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PREM 19/1870

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PART 9

CONFIDENTIAL FILING

SHIPBUILDING POLICY

SHIPBUILDING PAY

NATIONALISED INDUSTRIES

PART 1: MAY 1979
PART 9: FEB 1986

PREM 19/1870

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~14.2.86~~							
~~20.2.86~~							
~~6.3.86~~							
~~13.3.86~~							
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~~21.4.86~~							
~~22.4.86~~							
~~24.4.86~~							
30 29.4.86							
PART ENDS							

Material used by official Historian DO NOT DESTROY

PART 9 ends:-

P. Hares (Chief Exec. British Shipbuilders) to PM 30.4.86

~~MGA to T. BERGMAN 29/4/86~~

PART 10 begins:-

J. UNWIN to DN 1/5/86.

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(86) 17th meeting, item 3	24/04/1986

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed _____ Date 8/10/2014

PREM Records Team

British Shipbuilders

Phillip D. G. Hares, C.B.E.
Deputy Chief Executive,
Board Member for Finance

197 Knightsbridge
London England SW7 1RB
Telephone: 01-581 1393
Telex: 8814702 BSBLDR G

284/86/L1
30 April 1986

The Rt Hon Margaret Thatcher MP
Prime Minister
10 Downing Street
LONDON S W 1

Dear Prime Minister,

First of all let me thank you again for acting as sponsor to the Stena Seawell on Friday last. Your presence was most appreciated by all concerned particularly as we know how busy you are at this time.

You particularly asked me to write to you regarding the Fleet Support King 20/20 (FSK 20/20). This vessel evolved from studies started within British Shipbuilders in 1981 to develop a commercially designed and relatively low cost replacement for the ageing tankers and supply ships of the Royal Fleet Auxiliary (RFA) service.

FSK 20/20 has a displacement of about 30,000 tonnes and is designed to carry and transfer at sea all the supplies needed by a modern naval task force. For the Royal Navy these comprise diesel oil fuel for warships, furnace fuel oil for RFA ships (and the royal yacht), aviation fuel, lubricating oils, fresh water, refrigerated foods, munitions and all types of naval stores. To cater for the increasing use of helicopters a facility is included to carry three Sea King or EH 101 aircraft, with up to two operational at any time; maintenance workshops are also included. Accommodation is provided for a peacetime complement, with provision for increasing personnel in time of conflict. With regard to the supply and fitting of weapons, British Shipbuilders are precluded from doing this under the terms of the warship privatisation arrangements but provision could be made for a Stage A weapons fit to meet the post Corporate requirement on a "fitted for but not with" basis in readiness for subsequent equipment installation by a private sector naval yard.

In mid 1984 a presentation to industry by MOD indicated probable ship orders for six vessels of the AOR type as a first batch. The ships were to be about 30,000 tonnes displacement, designed to carry a mixture of stores, ammunition and fuel, and were to have self defence and aviation capabilities.

In October 1985 British Shipbuilders gave a presentation of the FSK 20/20 design to the MOD and to representatives of the Canadian, Australian, New Zealand and US navies. Firm prices and deliveries were quoted for four ships of this class. At its request, design specification details were given to MOD in December 1985; contract terms were also provided.

A study of the design was made by MOD against the Naval Staff Requirement for the AOR as this was the only MOD requirement for replenishment ships established at that time. A copy of its findings was forwarded to British Shipbuilders in April 1986; these appeared generally supportive of the FSK 20/20 but, compared with the AOR, the design was criticised in respect of some aspects of naval operations. These criticisms were primarily of its replenishment at sea and helicopter capabilities (especially in high sea states) and in its lack of a weapons fit. Relative to the AOR it was also deficient in accommodation for crew and weapons personnel. However, during the three months of the MOD study, additional information became available to British Shipbuilders concerning the latest naval requirements for this class of vessel. Accordingly, in April 1986 supplementary information was sent to MOD which pre-empted some of the criticisms which appeared in the MOD report referred to above.

The current situation is that despite the MOD not having a Naval Staff Requirement for an FSK 20/20 ship type it is willing to discuss the findings in its report with British Shipbuilders on an entirely non-commitment basis; a meeting for this purpose will take place in June 1986. We are confident that this meeting will show that the FSK 20/20 can, with the addition of certain available options, operate for the RN in both a front and second line role and, at the same time, be able to meet sufficient of the special AOR capabilities to deputise for it when the occasion demands. The price for the ship, including these options, will be within the £65m - £75m range I mentioned to you. I must emphasise that this would be a firm price, a situation probably unprecedented for large, first of class vessels for the MOD. Furthermore, in recognising the constraints on expenditure by the MOD at this time, we may well be able to assist here in the design of appropriate charter and/or leasing arrangements which could spread the cost over a number of years.

We believe that as the need to replace replenishment ships of the existing RFA fleet is urgent this can best be satisfied by building FSK 20/20s sequentially in our shipyards in Sunderland and Govan Shipbuilders where four such vessels could be delivered within five years of an order. The outcome would provide a compromise of say four FSK 20/20 complementing and, when the occasion demands, supplementing say two AORs to fulfil front and second line replenishment duties. We see this as a low-cost and operationally suitable alternative to the fleet of six AORs originally contemplated.

We hope that with the ordering process for the first AOR now complete, the existing Naval Staff Requirement for AOR can be modified or extended to incorporate this attractive alternative. From British Shipbuilders' viewpoint an early order would dramatically change our prospects over the next few years when we shall be struggling to provide a bridge to the expected market upturn at the beginning of the next decade.

With this letter I am sending you a model of the FSK 20/20 which will give you an impression of the vessel.

Yours sincerely,

T Philip Hares

CC: Secretary of State for Trade & Industry

FILE OA

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

29 April 1986

I am writing on behalf of the Prime Minister to acknowledge your letter of 25 April and to thank you for sending her a copy of the News Release.

(Mark Addison)

OA

Thomas E. Bergman, Esq.

Sir Michael Quinlan KCB
Permanent Secretary

Department of Employment
Caxton House Tothill Street
London SW1H 9NF
Telephone 01-213 3000

29 April 1986

CONFIDENTIAL

Sir Robert Armstrong GCB CVO
Cabinet Office
70 Whitehall
LONDON
SW1A 2AS

NBPM.

Dear Robert,

OFFICIAL GROUP ON THE SHIPBUILDING INDUSTRY

Many thanks for your letter of 24 April about the new MISC 127 under Brian Unwin. My Department's representative will be Graham Reid (01.213.4469). can request if necessary.

I am sending copies of this letter to Peter Middleton, Clive Whitmore, Robert Andrew, Alan Bailey, William Fraser, Brian Hayes, Brian Griffiths and David Norgrove.

Yours ever,

Michael

M E QUINLAN

Dear Mr Addison,

For your attention this was released to the media in the afternoon of 25th April.

GR

Article enclosed.

MEA 29/4

Thomas E Bergman and Partners,
North House, 17 North Street,
Newcastle upon Tyne.
NE1 8DF

Telephone 0632 323535
— three lines

With Compliments

Swan Hunter Shipbuilders Limited

WALLSEND SHIPYARD · P.O. BOX 1 · WALLSEND · TYNE & WEAR NE28 6EQ
Telephone National Tyneside (091) 262 8921 Telex 53151
International +44 91 262 8921 53556

Your Ref
Our Ref

25th April 1986

NEWS RELEASE

The joint Managing Directors of Swan Hunter this morning met the Prime Minister. There was an open and constructive discussion of the company's position and a review of ways to improve its prospects.

CONTACT: Thomas E. Bergman & Partners,
Tel: 0632 323535

Registered Number 924707 England
Registered Office: Wallsend Shipyard, Wallsend, Tyne & Wear NE28 6EQ

file

BM

Mark
Best if you hold
I think.
JC 28/4

MEA says Ethics
can now be
despatched.

10 DOWNING STREET

From the Private Secretary

25 April 1986

✓ cleared by DD (D&I) and DN.

I attach, as agreed, my notes of today's meetings at Newcastle Airport. I should be grateful for your urgent comments, by telephone if possible.

I know that Bob Clay has been claiming the Prime Minister agreed to devise a new package of credit facilities to help the shipbuilding industry. She didn't, of course, but you will wish to look at the draft record of the meeting with Mr. Clay and his colleagues, paying particular attention to that aspect of the discussion.

(Mark Addison)

David Durie, Esq.,
Department of Trade and Industry

BM

SUB SECT
CC MASTER

BM

Lie

10 DOWNING STREET

From the Private Secretary

25 April 1986

Dear John

The Prime Minister held a meeting today at Newcastle Airport with Mr. Alex Marsh, Mr. Roger Vaughan, Mr. Peter Vaughan and Mr. Ken Chapman, joint Managing Directors of Swan Hunter. Mr. David Durie (DTI) was also present.

Mr. Roger Vaughan said he and his colleagues were grateful to the Prime Minister for agreeing to see them. They were not seeking to re-open the decision on AORs announced in the House on Thursday. Of course they were disappointed with it, but they appreciated the decision had been a difficult one for the Government to make. He and his colleagues were nonetheless determined to keep Swan Hunter going. It had a strong track record on design, delivery and prices. They had reduced the size of their workforce significantly. They were convinced Swan Hunters was and would remain a competitive firm. On the AOR, he and his colleagues believed the Government's decision to offer Swan Hunter the second ship provided they could match the Harland and Wolff price represented a very onerous condition indeed. They were also concerned about reports that overspending by Harland and Wolff could be countenanced. He hoped the Prime Minister could reassure him that the terms of the Secretary of State's statement would be interpreted flexibly. If they were not, Swan Hunters had been set an impossible target. Even if the basic design was passed over by Harland and Wolff, the specification still had to be translated into production programmes afresh, and that would put Swan Hunter at a cost disadvantage of several millions of pounds. Mr. Vaughan also said that the timetable for MOD's orders for amphibious vessels was too long, and should be brought forward.

The Prime Minister said she appreciated Swan Hunter's disappointment at not securing the order for the two AORs. But they now had a real opportunity to obtain the order for the second. The important point was to get their prices down. She noted by how much their original bid for the first AOR had been reduced. The fact was if the Government were willing to pay more for the ships, that meant correspondingly less work and jobs elsewhere in the industry. She appreciated the strengths and the track record of Swan Hunter, particularly in design. But it was inescapable that the Harland and Wolff design had been the best. Furthermore, the Harland and Wolff figures had been scrutinised with the greatest care, and they had convinced the Government that the price quoted was a genuine one. The

Prime Minister also noted that only one-third of the cost was directly attributable, in any case, to Harland and Wolff itself. The Government was however sympathetic to Swan Hunter's concerns, and to the needs of the North East more generally, and the decision that had been taken was not a cost free option.

On the second Type 23 Frigate, the Prime Minister said she knew that MOD would like to place the order at Swan Hunter. The offer was still open provided they could offer a satisfactory price and contract conditions. Their price was still high, however. On the further Type 23s, Swan Hunter had been invited to tender, though the precise size and timing of an order had still to be determined. The Prime Minister reiterated that the point of overriding importance was that Swan Hunter should offer competitive prices to win the MOD orders.

Summing up the discussion, the Prime Minister said she had confidence in Swan Hunter's ability to succeed, despite the difficulties they faced. She congratulated them on the successful launch of their frigate. But they had to get to grips with their costs. For her part, she and her colleagues would continue to do everything they could to help the yard prosper. She had noted Swan Hunter's concerns about the future of their design team, about the Type 23 order, the second AOR, and the timetable for the replacement of amphibious vessels. She would ensure the Secretary of State for Trade and Industry and the Defence Secretary were aware of those concerns.

I am copying this letter to John Mogg (Department of Trade and Industry).

Yours ever

Mark Addison

MARK ADDISON

John Howe, Esq.,
Ministry of Defence.

SUBJECT
MASTER

EL

10 DOWNING STREET

From the Private Secretary

25 April 1986

Dear Mike

The Prime Minister held a meeting today at Newcastle Airport with Mr. Bob Clay, M.P., Mr. T. Carty (Boilermakers Union District Delegate), Mr. D. Storrs (Secretary, Sunderland Shipbuilders Joint Shop Stewards Committee) and Mr. P. Callaghan (Secretary, Austin and Pickersgill Joint Shop Stewards Committee) to discuss the prospects for the shipbuilding industry in Sunderland. Mr. David Durie (Department of Trade and Industry) was also present.

Mr. Clay said the existing orders for ships in Sunderland would provide work only up until the end of the year. The yards faced immediate redundancies and lay-offs, even if fresh orders were secured tomorrow. In addition to the 3,000 jobs directly involved, a further 6,000 in Wearside were dependent on the yards. The area already had a very high unemployment rate. He appreciated the national concern about jobs on Tyneside. But Wearside faced similar problems, if not worse ones. An unemployment catastrophe loomed. This, in yards whose record of building orders to cost and to time was well established. Once the associated skills and traditions were lost to the area, they could not be regained. It was time for the Government to help, with softer credit, a scrap and build policy and extra subsidy. In particular, he urged the Prime Minister to see that orders for ASKs were placed in Sunderland, and he deeply regretted that BNFL had decided not to place their recent order in the UK.

Mr. Carty said Sunderland was totally dependent on shipbuilding. The male rate of unemployment was already 42 per cent. It had the most modern yard in Europe, had diversified into building the most sophisticated vessels, and the unions had negotiated the introduction of new technologies and overcome demarcation problems. Sunderland's industrial relations record was good. The industry could match the Japanese in speed of work and productivity. What was needed were orders. He reiterated that the Government should provide easier credit facilities, a scrap and build policy and provide incentives for British firms to build in British yards. The Government should also consider building for stock.

Mr. Storrs confirmed that the existing order book would take the yards only into early 1987. The men who had worked on the first Stena Seawell vessel would have nothing to go

on to when that was concluded shortly. There had been no new apprentices for two years. The new skills which had been learned needed to be passed on. The men in the yards had done everything to justify fresh orders.

Mr. Callaghan underlined the points made by his colleagues. The social consequences for the town if shipbuilding collapsed would be devastating.

The Prime Minister said she appreciated the deep concern of Mr. Clay and his colleagues. The fundamental problem was a shortage of orders. She wished she could pull them out of a hat. But she could not. Indeed, British Shipbuilders' orders now amounted to only one-tenth of the level expected. The trouble arose in part because of over-buying worldwide, as a result of heavy subsidy. The key point was to be competitive to attract those orders which were available. Sunderland's work on the Stena Seawell, which she was naming that afternoon, was a major achievement, though she understood the disappointment that lower oil prices had prevented a third order being placed. The prospect of orders from China represented the best hope for Sunderland. She knew British Shipbuilders were chasing those hard. The Government had informed the Chinese that the special credit facilities agreed could be used for the two ships in question.

The Prime Minister appreciated the importance of trying to match the level of support provided by other countries, including Europe. This was not easy; matching on the specific project itself was one thing, but providing the sweeteners on the associated work was another matter. The Government had also pressed for support from the intervention fund to be increased. The Government would continue to do everything it could including through the use of Aid and Trade provision where possible. On the Chinese order, however, she could not promise an early result. China was notoriously slow in these matters. On Fleet Support Kings, she paid tribute to Sunderland's design work on this vessel. She could not be optimistic, however, that orders would be forthcoming, though the Government would continue to look at the matter carefully. On the BNFL ship, she noted that the Japanese price simply could not be matched; and requiring BNFL to place their order here would have had wider and unacceptable commercial repercussions. The Government stood ready to help with the anti-dumping case being brought against Mitsubishi.

The Prime Minister thanked Mr. Clay and his colleagues for coming to see her and for the courteous but forceful way in which they put their points. If they wished to pursue them further in London she hoped they would approach Ministers in the Department of Trade and Industry. But she was ready to consider a further meeting herself if they wished.

I am copying this letter to John Howe (Ministry of Defence).

Yours ever,
Mark Addison

(Mark Addison)

Mike Gilbertson, Esq.,
Department of Trade and Industry

AOR ORDERS

I attach a copy of the two letters today sent to MP's who have expressed concern over the placing of the AOR order.

2. The Harland & Wolff letter was sent to Messers Maginnis, Archer, Butler, Hirst, Biggs-Davison, Amery, Gow, Thorne, Prior, Wilson, Ross, Bellingham.

3. The Swan Hunter letter was sent to Messers Randall, Stern, Trotter, Merchant, Garrett, Beith, Holt, Lord Elliot, Knox, Dixon, Fookes, Page, Price, Jessel, Couchman, Wilkinson, Fallon, Sayeed, McNair-Wilson.

MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB

Telephone 01-218 6621 (Direct Dialling)
01-218 9000 (Switchboard)

Minister of State
for Defence Procurement

D/MIN/NL/4/1

24 April 1986

Dear Stuart

The Prime Minister, the Secretary of State for Defence and Defence Ministers have all received representations from Members of Parliament about the order for the Auxiliary Oiler Replenishment vessel. I am writing to tell you that, after careful consideration of all the relevant factors, the Government has now decided the outcome of the competition.

Later today, therefore, George Younger will be announcing that Harland and Wolff has won the order for the design and build of the first vessel of the class. In taking this decision, we were mindful of a number of aspects, particularly that the Secretary of State for Northern Ireland has given assurances that guarantees or subsidies are not applied to tenders for military vessels. He will be announcing today an additional financial discipline on H&W in respect of the AOR aimed at ensuring that any cost-overrun will have a similar effect on H&W as it would on a private sector company. We were also conscious of unemployment considerations, although both shipyards that tendered are in high unemployment areas. The tender submitted by H&W was technically preferred by both the Ministry of Defence and external consultants as well as offering earlier delivery and a keener price.

The Harland and Wolff contract is for the first of class but in view of the wider and relevant factors the Government has decided to offer to Swan Hunter Shipbuilders a preferential opportunity to bid for the second ship of the class to enter service in the early 1990's. To avoid the Royal Navy having two different ship designs for the AOR task this vessel would be built to the Harland and Wolff design. An eventual contract would be on the basis that the terms and conditions, cost and programme will be no less favourable to the Ministry of Defence than already quoted by the lead shipyard for a follow-on ship.

Stuart Randall Esq MP

I know you will be disappointed that Swan Hunters was not successful for the first of class in their bid but the offer we have made should provide some 3-4000 man years of work for the yard. As you will be aware, they have also been invited to tender for three Type 23 frigates, two in competition with other warshipbuilders. Tenders for these are currently being evaluated, but the precise size and timing of an order has still to be determined.

I very much hope that the Swan Hunter yard will win future Ministry of Defence orders, but they will only be able to do so if they can offer competitive prices. This applies equally to the current competition for Type 23 frigates. The offer of the second Type 23 is still open provided that Swan Hunter can offer a satisfactory price and contract conditions in accordance with Michael Heseltine's statement in the House on 28 January 1985.

Yours ever

Norman Lamont

(NORMAN LAMONT)

MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB

Telephone 01-218 6621 (Direct Dialling)
01-218 9000 (Switchboard)

Minister of State
for Defence Procurement

D/MIN/NL/4/1

24 April 1986

Dear Peter

As you will most likely be aware, the Prime Minister, the Secretary of State for Defence and Defence Ministers have all received considerable representations from Members of Parliament about the order for the Auxiliary Oiler Replenishment vessel. I am writing to tell you that, after careful consideration of all the relevant factors the Government has now decided the outcome of the competition.

You will therefore, I am sure, be pleased to learn that later today George Younger will be announcing that Harland & Wolff has won the order for the design and build of the first vessel of the class. We, for our part, were pleased that we have been able to obtain a design that meets the Ministry's requirement in full within the target price for the vessel.

The Harland and Wolff contract is for the first of class but in view of the wider and relevant factors the Government has decided to offer to Swan Hunter Shipbuilders a preferential opportunity to bid for the second ship of the class. This vessel would be built to the Harland & Wolff design and a contract would be dependent upon there being no extra cost to the Defence budget and subject to satisfactory negotiation of contract terms and conditions.

In taking these decisions, we were mindful that the Secretary of State for Northern Ireland has given assurances that guarantees or subsidies are not applied to tenders for military vessels. He will be announcing an additional financial

The Rt Hon Peter Archer QC MP

discipline on H&W in respect of the AOR aimed at ensuring that any cost-overrun will have a similar effect on H&W as it would on a private sector company. We were also conscious of unemployment considerations, although both shipyards that tendered are in high unemployment areas.

Yours

(NORMAN LAMONT)

CONFIDENTIAL

70 WHITEHALL, LONDON SW1A 2AS

01-233 8319

From the Secretary of the Cabinet and Head of the Home Civil Service

Sir Robert Armstrong GCB CVO

Ref. A086/1244

24 April 1986

My dear Peter,

Official Group on the Shipbuilding Industry

In summing up last week's meeting on the procurement of two naval vessels, the Prime Minister asked the Cabinet Office to set in hand an interdepartmental study to formulate a strategy for the shipbuilding industry, covering both naval and merchant capacity (E(A)(86) 13th Meeting).

Accordingly Brian Unwin will chair an Official Group, to be known as MISC 127. The following Departments are invited to be represented:

Treasury
Ministry of Defence
Northern Ireland Office
Department of Transport
Department of Employment
Scottish Office
Department of Trade and Industry
Policy Unit

I should be grateful if you and those to whom this letter is copied could let the Secretary, John Roberts (01 233 6161), know the name of your representative. We have in mind that these should be at Under Secretary level. It is envisaged that the first meeting of the Group will be in the week beginning 5 May.

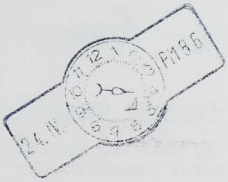
I am sending copies of this letter to Clive Whitmore, Robert Andrew, Alan Bailey, Michael Quinlan, William Fraser, Brian Hayes, Brian Griffiths, and David Norgrove.

Yours ever

Robert

Sir Peter Middleton KCB

CONFIDENTIAL



10 DOWNING STREET

From the Private Secretary

Prime Minister

MOD tell me they always write to the interested MPs giving details of an order, before the House is told, and have done so as long as anyone can remember.

It's odd how the conventions vary between Departments.

DCS

24/4.

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01 XXX XXXX 218 2111/3

MO 26/3/1E

24 April 1986

Dear David,

AOR

I attach, for information, a copy of the latest version of the draft announcement to be made this afternoon on the outcome of the AOR competition.

I am sending copies of this letter to the Private Secretaries to members of E(A) to the Attorney General and to Michael Stark (Cabinet Office).

Yours

(RICHARD HATFIELD)
Private Secretary

David Norgrove Esq
No 10 Downing Street

ORDER FOR THE AUXILIARY OILER REPLENISHMENT VESSEL

THE MINISTRY OF DEFENCE HAS NOW REACHED CONCLUSIONS ON THE COMPETITION FOR THE FIRST TWO AUXILIARY OILER REPLENISHMENT VESSELS OF THE FORT CLASS.

THIS IS A NEW CONCEPT FOR A "ONE-STOP" REPLENISHMENT VESSEL CAPABLE OF SUPPORTING FRONT-LINE WARSHIPS AND DEFENDING ITSELF.

UNDER ITS POLICY OF TRANSFERRING MORE RESPONSIBILITY TO INDUSTRY THE MOD INVITED FIRMS TO PUT IN THEIR OWN DESIGNS TO MEET THE NAVY'S REQUIREMENT AND TO PROCURE THE WHOLE SHIP INCLUDING SELF-DEFENCE WEAPONS AND ASSOCIATED ELECTRONICS.

ALTHOUGH A WIDE RANGE OF SHIPBUILDERS AND OTHER DEFENCE FIRMS WERE INVITED TO TENDER, DESIGNS WERE SUBMITTED BY ONLY TWO CONSORTIA, HARLAND AND WOLFF (IN ASSOCIATION WITH YARROW SHIPBUILDERS AND YARD) AND SWAN HUNTER (IN ASSOCIATION WITH BRITISH AEROSPACE/MARCONI).

THE TENDER SUBMITTED BY HARLAND AND WOLFF WAS TECHNICALLY PREFERRED BY BOTH THE MINISTRY OF DEFENCE AND EXTERNAL CONSULTANTS, AS WELL AS OFFERING EARLIER DELIVERY AND A KEENER PRICE.

THE GOVERNMENT HAS ACCORDINGLY DECIDED TO AWARD THE CONTRACT FOR THE DESIGN AND BUILD OF THE FIRST SHIP OF THE CLASS TO HARLAND AND WOLFF.

THE SHIP WILL BE NAMED THE ROYAL FLEET AUXILIARY FORT VICTORIA.

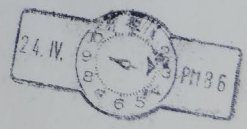
ONCE THE DETAILED DESIGN HAS BEEN COMPLETED NEXT YEAR CONSTRUCTION WILL BEGIN AT BELFAST AND THE SHIP WILL ENTER SERVICE AT ABOUT THE END OF THE DECADE.

THROUGHOUT THE TENDERING PROCESS THE GOVERNMENT HAS INSISTED THAT THE COMPETITION SHOULD BE SCRUPULOUSLY FAIR, PARTICULARLY AS IT INVOLVED A PRIVATE SECTOR AND A PUBLIC SECTOR COMPANY.
THE GOVERNMENT APPOINTED INDEPENDENT CONSULTANTS WHO HAVE EXAMINED THE H&W CONSORTIUM'S BID AND HAVE ADVISED THAT IT IS UNSUBSIDISED AND COMPREHENSIVELY COSTED.
THE SECRETARY OF STATE FOR NORTHERN IRELAND HAS TODAY ANNOUNCED AN ADDITIONAL FINANCIAL DISCIPLINE ON HARLAND AND WOLFF PLC IN RESPECT OF AOR AIMED AT ENSURING THAT ANY COST-OVERRUN WILL HAVE A SIMILAR EFFECT ON H&W AS IT WOULD ON A PRIVATE SECTOR COMPANY.

TO ENSURE COMMONALITY IN NAVAL SERVICE, FUTURE SHIPS OF THE CLASS WILL BE BUILT TO THE H&W DESIGN, BUT THE MINISTRY OF DEFENCE WILL ALLOW OTHER SHIPYARDS TO COMPETE TO BUILD FOLLOW-ON SHIPS.

THE GOVERNMENT HAS DECIDED THAT SWAN HUNTERS SHOULD BE GIVEN A PREFERENTIAL OPPORTUNITY TO BID FOR THE SECOND SHIP OF THE CLASS.

LATER IN THE SUMMER, MOD WILL BE OFFERING SHS THE OPPORTUNITY TO CONFIRM THAT THEY ARE READY TO ACCEPT A CONTRACT FOR THE SECOND AOR, WITH CONSTRUCTION TO BEGIN AS SOON AS POSSIBLE AFTER NEGOTIATIONS ARE COMPLETED, PROBABLY IN 1988. THIS WILL BE ON THE BASIS THAT IT WILL BE TO THE SAME DESIGN AS THE FIRST, AND THAT THE TERMS AND CONDITIONS, COST AND PROGRAMME WILL BE NO LESS FAVOURABLE TO MOD THAN ALREADY AVAILABLE FROM THE LEAD SHIPYARD FOR A FOLLOW-ON SHIP.


24. IV.
PM 3 6

CONFIDENTIAL

P 02022

From: J B UNWIN
22 April 1986

MR NORGROVE

AUXILIARY OILER REPLENISHMENT VESSEL (AOR) ANNOUNCEMENT

You asked for advice on the draft statements with the minutes of yesterday from the Defence and Northern Ireland Secretaries. The Defence Secretary's statement will take the form of a written PQ, followed by a press conference; Mr King's statement will be issued as a press release.

2. Subject to clearance by the Attorney General (to whom the MOD have now sent a copy of their draft), and to one or two minor points below, I think the Defence Secretary's statement is acceptable and I recommend the Prime Minister to approve it. The Treasury are content and are so advising the Chief Secretary.

3. For reasons explained in his covering minute, the Defence Secretary advises against being too specific on when the second ship would start construction. I think this is reasonable - not for the spurious Warsaw Pact argument, but because it has not in the time available been possible to sort out the public expenditure implications, and it would seem wrong to delay the announcement on this account. If early agreement on this cannot be reached (and realistically it may have to be sorted out in the forthcoming PES), then the consequent delay in starting construction will, of course, make it more difficult for Swan Hunter to avoid redundancies in 1988. But Swan Hunter will no doubt grumble and criticise the Government for not awarding the first ship to them anyway, whatever the arrangements for the second, so that I think this uncertainity on timing will just have to be tolerated. The fact is that the conditional award of the second ship to them will represent preferential treatment and a great prize; and they already have an order book of some £400 million.

4. The Trade and Industry Secretary may express some unhappiness at the possibility of delay and press for a start on AOR(2) in 1988. But I do not think he will want to hold up the statement and it will always be possible for him, of course, to offer DTI money to help meet the extra cost if he feels sufficiently strongly.

5. Two small points of detail on the Defence Secretary's statement;-

(i) the beginning of paragraph 5 seems pretty lame. The Government always takes into account "wider and relevant factors". Perhaps better to start this paragraph with simply "The Government has, however, decided ...";

(ii) it might be useful to bring out in the statement the fact that the mnajority of the work, and therefore jobs, will in fact be placed out by Harland and Wolff elsewhere in the UK. As I understand it, the division is something like 30% Northern Ireland, 35% Scotland, 20% North East, and 15% South East (Racal Marine Ltd). This could be done by adding a sentence to the end of paragraph 2 on the lines:-

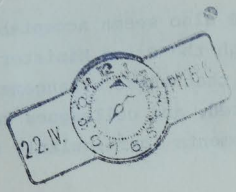
"Some 70% of the value of the contract will be placed by Harland and Wolff with engineering and electronics companies in the rest of the UK, so sustaining jobs there also".

6. On Mr King's letter and press release, I think it is a pity that he has not found it possible to produce a bowdlerized version of the PA report for publication with the statement. But this is clearly not possible in the time available now, and perhaps a little less necessary in view of the decision on AOR(2). I suggest, therefore, that the Prime Minister endorses his fall-back proposals (to have a summary ready for publication later if pressed, and to be ready to give the full report in confidence to the Select Committees if they ask for it). The draft press

release also seems acceptable (the Treasury are content with it), although the Prime Minister may wish to reinforce the need to ensure that these arrangements are very strictly applied and monitored, and colleagues kept informed of any significant developments (particularly if adverse).

J B UNWIN

22 April 1986
Cabinet Office


22.IV.

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RESTRICTED

cc CBS

NBPM.

PRIME MINISTER

AOR COMPETITION

WITH DRN

I have seen Tom King's and George Younger's minutes to you of 21 April. My only comments are upon the draft press release attached to Tom King's minute. I am concerned that the press release should reflect the Government's view that the assurance given to Swan Hunters has been honoured. Accordingly, I would suggest that in the third paragraph of the draft press release the second sentence be amended to include a reference to the assurance that Harland and Wolff bids would be comprehensively costed.

In the fifth paragraph of the draft press release the first sentence requires some amendment to make it clear that the Government is satisfied that the Harland and Wolff bid has been comprehensively costed as well as being free from subsidy. In the same sentence the words "unfairly cross-subsidised" appear to me to be a hostage to fortune in that they suggest that some cross-subsidisation may nevertheless occur. May I suggest that this sentence read, from "free of subsidy", something like the following: "in addition the Government intends to put Harland and Wolff on a similar footing to a private company".

I am copying this minute to members of E(A), the Lord President, the Secretary of State for Defence, the Chief Whip and Sir Robert Armstrong.

M.H

22 April 1986

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NAT IND
SHIPBUILDING
PT 9

011/2762

010

CC BG

COMMERCIAL IN CONFIDENCE

FROM: CHIEF SECRETARY
DATE: 22 April 1986

PRIME MINISTER

NBPM.

AOR ANNOUNCEMENT

WITH DRN

I have seen yesterday's minutes to you from George Younger and Tom King.

2 I agree with George Younger that we should not be too specific about the timing of construction of AORO2 for the reasons he gives. As he says, he and I have yet to discuss the implications for the defence budget in what is clearly going to be a very difficult public expenditure round. Nor can we sensibly resolve this problem until he has negotiated with Swan Hunter. I am therefore content with his draft statement.

3 I am also content with Tom King's proposals on publication of a summary of the PA Report. Like him, I prefer to make the full report available to a Select Committee if they request it.

4 I am copying this minute to the other members of E(A), to the Lord President, the Secretary of State for Defence, the Attorney General, the Chief Whip and Sir Robert Armstrong.

JOHN MacGREGOR

COMMERCIAL IN CONFIDENCE

NAT IND
SHIPBUILDING
PT 9

CBS

Prime Minister

Minute by Mr King attached. Content with the texts of the announcements by Mr Younger and Mr King, subject to the views of colleagues?

DGR
21/4.

Agreed (see one proposed amended) MT

MO 26/3/1E

PRIME MINISTER

COMPETITION FOR AUXILIARY OILER REPLENISHMENT VESSEL

At the meeting of E(A) Committee on 17th April I was invited to circulate to colleagues the draft of the announcement of the conclusions we reached then. This is attached. It includes wording by Tom King about the additional financial disciplines he will be applying to Harland and Wolff.

2. While making clear that Swan Hunters will be given a preferential opportunity to bid for the second ship, I am concerned for several reasons that we do not say too specifically when the second ship would start construction. The Navy does not require this ship until 1993 (which means that construction could begin at any time from about 1988 to 1990), and I cannot afford to bring it forward. I recognise that some colleagues would like to see work starting on the Tyne at the earlier end but until I have negotiated a contract schedule with the Company and settled the public expenditure implications with

the Chief Secretary it would be imprudent to commit ourselves. It is also better to avoid giving the Warsaw Pact precise information about our naval construction plans unnecessarily.

3. I propose to make the announcement on Wednesday 23rd April and shall proceed on this basis unless I hear to the contrary before 1700 on Tuesday.

4. A copy goes to members of E(A), the Lord President and Chief Whip and Sir Robert Armstrong.

G.Y.

Ministry of Defence
21st April 1986

MO 26/3/1E

COMPETITION FOR AUXILIARY OILER REPLENISHMENT VESSEL

1. The Ministry of Defence has now reached conclusions on the competition for the first two Auxiliary Oiler Replenishment vessels of the ROYAL FORT class. This is a new concept for a "one-stop" replenishment vessel capable of supporting front-line warships and defending itself. Under its policy of transferring more responsibility to industry the MOD invited firms to put in their own designs to meet the Navy's requirement and to procure the whole ship including self-defence weapons and associated electronics. Although a wide range of shipbuilders and other defence firms were invited to tender, designs were submitted by only two consortia, Harland and Wolff (in association with Yarrow Shipbuilders and YARD) and Swan Hunter (in association with British Aerospace/Marconi).

2. The tender submitted by Harland and Wolff was technically preferred by both the Ministry of Defence and external consultants, as well as offering earlier delivery and a keener price. The Government has accordingly decided to award the contract for the design and build of the first ship of the class to Harland and Wolff. The ship will be named the Royal Fleet Auxiliary FORT VICTORIA. Once the detailed design has been completed next year construction will begin at Belfast and the ship will enter service at about the end of the decade.

3. Throughout the tendering process the Government has insisted that the competition should be scrupulously fair, particularly as it involved a private sector and a public sector company. The Government appointed independent consultants who have examined the H&W consortium's bid and have advised that it is unsubsidised and comprehensively costed. The Secretary of State for Northern Ireland has today announced an additional financial discipline on Harland and Wolff plc in respect of AOR aimed at ensuring that any cost-overrun will have a similar effect on H&W as it would on a private sector company.

4. To ensure commonality in naval service, future ships of the class will be built to the H&W design, but the Ministry of Defence will allow other shipyards to compete to build follow-on ships.

This phrase was used in announcing the Type 22/23 orders for Cammell Laird and Swan Hunter.

5. In view of wider and relevant factors, the Government has decided that Swan Hunters should be given a preferential opportunity to bid for the second ship of the class to enter service in the early 1990s. Later in the summer, MOD will be offering SHS the opportunity to confirm that they are ready to accept a contract for AOR 02 on the basis that it will be to the same design as 01, and that the terms and conditions, cost and programme will be no less favourable to MOD than already available from the lead shipyard.

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PRIME MINISTER

AOR ANNOUNCEMENT

Following the discussion in E(A) on 17 April officials are urgently preparing a summary of the PA Report. However this is not an easy exercise. We recognised in our earlier discussions that the Report contains (and indeed is dependent on) commercially confidential figures which it would not be appropriate to divulge. I have grave doubts as to whether a summary without key figures will serve the intended purpose, particularly if we are now concerned about a legal challenge. It seems bound only to increase demands for the publication of the full report. I shall circulate the summary as soon as possible to colleagues to judge. It will also be necessary to agree with the Attorney General and with other interested Departments that the summary is a true representation. I have not yet consulted PA or Mr Parker on the proposal as to do so would have risked premature disclosure of the nature of our decision.

2. I hope we agree that the announcement should not be held up pending agreement on the content of the summary. It is important that the offer of the accelerated AOR II to Swan Hunters and the full account which I shall be giving of the financial discipline which we will apply to Harland and Wolff's performance on AOR I are provided as early as possible in order to put an end to the unhealthy debate being conducted in the press.

3. Nevertheless I accept that we should get ready to publish a summary of the PA Report and do so if pressure remains after the announcement.

/...

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My preference however would be that we should be prepared to make the full text of the report available on a confidential basis to either of the appropriate Select Committees, should they ask for it.

... 4. I attach a draft of the follow-up statement which I would intend to make following George Younger's announcement.

/ 5. I am copying this minute and enclosure to other Members of E(A), the Lord President, the Secretary of State for Defence, the Attorney General, the Chief Whip and to Sir Robert Armstrong.

Brian Porter

for TK
(Approved by the Secretary of State and signed in his absence in Northern Ireland)

21 April 1986

Encl

JLD

DRAFT PRESS RELEASE

ORDER FOR HARLAND AND WOLFF PLC

Following the announcement today by the Secretary of State for Defence that the contract for the first-of-class Auxiliary Oiler Replenishment vessel had been awarded by his Department to Harland and Wolff Plc, the Rt Hon Tom King MP, Secretary of State for Northern Ireland, issued the following statement:

There will be a widespread welcome for this news in Northern Ireland. The Ministry of Defence announcement makes clear that the contract has been awarded on commercial grounds and technical merit following a full and competitive appraisal of the bids.

The AOR decision was extremely difficult, not least because of the impact that failure in the competition would have on either tenderer . The Government required that competitive bids be on an unsubsidised basis and Harland and Wolff's tender met that requirement. This has been confirmed by an independent and internationally respected management consultancy appointed by the Government to review Harland and Wolff's bid.

The Government has throughout been concerned however to ensure complete fairness of competition. There is the possibility that publicly-owned companies such as Harland and Wolff, having submitted a wholly unsubsidised bid, can nonetheless encounter greater construction problems than expected, thereby incurring a loss which the taxpayer has to finance because of the ownerhsip of the company. Private sector companies have no such comfort on this point: a major cost-overrun on an important contract may exhaust shareholders' funds and therefore spell receivership or closure.

While the Government is satisfied that Harland and Wolff's bid is free of subsidy, it wishes to make absolutely clear its commitment to ensuring that the contract awarded today will not be unfairly cross-subsidised at any stage. In placing the AOR order with Harland and Wolff, therefore, it has specified that Harland and Wolff's performance and actual costs in building the AOR will be

E.R.

subject to a stringent system of actual financial and performance controls monitored by independent assessors. Under this:

1 If Harland and Wolff incurs higher costs than expected in building the vessel, the extent of the overrun will be netted directly and automatically off subsidy available for merchant shipbuilding with a direct effect on the company's ability to secure further work in the yard.

2 If in addition those higher costs exceed 5%, then Harland and Wolff will not be permitted to bid for Ministry of Defence contracts until it brings its costs again below that margin.

3 Should extra costs exceed 10% there will be an immediate review, by Ministers, of both alternative arrangements for completing the AOR contract and of the future of Harland and Wolff itself.

Finally Mr King said: "The arrangements for close monitoring of Harland and Wolff's actual performance and the consequences of not keeping to budgeted costs will put H&W on a similar footing to a private sector company. Everyone at H&W understood the importance of securing this vital order, but this is only the beginning of the real challenge. The terms on which the order has been placed are fair but tough. I commend the leadership shown by the company Chairman, Mr John Parker, in putting together the winning design and competitive bid. It is now up to everyone who works in the company to meet the tough challenge they have been set and to merit ~~to~~ confidence that the Secretary of State for Defence and the Royal Navy have placed in them."

cc BS

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NBPM.

PRIME MINISTER

COMPETITION FOR THE AUXILIARY OILER REPLENISHMENT (AOR) VESSEL

I have seen the draft statements ATTACHED proposed by the Secretaries of State for Defence and for Northern Ireland following the discussion in E(A) last week.

2 I am concerned that the proposed Ministry of Defence statement does not make it clear when construction of the AORO2 at Swan Hunter will begin. Our discussion last week and our decision were clearly on the basis of construction of AORO2 starting in 1988, with the contract being let later this year. Anything later would be bound to cause extra redundancies at Swan Hunter. The decision in any case will come as a blow to Swan Hunter and they will certainly need every encouragement to ensure that they face up positively to the challenge. In addition, failure to give a date for the AORO2 will cause additional difficulty for us during the debates on the British Shipbuilders (Borrowing Powers) Bill, whose Second Reading takes place next Monday.

1786 1986 BOARD OF TRADE BICENTENARY

3 The ambiguity as to the timing of the second AOR is bound to be probed as soon as the statement is made, and will cause us needless political difficulty - the very difficulty our decision to split this order was designed to avoid. I must therefore press for greater clarity in the statement on the timing of the second AOR order, to meet the political and employment pressures. Ideally, the statement should specify a target date for letting the contract, but if George Younger does not feel able to do this at least words should be found which clearly imply that the letting of the contract will follow promptly on the approach to Swan Hunter referred to in paragraph 5 of the statement.

4 I am copying this minute to the other members of E(A), the Lord President, the Secretary of State for Defence, the Attorney General, the Chief Whip and to Sir Robert Armstrong.

PC

PAUL CHANNON

April 1986

Department of Trade and Industry

1786 1986 BOARD OF TRADE BICENTENARY

999-49

10 DOWNING STREET

THE PRIME MINISTER

18 April 1986

Dear Mr. Douglas.

