PREM 19/2101

PART 15 SECRET. MT

176

CONFIDENTIAL FILING

Policy towards Privatisation
Disposal of Public Sector Assets
Contracting out of Public Sector functions

ECONOMIC POLICY

PT 1: June 1979

PT 15: November 1986

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~19.11.86~~		~~5.3.87~~					
~~24.11.86~~		~~16.3.87~~					
~~28.11.86~~		~~18.3.87~~					
~~3.12.86~~		~~19.3.87~~					
~~4.12.86~~		~~24.3.87~~					
~~8.12.86~~		25.3.87					
~~9.12.86~~							
~~22.12.86~~							
~~12.1.87~~							
~~15.1.87~~							
~~19.1.87~~		PART ENDS					
~~20.1.87~~							
~~21.1.87~~							
~~23.1.87~~							
~~28.1.87~~							
~~29.1.87~~							
~~3.2.87~~							
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~~19.2.87~~							
~~23.2.87~~							
~~24.2.87~~							
~~27.2.87~~							
~~3.3.87~~							

PREM 19/2101

PART 15 ends:-

HMT TO DRN 25.3.V7

PART 16 begins:-

MOS/MOD TO CHEXQ 1.4.V7

RT8.19

SECRET AND MARKET SENSITIVE
(until 8.30am on Thursday 26 March)

6

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

25 March 1987

D R Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David

BP

The BP Board has approved this afternoon an announcement, to be made at 8.30 am tomorrow, that BP North America intends to make a tender offer for the 45 per cent equity of the Standard Oil Company which it does not already own. Approval of BP's shareholders will be required.

This is a major acquisition, which could cost BP over £4 billion, and is bound to attract attention in the financial press, particularly in view of the interest in the Government share sale.

When the Government's sale was discussed with BP, Sir Peter Walters advised the Chancellor in strictest confidence that the Board was considering this acquisition and that it could go ahead at about this time. But beyond that the Treasury has had no knowledge of the terms and details of the negotiations.

If asked, Treasury Ministers will therefore take the line that this is BP's own commercial decision reached independently of the Government's decision to sell its remaining shares. Questions on it must be put to BP.

But there may be questions on whether Treasury Ministers knew of this proposal before the sale of shares was announced, and on what it implies for the sale.

To deal with this we have prepared the attached Q&A briefing, which has been cleared with BP. To be on the safe side, it goes into the matter at what is almost certainly unnecessary length: for most purposes the above should suffice.

I am sending copies of this letter to Geoff Dart (Energy) and to Steven Wood (Lord Privy Seal's Office). I must stress that until BP make their announcement, this information is market sensitive.

Yours ever,
Tony

A W KUCZYS
Private Secretary

BP SALE: BRIEFING ON BP's ACQUISITION PLANS

What discussions did you and BP have before the announcements?

1. We notified BP of our intention to announce a sale, in 1987-88, of the Government's shareholding in the Company. BP subsequently notified us of their intention of seeking the acquisition. But the decision-making was entirely separate.

When did the Government know of BP's plans?

2. Treasury Ministers were informed of this possibility after BP were advised of the Government's plans for a sale earlier this year.

Did you plan the timing of the announcements?

3. We had been in touch on our respective timing intentions. But [as I have said] the decision-making was entirely independent.

Wrong for the Government to know before other shareholders?

4. BP thought it right to inform the Government as the biggest single shareholder, with Board representation, of the possibility of this initiative. BP did so on the correct assumption that the Government would take no action on the news neither buying nor selling BP shares before the acquisition was public knowledge. BP have advised us that the Stock Exchange are satisfied that there has been no breach of Stock Exchange rules.

Does the Government support the acquisition?

5. This is a matter which BP have decided. It is the Government's normal practice to vote in support of proposals which have received the support of the Board.

How will the acquisition be financed?

6. This is a matter for BP.

Impact, if any, of acquisition for Government sale?

7. We will be examining all aspects of the sale with our advisers in due course including the implications of the acquisition.

Government's representation on the Board?

8. The Government have a Director on the Board. His responsibilities are exactly the same as all the other Directors ie to the Company as a whole.

What will happen to the Government Director after the sale?

9. This has not been decided.

JA2ANF

file

CBG

S

MTG RECORD

10 DOWNING STREET
LONDON SW1A 2AA

SUBJECT
CC MASTER

From the Private Secretary

24 March 1987

Dear Timothy,

PRIVATISATION PLANS

At the end of a meeting about mergers policy this morning (recorded separately) your Secretary of State sought the views of his colleagues about the privatisation of BSC and the Post Office. There were present the Lord President, the Chancellor of the Exchequer, the Secretary of State for the Environment, the Chancellor of the Duchy of Lancaster, the Chief Whip, Sir Robert Armstrong, Mr. George Guise, together with your Secretary of State.

Your Secretary of State explained that it cost BSC £160 million a year to keep Ravenscraig open as an integrated steel mill. It could well not be possible to privatise BSC including Ravenscraig with its losses running at that rate. A privatised BSC if left to its own devices would in any case close Ravenscraig immediately. Even if Ravenscraig's functions were reduced, its losses might still amount to £80 million a year. Nor would it be possible to privatise BSC with Ravenscraig remaining in the public sector, perhaps being financed through the Scottish Development Agency: a private steel company would not countenance a competitor of that kind. The immediate question was what might be said to Scottish interests in the run up to an Election or during an Election campaign about the future of Ravenscraig. Your Secretary of State said that in his view it might be possible simply to rest on the existing assurance which ran until August 1988.

In discussion the meeting recognised the immense political difficulty of closing Ravenscraig. It could also prove very difficult to resist extending the assurance. It was agreed that your Secretary of State and the Chancellor of the Exchequer would discuss with the Lord President possible forms of words which might be used in the coming months if Ministers were pressed about what would happen after the existing commitment expired. It would be most important to avoid setting a further date if at all possible.

The meeting also briefly discussed the prospects for the privatisation of the Post Office as a whole. The meeting

noted the strong emotional attachment to the Royal Mail as part of the public sector, and the risk of a major campaign against any proposal which might put sub post offices at risk. It was agreed that privatisation of the Post Office as a whole should not be pursued. The aim should be to privatise Giro Bank and to introduce other changes to improve efficiency in other areas of the Post Office, including greater competition.

I am sending a copy of this letter to Alex Allan (HM Treasury) and to Joan MacNaughton (Lord President's Office).

Yours,

David.

(DAVID NORGROVE)

Timothy Walker, Esq.,
Department of Trade and Industry

The following is a statement from the Treasury, issued at 1210 hrs 19 March 1987

The Budget arithmetic took full account of likely proceeds from the sale of BP shares.

The BP announcement therefore makes no difference to our estimate of privatisation proceeds in 1987-88 or subsequent years which remains £5 billion a year. It makes no difference to the PSBR which the Chancellor set in the Budget. It has nothing to do with the future scope for tax cuts.

It is simply a part of the Government's continuing privatisation programme, the overall size of which was announced in the Autumn Statement. The BP proceeds will be received in instalments, of which the first will be in 1987-88.

. 3362/48

010

CONFIDENTIAL
Until after announcement on evening of 18 March

cc BG

Treasury Chambers, Parliament Street, SW1P 3AG

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON SW1

cc BI
VFA
and pa

18 March 1987

Dear David,

SALE OF SHARES: BRIEFING

As you know, the Financial Secretary is announcing in his wind-up speech tonight the Government's intention to sell its remaining shares in BP.

I attach some briefing prepared by Treasury officials, in consultation with BP. I am copying this to Geoff Dart (Energy).

Yours sincerely

Nigel Williams

pp **JEREMY HEYWOOD**
Private Secretary

ENC

3684/006

CONFIDENTIAL
until after announcement on evening of 18 March

BRIEFING ON ANNOUNCEMENT OF GOVERNMENT's INTENTION TO DISPOSE OF ITS SHAREHOLDING IN BRITISH PETROLEUM

Factual

1. The Government owns about 578.5 million shares in BP - 31.6% of the total. The value at the 16 March price of 812p was about £4.7 billion.

2. The last Government sale of BP shares was in September 1983. 150 million shares were sold in an underwritten offer for sale by tender. The striking price was 435p - 7½% above the minimum tender price. Gross proceeds were £565 million (net about £540 million). There are no restrictions on when the remaining shares can be sold.

3. The Government's rights over BP derive from the Articles of Association. These can be changed by a 75% vote. They allow the Government to appoint two Government Directors to the Board. Their responsibilities, like the other Directors' are to the Company as a whole. They have the power to veto Board resolutions and to convene an EGM. They act within the framework of the established relationship between the Government and BP whereby the Government does not intervene in BP's commercial activities. There is one Government Director at the moment - Lord Barber of Wentbridge.

4. The Press Notice about the Government announcement asked financial advisers to contact the Treasury if they are interested in advising the Government.

5. There may be questions about the timing of the sale in relation to Rolls-Royce and BAA. The Rolls-Royce sale is planned for April/May and BAA for the summer. The BP sale will not cut across these plans. [If for any reason the RR or BAA sale had to be deferred it would be necessary to look again at the order and timing of those sales and of BP].

Positive

6. The Government is keeping up the momentum of the privatisation programme and its policy of encouraging wider share ownership.

Defensive

7. Method of sale? Overseas participation? Government's relationship with the Company?

These are matters for consideration with the Government's financial advisers, after their appointment, and with the Company.

Payment by Instalments?

8. The timing and number of instalments will be decided later.

Contribution to Privatisation Proceeds?

9. They will be an important contribution to the target of £5 billion a year from privatisation proceeds.

Company Reaction?

10. Should ask BP. Understand that content with the Government's decision.

Bad Time to Sell - Oil Markets Volatile

11. The shares will be sold "subject to market conditions". Oil markets always unpredictable. As an integrated company BP is less affected by oil price movements than pure oil producers. BP's share price rose strongly last year despite a halving of oil prices.

Fat Fees to the Government's Friends in the City?

12. The Government has led the way in reducing costs of share sales. Appointments made after competition to ensure the Government gets the best advice at the lowest cost.

Selling Assets to Fund Tax Cuts?

13. Privatisation receipts reduce borrowing below what it would otherwise have been but the prime purpose of the sale is to reduce Government involvement in the private sector.

010

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB
01-212 4581

SIR ALAN BAILEY KCB
PERMANENT SECRETARY

CF

Are DT really expecting a reply on this from us? We have not been asked for anything like this on any other privatisation while I have been here.

DCN
18/3.

Sir Michael Franklin KCB CMG
Ministry of Agriculture
Fisheries and Food
Whitehall Place
LONDON
SW1A 2HH

17 March 1987

Dear Michael,

PRIVATISATION OF BAA plc (FORMERLY THE BRITISH AIRPORTS AUTHORITY) - DISCLOSURE OF PROMOTERS' INTERESTS

I am writing to seek your assistance, and that of a wide range of copy recipients, in identifying and describing certain dealings of the Crown which we will have to disclose when shares in BAA plc are offered to the public in the summer. BAA plc is the successor to the British Airports Authority (hereinafter referred to as "the BAA"). The dealings to be disclosed are those between the Crown and BAA plc or any of its subsidiaries and associated companies (hereinafter referred to as "the BAA plc group") and between the Crown and the BAA. Similar exercises have taken place before other privatisations, and I understand they have worked effectively.

We need to take this action because the Crown is, in law, one of the promoters of BAA plc and has duties to disclose this information formally to BAA plc and to its prospective shareholders. Sufficient and proper disclosure is needed since otherwise it may be open to BAA plc, and indirectly its shareholders, to bring proceedings which might result in the rescission of contracts with the Government. Such proceedings

could give rise to government liabilities in damages. I am aware that this is a time-consuming task - but I fear it is absolutely necessary. I would therefore be grateful if you would provide information about your organisation's dealings with the BAA plc group and with the BAA along the lines set out in Annex 1 to this letter. If there are any questions about the details of this letter, I should be grateful if they could be directed to **Margaret Bethell** (212 4977, Room P1/036, 2 Marsham Street), to whom you should also address your replies.

I would be grateful for your initial response by 6 April, and for notification of any changes as they occur between then and the issue of the prospectus, probably in June/July 1987. In addition, would you and all copy recipients please confirm receipt of this letter by completing and returning the attached slip as soon as possible.

I am sending a copy of this letter to the Permanent Secretaries, Directors and heads of all bodies listed in Annex 3 to this letter. I would be grateful if you and copy recipients would consider whether there is any associated organisation not listed in the annex which, to your knowledge, should be regarded as a Crown body, and if so copy this letter to that body informing this Department that you have done so.

Yours sincerely,

Alan Bailey

ALAN BAILEY

ALL COPY RECIPIENTS

Please return this form as soon as possible to:

MISS M BETHELL

Department of Transport
CAP4
Room P1/036
2 Marsham Street
LONDON SW1P 3EB

"I confirm receipt of Sir Alan Bailey's letter dated 17 March which is receiving our attention."

Signed .....

Date .....

On behalf of (name of Crown body) .....

Tel No. .....

PRIVATISATION OF BAA plc (FORMERLY BRITISH AIRPORTS AUTHORITY): DISCLOSURE OF PROMOTERS' INTERESTS

WHAT NEEDS TO BE DISCLOSED IN THIS TRAWL?

1. Disclosure is required of all dealings or transactions between the Crown and members of the BAA plc group and the BAA during the "promotion period" (see paragraph 6 below), which are sufficiently significant that a potential investor in BAA plc or his professional adviser would reasonably require to know of them in order to make an informed assessment of BAA plc at the time of the prospectus. Examples of the dealings and transactions concerned are given in Annex 2.

2. All expenditure by the Crown and receipts by the Crown during the current financial year ie from 1 April 1986 to 31 March 1987 on any dealings with the BAA plc group and with the BAA also need to be reported.

DEFINITIONS

3. For this purpose, the Crown has a wide definition. It includes all manifestations of the Crown, except Her Majesty in a personal capacity. In essence, the Crown includes all government departments. It does not, however, include those public bodies which, by reason of their nature or by statute, are not agents or servants of the Crown. It therefore does not include nationalised industries, or commercial companies controlled by the Government such as the Rover Group plc.

4. Attached at Annex 3 is a list of bodies each of which we believe is or may be a Crown body, and at Annex 4 a letter sent from the Management and Personnel Office to the Department of Trade and Industry at the time of the sale of British Telecom, which seeks to define what constitutes a Crown body.

5. The members of the BAA plc group are:-

BAA plc
Scottish Airports Limited
Heathrow Airport Limited
Gatwick Airport Limited
Stansted Airport Limited
Prestwick Airport Limited
Edinburgh Airport Limited
Glasgow Airport Limited
Aberdeen Airport Limited
British Airports International Limited

An additional member of the BAA plc group will be British Airport Services Limited, from the date of its formation on 1 April 1987.

The Promotion Period

6. The promotion period commenced on 3 April 1985 and it will end on the date of issue of the prospectus, which until further notice should be assumed to be no later than July 1987. Prior to 1 August 1986, the date of abolition of the BAA and vesting of its business in BAA plc, you should consider transactions and dealings with the BAA.

7. The extent of disclosure for significant dealings or transactions (ie those referred to in paragraph 1) depends in part on the facts of each case. In general, both the fact that the Crown is interested in the transactions and any "profit" made as a result of the transaction requires to be disclosed. For these purposes "profit" means any net benefit accruing to the Crown as a result of the transaction and not just a cash surplus, so where the Crown has received some other sort of benefit from the transaction that too must be disclosed. Sufficient details of each transaction should be disclosed in order to enable the buyer of shares in BAA plc or the directors of BAA plc to evaluate the transaction. Where significant transactions are

identified, **Margaret Bethell** (212 4977) in the Department of Transport would be happy to advise on the level of detail that needs to be disclosed.

ACTION REQUIRED

8. (a) Significant transactions For such transactions, including any in the categories identified in Annex 2, we need to know essential details. To help simplify the task, I would be grateful if replies could follow the following pro-forma:-

(1) A statement along the following lines:

"We confirm that, having made due enquiry, this Department (Crown body etc) has had no relationship with any member of the BAA plc group or with the BAA in the promotion period other than:

(i) the supply of services by, or to, or any other transactions with, members of the BAA plc group or the BAA where such services or transactions are not significant;

(ii) the supply of services by, or to, or any other transactions with, members of the BAA plc group or the BAA where such services or transactions are significant, by reason of their value or extent, or are on terms known or believed to be preferential to the Crown, or in other respects differ from the terms of equivalent transactions entered into with other customers or relate to services unavailable to other customers, details of which are set out below".

(2) For each item in (ii) above the following information:-

A. Name of Crown body.

B. Name of any other Crown body involved in or associated with this contract or transaction.

C. Relevant date(s) of contracts or transactions - and the date on which the Crown obtain(s/ed) its interest.

D. Description of nature of transaction or contract, including terms which you know or believe to be preferential to the Crown or peculiar to the transaction or contract with the Crown.

E. Any "profit" (see paragraph 7 above) arising from the transaction.

F. Any further details considered relevant.

G. Name, address and 'phone number of a contact who could supply further details if necessary.

(b) <u>All transactions whether significant or insignificant</u>
For all dealings or other transactions with members of the BAA plc group or with the BAA (irrespective of whether or not the terms are special or the transaction is significant) you should complete the following statement:

"We understand that, for the purpose of writing the prospectus, a reasonably accurate estimate of the expenditure and revenues of the Crown in transactions or dealings with members of the BAA plc

group and the BAA over the year ended 31 March 1987 is required. After taking all due care to check on our expenses and receipts, we estimate the total expenditure in transactions or dealings with members of the BAA plc group and the BAA during that year for this Department (body, etc) to be £ * - and the total revenues of this Department (body, etc) in transactions or dealings with members of the BAA plc group and with the BAA during that year to be £ * ".

SIGNIFICANT TRANSACTIONS BETWEEN THE CROWN AND BAA plc

1. Examples of the transactions falling within paragraph 1 of Annex 1 include:

(a) dealings involving the supply of airport services by members of the BAA plc group or by the BAA to the Crown on terms which are known or believed to be preferential to the Crown, or which differ in other respects from the terms of equivalent dealings with other customers;

(b) dealings involving the supply of non-airport goods or services by members of the BAA plc group or by the BAA to the Crown on terms which are known or believed to be preferential to the Crown, or which differ in other respects from the terms of equivalent dealings with other customers;

(c) dealings involving the supply of goods or services to the Crown by members of the BAA plc group or by the BAA which are not made available to other customers;

(d) dealings under which the Crown provides or has provided goods or services to members of the BAA plc group or to the BAA;

(e) dealings between the Crown and members of the BAA plc group and the BAA involving land and/or buildings: This would cover either sale or leases of land and/or buildings;

(f) dealings of any description between the Crown and members of the BAA plc group and the BAA which are significant because of the amount of money or value or extent of goods or services involved.

2. Dealings to be disclosed should include the entering into a contract within the relevant period even though no action may occur under the contract until after the period has expired. It is not necessary to disclose transactions which, although they occur in the promotion period, are in implementation of a contract entered into before that period began.

