

CONFIDENTIAL FILING

Prime Minister's ^{meeting} with Neville Trotter MP,
13 March 1986, about Swan Hunter
shipyard.

PRIME MINISTER

March 1986

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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10 DOWNING STREET

From the Private Secretary

18 March 1986

*NAT. IND.
shipbuilding
A9.*

*copy reply on
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I attach a letter the Prime Minister has received from Neville Trotter, M.P.

I should be grateful for the draft reply for the Prime Minister to send, to reach us as soon as possible.

I am copying this letter and enclosure to Catherine Bradley (Department of Trade and Industry).

Tim Flesher

David Woodhead Esq
Ministry of Defence

[Handwritten scribble]



HOUSE OF COMMONS
LONDON SW1A 0AA

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aMA

Prime Minister

To note

TV

Monday 17th March 1986 19/3

The Rt. Hon. Margaret Thatcher, MP
Prime Minister
10 Downing Street
London SW1

Send a copy to
George Younger at. Release
part

Dear Margaret,

SWAN HUNTER

I much appreciated the sympathetic way in which you listened to what I had to say when we met. I am sorry to write again at length but the matter is of extreme importance to Tyneside.

As an accountant I am afraid that I remain unconvinced that Harlands can actually build the AOR for less than Swans. This is based on over ten years of constant contact with the shipbuilding industry. My view is confirmed by discussions which I have had since we met with very senior people at British Shipbuilders.

John Lee mentioned design, delivery and contract terms as well as price. On design; there cannot be much difference in their effectiveness as the Navy have been so involved with both. On delivery; Swans have an excellent record on all their Naval deliveries, had not thought it to be a significant factor for this ship and tell me that they will have no difficulty in matching Harlands. On contract terms; only a state company with no regard for the realities of commercial life and with the whole risk and penalties underwritten by Government could forego the fixed price incentive formula which has recently applied to all first of class contracts for shipyards in the private sector. While I understand this 'clean' bid by Harlands being attractive to MOD, it just confirms my view of the unfair way in which Harlands is competing.

The main problem for Swans is of course the price bid by Harlands. I just do not believe that it is realistic and allows for full recovery of overheads even if as seems possible some future overheads have unusually already been written off. There is widespread support for my view in the industry. It must surely be a cardinal principle of any remaining state concern that they compete fairly with the private sector. Might I suggest that there is a very strong case for appointing outside and independent accountants with no previous connection with Harlands to examine their figures.

Despite John Parker, Harlands have continued with massive losses funded by interest free unsecured loans from public funds. They are probably losing much the same as the whole of the British Shipbuilders yards. Not much of a record !

The present pay at Swans is in fact not high with over 80% of the hourly paid receiving £135 or less without overtime. The figure the management have in mind for the year ahead is not more than Yarrows, for example, paid last year. The management are determined to stamp out the bad practices of the past under nationalisation and hence their current trouble with an overtime ban. Harlands point to their lack of trouble but commonsense tells one that the peace in this commercially undistinguished yard is because adequate steps have not been taken to put things right. I know that British Shipbuilders regards Harlands working practices as inferior to those at Govan, Sunderland and Smiths at Teesside. This hardly supports their present bid.

All Swans current contracts were won in open competition and their price for the type 42's was the lowest of all the warship builders. The delay in placing 23/03 after 22/13 was steered to Cammells can only have exacerbated their overhead loading.

I appreciate the pressures on the defence budget but the problem we now face stems in part from the slowing down of Naval orders. This is a very labour intensive field where additional funds would enable the Navy to speedily find additional work. Lack of funds, for example, has prevented an aviation support ship being in the programme although my Naval friends are keen to have one. Again we could now order 23/04 which at present looks like being in 87 instead of in 85/6 as originally planned.

Swans management firmly believe in privatisation and are showing a commendable determination to make it work. There is tremendous potential at Swans from which all on Tyneside can benefit. By contrast if they lose the AOR with no alternative new order redundancy would be immediate with 1000 going this year and at least as many next year. A disaster for Tyneside with the loss three times as great as the jobs gained in Nissan.

