

FO-CI / NL / O / 1


PARFG

Clex  
Lawson

PART G

**CONFIDENTIAL**  
(Circulate under cover and  
notify REGISTRY of movement)

PO -CH /NL/0187

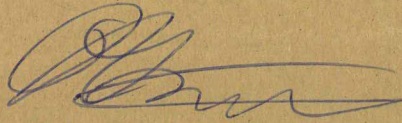


PART G

Begin: 10/11/88

DD: 25 years

Ends: 21/12/88



6/9/95

CHANCELLOR'S 1988 PAPERS  
ON THE SHIPBUILDING  
INDUSTRY

PO -CH /NL/0187  
PART G



SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

*DMP*

The Rt Hon Tony Newton OBE MP  
Chancellor of the Duchy of Lancaster  
and Minister of Trade & Industry  
Department of Trade & Industry  
1-19 Victoria Street  
LONDON  
SW1H 0ET

CHIEF SECRETARY	
REC.	10 NOV 1988
ACTION	Mr Guy
COPIES TO	Mr FSI, Sir Middelton
	Mr Booth, Mr Monck, Mr Moore,
	Mrs Brown, Mr Waller, Mr Am White
	Mr Rutnam, Mr Call

10 November 1988

*Dear Tony,*

Thank you for your letter of 31 October.

I am glad that you are confident you will be able to meet my concerns, and, like you, I hope the issue will not arise. I should perhaps clarify the point that I am already supporting through my own programmes a wide range of remedial measures in areas where British Shipbuilders have had a presence. The particular point that I was concerned about in my letter of 18 October was the likely reaction in Scotland to new measures made available exclusively to redundant British Shipbuilders' employees in Sunderland through British Shipbuilders. If you choose this route my feeling is still that there may be pressure, through British Shipbuilders and their former employees in Scotland, for equivalent measures to be made available, in addition to the remedial measures not specific to British Shipbuilders which I am already supporting through my programmes. If there is such concern, all I would be able to do would be to refer representations to you, making clear that I have no Ministerial responsibilities for British Shipbuilders.

Copies of this letter go to the Prime Minister and members of E(UP) and to Sir Robin Butler.

*Yours ever,*  
*Malcolm Rifkind*

**MALCOLM RIFKIND**

PP3-P1

FROM: MRS T C BURNHAMS  
DATE: 11 NOVEMBER 1988

1. MR WHITE  
2. FINANCIAL SECRETARY

cc Chancellor  
Chief Secretary  
Mr Anson  
Mr Monck  
Miss Peirson  
Mr Call

**JAMES MACKIE AND SONS LTD**

Mr Viggers letter of 7 November confirms that Mackies' Trustees have accepted in principle Howdens' offer, and detailed negotiations are taking place with a view to an exchange of contracts by mid-December.

2. The letter simply informs you of the latest position with regard to a private sector takeover of the company and requires no decision at this stage; although Mr Viggers does give warning that he will be seeking a swift response once all the formalities have been disposed of. No new information is available about the £18.75 package of assistance that Howdens require and the basis is expected to remain as set out in annex 1 to my minute of 7 November. IDB are unlikely to have completed their assessment of Howdens' application for assistance until well into December, and the timescale Mr Viggers is aiming for, which requires a final decision before Christmas, will be very tight. Much will depend on IDB's verdict on Howdens plans for Mackies and there is nothing we can do until their work is completed.

3. You are due to meet Mr Viggers to discuss NI issues, including Mackies, shortly and I would recommend that no reply is therefore necessary to this latest letter.



TERESA BURNHAMS



# DEPARTMENT OF ECONOMIC DEVELOPMENT

NETHERLEIGH

MASSEY AVENUE

BELFAST

BT4 2JP

09 NOV 1988

Telephone 63244

COMMERCIAL IN CONFIDENCE

The Rt Hon Norman Lamont  
Financial Secretary to  
Treasury  
Treasury  
Parliament Street  
LONDON SW1P 3AG

FINANCIAL SECRETARY	
REC.	9 NOV 1988
ACTION	MK. A. M. White
COPIES TO	PPS, CST
	Mr. A. B. March
	Miss. Penison
	Miss. Buckenham

7<sup>th</sup> November 1988

*Dear Norman,*

**JAMES MACKIE AND SONS LIMITED**

I wrote to you on 27 October to update you on the position on Mackies. *MK Call*

Since then I have met the Mackie Trustees who have confirmed that they have accepted in principle the offer from Howdens, and have turned down an initial offer from Lummus, though they have not closed the door entirely on a further approach from Lummus.

The Trustees have agreed a broad timeframe for further detailed negotiations with Howdens with a view to exchanging contracts by mid-December when the other necessary legal processes, involving the consent of the Mackie workforce and the approval of the Court for the sale of the company, will be invoked. At the same time Howdens are preparing a detailed business plan which they intend to submit to the IDB by 21 November. When this has been fully appraised by IDB and consultations completed at official level I would hope to be in a position to refer the proposal to Treasury colleagues for final decision. It is important that Government should reach a decision on Mackie within a timeframe which fits the expected pace of developments between Howdens and the Mackie Trustees. We therefore aim that this should be achieved before the Christmas break.

You are already aware of the preliminary discussions we have had with Howdens in relation to the dowry concept proposed by the Chancellor. These discussions are continuing on the basis of a dowry package of assistance of some £18.75m which is judged to be the minimum necessary to secure their interest, as described in my letter of 5 October. This compares with the £22m initially requested by Howdens and it also keeps us within current NGE ceilings for Northern Ireland thus avoiding potential EC complications. We are liaising closely with FCO and DTI on this aspect.

COMMERCIAL IN CONFIDENCE

COMMERCIAL IN CONFIDENCE

I will keep colleagues closely informed as our negotiations with Howdens continue, with the overall aim of reaching a final decision (conditional only upon the approval of the workforce and the Court) and announcement on the Mackie situation before the start of the Christmas holiday period.

*Yours ever,  
Peter.*

**PETER VIGGERS MP**  
Parliamentary Under  
Secretary of State

COMMERCIAL IN CONFIDENCE

The Rt. Hon. Tony Newton OBE, MP  
Chancellor of the Duchy of Lancaster and  
Minister of Trade and Industry

Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AQ

CHIEF SECRETARY	
REC.	11 NOV 1988
Mr Guy	
: CRIST, Sir PM DOCKET	
Mr Adams, Mr Mason, Mr Moore	
Mrs Brown, Mr Waller, Mr Ar White	
Mr Roman, Mr CAC	

Department of  
Trade and Industry

1-19 Victoria Street  
London SW1H 0ET

Switchboard  
01-215 7877

Telex 8811074/5 DTHQ G  
Fax 01-222 2629

Direct line 215 5147  
Our ref  
Your ref  
Date 11 November 1988

Dear Chief Secretary,

## BRITISH SHIPBUILDERS

My letter of 3 November reported two significant developments on the future of North East Shipbuilders Limited: interest by a Japanese group in acquiring the yard; and attempts by Lloyds Bank to restructure a consortium bid, possibly including a Tate and Lyle interest, and centred on a potential order from Cuba. At my request, John Lister has been urgently pursuing both of these developments in the course of this week.

Tate and Lyle proved not to have any interest in joining a consortium or in becoming involved in any other way with NESL. Lloyds Bank have been holding further talks in Havana on the possible Cuban order. I have ensured that our Embassy represented us at these talks which will not be completed until next Monday. No further information has emerged on the price they would be prepared to pay but both John Lister and I are sceptical that there is any price which BS could meet. The Cubans have indicated they are flexible on delivery dates and are prepared to move quickly to secure a deal this year. On the other hand it is highly implausible that firm contracts with a new owner for the yard could now be signed by the end of the

year when there is a strong likelihood that the level of Intervention Fund support permitted under the Sixth Directive will be reduced from the present 28% to, say, 23%. This would of course make it even less likely that a UK yard could take the order.

I have to conclude, in the light of these developments, that there is a risk that the Cubans are "playing politics" and will do what they can to make it difficult for me to take a final decision. In the meantime, however, there is a difficult presentational point. The Lloyds Bank representative will not be returning from Havana until Tuesday 15 November. I fully expect that, whatever I try to say in a Statement before then, they will seek to contradict on the basis of their detailed information from the talks. This points towards not taking a final decision at this stage.

The strength of the Japanese interest is also unclear. John Lister has been doing his best to get a feel for how committed they might be. He has now written to me saying that his representative in Tokyo has reported to him that the company remains very interested in pursuing a way of taking a major interest in NESL and is hopeful that we will have a formal letter from the President by Monday 14 November confirming this. John Lister's own view is that the Japanese are more than interested but, unless and until a letter is received, he cannot be more precise.

In the light of these developments, I have been considering the Statement I should make to the House on 14 November. I am in no doubt that I have to make a Statement that day. There has been considerable speculation about what has happened to the bids that have so far been submitted and I have previously undertaken to keep the House informed. With prorogation imminent, I feel I have to report the position. Moreover, there is very good news to report on progress with disposals of the other remaining BS facilities.

I have previously stated that I am concerned to ensure that every avenue for selling NESL has been fully explored. I think it would be indefensible, particularly in the light of John Lister's letter to me, not to establish how interested they were before taking a final decision. As I said in my previous letter, if the Japanese interest does prove to be serious then sale to them could well cost less than the total cost to the Exchequer of closure of NESL. As I have also mentioned, there is a difficult presentational point with respect to the position on Cuba. I have therefore decided that my Statement on 14 November should leave open the Japanese option. I shall not be announcing closure.



I attach a copy of my draft Statement on which I would welcome your comments. As you will see, despite the interest that has so far been shown, my assessment is that there can now be little doubt that at least some of the NESL facilities will close. I have also restated my commitment to BS not being allowed to take the Cuban order whilst NESL remains in public ownership.

I should also mention that my Department was today approached by Mr Ian Sproat asking whether we would consider a bid from "a UK blue-chip company" for NESL. He has since been trying to contact John Lister. Without knowing a lot more of the detail, I am rather sceptical that this will amount to a firm proposal but, while discussions are continuing with the Japanese, I do not think it would be right to rule it out. I do not of course wish to refer to this approach in the Statement. It is therefore drafted in terms of my having agreed that John Lister could consider any new bids from other sources. I have made clear to John Lister, however, that I certainly do not see this as the start of another lengthy bidding process and that he needs to establish, as quickly as possible, whether he can move to a preferred bidder stage with any of the current interests, including the Japanese.

I am copying this letter to the Prime Minister, Norman Fowler, Malcolm Rifkind, Tom King, Nicholas Ridley and John Wakeham and to Sir Robin Butler.

*Yours sincerely,*

*Peter Smith*

?? TONY NEWTON

*(Approved by the Chancellor  
and signed in his absence)*

## DRAFT STATEMENT ON BRITISH SHIPBUILDERS

With permission, Mr Speaker, I wish to make a statement on progress in returning British Shipbuilders to the private sector.

The Government's policy was set out clearly by my predecessor, my Rt Hon and Learned Friend the Member for Rushcliffe, in his statement to the House on 18 April. British Shipbuilders has cost the taxpayer some £2bn since 1979. In respect of shipbuilding contracts alone, losses amount to approximately £750m, of which only £250m represents Intervention Fund subsidy within the agreed European Community limits.

The Government can see no justification for the taxpayer to continuing to bear such losses, nor any prospect of British Shipbuilders in its existing form being able to restore the yards to viability. We therefore decided to seek private sector purchasers for the yards, with any future Government subsidy limited to that provided by the Intervention Fund, currently a maximum of 28% of the cost of a ship.

When my predecessor made his statement, British Shipbuilders owned shipyards at Govan, Sunderland, Appledore and Port Glasgow, together with the Clark Kincaid marine engine

builders on the Clyde and a services subsidiary, Marine Design Consultants at Sunderland and Dundee. Together these accounted for 6,500 employees - less than 20% of total UK employment in shipbuilding, which is of the order of 35,000.

The Govan shipyard was successfully sold in August to the Norwegian group Kvaerner Industrier, which placed orders for two gas-carrying ships with the possibility of similar orders to follow.

I am pleased to announce that negotiations for the sale of Clark Kincaid to a management buy-out team has reached the stage of a Letter of Intent. This has been helped considerably by Kvaerner's confirmation, following my visit to them in Oslo two weeks ago, that they would purchase from the firm the engines for the first two gas-carrying ships to be built at Govan. I have every hope that Clark Kincaid will be successfully sold by the end of the year.

Members will also be aware that negotiations have been proceeding for the sale of Appledore to Langham Industries. Here again I am delighted to announce that Heads of Agreement have been signed today. Langham hope to place significant work with the yard, with continuing Government support under the Intervention Fund, and the long term future of the yard seems assured. I expect the sale to be completed shortly.

In the case of the Ferguson yard at Port Glasgow, I am again pleased to announce that British Shipbuilders now have a preferred bidder. The firm is Ailsa Perth Limited, who previously bought the Ailsa yard at Troon. I have asked the British Shipbuilders Chairman, John Lister, to bring these negotiations to an early, and hope satisfactory, conclusion.

Finally, I am pleased to report that four bids have been received by British Shipbuilders for Marine Design Consultants. These are currently being evaluated by BS and their financial advisers.

Mr Speaker, I turn now to the largest remaining element of British Shipbuilders: North East Shipbuilders Limited at Sunderland, consisting of building yards on either side of the Wear at Pallion and Southwick, together with Sunderland Forge Services and a fitting-out yard at North Sands.

As the House knows, BS asked for bids for NESL by 30 September. Four bids were received. These were being evaluated when, as I told the House on 26 October, one of the bidders sought at a very late stage to modify his offer. I therefore thought it right to allow a further short period for all those who had submitted bids to modify them if they wished before a final assessment was made. Subsequently, we have also given time for further talks which could affect the possibility of an order for cargo ships for Cuba, and to

clarify whether there was any real substance in a tentative indication of a new overseas interest in purchasing some or all of the Sunderland facilities.

The four original bids were carefully considered by BS and their financial advisers. I am disappointed to have to tell the House that the Chairman has recommended to me that, on financial and commercial grounds, none of them is acceptable. I have accepted this recommendation.

None of the bids has the combination of shipbuilding experience and solid financial backing which, in the Government's view, would be required to sustain a viable operation in the highly uncertain conditions of the world shipbuilding market. Each of the bids also raises specific difficulties. One of them was in practice no more than a proposal and depended on the granting of a licence for dumping waste at sea which itself would take some considerable time to resolve. Another involved making the entire workforce redundant offering only piecemeal employment thereafter. The other two, which would themselves have entailed major redundancies, required a degree of subsidy which would be highly unlikely to be permitted under the Sixth Directive.

As regards the possible order for cargo ships for Cuba, my Department was recently advised that the Cubans were looking for a tender of less than £10m per ship and that the Cubans

hoped to place an order in the very near future. Further talks took place in Havana last week at which the Government was represented. At the conclusion of those talks, there was no firm indication of any change in the Cuban position on price. As regards the timescale, the Cubans appear not to be in any hurry to place the order and may well be prepared not to do so until sometime next year.

The British Shipbuilders Chairman has advised me that, even with Intervention Fund support, the lowest price at which he would have been able to tender would have been £15m per ship, more than 50% above what the Cubans had at one stage said was their indicative price. Moreover, in the absence of any firm indication about timing, it is extremely difficult to decide how seriously the bid should be taken. I therefore have to tell the House that, as my predecessor made clear, there can be no question of British Shipbuilders taking the order and I very much doubt that any private sector purchaser would be able to do so. Indeed, one of the original four bidders for NESL has announced that he no longer wishes to be considered because he could not possibly have taken the order at this price.

This is not say that we have reached the end of the process of seeking private sector purchasers for NESL. I am able to report that British Shipbuilders have received a firm expression of interest from a major overseas industrial concern with which they have been in contact over the last

few weeks. In view of this interest, I have decided that a further period should be allowed for confidential talks to continue. I shall of course keep the House informed of progress.

While these talks are continuing, I have agreed with John Lister that he should be prepared to consider any new bids that may come forward. In leaving the door open in this way, however, I have to make clear that the view of British Shipbuilders and the Government is that it is unlikely that any successful bidder for NESL would want to keep all of the existing facilities open. This reflects the continuing strongly competitive world shipbuilding market. This is confirmed in the latest assessment by the Association of West European Shipbuilders which has revised downwards its forecast for orders in the period 1990-95 from £19m to £12.5m Compensated Gross Tonnes per year, a reduction of one third.

Mr Speaker, I regret that I am not able to give the House a definitive answer on the future position of NESL. I appreciate the concern over the continuing uncertainty, particularly on the part of those whose livelihood depends on the yards. I am sure, however, that Members will agree with me that, while there is still some hope of securing a viable long term future for the yards, we must ensure that every avenue is fully explored.

CONFIDENTIAL

FROM: W GUY

CHIEF SECRETARY

(discuss with  
Mrs Brown)

Tad BS/101

cc Chancellor  
FST  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Moore  
Mr Burgner  
Mrs Brown  
Mr Waller  
Mr A M White  
Mr Rutnam  
Mr Call

Ch.  
I understand that  
CST agrees with  
these amendments and  
has passed them on.  
at 11

BRITISH SHIPBUILDERS

1. Mr Newton's letter of 11 November covers the text of a statement which he wishes to make today about the future of British Shipbuilders. It is unacceptable in a number of ways, and I recommend that your office should seek a complete redraft reflecting the points below, or insist on the amendments marked on the attached text as a minimum.

2. The statement follows the second postponement of the expected statement on NESL since the deadline for bids was passed on 30 September.

3. The draft statement is unsatisfactory for the following reasons:-

(i) it is far too bullish about the prospects for sale of Clark Kincaid, Appledore and Ferguson. Negotiations are underway and this draft gives hostages - it would be very difficult to walk away from unacceptable demands following an announcement in these terms. We know nothing of the detail of the Ferguson bid; you have laid down strict conditions for the sale of Appledore and Clark Kincaid. It is also too early to be optimistic about bids for Marine Design Consultants.

