

Shell chairman
Sir Philip Watts



A BROKEN SHELL

Shell scandal prompts industry call for new test of reserve auditors

by Richard Orange

THE oil industry is planning a professional qualification for auditing companies' oil and gas reserves, in a move designed to steer the US Securities and Exchange Commission (SEC) away from plans to force companies to have their claims verified by independent consultants. At present there is no professional standard or methodology for reserves auditors.

Confidence in the oil industry's claims of what it has in store beneath the ground was everely dented after Royal Dutch/Shell slashed its claimed oil and gas reserve estimates by 3%, primarily because the numbers failed to meet SEC guidelines. Shell's revision was followed by similar cuts from US independents Forest Oil and El Paso, but did not trigger the industry-wide epidemic feared at the time.

Representatives from the American Association of Petroleum Geologists and the Society of Petroleum Reserves Evaluators are drawing up the qualification under the Certification Programme for Petroleum Reserves Evaluators.

Daniel Tearpock of the American Association of Petroleum Geologists told *The Business*: "We are hoping it's a way to let the investment community and government know that we are regaining ourselves. It might help avoid the need for compulsory independent reserve auditors." The qualification would require auditors to be trained and to take professional exams in the geological and engineering expertise required and the complex array of defini-



Going alone: independent geologists needed to test reserves

tions of oil and gas reserves, with special attention paid to the SEC's guidelines.

Tearpock said: "It means companies can't just employ someone who's got a geology degree and leave them to learn the definitions as they go along. People just don't understand the variety of definitions out there. Also, quite often, people don't know the geological techniques."

Reports into the Shell scandal

by the SEC and the UK's Financial Services Authority (FSA) stressed that many within Shell showed imperfect knowledge of the, admittedly vague, SEC definitions of proved reserves and how they differed from the company's internal standards.

They also drew attention to the way the job of verification rested with a single, semi-retired Shell geologist, who was not given enough resources for the task. As

a result, the committee is also setting up an ethics committee to devise professional standards similar to those used in the legal and accounting professions.

Professional petroleum reserves evaluators would be taught to recognise when the information provided to them was inadequate, and to see it as their duty to require companies to provide better data. If they failed to do so, they would risk losing their qualification.

The SEC said in July it was considering requiring companies to have an independent reserves audit, but has issued no statement on its progress since then. Norwegian oil firm Statoil is a rarity in having its reserves annually evaluated by geologists DeGolyer and MacNaughton, which also appraise Yukos. Since its scandal, Shell has committed to employing consultant geologists as part of its audit.

But oil companies such as Exxon Mobil and Total are resisting the proposals, arguing that the expense would be unnecessary given that their company experts will always have a deeper knowledge of the fields concerned than any consultant.

Ron Harrell, chief executive of geologist Ryder Scott and a member of the team drawing up the qualification, has argued that there aren't enough independent geologists to carry out such a task.

Ratings agency Standard & Poor's last week added to the pressure on companies to introduce greater standardisation in a report calling for better disclosure of reserves auditing methodology, emphasising the need for companies to appoint qualified personnel.

BLOOMBERG

CITY & FINANCE SPECIAL

Going Dutch may be Shell's best hope

by **BRIAN O'CONNOR**

YOU can be sure of Shell... but lately it seems the only thing you can count on is disappointment. The apparently rock-solid Anglo-Dutch giant, once the biggest oil company in the world, has been shaken to its core.

Shareholders have been calling for the head of UK chairman Sir Philip Watts. Tomorrow will be a key test as he unveils Shell's 2003 profits, hoping their huge scale - about £6bn - will soothe City anger and see him through to retirement next year.

The cries for blood have died down but some big investors are set on changing Shell's two-headed structure. There is even talk that one head - Royal Dutch Petroleum - will devour the other in a nil-premium bid. That might be the ultimate answer.

Anger has been simmering since January 9, when Shell wiped 3.9bn barrels off its estimates of 'proven reserves' - confessing it had a fifth less proven oil than it had claimed. Sir Philip left the announcement to his investor relations staff, which some saw as adding insult to injury.

Shell shares were 401p then. Today they are 365p. The 9pc drop has wiped £8bn off the entire group's market value.

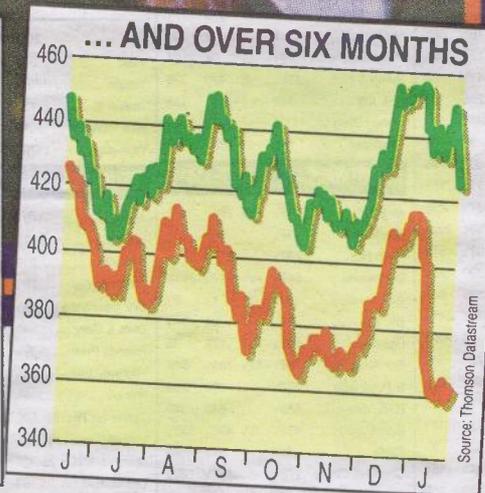
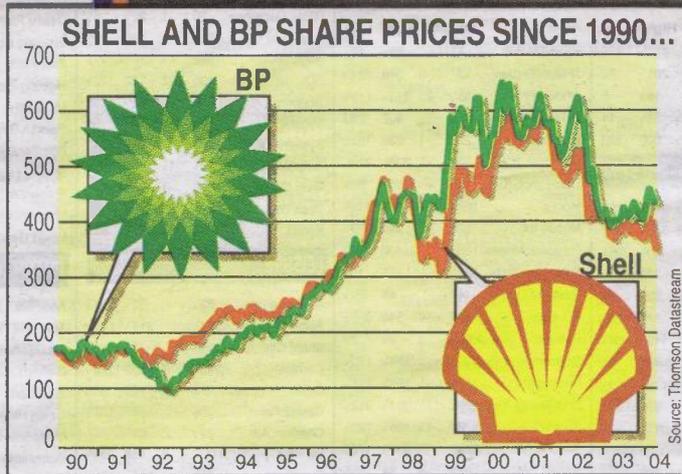
Rebels have gathered under the banner of the Association of British Insurers. Normally, irate shareholders' first port of call is a company's chairman. In Shell's case, Watts is the chairman.

