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Ex 12583
Worldwide
Court Reporters, Inc.

North America Funding Company
Long-term loan agreement with BP International Limited

Introduction

Your support is requested to:

1. Re-finance an existing short term funding and establish a fixed rate long term loan agreement between North America Funding Company (NAFCO) and BP International Limited (BPI) for an amount of US$ 10.0bn.
2. BP America Inc. (BPA) to provide a financial guarantee in favour of BPI on behalf of NAFCO in support of the long term loan relationship proposed.

Background

NAFCO is a US company owned in the US chain of companies through which BP America Inc and its US subsidiaries ("the US group") are funded. Surpluses and deficits arising within the US group are netted off in NAFCO and the balance is borrowed from or deposited with BPI through its existing IFA.

NAFCO's current IFA balance is structurally in deficit and therefore it is appropriate to transfer the core of the balance onto a long-term loan facility better to classify the substance of the balance.

The deficit balance on the IFA with BPI is US$ 10.3bn and this is expected to increase through the year as shareholder distributions are made; the US did not pay a dividend in 2008 and is forecast to have distributable reserves of around US$ 20bn. Operational cash flows are expected to be dedicated to funding the US group's capital expenditure programme.

At present NAFCO has all its funding from BPI on a single short term funding facility. In the current economic climate this is not reflective of funding practices of large corporate entities. There has been a significant trend for companies to secure longer term funding in place of short term commercial paper issuances. The significantly increased roll-over risk associated with short term funding has resulted in debt issuances for longer periods being preferred. Even though short term borrowings (less than 1 year) are currently available at artificially low rates, as a result of Federal Reserve intervention to stimulate the US economy, companies[1] are paying higher premia to gain the security of longer term funding.

Another trend among large corporates has been to secure an element of fixed rate funding to capitalise on the low interest rates available for terms of up to 5 years. Rates increase for debt issuances longer than this to reflect the uncertainty in the market. BP

[1] A number of examples during 2H 2008 and most recently Conoco Phillips replaced commercial paper with a US$ 6bn debt issuance

is an example of a large corporate that has switched some of its floating rate debt to fixed rates for periods out to 5 years.

Details of the Transaction

This proposal is for NAFCO to enter into an US$ 10.0bn fixed rate loan facility for a period of 3 years with semi-annual interest settlements. NAFCO will transfer US$10.0bn of its short term IFA deficit with BPI, on to the long term loan facility. The transaction does not change the gearing of NAFCO as we are switching short term funding to longer dated debt in line with market sentiment.

The pricing of the loan will be at *circa* 3.6%, representing a significant increase on the floating rate currently applicable of *circa* 0.4% [***note***. *The exact rate will be taken from the yield curve on the date of execution*]. We propose that NAFCO bears this premium above short term rates to enable this central financing entity for the US group to establish the funding structure that would be expected of such a company on arms-length basis. Interest rates for longer term debt (10 to 25 years) range from between 4.50% and 6.5% (for small debt issuance – see Treasury section).

The proposal affords NAFCO the opportunity to secure funding for a period of time at historically low rates, with greater certainty of funding and interest expense cash flows over this period.

Tax Issues

UK

BPI has losses brought forward from earlier years which fall into a tax category ("DIII") that restricts the income against which they can be off-set. The long term interest income generated by this transaction will be sheltered against these brought forward losses such that a cash tax liability will not arise in the current year. However, Finance has advised that the use of these losses will give rise to a charge to deferred tax in the UK for Net Income (this is offset for group reporting by the US treatment).

HM Treasury Consent

ICTA 1988, s765 clearance is not required for this agreement as the party issuing the debenture is a UK resident.

US

The proposed interest rate on the long-term loan of *circa* 3.6% is above the Applicable Federal Rate (AFR) which is seen as a transparent way to demonstrate a safe harbour rate for US transfer pricing purposes in relation to related party loans.

In this instance we are able to demonstrate through a combination of actual market rates available for companies with a similar credit risk profile to NAFCO, and the borrowing rates achieved by BP p.l.c., that the pricing of the fixed rate loan is arms-length.

