comes from Kuwait topping plant? I understand that. And you suggest that costs rise in case of the topping plant? I think they could. It is a pretty problematical contingency? No. As a matter of degree - I can understand the refining costs of full scale refinery increasing but in the case of a topping plant only is that not a minor consideration in comparison? No. The possibility exists that the Arab Government or the Kuwait Government would demand a higher part of profits and substantially increase costs. You say that even though it is a topping plant only? It seems to me to be very like the situation when the Gulf representative wanted to complete his arrangements with OPEC before committing himself to a price.

At the bottom paragraph of page 2101 - "Incidentally for Europa to pay the price of finished gas oil (53/57 D.I.) when they take delivery of a raw gas oil for feedstock is most unusual (see Feedstock Supply Contract, 1964, para. 7.01, Exhibit B, where gas oil is listed amongst the feedstocks)." Are you aware that the Mobil Company in New Zealand adopts the same practice exactly? No.

Looking at what you said to Mr Richardson when you made an addition to your evidence - "In this paragraph I described what happened in Pan-Eastern set up. But actually a company which wanted to go into the refining business as an independent refinery would expect to be tied to a single refinery. It would expect to take risks associated with ownership of a single refinery." You are talking there of a company that is formed and then buys a refinery? Yes. But what about a company like the Sleigh Company that has refining done by processing arrangement? What sort of risk does it take? It takes some risk - assuming arrangement is similar to that of Pan-Eastern - They are independent marketer in Australia and buy crude oil, and they pay processing fees to have it refined for them at a refinery they do not own - they take gasoline and some products - I don't know what happens to heavies - what risk do they take in that operation? They take some risks and leave other risks to the firm owning the actual refinery. As I understand it, they take risks that the price of crude may change, that the prices of products may change; I believe those are the only risks. There are some risks they do not take. And if Europa in 1955/56 had had the opportunities to build refineries of its own in New Zealand, what would they have had to do with heavy end products - they had no market for? They would have had to sell them. And then a long haul back again to cart them away? Yes. So that would you accept that Europa if it got into an actual refinery would have to have a partner that could deal with the heavy ends? Not necessarily a partner, but certainly a marketing arrangement. With some other oil company.

REXM: How would you compare the processing deal that Sleigh had to which Mr Mahon referred with Europa's position in the Pan-Eastern arrangements under the 1956 contracts? As Mr Mahon described them to me the Sleigh processing deal sounds like a conventional one. Sleigh would have to have a long term processing contract - it would want stability with processing costs? Yes. And that would have to be obtained by as long a contract as it could get? Yes. I suppose that I was looking at it more as a processing deal than as a long term supply arrangement. How do prices, profits and risks in the Sleigh deal compare with Europa's position under the Pan-Eastern arrangement? The risks in the Sleigh deal are related to the prices of all products. Whereas the risks in the Pan-Eastern arrangements are related only to the price of gasoline. And what was the position in that respect after the letter variations of 1959? After letter variations of 1959 the risk with respect to gasoline had been eliminated. Do you regard the Sleigh deal and the Pan-Eastern arrangement as truly comparable? They are different.

Did you get your instructions in this case from the Solicitor-General? As opposed to Inland Revenue? Yes. My instructions were entirely from the Solicitor-General

LUNCHEON ADJOURNMENT

I produce a copy of an extract from the New York Times of 5 April 1956 headed "Gulf Advancing $120,000,000 To Union Oil on Convertibles" (EXHIBIT 14). I also produce the full extract from the book by De Chazeau and Kahn referring to the Union Oil debentures to which I referred in my statement of evidence (EXHIBIT 15).

In cross-examination you were asked whether in 1955 when Europa was negotiating in respect of its supplies it should have enquired about contractual terms of supplies to Panama Canal company and Government contracts: could Europa have gained knowledge of such contracts by looking up Platts? Yes, it could have.

TO BENCH: I notice in this article in New York Times that this advance was made by Gulf to Union by way of convertible debentures? Yes. That means, does it not, that although there was a merger denied, it in effect gave Gulf the option at a later date of converting the debentures into stock of Union and gave it in effect the right to a substantial shareholding in Union? Yes, that is correct. And this advance was $120,000,000 - do you know what subscribed capital of Union was prior to this issue of debentures? No.

COURT ADJOURNED 2.55 p.m.

(CASE RESUMED 24/3/69)

MR WHITE CALLS:

BRIAN HENRY CHARLES TYLER: I am special inspector of Inland Revenue Department, Wellington Head Office. I am a member of the Society of Accountants and am a registered accountant.

I have been continuously employed by the Department since 1949, apart from one short break. The break was in 1961. In addition, I have been away on a Harkness Fellowship for two years. On that I left on this in August 1966. I spent one academic year at the Harvard Law School taking part in the International Programme in Taxation conducted by that School. I spent a period at Stamford University; four months with the International Monetary Fund in Washington and from January to July 1968 with the Internal Revenue Service of the United States based in Washington. I then returned to New Zealand in late July last year. I began enquiries into tax affairs of oil companies in very early February 1963, when I was assigned to do this work. I was working on that assignment until I left for the United States in August 1966. Although my work on the assignment tailed off in the two months before I went away. I began this investigation with Europa in February 1963. This investigation was more general in its application - not limited to Europa. It was an investigation of the tax affairs of those oil companies operating in New Zealand. That covered a wide field, various subjects within that field. Some of those subjects were - Mr Smith produced a schedule of some of the topics I discussed with him. The topics we discussed would include such questions as bad debts, valuation of trading stock, the deductibility of various items charged to revenue, bases for depreciation of industry assets and that type of thing. Amongst those matters was the question of pricing goods into New Zealand.

Coming to February 1963 and the subject of this case, what began your investigations into the matter? Looking at the tax file of AMP I noticed that that company had received non-assessable dividends from a company called Pan Eastern Refining Company Limited. Having done that, I took this matter up with Europa, Mr Smith. He told me that Pan Eastern was a company registered in the Bahamas, that is was 50% owned by Gulf and 50% owned by Europa. At that stage Mr Smith said he was not particularly conversant with these details. I made various notes. How did you record notes of this and other conversations with Mr Smith and Todd and others? My general practice was to make a file note of all relevant discussions I had. I cannot recall at this stage what I did at any particular interview but my general practice was to take very short notes during the course of the interview and to complete a final note at first opportunity after the interview. How cryptic those notes taken at the time of the interview would be would depend on the subject matter under discussion. If a matter with which I was conversant the notes would be more cryptic than if a subject which was new to me. Did you ever compare those notes with those of Mr Smith? I remember one occasion after a lengthy interview with Mr Todd comparing the notes I had taken with those which Mr Smith had taken to see that we corresponded.

I produce these notes. Actual cryptic notes taken at the time - I have not in fact kept them. The handwritten notes I will refer to will be notes made from cryptic notes after the interview and put on the file.

<u>TO BENCH</u>: How soon after the interviews did you make these elaborated notes? If interview was in the morning I would try to do that in the afternoon. One discussion with Mr Todd extended to about 5.30. Then I would have made the fuller notes the next morning.

<u>TO COUNSEL</u>: I now produce copy of note made after the initial interview with Mr Smith (EXHIBIT 16)(in my own notes and a

typed copy). "He mentioned that this was a company registered in the Bahamas in which the shareholding was:-

50% Europa

50% Gulf Oil

It appears that this company does not own a refinery but that Gulf Oil capacity is made available to it for the purpose of processing its requirements.

It is also likely (this requires checking) that Pan Eastern would dispose those products - from the refined crude - that were not required for the New Zealand market.

It seems more than likely that this is a joint scheme whereby both Gulf Oil and Europa syphon off part of their income to Bahamas with the consequent tax saving.

The following New Zealand sections could be of assistance:

Section 20

Section 108

" 111

" 169. "

The last paragraph regarding the New Zealand sections were a reference to my own possibly tentative views. That would not be mentioned to Mr Smith? I can't recollect that. Following notes referring to particular sections would not have been referred to Mr Smith. If I had expressed doubts about arrangement they would have been very tentative. I may have expressed some passing comment.

Later meeting with Mr Todd and Mr Lau. Before coming to that, at some time between original discussion with Mr Smith and the date of meeting with Mr Todd, did you see various contracts relating to Europa's relationship with Gulf Oil and Pan Eastern? Yes. Were some accounts produced to you for inspection on the company's premises at that time? Yes. I have heard Mr Smith's evidence as to accounts shown to me. I do not agree with what he said about accounts shown to me. I cannot remember specifically what accounts were shown to me. Do you remember if the information in those accounts was detailed? My recollection is that the information in the accounts that I saw was not very helpful. Can you say whether there was any reference to volume discount in the accounts you saw? I am sure that if the accounts that I was shown contained reference to volume discounts I would have noticed it.

Coming now to February 21st, the date you discussed the question with Mr Todd and Dr. Lau. I produce notes of this discussion (EXHIBIT 17.) Those red marks would have been made at some later time. (Reads the notes of interview).

Page 2 (b) you are dealing there with a matter you raised? Yes. Under 2(a) you recorded the comment of Mr Todd and Dr. Lau? Yes. But in respect of the other matters you raised the company's arguments are referred to later? Yes. F is in brackets - "(It is agreed by all that Europa made a particularly good deal with gulf). If this is a normal commercial transaction, would Gulf be prepared to enter into a similar agreement with third parties without the supplying agreement? Obviously not." That was a comment made in course of conversation but I am not clear whether it would have been made in respect of that particular point.

<u>TO BENCH</u>: Whose comment is that 'Obviously not'? That is mind.

<u>TO COUNSEL</u>: Was any check of formula made at that time? I asked Mr Todd on one or two occasions after this for an explanation of the formula and he said it was designed to act as a buffer against the refiner's squeeze. It was not until quite some time later that independently we analysed and arrived at the effect of the formula.

Paragraph 3 - "The Company's Arguments" -

"Of if it went back still further and jointly owned an oil well with Gulf, could we treat/allocate part of the profit at the well head as a discount on Europa's purchases of the refined product?" "Allocate" in my written note it looks as though I have used one word, crossed it out and put the other word above it. Did you in fact do any following up later? Yes, enquiries were made in a number of other countries by officers of the Department and by correspondence.

Next discussion is EXHIBIT 18. That took place on 14th March. I spoke to Mr Todd on that occasion, Mr Smith also being present. I produce the notes of that interview. This time you have named people making comments as you went along? This is one of the occasions when my notes taken at the time of the interview were rather full. And this recorded the flow of conversation. Would you go to an interview such as this with notes prepared? Yes. I would before going to an interview of this kind prepare subject headings of the matters I would want to discuss.

Page 3 of EXHIBIT 18 to bottom of page, these are my subsequent thoughts. As to "I agreed" at top of page 3, Mr Newton in his evidence stated that the posted prices of refined products did not reflect the discounts available on crude. In short, that was my view at the time; I was accepting that position. The statement re Whangarei Refinery on page 3 - "The position at Whangarei Refinery is quite different. In this case apparently Europa will be buying its supplies from the refinery - Its agreement is with the refinery". - is incorrect in the light of later knowledge.

"Also no doubt it will supply crude to the refinery. Once again its agreement is with an independent party - and that is important". "that is important" - that would be another misunderstanding in the sense that I was under the impression that crude would be sold to the refinery.

Page 4 is note of my interview continued. (Mr Todd's comments). At the foot in brackets (See memo. of 14-3-63) - refers to memorandum of mine signed by me on same date.

EXHIBIT 19 is same date. Paragraph 9 of page 2 is relevant -

"DOCUMENTS

Dr Lau asked whether the Commissioner may be prepared to return any documents relating to Gulf which are made available to him. (The company is reluctant to have these documents anywhere other than under lock and key.) I said that I could not (and would not) anticipate the Commissioner's attitude on such a question. I thought however, that he would be quite definite on his rights to the production (and taking copies thereof) if he so wished." This is a discussion I had with Dr Lau.

EXHIBIT 20, March 19th - further discussion with Mr Todd. Were all these discussions at your request? As I recall, one of these two discussions on 14th and 19th March - it was on the initiative of Mr Todd. I produce record of interview of 19th March. Page 2 - 950 refineries; in subsequent report of Mr Todd he showed that I think as 450.

Page 6 - "Boral" at this stage I was either told or knew that Boral owns refinery and buys crude ex Caltex. "Is the crude price fair?" - that is my question. Mr Todd did not reply directly to the question. It was more of a rhetorical question. "Oh yes", what did you mean? It indicates hesitancy. At the very end you spoke about memorandum - did he in fact supply memorandum? Yes, dated 20th March 1963 (EXHIBIT P). The effect of it: does it deal with matters dealt with at discussion? By and large it covers the points covered in our previous discussions.

At that stage were you aware of letter variations to 1956 contract? No I was not. They were not produced to you at that time? No. Were they referred to at any time during the discussions with Mr Todd? No they were not referred to at any stage.