So the issue has broadened to examining Shell's structure. Shell Transport, the UK company, is 40pc of the group. Royal Dutch is 60pc. They are separate companies with separate share quotes, but the combined group is run by a committee of managing directors.

Reformers are thinking the unthinkable - that the double edifice should end. Royal Dutch would make a share bid for Shell Transport. It could sweeten this by offering investors a cash element. The cost would soon be recouped from its massive cash flow.

This would be revolutionary. But some argue that this is needed to give Shell the lean, clean management it needs to compete with BP and Exxon Mobil - and with nimble minnows such as Cairn Energy.

Watts: Under pressure to turn around Shell's disappointing share price



It would be surprising if Watts unveiled anything so radical tomorrow. But it would be a start if he set up a committee to review the structure.

Most things in Shell are run by committee. Trading, investment, divestment and social responsibility have their own roomfuls of

sober suits in its ageing headquarters on London's South Bank. After the shocking events of 9/11, Shell's response was handled by two committees - a signal of their unprecedented gravity.

It is easy to make fun of Shell. But it has become one of the top global companies. Annual sales are

£120bn, it has 25 million customers and 100,000 staff in 140 countries.

It has oilfields in Nigeria, the Sakhalin project in Russia and petrol stations and refineries around the world. It has a growing 'gas to power' division and leading technology in freezing gas for transport.

And it makes shedloads of money. Three years ago its profits hit a record £6.4bn. Tomorrow's figures may come close to that. Peter Hitchens at broker Cheuvreux expects the final dividend to rise to 9.7p.

So why have its shares not done better? And why is such fury directed at Sir Phil, an affable Leicester-born physics graduate?

Watts took over in mid-2001 knowing he had a hard act to follow in Sir Mark Moody-Stuart, a polished performer who began the painful process of levering Shell into the modern age.

Watts followed, leading Shell to the £3.5bn acquisition of North Sea rival Enterprise. But he got off to a bad start with the City. The latest shock rekindled old grievances.

His appointment was a bold one by Shell standards. The top job alternates between an Englishman and a Dutchman, and it was the turn of the Dutch. But such customs jar with modern thinking on board behaviour.

It is a safe bet that Shell's structure will be attacked before the debate is over. The UK board is dominated by non-executives, but there will be pressure for more City heavies and fewer retired civil servants.

Sir Philip is due to retire by June 2005. He may not go the distance. Angry investors met independent directors, led by scientist Lord Oxburgh, this week. The board seems to have closed ranks, but the argument has broadened to how Shell should run itself.

The problem is not just one for Shell alone. BP's boss Lord Browne is hugely admired, while Watts is under the cosh. Yet, as our charts show, until recently Shell's shares had kept pace with BP for more than a decade.

The charts do not tell the full story. BP had huge problems in 1991-92, recovering with a breathtaking series of mergers. Its market value, once much smaller, is now £94bn against the £89bn to which Shell has slipped.

Investors are impatient with Big Oil, switching funds to more fleet-footed rivals such as Scots-based Cairn. Its shares soared after it found a prize oilfield in India - on territory Shell relinquished.

All this feeds City suspicions that Shell needs a shake-up. That is one thing you can be sure of, at least.

Shell boss is sorry but he won't resign

By **Andrew Johnson**

SHELL chairman Sir Philip Watts yesterday apologised for the botched way he handled a shock 20 per cent fall in the group's oil and gas reserves.

But the oil giant's boss did not apologise for the debacle itself and expressed his determination to stay on to sort out the mess, despite calls from shareholders for his head.

Shell lost £8.9 billion in stock market value when it said on January 9 that oil reserves had been overstated by 3.9 billion barrels.

Watts was not available then and has kept a low profile until yesterday's City briefing when he and the company offered an explanation for why the reserves were overbooked.

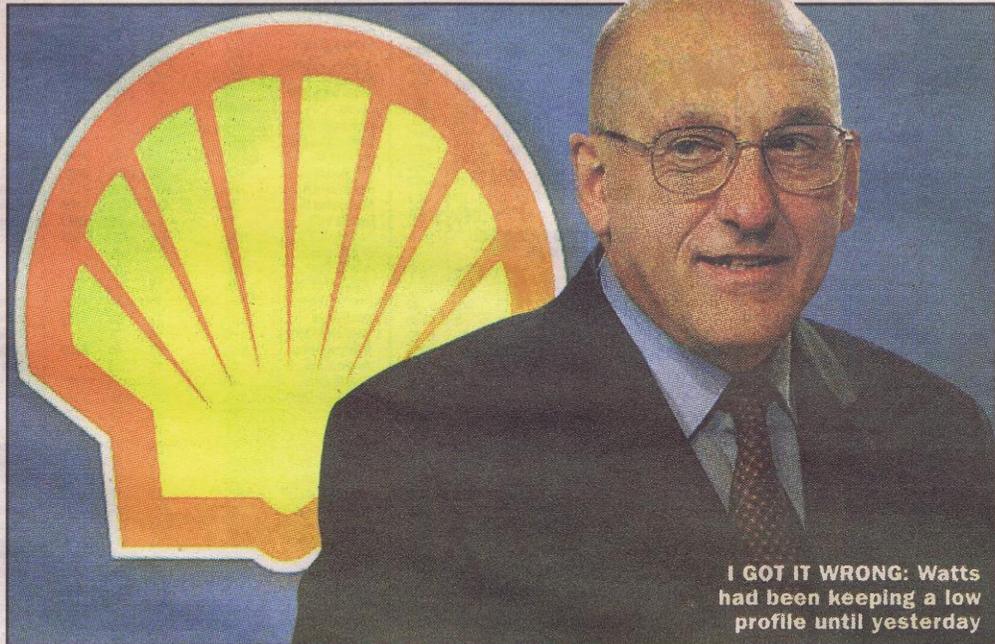
"January 9 is seared into my memory," Watts told a packed results meeting. "Why was I not here? I can come up with a number of perfectly logical explanations.

"But the fact of the matter is, knowing what I do now, it was a mistake. I am sorry I was not there and that's an unqualified apology. I got it wrong.

"No, I won't resign because I'm determined to fix the situation and pursue the strategic changes we have started."

Investors have demanded Shell reforms a complicated management structure to a normal board with a chief executive and chairman.