The political consequences for us on Tyneside would be very grave.

Yours ever

North

PRIME MINISTER

MTB WITH

N. TROTTER

3/86



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10 DOWNING STREET

From the Private Secretary

13 March 1986

SWAN HUNTER

Mr. Neville Trotter M.P., met the Prime Minister today to discuss Swan Hunter. The Parliamentary Under Secretary of State for Defence Procurement was also present.

Mr. Trotter explained his concern about the prospects for Swan Hunter. The management of the company, now in the private sector, had been making great efforts to remove restrictive working practices. The present industrial action was greatly to be regretted, but on the whole the company enjoyed good labour relations. Swan Hunter management had hopes of winning orders for landing craft and stores ships from overseas. However, the yard were short of orders, and there was a risk that the company could fold. The management had backed the Government's privatisation policies and it would not be understood if the order for the first AOR went to Harland and Wolff, a public sector company.

Mr. Trotter said there was some surprise in the industry that Harland and Wolff had been designated as a constructor of warships, in view of the over-capacity in the industry. Some sub-contractors on the mainland expected that they would get no orders from Harland and Wolff. These would be likely to go to GEC because GEC would place the work in Northern Ireland. There was concern that Harland and Wolff would cross subsidise its tender for the first AOR, and that it was in a position to put in a low bid because the management would expect to receive further financial backing from the Government if the contract went awry.

The Prime Minister said that Swan Hunter had to put in competitive bids if it was going to win work from MOD. Your Minister said that a Type 23 Frigate had been virtually guaranteed to Swan Hunter, but that Swan's bid was on the high side. It was likely that only one more Type 23 Frigate would be ordered this year. Swan's bid for the first of class AOR was also high - the difference between its bid and that of Harland and Wolff could not be accounted for by cross-subsidy - and Swan Hunter were also less competitive on design, programme timing and contract conditions. (This and other information was given in confidence).

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Whilst the MOD had a high regard for the technical competence of Swans, there was a substantial surplus of warship building capacity in the UK: the Controller of the Navy had said that the Navy could meet almost all its requirements for ships at Vickers/Camell Laird. MOD believed one reason why Swan Hunter's bid for the AOR might be uncompetitive was their choice of partners, though their price for the first Type 23 Frigate suggested that this was not the only reason. Mr. Lee concluded by describing the possible future orders for which Swan Hunter might bid: these were the refits of Britannia and Illustrious (though the latter would not arise until 1989/90) and in due course replacement amphibious capability, though a decision on the requirement for that had yet to be taken. There seemed to be nothing that Swans could do now to win the first AOR, but further orders would need to be placed later for which Swans could bid.

The Prime Minister emphasised the need for Swans to make themselves fully competitive. She undertook to establish that the bid for the first AOR from Harland and Wolff involved no cross subsidies, whether through allocation of overheads or in other ways. I should be grateful if you could arrange for the preparation of a note for the Prime Minister on this point.

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

(DAVID NORGROVE)

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

cc Blyp
Political
Blyp



MO 26/3/3E

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-~~936 7002~~ 218 6169

12th March 1986

John Cardine

You wrote to Richard Mottram about Mr Neville Trotter's appointment to see the Prime Minister tomorrow. Mr John Lee will attend, and I attach a brief for the meeting.

The Ministry of Defence has not yet finalised its negotiations to seek as low a price as it would like for the AOR vessel and further reductions are being explored. The latest figures will be given to you by telephone nearer to the time of the meeting.

In these circumstances, it is particularly important that neither Swan Hunters nor Harland & Wolff know their position in the competition and I shall be grateful if the brief can be safeguarded accordingly.

Copies of this letter go to Michael Gilbertson (DTI) and Philip Wynn Owen (Treasury).