(ii) the description of the shortcomings of bids received for NESL is unnecessary, and gives the impression that we have something in mind for it which is better than major redundancies, which we do not. Eg one bid was unacceptable because 'it involved making the entire workforce redundant offering only piecemeal employment thereafter.'

(iii) the decision not to let BS take the Cuban order is restated not as a matter of principle but as a consequence of negotiations about price which are still going on. This would open the prospect, by implication, of BS taking the order if the price were right.



(iv) The statement ends giving the impression that we are prepared to go on forever looking at late bids for NESL 'as long as there is still some hope'. This is a recipe for infinite delay. The whole point of the original 30 September deadline was to avoid this.

4. Ideally, we should have a much shorter statement saying that negotiations are underway for the minor facilities but that NESL must close. If a further delay is necessary, it should be made clear that it will be short, and related only to the latest expression of interest. You will wish to note that there is no indication yet that the latest Japanese bidder wishes to buy the yard - only to 'take an interest', which could mean anything.

5. If you agree with these points I suggest that your office speaks urgently to Mr Newton's. A letter recording them can be supplied afterwards. Mr Newton's PS rang me this morning and I confided the problems we have here at official level. He said that none of these points came as a surprise, and suggested that we should speak to DTI officials after you have seen the draft statement and our comments on it. We should be happy to do so, but you will first wish to confirm your attitude and get your views on the existing draft to Mr Newton's office.

*W GUY*

W GUY

## DRAFT STATEMENT ON BRITISH SHIPBUILDERS

With permission, Mr Speaker, I wish to make a statement on progress in returning British Shipbuilders to the private sector.

The Government's policy was set out clearly by my predecessor, my Rt Hon and Learned Friend the Member for Rushcliffe, in his statement to the House on 18 April. British Shipbuilders has cost the taxpayer some £2bn since 1979. In respect of shipbuilding contracts alone, losses amount to approximately £750m, of which only £250m represents Intervention Fund subsidy within the agreed European Community limits.

The Government can see no justification for the taxpayer ~~to~~ continuing to bear such losses, nor any prospect of British Shipbuilders in its existing form being able to restore the yards to viability. We therefore decided to seek private sector purchasers for the yards, with any future Government subsidy limited to that provided by the Intervention Fund, currently a maximum of 28% of the cost of a ship.

When my predecessor made his statement, British Shipbuilders owned shipyards at Govan, Sunderland, Appledore and Port Glasgow, together with the Clark Kincaid marine engine

builders on the Clyde and a services subsidiary, Marine Design Consultants at Sunderland and Dundee. Together these accounted for 6,500 employees - less than 20% of total UK employment in shipbuilding, which is of the order of 35,000.

The Govan shipyard was successfully sold in August to the Norwegian group Kvaerner Industrier, which placed orders for two gas-carrying ships with the possibility of similar orders to follow.

<sup>can also</sup>  
I ~~am pleased to~~ announce that negotiations for the sale of Clark Kincaid to a management buy-out team has reached the stage of a Letter of Intent. This has been helped considerably by Kvaerner's confirmation, following my visit to them in Oslo two weeks ago, that they would purchase from the firm the engines for the first two gas-carrying ships to be built at Govan. I ~~have every~~ hope that Clark Kincaid will be ~~successfully~~ sold by the end of the year.

Members will also be aware that negotiations have been proceeding for the sale of Appledore to Langham Industries. ~~Here again I am delighted to announce that~~ Heads of Agreement have been signed today. ~~Langham hope to place significant work with the yard, with continuing Government support under the Intervention Fund, and the long term future of the yard seems assured.~~ I <sup>hope that</sup> expect the sale <sup>will</sup> to be completed shortly.

In the case of the Ferguson yard at Port Glasgow, ~~I am again~~  
~~pleased to announce that~~ British Shipbuilders now have a  
preferred bidder. The firm is Ailsa Perth Limited, who  
previously bought the Ailsa yard at Troon. I have asked the  
British Shipbuilders Chairman, John Lister, to ~~bring these~~ <sup>move ahead quickly</sup>  
<sup>in the £ that</sup> negotiations to an early, and <sup>hope</sup> satisfactory <sup>terms</sup>  
~~conclusion.~~ <sup>can be secured,</sup>

Finally, I am <sup>able</sup> ~~pleased~~ to report that four bids have been  
received by British Shipbuilders for Marine Design  
Consultants. These are currently being evaluated by BS and  
their financial advisers.

Mr Speaker, I turn now to the largest remaining element of  
British Shipbuilders: North East Shipbuilders Limited at  
Sunderland, consisting of building yards on either side of  
the Wear at Pallion and Southwick, together with Sunderland  
Forge Services and a fitting-out yard at North Sands.

As the House knows, BS asked for bids for NESL by  
30 September. Four bids were received. These were being  
evaluated when, as I told the House on 26 October, one of  
the bidders sought at a very late stage to modify his offer.  
I therefore thought it right to allow a further short period  
for all those who had submitted bids to modify them if they  
wished before a final assessment was made. Subsequently, we  
have also given time for further talks which could affect  
the possibility of an order for cargo ships for Cuba, and to

clarify whether there was any real substance in a tentative indication of a new overseas interest in purchasing some or all of the Sunderland facilities.

The four original bids were carefully considered by BS and their financial advisers. I am disappointed to have to tell the House that the Chairman has recommended to me that, on financial and commercial grounds, none of them is acceptable. I have accepted this recommendation.

None of the bids has the combination of shipbuilding experience and solid financial backing which, in the Government's view, would be required to sustain a viable operation in the highly uncertain conditions of the world shipbuilding market. ~~Each of the bids also raises specific difficulties. One of them was in practice no more than a proposal and depended on the granting of a licence for dumping waste at sea which itself would take some considerable time to resolve. Another involved making the entire workforce redundant offering only piecemeal employment thereafter. The other two, which would themselves have entailed major redundancies, required a degree of subsidy which would be highly unlikely to be permitted under the Sixth Directive.~~

As regards the possible order for cargo ships for Cuba, my Department was recently advised that the Cubans were looking for a tender of less than £10m per ship and that the Cubans

A bid  
involving  
major  
redundancy  
in  
below  
proposals?

hoped to place an order in the very near future. Further talks took place in Havana last week at which the Government was represented. At the conclusion of those talks, there was no firm indication of any change in the Cuban position on price. As regards the timescale, the Cubans appear not to be in any hurry to place the order and may well be prepared not to do so until sometime next year. ←

The British Shipbuilders Chairman has advised me that, even with Intervention Fund support, the lowest price at which he would have been able to tender would have been £15m per ship, more than 50% above what the Cubans had at one stage said was their indicative price. Moreover, in the absence of any firm indication about timing, it is extremely difficult to decide how seriously the bid should be taken.

I therefore have to tell the House that, As my predecessor made clear, there can be no question of British Shipbuilders taking the order ~~and~~ I very much doubt that any private sector purchaser would be able to <sup>take the order</sup> ~~do so~~. Indeed, one of the original four bidders for NESL has announced that he no longer wishes to be considered because he could not possibly have taken the order at this price.

~~This is not say that we have reached the end of the process of seeking private sector purchasers for NESL.~~ <sup>However</sup> I am able to report that British Shipbuilders have received a firm expression of interest from a major overseas industrial concern with which they have been in contact over the last

short

few weeks. In view of this interest, I have decided that a further period should be allowed for confidential talks to continue. I shall of course keep the House informed of progress.

~~While these talks are continuing, I have agreed with John Lister that he should be prepared to consider any new bids that may come forward. In leaving the door open in this way,~~ However, I have to make clear that the view of British Shipbuilders and the Government is that it is unlikely that any successful bidder for NESL would want to keep all of the existing facilities open. This reflects the continuing strongly competitive world shipbuilding market. This is confirmed in the latest assessment by the Association of West European Shipbuilders which has revised downwards its forecast for orders in the period 1990-95 from £19m to £12.5m Compensated Gross Tonnes per year, a reduction of one third.

Mr Speaker, I regret that I am not able to give the House a definitive answer on the future position of NESL. I appreciate the concern over the continuing uncertainty, particularly on the part of those whose livelihood depends on the yards. I am sure, however, that Members will agree with me that, <sup>this further delay is justified.</sup> ~~while there is still some hope of securing a viable long term future for the yards, we must ensure that every avenue is fully explored.~~

EM2ABH

although we are reaching the end of the process of seeking a private sector ~~interest~~ purchaser for NESL

CONFIDENTIAL

The Rt. Hon. Tony Newton OBE, MP  
Chancellor of the Duchy of Lancaster and  
Minister of Trade and Industry

Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Treasury Chambers  
LONDON  
SW1P 3AG

Department of  
Trade and Industry

11-19 Victoria Street  
London SW1H 0ET

Switchboard  
01-215 7877

Telex 8811074/5 DTHQ G  
Fax 01-222 2629

CHIEF SECRETARY	
NOV 29 1988	
Mr GOS	
Mr FIRST, Sir P. M. ...	
Mr ...	
Mr ...	
Mr ...	
Mr ...	
Mr ...	

Direct line  
Our ref  
Your ref  
Date

215 5147

29 November 1988

### BRITISH SHIPBUILDERS AND THE NORTH EAST

Thank you for your letters of 26 October and 7 November. As you will have realised, your 26 October letter effectively crossed with mine of 31 October to Malcolm Rifkind.

On the 26 October letter, I am afraid we shall have to accept that a Sunderland company would be funded through British Shipbuilders. We have not been able to discover any alternative suitable powers. However, I do intend that the new company, should it be needed, will be identified as closely as possible with Sunderland and not with British Shipbuilders. I shall also seek to ensure that financial control is no less effective than that exercised directly by my Department.

On the question of who should pay for site clearance, I take the point in your letter of 7 November. My officials understand from British Shipbuilders that site clearance of previous shipyards generally pays for itself because of the high scrap value of metal clad buildings and metal fittings. For this reason it is unlikely to be the Corporation's commercial disadvantage to arrange the job themselves.

I am copying this letter to the Prime Minister, Members of E(UP), Paul Channon and Sir Robin Butler.

TONY NEWTON

EM3ACD



*Put on E(A) file*

FROM: A M WHITE  
DATE: 29 NOVEMBER

CHIEF SECRETARY

- cc Chancellor
- Financial Secretary
- Sir P Middleton
- Mr Anson
- Sir A Wilson
- Mr H Phillips
- Mr Monck
- Mr Moore
- Miss Peirson
- Mr Robson
- Mr Turnbull
- Mr Lyne
- Mr Richardson
- Mr Bent
- Mrs Burnhams
- Mr Call

*Office done  
on shorts*

<sup>50</sup>  
**E(A) (88): MACKIES, HARLAND AND WOLFF AND SHORTS**

In his paper the Secretary of State reports progress on his attempts to find a private sector purchaser for Mackies, his consideration of bids for Harland and Wolff, and makes proposals on the disposal of Shorts.

2. Detailed briefing on each of these issues is attached at Annexes 1-3. (Annex 4 provides background information on Shorts and illustrates balance sheet reconstruction as you requested). This note recommends the line you should take on each.

**Mackies**

3. You should take note. Sale to Howden's is proving a little more difficult than Mr King thought earlier, but matters are now coming to a conclusion and Treasury Ministers will be consulted on the final terms.

**Harland and Wolff**

4. Mr King has now explored, and found unsatisfactory all the external offers. The one possibility remaining is that he wishes

to pursue is an MEBO, but he does not indicate how long he wishes to defer final decisions.

5. You should argue that it is essential that final decisions are reached before steel workers are laid off next spring, with no prospect of further work in the yard.

6. To delay an announcement of a final decision beyond that point would simply add to Northern Irish pressures to sustain the yard in public ownership and risk protracted and costly delay to the two remaining orders as the remaining work force tried to spin things out.

7. It should take no more than two months for Mr King to determine whether a reasonably robust and acceptable MEBO can be constructed on the basis of a potential Sealink order. (We think this is unlikely).

8. If that cannot be made to work, then an orderly rundown and closure must be set in place. To secure worker cooperation and to mitigate the impact, proposals should now be developed by officials for a terminal bonus scheme to ensure timely delivery of the two remaining ships and a package of remedial measures to cushion the impact of closure.

9. Mr King should report back in two months time, so that agreement can be reached in time for an announcement next Spring.

10. On the cost of remedial measures, you can say that providing Mr King accepts this approach, and maintains his commitment to meet rundown and closure costs from his block up to a level of £60m a year, you would be prepared to look sympathetically at a bid to cover the cost of appropriate remedial measures, at least for that period in which he is bearing rundown and closure costs.

Shorts

11. The most difficult issue.

12. Your objectives are:-

(a) to get Mr King to agree that the company must be recapitalised before a sales memorandum is issued;

(b) to secure independent accountancy advice to determine what needs to be done by way of recapitalisation;

(c) to use that advisor to determine what configuration of the company might be disposed of at least cost;

(d) to get it established that the figure at (c) is the maximum you would be prepared to meet from the Reserve;

and (e) to seek Commission agreement to (b) so that the costs involved can be met by the Reserve in the current year.

To achieve these you need to knock down Mr King's proposals and set the Treasury approach in their place.

Against the King approach: Points to make.

a. It is unacceptable that Mr King should issue a sales memorandum seeking to sell the business as a whole without discharging the remit given to him by E(A) to report to this meeting the estimated cost of disposal.

b. Such an approach is likely to maximise the costs of disposal, and it is no good saying they are less than the costs of total closure, as no-one is arguing for total closure.

c. Even if the costs of the various options for sale in whole or in part were known and accepted Short's appalling balance sheet and weak trading position mean that attempting

sale without a capital reconstruction would be both hazardous and costly.

d. Not only would we be in a weak negotiating position with any potential purchaser, but we would have to secure EC agreement to whatever package of state aid that that particular buyer named as his price.

e. If we only invite offers for the whole we encourage any such purchaser to pitch his demands high and, if, as seems likely, no acceptable offer is made for the business as a whole that would not only be embarrassing, but prejudice the price we might then get for viable parts of the business.

f. Accept proposal for interim capital injection intended to be helpful, but would mean giving Commission two bites at the cherry which would add to difficulty and delay.

g. Approach runs unacceptable risk of loss of confidence of those doing business with Shorts either when sales prospectus issued or, more probably, when we have to admit that business as a whole is unsellable at an acceptable price.

The Treasury approach: points to make

a. Costs of various options for sale in whole or in part must be urgently established so that a rational choice can be made of affordable options.

b. Necessary information could be obtained by Touche Ross in a few weeks.

c. Way to keep company on side is to tell them Touche's work needed to establish proper basis for recapitalisation - we can give Touche hidden agenda.

d. To maximise prospects for sale recapitalisation should be final and presented to Commission as once and for all step

to be followed by disposal of the company and ending of all state aid.

e. That disposal should be at least cost to public purse on basis of Touche Ross advice on cost of potential options - and on that basis we would meet full costs from the Reserve.

f. But time is short if that is to be done this year. Touche must be put to work at once with terms of reference agreed by officials.

g. Should then be able to agree in January size of sum needed for recapitalisation and detailed approach to Commission based on disposal of Shorts at minimum cost in state aid.

h. Timetable for sales memorandum should be delayed, with company and potential purchasers made aware that this is to allow it to reflect Government proposals for recapitalisation of business. Should be possible to issue after meeting in January, with capital injection to be made if possible before end March, subject to Commission agreement.

#### Possible fallback

13. If agreement cannot be reached to this approach you could accept the proposal for an interim capital injection of £300m to be applied to repaying Shorts bank debt. But you should only accept that if it is agreed that the sales memorandum should not be issued until Touche have produced costed options for disposal.

14. Further detailed work needed on annexes to paper can be carried forward by officials in the meantime.

  
A M WHITE

**JAMES MACKIE AND SONS LIMITED**

At E(A) on 6 October Mr King was asked to report back in two months on the progress that had been made in attracting a private sector investor in Mackies. His paper brings colleagues up to date on the negotiations which have been taking place with Mackies' Trustees and the two firms who have expressed an interest in the company- Howdens and Lummus.

2. Lummus made an offer for the company, but the Trustees were unwilling to recommend this to the past and present employees of Mackies, who are the beneficiaries of the Trust. The Trustees doubted whether Lummus- a company of about the same size as Mackies- had the necessary financial strength to provide the investment necessary to give the company a viable future, and this obviously influenced their decision. The NI Industrial Development Board (IDB) shared the Trustees' misgivings about Lummus' plans for the company..

3. Discussions between Howdens-the front runners- and the Trustee are continuing. The Trustees have more confidence in the business plan Howdens have for the future shape of the company. A formal offer was made by Howdens which was thought likely to be acceptable, but this is now being reconsidered by Howdens pending a report from their accountants. The result is likely to be a lower offer for Mackie's shares; and it is also possible that the package of Government assistance that Howdens were expected to apply for (worth a total of £18.75m and made up of selective capital grants, employment grants and an up-front loan of £3m) may alter but is still likely to be within the £20m Mr King had suggested was the minimum that would be necessary to turn the company round.

4. Mr King is clearly still optimistic that a satisfactory outcome will be possible, and proposes that the matter of a dowry should be settled in correspondence between the Chancellor and himself. No action is called for until negotiations have been concluded between the Trustees and Howdens and a formal offer has been made for assistance.

**HARLAND AND WOLFF PLC**

At E(A) on 6 October Mr King was asked to report back to the Sub-Committee within two months on the prospects for the privatisation of the shipyard . In his paper Mr King explains the stages negotiations have reached with the 3 parties whom he had previously confirmed were interested in the yard, and reports on some new developments since the last E(A) meeting.

**Tikkoo Cruise Liners (TSL)**

2. As expected the counter-offer made by Mr King to TSL was not acceptable and all direct negotiations with the company have ended.