3. Transactions which merely represent the application of fiscal or other similar regimes of general application need not be disclosed, eg the payment of taxes or national insurance contributions.

4. The duty of disclosure arises in respect of any transaction and whether the Crown is, broadly speaking, the supplier or the customer. It is necessary to make disclosure in respect of both sides of any dealing (for example, both details of the goods or services supplied and payment for such goods and services) and whether goods and services are supplied to the Crown for its own use or for resale.

CROWN BODIES

ADVISORY, CONCILIATION AND ARBITRATION SERVICE
AGRICULTURE, FISHERIES AND FOOD, MINISTRY OF
AGRICULTURE FOR NORTHERN IRELAND, DEPARTMENT OF
AGRICULTURE AND FISHERIES FOR SCOTLAND, DEPARTMENT OF
ARTS AND LIBRARIES, OFFICE OF
CABINET OFFICE
CENTRAL OFFICE OF INFORMATION
CHARITY COMMISSION
COUNCIL OF TERRITORIAL, AUXILIARY AND VOLUNTEER RESERVE ASSOCIATION
CROWN ESTATE COMMISSIONERS
CROWN OFFICE, SCOTLAND
CUSTOMS AND EXCISE, HER MAJESTY'S
DEFENCE, MINISTRY OF
DIRECTOR OF PUBLIC PROSECUTIONS, DEPARTMENT OF
DUCHY OF CORNWALL
DUCHY OF LANCASTER
ECONOMIC DEVELOPMENT DEPARTMENT, NORTHERN IRELAND
EDUCATION AND SCIENCE, DEPARTMENT OF
EDUCATION FOR NORTHERN IRELAND, DEPARTMENT OF
EMPLOYMENT, DEPARTMENT OF
ENERGY, DEPARTMENT OF
ENVIRONMENT, DEPARTMENT OF THE
ENVIRONMENT FOR NORTHERN IRELAND, DEPARTMENT OF
EXCHEQUER AND AUDIT DEPARTMENT, NORTHERN IRELAND
EXPORT CREDIT GUARANTEE DEPARTMENT
FAIR TRADING, OFFICE OF
FINANCE AND PERSONNEL, NORTHERN IRELAND, DEPARTMENT OF
FOREIGN AND COMMONWEALTH OFFICE
FORESTRY COMMISSION
GENERAL REGISTER OFFICE, SCOTLAND
GOVERNMENT ACTUARY'S DEPARTMENT
GOVERNMENT WHIPS (HOUSE OF COMMONS)
GOVERNMENT WHIPS (HOUSE OF LORDS)
GREENWICH HOSPITAL
HEALTH AND SAFETY EXECUTIVE
HEALTH AND SOCIAL SECURITY, DEPARTMENT OF
HEALTH AND SOCIAL SERVICES, NORTHERN IRELAND DEPARTMENT OF

HOME OFFICE
INDUSTRY DEPARTMENT FOR SCOTLAND
INLAND REVENUE, BOARD OF
INTERVENTION BOARD FOR AGRICULTURAL PRODUCE
LAND REGISTRY, HER MAJESTY'S
LAW OFFICERS' DEPARTMENT
LORD ADVOCATE'S DEPARTMENT
LORD CHANCELLOR'S DEPARTMENT
LORD CHANCELLOR'S DEPARTMENT, NORTHERN IRELAND
LORD PRIVY SEAL'S OFFICE
MANPOWER ECONOMICS, OFFICE OF
MANPOWER SERVICES COMMISSION
METROPOLITAN POLICE OFFICE
NATIONAL INVESTMENT AND LOANS OFFICE
NHS HEALTH AUTHORITIES - ALL REGIONAL, DISTRICT AND SPECIAL HEALTH AUTHORITIES
NATIONAL SAVINGS, DEPARTMENT FOR
NORTHERN IRELAND CIVIL SERVICE
NORTHERN IRELAND OFFICE
NORTHERN IRELAND PARLIAMENTARY COMMISSIONER FOR ADMINISTRATION, OFFICE OF THE
OFGAS
OFTEL
ORDNANCE SURVEY
OVERSEAS DEVELOPMENT ADMINISTRATION
PARLIAMENTARY COMMISSIONER FOR ADMINISTRATION AND HEALTH SERVICE COMMISSIONERS, OFFICE OF THE
PARLIAMENTARY COUNSEL
PAYMASTER GENERAL'S OFFICE
POPULATION CENSUSES AND SURVEYS, OFFICE OF
PRIME MINISTER'S OFFICE
PRIVY COUNCIL OFFICE
PROPERTY SERVICES AGENCY
PUBLIC RECORD OFFICE
QUEEN'S HOUSEHOLD, THE
RATING OF GOVERNMENT PROPERTY, DEPARTMENT OF
REGISTRY OF FRIENDLY SOCIETIES
ROYAL HOSPITAL CHELSEA
ROYAL MINT
SCOTTISH COURTS ADMINISTRATION

SCOTTISH OFFICE
SCOTTISH DEVELOPMENT DEPARTMENT
SCOTTISH EDUCATION DEPARTMENT
SCOTTISH HOME AND HEALTH DEPARTMENT
SCOTTISH RECORD OFFICE
SPECIALISTS AND TECHNICAL CO-OPERATION OFFICERS, CORPS OF
STATIONERY OFFICE, HER MAJESTY'S
STATUTE LAW COMMITTEE, NORTHERN IRELAND
STATUTORY PUBLICATIONS OFFICE
TRADE AND INDUSTRY, DEPARTMENT OF
TRANSPORT, DEPARTMENT OF
TREASURY, HER MAJESTY'S
TREASURY SOLICITOR'S DEPARTMENT
WELSH OFFICE

(LOCAL HEALTH AUTHORITIES)

ANNEX 4

CABINET OFFICE

MANAGEMENT AND PERSONNEL OFFICE
70 Whitehall
London SW1A 2AS
Telephone 233 8389

Machinery of Government Division

Mr C Bridge
Room 511
Department of Trade and Industry
1 Victoria Street
LONDON SW1H OET

21 February, 1984

Dear Charles,

DEFINITION OF "CROWN SERVICE"

1 You phoned to ask whether we could provide a list of bodies which perform their functions under the Crown. If I understood you correctly, you need this because the "Crown" is to be a promoter for the flotation of British Telecommunications shares, and a legal requirement is that the prospectus should spell out any interests of the promoter in the business.

2 I explained that it is not possible to provide a definitive list of Crown bodies. "The Crown" is a concept rooted in antiquity, whose significance has changed over time, and which rests on a combination of Prerogative and statutory powers, and interpretation by the Courts. Accordingly, it would be easier for us to start at the other end, by considering which of a list of BT's customers are Crown bodies. However, given that you are unable to provide such a list, I promised to send some guidance.

3 Generally speaking the Courts regard the Crown as representing the "sum total of Government powers", that is, as synonymous with the Executive. Accordingly the Crown includes:

a) the Royal Household;

b) Ministerial offices covered by the Ministerial and other Salaries Act 1975;

c) the Armed Forces; and

d) Government Departments operating under the direction of Ministers. (This concept has been modified by the practice over recent decades of conferring statutory functions on bodies outside the traditional structure of Government Departments.)

4 Legal opinion is that all bodies included in Schedule 2 to the Parliamentary Commissioner Act, 1967, and in the list published by the Minister for the Civil Service in pursuance of S.17 of the Crown Proceedings Act 1947, perform their functions under the Crown. Other bodies regarded as Crown bodies on the basis of express statutory provision or legal advice include the following:

The Royal Hospital, Chelsea
Greenwich Hospital Department
Cabinet Office
Lord Advocate's Department
Office of the Parliamentary Counsel
Office of the Paymaster General
Prime Minister's Office
Privy Council Office

Parliamentary Commissioner for Administration
Northern Ireland Civil Service
Northern Ireland Court Service
Corps of Specialists and Technical Cooperation Officers
Council of Territorial, Auxiliary and Volunteer Reserve Association
NHS Health Authorities
Overseas Civil Service (constituted on 1.10.54 under Special R gulations by the Secretary of State for the Colonies)
Metropolitan Police (but not other police authorities)

It follows from what I have said earlier that this is not an exhaustive definition; I hope that, nevertheless, it is of some help.

Yours sincerely
Helen Leiser

HELEN LEISER

ps3/51K

SECRET

(4)

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

16 March 1987

David Norgrove Esq
10 Downing Street
LONDON
SW1

Prime Minister 2

DRN
16/3

Dear David

I think this will cause trouble. What does the Chief Whip say? MT

SALE OF BP SHARES

In his minute of 17 February, the Chancellor advised the Prime Minister that he would probably announce the sale of the Government's holding on 23 March or possibly at the end of the previous week.

The Chancellor has now decided that the Financial Secretary should make the announcement in his winding-up speech on the evening of Wednesday, 18 March. The Financial Secretary will say that, subject to market conditions, the Government will sell its remaining shares in BP during the 1987-88 financial year. Until the announcement is made this information is of course market sensitive.

The general answer to questions on the sale - including any on the Government's relationship with BP after the sale - is that these are matters for consideration with our financial advisers, who will be appointed shortly, and with the Company. As in other major Government sales, payments will be in instalments and their timing and number will be decided later. The proceeds will be an important contribution to the target of £5 billion a year from privatisation proceeds.

I am sending copies of this letter to Geoff Dart (Energy), Lyn Parker (FCO), and to Trevor Woolley (Cabinet Office).

Yours ever,

Tony

A W KUCZYS
Private Secretary

ECON POL: Privatisation Pt. 15.

CONFIDENTIAL

cc D/Trans
CO DTI
WO DOE
CDLO HMT
PGO BG
DN
CS/HMT

DAS

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

16 March 1987

Dear Robert,

OBJECTIVES FOR THE SCOTTISH TRANSPORT GROUP

The Prime Minister has been following with interest the correspondence about the future of the Scottish Bus Group which rests with the letter from the Secretary of State for Transport to your Secretary of State of 26 February. This latest letter sets out the experience in England with breaking up and privatising the National Bus Company and the Prime Minister hopes your Secretary of State will consider it very positively. She believes it should be possible to reach an early agreement on action in Scotland. But if not, she has asked that your Secretary of State should bring forward proposals for collective consideration before too long.

I am copying this letter to the Private Secretaries to other members of E(NI), John Shortridge (Welsh Office) and Trevor Woolley (Cabinet Office).

Yours,

David.

D R NORGROVE

Robert Gordon, Esq.
Scottish Office

CONFIDENTIAL

PRIME MINISTER

SCOTTISH TRANSPORT GROUP

Mr. Ridley, Mr. Moore and Mr. Tebbit have for months been pressing Mr. Rifkind to consider breaking up and privatising the Scottish Bus Group along the lines of what has happened in England. The Scottish Office have not yet shown their hand, although Mr. Rifkind late last year did ask Mr. Moore for information about the privatisation of the National Bus Company.

Mr. Moore did not reply until 26 February, thus himself adding to the delay. I understand Mr. Rifkind is unlikely to respond to that letter until the end of the month at the earliest.

It would be helpful for you to put on some pressure.

I suggest you say you have:

- followed the correspondence with interest, including Mr. Moore's material about experience in England;
- you hope the Scottish Office will look at this material very positively;
- you look to them either to reach agreement on early action or to bring forward proposals for collective consideration before too long.

Agree? Yes MT

DRN

(DAVID NORGROVE)

13 March 1987

DCABUH

127/3

Mr Norgrove (note at end)

CONFIDENTIAL

Reference No E 0256

MR UNWIN

cc Dr Walker

Scottish Transport Group

I have looked at the papers on this.

2. The subject seems to be progressing very slowly. As long ago as last October and November Mr Ridley, Mr Moore and Mr Tebbit were pressing the Scottish Secretary to consider breaking up and privatising the Scottish Bus Group along the lines of what has happened in England. The Scottish Office have not yet shown their hand on this, although Mr Rifkind on 22 December did ask Mr Moore for information about the privatisation of the National Bus Company in England. Mr Moore did not reply until 26 February, thus himself adding to the delay. The Scottish Secretary's Private Office tell me that he is unlikely to respond to that letter until the end of the month at the earliest.

3. We want to try to get this moving more quickly. One possible way would be to press for an early collective discussion (suggested by Mr Tebbit on 27 November). The E(NI) meeting arranged for 25 March could provide the occasion. But the Scottish office could very plausibly argue that they need time to digest Mr Moore's letter received only about ten days ago, and to draw up their own proposals. I do not think we could press for a discussion on 25 March without making a major issue of it with the Scots.

4. What I suggest instead is that we could fire a shot across their bows if Mr Norgrove could write to them to say that the Prime Minister:

- Has followed the correspondence with interest, and was especially interested in Mr Moore's material about experience in England.

- Hopes that the Scottish Office will look at this material as positively as possible.

- Looks to them either to reach agreement on early action or to bring forward proposals for collective consideration before too long.

5. Mr Norgrove told me he would be willing to write along these general lines. If he did, we would then have a basis for pressing the Scottish Office at the beginning of next month, by when, on their own admission, a reply to Mr Moore should be ready.

G W MONGER

This has been dragging on for too long. The Scottish Office are showing little sign of coming to satisfactory decisions. I think it would be very helpful if you could write on the above lines, with my interposition.

Economic Secretariat
10 March, 1987

11/3/87

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

A W Kuczys Esq
Private Secretary to
The Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

COPY NO 2 OF 6

5 March 1987

Dear Tony,

BP SHARES

The Secretary of State has seen your letter of 26 February to David Norgrove, as well as his reply.

Mr Walker welcomes the Chancellor's agreement that further study is needed of the issues he raised in his letter of 23 February and that Treasury and Energy officials should continue to consult closely. He also welcomes the Treasury's agreement that this Department should be represented on the Steering Group handling the sale.

I am copying this to David Norgrove.

Yours,
Geoff

G S DART
Principal Private Secretary

05 JUL PM 87

ECON POL

PRIVATISATION

PTTS

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OC09

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

2 March 1987

SALE OF BP SHARES

The Prime Minister has seen your letter to me of 26 February about the Government's relationship with BP after the Government's remaining shares are sold and has noted that the Chancellor will be putting forward firm proposals in due course.

I am copying this letter to Geoff Dart (Department of Energy) and Trevor Woolley (Cabinet Office).

DAVID NORGROVE

Tony Kuczys, Esq.
H.M. Treasury

CONFIDENTIAL

BS

10 DOWNING STREET

Nigel

I think it might be worth having David Moore over for a chat – this isn't all that helpful.

DRN
27/2

David.
Not worth it

NL

RT4.65 CONFIDENTIAL

CC BS

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

26 February 1987

David Norgrove Esq
10 Downing Street
LONDON
SW1

Prime Minister 2

DRN 26/2

Dear David

SALE OF BP SHARES

at tiap

The Chancellor has seen your letter to me of 19 February in which the Prime Minister asked about the Government's powers over BP once the remaining shares are sold. He has also seen Mr Walker's letter of 23 February which pointed out that some questions about our future relationship with BP need to be resolved.

The Chancellor agrees that these matters are important, though they do not need to be settled before the announcement. Treasury and Department of Energy officials have now had a preliminary discussion, and will continue to consult closely. They will sound out any other interested Departments on their thinking as it develops and it will be necessary to talk further to BP. The Chancellor will then put forward his firm proposals.

In the meantime the Chancellor's view is that once the remaining shares were sold the Government would not (indeed could not) keep its right to appoint Government Directors and the associated veto powers. He agrees that there is a question, which needs further consideration, over the need for Government powers, probably through a Special Share, to ensure BP's domicile remains in England and to enable us to prevent an unwelcome takeover of the Company. On this he does not have strong views either way, but feels that the case for such powers remains to be proven.

I am copying this letter to Geoff Dart (Energy) and Trevor Woolley (Cabinet Office).

Yours ever,

Tony

A W KUCZYS
Private Secretary

ECON POL: Privatisation PTIS

CC BG

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

Our Ref : JM/PSO/16381/86

The Rt Hon Malcolm Rifkind MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
LONDON SW1

NBPR.

26 February 1987

Dear Malcolm

OBJECTIVES FOR THE SCOTTISH TRANSPORT GROUP

I am sorry not to have replied sooner to your letter of 22 December about the future structure and ownership of the Scottish Bus Group (SBG).

I am enclosing, as you requested, a paper setting out the background to the privatisation of the National Bus Company and our experience so far with the disposal programme. I would draw your attention to three particular points.

First, contrary to what we were told by many people - including the former senior management of the NBC, it is proving possible to privatise relatively small bus operating companies. There are people willing to bid, and the financial backing is available.

Secondly, the pattern of disposals so far, with a number of management buy outs, often involving employee share schemes, is politically very attractive.

Thirdly, the early evidence suggests that subsidiaries operating in the more remote areas can indeed be privatised : in fact the very first NBC bus operating company to be sold was Devon General.

I hope that my paper will convince you that, as for NBC, piecemeal privatisation of the Scottish Bus Group is both realistic and politically attractive. I hope you and colleagues will also agree that, having deregulated bus services, and dismembered and privatised the major bus monopoly in England and Wales in order to promote competition, it will be increasingly difficulty for us to defende the continued existence of a powerful public sector monopoly in Scotland. I believe our position will be untenable if we delay much longer.

Finally, I would like to draw your attention to the SMT Insurance Company Ltd (SMTI) which is jointly operated by NBC and SBG to insure their vehicles. Under the Transport Act 1985 NBC are required to dispose of their (49%) share in the undertaking, which has been independently valued at around £3.6m. Third parties are unlikely to be interested in acquiring a share in a business in which its present form is limited to insuring a diminishing number of public sector operators. However, I understand that there are at least two such parties who may be interested in acquiring the whole business with a view to expanding its activities outside the public sector. I think this would be in line with your general policy of encouraging SBG to dispose of its more peripheral activities, and that it is likely to produce proportionately higher privatisation proceeds for the Exchequer than the disposal of NBC's 49% share, presumably to SBG, which could hardly be represented as reducing the size of the public sector. I would be grateful, therefore, if you would consider the proposition that NBC and SBG should jointly dispose of the whole of the SMTI undertaking.

/ I am copying this letter to members of E(NI), to Nicholas Edwards and to Sir Robert Armstrong.

Yours ever
John

JOHN MOORE

CONFIDENTIAL

PRIVATISATION OF THE NATIONAL BUS COMPANY

1. This paper describes the background to NBC privatisation, including the legislation and the timetable; the way in which sales are handled; the main problems which have arisen; and the lessons to be learned.

A. BACKGROUND

The Transport Act 1985

2. The break up and privatisation of NBC's operations is an important part of the policy of promoting competition in the bus industry set out in the Transport Act 1985. In view of its dominant position (30% share of the bus market), if NBC had remained in the public sector, or if it had been privatised as a single entity, the development of competition would have been seriously undermined.