List of dates relevant to production of documents (EXHIBIT 21). Some refer to matters outside my filing system. When were letter variations produced as far as Department was concerned? In June 1966. Was that before you had gone away? Very shortly before I went overseas. First date, 20 February 1963, is that from your own recollection or based on evidence of Mr Smith? Based from my recollection that I saw the documents before I spoke to Mr Todd but exact date is that referred to by Mr Smith in evidence. When you were looking at the documents, where did you look at them? I had been given a room in the Europa building for examining the documents that I was concerned with; I looked at contracts and accounts in that room.

" 15.12.64. Europa produces upon request contracts with BP and P.T.T." (A24 and A25).

26.4.65 - Letter from Mr Rathgen to Mr B. Todd asking for - "Copies of all agreements between the Gulf group and your own companies. Copies of any agreements, together with any amendments thereto entered into or operating with your other suppliers during the period 1 April 1959 to the present time should also be supplied." I am quoting from letters not in the case.

During conversations you had had with Mr Todd, was the BP contract ever alluded to? Not at stage I am speaking of - February/March 1963. Ever been any reference to 1962 contract? No, not at that stage.

After receipt by the Department of Mr Todd's memorandum of 20th March 1963 I reported on the position to the then Commissioner.

EXHIBIT 22 is a copy of my report (Interim Report No. 1). This deals with a number of matters under investigation. Dealing with 1956 contracts at paragraph 5 on page 4: Your own report is on Supply Agreement with Gulf Oil. At page 8 you deal with availability of discounts? Yes.

Paragraph 6(e) on page 9 - "Conclusion. The principal purpose of this memorandum is to decide whether or not a protective assessment should be issued for 1958. It is appreciated that further enquiries will be necessary before this question can be finally determined but it is felt that the points covered above give sufficient information to permit a discussion with Mr B.J. Todd."

Another point (page 8, paragraph (d) - availability of discount). I would like to point out that there is very little information included in that paragraph concerning the subject of the availability of discounts, as our research at that stage had not commenced. Does that paragraph make that clear? The paragraph makes it clear - last sentence

Internal file Minute (EXHIBIT 23). This is a Minute prepared by the then Chief Inspector which he attached to my interim report on the 25th March. The minute is addressed to the Commissioner. Another unsigned minute in different writing at bottom; that is the handwriging of the then Chief Deputy Commissioner, Mr Curran.

After that report and before the 31st March, do you recall a meeting between Mr Todd and the Commissioner? Yes, I was present. I made no record at all of that meeting. My general recollection is that Mr Todd covered much of the ground that he had included in his memorandum of 20th March.

EXHIBIT 24 - file minute by then Commissioner of Inland Revenue - "(b) Supply Agreement with Gulf Oil. Looking at page 4 of the Inspector's report it seems to me abundantly clear that the aim of the contracts is to divert to a Bahama company in which Gulf and Europa are interested

profits derived in the United States. Provided the sale of gasoline to Europa which is the final step is at posted prices and comparable with the base adopted by other companies I do not see how we could invoke Section 108 or any other Section to impute a New Zealand origin to any of these profits. It may be that we will have to inform the United States Tax authorities but that is a different question. At any rate there is not a sufficient base to justify a protective assessment on this score for 1958. Further investigation may disclose some basis of assessment but at the moment I fail to see how it can." Can you tell us what information Mr Macken would have before him at the time of that minute? My interim report of 25th March, Mr Todd's memorandum of 20th March and he would have Mr Russell's minute of the 25th March.

Passing to 29th March (EXHIBIT 25) that represents information concerning Pan-Eastern. That I obtained by 'phone from Mr Smith. It shows for years 1957 to 1962 the sales, purchases and refining fee paid by Pan-Eastern and also a summarised balance sheet of Pan-Eastern as at 31st December 1961.

TO BENCH: That is the top assets? Yes. Last year is not brought into balance sheet figures? No, I think it likely that 1962 balance sheet was not held at that time although interim figures from Pan-Eastern would have been.

TO COUNSEL: Did those figures give you sufficient to calculate Pan-Eastern's income? Yes.

On 5th April Mr Smith answered enquiries on a number of topics. EXHIBIT 26 - looking at original, the ink writing at top of pages 1, 2 and 3 represents my preparatory notes. The ink writing on page 1, or the other ink writing on page 1, other ink writing on page 2, represents the information that Mr Smith said he would try and get for me after I had asked my initial questions. Pencil notes were made at the time when information having been obtained by Mr Smith was relayed back to me.

SHORT ADJOURNMENT.

That was 5th April. The Commissioner had legal advice about this date: did you prepare a condensed account of Pan Eastern at that time? Yes. (EXHIBIT 27). As far as dates are concerned was Crown Law Office opinion received in June 1963? Yes. On 20th June 1963 the Commissioner made a file note? Yes. (EXHIBIT 28) I produce that and read it. "I have read the papers, refreshed my memory on the facts and studied the opinion given by the Crown Law Office. I agree with it.

There is no useful purpose in withholding the information from the Company. They are entitled to be advised.

The substantial remaining question is the obligation of the Commissioner under the double tax agreement with the U.S.A. to disclose the information to the U.S. authorities. This question however is not desperately urgent and can be considered when the investigation is complete." (Signed by the then Commissioner). On 27th June the Commissioner wrote letter EXHIBIT F.

At the time you furnished interim report of 26th March 1963 to Commissioner, had you conducted any research into validity of posted prices in ...? No, not at that stage. Between that time and writing of his letter of 27th June, had you conducted research. This had barely commenced. Investigations continued after the Commissioner had written his letter of 27th June.

Questions were asked regarding case against an International company in Australia; when were you first aware of such a case? In early May, I think 10th May 1963, I was talking to the New Zealand affiliate of the Australian company. Did you report that information to the Commissioner at that time? Yes. Were steps taken to obtain official information? Yes. The Commissioner wrote to Australia saying that he understood that action was being taken against an Australian company and he asked if a decision had been handed down and if so, whether the judgment was being made public. Was there a reply to that? Yes, the second Commissioner in Australia replied by letter dated 20th June. At that time he said he was sending a copy of the judgment by surface mail.

After the 27th June I continued with my investigation, into both Europa and the other companies operating in New Zealand . At that stage I was not concentrating on any particular aspects, but my enquiry became more centred on the pricing question as time went on. I did a good deal of reading at this stage. I produce as EXHIBIT 29 books and publications considered by me in the course of the investigation. Until the end of June how many of those in this list had you read? I had read the first item on the list (Price making and price behaviour in the Petroleum Industry : R. Cassady, 1954) and had received and at least commenced reading the second item (Oil Companies and Governments : Hartshorn, 1962). That was as far as I had gone. Hartshorn's book is the one referred to already. In the period that followed in remainder of 1963 into 1964 I made further enquiries at Europa office from time to time. I was often there.

On 17th February 1964 did you obtain information from Mr Smith? Yes, note in my handwriting (EXHIBIT 30). That represents information I received from Mr Smith when I asked him for the total purchases made by Europa from Gulf from start of the contract with Gulf to 31 March 1963. The note also shows under (b) information I had previously obtained from Mr Smith. Figures shown in EXHIBIT 27. (c) represents my calculation using my terminology relating to the figures shown under (a) and (b).

In March 1964 did you report to the Commissioner on this subject? Yes, it was a report entitled "Report on Pricing of Petroleum Products Imported into New Zealand" (EXHIBIT 31).

That is March 1964. Later that year I made enquiries regarding Pacific Trading & Transport Co. Limited. I had realised that I did not have a complete list of the companies in which Europa had an interest. I wrote to the company asking for details of all the companies in which Europa had a 20% interest or more. I received that. In that list I found mention of P.T.T. When I say "I wrote", either I wrote or it was on my instructions. On 2nd November I discussed P.T.T. with Mr Smith. EXHIBIT 32 is a photostat of typed report of my discussions. 2nd November 1964, is that date made at the time? Yes. (Reads Notes) -

"Mr Smith produced accounts for Pacific Transport for year ended 12 April 1963 and draft accounts for the year ended 12 April 1964. (The 1963 accounts were the company's first).

The 1963 accounts showed a profit (pre tax) of approximately £51,000.

The 1964 accounts showed a profit (pre tax) of approximately £71,000.

In each case, tax was provided for, at something in excess of 10/- in the £.

The only credit item in the accounts was "commissions" and the only debit ones a few insignificant items such as audit fees etc.

Mr Smith stated that whereas Europa previously concentrated almost exclusively on its service station outlets it had to prepare a much wider market in anticipation of the Whangarei refinery coming onstream - when they would have to take their share of a full range of products.

Their agreement with Gulf Oil only covered gasoline and gas oil (diesel).

They therefore entered into an agreement with B.P. London to supply their requirements of certain other products until Whangarei came on stream. As Gulf's gas oil was not meeting specifications they also included this product in the B.P. Agreement.

Europa was paid a commission (discount) for its purchases. Mr Smith thinks that B.P. London asked that this be kept in London (to avoid embarrassment if it was discovered that they were charging an independent less than their own subsidiary?).

Europa pays B.P. New Zealand the full posted price plus company freight. The "commission" is fed back in London.

Question: "Is this profit properly assessable in New Zealand?" -
(Despite fact that it is allocated to a separate overseas subsidiary and that tax has been paid thereon in U.K.)

Comment: This is further evidence of the discounts available on refined products?

To be discussed with Mr B.J. Todd 5 November 1964.

Mr. Smith will have available schedule showing quantities and values of products purchased under the B.P. Agreement.

B.H.C. Tyler

Special Inspector

2.11.64. "

5th November 1964 (EXHIBIT 33). I interviewed Mr Todd in connection with two matters - (1) Crude agreement with Gulf; and (2) P.T.T. Limited.

Mr Phillips and I travelled overseas in connection with the investigation in early 1965. In March 1965 I reported following that visit. I dealt with subject of availability of discounts on refined products East of Suez on long-term armslength sales to independent purchasers. The report included information obtained from Governmental authorities. I have been instructed by the Commissioner that unless this Court orders me so to do, I am not to give further details on this subject or to produce that report.

An assessment was issued on 30th March 1965 - Amended Assessment for income year ended 31st March 1960 in respect of Europa. (EXHIBIT K). Assessment also included in respect of A.M.P. for that year. That income was included in assessment in terms of section 138.

12th April 1965, an interview took place between the Commissioner and Dr. Lau at which I was present (EXHIBIT 34). (Reads notes of this interview). Page 2, paragraph (iv) relates to disallowing part of the cost of purchase. (Mr Rathgen was the Commissioner at this time).

EXHIBIT 35 - May 31st 1965 - I discussed with Mr Todd and Mr Smith the question of refinery; this was when Mr Rathgen was Commissioner.

Later assessment made were in December 1965. (EXHIBIT 36) (separate file). This has been prepared and headed "Income Analysis Statements". On top of the file, first bundle, accounts of Pan Eastern for years from 1959 to 1966 made available by Europa and A.M.P. Second bundle that contains blue paper represents a reconciliation of profits earned by Pan Eastern with profits which were expected by Pan Eastern for years 1960/1965 inclusive - all ending 31st December. Thirdly, single sheet at bottom of the file, showing a reconciliation of the profits shown in accounts of Pan Eastern with those incomes which have been assessed.

Dealing with Income Analysis statements which cover both contracts; what information has been used to prepare these? Information used in preparing these statements has all come from Pan Eastern apart from two items, both of which reconcile however with Pan Eastern figures. These are both shown on page 1 of each statement and are the figures on the top righthand corner of page 1 opposite Step 1, and an item shown against step 4 as being a rounding off calculation. These will be explained later. You said information came from company's own records; which records have you used for that purpose? The records included in EXHIBIT X - large brown box.

Dealing with year in 1956 contract - taking year 1962. In making this reconciliation, the reconciliation was broken down into four steps. Shown on page 1. Step 1 on page 1. Shows profit expected to be derived by Pan Eastern on the basis of a benefit to Europa equal to 2.5 cents per gallon for each gallon of gasoline purchased by Europa under the Supply Contract. This figure which is shown on right hand side of the page amounted to $2,607,000. The explanation of this figure is contained on page 2 of the document. This shows first the total gallons of motor gasoline imported by Europa and this totalled 52,000,000 gallons. Return expected by Europa is shown in the second section of page 2 and represents 2.5 cents per gallon on the 52,000,000 gallons. This amounts to $1,303,000. This amount has to be doubled to maintain Europa's 50% share at 2.5 cents a gallon, and that amount is $2,607,000.

TO BENCH: Why do you double? This is return expected by Pan Eastern. We arrived at return expected by Europa as $1,303,000 and that was the figure that we doubled to arrive at profit expected by Pan Eastern for purpose of showing reconciliation.

TO COUNSEL: That amount is carried forward to page 1 and is the amount I have already referred to in Step 1. Step 2, also page 1, shows profit that would be derived if the products obtained by Pan Eastern from quantity of crude supplied to it had been sold at posted prices. This would have amounted to $1,316,000 which is shown against Step 2. For the calculation of this figure I go to page 3, at the top of which I see Step 2 profit if products sold at posted prices. The top left hand corner of Step 2 shows purchase of crude, and shows that ...