The interest rate on the long-term loan will be significantly above the interest rate on NAFCO's existing IFA with BPI. However, for the reasons discussed in the Treasury section the classification of this balance as an overdraft facility does not represent commercial reality. On that basis, the US will obtain current tax relief of 27% on interest payments reflecting arms length terms.

Treasury / Finance Issues

Foreign Exchange

Both BPI (finance branch) and NAFCO are USD reporting entities for group accounts and tax returns, though BPI Limited has a presentation currency of GBP. As the existing IFAs and the proposed term facility will be USD denominated the transaction does not give rise to any foreign exchange issues.

Settlement

The transaction is to be implemented by way of book entries and does not involve the physical transfer of cash. Interest on the long term deposit will settle onto the respective IFA accounts for NAFCO and BPI.

To secure tax deductibility in the US, interest will be physically settled annually, before the financial year end, in line with a process imbedded in recent years.

Grossing up of interest income and expense

Although grossing up of balances is not expected to arise, to avoid concerns arising from the asymmetry of tax treatment of interest income and expense, were the US Group simultaneously to have a long term loan and a surplus on the IFA, Group Funding will be required to monitor the respective balances each quarter. If the IFA moves to a structural surplus balance, action will be taken to redress the situation.

Loan tenor and pricing

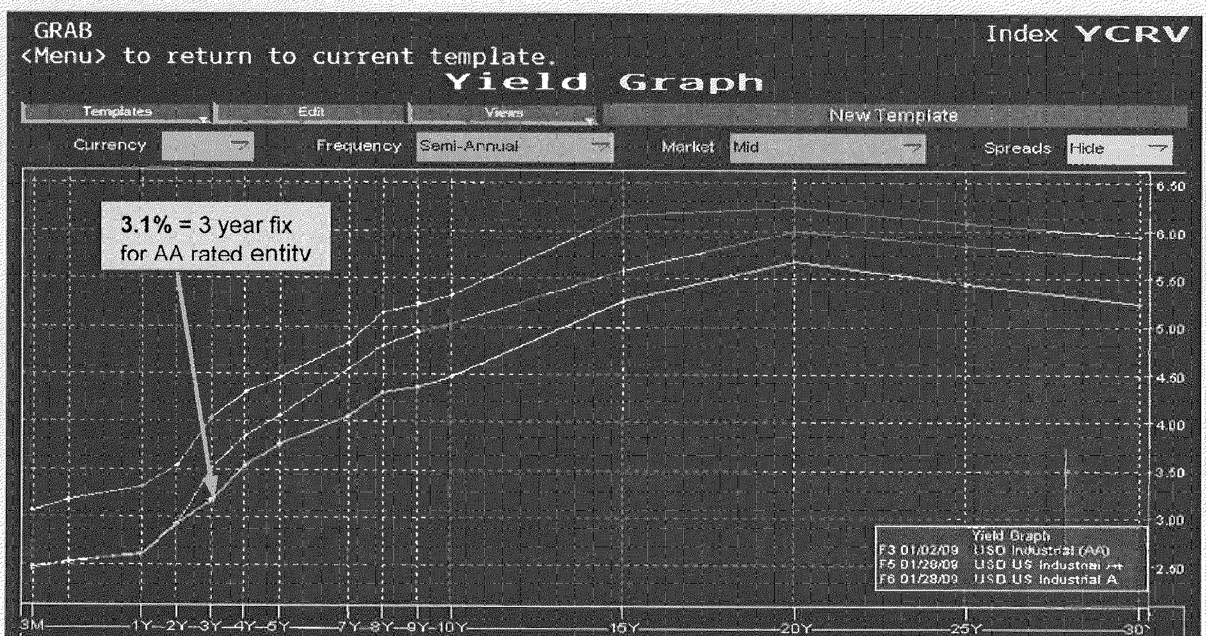
A loan tenor of 3 years and one day is proposed. This reflects our expectation that NAFCO will be in a deficit position for several years, beyond which the visibility of US operations activity is less transparent. Another reason for proposing a 3 year term reflects the extent to which we would like to manage the interest rate exposure. There are advantages of locking into a fixed rate loan; although a managed approach (fixing rates for a short period of time) seems optimal for a group the size of BPA. Longer periods of rate fixing present their own risks if yield curves deviate significantly.