Thank you for your letter of 28 March about the decision to extend the validity of the tenders for the Auxiliary Oiler Replenishment (AOR) vessel contract.

It is not unusual for tenders to be extended in this way. This has been done when the Government have needed more time to allow thorough study of the bids before placing a contract. It is not contrary to Procurement Rules provided that all tenderers are given equal opportunity to extend.

You ask for precedents. Another recent example was the last major warship contract, placed in January 1986 for three UPHOLDER class patrol submarines following several extensions to the original expiry date of the tender prices.

At Question Time on 10 April you asked me about further orders for the Type 23 Frigate. It remains the Government's intention to place the order for the second Type 23 with Swan Hunter Shipbuilders, subject to the negotiation of satisfactory price and contract terms, as originally announced by the then Defence Secretary in the House on 28 January 1985. Revised tenders for the third and fourth Type 23 vessels have just been received from Yarrows, Vickers/Cammell Laird, Vosper Thorneycroft and Swan Hunter. These are currently being evaluated by the Ministry of Defence. The number and timing of Type 23 orders has yet to be decided.

Yours sincerely

Margaret Thatcher

Dick Douglas, Esq., M.P.

cc

CANDOVER INVESTMENTS plc

Cedric House, 8-9 East Harding Street, London EC4A 3AS
Telephone: 01-583 5090 Telex: 928035 Fax: 01-583 0717

17th April, 1986

Prime Minister

Candover is a major investor in Swan Hunter. This letter gives warning about the prospects for the yard, & also the P.S.

DCW
17/4.

The Hon Peter Morrison MP,
The Minister of State for Industry,
Department of Trade and Industry,
1-19 Victoria Street,
London, SW1H OET

Dear Minister,

I thank you for your letter of 15/4/86 making some comments on my statement to shareholders yesterday. As you will see from the press reports on matters arising during the day, the most important one was the report to us from the Swan Hunter management of their estimate of probable costs involved in restructuring the company should they not receive the First of Class AOR order. They said that it was difficult to be precise about the estimated cost, but it was likely to be at least £10 million and possibly as much as £20 million if there were industrial relations difficulties. Not only would there be the requirement of severe redundancies but the whole organisation of the yard would need to be reoriented towards smaller scale operations as a "Follow-on" Yard operating at much lower profit levels. I was asked by the press after our meeting whether I thought the institutions would provide this kind of finance and I had to say that in the circumstances, in my judgement, they would not do so. In that event the survival of the yard as a going concern would, of course, be put at risk.

DIRECTORS: Chairman: P G Wreford BSc (Econ), ACIS, AIB; Chief Executive: C R E Brooke MA;
Deputy Chief Executive: S W Curran FCCA;
H A Hicks CBE, DSc, C Eng, FICE, FI Prod E, F Am SCE, M Soc C E (France), FCIOB, CBIM;
R A P King; P J Scott Plummer MA, FCA; M C Stoddart FCA; L V D Tindale CBE, CA, CBIM; J G West FCA.

Registered No 1512178 in England at the above address.
An investment company within the meaning of Part VIII of the Companies Act 1985.

Since yesterday was the first occasion on which we received a report on the costs involved, I do think it important to send you this letter now, since I think it must be an important factor in the consideration by your colleagues of this difficult matter.

Yours sincerely
Roger Brooke

C R E Brooke

P.S. I would like to draw you attention to pages 10 and 11 of the sale memorandum on Swan Hunter produced by Lazards. What is written there emphasises Swan HUnter's leading position as a ship designer, particularly in the fleet auxiliaries area, with the implication that Swan Hunter was likely to be favoured to receive the first of class order. This undoubtedly influenced the City institutions in supporting this investment.

c.c. Secretary of State for Defence
The Prime Minister's Office

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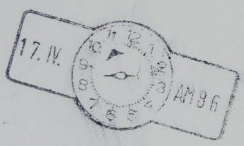
17. IV.
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17 April 1986

FLEET SUPPORT KING 20/20 - AOR

The British Shipbuilders vessels would be built at Sunderland shipbuilders, and probably Govan on the Clyde. They would cost just under £70m compared to £120m for the First of Class full specification AOR.

BS believe the FSK 20/20 meets virtually all of the MOD's requirement save that it is unarmed. It has low noise levels, high speed, is able to operate in high sea states, has extensive helicopter maintenance facility and has a flexible replenishment system. It apparently has a lot of secret support among Royal Fleet Auxiliary personnel.

Before the MOD could accept the FSK 20/20 in lieu of the armed AORs they would need to do sophisticated battle modelling. In view of the more limited MOD funds available it could now be the best solution.

Whilst orders for the British Shipbuilders vessel would help the merchant yards and give the MOD more ships for their money it would, of course, be taking work away from the warshipyards (albeit on present plans those yards would not start building the second AOR before 1990).

CONFIDENTIAL

cc BG
cc Bup

PRIME MINISTER

ORDERS FOR THE AUXILIARY OILER REPLENISHMENT VESSEL

I was not present at last week's meeting of E(A) but the Minutes record that there was a suggestion that placing an order for a new ship with Swan Hunter might be more cost effective than other job creation schemes. I have also seen the note by officials attached to George Younger's minute of 14 April. I thought it might be useful if I commented on this particular point in advance of tomorrow's E(A) meeting.

It is of course difficult to make a precise comparison, since defence procurement has different objectives from the employment measures operated by my Department. Nevertheless, some rough calculations providing a broad indication of comparative cost may be helpful.

Estimates provided by the Ministry of Defence suggest that if Swan Hunter were awarded the AOR(2) contract at a cost of £102 million, then approximately 1300 redundancies would be averted for the contract's duration (3 to 4 years). This would yield a gross annual cost of supporting each job of roughly £20,000-£26,000. If the redundant workers were to be unemployed for 3-4 years (a strong assumption), this would also be the gross cost per person off the unemployment count of awarding the AOR(2) contract to Swan Hunter. Flowbacks to the Exchequer of tax, national insurance and benefit savings, etc, would reduce the net cost per person off the count to about £14,00-£20,000.

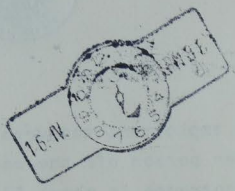
CONFIDENTIAL

The cost of employment measures varies, but the agreed first year cost per person off the unemployment count for the Community Programme is about £2,000 and for the Enterprise Allowance Scheme about £2,700. On this basis, employment measures are a much more cost effective way of reducing unemployment.

I also have considerable doubts about using our employment and training measures to mitigate the effects of particular redundancies. Many of our measures are demand led so they are available anyway if the demand increases in Tyneside. In the case of the Community Programme, which has a national limit of 255,000 places, it would no doubt be possible to put extra places in Tyneside, if sponsors could be found to take them up. But it has to be remembered that the Community Programme is for long term unemployed people only and would not therefore provide a response to large scale redundancy. Furthermore, any switching of provision would be at the expense of CP places in other areas. I have no wish to ask for further resources for employment and training measures at present.

I am copying this minute to other members of E(A), George Younger and Sir Robert Armstrong.

DY
16 April 1986



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-~~930 7022~~ 218 2111/3

MO 26/3/1L

16th April 1986

Dear David,

AOR

Thank you for your letter of 15th April enclosing one from Mr Nicholas Brown MP about the AOR. The assurances to which he refers were given by the Minister of State for Industry in his letter of 5th December 1985, a copy of which is attached. As you will see this passes on assurances given by the Minister of State for Northern Ireland. The question is therefore principally one for the DTI and NIO. Because of the inter-departmental interest we are arranging for the advice of the Law Officers to be available to Ministers at E(A) tomorrow. We understand the advice is likely to be that as long as Ministers are satisfied that Harland and Wolff's bid is unsubsidised, the prospect of legal action succeeding is remote. If that is confirmed we will arrange for one or other Department to let you have a draft reply tomorrow (or an addition to draft replies already due to Mr Brown).

A copy goes to Henry Steel (Law Officers Department), Michael Gilbertson (DTI) and Neil Ward (NIO).

Yours

(RICHARD HATFIELD)
Acting Private Secretary

David Norgrove Esq
No 10 Downing Street

Minister's copy

CA 224/5388.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5186
GTN 215) .....
(Switchboard) 01-215 7877

From the Minister of State for Industry

Copies to:

PS / Mr. Butcher
Mr Mountfield
Mr Hobbiett SBP2
Miss SCROPE (O/F)

THE HON PETER MORRISON MP

K R Chapman Esq
Beech Hurst
56 Painshawfield Road
Stocksfield
Northumberland

5 December 1985

Dear R. Chapman,

Thank you for your letter of 19 November, asking for the same assurances on equitable competition from Harland and Wolff that you have recently obtained from British Shipbuilders.

When I met you and the Swan Hunter management buy-out team in October, I undertook to write to the Northern Ireland Office to ensure that the Harland and Wolff bid for the Auxiliary Oiler Replenishment vessel was unsubsidised. Dr Rhodes Boyson, the Minister of State has already confirmed that Harland and Wolff will prepare all bids for all future MOD tenders on an unsubsidised basis. He has also assured me that officials from the Department of Economic Development will be monitoring the basis of future bids to ensure that they are not only unsubsidised but also comprehensively costed.

Harland and Wolff will still, of course, be eligible for regional aid for capital expenditure on the same terms as any other industrial concern in Belfast, as indeed Swan Hunter will be eligible for such aid as is available to firms in Newcastle.

Thank you again for writing. I hope that this letter will reassure you.

Yours sincerely

PETER MORRISON

1WEAUR

Beech Hurst,
56 Painshawfield Road,
Stocksfield,
Northumberland.

19th November 1985

Hon. Peter Morrison M.P.,
Minister of State for Industry,
1 Victoria Street,
LONDON.
SW1H OET

Dear Minister,

Following our last meeting, and the steps you were then able to take I am pleased to say that we have now reached agreement with British Shipbuilders in relation to equitable competition. However, I mentioned in our letter to you of 16th October our similar concern relating to Harland and Wolff and would therefore be grateful if you could now seek similar comfort from the Northern Ireland Office on our behalf. I believe the following would suffice:

"If Harland and Wolff ("H+W") is in competition with the Swan Hunter Group for the supply of "fighting vessels", (that is vessels whose principal purpose is to carry offensive weapons giving the vessel an attack capability) or other naval vessels (for example naval auxiliaries, fleet replenishment vessels which are either armed or unarmed) such competition will be equitable on a case by case basis. That is H+W will neither tender to supply such vessels at a loss (after taking due account of full overhead recovery and commercial risk), nor use support from the Intervention Fund or other subsidies when such support is not available to the Swan Hunter Group.

I would be most grateful if you were able to assist us in this matter.

Kind Regards,

K.R. Chapman.

K.R. Chapman

16. IV.
PM 86

RESTRICTED
COMMERCIAL IN CONFIDENCE

PRIME MINISTER

ORDERS FOR THE AUXILIARY OILER REPLENISHMENT VESSEL (AOR)

I have now seen the minutes of 14 April from the Secretaries of State for Defence and for Northern Ireland.

2. I remain concerned that if Swan Hunter did not win an order for an AOR, we would face considerable criticism about the fairness of the competition if the PA Management Consultants' report is not published. The Chief Executive of the main institutional backer of Swan Hunter, Candover Investments PLC, is making a lengthy statement today on the matter, to which the Minister for Industry has already replied in part. But the backers, as well as Swan Hunter, would certainly return to the charge. The Swan Hunter management believe that if they are forced to reduce the size of the yard substantially (to the levels foreseen in the note by officials), this could only be done with a considerable further cash injection (possibly £10 to £15m) from their backers and they fear that their backers would not be willing to make this investment. If the backers did not, they would certainly seek to pin the blame for their decision on the Government for the unfairness of the competition.

3. I still cannot accept that the existing PA Report is sufficient : only a marine consultant, with wide knowledge and experience of the problems faced by yards in building the first of a new type of complex vessel, could satisfy Swan Hunter and their backers that the basic judgements in the PA Report are correct.

4. On the other hand, if we were to decide now to give the second AOR order to Swan Hunter next year, with construction starting in 1988, that would give Swan Hunter real hope for the future. In those circumstances we could hope to persuade them that the combination of the order and the financial discipline on Harland and Wolff was a sufficient guarantee of fairness both for the present and for the future. This would alleviate to some degree the problems of the North East, to which I drew attention in my minute of 14 April.

5. I dislike the idea of allocating orders instead of relying on competition, which is why I prefer a further investigation. Even so, I think it would be less damaging to our policy of competition for defence procurement if the second AOR order were brought forward than if a further Type 23 frigate was allocated to Swan Hunter (though it remains of vital importance to them that they should actually be awarded Type 23-02). While other yards would grumble, the fact is that they declined to proceed with tenders for AOR-02 when they had the opportunity. The decision to split the order could be presented as a way of ensuring that there would be adequate competition for future AOR orders by ensuring that two yards had the necessary experience.

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999-49

6. As far as Type 23 frigates are concerned, the present tender round for Type 23-03 and -04 is being strongly contested by Yarrow, Cammell Laird and Vosper Thornycroft as well as by Swan Hunter. The winner of that competition will be disappointed to discover that MoD now intend to order only one frigate instead of the two they were expecting. It would not be easy to explain why at the same time Swan Hunter had been allocated a second Type 23 frigate - especially since if Yarrow was the winner of the frigate competition they would have to declare redundancies because of MoD's decision to place only one order with them instead of the two for which they had been hoping.

7. I am sending a copy of this minute to the Lord President of the Council, Members of E(A), the Secretary of State for Defence and to Sir Robert Armstrong.

PC

PAUL CHANNON

April 1986

Department of Trade & Industry

1786 1986 BOARD OF TRADE BICENTENARY

PRIME MINISTER

AOR

A guide to the papers, other than the brief by the Cabinet Office and the Policy Unit which are on top:

Flag A Minute by Mr. Younger;

Flag B Minute by Mr. Channon describing the difficulties of British Shipbuilders and the problems in the north east;

Flag C Minute by Mr. King arguing against publication of the PA report;

Flag D Further minute by Mr. Channon arguing that a further report from consultants should be commissioned or if not that the second AOR should be awarded to Swan Hunter;

Flag E Letter from Mr. Nick Brown suggesting that there might be legal problems if in the event Harland and Wolff over-run their bid;

Flag F Letter from MOD commenting on this (the Attorney General will be at E(A));

Flag G Letter from Lord Young arguing that employment measures are a more cost effective way of reducing unemployment than awarding the second AOR to Swan Hunter.

DRN

David Norgrove
16 April 1986

JAlAPM

cc Bup

PRIME MINISTER 16 April 1986

AOR ORDERS

Since the last meeting the following points have emerged:

1. The MOD long-term costing exercise will result in the delay of many Naval orders. Job losses and warshipyard closures seem inevitable.

2. Summer 1988 is the earliest that physical work could start on AOR-02.

3. If AOR-02 were brought forward it could only be by delaying orders for the frigates which the AOR is meant to support.

4. Even if the AOR orders are split the workforce in each yard would still reduce from 4,500 to a little over 3,000 by 1988. In the absence of further orders both yards' futures are in jeopardy.

5. The Swan Hunter design team is something of a red herring; they have not previously designed ships for the Royal Navy, and in any event, such resources can be bought just as Harland & Wolff did for their AOR bid.

6. The MOD have the necessary design rights to allocate orders outside Harland & Wolff.

7. PA are opposed to the publication of their report for mainly unsatisfactory reasons.

The basic problem remains: H&W have produced the best ship and won the tender; subsidy is suspected but cannot be proved; dividing orders between H&W and SH will only perpetuate the vicious cyle of 'buggins turn' and create

protest from all the other warshipyards. On top of this, British Shipbuilders merchant yards are in dire distress and there is an urgent need to support real jobs in the North-East.

Given that physical work cannot start on AOR-02 until Summer 1988 the best way of helping the North-East is surely through BS merchant yards which face crisis much earlier. This ought also to be more cost effective because once subsidising the privatised warshipyards starts it will be difficult to step off the treadmill (they are all deserving cases), and the MOD procurement process will be permanently compromised.

There are two ways to help the merchant yards: [redacted] soft loans to help secure the extra China orders (cost £20m), together with a flexible approach to BS's financial limits (although this will inevitably compromise the strategy of a gradual run-down of the merchant shipbuilding). Secondly; persuade the MOD to take another look at BS's unsolicited proposal for a £70m unarmed version of the AOR (the Fleet Support King 20/20). This could help MOD's budgetary problems and Sunderland Shipbuilders (but it might prove to be a red herring).

Paragraph 15 of the officials' paper proposes penal provisions to apply to H&W if costs over-run, (though it is doubtful that the most draconian measures could ever be enacted). Any cost over-run would have to be found from within the NI block. Publication of these penal provisions should be a useful goad to H&W performance and would certainly help in the public presentation of any decision. These proposals could be toughened by excluding H&W from all future MOD work except AOR follow-ons, and only permitting further AORs if they meet the cost on the first order.

We recommend:

1. That the first order goes to H&W; that the penal provisions suggested in the officials' paper be agreed and published; and that a bowdlerized version of the PA report be agreed with PA and published.

2. That no decision be taken on AOR-02, but that MOD be asked to seriously reconsider the BS alternative ship.

3. That extra support be given to British Shipbuilders merchant yards, particularly in the North-East.

Peter Warry

PETER WARRY

P 02004

PRIME MINISTER

Orders for Auxilliary Oiler Replenishment Vessels
[E(A)(86) 13th Meeting]

[Minutes of 14 April from the Secretary of State for Defence, Flag A.
Secretary of State for Trade and Industry, Flag B and Secretary of State
for Northern Ireland] Flag C

MAIN ISSUES AND DECISIONS

1. The main issues are:

   1. Should the contract for AOR 01 be placed with Harland and Wolff (HW);

   2. Should the order for AOR 02 be advanced and promised to Swan Hunter (SH).

2. Subject to discussion, you will wish to reach decisions on the following points:

   1. Can the PA Management Consultants Report on the HW bid be published; No

   2. Are the proposed penalties on HW for any cost overrun satisfactory;

   3. In the light of (1) and (2) can the order for the AOR 01 now be placed with HW;

   4. Should the order for AOR 02 be advanced, and if so how are the necessary resources to be found;

5. subject to (4) should AOR 02 be promised to SH on a single tender basis.

6. Can any other steps be taken to mitigate unemployment in the North East.

BACKGROUND

3. This issue arises against the background of overcapacity in warship building, with too many yards chasing too few orders. HW entered the field as part of their strategy of diversification. In retrospect this may be regrettable; but their bid for this contract has gone too far to be judged now other than on grounds of strict merit. HW have submitted the lower tender and the better design and PA management consultants have confirmed that there is no cross subsidy in their tender. Ministers were concerned, however,at E(A) on 8 April that HW might have taken insufficient account of the possibility of cost overruns and that the competition was not fair. They were also concerned at the damage to SH which would result from their not winning the tender, and the general industrial decline of the North East where further shipbuilding closures seem to be in prospect.

5. E(A) therefore invited the Defence Secretary to examine the possibility of awarding HW the first contract, with SH being offered the second on the basis of the HW design and provided their price was competitive. It was envisaged that SH might invite Yarrow to join them in place of British Aerospace as the weapons systems sub-contractor. E(A) also decided that HW should bear the same commercial risks as SH, including the possibility of closure.

CONTRACT FOR AOR 01

6. Paragraphs 11-17 of the agreed note by officials (attached to Flag A – the Defence Secretary's minute) set out the proposed arrangements for making HW bear the commercial risks. The key elements are:

1. Special monitoring so that cost overruns are identified early, and arrangements to notify all interested deparatments if they exceed 3 per cent.

2. Any overrun to be found within the contract support limit, thus limiting the company's ability to take on further work. The funding of any overrun would come from the Northern Ireland block, so that there would be no recourse to the Reserve.

3. If an overrun reached 5 per cent, HW would be excluded from tendering for further MOD work.

4. A 10 per cent overrun would lead to a Ministerial review of the future of the AOR contract and of the yard itself.

7. This regime has been constructed by agreement between officials to match as closely as possible what would happen with a private sector yard. You will wish to confirm that all the Minsters concerned accept it (paragraph 8 of Mr King's minute confirms his acceptance). To be effective the regime will need to be understood by the HW management and workforce and also to be made public to answer the claim that there can be no fair competition with a publicly owned yard. The Northern Ireland Secretary as sponsor Minister will be responsible for operating the regime; he might therefore announce it (if it is confirmed HW are to receive AOR 01) in parallel with the statement by the Defence Secretary.

PA Management Consultants' Report

8. E(A) asked the Secretary of State for Northern Ireland to seek clearance from to publish their report so that the Government could demonstrate the competition had been fair. The Northern Ireland Secretary's minute explains the difficulties in doing this. The main ones seem to be the commercial confidentiality of much of the report and the value of this to HW's

competitors. This is a great pity. Without the report, the Government will less be able to demonstrate that the HW bid is unsubsidised. It is, however, significant that the most recent public comments by SH have accepted that the basic bid is fair, concentrating instead on the argument about the risk of overrun. The new regime described in the previous paragraph, is designed to cover this. The Committee will, therefore, have to decide whether to press for publication of the report (it is not stated whether the Chairman of HW would in fact object - merely that he would need to be consulted), or to accept that it cannot be published and to rely on the overrun provisions.

9. In the light of these issues, the Committee will need to decide whether the order for AOR 01 can now be placed with HW.

AOR 02 TO SH?

10. Paragraphs 6-10 of the note by officials set out the implications of advancing the order for AOR 02 and promising it to SH on a single tender basis. The key issues are;-

(i) Can the Defence Budget afford the second AOR?

(ii) would it be advantageous to proceed by this route?

11. Although MOD have invited tenders for two AOR's, on the latest long term costing assumptions the delivery date for the second has been put back by two years, implying a start to construction in 1989-90. It would be possible to advance this to summer 1988 (compared with summer 1987 for the start of AOR 01 if a contract is placed now). This would, however, rephase MOD expenditure, bringing £46 million forward into the PES period. MOD are unwilling to find this from within their programme. It clearly makes no sense to the Navy to postpone a frigate in order to advance a stores vessel; nor would there be any net benefit to job creation for the defence industries. Advancing AOR 02 only makes sense if resources are diverted from some other programme:

this is considered in paragraphs 13 and 14 below.

12. It is not certain either that SH would derive much advantage from this course:

(i) AOR O2 would be built to the HW design, so apart from some low level work preparing construction drawings, there would be nothing for their design team.

(ii) MOD would expect SH to meet HW's price and the costs to MOD of transferring design information from HW to SH. Since the HW price allows for the benefits for the experience gained in building AOR O1, SH will be hard pressed to meet it.

(iii) even if AOR O2 is advanced, SH will still face 300 immediate job losses and a further 900 next year, although AOR O2 would save 1,350 jobs for 3 to 4 years.

13. From the point of view of both naval requirements and procurement policy the case for advancing the AOR O2 is weak. But the prospects for the North East are becoming increasingly gloomy, and there is a growing case for the Government to take measures to alleviate the problem. The question is whether expanding the naval procurement programme is the best way of doing this. The note by officials draws attention to MSC Community Programme; under this it would cost about £12 million to sustain 1,300 jobs for 2 years, compared with the need to rephase about £46 million in the defence procurement budget to achieve the same result. The Community Programme is therefore cheaper, although it can be argued that shipbuilding produces a more useful output.

14. If, however, the Sub-Committee are in favour of placing the order with SH, as a tangible symbol of the Government's concern for an area with the eighth highest unemployment level in GB, the financing issue will have to be faced. It would be possible to

transfer resources from, say, the MSC programme to the MOD (perhaps on a split the difference basis) to cover all or part of the cost of advancing AOR 02. But since the MSC programmes are cheaper per job created, this would result in a net loss of job opportunities for a given public expenditure total, and would not be the most cost effective way of reducing unemployment.

ORDER FOR TYPE 23 02 FRIGATE

15. The Cabinet decided in January 1985 (CC(85)4th Meeting)that SH should be allowed to tender without competition for the second type 23 Frigate, as compensation for losing the order for a type 22 Frigate to Cammell Laird on other than strictly commercial grounds. This was, however, on the basis of proposals making it clear that it was subject to satisfactory agreement on price and other contract terms. It was also made clear that the contract for 23 02 would be let at the same time as the competition for 23 03 and 04, so that up to date information on prices was available. Tenders for 03 and 04 were received last week. It would obviously help with sentiment in the North East if a decision to award 23 02 to SH could be announced at the same time as the award of AOR 01 to HW. It will, however, take a few weeks to analyse the results of the tender competition, because SH are resisting certain standard MOD contract conditions. Moreover, the SH bid for 23 02 is still on the high side. It has always been recognised that MOD would have to bear some additional costs by going down the single tender route for this contract, although DTI and MOD are in dispute over the precise assurances given to SH. But it is clear that MOD cannot accept the present excess price. Were SH ultimately not to receive the contract for 23 02, this would exacerbate their redundancy problems, as well as intensifying their resentment of the Government. Although these issues cannot be resolved in time to help in the presentation of the AOR decision, you will wish to ensure that the Defence Secretary reports to E(A) quickly on the position with regard to 23 02, and the results of the competition for 23 03 and 04 (there are signs that MOD do not wish to be called to collective

account on this).

HANDLING

16. You will wish to ask the Defence Secretary to introduce his minute. You may then wish to invite the Northern Ireland Secretary to deal with the publication of the PA Report and the financial regime covering HW. You will wish to obtain confirmation that this is acceptable to the Northern Ireland Secretary, Chief Secretary, Treasury, and the Committee as a whole. The Secretary of State for Trade and Industry will wish to speak on the position of the shipbuilding industry and the prospects for the North East. The Secretary of State for Employment and the Chief Secretary, Treasury will have views about the best way of directing Government help towards unemployment in both the province and the North East, and about the possibility of finding resources to expand the Defence budget.

J B UNWIN

Cabinet Office
15 April 1986

CJBG

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
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From the Minister of State for Industry

THE HON PETER MORRISON MP

C R E Brooke Esq
Chief Executive
Candover Investments plc
Cedric House
8-9 East Harding Street
London
EC4A 3AS

15 April 1986

Dear C. Brooke,

Thank you for sending me an advance copy of the statement you propose to make at the Annual General Meeting tomorrow of Candover Investments plc.

Since no decision has yet been taken on the tenders for the first AORs, it is not appropriate for me to reply at length to all the points in your proposed statement. However, I think it would be useful to pick up 3 of the points you make.

MOD have a policy of seeking value for money through competition in defence procurement wherever possible. Although 6 companies asked to receive the invitation to tender for the first of the new generation of naval support ships (not warships), the AORs, only 2 eventually tendered for AOR01 and AOR02;

As you know, British Shipbuilders made it clear to the Swan Hunter management before privatisation that after the then current round of privatisation they did not intend to build fighting vessels nor to fit weapons to any vessel. It is not the present Government's policy to allow British Shipbuilders to build fighting ships;

1MOBYB

The difficulties of ensuring fair competition between the public and the private sector was recognised by all parties before Swan Hunter was privatised. It was for that reason the Minister of State for Northern Ireland gave an assurance to the House of Commons that Harland and Wolff would prepare all bids for all MOD tenders on an unsubsidised basis. I also passed on to the Swan Hunter management before privatisation his assurance that officials from his Department would monitor the basis of such bids to ensure that they were not only unsubsidised but also comprehensively costed.

As far as British Shipbuilders is concerned, they gave the Swan Hunter management an undertaking that if they were in competition with Swan Hunter for the supply of non-fighting naval vessels, such competition would be equitable on a case-by-case basis, that is BS would not tender to supply such vessels at a loss (after taking due account of full overhead recovery and commmercial risks).

I will make the substance of this reply available to the Press when your statement has been made.

I am copying this letter to the Secretary of State for Defence and to the Prime Minister's Office.

Yours sincerely

PETER MORRISON

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Nat ind
Shipbuilding
pt 9

CONFIDENTIAL

PRIME MINISTER

AOR

These are the papers for E(A) on Thursday.

Paragraphs 11-16 of the note by officials attached to Mr Younger's minute discuss the proposal designed to make sure that Harland and Wolff would carry a real commercial risk if it won the order. The mechanism proposed would result in a risk to HW, provided Ministers were prepared to allow it to lose business and in the end to allow it to close. Management and workforce will need to believe this from the start. Mr King - and you - will have to make it quite clear that HW will be at risk if the contract goes wrong.

But whatever Ministers say on this, there is no getting round the fact that HW is in the public sector and cannot finally be brought within a true commercial discipline: the AOR will for example not be finished before the next election, so the workforce could always hope for a change of Government - or heart. (SHS share with MOD the risk of an overrun up to a ceiling, but their resources are such that officials believe a cost overrun of well under £10m. would lead to the collapse of the company.)

DR

David Norgrove
15 April 1986

MJ2BUE

ORIGINAL W G R's.

Mr. N. H. BROWN
MEMBER OF PARLIAMENT
EAST NEWCASTLE

15.4.86

PRC MA

HOUSE OF COMMONS
LONDON SW1A 0AA

A.O.R. - lead vessel

Dear Prime Minister,

May I ask you to consider one new point concerning the A.O.R. order. I am now led to believe that the owners of Swan Hunter received certain guarantees from the Department of Trade and Industry about unfair competition from the state owned sector before the yard was privatised.

If the A.O.R. is placed at Harlands and the real cost turns out to be more than Swan Hunters bid might this not amount to "unfair competition", in law?

Might the government not seek the advice of the Attorney-General as to whether or not Swan Hunters owners would, in these circumstances, have a remedy in law?

Yours sincerely

Nick Brown

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MO 26/3/1

PRIME MINISTER

ORDERS FOR THE AUXILIARY OILER REPLENISHMENT VESSEL

1. At the meeting of E(A) last week, I was asked to report on the implications of giving an option to award the first Auxiliary Oiler Replenishment vessel to Harland and Wolff (H&W) and offer the second to Swan Hunter (SHS) at a competitive price.

2. A note by officials of the Departments principally concerned is attached. The key points are:

a. Employment at both H&W and SHS is likely to decline in the coming years anyway. And given the over-capacity in the industry, there is no long-term defence requirement for the design or production capability of either yard.

b. The option identified by the Committee is feasible; and SHS could use Yarrow as partners rather than British Aerospace/Marconi (though we could not require it). This might help SHS a little in getting their costs down to the competitive price (of up to £102M). There would be

complaints from industry, particularly Scott Lithgow and Cammell Laird, about our forgoing competition for the second AOR (02)

c. On present Defence programme plans, this option would provide production work to H&W from 1987 and SHS from 1990 (of some 3500 man/years). Bringing forward work on AOR 02 as early as possible to 1988, would postpone some 1300 redundancies. But it would require re-phasing of some £46M of expenditure from the early 1990s to the late 1980s.

3. The note by officials also addresses two other points from your summing up: the unemployment costs that might be avoided at SHS and the question of exposing H&W to the same commercial risks as SHS.

4. I can see the attractions of this option in combining the benefits of the current competition for the first AOR with a measure to sustain the industrial base in the North-East. But offering the second ship to SHS, even at no extra cost to the Ministry of Defence, would run counter to our competition policy. It would be criticised on Merseyside and Scotland, where there is equally high unemployment. There is no defence requirement to sustain Swan Hunter's design or production capacity and we would simply be moving unemployment from one area of the country to another.

5. I regret that I cannot afford to order AOR 02 any earlier from within the present defence budget without disproportionate penalties. This ship is being delayed along with the reduced orders for the Type 23 frigates that it is intended to support. There would be no sense militarily in deferring even more frigates so as to bring forward their support ship. If colleagues saw pressing economic reasons for an earlier order in the North East, then some re-phasing of defence budget provision would be needed. No doubt the Chief Secretary will be able to tell us when we meet whether this would be offset by the reduction in public expenditure from the redundancies that would be avoided. If such funds were made available to me, however, it would probably make more sense to bring forward a further Type 23 frigate (to add to the one already promised to SHS).

6. I am sending a copy of this minute to the Lord President of the Council, members of E(A) and the Chief Whip, and to Sir Robert Armstrong.

J. F. Howe
Private Secretary

Approved by the Defence Secretary and signed in his absence.

Ministry of Defence
14th April 1986

ORDERS FOR THE AUXILIARY OILER REPLENISHMENT VESSEL

(Note by officials of the Treasury, Department of Trade and Industry, Northern Ireland Office and Ministry of Defence)

1. At the meeting of E(A) Committee on 8 April(1) the Secretary of State for Defence, in consultation with the Secretary of State for Trade and Industry, the Secretary of State for Northern Ireland and the Chief Secretary Treasury, was asked to consider the implications of awarding Harland and Wolff (H&W) the contract for AOR 01 with Swan Hunter Shipbuilders (SHS) being offered AOR 02 to the H&W design provided the price was competitive and possibly based on a new consortium allowing SHS access to Yarrow as sub-contractor; and to report back at a further meeting next week.

Loading of shipyards

2. The prospective loading of Swan Hunters and Harland and Wolff is shown at Annexes A and B. Without further orders beyond the second Type 23 frigate, SHS face a run-down from 4,500 to 2,000 by the end of 1988 including their 300 strong design team. Similarly H&W face a run-down from 4,500 to 2,000 in 1989 even if they win both AOR 01 and 02.

3. On MOD's latest projection for their programme, overcapacity in the warshipbuilding yards for both design and production will be substantial. There is no long-term defence requirement for the design capacity of either SHS or H&W, though retention of design capacity is important to both yards for their own commercial reasons. Other yards or design agencies could provide adequate scope for competition. Either yard could, in any case, buy-in design expertise, as H&W have done in the AOR competition.

Ordering pattern for AOR 01 and 02

4. The Ministry of Defence originally hoped to order AOR 01 and 02 as a pair in Spring 1986. After detailed design work fabrication would have begun in August 1987 (for 01) and August 1988 (for 02). Prices were obtained for AOR 02 of £103m(H&W) and £102.8-£109m(SHS) on the assumption that the tendering yard won AOR 01 (2). During MOD's annual programme review, following the Public Expenditure Survey 1985, the delivery date for AOR 02 has been put back by 2 years implying start of fabrication in 1989-90. Normally the opportunity would have been taken of this delay to mount a fresh competition. Tenders would be made on the basis of design and build information provided by the H&W Consortium under MOD's direction (the Department has already secured the necessary design rights).

(1) E(A)(86) 11th meeting
(2) These and other prices in the paper are given at constant 1984/85 prices. The SHS price was their late bid and has not been formally allowed.

The winning yard's own design team would produce detailed drawings to suit its own construction methods, but this would only require a limited amount of low level effort. As well as the two current tenderers, Cammell Laird (part of VSEL group, recently privatised) and Scott Lithgow (part of the Trafalgar House group) have already expressed interest in follow-on orders. Scott Lithgow, however, have no work beyond this Autumn, and may well close without substantial new work to carry the yard into 1987 and beyond. MOD expect competition would be fierce with keen fixed prices (ie with contractors able to claim only for general price increase as measured by industry-wide indices, and not for their own cost growth). Any favourable treatment for SHS would be likely to result in complaints from others.

Implications of awarding AOR 01 to H&W and offering AOR 02 to SHS (to the H&W design)

5. Awarding AOR 01 to H&W would give best value for money for this ship and provide 3,500 man-years of employment. Offering AOR 02 to SHS to MOD's annual programme review timetable (para 4 above) would provide similar man-years of work from 1989-90 as shown at Annex A.

Price

6. MOD would not wish to pay more than £103m overall (ie H&W's price) for AOR 02. If they incurred additional costs, this could attract criticism from the Public Accounts Committee. There would also be costs to MOD for transferring design information from H&W to SHS and for configuration management of AOR 02 which together are estimated at up £1m. It would be important to MOD to negotiate very tight contractual conditions so that the price could not be driven up during the build. To be no worse off, MOD could only offer SHS the second vessel at £102m (perhaps less if contract risks remained)(3). This is quite close to the bottom figure (£102.8m) offered by SHS for AOR 02 as the second of a pair to their design, although this price reflects the lessons they would have learned from the first ship and discounts from ordering two ships' sets of equipments. In practice SHS might well find it difficult to tender at this figure.

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(3) In Ministerial correspondence on the privatisation of SHS it was noted that there was a risk of financial collapse given the weak financial backing of the buy-out team. It was agreed that MOD should continue to place orders where SHS' overall terms were preferred but inform the Treasury of the likely extra costs to MOD if the yard collapsed with MOD ships uncompleted. On that basis the Chief Secretary did not rule out access to the Reserve if justified at the time. The MOD estimate that placing AOR 02 with SHS would extend the period of the Department's net exposure of £25-30m for an extra two years.

Partners

7. It would almost certainly be advantageous for SHS to use Yarrow as partners for weapon procurement and installation, rather than BAe/Marconi. On current tenders,BAe/Marconi appear to have been more expensive. This might make it slightly easier for SHS to achieve the £102m price that MOD could offer. While it would be unwise for MOD to direct what partners SHS uses since any failure to perform would lead to claims against MOD for additional payment, MOD and NIO would do all they could to ensure that H&W do not inhibit Yarrow contractually from supporting SHS' bid if a commercial partnership can be formed.

Timing

8. If AOR 02 were awarded to SHS, MOD's estimate of the earliest feasible timetable is as follows:

i. December 1986. Lead shipbuilder's design package available for SHS to prepare a tender (assuming H&W begin design work in April 1986).

ii. Up to Summer/Autumn 1987. Submission of tender and negotiations with MOD leading to formal order.

iii. Summer 1988. SHS start fabrication.

On this timetable, MOD's estimates suggest SHS would still face immediate job losses of 300 and a further 900 next year. It will provide 1350 jobs for three to four years from 1988 and would thus avoid the prospect of a further 1300 redundancies in 1988. Such close spacing of the timetable would, however, put MOD at additional risk since problems of the first of class would not have emerged by this stage.

9. Even assuming that the cost of AOR 02 was no higher than the current H&W tender, this would require rephased expenditure by MOD, compared to current plans of:

£m 1984-85 prices

1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	93-94
+2	+16	+30	+1	-26	-11	-12

10. MOD's view is that, although neutral overall, the increases in the earlier years could only be accommodated by corresponding adjustments to the Defence Budget or displacing other items from the programme (which would be liable to have adverse employment consequences elsewhere and be unbalanced militarily). There would be a net cost if diverting the order led to higher expenditure than the present H&W tender for AOR 02 (as second of a pair).

MAKING H&W BEAR COMMERCIAL RISKS

11. In summing up at E(A), the Prime Minister said that if H&W did receive the first order it should be made absolutely explicit that there could be no Government subsidy for H&W in the event of any cost overrun on the AOR contract: and how H&W could bear the same commercial risk as SHS, including the possibility of closure if they made a loss on the contract.

12. The basis of the SHS tender for the AOR is assumed to allow virtually no contingency for cost overrun. Even allowing some margin of tolerance, in the perception of investors, for SHS having won a "first of class" order, the best assumption must be that a cost overrun of well under £10m (on a contract worth £120-127m) would lead to the collapse of the company.

13. It would be necessary to set up, at H&W, an analogue for that situation which would ensure that competition was as fair as we could possibly make it. The following is proposed.

14. First, special arrangements would be needed to monitor the progress of H&W's work on the order, so that cost overruns come early to light. Existing quarterly monitoring procedures for H&W (backed by quarterly audit) should be extended to cover cost and physical progress on AOR as well as financial effects. If an overrun of 3% or more was identified, all interested departments should be immediately alerted at official level.

15. Secondly, the consequences of a cost overrun at H&W, once identified, should be as follows:

a. Any cost overrun would automatically impact via the existing contract support limit arrangements (a three-year limit on new subsidy commitments), on the company's ability to secure further work: if at all significant it could preclude their taking on a new order, provided Ministers ensure that the limit is held: and that would lead to contraction or closure.

b. An overrun above 5% would preclude the yard from tendering for further MOD work, for the duration of the overrun above 5%.

c. An overrun above 10% would lead to an immediate review by Ministers of the future of both the AOR contract and the yard itself.

16. The cost overrun would in principle have to be met by raising H&W's EFL - unless Ministers were prepared, by refusing to do so, to risk precipitating not only the collapse of the yard, but its inability to complete the AOR order. The increment to the EFL would be found from existing resources in the Northern Ireland block, and would thus be at the expense of other Northern Ireland programmes.

17. The arrangements in paragraph 15 above could be made public if E(A) decided to place the first AOR with H&W.

COSTS OF REDUNDANCIES AT SWAN HUNTER

18. The MOD figures in Annex A assume the Type 23 02 is ordered from SHS and show the workload consequences as between:

a. no AOR 02 order to SHS;

b. AOR 02 requirement advanced and order given to SHS;

c. AOR 02 ordered to present MOD timetable and won by SHS.

19. For the purpose of the present option lines (b) and (c) are relevant. In summary, there is no difference in total manpower required over the period to end 1990 between the two options. The difference is only of timing. Line (c) shows likely redundancies of 1300 during 1988, which would be avoided by earlier ordering. But earlier ordering would mean the same number of redundancies during 1990 as the work in the yard, including that on AOR 02, ran down.

Redundancies in 1986 and 1987 would be unaffected

20. Thus if the AOR order is not advanced there might as a direct result be some 1300 redundancies arising in 1988. Ministers might wish to see action to alleviate unemployment in the North East to compensate. It is assumed that any such action would be set in hand before 1988. It might include the use of MSC/DE employment schemes.

21. The most adaptable MSC scheme for reducing unemployment is the Community programme (although it only covers the long term unemployed and so would not directly help those just laid off). 1300 jobs preserved by the Community Programme for two years would cost about £12m in gross public expenditure.

22. Since the 1985 Budget the target for filled places on the programme in the North East has been 26,000 (of which about half are to be in North and South Tyneside). This represents an increase of about 13,000 places over the number in Summer 1985, or about 4,000 over the present number. It is about 8,000 more places than the strict MSC formula for allocating places (based on the number and concentration of the long term unemployed) would indicate.

23. The 1986 Budget raised the national target for filled places on the programme by 25,000. This increase has not yet been allocated to regions. But it might be expected that the North East would get about 2,500 of these extra places (with North and South Tyneside getting over 1,000 between them).