**Bulk Transport Ltd (BT)**

3. Mr King indicates in his paper that negotiations with BT are unlikely to be successful as the level of support they are seeking, for their plans to build large crude carriers in the yard, is beyond existing permitted limits and they are also seeking some sort of guarantee from the Government to enable it to provide pre-delivery recourse to lenders. It is reported in the newspapers that BT are considering a takeover bid from a Norwegian shipowner ( Bergesen ) who would not be interested in acquiring the yard- which suggests it is even more likely that nothing will come of this approach.

**UM Holdings (UM)**

4. Mr King reports that it is unlikely that an acceptable financial arrangement can be agreed with UM - a Turkish company - and there are doubts about the company's ability to finance their proposals for the yard.

**New developments**

5. The Chairman of Harland and Wolff is considering a management/employee buyout option (MEBO) but this is based on the construction of the "Ultimate Dream" in the yard .As such a project is unlikely to secure the necessary financial backing Mr

King does not regard this as a available proposition. But he wishes to see if an alternative basis for a MEBO can be developed.

6. James Sherwood of Sealink - although not interested in the acquisition of the shipyard - has written to Mr King about a possible £500/600m order for 10 ferries. Although in our view Mr Sherwood is almost certainly flying a kite, in his paper Mr King suggests that if such an order could be secured this might prove a better basis for a MEBO.

7. While an MEBO based on a Sealink contract might offer some prospect for the disposal of the yard the chance of its success does not seem high, particularly as the Chairman of Harlands is seeking a performance guarantee from the Secretary of State which would enable him to provide "comfort to lenders". Mr King proposes to pursue this option further but accepts that any financial arrangement which might be necessary to enable the MEBO to take over the yard must be within the expected cost of closure.

8. While acknowledging that closure may have to be faced Mr King asks colleagues to allow him more time to explore fully all the possibilities for the disposal of Harlands. This is acceptable, but a time limit should be agreed now.

9. While there will be some work in the yard until the completion of the AOR which is due at the end of 1990, it will be necessary to begin to lay off steel workers within the next few months as there is nothing further for them to do on the remaining orders. This will increase the rest of the work force's foreboding and unless the uncertainty is removed work on the two remaining orders could begin to slip even more badly as they try to spin work out in the hope that this will provide time for still further disposal options to be considered.

10. You should argue that consideration of possible disposals should now be brought to a conclusion - this should take no more than a couple of months - and that in parallel with this proposals for an orderly run down and closure of the yard should now be developed.



11. These should include terminal bonus arrangements to seek to ensure timely completion of the two remaining orders and a package of remedial measures which could both be included in an announcement of rundown and closure next Spring.

12. Mr King's paper raises the question of the remedial action which might be required in the case of closure; he estimates that the cost- which would be additional to closure costs- might amount to up to £100m over a period of 5 years over and above the costs of rundown and closure.

13. In an earlier paper to colleagues, Mr King had indicated that he would be prepared to meet rundown and closure costs from his block - provided that they did not amount to more than £60m a year. You should hold him to that, but indicate that you would be prepared to consider sympathetically some additional provision for remedial measures costs over the period when Mr King was meeting those rundown and closure costs. This is a generous position. Mr King has just received a good Survey settlement, enabling him to devote considerable resources to inner city regeneration in Belfast, and, of course, the costs of disposing of Shorts will also fall on the Reserve. So he should be prepared to accept this approach on meeting the costs. He will, however, be reluctant to accept that he should be tied to a timetable.

14. You should therefore make this offer conditional on an early decision to announce rundown and closure if the MEBO proposal cannot be demonstrated to provide a viable and acceptable alternative.

15. Finally Mr King's paper asks for agreement to an EFL for Harlands of £62.3m for 1988-89. This was the same proposal that he put forward to E(A) on 6 October but it was not considered at the meeting. We regard £62.3m as a realistic estimate of the end of year position and recommend that it is accepted.

**SHORT BROTHERS PLC**

At E(A) on 6 October the Secretary of State was asked to report back to the Sub-Committee within two months on the progress made in privatising Shorts, including a full description of the company's financial position, the anticipated cost of disposal, and details of any Government guarantees and Parliamentary assurances about the company's financial position which have been given. Despite our best endeavours his paper does not address these issues satisfactorily and it will be necessary to use E(A) to give direction to further essential work.

**Progress on privatisation**

2. Mr King's paper brings colleagues up to date on developments and proposes that the sale should go ahead on the basis of disposal of the company as a single unit. The sale was advertised in the press on 17 November and a sales memorandum is due to be issued on 16 December to potential purchasers who have registered an interest. Mr King's paper is silent on the cost of this option but recognises that a sale of the company as a whole may not be achieved. He proposes that only if the sale of the whole is not successful a sale of the parts will then be offered subsequently, arguing that if Government made clear it would entertain bids for parts of the business, sale prospects for the whole would be damaged.

**Financial position of the company**

3. Mr King reports the deteriorating financial situation for the company. The end year loss is now expected to be at least £75m - the fourth successive year that substantial losses will have occurred. The company has not realised expected sales, it has failed to make deliveries on orders it had, and is incurring heavy interest charges on its massive level of borrowing -standing currently at £336m.

4. This state of affairs will need to be reflected in the sales memorandum, and Kleinwort Benson the Government's advisers on the sale are not optimistic that they will be successful in finding a

purchaser who will be willing to take the company as a whole. Even if a potential purchaser were to emerge, who was willing to take the company as it stands, the price is likely to be unacceptably high and with no means of comparing any offer against the cost of other available options. There is also a risk that an unsuccessful attempt to sell the whole business will result in a loss of confidence in the company which might at worst precipitate its ultimate failure or at best increase the cost of the disposal of the component parts.

#### **An alternative strategy**

5. Mr King's proposals, while meeting the company's wish to sell the company as a single entity, place an unspecified price on the disposal of the company and seems to offer little chance of achieving a successful sale at an acceptable price. Before any commitment is given to any particular method of disposal, it is important to consider the likely cost of all the options. In addition it is necessary to have a firmly based assessment of the extent of capital reconstruction that will be required to enable the company to be saleable. None of this information is at present available and it would seem unwise to go ahead with the sale until it is.

6. I recommend that the sales memorandum should not be issued until further consideration has been given to the risks inherent in the approach Mr King favours, and that a study by a firm of accountants should be commissioned as soon as possible. While relations with the Chairman and Directors of Shorts have been strained - and they would be strongly opposed to any suggestion of a break-up of the company - they would welcome an early capital reconstruction of the company to make its balance sheet more attractive and so make it more saleable. The work should therefore be described to them as being needed to assess the costs of recapitalisation, although it should of course provide Government with the information needed to assess what the most cost effective form of disposal would be.

7. It should be possible to obtain a report by mid-January which would cost the various options for disposal, suggest the pattern of disposal which would provide the least cost option, and recommend the optimum size of capital injection necessary to attract serious purchasers -either for the whole or part of the company, and give confidence to the company's customers that Shorts can continue as a viable business.

8. This report would allow E(A) to set a cap on the cost of the privatisation within which Mr King would be required to effect a sale.

#### Capital Reconstruction

9. As the sale of Shorts will almost certainly not take place within the financial year Mr King has proposed an interim capital injection into the company of £300m. This would go some way towards meeting E(A)'s wish that if possible the cost of the sale should be met within the 1988-89 financial year when the pressures on the Reserve would be easier. It is by no means certain that £300m is the right level for an injection of cash into the company and as I have suggested above this needs to be considered urgently.

10. In addition it would be necessary to notify the European Commission of any assistance to Shorts as it would be regarded as a state aid. This is a difficult area particularly as we wish to avoid any undue delay to the sale, but the EC is likely to be more sympathetic to the proposal to reconstruct the company if we can be clear what the future plans for the company are- for example a successful sale would mark the end of any Government aid to Shorts; or if it was not possible to sell the aircraft division it would be closed rather than continue in State ownership. It would also be helpful if we could give some indication of the total assistance the Government is likely to have to provide. Mr King proposes early discussions with the EC but any decision will be taken by the new Director-General who has yet to be appointed and therefore it may be better to delay a formal Ministerial approach until further information is ready, which would allow a more developed case to be presented.

11. It may also prove more cost-effective to make a larger capital injection into the company at this stage, provided that if the sale was to prove more successful than anticipated it would be possible to claw back any excess from the proceeds. The most straightforward option would seem to be to make a new share issue which will enable the company to pay off most of its debts and to clean up its balance sheet. An application could then be made to the courts to reduce the company's share capital and steps could also be taken to reduce substantially Short's borrowing limits - presently set at £400m.

#### **Government guarantees and Parliamentary assurances**

12. Mr King's paper confirms that the overall aim must be to withdraw all Government guarantees and assurances at the date of sale but indicates it may not be possible to achieve a clean break. The guarantees fall into three main categories-

- a. bank borrowing
- b. contingent liabilities on sales financing arrangements
- c. contingent liabilities in connection with contractual obligations.

The first category is easily dealt with by means of repayment of the company's bank borrowings, but b. and c. are more difficult. If liabilities are to be avoided under c. it will be necessary to renegotiate contracts. Further work will be necessary in order to decide if it is better to retain certain contingent liabilities in order to avoid a disproportionate cost for their disposal and this will apply particularly to b.

#### **Conclusion**

13. Mr King's paper asks colleagues to note progress on privatisation; to endorse the framework for seeking proposals from offerors which will be included in the sales memorandum; and to agree to an interim capital injection of £300m.

14. In view of the disastrous financial position of Shorts, and the unquantified risks and potential costs involved if the sale

nov.68

CONFIDENTIAL AND COMMERCIAL IN CONFIDENCE

proceeds in the way Mr King proposes, I recommend that an urgent study should be made of the options for disposal, and the extent of capital reconstruction necessary to make the company saleable, which would allow E(A) to decide the size of the cap to be put on the cost of the sale; and that until all the necessary information is available the sales memorandum should not be issued.

15. In addition careful consideration should be given to the way in which Government can secure release at the point of sale from the various guarantees and assurances it has given in relation to the company.

**SHORT BROTHERS PLC : BACKGROUND NOTE**

The company sells into three main markets -aircraft, aerostructures and missiles. The company is the largest employer in NI and of the total of 7,500 3250 are employed on aircraft, 2750 on aerostructures and 1500 on missiles. The company have argued that the manufacture of aircraft and aerostructures are so inter-dependent that it would not be possible to continue in the aerostructures business if the aircraft division were to be closed. This possibility has never been properly tested or costed.

**Aircraft Manufacture**

2. The SD-3 series of short haul commuter aircraft, which has been the main stay of the division, is at the end of its lifecycle. So far this year the company have delivered 4 SD360s against planned deliveries of 18. The market for this sort of aircraft is very competitive and other manufacturers are proving more successful in obtaining orders. No orders for the SD330 were obtained in 1987-88, and none are expected for this year although one is in stock and two further in final assembly.

3. The company also assembles the Brazilian Tucano. This is the RAF's basic trainer (their order is for 130) and it was well received at the Farnborough airshow. There have been delivery delays but Shorts have now delivered 10 aircraft and are expecting to produce a further three a month. There are doubts that the company have the resources to to achieve the planned level of production and in many areas productivity is below plan.

4. The company has produced a design for a short haul commuter jet - the FJX - but recognises that because of the cost of development ( estimated to be at least £400m) partners will be necessary to share the cost and has been attempting to put together a consortium. The Government has made it clear that it will not allow the project to go ahead while the company remains in the public sector.

**Aerostructures**

5. The company has argued that the aerostructures business is not sustainable unless the aircraft manufacture continues alongside it. It claims many of the aerostructures orders are gained because of its reputation as an aircraft manufacturer and that there are common manufacturing facilities which reduces the overheads which would otherwise be incurred.

6. It is difficult to challenge their claim without access to company records as there is no easy way of splitting the shared costs. However there is some evidence of loss-making work in the aerostructures division and it is doubtful that the level of expertise and management skill that has led to delays and design problems in other areas of the business will be absent in this division. Touche Ross who monitor the company's performance report late deliveries and higher than planned labour costs.

**Missiles**

7. This is regarded as the most successful and most saleable part of the business producing Seacat and Javelin missiles. An estimate of £75m has been put on its worth if it was sold separately. It has its own engineering and manufacturing facilities. The main development project is the Starstreak which should form the basis of continuing profitable activity once it enters production.

**Turnover**

8. The split between the three arms of the business over the last five years is as follows:-

Turnover(£m)	1984	1985	1986	1987	1988
aircraft	88.0	104.1	109.2	98.1	66.2
aerostructures	23.8	36.3	42.1	40.2	57.1
missiles	51.2	60.4	48.6	87.7	68.6



## Balance sheet

9. The company is insolvent and relies on Government assurances to keep trading. Their financial position is deteriorating and the position as at 31 March 1988 is expected to be as follows-

Fixed assets	<u>12.6</u>
<b>Current assets</b>	
Stock and work in progress	205.4
Debtors	43.1
Cash in hand	<u>1.4</u>
	<u>249.9</u>
<b>Current liabilities</b>	
Bank loans, overdrafts	193.1
Creditors	<u>117.2</u>
	<u>310.3</u>
<b>Net current liabilities</b>	( 60.4)
<b>Total assets - liabilities</b>	( <u>47.8</u> )
<b>Capital and Reserves</b>	
Called up share capital	91.0
Share premium account	0.3
Profit and loss	<u>(266.9)</u>
<b>Shareholders' Funds</b>	(175.6)
Loans (due after 1 year)	76.6
Provisions for future losses	51.2
	<u>          </u>
	(47.8)
	<u>          </u>

10. As can be seen from the balance sheet the company's major asset is stock, however there is evidence from the long form report that there is overstocking. There are currently 328 days sale in stock and this has increased steadily over the last five years- in 1984 it stood at 217 days.

11. The business is financed entirely from bank borrowing and losses which are expected to reach £75m by the end of this financial year are due in part to the high interest charges necessary to service commercial lendings( currently £35m a year).

#### **Capital reconstruction**

12. The question of how best to achieve a capital reconstruction of the business has not yet been fully considered but there is obviously a need to create positive shareholders' funds. One way of achieving this might be to subscribe new share capital and to apply to the courts to reduce the enhanced share capital to the extent of past losses. A capital injection of £300m as Mr King has proposed would meet the £175m deficit in the shareholders funds, at 31 March 1988 and would cover the losses of £75m expected for 1988-89 but would leave little by way of shareholders funds to cover any future losses.

13. A more generous cash injection of say £500m would allow the company to repay its borrowings and to appear more robust to potential purchasers- even if no other action was taken to improve the company's trading position. This might therefore make it possible for Government to withdraw from the existing guarantees and assurances which have been supporting Shorts.

14. It is not possible to put a figure on the optimum level of reconstruction until a special study has been completed but a more substantial capital injection could have advantages both in putting a case to the EC and for making the company more saleable. Any decision would also need to take into account the conclusions reached about the viability of the company continuing intact or its possible break-up.

nov.61

CONFIDENTIAL AND COMMERCIAL IN CONFIDENCE

FROM: A M WHITE  
DATE: 24 NOVEMBER

CHIEF SECRETARY

cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Sir A Wilson  
Mr H Phillips  
Mr Monck  
Mr Moore  
Miss Peirson  
Mr Robson  
Mr Turnbull  
Mr Lyne  
Mr Richardson  
Mr Bent  
Mrs Burnhams  
Mr Call

**SHORT BROTHERS PLC: PRIVATISATION**

In advance of briefing for next week's E(A) discussion I felt it would be helpful to minute you outlining how matters have been developing, identifying the risks in the present approach, and suggesting a way forward that may best protect Treasury interests.

2. The detail is set out in the attached notes but what I think we now need to do is:-

- (a) get Mr King to agree that the company must be recapitalised before a sales memorandum is issued;
- (b) to secure independent accountancy advice to determine what needs to be done by way of recapitalisation;
- (c) to use that advisor to determine what configuration of the company might be disposed of at least cost;
- (d) to get it established that the figure at (c) is the maximum you would be prepared to meet from the Reserve;

and (e) to seek Commission agreement to (b) so that the costs involved can be met by the Reserve in the current year.

This last will not be easy to achieve and Mr King must be prepared to commit himself to the Commission that he is prepared to complete disposal on whatever basis he can find purchasers for the company - he may indeed have to say in terms that he will close those parts that do not prove attractive to purchasers (the almost certain candidate here is civil aircraft manufacture) and that the capital injection he is now making is an essential precursor to disposal and the end of Government support of Shorts.

3. We do not think you should accept the risks to confidence in the company, and hence to the Reserve, of continuing with the present scenario of a sales memorandum to be issued next month that could say not more than:-

- (a) the company's balance sheet is appalling;
- (b) we will only restructure in the context of a sale;
- (c) that the Government will no longer stand behind the privatised company.

Such a document would be unattractive to potential purchasers, would run a serious risk of a collapse of confidence in the business, and would raise expectations in the minds of potential purchasers of what might be expected by way of capital reconstruction without applying any tenable cap to the costs.

4. So I feel we must accept a brief delay to the offer document in order to approach these issues in the structured and controlled way outlined in my second note attached.

5. It would be helpful for me in preparing briefing for E(A) if you could confirm you were content with this general approach.

  
A M WHITE

**SHORTS BROTHERS PLC**

The Secretary of State will be reporting back to E(A) on 1 December on progress in privatising the company. This note describes developments since the July 22 Statement to Parliament that Shorts was to be sold 'in whole or in part'

**Background**

2. Kleinwort Benson have been appointed as the Government's advisers on Shorts privatisation. Following the discussions at E(A) on 6 October, about the handling of the company's privatisation, the Secretary of State has made it clear to the Chairman of Shorts that it is the Government's advisers who are in the lead over the detailed arrangements for the sale. Kleinworts have drawn up timetable aimed at completing the sale by the end of the financial year, but even at this early stage slippage has occurred and KB privately agree that a sale will not be achievable by 31 March.