Figures on page 5, are they all from Pan Eastern records? Yes, that is amount shown on page 3 on top left hand corner.

Page 5, this applies to kerosene distillate and residual - vouchers are Pan Eastern voucher numbers showing quantities but such vouchers do not show total price. On pages 3 and 5 the total price for products other than gasoline is calculated at posted prices. Quantity of each product is shown on Pan Eastern voucher, as is posted price. But calculation is not made converting or multiplying posted price by quantity.

Bottom left hand side of Step 2 is showing final profit that would have been derived if products had been sold at posted prices. Is that entirely correct - motor gasoline is shown at invoiced prices? Yes, which were equivalent to posted price.

<u>TO BENCH:</u> Step 3 - your calculation from Step 1 which is based on the formula? No. Step 1 also includes volume discount. A total amount of $141,000 had to be added to the profit that would have been derived if sales had been made at posted prices. To arrive at what I will call the formula profit. The formula profit therefore amounted to $1,457,000. The calculation of the $141,000 is shown in pages 6, 7 and 8 of the statement.

<u>TO COUNSEL:</u> Looking at it, is the situation referred to on page 9 varied in other years? Yes in some years rounding off

varies upwards or downwards. Rate of rounding off varies in different years? Yes, sometimes they have taken next cent down; or might be above. If the exact figure had been 23.5 - some years they would be allowed 24, other years 23. In year 1962 rounding off figure was 23.16 and they allowed 24, in accordance with the letter. Page 1, benefit of this rounding off calculation has been taken into account to show exact reconciliation with Step 1 and has been introduced to explain exact profit shown by Pan Eastern for that year.

TO BENCH: Does this final figure of $2,600,000 - does that exactly agree with Pan Eastern's balance sheet? No, exact figure in Pan Eastern accounts is shown on page 3 as $2,649,000 - $41,718 of that has been produced by rounding off. If rounding off had not been allowed they would have produced a profit of $2,607,000.

TO COUNSEL: Page 10 reconciles the amount actually realised by Pan Eastern from sale of products other than gasoline - that is the dollar column on page 10 (left) with the amount that would have been realised if the sales had been made at posted prices. The difference is the amount shown in Step 3, being amount necessary to increase the profit to the formula profit. The fractions shown on page 10 are those shown in the Pan Eastern vouchers and the voucher numbers shown on page 10 are the voucher numbers as included in EXHIBIT S. I follow the difference in Step 3 - it was only the difference with which Pan Eastern was concerned? That was the amount which they would not have received if they had sold at posted prices. But it remained - the lower products remained Gulf Oil's all the time? Yes. So Pan Eastern was only concerned with a difference? They received a grossed up return for those lower products; Pan Eastern did. The total amount received by Pan Eastern for those products was $8,324,000 and that amount was sufficient to give them the formula profit.

LUNCHEON ADJOURNMENT.

I summarise position under the contracts - Reconciliation of profits - this reconciles profits shown by Pan Eastern with income actually assessed. Referring to that - that reconciles profit as shown in Pan Eastern accounts with amounts actually assessed to A.M.P. and to Europa. This extends over a period to 1966? Figures for 1966 year are not relevant to this case.

I produce colour chart (EXHIBIT 37) - "Europa's share Pan Eastern's profit expressed as a gain per gallon of motor gasoline imported by Europa". That covers period from 30th June 1955 which predates start of contract to 31st September 1965. Relating to 1956 contract. For prriod to 31st December 1958 sources of information - we used graph prepared by Mr Todd when writing to Gulf (EXHIBIT B14 of Case Stated). Subsequent to that, from Pan Eastern records, supplied by Europa in recent times. This relates to 1956 income analysis statements discussed before lunch. Area in blue represents profit per gallon, or benefit per gallon that would have been obtained by Europa, would have been obtained by Europa if the sales of Pan Eastern had been at posted prices. This is Step 2 in Income Analysis Statement. Grey area represents the additional benefit obtained by Europa as a result of application of the formula, included in Processing Contract. That is Step 3 of Income Analysis Statement. Pink area represents benefit obtained by Europa as a result of the volume discounts or letter variations. This is Step 4 in Income Analysis Statements. The dotted area represents amount by which the profit of Pan Eastern or Europa's share of it was reduced below the benefit that would have been obtained if sales had been made at posted prices. The base of the dotted area represents formula profit for that period. That situation was caused by operation of the formula. The hump in the 1958 year is the period in which the volume discount was first allowed. My reading of EXHIBIT B14 suggests that the hump was intended to fill the hole in the 1957 year.

Looking at 1962/63 period - in the 1962 year the volume discount was producing approximately 44% of the total benefit being received by Europa through Pan Eastern. That increased every year after that, as indicated by bottom of the red.

I also as EXHIBIT 38 produce supporting Table of figures showing in figures what is portrayed for the four years 1960/1965.

TO BENCH: One matter of significance is almost exact profit per gallon through arrived at by addition of different figures you suggest? Yes. Referring

TO COUNSEL: Referring to information as to discount obtained from overseas authorities - has the Inland Revenue Department attempted to obtain that information on an unconfidential basis? Yes, but with no success at all.

EXHIBIT 39 - Letter dated 15th June 1965 sent by Minister of Finance regarding assessments and recommendation that would be made authorising cancellation of such amount as would be fitting. Second to last paragraph of this - sufficient to refer to that. "Nevertheless, I am sure you will recollect that both the Commissioner and I made it clear that there was no desire to collect more tax than was properly payable. The Commissioner also stated that if the Courts decided that both assessments issued were valid, he would recommend that Government authorise the cancellation of such amount as was fitting. I would support this recommendation."

EXHIBIT 40 - file of correspondence from Gulf, obtained at Pittsburgh through United States Government. Correspondence from Gulf and Europa.

EXHIBIT 41 - copy of Articles of Pan Eastern made available to Department on 14th June 1965, by Europa.

I next produce extract from Platt's Oilgram (EXHIBIT 42) dated 20th April 1955.

EXHIBIT 43 - reference to Union Oil - I understand evidence given by Professor Leeman regarding actual situation of Union Oil Co. Extract from Oil and Petroleum Year Book 1958, relevant paragraphs being under CAPITAL, showing issued capital of Union was 7,871,000 common shares. Also line 2 shows that these shares were $25 shares. Total issued capital of Union was of order of $200,000,000 at that time. Market capitalisation -

TO BENCH: Included in 375,000,000 capital was a large amount unissued. Market capitalisation - last paragraph before heading United Canso Oil & Gas Ltd. is reference to price on New York Stock Exchange of Union Stock. In year 1956 this Stock varied between $52 and $65 a share, thereby giving market capitalisation for Union of something between 400 and 500 million dollars. Price range between $52 a share - variation in stock market price of whole of their sares. As a result of your research into that, can you say whether Gulf took up shares in Union under their convertible rights? No, I can't.

TO COUNSEL: EXHIBIT 44 - letter of 5th February 1959 to Mr C. Rees Jenkins from Mr Hucks. This is a copy of a letter obtained from BP's records and is a letter written by I think the Managing Director of BP (N.Z.) at that time to Mr Rees Jenkins in London - B.P. London. It refers to the fact that Mr Todd had made enquiries of B.P. for the supply of his gas oil requirements.

From accounting point of view, would it be possible to calculate Pan Eastern's profits each quarter only variables being administration and interest which would need to be apportioned? That could be done. You have had referred to you evidence of Mr Smith (page 2175 of the Notes), referring to Propet share of Pan Eastern profits? Yes. And looking at income analysis statement (EXHIBIT 36) for year 1962 - the year you were looking at? Yes. What is Pan Eastern profit for that quarter in respect of 83 and 93 octane? Last quarter of 1962 - profit from 83 octane $237,953; 93 octane $101,226, shown on pages 7 and 8. Propet's share would be one half. That comes to $169,000. Is there any record in Pan Eastern documentation as to how Propet dealt with the matter when the volume discount was received by Pan Eastern? Not that I have seen.

Another passage on page 186, line 10 et seq. - "My information is that instead of the distillate quality in 6.03 Pan Eastern used No. 2 fuel? Instead of distillate 43/47 D.I. gas oil? I cannot comment on that. My information too is that the price base adopted by Pan Eastern was Abadan not the Caribbean? I comment - Do you know if that is right? I do not know. The price in accordance with clause 6.04 to be paid by Gulf is subject to adjustment upwards or downwards so the price recorded in the accounts I would think would not be either Caribbean or Abadan or in fact any quoted source reference. Is your answer that whatever the price they adopted it did not affect the position because the returns were then adjusted by the formula? Yes." - agreed that position as put to Mr Smith in cross-examination is now accepted. (Accepted by Objector as correct).

Referring to EXHIBIT I (Caltex tender file). We know that tenders are divided into two parts - originals contained in cables and later detailed proposals advanced by Caltex at later date. I have prepared a calculation of what the return to Europa would be under original Caltex proposal in 1955. That is now produced as EXHIBIT 45.

<u>TO BENCH</u>: Is this based on the proposed contract which is dated 27th May 1955? No, this was the proposal that was made to Mr Todd, accepted by him, but then not accepted by Caltex.

Let us have the result broadly? This compares the price Europa would pay for its purchases if it paid posted prices and the price that it would obtain its supplies for in terms of Caltex's original offer. It shows that in terms of Caltex's offer Europa would be obtaining its supplies for $1,009,000 less than posted prices. This is equivalent to 3.2 cents per gallon. I have also calculated result under later proposals (EXHIBIT 46). Result of that calculation - it shows that under Caltex's second proposal Europa would have been obtaining its supplies at either 1.66 cents or 1.8 cents below posted price per gallon. There is a reference on page 9 of Caltex's offer at paragraph 26, a reference to $623,000. Elsewhere it is suggested that the profit would have amounted to $673,000. It is not clear to me whether the lower of those two figures is a typing error and the calculation in EXHIBIT 46 has been made on both bases.

TO COUNSEL: Referring to the earlier contracts before 1956, I produce Table (EXHIBIT 47) showing freight saving at 1st January 1956 under that Agreement. That shows benefit to Europa - saving per gallon to be equal to .894 cents per gallon. .894 cents per gallon. I have considered small discount from gasoline purchases - Mr Todd in evidence said that Europa was receiving two small concessions from Caltex. The first was 1/8 cent per gallon and the second, either 1/8th or 1/4; the contract showed something like .14 cents per gallon, just over an eighth. Total of those benefits, do you know that? No. What was posted price of gasoline on 1st January 1956? I understand that the posted price of 79 octane gasoline at that time was 9.75 cents per gallon. (EXHIBIT 45). I have not calculated total benefits to Europa but I could easily do so.

I also produce by consent EXHIBIT 58 - two files - correspondence regarding 1961 accounts. Europa files.

Red file referred to by Mr Smith in evidence.

EXHIBIT 49 - in red book - end of Exhibits in that folder. Letter from A.M.P. (dated 13 July 1965) with attached schedule of dividends received from Pan Eastern.

EXHIBIT 50 - copy of balance sheet of P.T.T. as at 31 May 1967 supplied to Commissioner by Europa.

Accounts for 1961 (EXHIBIT AA) - you were shown those? I have seen this since the hearing. When you looked at it had you any recollection of seeing those accounts before? Not prior to this hearing. I have no recollection of having seen or heard of volume discounts until 1966 when letters produced. I have thought over the matter carefully since Mr Smith's evidence. I have considered if I could have been given accounts and failed to examine trading accounts or take notice of references; thought of this quite deeply. I feel that when I saw the accounts (EXHIBIT AA) during the hearing that this was the first occasion that I had seen such accounts.

You said you did recall having contracts in your hand to examine in that room; and some accounts? Yes. And you made notes following that in order to have the discussion? Yes. Did you have time to examine contracts and accounts? I had all the time that I required. Can you state what information you obtained - what the accounts disclosed to you? In the discussion with Mr Todd on 21st February I referred to undistributed profits of Pan Eastern amounting to approximately $10,000,000. This information would have been obtained from a balance sheet. Mr Smith referred to comment he had made about Price Waterhouse according to his recollection; do you recall any such reference? No, I do not recall that reference.

Having looked at EXHIBIT AA and having read what was there, what do you say about it having escaped your notice?

I would think that it is inconceivable that I could have looked at these accounts without noticing the references to volume discounts. I mean that is what I was looking for all the time. The next day in discussions with Mr Todd I was actively pursuing what I may call the discount argument. And as Mr Smith mentioned in evidence on a cursory examination of these accounts one must have noticed the reference to volume discounts with even a cursory examination of these accounts.