*Yours sincerely
D J Woodhead*

(D J WOODHEAD)
APS/S of S

Caroline Ryder
No 10 Downing Street

PRIME MINISTER'S MEETING WITH NEVILLE TROTTER MP

POINTS TO MAKE

1. Orders for warships will be decided on price and technical merit.

2. There is over-capacity in the warshipbuilding industry and almost all yards are in areas of high unemployment.

3. Auxiliary Oiler Replenishment Vessel (AOR)

Decisions have yet to be taken on the AOR competition. Government policy is that Harland & Wolff should not be offered guarantees or subsidies in connection with tenders for warships. Swan Hunters have had:

- a. the advantage of undertaking the original concept studies for the Ministry of Defence, and
- b. an opportunity to re-tender after privatisation

4. Type 23 Frigates

The offer of a Type 23 Frigate is still open but Swan Hunters must reduce their price to a competitive level.

PRIME MINISTER'S BRIEFING WITH NEVILLE TROTTER MP

BACKGROUND

1. As part of the Government's programme to privatise the warshipbuilding yards of British Shipbuilders, Swan Hunter Shipbuilders (SHS) was purchased by a management buy-out team in January 1986.

SHS CURRENT PROGRAMME

2. The Firm's current programme of work is:

	<u>Launch Date</u>	<u>Completion Date</u>
TYPE 22-09 (HMS SHEFFIELD)	26 March 86	November 87
TYPE 22-10 (HMS COVENTRY)	April 86	February 88
TYPE 22-14 (HMS CHATHAM)	August 87	September 89
RFA SIR GALAHAD	November 86	July 87

These dates have been amended in the light of last year's strike action at the Firm.

FUTURE WORK

3. SHS has tendered for the design and build of the first two Auxiliary Oiler Replenishment (AOR) Vessels and for the build of the next three Type 23 Frigates (02, 03 and 04).

AOR

4. The AOR is a "one-stop" Replenishment Vessel for the support of the Front Line Fleet. It will be capable of simultaneous replenishment at sea of stores, fuel and ammunition, and will also provide support facilities for helicopters on Type 23 Frigates. Because of the value of its cargo (£150m, including embarked helicopters), it needs a self-defence capability.

5. SHS and Harland & Wolff (H&W) have submitted tenders for the design and build of the AOR. Defence Ministers have not yet reached a final decision but H&W are emerging as clear winners of the competition. Apart from price, their design, prepared with the support of specialist design agencies, is technically superior. This has been confirmed by an independent commercial assessment. H&W have offered earlier delivery and are more compliant with the Ministry of Defence's contract conditions.

6. On price, the SHS tender for a first of class ship that meets the Ministry of Defence requirement in full was much higher than the H&W tender. The Ministry of Defence's target price was £122M. SHS has offered (post privatisation) a design for £126M but for a ship with a significantly reduced capability, eg on survivability after damage.

7. In his letter of 27 February, Mr Trotter implies that the H&W tender for the AOR is subsidised and SHS will be at a disadvantage. The Northern Ireland Office has, however, made it quite clear that it is not Government policy to offer guarantees or subsidies to H&W in relation to specific tenders for Naval Vessels when there is competition with other UK Warship Yards for the contract (Hansard 20 February, col 274, copy attached).

8. Depending on the Northern Ireland Secretary's advice on the current situation in the Province, the Ministry of Defence is likely to order AOR-01 this month. Decisions on timing of the order for AOR-02 will be delayed because of defence budget pressures.

TYPE 23 FRIGATES

9. SHS has submitted a single tender for Type 23-02 and a tender in competition with other shipyards for 23-03 and 04. The single tender only for 23-02 was announced by the then Defence Secretary on 28 January 1985 following the award of a Type 22 Frigate Contract to Cammell Laird (Hansard col 21 refers, copy attached). The order is subject to satisfactory agreement on price and contract conditions.

10. SHS tenders for 02 and 03-04 are very high in relation to the other tenders. All firms have been invited to retender by early April. SHS, who will be re-tendering with a first bid from the new management, have been advised that their tenders were high.