3. Work is proceeding on the sales memorandum which is targeted for release in interested parties on 16 December. Deloitte's have now produced the first draft of the long form report and reports on the company's contractual obligations have also been prepared. All the evidence confirms the company's deteriorating trading performance, and the disastrous balance sheet which has been allowed to develop. The company's borrowings - which the Government stands behind - now total £336m on an annual turnover of £246m. The end year position is likely to be a loss of £75m or more - the fourth successive year the company has made substantial losses. That the company's suppliers and customers are still doing business with them indicates the worth they see in the more general assurances given that the Government would, in the last resort, ensure that the claims of those dealing with the company would be fully met. Any loss of confidence on that front would be potentially very costly and damaging to privatisation.

4. The company have argued strongly that if privatisation is to go ahead the company should be sold as a single entity. Mr King reported at E(A) on 6 October that he had agreed with Short's

board that the company should be sold as a single entity, if possible. But if the approach was unsuccessful, other options would have to be considered.

5. Noone will be interested in taking the company as it stands. Nor is it likely that the sift that will follow the sales memorandum will identify many serious players who would be prepared to take the business as a whole, and anyone who is prepared to negotiate would demand a high price. That is because the present aircraft products are at or beyond the option at which any continuing sales can be expected and a new aircraft - whether the FJX or some other project - would be needed to sustain that side of the business, which would continue to sustain heavy losses until that new product established itself in the market.

6. Despite E(A)'s request that he should quantify the cost of privatisation, Mr King's paper to E(A) is unlikely to put any quantum on this cost. For what it is worth, his officials have indicated to me that they would expect it to amount to at least £500m for sale as a whole.

7. But Mr King cannot be left with the impression that he has carte blanche to seek to find someone who at a price will take the business in its present configuration. Without quantifying the amounts implicit, his paper is likely, at my insistence, to say that the cost of such a sale should not exceed the costs of either closure or a break-up sale involving disposal of those parts of the business that are attractive to purchasers in their own right (and closure of the other elements).

8. On the basis of the incomplete information available to me I believe that we could argue convincingly that - provided recourse for default on Short's existing contracts with Boeing, Rolls and Fokker could be avoided in the event of closure of the aero-structures as well as the aircraft division - this cap should be no more than £400m. That would be based on the assumption, which I believe to be well founded, that a purchaser for the missiles business at least can be found.

9. The likelihood is that noone will be prepared to take the business as a whole at even this price, but the sum is sufficiently substantial to allow Mr King to claim that he has made all efforts to dispose of the business as a whole. That stance will be particularly important for relations with the Chairman and board of Shorts over the coming months.

### Working with Shorts

10. The relationship with the company remains poor following the initial difficulties Mr King had with the new Chairman - Mr Lund. The Board led by Mr Lund clearly see the risk to their own position in any break-up or outright sale, and are trying to promote the idea of a consortium to develop the FJX - as the new generation of aircraft needed to maintain the company. But it is difficult to imagine that potential purchasers would not want solid support from HMG for such a venture, so it could lead to pressure for the Government maintaining a minority shareholding in the new business. Whether or not this was avoided the company would in any case be seeking launch aid from the Government and a speculative assessment of the development costs suggests this would add at least £40m to the cost of disposal. (Mr King has helpfully made it clear that he sees no role for such a Government holding - but he may change his mind if he realises sale as a whole is proving unattainable without it.)

11. The company have appointed a public affairs manager to promote their ideas for the future of the company, and the Chairman has been giving frequent briefing meetings to the press and small groups of MPs. I attach some recent articles which have obviously been inspired by the briefing provided, and are at best unhelpful.

### The Chairman

12. Mr Lund is feeling very bitter. It is quite uncertain whether he can be brought to play a constructive part in this exercise, particularly if sale as a whole becomes clearly

unattainable. His perception of the position is that, having accepted a difficult task he has:-

(a) first had his preferred strategy rejected in circumstances in which public criticism was made by Ministers of the company and its management;

(b) second, been led to believe and made public that he was to be responsible for privatisation only to be subsequently told that that responsibility must rest with Government.

He appears to believe that only development of the FJX provides a satisfactory route to sale of the business and has made his concern over the risks inherent in any other approach widely known both inside and outside Government. (Indeed it is quite possible that his views influenced the Select Committee on Trade and Industry in deciding the timing of their consideration of Shorts and Harlands.)

13. It is questionable whether he will now be able to retreat with good grace from the positions he has taken. There must therefore be a risk that as and when it become apparent to him that events are not moving as he would wish that he may become more destructive and indeed offer his resignation. So Mr King might well wish to consider how best to contain these risks and, as a piece of contingency planning, identify a possible successor.

#### Progressing the sale

14. I am a member of the steering group which was set up at my instigation to monitor, and where possible to expedite progress in returning the company to the private sector. This has enabled us to influence the handling of the privatisation and to keep a close eye on developments, but we are still a long way from achieving the sale of the company. We need now to determine the approach to be taken.

15. My assessment, and one which seems to be shared by Kleinworts, after an initial study of possible purchasers, is that



break-up is likely to be the best chance of disposing of Shorts. (KB say they have identified buyers for missiles business, Short's airport facilities, and the small armoured car business). There is clearly only a very limited market for a company like Shorts and it is questionable whether any of the major players (who are mostly American companies) might conceivably want to acquire the company as a whole. As noted above the cost of such a disposal could well be excessive. But we are not in a position yet to determine what particular pattern of disposal would provide the least cost solution.

16. Mr King will be very reluctant to consider the possibility of a break-up of the company at this time although he must be aware that the sale of the company as a single unit is remote. I would expect the paper he will put to E(A) for the 1 December meeting to ask colleagues to endorse his proposal to seek offers only for the company as a whole and not to solicit offers for the individual parts. He will argue that any invitation now for bids to break-up the company would worsen the already difficult relationship with the company, and diminish the prospects of a sale still further.

17. He is anxious to progress matters but will seek to maintain an open position on the cost of disposal so as to maximise the possibility of persuading colleagues that Northern Irish factors dictate disposal as a whole at whatever cost that might involve. So we need to ensure that a cap is placed on the costs of disposal as a whole, and that Mr King is not allowed to back-off the break-up alternatives should one of those prove more cost effective. My parallel note suggests a way forward.

18 — FRIDAY, 18 NOVEMBER, 1988

## FINANCIAL EVENING STANDARD

Selling  
Shorts  
far too  
short

ANTHONY

HILTON



ONE of the most common criticisms of the Government's privatisation programme—not least from the Public Accounts Committee of MPs—is that too often the Government has not appreciated the value of what it was selling.

In fairness most such judgments draw heavily on hindsight.

But it is still unfortunate to see the Civil Service determined not to learn from its mistakes.

As a result there is a real danger that the plan announced this week to sell off Shorts, the Belfast aircraft and missiles manufacturer, will not only short-change the taxpayer but will also put in jeopardy what could, with the right support, be a highly successful business.

The public perception, and one apparently shared by Cabinet, is that Shorts is a lame duck, propped up over the years by massive injections of public funds only because of the jobs it provides in Belfast.

But the reality could scarcely be more different.

For a start Shorts has produced in the Skyvan family of aircraft the most successful British commercial plane ever in sales terms—outselling even the Viscount.

## Advanced

It was in its missiles some of the most advanced systems in the world. And it is one of the few companies in the world trusted by Boeing to be a sole supplier.

It is in fact a world leader in its field, and just the kind of business on which Britain's future depends.

But it has three problems. First, Shorts is weighed down by an overdraft, currently £80 million, which eats up some £40 million a year in interest. That debt originated when the then Labour Government reneged on a commitment to buy 30

transport planes after Shorts had spent the money developing it.

But the overdraft is quite different from Government aid, and the group has received not a penny in public funds, with the result that it has been consistently starved of capital.

The second problem is that the Shorts worker has some £2500 of equipment to work with against an industry average of £17,000.

Third, it needs cash to launch its next generation of aircraft and missiles.

But the Government says that is a problem for the buyer of the company, not the present owner, without seeming to realise that such an uncertainty would deter all but the most foolhardy buyer.

## Turn round

In a sensible world the Government would accept its own logic that Civil Servants cannot take business decisions and instead back the judgment of the businessmen it has put into Shorts with the capital they need.

It could then give them two or three years to turn the company round and float it on the stock market—as it did with British Airways and Steel, thereby increasing massively the receipts from the sale.

But for reasons best known to itself the Government prefers simply to wash its hands of the company, even if has to pay someone to take Shorts off its hands and that someone may be foreign.

So the issue is clear cut. The Treasury should put a stop to this nonsense while there is still time. The money it will lose by not selling Shorts without trying to turn it round would pay a lot of nurses.

FINANCIAL TIMES

21/11/88

THE LEX COLUMN

# Short-term thinking 32% over Shorts

LEX COPY SUNDAY FOR MONDAY There is a bizarre contrast between next Wednesday's £2.5bn-plus privatisation of British Steel and Short Brothers, the Belfast plane maker whose sale was unceremoniously advertised in the small ads last week. British Steel has been transformed from an inefficient, loss-making business into the most profitable steel company in Europe. Short Brothers, by contrast, is a high-tech company which has been starved of investment, has a negative net worth of £100m, annual sales of around £250m, and has done no more than break even on a pre-interest basis for the last five years. It is hardly the sort of record which will attract the big spenders, so why the hurry to get rid of it?

The Government is prepared to spend years nurturing a mature business like British Steel back to health, yet is rushing to sell Shorts even before an up-to-date balance sheet is available. Shorts consists of three businesses, at least two of which have considerably greater growth and profit potential than British Steel. The missiles business is the jewel in the crown, and the aerostructures side is a key supplier for companies like Boeing. Granted, there is also the aircraft manufacturing business, the weakest part by the company's own admission. The current product range is almost at the end of its useful life, and if Shorts is to continue as a plane maker it needs £500m-plus to build the next generation of commuter jets.

The Government's keenness to get rid of Shorts before it has to stump up for this latest project probably reflects its own dismal record at backing dud business ideas in the Province. Despite its denials, the most obvious solution would be to break the company up. Given more time, it should have been able to prove that Shorts, like British Steel, is an opportunity rather than a disaster.

THE INDEPENDENT

# Shorts<sup>19/11</sup><sub>23</sub> may have to drop<sup>11</sup> jet launch

By Michael Harrison  
Industrial Correspondent

FEARS are growing that Short Bros, the state-owned aerospace concern, will not find a buyer by next spring, forcing it to abandon the crucial £400m launch of a new regional jet and threatening the survival of the entire company.

The collapse of Shorts, Northern Ireland's biggest employer, could leave the Government with a bill of up to £2bn and lead to 16,000 jobs losses, according to industry sources.

The Government put Shorts up for sale last summer and has asked the Belfast company to come up with a buyer by next March. But at the same time it is refusing to commit funds for the FJX regional airliner project.

Senior executives at Shorts are understood to have warned Northern Ireland ministers that without a decision on the FJX it will be impossible to sell the company back into the private sector.

If the FJX is not built, Shorts will not only cease to be an aircraft manufacturer but could lose lucrative sub-contract work on aerostructures from companies such as Boeing.

An official notice for sale of Shorts will appear this Thursday and a detailed mini-prospectus has been drawn up.

The best hope of privatising Shorts now lies in getting collaborative partners on the FJX programme to take over the company at the same time.

However, there are misgivings within Shorts about this being achieved within the deadline imposed by the Government.

Rodney Lund, who was drafted in as chairman of Shorts earlier this year to prepare it for privatisation, has lost his argument for the sale to be delayed at least a year until its balance sheet has been cleaned up and it can show a profit.

But he has won the battle to keep Shorts intact, after the Northern Ireland Industry Minister Peter Viggers indicated it might be split up and sold as three divisions. Relations between the two remain poor.

Shorts plans to take a 25-30 per cent stake in the FJX and has lined up the German manufacturer MBB as a collaborative partner. A decision on a partner to build the engine will be made by Christmas with power plants offered by three US manufacturers and Rolls-Royce under eval-

**SHORTS PRIVATISATION: THE WAY FORWARD**

In some ways Shorts has similarities with the Rover disposal in that the Treasury objective must be to seek to minimise the cost of sale. But the position of Shorts is more difficult than that of Rover and we are not confident that the approach so far adopted by Mr King will be controllable or cost effective in our terms.

2. Given the very poor state of the company's balance sheet we are concerned that the present approach runs a considerable risk of a collapse in confidence in the company before a sale can be negotiated for part or all of the business.

**Avoiding Collapse of Confidence**

3. It is clear that no capital reconstruction could be carried through in time to be included in a sales memorandum issued on 16 December. However, if such a memorandum is issued which simply makes the standard privatisation statement that the Government will no longer stand behind the company after sale then, given Shorts known difficulties and the other information that the sales memorandum will contain, there must be a substantial risk that those doing business with the company will take fright. So in our view the sales memorandum should be deferred so that when issued it portrays a reconstructed company in which some confidence might be retained during the time it takes to negotiate disposal in whatever form, and in the surviving entity thereafter.

4. Collapse of the business caused by a move to sell without restructuring in advance of sale would be extremely expensive and could mean that not even the missiles business could be continued. Costs would include recourse claims by Boeing, Rolls etc in addition to the costs involved in meeting the claims of Short's bankers and other creditors. A crude estimate of the costs of such a collapse would be of the order of £750m. And of course the political impact in Northern Ireland would be severe.

5. These risks should not be faced. In our view reconstruction, which will be welcome to the board, and understandable to

potential purchasers, should precede the issue of a sales memorandum. In order to quantify the sums needed (and to obtain independent and confidential to government advice on e.g how realistic it may be to seek to sell the aero-structure business) this will require the appointment of an additional accountancy firm to undertake this task over the coming weeks. (Deloittes, reporting jointly to Government and the board are not well placed for this role). The necessary delay to the issue of the sales memorandum would rule out a sale this financial year, but the capital reconstruction would provide an opportunity to meet most of the costs this year in advance of sale, providing EC agreement can be obtained.

#### Meeting the cost

6. Even under Mr King's present approach there is a strong risk that there will be no sale this year and the total cost therefore could easily fall next year, when pressures on the Reserve will be more severe. But capital reconstruction in advance of issuing a sales memorandum creates the opportunity to both improve the prospects for sale by eliminating a major areas of uncertainty and to bring much of cost forward into the current year. Discussion to date has focused on an interim capital reconstruction in advance of the sale which would bring a substantial part of the cost (some £300m) forward; but any reconstruction has its problems not least as EC agreement would need to be sought - and may be difficult to obtain - which might delay implementation beyond the end of the year. I have requested that this issue should be considered further at a meeting with KB next Monday and Mr King's paper to E(A) should put forward proposals for at least an interim reconstruction. Subject to your views I would now like to press for this to be as near final a reconstruction as possible - leaving for later only such 'fine tuning' as may be needed to conclude a sale on whatever basis proves possible and acceptable. (This could of course be complemented by recovery of some of the funds injected through increased disposal receipts).

Controlling the exercise

7. In order to improve both our chances of achieving the least cost outcome, and to improve the prospect for early EC approval, it will be necessary to persuade Mr King to confirm in his approach to the Commission that the Government not only sees this reconstruction as an essential preliminary to disposal but that the Government is firmly intent on early and complete disengagement from the company even if that means the closure of those parts of the business that do not prove attractive to purchasers - so that if the aircraft business, for example, cannot be sold it will not be retained in State hands.

8. At E(A) you should press for the appointment of independent accountancy advice to determine what the quantum involved in the proposed capital reconstruction should be. You should indicate that you would be prepared to meet this amount from the Reserve, once it has been determined, and suggest that you and Mr King should agree the figure involved bilaterally. You should however make it clear that an essential condition to this would be acceptance by Mr King that you would then expect him to accept that the subsequent sales must be on a least cost basis - even if that precluded the disposal of the business as a whole and meant at least withdrawal from the civil aircraft business.

9. If he is unwilling to accept this, the most you should be prepared to agree is that he could, if he chose, find the difference between that cost and an attainable but more costly alternative that he found politically attractive by offering offsetting savings from elsewhere in his Block. But the independent accountants report must be produced first so that an accurate assessment of these relative costs could inform any such decision.

Presentation to the company

10. It is unlikely that the company, which proposed its own views on capital reconstruction as soon as disposal was announced, would resist a proposal to reconstruct now. Nor can they reasonably

object to the appointment of independent accountants to advise Government on what is necessary. But they would be very nervous over any overt discussion of break-up so that this vital element of the new accountancy work would need to be a hidden agenda between ourselves and the appointed firm. We believe that this is manageable without undue risk of disclosure to the company until the sale process is well advanced, although it will take careful drafting of the eventual sales memorandum (and off the record briefing by Kleinworts of potential bidders) to ensure that bids are properly targeted. That is because Mr King will not wish to be seen to abandon sale as a whole until the possibility has been exhausted - even if, as we expect, the fresh independent advice we are seeking confirms our and KB's view that such a sale is both unlikely and, even if possible, more costly than other forms of disposal.

dti

the department for Enterprise

*[Handwritten signature]*

PWP

CH/EXCHEQUER	
REC.	- 1 DEC 1988
ACTION	MR WALLER
COPIES TO	CST, FST
	SIR P MIDDLETON
	MR ANSON
	MR BURGER
	MR MOORE
	MR CALL

✓ 1/12

CONFIDENTIAL

cc: PMG, ESTIM, Mr RIGAN, Mr Tyrie

PRIME MINISTER

I promised at Cabinet today to let you and Geoffrey Howe have the current position on exports of UK-built Nissan cars to France, Italy and Spain, for the Rhodes summit. This is a prime example of how those who criticise our stance towards the Community are only too ready to bend the rules when it suits their purposes.