Watts, who is due to retire



I GOT IT WRONG: Watts had been keeping a low profile until yesterday

in 2005, said he would be spending the next two or three weeks talking to shareholders about their concerns.

One analyst expected Watts to remain in the short term but suggested he might go early in the autumn.

Watts was in charge of the company's exploration and production between 1997 and 2001, when the bulk of the overbooking took place.

Shell said reserves were overbooked because it did not have a true understanding of what was in the ground, despite partners on some projects not booking their rights as reserves.

Record results fail to impress

SHELL tried to set its woes aside by trumpeting a record set of earnings for the year to December.

Beleaguered chairman Sir Philip Watts said underlying profits were up 46 per cent to \$13 billion (£7 billion), buoyed by strong oil prices, with good incoming cashflow being used to pay down debt.

He said organic growth would be driven by higher capital expenditure. The impact of the reserves cut

was an "immaterial" \$86 million and costs had been cut by \$1 billion over the next two years.

But the company disappointed analysts by saying production growth would be flat until 2006 and results in for the fourth quarter were down 33 per cent year on year to \$1.85 billion. Analysts said the reserves cut meant the company had much catching up to do and the shares fell 7p to 358½p.

Reserves shock wipes £8bn from value of oil giant Shell

BY MICHAEL HARRISON
Business Editor

SHELL, THE world's second biggest oil and gas company, saw £8bn wiped from its market value yesterday after it stunned the industry and the financial markets by cutting its estimate of proven reserves by a fifth.

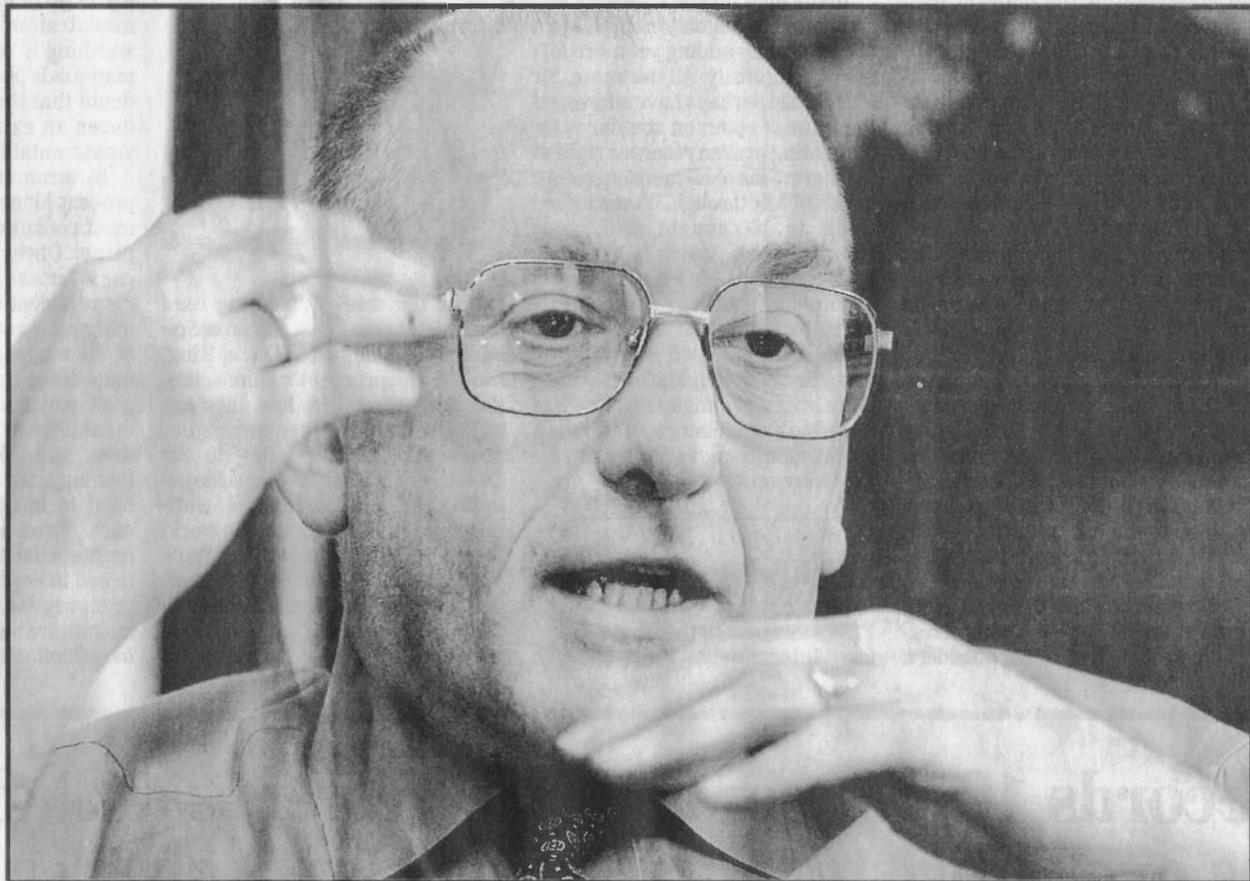
The disclosure sent shares in the Anglo-Dutch company tumbling by 8 per cent and also hit its UK rival BP, although BP said it had no plans to follow Shell's lead.

Shell said that after an internal review it had decided to "re-categorise" 3.9 billion barrels of proven reserves as probable reserves or reserves that have "scope for recovery".

Late last year the US Securities and Exchange Commission approached Shell and several other oil companies about the booking of reserves in the Gulf of Mexico. But Shell denied that this was the trigger for its review and said that less than 10 per cent of the reserves it had re-categorised lay in this region.

The company said it had decided to conduct a worldwide review of its booked reserves after a number of one-off reviews of proven reserves in particular fields. The re-classification is important because an oil company's proven reserves represent its future value and Shell said that, on this measure, it was now worth 10 per cent less on a discounted cash-flow basis.

However, Shell was adamant the cut in reserves would have no impact on its financial results for 2003, nor would it materially change the volume of oil and gas that the company ultimately expected to recover. "It is anticipated that most of these



Shell chairman Sir Philip Watts: Reputation may be hurt by 20 per cent cut in booked reserves *Financial Times*

reserves will be re-booked in the proved category over time as field developments mature," it added.