3. The Act required NBC to prepare a programme for disposing of all their operations, to submit it for approval (and if necessary amendment) by the Secretary of State, and then to implement the agreed programme. Section 48 of the Act gives NBC three duties in preparing and implementing the programme:

(a) Their main objective is to promote sustained and fair competition, both between their own subsidiaries and former subsidiaries and between these and other operators. In pursuing their main objective NBC must -

(b) have regard to net proceeds of sale; and

(c) give employees a reasonable opportunity to acquire a controlling interest in the part of NBC in which they work.

Restructuring the group

4. It is important to note that the main objective applies not just to privatisation but also to the continuing operation of the NBC group from 6 January 1986 (when Section 48 came into effect), onwards. So, in preparation for the deregulation of the bus industry and privatisation, NBC's operating subsidiaries were re-organised as free-standing units. Their balance sheets were re-structured with effect from 1 January 1986 with a view to each subsidiary operating as a viable independent company at arm's length from its sister companies and without cross-subsidy within the group. In order to promote competition, regional groupings of subsidiaries were broken up and subsidiaries encouraged to compete with their sister companies both on commercial services and in tendering for local authority subsidy contracts. In addition, to ensure that the development of competition is not inhibited by the existence of large, dominant NBC operators, the Secretary of State directed the NBC on 13 February 1986 to break up some of its larger local bus companies into smaller units; most of the subsidiaries now have fewer than 500 vehicles.

The Disposal Programme

5. The programme provides for the disposal of:

- 52 local bus operating subsidiaries
- 6 local coach operating companies
- 8 engineering companies
- the four companies in the National Products group (including National Express).

In accordance with the Secretary of State's directions, it provides for the bus subsidiaries to be sold individually. The programme would therefore need to be amended before two or more such companies could be sold jointly.

6. In order to encourage staff buy-outs NBC invited managements and employees to consider mounting bids for their subsidiaries well before they were advertised in the press, and they are providing them with financial assistance towards the costs of professional advice, which is repayable only if their bid is successful. In addition, NBC is prepared to give them a price preference of up to about 5% in cases where their bid is broadly comparable to that of an outside party. This has arisen in one instance so far. In another recent case the management's bid was higher than those of two outside parties.

7. National and local advertising of subsidiaries for sale was initiated on 25 March 1986 and followed up by additional advertising and direct approaches to potential purchasers both within and outside the transport industry. Briefing of business columnists (Financial Times, Times, Economist) has also helped to stimulate interest in the City and in the transport industry.

B. SALES

Timing and Progress

8. The Transport Act required NBC to produce the disposal programme by 6 April 1986 - 3 months after the relevant provision came into force - or a later date specified by the Secretary of State. In the event the deadline was extended, because of a change of chairman at NBC, and the programme was approved on 19 May 1986. In accordance with a direction previously given by the Secretary of State, the programme provided for as many sales as possible to be completed by deregulation day - 26 October 1986. Under the Act, the programme has to be completed by 6 January 1989.

9. For reasons described below, privatisation was slow to start. The first sale was not until 15 July. But by last autumn the programme was gaining momentum and to date a total of 17 out of 70 subsidiaries have been sold. They are National Holidays (sold to the Pleasurama Group); Devon General, Badgerline, Southern Vectis, Cheltenham and Gloucester, Maidstone and District, Cambus, PMT Ltd, South Midland, Midland Red West, Midland Red Coaches, Eastern National, Trent Motor Traction, City of Oxford, Yorkshire Traction, West Riding and East Yorkshire (all of which were management buy outs). In addition, the sale of NBC's eight engineering subsidiaries to an outside party, Frontsource Ltd, has been approved but not yet completed.

10. Sales of some 15 more operating subsidiaries are currently being negotiated for early completion, including several subsidiaries in predominantly rural areas. NBC believe that the disposal programme should be substantially completed by the end of 1987.

11. Nearly all the management teams have expressed interest in mounting bids for their companies and many have already done so. Predictably, interest from third parties has been slower to materialise; but NBC's Chairman expects that half the companies will eventually be sold to buyers other than their managers.

Mechanics of sales

12. As a first step before marketing their subsidiaries NBC stripped out all non-operational properties and transferred them to National Bus Properties Ltd for separate sale. The packages offered for sale therefore include only operational properties. NBC and their advisers prepare information packs on each subsidiary; these consist of an Information Memorandum (describing the assets, manpower resources, the business of the subsidiary, and historical financial information); and the Company's Corporate Plan, which together provide prospective purchasers with the information they need to construct a bid. These information packs are sent to bona fide interested parties only.

13. Negotiations are conducted by a team of specially recruited experienced negotiators headed by the Executive Board Member in charge of the disposal programme. There is no publicly announced date by which bids for a subsidiary must be submitted. NBC negotiate with the bidder or bidders until, in their judgement, the best offer has been obtained. In some cases, where offers are very close, the final stage involves a sealed bid procedure. A recommendation, approved by the NBC Board, is then made to the Secretary of State, whose consent is required for each disposal. Advice is sought in each case from the Secretary of State's financial advisers (Price Waterhouse), and, where appropriate from his property advisers (Richard Ellis). Views are also sought from the Treasury.

14. Prices obtained for individual companies are not being disclosed so as not to weaken NBC's hand in future negotiations, but a statement of the total proceeds has been promised when the programme is completed. As might be expected the prices offered are generally based on the earning capacity of the subsidiary concerned and the forecast cashflow, rather than the book value of the assets (though account is taken of estimated break-up value, as a minimum bench mark).

C. PROBLEMS

15. The major problem in carrying foward the policy arose because of opposition by the previous Chairman of NBC and his most senior managers. They wanted NBC to be privatised en bloc or in a few very large groups of subsidiaries and they fought the break up of large subsidiaries such as London Country Buses. They were supported by their advisers, Barclays Merchant Bank (now BZW) who argued that sales of 60-70 individual subsidiaries would be impracticable within the timescale set by the Act. The senior management's hand was greatly weakened at the end of 1985 when Ministers, in effect, went over their heads to ask the local subsidiary managers whether they wanted to buy out their own companies. Faced with a very enthusiastic response the Chairman,

within a short time, indicated his wish to resign. The new executive Chairman (from outside NBC) brought in new senior management and a negotiating team to handle a number of sales simultaneously.

16. The disputes with the Company meant that the Department's advisers, Price Waterhouse, had to play a particularly active role. They had been chosen in preference to a Merchant Bank because their accountancy expertise was particularly relevant to the nature of this privatisation which involved the restructuring of NBC prior to disposal of the individual units. Price Waterhouse did a valuable job, but the real breakthrough came with the change of Chairman and senior management. Without that, rapid progress would not have been possible.

17. During the passage of the Transport Bill, there had been considerable lobbying, orchestrated by NBC, over the issue of accrued pension rights. Because the policy involved not only privatising NBC but also breaking it up, there was concern that there would in future be no one large body to stand behind the two pension funds and therefore that the members' security would be diminished. The Government refused to guarantee the funds after privatisation, on the grounds that NBC never provided a formal guarantee and that a Government guarantee would put the funds' members in a specially privileged position. An alternative package was developed, after lengthy negotiations. The main elements were: that the funds would be kept open, with the benefits unchanged, up to the time of NBC's dissolution, and that NBC would provide the necessary employers' contributions for this; that NBC would top up any deficiencies in the funds at the time of dissolution, on the basis of a fresh actuarial valuation; that in return the Trustees would repay any surpluses; and that transfer values to new funds ought to be sufficient to provide year-for-year credits for past service in an equivalent scheme.. The trustees also indicated that it was their intention to secure

the accrued benefits, for pensioners and serving staff who did not take transfer values, with a major insurance company; the Department and NBC had jointly established while the Bill was in Parliament that this should be possible within the assets of the funds, and this seemed a major factor in swaying opinion in the House of Lords.

18. An issue which occurred at the start of the sales programme was the strategy to be adopted in relation to property. NBC had already stripped most of the non-operational property out of subsidiaries for separate disposal by National Bus Properties Ltd. But some operational properties have substantial development value (eg city centre bus stations). It was agreed that if this value was not reflected in the price of the relevant subsidiary and there appeared to be a real possibility of asset stripping, mortgage charges could be imposed to secure for the Exchequer a proportion of any development profits achieved within a period of 10 years, while leaving an incentive to management for re-siting and worthwhile development.

D. LESSONS AND CONCLUSIONS

19. The main lessons which have so far emerged from the NBC privatisation are:

- Individual subsidiaries are saleable; there are both potential buyers - often the companies' own management teams but outside interests as well - and a variety of sources of financial backing;

- Enthusiasm for buyouts at local subsidiary level is not enough to guarantee success: there must also be strong commitment at Board level and among senior headquarters management;

- The sponsoring Department itself needs strong and active financial advisers. In the case of NBC, the decision to appoint Chartered Accountants rather than a Merchant Bank - the usual source of privatisation advice - has proved a good one .

20. Finally, in terms of public presentation, the NBC privatisation has so far gone very well. There has been much favourable comment about the management buy-outs, in particular the opportunities available to employees, in most cases so far, to acquire a proportion of the equity in their company (normally up to 20%). Managers are enthusiastic, and there is already evidence that privatised subsidiaries are preparing to expand outside their traditional areas and diversify their business. The opportunity and the incentive to do so are provided by the deregulation of the market. It is obviously too early to judge whether all the former subsidiaries will remain viable as separate companies in the deregulated market, but so far there is no reason to doubt that the great majority of owner-managers will succeed in validating their own and their backers' judgements on viability.

ECON. POL: Privatisation: Part 15

Devonport Dockyard

3.30 pm

The Secretary of State for Defence (Mr. George Younger): With permission, Mr. Speaker, I would like to make a statement about Devonport dockyard.

As the House will recall, I announced on 20 January that I was satisfied that there existed the basis for an advantageous contract to be placed for the future operation of Devonport dockyard with Devonport Management Ltd. At the same time, we provided the trades unions with further information summarising the main aspects of the draft contract arrangements negotiated with that company. In a statement made on 21 January my hon. Friend the Parliamentary Under-Secretary of State for Defence Procurement informed the House that I had invited the trades unions to a meeting on 13 February so that I might hear and consider their views before taking any final decision on the future management of Devonport dockyard.

At the time of that statement the Devonport Management Ltd. consortium comprised Brown and Root (UK) Ltd. with 30 per cent. of the shares, the Weir Group plc with 25 per cent. and Barclays de Zoete Wedd with 45 per cent. As the House knows, it has been our hope that some or all of the 45 per cent. held by Barclays might be transferred to one or more British industrial companies. I am glad to inform the House that since my hon. Friend's statement BICC, acting through its subsidiary Balfour Beatty, has now joined the consortium. BICC, Brown and Root and the Weir Group now each holds 29·9 per cent. of the shares with the 10·3 per cent. balance held by Barclays de Zoete Wedd, in trust to provide an incentive scheme for key employees.

I met general secretaries and other trades union representatives on 13 February to discuss the way ahead on Devonport. The unions made it clear to us that they remained as opposed as they have always been to the introduction of commercial management, continuing to prefer the idea of a dockyard trading fund with the work force remaining in the Civil Service. As I have already told the House, it remains our view that a dockyard trading fund, which is the option involving minimum change, is unlikely to secure the improvements in efficiency we seek or to compete as successfully as a commercial company for commercial and naval non-core work.

We have provided a great deal of information to the unions on our proposed changes to the management of the dockyards, over a very long period. I am grateful to the unions for the work they have done in recent weeks to consult the work force locally. I have considered closely the points they have put to me. These have included the request for the contract which we hae already signed in respect of Rosyth dockyard, and the one we have negotiated with Devonport Management Ltd., to be made public; but I am sure that the House will understand the reasons of commercial confidentiality that prevent me from meeting this request. However, I have made every effort to provide all the relevant information that I can.

I am fully aware of my obligations to inform and consult the trades unions and I am satisfied that I have complied with such duties as the Act imposed on me at this stage. I have, therefore, authorised the signature today of a seven-year-term contract for the future operation of Devonport dockyard from 6 April 1987 with Devonport Management Ltd. We are also signing a service contract with the company to cover its operations in the dockyard from now until vesting day, during which time the management of the dockyard will remain the responsibility of my Department.

I have renewed my invitation to the trades unions to devote the period between now and vesting day to useful discussions on matters affecting the work force and have proposed a series of meetings to that end.

Mr. Denzil Davies (Llanelli): This statement again demonstrates that the Government had no intention of changing their original decision to privatise the dockyards. All the talk about consultation, frankly, was a sham. As all the independent and outside evidence has shown, there is no reason why the dockyards cannot be run commercially and efficiently by means of a trading fund, as in the case of other companies, within the public sector. We believe that these changes will lead to lower efficiency, a lower standard of service for the Royal Navy, and ultimately a higher cost to the taxpayer.

The House will remember that the Government have now destroyed four dockyards. First, there was Chatham, which has closed. The naval dockyard in Gibraltar was the second. Then Portsmouth was relegated from a dockyard to a fleet maintenance base. Now we have the destruction of Devonport and Rosyth. That does not augur very well for the future of the Royal Navy and the services provided for it.

Could the right hon. Gentleman confirm that the lead company in all this will be Brown and Root, a foreign-owned subsidiary, and could he tell the House what expertise and experience Brown and Root has in operating dockyards of this kind? Could he also confirm that, as is widely believed, the change will lead to a lowering of engineering standards and also to at least 5,000 redundancies at Devonport?

Who are the key employees who are apparently to be provided with an incentive scheme? Why not such an incentive scheme for all the employees at Devonport?

Mr. Younger: The right hon. Gentleman really must appreciate that the objective of all the consultations that I have been having over recent weeks with such great care and consideration has been to find out whether there were any good reasons to assume that one of the alternatives to what I have announced today would be better for the future of the dockyard. The only criterion in my mind in assessing these has been which would give the dockyards, in this case Devonport dockyard, the best opportunity to operate successfully and to get more business for those who are working in the yards. With great respect to the right hon. Gentleman, I really think that those who will work in this yard for many years in the future will be somewhat depressed to hear him today talking about the destruction of the yards, which is so remote from the truth that it makes what he says quite absurd.

I thought that the right hon. Gentleman would know that Brown and Root has very wide experience of engineering work both in the United States and in this country. There is certainly no reason whatever to think that its standards will be lowered.

With regard to employment, I have expressed the opinion that in the worst case, if the dockyards remained under the present management, there might be 5,000 redundancies over the next 10 years. I understand that the

shortages and when even the Chancellor of the Exchequer has to admit that, this year, we shall have a manufactured trade deficit of over £7 billion? I ask again, where is the healthiness?

The Prime Minister: The right hon. Gentleman says that there are 2 million fewer jobs in industry. It will not help to overman manufacturing industry to the extent of 2 million jobs, even though it is nationalised. That is the right hon. Gentleman's policy — put manufacturing industry back to overmanning and make it less competitive. That is the road to ruination. We must have competitive, sound manufacturing firms. They are. Their profitability is up, their productivity is up and their export volume is up. Manufacturing output has risen by nearly 11 per cent. since the last general election. It is in a good state. That is what the right hon. Gentleman cannot stand. The Confederation of British Industry and everyone else is saying that things are optimistic and good, but not the right hon. Gentleman.

Mr. McCrindle: Perhaps I may revert to the question about pensions asked by the leader of the Social Democratic party. Was the right hon. Gentleman not a member of an Administration which, having introduced the very linkage to which he now refers——

Mr. Speaker: Order. Will the hon. Gentleman please link his question to Prime Ministerial responsibility?

Mr. McCrindle: Does my right hon. Friend recall that, when the leader of the SDP was a member of a Labour Administration, there was indeed the link to which he now refers, but does she also recall that in two years out of five that Administration failed to implement the link?

The Prime Minister: I thank and congratulate my hon. Friend on making his point so effectively and accurately.

Q5. **Mr. Tom Clarke** asked the Prime Minister if she will list her official engagements for Tuesday 24 February.

The Prime Minister: I refer the hon. Gentleman to the reply that I gave some moments ago.

Mr. Clarke: Does the Prime Minister accept that the present industrial dispute involving a large majority of Scottish prison officers is an indication of their frustration at overcrowding, understaffing and a lack of revenue resources for Scottish prisons? Does she further accept that the Government's neglect is particularly unacceptable in view of the increase in the Scottish crime rate of over 50 per cent. since she came to office?

The Prime Minister: I accept that there are considerable problems with prisons in England and Wales and in Scotland. I have also told the hon. Gentleman that the Government have done more to build new and modern prisons than any previous Government.

Q6. **Mr. Richard Shepherd** asked the Prime Minister if she will list her official engagements for Tuesday 24 February.

The Prime Minister: I refer my hon. Friend to the reply that I gave some moments ago.

Mr. Shepherd: Will my right hon. Friend urgently consider introducing legislation to adopt the practice of India, Pakistan, Canada, the United States of America, Mexico, Brazil and Argentina, among others, and impose fines on airlines which bring in people without valid entry documents?

The Prime Minister: It is crucial that airlines do not bring in people unless they have the proper documentation. Carriers are already required to pay the detention and other costs of people whom they bring in to the United Kingdom and who are refused entry. As my right hon. Friend the Home Secretary said last week, the Government are considering urgently whether to follow the example of certain other countries, including the Federal Republic of Germany and Canada, in taking powers to impose financial penalties on carriers who bring people to this country without the necessary passports, visas or other documents. Both the powers and the penalties may well need to be retrospective.

Mr. Hume: Will the Prime Minister join me in calling on the leaders of all the major parties in the House to make clear, as she and the Leader of the Opposition have already done, that whatever the outcome of the election, it will make no difference to the attitudes of those parties to the Anglo-Irish Agreement, as expressed in a vote in the House, and that they will not engage in any power bargaining on that issue?

The Prime Minister: These agreements are signed between countries and not between parties. The Anglo-Irish Agreement therefore will continue.

Q7. **Mr. Bellingham** asked the Prime Minister if she will list her official engagements for Tuesday 24 February.

The Prime Minister: I refer my hon. Friend to the reply that I gave some moments ago.

Mr. Bellingham: Will the Prime Minister find time today to consider the City? Will she agree with me that recent criminal proceedings are evidence that the Government's legislation to stamp out insider trading is working? Will she also agree with me that under the last Labour Government nothing whatsoever was done to combat fraud in the City?

The Prime Minister: Yes, Mr. Speaker. This Government will give priority to rooting out financial misconduct and wrongdoing wherever it occurs; witness the action we have taken to make insider trading a criminal offence. As my hon. Friend also raises the general matter of the City, may I point out that the City as a whole earns a net £7·5 billion in foreign exchange? It is of immense value to our balance of payments and to the country as a whole.

ne managers who are being appointed today expect about 2,300 redundancies over the next four years, which is at least a rather better outcome than we had feared. I certainly think that this company has the capacity to run the dockyard extremely successfully and to get new business into it, and that is the greatest security that those who work there could possibly have.

Miss Janet Fookes (Plymouth, Drake): I wish first to dissociate myself from the very gloomy interpretation of events described by the official spokesman for the Opposition. Secondly, I express my pleasure that a place has been found in the new arrangements for the present managing director, Mr. David Johnston, and at the same time inquire whether places will be found for the other senior managers who form the non-winning consortium.