2 The Nissan factory in Sunderland is now producing cars with a local (EC) content level of over 70 per cent, more than fulfilling their commitment to us to reach a 60 per cent local content level on average in 1988. Exports to EC markets began earlier in the autumn. These are so far on a small scale, but should exceed 30,000 in 1989 including up to 6,500 cars to France, 3,500 to Italy and 3,000 to Spain.

3 The French Government told us earlier this year that there would be no obstacle to the cars entering the French market; and indeed the first deliveries have now reached French showrooms without difficulty. However, France has insisted that until the cars reach an 80 per cent level of EC content they will be counted against the informal quota under which imports of Japanese cars are limited to 3 per cent of the market. My position has been that, at over 60 per cent EC content, the cars clearly qualify under Community law to be treated as products of EC origin. Though there is at present no specific Community origin rules on cars, that is the level defined for EC/EFTA trade.

4 Following unavailing protests to my French opposite number, I wrote to Arthur Cockfield in September to ask for the Commission's support. His reply merely relayed French assurances that the cars were free to enter and invited me to let him know



if any difficulties were encountered. It did not not include - as it should have - a clear Commission statement that the cars qualify to be treated as of EC origin. Meanwhile the indications are that the French position remains unchanged.

5 The Italian Government share French anxieties about the cars, but have so far avoided committing themselves. First deliveries have reached the Italian market without mishap, but there remains a danger that they will be counted against the formal Italian quota on imports of Japanese cars.

6 As for Spain, a first consignment reached the country two weeks ago, and Nissan's Spanish importer was told they would be counted against the formal Spanish quota for vehicles of non-European origin. In view of this, the importer refused to accept the cars and cancelled his order for the next shipment.

7 Last Friday, I wrote again to Arthur Cockfield setting out my understanding of the position in all three countries; formally asking him to investigate the reported actions of the Spanish Government; and urging him to answer the central question, namely whether the Commission consider that the cars should be regarded as of EC origin. But there is no sign that we shall have a satisfactory reply before Rhodes.

8 The integrity of the internal market is under attack, and needs to be upheld. Not only Nissan themselves, but other potential Japanese investors in the UK, need to be reassured that if they live up to their commitments to us on EC content - as Nissan have - the UK will fight to ensure that their products do not face discrimination in other EC markets.



the department for Enterprise

9 Since the Italians have not yet declared themselves, our best targets at present are the French and the Spanish. And we must maintain pressure on the Commission not to shirk their responsibilities, since this is the surest way to a quick solution.

10 I am copying this minute to Geoffrey Howe, Nigel Lawson and to Sir Robin Butler.

A handwritten signature in black ink, appearing to be 'D Y', is centered on the page.

D Y

1 December 1988

Department of Trade and Industry

cc Mr Taylor  
Ps see CST's amendments  
C Burn

FROM: MRS T C BURNHAMS S/12  
DATE: 5 DECEMBER 1988

*Handwritten initials*

This copy contains  
CST's suggested amendments to the  
draft -  
Content that  
he writes on  
these lines?

I agree. It is unlikely  
that the company,  
which has argued for  
some time for a  
capital reconstruction,  
could reasonably  
complete of this  
development in the  
Government position.

Mr Viggers, who  
has mentioned the  
16 December date to  
some potential purchasers  
will have to explain  
himself a little, but  
in the view of his affairs  
should be able to do so  
without undue  
inconvenience

- cc Chancellor
- Financial Secretary
- Sir P Middleton
- Mr Anson
- Sir A Wilson
- Mr H Phillips
- Mr Monck
- Mr Moore
- Miss Peirson
- Mr Robson
- Mr Turnbull
- Mr Lyne
- Mr Richardson
- Mr Bent
- Mr Call

*Handwritten initials: TM, APB, CS*

1. MR WHITE

2. CHIEF SECRETARY

*Content of 5.12.*

**SHORT BROTHERS PLC**

I attach a draft letter to Mr King which sets out the reasons why it is necessary to delay the issue of Shorts' sales memorandum which is due be issued on 16 December.

2. The letter draws attention to the individual pieces of work which need to be completed before the memorandum can be issued, including a legal opinion on how we might best get out of the guarantees and assurances the Government has given in relation to Shorts' financial position. This is a key area and one that must be fully addressed before the drafting of the sales document can be finalised. The preliminary advice which we have obtained from Treasury Solicitors, (and which supports our own opinion on the need for an early recapitalisation of Shorts) suggests that to recapitalise first may provide the best chance of the Government achieving a clean break on sale.

3. You wished to copy the letter to the Foreign Secretary in view of the EC position, and you may also like to include the Chancellor of the Duchy of Lancaster on the copy list as DTI are a minority shareholder in Shorts.

*Handwritten signature of Teresa Burnhams*

TERESA BURNHAMS

DRAFT LETTER FROM CHIEF SECRETARY TO SECRETARY OF STATE FOR  
NORTHERN IRELAND

## SHORT BROTHERS PLC

There was very little time at E(A) on 1 December to discuss Shorts' privatisation, and I thought it would be helpful therefore if I set out ~~the difficulties as I see them in obtaining a satisfactory disposal of the company as a whole, and~~ how I feel we should proceed.

Let me say first of all that there is no doubt that the sale of Shorts as a whole on suitable terms is clearly preferable, and only if this is not possible will we need to consider other alternatives.

It is important however not to proceed without first obtaining some idea of the cost. I was pleased to hear you have already put some work in hand on this, and your officials should agree terms of reference with mine and keep them in close touch as the work develops. As you know I am most anxious that we should attempt to meet the ~~major part of the disposal costs~~ <sup>or at least the major part of them,</sup> from the Reserve this year, when pressures are likely to be easier than in 1989-90.

On the timetable you propose the sales memorandum is due to be issued on 16 December - about four weeks from the first substantive draft. Even with no other difficulties to consider this would be a very ambitious timescale to achieve. For recent trade sales the average time from the first substantive draft of the information memorandum to issue is eight weeks; and in the case of Shorts we are facing a number of additional problems which must be resolved before the sales memorandum can be issued.

Firstly there is the weak and deteriorating financial position of the company which in its present form makes it a far from attractive prospect for purchasers. If we are to be in the best possible position for achieving the sale of the company as a whole, and to improve our negotiating position with potential purchasers, I regard it as essential to undertake a full

recapitalisation of the company before inviting offers for its sale. Work on the extent of the necessary recapitalisation must be undertaken over the next few weeks at the same time as the other costing work is in progress.

Secondly, as our aim must be to withdraw completely all Government guarantees and assurances at the date of sale, we need to consider how this can be best achieved, and how our position should be represented to best advantage in the sales memorandum. This is a very complex area and one where we will need to rely very heavily on our legal advisers.

I understand that Norton Rose the commercial lawyers appointed to advise on the privatisation have more work to do on this and I hope this can be completed as a matter of urgency. The preliminary advice we have received from Treasury Solicitors suggests that there may be a better chance of the Government disentangling itself from its existing assurances if a complete recapitalisation took place before the company is offered for sale.

Your paper to E(A) touched upon the attitude of the European Commission to any capital reconstruction of Shorts. A complete recapitalisation of the company would have the additional advantage of allowing a single negotiation with the Commission to take place - which they will almost certainly prefer. While I acknowledge that any negotiations will not be easy, there may be an additional benefit in an approach based on an end to any future aid to the company (particularly as the Commission could have serious reservations about certain purchasers who might come forward). As this process will inevitably be time-consuming it is essential to begin careful preparation of our case as soon as possible.

If you agree that this is the approach we should now follow, I suggest that we put the necessary work by our officials and advisers in hand forthwith. If, however, you are not persuaded we can of course discuss.

I am copying this letter to Geoffrey Howe and Tony Newton.

1. MR WHITE
2. CHIEF SECRETARY

I agree. It is unlikely that the company, which has requested for some time for a capital reorganisation, could reasonably complete of this development in its government position. Mr Viggers, who has mentioned the 16 December date to some political purchasers will have to explain himself a little, but in the view of his affairs should be able to do so without undue embarrassment

FROM: MRS T C BURNHAMS  
DATE: 5 DECEMBER 1988

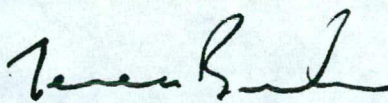
cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Sir A Wilson  
Mr H Phillips  
Mr Monck  
Mr Moore  
Miss Peirson  
Mr Robson  
Mr Turnbull  
Mr Lyne  
Mr Richardson  
Mr Bent  
Mr Call

SHORT BROTHERS PLC

I attach a draft letter to Mr King which sets out the reasons why it is necessary to delay the issue of Shorts' sales memorandum which is due to be issued on 16 December.

2. The letter draws attention to the individual pieces of work which need to be completed before the memorandum can be issued, including a legal opinion on how we might best get out of the guarantees and assurances the Government has given in relation to Shorts' financial position. This is a key area and one that must be fully addressed before the drafting of the sales document can be finalised. The preliminary advice which we have obtained from Treasury Solicitors, (and which supports our own opinion on the need for an early recapitalisation of Shorts) suggests that to recapitalise first may provide the best chance of the Government achieving a clean break on sale.

3. You wished to copy the letter to the Foreign Secretary in view of the EC position, and you may also like to include the Chancellor of the Duchy of Lancaster on the copy list as DTI are a minority shareholder in Shorts.

  
TERESA BURNHAMS

DRAFT LETTER FROM CHIEF SECRETARY TO SECRETARY OF STATE FOR  
NORTHERN IRELAND

**SHORT BROTHERS PLC**

There was very little time at E(A) on 1 December to discuss Shorts' privatisation, and I thought it would be helpful therefore if I set out the difficulties as I see them in obtaining a satisfactory disposal of the company as a whole, and how I feel we should proceed.

Let me say first of all that there is no doubt that the sale of Shorts as a whole on suitable terms is clearly preferable, and only if this is not possible will we need to consider other alternatives.

It is important however not to proceed without first obtaining some idea of the cost. I was pleased to hear you have already put some work in hand on this, and your officials should agree terms of reference with mine and keep them in close touch as the work develops. As you know I am most anxious that we should attempt to meet the major part of the disposal costs from the Reserve this year, when pressures are likely to be easier than in 1989-90.

On the timetable you propose the sales memorandum is due to be issued on 16 December - about four weeks from the first substantive draft. Even with no other difficulties to consider this would be a very ambitious timescale to achieve. For recent trade sales the average time from the first substantive draft of the information memorandum to issue is eight weeks; and in the case of Shorts we are facing a number of additional problems which must be resolved before the sales memorandum can be issued.

Firstly there is the weak and deteriorating financial position of the company which in its present form makes it a far from attractive prospect for purchasers. If we are to be in the best possible position for achieving the sale of the company as a whole, and to improve our negotiating position with potential purchasers, I regard it as essential to undertake a full

recapitalisation of the company before inviting offers for its sale. Work on the extent of the necessary recapitalisation must be undertaken over the next few weeks at the same time as the other costing work is in progress.

Secondly, as our aim must be to withdraw completely all Government guarantees and assurances at the date of sale, we need to consider how this can be best achieved, and how our position should be represented to best advantage in the sales memorandum. This is a very complex area and one where we will need to rely very heavily on our legal advisers.

I understand that Norton Rose the commercial lawyers appointed to advise on the privatisation have more work to do on this and I hope this can be completed as a matter of urgency. The preliminary advice we have received from Treasury Solicitors suggests that there may be a better chance of the Government disentangling itself from its existing assurances if a complete recapitalisation took place before the company is offered for sale.

Your paper to E(A) touched upon the attitude of the European Commission to any capital reconstruction of Shorts. A complete recapitalisation of the company would have the additional advantage of allowing a single negotiation with the Commission to take place - which they will almost certainly prefer. While I acknowledge that any negotiations will not be easy, there may be an additional benefit in an approach based on an end to any future aid to the company (particularly as the Commission could have serious reservations about certain purchasers who might come forward). As this process will inevitably be time-consuming it is essential to begin careful preparation of our case as soon as possible.

If you agree that this is the approach we should now follow, I suggest that we put the necessary work by our officials and advisers in hand forthwith. If, however, you are not persuaded we can of course discuss.

I am copying this letter to Geoffrey Howe [and Tony Newton].





cc:  
 Chancellor  
 FST  
 Sir Peter Middleton  
 Mr Anson  
 Sir A Wilson  
 Mr H Phillips  
 Mr Monck  
 Mr Moore  
 Miss M Peirson  
 Mr Robson  
 Mr Turnbull  
 Mr White  
 Mrs T C Burnhams  
 Mr Lyne  
 Mr Richardson  
 Mr Bent  
 Mr Call

Treasury Chambers, Parliament Street, SW1P

The Rt Hon Tom King MP  
 Secretary of State for Northern Ireland  
 Northern Ireland Office  
 Whitehall  
 London  
 SW1A 3AZ

6<sup>th</sup> December 1988

*Dear Tom,*

**SHORT BROTHERS PLC**

There was very little time at E(A) on 1 December to discuss Shorts' privatisation, and I thought it would be helpful therefore if I set out how I feel we should proceed.

Let me say first of all that there is no doubt that the sale of Shorts as a whole on suitable terms is clearly preferable, and only if this is not possible will we need to consider other alternatives.

It is important however not to proceed without first obtaining some idea of the cost. I was pleased to hear you have already put some work in hand on this, and your officials should agree terms of reference with mine and keep them in close touch as the work develops. As you know I am most anxious that we should attempt to meet the disposal costs or at least the major part of these, from the Reserve this year, when pressures are likely to be easier than in 1989-90.

On the timetable you propose the sales memorandum is due to be issued on 16 December - about four weeks from the first substantive draft. Even with no other difficulties to consider this would be a very ambitious timescale to achieve. For recent trade sales the average time from the first substantive draft of the information memorandum to issue is eight weeks; and in the case of Shorts we are facing a number of additional problems which must be resolved before the sales memorandum can be issued.

Firstly there is the weak and deteriorating financial position of the company which in its present form makes it a far from attractive prospect for purchasers. If we are to be in the best possible position for achieving the sale of the company as a whole, and to improve our negotiating position with potential purchasers, I regard it as essential to undertake a full recapitalisation of the company before inviting offers for its sale. Work on the extent of the necessary recapitalisation must be undertaken over the next few weeks at the same time as the other costing work is in progress.

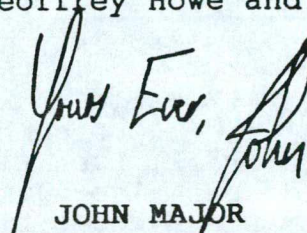
Secondly, as our aim must be to withdraw completely all Government guarantees and assurances at the date of sale, we need to consider how this can be best achieved, and how our position should be represented to best advantage in the sales memorandum. This is a very complex area and one where we will need to rely very heavily on our legal advisers.

I understand that Norton Rose the commercial lawyers appointed to advise on the privatisation have more work to do on this and I hope this can be completed as a matter of urgency. The preliminary advice we have received from Treasury Solicitors suggests that there may be a better chance of the Government disentangling itself from its existing assurances if a complete recapitalisation took place before the company is offered for sale.

Your paper to E(A) touched upon the attitude of the European Commission to any capital reconstruction of Shorts. A complete recapitalisation of the company would have the additional advantage of allowing a single negotiation with the Commission to take place - which they will almost certainly prefer. While I acknowledge that any negotiations will not be easy, there may be an additional benefit in an approach based on an end to any future aid to the company (particularly as the Commission could have serious reservations about certain purchasers who might come forward). As this process will inevitably be time-consuming it is essential to begin careful preparation of our case as soon as possible.

If you agree that this is the approach we should now follow, I suggest that we put the necessary work by our officials and advisers in hand forthwith. If, however, you are not persuaded we can of course discuss.

I am copying this letter to Geoffrey Howe and Tony Newton.

  
JOHN MAJOR



NORTHERN IRELAND OFFICE  
WHITEHALL  
LONDON SW1A 2AZ

*[Handwritten initials]*

SECRETARY OF STATE  
FOR  
NORTHERN IRELAND

Rt Hon John Major MP  
Chief Secretary to the Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

CHIEF SECRETARY	
REC	6 DEC 1988
	Mr A M White,
	Mr A J. S. W. Middelton
	Mr Benson, Sir N. Wilson, Mr Phillipps
	Mr Monek, Mr Moore, Miss Pearson,
	Mr Robson, Mr Tomblin, Mr Lyne,
	Mr Richardson, Mr Bent, Mrs Bunnham,
	Mr Call

8, December 1988

*[Handwritten signature]*

SHORT BROS PLC

Thank you for your letter of 6 December about how we might proceed on aspects of Shorts' privatisation. It was unfortunate that we did not have an opportunity to discuss this subject more fully at E(A) when these matters could have been explored.

I agree entirely with you that we must proceed with the sale of Shorts as a whole as a preferred course while recognising at the same time that this approach is not incompatible with a decision ultimately to sell the company in parts should this prove to be the most practical and advantageous way to proceed. It is partly because of this prospect that work is in hand to try to place values on individual parts of the company and allow us to consider a series of possible options. Your officials will be kept closely in touch with this work.

E(A)'s reservations about an interim capital reconstruction seem to leave a choice between a complete capital reconstruction prior to

sale (which we have set our face against so far) or leaving the entire capital reconstruction to be dealt with at the point of sale. While I would agree that there are undoubted attractions in trying to recapitalise the company now from the point of view of improving its attractiveness to the market, I have considerable concerns about the practicability of doing so. A full restructuring of the balance sheet seems to imply an ability to identify and cost all the various liabilities which could affect the company in the future. While certain components of these liabilities are recognisable and quantifiable, the contingent liabilities are not. To attempt to quantify them in advance of sale runs the risk of injecting excess funds and makes no allowance for what potential purchasers might be persuaded to accept by way of liabilities.