Have you looked again at various types of accounts of Pan Eastern produced? Yes in EXHIBIT 36, I have a balance sheet for 1961 produced under cover of letter dated 2nd March 1967. That is set of accounts Mr Smith referred to also in his evidence. There is also a balance sheet and set of accounts for year ended 31st December 1960 which was forwarded to the Department under cover of letter of 29th March 1967. These make no reference to volume discounts. Under cover of the same letter a balance sheet as at 31st December 1959 was also enclosed. There was no trading account attached to those accounts and there was no reference to volume discounts. EXHIBIT AA is for year 1961. That group do not include 1961. Further set of accounts this for the 1963 year which was included in EXHIBIT X. This represented a balance sheet and profit and loss account which did not refer to volume discounts. Only one that refers to volume discounts is 1961 year.

TO BENCH: You say you did not see that till forwarded with letter of 2nd March 1967? I was overseas at the time. Not till after it was forwarded with that letter.

TO COUNSEL: What type of accounts did you see? Yes, I have come to a conclusion on that. From the information that I had for the purpose of my discussion with Mr Todd on 21st February 1963, I must have had some information concerning 1961. I feel that I saw a balance sheet only or a set of accounts in some form other than that in EXHIBIT AA. At that time you were making those enquiries would you have been able to distinguish between discounts on crude and discounts on products? I would have been able to distinguish significance of one as opposed to the other. At the interviews you had there was no mention of volume discounts? That is correct.

In your own report have you ever made any reference to crude being supplied to Pan Eastern at other than posted prices? No my interim report of the 25th March and the summarised trading account which I prepared in respect of Pan Eastern shortly after makes reference to sales by and purchases by Pan Eastern at posted prices.

When you received the details you obtained on 29th March 1963 from Mr Smith those were sales, purchases and refining fees; did Mr Smith make any reference to volume discounts? No.

COURT ADJOURNED 3.50 p.m.

COURT RESUMED 25/3/69.

EXAMINATION IN CHIEF (B.H.C. Tyler) (continued)

EXHIBIT 36 - would you look at that Exhibit - accounts for 1962 in particular. (Evidence of Mr Smith, page 136, last paragraph) - "In each quarterly statement by Pan Eastern is there a factor adjustment? In respect of prices? Yes. For example in voucher 1/2 for January 1964 relating to last quarter of 1963, is there at page 4 a column headed "Adjusted price"and then in brackets 1.016340? Yes. How was this adjusting factor in Pan Eastern vouchers arrived at each quarter? I think the matter is explained in the paper which was produced yesterday covering the December 1963 accounts but briefly on a month by month basis the Pan Eastern accounts record purchases of crude and processing fee and sales of products. Those transactions from the three months of any one quarter will show a profit to Pan Eastern. That profit is then compared with the formula profit. And

an adjustment is made to the selling price of kerosene residual and distillate, to Propet so that the quarterly profit in Pan Eastern accounts is equal to the formula profit. This is provided in the contract. And was the ratio of first set of selling prices to prices needed to get the formula profit, the adjusting factor in the voucher? Yes in this case 101% - an addition of 1% in other words. This adjusting factor that appears quarterly was simply to produce a designed result and had no business reality? It produces the formula result."

Looking at 1962, would you explain the adjusted selling price? The adjusted selling price is the actual amount realised by Pan Eastern from the sale of the kerosene distillate and residual fuel, obtained by Pan Eastern from processing of the crude purchased by it. This figure is obtained by the following process - the quantity of each fuel is known, the posted price of each fuel is known, and the adjusted selling price is obtained by grossing up the amount that would be realised if the sales had been at posted price and the calculation is by means of the factor shown in the middle of the page. This factor is shown on the Pan Eastern voucher. In each case on voucher as referred to here.

TO BENCH: How is factor arrived at? Pan Eastern knows how much they would have got if they had sold at posted prices. They know how much they must realise in order to produce the formula result and ratio of one to the other is the same as the factor shown in the centre of the page. To put it another way - the company knew that in the first quarter a sale at posted prices would have produced one million six hundred and sixty eight thousand dollars. They have calculated that if they multiply that figure mentioned, by the fraction 103 over 100, they will obtain the amount that must be realised if the formula result is to be obtained such amount being $1,724,000. $1,724,000 charged is the formula price? Yes.

That is at stage of the formula? Yes.

XXN: MAHON:

When you first went to Europa office on 13th February 1963 had you made up your mind to attack the Pan Eastern earnings as being a discount? When I went to the Europa office - Answer Yes or No? No. When I went to the Europa office I had no idea as to whom Pan Eastern Refining Company was. You knew that A.M.P. got dividends from Pan Eastern? Yes. And on 13th February Mr Smith told you about Pan Eastern, did he not? He told me something of Pan Eastern. I refer you to EXHIBIT 16 where you consider in a note made on 13th February the different sections that might apply? Yes. And on page 2 of EXHIBIT 16 you refer to section 108? Yes. You say - "This appears to be our best bet"? Yes, I do. At the time you made that observation you had never seen the contracts? No I had not seen them at that stage. Nor had you seen the Pan Eastern accounts, had you? No, I had not.

You accept Mr Smith's evidence that he showed you the contracts on 20th February 1963? Yes I have no reason not to believe that was the date. Do you accept that he showed you Pan Eastern accounts on the same day, 20th February? Yes. Do you accept that those accounts included accounts for year ended 31st December 1961? Some accounts for 1961.

Look at EXHIBIT 17 - this is your note of meeting of 21st February 1963? Yes it is. This is the day after you saw the contracts and saw some Pan Eastern accounts Mr Smith showed you? Yes. And on the first page of EXHIBIT 17 you note the return of capital earned by Pan Eastern? Yes. You put in a note of undistributed profits for period of five years, from 1st January 1957? Yes I do. Where it says 1st January 1957 - 31st December 1962, that should read 1961, should it not? Yes. How did you find out what the undistributed profits were to 31st December 1961 if you had not seen 1961 Pan Eastern accounts? I agree that I saw some accounts for the year ended 31st December 1961. The information shown in my note of interview of the 21st February (EXHIBIT 17) would have been obtained from a balance sheet. Are you now suggesting you saw balance sheet and no trading accounts? I cannot recall whether I only saw a balance sheet but as I mentioned yesterday I find it inconceivable that I would have been shown the accounts included in I think EXHIBIT AA. You asked, did you not, for accounts from Pan Eastern? I can't recall whether I simply asked for accounts from Pan Eastern but it would be a logical request. When you asked for the accounts of the company you expect to see not only balance sheet but trading accounts for the year? When we were supplied with the accounts of Pan Eastern for the year ended 31st December 1959 which were forwarded under cover of A.M.P.'S letter of 29th March, we were forwarded a balance sheet only. You expect to see trading accounts, don't you? We would like to see one, but if that is not available we have to take what we are given. If you look at this EXHIBIT AA - look at the balance sheet, that is headed Exhibit 1 on right top corner? Yes. And under heading of Net Income for Year you will see a bracket reading Exhibit 2? Yes. So even to the uninstructed eye, that is telling you the income is shown on another document? Which could be one reason - yes I agree - which could be one reason why I asked Mr Smith whether there were any supporting statements. When did you ask him that? I understood he said in eviddnce that when I returned the contracts and accounts to him I asked whether there were any supporting statements. He said any processing statements? Didn't he tell you there would be processing statements? (Page 161 of Mr Smith's evidence, line 6). (Mr White refers to lines 14 and 15, page 161). "He asked me in connection with the accounts were there any supporting papers.

I told him there were processing statements." But processing statements are the calculations how income is made up, are they not? Which could be a form of ... Are they not? Processing statements: what do you understand by that term? I think this would be closely related to term "supporting statements" or "supporting papers". Did Mr Smith use to you expression "processing statements"? I don't recollect what he said. I do recall what he said in evidence. Well if he said there may be processing statements, you would ask him what they were, wouldn't you? Not necessarily. You are saying now are you that you must have seen balance sheet for 1961? Yes I agree that I must have seen a balance sheet for 1961. Did you suggest yesterday it might have been some other sort of balance sheet? I suggested yesterday it may have been some other set of accounts incorporated in which however could be the balance sheet containing exactly the same information as the one we have in EXHIBIT AA. You disagree with Mr Smith's evidence that you were given Pan Eastern accounts for 1961 statement of income? I disagree - I find it inconceivable that I could have been given a statement of income showing volume discounts as a separate clearly identifiable item in the statement. You won't admit you could have not made a mistake - not picked it up? Bearing in mind the argument that I was developing, and which I actively pursued the following day, knowing I had ample time to examine these accounts, and I clearly recall making such examination, I find it inconceivable that such an item would have escaped my attention.

TO BENCH: You have a brief record of interview of 13th Febraury? Yes. And a record of interview of 21st February? Yes. Have you any notes of what you extracted from papers shown to you on 20th February? No. I would imagine that when examining the contracts and other papers on the 20th February I would have made notes which formed the basis of my discussion on the 21st February and which were in turn incorporated in my notes of interview of that date. Those 20th February notes have not been preserved? No.

TO COUNSEL: You must have written down for file purposes the particulars of the documents you saw on 21st? I have looked in my records to see if I made any such notes. If I did perhaps under the circumstances just explained it has not been retained. You must have noted the figures of retained earnings - you quoted them on 21st February? Yes I would have noted that figure. And that would have been a subject heading for our discussion on the 21st February.

You know the accounts for 1961 onwards all refer to crude discounts obtained by Pan Eastern? Yes, I believe they do. That is to say, those accounts which were forwarded to the Department in 1967 refer to such discounts. From 1961 onwards? I believe so. You don't remember Mr Smith making a reference to Price Waterhouse when he handed you this file? No, I do not recall that.

Moving on to page 2 of EXHIBIT 17 - you see under paragraph (b) "This at least suggests that all documents should be regarded as part of the one overall agreement entered into by Europa for the supply of its requirements in New Zealand"? Yes. You retained that view right throughout your dealings with Europa? That was one of the points that I referred to. You maintained that view throughout - that one could disregard the constitution of Pan Eastern and the different contracts and treat them as representing one contract for supply of products at a discount; that was your view? That was the argument I put throughout our discussions. And you still take that view? Yes I do. Disregard all the contractual arrangements except the supply contract - and then alter the price to another figure? Yes I felt that the benefit obtained by way of Pan Eastern was in effect a reduction of price Europa was paying in terms of the Supply Agreement. And you stuck to your view right throughout; that this was only one contract of supply? A bundle of contracts making one overall agreement.

You were told weren't you at those February discussions by Mr Todd that one could not get discounts at that time 1955? Discounts on products? My recollection of our discussions was that the question as to the availability of discounts referred to the period of discussion namely 1963, and not to 1955. Can you quote any statement of Mr Todd's in the discussions that related to 1963? I could quote a number. In which it is explained no discounts on products in 1963? I can quote I think a number of comments which make it clear that the discussion was relating to the period then current. What were you enquiring about in February 1963? I was exploring the Pan Eastern set of arrangements. And was not the discussion centred on the point of what Mr Todd could have negotiated in 1955? My recollection is that from the very start of our discussions Mr Todd claimed that discounts just were not available and we did not move from 1963 at all. If discounts had not been available in 1963 that would have disposed of the issue in my mind at that time. Look at page 4 of EXHIBIT 17: you set out there the company's Arguments - "Oil companies jealously guard the posted price system and no company would be prepared to offer a discount to the extent suggested by me." Isn't that a reference to the making of the contract in 1955? Not at all. Our discussions were solely related to 1963 and some confirmation of this point is contained in my Memorandum of November 5th, 1964 to which I will refer. EXHIBIT 33, page 2, paragraph 4, when I asked him whether he did not think that obtaining the discount from B.P. was inconsistent with his argument in 1963 that discounts were not available on refined products. Also as I read Mr Todd's memorandum of the 20th

March 1963 (EXHIBIT P). I do not recollect that there is any reference to the 1955, 1956 period. I understood that when you went to see these people in February 1963 the question was under what circumstances did you negotiate the contracts in 1955 - was not that the question? No It wasn't. You said "I'll put my cards on the table. I think this is a discount arrangement" when you read the contracts? Yes and from that stage the discussion developed into a discussion on the availability of discounts with reference to the current period. As I said before, I think this is indicated by my notes of interview, Mr Todd's memorandum, my interim report showing my understanding of the position and my memorandum of November 1964. Was not the question at issue could they have got the discounts in 1955? Because of the way in which this discussion on availability of discounts developed, I must confess that it was not until some time in 1965 that the full relevance of the 1955/56 period became obvious to me.