The re-classification is, nevertheless, a blow for the credibility of the company and the reputation of its chief executive Sir Philip Watts, who will present Shell's annual results to the City early next month. Industry sources said the review appeared to have been sparked by the fact that different parts of the Shell global empire adopted different standards when booking reserves. Shell itself hinted

this had been the case by saying the re-categorisation exercise would bring its global reserve base up to a "common standard of definition".

Of the 3.9 billion barrels that have been re-categorised, about half had been booked in Australia and Nigeria. Two-thirds are oil reserves and one-third natural gas. Shell said that 90 per cent of the reserves involved were in fields that had yet to be developed.

Simon Henry, Shell's head of investor relations, said that, notwithstanding the huge

extent to which proven reserves had been over-booked, none of the executives involved would be disciplined. The calculations, relating mainly to reserves booked between 1996 and 2002, had been carried out in "good faith" but now Shell recognised it had to work to tighter specifications.

Analysts were also unnerved by the disclosure that Shell is still failing to replenish its oil and gas reserves at the same rate as they are being depleted. The company said its reserve replacement ratio for

2003 would be in the range of 70-90 per cent. Mark Lanotti, of Merrill Lynch, cut his rating on Shell from "buy" to "neutral", saying: "This will be the third consecutive year that Shell's reserve replacement will be lower than 100 per cent, raising questions over the sustainability of future growth."

The market was further unsettled by a trading update from BP pointing to lower margins in its US gas marketing and refining businesses in the fourth quarter.

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Shell chairman issues an unreserved apology

By CHRISTOPHER HOPE
BUSINESS CORRESPONDENT

SIR Philip Watts yesterday issued "an unqualified apology" for not personally making Shell's shock announcement that it was cutting its proven reserves by 20pc and admitted he had considered resigning over the matter.

The chairman of Shell's committee of managing directors also revealed the company had exaggerated its proven reserves for at least 10 years and announced two inquiries into the way it accounts for them.

Sir Philip said he would be meeting Shell's investors over the next four weeks to "hear at first hand" their concerns, which have included demands for changes to Shell's complex corporate structure.

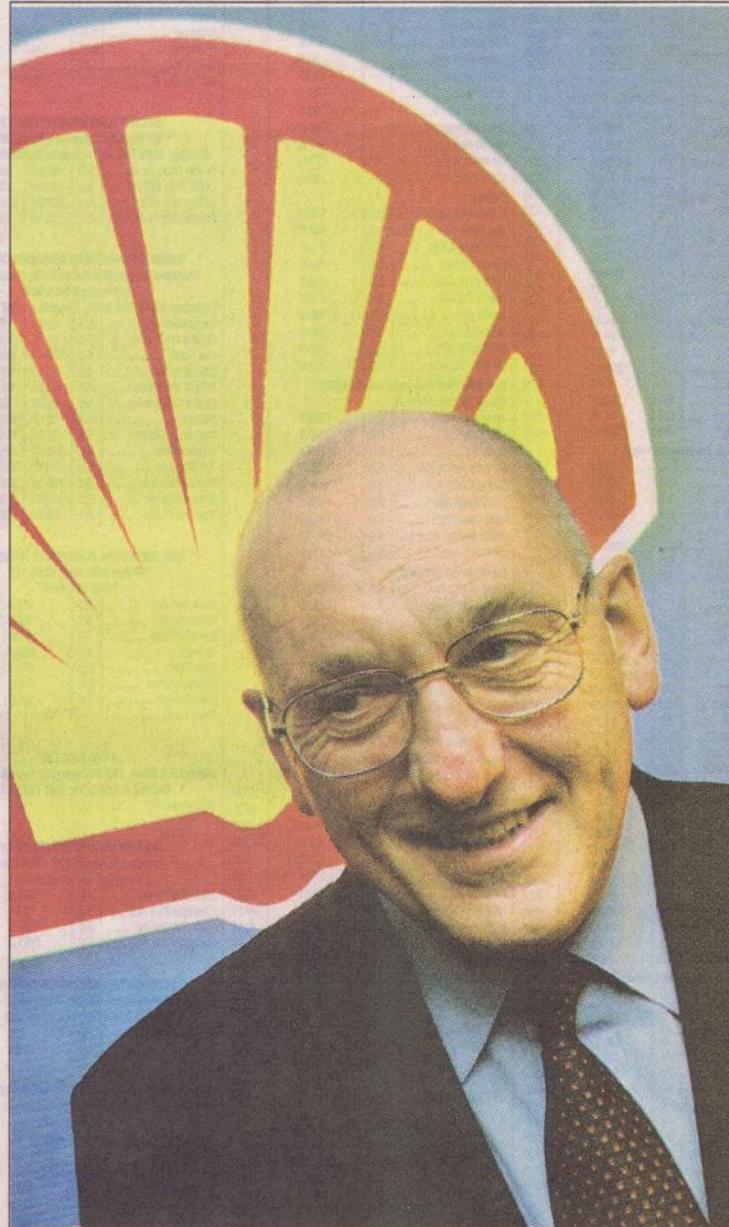
The surprise news on January 9 that Shell had overstated its proven oil and gas reserves by 3.9 billion barrels of oil equivalent (boe) sent the shares tumbling by 8pc.

Sir Philip and Judy Boyton, the finance director, were heavily criticised for not facing analysts and journalists on the day. Speaking at Shell's 2003 results presentation yesterday, a chastened Sir Philip said the day was "seared into his memory". He said: "It was a mistake not to be there. I regret that and I am sorry that I was not there. That is an unqualified apology. I got it wrong. That is the reality that I face."

Shell had been wrongly classifying some of its reserves since before 1994. About one third came from Nigeria, with the rest from Australia, the Middle East and Norway among others. Sir Philip ran Shell's operations in Nigeria from 1991 to 1994. He was head of exploration and production from 1997 to 2001, when he became chairman.

He said the recategorisation as proven of 600m boe from Australia's Gorgon gas field in 1997 was "an embarrassment". The company never admitted the reserves were proven until last month.

Sir Philip said that he had considered resigning. He said: "I



‘It was a mistake not to be there. I regret that and I am sorry that I was not there. That is an unqualified apology. I got it wrong. That is the reality that I face’

**Shell chairman
Sir Philip Watts
yesterday**

came to my own personal decision that I should not do that. This thing has happened on my watch. I am very determined to see it through this difficult patch."