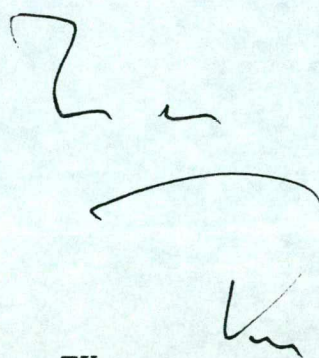
You indicated in your letter that recapitalisation would assist Government in disengaging from the assurances it has given. I understand however that Norton Rose and the Treasury Solicitors have now agreed that it would not be possible to withdraw existing assurances with retrospective effect, regardless of the strength of the Shorts balance sheet at the time of privatisation, though it would clearly assist in relation to future commitments.

I do not believe, therefore, that a recapitalisation to take account of these contingencies in advance of sale offers a defensible way forward. I suggest instead that, when we meet on Monday, we should discuss alternative prospects. One option would be now to recapitalise, although only to the extent of Shorts' bank loans and prospective losses, but this route would confront us with major, and probably insuperable difficulties. First it would almost certainly be unacceptable to the Commission. Secondly, we would in any case be very unlikely to secure the Commission's approval in time to make provisions in the Northern Ireland Spring Supplementary Estimates.

Thirdly, we are strongly advised by Kleinwort Benson that an inevitable consequence would be delay in issue of the sales memorandum until we could be clear about what we will do by way of recapitalisation; and further delay in its issue will undermine confidence amongst prospective buyers and could thereby prejudice the prospects of a successful sale.

The alternative is to postpone full recapitalisation to the point of sale and on balance I believe that this is the preferable course.

I am copying this letter to the Foreign Secretary and the Chancellor of the Duchy of Lancaster.

Handwritten signature and initials, including a large stylized 'Z' or 'L' shape, a horizontal line, and a checkmark-like mark.

TK

CONFIDENTIAL

*pp. 11*  
FROM: M PARKINSON

DATE: 9 December 1988

- 9/11*
1. MR WALLER
  2. CHIEF SECRETARY

*Pz*

cc. Chancellor  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Mrs Brown  
Mr A White  
Mr Rutnam  
Mr Call

**BRITISH SHIPBUILDERS AND THE NORTH EAST**

1. Mr Newton's letter of 29 November confirms that the Sunderland enterprise company will be funded through British Shipbuilders, as alternative powers have not been found for an independent company. This merely confirms Mr Newton's letter to Mr Rifkind of 31 October (Mr Rifkind had suggested an independent company, which you supported subject to legislative powers being available). Mr Newton notes that he will seek to ensure that financial control is no less effective than that exercised directly by his Department.

2. He also replies to your letter of 7 November in which you made clear that either site clearance costs for the shipyard sites undertaken by British Shipbuilders in the proposed Enterprise Zone should be carried out on a commercial basis or that costs not covered by higher sales proceeds should be met within DTI and DOE existing provision. Mr Newton takes your point and says that it is unlikely to be to the Corporation's commercial disadvantage to arrange the job themselves, because of the high scrap value of metal clad buildings and metal fittings.

CONFIDENTIAL

3. PE are a little surprised that this activity is claimed to be fully commercial and are pursuing the issue at official level. But Mr Newton's letter does not call for you to reply.

*Mark Parkinson*

**M PARKINSON**

APB - M

FROM: A W WHITE  
DATE: 9 DECEMBER 1988

CHIEF SECRETARY

cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Sir A Wilson  
Mr Monck  
Mr Moore  
Miss Peirson  
Mr Robson  
Mr Turnbull  
Mr Richardson  
Mr Lyne  
Mr Bent  
Mrs Burnhams  
Mr Call  
Mr Hyett T/ Sol

**SHORT BROTHERS PLC: PRIVATISATION**

While Mr King's letter comes down against a full early recapitalisation I understand he is persuadable on the point.

2. To persuade him you need to address these points:-

- a) the risk of Commission opposition to recapitalisation before they know the final terms of disposal and the identity of the purchaser;
- b) the practicability of providing a reasonable figure for the capital injection by 6 February - the last day on which NI Estimates can be put to Parliament;
- c) the assertion, supported by KB, that delaying the sales memorandum would damage the confidence of potential purchasers.

3. You will also wish to remind him forcibly how much more difficult you would find it to provide these sums from next year's Reserve.



4. Points a) and b) are clearly related and in our view, supported by Treasury Solicitor, could be achieved by making the capital injection initially into a non-trading financing company (Shorts Holdings may be an appropriate vehicle). Payment on into the Shorts trading company could be made at a later date, once Commission approval had been obtained. We could, of course, in the meantime produce a pro forma balance sheet outlining our intentions.

5. We believe that work on the company's balance sheet can be done rapidly enough to ensure that a firm figure for Estimates purposes - and the Accounting Officer's position would be guarded by the fact that the money paid into the finance company could be clawed back if it was subsequently clear that a lesser sum was needed by the trading company.

6. On the third point, neither I or Martin Lyne, who are participating in the drafting of the sales memorandum attach any credence to the view that the major companies who may take an interest in Shorts would be deterred in any way by a delay to the sales memorandum that meant a more that at issue it promoted a more credible business with a believable balance sheet.

7. The present memorandum is an extremely gloomy one. It shows the aircraft business is responsible for a loss in the last financial year of £100m, with poor trading so far this year and no prospect of profitability until the at present totally speculative FJX attracts substantial sales at some point in the 1990s.

8. The company, which does not want to be sold at all, is quite happy about this and that only a vague promise of capitalisation should be the basis of an approach to the market.

9. So are KB, because they have no belief that a sale as a whole is any thing other than a very remote prospect, and they would sooner get on with selling those parts of the business for which they believe buyers can be found.

10. We accept that sale as a whole may not be easy to achieve but are confident that an early recapitalisation is more likely to provide some balance to the present sales memorandum - and hence encourage interest by injecting some good news into the present bleak draft.

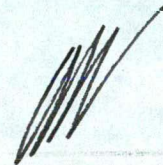
**POINTS TO MAKE**

A. You should argue that a payment into a non-trading Shorts company - and Shorts Holdings may be the right vehicle - would not constitute State Aid. The Commission could be assured that no payment into the trading company would be made until we had their consent. But for purposes of a new sales memorandum we could produce a pro forma balance sheet illustrating what we might then do.

B. The sum would need to be calculated by 6 February, but payment into the holding company would allow us to later claw back any excess, so preserving proper accountability.

C. It is difficult to believe that the present draft sales memorandum would elicit any interest in the business as a whole. The potential purchasers are all sophisticated and will understand that a delay to recapitalise is more likely to provide a platform for realistic negotiation.

11. Mrs Burnhams submission below provides detailed briefing and supplementary points to make.



A.M. WHITE.

FROM: MRS T C BURNHAMS  
DATE: 9 DECEMBER 1988

1. MR WHITE
2. CHIEF SECRETARY

cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Sir A Wilson  
Mr Monck  
Mr Moore  
Miss Peirson  
Mr Robson  
Mr Turnbull  
Mr Richardson  
Mr Lyne  
Mr Bent  
Mr Call  
Mr Hyett T/ Sol

**SHORT BROTHERS PLC: PRIVATISATION**

You are to meet Mr King on Monday 12 December to discuss how to proceed with the privatisation of Shorts. The background to the privatisation was provided under cover of Mr White's minutes of 24 and 29 November and this briefing is confined to the points Mr King raises in his letter of 8 December.

2. Your letter of 6 December to Mr King suggested that the best way of achieving a successful privatisation of the company was by means of a full recapitalisation before inviting offers for Shorts. Mr King has been advised by Kleinwort Benson that there should be no delay in the issue of the sales memorandum - due to be issued on 16 December - and that the best option would be to undertake a final recapitalisation at the point of sale.

3. Mr King has concluded in his letter that on balance he would prefer this latter option. However the case put forward by Kleinwort Benson in support of a final recapitalisation is based on a misguided premiss about what work would be necessary, before the extent of recapitalisation could be decided, and how far this would then delay the issue of the sales memorandum.

4. You will therefore wish to convince Mr King at your meeting that your preferred option for a full early recapitalisation would involve only a modest delay in the issue of the sales memorandum -

time which could be well spent improving the document that is finally issued. In addition there are a number of important advantages with an early recapitalisation which are outlined below.

#### WORK REQUIRED BEFORE ISSUE OF SALES MEMORANDUM

5. In his letter Mr King suggests that a full restructuring will require an exhaustive report on all the liabilities of the company including contingent liabilities. It is undeniable that such an undertaking would involve significant delay, and might not at the end of the day be very conclusive; but that is not what we have proposed.

6. The work that we have proposed Touche Ross should undertake can be divided into two parts. Firstly they will be asked to make some broad estimates of the likely cost of disposal of Shorts, either in whole or in part, against which any offers from prospective purchasers can be compared. This will then allow Mr King to meet E(A)s request that estimates of the likely cost of disposal should be available for E(A) at the beginning of February.

7. The second part of their work would be to consider and make recommendations about the appropriate level of recapitalisation that would be necessary for Shorts to be sold as a going concern. Provided this work begins at once there is no reason why it should not be completed by mid-January. A major part of the recapitalisation will be taken up with extinguishing the company's debt, but the intention would be to try to identify other specific areas where an injection of capital would make Shorts more saleable by creating a robust balance sheet.

8. In any event there must be serious doubts that all the necessary stages including verification can be completed satisfactorily in time to meet an issue date of 16 December. Mr King has not commented in his letter about the tightness of his proposed timetable and you will wish to press him on its feasibility.

## THE ADVANTAGES OF AN EARLY RECAPITALISATION

### Improving prospects for a sale

9. In its present financial state the company is not an attractive proposition and to offer it for sale before recapitalisation must harm the chance of achieving its' sale as a single entity. Kleinwort Benson have suggested this can be dealt with adequately in the sales memorandum by a reference to the Government's intention to "restructure the balance sheet of the Company in conjunction with the purchaser ....". In our view such an unquantified approach would put the Government at a disadvantage when negotiating with prospective purchasers, and could lead to a higher cost for disposal.

### Withdrawal from Government Assurances

10. An early recapitalisation would seem to offer the best prospect for the Government to withdraw from the Parliamentary assurances it has given about the Company's finances. If the company could be offered for sale with a sufficiently robust balance sheet, which would clearly allow it to meet its trading obligations for some time under reasonable management, the assurances would no longer be necessary, and withdrawal would not cause any loss of confidence by suppliers or customers.

11. Ideally the Government would wish to withdraw their assurances retrospectively in the same way as happened in the Rolls Royce case. However, the legal advice from both Norton Rose- the commercial lawyers appointed to advise Government- and the Treasury Solicitor is that there are differences between the two cases and retrospection would not be appropriate in the case of Shorts.

### Negotiations with the European Community

12. Following approaches to the EC it is clear that the Commission would prefer a full recapitalisation of the Company to an interim recapitalisation followed by a further injection of capital at the point of sale. We would however see some risks in the final recapitalisation route as negotiations would, at that stage,

depend very heavily of the view the EC took about the potential purchaser. The sale to a less favoured buyer would make the position much more difficult, and at this stage it is not possible to have any clear indication of the ultimate purchaser.

13. Our preferred approach could be justified as facilitating the Company's sale which would allow State aid to be ended once and for all. The only alternative might be the closure of the Company with all the serious political implications that would imply, and which the EC would wish to avoid. This strategy seems to offer less risks and would allow the formal procedures to begin much sooner.

#### Meeting the cost of sale this year

14. Finally if we are to meet the cost of the disposal of Shorts from this year's Reserve an early full recapitalisation would be preferable.

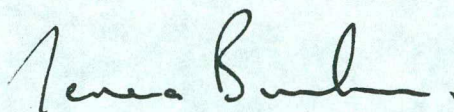
15. While we would agree with Mr King's view that it would be difficult to secure EC agreement before the end of the financial year, we have been exploring ways in which provision could be made for the cost of the disposal ( which we estimate could amount to £500m) this year, even though the Company would not be able to benefit in any way from this provision, until EC agreement had been given. I understand a similar problem about timing arose with the Rover sale, and contingent arrangements were made, although they proved not to be required. There do not appear to be any insuperable legal or Government Accounting problems with such a proposal and the detailed arrangements could be discussed by officials. Shorts Holdings ( the non-trading parent ) may well prove a suitable vehicle.

16. Mr King's letter draws attention to the timing of NI Spring Supplementary Estimates. I understand that the latest date a decision could be taken would be 6 February. Provided Touche Ross report and a decision is taken before then about an early full recapitalisation it should be possible to make this deadline.

**CONCLUSION**

17. Mr King's letter makes great play of the practical problems of achieving an early full recapitalisation of Shorts and asks that alternatives should be considered at Monday's meeting. The difficulties he identifies are the result of some misunderstanding about the Treasury's position and most can be resolved. He does not however argue on grounds of principle against what you have proposed, and may therefore be willing to accept the case for an early recapitalisation (which he agrees would improve the attractiveness of the Company), if he can be persuaded that it is a viable option.

18. I attach a note of the main points you will wish to make at the meeting.

A handwritten signature in cursive script, appearing to read "Teresa Burnhams".

TERESA BURNHAMS

SHORT BROTHERS PLC:PRIVATISATION

POINTS TO MAKE AT THE MEETING WITH MR KING ON MONDAY 12 DECEMBER

There is agreement on the following:-

sale as a whole is the preferred option  
the need to cost the likely disposal of Shorts  
the need to make Shorts as saleable as possible  
the necessity of a recapitalisation

The only difference between you seems to be when the recapitalisation should take place.

You favour an early full capitalisation because-:

1. it makes the Company more attractive and facilitates its disposal as a single entity.
2. it improves the Governments negotiating position.
3. it provides the best chance of maintaining the confidence of Shorts' customers and suppliers and therefore of withdrawing the Government's assurances.
4. it allows earlier negotiations with the EC and may make negotiations easier than if a purchaser unwelcome to the EC were in play.
5. there would be a better chance of meeting the cost of the disposal this year when there were less pressures on the Reserve.
6. it would be favoured by Short's Board and might improve relations with the company.

**Mr King's position**

Mr King seems to favour a final recapitalisation because of the practical difficulties he sees with an early capitalisation. The problems he identifies can be dealt with as follows-:



undue delay while necessary work undertaken

Exhaustive reporting on all liabilities is not required simply an estimate of the likely cost of disposal and an indication of the extent of recapitalisation required.

difficulty of meeting requirements of NI Estimates

If Touche Ross begin work immediately their report on which to make a decision should be available before late January, and while tight the Estimates deadline could be met.

A provision could be made- but not made available to Shorts until EC approval obtained.

**The difficulties of proceeding as Mr King proposes**

The timetable is very ambitious and there must be doubts it can be adhered to.

The sales memorandum issued now would not present the company to its best advantage and might increase the cost of disposal.

Final recapitalisation would almost certainly mean the cost could not be met in this financial year.

To issue the sales memorandum without making clear the Government's position on recapitalisation or its' assurances runs unacceptable risks.

*risks on the former*

*agreement on the latter*

FROM: A M WHITE  
DATE: 12 DECEMBER 1988

CHIEF SECRETARY

cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Sir A Wilson  
Mr Monck  
Mr Moore  
Miss Peirson  
Mr Robson  
Mr Turnbull  
Mr Richardson  
Mr Lyne  
Mr Bent  
Mrs Burnhams  
Mr Call  
Mr Hyatt T/Sol

*Ch. CST would like to discuss shorts at your breakfast.*  
21 13/12

### SHORT BROTHERS PLC: PRIVATISATION

Further to my minute of 9 December, there are two points which you should argue in favour of delay to the present timetable of Mr King is not persuaded to go for our preferred approach of an early full recapitalisation followed by a sales memorandum.

2. At present, KB are seeking to obtain Mr Vigger's target date of this Friday 16 December for the release of the sales memorandum to interested parties. This is a breakneck process, far faster than we have attempted in other (easier) trade sales. You pointed this out in your letter of 6 December, and although Mr King did not comment in his reply I understand his position to be that he wants the document issued "as soon as possible" - so some delay beyond 16 December should be negotiable.

3. There are two good reasons for this:-

(a) the need to obtain clear legal advice on the effect and coverage of Government assurances so that the Government can position itself to best advantage in the sales memorandum;

(b) doubts we have on the accountants short form report, which will form part of the sales memorandum, and the need for further discussion with Deloittes to clarify these.

#### Assurances

4. I discussed the position here with Stephen Hyatt (Treasury Solicitors) this morning. His conclusion was that in order to know how best to address this issue in the sales memorandum we should now take advice from commercial Counsel. He is going to discuss the point with John Wright (the NICS Solicitor) but clearly Counsel's opinion could not be obtained in time for a document to issue on 16 December

#### Line to Take

5. You should point out to Mr King that the way in which Government seeks to disengage from the assurances is of vital significance not only to the possible costs of disposing of Shorts but to any future privatisations where the precedent could be argued. As Treasury Solicitor has advised that Counsel's opinion should be sought, the sales memorandum must wait until that has been obtained.

#### Accountancy issues

6. There are a number of points here, but the key one relates to the fact that Deloittes have qualified their Short Form Report in respect of £15m of stock carried at that value in the accounts for the year to March 1987, but now written down to nothing in the accounts to March 1988.

7. Sir Anthony Wilson, who I have consulted on the point, agrees that the proper treatment for Deloittes to apply would be to throw the provision back to 1987 in their Short Form Report. (Inter alia, this would give a more reasonable pattern to the five year figures in that report).

8. We now need time to discuss these issues further with Deloittes - which again militates against seeking to get the memorandum out by 16 December.

Line to Take

9. You should say that further discussions are needed with Deloittes on a number of point but particularly on their qualification to their Short Form report, on which Sir Anthony Wilson's advice is that the proper approach would be to throw the £15m provision at issue back into 1987. As this would improve the position it would be sensible to allow time for these further discussions with Deloittes before the sales memorandum was issued.



