Treasury Key Issues Report
3Q 2010

Financial Markets

Global Markets

The second half of the year began with growing concerns about the outlook for the global economy after a significant drop in growth momentum. Although this was isolated to large, indebted economies, investors were not willing to pursue the de-coupling theme, and central banks everywhere gave more weight to the uncertainty of global conditions in their interest rate decisions. The US recovery in particular looked fragile, with economic data (particularly in housing and labour markets, but also in manufacturing) disappointing early in Q3, while cautious-sounding Federal Reserve officials unnerved investors. That moved equity markets sideways in July and August, while government bonds and safe-haven currencies remained well supported. In September, the Fed signalled it was considering restarting asset purchases, while the Bank of Japan intervened in foreign exchange markets to weaken the yen. Investors welcomed the moves to support the recovery with the best September rally in the S&P 500 since 1939, but gold continued to make new record highs on money-printing fears, and bond yields sank lower as markets anticipated more quantitative easing. That prospect hit the dollar hard, resulting in its worst quarter since 2002. That, alongside strong emerging market demand and various supply disruptions saw commodity prices rise sharply, led by agricultural commodities.

US

Weak economic data threatened confidence, causing equity markets to fall and the dollar to strengthen. However, the FOMC's August decision to keep the balance sheet elevated by reinvesting the proceeds of maturing assets from its first QE programme signalled its continued dovishness, and, by September the dollar began to slide. Although US economic data improved, deflation risks and thus the prospects for more QE rose. Meanwhile, Congress passed a bill warning China on exchange rate policies ahead of the G-20 and IMF meetings, although US mid-term elections were expected to impede the progress of this bill in the Senate.

Europe

European bank stress-test results, although lacking in credibility thanks to rather lax criteria, showed only 7 out of 91 banks failing and a far smaller need for capital injections than markets had expected. Despite a general lack of conviction and light volumes, the euro began to strengthen. Then, with exports aided by Q2's euro-weakness, the economic data released in the euro-zone improved markedly, led by German exports to Asia. Although sovereign concerns resurfaced on Ireland's banking sector bail-out, contagion risks were reduced by the European Financial Stability Facility set up in May. With the ECB the only of the three major central banks not actively easing, the euro had a very strong September.

UK

Buoyed by expectations that strong inflation figures would force the BoE to emerge from emergency policy earlier than expected, sterling enjoyed a strong run through July, accompanied by decent output readings. However, the pound's luck appeared to run out in August; despite an inflation report that acknowledged price pressures were likely to stay elevated in the medium term, the MPC chose to emphasise the risks to growth – even though Q2 GDP was revised higher. Markets also worried about the fiscal austerity measures soon to be implemented to reduce the government's budget deficit.

Japan

With worries about the global recovery gathering pace early in the quarter, the safe-haven yen had a strong run putting the BoJ under pressure to act to pull the country out of deflation. The currency was also the strongest performer in August and in response, the BoJ announced an expansion of its fixed rate loan facility, and the government announced further fiscal measures. However, investors were unimpressed and the yen continued to rise. For the first time in six years, the BoJ finally intervened aggressively in FX markets to weaken the yen in September. But despite a sharp move lower on the day, even this could not keep the yen down against the dollar in the weeks that followed as the chance of further Fed QE increased.

Financial Information

$m	3Q'10	2Q'10	4Q'09
Gross Debt	39,978	30,580	34,627
Less FV of debt hedges	(797)	(53)	(127)
Cash	(12,805)	(7,310)	(8,339)
Net Debt	26,376	23,217	26,161
Net Debt Ratio	22%	21%	20%
Income Statement	**3Q'10**	**2Q'10**	**4Q'09**
Interest Payable	271	192	195
Finance Costs	349	224	252
Qtr End Exchange Rates	**3Q'10**	**2Q'10**	**4Q'09**
USD/GBP	1.5798	1.5058	1.6010
USD/EUR	1.3598	1.2177	1.4300

Financial Commentary

Reported net debt increased by $3.2bn in the quarter. Gearing increased to 22% taking into account the effect of provisioning for GoM. Net Debt and the Net Debt ratio are now shown including the offset of debt-related hedges.