No Shell employee has quit over the affair. Sir Philip did not criticise any employees, saying: "Judgments made then would probably not be made today."

Shell said that the impact on earnings would be \$86m, with

85pc of the reserves likely to be reclassified as proven over the next 10 years. It should replace more than 100pc of its reserves for the next five years. Production will be flat for 2004 and 2005, and growing in 2006. Sir Philip said Shell's non-executives would be canvassing support among investors for change to its structure. The company has boards in Britain and the Netherlands, as well as a com-

mittee of managing directors. He said: "We need to think hard about the group's structure."

Shell posted fourth quarter pre-tax profits of \$3.94 billion, down 7pc because of a \$984m exceptional hit, on turnover ahead 13pc to \$68.7 billion.

For the year to the end of December, pre-tax profits were up 35pc to \$23.2 billion on turnover of \$269.1 billion. Shell's shares closed down 7 at 358.5p.

Picture: GETTY IMAGES



RACING TO COURT: A class-action suit against Shell, sponsor of the Ferrari Formula One team, has started in the US

Shell's Watts sued in oil reserves row

OIL giant Shell and boss Sir Philip Watts came under further shareholder fire yesterday when a class action lawsuit was filed alleging the company deliberately overstated its oil and gas reserves.

The suit — filed in a US court by law firm Milberg Weiss Bershad Hynes & Lerach — alleges the company had “deliberately violated accounting rules and guidelines”.

Milberg Weiss launched the action after Shell said proved reserves of 3.9 billion barrels, or 20 per cent of the total, had been “recategorised” after a review.

Shell shares plummeted 30p to 371¼ on the day the news broke. The life of Shell's

By Andrew Johnson

reserves dropped from 13.4 years to 10.6 years as a result of the overstatement and the shares closed down 2¼p at 359½p yesterday.

Milberg Weiss claims the overstatement was not a result of “error or accident” but that reserves were “knowingly overstated” to preserve the company's credit rating and to shore up its competitive position.

The suit also names Shell chairman Watts as a potential defendant, along with other senior company directors and executives.

Milberg Weiss is attempting to find shareholders to support the action and asked for share buyers between

December 3, 1999, and January 9, 2004 — the date the overstatement was disclosed — to come forward. It said the disclosure of the reserves overstatement had “damaged purchasers of Shell Transport securities and rocked the investment community”.

Shell attempted to calm investor fears over its position when it announced the cut to reserves, arguing the oil or gas was still in the ground or under the sea but could no longer be counted as “proved” under US rules.

The statement announcing the reserves cut led to further calls for Watts's head.

But Shell non-executive directors are not thought



WATTS: Investors have been calling for his head

likely to force Watts to stand down before he reaches the compulsory retirement age of 60 in June next year.

However, the company is considering changes to the group's complicated board structure.

...AND HERE'S ANOTHER FOR THE HIGH JUMP

SHELL SUED



Oil slick . . . boss Sir Philip

OIL giant SHELL and its chairman Sir Philip Watts are facing a damaging lawsuit in the US.

A group of shareholders have accused Shell and its sister company, **ROYAL DUTCH**, of deliberately breaking accounting laws.

Also named in the action are chief financial officer Judy Boynton and **LLOYDS TSB** chairman Maarten van der Bergh, a former Shell managing director.

The legal move follows

Shell's admission less than three weeks ago that its oil and gas reserves were a fifth smaller than thought.

That sparked a plunge in Shell's share price which wiped £2.9billion from the company's stock market value.

The lawsuit piles more pressure on Sir Philip, who has been slammed by some shareholders for not speaking publicly on or after the admission.

The claim for damages — which could run into hundreds of millions of pounds — was filed in New Jersey late on Friday by law firm Milberg Weiss Bershad Hynes & Lerach. The

writ says: "The complaint alleges that defendants deliberately violated accounting rules which resulted in a shocking and unprecedented overstatement of oil and gas reserves.

"The eventual disclosure damaged purchasers of Royal Dutch and Shell Transport securities and rocked the investment community."

Sir Philip *did* write to staff last week saying: "I know there is significant concern and, in some quarter, outrage . . . but we did achieve the objective of giving the facts unclouded by personality."

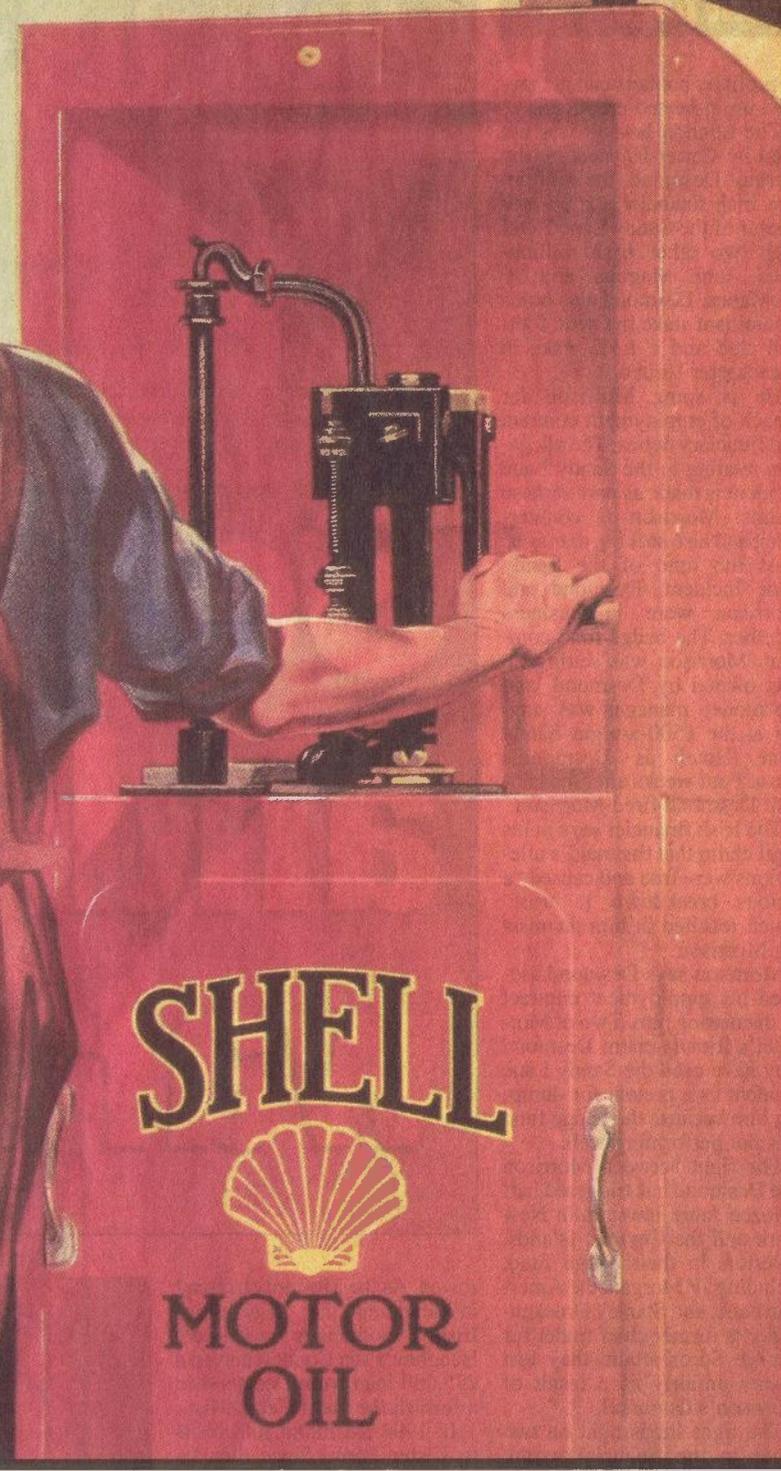
The shares fell 2.25p to 359.5.