Let me quote to you from EXHIBIT BB - Mr Smith's notes of the interviews, dated 25th February. At page 2 of that exhibit he sets out the points you were making at that time. Under Number 9 he said - "Because Gulf unable or opposed to granting a discount - this concession (refining) granted instead or in place of a discount. Gulf would not make the P.E. contract unless they had the Sales Contract." Now does that correctly put forward the substance of the point you were making? That particular point. I agree that is so. Weren't you saying to him that Gulf either would not or could not grant you a discount in 1955 and gave you this concession instead? Yes. I would like to make one point clear. We did not get past 1963 when discussing availability of discounts although I made the point one of a number that you mentioned a second ago. I understood that at these interviews there were two competing viewpoints - you said "You got a discount in in 1955". They said "We agreed on a refinery deal in 1955". Wasn't that the point? No. I think the contest was something like this: You are getting a discount to which the reply was "That is just not possible". "We can't get such discounts". But the discount you were speaking of, if you are right, was settled by the contract in April 1956? Yes. And subsequent arrangements in 1958. You didn't know about them then, did you? No. I again put - the discount question was related to 1955/56, and there was not one reference in these notes to any person in Europa saying "You cannot get product discounts in 1963" - was that ever said in those words? I would have difficulty in reading the papers I have referred to without coming to the conclusion that the period under discussion was 1963, and this was my clear understanding at that time.

TO BENCH: Wouldn't the matter under discussion be 1963 and the earlier years? Mr Todd was taking a stand that they were not available now and my knowledge of the situation was not sufficient to realise that conditions may have changed. But wouldn't you be commencing an investigation over a period of years up to 1963? Yes. So wouldn't it be likely that the discussion would cover the period of years you were commencing to investigate? Perhaps the tone is set by opening words on 14th March 1963 (EXHIBIT 18) where Mr Todd said that he found it difficult to see why I thought they were receiving a discount from Gulf. We were talking about 14th March 1963.

TO COUNSEL: But they were getting the discount under the 1956 contract; that was your whole point? It was not until I spoke to counsel after or some time after March 1965 that I realised the significance of 1956.

Your explanation is that although you were investigating discounts under 1956 contract the question of discounts in 1956 did not arise? Yes I am saying that. You have been a Tax Inspector for some years prior to 1963? Yes.

Remember in February discussions them telling you that the 47.5 cents processing fee was realistic? Yes. They were explaining to you that this was a valid refinery agreement they had made with Gulf? That was the point. They gave you various reasons to try and persuade you it was a refining agreement? Yes.

Coming to the question of production of 1956 contract by Europa; it is clear from the memoranda that they did not mind the Department seeing them but were concerned about what Gulf might say? Yes I think that is so. Apart from one reservation expressed by Dr. Lau as to the security aspect.

Now referring to your last meeting in this period (EXHIBIT 20) 19th March, and if I turn to page 3 of that. You say one-third of the way down - "If other quotations are subject to discount - why not the export posting?" Todd: "Are they?" Tyler: "Government agencies and other large buyers get discounts". Where did that information come from? I was refer ing to the American scene and the information came from a book by a person called Cassady. The earlier sections of page 3 also refer to the American scene. You had at that time information you produced in EXHIBIT 2 - table of sales that were referred to by Mr Newton and Professor Leeman? No. When did you get that? When did you get that? I would have to lo k at that specifically; but much of that information was what I collected probably. I did not prepare that statement. However much of it I did collect and this would have been probably October 1963 - March 1964 and some of it after that date too. Now turn to page 4 of EXHIBIT 20, down here is a note of a colloquy - You say that "The test is - are you in the refining business?" "Yes". "Thats where the doubt arises. Europa entitled to have overseas interests (instanced N.Z. Insurance) provided you <u>are</u> refiners." "If had own refinery - there would be no argument." "Depends on circumstances - entitled to look at position overall and see where profits lie." What was meant by that statement? It is possible that when company operates internationally to have inter-company pricing arrangements which in effect shift profits from where they would be derived if the transactions were on an armslength basis to some other point. And the big integrated oil companies have numbers of subsidiaries dealing with different phases of their overall activities? Yes, I believe so. I thought you would be quite sure of that by now? I believe so. And the point you are making here is that a big international company can raise the profits in any particular operation in more than one country? As you say by having inter company transactions in which sales take place? Yes. That is what you meant by looking to see where the profits lie? Yes. If you brush all contracts aside it does not matter where they lie does it? I am not quite certain about that at the moment. If you are saying brush all contracts aside, in this case, one would see them for what they are, as being a benefit derived by Europa from its supply contract. Further down on page 4 Mr Todd is reported as saying "You can get discounts but only on spot, short term sales from sellers in distress. Gulf not in distress." Gulf not a distressed seller? Yes. Your researches show according to EXHIBIT 2 that this is correct? EXHIBIT 2 is limited to spot transactions, short term sales and some distressed sales? Yes I think these are all short term sales. It depends on definition of spot sale. One offering here equal to 55 million gallons which was very much in excess of Europa's requirements at that time. The German sales referred to are in distressed market? Mr Newton in evidence said that most sales on German market at that time were based on Caribbean parity. I thought he struck these sales out of EXHIBIT 2? Yes that is what I am saying. And on page 5 you say -

"If you are to get a discount of a certain value this can be effected by a given (calculated) % interest in a refinery". You put that as a proposal? Yes. Weren't you there referring to a discount negotiated in 1955? Yes. Towards the bottom - "Gulf is not prepared to give you a discount - but they are prepared to give you a refinery profit. But this does not put you into the refinery business." That was your contention? Yes. And I take it that is still your contention?

You got Mr Todd's memorandum which you asked for, and then the question had to be decided whether a protective assessment would issue for 1958? Yes. That was decided against was it not? Yes. And then in April 1963 Europa sent to you the Sands letter - the letter where permission was asked from the British Exchange Authorities (EXHIBIT K). That letter went over to your Department on 5th April 1963? Yes. Did you study that EXHIBIT K when it arrived? I cannot recall studying it but it is familiar to me. I am sure I would have. And that letter set out the proposed course of dealings between the companies? Yes. Now that sets out proposed transactions? Yes. It also sets out the expected level of profit to be earned by Pan Eastern? Yes. Was that 50 U.S. cents per barrel of crude? Yes. And allowing for minor fluctuations that was the level of profit Pan Eastern did in fact earn at the time? Yes. So that the dealings between the companies did follow the terms of EXHIBIT K and the level of profit followed in general terms of EXHIBIT K? Of EXHIBIT K but not of the contracts. EXHIBIT K certainly shows expectations at March 1956. And those expectations - the scheme laid before the British authorities there was the scheme that was carried out? I would not be able to state whether it was without looking at it further. To see whether this letter makes any reference to cost price of crude and to various other factors which go to make the final Pan Eastern profit. Does not correspondence recite the way Pan Eastern will be earning its profit? Yes. Also indicates the rate of profit that it expects to earn? Yes, at 1956. And you had EXHIBIT K in your possession in April 1963? Yes. If I may refer to the letter at page 5 it makes reference to sale of crude to Pan Eastern at posted prices. That was the contract, wasn't it? Yes. What your complaint is that the letter did not forecast the alteration of the contract that was made in 1959? I was commenting on the fact that the contract did not develop quite as anticipated in this letter. But the profit level did eventuate as contemplated? Yes I agree, following the allowance of the volume discounts. The profits were in accordance with expectations until about 1958? Yes. Then the Pan Eastern profits took a sudden dive? Yes. And they expected to earn at rate of 2.5 cents a gallon for gasoline? That had been their expectation. Your chart shows that for a while that moved up to about 2.7 cents?

TO BENCH: Went up to over 2.8 didn't it?

TO COUNSEL: The formula profit got to 2.7? Yes. And then it moved down to about 2.1? And then moved down to 1.7 in first half of 1958? Yes. At that point it was then earning one-third less than anticipated profit? Yes.

SHORT ADJOURNMENT.

Looking again at the coloured chart - an area marked there "Decrease to arrive at Formula Profit? Yes. That covers period when profits from posted price were reduced by application of the formula? Yes. That is an example of how the formula operated as a buffer against high returns on posted price? Yes. And then a little further along - the area when formula operated to lift the profit higher than the posted price level of profit? Yes. One point in connection with previous statement - it was that fall which gave rise to Mr Todd's representations to Gulf to ensure that in fact Pan Eastern's profits were not reduced as indicated by the chart. On the chart are examples of how formula operated as a buffer against the two extremes? Yes. And then you get to a point on the chart where the forluma profit commences to steadily decline? Yes. And Mr Todd as you say approached Gulf did he not to try to negotiate an adjustment against this adverse tendency? Yes. That was in 1958. Correspondence went on to 1959 (B14)? Yes. If he had not succeeded in getting Gulf to vary their strict contractual rights, the formula profit would have gone way down to a point over on the right side of your chart? Yes. And the anticipated profit in Sands' letter (EXHIBIT K) would have been entirely nullified? Result would not have been obtained. Down to about .85 cents. Top of the grey area. And the reason for that heavy decline on the chart is the static price of crude oil and the declining price of products? Yes I would think so. Of gasoline. And your witnesses say that the market price of crude is falling from about 1958? Yes. Posted price whereas remained the same? Yes. So that Gulf in agreeing to these crude volume discounts were really complying with the market tendency? Not necessarily. With the market tendency which was drop in crude prices at that period? Yes. Whatever their reasons you read B14 correspondence. I would make a point here that freezing of crude prices took place in August 1960 whereas Mr Todd's representations took place in early 1958. If he had not got Gulf to waive their strict rights under the contract and to adjust the calculation of profit provisions, then the formula profit would have declined in accordance with your chart? Yes. I don't know if the occurrence in August 1960 which produced that falling away of formula profits could have been reasonably foreseen in early 1958. Certainly would not be foreseen in 1955? No.

Now you produced as EXHIBIT 24 Mr Macken's minute -

do we have the date of that? No but it would be some time before 31st March 1963 - some time after 25th March 1963. Between those dates. And it is apparent that there seems a difference in principle between you and him as to what the Pan Eastern arrangements really is? Yes. Briefly Gulf had moved to Bahamas one sector of its profit earning operations and brought Europa in as a partner in that sector? Yes I think that is fair enough.

Turning to EXHIBIT 28 (Mr Macken's minute of 20th June 1963). It reads : "I have read the papers, refreshed my memory on the facts and studied the opinion given by the Crown Law Office. I agree with it.

There is no useful purpose in withholding the information from the Company. They are entitled to be advised." Now that referred to the decision that Pan Eastern arrangements would not be upset by the Commissioner? Yes, letter of 27th June 1963. (EXHIBIT F of Case Stated). It goes on to say - "The substantial remaining question is the obligation of the Commissioner under the double tax agreement with the U.S.A. to disclose the information to the U.S. authorities. This question is not desperately urgent and can be considered when the investigation is complete." Now didn't that word "investigation" refer to these other points such as service station expenditure, similar matters, which you were enquiring into with Europa? I can't say what Mr Macken intended when he wrote this. My expectation was that my enquiries into all aspects of the investigation would be continuing. Even though a determination had been reached as to the validity of Pan Eastern contracts; did you still continue your investigations into that matter? Mr Macken's memorandum of March 1963 seems to indicate that his decision was based on the validity of posted prices. That was a very material aspect of the investigation and directly related to Europa. To be precise about it, you were investigating International marketing companies in New Zealand under section 20 of the Statute? That was one of the sections which was relevant. That was the section under which there was power to assess a subsidiary of an overseas company? In certain circumstances. And you were engaged for a long time in looking at posted price as it affected international marketing companies in New Zealand? Yes. I suggest that as at June 1963 the question of the Pan Eastern profits had been decided on by the Commissioner in favour of Europa, and that there still remained to be cleaned up these other points concerning Europa which you were enquiring into? If that is what Mr Macken intended that is not what I understood. You didn't agree with it, did you? No, I might have come to a different conclusion. But I don't know I would have disagreed with the legal advice we received. But did you see the letter (EXHIBIT Q) Europa sent back to Commissioner after receiving his letter of 27th June (EXHIBIT F). Did you see EXHIBIT Q - did you see that letter? I can't remember, but it is most likely that I did. You know that was not replied to? Yes. And when you saw Europa on different occasions after June 1963 you did not raise with them again the question of their own liability under the Pan Eastern contracts? No. What you were really doing was trying to get information from them to use against the other marketing companies? Some of my visits to Europa concerned Europa, some concerned other companies and some of my visits to other companies concerned Europa. Taking care not to tell any of them what the purpose of the visits was? I think as time developed the development of my thinking would probably have been obvious from the very questions that I asked. Mr Smith says your method over the whole enquiry after the initial interview was to ask a question, never get into any discussions, why? I can only think of three occasions when I went back to

Europa; I don't know that that is altogether correct. Could you be specific. Was that your method of approach - turn up, make enquiries and decline to discuss the reasons; was that your method of handling the enquiry? Insofar as my enquiry related to another company if I was enquiring of Europa I would not disclose to them the company I was enquiring about or give any information that would lead to the conclusion who I was dealing with. On EXHIBIT 26 you have a note of discussion with Mr Smith? Yes. On 5th April 1963 he told you that the Caltex 1956 negotiations were verbal? Yes. You know that he was not the negotiator? Yes, but I would also point out that he did not answer those questions off the cuff. Did he have a look at the files? Either that or asked or obtained information from other people within the organisation. I don't know how he made his enquiries.