.

Funding and Liquidity

BP returned to the conventional long term bond markets in late September/early October issuing $3.5bn in the US markets and €2bn in the Euromarkets. The timing was chosen to ensure that we could issue with the same T&Cs as prior to Macondo and to benefit from the improvement CDS and secondary market levels during September. Both deals were heavily oversubscribed.

The success of the issues gave further impetus to tightening in our CDS and secondary spreads throughout 4Q. By early January 2011, BP's 5year CDS had fallen below 90 bps, down from over 160 bps at the start of the quarter.

Throughout the quarter, we have continued to run with a very prudent balance sheet:

- We have maintained a sizeable cash buffer, in excess of $10bn. Including M&A deposits, cash totaled $18bn at year end.
- Post Macondo, we put in place bank facilities of around $17bn. This level is excessive on an ongoing basis and is detrimental to general credit availability for BP. Therefore we anticipate restructuring our facilities in the first quarter onto a more sustainable basis.
- As the Group's financial position has normalized, the more expensive funding raised from various IST working capital initiatives have been minimized. However, the processes are being maintained to allow rapid expansion, should funding needs occur.

Pensions

Our funded pension plans performed strongly in 4Q, driven by strong asset performance and some recovery from the record lows in government bond yields in 3Q. Overall, at year end our funded plans were 103% overfunded, the highest year end position since 2007. The main UK plan is overfunded at 110% and the US plan funding on an IAS19 basis is around 89% On a PPA basis the US plan is funding level is expected to be over 90%. Total planned 2011 contributions are $1.25bn, in line with 2010.

We have completed reviews of our investment strategy with both the UK trustees and the US fiduciary board. We have agreed to establish a framework to moderate the plans' equity bias based on market triggers.

Key Issues

GoM incident response

The Macondo well incident has required a broad-based and sustained Treasury response. During 3Q, we have:

- Co-ordinated the formation and initial $3 bn funding of the Deepwater Horizon Oil Spill Trust on 9 August 2010 and facilitated the timely establishment of both disbursement and governance procedures. The next cash contribution of $2 bn is planned for 4Q 2010.
- Supported the provision of $17 bn in collateral to the Deepwater Horizon Oil Spill Trust through the conveyance and pledge of overriding royalty interest in certain of producing GOM oil and gas fields.
- Begun implementation of a managed programme of redemption / term out of certain US tax exempt bonds to reduce short term liquidity risk. In 3Q, Treasury issued redemption notices to the bondholders of 27 bonds with an aggregate principal value of $457 m.
- Arranged multiple letters of credit to satisfy certain EPA financial responsibility requirements.
- Supported various IST financing initiatives;
- Continued providing due diligence and pre and post-closing support to a number of large M&A-led efforts which underpin the Group's announced divestment agenda, including (1) the announced divestment deals with Apache, Ecopetrol, Talisman, and Hess and (2) numerous "in progress" divestment transactions.

GoM Claims

Insurance Risk Solutions are continuing to assist in the GoM oil spill response primarily on making claims on our contractors' insurance policies where we have a right to do so.

The claim on Jupiter, the BP Group captive insurer has been settled.

Counterparty Risk

Bank counterparty risk exposures are increasing in line with the rising cash balances. Treasury dynamically manages the bank deposit limits to ensure cash is well diversified and to avoid excessive concentration risk. All Treasury cash is deposited with strong financial institutions rated A+ or higher.

Each month Treasury reviews a forward looking cash credit strategy for the month ahead, based upon current and forecast cash balances. During much of 3Q counterparty tenor limits were kept short to ensure the highest possible levels of liquidity for all Treasury cash.

Devon Asset Acquisition

Treasury facilitated the 3Q replacement of the Independence Hub guarantee, a post closing item related to the GOM asset package.

To enable the future closing of the Brazil asset package, Treasury advanced pre-closing activities, including clarifying closing payment logistics, arranging the expected issuance of letters of credit, and selecting to continue existing insurance arrangements. Treasury also supported BP's response to an ANP request for certain financial and rating agency information.