Thirdly, will my right hon. Friend explain in more detail what the precise arrangements are for the service contract between now and vesting day, and what that will involve?

Mr. Younger: I am grateful to my hon. Friend. I entirely agree that it is most unhelpful to talk inaccurately about the destruction of the dockyard when this is the best opportunity that we can give to those who work there for a better and secure future.

My hon. Friend asked about the people who have been working as managers in the dockyards and, in particular, about Mr. Johnston. I understand that most of those who were in the consortium with Mr. Johnson are likely to continue in employment with the new company, although probably not all. I expect the new management to attain high standards. The understanding that we shall work with it during the interim period will enable it progressively to move in to take over management, but until vesting day responsibility will rest with my Department.

Dr. David Owen (Plymouth, Devonport): How does the Secretary of State justify restricting shares in the new commercial enterprise to key employees only? In view of the fact that the commercial management has been criticised not only by the unions, but by distinguished industrialists, managers throughout the country, two all-party Select Committees, all three Opposition parties and the local and district councils, will he not at least take into account that this decision will be reversed and that a unified, integrated commercial enterprise will be established in Devonport dockyard with share ownership open to all employees?

Mr. Younger: I note what the right hon. Gentleman says and know from his close contacts locally that he will be anxious to know what the future arrangements can be. At this stage the shareholding system that has been set up offers the best opportunity for good, sound management of the company. However, I note what the right hon. Gentleman says, and no doubt it can be considered.

Mr. Robert Hicks (Cornwall, South-East): In view of the consequences for employment opportunities in the area arising in part from the decision to alter the system of management, can my right hon. Friend say what tangible assistance his Department will make available, in addition to that provided by the Department of Employment and the Department of Trade and Industry, to alleviate those adverse affects and to promote the introduction of new suitable industry into the area, thus diversifying the local economy?

Mr. Younger: I am grateful to my hon. Friend. The decision that I have announced today does not in any way obviate or remove the obligations that my Department and I have to do all we can to help all aspects of the changeover, including giving any help that can be given from parts of the old dockyard which may no longer be required in the new set-up. I do not regard our responsibilities for that as ending with the new regime. I hope that my hon. Friend and those who are employed in the dockyard will recognise that, while the new system of management will come in on vesting day, 6 April, that does not end my Department's interest in the dockyard, nor our responsibility to supervise what goes on there.

Mr. Dick Douglas (Dunfermline, West): Will the Secretary of State reflect on what he has been saying about commercial confidence in relation to the contracts? While it may be acceptable to acknowledge that certain aspects of confidentiality must be adhered to prior to signing the contract, there is no overwhelming reason to keep these contracts strictly secret now that they have been signed. Why cannot the trade unions see the terms and conditions that the Secretary of State has accepted with these companies? Who will be the boss at Devonport? If the existing personnel and expertise are retained, who will administer the yard? Who signed the contract with the Ministry of Defence and——

Mr. Speaker: Briefly.

Mr. Douglas: Yes, Mr. Speaker. What was the nationality of the individual who signed the contract with the Ministry of Defence? May we have a complete assurance that at Rosyth the apprentice numbers that we have been led to expect in the past year will be maintained and not diminished, as we heard in previous answers?

Mr. Younger: I understand the hon. Gentleman's desire for more information. However, if he reflects about the contracts and thinks a little further about them, he will appreciate that when two separate contracts with different companies in different dockyards are negotiated simultaneously it would not be fair to either of the parties if the precise terms, conditions and details of one became common knowledge to the other.

If the hon. Gentleman thinks further ahead, after the seven-year period there may be a renegotiation of the contract or even a new contract with a new consortium and it would not be right for the precise details of the previous contract to have been known publicly.

The trade unions have had a huge amount of information passed to them for more than two years, and a great deal of which, I fear, has not been adequately digested. They have plenty to go on with all of that.

The boss will be the managing director of the new company that is to run the consortium that will take over.

Apprentices at Rosyth have been the subject of a statement by the new company. If more information is required, the unions would be well advised to break what they previously regarded as their blockage on discussions with the new company because, with great respect to the unions, that would be valuable to them and their members.

Mr. Robin Maxwell-Hyslop (Tiverton): Has my right hon. Friend noticed the absence of all the Liberal Members from the House? Does he agree that that suggests that they are entirely satisfied with the decision

[Mr. Robin Maxwell-Hyslop]

that he has reached? Does he further agree that as there is only one SDP Member present, presumably the other SDP Members are also satisfied with the decision?

As the volume of naval orders does not depend on the decision announced today, will not employment in the dockyard depend wholly on the ability of the winners of the competition to attract overseas repair orders? Does my right hon. Friend agree that world-wide experience is the best warranty that there could ever be for future employment in Devonport dockyard?

Mr. Younger: I thoroughly agree with my hon. Friend's last point. There is no doubt that the level of work in the dockyard, under any form of management, including under the present management, depends on the yard becoming more competitive and able to acquire business, other than normal naval dockyard work. I am absolutely clear that the new arrangement with the commercial consortium is much the best way of giving the yard the best chance to obtain new work. However, I do not wholly agree with my hon. Friend's theory that, because Liberal Members are not in the Chamber, they agree with everything that has been done. If that were so, they would be the happiest Members of the House by a long way.

Mr. Michael Foot (Blaenau Gwent): If this wretched plan goes through, despite opposition from all the independent bodies that have considered it, will the Secretary of State confirm that the assurance on control of future employment in the yard will be taken from the Government and transferred to the company—and that the guarantees that the Government have given about employment in the yards are of no use or worth?

Mr. Younger: That is a fair point. When the new employers take over the management of the yard, the employees will be responsible to their new bosses for doing their jobs properly and for negotiating any changes that they may wish in their conditions of service. However, on vesting day, their present rights and conditions will be carried through. That is fair treatment for those transferring to a new employer. The Minister of Defence will retain an interest as being responsible overall for the dockyard, subject to the contractors.

Mr. Jonathan Sayeed (Bristol, East): Does my right hon. Friend know that the one interested party that Opposition Members have neglected to mention is the Royal Navy? Will he confirm that the Royal Navy greatly favours his plans for Devonport?

Mr. Younger: My hon. Friend is correct. I understand that the trade unions had a meeting with the Navy Board, asked that question, and were told that the board was absolutely clear that this was the right policy.

Mr. Willie W. Hamilton (Fife, Central): In the light of the information supplied, does the Secretary of State accept that Brown and Root is a company of complete honesty and integrity? As the right hon. Gentleman has estimated that thousands of jobs will be lost, does that not add to the importance of accepting my Bill for the establishment of a development agency for the south-west of England?

Mr. Younger: The hon. Gentleman would not expect me to comment on a south-west England development agency. That is not a matter for me to decide. However, I can confirm that I have no reason to think that Brown and Root is not an entirely honest firm with integrity. It has operated, as he should know, for a long time in Scotland and has provided a great many jobs there.

Mr. Gordon Brown (Dunfermline, East): Will the Secretary of State now admit that he cannot conduct and complete the remaining consultations on conditions of service, pensions and the social and economic consequences of what he is doing and still meet his proposed deadline for transfer, which is only five weeks and a few days from now? Will he take note of the advice from my hon. Friend the Member for Dunfermline, West (Mr. Douglas) and publish all those details of what I understand are 1,000-page contracts involving jobs, apprenticeships, work load and reserve powers available to the Ministry of Defence so that we can see for ourselves the surrender of British interests and the unpatriotic betrayal of the work forces involved in this pernicious statement?

Mr. Younger: The hon. Gentleman is wrong about the amount still to be discussed. I remain ready to discuss solidly with all concerned between now and vesting day, and indeed beyond if necessary, any points that they wish to discuss. The conditions of service for the employees will be carried through to the new employment, and it is thereafter for them to negotiate any changes that they wish with their new employer. That is a perfectly fair treatment.

Some amendments will have to be made to conditions to recognise the changeover. Those can easily be discussed, and I remain ready to discuss them at any time. The position is, I am sorry to say, that repeated suggestions of dates for meetings to discuss those matters further have been turned down by the unions. I hope that they will now appreciate, in the interests of their members, that they should discuss much more fully all the details with me and my representatives and with the potential contractors at both dockyards. They have plenty of information upon which to work.

Mr. Dennis Skinner (Bolsover): Did the Secretary of State hear my right hon. Friend the Member for Llanelli (Mr. Davies) ask who were the key personnel? Is it not important that we know who those people are and what influence they will have? Is it not somewhat ironic that the flag-waving Tory party, represented by the Secretary of State today, is prepared to allow internationl money, say, from Libya or Argentina to be invested in this defence area while, at the same time, many British workers who are not key personnel will not be allowed to play a part in it? I think that the Secretary of State must answer that question.

Mr. Younger: On the matter of hearing what was said, my only problem in hearing is usually the hon. Gentleman's sedentary speech which goes on throughout the proceedings. It is for the new management to discuss key personnel with the unions, no doubt, and with representatives of the work force if they wish, on how that scheme can best be put forward. That is much the most sensible way to proceed.

Mr. Sydney Bidwell (Ealing, Southall): How can the Secretary of State be sure that there will be no greater security risk as a result of this widespread involvement in the docklands area? In view of the growing sophistication of armoury of the Navy and other forces, how can he be sure that there is not a grave security risk?

Mr. Younger: There are two points worth making in connection with that question, which is a perfectly fair one. First, all the security conditions and security arrangements that apply at the present will apply in the future. All that will have changed is the precise form of the management. I remind the hon. Gentleman and the other Labour Members who have expressed doubts of the structure of the management company that I have announced today. Certainly 29·9 per cent. of the shareholding is held by Brown and Root, whose parent company is an American company, but BICC has 29·9 per cent. and the Weir Group has 29·9 per cent. Barclays de Zoete Wedd has just over 10 per cent. That is a clear security for anyone who feels that there is foreign ownership of the dockyard. There is clearly a large majority shareholding of non-foreign ownership, for what that is worth. I expect all of those companies to be dedicated to the success of the dockyard under its new management.

Mr. Martin J. O'Neill (Clackmannan): Will the Secretary of State please be more specific about what he thinks the outcome will be in relation to key employees? Will those be people who are at present in the employ of the Ministry of Defence or are they likely to be Brown and Root placemen in the new organisation? Would it not be more sensible to make the terms of the contract clear and explicit so that employees could decide whether they wished to participate in the incentive scheme and so that people are not asked to take a pig in a poke, as the British Navy is having to do in this wretched business?

Mr. Younger: No, the British Navy is not taking any pig in a poke; it is taking an alternative form of management which should have a better chance of making a success of the dockyard. Of course, the key personnel could come from those presently employed in the dockyard and they could also come from outside. It should be an advantage for the future management of the dockyard to obtain the best talents from either of those two sections. The details of the scheme should be negotiated between the unions and representatives of the work force and the new management.

Trade Unions

3.55 pm

The Paymaster General and Minister for Employment (Mr. Kenneth Clarke): With permission, Mr. Speaker, I wish to make a statement on trade unions and their members.

Since 1979 we have proceeded step by step to introduce a succession of measures which, together, have helped achieve the least number of working days lost to industrial action for a generation. We have sought to restore a proper balance of bargaining power between trade unions and employers. We have also sought to establish democraticrights for individual members within their unions. Above all, we have sought to promote an environment in which both sides of industry can work together to generate the wealth the country needs.

We have observed closely the impact of our legislation. In general, progress has been marked and encouraging. However, some unions have declined the opportunity to put their house in order, and union members have not always felt able to take a stand and ensure that abuses are corrected. It is therefore clear that we need now to take another step both to strengthen the rights of individuals within a union and to reinforce their ability to exercise those rights. That is why we are today publishing a Green Paper "Trade Unions and their Members" which sets out a number of possible changes, on which comments are invited, as a basis for further legislation.

The Government have always believed that individuals should be able to choose for themselves whether to belong to a trade union. We also object strongly to attempts to coerce an employer into putting someone out of work on the ground that the person does not belong to any union or to a particular union. Our earlier measures have certainly reduced the scope for the worst excesses of the closed shop. However, I am afraid that in some industries the power of the closed shop still remains. We therefore propose measures which will end the legal protection of a post entry closed shop in any circumstances.

The present law allows a closed shop to be enforced if a weighted majority of employees votes for it in a ballot. Few major employers have yet been affected by this provision but in the cases where ballots have produced a lawful closed shop the rights of many individuals to choose whether to join a union or not have been extinguished. Experience has shown that unions' legitimate interests are not seriously weakened where the closed shop is not protected by law. The repeal of balloting provisions for the closed shop would give any individual dismissed for not belonging to a union the right to compensation for unfair dismissal. We also propose to end all legal immunity for industrial action designed to force an employer to create or maintain any closed shop. In short, we are proposing to end completely the use of the law in any circumstances to sustain the closed shop.

The most important feature of democracy within a trade union must be the right of the members to a secret vote in the direct election and re-election of their union leaders. The Trade Union Act 1984 established such a right for the election of the voting members of union executives and created a presumption that postal ballots would be used. However, a large number of trade unions have retained workplace ballots and the conduct of such ballots continues to give rise to controversy. Now is the

010/1285

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COMMERCIAL IN CONFIDENCE

Treasury Chambers, Parliament Street, SW1P 3AG

W C Clark Esq
Private Secretary to the
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London
SW1A 2HB

24 February 1987

Dear Bill,

NBM.

MANAGEMENT OF THE ROYAL DOCKYARDS

WITH DRN

The Chief Secretary has seen your Secretary of State's minute to the Prime Minister of 23 February and is content that he should go ahead as he proposes. The Chief Secretary is pleased that arrangements have been made to provide scope for senior management to participate in DML.

I am copying this letter to the Private Secretaries to the Prime Minister, all members of EA, to the Law Officers and to Sir Robert Armstrong.

Yours sincerely,

Jill Rutter

JILL RUTTER
Private Secretary

Recd Pdl

PRIVATISATION
PT 15

Prime Minister

Yet another turgid minute on the dockyards. The only point to note is that Mr Younger plans to announce tomorrow the award of the contract to the consortium which includes the American company Brown and Root. However another British company, BICC, is now in the consortium.

DRN
23/2

MO 10/2E

PRIME MINISTER

MANAGEMENT OF THE ROYAL DOCKYARDS

1. I have now completed my consideration of the way ahead on the commercial management of Devonport Dockyard, about which I last wrote to you on 19th January. I am therefore writing to inform you and E(A) colleagues of my intention to authorise, subject to the final stages described in paragraph 6 below, the signature tomorrow of a contract with Devonport Management Limited (DML) for the operation of Devonport Dockyard for a period of 7 years from 6th April 1987, which I intend to announce by means of the attached statement.

Background

2. Colleagues will recall that on 27th January, following a statement in the House of Commons earlier that day, we signed a similar contract with Babcock Thorn Limited (BTL) in respect of Rosyth Dockyard. We also signed a separate service contract with BTL on the same day to cover its operation in the Dockyard from now until Vesting Day, and it is our intention to do the same for DML.

3. The proposed contract with DML follows my announcement in the form of a written Answer on 20th January that that company was our preferred contractor for Devonport Dockyard. At the same time I produced a further consultative paper for the Trades Unions on Devonport; I met General Secretaries and other representatives on 13th February to hear their views on the proposed way ahead for that Dockyard. It was clear that the Unions remain as opposed as they have always been to the whole idea of commercial management, continuing to prefer the idea of a Dockyard Trading Fund with the workforce remaining in the Civil Service. We have repeatedly explained why we believe that commercial management under fixed-term contracts offers the best way ahead for the Dockyards, a view shared by the Navy Board, and I did not hear anything in what they said to me to make me change my view.

Consultation

4. I have formed the impression that a part of the tactics that the Unions have adopted in our discussions has been to decline to talk about the substance of the information with which they have been provided over the last 20 months or so, but at the same time, to press for more. Clearly they have adopted this approach not only with a view to delaying Vesting Day but with an eye on possible High Court action under the Dockyard Services Act claiming that consultation has been inadequate. But I would emphasise that I am as satisfied as I can be, as I was with the Rosyth contract, that we have complied with any obligations placed on us at this

stage by the Act. Nonetheless, legal action cannot be ruled out if for no other reason than to satisfy the expectation of it, which has been fostered for many months among the workforce by the Trades Unions themselves. What effect, if any, such action would have on our plans would have to be considered at the time.

The Contract

5. In my minute to you and colleagues on 19th January I reported that commercial management was a credible option for Devonport on the basis of the contract we had negotiated with DML; I added that some further progress was possible, and I am glad to report that we have made considerable headway. There have, in particular, been a number of changes to the composition of the DML consortium. Previously Brown & Root (UK) Limited held 30% of the shares, the Weir Group Plc held 25% and Barclays de Zoete Wedd (who replaced Lazards) held the balance, 45%. I had always hoped that some or all of the 45% held by merchant bankers might be transferred to one or more British industrial companies. On 12th February DML announced that Balfour Beatty had been prequalified by the Ministry of Defence as a prospective partner in the consortium.

6. Since then, intensive negotiation has been under way resulting in the participation of BICC (the parent company of Balfour Beatty) as a full member of DML, and I am confident that I will have their final and formal Board level endorsement by tomorrow morning. The DML consortium will therefore consist of Brown & Root (UK), the

Weir Group and BICC (acting through Balfour Beatty), each holding 29.9% of the shares, with Barclays de Zoete Wedd holding the remaining 10.3% in trust for senior management in the Dockyard. As colleagues will recall, a small team of local management submitted a gallant but unsuccessful bid, as Devonport Dockyard Ltd, to win the contract. This trust holding will provide a vehicle for selected individuals who wish to participate in the future financial success of the Dockyard; this will include David Johnston, the current Managing Director of the Dockyard, who will take up an appointment of Deputy Chairman of DML on Vesting Day.

7. Such a broadening of the consortium will improve the parent company guarantees to the operation of the Dockyard and will remove some of the (albeit unwarranted) claims of those who oppose the whole scheme that (because Brown & Root's parent company is a US company) the Dockyard would be under US control.

8. Whilst, as I said in my minute of 19th January, I was satisfied with the contract we had negotiated with DML, I believe that the subsequent negotiation has strengthened its terms considerably. With Vesting Day less than six weeks away it is important that the contract should be signed as quickly as possible. Although time is then very tight, I am satisfied that an orderly transition is still capable of achievement; and that, if the

Unions refuse to co-operate, we shall nonetheless be able to implement what has to be done by 6th April to operate the Dockyard on a commercial basis from then on.

9. I am sending a copy of this minute to all members of E(A), to the Law Officers, and to Sir Robert Armstrong.

G.Y.

Ministry of Defence

23rd February 1987

DRAFT STATEMENT TO BE MADE IN THE HOUSE BY SECRETARY OF STATE FOR DEFENCE

With permission, Mr Speaker, I would like to make a statement about Devonport Dockyard.