A M WHITE

*[Handwritten signature]*

FROM: A M WHITE  
DATE: 13 DECEMBER 1988

CHIEF SECRETARY

cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Sir A Wilson  
Mr Monck  
Mr Moore  
Miss Peirson  
Mr Robson  
Mr Turnbull  
Mr Richardson  
Mr Lyne  
Mr Bent  
Mrs Burnhams  
Mr Call  
Mr Hyett T/Sol

*[Handwritten initials]*

*[Red checkmark]*

**SHORT BROTHERS PLC: PRIVATISATION**

I discussed the question of the likely attitude of the European Commission towards a complete recapitalisation of Shorts in advance of sale with officials from the FCO and DTI earlier today.

2. While they were of the opinion that EC would not be willing to agree the the recapitalisation of Shorts without a counterpart- in this case assurances about the future viability of the company and its' purchaser - they did not rule out the holding company option as a means of ensuring that the cost of the privatisation can be met from this year's Reserve, and thought it worth taking soundings in Brussels.

3. In our favour there is the clear wish of the Commission to do nothing to exacerbate the difficult political and economic situation in Northern Ireland. In addition the difficulties of subsidisation in the aircraft sector are less acute than in other sectors. Finally they would regard a single final recapitisation more favourably than an interim cash injection, which is all they have been approached about previously.

4. The consensus was that provided guarantees can be given to the Commission that Shorts, as a trading company, will not be able to gain access or benefit directly from the money set aside for the recapitalisation until EC agreement is given, there was a clear chance that the Commission would not wish to initiate a Section 93 procedure, or even treat it as a formal notification of state aid. There is, of course, some risk that they might object, and if this was to be the position we would have to consider whether we would wish to proceed and put in jeopardy their cooperation when negotiations started in earnest.

5. In our approach to the Commission we would make it clear that the recapitalisation would improve the chance of the sale of the company and thus mark an end of its status as a pensioner of the state. We would also make it clear that we would intend to consult fully about the the final terms of the disposal and the purchaser.

6. I understand that Mrs Chalker, who will be attending Thursdays meeting, is likely to point out the difficulties of what we propose but will agree that it is well worth making an informal approach to see if what is proposed is acceptable.



A M WHITE

FROM: A M WHITE  
DATE: 15 DECEMBER 1988

CHIEF SECRETARY

cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Sir A Wilson  
Mr H Phillips  
Mr Monck  
Mr Moore  
Miss Peirson  
Mr Robson  
Mr Turnbull  
Mr Beastall  
Mr Richardson  
Mr Waller  
Mr Lyne  
Mr Bent  
Mrs Burnhams  
Mr Call

**SHORT BROTHERS PLC: PRIVATISATION**

The attached note records the position reached following my discussions with Mr King's officials on the matters identified at Monday's meeting as needing further examination.

2. It was agreed that before the sales memorandum could be issued advice from commercial Counsel should be obtained about the Government assurances which had been given in respect of Shorts' credit-worthiness; and secondly further advice should be sought about the short and long form reports produced by Deloitte's.

3. Annex A sets out the advice obtained from Counsel which concludes that the Government cannot withdraw their assurances retrospectively even if a full recapitalisation of the company takes place. The advice also addresses the Government's liability after the assurances are withdrawn, how the position could be improved and what should be said in the sales memorandum. Treasury Solicitors have no further objections to the issue of the sales memorandum.

4. Touche Ross have examined the reports prepared by Deloitte's and I will be able to confirm their conclusions at tomorrow's meeting. However Deloitte's have already shifted their position on the timing of losses in a way which is acceptable to us.

5. We have also been examining the recapitalisation of the company taking into account the likely attitude of the EC, public expenditure implications and accountability to Parliament. The EC dimension has been discussed with FCO and DTI officials and the note reflects their advice. TOA have been consulted on the propriety of the various options and are content that Annex B accurately sets out the position on the accountability issues.

6. Unless Touche Ross identify any further difficulties with the accountant's reports there are no further objections to the issue of the sales memorandum. The necessary wording to reflect the legal advice can be agreed by officials.

7. If we are to meet the Estimates deadline an early decision on the method of recapitalisation will be needed and we will need to consult the EC informally as soon as possible.



A M WHITE



## SHORT BROS PLC

## NOTE BY TREASURY AND NORTHERN IRELAND OFFICIALS

Introduction

On 12 December the Chief Secretary to the Treasury and the Northern Ireland Secretary asked their officials urgently to examine:-

- (a) the question of the issue of the sales memorandum by Kleinwort Benson
- (b) issues related to the recapitalisation of the company. In considering this point the EC dimension should be taken clearly into account.

Sales memorandum

2. Both Ministers acknowledged on 12 December that two difficulties should be resolved before issue of the memorandum.
3. The first related to the implications of previous Government assurances on the credit-worthiness of Shorts and references to these in the memorandum. Commercial counsel's opinion was provided at a meeting on 14 December: a note of the discussion is at Annex A. Essentially counsel's advice is that the assurances may not be withdrawn with retrospective effect; they would continue to apply up to the point of sale; in certain circumstances, particularly subsequent insolvency of Shorts, the Government could retain contingent liabilities, but our position would be improved if customers were notified about the withdrawal. As to the terms of the memorandum, counsel advised that it should state when the assurances would be withdrawn, eg point of disposal. Following counsel's advice officials believe that this aspect should be longer impede issue of the sales memorandum.
4. The second difficulty related to both the short and long form reports and the 1987-88 company accounts. On the short form

report, Deloitte appear to have reconsidered their position on the question of timing of certain losses in a way which seems likely to resolve the problem without further references to the Treasury. On the long form report and company accounts, Touche Ross have been asked to examine loss provisions and to report by tonight: officials should be in a position to report orally tomorrow. In the event that problems arise in the light of the Touche report, they should be remitted to officials. (It is understood that Touche Ross are undertaking their work without reference to the company.)

5. Officials believe that, provided Touche Ross' report is positive, the way is now clear to issue of the sales memorandum in the week beginning 19 December.

#### Recapitalisation

6. Officials have borne the following three main criteria in mind in examining options:-

- (a) the EC dimension
- (b) public expenditure implications
- (c) accountability to Parliament.

7. Three main options have emerged:-

- (a) fully recapitalise Short Bros plc in 1988-89
- (b) inject equity into SB Realisations, the holding company, in 1988-89
- (c) convert Shorts' commercial debt into Government debt in 1988-89.

8. Annex B (agreed between the Treasury and DFP Treasury Officers of Accounts) examines each of these options from an

CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE

accountability view point. Taking account of this, officials' assessment of the options is as follows:-

(a) full recapitalisation: this option would clearly make the greatest contribution to making the company as a whole attractive to potential purchasers. It fully meets both the public expenditure and accountability criteria. It may however encounter stiff opposition from the Commission on the grounds that it would offer no "counterpart" (in the form of evidence drawn from a corporate plan prepared by the new owner that Shorts would require less state aid in future than currently, and possibly in the form of a restructured company); and that our actions would be taken before the identity of the actual purchaser was known. The chances of successfully passing muster with the Commission must therefore be slim but officials believe that very early soundings should be taken with the Commission.

(b) SB Realisations: this option would not enable Shorts to reconstruct their balance sheet but would be a tangible demonstration of the extent of Government's intent to do so. As such it would be less satisfactory than the previous option but it would still make the business as a whole more attractive to prospective purchasers. This option would meet the public expenditure criterion. It should be easier to negotiate with the Commission than option (a) but it could still meet significant opposition. There are, however, grave objections to this <sup>option</sup> on grounds of propriety, since it would involve payment of the money so that it could rest in the hands of the holding company.

Our preliminary estimate is that either (a) or (b) would cost some £450 - £500m.

(c) Conversion of commercial to Government debt: this might enable DED to lend to Shorts, say, £350m in 1988-89 in convertible loans so that the company could repay its commercial debt. This would not reconstruct the balance sheet, but again would be a tangible demonstration of our

CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE

intent. It would be less likely to encounter initial problems with the Commission. This option would meet the public expenditure criterion to the extent that, say, £350m could be met this year, but it could well leave a requirement for a further 'tidying-up' in 1989-90. It raises some accountability problems, because there may be difficulty in formulating an accurate description of the assistance for the purposes of Parliament which would also be acceptable to the Commission.

#### DTI views

9. Lord Young (Private Secretary letter of 14 December) has pointed out that securing Commission agreement to early action will not be easy. Difficulties were encountered on Rover, where a reconstruction plan and an acceptable purchaser were available. Having neither on Shorts there is a risk that an approach to the Commission may provoke an investigation by them, with consequent delay to the privatisation.

10. His officials have subsequently said that the safest course may be to simply replace existing loans by Government loans without formal notification, subsequently arguing that this had not constituted additional state aid.

#### Action in Brussels

11. If either of the main recapitalisation options (a and b in paragraph 7 above) is to be pursued an early approach to Brussels must be made. If, in the light of Commission reaction, we need to fall back to replacing existing commercial loans by Government lending it should be left to UKREP's discretion the extent to which they sounded the Commission informally on this point.

#### Timetable

12. Ministers' decisions will have to be reflected in the Supplementary Estimates. Allowing for an approach to the Commission, the Appropriation process will need to be compressed

**CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE**

and this will require the agreement and co-operation of the Lord President and the Chief Whip. Further advice to the Northern Ireland Secretary will follow.

**CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE**

## NOTE OF CONSULTATIONS WITH COUNSEL

Richard Sykes QC advised on the withdrawal of the assurances, and on their coverage. He was asked to advise on the basis that HM would wish to act as if the assurances were legally binding.

2. The first question was whether the assurances could be withdrawn with retrospect effect if prior to their withdrawal, Shorts were recapitalised. Counsel advised that retrospective withdrawal was not permissible even if there were a recapitalisation. He advised that they could be withdrawn for the future. The withdrawal should be widely publicised and notice should be given rather than the withdrawal taking effect as soon as an announcement was made.

3. The second question was the extent to which the assurances would cover liabilities which arose after withdrawal of the assurances but pursuant to agreements entered into by Shorts while the assurances were current. Counsel advised that the assurances referred to those dealing with the company. This meant that where a person dealt with the company while the assurances were current, that person was entitled to rely on the assurances. Therefore, for example, where a customer of Shorts had bought an aircraft while the assurances were current but a defect was discovered after withdrawal of the assurances, HMG would be required to indemnify the customer if Shorts became insolvent. In practice insurance might cover that liability. The position would appear to be different if there were a long term supply contract entered into while the assurances were current, but the product was supplied after withdrawal of the assurances in circumstances where the customer was not bound to buy from Shorts. In those circumstances the customer would not have recourse to HMG under the assurances. The Government's position would be improved if those customers were notified about the withdrawal.

4. Finally Counsel was asked to advise on the statement in the Information Memorandum about withdrawal of the assurances. He

CONFIDENTIAL

advised that the paragraph should state when the assurances would be withdrawn, for example, the time of sale of the company.

5. The advice was given in part on the assumption that the letter sent by Merlyn Rees to the Directors of Shorts on 10 August 1976 had not been withdrawn. DED are investigating this.

## ACCOUNTABILITY ISSUES

There are no accountability problems with the desired outcome of reconstruction in the current year.

2. The variant of making a payment this year to the Holding Company SBR for a payment to Shorts at some undefined stage in the future breaches the fundamental tenet of Government Accounting that monies should not be paid in advance of need. The fact that in this scenario the cash may not be used quickly by SBR would be seen as evidence that it was not 'needed' in the normal sense of the term.

3. It would have to be argued that there existed the immediate 'need' of giving a clear signal to the market place of Government's intentions for Shorts by actually paying money into the Holding Company. This assessment would certainly need to be unambiguously supported by private sector advice and even then it would be difficult to argue that a clear statement in the House would not achieve the same purpose. In summary officials believe that this route would be highly risky, see difficulty in defending it in terms of Parliamentary propriety (payment in advance of need) and officials do not recommend it.

4. The final option of making a loan to Shorts now to enable repayment of commercial debt could be criticised on two grounds. First, since the Estimates before Parliament would seek approval for a loan, repayment of which was not expected, Ministers might be accused of misleading the House. Secondly, it could be queried whether the repayment of commercial loans had been undertaken sooner than was really necessary.

5. Officials believe that these problems might be overcome by a combination of steps. First, the loan should be described in Estimates as a 'convertible loan'; secondly in presenting the Estimates to the House the Minister should make clear that the use of the loan mechanism was necessary to minimise Commission



**CONFIDENTIAL**

difficulties and that the intention was to convert the loan to equity as soon as Commission agreement was obtained; and thirdly that once the decision had been taken it made sense to move quickly since commercial loans, which Government was guaranteeing, and would eventually have to discharge, were at a higher rate of interest than was necessary. The text of the Minister's statement would need to be agreed with the Commission in advance.

**CONFIDENTIAL**



FROM: CHIEF SECRETARY  
DATE: 16 December 1988

CHANCELLOR

**SHORT BROTHERS PLC: PRIVATISATION**

I saw Tom King again this morning with the aim of trying to resolve all the outstanding difficulties in order to allow an early issue of the sales memorandum. We also considered the view the EC might take of a recapitalisation of Shorts in advance of sale.

*This is attached to Mr White's minute, behind.*  
2 The note prepared jointly by Treasury and Northern Ireland officials on 15 December confirmed that, provided Touche Ross (who were appointed to examine the long and short form reports) identified no further problems, the way would be clear to issue the sales memorandum in the week beginning 19 December.

*16/12*  
3 Touche Ross have confirmed that certain of our concerns were justified, but in the meantime Deloittes have proposed an amendment to the figures in the sales memorandum which meets these concerns. This has placed pressure on the company in finalising its accounts.

4 A new problem has now arisen which you will wish to be aware of. Relations with the Chairman of Shorts have been strained for some time, and he is now asking, on behalf of the Board, for a number of indemnities. The first concerns any liability that they may incur in respect of the sales memorandum; the second is for damages arising from statements and actions of Government in their handling of Shorts' privatisation, and which we believe may be related to problems they have had with Deloittes in finalising the Accounts; and the third an absolute indemnity for any claims arising once the Government withdraws its existing assurances with regard to continuing support for Shorts.

5 These requests for indemnities go far beyond the indemnities that we normally consider appropriate in privatisations, and it is important to avoid any unacceptable precedents or expose Government on matters which should properly be the responsibility of the Directors. Clarification of the precise nature of the concerns of the Directors is being sought so that the issues can be addressed by the Government's legal advisers.

6 These issues may simply be delaying tactics which can be resolved, but if the Directors refuse to sign off the accounts without the requested indemnities there must be serious doubts about the early issue of the sales memorandum. Its issue before Christmas may now be out of the question - but we still need to resolve these issues with the Chairman quickly, and Tom may need to see him early next week.

7 The possibility of recapitalisation may be a sufficient carrot to induce the Board's cooperation, but at this stage it would be unwise to make too much of this without first taking soundings in Brussels.

8 On this I hope to have some informal indication of the likely view of the Commission on our preferred options for recapitalising before Christmas. A decision will need to be taken very shortly if we are to meet even part of the cost of disposal from this year's Reserve. If the signs from the EC are adverse the fall-back option would be to replace the company's commercial borrowing -currently standing at £350 million- by Government loans, which should not cause the same difficulties with the Commission who may be willing to turn a blind eye.

9 I am expecting to have a further meeting with Tom in the next few days once further advice is available on the indemnity question.

*Carys Evans*

pp

JOHN MAJOR

FROM: MRS T C BURNHAMS  
DATE: 21 DECEMBER 1988

1. MR WHITE ✓ ~~21.12~~  
2. CHIEF SECRETARY

cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Sir A Wilson  
Mr H Phillips  
Mr Monck  
Mr Moore  
Miss Peirson  
Mr Robson  
Mr Turnbull  
Mr Beastall  
Mr Richardson  
Mr Waller  
Mr Lyne  
Mr Bent  
Mr Call  
Mr Hyett T/Sol

**SHORT BROTHERS PLC: PRIVATISATION**

Following your meeting on 16 December with Mr King you asked for an assessment of the indemnities which Shorts' Board are seeking.

2. Three separate indemnities have been requested, either through Shorts' legal advisers, or in a letter dated 15 December from the company's Chairman- Mr Lund. The first relates to the verification of information used in the sales memorandum. Here it is argued that as HMG and their advisers will not be exposed in respect of the sales memorandum, Shorts' Directors and employees should not have any liability as a result of the conduct of the verification process.

3. However we have been advised that, while the Government and its advisers should not have any civil liability, a liability to criminal penalties under Section 47 of the Financial Services Act might arise if information was included in the sales memorandum recklessly. In view of this we need to be satisfied that the relevant Directors and employees accept responsibility for the verification work they have carried out.

4. Although the Directors would have no liability to third parties for the sales memorandum they are concerned that the Government may warranty information from the memorandum in the sales contract. We would therefore be prepared to offer an indemnity in respect of innocent misrepresentation - which is our normal approach in Privatisations- but it would be without precedent to

go as far as the company has requested, and would leave the Government in an untenable position. We await further comments from Shorts' advisers but we are hopeful that the more normal indemnity will be acceptable, provided it is agreed that the company's responses will not be used to increase their exposure without further discussions.

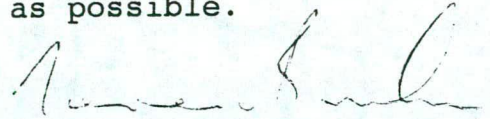
5. The second indemnity relates to damages arising from statements and actions of Government in their handling of the privatisation. This seems to amount to an indemnity to the Directors for failing to sue the Government as a result of actions by the Government which might be damaging to the company. Since the common aim of the Government and the Directors is a successful privatisation it would be against the Government's own interests to seek to damage the company and there can therefore be no case for this particular indemnity.