Shell in hell

The oil giant has been heavily fined for overstating its reserves, but now looms the prospect of law suits against the individuals involved. **Sylvia Pfeifer** reports

You ~~can~~ can't
be sure
of SHELL



SHELL

**MOTOR
OIL**

Tommy

Shell pumps in £25bn to restore reputation

Training is the key to avoiding new fiasco

OIL GIANT Shell is to step up investment by 20 per cent to \$45 billion (£25 billion) for the next three years in a major shake-up designed to restore the group's battered reputation.

More than \$34 billion has been earmarked for the group's exploration and production arm, the division at the centre of the scandal which saw nearly 4.5 billion barrels wiped off the Anglo-Dutch oil giant's reserves.

The focus is on bringing oil and gas fields on line and turning potential into production. However, \$4.5 billion will be spent searching for oil resources, an area in which Shell has under-invested until recently.

Executive chairman Jeroen van der Veer said yesterday the group hoped to finance the programme with \$12 billion from disposals and extra cash generated by the present high oil price.

Shell will also merge its oil products and chemicals arms to help make cost savings.

Investors were underwhelmed. The shares fell 14½p to 418p as analysts complained about a lack of information on share buybacks and fretted over the increased investment, which could mean less money for shareholders.

Van der Veer said the company's break-even price for a barrel of oil had increased from

By **Andrew Johnson**

\$20 to \$25, which he felt acceptable given historically high oil prices.

Significant growth in output is not expected to kick until 2009, with next year seen as a "low point".

The reserves fiasco led to a board shake-up, with van der Veer's predecessor, Sir Philip Watts, and exploration boss Walter van de Vijver losing their jobs. "I wish we had not had to go through the past six months — crisis is not the best way to operate," van der Veer said.

"However, we are where we are and we will use this as an opportunity to show what we can do."

Much depends on the new production chief Malcolm Brindred. He said the firm had cut the number of countries where it has a presence from 40 to 25.

Short-term production will be driven by oil fields in West Africa, the Middle East and North Sea, later shifting to Sakhalin, off the Russian East coast, central Asia and the Asia-Pacific region.

He said Shell had possible reserves in oil and gas of up to 60 billion barrels but admitted some of the short-term replacement of actual reserves would come from rebooking reserves wiped off by the scandal.



OPPORTUNITY: Van der Veer hopes to turn crisis into a coup

SHELL has so far trained more than 2,000 staff to ensure the way they book future oil reserves will meet regulations laid down by the US watchdog, the Securities and Exchange Commission.

Exploration and production chief Malcolm Brindred said the group also planned to have more than 3,000 employees versed in SEC compliance tactics by the end of this month.

It was a failure to comply with SEC guidelines, partly the result of slack internal and external controls, that led to the shock reserves downgrade earlier this year.

The firm has also hired a series of external reserves auditors to ensure the debacle will not happen again.

However, Shell had no news yesterday on the biggest changes of all — in the company's complex, three-board structure. Shareholders want a single board with clear lines of accountability.

Jeroen van der Veer, executive chairman, said a "unified structure" was one of the options the company was considering, adding: "There are different ways of unification." The group is expected to reveal its plans in November.

The Financial Services Authority said it was "confident" it had followed the right guidelines in fining Shell £17 million for market abuse earlier this year.

Investors howl for Shell's blood

By John Phaceas

OIL giant Royal Dutch Shell is again expected to come under immense pressure this week from investors around the world after Friday's shock revelation it had slashed its oil reserve estimates by 20 per cent.

Shell, which owns 24 per cent of Woodside

Analysis

Tarnished Shell seeks to be born again

Tim Webb on the oil giant's attempts to put scandal behind it and give itself a facelift

Shell is expected to outdo its rival, BP, when it announces higher third-quarter earnings this week. In fact, it has already earned more than BP this year, which isn't bad for such a "troubled" company.

It underlines the fact that the Anglo-Dutch company has continued to perform financially despite spending most of the year mired in controversy. This is the same Shell which in the past six months has seen its chairman, exploration chief and finance director leave after a fifth of its proven oil and gas reserves were found to be wrongly booked. And it is the same company whose new chairman, Jeroen van der Veer, vowed last month at its annual strategy meeting: "Much more needs to be done. We are driving Shell to be a different company."

So why is the oil giant – motto, "You can be sure of Shell" – changing and what will the "new Shell" look like?