As the House will recall, I announced on 20th January that I was satisfied that there existed the basis for an advantageous contract to be placed for the future operation of Devonport Dockyard with Devonport Management Limited. At the same time we provided the Trades Unions with further information summarising the main aspects of the draft contract arrangements negotiated with that company. In a statement made on 21st January my honourable Friend the Parliamentary Under Secretary of State for Defence Procurement informed the House that I had invited the Trades Unions to a meeting on 13th February so that I might hear and consider their views before taking any final decision on the future management of Devonport Dockyard.

At the time of that statement the Devonport Management Limited consortium comprised Brown & Root (UK) Ltd with 30 per cent of the shares, the Weir Group plc with 25% and Barclays de Zoete Wedd with 45%. As the House knows, it has been our hope that some or all of the 45% held by Barclays might be transferred to one or more British industrial companies. I am glad to inform the House that since my honourable Friend's statement BICC, acting through their subsidiary Balfour Beatty, have now joined the consortium. BICC, Brown & Root and the Weir Group now each hold 29.9% of the shares

with the 10.3% balance held by Barclays de Zoete Wedd, in trust to provide an incentive scheme for key employees.

I met General Secretaries and other Trades Union representatives on 13th February to discuss the way ahead on Devonport. The Unions made it clear to us that they remained as opposed as they have always been to the introduction of commercial management, continuing to prefer the idea of a Dockyard Trading Fund with the workforce remaining in the Civil Service. As I have already told the House, it remains our view that a Dockyard Trading Fund, which is the option involving minimum change, is unlikely to secure the improvements in efficiency we seek or to compete as successfully as a commercial company for commercial and Naval non-core work.

We have provided a great deal of information to the Unions on our proposed changes to the management of the Dockyards, over a very long period. I am grateful to the Unions for the work they have done in recent weeks to consult the workforce locally. I have considered closely the points they have put to me. These have included the request for the contract which we have already signed in respect of Rosyth Dockyard, and the one we have negotiated with Devonport Management Limited, to be made public; but I am sure that the House will understand the reasons of commercial confidentiality that prevent me from meeting this request. However, I have made every effort to provide all the relevant information that I can.

Mr Speaker, I am fully aware of my obligations to inform and consult the Trades Unions and I am satisfied that I have complied with such duties as the Act imposed on me at this stage. I have, therefore, authorised the signature today of a seven-year Term Contract for the future operation of Devonport Dockyard from 6th April 1987 with Devonport Management Limited. We are also signing a Service Contract with the company to cover its operations in the Dockyard from now until Vesting Day, during which time the management of the Dockyard will remain the responsibility of my Department.

I have renewed my invitation to the Trades Unions to devote the period between now and Vesting Day to useful discussions on matters affecting the workforce, and have proposed a series of meetings to that end.

ECONPOL: Privatization PT15

SECRET

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COPY NO 2 OF 9.

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

23 February 1987

Dear Nigel

WSPA

SALE OF BP SHARES

at-Hap

Thank you for sending me a copy of your minute to the Prime Minister of 17 February.

As you say, the sale will need careful planning, and I will ensure you get any help you need from my Department. In particular, the sale will raise questions about our future relationship with BP because at present:

- the Company's Articles of Association provide the right to appoint Government Directors with the power to veto Board resolutions;

- the Articles also require BP's domicile to be in England; and

- our remaining shareholding protects the Company from takeover.

I recognise that these are just some of the questions that will need to be addressed, and that we still have some time to consider them. But I felt I should put down a marker now so that we can consult before final decisions are taken.

I am copying this letter to the Prime Minister and to Sir Robert Armstrong.

Yours ever
Peter

PETER WALKER

SECRET

ECON POL: Privatisation
Pt 15

CC DRP
(+ Owin)

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MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~830 7822~~ 218 6169

MO 10/2L

MBA

20th February 1987

Dear Mark,

STATEMENT ON DEVONPORT DOCKYARD

I attach a copy of the statement my Secretary of State plans to make in the House on 24th February regarding Devonport Dockyard, subject to the satisfactory completion of the final stages of contract negotiations. I have sent copies to Brian Dyer at the Treasury, Alison Smith in the Lord Privy Seal's Office, Nick Baxter in Lord Young's Office, Mike Gilbertson in Trade and Industry and Sarah Straight in the Chief Whip's Office.

Yours aye,

(W C CLARK)
Private Secretary

Mark Addison Esq
No 10 Downing Street

DRAFT STATEMENT TO BE MADE IN THE HOUSE BY SECRETARY OF STATE FOR DEFENCE

With permission, Mr Speaker, I would like to make a statement about Devonport Dockyard.

As the House will recall, I announced on 20th January that I was satisfied that there existed the basis for an advantageous contract to be placed for the future operation of Devonport Dockyard with Devonport Management Limited. At the same time we provided the Trades Unions with further information summarising the main aspects of the draft contract arrangements negotiated with that company. In a statement made on 21st January my honourable Friend the Parliamentary Under Secretary of State for Defence Procurement informed the House that I had invited the Trades Unions to a meeting on 13th February so that I might hear and consider their views before taking any final decision on the future management of Devonport Dockyard.

At the time of that statement the Devonport Management Limited consortium comprised Brown & Root (UK) Ltd with 30 per cent of the shares, the Weir Group plc with 25% and Barclays de Zoete Wedd with 45%. As the House knows, it has been our hope that some or all of the 45% held by Barclays might be transferred to one or more British industrial companies. I am glad to inform the House that since my honourable Friend's statement BICC, acting through their subsidiary Balfour Beatty, have now joined the consortium. BICC, Brown & Root and the Weir Group now each hold 29.9% of the shares

with the 10.3% balance held by Barclays de Zoete Wedd, in trust to provide an incentive scheme for key employees.

I met General Secretaries and other Trades Union representatives on 13th February to discuss the way ahead on Devonport. The Unions made it clear to us that they remained as opposed as they have always been to the introduction of commercial management, continuing to prefer the idea of a Dockyard Trading Fund with the workforce remaining in the Civil Service. As I have already told the House, it remains our view that a Dockyard Trading Fund, which is the option involving minimum change, is unlikely to secure the improvements in efficiency we seek or to compete as successfully as a commercial company for commercial and Naval non-core work.

We have provided a great deal of information to the Unions on our proposed changes to the management of the Dockyards, over a very long period. I am grateful to the Unions for the work they have done in recent weeks to consult the workforce locally. I have considered closely the points they have put to me. These have included the request for the contract which we have already signed in respect of Rosyth Dockyard, and the one we have negotiated with Devonport Management Limited, to be made public; but I am sure that the House will understand the reasons of commercial confidentiality that prevent me from meeting this request. However, I have made every effort to provide all the relevant information that I can.

Mr Speaker, I am fully aware of my obligations to inform and consult the Trades Unions and I am satisfied that I have complied with such duties as the Act imposed on me at this stage. I have, therefore, authorised the signature today of a seven-year Term Contract for the future operation of Devonport Dockyard from 6th April 1987 with Devonport Management Limited. We are also signing a Service Contract with the company to cover its operations in the Dockyard from now until Vesting Day, during which time the management of the Dockyard will remain the responsibility of my Department.

I have renewed my invitation to the Trades Unions to devote the period between now and Vesting Day to useful discussions on matters affecting the workforce, and have proposed a series of meetings to that end.

Kill

CONFIDENTIAL

10 DOWNING STREET

From the Principal Private Secretary

19 February 1987

SALE OF BP SHARES

The Prime Minister has seen the Chancellor's minute of 17 February and has noted his intentions about the sale of BP shares. She has asked what the Chancellor's plans are for the Government's powers over BP once the Government's remaining shares are sold.

I am copying this letter to Geoff Dart (Department of Energy) and to Trevor Woolley (Cabinet Office).

(David Norgrove)

Tony Kuczys, Esq.,
HM Treasury.

CONFIDENTIAL

G10 MR 10/106

CONFIDENTIAL

CCBG

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

Prime Minister!
I suggest you note the Chancellor's intentions, and ask his intentions for the Government's powers over BP, right to appoint two directors etc.
DRN 18/2
Agree?

PRIME MINISTER

SALE OF BP SHARES

I propose to announce shortly after the Budget that, market conditions permitting, we intend to sell the Government's remaining BP shares sometime during 1987-88. I would probably do so on 23 March, during my wind-up speech in the Budget Debate, or just possibly at the end of the previous week.

Although I would not indicate the timing of the sale any more precisely, the likeliest date is in either October or November. I have sounded out Sir Peter Walters. He would welcome an autumn sale which would fit in well with BP's own plans.

Our 31.7% holding is currently worth around £4½ billion. We would take the proceeds in either two or three instalments, and these will be a valuable contribution to our annual targets for privatisation proceeds. Although BP is clearly different in kind from the privatised utilities, and calls for a different marketing campaign than for Gas, I see considerable scope for using the sale to promote our objectives of wider share ownership.

I need to announce our intentions shortly for two reasons. First, it is becoming increasingly obvious to the Press and to the City that to achieve our published target of £5 billion privatisation proceeds in 1987-88 we will have to sell BP shares in order to top up the known instalments due from Gas and Airways and the estimated proceeds from Rolls-Royce and British Airports Authority. There are no other major, obvious options open to us during the year.

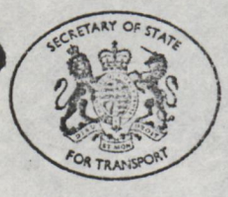
But more important, although it is a secondary sale, it is a very large one and will need careful planning, particularly if it is to appeal to smaller shareholders. The Treasury needs, therefore, to appoint merchant bank advisers as soon as possible, and I believe we should hold a competition for the appointment immediately after the announcement.

I am sending a copy of this minute to Peter Walker and to Sir Robert Armstrong.

NL.

N.L.
17 February 1987

CC BS



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Hon Peter Brooke MP
Minister of State
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

9 February 1987

NBM.

Dear Peter

USING PRIVATE ENTERPRISE IN GOVERNMENT

Thank you for sending me a copy of your letter to Douglas Hurd of 12 January.

I am taking a very close personal interest in the Department's proposals in response to Recommendations 4 and 5 of the Efficiency Unit's Report. The report which is now being sent to the Central Unit on Purchasing will show that some 20 activities have been identified for review over the next four financial years, of which over half are currently under review or to be reviewed during the 1987/88 financial year. Each year my officials will examine the possibility of adding further areas to the review programme. But, as you will appreciate, we are not dealing with a bottomless well! This is all the more apparent when one looks at the large number of functions which we have already contracted out.

I am copying this letter to the Prime Minister, Ministers in charge of Departments, Sir Robert Armstrong and Sir Robert Ibbs.

Yours
John

JOHN MOORE

RECON POL
PRIVATISATION
PT 15

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CSBG

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CONFIDENTIAL

NBPM.

Treasury Chambers, Parliament Street, SWIP 3AG

Shirley Trundle
Private Secretary to the Secretary of State for
Education and Science
Department of Education and Science
Elizabeth House
York Road
London
SE1 7PH

6 February 1987

Dear Shirley,

PBI/NSDO PRIVATISATION - NEGOTIATIONS WITH AGC

The Chief Secretary held a meeting this morning with your Secretary of State and the Minister for Agriculture at 8.30am in the Treasury. Also represented were the three departments, the AFRC, Lazards and Herbert Smith.

Your Secretary of State asked Lord Selborne to report on progress reached in negotiating with AGC. Lord Selborne said that as instructed at the Ministers' last meeting on Tuesday the AFRC and Lazards had met with AGC and offered them the package authorised at that meeting based around the oil seed rape programme. They had made some good progress. There was clear indication that AGC were interested. They had dropped claims for a cash payment or a limitation on royalties payable by AGC to the AFRC. But two problems had arisen on the details of the package.

The first was on the application of the fair trading clauses. As they stood at the moment if the AGC went into plant breeding they would have to make available to at least one other plant breeder any techniques or material they adopted from PBI. That obviously substantially limited the value of the programme to them. He therefore wanted a steer on a possible modification to those terms. He thought it would be right to give other plant breeders the option to take up oil seed rape material and techniques when it reached the stage of being one year away from national list trials.

The second problem was that three strains of oil seed rape (and two strains of barley) had already passed from the PBI to the NSDO for national list trials. AGC had assumed that those three strains were included in the oil seed rape programme as offered. AFRC had not intended this; nor had they consulted the NSDO. There

was no doubt that without those three strains the attraction of the portfolio to AGC was diminished because of the potential competition or the possibility those strains might be released before the material AGC had access to was ready to go to market. This misunderstanding had only emerged in this week's discussion.

You Secretary of State asked what the valuation of these three strains might be. Lord Selborne said that any valuation would be highly speculative. But if one proved successful, as Mikado had, it could generate substantial revenues. In his view this was a crunch issue for AGC. If the three strains were not included in the package, they would not accept it. The Minister for Agriculture said that he had never envisaged that the NSDO would be asked to surrender strains that they were developing. This was a matter for his decision. He would not be prepared to concede. He asked Lazards what the effect would be on the proceeds of the privatisation. Lazards felt that leaving the three strains in the privatisation package would enable a prospective bidder to look to revenue from the commercial sales of oil seed rape. It would also have a psychological effect on the perception of the package and would increase the number of likely bidders and hence offer the prospect of a better price for the privatised package.

Your Secretary of State asked if there were any questions the AFRC compensating the NSDO. Lord Selborne said that if the NSDO were prepared to give up these strains he believed that some arrangement could made. AGC and NSDO could share the royalties on a 50 - 50 basis at the very least and AGC's share could then be shared with the AFRC.

Returning to the problem over the fair trading principles, the Secretary of State noted that the AFRC proposed a period of delay before lines were made available to third parties. In his view that sounded reasonable. The package had to be of some value to AGC. The Minister for Agriculture said that he did not think that the AFRC proposal to make material and techniques available one year before nationallist trials was likely to satisfy the plant breeders. He felt that they should have access to the material and techniques at a much earlier stage. There was some discussion about the likely preference of plant breeders between having the material at a fairly developed stage or at an early stage. Mr Turner pointed out that a company like ICI would prefer to have access at an early stage, whereas commercial plant breeders would prefer access later on when the product was at a more developed stage. Herbert Smith pointed out that whatever arrangement was made, plant breeders were arguably in a better position with material and techniques transferred to AGC than they were with those left with the privatised package. One plant breeder at least would be able to have access at some stage before national list trial . But with techniques and material remaining with the privatised package, they would have no access. The Chief Secretary said that he thought that was a very strong line for the Minister for Agriculture to take with the plant breeders. Your Secretary of State noted that this would be a more general handling problem in relation to the privatisation itself.

Lord Selborne said that what he sought was discretion to make a deal with AGC which would allow them some derogration from the

principle it stood at the moment. He would take full account of the Minister's preference for the material and techniques to be available on a one-off basis at an early stage. But his view was that this would in any case not arise since the non-availability of the NSDO strains would mean that no agreement could be reached with AGC and hence the agreement would have to be terminated today.

Your Secretary of State said that the Minister for Agriculture's attitude meant that no deal could be reached with NSDO. That obliged the Government to commit £2½ million for public funding in an attempt to maintain the viability of the PBI over the interim period for the sake of three strains of seed whose value was entirely speculative. He thought that was an absurd position to reach. The Minister for Agriculture said that he stuck by his view.

Your Secretary of State said that he would not wish Lord Selborne to decide to terminate the agreement if negotiations with AGC broke down again on this point without reference again to Ministers. The NSDO had not been consulted. It was obvious that they had to be consulted on any possible deal on their three strains. Should this therefore prove a sticking point Lord Selborne should tell AGC that he would need to consult the NSDO. That would be the basis for seeking a further extension.

The meeting concluded at 9.30am.

Copies of this letter go to Shirley Stagg (MAFF) and to David Norgrove (No. 10) Mike Gilbertson(DTI), Cathy Roberts (Mr Walden's Office, DES), Henry Steel (Law Officer's Department) and to Trevor Woolley (Cabinet Office).

Yours sincerely,

Jill Rutter

JILL RUTTER
Private Secretary

3681/001

CONFIDENTIAL

FROM: D J L MOORE
DATE: 5 FEBRUARY 1987

cc: Chancellor
Chief Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mr Burgner
Mrs M E Brown
Mr Lyne
Mr McIntyre
Mr Ross Goobey

FINANCIAL SECRETARY

BAA PRIVATISATION

Mr Boote's minute of 4 February, attached advises on the Secretary of State for Transport's letter of 23 January. The difficult question is on instalments and we recommend that a decision on this should be deferred. If we were looking at the BAA sale in isolation there would be a case for agreeing now to two instalments as helpful to marketing and proceeds. But the risks to proceeds from the overall programme for 1987-88 are such that we must avoid being prematurely locked into commitments on instalments, and you need to look at the BAA proposal in this wider context which is also relevant to Rolls-Royce.

2. The worse case (which was discussed in Mr McIntyre's minute of 16 January on the privatisation time-table) is a Summer Election so timed that we cannot do either BAA or Rolls-Royce before the summer holidays. In this situation we have two broad options.

Option I

3. Under this option, which the Chancellor prefers, we would go ahead with BP in October and sell either RR in November or BAA in January. To hope to have all 3 sales in 4 months seems unrealistic.

4. If we kept RR, and deferred BAA to 1988-89, we could if necessary have two RR instalments with the second in February/March 1988. If our present assumptions on proceeds from the various sales are in the right ballpark, we would still get around £5 billion proceeds in the year.

5. If we preferred BAA to RR, it would not be sold until January because an earlier sale would not fit sensibly with BAA's accounting cycle. It would not then be practicable to have a second instalment in 1987-88. In that case the loss of RR and of the second BAA instalment would take us down to around £4½-£4¾ billion in 1987-88 unless we were to tilt the balance of the BP instalments.

6. If faced with this situation, it follows that to ensure proceeds of at least £5 billion in 1987-88 we ought:

either to press for RR rather than BAA

or if BAA were preferred to go for one payment only.

Option II

7. This option comes into play if, against the Chancellor's present preference, it were decided to defer BP and have both RR and BAA in 1987-88. The loss of BP proceeds would take us down to around £4 billion in 1987-88. To prevent any further loss we may want to insist that all the proceeds for BAA came into 1987-88 - i.e. by having only one payment.

RR Sold in the Summer, and BAA Deferred

8. If a Summer Election deferred only the BAA sale we would aim to have it in January 1988. If both RR and BP had gone ahead, and if our proceeds assumptions are of the right order, we could then get around £6 billion if all BAA proceeds came in 1987-88. Or we would get, say, £5.6 billion if there were a second instalment falling in 1988-89.

An Autumn Election

9. If there were an Autumn Election we would aim to squeeze BP into late November. If so, and assuming RR and BAA had gone ahead in the summer, we could get proceeds of up to £6 billion.

10. But to allow for the possibility of BP falling back to November we cannot agree that either RR or BAA second instalments should be planned for then.

Proceeds/PSBR

11. Delaying a decision on BAA instalments has the advantage that, if the sale had to be delayed to January 1988, we could decide nearer the time whether general proceeds and PSBR considerations pointed to one instalment or two. For example, we might find that we had been too optimistic on proceeds from other sales and needed all we could get from BAA proceeds in the year. Or, if the outlook for the PSBR turned out to be very favourable, there might be a case for opting for two instalments even if this meant undershooting our £5 billion.