24. The share of the North East and of Tyneside in the 25,000 extra places could be increased (although the North East already has more than its share of places according to its share of long term unemployment). Further examination would be needed to say

how many extra places could be provided, how quickly and how close to SHS. But it would in any case be unlikely that the number of extra places could be increased by more than about 1000 in the North East, to total about 3000-4000 extra places. Any extra places for the North East would have to be at the expense of other parts of the country.

25. Other MSC schemes could not be expended by central decision, since their uptake is in practice limited by demand. But if unemployment rose in the area, and MSC/DE focussed publicity on the area, the number of applicants for eg the Enterprise Allowance Scheme and the New Workers Scheme would be likely to increase; and in both cases MSC/DE are likely to be able to finance such an increase within the totals available for these schemes. There is provision for each scheme for a nationwide rate of entry equivalent to 100,000 a year by the end of 1986/87.

TYPE 23 CONTRACT NEGOTIATIONS

26. The second Type 23 frigate (Type 23-02) was allocated to SHS as part of the Cabinet decision in January 1985, subject to satisfactory agreement on price and other contract terms. Mr Heseltine told Parliament that he would expect the price for this frigate to reflect the economies obtainable with an order for two frigates rather than one, and to be competitive; in order to establish this, tenders would be invited for the third Type 23 order in the same timescale from all UK yards capable of carrying out the work. Tenders for Type 23-03 and 04 have therefore been obtained from SHS and the other frigate building yards, although MOD is likely to be able to order only one more of these in 1986; and re-tenders were received a few days ago which are now being assessed. A conclusion on the contract negotiation for Type 23-02 is therefore in sight but SHS's tender is still on the high side and they are resisting certain standard MOD contract conditions (which would make price enforcement difficult). Nonetheless with price reductions smaller than those offered in the closing stages of the AOR competition and a reasonable negotiating approach, SHS could secure Type 23-02 within a month or two.

ANNEX A

FORECAST OF SWAN HUNTER LABOUR REQUIREMENTS FOR MINISTRY WORK

Programme Assumptions	Current Workforce Numbers		Requirement at Year End				
			1986	1987	1988	1989	1990
Type 23-02 ordered. No AOR orders.	Blue Collar	3,154	3,200	2,500	1,500	1,000	-
	White Collar	1,345	1,000	800	500	350	-
Type 23-02 ordered. AOR 02 ordered 1987. (Earliest Possible Start)	Blue Collar	3,154	3,200	2,500	2,500	2,000	1,000
	White Collar	1,345	1,000	800	800	650	350
Type 23-02 ordered. AOR 02 ordered to LTC 86. 1989.	Blue Collar	3,154	3,200	2,500	1,500	1,000	1,000
	White Collar	1,345	1,000	800	500	350	350

Notes: (1) SHS are unlikely to be able to obtain commercial work due to not being eligible for intervention funding
(2) SHS will be eligible to compete for further Type 23 frigates and refits of RFAs

** TOTAL PAGE.05 **

ANNEX B

FORECAST OF HARLAND AND WOLFF LABOUR REQUIREMENTS FOR ALTERNATIVE PROGRAMMES

Programme Assumptions	Current Workforce Members	Requirement at Year End 1986	1987	1988	1989	1990	1991
A. Current workload and BSC 170K and no other orders	4500	3500	3500	-	-	-	-
B. Current workload and BSC 170k and AOR1	4500	4350	4350	3150	500	-	-
C. Current workload and BSC 170K and AOR1 and AOR2 to LTC 86 programme	4500	4350	4350	3500	2000	2000	500

NOTES

(1) Figures show shipbuilding only: engineering account for further 500-600

(2) Underlying changes between A and B in 1986 is loss of design team of 300.

NAT IND Shipbuilding PTY

cc BG

CONFIDENTIAL

BT 11 B/F tomorrow for EA pm Tuesday

PRIME MINISTER

BRITISH SHIPBUILDERS AND THE NORTH EAST

We are to discuss the AOR order with colleagues later this week. In that context, it might be helpful if I set out some background relating to British Shipbuilders and manufacturing industry more generally in the North East of England.

2 You will recall that I minuted you on 14 February following a discussion I had had with Graham Day reporting the difficulties facing British Shipbuilders' merchant shipbuilding operations.

3 Phillip Hares, the Chairman-designate of British Shipbuilders, wrote to me and came to see me last week to bring me up to date with the situation. BS have managed to secure orders for only 23,000 compensated gross tonnes (cgt) in 1985/6 against their target of 200,000 cgt.

4 BS are continuing to pursue orders vigorously but none are yet certain. They have already warned that they are unlikely to be able to remain within their £73m External Financial Limit this year. Their draft budget (which has been rejected by their Board) foresees the need for £94m. I have told Mr Hares that I regard this as most serious and that he must take whatever steps he can to bring BS back within or close to their EFL and I have asked him to discuss this with my officials. One move BS have been considering

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would be to reduce current direct labour employment by at least 15 per cent to a 'core level' in each yard. BS's intention would be to support the core levels with supplementary labour on temporary employment terms as the work demanded. I have encouraged Mr Hares to pursue this course - but of itself it will lead to about 1,500 redundancies.

5 BS's main prospects for work in the short-term are a rail ferry for Sealink (on which I am writing separately to Nicholas Ridley) which would be built at Govan on the Clyde; four or five small ships for Cuba which would be built at Austin & Pickersgill in Sunderland or at Smiths' Dock on the Tees; and two ships for China which would be built at Sunderland Shipbuilders. Even with these orders BS believe that they will have to close their Wallsend engine works (400 jobs), Smith's Docks (1500 jobs) and Ferguson-Ailsa's yard at Troon (400 jobs), bringing a total redundancies this year (including the effect of 'core level' labour) to about 3,500 of which some 2,500 will be in the North East.

6 BS are also due to begin their wage negotiations. They believe that their best chance of securing the changes they require with the minimum of industrial disruption will be to inform their unions of their proposed actions at a meeting fixed for 14 May. They will be able, however, to say that the closure of Smith's Docks and the Troon Yard could be avoided if further orders were secured. On the other hand, further closures in the winter of 1986/7 will be necessary if some of the orders they are now hoping for are not secured. The most vulnerable yards are Austin & Pickersgill (1,250) and the Ferguson Yard at Port-Glasgow (400 jobs). It is also very likely that Scott Lithgow, owned by Trafalgar House, at

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Port Glasgow will have to close (1,600 jobs) this winter if it is unable to secure extra work.

7 We can do little to help BS even if we were prepared to relax our financial controls. The European Commission limit the amount of aid we can give and we could face problems with them even as things stand. There is one possibility which avoids this difficulty: BS have told me that in addition to the two ships (worth some £40m) on which we have offered soft credit terms, the Chinese state shipping company (COSCO) could be interested in a further 3 identical ships which would be worth a further £60m. This would provide valuable extra work at Sunderland (and later at Govan). I think that this is worth considering although it may not be easy to achieve. One difficulty is that our soft credit facility with the Chinese can cover projects worth £300m - UK companies in other sectors (including manufacturing companies from the North East) have already come forward with potential projects exceeding £1,000m. But I think officials should be asked to explore the possibilities.

8 In the North East of England unemployment is already 50 per cent above the national average rate; the area is characterized by basic, traditional declining industries. These industries still represent a major part of the regional economy; for example it is estimated that for every 100 jobs lost in primary shipbuilding a further 50 to 60 are lost in local supplier industries. Moreover unemployment in the North East tends to be concentrated in the major urban areas along the 3 rivers Tyne, Wear and Tees, which are among the Travel to Work Areas with the highest unemployment rates in Great Britain, with male unemployment of around 30 per cent.

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CONFIDENTIAL

9 I will keep you and colleagues in touch with developments on BS, but I fear that we face some difficult decisions.

10 I am copying this minute to other members of E(A), Geoffrey Howe, George Younger, and Sir Robert Armstrong.

PC

PAUL CHANNON

14 April 1986

DEPARTMENT OF TRADE AND INDUSTRY

JF6AEQ

999-49

Not. Ind:
Shipbuilding PE-9

COMMERCIAL IN CONFIDENCE

RESTRICTED

c/c BG
and B/f tomorrow
for E(A) on Thursday.

Prime Minister

AOR COMPETITION

mCnotes attached

1. At E(A) (86) 11th Meeting on 8 April we agreed on the need to be able to give clear assurance about the absence of subsidy in H&W's preferred bid. In this connection I was asked to look into the question of possible publication of the PA report.

2. Our two options are (a) publish the full text or (b) publish a summary, possibly in letter form. My officials have consulted PA and ... I attach a copy of PA Chief Executive's letter of 11 April.

3. In regard to publication in full, I think the Chief Executive is right to oppose this. He makes a number of points, amongst which I note particularly his view that the large amount of commercially confidential information contained in the report would, if released, be of high commercial value to H&W's competitors, not only here but overseas.

4. The alternative is to publish a summary. The problem here is that having deleted all the necessary information the document would lack the evidence necessary to prove our case.

5. I therefore believe that publication of PA's report, in full or in summary, is not the right course and that we need to establish another way to present our decision.

6. As to whether the tender is subsidised, all relevant Departments have been able to study the PA report. I understand that there is now agreement that, as revealed by PA's findings, it is an unsubsidised tender, and I therefore think that it is for the Government, who commissioned the PA report, to reach its assessment on the findings of the independent consultants and to be prepared to stand by them.

7. However I recognise that in our discussion concern focussed, not just on the question of any subsidy in the tender, but also on the question of the different position of the two yards in the event of a cost overrun or serious problems arising during construction. In this connection colleagues asked George Younger together with Paul Channon, John MacGregor and myself to see how it could be made quite explicit that there could be no Government subsidy in the event of a cost overrun. I am now writing to confirm that I believe we should adopt proposals that our officials have now produced for a strict financial discipline over the company. The specific purpose is to recreate for H&W, as closely as we can, the commercial exposure faced by SHS. In this way the conditions under which the order has been placed will have the effect of exposing H&W to the same risks and penalties as those faced by a private sector company and we shall be able to say so publicly.

8. I personally think that this new system has much to commend it in any case and reinforces the new Contract Support Limit system. This will certainly exert a strigent discipline: failure to live within it will by itself lead to contraction and possible closure. I believe the new proposals represent a valuable addition because difficulties can always arise with slippage or construction problems; indeed, George Younger's letter of 25 March has already noted that there has been some slippage in H&W's contract to convert an existing container-ship into an Aviation Training Ship, although he has fairly recognised that some is attributable to his Department. Certainly the unexpected presence of blue asbestos and lead-based paints in the original ship is causing additional manhours. If consequential cost arising from any slippage on this or any other existing orders (on which a review is being conducted) fall to be borne by H&W these will in turn trigger the Contract Support Limit system to penalise the company. Even though the AOR would already be within this system, the additional discipline proposed for AOR construction has much to commend it and is very much directed to the concerns expressed by colleagues at our last meeting.

9. I am copying this to E(A) colleagues, George Younger and Sir Robert Armstrong.

G. H. H. Somerbey
(Private Secretary)

for TK

14 April 1986
(Approved by the Secretary of State and signed in his absence in Northern Ireland)

PA Management Consultants

Bowater House East
68 Knightsbridge
London SW1X 7LJ

Telephone 01-589 7050
Telex 295501

PA Management Consultants

COMMERCIAL IN CONFIDENCE

11 April 1986

14 APR 1986

D Fell Esq
Permanent Secretary
Department of Economic Development
Netherleigh
Massey Avenue
Belfast BT 2JP

Dear Mr Fell

When our people met yesterday, the PA consultants concerned were given to understand that Ministers were considering publication of PA's report on the Harland and Wolff bid for AORs 01 and 02. You may find it useful to have on record PA's views.

We feel that publication would be inadvisable because:

- the report is a commercially confidential document; the information required to prepare it was provided on that basis;

- Harland and Wolff has been extremely 'open' and co-operative throughout this assignment and would be entitled, in our view, to feel that their trust had been abused;

- loss of Harland and Wolff's goodwill would make the future monitoring of the yard more difficult and less productive for the DED. Certainly we feel that the Chairman of Harland and Wolff would have to be consulted prior to publication;

- the report would be of high commercial value to Harland and Wolff's competitors at home and abroad;

- PA greatly values, indeed depends upon, the trust of those with whom it works. This applies, of course, to our clients, but it applies equally to wider commercial relationships across the range of our business and upon which our ability to perform effectively depends. It is vital for us not only to observe the ethical standards of the profession, but also to be seen to be so doing;

- the report could all too readily be taken out of its proper context. Ministers must, of necessity, address the full range of complex and difficult issues which arise from the particular circumstances of this competition. Publication of the report would increase, we believe, the risk of the Harland and Wolff tender assessment being viewed in unrepresentative isolation.

It has been suggested that a 'bowdlerised' or summary version of the report might be published, or even my recent letter to your Secretary of State which confirms PA's steadfastness in the report's findings. Given the entrenched nature of this competition, we believe it would be most difficult for any form of summary (which would perforce omit many important detailed points) to satisfy the principal purpose of publication - that is, to carry worthwhile conviction. Further, we consider that each of these approaches carries to a greater or lesser degree the disadvantages referred to above. Finally, we believe that there is a risk that a cut-down version of our report could inadvertently lose sight of the complex and judgmental issues which were involved in the work.

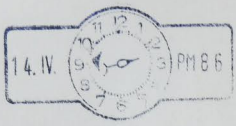
As you know, we found the tender, as constructed, to have been put together fairly and to contain profit, so that the question of subsidy does not arise. However, the several caveats we have entered concerning the eventual outcome of the build (for example the issues of project management, sizing etc.) are important and should not be neglected. Indeed, we appreciate that officials are currently looking at ways and means of enforcing a rigorous "commercial" regime to govern the project's management in recognition of these factors.

If PA can be of any further assistance at all in this current matter, my consultants are, of course, ready and willing to make themselves available.

Yours sincerely

Neil Kilpatrick.

N O Kilpatrick
Chief Executive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PM 8 6

CANDOVER INVESTMENTS plc
Cedric House, 8-9 East Harding Street, London EC4A 3AS
Telephone: 01-583 5090 Telex: 928035 Fax: 01-583 0717

14th April 1986

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NBPM.

The Hon Peter Morrison MP
Minister of State for Industry
Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET

Dear Minister,

SWAN HUNTER SHIPBUILDERS LIMITED

We are having the Candover AGM on Wednesday and I already know that we are going to be asked questions about Swan Hunter. I thought that as a matter of courtesy I should send you the text of the statement which I expect to make assuming, of course, that no decision has by then been taken.

At David Hardy's suggestion I am sending a copy to the Secretary of State for Defence and the Prime Minister's Office.

With many thanks for your interest.

Yours sincerely
Roger Brooke

C R E Brooke

3554B

DIRECTORS: Chairman: P G Wreford BSc (Econ), ACIS, AIB; Chief Executive: C R E Brooke MA;
Deputy Chief Executive: S W Curran FCCA;
H A Hicks CBE, DSc, C Eng, FICE, FI Prod E, F Am SCE, M Soc C E (France), FCIOB, CBIM;
R A P King; P J Scott Plummer MA, FCA; M C Stoddart FCA; L V D Tindale CBE, CA, CBIM; J G West FCA.

Registered No 1512178 in England at the above address.
An investment company within the meaning of Part VIII of the Companies Act 1985.

STATEMENT BY THE CHIEF EXECUTIVE OF CANDOVER INVESTMENTS PLC, MR ROGER BROOKE, AT THE ANNUAL GENERAL MEETING OF SHAREHOLDERS ON WEDNESDAY 16th APRIL, 1986

You will have read in the Press about the problems that have arisen in relation to the competition between Swan Hunter and Harland & Wolff for the first of a new series of auxiliary vessels for the Royal Navy (AORs). You will have seen that if both these orders go to Harland & Wolff, Swan Hunter will suffer a major setback with serious consequences for the company and its workforce. I thought it right to give you some comments on the situation.

Candover led a group of institutions in backing the Swan Hunter management in a buy-out of the company from British Shipbuilders. The new company started life at late January this year. You might think it surprising that a management buy-out would be considered in a traditional industry which most of you will perceive as having been one in which Britain was no longer competitive. We established that on the contrary Swan Hunter had an excellent record of building warships profitably for the Royal Navy and delivering them on time and with minimal defects. Swan Hunter have in fact built more of the present fleet than any other shipyard. We made our own direct enquiries and were assured by the senior people concerned both in the Royal Navy and the Ministry of Defence that as customers they were very keen to see Swan Hunter continue as a warship builder. They gave the company a particularly high rating in terms of its design and technical expertise and we were surprised and impressed to discover that in some areas, notably computer aided design, Swan Hunter were world leaders. We were assured by the appropriate Government departments that the newly privatised business would not encounter unfair competition from State-owned businesses.

The current pending order for the first two AOR's emerged as a competiton between Swan Hunter and Harland & Wolff, the State-owned shipyard in Belfast. Swan Hunter have their own design team who have been involved in the tender and would be responsible for all thedesign work on this new class of vessel. This is logical since Swan Hunter were the designers of the previous class of auxiliary vessels and in fact built ten out of thirteen of those ships. It is vitally important for Swan Hunter to maintain an in-house design capability if they are to win new export business which they confidently expect to do as a private sector company. Indeed they already have some encouraging evidence of export potential.

Swan Hunter have linked simply with British Aerospace to provide a single point specialist weapons expertise. Harland & Wolff, by contrast, do not have the same capability and their tender involves splitting up the design function among a number of companies, including Yarrow (recently privatised and bought by GEC and probably Swan Hunter's major competitor), Yard, another Scottish company and others. Not only is such an arrangement inherently inefficient but Yarrow will reportedly need to recruit a substantial number of high-level systems engineers - the very people who are already present in the Swan Hunter team at Newcastle or in the British Aerospace team at Bristol.

Harland & Wolff is a loss-making business and has received subsidies from the British taxpayer in recent times of over £200 million to fund its losses, including over £30 million in the past year. It does not have to face the consequences, as does Swan Hunter, of its own bids. There are suggestions that some aspects of the Harland & Wolff tender were based on false assumptions about the costs of the work involved which would indicate that the Harland & Wolff bid would indeed end up in yet another loss. Fortunately for them the Harland & Wolff management can shrug their shoulders and pass the tab to us all as UK taxpayers.

You may ask why in this situation there have been industrial relations difficulties at Swan Hunter. It should be remembered that over the three years between 1982 and 1985 the workforce was almost halved from just under 9,000 to 4,500 without any industrial difficulties and at the same time a great many advances were made in new working methods to increase productivity. However, the uncertainty about privatisation and its effects, and, more recently the reports about job losses that would result if the AOR orders went to Belfast, have undoubtedly provided fertile ground for troublemakers in the company. The recent dispute which partly led to the new frigate HMS Coventry having to be launched in the night by the management - much to their credit - is now over and everybody is back at work. I believe, as do the management, that with a more settled situation that would result from a more secure future based on an AOR order, the previous record of good industrial relations will be re-established.

I think that we should ask the Ministers who are dealing with this problem the following questions:

First, why should Harland & Wolff be encouraged to enter the business of building warships for the Royal Navy for the first time in over twenty years when the newly privatised yards - Yarrow, Vickers Cammell Laird, Vosper Thorneycroft and Scott Lithgow - already offer capacity probably in excess of the Navy's requirements and certainly offer plenty of competition?

Secondly, does the position at Harland & Wolff mean that British Shipbuilders, which remains nationalised, may at some stage come back into the business of building warships? and

Thirdly, is it not self evident that in this area it is virtually impossible to ensure fair competition between a private sector company and a subsidised loss making State-owned business.

This situation causes me such concern for two main reasons. Firstly, while the investment is not a major one for Candover, we persuaded a number of important City institutions to join us despite their general reservations about the sector. It would be deplorable if City support for new efforts to modernise old established British manufacturing industries were rewarded by an instant kick in the teeth. Second, I would be appalled if a fine shipyard with a firstclass management team had its prospects blighted before it had had a chance to get going. This cannot be the Government's intention and it would go against all its wishes in the context of the privatisation programme. Furthermore, it would undoubtedly have serious implications for future privatisations where the newly-to-be privatised companies may have to compete with publicly owned businesses. The National Bus privatisation plan is a case in point, as could be the Water Authorities.

I think that the solution in this case is not hard to see. If Swan Hunter were awarded the first of class AOR their design team could be kept together and used to build an export business. If it was thought essential to award an order to Harland & Wolff they could build the second ship and thereafter the Government could review its competition policy in this area. There will be no problem about ensuring genuine competition for the subsequent AORs as is the case with frigates and other naval vessels.

Finally, I emphasise that I have reported this matter to you at some length not primarily because of the financial implications for Candover but because I am concerned that a mistake might be made which would not only be seen as a betrayal by all those who work at Swan Hunter in one of the highest unemployment areas in the country but would have damaging implications for privatisation which most of us believed to be a thoroughly constructive and sensible aspect of the present Government's policies.

CREB
14.4.86
3550B'

MaMc.

As promised

Joy

Swan Hunter Shipbuilders Ltd. safely launched the frigate HMS Coventry at 3.45 a.m. today 8th April 1986 from their Walsend Shipyard

The Managing Directors

FILE DA

PRIME MINISTER

Swan Hunter Shipbuilders have sent you a bottle of champagne to mark the launch of HMS Coventry yesterday morning. Joy has placed it in the flat.

DTI have received a similar gift, and I have agreed with them that Swan Hunter should receive a Private Secretary acknowledgement and note of thanks.

(Mark Addison)

9 April 1986

file

JA

C.F.

10 DOWNING STREET

THE PRIME MINISTER

8 April 1986

Pse cc to C/F (all PPS)

Dear Robin,

Thank you for your letter of 4 April with which you enclosed one from Ken Maginnis.

As you may know I have had a meeting with Ken Maginnis during which he expressed some of the same concerns as in his letter to you. I can assure you that it is one of my principal concerns to ensure that the decision on the AOR order is taken on the basis of fair competition and I know that you will understand if I can say no more at this stage.

Yours ever

Margaret

Robin Maxwell-Hyslop, Esq., M.P.

DSC

MESSAGE TO THE PRIME MINISTER FROM NEVILLE TROTTER MP

Pre-dawn launch of HMS Coventry shows initiative and determination of Swan Hunter's team.

This surprise move required much planning and cooperation from those on the River Tyne.

It proved that Tyneside has got what it takes to get things done and is determined to succeed in shipbuilding.

You can be assured that future Navy orders will be satisfactorily completed on time, as have all previous Naval orders of Swan Hunter's.

8 April 1986

Similar messages have gone to other Cabinet ministers.

JB.

PRIME MINISTER

Order for the Auxilliary Oiler Replenishment Vessel [E(A)(86) 11th Meeting]

--- [The letters of 25 March from the Secretary of State for Defence to the Secretary of State for Trade and Industry and of 26 March from the Secretary of State for Trade and Industry to the Secretary of State for Defence, and the minute of 26 March from the Secretary of State for Northern Ireland to the Prime Minister are relevant.]

BACKGROUND

1. The Ministry of Defence (MOD) is on the point of placing the order for the first Auxiliary Oiler Replenishment Vessel (AOR). This will be a one-stop replenishment vessel capable of providing fuel, ammunition, and other stores simultaneously to warships at sea. Because of the high value of its cargo and the need to deploy in hostile waters the ship will have self-defence weapons. It will cost about £120 m. It is envisaged that a second AOR may be ordered in the autumn, and four more in due course.

2. Under a new procurement strategy MOD invited tenderers to take responsibility for designing and building the whole ship. The competitors are a consortium led by Harland and Wolff (HW) and Swan Hunter (SH). In the view of MOD HW have won the competition not just on cost and delivery but also on technical and design grounds: but SW have been lobbying strongly, arguing that HW's bid is unfair. MPs from both Northern Ireland and the North East have met you to press the respective cases. A

decision must now be made and announced as to who is to win the first order.

MAIN ISSUE

3. The main issue is whether the contract for the first AOR should be placed with HW or SH.

4. With substantial overcapacity for building war ships this order is very important to the yards concerned. SW claimed that 1,000 of its workforce (out of 4500) would be laid off later this year, with another 1000 threatened in 1987, if it does not receive the contract; while HW claim that 5000 jobs there would be at risk. Feelings are running high. SH are particularly aggrieved at the apparent re-entry of HW after a 20 year gap into the market for warship building work, just as the Government has completed the privatisation of its warship building capabity. SH was subject to a management buy out only three months ago, and the co-directors would face financial disaster if their enterprise were to collapse. Conversly HW will rightly be aggrieved if the Government appears to bend the rules of the tender competition to deprive them of an order they consider already won

5. The decision is particularly sensitive for the Government given that one contender is in the private sector and one the public, and that one is in Northern Ireland and the other in England (both areas of high unemployment). It must therefore be seen to be taken on scrupulously fair grounds.

The Competition

6. Tenders were invited on 13 November 1985, and sealed bids were delivered by 2 December. These showed a substantial price advantage to HW. SH put in a unsolicited revised bid in February, and HW were then invited also to submit a revised bid. These again showed a price advantage to HW. Finally in March SH submitted a further unsolicited bid on 21 and 23 March showing a

price similar or slightly above that offered by HW. (Details are shown in Annex A to the letter of 25 March from the Defence Secretary to the Trade and Industry Secretary). It is questionable whether the late bid from SH should be admitted (and it is agreed that if it were, HW should also be given a chance to revise their bid) but even if it is and can be validated, the Defence Secretary still believes that HW's tender remains the most competitive on all main grounds. It is therefore clear that according to the conventional rules, HW have won the competition.

Criticisms of the HW Tender

7. SH and their supporters have, however, levelled two main criticisms at the HW bid;-

(i) First, they claim that they had an expectation of the AOR contract, and this was built into the terms put forward by the management consortium which acquired the yard from British Ship builders. I know of no specific evidence forthis. SH appear to have been promised that they would not be subject to unfair competition from firms still in state hands; but this is quite different from an assurance about the AOR contract;

(ii) Second, SH allege that HW's tender is effectively being subsidised by the Government. You assured North East MPs on 20 March that the AOR tender would be studied with scrupulous care to ensure that no cross subsidies are involved. The Northern Ireland Department commissioned PA management consultants to review the tender. They concluded that HW's bid was fairly costed, unsubsidised and contained a profit margin. They were content with the realism of the underlying assumptions, and that there was no cross subsidisation through allocation of overheads or in other ways. In the view of NI Ministers, HW have been able to offer a competitive price because of the strength and experience of their consortium partners - 70 per cent of the value of the ship comes from these partners and sub-contractors, including the

newly-privatised Yarrow shipbuilders on the Clyde.

PA did, however, point out that the margin of risk could subsume the profits in the tender, which is based on a fixed price. It could be that HW have taken insufficient account of these risks in settling their tender price, on the assumption that the Government would stand behind them. The Trade and Industry Secretary has therefore suggested that further consultants should be asked to look at the bids by both yards to determine whether the prices offered reflect the costings and the extent to which contingency provisions are likely to prove adequate. The Defence Secretary has, however, pointed out that MOD can look only at the prices presented to it, and that since the price offered by HW is very close to the internally developed target price based on a feasibility study undertaken by SH there is no reason to suggest that HW's price is artificially low. Moreover, there are few if any consultants who know sufficient about the subject who are not closely allied with one of the shipbuilding yards or their consortium partner.

9. The issue of subsidisation and fair competition at (ii) above is clearly the most important one on which the Government must be able to defend itself. It must be able to show that HW's bid has been prepard on a scrupulously fair basis. It seems doubtful whether a further consultants' study - assuming the right consultants could be found - would help much in achieving this. HW would have to be allowed to revise their tender themselves, and they would no doubt mobilise their own lobby to argue that they had been unfairly treated. It is also worth bearing in mind that the more the rules are bent in SH's favour in this case, the more they are likely to expect further special treatment in the future. This could store up serious problems on other future MOD contracts. If the Government confirm the Defence Secretary's choice in favour of HW, it may be worth publishing the PA Report. NI Ministers could also draw attention to the new monitoring arrangements which have been introduced at

HW to police their costing methods, as further reassurance that the Government have acted prudently and that HW's bid is fair.

Consequences for SH of losing the contract

10. SH's finance director (Mr Vaughan) is quoted in the press as saying that if SH do not get the first AOR order 200 design jobs are in immediate jeopardy, and a further 2000 jobs by the end of 1987. It has also been suggested that the whole existence of the company could be in jeopardy because institutional investors would withdraw their financial support, and that Britain could lose a multi-million pound overseas contract (Project Cheviot) unless MOD demonstrate their confidence in SH by giving them the AOR order. There is no doubt some truth in these claims, though also much special pleading. Since SH is now privatised the Government do not have detailed access to its working figures, but their present order book is valued at £400 million, securing jobs until 1989, compared with an order book of £160 million for HW securing jobs until 1988. MOD officials suggest that the design team is at most serious risk, but that it is not essential in the national interest that it should continue since design consultants could be contracted in as necessary in the future. You may wish to ask the Trade and Industry Secretary for his assessment of the Company's claims.

Consequences for HW of loosing the contract

11. E(A) considered the HW corporate plan on 6 March, and endorsed a strategy relying on a system of Contract Support Limits (CSL) to improve the discipline over the company's operations. It was agreed that an important objective should be to secure a lower EFL for 1987-88 than for 1986-87, and the Secretary of State for Northern Ireland is under a remit to report on studies for reducing overheads and more flexible working practises by early summer. There is, however, no straightforward relationship between the AOR order and HWs EFL.

The EFL for 1986-87 will actually be slightly higher if they win the order than if they do not, but lower in 1987-88. Without at least one AOR there are likely, however,to be substantial redundancies. Moreover, since 70 per cent of the work will go to sub-contractors (the newly privatised Yarrow shipbuilders on the Clyde and YARD, a specialist naval designer), they too will be adversely affected if HW fail to win the order. As the Defence Secretary comments, given the present general overcapacity, whatever decision is taken on this or on future orders, redundancies somewhere are inevitable. There is no painless solution.

Alternative work for SH

12. It would clearly be easier for SH to accept the loss of the AOR order if they could be promised some other work in future. A second AOR may be ordered in the autumn and it would be possible, for example, to offer them that on the basis of the HW design and price. But this would be to forego the benefits of batch ordering, and there are also other yards such as Scott Lithgow, and Cammell and Laird who would want to compete. The Defence Secretary has offered, however, to say publicly that he will postpone the decision on the second AOR until the autumn and decide how to procure it in the light of all the factors at that time. It would seem imprudent to go beyond that.

13. SH were promised the order for the second Type 23 frigate earlier this year, when the first order was switched to Cammel Laird, provided their terms are competitive. They are also tendering for the third and fourth Type 23s along with Yarrow, Cammel Laird, and Vosper Thorneycroft (tenders are due to be returned on 8 April). Once the fate of the AOR order and the price offered for the 23-03 and 04 are known, the way should be clear for MOD to confirm the order for 23-02; but it should be noted that SH's latest price for this is still much higher than the prices emerging from the competition.

HANDLING

14. You will wish to ask the Defence Secretary to introduce the discussion. The Secretary of State for Trade and Industry, as sponsor Minister for SH, will wish to speak second. The Secretary of State for Northern Ireland will also wish to speak. You will also wish to hear the Chief Secretary's views on the financial and public expenditure implications (I understand Treasury officials are briefing him strongly to support HW, on the grounds that it is the lower offer and the competition is fair); and the Chief Whip's assessment of the extent to which SW have been able to secure support from back bench MPs.

CONCLUSION

15. You will wish to reach decisions on:

1. whether it has been reasonably demonstrated that the HW tender is fair and realistic;
2. if so, whether MOD should now proceed to place the order;
3. how this decision should be presented.

J B UNWIN

Cabinet Office
7 April 1986

10 DOWNING STREET

From the Private Secretary

7 April 1986

Dear Denis,

AOR COMPETITION

Members of E(A) will wish to see the letter from Mr. Nick Brown MP, enclosed, about the AOR competition.

I am copying this letter and enclosure to the Private Secretaries to members of E(A) and Michael Stark (Cabinet Office).

Yours

David,

(David Norgrove)

Denis Brennan, Esq.,
Ministry of Defence.

Tim for E(A) Tuesday

CONFIDENTIAL

PRIME MINISTER

4 April 1986

AOR ORDERS

All the warshipyards are in depressed areas; they are all financially constrained; and they all have an excellent claim for extra orders. But there are not enough orders to keep all of the yards solvent. There can be no solution until at least one of the yards (hopefully the least efficient) goes under; sharing orders only prolongs the agony for them all.

All Ministers agree that future orders should be placed on a strictly commercial basis. Anything less would continue the sorry cycle of 'buggins' turn, intense political lobbying (from which one yard must always lose), and the perpetuation of an inefficient industry with resulting high defence costs.

Even if Swan Hunter's latest 25% price cut is accepted, the MOD still prefer the Harland & Wolff proposal. The only issues are whether the H&W price is fair (or at least as fair as the SH price) and how this can be proved.

Having visited both yards I am not surprised that H&W are cheaper: the rich diet of MOD work that SH have relied upon has stifled their enterprise and efficiency. Only this week the SH workforce has reimposed an overtime ban. H&W by contrast have produced a much cleverer solution and their partners (who account for more than half the cost) have put together a better deal.

PA have already given the H&W bid a qualified bill of health. In the light of the latest 25% price cut by SH, it is very difficult to see how any further investigation into the pricing of both yards could do more than confirm PA's

CONFIDENTIAL

opinion; whilst at the same time further delaying decisions and prolonging the political agony.

A further (fourth) round of tenders would be equally nugatory as there is no way that H&W can both reduce their price and still keep it unsubsidised. Any further tendering must surely undermine the MOD's bidding process and allow it to be controlled by the demands of unsuccessful bidders.

We recommend:

1. the order should go to the yard that makes the best bid - H&W;

2. that further investigations or re-tendering will only undermine the bidding process and

3. that splitting orders between the two yards can only perpetuate the vicious cycle of 'buggins' turn.

Peter Warry

PETER WARRY

File BM

PRIME MINISTER

Attached is a long letter from Nicholas Brown, M.P., putting the case for Swan Hunter in the AOR order which is to be discussed at E(A) on Tuesday. The letter was obviously prepared in collaboration with Swan Hunter.

As you will see from his letter, Mr. Brown is pressing for a "compromise" for the lead AOR vessel to be placed at Swan Hunter and the second vessel to be placed at Harland and Wolff to Swan Hunter's design. Mr. Brown says that he would welcome the chance of a further meeting with you which would have to be on Monday evening. I think, however, that he has now had a good hearing and will not necessarily be expecting you to agree. I have drawn his letter to the attention of Ministers principally concerned.

Timothy Flesher
4 April 1986

BM2AHX

file BROADHEAD

10 DOWNING STREET

From the Private Secretary

4 April 1986

The Prime Minister has received the attached further letter from Nicholas Brown, the Member of Parliament for Newcastle East, about the Auxiliary Oiler Replenishment vessel. Mr. Brown particularly asks that it should be drawn to the attention of those principally involved in the decision on the AOR order and I have undertaken to do so.

As you will see, Mr. Brown asks for a further meeting with the Prime Minister. I shall consult her on this but I imagine that she will think Mr. Brown has now had a fair hearing. Any such meeting would be on Monday evening.

I am sending copies of this letter, together with Mr. Brown's letter, to Mike Gilbertson (Department of Trade and Industry) and Neil Ward (Northern Ireland Office).

(Timothy Flesher)

David Woodhead, Esq.,
Ministry of Defence

file

BM

10 DOWNING STREET

From the Private Secretary LONDON SW1A 2AA 4 April 1986

I am writing on behalf of the Prime Minister to thank you for your letter of 3 April.

I will ensure that you receive a reply as soon as possible.

(Timothy Flesher)

Nicholas Brown, Esq., M.P.

From: Robin Maxwell-Hyslop, MP.

HOUSE OF COMMONS
LONDON SW1A 0AA

Personal

4/4/86

My dear Margaret,

Cabinet Sub-Committee on Tuesday April 8th.

Those Conservative Members who have good personal relations with Ulster MPs have been asked to make special efforts to maintain them during this rather difficult time. This I have done, and that is doubtless why Ken Maginnis has written me the enclosed letter, which was forwarded to me on holiday. I have telephoned him to say that I have received it, and would write to you to-day.

While I would like to believe that his fears are groundless, I am unhappily aware of the dirty-work which went on in MoD over the RAF Trainer A/c contract, in an attempt to defraud Sorts of the fruits of their lowest bid for that contract.

Add that experience to their general (and unreasonable suspicions, and one cannot be surprised if Ulster MPs think that they detect a plot to do down Harland & Wolff over the MoD contract for the auxiliary oil replenishment vessels.

I trust that the Cabinet will not see fit to feed thes fears by re-opening the bidding for the benefit of the party which bid too high.

Yours sincerely,

Robin

Rt Hon Mrs. Margaret Thatcher, MBE, MP.

Mr. N. H. BROWN

MEMBER OF PARLIAMENT
EAST NEWCASTLE

HOUSE OF COMMONS
LONDON SW1A 0AA

NB/EH

3 April 1986

The Rt Hon Mrs Margaret Thatcher M.P.
10 Downing Street
London

Dear Prime Minister,

Auxiliary Oiler Replenishment Vessel - Lead Order

When you met Mr Ted Garrett and myself last Thursday week, 20th March, we expressed our concern over the placement of the impending order for the A.O.R. lead vessel and stressed the importance of the order for the shipbuilding community we represent on Tyneside. I am grateful for the hearing that you gave us and the interest that you have taken in the representations that we have made.

I have, as I promised I would, conveyed the points you made on costs to Swan Hunters. Indeed, I did so the day after our meeting. The owners of the newly privatised yard are keen to do their uttermost to meet the points that you made and, following negotiations with their sub-contractors, particularly British Aerospace, have made further representations to the Ministry of Defence over the week-end (March 22/23rd). There has been tremendous support from the local community and suppliers for this initiative. As I understand the situation, Swans have now got their bid down to the absolute minimum and yet it is rumoured that there is still a price gap between the Swan bid and Harland & Wolff's.

In these circumstances it is not surprising that there is a wide spread fear on Tyneside that like is not being compared with like, and that Harland & Wolff enjoy an unfair competitive advantage because of the substantial state subsidy that it receives. The importance of the point about cross subsidy and fair competition is right at the heart of the whole issue. Because of its importance, may I put a number of specific points to you regarding cross subsidisation ?

continued...../

Because of the level of public subsidy that is enjoyed by Harland & Wolff, it is possible that items that ought to be charged as direct costs to the A.O.R. contract may, in fact, be being absorbed into Hardland & Wolff's subsidised central overheads. In particular, I am concerned that Harland's may have recently changed their accounting practices, facilitating this.

Although I can only speculate on the size of the gap, and the reasons for it, between the two tenders, it does seem to me that if there is a substantial difference in the direct man hours charged to the two contracts, this could be evidence of either indirect charging or direct but concealed cross subsidy on Harland's part.

It certainly would not be evidence of greater productivity at Harland & Wolff. Productivity at Swan's is substantially higher than that at Harland & Wolff. It is one of my fears that Harland may have built into their calculations gains in productivity which are planned for the future and which are not going to be realised, thus providing a reason for cost increases at a later date.

Well over half of the price of the A.O.R. is made up with the cost of materials. Harland & Wolff have not been in this particular market for the past twenty years and it is possible that they may have under-estimated the material cost in their contract, again a factor which would cause the price to rise later, but only after they had won the order.

I am not well versed in the workings of the various subsidies that are available to the Northern Ireland Office and major employers in Northern Ireland. Is it possible for concealed subsidies to work their way back into the overall price by use of sub-contractors hidden under the umbrella of a United Kingdom mainland main contractor placing work out in Northern Ireland?

continued..../

My greatest fear is that the substantial subsidy of Harland & Wolff's overheads provides such an important level of cross subsidy that it is practically impossible to separate it from the A.O.R. bid. In particular, state subsidy for the troughs in workload, capital investment and product development, provides Harland with a cushion which is just not available to Swan Hunter's.

Overshadowing all of these points is the fear that any upward movement in Harland's price will only come to light after they have won the order. It will of course be of no practical value to the 2,000 shipyard workers who will be made redundant on Tyneside as a result of losing the A.O.R. order to be able to say "I told you so".

If Swan Hunter have under-estimated on their price the private company has to bear the loss. If Harland & Wolff have under-estimated, whether deliberately in order to win the order in the first place, or by over optimism and inexperience of this particular field, I do not see that the Government would have any option but to pay the increased bill. There is nowhere else that the money could come from, and work on the A.O.R. lead vessel could obviously not be stopped because the original Harland estimate had run over price. It seems to me to be basically so unfair that Swan Hunter's are having to price with their own resources and that the management of Harland & Wolff are able to gamble with money that does not belong to them but to the British taxpayer.

When we met last Thursday week you made the point, and I readily accept it, that the price of the A.O.R. does not just involve imput at Harland & Wolff but also that of their sub-contractors and their suppliers. I notice that the management of Harland & Wolff blame increased prices from their sub-contractors as one of the reasons for the 20% increase on their losses last financial year. If in their A.O.R. tender Harland's have kept the terms between themselves and their sub-contractors set out in a less than stringent way, it may be that there will be an unaccounted for drift in sub-contractors'

continued /

prices after the Ministry of Defence have placed the main contract with Harland's, perhaps as validity dates are passed. Swan's of course have to bear any such on-costs themselves.

I do not know what the arrangements are for Harland's making a contribution to the cost of sub-contractors' working capital but I can see how it could be possible for them to enjoy a competitive advantage in this area because of public funding. I am worried that the present situation may be manipulated by sub-contractors to the long term disadvantage of the Ministry of Defence. At the moment there is a surplus capacity in the domestic warshipbuilding industry - even without Harland & Wolff's re-entry into the market. This surplus capacity means that Ministry of Defence orders are keenly fought for, which, as I understand it, was one of the main points of privatisation in the first place. It is clearly in the commercial interest of some of the major industrial conglomerates who now have financial stakes in the shipbuilding industry to permanently remove this surplus capacity from the market as quickly as possible. Because of the nature of warshipbuilding, the Ministry of Defence could well find that they were left with no choice of shipbuilder at all.