COMPETITION POLICY

11. It is the Ministry of Defence's policy to place orders for warships on the basis of price and technical merit following competition. Exceptionally, wider factors were taken into account in inviting a single tender for Type 23-02. With Vickers/Cammell Laird, SHS, Vospers, Yarrow Shipbuilders, Scott Lithgow and H&W competing for naval orders, there is significant over-capacity in the warshipbuilding yards at present. The Ministry of Defence alone does not have sufficient orders in its future programme (which is in any case under pressure) to sustain the present size of the industry. It therefore seems inevitable that, without an increase in orders (eg for export), some of these yards will have to close with significant job losses.

12. SHS has, in recent years, transferred from a very large group with a minority interest in warshipbuilding to only two shipyard sites now building solely for the Ministry of Defence. The firm completed its last merchant ship in January 1985. Failure to win the AOR order will put retention of the SHS Design and Drawing Offices at risk. If they also fail to win frigate orders their viability is doubtful, but splitting the AOR order would be especially expensive because two first of class costs would be involved in addition to SHS higher price. SHS capacity is not essential to the RN Warshipbuilding Programme and there is no case for disturbing the natural results of competition to sustain the yard.

13. Unemployment in the SHS Travel to work area is 68,040 (19%)
and for H&W it is 62,118 (18.3%).

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.

Frigate (Orders)

3.32 pm

The Secretary of State for Defence (Mr. Michael Heseltine): As the House knows, I have been considering the results of a tendering exercise for two type 22 frigates for the Royal Navy. Cammell Laird, Swan Hunter and Vosper Thornycroft were each invited to tender for these warships—one, the fourth replacement for warships lost in the South Atlantic, and the other an addition to the naval programme which I authorised in 1983.

The tendering process has been unusually protracted, for several reasons. I have been concerned to obtain the best available prices and tauter contract terms than we have been accustomed to in this area of defence procurement. The earlier tender replies did not adequately contribute to this objective, and it was not possible to take a decision on the order before the validity of the tenders expired. A final round of tendering was initiated in late July last year. The results of this round met several of the concerns to which I have referred, and, as with the earlier rounds, showed that the competition had been close and keenly fought.

The House will be aware that the decision on the orders for the frigates has important implications for each of the competing yards. I have considered the implications carefully, in consultation with my ministerial colleagues.

At this point, I should say that the deplorable and unnecessary industrial action which occurred last summer at Cammell Laird would, as I made clear at the time, had it continued, have excluded the yard from further consideration in the competition. The courage and determination shown by the moderate element of the work force at Cammell Laird, in the face of the intimidatory behaviour of their former work colleagues, has averted the almost certain closure of the yard at an early date.

The cheapest solution from the point of defence procurement would be to place the order for both ships with one yard, but, in the light of the wider and relevant factors involved, I have decided that an order for one type 22 frigate will be placed with Cammell Laird and for the second with Swan Hunter, and I am prepared to authorised the necessary expenditure. This offers the prospect of survival of Cammell Laird as a major warship builder; without such a contract the yard would have closed. I hope that the yard will succeed in obtaining other business in the short as well as the long term.

Swan Hunter, which is a much larger firm and is implementing a large redundancy programme at the moment, could face further substantial redundancies even with the order which I have just announced. The Government wish to do what they reasonably can to prevent this. Last autumn we embarked on the construction of a new class of frigate, the type 23, and negotiated a first order at Yarrow on the Clyde. I have decided to negotiate an order for the second type 23 frigate at Swan Hunter as soon as this can sensibly be done, and subject to satisfactory agreement on price and other contract terms. I will 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 will be invited for the third type 23 order in the same time scale from all United Kingdom yards capable of carrying out the work.

Mr. Denzil Davies (Llanelli): The Secretary of State's statement will obviously be welcomed both by the Royal Navy and by the two warship yards which have been given orders to build the three new frigates. It will be welcomed especially because it seems likely that this will be one of the last statements on major equipment orders in defence which the Government will make in this Parliament. From now on it is likely to be cancellations all the way.

The statement has an air of desperation about it. The Secretary of State is desperate because the Treasury will demand, if we read the public expenditure White Paper correctly, larger and larger cuts in defence. He is desperate also because the cost of Trident over the past months has increased by about £200 million a month. For the Secretary of State to talk about "tauter contract terms" is cynical and ridiculous. When are we to see tauter contract terms for Trident, the costs of which have doubled under the Government?