One of the biggest problems facing Shell is how to replace the oil it is pumping. After it downgraded four billion barrels of "proven" oil and gas reserves to "probable", the company was left with one of the lowest reserve replacement ratios among its peers. Since 1999, excluding reserves from companies it bought, it has averaged less than 100 per cent replacement; last year it was 80 per cent. This means that it is selling oil faster than it can find it. In effect, the company is shrinking. By comparison, BP's ratio has been comfortably over 100 per cent over the last five years.

Peter Hitchens, an analyst from the French stockbroker Cheuvreux, says that the problems date back to the late 1990s when Shell cut exploration spending. "As a result, it could not find enough reserves and could not meet its production targets," he says.

Rather than massaging the figures, as his predecessor had, Mr van der Veer promised "actions and urgency" to solve the reserves problem. Disposals would raise up to \$12bn (£6.6bn) by 2006 and capital spending would be boosted to \$15bn per year over the next two years from an original budget of \$12bn,



Venus rising: by selling up to \$12bn in assets and ploughing the money into major exploration projects, the Anglo-Dutch oil company hopes to regain its faded charm. But it still has a lot of catching up to do

STEVE CAPLIN

most of it on exploration and production. This is around four times the amount earmarked five years ago and the same spending level as US oil major Exxon Mobil, which is a third bigger than Shell.

'Shell directors have spent the last year reading the newspapers about how bad they are'

Mr van der Veer also promised the money would be spent differently. Rather than drilling smaller wells in more areas, exploration would concentrate on "big cat" discoveries, he said. In future, it will focus on West Africa, and in particular Nigeria, Russia and the Middle East, as well as on deep well drilling and liquefied natural gas. It is selling out of country positions where the deposits are smaller – Thailand, Angola, Sweden and Spain.

Andrew Archer, an analyst at Commerzbank, argues that it is more a case of tidying up rather than a radical departure from the past. "The worry is that it's not going to be a very 'new Shell'. It's much more a case of trying to catch up with its peers. They are trimming and tidying where they can."

Mr van der Veer said that reserve replacement would average at least 100 per cent until 2008, hardly an ambitious goal but if met, much improved on recent performance. Production, he said, would be little more than flat, giving a range of between 3.8 million and four million barrels of oil a day by 2009, after falling next year.

With production this year at a maximum of 3.8 million barrels a day – and the company's recent appalling track record for meeting targets – some analysts are sceptical even that current levels can be maintained. Not alone in seeing production growth falter, Shell will give more specific production targets with its full-year results early next year. Tellingly, however, the official presentation did not mention the word "target".

Shell has also given itself more flexibility by raising its oil price assumptions – the price of oil it assumes when it decides whether a project would be economic – to \$25 per barrel on the back of record crude prices now above \$50. This is higher than companies such as BP and ENI and Total, which have also raised assumptions, and will

allow more exploration projects to go ahead. Ron Mobed, the president of consultancy IHS Energy, says that since oil companies raised their assumptions this year, he has already seen an increase in requests for data on new areas, suggesting that it is already having an effect.

Mr Hitchens says that the bar has been left deliberately low by new executives to manage expectations and avoid more missed targets. He points to the relatively high \$1.20 per barrel finding cost as an example of targets that are "verging on the ridiculous". "Shell directors have spent the last year reading the newspapers about how bad they are," he says. "The last thing they want to read is that they have failed again."

Mr van der Veer's caution is understandable. Oil exploration and production require billions of pounds of investment and it takes up to a decade for some fields to come on-stream. Analyst JJ Traynor from Deutsche Bank says Shell has had some exploration successes this year. But there is no quick fix to its predicament of lagging reserve replacement and minimal production growth.

Mr Archer adds: "The problem Shell faces is that, despite big projects coming on-stream towards the end of the decade, there is nothing which will fill the near-term production gap over the next four years." One thing you can be sure of: this supertanker will take a long time to turn around.

SELL-OFFS WILL OIL THE WHEELS

Shell plans to raise between \$10bn (£5.5bn) and \$12bn from disposals in the next two years. It has already identified \$8bn of non-core or underperforming assets to sell, and wants to raise another \$5bn by selling off smaller and mature oil and gas fields. More businesses could be sold as new finance director Peter Voser only arrived this month.

BASELL

What is it? A chemicals company which Shell owns with German company BASF. **How much is it worth?** Shell's 50 per cent stake is worth around \$3bn.

Shell, which said it was reviewing "strategic options" for the venture with BASF over the summer, could also float Basell. But following strong

buyer interest – first-round bids were tabled a fortnight ago – a sale early next year appears the most likely option.

INTERGEN

What is it? A global power-generating business, owning or building power stations which generate 16,000 MW. Another joint venture: Shell owns 68 per cent, with US conglomerate Bechtel owning the rest.

How much is it worth? Shell's stake could fetch \$2bn.

LPG DIVISION

What is it? LPG stands for liquefied petroleum gas, a clean-burning gas, usually bottled and used in cooking and heating systems. Shell produces and distributes LPG.

How much is it worth? Around \$4.4bn.

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Shell moves to unify boards and look at merger

By Carola Hoyos and James Boxell in London and Ian Bickerton in Amsterdam

Royal Dutch/Shell, the energy group, has reached a preliminary agreement to unify its two boards and has hired bankers to assess the feasibility of merging its Dutch and British holding companies.

The review, advocated by several important members of Shell's steering committee, goes beyond investors' expectations. The advocates of reform are pushing for a "root and branch" restructuring, including consideration of a full merger, to restore the company's credibility. They see less resistance than they had expected for their proposals.

Royal Dutch/Shell at present is made up of Royal Dutch, the Dutch holding company controlling 60 per cent, and "Shell" Transport and Trading, the UK side controlling the remaining 40 per cent. The two companies have separate main stock exchange listings in Amsterdam and London.

Informal agreement has been reached by members of the boards that the least Shell needs to do is to unify its boards. But any formal decision about the

OIL PRICES KEEP RISING

Oil prices rose further yesterday despite an assurance from Saudi Arabia, the world's largest oil exporter, that it could immediately tap spare production capacity of about 1.3m barrels a day and that its oil installations were well-defended, write Kevin Morrison and Henry Tricks.

New figures showed global oil demand was stronger than expected, while US inventories had fallen. Meanwhile, tropical storms in the Gulf of Mexico forced many operators to suspend production.