Management buy-outs are clearly more vulnerable to the sort of price war that goes on in these circumstances than are large industrial companies who have sufficient assets to fund themselves through difficult times until they have secured the monopoly they are seeking. Some of these factors may well be at the back of the minds of Harland's partners in the A.O.R. bid.

I understand that many of these points, except perhaps the last one, have been looked at by P.A. Consultants. Without wishing to be critical of P.A., their knowledge of the ins and outs of the shipbuilding industry cannot be a specialist one and, in any event, it is my understanding that they are reporting to the Northern Ireland Office, who are not impartial. I would be far happier if there was a truly independent enquiry into the operation of Harland & Wolff, conducted by a shipbuilder with a national reputation,

perhaps Mr Graham Day, or somebody of his stature in the industry.

All of Swan's contracts have been won by competitive tender giving the M.O.D. value for money each time.

I have given some thought to the points about cost, because you emphasised to me that costs was the main criteria upon which the contract would be awarded. I do appreciate that other factors may also become involved; indeed it would be surprising if they did not. For the north east of England, gaining the A.O.R. order is the equivalent in terms of employment of five more Nissans establishing themselves in the region. Failure to gain the order will mean that Swans are forced to declare 1,000 redundancies this year with a further 1,000 to come next year. Swan Hunters has just been through a 2,800 redundancy declaration. There are not sufficient volunteers for redundancy to take up a further round on such a scale and so a substantial element of the total package would be compulsory redundancies. I am not exaggerating when I say that the effect of this on the workforce and the community at Swans would be devastating.

The redundancies include the loss of Swan Hunter's design team. Following privatisation Swan's new owners see the high technology capabilities of the design team and the advanced manufacturing processes, including robotics, as a springboard to future overseas sales. If their plans do not bear fruit in the future, it would be fair to take a critical attitude to the viability of the in-house team. Without the A.O.R. order the team is broken before the export drive has had a chance to succeed. This is all the more tragic because Swan's are leaders in the implementation of computer graphics into the industry, having gained an international reputation in this respect.

continued...../

Male unemployment in the Tyneside shipbuilding community is already higher than the equivalent for Belfast, as far as I can extrapolate from the Department of Employment's figures. A further 2,000 manual redundancies from a primary employer (with the consequent loss of secondary employment) would give Tyneside's shipbuilding community overwhelmingly the highest level of unemployment in the United Kingdom..

I have always been very conscious of the fact that the shipbuilding community in Northern Ireland has similar problems, as well as extra ones that are unique to the province. It has never been my wish or intention to advocate a solution of this issue that would hurt shipyard workers in Belfast. There is a possible compromise which I would urge you to consider. The existing workload at Swan Hunter and Harland & Wolff is broadly equivalent in financial terms. Swans are faced with a shortfall of work in the immediate future due to the longer term nature of defence contracts. Such a shortfall does not occur at Harland & Wolff before 1987. Harland & Wolff have the additional advantage of being able to tender for merchant and offshore work using intervention and loss funding, opportunities which are now denied to Swan Hunter.

If the lead A.O.R. vessel were to be placed at Swan's and the second vessel were to be placed at Harland & Wolff's but built to Swan's design, it would provide sufficient work to keep both shipbuilding communities employed for the immediate future. Whilst I am aware that such a solution is a compromise and would not be fully acceptable either to Harland & Wolff or to Swan Hunter, it would, I think, be widely seen as a fair compromise and one which sought to avoid inflicting further massive unemployment on either community, neither of which in my view can bear it.

This compromise solution would also prevent the immeasurable bitterness that would

continued..../

spill over on Tyneside if it emerged later that Harland's lower price had not endured and was subsidised by public funds. It would also, and this is more an advantage from the Government's point of view than mine, give clear notice that the Government was supporting management buy-outs as part of its privatisation programme, rather than just those that are funded by existing large private companies.

I understand that some concern has been expressed in City quarters, not least from those who have invested money in Swan Hunters, about the justice of the Government's privatising state owned companies and then making them compete for Government orders with Government owned companies in the same industrial sector.

There is one further point, one of national security, which I feel should be considered. The A.O.R. is designed to service type 23 frigates which have a three-day journey time without replenishment from an A.O.R. The type 23 frigate will provide one of the main elements of British naval defence towards the end of this century, but it is rendered ineffective without the accompanying A.O.R. If the type 23 frigates are to be able to play their full part in Britain's defence, it is vital that the first A.O.R. arrives securely and on time. Swan Hunter's has an excellent record for delivering warships to the Royal Navy on schedule. Harland's does not have such a record, but that is not the key point I am making. It is my fear that the placement of the A.O.Rs at Harland and Wolff hands to those who wish, for sectarian political reasons, to make trouble, a substantial weapon.

In view of the increasing build-up of conventional Soviet naval forces, it is more important than ever that Britain is able to play its full part in NATO's conventional naval defences. Placing both A.O.Rs in Northern Ireland might jeopardise this whereas the compromise solution to build the first at Swan Hunter and the second at Harland & Wolff clearly

continued...../

HOUSE OF COMMONS
LONDON SW1A OAA

removes this risk. It even reduces the attractiveness of obstruction as a tactic to those who might otherwise be tempted by it. In short, I am suggesting that we do not put all our eggs in one basket.

I am sorry that this letter is so long but it would be impossible for me to overstate the importance of this order for our community, or the depth of feeling that there is about it here on Tyneside. Last night the City Council unanimously passed a resolution urging that the order come to Tyneside.

I understand that a final decision is imminent and I would not wish to let pass the opportunity to fully set out my views.

I am grateful to you for the consideration and courtesy that you have extended to myself and my colleague, Mr Garrett, during the past fortnight. I would welcome the chance of a further meeting with you personally before the decision on the A.O.R. is made, in order to discuss the points I make in this letter, if such a meeting would be of value. I am available for a meeting at very short notice, and may I thank you again for considering these representations.

Yours sincerely

Nick Brown

From: KEN MAGINNIS, M.P. *Fermanagh & South Tyrone*

HOUSE OF COMMONS
Tel: 01-219-5234

10 SPRINGFIELD LANE,
MULLAGHMORE,
DUNGANNON.
Tel: 08687-23265

2/4/86

Dear Robin,

You will recall that I wrote to you on 19 February about the auxiliary oil replenishment vessels (AORs) which were soon to be ordered by the MOD. I am grateful for the positive response I received from many colleagues to whom I wrote.

It is now well known that the order was intended to be placed with Harland & Wolff on Monday 24 March but that, following a number of unfounded allegations by Swan Hunter, the DT&I have been instrumental in having the decision delayed.

I am worried that the Swan Hunter device of alleging unfair competition may result in yet another re-bid being sought. This would be grossly unfair now that it is generally known what price Harland & Wolff tendered.

Although final bids were submitted in December, Swan Hunter pressed for a further 'final bid' on the grounds that it had recently been privatized and this request was agreed to in January. **If yet a third 'final bid' was permitted the MODs competitive tendering policy would surely be in shreds.**

A number of questions should now be answered:-

1. Why, if Swan Hunter's allegations were other than mischievious, did it not press them until the eleventh hour?

2. If the independent appraisal of Harland & Wolff's tender, which was insisted on by the Northern Ireland Office, was inadequate proof that there is no subsidized element within the bid why was further evidence not requested sooner? When I met a Minister at DT&I to discuss the matter on 25 March I was told that there was no further information required from Harland & Wolff.

3. How can the DT&I explain its inactivity in the matter up until the Swan Hunter allegations were made? Is DT&I really seeking to ensure fair competition or has it merely become the agent of Swan Hunter?

I would point out that, since 70% of the Harland & Wolff bid is based on direct contracts between that company and UK private sector industry, it would require the 30% Northern Ireland content to be very powerfully subsidized for it to have significance in relation to the overall price. e.g. It would require a subsidy of 33% on the Harland & Wolff element to make a 10% impact on the total. More realistically, a 10% subsidy in the Harland & Wolff element would only result in a 3% overall effect.

Swan Hunter, on the other hand, having been given an undertaking by MOD that it will receive an order for a Type 23 Frigate on

From: KEN MAGINNIS, M.P. *Fermanagh & South Tyrone*

HOUSE OF COMMONS
Tel: 01-219-5234

10 SPRINGFIELD LANE,
MULLAGHMORE,
DUNGANNON.
Tel: 08687-23265

a 'negotiated price' basis will almost certainly achieve a price well above that which might have been obtained had MODs competitive tendering policy been applied. Inflated margins from that deal would provide attractive subsidy for the AOR vessel contract.

Swan Hunter allege that if Harland & Wolff has underpriced its bid the balance of the cost can come out of the Northern Ireland block grant. That is true but it would not be in Harland & Wolff's long-term interests as it competes for further MOD orders. Besides, should Swan Hunter underprice and run out of capital it is hardly likely that Government will be able to abandon a warship in the final stages of completion.

Certainly there no evidence to sustain the allegations against Harland & Wolff. Its industrial relations are, almost literally, 100 times better than Swan Hunter's. Indeed Swan Hunter's ability to meet any price bid must be doubtful, due to the extremely high wage claim still unresolved.

I enclose a copy of a submission from the Confederation of Shipbuilding and Engineering Unions.

I have reason to believe that the whole matter will go before a Cabinet sub-committee on Tuesday next and would be grateful if you could write, before then, to the PM in support of Harland & Wolff.

Yours sincerely,

Ken Maginnis

AOR ORDERS

I am writing to you on behalf of the Confederation of Shipbuilding and Engineering Unions responsible for engineering employees in Northern Ireland, including Harland and Wolff, to express our deep concern at the delay in Government reaching a final conclusion in respect of the AOR orders.

We trust this delay will not enable Swan Hunter to re-tender as this would break the competitive tendering rules - particularly as they will inevitably now know the Harland and Wolff prices.

Over the past few years we have co-operated with the Harland and Wolff management in the introduction of new technology, changes in the methods of building and in the introduction of new working practices. This management and workforce co-operation has enabled the company to target a reduction of 22% in manhours between the first 170,000 tdw bulk carrier they delivered in 1984 and the second now 75% complete.

Despite the perceived instability of Northern Ireland over the last ten years, Harland and Wolff has lost only 0.15% of available manhours through any form of dispute which is a unique and enviable stable industrial relations climate. March 3rd was the first full days lost production across the workforce for almost 12 years. This is in marked contrast to Swan Hunter who during autumn 1985 had an 8 week shut out of staff and management and have recently suffered further disputes.

Harland and Wolff's order book is currently less than half that of Swan Hunter's which stands at £400M as opposed to £160M. The Swan Hunter order book stretches into 1989 compared to that of Harland and Wolff which finishes in early 1988. Furthermore, and very importantly, Swan Hunter have been promised a Type 23 Frigate order which is approximately the same value as one AOR. If Swan Hunter win one AOR plus the promised Type 23 Frigate their order book would soar to over £600M, which would then be four times the value of the present Harland and Wolff order book.

I wish to underline our concern about the crucial need for new work in providing a degree of continuity on the jobs front at Harland and Wolff. Without AOR the Harland and Wolff order book will run out in early 1988 with all 5,000 jobs at risk.

I need not remind you of the already disasterous level of unemployment in the province, now running at about 23%. Harland and Wolff are also doing business with 150 private sector companies in Northern Ireland on a regular basis.

Thank you for taking the time to be made aware of our deep concern.

10 DOWNING STREET

THE PRIME MINISTER

1 April 1986

Dear Mr. Fortin.

Thank you for your letter of 26 March.

I am delighted that the offer of shares has gone well, and that so many local residents, as well as employees, have taken up shares. This will give the new company the best possible start.

I do congratulate all concerned in mounting the consortium bid, and I wish Vickers and Cammell Laird every success in the future.

Yours sincerely

Margaret Thatcher

R. C. G. Fortin, Esq.

From: Dick Douglas MP

CCMA

HOUSE OF COMMONS
LONDON SW1A 0AA

28 March 1986

C114

The Rt Hon Mrs Margaret Thatcher MP
Prime Minister
10 Downing Street
LONDON SW1

Dear Prime Minister

ORDERING OF AORs

I note that the process of bidding for the Auxiliary Oiler Replenishers for the Royal Navy has been extended.

In view of the implications of this relating to the Procurement Rules of the MOD, I should be grateful for details of the reasons for such a decision and information relating to precedents.

I am copying this letter to both the Secretary of State for Defence and the Secretary of State for Scotland.

Yours sincerely

Dick Douglas

Lloyds Merchant Bank

Lloyds Merchant Bank Limited
40-66 Queen Victoria Street
London EC4P 4EL
Telephone 01-248 2244
Telex 888421/2

RCGF/LW

26th March 1986.

PRIVATE & CONFIDENTIAL

The Rt. Hon. Mrs. Margaret Thatcher, M.P.,
10 Downing Street,
London, S.W.1.

Dear Prime Minister,

VSEL CONSORTIUM PLC - SHARE OFFER

I am writing to let you know the detailed results of the Offer of shares to the employees of Vickers Shipbuilding and Engineering at Barrow and Cammell Laird at Birkenhead and the residents of Barrow and Birkenhead which we are announcing today. I am sure that you will be as delighted with the results as we are. The Offer was subscribed twice with 82.3 per cent. of the 14,000 employees applying and over 5,000 local residents. The combined shareholding of employees and local residents - at nearly 25 per cent. of the equity - will represent the largest shareholding group in the new company. We will, therefore, have achieved the very strong combination of local resident and employee backing through share ownership we sought, and we believe this will provide an excellent start for the new company.

Everyone who has been involved in this exercise is absolutely thrilled at this outcome and I, personally, would like to thank you and your colleagues for your act of faith in giving approval to the VSEL Consortium's bid. I hope very much that this exercise may prove a precedent for other successful privatisations.

I enclose, for your interest, a copy of the Press Announcement issued this afternoon which contains the full basis of allocation.

Yours sincerely,

Richard Fortin

R.C.G. Fortin,
Executive Director.

Enc.

Lloyds Merchant Bank Limited is registered in England. No. 1583994 Registered Office: 40-66 Queen Victoria Street, London EC4P 4EL

Lloyds Merchant Bank

Lloyds Merchant Bank Limited
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Telex 888421/2

NEWS RELEASE

FOR IMMEDIATE RELEASE

26TH MARCH, 1986

VSEL CONSORTIUM PLC

VSEL CONSORTIUM PLC

Offer for Subscription
by
Lloyds Merchant Bank Limited

to employees and their immediate families and pensioners of
Vickers Shipbuilding and Engineering Limited
and its subsidiaries
Cammell Laird Shipbuilders Limited and
Warship Design Services Limited and
to residents of Barrow and Furness and of Birkenhead

of Ordinary Shares in
VSEL Consortium PLC
at £1 per share

Lloyds Merchant Bank announces that the Offer for Subscription has been oversubscribed.

In respect of the 6,692,000 Ordinary Shares of £1 each available, under the Offer, to:

- employees of VSEL, Cammell Laird and Warship Design Services;
- the immediate families of such employees;
- the Group's pensioners; and
- residents of Barrow and Furness and of Birkenhead

16,654 applications have been received for a total of 12,882,000 such shares, thus subscribing the Offer approximately twice.

Lloyds Merchant Bank Limited is registered in England No. 1583994 Registered Office: 40-66 Queen Victoria Street, London EC4P 4EL

Applications were received from 11,547 employees, representing approximately 82.3 per cent. of the Group's workforce, for a total of 7,510,800 shares. The average application from employee applicants was for approximately 651 shares. The average application from other applicants was for approximately 1,052 shares.

Since applications have been received for more shares than are available, Lloyds Merchant Bank has, following consultation with the Board of VSEL Consortium PLC, determined that certain applications will be scaled down. Accordingly, applications have been accepted on the following basis:

EMPLOYEE APPLICANTS

Application	Allocation	Free Shares
100	100	NIL
200	200	50
300	300	50
400	400	50
500	500	150
600-1500	600	150
1600-2500	700	150
2600-3500	800	150
3500-5000	900	150
5000+	1000	150

OTHER APPLICANTS

Application	Allocation
100	100
200	200
300+	220

Lloyds Merchant Bank and the other institutional investors will be giving a total of 1,620,000 free shares to employees as a result of which employees will together constitute the largest single shareholding group with approximately 22 per cent. of the Consortium's Ordinary Shares.

It is expected that allocation letters will be posted to successful applicants in the first two weeks of April and that Share Certificates will be despatched as soon as possible thereafter.

A number of ineligible and/or defective applications has been received. All such applications have been rejected.

Enquiries

Lloyds Merchant Bank:	Office	Home
Richard Fortin	01-248 2244	01-789 4456
Stephen Barrett	01-248 2244	01-228 7272
VSEL Consortium:		
Rick Emslie	0229-23366	0524-63844

Shipbuilding

RESTRICTED AND COMMERCIAL IN CONFIDENCE

DG.

file
cubg.

10 DOWNING STREET

From the Private Secretary

26 March 1986

Dear Denis,

AOR ORDERS

I understand that the Secretary of State for Trade and Industry is very concerned that there should be a collective discussion before a decision on the AOR orders is announced. The Chief Secretary took the same view in his letter of yesterday. It would also cause a substantial Parliamentary row to announce a controversial order of this kind on Maundy Thursday. As you know, the Prime Minister feels that E(A) should discuss the order for the first AOR, and a meeting will be arranged to take place shortly after the House returns.

I am copying this letter to the Private Secretaries to the members of E(A) and to Michael Stark (Cabinet Office).

Yours,

David.

David Norgrove

Denis Brennan, Esq.,
Ministry of Defence.

RESTRICTED AND COMMERCIAL IN CONFIDENCE

COMMERCIAL IN CONFIDENCE

PRIME MINISTER

AOR ORDERS

Mr. Younger's letter below sets out the position on the AOR competition. He concludes that he would like to announce a decision in favour of Harland & Wolff tomorrow, Thursday.

The strong view of the Lord Privy Seal's Office and the Chief Whip's Office was, naturally enough, that to announce this tomorrow would cause a major row. There is in any case a clear need for a collective discussion.

MOD have accordingly agreed to wait till after the recess. An E(A) is being arranged for early in the week beginning 7 April.

DN

26 March 1986

VC3AKL

COMMERCIAL IN CONFIDENCE
RESTRICTED

Prime Minister

NBPM at this stage

AOR COMPETITION

1. I have seen George Younger's letter of 25 March on the AOR Competition, which follows on from Paul Channon's letter of 24 March and John McGregor's letter of 25 March to George.

2. George has recommended both that the order for the first of class AOR be awarded to Harland and Wolff (H&W) and that we should make an announcement to that effect tomorrow. I believe that it would be a sound and defensible decision: for us to admit any further delay in the decision could, I believe, carry very serious consequences for our competitive procurement policy.

3. MOD's invitation to tender issued to H&W and Swan Hunter on 13 November last, sought final sealed bids by 2 December. Bids were to be open for acceptance until 31 March 1986. H&W lodged a bid by the due date, and subsequently responded to an MOD request for a revised bid by 21 February 1986. I understand that Swans, on the otherhand, having also lodged a bid on 2 December, put in an unsolicited revised bid early in February (the terms of the invitation to tender notwithstanding) and that it was this that prompted MOD to seek a revised bid from H&W by 21 February. It has become clear that Swans submitted a yet further unsolicited revised bid last weekend.

4. MOD officials have confirmed that any extension to the current tenders beyond 31 March would technically permit revised bids. We would therefore be dealing with Swan's last out-of-time bid lodged in breach of the tender rules. This would be intolerable, both in equity, and for the credibility of our competition policy. A deferment could only be to the advantage of Swans, who have not

stuck to the terms of the invitation to tender. Swan's actions in submitting a tender in the last few days would have ensured that a race which - on MOD's terms of competition - had already been won, would have been restarted. The admission of Swan's latest bid would be grossly unfair to H&W who have adhered to the terms of the competition.

4. If the decision is taken now on the basis of the thorough appraisal set out in George Younger's minute, and within the proposed timetable, it will be seen to be being done in an orderly manner. If the decision is shelved to a later date, taking it outside the expiry date of the tenders it will look very disorderly quite apart from raising very serious issues for the whole tendering process for MOD.

5. The whole basis of the H&W bid is that it was required to be on an unsubsidised basis. Not only was this requirement absolutely understood by H&W, but my Department also appointed PA as independent consultants to scrutinise the bid to ensure that this requirement had been met. They confirmed that it had, and I arranged for my officials to be available for full discussions with the DTI and Treasury. I understand that Treasury officals expressed themselves content and that following their meeting with my officials, DTI have acknowledged that the bid is unsubsidised.

6. Two further points should be borne in mind. The first is that DTI have suggested that a marine consultants' review be commissioned of H&W's bid - George's letter records that Three Quays Marine Services were engaged by MOD to examine both tenders against commercial shipbuilding practice and they came down in H&W's favour. The second is that although this is always referred to as an order for Harland and Wolff, they are in fact the minority partner, within the recently privatised Yarrows in Scotland getting the largest part of the order.

?...

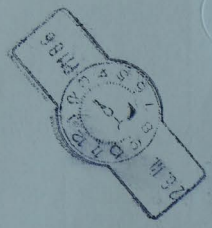
7. I was grateful for the opportunity to explain to you my own views about this matter, and the major difficulties that will arise if the announced tendering procedures are not fulfilled. Having now seen the full appraisal together with the whole history of the different bids, I am all the more persuaded that the right course is to proceed as set out in David Norgrove's letter of 21 March to MOD and as proposed by George Younger in his letter. To do otherwise will raise all the difficulties to which I have referred to above and at our meeting.

/ 8. I am copying this to George Younger, Members of E(A) and to Sir Robert Armstrong.

TK

26 March 1986

NAT IND : Ships : Pt 9.



CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET 5422
TELEPHONE DIRECT LINE 01-215
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Secretary of State for Trade and Industry

26 March 1986

The Rt Hon George Younger MP
Secretary of State for Defence
Ministry of Defence
Main Buildings
Whitehall
LONDON
SW1A 2HB

Dear George,

AOR ORDERS AND SWAN HUNTER

Thank you for your letter of today in response to mine. I cannot accept that a decision should be announced tomorrow, for reasons of substance as well as Parliamentary and political considerations. Given that my main concern is that we should not only take the right decision but be seen to have taken it, it would be quite wrong to rush through an announcement which will be widely criticised on the last day before the Easter break. If you cannot accept this we must discuss the matter collectively given that the two bids are now quite close.

Before considering how we should deal with the present situation, I would like to make it clear that I remain strongly of the view that, particularly given the over-capacity in the warship sector perpetuated at least in part by the Type 22 frigate decision last year, we must continue to place orders for major naval vessels on the outcome of the tender process. But we also need to take account (when the problem arises) of the need to ensure fair competition between the private and public sector. This latter point is of course particularly relevant to the present decision. If we were to depart from this policy now (except for the Type 23 frigate, which we agreed last year should be awarded to Swan Hunter) we would not find it easy to resist claims for special treatment from other yards (particularly Scott Lithgow and Yarrow).

I am not therefore asking for Swan Hunter to be given the contract if our assessment remains that the Harland's bid is indeed unsubsidised and if MoD prefer it. My concern is that we must be able unhesitatingly to defend our decision in the House and publicly. Colleagues are no doubt aware that the Swan Hunter management are mounting a wide public campaign and seeking to enlist the support of MP's of all parties to suggest that Harland's could only beat them by taking unacceptable risks. They have suggested therefore that there should be a demonstrally independent investigation of Harland & Wolff's bid carried out by experts (not only accountants).

I realise of course that Tom King has had the Harland's bid carefully examined by PA Management Consultants and that they have concluded that the bid has been reasonably costed, though they were careful to point out that the margin of risk could subsume the profits shown in the tender. They also pointed to the need, accepted by Harlands, for improved project control. I therefore remain unclear that we could adequately defend a decision to place an order with Harlands which had not been independently examined by experienced marine consultants (such as 3 Quays Marine whom I understand that you have already employed on the technical aspects of the AOR tenders) backed up by accountants who could give us the assurance based on wide experience of shipbuilding practice across the world that adequate contingencies had actually been allowed for in a first of class vessel of this complexity.

I note from your letter that, while Harland's performance on the Aviation Training Ship (ATS) gives them the opportunity to develop their project control, some of the current delay on the ATS is attributable to Harland and Wolff. I also note and of course accept that your Department can only look at the prices presented to it and that you are unsure whether you can further help reduce my concerns that we can successfully defend the Harland's bid as unsubsidised. For that very important reason I therefore suggest that the right course would be for your Department to employ marine consultants (such as 3 Quays Marine) supported by independent accountants to look at the bids and the likelihood that the yards costs will be below their bid price. The question would need to be fair to Harland & Wolff as well as to Swan Hunter, and we must be able to demonstrate that with certainty to the House of Commons.

Press reports indicate that Swan's in cutting their price are not planning to make a profit on the contract and it is hard to see why Harland's should be required to take a different attitude (even bearing in mind the assurance given to Swan Hunter that Harland's bids for MoD work would not only be unsubsidised but would be comprehensively costed). I suggest that the consultants should be

1786 1986 BOARD OF TRADE BICENTENARY

asked to look at the bids by both yards and to determine whether the prices offered by each reflect the costings of the yards and the extent to which contingency provisions are likely to prove adequate; and if after taking account of contingencies either yard seems likely to make a loss whether the difference between the anticipated level of losses is such as to alter the ranking of the bids.

I realise that this is a somewhat unusual proposal but I believe something on these lines to be necessary to ensure fairness between the public and private sectors. If Swan Hunter objected to their own bid being examined in this way, we would have to consider whether we would then be justified in relying on the present information.

Two final points : I agree that if Swan Hunter is to be given the opportunity to revise its bid, Harland & Wolff should also; second, there is no question of Swan Hunter being subsidised for the future by the terms of the sale from British Shipbuilders. The amounts due from both sides were set at the time of the sale and are not subject to alteration by changes in loss or profit forecasts on existing contracts.

I am copying this letter to the Prime Minister, members of E(A) and to Sir Robert Armstrong.

Yours,

PAUL CHANNON

Paul

1786 1986 BOARD OF TRADE BICENTENARY

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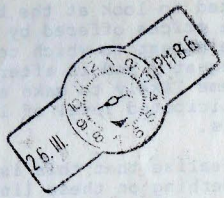
NAT IND : SHIPS : PE 9.



MINISTRY OF DEFENCE WHITEHALL LONDON SW1 2HB

MO 26/3/1V

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

25th March 1986

Dear Paul,

AOR ORDERS

Thank you for your letter of 24th March about the competition for the Auxiliary Oiler Replenishment vessel. John MacGregor also wrote to me on 25th March.

As you asked, I am circulating a note giving a comparative assessment of the bids received in the competition. This gives the position following the third round of tenders on 21st February. We thought it right to give Swan Hunters (SHS) an opportunity to have another look at their bid after privatisation (I know that Tom King was concerned that we did so having sought final offers in December and I will be replying separately to his letter of 5th March about that).

The assessment shows that Harland and Wolff (H&W), though weaker than Swan Hunter on a few points, were ahead in all the main categories - technical merit, price/operational capability,

The Rt Hon Paul Channon MP

delivery and contract terms. We were surprised that Swans did less well on design having done the original feasibility study for the MOD in the early 1980s; the interesting new development was that H&W assembled a design capability from across the industry using Yarrows and YARD (consultants) to supplement their in-house team. On price SHS were still 4-12 per cent higher for a ship with major shortcomings in capability.

As colleagues know SHS sent in revised bids on 21st and 23rd March. It is questionable whether we should allow such late bids, which undermine the orderly conduct of fair competitions. Certainly Harland and Wolff would have to be given an opportunity to retender before we could consider them formally; and there would be many details to be validated.

Nonetheless I have looked at whether, if the latest bid were validated, it would be likely to change the outcome of the competition. The figures at Annex A to the attached note show that SHS have both reduced their February price by 5-9 per cent and restored most of the features they had previously cut out. In broad terms, they have improved their price for a fully capable ship by over 25 per cent. Even this reduction would leave the maximum price payable by MOD some 5 per cent higher than Harland and Wolff's price (and in the circumstances of a major last minute price reduction we would have to reckon on paying the ceiling price quoted).

You also raised the question of fairness of the competition. I see that the Department of Trade and Industry and the Northern Ireland Office have been discussing the make-up of the H&W bid since last Autumn (Tom King's letter of 22nd November to your predecessor). Obviously we all want MOD orders to be placed on a fair and unsubsidised basis. Rhodes Boyson's letter of 20th March, backed by an independent report assures us this is so. My Department can of course only look at the prices presented to it and I am not sure how I can help resolve the doubts which come through in your letter. The Aviation Training Ship is indeed running about three months late (on a two year programme) though this is partly my Department's fault; but it is also the first ship subject to "whole ship" procurement and is allowing H&W to gain experience on this new technique. As far as MOD can tell H&W's price is not artificially low (they are close to the target price we developed internally based on the SHS feasibility study). We should also bear in mind that about two-thirds of the costs derive from outside the shipyards (on materials and weapons). Certainly SHS have suffered because their weapons partners (BAe/Marconi) have turned out more expensive than H&W's (Yarrow/YARD). It may be that public sector ownership has allowed H&W to offer a fixed price while SHS sought contractual protection against cost overrun and had to be careful on contract conditions (though these featured in the bid even before privatisation). But even if I made allowance for these factors by:

a. considering the bottom of SHS's revised price range - £119.7M compared to £119.9M for H&W).

b. assuming that contract conditions were on a par.

MOD officials would still consider that the superiority of H&W's design and earlier delivery date would outweigh a small price advantage. Therefore, even if we were to go well outside our normal procurement system to be generous to SHS, MOD would still assess H&W to be the winners.

The Prime Minister asked about what might be done to provide work for Swan Hunters and your letter referred to previous decisions on Type 22 frigates. The quid pro quo for diverting that order to Cammell Laird was of course, the second Type 23 frigate, which is currently on offer to Swan Hunters; but their latest price for this, as for the other two Type 23 frigates currently out to tender is still much higher than the prices emerging from the competition.

As John Lee explained in his letter of 19th March, in order to retain budgetary flexibility I can only order one AOR now, although it may be possible that we should order another in the autumn. To offer SHS the next AOR to H&W's design and price would be to forego the benefits of batch ordering; in any case there are other yards short of work such as Scott Lithgow and

Cammell Laird who would want to compete. What I could do, however, is to say publicly that we will postpone decisions on AOR 02 until the Autumn and decide how to procure it in the light of all the factors at the time. That apart, with current overcapacity in the warshipbuilding industry we would only promise work to SHS by robbing another yard. Redundancies somewhere are inevitable and unemployment levels in most shipbuilding areas are comparable. While I sympathise with the difficulties you face as sponsoring Department this situation was expected when we decided to sell the yard earlier this year (my predecessor's letter of 8th January).

It would, of course, be technically possible to extend the competition by a further round of formal retendering or to go over in collective discussion SHS' opportunities for further work. But I see this as a fairly straightforward purchasing issue. Wider factors are most unlikely to affect the result. Accordingly I am minded to proceed with an announcement on Thursday that Harland and Wolff are to have the first AOR, with a decision on the second in the Autumn.

A copy of this letter goes to the Prime Minister, the members of E(A) Committee and Sir Robert Armstrong.

Yours ever, George.

George Younger

COMPETITION FOR THE AUXILIARY OILER REPLENISHMENT VESSEL

1. The AOR is a new concept for a "one-stop" replenishment vessel capable of providing fuel, ammunition and other stores simultaneously to warships at sea. It also provides support facilities for ships' helicopters. Because of the high value of its cargo (up to £150m) and the need to deploy in hostile waters the ship needs self-defence weapons. Under a new procurement strategy my Department invited tenderers to take responsibility for the design and build of the "whole ship".

2. The competition has been judged against five main criteria (technical quality, operational capability, price, delivery and contract terms).

Technical Quality

3. Assessments by the MOD technical staff showed that the two designs were on a par in about half the areas examined. The H&W design had advantages in:

a. Stability

b. Underwater noise.

c. Communications, aerial arrangements and weapon lay-outs.

d. Seakeeping qualities.

e. General lay-out

f. Improved internal electrical supplies.

The SHS design was preferred in the following areas:

a. design of military systems.

b. in-service support of weapons.

H&W's design was clearly superior. This view was confirmed by an independent assessment from Three Quays Marine Services Ltd - a ship purchasing subsidiary of P&O. They were engaged by MOD to examine both tenders against commercial shipbuilding practice.

4. Price and Operational Capability

As the competition developed, consideration of price and operational capability offered became closely linked. Tenders received in Summer 1985 from Harland and Wolff and Swan Hunters were too high. Both firms were asked to reduce their bids and

if necessary show what ship they could supply for MOD's target prices. These were £122M for the first of class and £103M for the second (at 1984-85 prices) based on earlier feasibility

studies by SHS. In revised tenders in December 1985, H&W were able to reduce their bid to these target prices whilst still meeting the full operational requirement. SHS' price for a comparable ship to meet full operational requirement was 30% higher. SHS offered a design-to-cost vessel, but with significantly reduced capability and still 14-26% above the MOD target price. The prices received since then are set out at Annexes A and B (for one ship only or a pair).

5. Earlier this year two new factors emerged: the privatisation of SHS and the MOD's need for more flexibility in its forward programme. During a final round of tenders in February both companies were asked to submit new bids to take account of a possible one-year delay to the delivery of AOR 02.

6. H&W took this opportunity to reduce slightly their bid for AOR 01 to £121M. SHS did not review their £168M bid for the ship to meet the full operational requirement. They reduced their price for a design-to-cost vessel to £126-£140M, closer to the MOD target; but it still offered a significantly reduced capability.

Delivery date

7. Neither H&W nor SHS could meet the dates MOD originally wanted, but H&W offered delivery 8 months earlier than SHS.

Contract terms

8. Neither contractor will accept MOD's terms and conditions of contract in full, but H&W are generally more compliant. SHS have sought greater limitation of their responsibility for design, and have offered less favourable guarantees against defects and indemnities to MOD against fire, accident and other risks during construction.

Conclusion

9. The MOD's assessment based on bids received to 21st February was that H&W were preferred to SHS in each of the four main areas - technical merit, price/operational capability, delivery and contract terms. They were clear winners of the competition.

Post-tender negotiations

10. In accordance with the recommendations of the report on Government Purchasing, MOD undertakes further negotiations with the successful tenderer if it believes there are grounds for further price reductions. In this case the Department

assessed that H&W prices from weapons suppliers were too high and secured a further reduction of £0.75M a ship.

Whole ship procurement

11. The AOR represents a major innovation in naval ship procurement. Traditionally weapons, radars and other military equipment are procured by MOD and supplied to the shipbuilder for inclusion during the construction. Under the policy of transferring more responsibility to industry, the tenderers for the AOR were invited to procure the weapons themselves and quote an overall price for the "whole ship" (with minor exceptions). The consortia formed and prices included were:

H&W with Yarrows, YARD (ship designers) and Ferranti (£29.0M).

SHS with British Aerospace, Marconi and Ferranti (£35.3M).

12. The Department expects to pay a small premium of about £1M on the H&W bid compared to the traditional method but considers this worthwhile for an important experiment.

COMPARISON OF BIDS £M 1984-85 prices

	Harland and Wolff	Swan Hunters (3)
MOD target Price (1)	122	122
Delivery date	Mar 90	Nov 90 (4)
2 Dec 1985		
Full NSR (2)	122.2	168.1
Design to Cost (1)	122.2	139.3-156.0
21 Feb 1986		
Full NSR	120.6	168.1
Design to Cost	120.6	125.6 - 140.7
21-23 Mar 1986		
Full NSR	119.9	119.7 - 126.9
Design to Cost	119.9	119.7 - 126.9

(1) The MOD's target price is based on the original feasibilty study (undertaken by Swan Hunters) and represents the maximum the Department wishes to pay for this capability.

(2) The December bids were sought on two bases:

- to meet the full naval staff requirement (NSR).
- to the MOD's target price but with reduction in capability.

(3) Harland and Wolff offered fixed prices throughout. SHS prices for "design to cost" and their 21/23 March bid against the full NSR are Fixed Price Incentive Fee (i.e. a target price with MOD and the Shipbuilders sharing variations in cost up to a ceiling price).

(4) SHS have offered to "review" their delivery date in their latest bid.

COMPARISON OF BIDS (TWO SHIP ORDER) £M 1984/85 prices

	Harland & Wolff		Swan Hunter (3)	
	AOR 01	AOR 02	AOR 01	AOR 02
MOD target price(1)	122	103	122	103
Delivery date	Mar 90	Mar 91	Nov 90 (4)	May 91
2 Dec 85				
Full NSR (2)	120.6	103.1	165.8	141.5
Design to Cost (1)	120.6	103.1	138.4-155.0	117.9-132.0
21 Feb 86				
Full NSR	119.1	102.8	165.8	141.5
Design to Cost	119.1	102.8	123.1-137.9	108.1-121.7
21 Feb 86 one year delay to 02				
Full NSR	120.6	103.7	165.8	141.5
Design to Cost	120.6	103.7	123.1-137.9	108.7-121.7
21-23 Mar 86				
Full NSR	119.9	103.0	117.2-124.2	102.8-109.0
	222.9		220.0-233.2	

(1) The MOD's target price is based on the original feasibility study (undertaken by Swan Hunters) and represents the maximum the Department wishes to pay for this capability.

(2) December bids were sought on two bases.

- to meet the full Naval Staff Requirement (NSR)
- to the MOD's target price but with a reduced capability ("design to cost") where necessary to achieve the price.

(3) Harland and Wolff offered fixed prices throughout. SHS prices for "design to cost" and their 21/23 March bids are Fixed Price Incentive Fee (i.e. a target price with MOD and the shipbuilder sharing variations in cost up to a ceiling price).

(4) SHS have offered to "review" their delivery date in their latest bid.

NAT IND
SHIPBUILDING
PT 9

2

PRIME MINISTER

25 March 1986

VICKERS SHIPBUILDERS EMPLOYEE BUY-OUT

81% of Vickers' employees have bought shares in the consortium, and overall employees and local residents have subscribed for double the 20% of shares available to them. Although employees were offered interest-free loans for buying shares, the take-up is still very impressive indeed.

Lloyds Merchant Bank plan to put out a press release, probably later tomorrow.

Peter Warry

PETER WARRY

SUBJECT.

Pite JA

cc BG
J. Wiggins (CO)
Ce Master

10 DOWNING STREET

From the Private Secretary

25 March 1986

Dear Dick,

AOR COMPETITION

Mr. Maginnis MP this afternoon saw the Prime Minister briefly about the AOR competition. He left with her copies of his letter of 26 February to Mr. Lee and a telex from Harland and Wolff, both attached for convenience.

Mr. Maginnis believed that MOD had been about to make an announcement that the first AOR would be awarded to Harland and Wolff when Swan Hunter had made allegations about cross subsidies and sought a reconsideration of the tenders. It was however possible that Swan Hunter itself had gained from subsidies. Mr. Maginnis claimed that Swan Hunter management had paid £5 million for £12 million of assets, that there continued to be support from public money for capital investment in Swan Hunter and that an arrangement had been made to underpin with public money any losses which might be made on existing orders, which itself could allow cross subsidy. In a meeting with Mr. Morrison, a DTI "adviser" had been surprised that Mr. Maginnis knew these details and at the same time had claimed that there was no further public support.

Continuing, Mr. Maginnis said that December had been the deadline for final bids. There had been a further round of tenders in January. If now there were yet a further round of tendering the MOD's competition policy would be "shattered". Harland and Wolff had met all the requirements and submitted a fair tender, as the independent report by PA consultants showed. The yard had a good record, as illustrated by a comparison of the ships built for BP by Harland and Wolff and Swan Hunter. To refuse the order now to Harland and Wolff would be bad for Harland and Wolff and would destroy MOD's competitive tendering process.

The Prime Minister said she could do no more at this stage than listen.

I am copying this letter to Jim Daniell (Northern Ireland Office), Michael Gilbertson (Department of Trade and Industry) and to Jill Rutter (HM Treasury)

Yours,

David

(DAVID NORGROVE)

R. Doran, Esq.,
Ministry of Defence.

KEN MAGINNIS, M.P. for FERMANAGH & SOUTH TYRONE.

26 February, 1986.

John Lee, M.P.
Ministry of Defence
Westminster.

As you are aware the subject of the auxiliary oil replenishment vessels (AORs) was raised, as you predicted when we spoke briefly on 6 February, during the Navy Debate that afternoon. Although Party discipline prevented me from being in the House I doubt, had I been there, whether I would have felt obliged to challenge the fairly weak arguments employed by Ted Garrett and Nicholas Brown against Harland & Wolff during their speeches.

However I felt it prudent to write to several Members in order to refute (Col:495) the remark, "...I hope that they (Government) will not be gulled into accepting a lower tender, which has probably been bolstered by the many forms of aid available to Northern Ireland".

I have pointed out to them that there is no subvention available for building warships but that, anticipating such an innuendo, Harland & Wolff had had their bid subject to a Government sponsored audit by independent consultants to ensure its viability on **a purely commercial and profitable basis**. Swan Hunter, having had no such constraints imposed, would obviously enjoyed greater flexibility in taking it's commercial decisions.

I also pointed out that Harland & Wolff heads up a consortium including YARD Ltd., YARROW Ltd., & RACAL MARINE plc. where the **private sector** element is obvious and where, like Swan Hunter, **YARROW** is a very **recently privatised yard**.

You will, I know, agree that the H & W consortium is recognised as probably the strongest technically, and commercially the most competitive which could have been brought together within Europe to design and build the AORs.

The competence of the individual associates within the group are well known to you. Yarrow's experience as weapons systems designer for the Type 23 Frigate has obvious attraction where the comparable AOR weapon system is concerned.

It is to the regional aspect of this contract, however, that I want to draw your attention. Harland & Wolff's direct employment represents 5 1/2% of Northern Ireland's manufacturing sector employment, which would equate with 300 000 jobs on UK mainland.

/Without

Without the AOR contract the Harland & Wolff workforce must face savage reduction from 1987 omwards. Its last vessel on order in its mixed merchant/naval workload is due for delivery early in 1988.