Why was there delay in placing the order, especially for type 22 frigates, the first one of which will be a replacement for the one lost in the Falklands war? Why does the Secretary of State not make it clear that the delay stems from budgetary problems in his Department and not from industrial problems at the yards? What will be the cost of a type 23 frigate? Some of us remember that one of the reasons for closing Chatham dockyard was that type 23 frigates would be disposable vessels and would cost about £70 million. What is the cost of a type 23 frigate now? If the type 23 is not to be disposable after all, is the right hon. Gentleman satisfied that the Royal Navy, after he and his business partner, Mr. Levene, have finished with it, will have the necessary dockyard facilities to refit the types 22 and 23 and all the other warships of the Royal Navy?

Mr. Heseltine: I suppose that the House will sympathise with the right hon. Gentleman for talking about everything except the subject of the statement. I shall answer the relevant questions that he put to me. The delay of which he spoke has nothing to do with any budgetary problems in my Department. Anyone who has any idea of the considerations that have been brought to this matter will know that. The approximate price of a type 23 frigate now is about £110 million. We shall ensure that there are adequate servicing and repair facilities. Our problem is one of over-supply of facilities, rather than under-supply.

The House will perhaps judge the sincerity of the right hon. Gentleman's contribution to my statement against the background of the Government having increased defence expenditure in real terms by £3 billion a year, while the Labour party was committed to reducing it by a third as soon as it came to power.

Sir Antony Buck (Colchester, North): Is my right hon. Friend aware that most of us on the Conservative Benches will welcome his statement, which will certainly end the uncertainty about these matters? When are the type 22s likely to go into service with the Royal Navy? Similarly, when will the type 23s, which will be following thereafter go into service?

Mr. Heseltine: I am grateful to my hon. and learned Friend. As a rule of thumb, one can broadly assume that an order takes four to five years—probably nearer four years—to complete. That will give my hon. and learned Friend and the House the answer to his question.

MERCHANT SHIPBUILDING IN THE NORTH EAST

1. Merchant shipbuilding in the North East is concentrated on 3 British Shipbuilders (BS) yards - two on Wearside (Austin & Pickersgill and Sunderland Shipbuilders, at Sunderland) and the other on Teeside (Smith Dock at Middlesbrough).

2. BS recently announced that these three companies would be brought under common management to form a new BS company - North East Shipbuilders Ltd. Under this plan Austin & Pickersgill and Sunderland Shipbuilders will merge on 1 April and Smiths Dock will join the group in the summer of this year. The merger is primarily an efficiency measure to help reduce overhead costs, accelerate the sharing of services, and provide greater efficiency to helping to adjust to market conditions. The formation of this company is not viewed as a prelude to further redundancies. No further redundancies (beyond those already announced - see para 4) or yard closures are currently planned.

3. As with all merchant yards at present in the face of a continuing and deteriorating slump in the world market, these yards are desperately seeking new orders, although all currently have work until the end of 1986.

4. Their combined employment is currently a little over 4,500. redundancy programmes have been initiated at Austin & Pickersgill and Sunderland Shipbuilders over recent months. Some 200 redundancies have yet to be effected from the earlier programmes.



Briefing with
TF: 13/3



12/3

10 DOWNING STREET

From the Private Secretary

7 March 1986

As I mentioned on the telephone this morning Mr. Neville Trotter MP has an appointment to see the Prime Minister at 1615 on Thursday 13 March in Mrs. Thatcher's room at the House of Commons at which one of your Ministers would be present.

I would be grateful if you would let me know at your convenience who it would be and also supply us with a short brief to reach us by close of play on Wednesday 12 March.

I enclose a copy of Mr. Trotter's letter to the Prime Minister with all the relevant details.

I am copying this letter to Michael Gilbertson (Department of Trade and Industry) and to Philip Wynn Owen (HM Treasury).