Now Pacific Trading - you have in EXHIBIT 32 set out the discussion on 2nd November 1964 with regard to Pacific Trading? Yes. I see that it is here reported, two-thirds of the way down -"Europa was paid a commission (discount) for its purchases. Mr Smith thinks that B.P. London asked that this be kept in London (to avoid embarrassment if it was discovered that they were charging an independent less than their own subsidiary?)" Words in brackets are your own query? Yes. And in EXHIBIT 33 you discussed the same matter with Mr Todd on 5th November 1964. Bottom of page 2 he says - "B.P. wanted commission paid in London. Not sure as to reason but assumes that London thought that the least known about these discounts the better." - and so far as Europa was concerned, it did not matter to them did it whether they paid New Zealand tax or U.K. tax on commission? No U.K. and N.Z. tax were at about the same rates.

<u>TO BENCH:</u> Was U.K. tax then 10/- in the £? I have a note that the tax provided for in the U.K. was at something in

excess of 10/-. I don't know the rate applicable to this income in U.K. I presume amount provided for was their anticipated liability. That would be more than N.Z. tax? Just a shade more. 10/- here and 10/7 in England? I don't know.

TO COUNSEL: It cost Europa more to have it taxed in London? Slightly more.

You suggested did you not that Pacific Trading was a company that had its seat of management in New Zealand? Yes. And consequently it ought to pay New Zealand tax? Yes. And Europa agreed did it not to take up with U.K. authorities the question whether they would accept that this was technically a New Zealand taxpayer? Yes that is so. In New Zealand we had formed the view that this company was a New Zealand taxpayer. Because it was 100% owned by Europa? Yes, and its seat of management was here. The United Kingdom authorities in the end agreed to accept that view? I understand so. And we then got the U.K. credit to pay the tax here? I understand so. I am not aware of when Europa paid the tax in New Zealand. It would be for over whole period of Pacific Trading's trading? Yes. And now in these proceedings the Commissioner claims that Pacific Trading Company and the contract with B.P. were all constituted to avoid New Zealand tax? I don't know whether he is claiming that or not. I think he is claiming the B.P. contract is evidence of discounts. With regard to that B.P. contract made December 1961 - Europa could not get right qualities of gas oil from Gulf? I understand so, yes. So made contract with B.P.? Yes.

Looking at EXHIBIT 36 - analysis of accounts - year ended 31st December 1962 - 1956 contracts - the reconciliation of profits earned with expected profits - I agree with your figures but not the way you set them out - go down to Step 4, front page, and you get profit as shown in company's accounts of $2,649,452. That is the profit in the accounts as against the profit expected at 2.5 cents a gallon? Yes. One is actual, bottom one, and top expected. And difference of $41,718 is because they have allowed a higher crude discount than what would be required to bring the profit to 2.5? Yes in some years they allowed less - some more. This year they allowed more. An even 24 cents. On your EXHIBIT 38 you show the cents per gallon from 1960 to 1965 and they never actually strike 2.5, go under it and over it, depending on extent of crude discount? And this EXHIBIT 38 shows first the effect of applying formula under the agreement to profits earned? Yes. And secondly it shows the effect of applying the crude discount - crude volume discount, agreed under the 1959 variation? Yes. So your EXHIBIT 38 then shows as a final figure cents per gallon calculated exactly andthey are always around that level minimum guarantee of 2.5 cents per gallon? Yes.

Still keeping to that same 1962 sheet on EXHIBIT 36 - turn to page 3 of that - you set out there particulars of how different steps are taken to arrive at the company's profit? Yes. I notice that there are over 4 million dollar's worth of sales of gasoline? Yes. . Made to Gulf Iran by Pan Eastern? Yes. And then there are over 8,000,000 dollars of sales of kerosene, gas oil, residual oil, made to Propet? Yes. And then sold by Propet to Gulf Iran? We saw one voucher only where that was the case. All others were - the point is there is one voucher showing sale by Propet to Gulf Iran. I have no knowledge as to how Propet handled all other purchases by it. That voucher is not a Pan Eastern voucher. And just deals with one sale from Propet to Gulf Iran? Just gives one quarter. But whatever method Gulf used they disposed of in this case the $8,000,000 worth of products out to their other customers in some part of the world? At some price -

not necessarily related -

Gulf has a big fuel oil market? I understand so. So you show then the total sales over $2\frac{1}{2}$ million U.S. dollars Pan Eastern to Gulf Iran and Propet? Yes. And these formula calculations worked out here (EXHIBIT 38) are they the same as the calculations that Professor Leeman produced? I think so. Who prepared them on EXHIBIT 36? I believe Professor Leeman produced a formula such as this and our statistical officer arrived at the same or a very closely related simplification independently. They are independent calculations coming to approximately the same result. I believe either Professor Leeman or our statistical officer stopped at a slightly different point. If you refer to page 6 of the statement - this is a progressive simplification - Professor Leeman stopped at one point and our statistical officer at the other.

In EXHIBIT 40 you produce the correspondence from Gulf? Yes. You have read these before? Yes. And the first letter is a Gulf internal note dated August 17th, 1955? Yes. That relat s to currency problems dollar earnings as opposed to sterling earnings? Yes. Then another one, Gulf internal Memorandum of 22nd August 1955? Yes. This deals with marine aspects of the freight contract? Yes. Then file note dated 26th August 1955 when Mr Todd suggests a Gulf team come out to negotiate - a Gulf memorandum? Yes. And then 7th October 1955 Mr Todd's letter to Mr Paton? Yes. And he there encloses drafts and is going to be in Pittsburgh area later in the year to consider the matter again? Yes. Then a memorandum of 13th October 1955 - internal memorandum - saying drafts have been received and goes on talking about currency aspects of the proposed transactions? Yes. And then a further Gulf internal memorandum of 17th October 1955, dealing again with currency problems? Really the contract is it not. On the second page no firm agreement reached, etc. - "If the signing is to be conditioned upon our obtaining clearance from the Bank of England and the British Treasury, we should, of course, make every effort to obtain such clearances prior to Mr Todd's arrival.

I sincerely trust that this information will enable you to review the currency problems which may be involved, and to advise Mr Paton accordingly." ? Yes.

Letter of 17th October, Mr Paton to Mr Todd? Yes. Letter from Mr Todd to Mr Paton of 20th October? Yes. And then we come to January 20th, internal memorandum Paton to Mr Gray, 20th January 1956. So that is that - you still suggest in the light of this memorandum do you that there is some sort of acting in concert between Gulf and Europa to avoid New Zealand tax? (Mr White objects).

You applied to the U.S. Internal Revenue to ask Gulf to produce any relevant letters or memoranda in relation to Europa contracts? Yes. And Gulf declined? I think they declined to make available information without first consulting Mr Todd. First of all they took the point of what was the jurisdiction to require production? I don't recall this. And in the end you asked us if we would give our clearance for Gulf to produce anything they had? Let me make it clear, I am speaking from memory. My recollection is that Revenue service went to Gulf and Gulf declined to give this information without first getting Todd's approval. The time required to enforce production provisions in the United States which requires Court action and a considerable amount of time precluded this information being available. I believe Mr Todd then gave authority. We gave authority for Gulf to produce whatever they had in regard to the contracts? Yes. EXHIBIT 40 is the result, dated 19th February 1969. Re-assessment March 30th, 1965.

COURT ADJOURNED 1 p.m.

Coming now to EXHIBIT 44 - this was the B.P. letter of 5th February 1959? Yes. Now do you know what the result of that was? Was contract taken up? I understand from what I was told yesterday that London replied and said that they were not interested at that time. Mr Todd was suggesting they could supply gas oil at a discount or rebate? He was making enquiries of B.P. for a contract to supply him with his gas oil requirements. And on your information London said they were not interested? Yes, that is so, I understand.

EXHIBIT 45 - this is your analysis. This return per gallon of 3.2 cents would that have been Europa's share of refining profits Caltex contemplated? Benefit Europa would have received from the contract on those terms. You are disregarding the fact that Caltex made a refinery proposal and are simply calculating the return to Europa which would have been achieved had the whole proposal been accepted? I am not sure whether a refinery proposal had been made at that time. One was made subsequently.

EXHIBIT 46 - second proposal? Second proposal is the one Caltex later said was what they really had in mind. That was the Caltex proposal 1955; that was a refinery proposal was it not - documents show that? It developed into a refinery proposal but I am unable to say that at the time Mr Todd wrote to Caltex in April 1955 this was a refinery proposal. I feel in fact that the indications may be ...

EXHIBIT I cable there - there is a telegram 26th February 1955 from Singleton to Mr Todd and it refers on first page to 40 cents per barrel of crude? Yes. Isn't that a reference to a refinery proposal? Yes. And the second proposal was the one they outlined in a form of draft agreement? Yes. 27th May. They said that was the same as first one in outline but they had made an error in a calculation? Yes. But what you have done is to say Well irrespective of what type of proposal the first proposal would produce to Europa 3.2 cents per gallon and the second would produce 1.6 cents or 1.8 cents? Yes.

This report EXHIBIT 31 - you prepared that for Department in March 1964. This report sets out your information as at March 1964 which you were conveying to the Commissioner? Yes. It covered the oil industry generally? Yes. And then made particular reference to Europa? Yes. Europa could not be assessed under section 20? No. Under that Commissioner can merely make an educated guess on correct margin of profit and then assess the company? That is the effect of the section. Using the best information he has available. But you dealt in this report with Europa in some detail because different problems arose with regard to Europa? Yes. I notice on page 2 of Part I, paragraph 1.08 - "1.07. Joint ventures in the post production stages are also encountered. 1.08. For example Gulf has contracted to sell a considerable part of its Kuwait production to Shell (in 1958 58% of its Kuwait output equal to 9.7% of the entire Middle East output). Rather than sell the oil outright to Shell, the two companies have agreed to share equally in the total profits derived from the production, refining, transportation and marketing of this crude." That is Gulf/Shell agreement your expert witness spoke about? Yes. And then paragraph 1.10 - you are pointing out there the disinclination of Gulf to compete with Shell, also had an effect on B.P.? Yes. Then at page 3, Part I, end of paragraph 1.17 - that was a factor you say which leads to conclusion that in case of big companies it is not necessarily a cartel arrangement to have a joint venture? That is the suggestion made by numerous writers.

Then you refer on page 1 of Part IV to Mr Todd - paragraphs 4.06, 4.07. There again you state that your discussion with Mr Todd the previous year were restricted to the current discount situation as at 1963? Yes. And then you say - "The reason why Mr Todd takes this stand is clear, i.e. to retain free of tax the discount at present being obtained by his company (under the guise of a share of the refining profit) which is siphoned off to the Bahamas free of tax." This means that in 1956 Mr Todd would have obtained long term discounts ranging from 23% to 30%? I think I am pointing out the effects of what actually happened. I refer to the discount at present being obtained which is looking at the particular form in which it was obtained. I am not applying my mind to whether the same quantum of discount could have been obtained in another form. I had the impression you were doing that in the previous paragraph? In your question you mentioned a discount of a specific percentage. In the previous paragraph I am not looking at a specific percentage, but rather to the general availability of discounts. As at 1964? Yes, 1964. Well, shouldn't you have pointed out that Mr Todd's contract is a ten-year contract negotiated in 1955 and signed in 1956? Yes. I think it is a shame we did not discuss this point in 1963. But you had seen the contract in 1963? Yes. And you discussed them with Mr Todd after seeing them? Yes. Weren't you aware he had a ten-year contract? Yes, but as I mentioned this morning with the conversation with Mr Todd centering on current period, it was not until some time later that we fully appreciated the significance of the 1956 period.

Page 4 of Part V, last paragraph No. 5.20 - "The fact that Gulf may allocate supplies to N.Z. from such sources as would best fit in with its refinery runs and the world wide markets for its refined products, that shipments to N.Z. would be infrequent, would possibly originate from another company's refinery (i.e. Shell under the exchange agreement referred to) and would account for only a small proportion of its throughput (Abadan - admittedly the world's largest refinery - has a capacity of 400,000 barrels a day; Europa's requirements are something less than 3000) together with the probability that the transactions between Pan Eastern and Gulf are only calculated annually all place a grave doubt on the genuineness of the Pan Eastern agreement."