Conclusions

12. All this points to:

(i) allowing RR two instalments, if DTI and their advisers seek them, but on the understanding that the second will not be until February 1988 thus allowing for the possibilities of both a BP sale in November and a BAA sale in January;

(ii) deferring until mid-May (as recommended by Mr Boote) any further consideration of BAA instalments because, to underwrite our proceeds target of at least £5 billion, we may need all BAA proceeds in 1987-88.

Joan Lane

p.p. D J L MOORE

Enc:

006/2985

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CCBG

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Malcolm Rifkind MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
London
SW1A 2AU

5 February 1987

NBPM.

Dear Malcolm,

SCOTTISH TRANSPORT GROUP: CORPORATE PLAN REVIEW AND OBJECTIVES

WILL REQUEST IF REQUIRED

Thank you for your letter of 22 December. I have also seen John Moore's letter to you of 1 December and your reply of 22 December.

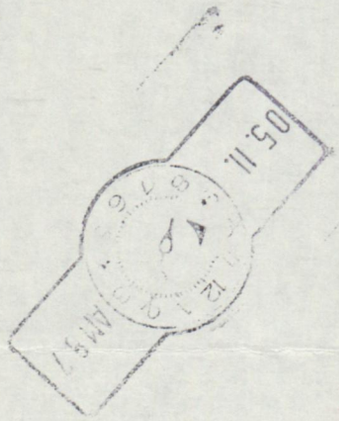
I am content with the revised objectives for the Scottish Bus Group (SBG) you propose together with the preamble your Department has drafted, incorporating references to the assurances on cross subsidy mentioned in your 19 November letter to Nicholas Ridley. I believe the preamble strengthens the objectives considerably. I am also content with the objectives you propose for CalMac.

As far as performance aims are concerned, I understand that our officials have discussed your proposals and STG's response to them, and that your officials are now reconsidering possible performance aims for the Group. Given SBG's protected position, I think it is important that we agree demanding performance aims for the Group.

I am pleased that you agree to SBG being the subject of a Monopolies and Mergers Commission reference later this year. I am also encouraged to hear that you are seeking a commentary from John Moore on the progress of the National Bus Company's disposal programme in order to reconsider the structure and ownership of

SBG. I hope that in the light of this report you will consider an early review of the prospects for privatisation of SBG, in which my officials would wish to participate.

I am copying this letter to other members of E(NI) and to Sir Robert Armstrong.



Yours ever,

JOHN MacGREGOR

007/2985

010

CONFIDENTIAL

CC BG

Treasury Chambers, Parliament Street, SW1P 3AG

Mrs Shirley Trundle
Private Secretary to the Secretary of State
for Education and Science
Department of Education and Science
Elizabeth House
York Road
London
SE1 7PH

3 February 1987

Dear Shirley,

NBPM.

NSDO/PBI PRIVATISATION: NEGOTIATIONS WITH AGC

The Chief Secretary held a meeting with your Secretary of State, Parliamentary Under Secretary of State, and the Minister for Agriculture at 7.15pm yesterday evening in the Treasury. Also represented were the AFRC, the three Departments, Lazards, and Herbert Smith. The meeting had before it a paper prepared by officials from the three Departments and AFRC in consultation with Lazards setting out the financial and other implications of the various packages on offer.

Your Secretary of State asked Mr Turner to report on the situation reached in negotiation with AGC following last Thursday's meeting. Mr Turner said that he had met with representatives of AGC that morning. They said they had no progress to report following their board meeting. Their proposal of items 1, 2 and 7 plus £4 million in cash plus a 2 per cent limit on royalties payable to the AFRC remained their offer. Mr Turner repeated the offer authorised by Ministers last week. There was discussion of the relative values of various items in the plant breeding programme and he tried to draw AGC on the question of the value of the privatised package. AGC refused to be drawn. He had asked Dr Gilmore whether he accepted the 9 principles on fair trading and to confirm that he had room for negotiation. Dr Gilmore refused to respond to the question of the 9 principles and said that he felt that the negotiating team did not appreciate the damage that

the privatisation proposal would do to AGC. The Board were insisting that future meetings be held in Cambridge, which Mr Turner thought was indicative of their attitude. They were offering three possible packages:

(i) 1, 2 and 7 plus royalties plus £4 million (value £8 million);

(ii) 1,2 and 7 plus the oil seed rape programme (3)plus £2 million (value £11 - 13 million) or

(iii) a 26 per cent stake in the privatised package.

Your Secretary of State ruled out any option giving AGC a share of the privatised package. He said that he had been approached by Mr Cooksey asking for a meeting. He had refused. Mr Cooksey claimed that AGC provided one-third of the funding of AFRC. Lord Selborne contested that. Your Secretary of State said he would find it very useful if his officials could prepare a note for him clarifying the relationship between AGC and the AFRC. He noted that the values attached to various packages seemed to vary without obvious explanation. There was some discussion of the valuation of the various packages. Your Secretary of State asked about the position on royalties. Lord Selborne said that the normal expectation would be that royalties would be in the range of 2 to 10 per cent. In some cases they could be as high as 50 per cent. It was difficult to put a definite valuation now of AGC's demand. AFRC received two-thirds of any royalties, one-third went to the Exchequer, up to a limit of £2½ million after which the formula is recalculated.

Your Secretary of State asked Lord Selborne for the AFRC's view on the current state of negotiations. Lord Selborne said that he thought that AGC's demand was too high. His attitude last week had been based on the fact that AFRC valued its relationship with AGC. But the proposal now on offer was such that he did not believe that Ministers should agree. He would prefer to try to renegotiate AGC back to £5 to £6 million. If that failed then AGC's contract should be terminated. He thought that the Council, whom he had not consulted, would follow that advice though they would no doubt think that the whole episode had been very badly handled. If termination were the course chosen the future of the PBI would depend on the transitional arrangements to tide them over the period when the agreement with AGC wound down. The PBI would have to look to MAFF for bridging finance, in the range of £1½ to £2 million. The lawyers' advice was that the balance was strongly in favour (75: 25 in Herbert Smith's assessment) of the AFRC being successful in the outcome of any litigation over material AGC should bring. There was no substance at all to any litigation AGC might bring over termination itself.

Your Secretary of State asked what was said about the relationship with AFRC in AGC's prospectus. It was pointed out that while it did mention the break-clause it also spoke of the expectation of AGC's contract being renewed. There was no doubt

that the City would feel badly let down were the Government to opt for termination.

There was some discussion of AGC's attitude. It was recognised that AGC's line appeared to have hardened in recent weeks. The Board seemed to be taking a harder line than the executives. Mr Turner reported that he felt the Board believed this was a matter of principle on which they should fight. They felt very badly treated. The 10 year period they had expected had been cut in half and the amount of science they had hoped to exploit had been cut back. Lord Selborne said that he agreed with this assessment of AGC's attitude. The AFRC had welcomed the setting up of the AGC, with Government approval. AFRC had gone along with the idea of privatisation as long as the integrity of strategic research was protected. Now they were facing the prospect of a dismantling of the PBI and would have a bad track record with the City. He believed there was a need to move fast to limit damage.

The Chief Secretary and your Secretary of State noted that Lord Selborne's attitude pointed towards settlement. But Lord Selborne said that there were also problems if the Government appeared to be too generous to AGC. There were also problems vis a vis other plant breeders. The Minister for Agriculture said that there was already evidence that the plant breeders were very upset at the prospect of giving AGC a favoured position post-privatisation. They did not wish to see AGC move into plant breeding.

Your Secretary of State said that a thorough analysis of what termination would entail was needed. In particular there should be an assessment by lawyers of possible litigation, and there should an assessment of what extra public money might be required to find PES in the interim. His own view was that it would be better to come to some settlement with AGC. Lord Selborne's view was that £8 million was too high a price to pay. But Lazard's advice was that AGC would not settle at the £5 to £6 million, already endorsed by Ministers. He thought a package valued at less than £8 million should now be explored. He agreed that Lord Selborne should not be personally involved in the negotiations, but Lazards should make Lord Selborne's position clear to AGC. He suggested a package of items 1, 2 and 7 and £4 million in cash. There would be no question of offering any more programmes and no offer on royalties. Mr Turner said that he thought that it would be possible to do a deal with AGC on that basis. He noted that AGC were asking for the cash payment up front and would want to keep the interest on it if it were returned in the event that privatisation did not go ahead. Lord Selborne said that he could accept a deal on that basis.

It was pointed out that on Lazards top estimate of the proceeds from privatisation, such a deal with AGC would leave net cash proceeds of £18 million. It was pointed out that the site alone was valued at £15 million.

Moreover the Minister for Agriculture pointed out that there was a loss of revenue flow from NSDO of £3 to £4 million a year net of transitional funding for PBI. The Chief Secretary said he

had two points of concern. He had not seen any assessment of the value to AGC of the "continuing close relationship" of the PBI with AGC after privatisation. He was also concerned about negative reaction of other plant breeders. Moreover the deal on offer seemed to offer AGC a very high return of venture capital that they had put in which was reckoned to be £2 million.

Mr Turner said that he thought that AGC had overstepped the mark. They had taken a very aggressive line. The Board was sticking out on a principle and was asking too much. He thought there was no option to terminate and then proceed with the privatisation. Lord Selborne said that he thought that a deal along the basis outlined earlier by the Secretary of State, valued at £7 million would be acceptable. But £8 million was too high. He thought is was worth making a further attempt to negotiate with AGC. The Chief Secretary said he was very unhappy about making a decision, especially in the light of Lazard's advice. He wanted a fuller assessment of the position if no deal were done with AGC. He also wanted more information about the value to AGC of the post-privatisation relationship. Only when those assessments were available would he be prepared to make a final decision on whether a deal was worth doing. The Minister for Agriculture indicated he would not be prepared to accept a deal on the basis set out by your Secretary of State.

Your Secretary of State summed up the meeting saying that he would want to see a paper tomorrow+ on the downside of termination. There should be a further meeting to discuss that paper and a final conclusion should be reached tomorrow evening. Meanwhile Lazards should not communicate with AGC.

Copies of this letter go to the Private Secretary of the Prime Minister, the Secretary of State for Trade and Industry, the Solicitor General, Sir Robert Armstrong and Ministers present at the meeting.

Yours sincerely,

Jill Rutter

JILL RUTTER
Private Secretary

+ i.e. 3rd February

PRIME MINISTER

B/F 17/2

DRS 3/2

PRIVATISATION OF THE COAL AND ELECTRICITY INDUSTRIES

John Redwood's interesting minute below, on which the Policy Unit advise at Flag A, illustrates why the coal and electricity industries are the most challenging to privatise. Challenging politically because of the need to carry the powerful electricity workers along with the Government; challenging organisationally because the industries can hardly be privatised as a block a la BT/BGC; and challenging financially because of the need to work out proper pricing regimes and a financial record which will impress the Stock Market.

The timetable might go something like this:

Year One - decide what to do and draft legislation;

Year Two - pass legislation;

Year Three - reorganise the industry;

Year Four - establish one year's accounts on which to base the prospectus;

Year Five - Privatisation.

This timetable may be pessimistic and might be compressed. But it is not easy to see how unless the industries are to be privatised as a block.

I suggest that in the first instance you discuss the issues of coal and electricity privatisaton with Mr. Lawson, rather than Mr. Walker. You might ask him how he sees the timetable, especially in relation to the expected decline in privatisation receipts towards the end of the decade.

Agree to put this on the agenda for a bilateral with Mr. Lawson, warning him that you will want to raise the issue?

N.L.W.

N L WICKS

30 January 1987

A.

PRIME MINISTER 30 January 1987

PRIVATISATION OF THE COAL AND ELECTRICITY INDUSTRIES

We agree with John Redwood's prescription for privatisation of the coal and electricity industries. There are risks that the implementation process will be painful and disruptive. But none of the candidates for privatisation in the next Parliament offer such valuable rewards for success.

If anything, John understates the case. You might bear in mind one or two additional points:

1 If we believe - as we should - that our restructured, modernised economy has considerable potential for expansion, we should recognise the likelihood that electricity demand will continue to grow at least 2% pa. Combined with the approaching retirement of the high proportion of power stations ordered in the late 1950's and 1960's, this will mean a rapidly growing electricity supply gap opening up from the early 1990's.

Sizewell B therefore marks the beginning of a major redevelopment of our electricity industry. The investment requirements will be daunting - probably of the order of £20 billion during the 1990's; and no let up as we move into the decade thereafter.

2 Electricity privatisation along the lines proposed by John Redwood has a lot to offer as regards the more efficient operation of existing power stations. It is even more compelling in the context of an industry on the verge of massive reinvestment and modernisation.

3 Avoidance of the pressures on public expenditure is one obvious advantage. More exciting is the scope for private sector competition to create an electricity supply system

which is more diverse, more flexible, more energy efficient and less environmentally obtrusive than that being planned by the CEGB.

The CEGB's mind set is rigidly established. In their eyes the model of an efficient system for a densely populated country comprises very large power stations linked by the national grid. Leave aside the planning problems, power stations on this scale take the best part of 8 years or more to construct. Too often they have been dogged by serious delays and cost overruns. They are so large there is little practical scope for the added efficiency gains achievable by using the waste heat for neighbouring industrial activity or district heating.

There are interesting alternatives. One, which is catching on fast in the US, is the combined cycle gas generator - fuelled by natural gas, fuel oil or gas from coal. The compact modular power units, largely prefabricated in factories, can generate up to 300 MW (25% of Sizewell B's output). They have a thermal efficiency of 47% compared with the 37% of a modern coal station. They start generating power 2-3 years after ordering. Small modular power stations of this kind lend themselves to schemes for utilising the waste heat for industrial applications and for domestic and commercial heating.

Conclusion

We think of coal and electricity privatisation as the best means of promoting efficiency in mature established industries. Yet both industries - and particularly electricity - are ripe for extensive reinvestment and modernisation. This makes the case for early privatisation based on competition even more compelling.

JOHN WYBREW

CCBG

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the Minister's Private Office

CONFIDENTIAL

Mr R Smith
Private Secretary to the
Secretary of State for
Education and Science
Elizabeth House
York Road
LONDON SE1 7PH

NBPM.

29 January 1987

Dear Robert

NSDO/PBI PRIVATISATION: NEGOTIATIONS WITH AGC

Your Secretary of State met my Minister and the Chief Secretary last night to discuss the negotiating position set out in his 28 January letter to my Minister. Mr Walden (PUS, DES); Lord Selborne, Professor Jinks and Dr Jameson of AFRC; Mr Tanner, Mr Norton and Miss Gane of DES; Mr Cann of MAFF; Mr Burr and Mr Kaufmann from the Treasury; Mr Johnston and Mr Turner of Lazards; and Mr Walker-Arnott of Herbert Smith were also present at the meeting.

2. Professor Jinks explained for the record that, although he was a Director of AGC, he had stood aside from any involvement in AGC activities to ensure there could be no suggestion of impropriety. Ministers made clear that there was no criticism of Professor Jinks' conduct in this affair. Nonetheless, given the sensitivity and close public scrutiny to which the privatisation issue would inevitably be subjected, it was agreed that Lord Selborne (supported by Dr Jameson as necessary) should represent AFRC in the negotiations.

3. Your Secretary of State outlined the proposed negotiating position set out in his 28 January letter. Lord Selborne pointed to the considerable difficulties for AFRC if the AGC agreement were terminated: for them the difficulties for the privatisation of conceding either wheat and potatoes or oilseed rape (paragraph 4, items vii and viii of your Secretary of State's letter) were by far outweighed by the problems of termination. He thought it quite possible that the negotiators would have to go as far as items vii and viii in order to obtain a settlement. My Minister

Read for information
PTS

and the Chief Secretary were impressed by the force of the argument put forward by Lazards that excluding the AGC's wheat claim and all potatoes or oilseed rape material would not only reduce the privatisation package but also, most importantly, the degree of competition for the package. Our negotiating position was strong since the AFRC interpretation of the agreement was soundly based. Moreover termination would not be an attractive prospect for AGC. They both therefore felt very strongly that we should not extend the counter offer from the main six items (paragraph 2, i to vi of the 28 January letter) to include wheat and potatoes or oilseed rape. Indeed they were reluctant to go as far as the £4 m cash offer proposed at item vi of the letter.

4. Ministers finally agreed the following negotiating parameters:

(i) The framework for the negotiation should be that, unless a reasonable settlement could be agreed, the AGC agreement should be terminated.

(ii) The negotiators should be empowered to work on the basis of the six sequential items set out in paragraph 2 of the 28 January letter on the strict understanding that we should concede as little as possible.

(iii) If (ii) above resulted in a stalemate, the negotiators should indicate to AGC that this meant termination but should seek further advice from Ministers who would then have to consider whether to offer the wheat and potato or oilseed rape programmes (items vii and viii) - a position to which your Secretary of State and the AFRC inclined - or whether to go no further than the £4 m cash offer (item vi) as favoured by the Chief Secretary and my Minister.

(iv) The negotiators should work to the end of week deadline: to extend this would merely weaken our negotiating position. However, if necessary, and if there were prospects of an acceptable settlement, they should "stop the clock" at the deadline and continue talking.

Your Secretary of State stressed that he was not at this stage directing the AFRC to terminate if agreement was not reached on items i to vi. He would make this decision in the light of progress in the negotiations and bearing in mind the consequences of the alternatives open to us.

5. I am copying this letter to Private Secretaries to the Prime Minister, the Secretary of State for Trade and Industry, the Solicitor General, Sir Robert Armstrong and Ministers present at the meeting and also to officials who attended.

Yours sincerely

Shirley Stagg

SHIRLEY STAGG (MRS)
Principal Private Secretary

CONFIDENTIAL

DEPARTMENT OF EDUCATION AND SCIENCE
ELIZABETH HOUSE YORK ROAD LONDON SE1 7PH
TELEPHONE 01-934 9000

FROM THE SECRETARY OF STATE

The Rt Hon Michael Jopling MP
Minister of Agriculture, Fisheries and Food
Whitehall Place
London SW1

28 January 1987

Dear Michael,

PBI-NSDO

1. Following our meeting on Monday this week, our officials and those of AFRC and the Treasury have met with our advisers to explore what improved counter proposal should be offered to AGC. They judge that the Government's negotiating position will be stronger if we make a determined effort to settle with AGC before the 31 January deadline for renegotiating the AFRC/AGC agreement, or terminating it. I am therefore seeking decisions very quickly.

2. Officials are agreed on a number of counter proposals that might be offered to AGC, in the following sequence:

i. a cash settlement of up to £2m, with the initial offer well below this ceiling; or
ii. part of the potato breeding material - potato somaclones, cDNA probes and micropropagated potatoes; or
iii. part of the wheat germplasm - material including the mildew resistance gene, the eye spot gene and other minor AGC claims. The material might be offered in stages; or
iv. all of the potato breeding programme; or
v. either all of the items in iii. or iv. plus up to £2m cash; or
vi. £4m cash.