(Mrs. Caroline Ryder)

Richard Mottram, Esq.,
Ministry of Defence.

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HOUSE OF COMMONS
LONDON SW1A 0AA

The Rt. Hon. Margaret Thatcher, MP
Prime Minister
10 Downing Street
London SW1

Thursday 27th February 1986

Dear Margaret,

SWAN HUNTER

I feel that I must write to you to express my grave concern at the imminent threat to the recently privatised Swan Hunter from the State owned Harland & Wolff. Swans being no longer eligible for intervention fund payments are now effectively out of the merchant market and wholly dependant on their specialist Naval work into which field Harlands are seeking to enter and in particular to undercut Swans on the AOR order about to be placed.

The management at Swans are a good team and I know you will agree with me that they are to be congratulated in taking on the challenge of privatisation. All my naval friends regard the yard very highly and their record in the naval field is excellent. Apart from building the two recent aircraft carriers they have over many years designed and built most of the Navy's supply ships. For several years they have been working with the Navy on plans for the very complex new AORs and I might add that John Nott, when at MOD, personally assured me that they would build these ships.

As an efficient yard greatly experienced in complex warship work they have cut their price to the bone for this sophisticated ship and yet it seems that they may be undercut by Harlands who just do not have the background of expertise in this field. The contrast between the two yards is very great: Swans are a market leader in computer graphics, have an excellent design staff and project management capability; Harlands have been out of warship building for some 25 years, do not have an inhouse project management capability and would have to recruit or subcontract the necessary design team. All this at the expense of the existing facilities at Swans. This is surely absurd and could only be entered into by a State owned concern with no commercial restraints.

Whatever Harlands may say it is beyond belief that they can actually design and build this sophisticated ship for less than Swans. While MOD might benefit from a lower quote now I am sure that the taxpayer would have to pay far more at the end of the day when Harlands failed to carry out the work at this figure.

.../...

The Rt. Hon. Margaret Thatcher, MP

27th February 1986

I understand the arguments for supporting Harlands in the Northern Ireland context. Surely, however, the assistance going there should be to help them compete for merchant or offshore work with foreign yards and not with our own traditional warship builders who as you know are all short of work. Having just privatised all the traditional warship builders it surely does not make sense, and is indeed unfair, for the State sector with the taxpayer behind them to return to the Naval field through Harlands entering this activity.

When I wrote to you a year ago Swans were reducing from 7,000 men to some 4,500. Without the AOR they will be down to about 2,000 and at this level the volume of work becomes too low to support the yard's activities and they will be in terrible trouble. The situation facing them is thus crucial and I need hardly point out to you the appalling effects in every way if they were forced out of business shortly after privatisation. Apart from the political implications it would have a devastating effect on the whole of Tyneside. The North East has the highest unemployment in Britain. Over 50,000 men are out of work on Tyneside. Male unemployment in the County is now 26% and in the riverside area of my constituency next to Swans it is much higher.

With frigate design centered at Yarrows the design work on the first of class AOR is vital for the maintenance of design capacity at Swans which apart from anything else the Navy surely wishes to retain. The management believes there to be export work to be obtained in this field but not in time to enable them to keep their design staff occupied unless they are engaged on the detailed work on the AOR. Without an inhouse design capability the export market cannot be penetrated despite the many existing promising leads.

You will recall that after I wrote to you a year ago about frigate orders a Type 22 was given to Cammells despite the lower bid from Swans but they were promised the next Type 23 order. A year later this ship has still to be ordered! It certainly shouldn't be thought that it could be used to compensate them for the appalling loss of the AOR as well. Only the first of class AOR can enable Swans to keep the design staff and capacity necessary for the future.

I believe that for this order to be placed with Swans is not only vital to the North East but also fair to the private sector and in the national interest. The matter should be of wider concern than just MOD and the views of the Treasury and the Northern Ireland Office who would ultimately have to pay the bill, should be sought.

Yours ever

North

To finance their buy out the Swan's management have had to take considerable personal financial risk - lets back their courage as well as their expertise!

Grey Scale #13



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