Swan Hunter, on the other hand, has a 3 X Type 22 Programme running into 1990 with the promise of a 120 million pound order for the second of the Type 23 Frigates. **Harland & Wolff has no such alternatives.**

It should, of course, be remembered that only 30% of any AOR contract would actually be for Northern Ireland. 35% will go to Scotland, 20% to the North-East and 15% to the South.... **to private sector consortium associates** and private sector engineering and electronic suppliers like Marconi, British Aerospace, Ferranti and Plessey. Swan Hunter's bid is largely confined to England.

As far as Harland & Wolff's competitiveness in relation to their 30% direct input I know that it would be content to submit to any independent audit of construction costs for similar vessels recently built in its and Swan Hunter's yards for the same British owner. Both on this and on the technical and engineering side a comparison on a 'like-for-like' basis would demonstrate a wide differential in all-round competence.

I would also stress that despite perceived instability in Northern Ireland over the last 10 years Harland & Wolff has exceptionally stable Industrial Relations with minimal loss of man/hours through dispute. This contrasts with an 8 week lock-out of staff and management by its own workforce at Swan Hunter last autumn.

The AOR contract would support John Parker's strategy of moving to a broader based product range and would give Harland & Wolff the sort of flexibility which close neighbours Shorts Bros. has achieved in it's field.

During the past 2 years, despite the market for merchant ships being totally depressed, Harland & Wolff has achieved a 30% reduction, in real terms, in it's dependence on Government subvention. But John Parker admits that the progress achieved under his chairmanship cannot be maintained without a significant share in the Warship sector of the industry.

The way in which Cammel Laird won it's submarine contract despite considerable political pressure gives me encouragement that the MOD will adhere to it's policy of competitive tendering. It is to counter arguments for not maintaining the policy that I make these various points and I am grateful for the time you have taken to read this letter.

John Parker is, I know, a keen supporter of the Government's competitive procurement policy and will be content to be able to compete within that framework.

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ATTN PAT

COPY OF ''PRESS RELEASE'' AS REQUESTED PER OUR TELECON

JENNIFER

H A R L A N D AND W O L F F PLC
==========

SHIPBUILDERS AND ENGINEERS, BELFAST

U R G E N T .... ..PRESS..RELEASE. .-. ..U R G E N T ....

ATTN NEWS EDITORS

TEXT BEGINS: 25.3.86

HARLAND AND WOLFF FIND IT NECESSARY TO ISSUE THE FOLLOWING STATEMENT IN RESPONSE TO MANY RASH AND ERRONEOUS STATEMENTS BEING MADE BY AND ON BEHALF OF SWAN HUNTER IN THE MEDIA AND ELSEWHERE AND TO CLARIFY HARLAND AND WOLFF'S POSITION ON A NUMBER OF KEY ISSUES.'

COMPETITIVE TENDERING

+ SWAN HUNTER OBVIOUSLY FEAR GENUINE COMPETITION

+ THEY ARE CHALLENGING NOT ONLY THE HARLAND AND WOLFF CONSORTIUM BID REGARDING ITS FAIRNESS, BUT ALSO ATTEMPTING TO BREAK COMPETITIVE TENDERING RULES BY SEEKING TO LODGE YET ANOTHER BID AFTER THE BIDS HAD CLOSED.

+ EARLIER THIS YEAR SWAN HUNTER ALSO PERSUADED THE MINISTRY OF DEFENCE TO RE-OPEN THE BIDDING ON THE BASIS OF THEIR PRIVATISATION

+ SWAN HUNTER ERRONEOUSLY APPEAR TO BELIEVE THAT PRIVATISATION GIVES THEM AN AUTOMATIC RIGHT TO THIS ORDER.

+ OUR CONSORTIUM HAVE COMPLIED WITH THE TENDER RULES THROUGHOUT AND MET ALL THE MOD'S DEADLINES AND WE ARE HAPPY TO ABIDE BY COMPETITIVE TENDERING POLICY.

+ THE ORDER WAS ON THE POINT OF ANNOUNCEMENT WHEN SWAN HUNTER SENSING THAT THE TIDE WAS FLOWING AGAINST THEM BELIEVED THAT THEY COULD NOW GET A REBID ACCEPTED AT A LOWER FIGURE THAN HARLAND AND WOLFF, GIVEN THAT THEY NOW HAVE OBTAINED OUR PRICE LEVELS. IF SUCH A MOVE WERE PERMITTED, IT WOULD COMPLETELY SHATTER AND RUPTURE MOD COMPETITIVE TENDERING POLICY.

UNFAIR COMPETITION

+ SWAN HUNTER HAVE WRONGLY PORTRAYED THE HARLAND AND WOLFF LED BID AS A SUBSIDISED PUBLIC SECTOR BID.

+ OUR BID HAS NOT ONLY BEEN SCRUTINISED BY GOVERNMENT DEPARMENTS, BUT ALSO AUDITED BY INDEPENDENT CONSULANTS WITH AN INTERNATIONAL REPUTATION. THE SWAN HUNTER BID HAS NOT BEEN SUBJECTED TO SUCH CONSTRAINTS: WHICH ALLOWS THEM GREATER COMMERCIAL FREEDOM.

+ NO SUBSIDIES ARE AVAILABLE TO HARLAND AND WOLFF FOR NAVAL VESSELS. HARLAND AND WOLFF HAVE ACCESS TO THE SAME LEVEL OF SUBSIDY SUPPORT AS OTHER UK YARDS BUILDING MERCHANT SHIPS.

+ THE HARLAND AND WOLFF BID IS A CONSORTIUM APPROACH INCLUDING RECENTLY PRIVATISED YARROW SHIPBUILDERS (GEC), YARD OF GLASGOW AND OTHER PRIVATE SECTOR COMPANIES, REPRESENTING SOME 70% OF THE VALUE OF THE HARLAND AND WOLFF BID.

+ YARROW IS THE UKS LEADING SURFACE WARSHIP DESIGNER AND BUILDER AND THIS CONSORTIUM APPROACH HAS NOT ONLY PRODUCED THE BEST TECHNICAL BID, BUT COMMERCIALLY THE MOST COMPETITIVE BID.

+ POTENTIAL SUBSIDIES ON THE SWAN HUNTER BID CANNOT BE RULED

TELEX db telecopy plus from Telephone Rentals plc

OUT GIVEN THE FAVOURABLE BUYOUT TERMS ON SWAN HUNTER'S RECENT PRIVATISATION. FOR EG. ALL THE LOSSES ON THEIR CURRENT ORDER BOOK ARE BEING UNDERPINNED BY BRITISH SHIPBUILDERS, THEIR FORMER OWNERS.

+ HARLAND AND WOLFF DO NOT NEED TO PRIVIDE CONTINGENCY SUMS IN THEIR COSTING FOR UNSTABLE INDUSTRIAL RELATIONS WHICH HAVE BEEN A RECENT FEATURE OF SWAN HUNTER RELATIVE TO THE STABLE INDUSTRIAL RELATIONS CLIMATE THAT PREVAILS IN HARLAND AND WOLFF.

PERFORMANCE

+ AS FAR AS THE RELATIVE PERFORMANCE OF SWAN HUNTER ON DELIVERY AND COST IS CONCERNED. THEN AN AUDIT OF THE CONSTRUCTION COSTS OF SIMILAR SHIPS RECENTLY CONSTRUCTED IN BOTH SHIPYARDS WOULD DEMONSTRATE THAT HARLAND AND WOLFF'S FINAL COSTS WERE AT LEAST SOME 30% BELOW THOSE OF SWAN HUNTER FOR THE SAME SHIP.

+ IN ADDITION, THE SWAN HUNTER SHIP HAD TO BE RE-NEGOTIATED SINCE ITS DELIVERY HAD PASSED THE CANCELLATION DATE AND ITS QUALITY OF CONSTRUCTION WAS GENERALLY REGARDED AS UNSATISFACTORY.

INDUSTRIAL RELATIONS

+ DESPITE THE PERCEIVED INSTABILITY OF NORTHERN IRELAND, HARLAND AND WOLFF HAVE LOST ONLY 0.15% OF MANHOURS THROUGH ANY FORM OF DISPUTE, OVER THE PAST 10 YEARS.

+ THE POLITICAL STRIKE OF MARCH 3RD WAS THE FIRST FULL DAY LOST ACROSS THE WORKFORCE FOR 12 YEARS SINCE MAY 1974.

+ IN THE SECOND HALF OF 1985 ALONE, SWAN HUNTER LOST 8 WEEKS THROUGH A LOCKOUT OF MANAGEMENT AND STAFF BY ITS OWN WORKFORCE.

+ SWAN HUNTER HAVE RECENTLY SUFFERED FURTHER DISPUTES IN A CURRENT WAGE DISPUTE WHICH STILL REMAINS UNSETTLED.

+ REPRESENTATIVES OF THE SWAN HUNTER WORKFORCE RECENTLY STATED THROUGH THE PRESS THAT THEY WERE PREPARED TO 'SACRIFICE THEIR FUTURE' IF THEY COULD NOT REACH AGREEMENT ON THE ACHIEVEMENT OF A SUFFICIENTLY HIGH WAGE.

ORDER BOOK AND JOBS

+ SWAN HUNTER ORDER BOOK IS VALUED AT ABOUT £400M AND STRETCHES INTO 1989.

+ HARLAND AND WOLFF ORDER BOOK IS VALUED AT ABOUT 160M AND WILL BE COMPLETED IN EARLY 1988.

+ WITHOUT AOR AND FURTHER WORKLOAD 5,000 JOBS WILL BE AT RISK AT HARLAND AND WOLFF.

+ IN ADDITION, AND VERY IMPORTANTLY, SWAN HUNTER HAVE BEEN PROMISED A £120M TYPE 23 FRIGATE ORDER WHICH IS OF SIMILAR VALUE TO AN AOR.

+ HARLAND AND WOLFF HAVE NO SUCH ALTERNATIVES.

TECHNICAL COMPETENCE

TELEX telecopy plus from Telephone Rentals plc

+ THE OVERALL TECHNICAL PACKAGE FROM THE HARLAND AND WOLFF CONSORTIUM IS, WE BELIEVE, REGARDED AS SUPERIOR TO THAT OF SWAN HUNTER. THE PACKAGE HAS BEEN EVALUATED NOT ONLY BY MOD, B U T ALSO BY INDEPENDENT CONSULTANTS EMPLOYED BY THE MOD.

+ HARLAND AND WOLFF AND ITS CONSORTIUM MEMBERS ARE CONDIFENT THAT THIS WOULD DEMONSTRATE THE PROFESSIONAL AND TECHNICAL COMPETENCE OF THE HARLAND AND WOLFF CONSORTIUM VERSUS THE COMPETITION.

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10 DOWNING STREET

THE PRIME MINISTER

25 March 1986

Dear Mr. Cushnahan,

Thank you for your letter of 19 March.

I deplore the events of 3 March, as you do. But I can assure you that they are not a significant factor in the decision on where the order for the first AOR will be placed.

Yours sincerely,

Margaret Thatcher

John Cushnahan, Esq.

1903-025

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London SW1

NRBM.

Dear George, 25 March 1986

AOR ORDERS AND SWAN HUNTER

I have been following the correspondence about the competition for the first AOR order, and the debate about what failure to win this might do to Swan Hunter's longer term prospects. Your officials have been keeping mine in touch with the details of that competition.

There are obviously a number of factors in the decision. Some may turn out on closer examination not to be factors at all (like perhaps Swan Hunter's very late revised bid). But notwithstanding that, as I understand it, current tenders expire on 31 March, I have some sympathy with Paul Channon's suggestion that our decision should be taken on the basis of a proper and full consideration of all the relevant implications. I would therefore think it worth taking a little more time to ensure that we have all the facts before us, including a proper comparative assessment of the bids together with your proposals for the way ahead and a final assurance that there is no element of subsidy in the Harland and Wolff bid. In the circumstances might it not be worth seeking an extension of the tender expiry date to avoid perhaps too hasty consideration before Easter?

I am copying this letter to the Prime Minister, members of E(A) Committee and Sir Robert Armstrong.

Yours ever,

JM

JOHN MacGREGOR

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

Mike

Staff

10 DOWNING STREET

THE PRIME MINISTER

25 March 1986

Dear Mr. Hardy.

Thank you for your letter of 20 March.

I do assure you that every effort is being made to ensure that the competition for the first AOR is fair. No decision has yet been made.

Yours sincerely

Margaret Thatcher

D. W. Hardy, Esq.

BM

CANDOVER INVESTMENTS plc
Cedric House, 8-9 East Harding Street, London EC4A 3AS
Telephone: 01-583 5090 Telex: 928035 Fax: 01-583 0717

24th March 1986

R 25/3

Prime Minister 2
MoD will reply.

Rt.Hon. Margaret Thatcher
10 Downing Street
London SW1

Dear Prime Minister,

SWAN HUNTER SHIPBUILDERS LIMITED

On behalf of the institutional investors in the newly privatised Swan Hunter Shipbuilders, I am writing to express our very serious concern at the recent reports that the order for the first pair of AOR (fleet auxiliary vessels) is to be granted to Harland and Wolff.

As the DTI, the MoD and I believe the Treasury were aware, investors' confidence in the privatisation of Swan Hunter was substantially encouraged by the high design skills of the company which was perceived as a high-tech, profitable supplier of warships and naval fleet auxiliary vessels. Indeed the company was recognised as the market leader in this latter category with significant growth potential from export orders for this class of vessel. The award of the AOR order to Harland and Wolff will almost certainly result in the laying off the company's senior design staff thereby severely restricting the company's ability to obtain export orders in this area.

The absence of AOR orders could also result in grave commercial consequences with regard to future frigate orders. The Treasury are aware that as a condition of any further orders from MoD the company has to obtain an insurance bond for £3 million, and if the underwriting market is as concerned as shareholders are at the financial implications of this measure this may prove to be an impossible requirement to fulfill, at least until the company has developed a trade record post privatisation

DIRECTORS: Chairman: P G Wreford BSc (Econ), ACIS, AIB; Chief Executive: C R E Brooke MA;
Deputy Chief Executive: S W Curran FCCA;
H A Hicks CBE, DSc, C Eng, FICE, FI Prod E, F Am SCE, M Soc C E (France), FCIOB, CBIM;
R A P King; P J Scott Plummer MA, FCA; M C Stoddart FCA; L V D Tindale CBE, CA, CBIM; J G West FCA.

Registered No 1512178 in England at the above address.
An investment company within the meaning of Part VIII of the Companies Act 1985.

The inevitable consequences are a substantial restructuring of the company and a major redundancy programme which would be both a burden on the company and The Treasury in an area of very high unemployment.

Harland and Wolff is constantly loss funded and at an increasing rate before taking into account the fixed price AOR tender, said to be unsubsidised. We understand that it is unprecendented for an experienced first of class builder to risk his price being fixed and we believe that by awarding an AOR order to Harland and Wolff the tax payer will inherit contract losses of many millions of pounds.

It has been indicated that the Harland and Wolff tender price is significantly less than that submitted by Swan Hunter, but in our opinion the plausibility of the Harland and Wolff tender must be in doubt and may well justify genuinely independent investigation.

Since 1980 we understand that Harlands have received nearly £200 million of subsidy and even in the last eleven months, against a full order book, the company has received an increase in their interest free unsecured funding of £31 million, which is equivalent to their wage bill.

Against this background it is difficult to imagine how Swan Hunter can fairly compete against such fixed price tendering and it would appear that Harlands are trying, at the expense of the tax payer, to drive Swan Hunter, the market leader, out of business.

Inevitably, it must be recognised in this extreme situation that one alternative for investors is formally to ask the Government to repurchase the company.

Yours sincerely

Roger Brooke

C R E Brooke

3443B

copy letter not sent

10 DOWNING STREET

BF // Expect a reply by 26.3.86.

From the Private Secretary

24 March 1986

The Prime Minister has received a letter from Mr. D. W. Hardy, Chairman of Swan Hunter Shipbuilders Ltd, a copy of which has already been sent to you.

I should be grateful for advice on whether the Prime Minister should reply or whether a Minister in your Department should take this on, and for a draft for the Prime Minister's signature if appropriate.

(John Lee ← replying after decision is made)

(David Norgrove)

R. Doran, Esq.,
Ministry of Defence.

cc DG

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215 5422
GTN 215 .....
(Switchboard) 01-215 7877

Secretary of State for Trade and Industry

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24 March 1986

Prime Minister 2
The lobbying is now intense.
I suggest await Mr Younger's reply before deciding the next steps.
An E(A) after the Easter recess may be the best course. MS
DW 24/3

The Rt Hon George Younger MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
LONDON
SW1

He wants to ask for a new letter.

Dear George. Mixed good news. MS

AOR ORDERS AND SWAN HUNTER

I am most anxious that we should have the opportunity to consider collectively the implications of the placing of the order for the first Auxiliary Oiler Replenishment (AOR) vessel for Swan Hunter as well as for Harland and Wolff. Unlike the situation on the placing of the Upholder Class Submarine order at the end of last year, we have not been given your Department's full comparative assessment of the bids. I urge that this assessment should consider the latest offers.

I hope that you will be able to let us have this shortly at the same time as you reply to the Prime Minister's request (David Norgrove's letter of 20 March to Ian Lee) for you to consider more generally what might be done to provide the work for Swan Hunter because of the way the Type 22 Order went to Cammell Laird last year and of the need, if at all possible, to avoid damaging a newly privatised yard.

I have to remember the assurances that were given to the new owners of Swan Hunter before the completion of the sale of the yard about the fairness of the competition they would face, and the Prime Minister's assurances to North East MP's on 20 March that the Government would study the AOR tenders with scrupulous care to make sure no cross-subsidies were involved. In the assessment so far seen of the Harland and Wolff tender there is little or no margin for error. If the facts as we know them came out, Swan Hunter would certainly claim that the allocation of overheads at Harland

1786 1986 BOARD OF TRADE BICENTENARY

and Wolff represented a subsidy. Perhaps more important are the losses Harland and Wolff would incur if there were any significant delays in production given the fixed price tender Harland and Wolff have offered, which I believe is most unusual for a major first of class ship. Swan Hunter have represented that only a yard in Harland and Wolff's position could afford to take such a risk. It would be useful in assessing this point to know whether, for instance, the ATS and SWOPS vessels at Harland and Wolff are running to time and, if not, what allowance has been made for this in the Harland and Wolff tenders.

There are very serious consequences for Swan Hunter if they do not succeed in this competition. They may well, for instance, not be able to get the insurance bond required by your Department, which would preclude them from bidding for Type 23 orders. In this case they would have no future.

I am sending copies of this letter to the Prime Minister, the members of E(A) Committee, and Sir Robert Armstrong.

PAUL CHANNON

JF2BCA

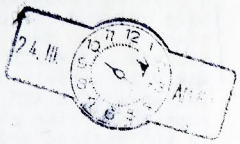
1786 1986 BOARD OF TRADE BICENTENARY

PM

Meeting with

CARRETT + BRAUN

3/86



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TO : PRIME MINISTER - THE RT HON MARGARET THATCHER MP
CHIEF SECRETARY OF THE TREASURY - THE RT HON JOHN MACGREGOR MP

FROM : SWAN HUNTER SHIPBUILDERS LIMITED.

NO 10. D.S.
RT. HON. JOHN MACGREGOR.

FOR URGENT AND IMMEDIATE ATTENTION.

TO: HON., PETER MORRISON MP.
MINISTER OF STATE FOR INDUSTRY
ASHDOWN HOUSE
1 VICTORIA STREET.
LONDON SW1 0ET

DEAR MINISTER,

SWAN HUNTER LIMITED

WE ARE WRITING TO YOU TO SET OUR THE POSITION AS WE NOW SEE IT. FOLLOWING THE INFORMATION RECEIVED BY US THAT THE PRIME MINITSER HAD SUGGESTED ON THURSDAY LAST THAT THERE WAS SUCH AN OPPORTUNITY, WE SUBMITTED A REVISED TENDER FOR THE AORS WHICH WE UNDERSTAND FULLY MEETS MOD'S REQUIREMENTS.

BECAUSE WE RECOGNISED THE POTENTIAL THREAT FROM UNFAIR COMPETITION FROM HARLAND AND WOLFF WE SOUGHT HMG ASSURANCE OF EQUITABLE TREATMENT PRIOR TO INVESTORS PROVIDING FINANCIAL SUPPORT. WE ARE NOW CONCERNED THAT ANY ANNOUNCEMENT OF THE ORDER GOING TO HARLAND AND WOLFF WILL HAVE THE FOLLOWING RESULTS.

- A REDUNDANCY COST OF SOME 2000 JOBS LOST, FUNDAMENTALLY UNDERMINING THE COMPANY

- THE STRONG POSSIBILITY OF SWAN HUNTER NOT BEING ABLE TO ACHIEVE THE INSURANCE BOND REQUIRED BEFORE WE CAN RECEIVE ANY FURTHER SUBSTANTIAL ORDERS FROM MOD.

- OUR BEING FORCED TO CONSIDER THAT THE CHANGED PROSPECTS OF THE COMPANY RESULTING FROM AN EARLY ANNOUNCEMENT OF AN ORDER TO HARLAND AND WOLFF MUST MAKE US SERIOUSLY QUESTION WHETHER WE COULD PROPERLY PAY OUR FIRST PREFERENCE SHARE DIVIDEND DUE 31 ST MARCH. IF THE DIVIDEND WERE PASSED MANAGEMENT WOULD LOSE THEIR CONTROL OF THE RUNNING OF THE COMPANY AND THE INVESTMENT INSTITUTIONS WOULD BE ENTITLED TO TAKE WHATEVER STEPS THEY THOUGHT NECESARY TO PROTECT THEIR INTEREST.

- THERE IS THEN A STRONG PROBABILITY OF THE COMPANY RUNNING INTO IRREVERSIBLE DECLINE.

IF MOD DO CALL FOR A FORMAL RETENDER WE HAVE NO CONFIDENCE IN HARLAND AND WOLFF DOING ANYTHING OTHER THAN UNDER CUTTING US PRESUMABLY AT THE TREASURY'S ULTIMATE EXPENSE. THIS IS IN EFFECT A DUTCH AUCTION WHICH WE WOULD NOT BE ABLE TO CONTINUE. WE DO NOT BELIEVE THAT ANY EXPERIENCED, PRACTICAL, PRIVATE SECTOR COMPANY (AND WE ARE THE MARKET LEADER) WOULD RISK TENDERING AT THIS LEVEL AT A FIXED PRICE WITHOUT AN FPEF ELEMENT IN THE WAY ATTRIBUTED TO HARLAND AND WOLFF, IF IT HAS TO SURVIVE WITHOUT A SUBSIDY.

WE UNDERSTAND THAT THE DEPARTMENT OF COMMERCE, NORTHERN IRELAND OFFICE, WISH TO CARRY OUT AN INDEPENDENT COMPARISON OF WORKING PRACTICES, PERFORMANCE AND METHODS BETWEEN HARLAND AND WOLFF AND BRITISH SHIPBUILDERS - PRESUMABLY BECAUSE THEY ARE CONNCERNED AT THE LEVEL OF PERFORMANCE AND SUBSIDY AT HARLAND AND WOLFF.

THEREFORE, WE BELIEVE THAT BEFORE HARLAND AND WOLFF AE ARE AWARDED ANY FIRST OF CLASS ORDER FOR THE AOR THERE SHOULD BE A DEMONSTRABLY INDEPENDENT INVESTIGATION INTO THE HARLAND AND WOLFF BID CARRIED OUT BY EXPERTS (NOT ONLY ACCOUNTANTS). GRAHAM DAY WOULD BE AN APPROPRIATE CHAIRMAN OF SUCH AN INVESTIGATION.

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ONE POSSIBLE SOLUTION, RECOGNISING THAT COMPETITION HAS ALREADY ACHIEVED A MASSIVE PRICE REDUCTION, IS FOR THE FIRST OF CLASS TO BE AWARDED TO SWAN HUNTER AND THE SECOND TO HARLAND AND WOLFF. IN THIS SITUATION WE WOULD COMMIT OURSLVES TO ACTIVELY COOPERATING WITH AND INVOLVING HARLAND AND WOLFF SO THAT THE USUAL LEAD YARD PROCESS PROBLEMS WOULD BE MINIMISED. THIS WOULD PROTECT OUR DESIGN (AND HENCE EXPORT) CAPABILITY AND YET PROVIDE WORK FOR BOTH COMPANIES WHEN THEY NEED IT.

HARLAND AND WOLFF STATE THAT THEIR FAILURE TO WIN THE FIRST AOR WOULD RESULT IN NO REDUNDANCES UNTIL LATE 1987, A VIEW SUPPORTED BY THEIR SUBSTANTIAL WORKLOAD. HOWEVER, SWAN HUNTER WOULD HAVE 1000 REDUNDANCIES IN 1986 ALONE, 200 NEXT MONTH BEING HIGHLY QUALIFIED DESIGN STAFF.

THIS IS CLEARLY NOT OUR PREFERRED OPTION SINCE WE SEEK TO BUILD BOTH VESSELS. RECOGNISING THE POLITICAL REALITIES OF LIFE, HOWEVER, IT IS AN OPTION WHICH MAY SATISFY THE NEEDS OF BOTH CMMUNITIES.

WE ARE AVAILABLE AT ANYTIME TO DISCUSS THIS MATTER WITH YOU AND DO APPRECIATE YOUR CONTINUING SUPPORT.

KIND REGARDS
KEN CHAPMAN
ALEX MARSH
PETER VAUGHAN
ROGER VAUGHAN.

+++++

27582 CABOFF G
53151 SWANS G

10 DOWNING STREET

THE PRIME MINISTER

24 March 1986

Dear Piers.

Thank you and Michael Fallon for your letter of 20 March.

I too am very concerned to ensure that the competition for the first AOR should be fair, as I am sure Neville Trotter will have told you.

I have asked John Lee to write to you with a full explanation of the position, once a decision has been taken.

Yours

Margaret

Piers Merchant, Esq., M.P.

Swan Hunter Shipbuilders Limited

WALLSEND SHIPYARD · P.O. BOX 1 · WALLSEND · TYNE & WEAR NE28 6EQ
Telephone National Tyneside (091) 262 8921 Telex 53151
International +44 91 262 8921 53556

Your Ref
Our Ref rw/dr/0323/2

23rd March 1986

Hon Peter Morrison MP
Minister of State for Industry
Ashdown House
1 Victoria Street
LONDON SW1H 0ET

Dear Minister,

Swan Hunter Limited

We are writing to you to set out the position as we now see it. Following the information received by us that the Prime Minister had suggested on Thursday last that there was such an opportunity, we submitted a revised tender for the AORs which we understand fully meets MOD's requirements.

Because we recognised the potential threat from unfair competition from Harland and Wolff we sought HMG assurance of equitable treatment prior to investors providing financial support. We are now concerned that any announcement of the order going to Harland and Wolff will have the following results

- A redundancy cost of some 2000 jobs lost, fundamentally undermining the company

- The strong possibility of Swan Hunter not being able to achieve the insurance bond required before we can receive any further substantial orders from MOD.

- Our being forced to consider that the changed prospects of the Company resulting from an early announcement of an order to Harland and Wolff must make us seriously question whether we could properly pay our first preference share dividend due 31st March. If the dividend were passed Management would lose their control of the running of the Company and the Investment Institutions would be entitled to take whatever steps they thought necessary to protect their interest.

- There is then a strong probability of the Company running into irreversible decline.

If MOD do call for a formal retender we have no confidence in Harland and

Registered Number 924707 England
Registered Office Wallsend Shipyard, Wallsend, Tyne & Wear NE28 6EQ

23rd March 1986

Hon Peter Morrison MP
Minister of State for Industry

Wolff doing anything other than under cutting us presumably at the Treasury's ultimate expense. This is in effect a Dutch Auction which we would not be able to continue. We do not believe that any experienced, practical, private sector company (and we are the market leader) would risk tendering at this level at a fixed price without an FPIF element in the way attributed to Harland and Wolff, if it has to survive without a subsidy.

We understand that the Department of Commerce, Northern Ireland Office, wish to carry out an independent comparison of working practices, performance and methods between Harland and Wolff and British Shipbuilders - presumably because they are concerned at the level of performance and subsidy at Harland and Wolff.

Therefore, we believe that before Harland and Wolff are awarded any first of class order for the AOR there should be a demonstrably independent investigation into the Harland and Wolff bid carried out by experts (not only accountants). Graham Day would be an appropriate Chairman of such an investigation.

One possible solution, recognising that competition has already achieved a massive price reduction, is for the first of class to be awarded to Swan Hunter and the second to Harland and Wolff. In this situation we would commit ourselves to actively cooperating with and involving Harland and Wolff so that the usual lead yard process problems would be minimised. This would protect our design (and hence export) capability and yet provide work for both companies when they need it.

Harland and Wolff state that their failure to win the first AOR would result in no redundancies until late 1987, a view supported by their substantial workload. However, Swan Hunter would have 1000 redundancies in 1986 alone, 200 next month being highly qualified design staff.

This is clearly not our preferred option since we seek to build both vessels. Recognising the political realities of life, however, it is an option which may satisfy the needs of both communities.

We are available at anytime to discuss this matter with you and do appreciate your continuing support.

Kind regards,

Yours

Ken Chapman Alex Harsh Peter Vaughan Roger Vaughan

Already given to DRN.

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53151 SWANS G
1658 86-03-21 14:20

FOR THE ATTENTION OF :

RT. HON MARGARET THATCHER MP. PRIME MINISTER.
RT. HON GEORGE YOUNGER TD MP SECRETARY OF STATE DEFENCE
RT. HON PAUL CHANNON MP SECRETARY OF STATE TRADE AND INDUSTRY
HON. PETER MORRISON MP MINISTER OF STATE FOR INDUSTRY
NORMAN LAMONT MP SECRETARY OF STATE DEFENCE PROCUREMENT
JOHN LEE MP PARLIAMENTARY UNDER SECRETARY OF STATE FOR DEFENCE PROCUREMENT.
VICE ADMIRAL SIR DEREK REFFELL KCB, CONTROLLER OF THE NAVY.

INVITATION TO TENDER NSS51A/87414

YOU WILL BE AWARE OF THE CURRENT TENDERS FOR THE CONSTRUCTION OF THE AUXILIARY OILER REPLENISHMENT SHIP (AOR) THAT HAVE BEEN SUBMITTED TO THE MINISTRY OF DEFENCE UNDER INVITATION TO TENDER NSS51A/87414.

IN VIEW OF THE DIRA CONSEQUENCES TO THE NEWLY PRIVATIZED COMPANY SWAN HUNTER AND TO THE LOCAL COMMUNITY WHICH WOULD FOLLOW IF THIS SHIP WERE NOT TO BE PLACED WITH SWAN HUNTER SHIPBUILDERS, WE HAVE HAD FURTHER DISCUSSIONS WITH OUR SUPPLIERS AND INSTITUTIONAL INVESTORS.

FOLLOWING THE MEETING WITH MRS. THATCHER, MR. J. LEE, THE MP FOR NEWCASTLE EAST MR. N. BROWN AND THE MP FOR WALLSEND MR. E. GARRETT, WE WISH TO REVISE OUR TENDER PRICE AS FOLLOWS:

ONE IN NUMBER - AOR 01 £127.50 MILLION.

THIS PRICE ASSUMES THAT SWSA JIGS AND TOOLS ARE PROVIDED FREE ISSUE BY THE MINISTRY OF DEFENCE AS PART OF THE TYPE 23 VERTICAL LAUNCH SEAWOLF PROGRAMME. THIS FACILITY WE UNDERSTAND IS AVAILABLE TO OUR COMPETITORS. IF THIS EQUIPMENT WAS NOT PROVIDED BY THE MINISTRY OF DEFENCE A FURTHER £1.5 MILLION WOULD BE ADDED TO THE PRICE GIVING A TOTAL PRICE FOR AOR 01 AS £129 MILLION.

OUR PRICES FOR TWO IN NUMBER (AOR 01 AND AOR 02) ARE AS FOLLOWS:

AOR 01 £124.8 MILLION

AOR 02 £109.5 MILLION

THESE PRICES MAKE THE SAME ASSUMPTIONS AS IN THE PREVIOUS PARAGRAPH ON SWSA JIGS AND TOOLS. IF THIS EQUIPMENT WAS NOT AVAILABLE FROM THE TYPE 23 PROGRAMME THEN THE PRICE OF AOR 01 (ORDERED AS A PAIR) WOULD INCREASE TO £126.3 MILLION.

TERMS AND CONDITIONS REMAIN AS STATED IN OUR RECENT OFFER WITH EXCEPTION THE FPIF ARRANGEMENT WOULD BE BASED ON A MAXIMUM OVERRUN OF 8 % ON TARGET PRICE.

IT SHOULD BE NOTED THAT THE ABOVE PRICES ARE BELOW THE DESIGN TO COST BUDGET STIPULATED IN THE INVITATION TO TENDER.

REGARDS
ALEX. J. MARSH
SWAN HUNTER SHIPBUILDERS LIMITED.

27582 CABOFF G
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53151 SWANS G
1661 86-03-21 14:53

NBPN. (re AOR Competition)

FOR THE ATTENTION OF :

RT. HON MARGARET THATCHER MP. PRIME MINISTER.
RT. HON GEORGE YOUNGER TD MP SECRETARY OF STATE DEFENCE
RT. HON PAUL CHANNON MP SECRETARY OF STATE TRADE AND INDUSTRY
HON. PETER MORRISON MP MINISTER OF STATE FOR INDUSTRY
NORMAN LAMONT MP SECRETARY OF STATE DEFENCE PROCUREMENT
JOHN LEE MP PARLIAMENTARY UNDER SECRETARY OF STATE FOR DEFENCE PROCUREMENT.
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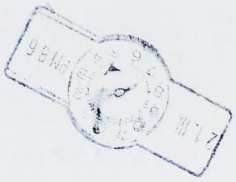

AUXILIARY OILER REPLENISHMENT VESSELS (AOR)

Progress of the Competition

1. The AOR is a new concept for a "one-stop" replenishment vessel capable of providing fuel ammunition and other stores to warships at sea. It also provides support facilities for helicopters. Because of the high value of its cargo (and the need to deploy in hostile waters) the ship needs self-defence weapons. Under a new procurement approach my Department invited tenderers to take responsibililty for the design and build of the "whole ship".

2. Tenders received last summer from Harland and Wolff and Swan Hunters were too high. Both firms were asked to reduce their bids and if necessary show what ship they could supply for MOD's target price (£122M for the first of class, of £103M for the second at 1984-85 prices) based on earlier feasibility studies by SHS. In revised tenders, H&W were able to reduce their bid to these target prices whilst still meeting the full operational requirement. SHS' price for a comparable ship to meet full operational requirement was 30% higher. SHS offered a design-to-cost vessel but with significantly reduced capability and still 14-26% above the MOD target price.

3. Apart from price H&W produced a technically superior design giving a more robust and stable ship. This view was confirmed in an independent assessment by Three Quays Marine Services Ltd - a

specialist ship purchasing subsidiary of P&O. H&W were also generally more compliant with my Department's conditions of contract and offered delivery dates we wanted.

4. While the competition was underway British Shipbuilders put forward a much cheaper (£55M) design for an unarmed vessel for the export market. We looked carefully at this, but as well as being too vulnerable for front-line duties the ship had technical defects confirmed by Three Quays.

5. Earlier this year two new factors emerged: the privatisation of SHS and our need for more flexibility in MOD's forward programme. During a final round of tenders in February both companies were asked to submit new bids to take account of a possible one-year delay to the delivery of AOR O2.

6. H&W took this opportunity to reduce slightly their bid for AOR O1 to £121M. SHS did not reduce their £168M bid for the ship to meet the full operational requirement. They reduced their price for a design-to-cost vessel to £126M, closer to the MOD target; but it still offered a significantly reduced capability, which would ignore the lessons learned from the Falklands Campaign, and was less compliant on contract conditions; and they still wanted overrun protection of up to a further 12%.

7. Splitting the order for AOR O1 and O2 between the two tenderers could only be achieved at substantial extra cost

because two sets of design costs would be involved. There would also be additional through life cost.

HANSARD EXTRACT - 20 FEBRUARY 1986

WRITTEN ANSWERS - COLUMN 271

Harland and Wolff

Mr. Sayeed asked the Secretary of State for Northern Ireland what is his policy in offering guarantees or subsidies to Harland and Wolff in relation to specific tenders for warships or naval vessels to be built in the United Kingdom when Harland and Wolff would be in competition with other United Kingdom warship yards for the contract.

Dr. Boyson: It is Government policy not to offer guarantees or subsidies to Harland and Wolff in relation to specific tenders for warships or naval vessels when there is competition from other United Kingdom warship yards for the contract.

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FILE CAJANZ

cc BG

10 DOWNING STREET

21 March 1986

From the Private Secretary

Dear Dick,

AOR COMPETITION

The Prime Minister saw Dr Rhodes Boyson's letter of 20 March to Mr Lee which set out the basis for Harland and Wolff's bid.

As I told you, the Prime Minister accepts that the First of Class AOR should be awarded to Harland and Wolff. She was, however, concerned at the prospect that an announcement might be made on Monday, so soon after she had seen Mr Brown and Mr Garrett. You told me that Mrs Stanley will be launching a frigate at Swan Hunter on Wednesday, and in the light of that, the Prime Minister accepted that an announcement could be made on Monday. She has asked that Mr Lee should speak to Mr Trotter, Mr Garrett and Mr Brown to explain the position and to follow that with a full letter setting out the reasons why the bid from Harland and Wolff had been successful. Mr Lee should emphasise that everything possible had been done to check that no cross subsidies were involved in the Harland and Wolff bid.

You told me later in the morning that Mr Garrett and Mr Brown had been left with the impression at the meeting that there was an opportunity available to Swan Hunter to revise and to resubmit their bid before the end of the month. This point was touched on briefly at yesterday's meeting, and my own impression was that the possibility was as quickly ruled out by Mr Lee. You told me that Mr. Lee himself believes it was firmly ruled out. Neither the Prime Minister nor Mr Garrett returned to it at the end of the meeting: the emphasis was entirely on checking that there were no cross subsidies at Harland and Wolff. The Prime Minister, however, recognised this morning that the MPs had taken that impression. It is possible that they misinterpreted a statement of Mr Lee's that tenders expired at the end of the month. They may have understood that the MOD was open to fresh bids until the end of the month, rather than that the tenders already received would expire at the end of the month.

Mr Brown telephoned after you had spoken to me. He asked whether there was any possibility of coming back with a new price and also whether the Government could look again at the possibility of work sharing between the two yards,

PA

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with Swan Hunter taking AOR 1 and Harland and Wolff AOR 2. I said I understood that there was no possibility of submitting new bids and that, as Mr Lee explained yesterday, AOR 2 would also have to be placed on a competitive basis. But Mr Brown would need to discuss these points with Mr Lee. At Mr Brown's request I undertook to mention the points to the Prime Minister, but again said that he should discuss them with Mr Lee. Mr. Brown expressed his appreciation of the great interest and understanding the Prime Minister had shown about the situation facing Swan Hunter.

I now attach a copy of a letter received this morning from Piers Merchant MP and Michael Fallon MP. I should be grateful for a draft reply for the Prime Minster's signature on Monday 24 March, assuming that the decision is still to be announced that day.

I am copying this letter to Michael Gilbertson (Department of Trade and Industry), Jim Daniell (Northern Ireland Office) and Jill Rutter (HM Treasury).

Yours sincerely,

David Norgrove.

DAVID NORGROVE

R. J. M. Doran, Esq.,
Ministry of Defence

(1)

PRIME MINISTER

AOR COMPETITION

The Northern Ireland Office letter below argues strongly that there is no cross-subsidy in the Harland and Wolff bid. It is difficult to tell from the summary material attached to the letter, but there is some reassurance in that Peter Levene has said "it would certainly appear that there is no evidence of any subsidy in this bid".

I have commissioned urgent work by MOD on possible orders for Swan Hunter.

MOD would like to announce on Monday that Harland and Wolff have won the order. Content?

It is a little soon after the MPs interviews. I think it should be delayed until close Wednesday - to give them time.

DAVID NORGROVE
20 March 1986

LO4ACX

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SCPC

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

Minister of State

John Lee Esq MP
Parliamentary Under-Secretary of
State for Defence Procurement
Ministry of Defence
Main Building
Whitehall
LONDON
SW1A 2HB

20 March 1986

Dear Minister,

AOR COMPETITION

Thank you for your letter of 19 — with DRN?

As you are aware, the then Northern Ireland Secretary accepted, in his letter of 2 August 1985 to the then Chief Secretary, that Harland and Wolff's bid should be comprehensively costed, unsubsidised and contain a profit margin. Thereafter my Department commissioned PA Management Consultants to review H&W's tender. The conclusions of their review have been the subject of correspondence between MOD, DTI, Treasury and my officials.

I can confirm that PA concluded that H&W's bid was fairly costed, unsubsidised and contained a profit margin. They were content with the realism of the underlying assumptions. The bid therefore contains no cross-subsidisation through allocation of overheads or in other ways. My officials are sending copies of PA's report to your officals, but I attach a technical Annex summarising PA's main findings.

I have also seen the record of the Prime Minister's meeting with Neville Trotter on 13 March. My own assessment is that H&W have been enabled to offer a competitive price because of the strength and experience of its consortium partners - 70% of the value of the ship comes from these partners and sub-contractors who are located in GB and H&W have firm prices covering the bulk of these. Its prime partner is, as you know, the newly-privatised Yarrow Ship-builders on the Clyde, who have considerable experience in the manufacture of ship borne weapon systems.

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You also referred to the events of 3 March and asked for our assessment. As far as the shipyard is concerned the one day political protest was the first full day's lost production across the labour force for almost 12 years.

Many ordinary Unionists were disgusted by the violence and intimidation which accompanied the 3 March protest and it seems to have changed the attitude to the future use of this form of protest. It is also worth pointing out that the shipyard stayed at work in May 1977 when Dr Paisley and other Loyalist worker elements sought for some 10 days to organise a "constitutional stoppage". But even if short term opposition to the agreement remains, it is unlikely to have any material effect on AOR production as steel work is not scheduled to commence until early 1988.

Tom King and I have also made it perfectly clear, as has John Parker, that any repetition of the events of 3 March will do further serious damage to Northern Ireland's image and will make it even more difficult to secure further orders for H&W. The workforce are thus well aware of these inevitable consequences. It is also worth adding that MOD is perfectly content with the progress on its ATS conversion contract at Harland and Wolff.