"Annually" is incorrect? Yes. It should read monthly? I think it should read quarterly although I must point out that volume discounts which make up a very important element in total profit are allowed annually though I was not aware of them in 1964. You did not see any accounts with that reference on in 1963? No. It should read quarterly, not annually. And then at page 5 you refer to high earnings on capital (5.21). Do you know the position that H.C. Sleigh Limited in Australia - having crude oil refined for them under processing contracts? This has been referred to in previous evidence. If a company like Sleigh had the credit terms for payment of invoices, that we had, namely 120 days, would not they be able to make their processing payments without having to utilise the working capital of Sleigh? Yes. So that if you have a processing deal and have got extended credit for payment, you can operate on a minimal capital, can you not? Yes. But I should point out that I am not able to say that Sleigh would have been deriving a similar profit from its processing contract as Pan Eastern did from its. But Pan Eastern profit is based on commercial refiner's margin of today? Whether Sleigh would derive a profit in any way related to the profit derived by Pan Eastern would depend upon the processing fee paid by it and the price at which it was paid for the products not uplifted by it. But you agree that Pan Eastern's estimated profit was the $1 U.S. crude refiner's margin less the 47½ cents processing fee? Yes. And both the $1 and the

47½ cents are realistic commercial figures? I accept the $1; I have some reservations about the 47.5 cents. I would hasten to add that I do not wish to hold myself out as an expert in this field. Your experts did not challenge the 47.5? I don't believe so. I don't know.

Pan Eastern was incorporated to earn nothing more than the ordinary commercial refiner's margin and that in fact is what it earned? If you have extended credit you can operate on small capital and make large returns? In this connection Whangarei has been referred to as an analagous situation. My thought is that Whangarei receives a fee of approximately $1 per barrel for the service which it provides. This service is similar to that performed by Gulf. Gulf however has accepted a much greater risk than has Whangarei. But it does occur to me that whereas Whangarei is paid a fee of approximately $1 a barrel Gulf was paid 47.5 cents. If Gulf had received the same fee that is received by Whangarei which provides less by way of guarantees and so on, Pan Eastern would not have derived any profit at all.

You put in a list of dates as to when you received documents? Yes. EXHIBIT 21. You have any personal knowledge of requests for production of documents in 1966/67? At no time subsequent to August 1966 when I left for the United States.

With regard to these letter variations, you were enquiring in 1963 according to you as to current discounts? Yes. And did you ask Europa to produce to you details of how Pan Eastern details were calculated? I said on a couple of occasions that I would like the effect of the formula explained to me. But didn't Mr Smith mention to you there would be processing statements that would show the calculations? I don't recall it, but I accept it. You didn't press, did you, for any calculations of how this alleged discount was made up? On 29th March 1963 EXHIBIT 25 I obtained from Mr Smith by 'phone details of Pan Eastern's sales, purchases and refining fee paid which I thought gave me sufficient information to calculate or substantially calculate the profit of Pan Eastern. They had retained earnings in Pan Eastern and noted the point at interview of 21st February? Yes. I suggest that what you were interested in was the amount of Pan Eastern profits, not how it was obtained, not how it was calculated? Was that not your prime interest? Yes, I think that would be my prime interest. However the formula did concern me. It was quite meaningless to me and I did express a wish on a couple of occasions to have it explained to me.

I incline to agree with you that they should have given you the letter variations, but you realise that Mr Smith thought you had seen crude discount references on the 1961 accounts? He says that? Yes. However the conversations in February and March 1963 were I think inconsistent with the presence of volume discounts. There was reference to purchases and sales at posted prices, there was reference to the formula only being a buffer, and there was reference to the possibility of loss in Pan Eastern which possibility is not present or was not present after the allowance of the volume discounts. Your object of enquiry was the 1963 discounts, that is what you were enquiring about you say. But they say you were enquiring as to the validity of the contract they made in 1956? I don't know that I follow you. You relate everything they said in February/March 1963 on product discounts as relating to that period? Question of discounts which was a very substantial part of the whole consideration were in respect of 1963 but as you point out we were also considering the contracts themselves.

<u>TO BENCH</u>: You would also be considering results of contracts up to 1963? Yes.

<u>TO COUNSEL</u>: But should you not have said to them "I want a

calculation worked out for me showing how the profits are calculated so I can see the method by which Pan Eastern made its money? In retrospect it is a shame I didn't. But the information I got on 29th March I thought was sufficient for my purposes. This was information on the telephone? Information received by me on the telephone. The request may or may not have been by phone. And when you made later enquiries about Pan Eastern profits at a later time you again made them by phone? On that occasion I think it is very likely that the request would have been made by phone. Once again I can't be certain. You would ring up and say "Give me the 1962 profit" because you wanted it for your files? I could have either done that or remembering that the Europa office was only 150 yards up the road, I could have called on Mr Smith and made a request. I am sure both methods were used. Mr Smith said you got it by phone? Your prime concern was what they made? Yes I think that is fair. And the method adopted of crude discounts would not have affected your calculations one iota if you had known about it? It may well have affected my conclusions in respect of the agreements. You mean if you had read the correspondence (B14) and read that long negotiation with Gulf you would have seen that Gulf had now contracted themselves with a minimum guarantee of 2.5 cents? I would have seen that from B14. And you would have said that that was different from a return which could go over or below 2.5 as provided for in the original contract? Yes and I would also have considered it relevant the very large proportion of Pan Eastern profit which was represented by this allowance.

Now these Pan Eastern accounts (EXHIBIT X) you tried to get those from Gulf? Yes. In 1967? I don't recollect. I did not return to New Zealand until August 1968.

Would you look at EXHIBIT 2 - Shedule of Platt's

Was such a price quoted at Puerta Le Cruz on 27th October 1955? There are no quotations here from Puerta Le Cruz, which however is I understand in the Caribbean and geographically very close to the export centres here named, Aruba, Curucao. I also imagine Amuay and Carapito. But my knowledge is not very extensive in that area. These are really notional calculations - prices, aren't they? I think the second one we looked at is by no means notional in that the f.o.b. or the successful tender even on a most conservative calculation is a good way below the posted price. When was that prepared do you know? Some time early this year. And the effect is only two sales in 1955 of gasoline referred to? I think there may be three. Third is gas oil? Yes. And Mr Newton struck out the German sales? Yes he did.

Now about the Pool Account: would you agree that the Pool Account was operated by Government to establish the landed cost of gasoline? Yes. And does it work in this fashion - you enquired into the Pool Account when investigating Europa and other companies? Yes. And there was some very deep fiscal questions raised as to the balance held in the account from time to time? Yes. Anyhow you became familiar with the way it is run? Yes. And the Shell Company collects from all the other oil companies the c.i.f. landed cost of gasoline, tanker by tanker? I think a firm of public accountants who are advisers to Shell. And then these costs tanker by tanker are circulated among other companies by Shell? These mechanics I am not conversant with. You know that Shell submits returns to the Department of Industries and Commerce which show landed cost of each tanker load? I believe that is true. I was under the impression at one time that the firm of public accountants amalgamated the figures and furnished an industry average to the Industries and Commerce Department but I would not dispute if you said that shipment by shipment figure

Oilgrams. First item is sale at 27th October 1955 in United States. Military authorities are the buyer at 83-91 octane. You put in there a selling price of 9.875 cents.

TO BENCH: Was this a document prepared by you? It was not prepared by me but in the Department. Not by Mr Newton.

TO COUNSEL: You are familiar with the way this would be constructed? In general - whether I can answer any specific question I cannot say. I am told that 83-91 octane - compiler of EXHIBIT 2 has averaged those two figures and has treated it as a sale of 87 octane? I understand that if that is so, that that was the suggested approach by Mr Newton when this was discussed with him, but it was not discussed by me. But calculation assumes equal quantities of 83 and 91 octane for sale? If what you say is correct, if that average was made, that is the result. That is an assumption as to what quantities of each? Yes. But I am told that in New Zealand for example our Government sales to the Military were 98% 83 octane? I would have no information on that at all. Also no information as to whether New Zealand Military authorities buy gasoline at same grade as American authorities. Would you accept our company's secretary's certificate? Yes. (EXHIBIT II.)

But if in Example No. 1 on EXHIBIT 2 the great bulk of sales was 83 octane then the posted price would be 9.875 the same as the selling price? That is true. I would have expected however that if this estimated posted price was fixed on the suggestion of Mr Newton that he would have had some acquaintance with transactions of this kind.

Would you look at the second item on EXHIBIT 2 - second one is - I would point out that what you say is quite correct - but 79 octane I notice, which is less than lowest of that range, had a posted price at that time of 9.75 which is still well in excess of 9.19 which was the successful tender.

was supplied. Is it not the case that the companies know about variations in landed cost as among themselves when they occur? This would be obvious under either of the two approaches I mentioned. Because as a result of variations debits and credits would arise in the pool? Yes. Do you know how the Industries and Commerce used to run it in past years? My impression was that the firm of public accountants prepared industry averages but I am by no means certain on that point. But on either of the two methods it is obvious the company at any given time would know each other's landed costs? On the basis you suggested the answer would be Yes; on my understanding a company would certainly be able to see whether he was in line with the industry average but would not be able to identify the company which threw him outside the average. The company could always make enquiries to find out?

And it was suggested by the Solicitor-General in opening that you had been misled with regard to posted prices when you were discussing various matters with Mr Smith in 1963? Wittingly or otherwise - the impression Mr Todd conveyed to me was not the position I subsequently arrived at. You mean that you took it he was claiming no product discounts in 1963 whereas you ascertain product discounts were available in different parts of the world in 1963? That was the conclusion I came to. And I think you agree that there may have been between you a misunderstanding as to what actual period was being discussed? There is no doubt in my mind that we were talking about 1963. What relevance would the level of the 1963 discount have to a contract negotiated in 1955, eight years before? What possible connection could there be? Mr Todd was not alone in the industry in maintaining that this was the position. I walked into his office on 21st February and suggested in effect that he was receiving a discount. His reaction or response was to persuade me that discounts were not available. That the posted price system was sacroscant jealously guarded and that discounts were just not on. We were talking primarily about products although in the initial interview I understood him to be referring to crude also. There was at one time a general discussion about oil and products? I think there may have been. But when you said "I have seen the contracts. This is a discount rate", Mr Smith says that on 20th February 1963 when you returned the contracts and accounts to him you said to him "I will lay my cards on the table. I think this is a discount" - did you say that to him? I accept I did. He took a note of what you said? Yes. Now were you not saying that the arrangements reached under the contracts was an arrangement covering a discount? Giving a discount to Europa? Yes. And were you not also saying that these discounts commenced under the contracts at the beginning of 1956? I don't know that I said that but that would be a reasonable inference, that I was suggesting that this discount was received from the commencement of the contract. And when you then approached Mr Todd, Mr Todd's reaction was that here was a man alleging that in 1956 they contracted for a huge discount? Yes. And he would not consider such a suggestion would he? If Mr Todd had been referring to 1956 I would not have expected his memorandum of 20th March to be couched in the terms a reading of which suggests that he is referring to the current time and I would also have expected some historical narrative explaining why if discounts were available in 1963 and not in 1955 what historical factors had produced this change. But there is no such reference either in our discussions or in his memorandum. In fact I think - and I must check this - a reading of Mr Smith's record of interviews also suggests that it was the current period we were speaking about.

COURT ADJOURNED 4 p.m.

COURT RESUMED 26/3/69

XXN: B.H.C. TYLER (continued)

(Three letters put in added to EXHIBIT 48).

We were discussing last night the manner in which the pool account adjustments were made by the Department of Industries and Commerce: will you look at a document referring to week ended 5th November 1955 which sets out particulars of imports of gasoline and which is headed up "All Companies"? I saw this for a few minutes before the hearing. That ascertains the landed cost of each shipment of gasoline that arrives? Yes. And then were you shown this second document referring to December 1968 which contains the same type of material? Yes. (Crown accepts the situation). EXHIBITS JJ and KK.

Adverting to one or two remaining points - in the case of Europa there was a long term supply contract? Yes. The other supply companies in New Zealand merely import from their parent companies? Yes. Question of long term contract does not apply in their case? I am not aware of what their contractual relationships are with their parent and associated companies but different factors would apply. I know at least some of the New Zealand International companies are very concerned to maximise their profitability.

Coming to another point - you made your general enquiries into the industry in 1963 and 1964 and you became aware that a buyer of petroleum products could get certain benefits arising out of the freight contracts and out of extended credit terms and matters of that kind? Yes, I became aware of this and also aware of the fact that very often this type of measure was allowed either as a means of concealing or certainly in lieu of direct discounts. That was the point you made - methods other than direct discounts? Yes. In the Gulf contracts Europa got a freight concession? Yes, got the alternate freight rate. And Mr Todd has said in evidence that if tanker freight rates had not become depressed part of the way through the contract Europa would have obtained a total benefit under that contract of 1½ million pounds? He mentioned a substantial sum. Remember he said how there was a slump in the tanker market and in the end over the whole period Europa's total profit on the freight was only £65,000? Something like that. That freight benefit was one derived direct by Europa? Yes. And taxable in New Zealand in the hands of Europa? Yes. On completion of contracts. So that there was the freight concession which Europa got by contract and on which as at 1956 Europa was paying tax in New Zealand? Yes.

TO BENCH: Is that quite correct. They paid tax at the end of the contract? Yes the contract extended from 1956 to 1966 or was stated to extend that time and the benefit under the freight element was set to one side in Europa's books to be assessed. And it came into profit and loss account when that contract was replaced? Yes.