US benchmark crude futures closed up 31 cents at \$44.83 a barrel while Brent crude hit a record high of \$41.70.

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unification, and other proposals, would need the vote of both boards and an agreement at next year's AGM.

Some legal experts in the UK and the Netherlands, and some advocates of the reform, believe closer alignment of the two com-

panies, rather than a full merger, could be Shell's best option.

Shell in January revealed it had wrongly booked more than 20 per cent of its oil and gas reserves with the US Securities and Exchange Commission. Shell is also under pressure because it lags behind its peers in its fundamental business of finding and producing oil and natural gas.

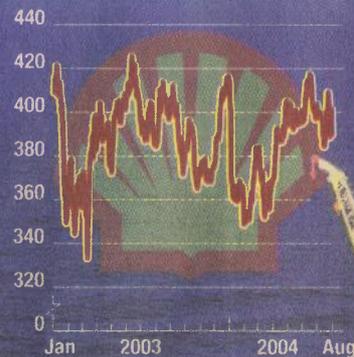
After months of pressure from investors, rating agencies and regulators, most investors had expected that the world's third largest energy group would at most unify its Dutch and UK supervisory boards.

But people close to the discussions say far more is seriously considered – although the details of the reform, the most ambitious in the company's 100-year history, have still to be determined. They also say that the working group advising the steering committee about how the reform would work and on the implications – especially in terms of Shell's international tax burden – has not yet completed its work.

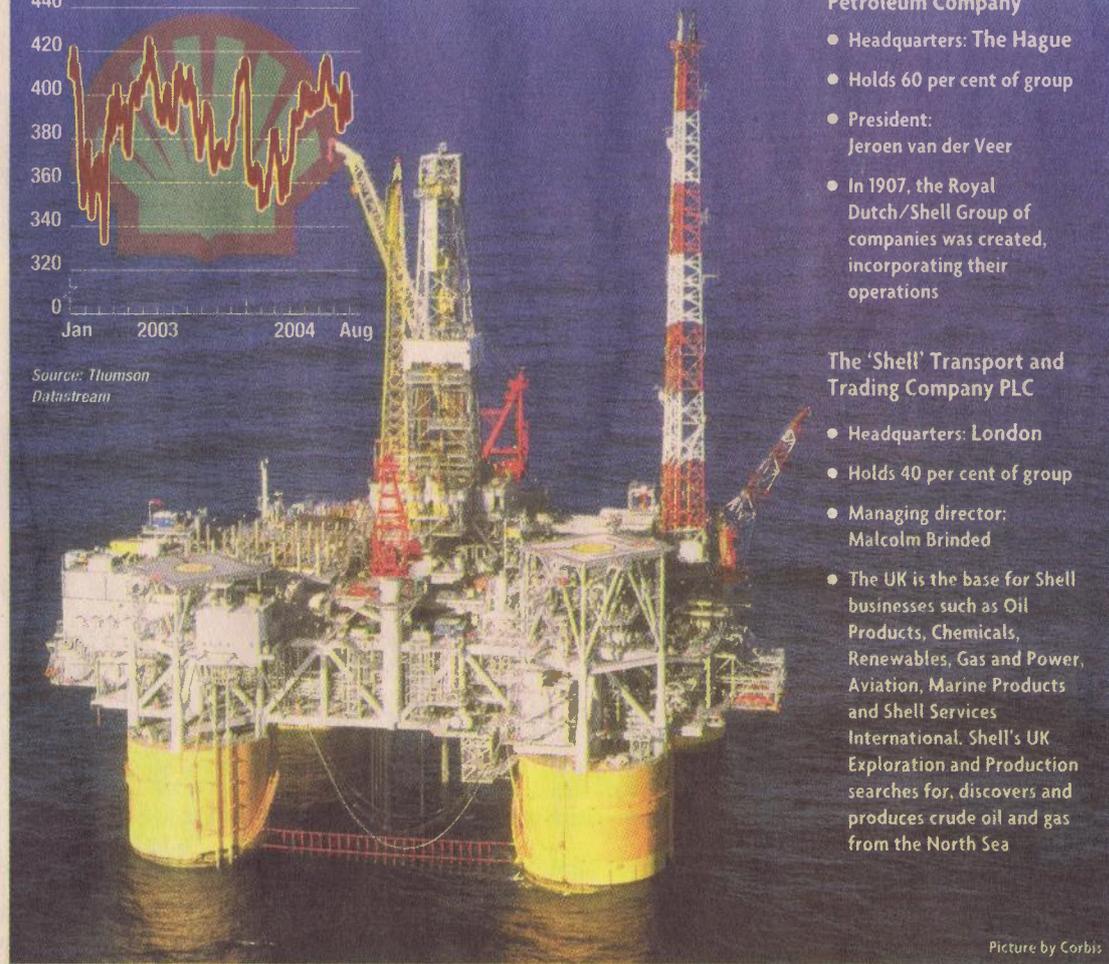
Some UK board members are pushing for a 50/50 structure, which would deprive their Dutch counterparts of what amounts in effect to a veto over important decisions of the group.

Sea change

Share price (pence)



Source: Thomson Datastream



Picture by Corbis

Royal Dutch Petroleum Company

- Headquarters: The Hague
- Holds 60 per cent of group
- President: Jeroen van der Veer
- In 1907, the Royal Dutch/Shell Group of companies was created, incorporating their operations

The 'Shell' Transport and Trading Company PLC

- Headquarters: London
- Holds 40 per cent of group
- Managing director: Malcolm Brinded
- The UK is the base for Shell businesses such as Oil Products, Chemicals, Renewables, Gas and Power, Aviation, Marine Products and Shell Services International. Shell's UK Exploration and Production searches for, discovers and produces crude oil and gas from the North Sea

Details of the reform, which would take three to five years to complete, according to its advocates, are expected to be made public in November.

A person close to the talks said: "This is not a straightforward exercise. The current corporate structure has been in place for 100 years. If you want to play

around with it, make more solid the relationship between the two, it requires quite a bit of work."

Jeroen van der Veer, the group's chairman, said recently the review committee was still examining drastic options.

Shell last month settled its dispute about its reserves booking with the SEC and the Financial

Services Authority, the UK regulator, and agreed to pay \$151m.

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Newsfile: www.ft.com/shell