6. The last request is for an absolute indemnity for any claims arising once the Government withdraws its existing assurances of continuing support for Shorts. It is doubtful if any liability could fall on the Directors in these circumstances since the Government has made it clear that the assurances will remain in place until privatisation and the company will be recapitalised before sale so that it was in a position to meet its future obligations.

7. Mr Lund's letter also raises the question of the basis on which the company is to be sold and expresses concern about the Directors' responsibility for the accounts and whether it would be valid for them to be signed on a going concern basis if the Government is to break-up the business.

8. I attach recent correspondence from Mr Lund together with a proposed reply. This is based on an original draft prepared by NI officials, but it has been amended to reflect our comments and those of Treasury Solicitor. I understand these amendments will be acceptable and that Mr Viggers will be writing very shortly. The letter should be able to satisfy Mr Lund on the Government's intentions, convince him that the indemnities he seeks are not necessary and should ensure that the accounts can be finalised without any further delay. The way would then be clear to issue the sales memorandum early in January.

9. Finally you will be pleased to know that the terms of reference for the costings exercise Touche Ross are to undertake have been agreed, and a briefing meeting is expected to take place shortly to enable work to start as soon as possible.



TERESA BURNHAMS

**DRAFT LETTER FROM:- MINISTER**

**TO:- MR RODNEY LUND**

I refer to your letter of 15 December 1988 to the Secretary of State. You also wrote on 25 November and 7 December, and I would also like to deal with the main points raised in those letters.

Firstly I would like to reassure you, that there has been no change in Government's policy regarding the basis of selling the company. It is Government's clear preference to sell the company as a whole and the company is being offered for sale on this basis. Only if this is not possible on suitable terms will the Government need to pursue other alternatives.

The Government recognises the importance of the Parliamentary Assurances to the directors and creditors of the company. However it is intended that at privatisation, following a recapitalisation, the Government will be able to withdraw its assurances as they will be no longer required, nor indeed could their continuation be justified to Parliament once ownership and control of the business has passed to other hands. Such withdrawal is an integral part of Government privatisation policy and has been implemented in all similar privatisation. In this case, as in all others, we would of course ensure that this was done in a proper manner without the company or any creditor being disadvantaged. I do not accept your Board's belief that we would need to receive the prior agreement of all parties dealing with the company before withdrawing the assurances. However, I can reassure you that, as I said in the House of Commons on 21 July, the Government's assurances remains in place for the period to privatisation.

I note your comments regarding the issue of indemnities to you and your fellow directors. I agree wholeheartedly that it is vital that nothing is said or done which will jeopardise a successful privatisation. I believe that the recent press reports attributing statements to Kleinwort Benson, yet again underline the need for great care from all parties when dealing with the press. In this general context I consider it essential that when meeting the press, we both adopt a positive approach and concentrate on the positive aspects of the company. [ I do not, for example, see it as helpful to infer that the company's current unsatisfactory financial position is solely the consequence of government policy, nor for the press to suggest misleading analogies with other privatisations.][Editor is this necessary?]

Since our common aim is a successful privatisation, and it would be against Government's own interests to seek to damage the company and hence the prospects for privatisation, I can see no case for an indemnity.

I trust that in the light of my officials letter of 2 December and the further comfort in paragraph 3 above your Board will now be in a position to approve the 1988 Accounts, so that they can be issued along with the Information Memorandum at the beginning of January.



**SHORTS**

Rodney Lund

Our ref: RL/mbt

25 November 1988



The Rt Hon. Tom King MP  
 Secretary of State for Northern Ireland  
 Stormont Castle  
 BELFAST  
 BT4 3ST

*Dear Secretary of State,*

Our meeting last week was not an appropriate forum for me to comment on your remarks that recent press articles were damaging.

The damage to the privatisation process was done last July when Shorts was placed squarely in the "lame duck" category. We have had to do our best since to counter epithets such as "millstone" and "dinosaur".

As you know, Shorts is far from being a dinosaur, and when we give briefings, the press and other opinion-formers are surprised to discover that Shorts is at the frontier of design, innovation and technology in all three of its businesses; that there is a forward order book of £1 bn; that it had impressive growth until the last couple of years when lack of capital investment began to take its toll; and that it developed its impressive product range despite being starved for 25 years of HMG military aircraft and aerostructures work.

I make it clear to those I meet that we are pulling out all the stops in the hope of achieving an early and successful privatisation.

It should not be a surprise that commentators draw on analogies of Government treatment of British Airways, Rolls Royce and British Steel on the road to privatisation. Although Shorts is smaller, its relevance in employment terms to the Province is the equivalent to that in Britain of British Coal, Rolls Royce, British Gas, Jaguar and British Airways rolled into one.

*Yours sincerely*  
*Rodney Lund*

**SHORTS**R C LUND  
CHAIRMAN

RCL SK

7 December 1988

The Rt Hon Tom King MP  
Secretary of State  
Northern Ireland Office  
Stormont Castle  
BELFAST 4*Dear Secretary of State,*

I think that you may agree that it is unfortunate that an agent of Government should make statements to the FT (6 December) which give rise to the same fears and uncertainties we experienced last July. Customers, potential purchasers and employees read that "bidders are not to be required to guarantee the Company will stay as a single entity", nor need they "keep Short Brothers in the airliner business". And yet again customers are told that "the 330 and 360 are reaching the end of their commercial lives".

I fail to see what purpose such an interview serves.

In fact, the reiteration of the possible break-up of the business and withdrawal from the airline business runs completely counter to the basis upon which the annual accounts and the Sale Memorandum have been prepared. Both have been prepared on the basis that we are seeking to privatise the Company as a going concern. This principle has been agreed between Kleinworts, your officials, Deloitte and Shorts.



If the Business is not to be sold as a going concern, then the privatisation process as we have been planning it for the last few months grinds to a halt. The Board now needs to examine two issues:

- 1) In the light of the Kleinworts press statement, should the Board sign off accounts prepared on a going concern basis? The auditors have signalled their concern; and
- 2) For their own protection what remedy the Board may be required to seek in law against the issuing of statements they believe damaging to the business.

*Yours sincerely*  
*Rodney Kunal*

# SHORTS

15 December 1988

The Rt. Hon. Tom King MP  
Secretary of State  
Northern Ireland Office  
Stormont Castle  
BELFAST BT4 3ST

*URGENT*

*SJS*

*To see  
m  
15/12*

*cc PS/SofS (BOL) - T  
PS/m. Laggan (BOL) - T  
PS/PUS (BOL) - T  
PS/si W. Blawfield  
m. Fell - T  
m. Anthony - T  
m. Weather - T  
m. G. M. Connell - T  
m. T. Thomson - T  
for advice & info only a.s.p.*

Dear Secretary of State

Today the Shorts' Board concluded that recently reported changes to agreed policy, and uncertainties over the handling of assurances to those doing business with the Company, make impossible the signing-off of the Annual Accounts in their present form.

*No change*

*Not true*

The basis of preparation of the accounts had been agreed with Government for many months - a basis predicated by your decision to pursue Option A of the Strategic Review. Your Information Memorandum states that 'the financial information has been prepared on a going concern basis and on the assumption that there is no requirement to curtail significantly any of the operations of the Company'.

*accounts*

The agreed objective was to move the Company into the Private Sector as a whole.

The Board's belief has always been that with proper handling there was a high probability that the business could be privatised as a single entity. Appropriate accounts were prepared. But we are advised that those accounts may no longer be appropriate in the light of attributable press briefings which virtually concede that curtailment of a major part of the business is admissible, and indeed break-up may be considered.

*Not true*

The Board fail to see why, when a positive plan for Privatisation has been agreed, an attributable briefing to the Press should presage the failure of that plan. Not to pursue the plan in a robust manner renders failure and consequential break-up of the business much more likely. The Board is deeply conscious of the enormous extra cost to the British Tax payer that break-up would bring, and of the grave consequences in terms of job losses.

The Board is fully aware that if, in some months time, the financial considerations for the transfer of the shares of the Company prove to be so costly that an alternative course of action would be of greater benefit to the Exchequer, then a new plan of action would certainly be required. Only at that stage might we be contemplating the preparation of Accounts containing provisions for break-up and closure.

SHORT BROTHERS PLC  
PO Box 241 Airport Road Belfast BT3 9DZ Northern Ireland  
Telephone 0232 58444 Telex 74688 Cables Aircraft Belfast  
FAX 0232 732974 0232 54406  
Registered in Northern Ireland: Certificate NI 1082

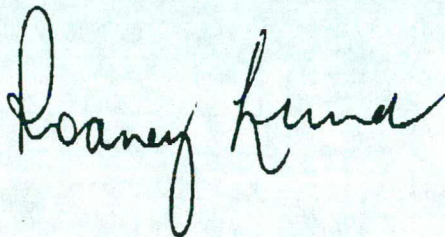


Every business has contingency plans, but very few businessmen, once having selected their preferred objectives and declared their plan of campaign would be so foolish as to publish contingency plans, particularly if such publication was likely to affect customer confidence, cause employee unrest and in any other way damage the business. The Board believes that damage has been caused to Shorts by recent reiteration by agents of Government of possible curtailment of activities of the business and break-up - just as we believed damage was caused by similar statements attributable to Government spokesmen in July last. The Board owes a duty to the Company, and we cannot stand idly by while damage is being caused. The Board seeks from you an indemnity absolving us from any liability for damage arising from statements and actions of Government in their handling of the privatisation of Shorts. We also wish to place on record, for the National Audit Office and the Public Accounts Committee, that the Board did advise members of Government in July 1988 that talk of part closure and piecemeal sale of the company could have damaging effects on the business, and consequently on the proceeds of sale.

The Board is also concerned that Government may be seeking unilaterally to remove guarantees for the borrowings and liabilities of the Company. The Board has sanctioned contracts and borrowings in the knowledge that HM Government assurances are in place (Hansard 27 December 1981 and 13 November 1986). The Board believes that it is for those doing business with the Company to agree to the removal of guarantees before Government states that it is withdrawing them. In the event that Government does seek to withdraw their assurances, the Board of Shorts seeks absolute indemnity for any claims arising from such withdrawal.

We trust that these matters may be resolved quickly by you in such a way that we and the Auditors might judge it proper to submit Accounts on the basis we thought had already been agreed.

For and on behalf of the Board



CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE  
FM UKREP BRUSSELS  
TO PRIORITY FCO  
TELNO 3998  
OF 211410Z DECEMBER 88

YOUR TELNO 412  
SHORT BROTHERS PLC

SUMMARY

1. CONFIRMATION THAT COMMISSION WOULD HAVE DIFFICULTIES IN APPROVING A RECAPITALISATION IN ADVANCE OF SALE. THEY WOULD BE UNLIKELY, HOWEVER, TO HAVE ANY PROBLEMS WITH INJECTION OF EQUITY INTO A BLOCKED ACCOUNT, THOUGH THEY WOULD WANT TO BE INFORMED. AS THIS LATTER OPTION WOULD NOT REQUIRE FORMAL COMMISSION APPROVAL, WE COULD PROCEED WITH IT WITHOUT DELAY IMPOSED THIS END.

DETAIL

2. WE HAVE ACTED ON YOUR TEL UNDER REF SEPARATELY WITH MISS DAY (SUTHERLAND CABINET - AND TO CONTINUE DEALING WITH STATE AIDS IN THE BRITTAN CABINET) AND SUNNEN (DIRECTOR, DGIV).

3. WE EXPLAINED THE BACKGROUND TO EACH (STRESSING THE NORTHERN IRELAND DIMENSION) AND BEGAN BY CANVASSING OPTION (A), IE RECAPITALISATION IN ADVANCE OF SALE. MISS DAY SAID THAT, WHILE THERE WOULD BE A DISINCLINATION ON THE PART OF THE COMMISSION TO ROCK THE BOAT IN STATE AID CASES IN THE AIRCRAFT SECTOR, THEY WERE EXAMINING THE PROPOSED GERMAN AID TO MBB CAREFULLY, AND WOULD HAVE TO BE SEEN TO APPEAR EQUALLY RIGOROUS WITH OTHER AIRCRAFT CASES. (SUNNEN SPOKE IN A SIMILAR SENSE.) THE LACK OF EC JUSTIFICATION (AS OPPOSED TO A COMMERCIAL ONE) FOR THE RECAPITALISATION WOULD MEAN THAT IT WOULD BE DIFFICULT FOR THE COMMISSION TO APPROVE THE APPROACH.

4. SUNNEN WENT FURTHER. THE RECAPITALISATION WOULD, HE ASSUMED, BE TREATED AS RESCUE AID, AND THE COMMISSION WOULD NEED TO ASSESS IT AGAINST THE CRITERIA OF WHETHER IT LED TO VIABILITY: WHETHER IT DAMAGED EC COMPETITORS: AND WHETHER THE DEVELOPMENT OF THE SECTOR WAS BEING ASSISTED AT EC LEVEL. THIS LAST FACTOR DID NOT NECESSARILY MEAN THAT CAPACITY CUTS WOULD BE REQUIRED (THAT WAS A PRE-REQUISITE IN SECTORS OF EC OVER-CAPACITY): BUT THERE WOULD HAVE TO BE A 'RESTRUCTURING PLAN' OF SOME SORT. IF WE NOTIFIED A RECAPITALISATION IN THE ABSENCE OF SUCH A PLAN, DGIV WOULD BE LIKELY TO RECOMMEND DELAYING APPROVAL UNTIL A PLAN (IE INFORMATION ON THE PURCHASER AND

HIS INTENTIONS) WAS AVAILABLE. IF WE WERE TO MAINTAIN THAT THIS DELAY DAMAGED THE COMPANY, DGIV MIGHT SUGGEST THE PROPOSED RECAPITALISATION WAS TURNED INTO A LOAN AT COMMERCIAL RATES.

5. THIS LED TO A DISCUSSION OF PROCEEDING VIA A LOAN AT COMMERCIAL RATES (THOUGH WE DID NOT IDENTIFY OPTION (C) OF YOUR TEL UNDER REF AS AN OPTION BEING ACTIVELY CONSIDERED). SUNNEN CONTENDED THAT DGIV WOULD REQUIRE SUCH A LOAN TO BE NOTIFIED (SOMETHING WE MIGHT WANT TO RESIST AS A MATTER OF PRINCIPLE), BUT HE DID NOT FORESEE PROBLEMS IN SECURING COMMISSION APPROVAL - THOUGH WE COULD NOT RULE OUT THAT, WHEN WE NOTIFIED CONVERSION OF THE LOAN INTO EQUITY AT A LATER DATE, THE COMMISSION MIGHT REQUIRE PART OF THE SUM TO BE REPAID.

6. SUNNEN AND MISS DAY WERE MORE ENTHUSIASTIC ABOUT OPTION (B) - INJECTION OF EQUITY INTO A HOLDING COMPANY, BUT RELEASE TO AWAIT COMMISSION APPROVAL. MISS DAY SAID THAT THERE WERE PRECEDENTS FOR THIS. SUNNEN SUGGESTED THAT IT WOULD BE WISE FOR US TO INFORM THE COMMISSION OF OUR ACTION, EXPLAINING THAT IT REPRESENTED THE FIRST STEP OF A PLAN TO GRANT AID, BUT THAT NO AID WOULD BE RELEASED UNTIL AFTER A FORMAL NOTIFICATION HAD BEEN MADE AND COMMISSION APPROVAL RECEIVED. THIS WOULD ENABLE THE COMMISSION TO RESPOND TO ANY ENQUIRIES/COMPLAINTS THEY RECEIVED FROM OTHER INTERESTED PARTIES WITHOUT MAKING WAVES FOR US (AND SUCH COMPLAINTS - EVEN FROM UK INTERESTS - CANNOT BE RULED OUT, AS WE WITNESSED IN THE CONTEXT OF BRITISH STEEL PRIVATISATION).

#### COMMENT

7. THESE INFORMAL CONTACTS POINT US FIRMLY TOWARDS OPTION (B). OPTION (A) COULD BE EXPECTED TO RUN INTO A COMMISSION ROAD-BLOCK. OPTION (C) IS LIKELY TO BE ACHIEVABLE AT THE BRUSSELS END, BUT - IF WE FELT OBLIGED TO NOTIFY - CREATES THE PROBLEM (IDENTIFIED BY SUTHERLAND TO MR VIGGERS) OF THE COMMISSION HAVING TWO BITES OF THE CHERRY.

8. AS TO TIMING, OPTION (B) WOULD NOT INVOLVE ANY DELAY AT THE BRUSSELS END, AS WE WOULD NOT BE SEEKING FORMAL COMMISSION APPROVAL OF THE ACTION (WE WOULD SIMPLY BE INFORMING THEM). OPTION (A) COULD, CONVERSELY, LEAD TO AN INDEFINITE DELAY, IE UNTIL WE HAD A RESTRUCTURING PLAN (UNLESS WE WERE READY TO TRANSLATE THE EQUITY INJECTION INTO A LOAN). AS FOR OPTION (C), IT SEEMS LIKELY THAT THE COMMISSION WOULD WANT FORMAL NOTIFICATION IN ADVANCE OF ACTION: A DECISION COULD BE EXPECTED WITHIN 2 MONTHS OF THE NOTIFICATION.

HANNAY

YYYY

DISTRIBUTION

29

MAIN 14

LIMITED  
ECD(I)

PS/MRS CHALKER  
MR KERR

ADDITIONAL 15

ARTHUR FCO  
ALTY CAB  
KING (IEP) DTI  
MS ANDERSON (AIR) DTI  
AM WHITE TSY  
THOMSON DED NORTHERN IRELAND  
BLYTHE TSY SOLS  
PS/CHIEF SECRETARY

PS/MR KING  
PS/LORD YOUNG  
MR A M WHITE, ST3 TREASURY  
MR G MCCONNELL, NIO(L)  
MR R KING, IEP, DTI  
MS R ANDERSON, AIR DIV'N, DTI  
MR J HOLROYD, CABINET OFFICE

NNNN