TO COUNSEL: Whatever they made out of it they had to pay on in New Zealand? Yes but while that is quite so, while similar provision was included in the 1964 contract, in the 1962 contract this advantage was also diverted to the Bahamas but the 1962 contract was amended for the reasons given by Mr Todd. They thought they had better have a 1964 contract to conform. And I don't know whether the anticipated value of the freight contract as at 1956, if you relate it to f.o.b. prices for gasoline, would be between 7% and 8% of the f.o.b. prices? I have not worked that out. I did calculate at one time that freight amounted to approximately 30% of the landed cost of gasoline in New Zealand. This calculation I just mentioned can of course be made by simply relating expected values of freight on one hand and then the actual prices paid for gasoline over the period on the other? Yes. Then you raised as another type of benefit interest rates and extended credit terms? Yes. Europa got did they not extended credit terms for payment of their import invoices? Yes. And of course the results of that was also taxable in the hands of Europa? I think that could be looked at in another way. It would be a saving of bank interest - one could ask whether this was extended credit in that Gulf in effect acted as the Pan Eastern banker and was holding very large amounts of undistributed profits. Gulf was obtaining the benefit of Pan Eastern's credits, including Europa's share thereof, and it would be reasonable for them to extend this as a set-off. With the result that Europa was obtaining the use of this money, or rather had in effect brought these profits home without any New Zealand tax liability.

TO BENCH: It would have New Zealand liability by the fact that interest on - less interest on borrowed money? Certainly, but each dollar brought home would raise no New Zealand tax liability.

TO COUNSEL: The reasons for the credit have already been canvassed in evidence, but as His Honour has pointed out the savings that Europa makes on 120 days' credit is income in the hands of Europa Oil? Yes. So that there are two benefits you mentioned - freight concession and extended credit, credit concessions; you agree Europa got both those? Not necessarily. To the extent that Europa was in effect only getting its own back and to the extent that Pan Eastern's Articles I understand gave either party the right to demand distribution one can at least ask whether this was truly extended credit. You are commenting now - can I have you recorded as saying Europa did not get freight concession and extended credit? No, you can record me as saying Eruopa got a freight concession and also did not have to pay immediately for its purchases from Gulf but I suggest there are a number of interpretations as to how that extension could be looked at.

Coming back to EXHIBIT 40 - Gulf correspondence. Yesterday I asked you to look at correspondence up to January 1956 and I ask you to look at a letter from Mr Langworthy to Mr Beckett dated 8th February 1956. Mr Langworthy is a Gulf man. Now it reports termination of that currency problem? Yes. That last paragraph I think is a general comment is it not - not directly related to Europa. They must in course of dealings with British authorities - involving other deals and other contracts? Yes. Now the balance of the correspondence in EXHIBIT 40 deals with years 1959 and 1960? Yes. And this refers to the probable building of a refinery in New Zealand and the attempts by Gulf to gain the feed stock contract with Europa? Yes. It did. That is the basis of the rest of the correspondence? Yes.

TO BENCH: In some of this correspondence are references to CFB? A French Company.

With regard to EXHIBIT 48 - correspondence over the 1961 accounts, Price Waterhouse: have you seen these other two or three letters put in this morning to complete that correspondence? No. And you gave evidence yesterday that in effect you were misled with regard to product discounts as a result of these February/March 1963 conversations? Yes. I did say wittingly or unwittingly. Do you accept the position that your Department never made that suggestion in any letter to Europa? No I don't think I would. I think did we not in a letter which was from Mr Twhigg - it is said something like this - "It is my understanding that in the conversations with Mr Tyler Mr Todd maintained that discounts are just not available". I think the whole development of these assessments indicates that the Department's view and that of Mr Todd on this question did not coincide. But my point is that the assertion that you had been misled, wittingly or unwittingly, is not actually stated in any letter from the

Commissioner or his advisers in which we asked for reason for the amended assessments? I think that while it is not spelt out in so many words the tenor of the conversations in 1963 and our subsequent action in 1965 indicates a fundamental disagreement. But you confirm I take it that Europa wrote on various occasions asking the reasons for the amended assessments? Yes. And the reply was always in the general form stated in Mr Twigg's letter? There were at least two such letters. No-one said in these letters "You either wittingly or unwittingly misled us" - no-one said that in a letter did they? It was not spelt out in so many words. But once again our subsequent actions must have shown that we did not accept what Mr Todd stated in 1963.

I now put to you to have in the record two letters, one from myself to Solicitor-General of 24th June 1965 asking what new information was, and his reply of 23rd July 1965 saying I was asking for his evidence (EXHIBITS LL and MM).

This correspondence (B14 of Case Stated) which deals with agreed variation of the 1956 contract, did you receive that on 14th June 1966? I am not certain that that is correct. B14 - letter variations were received in 1966 - 14th June 1966. So letter variations were received then but the file of correspondence relating to them (B14) that was in 1967? Now you therefore amended the assessments in 1965 before you knew about the letter variations? Yes.

You said on Monday when giving evidence in chief that you thought the 1961 Pan Eastern accounts were the only ones that had the crude discounts referred to? In fact the latest balance sheet that I would have seen in February 1963 was the balance sheet as at 31st December 1961. So what I think I would have been saying was that 1960 and earlier would not have shown them. But subsequent ones from 1962 onwards that were not on the file? They did in all cases show crude discounts? Yes I think they do. They were received in March 1967 I think.

Over the period of time you have been concerned in oil company taxation you have studied many Platt's Oilgrams I suppose? I read quite a number. And you would have consulted those covering a fairly long period of years back from 1967? Back from 1966 probably. And you would agree that over the years you would see from Platt's Oilgrams some hundreds of changes in posted prices of products? Yes, although the posted price for any one product tended to stay constant for some time, which time varied however. You don't mean posted price of a product would change every week? No. Over a period from 1956, say to 1966, according to Platt's Oilgram there would be some hundreds of changes in gasoline and other product prices over that period? That is conceivable.

When you had these discussions with Mr Todd in early part of 1963, you were putting to him were you not your views as to whether the Pan Eastern agreements really constituted a discount off the supply contract? Yes. You put to him your reasons for holding that view? Yes. You said that you might think up other reasons but these were your present reasons? Yes, the matter was discussed at some length. And then Mr Todd put his reasons to you which were that he supported his view? Yes. And he mentioned among others the following points - Gulf having large crude productions and a large fuel oil market, and limited gasoline market? Yes, he made that point. And he referred to the reluctance of the big companies to price cut marketing fields? More than that. He said that the Pan Eastern company was to earn a commercial refinery margin and that the 47.5 cents processing fee was realistic? Yes. He pointed out that a company like H.C. Sleigh Limited had crude oil refined by processing agrement? He mentioned Borol. And he raised these matters which you have also heard him raise in evidence in this case? Yes. And the reasons he has given in evidence here are in substance the same as what he told you when you saw him in 1963? Yes, I think so.

REXM: WHITE:

You were shown EXHIBIT AA yesterday (page 2166 of Notes of Evidence). On Balance Sheet EXHIBIT 1, it was pointed out to you. Looking at EXHIBIT 10 (also in EXHIBIT 36, letter of 2nd March 1967) enclosing accounts for year ended 31st December 1961 - balance sheet produced at that time. It does not have the Price Waterhouse note at foot? No. And does not have the exhibit note at the top? No. Nor does the statement of income have either note or exhibit note on it? No, it doesn't.

You were asked a number of questions regarding discussions as to discounts and availability of them when discussing matter with Mr Todd in 1963? Yes. And if you look at your report of 31st March 1964 (EXHIBIT 31) Part IV, paragraph 4.06, at the beginning of that paragraph you say - "This point has been dealt with in some detail because of the general attitude adopted by the industry that product discounts are not available." Can you say more about that, as to general attitude of oil industry and people you would be talking to in the industry at that time? Yes, attitude throughout the industry, New Zealand industry, those in the industry with whom I spoke were adamant that discounts off posted prices were not available. That is the reasons for the words in that paragraph? Yes.

After the Commissioner wrote his letter in June 1963 you have in the Exhibits produced recorded interviews you had with Mr Todd and other members of Europa organisation during 1964? Yes. During that period 1963/64 in addition to those recorded interviews were you also in communication with Europa over various matters? Yes. EXHIBIT 45 - that is calculation of return to Europa in Caltex first proposal? (page 219). In that evidence Mr Tyler, one-third of way down - "EXHIBIT 45 - this is your analysis - this return per gallon of 3.2 cents would that have been Europa's share of refining profits Caltex contemplated? Benefit Europa would have received from the contract on those terms." And later on - reference to telegram from Singleton to Mr Todd dated 26th February 1955 - "and it refers on first page to 40 cents per barrel of crude? Yes. Isn't that a reference to a refinery proposal? Yes." Would you explain the proposal and the benefit to which you refer?

SHORT ADJOURNMENT

I have EXHIBIT I here also - two matters, telegram of 26th February 1955? This Exhibit is designed to show the benefit Europa would have obtained from the first proposal made by Caltex and as understood by Mr Todd. The top line - "Cost at Posted Prices" represents the price that would have been paid by Europa for its estimated requirements of 79 octane gasoline if it paid the posted price of 9.75 cents a gallon. That cost would have been $3,067,000. The next calculation shows the cost under the proposal. From the first section will be seen Europa's total requirements of 749,000 barrels. In terms of Mr Bramstedt's cable of 1st March 1955, it will be seen in the bottom half of the cable that it is assumed that 1.2 barrels of crude oil will be required for each barrel of gasoline purchased. Applying this ratio to Europa's actual requirements would mean a total crude requirement of 898,000 barrels. The posted price of this crude was $1.89 per barrel which would produce a total raw material cost of $1,699,000. The processing fee provided for was 40 cents a barrel or a total processing cost of $359,000. The total cost therefore of Europa's gasoline requirements would have been $2,058,000 or an amount which was $1,009,000 less than the posted price of

79 octane gasoline. Therefore the return per barrel of gasoline to Europa is the advantage in dollars divided by its requirements in barrels. This would have given a benefit of $1.34.7 per barrel or 3.2 cents per gallon. Billing price. In Mr Todd's letter to Mr Ernst dated 28th April 1955, he refers on page 2 when explaining column 5 to the billing price of the finished product. This amount which is shown on his attached statement and which correspondes with the figure I have just explained - and the term 'billing price' of the finished products is referred to. Mr Todd says that the first three lines of the statement represent the determined total billing to them. "Them" I take it as - "Billing to us" - which I take to be Europa because he then refers to the other products which "you" would buy. "You" I take it being Caltex. That relates back to the telegram to which you have referred? Yes.

Then when talking of quantities lifted by us are those finished products? Yes. So the billing price is price for finished products both to Europa and Caltex? Yes. What is the effect of that on the posted price? That would mean that the amount for which Europa would be billed would be 3.2 cents a gallon below the posting. You were asked if you had received some papers this morning, and you said you had not seen them? Yes, I saw them in the adjournment. Letter of 9th April 1962 from A.M.P - from Smith to Gulf Oil Corporation? Yes. Have you seen that letter before? No. Page 2, paragraph 2? That deals with the 1961 year. EXHIBIT 36 and analysis prepared by the Department for that year? Yes, for 1961. Page 1 of that Exhibit? Then looking at that paragraph, relate those and compare them? That paragraph in the A.M.P. letter you referred to (Part EXHIBIT 48) letter of 9th April 1962 top of page 2, it states that a processing profit of 2.5 cents per U.S. gallon on twice the gallons of gasoline sold to Europa during 1961 equals

$2,964,000. That is the same as Step 1 on my reconciliation. It shows the amount of profit that was earned before the crude price adjustment, the amount required by way of crude price adjustment, and that actually made so producing what is called a shortage of crude price adjustment, of $12,890 which amount is also shown on page 1 of our 1961 statement (EXHIBIT 36). Earlier figures Step 3 total are the same in the letter? Yes.

Reference to cumulative shortage - what is that? As I read this it suggests that the amount under-allowed in any year is carried forward for the purpose of making an over-allowance in a subsequent year or vice versa, so as to provide over the term of the contract an exact 2.5 cents per gallon.

One document yesterday (EXHIBIT BB) you were asked to check? Yes, availability of discounts, what Mr Smith had recorded. Referring to page 4, and subsequently page 5. On page 4, last paragraph before Paragraph 6, Mr Smith states that "you have absolutely no show of getting a discount from International Company. They would never depart from Posted Prices". And again on page 5, referring to point summarised by Mr Smith on page 2, it says at Paragraph 9 - "No, definitely not - this is a joint refining venture which is a totally different thing altogether. No international Company would grant discounts - there is absolutely no show of getting them. To Mr Tyler's suggestion that there are discounts however, Dr. Lau stated only for spot purchases." And five lines further down, "You just cannot get discounts on a contract basis. Any international Company offering a discount would destroy their market and commit suicide. They protect the posted prices system most jealously". I understood those matters being referred to as at that time - the time at which they were spoken.

CONCLUSION OF EVIDENCE FOR RESPONDENT.