I am therefore quite sure that the right course is, as I believe you propose, to decide the AOR competition on commerial grounds and that political consideration should not have an undue bearing.

Copies of this letter go to the Prime Minister, John MacGregor, Peter Morrison and to Sir Robert Armstrong.

Yours sincerely

Damian Kingsley
(Private Secretary)

pp DR RHODES BOYSON MP
(Approved by the Minister and signed in his absence)

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SUMMARY OF PA REPORT

Tender Price

	AOR I	AORs I & II
Estimated Cost		
Labour	13.1	23.4
Materials	43.7	85.9
Overheads	30.4	56.9
Weapons	38.4	64.3
Total Estimated Cost	125.6	230.5
Tender Price	129.1	237.0
Profit included in tender	3.5	6.5

Labour

- Man hours based on current productivity performance levels.
- No productivity improvements assumed in contract despite introduction of new technologies and Performance Improvement Programme.
- Work content based on YARD's designs (YARD being experienced naval design consultant).
- Historical blue collar wage rate has averaged at some 11p per hour lower than rate in tender. The payroll element is subject to MOD escalation.
- As overheads are recovered based on labour costs, a contingency of £0.9m is built in due to the use of the higher than actual wage rate.

Material

- 70% of material is covered by supplier quotation sought by competitive tendering.
- Quotations are on a "fixed" price basis, ie subject to standard MOD escalation.
- All sub-contractors in excess of £25,000 submitted to MOD (in total £31m).

- BSC's mild steel prices are currently some 12% below amount included in tender.
- In general back-to-back arrangements sought even beyond area specified by MOD.

Overheads

Actual overhead rates compared to AOR tender:

	1985/86 (Forecast)	AOR
Shipbuilding	287%	250%
Drawing Office	120%	120%
Engineering	542%	500%

- An overhead reduction study is now in hand and is expected to produce early savings. No savings have however been assumed in the AOR bid.
- Overhead recovery excludes/rates an additional £4.0m overhead on AOR ie before savings would be incurred but this is still covered by the contingencies and profit included in the tender.
- Recovery assumes sufficient other workload in 1986/87. H&W are close to securing a major merchant order which would cover this gap.

certain excess capacity costs. On full overhead recovery

Weapons

- Being supplied by Yarrow, who are also experienced shipbuilders, and recently privatised. Installation to be supervised by Yarrow; H&W recruiting a weapons expert and have experience from ATS contract.
- Built in profit element of £0.6m in sub-contract, which is in effect a contingency.
- Delay and dislocation cover obtained for any delay resulting from Type 23.

Cash Flow

- Timing of receipts and payments results in a neutral position and hence no external funding required.

Commerical Risks

Lessened by

- Use of YARD - a specialised naval designer.
- Use of Yarrow with experience of weapons on Type 23 frigate.
- Prudent assumptions throughout especially on productivity.
- Introduction of project management.

Profit

- Tender includes no amounts specifically called contingencies but the use of prudent assumptions etc lead PA to believe these could amount to £2m.
- Together with built-in profit this gives a profit margin of some £5/6m (on AOR I) - more than sufficient to meet full overhead recovery.

From the Chairman
Globe Investment Trust P.L.C.

ELECTRA HOUSE
TEMPLE PLACE
VICTORIA EMBANKMENT
LONDON WC2R 3HP
01-836 7766

20th March, 1986

The Rt. Hon. Margaret Thatcher, MP,
10 Downing Street,
LONDON S.W.1.

Dear Prime Minister

The Swan Hunter management have recently received certain indications that the pending first AOR (fleet auxiliary vessels) order may be diverted to Harland & Wiolff against what we believe to be the advice of the professionals involved at the Royal Navy and MOD. The ostensible reason is price but this must be viewed against the background of massive subsidies received by Harland & Wolff. The investors in Swan Hunter Limited - Globe Investment Trust, Candover Investments, County Bank Development Capital, 3i, Legal & General Assurance, The Hoare Candover Exempt Fund and Scottish Eastern Investment Trust, together with many of the senior managers - subscribed their funds on the basis that the company would operate competitively in the private sector, and it was clearly agreed at the time that there would be no unfair competition from State-subsidised companies and the decision would be taken on commercial not political grounds. We do not consider Harland & Wolff, who so far this financial year have received subsidies greater than their wage bill, as equitable rivals for the AOR and regard it as unsatisfactory and against the principles of privatisation that having enthusiastically supported Swan Hunter's re-emergence as an independent company, the Government might be facing us on the first order with such unfair competition. The entire basis of our investment, which involves the jobs of 4,500 people in Newcastle, is what could be put at risk here.

As Chairman of Swan Hunter I would ask you personally to enquire into this matter so as to ensure equitable treatment for Swan Hunter - the Government can be sure of value for money for the taxpayer from Swan Hunter.

If this AOR order goes to Harland & Wolff the institutions and management that supported the buy-out of Swan Hunter will feel themselves most unfairly treated, since Harlands benefit from so much State support and are not required to be profitable.

Yours sincerely,

D.W. Hardy
Chairman, Swan Hunter Shipbuilders Ltd.

HOUSE OF COMMONS
LONDON SW1A 0AA

121

20 March 1986

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Dear Prime Minister

We know you have already received representations from Neville Trotter and others about the situation at Swan Hunters shipyard on the Tyne and the dependence of thousands of jobs on naval orders.

We fully support Government economic policy, including the need to make decisions on procurement on purely commercial and competitive grounds.

However in the case of the AOR 01 order we are concerned at reports that the competition may be unfair in that the Harland and Wolff tender may be cushioned by some degree of subsidy and the yard's nationalised status. (- as also set out in Neville's letter to you of 17 March)

We hope you would ensure that this matter is fully investigated and taken into account before a final decision.

You will know of the very severe impact on the yard, its future and its workforce if this order is not won. If circumstances of further high unemployment arise we hope more attention would be given to the implementation in the North of the sort of "enterprise culture" policies we asked for in our letter to Nigel Lawson before the Budget, a copy of which we enclose.

Yours ever

Piers Merchant MA MP
Newcastle Central

Michael Fallon MP
Darlington

MICHAEL FALLON, M.P.

HOUSE OF COMMONS
LONDON SW1A OAA

11th March 1986

Dear Nigel,

In your Budget preparations and in your review of the economy for the year ahead we hope you will take into account the progress of economic change in the North-East and the particular needs of our region.

We include below some suggestions which we believe would help speed-up the economic development of a region which has suffered severely from a range of structural problems exacerbated by failed Socialist solutions. These are ideas which would be implemented in addition to the Government's economic strategy for the nation as a whole which we fully support. We believe the fruits of these policies are now clearly evident and that it would be fatal to vary or draw back from their full implementation. Indeed, to slow down these policies now would deny their benefits to areas like the north-east.

We are also concerned that for historical reasons the region has less flexibility to seize opportunities than those regions where there is a stronger entrepreneurial spirit and a more widely diversified economic structure.

Our region is still too heavily dependent on the old smoke-stack industries despite some very welcome modernisation; there is a marked and dangerous drag on development from an adverse local political environment which constrains rather than inspires worthwhile, market-orientated investment.

We therefore firmly reject policies based on the tired and failed formulae of the past. We do not believe that the long-term future of our region will be helped by more Government subsidy, intervention or any increase in public spending. We do not support so-called "economic planning" and do not believe in the elixirs of development agencies, regional economic structures and, worst of all, the intervention in the business field of civil servants and their poorer cousins: local government officers.

/It is time .....

It is time for our region to do what the nation has increasingly done in the last seven years - encourage the natural growth of a realistic market economy. It was this that made the region great in the first place, and economic reality has not changed. Put simply, the North has got to attract investment in areas which will match supply to market demand and then organise its means of production to out-compete alternative suppliers. It must do this naturally and without subsidy otherwise the development will be distortive and ultimately will fail. It must do it without resort to sentiment or political prejudice, otherwise the process will not be natural or realistic.

That is not to say that there is no role for government. Government can create the conditions; the people of our region must exploit the right opportunities. To confuse these roles is to court disaster. When government (nationally or locally) starts to dictate the opportunities then development moves in the wrong direction.

There is a great deal to do to help create those opportunities in our region.

1. There is still enormous waste in the public sector to be eliminated. Every day in which subsidy continues to sustain inefficiency, and dated industry is a day in which the region moves further away from real economic development and growth. The region's resources become thus further distorted and misdirected making the ultimate reality that more painful when it comes. The same effect flows from local authority over-spending which chokes new businesses with penal rates and restrictive planning policies. We thus call for faster withdrawal of subsidies from the public sector industries and speeding up of privatisation in order to secure and endorse the spirit of competition. We also call for stricter rate-capping in order to reduce local authority spending in the region to the GREA levels. This would produce a marked reduction in rates and force local authorities to cut out the wasteful unnecessary spending. So would compulsory competitive tendering of all local council services.

2. We see little argument for increased public investment in the infrastructure. The region's infrastructure is excellent with very few weakpoints. Where there is a case for improvement this is included in government plans in any case. Road-building, sewer renewal etc. do not provide new or long-term jobs. It is a cruel delusion to pretend otherwise. The one area where we believe there is a case is in housing modernisation in the private sector. We would like to see further modernisation grants and loans made available to help improve the private housing stock. There is a proven need, it improves the quality of the region, and it provides work and employment in many small firms in the building sector.

/3. We want .....

3. We want to see greater incentive and motivation within the private sector. Undoubtedly this is best achieved by reducing Government burdens on business. We welcome reductions in interest rates and reductions in tax. We believe the region would benefit economically from a significant reduction in the basic tax rate. But the most helpful incentive would be a regional reduction in national insurance payments, particularly for employers but perhaps also for employees. This would make industry in all sectors more competitive, would encourage new investment and would help either increase disposable income or depress gross (but not net) wages. As a spur to development this would be fairer and less distortive than grants or subsidies and amounts to a lightening of the government burden rather than intervention.

4. A similar, and tested, set of incentives lies in the Enterprise Zone. We applaud the success of these zones, particularly on Tyneside. We would like to see them extended in time and geography. One negative effect is that at present they are discriminatory because of the tight boundaries which cut across natural economic areas. The answer lies in extending the boundaries to cover a wider industrial or urban area.

5. The enterprise concept could be extended to one specific sector of particular significance to the North-East - tourism. We would like to see a new innovation, Special Tourism Zones (STZs) where special incentives are offered to encourage the growth of the tourism and leisure industries. Development here has been slow in an area of proven potential. We would like to see three incentives: first STZ status for new investment in tourist-attractive facilities (eg historic sites, health spas, private museums, zoos, steam centres etc), second rates-free status for hotels (new and old) for a 10-year period within certain other defined areas, third a greater emphasis on tourist promotion based on a partnership between Government and the industry replacing the Northumbria Tourist Board.

6. Too much of the huge and very welcome increase in venture capital is concentrated in the southern half of our country. Some of that venture capital has gone, through the Business Expansion Scheme, into purely asset-backed projects such as wine cellars or property companies. It is quite wrong that ordinary tax-payers should pay 30 per cent tax to subsidise relief on essentially candy-floss schemes which do not create new jobs, or even new work: we want to see such projects subject to a job-creating criterion and the existing high relief confined to those in the assisted areas.

/7. The black economy ...

7. The black economy is rampant in the north-east, losing the Treasury significant revenue but contributing to enterprise within the region. Its growth is largely caused by government itself as people are deterred from going legitimate by high tax and excessive regulation. Government should acknowledge this and try to win over the underground economy. We propose an official amnesty until 1st October protecting all such workers from retrospective revenue demands before that date. After that much tougher penalties for non-declaration should apply with a lighter legislative framework and a £75,000 VAT registration ceiling.

8. Most government employment schemes are now working well. We should like to see more places provided on the Enterprise Allowance Scheme from which nearly 7,000 north-easterners have already benefited. The Job Start and Job Club experiments have provided valuable counselling for the long-term unemployed: the Billingham experiment should be copied more widely and further Job Clubs established in every large town. We also favour a move towards a system of "workfare" whereby unemployed people unable to find work within 6 months are required to work on community schemes in return for a higher rate of benefit after that period.

9. Inflation is low enough to obviate the need for heavier excise duties. Too many of these duties are entirely arbitrary, and unrelated to the cost of relevant public spending programmes. Tobacco taxation, in particular, has been increased sharply in recent years, destroying jobs in an industry that is already in difficulty. This year tobacco tax should be left alone.

Yours sincerely,

Michael Fallon

MICHAEL FALLON

Piers Merchant

PIERS MERCHANT

The Rt. Hon. Nigel Lawson MP
The Chancellor of the Exchequer,
HM Treasury,
Parliament Street
London SW1

THE ALLIANCE PARTY OF NORTHERN IRELAND

Headquarters:
88 UNIVERSITY STREET
BELFAST BT7 1HE

Telephone:
Belfast 224274/5

JC/ER/P.L.

19TH March 1986
R2213

Rt. Hon. Margaret Thatcher P.M.
Downing Street,
L O N D O N.

Dear Prime Minister

When we recently met I made a special plea that the Harland & Wolff bid for the new A.O.R. Contract should not be jeopardised because of the recent strike which took place on 3rd March. Despite the events of this day the industrial relations record of Harland & Wolff is excellent, particularly in comparison to Swann Hunter which I understand had an 8 week lock-out of staff and management in Autumn 1985.

If this order were to go to Harland & Wolff it would be crucial for jobs and stability generally in Belfast. Furthermore I am certain that it would do wonders for morale within the province as a whole, particularly for the moderate people who would interpret it as a sign that you were not casting us adrift, especially after the horrors of the bully-boy activity which was witnessed on Monday 3rd March.

Yours sincerely
John Cushnahan

John Cushnahan
PARTY LEADER

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 6328 (Direct Dialling)
01-218 9000 (Switchboard)

PARLIAMENTARY UNDER-SECRETARY OF STATE
FOR DEFENCE PROCUREMENT

USOFS(DP) 21/1/6

19 March 1986

Dear Rhodes.

We are now quite close to reaching conclusions on the competition for the Auxiliary Oiler Replenishment vessel (AOR).

In order to retain budgetary flexibility, we can only afford to order AOR 01 this month. Tenderers offered an option on AOR 02, open to the Autumn. I shall decide later whether to take this up or have a fresh competition.

Last week, I joined the Prime Minister for a meeting with Neville Trotter, of which you should by now have seen the record. He complained that the competition between Harland and Wolff and Swan Hunter has not been conducted on a fair basis because of financial support to Harlands through your Department. I have to recognise that the failure of Swan Hunters to win this order may prejudice the future viability of this newly-privatised yard's design team. You indicated in the House on 20 February 1986, that Harlands bids for warships are not subsidised. Before the Ministry of Defence reaches a decision, however, I know that the Prime Minister and other colleagues will want to be absolutely sure there has been fair competition and in particular that Harland's bid involved no cross-subsidies through allocation of overheads or in other ways. It would therefore be helpful to have what further assurance you can provide on this point.

We have also considered whether recent events at Harland & Wolff and their workforce's response to the recent one-day strike call should influence our view. I should therefore be grateful for your assessment of whether the Protestant leadership might interfere with this important Defence programme for political reasons.

/Tender

Dr Rhodes Boyson MA MP
Minister of State for Northern Ireland
Whitehall
LONDON
SW1A 2AZ

COMMERCIAL IN CONFIDENCE
CONFIDENTIAL

Tenders expire on Easter Monday. Subject to your comments on these points, the usual post tender negotiations, and John MacGregor's confirmation that he is content with the expenditure involved (which can be accommodated within our forward programme), I hope to announce the placing of an order through an inspired PQ and a press conference on Monday 24 March. We would give you advance warning if Harland & Wolff are successful.

I am sending copies of this letter to the Prime Minister, John MacGregor, Peter Morrison and to Sir Robert Armstrong.

With kind regards.

Yours

(JOHN LEE)

19 III
AM 86

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215 5186
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(Switchboard) 01-215 7877

From the Minister of State for Industry

Private Secretary to
THE HON PETER MORRISON MP

Richard Broadbent Esq
Private Secretary to
Chief Secretary
H M Treasury
London
SW1

Prime Minister 4
DGS
13/3

13 March 1986

SALE OF HALL RUSSELL

I am writing to inform you that we intend to announce tomorrow, 14 March, by means of a written Answer to an arranged Question that my Secretary of State has given his consent to the sale by British Shipbuilders of Hall Russell Ltd to Aberdeen Shipbuilders Ltd. A copy of the proposed Answer is attached. While BS will receive upto £2.1 million, the sale will involve it in net costs of up to £3.1 million. Apart from a nominal payment of £2,175 for the share capital, the sale consideration is deferred in two tranches of £1m. The first, due in six months, will be on conditions set out below. The second tranche will be paid in equal annual instalments between 1988 and 1992.

BS received 2 other offers considerably less attractive than Aberdeen Shipbuilders'. All the offers were cheaper options than closure, which BS estimate would cost £6.5 million in total, most of which would fall to Government as payment under the statutory redundancy scheme.

The first £1 million tranche of the sale consideration will be paid to British Shipbuilders only if Hall Russell does not get a merchant order of more than £5m in the next 6 months; if it gets a smaller order, BS will receive a proportionate part payment; only if Hall Russell gets a merchant order worth at least £5m will BS not receive any of this first tranche. This arrangement is complicated but replaces one which might have been considered as tantamount to Intervention Fund support for which Hall Russell is normally ineligible.

1WEBLR

The request for consent has been cleared at officials level with Treasury, MoD, and the No 10 Policy Unit. The Department's financial advisers also agree that consent should be given.

I am copying this letter for information to Mark Addison (No 10), Richard Mottram (Defence), Robert Gordon (Scotland) and Miss Joan MacNaughton (Lord President of the Council).

MALCOLM MCHARDY

ANNEX B

Draft Question and Answer

Q. To ask the Secretary of State for Trade and Industry if he will make a statement on the latest progress in privatising the interests of British Shipbuilders.

A. The Secretary of State has given his consent to British Shipbuilders for the sale of Hall Russell Ltd to Aberdeen Shipbuilders Ltd. The terms of sale, net of purchase consideration and other aspects of the transaction, represent a cost to British Shipbuilders of not more than £1.6 million. British Shipbuilders has also accepted a limited contingent liability in the event of redundancies. This is considerably less than the cost of closing the yard.

Mr. Clark: The House can reach its own conclusions and read the press, but I do not want to pick a fight with any of our Community partners or with any of the other countries involved. The facts speak for themselves. The failure to achieve harmony, a united attitude, or a level of contributions is at the root of the mishap.

Mr. Frank Cook (Stockton, North): Has the Minister tried to solicit American involvement as a means of rescuing the industry, or are Americans who invest in this country interested only in cleaning up profits and milking the economy?

Mr. Clark: I understand that America is not a member of the International Tin Council.

Vickers Shipbuilding and Engineering Ltd

11.18 am

The Secretary of State for Trade and Industry and President of the Board of Trade (Mr. Paul Channon): With permission, Mr. Speaker, I should like to make a statement.

I have today given my consent to the sale of Vickers Shipbuilding and Engineering Limited to the VSEL Employee Consortium plc. Its offer consists of a downpayment of £60 million, together with a profit-sharing arrangement for the period 1986 to1992, which could provide British Shipbuilders with further payments of up to £40 million in 1992 and 1993. The consortium has undertaken to complete and fund the remainder of the work on the submarine facilities project, which will modernise the production facilities at VSEL and enable the company to complete the Trident submarine programme in accordance with the Ministry of Defence's requirements.

As far as the Trident submarine programme is concerned, the consortium on Wednesday gave the Ministry of Defence an undertaking that it would negotiate a contract for the first Trident submarine on terms, price, programme and conditions which represent a significant improvement to the Ministry of Defence on the terms previously offered by VSEL while it remained under the control of British Shipbuilders.

The House will be aware that the consortium's bid was not the only one for VSEL. The commercial terms of the other bid were judged by British Shipbuilders and its financial advisers, in so far as they affected British Shipbuilders, to be superior to those of the consortium's bid. But there is a further term in the other bid, which I am bound not to disclose without the bidder's permission, which I found very difficult to accept. British Shipbuilders moreover acknowledged that other interests beyond the remit of British Shipbuilders to consider are involved in the sale. I agree with this. I have therefore decided that the consortium's bid is to be preferred. I wish the consortium well.

Mr. Alan Williams (Swansea, West): I strongly object to the right hon. Gentleman's grave discourtesy. He was aware that the Opposition had asked that the statement should be deferred until Monday, and not only did the Government persist in going ahead with it today, but they ensured that I received a copy of the statement only at 10.53 — seven minutes before the House was due to break into the morning business. As the Government were able yesterday to indicate to *The London Standard* that they planned to make some form of statement today, how on earth can the Secretary of State justify the discourtesy to the Opposition?

I also object to this furtive device of slipping such an important announcement through on a Friday. It is not only that it has taken up rare private Members' time—though that is an important consideration for hon. Members. It has also denied many hon. Members with a deep interest in this major policy decision a chance to ask questions on this important statement. Why was the matter so urgent that the statement had to be made this morning?

Does not the whole saga reveal the tensions and disagreements that exist between the Ministry of Defence

and the Department of Trade and Industry? Have we not clearly heard over the last two weeks the squelch of firm government? First, we had the extended deadline; then, within hours, the extension was cancelled; then the Government were to take the bids without first settling the contract for Trident; then, after Tuesday's deadline, according to *The Guardian,* the Government demanded theoretical terms for the Trident contract. I note from the statement that there are still no firm terms. When can we expect them to be finally negotiated?

How realistic was it to expect either of the parties to end months of haggling within a couple of days and give the Secretary of State a firm price? If, as *The Guardian* says and as the right hon. Gentleman's statement reveals, the terms in relation to Trident are purely theoretical and are only an indication of goodwill, how was the Secretary of State able to decide between the merits of the two bids? How was he able to decide whether the valuation was soundly based? What was the basis on which he eventually decided? I note that the right hon. Gentleman said that there is an element of confidentiality, but the House is entitled to more information about what led him to choose the bid which he says was the less commercial. Is it true, as has been suggested, that Trafalgar House was allowed to submit its bid after the deadline?

Hon. Members will want to know what assurances are given in the bid that has been accepted about the future of Cammell Laird and about the security of employment of those who will be affected by the decision. Is it not the ultimate absurdity that the Government are selling into private hands our only yard which is capable of producing nuclear submarines? Is it not an abuse of public funds to do that after £200 million of public money has been invested in the yard?

Mr. Channon: I am a little surprised at the terms of the right hon. Gentleman's question. The last thing that I expected to be told this morning was that our decision was an abuse of public funds. However, I apologise to the right hon. Gentleman and to the House for the fact that the statement has to be made this morning. I know that that is inconvenient—

Mr. Dennis Skinner (Bolsover): The right hon. Gentleman is hardly ever here.

Mr. Channon: I am occasionally here. The House surely understands that once I had come to a decision it would have been quite wrong for me not to disclose it to the House at the earliest opportunity. To do otherwise would be a very serious mistake. I am sorry if the right hon. Gentleman and his colleagues have been inconvenienced, but I fear that there was no alternative.

I cannot accept what the right hon. Gentleman says about disagreements between my right hon. Friend the Secretary of State for Defence and myself. We have worked in complete harmony. I made clear in my statement the reasons why we have come to this decision, which I am sure will be welcomed by some Members.

Mr. Cecil Franks (Barrow and Furness): On behalf of the management, employees, local communities and the whole of the north-west, may I express deep gratitude and pleasure at my right hon. Friend's announcement? I am sure he will agree with me that the decision ably and amply demonstrates the Government's confidence in the north-west and their firm commitment to the principle of wider share ownership, with the opportunity for employees to share in the fruits of their labour. I assure my right hon. Friend that the premier submarine builder of the nation can look forward with great confidence to the 21st century and continue to serve the nation as it has for the past century.

Mr. Channon: I am very grateful to my hon. Friend for his support.

Mr. Gregor MacKenzie (Glasgow, Rutherglen): During the discussions that the Secretary of State and his colleagues had leading up to the statement, was there any discussion about the apportionment of the submarine programme? The right hon. Gentleman will be conscious of the fact that we on Clydeside felt that we got a shabby deal on that matter, and, on behalf of my colleagues in the west of Scotland, I should like to know whether there is to be a reapportionment of the substantial submarine programme and whether we on Clydeside are to get a share of it.

Mr. Channon: With respect to the right hon. Gentleman, that question raises different issues from those with which I am dealing. However, I am told by my hon. Friend the Minister of State that the answer to his question is no.

Sir Antony Buck (Colchester, North): Is my right hon. friend aware that his statement will be widely welcomed on the Government Benches, particularly as was courteous enough to apologise to the House for making a statement on a Friday, which, as a general rule, is inconvenient? Will my right hon. Friend confirm that his solution provides the best chances of the Royal Navy getting its ships and submarines on time and on cost?

Mr. Channon: I am sure that this provides a very good assurance for that to happen.

Mr. Frank Field (Birkenhead): I thank the Secretary of State for his statement and express the relief that will be felt in Cammell Laid this morning about the decision that he has made. Before the right hon. Gentleman finally ties up the deal, will he Wirral Members, so that we can ensure that Cammell Laird is effectively represented on the board that will run the new company?

Mr. Channon: I am extremely grateful to the hon. Gentleman for his support. I note the views in the latter part of his question. I am not sure that that is a matter for me, but I shall certainly study what he has said. I am, of course, always available to see hon. Members who wish to see me.

Mr. Peter Thurnham (Bolton, North East): I join my hon. Friend the Member for Barrow and Furness (Mr . Franks) in congratulating the Government on deciding to privatise the yard. I am sure that all hon. Members from the north-west will join me in congratulating the Government on taking such an important decision for the largest engineering complex in the country and on their commitment to wider share ownership. I am sure that the committed work force led by Sir David Nicolson and Rodney Leach, will be successful in world markets as well as in satisfying all the requirements for defence in this country.

Mr. Channon: I am grateful to my hon. Friend for his support.

Mr. John McWilliam (Blaydon): Will the Secretary of State accept that his statement is not acceptable because

[Mr. John McWilliam]

it is incomplete without the clause which he seems to suggest is commercially in confidence? Will the right hon. Gentleman tell us what was worrying him about that aspect, because I am sure that we would all like to know? Will the right hon. Gentleman also tell the House how many jobs he expects to remain in British shipbuilding after the management buy-out?

Mr. Channon: No, Sir. I made it clear in my statement to the House that I am bound not to disclose the terms of the other bid without the permission of the bidders. Therefore, I have nothing to add to what I said earlier. As to the second part of the right hon. Gentleman's question, that is a matter for the consortium.

Mr. Christopher Chope (Southampton, Itchen): I congratulate my right hon. Friend on the wise counsels that have prevailed in this instance. May I ask him to confirm that 38 per cent. of the work force confirmed, when asked the question, that their principal reason for being in favour of the management buy-out and privatisation was that it would give them an incentive to work harder? Is my right hon. Friend also able to say whether the terms on which this agreement has been negotiated will not be such as to mean that Vosper Thornycroft will be unfairly hindered in its efforts to compete freely and openly in bids for merchant and Royal Navy ships?

Mr. Channon: I am sure that it can compete, and I am grateful to my hon. Friend for his support. I note what he said in the earlier part of his supplementary question.

Mr. Robert Maclennan (Caithness and Sutherland): As a Member of Parliament whose constituency has for many years enjoyed a close relationship with Vickers through it subcontracting work, may I say that, of the options before the Minister, it appears that he has chosen the better one? However, it would be helpful if he could say more than he has done in answer to the questions that were put to him by the right hon. Member for Swansea, West (Mr. Williams). Is he able to say whether the arrangement includes the initial proposal that shares in the consortium should be offered for purchase by members of the local communities surrounding the shipyard?

Mr. Channon: I am grateful to the hon. Gentleman for his support. I understand that the answer to the latter part of his supplementary question is yes.

Mr. Cyril D. Townsend (Bexleyheath): Is my right hon. Friend aware that his decision is likely to be widely welcomed in the defence establishment as sound and sensible? Will he comment on his discussions with the two bidders about the theoretical cancellation of the Trident programme in the event of a Labour Government being returned to power at the next general election, and say what guarantees, if any, were given to the two bidders about that possibility?

Mr. Channon: I am grateful to my hon. Friend for what he said in the first part of his supplementary question. However, any discussions with the bidders must remain confidential.

Mr. Eric Forth (Mid-Worcestershire): Will my right hon. Friend accept that this is an excellent example of a policy which is of the greatest benefit to taxpayers, employees and all those involved with the industry? Does he agree that there is nothing to be feared from the provision of vital defence supplies by the private sector, as this has been done very successfully in the United States for many decades?

Mr. Channon: I note what my hon. Friend said, and I am grateful to him.

Mr. Don Dixon (Jarrow): Obviously we welcome the fact that the Secretary of State has accepted this bid rather than the Trafalgar House bid. However, does he realise that what he has said today sounds the death knell for British Shipbuilders? By selling off its profitable warship yards the Secretary of State has virtually killed off British Shipbuilders. When Mr. Day goes to British Leyland, we must hope that he will not have the same effect upon our car industry as he has had upon our British shipbuilding industry.

Mr. Channon: With respect to the hon. Gentleman, I think that uncharacteristically he is being a little unfair.

Employment Rights

Question again proposed.

11.34 am

Mr. Foot: I should like to return to the topic with which I was dealing when I was so rudely interrupted by at least one Government botch, if not two Government botches, although I suppose that on the second count we must give the Government the benefit of the doubt, even though there are some difficulties there.

I said that I wanted to refer to the Wapping dispute. I say that all the more in the light of the reply, or the non-reply, that the Under-Secretary gave to my hon. Friend the Member for Newham, North East (Mr. Leighton) on Monday night. To all of the questions that were put to him by my hon. Friend about the Government's view on any of these matters and what they would do about them, the Minister gave no reply. He turned aside to other aspects of the matter.

This is a most serious dispute. It is serious for those individuals who have been sacked. From 5,000 to 6,000 people have lost their jobs without compensation, redundancy, or even any dole at the moment. It is a serious crisis for them. If this kind of industrial operation were to be repeated or tolerated by the Government of the day, the consequences for British industrial relations would be very serious indeed.

I have been interested in the printing trade for many years. Indeed, if I have any interest to declare in the matter, it is that I have been a member of the National Union of Journalists for 50 years or so. The NUJ has a deep interest in this dispute because its members have been profoundly divided by what has occurred. I shall try to keep my language as temperate as possible, because I am seeking, on behalf of those who have been so gravely injured — the members of SOGAT '82, the NUJ and others — a solution to the problem and I want the Government's assistance in achieving that aim.

To illustrate what happened I shall quote from an article that was printed in *The Times* a week or so after the move to Wapping. This article was written by Mr. Longley, the religious affairs correspondent of *The Times*. I do not know whether the fact that he was writing as the newly appointed father of the NUJ chapel of *The Times*, the previous father of the chapel having refused to go to

Qu Press DIC

JU669
Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
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7 March 1986

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Prime Minister 2

DRS 7/3

Dear David,

THE PRIVATISATION OF VICKERS SHIPBUILDING AND ENGINEERING LTD

I attach for your information a copy of the statement which my Secretary of State made in the House this morning on this subject. I am copying this letter and attachment to Private Secretaries to Cabinet Ministers.

Yours ever,
Michael

MICHAEL GILBERTSON
Private Secretary

Enc

1786 1986 BOARD OF TRADE BICENTENARY

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FINAL

THE PRIVATISATION OF VICKERS SHIPBUILDING AND ENGINEERING LTD

With permission, Mr Speaker, I would like to make a statement.

2 I have today given my consent to the sale of Vickers Shipbuilding and Engineering Limited to the VSEL Employee Consortium plc. Their offer consists of a downpayment of £60 million together with a profit sharing arrangement for the period 1986-1992 which could provide British Shipbuilders with further payments of up to £40m in 1992 and 1993. The Consortium has undertaken to complete and fund the remainder of the work on the Submarine Facilities Project which will modernise the production facilities at VSEL and enable the company to complete the Trident submarine programme in accordance with the Ministry of Defence's requirements.

3 As far as the Trident submarine programme is concerned, the Consortium on Wednesday gave the Ministry of Defence an undertaking that it would negotiate a contract for the first Trident submarine on terms, price, programme and conditions which represent a significant improvement to the Ministry of Defence on the terms previously offered by VSEL while it remained under the control of British Shipbuilders.

4 The House will be aware that the Consortium's bid was not the only one for VSEL. The commercial terms of the other bid were judged by British Shipbuilders and their financial advisers, insofar as they affected British Shipbuilders, to be superior to those of the Consortium's bid. But there is a further term in the other bid (which I am bound not to

disclose without the bidder's permission) which I found very difficult to accept. British Shipbuilders moreover acknowledged that other interests beyond the remit of British Shipbuilders to consider are involved in the sale. I agree with this.

5 I have therefore decided that the Consortium's bid is to be preferred.

6 I wish the Consortium well.

JF5AZE

07 MR 93 PMSC

10 DOWNING STREET

Lord Privy Seal

I am told that the printing of prospectuses by the Land Bank would have to be postponed by two weeks if the decision is not announced today.

cc ~~DN~~
PRESS
DIC
PU

FINAL

THE PRIVATISATION OF VICKERS SHIPBUILDING AND ENGINEERING LTD

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6 I wish the Consortium well.

JF5AZE

CONFIDENTIAL

PRIME MINISTER

VICKERS SHIPBUILDING

The Attorney General advises that a delay of a few days in taking a decision would be unimportant from a legal point of view.

He says, however, that the Consortium is very fragile and a delay risks break-up.

I attach figures for the Consortium, which suggest that it is soundly financed.

Could you confirm please that you do not want to go ahead with the discussion at E(A) so that I can stand down the Attorney General, who would otherwise be coming to E(A)?

Paul I think we should wait until next week - early. Agreed? MT

DGN

David Norgrove

6 March 1986

DG2AWY

Competition in the Defence Sector

In Dr. Leach's letter of 12th February, our clients pointed out that VSEL, under the Consortium's ownership, would be able to play an important role as a strong independent defence contractor, competing across a wide range of products. HM Government attributed a saving of £10 million to competition for the three Upholder diesel-electric submarines ordered in January. We understand that the Royal Navy plans a 10 year programme for building and introducing Upholder submarines. Similar savings for future submarine orders can be secured through competition if the Consortium's bid succeeds. This would not be the case if the VSEL Group was taken over by the parent company of its major competitor. This factor should also weigh heavily on the Consortium's side when rival bids are considered.

SFP

The Consortium's bid is based on a commitment to complete and fund the remainder of the work on the SFP. This recognises HM Government's preference for having no further funding responsibilities in connection with the SFP. It will mean a direct saving for the public sector of £92 million. The SFP will also offer substantial benefits for HM Government when completed since it will provide an efficient and cost effective means of building submarines and surface warships. Already HM Government is anticipating savings of around £20 million in the first Trident contract directly as a result of the SFP, with the prospect of enhanced savings for the remainder of the Trident programme. In this way, HM Government will recoup the costs of construction that it has borne prior to privatisation.

Financial Strength of the Consortium

The Consortium's financial projections, based on the Corporate Plan approved by your client, show a sound financial structure over the next ten years. We should stress that the projections do not envisage any recourse to shareholders over the period and have been prepared on a prudent and conservative basis, thereby giving the Consortium a comfortable margin against any adverse unforeseen circumstances. They have been the subject of formal in-depth reviews by KMG Thomson McLintock, and ourselves, as Issuing House, and have been scrutinised by the institutions backing the bid. All the key ratios, such as gearing, interest cover and cash flow are within normal commercial limits (summarised figures for the next five years are given in Appendix 3). We have already held discussions with MoD to confirm the soundness of the present and projected financial structure for the Consortium. We should be glad to expand on this further.

(attached)

Golden Share Arrangement

The "golden share" arrangement enshrined in the Consortium's Articles of Association guarantees that the VSEL Group remains under national direction. It provides the means of limiting the shareholding of any shareholder to 15 per cent. of the voting equity and requires the Chairman, the Chief Executive and a majority of the Directors to be British citizens.

APPENDIX III

VSEL Consortium PLC

Summarised forecast financial information

Year to 31 March	1987	1988	2989	1990	1991
Turnover	£380m	£440m	£506m	£523m	£553m
Profit before tax	£ 12m	£ 11m	£ 17m	£ 20m	£ 32m
Interest cover	2.60	1.86	2.28	2.77	4.40
Net assets	£208m	£216m	£230m	£246m	£274m
Gearing	31%	52%	41%	37%	24%

Trafalgar House

PUBLIC LIMITED COMPANY

1 BERKELEY STREET · LONDON W1A 1BY

Telephone 01 499 9020
Cables TRAFULGENT
Telex 921341

Eric W. Parker,
Group Chief Executive

CONFIDENTIAL

6th March 1986

The Rt. Hon. Paul Channon MP,
Secretary of State for Trade and Industry,
Department of Trade and Industry,
1-19 Victoria Street,
London SW1H OED

Dear Secretary of State

VICKERS SHIPBUILDING AND ENGINEERING LIMITED ("VSEL")

As I mentioned in my letter dated 5th March 1986 it was our understanding that the preferred bidder for VSEL had been identified by British Shipbuilders to the Department of Trade and Industry on 28th February 1986. You will therefore understand my concern at the phrase "if you are declared the preferred bidder" in the first paragraph of the letter to me from Mr. Levene of the Ministry of Defence dated 3rd March 1986 (a copy of which is enclosed).

In the circumstances, would you please be good enough to let me have answers to the following questions:-

(a) Has British Shipbuilders submitted to you for your consent a preferred bid for VSEL as envisaged by the procedure for bids set out in paragraph 7 of the letter dated 29th November 1985 from Lazard Brothers & Co. Limited to Trafalgar House?

(b) If so, was that preferred bid the Trafalgar House bid made in my letter to Lazards dated 25th February 1986?

(c) When is it anticipated that you will decide whether or not to give your consent to the preferred bid in accordance with paragraph 7 of the letter from Lazards mentioned above and sought by British Shipbuilders within Section 3(3) of the Aircraft and Shipbuilding Industries Act 1977?

cont'd...

Directors: Sir Nigel Broackes (Chairman) E. W. Parker (Group Chief Executive)
G. H. B. Carter W. B. Slater, CBE VRD The Marquess of Tavistock V. A. Grundy D. M. Taylor A. W. Clements
G. E. Knight, CBE D. M. Calverley J. W. S. Fletcher I. Fowler J. R. Williamson A. G. Kennedy, OBE
Registered Office: 1 Berkeley Street, London W1A 1BY Company No. 867281 Registered in England

The Rt Hon Paul Channon MP
Secretary of State for Trade & Industry
London

6th March 1986

There has been intense lobbying by the VSEL Management Consortium which has emphasised that their proposals envisage a small proportion of the share capital in the consortium company being held by VSEL employees. In this context it may be helpful if I amplify the reference made in our bid letter to Lazards dated 25th February 1986 under the heading "Employee Benefits".

If Trafalgar House acquires VSEL a large number of VSEL employees will be eligible to participate in our Government approved Profit Sharing Scheme, under which they would receive Trafalgar House shares at no cost to themselves. As a result we estimate that at least 4,500 VSEL employees would become shareholders in Trafalgar House later this year, with the number increasing in future years as further allocations of shares are made under the Profit Sharing Scheme. In addition senior executives of VSEL will be eligible to participate in our Share Option Scheme.

I did request a meeting with you prior to bids being submitted. If you feel a meeting at this time would be helpful I would be pleased to come to see you.

I am sending copies of this letter to the Prime Minister and the Secretary of State for Defence.

Yours sincerely,

Eric Parker

CONFIDENTIAL
COMMERCIAL-IN-CONFIDENCE

cc BTUP

Chancellor of the Duchy of Lancaster

for E(A) meeting folder.

PRIME MINISTER

VICKERS/CAMMELL LAIRD

I regret that I shall not be able to attend the further meeting of E(A) arranged for tomorrow morning, at which you are to consider the bids for VSEL.

I should tell you that it is my view that we should allow the bid from Trafalgar House to go forward. There are, as Paul Channon set out in his minute, a number of good reasons for wishing to accept the employee consortium offer. We should by no means underestimate the importance of retaining and building on the enthusiasm of the workforce at Vickers and Cammells.

But, equally, there are compelling reasons for preferring the TH bid, quite apart from the simple one that it has made the highest offer. Trafalgar House have shown a commitment of a very substantial kind towards private sector shipbuilding. It has been shown to be a risky and potentially costly business to be in. Nonetheless, TH have shown their further commitment by this offer for VSEL. We should not underestimate the strength of their reaction if their bid (which, of course, they believe strongly to be the preferred bid in financial terms for BS) were to be rejected, even if any case for judicial review were not be successful.

I am sure that TH will themselves not be unmindful of the need to carry the enthusiasm and commitment of the workforces at Vickers and Cammells. I would also expect wise heads in the North-West to be aware of the need for the financial backing and resources of a company like TH if they are to be able to pursue a successful path in shipbuilding in the long run.

I am sending a copy of this minute to members of E(A), George Younger, Michael Havers, and to Sir Robert Armstrong.

NT

NORMAN TEBBIT

6 March 1986

CONFIDENTIAL

PRIME MINISTER

PRIVATISATION OF VICKERS/CAMMELL LAIRD

The Lord President will not be at EA tomorrow morning. His Private Secretary telephoned to say that he would want EA to give very careful consideration to the political aspects of this decision. Feelings in the North West, in areas which he knows well, are running extremely high. He believes that economic considerations would have to be "strongly unequal to think in terms of refusing the Consortium offer".

A further point the Committee might consider (for the avoidance of doubt, from me, not the Lord President) is how this would be seen in relation to the Landrover decision. The arguments here point both ways.

If the decision goes in favour of the Consortium bid in this case, even though this bid is lower than that of Trafalgar House, people might expect the Government to accept the management buy-out for Landrover. If the arguments in favour of the one (employee participation, etc., and modification) are overriding in the one case, why not in the other two?

Against this, if the Government accepts the Consortium bid for Vickers, it could be argued that this would make it easier to reject the management buy-out for Landrover: the Government would be seen to be maintaining its support for employee participation, but in the case of Landrover it could be argued that the industrial considerations and the price differential had to outweigh this aspect, regrettably.