Two other AGC claims, for small amounts of barley germplasm, are trivial and could be added to any of the above items if so doing would lead to settlement.

3. Officials are also agreed that AFRC should serve notice to terminate the agreement if AGC continues to press their claim. Other termination conditions are if AGC will not drop their claim to the physiology know-how in the wheat breeding programme; or if they insist on all of the MAFF funded oil seed rape programme and either key potato or wheat material.

4. It is not possible to assess whether AGC are likely to settle within the negotiating brief in para 2 above. Our officials are agreed that the chance of a successful negotiation will be improved if we extended our counter offer to include two more items:

vii. their claim on wheat and all the potato programmes - iii and iv in para 2; or

CONFIDENTIAL

viii all the MAFF funded oil seed rape programmes.
However our officials are not agreed on whether conceding these two items or termination - and therefore cancelling the privatisation - is the lesser evil.

5. Lazard Brothers cannot estimate the effect of excluding either AGC's wheat claim and all potatoes or oil seed rape on the sale proceeds. They advise that a package including oil seed rape will attract a wide range of potential purchasers. Thus excluding this programme is likely to reduce the sale proceeds by not only its value but also more generally as a result of more limited competition for a more limited range of assets. Their best guess is that the effect of excluding the AGC wheat claim and all potatoes would be similar.

6. Our legal advisers, Herbert Smith, say that the all the AGC claims are weak, except for potato somaclones and cDNA probes. The strongest of their other claims is to some wheat germplasm. The weaker claims are to oil seed rape and, especially, potatoes other than somaclones and cDNA probes.

7. I understand that your officials, and Treasury officials, think our counter proposal should not extend beyond the items in para 2, in view of the advice from Lazard Brothers. If AGC refuse to accept any of these proposals they think the AFRC should terminate the agreement.

8. I accept the AFRC view that the difficulties for the privatisation of conceding either wheat and potatoes or oil seed rape are outweighed by the costs of termination for them. For oil seed rape AGC is already funding work at PBI. Concentrating the UK effort on this crop might benefit UK farmers by increasing the chance of developing better varieties. However, we should not concede these programmes without obtaining a committment from AGC that they would fund key development work.

9. I would be unwilling to terminate the agreement if there was a realistic possibility that AGC would settle for the more generous counter proposal: that is vii or viii. I recognise that asking our negotiators to refer back in certain circumstances may weaken their position. But I think that there is too much at stake to decide **now** to terminate if agreement cannot be reached within i to vi. There should be **some** probing of the scope for agreement beyond vi. I would, however, be willing to leave that judgement to the negotiators. I therefore suggest that we empower a negotiating team consisting of AFRC, Lazard Brothers and Herbert Smith to:

a. offer and, if possible settle on, any items in para 2;
b. if settlement is not possible on this basis, to either terminate or refer more generous proposals back to us, depending on their view of the scope for agreement.

If you and John MacGregor are content, I will ask AFRC and our advisers to proceed on this basis. However we are holding a time tomorrow evening or Thursday morning for a meeting to include John and Lord Selborne as well as you and me, in case we cannot agree.

10. I am copying this letter to the Prime Minister, John MacGregor, Paul Channon, Sir Patrick Mayhew, Sir Robert Armstrong and Lord Selborne.

Yours ever

Norman

Royal Dockyards

3.34 pm

The Secretary of State for Defence (Mr. George Younger): With permission, Mr. Speaker, I would like to make a statement about the Royal dockyards. As the House will recall, I announced on 4 December that I was satisfied that there now existed the basis for an advantageous contract to be placed for the future operation of Rosyth dockyard with Babcock Thorn Ltd.

I made that announcement some 21 months after my right hon. Friend the former Secretary of State for Defence first published his consultative document outlining plans for the future operation of the dockyards. Throughout that time we have provided this House and the trade unions representing the dockyard work force with a great deal of information on our proposals, including material on the options for the future management of the dockyards and on our preferred contractors. My noble and hon. Friends and I have been personally involved in discussions with the unions most concerned.

The trade unions continue to favour the option involving minimum change, with the dockyards remaining in the Civil Service under a system of trading funds. I have considered very carefully what the unions have said and I have explained to them why, in the Government's view, a dockyard trading fund is unlikely to secure either the improvements in efficiency we seek for the Royal Navy and the dockyards, or to compete as successfully as a commercial company for commercial and naval work.

I am, of course, fully aware of my obligations under the Dockyard Services Act 1986 to inform and consult the trade unions. I have always said that I would take final decisions only when I was satisfied that I had complied with such duties as the Act imposed on me. I am satisfied that I can take a final decision in respect of Rosyth dockyard and have today authorised the signature of a term contract for the future operation of that dockyard from 6 April 1987, with Babcock Thorn Ltd.; I have in addition authorised the signature of a service contract with Babcock Thorn Ltd. to cover its operations in the dockyard from now until vestng day; during this period, the mangement of the dockyard will remain the responsibility of the Ministry of Defence.

As the House knows, I announced on 20 January that Devonport Management Limited was our preferred contractor for Devonport dockyard. I have invited the trade unions to meet me on 13 February, so that I may hear their views on this. Only when I have carefully considered any such views will I take a final decision on the future operation of Devonport dockyard.

Mr. Martin J. O'Neill (Clackmannan): The Secretary of State will be aware that his statement comes as no surprise to us because since 1985 we have had a series of statements indicating preferred options and so far none of them has been changed as a result of consultations with the trade unions. Furthermore, the statement's dismissal of trading funds is a gross oversimplification of the unions' case for this option. Is not the Secretary of State aware that they are prepared for a wide-ranging set of changes and that they seek to co-operate with management to secure increases in efficiency and cost savings?

However, the Secretary of State will also be aware that there is evidence of indecent haste on his part in the manner that he is now rushing into signing a service contract to get Babcock Thorn into the yard as quickly as possible. In regard to the further contract starting on 6 April, can the Secretary of State tell us how long it is for? Is it to be for seven years, as was originally thought? He did not mention that in the statement. Does he agree that his decision, with the sham consultation, will only serve to exacerbate the resentment that is felt by the work force in Rosyth at the proposed loss of at least 1,200 jobs in the near future? In the eyes of the unions, this is simply an alien management coming in to do the Government's dirty work.

In his further discussions with the work force at Plymouth, Devonport, will he examine seriously the revelations that have been appearing in *The Independent* and the *Western Morning Post* about the links of Brown and Root with Libya, which were such an embarrassment to the American Government that they required the company to remove that part of its operation from the United States. Secondly, in respect of Brown and Root, will he examine the revelations that have come to light concerning the penalties it has had to pay because of poor quality work in some major contracts?

Will he also bear in mind that in the view of my right hon. and hon. Friends these contracts can be severed by legislation, and that they will be as soon as there is a change of Government so that we can secure happy and harmonious service from these workpeople to the nation and to the fleet, as happened for centuries in the past?

Mr. Younger: I am grateful to the hon. Gentleman for one thing, that in his opening remarks he made it clear that this was no surprise to him, and to the House, I suppose. That I take as a clear recognition, that, whatever else is right, the consultation process must have been extremely effective. Secondly, it certainly is the case that the trade unions have made it clear that there is quite a considerable area of agreement between ourselves and them. For instance, they agree thoroughly that the present system has to be changed and they are prepared to co-operate in discussing what changes are best. As I said in my statement, they still maintain their view that a trading fund would be the best option.

I was puzzled by the hon. Gentleman's reference to indecent haste, considering that I was in a position, and made it clear that I was as long ago as 4 December to sign a contract with Babcock Thorn for Rosyth but deliberately held that back in order to ensure that the maximum opportunity was given for all concerned to consult me about it before making such a decision.

I do not think that indecent haste has any relevance to that.

I confirm that the contract that we are signing today will be for seven years, as suggested. The hon. Gentleman mentioned Devonport and I want to make it clear that the suggestion of Brown and Root being involved is under consideration. I have made no final decision on that. I can assure the hon. Gentleman that Brown and Root has made it clear that there will be no connection whatever between its operation in Libya and that in Devonport, should the company receive the contract. The company has made it clear that there will be no connection of any kind in that regard.

The hon. Gentleman referred to the loss of jobs. I want to make it clear to the hon. Gentleman that I made it clear to the unions that I expect that, with commercial

management, the likely loss of jobs will be no greater and will possibly be somewhat less than it would be under any other option. Under any form of organisation, even a trading fund or a Government owned Public Limited Company, there is no altering the fact that the likely work load of the dockyard in years to come will mean some loss of jobs. We hope to make that the minumum loss of jobs, and we believe that commercial management will ensure that it is the minimum.

I want to draw the hon. Gentleman's attention, if this is necessary, to the fact that the only real threat to the substantial number of jobs in Rosyth dockyard would be the cancellation of the Trident programme, which would immediately put at risk at least 2,000 people employed at Rosyth. I know that the employees appreciate that.

Miss Janet Fookes (Plymouth, Drake): Would my right hon. Friend confirm that the project undertaken by Brown and Root in Libya was a humanitarian civil project to bring much-needed water from a desert area to the coastal project? I would have thought that that would be very interesting to those who support the Third world.

Mr. Younger: I agree with my hon. Friend that there is no connection whatever in that matter. I repeat that Brown and Root has confirmed that under no circumstances will any Libyan nationals be allowed access to the Colliers Wood offices from which the dockyard contract would be operated. Brown and Root has also confirmed that the Devonport dockyard and the Libyan irrigation projects will be dealt with entirely separately. I hope that that will reassure my hon. Friend.

Dr. David Owen (Plymouth, Devonport): Does the right hon. Gentleman realise that many people, especially those closely associated with the Navy, believe that the House will come to regret vesting in a private monopoly the safeguarding and refitting of this country's nuclear deterrent? Will the Secretary of State nevertheless, despite making this decision for agency management in Rosyth, which I and many others regret, at least express a readiness to consider the Government-owned option for Devonport dockyard? Will he realise that the trade unions, although preferring the other option, would far prefer a Government-owned plc for Devonport dockyard to agency management?

Mr. Younger: I fully appreciate the right hon. Gentleman's point. I can confirm that the trade unions and local representatives who saw me recently confirmed that, while they would prefer to have a trading fund, as a fallback position they would be prepared to work along with a Government-owned plc as an alternative. I can give an undertaking to the right hon. Gentleman that I do not intend to make a firm decision on this until I have had further information about the views of those concerned. At this stage, it remains open either for a Government-owned plc or for commercial management at Devonport.

Mr. Bill Walker (Tayside, North): Does my right hon. Friend agree that the companies concerned are highly respected in Scotland, that they are noted for their management skills and that they will be appreciated by the people working at Rosyth when they realise that they are being managed effectively? Does he also agree that in the days when the Vulcan and V force were deterrents, the aircraft were serviced in part by civil contractors? There is nothing new in that practice.

Mr. Younger: My hon. Friend is correct in his last point. There is nothing new in the practice of major defence equipment being provided under contract from private enterprise. The vast majority takes place in that way and is successfully carried out.

I also agree that Babcock's is an extremely well respected company in Scotland and enjoys very good relations with its work force. My consideration of this has always been to ensure that there is the best possible chance of the dockyard not only being well managed but having the best chance of receiving extra work from private sources to help the redundancy position. Today's decision makes that more likely rather than less.

Mr. Gordon Brown (Dunfermline, East): Will the Secretary of State confirm that this decision, which no other comparable country, including America, would contemplate, has been accurately described by one of his officials as the high-risk option for our national defences and national security? Will he further confirm that, as a result of his announcement, up to 1,000 jobs will be written off in Rosyth in Scotland? Will he explain why he will sacrifice any interest, whether it be the interest of the work force or the interests of Britain, in pursuit of the Government's privatisation dogma?

Mr. Younger: That all sounds very good but it does not accord with the facts. The hon. Gentleman speaks about the axing of 1,000 jobs. I stress to him that that regrettable situation would arise under whatever form of management is chosen for the dockyard. Secondly, the hon. Gentleman is the representativ e of the Opposition and I remind him yet again that the only real threat is the 2,000-plus jobs that would go immediately if the Trident programme were to be destroyed by the Opposition. That is the matter that the people of Rosyth are most worried about, and they are right.

Mr. Tony Speller (Devon, North): Is my right hon. Friend convinced that, in time of emergency, let alone in time of war, the control exercised over a dockyard operation would in any sense be as efficient under a private company as it would be under the control of the Government?

Mr. Younger: In every respect it can be as efficient. There is nothing new about it, because it is done in many other spheres of defence procurement, both in war and in peace. I have every confidence that the control which we shall exercise over the contractors not only in the form of the Government's share and so on but in other ways will ensure that these facilities will remain available to the nation in times of need. The facilities will be as good as, and I hope better than, they have been in the past.

Mr. Dick Douglas (Dunfermline, West): Can we get some assurances from the Secretary of State about the new or projected management structure for Rosyth? Who will be in charge of the Rosyth dockyard? Will it be Mr. Smith of Babcock Thorn or will it be Rear Admiral Burgess? What assurances do we have about the technology for the new PWR that is likely to go into Rosyth in terms of an SSBN or an SSN? How can we ensure that that technology will not leak to Babcock Thorn, which might be highly interested in new developments in relation to Sizewell?

Mr. Younger: The hon. Gentleman asks about management. I can assure him that Babcock Thorn fully shares our concern that the skills and experience of those

[Mr. Younger]

who are at present responsible for running the Rosyth dockyard should not be lost to its future operation. A measure of continuity over the period of change ahead must also be an important consideration in selecting senior managers to run the dockyard after vesting day. Although discussions between the contractor and existing senior management are not yet fully complete and the final management plot cannot therefore be made public, I am satisfied that the arrangements for the future will meet our requirements in this vital area. I can assure the hon. Gentleman that any secret matter in the Rosyth dockyard will be as secure in future as it is today.

Mr. James Couchman (Gillingham): Will my right hon. Friend say what plans he has for the storage and disposal of low and intermediate radioactive waste from the refuelling and refitting of SSNs at Devonport should commercial management take over there? Will he reassure my constituents in Gillingham that he has no intention of transferring such waste to the Royal Navy facility at the former naval dockyard in Chatham?

Mr. Younger: I appreciate my hon. Friend's concern about this matter but, as he knows, we never comment upon the methods of transport of such materials. I can assure him that the greatest care is taken in all such matters and, in any case, the safety measures and the care taken will not in any way be adversely affected by the change that I have announced.

Mr. Nicholas Brown (Newcastle upon Tyne, East): What information and what commitments has the Secretary of State given the new management of the dockyards about a future work programme? Has he been more candid with the privatised dockyard management than the Government ever were with the new owners of the privatised warship yards?

Mr. Younger: As the hon. Gentleman knows, we have had discussions with the proposed contractors about the likely work load at the dockyard and they have made their calculations based on that. They hope that, under their management, it may not be necessary to have as many redundancies as were previously announced as likely some weeks ago. Although there can be no guarantee of that, it is a somewhat hopeful sign. I hope that that reassures the hon. Gentleman as about information on other contractors. We have been extremely free with giving information to Swan Hunter, which is the hon. Gentleman's constituency interest—and rightly, because it is a valued contractor.

Mr. Frank Cook (Stockton, North): The Secretary of State will already be aware of my coming inquiry, as during business questions last Thursday the Leader of the House gave an assurance that he would acquaint him with it. Therefore, he will be aware of my question. What truth is there in the reports that Brown and Root refused to accept responsibility for the irradiated materials stored at Devonport? Without disclosing any official secret, will the Secretary of State tell the House what broad arrangements will be made to take care of the material because of that refusal?

Mr. Younger: Again, I cannot comment directly on the precise methods or the routes for transporting such material. I make it clear that every possible safety measure has been taken up to now and will continue to be taken in the future under the new form of management at Rosyth dockyard. That is the reassurance that I think the hon. Gentleman seeks.

Mr. D. N. Campbell-Savours (Workington): What sort of arguments would convince the Secretary of State in favour of a Government-owned plc or trading fund at Devonport as against privatised management? Of what must he be convinced before he will change his mind in favour of the arguments being deployed by the unions, because they will have to deploy them at the meeting on the 13th.

Mr. Younger: I wish to have the fullest expression of the views of the unions and others involved before I come to a final decision, but what I hope and intend to take into account principally in making my final decision is which of these alternative methods is likely to bring the most outside work into the dockyards while allowing them to do an efficient job with the work they have. Any of these alternatives will be preferred, if I believe that it is the most likely to produce more work for those in the dockyard.

cc: BG

cf.

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~218 7822~~ 218 6169

MO 10/2L

26th January 1987

Dear Mark,

STATEMENT ON ROSYTH DOCKYARD

I attach a copy of the statement my Secretary of State will be making in the House tomorrow on Rosyth Dockyard.

I have sent copies to Brian Dyer at The Treasury, Alison Smith in the Lord Privy Seal's Office, Nick Baxter in Lord Young's Office, Andy Rinning in the Scottish Office, Mike Gilbertson in Trade and Industry and Teresa Rawlinston in the Chief Whip's Office.

Yours aye,

Bill Clark

(W C CLARK)
Private Secretary

Mark Addison Esq
No 10 Downing Street

PARLIAMENTARY STATEMENT - ROYAL DOCKYARDS

With permission, Mr Speaker, I would like to make a statement about the Royal Dockyards.

As the House will recall, I announced on 4th December that I was satisfied that there now existed the basis for an advantageous contract to be placed for the future operation of Rosyth Dockyard with Babcock Thorn Ltd.

I made that announcement some 21 months after my Rt Hon Friend the former Secretary of State for Defence first published his consultative document outlining plans for the future operation of the Dockyards. Throughout that time we have provided this House and the Trades Unions representing the Dockyard workforce with a great deal of information on our proposals, including material on the options for the future management of the Dockyards and on our preferred contractors. My Hon Friends and I have been personally involved in discussions with the Unions most concerned.

The Trades Unions continue to favour the option involving minimum change, with the Dockyards remaining in the Civil Service under a system of Trading Funds. I have considered very carefully what the Unions have said and I have explained to them

why, in the Government's view, a Dockyard Trading Fund is unlikely to secure either the improvements in efficiency we seek for the Royal Navy and the Dockyards, or to compete as successfully as a commercial company for commercial and Naval work.

Mr Speaker, I am, of course, fully aware of my obligations under the Dockyard Services Act 1986 to inform and consult the Trades Unions. I have always said that I would take final decisions only when I was satisfied that I had complied with such duties as the Act imposed on me. I am satisfied that I can take a final decision in respect of Rosyth Dockyard and have today authorised the signature of a Term Contract for the future operation of that Dockyard from 6th April 1987, with Babcock Thorn Limited; I have in addition authorised the signature of a service contract with Babcock Thorn Limited to cover their operations in the Dockyard from now until Vesting Day; during this period, the management of the Dockyard will remain the responsibility of the Ministry of Defence.

As the House knows, I announced on 20th January that Devonport Management Limited was our preferred contractor for Devonport Dockyard. I have invited the Trades Unions to meet me on 13th February, so that I may hear their views on this. Only when I have carefully considered any such views will I take a final decision on the future operation of Devonport Dockyard.