<u>Pricing of the loan for a AA rated entity proposed at a fixed rate for a 3 year tenor</u>.

Fixed rate basis. Current market conditions display wider spreads over reference rates due to the lack of liquidity; however, absolute rates are currently low due to extraordinarily low underlying policy rates. This reflects the uncertainty in credit markets and the resulting lack of liquidity in funding markets. NAFCO is potentially in a stronger position today to achieve favourable debt pricing compared to later periods given the business risks faced by the US group and the re-pricing of credit risk by the market. As a result, it is recommended that a fixed rate loan is entered into to provide certainty of cash flows against a volatile income profile and to secure liquidity while the balance sheet of US group is stronger.

Determination of the interest rate. The fixed interest rate proposed for a 3 year tenor is reflective of price shown on the market yield curve for an AA rated entity (Bloomberg indices). This is in line with the methodology accepted by HMRC and adopted by BP through the interest rate 'Matrix' when pricing loans between Group tier entities. The market interest rate for an AA rated entity for a transaction size of less than US$ 100m would be 3.1% (graph 1); the balance of 0.5% reflects the additional premium for a loan sized at US$ 10.0bn. To demonstrate further the arms-length nature of the pricing, the rate proposed is in line with third party quotes gained by BP p.l.c. for fixed rate loans of a similar tenor (BP p.l.c. has current quotes to issue US$ 2.0bn of debt for a term of 5 years at 3.85%).

Graph 1. Yield curve for different industrial credit risk profiles



Pricing in a 'New Issue Premium' to reflect size of funding. Pricing given in the yield curve reflects trading levels in the secondary market of lot size typically US$ 10m to US$ 20m. As the loan facility in this transaction is for US$ 10.0bn, to reflect the market dynamics (i.e. increased risk for lenders and ability to match counterparties to the debt issuance), a *new issue premium* is required to be added to the rate referred to above. Recent analysis of bonds issued by investment grade corporate entities and research by the BP Capital Markets team enables us to estimate the new issue premium to reflect the size of issuance. The results help to demonstrate that the premium for debt issuances greater than US$ 0.5bn (though rarely greater than US$ 3.0bn) range from 0.15% to 0.75% above the market rates for smaller size issuances. A funding size of US$ 10.0bn is greater than may normally be expected to be priced as a single issuance. We have taken 0.5% as a prudent proxy for what might be payable in order to issue debt of this size. Hence the fixed rate for the 3 year loan would be *circa* 3.6% (3.1%

yield curve + 0.5% premium for lot size). On the transaction date the actual rate for this funding will be taken from the yield curve and a premium of 0.5% will be added to reflect lot size.

Group guarantee

In order to ensure that the US group will be entitled to a US tax deduction in respect of the interest expense arising from the funding, a group guarantee will be provided to BPI from BPA, the ultimate parent entity within the US group.

The quantum and duration of the financial guarantee will be in line with the long term loan agreement between BPI and NAFCO.

A guarantee fee agreement between BPA and NAFCO is not required as both entities consolidate within the US group.

Thin Capitalisation

As this transaction relates to the reclassification of existing balances from short to long term the net gearing of the entities is unchanged.

Company Secretarial

US and UK

The directors of companies are required to act in good faith and ensure that any transaction they enter into is likely to promote the success of the company for the benefit of its members as a whole.

The transaction details in this SFN do not compromise the above duties. The fixed rate debt between NAFCO and BPI provides security of funding for NAFCO and certainly of cash flows. For BPI there are two advantages to funding a high fixed rate compared to low IFA rates. Firstly, BPI is funded from BP Capital Markets p.l.c. who themselves are funded from the external capital markets at rates similar to the rates BPI will be funding BPA (to the extent that the fixed rate group debt is not swapped to floating rate). Secondly, the long term interest income created in BPI provides an opportunity to optimize the use of brought forward losses in this company.

External Approvals

No further external approvals are required.

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