My own suggestion would be that having recognised these arguments, the Committee could decide that the Vickers decision was best taken on its own merits.

Amanda Ross

pp DN

6 March, 1986.

JD3AKF

CONFIDENTIAL

cc B/HP

COMMERCIAL IN CONFIDENCE

PRIME MINISTER

VSEL SALE : FINANCIAL STRENGTH OF THE EMPLOYEE CONSORTIUM

Colleagues may find the following additional information on the Consortium's financial position helpful.

2 The Consortium's financial position is described in the attached extract from their offer letter with the figures set out in Appendix 3. The extract from the offer letter makes clear that the figures have been reviewed by Thomson McLintock, and scrutinised by the institutions backing the bid. Although the Consortium has not been prepared to reveal the absolute structure of their bid, we know that they plan to raise £35m by way of share capital (£28m from the institutions, £7m from workforce and local residents), £40m by way of a long-term loan note (1986) from the institutions and we believe that they have short-term facilities of some £60m. The gearing is initially high (rising to 52 per cent in 1988 reflecting the cost of completing the Submarine Facilities Project and before the full benefits of the Trident submarine programme come through). Gearing however falls to the more normal level of 24 per cent by 1991.

3 The view of British Shipbuilders' financial advisers, Lazards, is that the finance available once the offer has been subscribed is adequate for the business foreseen in the VSEL business plan. If, however, they were to seek to diversify or expand the business significantly they would need more capital. They do, however, plan to place shares in the Stock Market later this year and might then or later be able to raise further finance if required. Ministry of

JF4AYS

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Defence is also satisfeed that the Consortium have adequate financial strength to undertake major contracts, though as I pointed out in my minute of yesterday MoD do consider the Consortium to be financially vulnerable to some extent.

4 I am circulating this to Members of E(A), the Lord President the Secretary of State for Defence, the Attorney General and the Secretary to the Cabinet.

PC

PAUL CHANNON
6 March 1986

DEPARTMENT OF TRADE AND INDUSTRY

JF4AYS

EXTRACT FROM CONSORTIUM's OFFER LETTER

(from Lloyds Merchant Bank)

Financial Strength of the Consortium

The Consortium's financial projections, based on the Corporate Plan approved by your client, show a sound financial structure over the next ten years. We would stress that the projections do not envisage any recourse to shareholders over the period and have been prepared on a prudent and conservative basis, thereby giving the Consortium a comfortable margin against any adverse unforeseen circumstances. They have been the subject of formal in-depth reviews by RMG Thomson McLintock, and ourselves, as Issuing House, and have been scrutinised by the institutions backing the bid. All the key ratios, such as gearing, interest cover and cash flow are within normal commercial limits (summarised figures for the next five years are given in Appendix 3). We have already held discussions with MoD to confirm the soundness of the present and projected financial structure for the Consortium. We should be glad to expand on this further.

APPENDIX III

VSEL Consortium PLC

Summarised forecast financial information

Year to 31 March	1987	1988	2989	1990	1991
Turnover	£380m	£440m	£506m	£523m	£553m
Profit before tax	£ 12m	£ 11m	£ 17m	£ 20m	£ 32m
Interest cover	2.60	1.86	2.28	2.77	4.40
Net assets	£208m	£216m	£230m	£246m	£274m
Gearing	31%	52%	41%	37%	24%

MR NORGROVE 5 March 1986

SALE OF VICKERS SHIPBUILDERS

The Trafalgar House bid of £82.5m is some £10 to £15m more than the VSEL Consortium. Following on discussions prior to the bid deadline last week, both bidders had been asked to confirm whether they would agree to the MOD Trident contract being on no worse terms than those currently proposed by the MOD. The employee Consortium have agreed to this; TH have merely said that they will match whatever the Consortium say they can do.

In normal circumstances equity would demand that the TH 'matching offer' be thrown out, otherwise anybody could merely offer £1 more than the highest of all the bona fide bids. However, because of the somewhat unsatisfactory way in which the bids have so far been handled, it is rather more difficult to take such a cavalier approach. TH are already threatening judicial review should they lose. But if Vickers win the employee Consortium could with justice be equally upset.

The right answer must surely be to insist that TH come forward with a concrete proposal of their own for the Trident contract. If they refuse it will be more difficult for them to claim injustice.

TH may also threaten to close Scott Lithgow and blame it on the Government. But TH have never been backward in rationalising their businesses, and if they did acquire Vickers two yards then this must surely make Scott Lithgow's closure more likely, not less. In any event TH have already had more than their money's worth on Scott Lithgow. They were paid £70m initially and then a further £70m to meet various liabilities, and are seeking yet a further £50m which is currently in arbitration.

TH are far more likely to make efficiency improvements at Vickers than the Consortium, but it is arguable whether any of the resulting improvements will show up in cost reductions to the MOD. Against this, selling to the Consortium would enhance competition for MOD orders.

The Government is in for a row whatever decision is taken. Given that the Consortium promotes our goals of competition and wider shareownership we believe, particularly in the light of the forthcoming Land Rover-Leyland privatisation, that on balance it would be best to accept the Consortium's bid.

Peter Warry

PETER WARRY

cc PJ/YP.

CONFIDENTIAL

P 01946

PRIME MINISTER

PRIVATISATION OF VICKERS/CAMMELL LAIRD

Fag A — Minute of 5 March from the Secretary of State for Trade and Industry to the Prime Minister.

BACKGROUND

Steady progress has been made with the piecemeal privatisation of British Shipbuilders' (BS) warshipbuilding yards. The Government's objective was to complete the process by 31 March 1986. A decision is required now on the sale of the Vickers yard at Barrow-in-furness and the Cammell Laird yard at Birkenhead, which are run together as a single unit. The Vickers yard will essentially be devoted to the building of Trident submarines; Cammell Laird was rescued by the allocation last summer of an order for a Type 22 frigate, and has subsequently secured orders for some small submarines. In order to give the bidders time to raise the necessary finance, and pay it over to the Government by the effective deadline, Maundy Thursday 27 March, a decision needs to be announced on 7 March.

2. The bidders are Trafalgar House (TH) and an Employee Consortium (EC) put together by the management of Vickers Shipbuilding and Engineering Limited (VSEL). TH have bid £82½ million, plus a further £2½ million for each Trident submarine beyond the first (up to three) ordered by 25 February 1987. (TH have also sought to claw back all the bid price if the Ministry of Defence are unwilling to agree to a contract for the first Trident submarine (SSBN05) by 25 February 1987 and sign it by 25 February 1988.) The EC have bid £60 million, together with a profit-sharing arrangement which could produce further payments of between £10 and £40 million in 1992 and 1993. The Net Present Value (NPV) of the TH bid is assessed at £82½-85 million, and that of the EC at £60-81 million (with a central probability of £70-75 million). On the face of

things, therefore, the TH bid is worth £10 to 15 million more than the EC's.

3. TH is a strong and aggressive group with wide experience and contacts overseas. It already owns the Scott Lithgow (SL) yard on the Clyde, which will run out of work by the end of this year unless new MOD or offshore oil installation orders can be secured. TH have nonetheless indicated that they would not intend transferring work from the Barrow or Birkenhead yards to keep SL going. The EC is, not surprisingly, much weaker financially, but there would clearly be other advantages - managerial and political - in a successful management buy-out which commanded the enthusiastic support of the workforce. It is a condition of both bids that the purchaser will meet the remaining £90-92 million costs (out of a total of £230 million) of the Submarine Facilities Project (SFP) at Barrow which is essential for the production of Trident submarines. (£140 million of this cost has already been met by the DTI through BS.)

4. The issue is further complicated by the terms of the contract for SSBNO5. The Barrow yard will be the monopoly supplier of Trident submarines, and MOD have accordingly invited the competing bidders to indicate on what terms they would be willing to undertake this contract. Since each submarine is likely to cost around £400 million, even a 5 per cent variation in the contract price would more than outweigh the difference between the two bids for the yard. The EC have told MOD today (5 March) that they would be ready to build the submarine on terms slightly more favourable to MOD than has hitherto been negotiated. TH have offered to undertake the contract on the terms hitherto negotiated, subject to any modifications in favour of MOD offered by the EC. MOD and DTI officials are now seeking legal advice on whether TH's method of over-jumping the EC is fair and acceptable.

5. There are two further aspects to be considered:

i. BS have to consent to the terms of the sale (since they are actually the vendor), and they will naturally prefer the higher bid;

ii. the EC have offered a 'golden share' to MOD, who would wish to see this offer taken up in an appropriate way.

MAIN ISSUE

6. The main issue is the choice between TH and the EC. The Secretary of State for Trade and Industry proposes that he should announce the decision by Written Answer on 7 March, and settle afterwards, in consultation with the Secretary of State for Defence and the Chief Secretary, Treasury the appropriate form of golden share or undertaking on ownership.

7. The advantages of TH are that the immediate proceeds are higher; that the consent of BS will more readily be obtained; that there should be no 'Accounting Officer' problems; and that, if TH's form of undertaking is accepted as legitimate for the purposes of the competition, the first Trident submarine will be built on terms no less favourable than the EC would offer.

8. The EC has the advantages of strong management commitment, and probably strong support from the workforce; strong local political support; and the contribution it makes to the Government's objective of securing wider share ownership, and particularly employee share ownership. Against this, the EC does not have TH's financial strength and breath of experience, and there is some risk that if the decision were to be in favour of EC, TH might seek to represent that it had been taken improperly. (We have heard since the brief was written that TH have today written to DTI threatening an application for judicial review of the Government's decision if they are unsuccessful.)

9. Depending on legal advice on the form of TH's undertaking on the submarine contract, the decision must in the end rest largely on a political judgment. Although economic considerations would tend to favour TH, a respectable case could be constructed for regarding the EC bids for the yard as no significantly

lower than that of TH, while the greater management commitment in the case of the EC bid should eventually deliver better work at lower cost for MOD when the Trident submarines are built. We understand that the Secretary of State for Trade and Industry is inclined to favour the EC bid, essentially on these grounds. If the legal advice were that TH should not receive credit for the contract improvements offered by the EC, the case in favour of the latter would be appreciably stronger.

HANDLING

10. You will wish to invite the Secretary of State for Trade and Industry to set out the issues and indicate his recommendation. The Secretary of State for Defence and the Chief Secretary, Treasury will wish to state their positions, and the Attorney General may wish to express a legal opinion. Other Ministers will have views on the financial and political aspects of the choice.

CONCLUSION

11. You will wish the Sub-Committee to reach conclusions on

i. the choice between Trafalgar House and the Employee Consortium as purchaser of VSEL;

ii. the method and timing of the announcement of the Government's decision; and

iii. a remit to the Secretary of State for Trade and Industry, in consultation with the Secretary of State for Defence and the Chief Secretary, Treasury to make appropriate arrangements for a 'golden share' or undertaking on ownership.

J B UNWIN
Cabinet Office
5 March, 1986

CC BU
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PRIME MINISTER

SALE OF VICKERS SHIPBUILDING AND ENGINEERING LIMITED (VSEL)

We have agreed to consider at E(A) tomorrow whether Trafalgar House or the VSEL Employee Consortium should be permitted to buy Vickers Shipbuilding and Engineering Limited from British Shipbuilders. I would propose to announce my consent to the sale of VSEL to the successful bidder as soon as practicable. It is essential to keep to this timetable if the VSEL Employee Consortium is successful in order to allow them to maintain the public momentum of their bid and to win financial backing from the workforce before Easter.

2. The VSEL Group comprises the Vickers Shipbuilding and Engineering Ltd yard at Barrow and its subsidiary Cammell Laird at Birkenhead. VSEL is the sole supplier to the Ministry of Defence for nuclear submarines and is the designated yard for the Trident submarine. VSEL has been negotiating with the Ministry of Defence the contract for the first Trident submarine (SSBN05). These negotiations are not yet complete. The Government has, through British Shipbuilders, been funding a £230m investment in the Submarine Facilities Project (SFP) at Barrow to enable VSEL to modernise and improve its production methods and to allow it to produce the Trident submarines in time to meet the Ministry of Defence's needs. Some £90m-£92m remains to be

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spent. It will be the responsibility of the new concern to complete the SFP at their own expense. Cammell Laird recently won an MoD order for three conventional submarines.

3. Despite initial wider interest in the company, only two bidders came forward - Trafalgar House and the VSEL Employee Consortium:

The value of the Trafalgar House bid is £82½m if MoD is contractually committed to buying the first Trident submarine (SSBN05) by 25 February 1987 with a further £2½m (maximum £7½m) for each further Trident submarine ordered by that date. Their bid is probably worth some £82½m-£85m. They have, however, sought to clawback all of the bid price against the possibility that the MoD will neither agree to a contract for SSBN05 by 25 February 1987 nor sign one by 25 February 1988. They have however said that they would negotiate in good faith and use their best endeavours to sign a contract in this period.

The VSEL Employee Consortium have offered a £60m initial consideration and a profit sharing arrangement which could produce further payments of between £10m and £40m in total in 1992 and 1993. While this could lead to higher total payments (up to £100m) in money terms, the Net Present Value (NPV) of the Consortium bid, discounted at 10 per cent p.a is between £60m and £81m. The likely NPV is probably in the range £70-£75m.

4 It is not easy to make a direct comparison of the two offers. At best, the Trafalgar House offer is some £25m better than the Consortium's; at worst (ignoring the Trident clawback clause) it is £1½m better. The

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more likely range is that the Trafalgar House offer is £10-£15m better.

5. Both bidders say that they intend to continue shipbuilding at Barrow (VSEL) and Birkenhead (the Cammell Laird subsidiary). Trafalgar House specifically state that they have no plans to transfer work from Barrow or Birkenhead or to close Cammell Laird. On the other hand if Trafalgar House are successful they will face awkward decisions affecting the future of both Cammell Laird and Scott Lithgow which could have political repercussions. The workforce at Scott Lithgow is now 2,000 reduced from 3,500 at the time of the sale to Trafalgar House in March 1984, and is likely to reduce further to some 1,200 even if new work can be found. At present the only work at Scott Lithgow is a rig for Britoil expected to be completed in November. There is a number of other offshore projects, none certain, as well as the offer from MoD of some small vessels (subject to satisfactory terms) following the award of the 3 conventional submarines to Cammell Laird. If no work is found by November Trafalgar House will have to decide whether to close Scott Lithgow.

6. There are other aspects to be considered. On the one hand Trafalgar House is a financially strong and aggressive group with wide experience and contacts overseas. They have said that they would assist in broadening the base of VSEL's business. The Ministry of Defence while making it clear that it has no objection in principle to either bidder, has told my officials that MoD consider the Consortium to be financially vulnerable to some extent.

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7. On the other hand, the Consortium's bid if successful seems likely to win wide backing from the management, the workforce and local residents and would help spread the Government's aim of wider share ownership and give the workforce a real stake in the success of the business. There would clearly be wide disappointment particularly at senior management level if the Consortium were not to succeed and this could lead to some loss of morale and motivation.

8. A separate point is that although the Government had not asked either bidder for a 'golden share' to protect the national defence interest, the Employee Consortium has offered one to the Ministry of Defence and Trafalgar House has offered to discuss the issue with Departments. I understand that the Ministry of Defence now takes the view, at least in the case of the Consortium, that they would wish to take up the offer of a golden share and that they would be willing to accept one if offered by Trafalgar House. In either case, the precise form of the golden share will need to be agreed between Departments and the successful bidder. The form of share offered by the Consortium is akin to the one held by the Government for British Telecom, whereas it may be more appropriate for any golden share to resemble more closely the one held by Government for British Aerospace. This issue which will need to be resolved between Departments need not hold up the consent process.

9. A further extremely important element is the attitude of both bidders to the contract for the first Trident submarine (SSBN05). The cost of the SSBN05 contract with VSEL will be of the order of £400m. A 5 per cent difference in the price per submarine (£20m) would itself outweigh the likely financial difference between the bids. MoD therefore asked both bidders to let them know by this evening whether if

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successful in their bid for VSEL they were prepared to give MOD an undertaking on the contract they would be prepared to agree for SSBN05. Both bidders responded. The Consortium gave a detailed appraisal of the terms they could accept; Trafalgar House have given an undertaking in the following terms:

> "We undertake that if we complete the purchase of VSEL we will procure that VSEL negotiates with the MoD a contract for SSBN05 on the basis of terms and conditions, price and programme no less favourable to MoD than the conditions of which we have been made aware as modified by any undertaking given to you by the VSEL management consortium by 5.30pm on 5 March 1986".

10 MoD consider that the Consortium has given the required undertaking and that their offer is an improvement on their previous position. They consider the Trafalgar House offer as putting Trafalgar House on an equal footing as regards the Trident contract provided that Trafalgar House's undertaking is legally binding. Their preliminary legal advice is that the Trafalgar House offer is legally binding. If this legal advice is confirmed there is therefore nothing to choose between the bidders as far as the SSBN05 contract is concerned. Even though the form of Trafalgar House's offer is unconventional, MoD regard it as acceptable.

11 Trafalgar House have, however, written to me this afternoon complaining that the procedure for the bids has been altered and suggesting that although Trafalgar House are rumoured to have been recommended by British Shipbuilders, the Government may decide against them because "the decision regarding the sale of VSEL may be influenced by considerations outside the predetermined rules and of a non

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commercial nature." They are concerned that such a decision would be damaging to the reputation and goodwill of Trafalgar House and have said that if they find themselves in the position of being preferred bidder but for non-commercial reasons prevented from acquiring VSEL, they would regard the matter most seriously and would have to consider legal remedies including seeking a Judicial Reviw and substantial damages. British Shipbuilders have not in fact recommended a preferred bidder to me though they have told me their view that the commercial terms of the Trafalgar House offer, insofar as they affect British Shipbuilders, are superior. I understand that the Attorney General's view is that they have little chance of mounting a successful challenge but he will no doubt wish to give colleagues his views in discussion.

CONCLUSION

12 I favour the Consortium's bid even though its price is somewhat lower than that of Trafalgar House. My reasons for this view are that a bid of this kind is calculated to promote the enthusiasm and commitment of the management to the success of VSEL, a major enterprise. Furthermore there is every expectation that the workforce and local residents in Barrow and Birkenhead will take up shares in large numbers thus in turn committing themselves to the success of the company. This is a healthy development which we should go out of our way to support and which promotes wider share ownership. I consider that this is more than sufficient in itself to outweigh the likely financial advantages to British Shipbuilders of the Trafalgar House offer and am prepared to say so both to British Shipbuilders and publicly (though in the long run the Consortium's bid could produce more in money

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terms). I recognize that this will be unwelcome to Trafalgar House who may seek a Judicial Review and who would be unlikely to pursue their interests in other projects such as the Royal Dockyards.

13 Colleagues will in addition wish to be aware that there is a groundswell of political support for the Consortium. An Early Day Motion in their favour has been signed by a large number of our supporters. I and my colleagues have received numerous letters in support of the Consortium including letters from a number of trade union branches at both Barrow and Birkenhead. Our own Members in the North West feel particularly strongly on the issue.

SUMMARY

14 I therefore invite colleagues at E(A)

(i) to agree that I should give my consent to the sale of VSEL to the Consortium

(ii) to agree that I should announce this to the House at an early moment;

(iii) to agree that in consultation with the Chief Secretary and the Secretary of State for Defence, I should work out with the successful bidder an acceptable form of golden share or undertaking as to ownership.

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15 I am copying this letter to Members of E(A), to the Lord President of the Council, the Secretary of State for Defence, to the Attorney General and to the Secretary to the Cabinet.

M.R. Channon

pp PAUL CHANNON

5 March 1986

DEPARTMENT OF TRADE AND INDUSTRY

JF4AYL

Trafalgar House

PUBLIC LIMITED COMPANY

1 BERKELEY STREET · LONDON W1A 1BY

Telephone 01 499 9020
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Eric W. Parker,
Group Chief Executive

EWP/MC/TH

Private and Confidential

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1H OET

By Hand

5th March 1986

Dear Secretary of State

VICKERS SHIPBUILDING AND ENGINEERING LIMITED

I understand that British Shipbuilders have identified to you the preferred bid for VSEL and under the procedure detailed in the letter to us from Lazard Brothers & Co Limited of 29th November 1985 your consent to the preferred bid is required before the transaction can be completed.

In view of speculation in the press, unforeseen developments involving the Ministry of Defence and the delay in announcing the preferred bidder, I feel obliged to inform you of the background to the decision by Trafalgar House to bid for VSEL and some of the subsequent important developments.

On 1st October 1985 we had a meeting with the then Secretary of State for Trade and Industry, Mr Leon Brittan, who encouraged us to bid for VSEL and assured us that our previous reservations about the bidding procedures for British Shipbuilders' naval shipyards had been removed by the new bidding rules introduced by the Department of Trade and Industry following our complaints about the way the Yarrow disposal was handled.

On 29th November 1985 Lazards wrote to us confirming the bidding procedure for VSEL. Immediately prior to submitting our bid we confirmed with both British Shipbuilders and Lazards that Lazards' recommendation to British Shipbuilders and British Shipbuilders' recommendation to HM Government would be made in accordance with the criteria in Lazards' letter.

cont'd....

Directors: Sir Nigel Broackes (Chairman) E. W. Parker (Group Chief Executive)
G. H. B. Carter W. B. Slater, CBE VRD The Marquess of Tavistock V. A. Grundy D. M. Taylor A. W. Clements
G. E. Knight, CBE D. M. Calverley J. W. S. Fletcher I. Fowler J. R. Williamson A. G. Kennedy, OBE
Registered Office: 1 Berkeley Street, London W1A 1BY Company No. 867281 Registered in England

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
London

5th March 1986

As mentioned above we understand that the preferred bidder was identified by British Shipbuilders to the Department of Trade and Industry on 28th February 1986. It is strongly rumoured that British Shipbuilders recommended our bid and nominated Trafalgar House as the preferred bidder.

Earlier this week the Ministry of Defence asked us for an undertaking concerning the proposed Trident contract in the event of Trafalgar House becoming the new owners of VSEL. Such a development was not envisaged in the bidding procedure; however we are responding positively to the Ministry of Defence today in a manner we trust HM Government will find satisfactory and in a way which will ensure that consideration of the competing bids for VSEL is not complicated by the question of future negotiations on the contract for SSBN05.

You will appreciate we have expended substantial sums of money and considerable management time to mount our offer for VSEL. In addition, the recent changes to the bidding procedure have caused much disruption to our business within the last few days. However we have been able to accommodate HM Government's requirements.

We have read in the press suggestions that our offer for VSEL may not be successful because the decision regarding the sale of VSEL may be influenced by considerations outside the pre-determined rules and of a non-commercial nature. You will understand our concern regarding these suggestions in terms of the impact and damage that such a decision would have on the reputation and goodwill of Trafalgar House.

In the most unlikely event that we find ourselves in the position of preferred bidder but for non-commercial reasons prevented from acquiring VSEL, we would regard the matter in a most serious light and would have to consider our legal remedies including seeking a Judicial Review and substantial damages.

I regret the necessity of having to write to you in the above terms and I find it difficult to envisage circumstances in which HM Government would fail to honour its commitments in a matter of this importance unless it was not fully aware of the facts.

In view of the imminence of your decision I am sending copies of this letter to the Prime Minister and the Secretary of State for Defence.

Yours sincerely

Eric Parker

CONFIDENTIAL

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 6304 (Direct Dialling)
01-218 9000 (Switchboard)

PETER LEVENE
CHIEF OF DEFENCE PROCUREMENT

5 March 1986

Prime Minister

This correspondence would no doubt be evidence to any judicial review?

DRS
6/3

Eric W Parker Esq,
Group Chief Executive,
Trafalgar House plc,
1 Berkeley Street,
LONDON W1A 1BY

Dear Mr Parker,

VICKERS SHIPBUILDING AND ENGINEERING LTD

As explained to you by the Department of Trade and Industry, the Government has asked whether, if you are declared the preferred bidder and go on to complete the purchase of VSEL, you will undertake to negotiate with the Ministry of Defence a contract for SSBN 05 on the basis of terms and conditions, price and programme, no less favourable to the Ministry than the conditions of which you have been made aware.

If you would be prepared to give the undertaking only after varying one or more of these elements, you should give the undertaking specifying the changes you propose.

Your reply should be delivered to the office of Mr J B Bourn, DUS(DP) (Ministry of Defence Main Building Room 6267) no later than 5.30 p.m. on Wednesday 5 March.

Yours Sincerely,

Peter Levene

CONFIDENTIAL

A.D.R.

MR NORGROVE

5 March 1986

HARLAND AND WOLFF

Tom King accepts that by any ordinary commercial criterion Harland and Wolff (H&W) is not, and is unlikely to become, a viable company. The question is, therefore, what is the politically acceptable minimum level of H&W employment, and what is the best way of minimising the cost of achieving it? Whatever solution is adopted, it ought also contribute to gradually reducing H&W's prominence in the Northern Ireland manufacturing scene where its 4,800 workers still represent some 5% of the manufacturing workforce of the province.

The Contract Support Limit which rolls contract losses and subsidy up into a single measure has worked effectively with British Shipbuilders, minimising the cost of Government support whilst giving the company sufficient freedom from Government interference to make its own commercial decisions. Replicating this system for H&W is sensible.

But the management need to recognise that freedom is also coupled with responsibility, and that they cannot continue crying to Government as each small buffet of fate knocks them off course. Unless this is firmly agreed, HMG will have disposed of its authority without distancing itself from the responsibility for every H&W action.

Pulling out of the marine engine business as proposed would be a decisive contraction of loss-making activities. It would also significantly help the viability of British Shipbuilders' engine building. But there is little sense in a further study. This is a bankrupt part of the business and should be treated in the same way as in the private sector. The firm's accountants should act as quasi-receivers and sell it off for what they can get. If they

fail to sell it then it should be closed in March 1987 as proposed.

Conclusion

We endorse the Contract Support Limit provided the management firmly understand that they will be on their own without further recourse to Government.

The disposal or closure of the Engineering Division is right, but it is action, not study, that is required.

Peter Warry

PETER WARRY

cc BL/P

CONFIDENTIAL

P 01944

PRIME MINISTER

HARLAND AND WOLFF PLC

A – E(A)(86)10

BACKGROUND

Harland and Wolff (H&W) is wholly owned by the Northern Ireland Department of Economic Development (DED). It employs around 4,800 or 5 per cent of total manufacturing in Northern Ireland, making it the second largest manufacturing employer in the province. Its major activity is shipbuilding, but it also manufactures marine engines, electrical and general engineering products and repairs ships. Its current order book includes a major conversion into an aviation training ship (ATS) for the Ministry of Defence (MOD) due for completion early in 1987; and a sophisticated Single Well Oil Production (SWOPS) vessel for BP due for delivery early in 1988. On the basis of its existing order book, outfit and steelwork begin to run out towards the end of 1986.

B — 2. In September 1984 (E(NI)(84)5th Meeting) Ministers agreed that H&W's dependence on public funds should be reduced. And last July Ministers agreed in correspondence on:

- the setting of H&W's EFL for 1985/86 at £35.6 million, with early access to certain company deposits of up to £5 million and a ring-fence around capital expenditure provisions of £4 million;

- the preparation of a revised Corporate Plan on a tougher and more realistic basis, showing sound prospects for declining EFLs (taking account of repayment of deposits);

- an analysis of the option of significantly reducing EFL requirements by substantially reducing the size

and capacity of the yard - the so-called 'small yard' strategy; and

- further work on a revised financial control regime for the company.

E(A)(86)10 sets out the Secretary of State for Northern Ireland's proposals in the light of H&W's 1985 Corporate Plan Update; an analysis by officials of this and of the 'small yard' strategy - based on an assessment by PA Management Consultants - has been circulated under cover of the letter of 14 February from Mr King's Private Secretary to yours.

3. H&W combines the problems of the shipbuilding industry with those of Northern Ireland. The yard is in East Belfast, and is a stronghold of Protestant sectarianism. The major facilities were constructed to build super-tankers, and were installed just before the oil price explosion of 1973. Thus they have hardly been used for the purpose originally intended. The scale of the facilities makes it difficult to cut costs, and particularly overhead costs, by contracting the size of the business; this is essentially why the 'small yard' strategy has been shown not to offer a promising way forward. H&W's engineering and ship-repairing activities are on a relatively much smaller scale; together they employ about 1,000 people (as compared with more than 3,500 on shipbuilding), and are not far off self-financing. The implication of this is that it costs nearly £10,000 a year per man employed to keep the shipbuilding operation going; and none of the scenarios considered by officials with the help of PA Management Consultants offers any realistic prospect of substantial improvement over the next three years. The subsidy per man employed in shipbuilding appears to be roughly double that currently applicable in British Shipbuilders. A confidential study undertaken in 1983 showed clearly that it would be in the interests of the Exchequer to close H&W down; but successive Northern Ireland Secretaries have shrunk from such a decision because of its wider implications for the

economic and political future of the Province.

MAIN ISSUES

4. If closure is still ruled out (and the industrial action which closed down H & W earlier this week exhibited some form of a death wish), and the 'small yard' strategy does not offer a reasonable way forward, the issues for consideration essentially cover various forms of financial pressure on the company to do better:

(i) the size of the 1986-87 External Financing Limit (EFL);

(ii) the institution of a Contract Support Limit (CSL) comparable with that already in force at BS;

(iii) possible further measures to improve efficiency in the yard;

(iv) the future market strategy; and

(v) the future of the Engineering Division.

External Financing Limit

5. The Secretary of State's proposal for 1986-87 is £38.5 million (£37.0 million in direct support from the Department of Economic Development and £1.5 million bank borrowing). The Treasury would have liked a lower figure than the current year's £36.5 million, but this figure has been held down by drawing on customers' deposits to the extent of £5 million, so reducing receipts in later years. It is arguable, therefore, that the 1986-87 figure proposed represents some progress as against the current year; and it would only be possible to reduce the 1986-87 figure by cutting back on essential investment and imposing a wage freeze with disruptive industrial effects. It appears that the Treasury will not dissent from the proposed EFL figure. Decisions are not required at this stage about the following two years, when the outcome will be greatly affected by whether or not H & W are successful in securing further orders.

Contract Support Limit

6. The proposal here is to limit the amount of subsidy H&W could give on future orders to £14 million and £13 million for 1986-87 and 1987-88. If H&W then fail to control costs in line with the projections made when orders were taken, the effect of the EFL discipline should then be to enforce contraction on the company, essentially because of their own failings. Although an application by the company for some relaxation in these disciplines cannot be ruled out, either as a result of their own failings or as a result of market difficulties, there is some prospect that this arrangement would enable the Government to distance itself somewhat from the future course of H&W's business, leaving more of the responsibility with the management of the company. The Secretary of State apparently contemplates that the £14 million and £13 million figures might be adjusted in agreement with the Treasury, depending on H&W's progress in securing new orders; no such new orders have yet been secured.

Measures to increase efficiency

7. A previous drive in 1982 secured an improvement of £7 million a year in overhead costs. Overheads are now, however, higher than in 1982, and further efforts are clearly required. The company's management are thought to have done reasonably well in difficult circumstances, but it seems likely that savings could be made, particularly through the institution of more flexible working practices. The Secretary of State proposes that consultants should be used to review the scope for reductions in overheads, and that his Department should study the prospects for improving working practices. The Treasury would have preferred the second element in the study to be undertaken externally as well as the first; unless these studies produce significant results by, say, the early summer, which offer the prospect of a clear downward trend in future EFLs, the Treasury will urge the need for a further consultants' study, drawing on the experience of foreign shipyards as well as those of BS. Meanwhile £2.3 million of the 1986-87 EFL should be ring-fenced for capital expenditure;

this is common ground between the Treasury and the Northern Ireland Office.

Marketing strategy

8. H&W's general approach is to look more to defence and offshore oil and gas orders than to future merchant shipping orders. They are currently building the first Single Well Oil Production Ship (SWOPS) for BP, and there should be the prospect of follow-on orders towards 1990 if they are successful. There is also a prospect of H&W securing an oil supply vessel (AOR) for the Ministry of Defence.* But in the near future they urgently need to obtain additional merchant shipping orders to provide sufficient loading for their steel-work and out-fitting capacity in 1987; if they cannot find sufficient work, a run-down of the yard would probably be inevitable beyond the point at which they could undertake an AOR next year. There is no question of any Government decision at this stage on product strategy, beyond requiring H&W to submit the terms of all new orders worth more than £½ million for approval by the Northern Ireland Office, with the understanding that all orders worth more than £5 million would be put by the Northern Ireland Secretary to his colleagues. But it must be recognised that the Company will be facing a very difficult market situation; merchant shipping orders are very few and far between, and H&W are likely to be in competition with BS where fresh closures are now a probability, while the fall in oil prices seems likely greatly to reduce the amount of work available in the offshore oil and gas sector. It would clearly be sensible to ask the Company to produce a new assessment of its market prospects, particularly in the offshore oil and gas sector, which Ministers could take into account when reviewing the results of efforts to secure reductions in overheads and other efficiency savings.

Engineering Division

9. The proposal is that the Division should achieve break-even by 1988-89; that advisers be appointed to assess the prospects for disposal of the Division to a

* A competition for one, or possibly two AORs is currently under way. The yard which gets the first order will be in a very strong position to secure the second, if placing the contract is delayed. The choice will be between H&W and Swan Hunter. The Defence Secretary is expected to put t he is sue to colleagues in a few weeks time.

to a third party; and that plans should accordingly be set in hand for closure if neither break-even nor disposal is in prospect by March 1987. This appears to be common ground.

HANDLING

10. The Secretary of State for Northern Ireland will wish to introduce discussion of his paper. The Chief Secretary, Treasury will wish to state his position on the EFL and CSL proposals and on the steps to be taken to increase efficiency and cut costs. The Secretary of State for Trade and Industry will wish to comment from the standpoint of his responsibility for the shipbuilding industry and the world market situation it faces. Other Ministers may wish to comment on the political and financial aspects of the Secretary of State's proposals.

CONCLUSIONS

11. You will wish the Sub-Committee to reach conclusions on

i. the amount of the EFL for H&W in 1986-87, and on the ring-fencing of £2.3 million of the total £38.5 million proposed to be devoted to capital expenditure;

ii. the institution of a CSL system analagous to that operated for BS, subject to appropriate arrangements for consultation between the Company and the Government on the terms of significant new orders;

iii. the arrangements for further studies of the scope for reducing overheads (by consultants) and for improving working practices (by the Northern Ireland Office);

iv. a remit to the Company to prepare a full analysis of future market prospects, concentrating particularly on those in the offshore oil and gas sector;

v. the future framework for planning the operations of

the Company's Engineering Division; and

vi. appropriate arrangements to report back to the Sub-Committee on efficiency savings and future market prospects (iii. and iv. above).

J B UNWIN
Cabinet Office
5 March, 1986

10 DOWNING STREET

David

Political office have no meeting with Christopher Chope planned for the immediate future.

May we just file this note now?

Yours ever,

Julie

28/2

CF Please hold against a possible meeting with Christopher Chope MP next week. DOT 20/2

DEPARTMENT OF TRADE AND INDUSTRY
Room
1–19 Victoria Street
London SW1H 0ET
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GTN 215)
(Switchboard) 01-215 7877

With the Compliments of

Office of the Minister of State
for Industry

Mr Norgrove

Further to your telephone conversation of Wednesday 19 with Malcolm McHardy. I now attach background note on Vospers.

Andrew Adams.

CS5

VOSPER HOVERMARINE

Background

Vosper Hovermarine is principal subsidiary in Vosper Group, a publicly quoted company with market capitalisation of £12 million. Vosper Hovermarine employs 160 people in and around Southampton principally building Surface Effect Ships (a type of hovercraft) although the company has recently diversified, for example by constructing glass fibre windsails.

The company requires an immediate capital injection of £½m to £1m but the ultimate holding company, David Brown Holdings plc, is unwilling to provide further support. National Westminster, the company's bankers, are threatening to appoint a receiver on Monday.

The best prospect of saving the company is for a £2½ - 3m order from Indonesia but the chances of securing this in time seem remote.

The Group is also hoping for a favourable judgement from Strasbourg in respect of compensation following nationalisation in 1978 of its UK shipbuilding and shiprepairing interests. The Group is claiming some £70m (including interest) compares with £5m offered. Decision is now expected in April/May but it is by no means certain that the Court's judgement will be in their favour. Even it if is, it will be some time before any payment is forthcoming.

Line to Take

It is unfortunate that the company has been unable to persuade either its holding company (David Brown Holdings) or its bankers to provide further support.

Even if company is faced with receivership I hope that there will still be the opportunity for a potential investor to purchase the business from the receiver.

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bc: Prof. Griffiths

10 DOWNING STREET

From the Private Secretary

20 February 1986

BRITISH SHIPBUILDERS

The Prime Minister was grateful for your Secretary of State's minute of 14 February reporting the prospects at British Shipbuilders.

I am copying this letter to the Private Secretaries to members of E(A), to Colin Budd (Foreign and Commonwealth Office), Richard Mottram (Ministry of Defence), Martin Dinham (Overseas Development Administration) and Michael Stark (Cabinet Office).

David Norgrove

John Mogg, Esq.,
Department of Trade and Industry.

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PRIME MINISTER

BRITISH SHIPBUILDERS

I recently met the Chairman of British Shipbuilders, Graham Day, to discuss the short to medium term prospects for the Corporation.

The sale of the warship-building yards is progressing very satisfactorily. Only Vickers and Hall Russell remain to be sold and there is strong interest in both. I hope that the sales will be completed by the deadline of 31 March.

The position in the merchant shipbuilding yards is, however, very poor indeed. The UK industry is suffering the impact of an unprecendented shipbuilding crisis worldwide. Even Korean export orders fell by two thirds last year. So far BS has secured only 18,000 compensated gross tonnes (cgt) of new orders out of a 1985/86 Corporate Plan target of 200,000 cgt. Now that the BNFL order has gone to Japan, even if all other current order prospects were secured, BS could at best obtain orders totalling 60,000 cgt by the end of March.

So the Corporation will have to take immediate steps to rationalise and cut costs. To achieve this, BS with my consent, has announced its intention to amalgamate Sunderland Shipbuilders and Austin

1786 1986 BOARD OF TRADE BICENTENARY

and Pickersgill (both on the Wear) into a new company called North East Shipbuilders Ltd. BS has announced that Smiths Dock (on the Tees) will join this grouping in the summer. But Graham Day has told me privately that if, as seems likely, Smiths Dock is by then running out of work, it will instead be closed. At the same time, and again barring totally unexpected orders, BS will be forced to close the small yard at Ailsa and the engine-building site at Wallsend. Spread over a number of months starting this summer, resulting job losses could amount to 2,250. This compares with the present BS merchant total of some 10,000.

If no further orders were to materialise, the position would become considerably worse. A total of over 4,000 jobs would be at risk by the end of 1986. This fact, which Mr Day has made known to his unions, was the origin of Don Dixon's allegations about redundancies at Question Time last Thursday 6 February.

Against this background BS is rightly exploring options which might provide additional work. The most immediate prospect is a Chinese order for two specialised container ships, which will require support from the Aid and Trade Provision (ATP) to stand any chance against German development aided competition. While the ATP case must be judged against the usual criteria, I need hardly emphasise its extreme importance given the background set out above.

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There are a few other new order possibilities on the horizon. My Department is working closely with Mr Day to identify the best opportunities. But all of them will need our help in one form or another, and none will be easy. Whatever happens the immediate financial costs will be greater than previously envisaged, either because of capacity cuts, under-recovered overheads, or because of additional help to win new orders. Privatisation receipts, on the other hand, may be better than expected.

I shall keep you fully in touch with further developments.

I am copying this minute to other members of E(A), Geoffrey Howe, George Younger, Timothy Raison and Sir Robert Armstrong.

PC

PAUL CHANNON

14 February 1986

Department of Trade & Industry

1786 1986 BOARD OF TRADE BICENTENARY

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From: THE PRIVATE SECRETARY

cc BJ Cartledge
cc Blue

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

David Norgrove Esq
10 Downing Street
LONDON
SW1

14 February 1986

Dear David,

HARLAND AND WOLFF PLC: 1985 CORPORATE PLAN

At the E(A) meeting scheduled for 20 February consideration will be given to Harland and Wolff's 1985 Corporate Plan and 1986-87 funding.

The Secretary of State will be tabling a memorandum summarising the main issues arising from the Plan and recommending the way forward on Government policy towards the company. You will however wish to see the attached Note by Officials which provide a fuller analysis of the Corporate Plan issues and also an analysis by officials of the small yard strategy which the then Secretary of State undertook last summer to place before colleagues alongside the Corporate Plan.

Copies of this letter plus enclosures go to the Private Secretaries of E(A) members and to Sir Robert Armstrong.

Yours Sincerely
Neil Ward.

N D WARD

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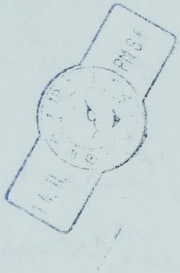

HARLAND AND WOLFF PLC: ALTERNATIVE STRATEGY PROPOSALS

Introduction

1. At E(NI)(84) 2nd meeting on 20 February 1984, the then Secretary of State for Northern Ireland indicated that he had agreed with the Chief Secretary to initiate a study of the feasibility of further reducing the scale of the H&W operation with the objective of a substantial cut in its public expenditure support requirement, for presentation to E(NI).

2. The company was asked to consider alternative strategies which might be followed but, in the end, plumped for an analysis of the effects of reducing the shipbuilding capacity of the yard to about 50% of the level which formed the basis of the 1983 Corporate Plan (67% of late 1985 levels). As shipbuilding, rather than engineering or ship repair, is by far the dominant activity of the company it was a logical decision to concentrate on reduction in shipbuilding capacity. Other strategies, including the cessation of engineering and ship-repair activities were considered but discarded on the grounds that they were not significant in relation to the company's overall activities and would not in themselves produce manpower or capacity reductions on the scale envisaged. At the time of the study, the Engineering Division provided only 12.5% of company turnover and employed some 700 people, of whom about half only were engaged in engine-building. Ship-repair accounted for only 4/5% of the company turnover with employment of around 250.