Letters of Credit

$1.75bn of committed letter of credit facilities, available for BP use globally, has been arranged by Treasury to ensure funding flexibility and enhancing BP's liquidity stronghold. Further uncommitted facilities have also been negotiated. Treasury continues to work with the businesses to build capacity and optimise letter of credit facility use.

Alaska

Treasury continued to advise upon credit support issues related to participation in either of the gas pipelines being advanced by Denali or TCX-XOM.

Trinidad

During 3Q, Treasury coordinated the payment of \$175m (net BP) of dividends from Trinidad entities and a partial loan repayment (trapped cash release) from of \$37m (net BP).

GOM (Tubular Bells)

In 3Q, Treasury provided guidance on the preparation of the "lease versus buy" analysis for a production handling facility and then advised the BP negotiation team on desired terms for the provision of a BPCNAI guarantee in support of the production handling agreement with the third party host.

US Wind Financing

Treasury closed the Fowler II wind project financing (\$348 m gross) on 20 August with a group of six initial banks. This financing included the monetisation of Production Tax Credits (PTCs) and faced a notable challenge in accommodating endangered species risk.

Treasury continued to progress the circa \$300m gross Cedar Creek II wind financing. Treasury selected a group of nine banks to advance a club financing. Closing of this transaction is targeted for 4Q 2010.

US Biofuels

Treasury supported the 3Q purchase of all of partner Verenium's assets related to its biofuels business. Treasury-related activities included arrangement of a BP guarantee for certain office space and the establishment of banking and funding processes.

Funding of the Highlands project through a DOE FLG is now in some question, as BP is 100% investor.

Hydrogen

Treasury worked with its counterparts in Rio Tinto Treasury to draft a Financing Plan for the HECA project. This plan outlines the financing expected to be pursued, as well as the significant risks to financing.

Insurance

A review of the Groups insurance strategy has now been completed for review post the GoM incident.

Collateral requirements by insurers has increased post the GoM incident. Negotiations with insurers are continuing to prevent posting collateral and to date have been successful. A tender has been prepared to look at optionality before the key renewal date of Jupiter's programmes at 1.1.2011.

Feasibility analysis on the establishment of a new US based captive insurance company is near completion. Target date for that is 1.10.2011

BP Gibraltar Disposal

Treasury supported the disposal of BP Gibraltar to Cepsa Ltd, as part of the Iberia FVC's portfolio optimisation. Treasury performed a number of pre-transaction restructurings for the share sale, including dividend payments and cash sweeps, as well as ensuring a clean-break with no trailing liabilities.

French Asset Disposal

Treasury supported the closing of the sale SAM FVC's retail business in France, together with three terminals, to Delek Europe BV. The sale was agreed in January subject to a works consultation process and closed on the 1 October. Treasury advised on financing, structuring, foreign exchange, pension risks and ensuring a clean-break.

Liquidity Initiatives

IST and Treasury have been working together on current and future working capital financing initiatives in support of Group liquidity and risk management activities. Existing trade finance funding instruments and new structures being progressed to implementation will form part of the Group's longer term diverse source of funding.

Angola and Azerbaijan Pre-export Financings

Treasury and IST negotiated two material pre-export financings linked to the company's operations in Angola and Azerbaijan for $2.5 and $2.25bn, respectively. Senior syndication by the arranging banks were launched on 16th August for both transactions and successfully concluded on 7th October. The very strong reception of the deals avoided the need for launch into a broader general syndication.

Weighted Average Cost of Capital Review

Treasury completed a review of BP's Weighted Average Cost of Capital which led to a recommendation to change the estimation of BP's post-tax WACC to 8%. The recommendation took account of changes in the financial markets and the impact of BP's changed credit rating since the previous review of WACC in 2009 and will be implemented in 4Q.

China Funding

BP businesses in China refinanced about $154m (gross) of loans at favourable terms during 3Q. Market liquidity had been stable in 3Q but the Chinese Government remains cautious on loan growth and raised the reserve requirement ratio of six major Chinese commercial banks by 50 bps in October for two months to further manage market liquidity. RMB appreciation has once again been the focus of international attention especially after the U.S. House of Representatives recently passed a bill targeting China for "currency manipulation".