3. In H&W's view, the sensitivity of the study required its restriction to a very small team of senior management, who were also heavily involved in negotiations for the BP SWOPS and BSC orders. This constraint delayed production of the study. It is also clear, however, that the management team had difficulty in regarding a drastic reduction in the Yard's capacity as a constructive exercise.

Background

4. A critical factor in assessing the results of H&W's study is that H&W differs crucially from most other publicly-owned companies in the UK which typically are multi-site operations and whose overall productivity can in many cases be increased markedly by closing the least efficient.

On the other hand H&W consists of only one site which has been reduced in area by 45% in the last three years. Despite this reduction the Yard is still the only one in the UK with facilities to build large ships. The scope for achieving dramatically improved efficiency through further capacity cuts alone is limited.

5. H&W began its study of an alternative strategy before approval was sought for the BP SWOPS and BSC orders and, as such, the study related to the then firm order book of four Blue Star reefers, an Aviation Training Ship for MOD and two small barges. The study assumed an order book equivalent to four 22,000 dwt Friendship-class vessels built under licence from IHI of Japan with approval to proceed with the first order by August 1984. No orders for this type of vessel have been received to date.

Discussion

6. The following table analyses the results of the H&W study in financial and manpower terms:

	1985/86	1986/87	Annually thereafter
	£m	£m	£m
EFL	44.2	38.8	35.0
Loss	32.4	28.9	25.1
Manpower	3,150	3.035	3,000

7. The Study shows that by comparison with the 1983 Corporate Plan (and also the 1985 Update after taking account of financing of short-term fluctuations) only marginal EFL savings would result in the long term from an exercise that would have short-term cost implications, involve the loss of 2,750 jobs (by comparison with the 1983 Plan) and result in a higher level of loss for the company. The main reason for this is that many of the company's overheads are indivisible; it is considerably more difficult to achieve savings in one very large shipyard than in an organisation with several smaller shipyards where work can be concentrated by closure of less profitable yards.

8. Other drawbacks identified by the study are:

(a) the reduction would place H&W in the small yard category, with consequential disadvantages. This would be a misuse of

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facilities which are more suitable for the simultaneous construction of a number of large ships and relatively sophisticated vessels - thereby exacerbating losses - and would put the company in direct competition with BS;

(b) the company would have less flexibility in seeking MOD work and this could damage its current aim of obtaining more of that work. This would be unfortunate at a time when MOD is seeking to increase the competitive element in tendering; and

(c) losses of productivity, pronounced in the short-term but also continuing in the longer term. This would be partly due to less efficient use of capital intensive resources but also to deterioration in morale, loss of best workers/ graduates etc.

9. The study takes no account of the possible effect on sub-contractors and other suppliers in Northern Ireland and GB.

Conclusions

10. Even after searching analysis by the Department and PA Management Consultants, the Study shows that by simply cutting numbers employed relatively small savings in cash can be achieved at the expense of a large number of job losses and considerable loss of productivity and efficiency. A more desirable scenario is one in which larger cash savings could be achieved by productivity and efficiency measures which would have a lesser impact on jobs.

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HARLAND AND WOLFF PLC

CORPORATE PLAN (SEPTEMBER 1985 UPDATE)

NOTE BY OFFICIALS

Harland and Wolff PLC: Corporate Plan (September 1985 Update)

Note By Officials: Contents

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2. Scenario B1: intermediate case
3. Scenario B2: intermediate case
4. Scenario C1: intermediate case
5. Scenario D2: lowest case
6. Financial Consequences of Scenarios
7. Proposed System for Financial Control and Flexibility
8. H&W net loss, EFLs and manpower over last 5 years

HARLAND AND WOLFF PLC: CORPORATE PLAN (SEPTEMBER 1985 UPDATE)

NOTE BY OFFICIALS

Introduction

1. Harland and Wolff PLC (H&W) is incorporated under the Companies Acts (NI) and its shares are owned 100% by the Northern Ireland Department of Economic Development (DED). It is the second largest manufacturing employer in Northern Ireland employing around 4,800 or 5% of total manufacturing in the Province. Its major activity is shipbuilding but it is also engaged in the manufacture of marine engines, electrical and general engineering products and ship repair. Appendix 8 provides details of the company's net loss, EFLs and manpower over the past 5 years.

2. H&W's current order book includes three refrigerated cargo vessels for Blue Star being delivered during January; a 173,000 dwt bulk carrier for British Steel Corporation due for delivery in autumn 1986; the major conversion of a RO/RO ship to an aviation training ship (ATS) for MOD due for completion early in 1987; and the sophisticated Single Well Oil Production (SWOPS) vessel for BP due for delivery early-1988. Based on this order book outfit and steelwork begin to run out towards the end of 1986.

3. E(NI) Ministers decided by correspondence in the course of July 1985 to:-

- approve an EFL of £36.5m for 1985-86, supplemented by early access to certain company deposits of up to £5m and placing a ring-fence around capital expenditure provisions of £4m within the overall sums;

- insist on preparation of a revised corporate plan on a tougher and more realistic basis, and showing sound prospects for declining EFL's (taking account of repayment of deposits as noted above);

- consider later in 1985 an analysis of the option of significantly reducing EFL requirements by substantially reducing the size and capacity of the yard, previously sought by Treasury Ministers and prepared by the company;

- instruct officials to develop a revised financial control regime for the company; and insist that H&W's bids for MOD orders, especially AORs (Auxiliary Oil Replenishment vessels), be unsubsidised and include a profit margin.

4. The company is confident that it can live within the EFL agreed for 1985-86, using the facility of early access to deposits.

5. An analysis of the small yard option has been completed and with officials for some time and the Secretary of State for Northern Ireland will wish to put this before his colleagues alongside this note.

6. Officials have drawn up proposals for a new financial control mechanism drawing on the regime recently introduced for British Shipbuilders; these proposals are discussed later in this note. H&W was advised of the terms on which its bid to the MOD should be prepared; these were accepted and the yard's bid has been lodged.

7. At meetings involving both the NIO Minister of State and officials, the company was told in very clear terms of the Government's dissatisfaction with its previous plan and of its wish to see a new tougher, more realistic prognosis. The remainder of this note is an analysis of the new plan. The Treasury, DTI, No 10 Policy Unit, MOD, FCO, OSO and DTp have been consulted about the note.

Corporate Plan (September 1985 Update)

8. The plan has been assessed by PA Management Consultants who advise DED on matters relating to H&W. This analysis draws on their assessment.

9. **Marketing:** in recent years the company's shipbuilding has been concentrated mainly on merchant-building, although in 1984 it won a

major conversion of a RO/RO ship to an ATS for MOD. The company now foresees activities as follows:

- **merchant building**: H&W recognises that prices are and are likely to remain wholly unremunerative, leaving a cost/price gap of the order of 35% (after normal credit). PA and officials believe that this could be closer to 40%, at least in certain cases. H&W believes, with some justification on the basis of trends in freight rates, that the larger product carrier and bulk carrier sectors (ie 70,000 dwt upwards) offer the best demand prospects: but demand even for these will be low and competition intense. The company therefore wishes to spread risk away from its traditional merchant building activities;

- **MOD orders:** H&W aims to capitalise on its penetration of this market through the ATS order by focussing on future contracts for AOR and ASS (aviation supply ship)contracts. The yard has bid for the first two AOR contracts (in competition with Swan Hunter for both; Cammell Laird are also expected to compete for the second), involving design, weapon system and build. Further AOR orders may follow though the timescale is uncertain. H&W has been instructed to base its AOR bids on an unsubsidised, profitable basis in order to avoid distortion of competition with warshipyards in GB which are expected to have been privatised at

the point of contracting. As to the ASS order prospects, MOD do not foresee orders being placed in the near term;

- **offshore work:** following the SWOPS order which has brought H&W into the quasi-offshore sector and raised its profile as a potential offshore supplier, the yard aims at gradually penetrating further into this market (offshore would account for at most 30% of capacity in the Plan period). It recognises the pitfalls experienced by BS in construction of large structures and plans instead to enter partnerships with other specialist contractors with inherently less risk and start production on the less sophisticated elements of overall projects. The company has also recruited an offshore specialist to its senior management. Nonetheless the Plan fails to put forward an in-depth analysis of this market and H&W's prospects within it. Both PA and officials recognise that competition in this market is intense and H&W will find it far from easy to penetrate, even if it performs well on SWOPS. H&W believes that it cannot hope to cover more than 75-90% of its costs from initial contracts. This poses problems: on the one hand it would be wrong to block off one possible way for H&W to reduce its external financing requirements, and moreover almost all companies entering a new activity will not cover costs on initial contracts; on the other hand, it would be unfair to the private sector competitors in the market to allow H&W to take on effectively subsidised contracts.

DED recommends that H&W be instructed to develop an in-depth analysis of the offshore market and its prospects within it. If orders arise before the market analysis has been endorsed those over £0.5m should be notified to DED; any exceeding £5m would be referred to Ministers. Any losses actually incurred should be handled in the same way as shipbuilding losses (see paragraphs 30-32).

10. **Financial projections**: in response to pressure from NIO Ministers and officials to plan for a realistic degressive EFL, H&W have switched its planning basis from one where levels of activity determined cash flow to one where fixed cash flow limits determine levels of activity. The company has prepared financial projections corresponding to 12 scenarios, all designed to fit within an assumed Government cash support figure of £100m over three years (£36.5m, £34m and £29.5m in 1986-87, 1987-88 and 1988-89 respectively). Appendices 1-5 analyse five options: the highest and lowest cases, and three intermediate cases which look most realistic. Appendix 6 tabulates their financial consequences in terms of direct DED support, bank borrowings and restructuring costs.

11. H&W has reduced its Government cash support, from £46.2m in 1982-83 to £40m, £37.5m and £36.5m in the succeeding years. Should the company achieve the £100m limit over the next three years, by 1988-89 it would

have reduced its cash support requirements by 36% since 1982-83 under Mr Parker's chairmanship. However H&W's forecasts for a declining cash support level need careful qualification:

- in addition to Government cash support, short-term bank borrowings (under Government guarantee if advantageous) - which have to be included in the company's EFL - are required to smooth out anticipated imbalances between years. The payment of the final £0.5m of the basic contract price of SWOPS together with the £7.5m incentive bonus will not be made until after the ship leaves H&W. The incentive bonus is payable at six monthly intervals for 2 years after delivery. H&W are consequently required to fund the costs of completion of the ship themselves during 1987 and 1988. Four of the five scenarios assume the ability to borrow from banks to cover this funding. DED accepts that it would be normal commercial practice to handle short-term fluctuations in this way. On the scenarios examined in the Appendices these temporary end-year borrowings could amount to as much as £1.5m in 1986-87 and an additional £7.5m in 1987-88, with repayment of £9m in 1988-89. Ability to repay in 1988-89 depends critically on prompt delivery of SWOPS upon which the company will qualify for payment of £7.5m from the owners (a feature of the contract approved by Ministers in 1984); although delivery performance has been improving, and BP would share some of the cost of late delivery (depending on cause) there must be serious risk of late delivery

on such a complex, first-of-type vessel, so the yard's ability to repay borrowings must be in question. H&W has the power to take bank borrowings but doubts about its ability to repay suggest that only 1986-87 borrowings be authorised at this stage, with 1987-88 subject to review nearer the time.

- as well as prompt delivery of SWOPS, on most scenarios the forecasts assume success in filling workload gaps between MOD orders by merchant and/or offshore work. This is analysed more fully in Appendices 1-5, but there is a serious risk that gaps will not be filled. While the company would then plan corrective action, the financial forecasts will be put at further risk;
- the forecasts exclude the costs of restructuring (see paragraph 17 -18 for the Plan's implications for capacity and employment), which should also be included in the EFL. While restructuring costs are unlikely to exceed £3.0m for the intermediate scenarios, in the lowest case they would be around £13m over two years.

12. Under the lower case scenarios, which in the current state of the shipbuilding industry are arguably the most realistic, the move towards the reducing EFL line sought by Ministers is threatened. However it is a significant improvement in the current plan that these scenarios themselves trigger action to cut capacity and move back towards a declining EFL path.

13. The aggregate EFL figure of £38.5m for 1986-87 in the intermediate scenarios does not, in nominal terms, adhere to the policy of declining cash requirements (1985-86 £36.5m) established by the then Secretary of State for Northern Ireland in seeking agreement to the SWOPS and BSC orders in September 1984. In agreeing to the 1985/86 EFL the then Chief Secretary proposed that H&W should use internal deposits to reduce its demand for external finance of £41.5m which would have meant a breach of the declining EFL policy. The then Northern Ireland Secretary's letter of 2 August 1985 to the then Chief Secretary pointed out that early use of these deposits would deprive H&W of revenue in 1986-87 and this would have to be taken into account when considering whether future EFL's showed a satisfactory decline. DED officials believe that an EFL of £38.5m is satisfactory when account is taken of early use of £5m deposits. Treasury officials do not accept this and suggest that an EFL of £35.5m is the maximum consistent with the cash decline policy agreed in 1984. In order to apply a £3m reduction in 1986-87, the following cuts would have to be imposed:

- £1m from capital expenditure: Ministers instructed H&W in August 1985 that the £4m capital expenditure provision in that year should be ring-fenced. Commitments entered into in 1985-86 will entail a level of cash expenditure in 1986-87 which would mean that a cut of £1m in provision would hinder the company in its programme of normal replacement and safety investment;

- £2m through a wages freeze: in recent years H&W's settlements have been low and NIO Ministers will as usual be enjoining a tough stance towards the 1986-87 wage settlement. Pay levels are already significantly below BS levels and compare unfavourably with many other engineering companies in NI. While H&W will be aiming for a low award, management believes that a freeze could prove counter-productive particularly in view of tight delivery schedules and potential heavy penalties on SWOPS.

14. Both PA and DED believe that there is otherwise little flexibility or scope for significant manoeuvre in the forecasts. The company faces inescapable costs from financing of previous ship sales amounting to some £5m a year; the Government's decision to instruct the company to make use in 1985-86 of up to £5m from early owners' deposits reduces revenue by that amount in 1986-87; because of the financings under the SWOPS contract some £10.5m will by mid-1987-88 remain receivable over the following 2½ years; and in 1988-89 the company will have to make an interest-free loan of £5m to BP under the same contract. These pre-determined and obligatory outgoings will make any significant reduction in EFL exceptionally difficult in the period to 1988-89, save on the highest case scenario which is regarded as very optimistic. The assumed AOR contracts will have nil financial impact until 1988-89.

15. As far as 1986-87 in particular is concerned, the company's revenue and expenditure are all but fixed by existing contracts and labour requirements for them. The forecast is highly sensitive to receipt of instalments of at least £4m towards the end of 1986-87; any slippage would postpone these into the following year. There is a further threat to the forecasts (£36.5m DED support plus maximum bank borrowings and restructuring costs in the lower cases) in that, as shown in Appendices 1-5, the company must win an order by summer 1986 to bridge a major workload gap between SWOPS and the first assumed AOR (January 1987 -early-spring 1988). Without this it will be deprived of initial income from the assumed order: it must be questioned whether the company could undertake the AOR contract in these circumstances, but, if it were decided that it could, it would face additional costs in carrying underutilised capacity. Paragraph 32 considers how this risk might be handled.

16. In 1982 the company initiated an overhead cost reduction exercise which has saved some £7m annually. Overheads are nonetheless higher now than prior to that exercise. Officials therefore believe that a new exercise should be put in hand by the company, with the advice of consultants, which would in particular examine ways of reducing or eliminating that rump of overheads which the company now believes to be irrecoverable (largely as a result of its physical size). This exercise should take account of the actions of yards in other countries - H&W's facilities are unique in the UK - which have faced

similar problems; inevitably this study will also have to address the capacity of the yard, based on assumptions about working practices/manning levels, scope for contracting out etc. This exercise is however unlikely to yield significant savings in 1986-87.

17. **Capacity and employment:** details are provided in Appendices 1-5. H&W's plan is that it should move down the scenarios depending on whether or not it is successful in winning certain orders. The company has identified two early trigger points. The first arises in March 1986 and depends on MOD decisions on the award of the first AOR contracts. If H&W wins either the first, second or both AORs then it will follow scenarios B1, B2 or C1 as appropriate. The immediate problem then becomes the workload gap arising from early 1987 onwards. If it is wholly unsuccessful in its AOR bid the company will be forced on to scenario D2 possibly with some offshore work. The second trigger point arises in May 1986 when the outcome of current serious negotiations with two owners for merchant orders should be known. Success in this and the AOR competition will ensure adequate loading until 1990. Failure in the merchant bids accompanied by success in the AOR bids will make for acute workload problems beginning early 1987. Failure in both will mean that the company starts to run out of work early in 1987. The manning levels will flow from the actual outcome of these possibilities.

18. Discounting the highest case option as unattainable, the other four options closely examined forecast job losses of up to 370 by 1988-89 in the intermediate cases(7% reduction in current manpower) and 1,550 in the lowest case (32%). In the last case total workforce would reduce to some 3,300 -effectively equivalent to the levels foreseen in the small yard study.

19. **Engineering Division:** this undertakes general and electrical engineering as well as marine engine manufacture. On both scenarios for this Division the latter activity diminishes to around 10% of turnover.

20. Ministers decided in summer 1985 that the engineering activities of both BS and H&W should be required to break even, and be subject to close monitoring. H&W forecasts that its trading performance and cash requirements (which are included in the company's overall forecasts) will be as follows:

	1986-87		1987-88		1988-89	(£m)
	Upper	Lower	Upper	Lower	Upper	Lower
P/(L)	(1.2)	(1.2)	(1.3)	(1.9)	(0.2)	(0.2)
Cash Requirements	1.0	1.0	1.8	2.3	-	-

21. The company claims that it is unable to achieve break-even before

1988-89 because it is locked into prices on SWOPS work until well into 1987-88. It plans to reach break-even by moving into potentially more profitable offshore work, improving efficiency and reducing overheads. The current level of about 13,000 hours/week would have to be reduced to 10,000 hours in the upper case, 6,500 hours in the lower, but the Plan does not reveal any detailed means of achieving these reductions. Although the Plan's concepts may be sound, there must be serious doubt about the company's ability to achieve the assumed volume and price of new work or cost reductions.

22. The Plan also suggests that thought should be given to establishing this activity as a separate company, first under minority, later majority private ownership, the new company to be eligible for selective assistance from the Northern Ireland IDB. Little interest has been shown in H&W's engineering facilities by private owners in the past and DED believes that there is no prospect of selling the Division on terms which would normally be regarded as acceptable. The Department recognises however that Ministers would wish to approach closure with the utmost caution and this is not simply a question of avoiding a row with the Board: the Division has work for almost two years ahead, and its financial and production performance stands comparison with BS's Clark Kincaid. DED recommends that the Board should be instructed (a) to establish break-even by 1988-89 <u>at the latest</u> as the Division's overriding <u>operational</u> objective; (b) to retain merchant bankers or accountants now to assess the prospects for

complete disposal by March 1988 to a third party and to sound out potential buyers; and (c) to plan on the basis that, should it appear by March 1987 that neither break-even by 1988-89 at the latest nor early and complete disposal is feasible, the company should plan for closure. This would have the merit of applying maximum pressure on the company while enabling the Government to put the future of the works more clearly into the hands of the company itself.

23. **Productivity**: DED has the services of an expert production engineer from PA as an adviser. Based on his work it is clear that the company is making major strides in developing reliable productivity measurements - a notoriously difficult task in shipbuilding. The overall aims are for a 25% productivity increase in the 4-year period to end 1987-88 (15% on steelworking, 35% on outfit).

24. Management has been restructured on to a more accountable basis; project management teams are dedicated to individual contracts; ships are built according to a pre-determined strategy in order to promote the most rational utilisation of resources; an extensive and advanced CAD/CAM system, including automated pipe-cutting (developed in conjunction with Wartsila (Finland) and Kockums (Sweden) and independently regarded at least as advanced as BS's merchant yard system) is well in place: and a programme of communication with the workforce about new working methods, using video techniques, is underway, together with an extensive training and personnel

development programme. Much more progress remains to be made in developing flexible working practices and DED believes in the first instance that the company should be asked to assess the scope for further improvements in flexible working practices. In the light of this, consideration might be given to appointing consultants to examin H&W working practices by comparison with those in other yards both in the UK and abroad. This would need to be separate from the overhead study (paragraph 16) lest an amalgamated exercise become too diffuse and risk postponing achievement of early overhead savings.

25. In response to pressure from Northern Ireland Ministers the company has taken steps to deal with work requirements in excess of capacity by means of short-term contract labour. This suggests a recognition on part of both management and workforce of the need for a flexible aproach to the company's problems.

26. PA have appraised H&W's action on this front. They confirm that H&W is on target to date in actually achieving its forecast productivity targets on the second BSC carrier currently under construction. Manpower targets for the vessel have been set, in relation to actual man-hours spent on the earlier sister ship adjusted to ensure a fair comparison. Current indications are that improvements targeted at 22% are being achieved. PA also agree that the wider H&W productivity forecasts are realistic.

27. In summer 1985 Ministers were concerned lest productivity plans might falter through inadequate capital investment. They therefore ring-fenced £4m of the 1985-86 EFL for this purpose. The company's forecasts of (net) capital expenditure, for those options considered most realistic, are as follows:

1986-87	1987-88	1988-89	(£m)
2.3	2.0	2.1	

28. DED is concerned that this level will prove inadequate to underpin H&W's productivity drive. It recommends that these provisions be ring-fenced and that the company be told to regard them as absolute minima and to increase investment as far as possible within total annual EFL's.

29. **Summary:** the Plan shows that H&W has fully realised the necessity to trim production and capacity according to financial resources. Its productivity achievements are substantial and its further planned improvements in this area are realistic. It has planned to deal with the uncertainties as to future ordering levels in a sensible way.

But the degree of uncertainty which in the current market inevitably surrounds its plans casts serious doubt on its ability to live within its forecasts of Government cash requirements. The Engineering Division requires special handling.

Future financial control regime

30. These uncertainties, and the proven inability of the EFL system to cope with them, confirm Ministers' recognition that a new financial control regime should be put in place for H&W if at all possible. The preferred course is set out in Appendix 7.

31. The preferred option - a BS-type Contract Support Limit (CSL) adjusted to take account of H&W's different status and structure - would in effect mean that any future contract losses would erode the resources available for subsidy on new work, and it should therefore force the company to greater efficiency; if this is not achieved the EFL discipline should force contraction on the company. DED proposes to include in the CSL, in addition to ship subsidies, actual losses on all contracts worth over £500,000 whether on merchant building, quasi-naval building (despite the requirement to tender on a profitable/break-even basis), offshore or engineering. This should provide a tight discipline on the company, delegate more responsibility for the company's future to the Board (including decisions on new order terms and their consequences), thereby release Ministers from having themselves to take decisions which would be unwelcome in current circumstances and give Ministers defence against criticisms that BS is treated unfairly by comparison with H&W. It marks of course an abrupt departure from the interventionist stance which Ministers have

hitherto taken on H&W because of the importance they have attached to safeguarding its future; and the new system cannot be expected to work quite as effectively as at BS because H&W is a single-yard company. The discipline would nonetheless be salutary for the company as a means of firmer control and managing the company's capacity and finance according to performance.

32. The new system would be particularly helpful in handling the workload gap expected to arise in 1987-88 (paragraph 15). H&W already has a major incentive to avoid underutilised capacity over this period: apart from the immediate expense, it will wish to avoid the damage which this would inevitably cause to productivity on SWOPS and ATS, which would in turn spill over into further costs, the loss of all or part of a £7. 5m payment for prompt delivery of SWOPS, and critical damage to H&W's reputation as reliable suppliers to the offshore and naval markets. There will therefore be intense pressure to take an order by summer 1986. Without the adjusted CSL-system, this pressure would be transferred to Ministers in the form of approval to a subsidy for an order. Under the CSL system the company could itself decide on the subsidy knowing that it would have to limit both this and losses which the company would have to pick up itself. It will therefore have maximum incentive to contain costs and/or seek an order on the best achievable terms. In the worst case, of course, the company could come back to Ministers in, say, 2 years seeking alleviation from the immediate CSL-constraints. But the very existence of an untried new

system would put pressure on the company to avoid this; and should it nonetheless occur Ministers would be invited to take decisions on the company's future in the clearest possible light of the company's performance. Officials recommend that provisional CSL totals of £14m and £13m be notified to the company for the 2 years to 1987-88, but since these figures are exposed to major change in the light of H&W's actual order intake in the first quarter of 1986 (eg AOR's and whether a merchant order is taken before 31 March 1986) they should be reviewed by officials in the course of March before ratification.

Shipbuilding Redundancy Payments Scheme (SRPS)

33. Like the BS scheme, SRPS will lapse after 31 December 1986. Thereafter redundancy terms are to be provided by the company. These should be cleared by DED in consultation with DTI, the Northern Ireland Department of Finance and Personnel and the Treasury, and their cost will undoubtedly have to be borne indirectly by the Department (ie within EFL's funded by DED). H&W's forecast EFL's make no allowance for the cost of a new scheme and so will have to be adjusted in due course.

34. Assuming that redundancy terms offered by the company will not differ significantly from the statutory scheme, the cost could amount to some £2.9m under the intermediate Corporate Plan options or £12m under the lowest case.

EC Dimension

35. The Commission has approved an Intervention Fund regime for H&W until 31 December 1986 under which new orders for ships up to 70,000 dwt qualify for 20.5% grant, larger vessels for 25.5%. These rates are accommodated within the recommended CSL amounts, although cases may arise where specific notification to the Commission is required.

36. DED officials are liaising closely with DTI and FCO counterparts on the implications for H&W of a new Council directive on aids to shipbuilding to replace the current regime which expires on 31 December 1986.

Conclusions and Recommendations

37. DED recommends that:

(i) the company be instructed to provide an in-depth analysis of the offshore market and its prospects; in the meantime notify DED terms for orders over £0.5m; Ministers should be consulted on any case over £5m; losses should be covered from the CSL - paragraph 9;

(ii) the Department provide cash support (under the intermediate scenarios) of £37m in 1986-87, supplemented by bank borrowings of up to £1.5m possibly under Government guarantee, and monitor progress and prospects very closely with access to bank borrowings in 1987-88, subject to review nearer the time -paragraphs 10-13;

(iii) the company be instructed to retain consultants to examine ways of achieving further savings in overhead costs - paragraph 16;

(iv) the company be instructed to break-even on engineering by 1988-89 at the latest, and seek merchant bank or accountants advice on early and complete disposal; if by March 1987 neither early break-even nor sale looks achievable, plan to close - paragraphs 19-22;

(v) the company be asked to assess the scope for further improvements in flexible working practices - paragraph 24;

(vi) within future EFL's, a ring-fence be placed around capital expenditure provisions and the company be encouraged to spend more on productivity-boosting measures - paragraphs 27-28;

(vii) an adjusted CSL-system, as described in Appendix 7, be put in place with effect from 1 April 1986 and that provisional CSL amounts of £14m and £13m be notified to the company for the years 1986-87 and 1987-88, subject to ratification in the light of the timing of new orders in the first quarter of 1986 - paragraphs 30-31;

(viii) Ministers note that adjustments will have to be made to EFL's in due course to reflect the changes in arrangements for payment of special redundancy terms - paragraph 33;

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APPENDIX 1

SCENARIO A1: highest case

1. **Orders:**

   1 x ASS: work commences mid-1986
   1 x AOR: work commences mid-1987
   1 x AOR: work commences mid-1988

2. **EFL:**

	1986-87	1987-88	1988-89	(£m)
DED support	34.6	32.6	11.5	
Bank Borrowing	-	-	-	

3. **Redundancy:** Natural wastage only

4. **SRPS costs:** Low cost to cover natural wastage

5. **Workload profile:** significant peaks in excess of current capacity during 1986-87 in both steel and outfit; followed by a deep trough in steelwork until the commencement of the first AOR in 1987.

6. **Comment:** unrealistic because an early ASS order can now be ruled out.

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APPENDIX 2

SCENARIO B1: intermediate case:

1. **Orders:**

   2 x AORs : work commences mid-1987 (AOR 1), mid-1988 (AOR 2); other merchant work, not yet contracted - the critical one being won in spring/summer 1986.

2. **EFL:**

	1986/87	1987/88	1988/89	(£m)
DED Support				
- trading	36.5	34.0	29.5	
- restructuring	0.5	2.4	-	
Bank borrowings	1.5	9.0	-	(see footnotes in Appendix 6)
TOTAL	38.5	45.4	29.5	

3. **Redundancy:** 120 by March 1989

4. **SRPS costs:** £1m

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APPENDIX 2 (Contd)

5. **Workload profile:** without an order (merchant) placed by spring/summer 1986, a large gap January 1987-early 1988 in both steel and outfit.

6. **Comment:** a plausible scenario. Critically dependent on obtaining early merchant order to bridge gap between SWOPS and first AOR. Without this severe problems of short-time working.

APPENDIX 3

SCENARIO B2: intermediate case

1. **Orders:**

1 x AOR (the first of MOD's batch): work commences mid-1987, other merchant orders not yet contracted - the critical one being won in spring/summer 1986.

2. **EFL:**

	1986-87	1987-88	1988-89	(£m)
DED support		-		
- trading	36.5	34.0	29.5	
- restructuring	0.5	3.7	-	
Bank borrowings	1.4	8.5	-	(see footnotes in Appendix 6)
TOTAL	38.4	46.2	29.5	

APPENDIX 3 (Contd)

3. **Redundancy:** 370 by March 1989

4. **SRPS costs:** £2.9m

5. **Workload profile:** without an order (merchant) placed by spring/summer 1986, a large gap January 1987-early 1988 in both steel and outfit.

6. **Comment:** a plausible scenario, merchant contribution over 3 years (£29m) higher than quasi-naval (£23m). Critically dependent on obtaining early merchant order to bridge gap between SWOPS and first AOR. Without this heavier redundancies than planned.

APPENDIX 4

SCENARIO C1: intermediate case

1. **Orders:**

   1 x AOR (the second of MOD's batch): work commences mid-1988 other merchant and offshore work so far unidentified - again orders critical to fill early and lengthy workload gap.

2. **EFL:**

	1986-87	1987-88	1988-89 (£m)
DED support			
- trading	36.5	34.0	29.5
- restructuring	0.5	3.5	-
Bank borrowings	0.7	6.0	- (see footnotes in Appendix 6)
TOTAL	37.7	43.5	29.5

3. **Redundancy:** 350 by March 1989

4. **SRPS costs:** £2.7m.

APPENDIX 4 (Contd)

5. **Workload profile:** a very deep, long trough in both steel and outfit throughout 1987 and 1988.

6. **Comment:** it is wholly possible that H&W may win only the second AOR. Contribution comes mostly from merchant (£28m), £16m from offshore, £4m from naval. In that case it is faced with the imperative need to win major merchant and offshore orders, so far unidentified, to cover the 2-year workload gap opening early in 1987. There would also be significant restructuring costs exclusive of SRPS. This course exposes the yard to high risk (can it win sufficient orders to cover the 1987 and 1988 gap?) and also the MOD to risk in committing itself to placing the second AOR contract.

APPENDIX 5

SCENARIO D2: lowest case

1. **Orders**: merchant work only, no orders so far identified.

2. **EFL**:

	1986-87	1987-88	1988-89	(£m)
DED support				
- trading	36.5	34.0	29.5	
- restructuring	0.5	12.5	-	
Bank borrowings	-	3.1	-	
TOTAL	37.0	49.6	29.5	

3. **Redundancy**: 1,550 by March 1989

4. **SRPS costs**: £12m

5. **Workload profile**: no firm ship work after early-1987. Company would be forced to restructure radically - 1,550 jobs lost - but also physical restructuring to enable the company to operate on a significantly reduced scale. This option effectively represents the small yard strategy consideration of which was sought by Treasury Ministers in 1984. Although H&W might still be able to produce a large unsophisticated ship, PA advise that it would be

unable to build any other ship at the same time; more probably it would concentrate on small ships which it could complete in more acceptable timescales. In this case H&W could not compete for, eg repeat SWOPS or quasi-naval orders; and would find itself more often than not in head-on competition with BS.

APPENDIX 6

SCENARIOS	A1 (Optimistic) £m			B1 (intermediate) £m			B2 (intermediate) £m			C1 (intermediate) £m			D2 (lowest) £m		
	1986 -87	1987 -88	1988 -89	1986 -87	1987 -88	1988 -89	1986 -87	1987 -88	1988 -89	1986 -87	1987 -88	1988 -89	1986 -87	1987 -88	1988 -89
1. Direct DED Support (mainly Intervention Fund and interest-free Loans)	34.6	32.6	11.5	36.5	34.0	29.5	36.5	34.0	29.5	36.5	34.0	29.5	36.5	34.0	29.5
2. Bank borrowings (1)	-	-	-	1.5	9.0	-	1.4	8.5	-	0.7	6.0	-	-	3.1	-
3. Restructuring costs (financed by DED)															
- Redundancy	-	-	-	0.5	0.1	-	0.5	1.4	-	0.5	1.2	-	0.5	7.8	-
- Capital	-	-	-	-	2.3	-	-	2.3	-	-	2.3	-	-	4.7	-
TOTAL EFL (2)	34.6	32.6	11.5	38.5	45.4	29.5	38.4	46.2	29.5	37.7	43.5	29.5	37.0	49.6	29.5

NOTES: (1) Sums borrowed in 1986-87 will be repaid early in 1987-88; a similar sum will be borrowed in addition to fresh borrowings, at the end of 1987-88. The total will be repaid early in 1988-89. This procedure keeps interest costs to a minimum and helps smooth out short-term fluctuations. On Government's definition however it inflates the 1987-88 EFL

(2) The 1988-89 EFL figures take account of repayment of bank borrowings.

APPENDIX 7

PROPOSED SYSTEM FOR FINANCIAL CONTROL AND FLEXIBILITY FOR HARLAND AND WOLFF

INTRODUCTION

1. This paper outlines the new financial control and contract approval system to be called the Contract Support Limit (CSL).

I - FRAMEWORK FOR NEW SYSTEM

2. The primary aim of the new system - supplementary to the EFL controls - is to reduce the risk of H&W incurring losses greater than the Government is prepared to finance. The objective is to place a strict limit, insofar as this is possible, on HMG's exposure to excessive losses by providing the maximum incentive to reduce trading loss and limiting H&W's ability to take new loss-making work and to do so in a way which leaves them with the main responsibility for deciding what work to take. The system will operate on the aggregate cost of orders in order to reduce the risk of future losses, while allowing H&W to take more orders within the same overall cost if they become more efficient.

3. The aggregate cost of orders (the cost/price gap) is met in three ways:

- Intervention Fund (IF)
- Special credit
- Contract losses

The control system will apply to all three, by setting an annual limit on the aggregate cost of IF special credit and contract losses on all orders - the CSL. In addition any third party financial guarantees given by H&W will be valued and that valuation will count against the limit.

II - STRUCTURAL DETAILS

4. The system will thus consist of a predetermined annual limit for the funds available for commitment in the form of:

- IF (or equivalent)
- contract losses, including soft credit
- third party guarantees

and these are considered in more detail below.

Appendix 7 (Contd)

The limit will apply to all existing and new contracts over £500,000 in total (including MOD, offshore, merchant and engineering). MOD orders are expected to be taken at a profit. Should actual losses be incurred on naval work these should be charged to the CSL.

5. As new commitments appear, either as a result of new contracts or by an increase in the management account estimates of the loss on existing contracts, they are deducted from the contract support funds available. When the limit is exhausted or seems likely to be exhausted no further commitments can be made which would cause the limit to be exceeded.

Intervention Fund

6. For a given new order, the whole of the IF committed is to be scored against the limit for the year in which the order is taken. The date at which an order is taken is defined variously for different purposes; for this control system, it is the date when it is treated in the management accounts as a firm contract, and direct costs are charged against it.

7. IF may not of course be utilised to fund MOD contracts.

Contract Losses

8. Contract losses on actual contracts, excluding yard under-recoveries, are to be scored for the whole contract as soon as they appear in the management accounts, either as new provisions for new contracts or as alterations in loss provisions for older contracts. Contracts should be reviewed at least quarterly and provisions and their bases will be subject to review by the auditors.

9. The Department will need advance notification of any changes in accounting practice in respect of overhead allocation and recovery.

Special Credit

10. Special credit is currently recorded in H&W's management accounts separately from contract costs. For the purposes of this scheme, any special credit in relation to specific future contracts will count as a contract cost and will score against the limit.

Flexibility

11. It is recognised that due to the small number of orders taken over any 1/2 year period, flexibility is required between years, and to overcome this the following provisions will apply:

(a) The limit will be set on an annual basis for each year, and all charges must initially be charged against the current year.

(b) When the current year limit is fully utilised then the unutilised portion of the previous year and/or the whole of the future year's limit may be used, the previous year being used first.

(c) The total limit (or balance remaining) in respect of any year may not be carried either forward or back more than one year. If Year 1 balance is not utilised in Year 2 it will be lost and cannot be carried forward to Year 3, and similarly none of the Year 3 balance can be taken back to Year 1.

12. A "pool" will therefore be created in any year consisting of the current year limit and any balance from either the preceding or succeeding year.

Financial Guarantees

13. Guidelines for the giving of third party guarantees are attached at Annex 1. The total gross contingent liability arising from such guarantees shall at no time exceed £50m. For the purposes of scoring against the CSL, guarantees will be valued at 10% of exposure net of

security for UK owners or where the risk lies with a country for which adequate ECGD cover is available at the time of contract, and at 15% of exposure net of security where the risk lies with a country for which adequate ECGD cover is not so available. The value of security taken in individual cases will be subject to post hoc evaluation by the Department of Economic Development (DED).

Exceptional Items

14. Experience shows that H&W can suffer some large exceptional losses, often arising from events outside their control. It could be onerous if these were all to be directly scored against the limit regardless of circumstances. One default could absorb a substantial part of the annual limit. Exceptional items should arise only from events outside the control of the company eg defaults; and the company will need to seek the approval of DED before any loss can be classified as exceptional. The treatment of such exceptional items will be determined on an ad hoc basis.

Information requirements

15. For DED control purposes we will need to know for each order taken at least:

- IF committed

- special credit and any other contract loss
- guarantee arrangements
- the headroom available within the limit, after deducting other commitments and contracts losses according to the rules above
- a description of the full financial arrangements.

DED detailed requirements will be set out in a standard form for completion by H&W.

16. The operation of the CSL will be reported regularly to DED as part of the normal monitoring procedures.

III PROPOSED GUIDELINES AND CONSTRAINTS

17. The principal constraint is the overall annual limit. Within this overall constraint H&W will no longer be required to clear with DED beforehand and in detail the IF and any other subsidies involved for an order which meets certain conditions outlined in Paragraph 19 below. The IF scheme will otherwise be operated as at present, with post hoc evaluation of costs and appropriate clawback arrangements for overpayment of grant.

APPENDIX 7 (Contd)

18. H&W will no longer normally be required to produce detailed cost estimates in each case to demonstrate that orders were not taken at a loss. Such losses as are incurred on individual contracts will be deducted from the available funds under the proposed new financial control arrangements.

19. In order to meet EC requirements, the following conditions will apply:

(i) A maximum IF of 20.5% for vessels below 70,000 dwt and 25.5% for those above. H&W should, however, bear in mind the possibility that at some stage cases may need to be notified to the European Commission. Cumulative IF volume applied must not exceed tranche agreed.

(ii) No orders to be taken on terms manifestly involving a loss ab initio after crediting IF and any special credit.

(iii) A limit of 8% of contract price in NPV terms on the amount of special credit that can be applied to individual contracts.

APPENDIX 7 (Contd)

(iv) H&W must consult DED in advance about the terms of any IF or special credit in all cases where there is competition from the UK private sector or from British Shipbuilders, and in all cases where there is competition from within the EC.

20. Financial arrangements not meeting these conditions will require Government clearance in advance on those aspects falling outside the guidelines.

ANNEX 1
(to Appendix 7)

THIRD PARTY GUARANTEES

PROPOSED GUIDELINES FOR HARLAND AND WOLFF:

1. There are serious legal difficulties in the Department of Economic Development issuing third party guarantees. These should be avoided where possible and guarantees should be provided by the company on the strength of the Parliamentary Statement that the Government is standing behind it.

2. Guarantees to be given only in support of established owners with a known track record.

3. H&W to seek to limit their exposure to any single owner to a prudent level.

4. No guarantee to be given without adverse consequences for the owner should it be called; H&W to try to secure the maximum available security from the owner. There should be sufficient adverse consequences, triggered either by the lending bank or H&W, to give rise to substantial cost to the owner should he default.

5. All guarantees to be subject to UK Law.

Annex 1 (Contd)

6. Except where H&W directly hold security, guarantees to be structured such that they are exercisable by the lending bank only after it has-

   i. consulted H&W on its course of action;

   ii. exercised, before calling its guarantee, whatever security it holds from the customer.

7. Security of the following types should typically be sought, singly or in combinations as appropriate:

   i. mortgages on the vessel preferably first, with second mortgages only if the available security remains appropriate to the liability associated with the guarantees;

   ii. mortgages on other vessels in the customer's fleet;

   iii. long term charter earnings, routed through the lending bank and appropriately pledged;

   iv. mortgages on the owner's other (non-shipping) assets;

   v. guarantees from parent or associated companies;

   vi. guarantees from banks or insurance companies.

Annex 1 (Contd)

8. In the case of high risk countries to ensure, as far as possible, that mortgages on ships are enforceable, in the sense of being held only on ships which regularly ply in waters where seizure is a practical option.

9. The aggregate of H&W gross exposure through third party guarantees at no time to exceed £50m.

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APPENDIX 8

FIVE YEAR SUMMARY

	1980 (1))	1981/82 (15 months)	1982/83	1983/84	1984/85
Net Loss (£m) (1)	32.0	26.2	42.8	29.8	35.8
EFL's (£m) (2)	41.5	46.0	46.2	40.0	37.5
Manpower (3)	7370	7034	6162	5309	4998

NOTES:

(1) The net loss is as recorded in the annual accounts - the figures for 1981/82 being for 15 months when the accounting year end was changed from December to March.

(2) The EFL is on a financial year basis.

(3) Manpower represents employment at the end of the accounting year.

PART 8 ends:-

SS/TRP TO LORD CAITHNESS 31.1.86

PART 9 begins:-

NIO TO DRN 14.2.86