PQ 6637.

SPEAKING NOTE FOR THE PRIME MINISTER

THE ROYAL DOCKYARDS

GENERAL

My Rt Hon Friend the Secretary of State is consulting the Trades Unions on the question of commercial management for the Dockyards, and on the terms of a contract which has been negotiated with our preferred contractor (Babcock Thorn) for Rosyth Dockyard. My Rt Hon Friend plans to meet the Unions on this tomorrow.

Today, we are providing the Unions with a similar paper on Devonport Dockyard naming our preferred contractor there as Devonport Management Limited. The Unions will be consulted on this paper too. [Letters have been sent to MPs concerned, to the PAC, Select Committee on Defence and the Opposition.]

DEVONPORT MANAGEMENT LTD (AND FOREIGN CONTROL)

The Company (DML) is a consortium of Brown & Root (UK) Ltd, the Weir Group and Barclays de Zoete Wedd. Brown and Root are foreign controlled and, in accordance with the foreign control provisions in the contract, their holding in DML is limited to 30%.

MoD

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The provisions in the contract (which have been discussed many times in this House) ensure that at all times security remains our paramount concern. There are plenty of foreign firms that satisfy Government security rules for sensitive defence work. DML will comply with all these rules. Security is not a problem.

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BACKGROUND NOTE

The Secretary of State for Defence minuted the Prime Minister and E(A) colleagues yesterday on the Dockyards and the latest developments.

The only change of which the Prime Minister should be aware is that the composition of the consortium of Devonport Management Ltd has changed. Brown & Root and the Weir Group continue to have holdings in DML of 30% and 25% respectively, but Barclays de Zoete Wedd have today replaced Lazard Defence Management Ltd (45%).

The composition of the various consortia bidding for Devonport has changed frequently of late and this latest change should cause no particular interest. Because of the very tight provisions which have been set for foreign control (which apply not only to the companies in the consortia but also to their parent companies) Lazards cannot satisfy this terms of the draft contract in this respect. They have been replaced by Barclays de Zoete Wedd who satisfy the terms. There is no intention on our part to reveal the reason for the change in the composition of DML; nor have we done so for any other earlier changes.

Barclays de Zoete Wedd were previously associated with the DDL consortium (management buy-out). However they only joined the winning consortium this morning after negotiations started last night so Barclays de Zoete Wedd never had an opportunity to influence the content of the tender put forward by DML.

E1.

Row looms as dockyard contract goes to US

By Michael Harrison
Industrial Correspondent

GEORGE YOUNGER, the Defence Secretary is expected to face a Commons outburst today by announcing that a consortium led by an American-owned company is being handed the contract to manage the Royal Naval Dockyard at Devonport, Plymouth.

The decision to award the seven-year contract to a group led by the US offshore company Brown & Root is also likely to cause an outcry amongst MPs and councillors in the West Country where a last-minute campaign had been launched in support of a rival bid by the dockyard's management.

Trade unions representing the yard's 11,000-strong workforce fear that the decision to favour Brown & Root will result in heavy job losses and endanger Britain's defence capabilities in an area of key strategic importance.

[illegible] provoked political storm in December by announcing that Babcock-Thorn EMI had been selected to take over the Rosyth nuclear submarine refit yard in Scotland before its workforce had been consulted on the Government's choice. Labour front bench spokesman Gordon Brown claimed there would be 1,300 compulsory redundancies and he accused the Government of betraying the workforce.

The Defence Secretary is expected to tell the Commons today that the Brown & Root consortium, which includes the British engineering group Weir and Lazards Defence Holdings, has been chosen as the Government's preferred contractor for Devonport.

It is expected that Mr Younger will attempt to limit the political damage by revealing that the US-led consortium has offered to take the existing management in as a small partner.

The yard has a turnover of £200m a year maintaining both the surface fleet and submarines. [illegible] with the private consortium in the next two weeks and the yard will be handed over to its new managers in April.

Brown & Root told the Devonport workforce last October that "fundamental changes will be required in the dockyard" if it won the management contract but it declined to give any indication of the extent of likely job losses.

The Government says that Devonport's core naval refit work will only provide jobs for 5,000 of the 11,000 workers by the early 1990s. The management group bidding for the yard, led by director, David Johnston, estimated [illegible] job losses in the next two years of private management through redundancies and early retirement. It also promised to offer 60 per cent of shares in the new management-run company, Devonport Dockyard, to employees and local residents.

Last week Mr Johnston staged a last-ditch attempt to salvage the contract by writing to West Country MPs, Defence Ministers, the full Admiralty Board and backbench Tories such as Michael Heseltine and the former Navy Minister Keith Speed urging them to support the management bid.

The Brown & Root consortium, which is called Devonport Management, has ambitious plans to increase the workload at Devonport by attracting civil ship refits and offshore construction work. It also proposes to turn part of the site into a mini industrial estate for electronics, furniture and boat repair companies.

Defence Secretary George Younger: facing Commons outburst over his decision to hand Devonport refit yard over to American-led group.

DTI given Bell takeover dossier

By Jeremy Warner
and Clare Doble

RAYMOND MIQUEL, former chairman of Arthur Bell & Sons, the Scotch whisky group which Guinness bought in 1985, has handed a dossier on the Bell's takeover to Department of Trade and Industry inspectors investigating wrongdoing at Guinness.

£340m Bell's takeover or whether it was requested by the inspectors.

The dossier contains details of the role played in the Bell's [illegible]

Peter Stevenson, a director of Noble-Grossart, the Edinburgh merchant bank which was helping advise Guinness at the time, and asked to help swing behind the Guinness bid the 12.5 per cent stake in Bell's owned by General Accident, where Sir Norman [illegible]

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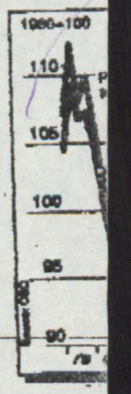

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DEPARTMENT OF EDUCATION AND SCIENCE
ELIZABETH HOUSE YORK ROAD LONDON SE1 7PH
TELEPHONE 01-934 9000

FROM THE SECRETARY OF STATE

23 January 1987

Ivor Llewelyn Esq
Private Secretary to
Minister of Agriculture, Fisheries and Food
Whitehall Place
LONDON SW1A 2HH

NBPR

Dear Ivor,

PBI-NSDO

1. The AGC, under its present agreement with the AFRC, has claims on parts of the privatisation package that we have agreed. The AFRC have said that they will not renew the agreement unless satisfactory agreement can be reached on the package. The view of AFRC and their lawyers is that the legitimate AGC claims are worth perhaps £30K, or giving them the benefit of some debatable areas, £0.5M. AGC and their lawyers assert that their claims are much larger. The view of AFRC and their lawyers is that the strength of those AGC claims which lie outside the £0.5M varies from near unreasonable to fifty-fifty. The impasse cannot be resolved by the lawyers, only by the courts or by negotiation. The deadline for completing the re-negotiation of the agreement or of serving notice to terminate is 31 January. The present agreement runs to July 1993 unless it is terminated, in which case it runs to July 1988. My Secretary of State thus needs urgently to offer guidance to AFRC on how any further negotiations with AGC should proceed.

2. Officials from DES and MAFF, with those of AFRC, have had exploratory discussions with AGC, without commitment, to see whether there was any middle ground. As a result the AGC have produced a set of propsals for which their Board might be prepared to settle, waiving all future claims on the privatisation package. Officials from DES, MAFF and the Treasury have thoroughly discussed AGC's proposals with officials of AFRC and with our legal and financial advisers - Herbert Smith and Lazard Brothers. They examined a number of options and these in particular:

(i) settle for the AGC proposals;

(ii) sell the privatisation package to the AGC, without going to the market but retaining a controlling share for Government against subsequent flotation;

(iii) serve notice to terminate the agreement unless AGC accept a counter proposal set by the Government.

3. The AGC proposals involve our making them a cash payment of £7M; excising some wheat and virtually all oil seed rape germ plasm from the package - effectively

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giving it to AGC; and sharing some potato germ plasm between AGC and the purchaser of the privatisation package. MAFF officials (and those from the Treasury and the AFRC) have the details. Lazard Brothers cannot quantify the effect of the excision and sharing on the sale proceeds but it is likely to exceed £5M. The difference between AFRC's estimate of AGC's legitimate claim - £0.5M - and our best estimate of the cost of settling on AGC's terms - more than £12M - arises because of a fundamental difference in interpreting the AFRC-AGC agreement. Officials and advisers are agreed that the Government should not contemplate settling on AGC's terms. To do so would give them perhaps as much as 60% of the sale proceeds and create an undesirable legal precedent by accepting AGC's view of a scientific discovery.

4. As to the second option, selling to AGC without going to the market, our officials advise that that would be indefensible.

5. This letter now concentrates on the last option (paragraph 2(iii)), because I understand that all officials, and our advisers, are agreed in preferring it.

6. The main features of the conditions should be offered as an alternative to termination are these:

(i) AGC to waive all claims on the package;

(ii) financial compensation of up to £2M;

(iii) an extension of the deadline by a few days - say to midnight on Monday 9 February;

(iv) the new agreement, on which AFRC and AGC have been working for the last six months and which is pretty well completed and satisfactory in all other respects, to take effect from that new deadline.

7. The proposal is that Ministers should authorise officials and advisers to meet AGC as soon as possible and present them with a choice. They would hand AGC a letter setting out our counter proposal which would be based on paragraph 6(i)-(iv) save that £0.5M would be offered as financial compensation. They would also show AGC a letter of termination from the AFRC and a related DES Press Notice and would explain that, unless our counter-offer is accepted within 24 hours, those documents will be activated. This would indicate that Ministers are fully prepared to terminate the agreement and very probably postpone or cancel the privatisation unless AGC meet us on our terms. For the subsequent negotiations in the next 24 hours, officials and advisers would be authorised to negotiate up to a ceiling of £2M for the financial compensation or some minor excisions of germ plasm from the privatisation package.

8. Ministers may wish to consider collectively the possible implications of following this route. It is possible (and some of our advisers think likely) that AGC will capitulate rather than face termination. But we must be prepared for the alternative, the implications of which are serious. The consequences are of at least two kinds, those flowing from the termination itself, and those from its effect on privatisation.

9. Possible direct adverse consequences of termination include:

(i) possible termination of AGC contracts with AFRC, and loss of future contracts;

(ii) damage to the Council's standing as a partner in any future technology transfer agreements;

(iii) litigation about the termination itself and its reasonableness;

(iv) wider damage to our attempts to encourage other Research Councils to develop methods of technology transfer;

(v) possible demise of AGC which, as seen by DES and AFRC, was developing successfully;

(vi) embarrassment for Government from AGC and its shareholders in so damaging a company whose creation DES and DTI (at least) welcomed and in which Government is perceived by the investors to have a financial stake, through the BTG.

10. It is also necessary to consider the effects on privatisation. Officials believe that if the AGC agreement is terminated it will be necessary to call off privatisation for the foreseeable future. They believe that to proceed with it while the existing agreement had eighteen months to run would expose the purchaser to contentious litigation over the ownership of major components of its privatisation package. It is not feasible to set a new date for privatisation from July 1988 because of the likely deterioration of the privatisation package in the intervening period. The uncertainty would result in the loss of key staff. Possible consequences of calling off the privatisation include:

(i) the need to find alternative sources of funding for the commissioned work at PBI from which MAFF will be withdrawing support in the autumn of this year;

(ii) problems with PBI and NSDO staff;

(iii) loss of the proceeds and economic advantages of privatisation;

(iv) major adjustments to AFRC's plans for a new single site Institute of Plant Research;

(v) meeting the costs of the work of advisers to date;

(vi) embarrassment for the Government in calling off the privatisation, and justifying it publicly.

11. My Secretary of State does not wish to give an unbalanced picture. He thought it right to go into more detail about the consequences of termination and about the disadvantages of some of the other options. MAFF and Treasury officials can amplify on these from their discussions but our understanding is that there are major commercial, legal and perhaps constitutional objections to accepting the AGC terms or any lesser variant that exceeded what is proposed under the preferred option above. All of the options have disadvantages and possible adverse consequences.

12. For this reason we are holding a time on Monday evening for your Minister and the Chief Secretary or his officials, together with Lord Selborne, to see my Secretary of State before he gives guidance to AFRC and our advisers.

13. I am copying this letter to the Private Secretaries to the Prime Minister, the Chief Secretary, the Secretary of State for Trade and Industry, the Solicitor General, Sir Robert Armstrong and Lord Selborne.

Yours sincerely,

Robert Smith

PRIVATE SECRETARY

Prime Minister,

23rd January, 1987

PRIVATISATION OF THE COAL AND ELECTRICITY INDUSTRIES

In order to maintain the momentum of the privatisation programme and to ensure adequate receipts during the third term of government, it will be necessary to tackle the coal and electricity industries.

The government is already under some pressure for privatising monopolies. This pressure would intensify if electricity were privatised as a single entity with inadequate guarantees for customers. It would also make privatising the Coal Board more difficult because of the CEGB's enormous buying power and the temptation for a private CEGB to buy foreign coal.

It is also important politically to consolidate the gains made in the last three years in removing some of the threat of mine workers' excessive power. It is the purpose of this paper to outline a privatisation scheme which could meet all these major objectives:

(a) a system which was friendly to the customer and ensured competition in the supply of energy;

(b) a system which was fair to British Coal, but did not deliver back to the NUM a monopoly power;

(c) a privatisation which produced major receipts for the Treasury.

British Coal

In 1985/86 the open-cast operations of the Coal Board made an operating profit of £343 million. The deep mining areas of Nottinghamshire and South Yorkshire also made operating profits, in the case of Nottinghamshire a significant £97 million contribution. The rest of the regions were loss-making, in the case of South Wales, North Yorkshire and Scotland substantially so.

The bulk of the saleable output from British Coal is purchased by the CEGB. In order to create a satisfactory coal market there is a strong argument both for creating more than one purchaser of coal - several electricity generating companies - and splitting the producers of coal into several operating groups who would compete one with another. There is

also the prospect of creating a middle way between the two in the form of separately financed new coal stations linked to particular coal supplies in a combined power generation and coal-mining company. The Northern Ireland Lignite Power Station is a partial pioneer of this approach, being a privately-financed venture linking in to the national grid.

The first task in privatising the coal industry would be to sell the Open-cast reserves in Scotland and under the Open-cast Executive. If the new owners are to be entitled to enjoy all of the profit that comes from the cheap costs of Open-cast mining compared with the favourable average price of coal, the proceeds of the sale would be substantial. If the business was unencumbered with debt the net profits of some £220 million could be sold for a capital sum well in excess of £2 billion. If the government wish to retain a royalty on the coal to reduce the profitability of open-cast mining and enjoy a continuing annual income, then the proceeds would be proportionately reduced depending on the level of royalty fixed.

The next task in privatising British Coal could be a management and employee buy-out of the Nottinghamshire and perhaps the South Midlands pits. This could be done on extremely favourable terms to the miners, although the current progress being made in restoring profitability is serving to

raise the value of these assets all the time. The government could decide either to give the miners good terms or could transfer some of the commercial debts with the Nottinghamshire mines to reduce the operating profits at the pre-tax level and so make the purchase price realistic.

Once these two sales have been achieved there would then be three competing coal producers in the country. The market should also be opened up to other investors who wished to produce coal. You could find other groups interested in sinking deep mine shafts in new coalfields using private capital, and you could also find people interested in re-entering disused NCB coal mines or processing spoil tips in order to augment coal at a realistic price. The main gain from all this activity would be to break the national average price of coal and thereby serve to lower the effective market price, enabling more to be sold against competing and often imported fuel stuffs.

The government at the same time should remove from the Coal Board the monopoly it has over licensing the extraction of coal. This should become a matter for the Department of Energy operated under a clear policy of impartiality between British Coal, the newly privatised coal businesses and the long-standing private sector interests.

Electricity

The electricity industry is a colossus comprising both the Central Electricity Generating Board and the Area Boards under the loose framework provided by the Electricity Council. The provision of an electricity supply to every home and factory in the country is as near to a monopoly as you can get. There are those who believe that the Area Boards could be made to compete by emulating one another were they sold separately. In practice this is likely to amount to little as each Area Board will always be able to argue that the circumstances of its own area are different justifying a different performance from those of its neighbours. The only type of competition that really works is where someone else can offer an alternative supply and the costs of entry into the retail distribution market in electricity are near to prohibitive.

Conversely, the supply of power to the grid is not a monopoly at all. It is quite economic for an individual investor to buy one, two or three power stations and supply his power to the Area Boards assuming satisfactory contractual relationships can be worked out. At the moment power is supplied to the electricity grid on the basis of a merit order. The merit order is based on the accounting unit costs

of the power produced in each station. The nuclear stations provide the base load both for operational reasons because they cannot be turned on and off quickly, and because they produce quite cheap power once the costs of construction have been sunk.

This merit order system could be rejigged to produce a competitive pricing system enabling private suppliers to plug in to the national grid. A National Nuclear Corporation could own the nuclear power stations and take with them the nuclear research establishments and reprocessing plant, remaining in public hands. The rest of the power stations could be grouped into area and/or merit order groupings and sold off to private investors. An ideal system would be to have five such companies owning groups of power stations, all of them floated on the Stock Market. Their contract with the grid and Area Boards would entitle them to sell that amount of power which the system required from them. The allocation between the competing companies would be based on the price at which they were prepared to supply it. As the days got colder or as the peak hours approached, more power would be called up from the marginal producers. They could base their prices on the current merit order system of unit costs or they could, of course, decide to cut their price and reduce their margin if they were keen to run their power stations more extensively.

Privatisation of the assets of the CEGB on this basis could bring in more than £4,000 million. This is considerably below the stated current cost balance sheet value, but this is inevitable given the very high costs of replacing the plant and the relatively low margins on electricity sold. It would not be a good idea to increase the margins substantially before privatisation in order to raise the proceeds: electricity would then, indeed, be a surrogate form of tax collection and seen as such. Subsequently Area Boards could be sold, but they would need a regulatory system to control them.

The politics of it

The politics of the individuals involved is complicated. Robert Haslam at British Coal is not a particularly strong man but he and his senior colleagues will resist the idea of splitting British Coal into bits. The whole Coal Board is wedded to the notion of a great national utility based on years of experience as a monopolist. It was this that made your task in winning the miners' dispute so difficult and makes the task of splitting it even more vital.

The bitter hatred of the pre 1948 private owners is also still a factor.
DRS

There will be those who worry about NUM reactions. My own view is that the NUM is not going to recover major power within the next three years and this should be done at the

beginning of the next term of government whilst the government is still riding high. High stocks and a Spring announcement will also give protection.

The politics of the CEGB are even more complicated. Lord Marshall is an extremely powerful character who wishes to privatise the electricity industry whole. He might accept the idea of running a National Nuclear Corporation in the public sector if, at the same time he had influence over the number of new nuclear power stations that were going to be built. These could be factored in to the system of a privatised CEGB, as all nuclear stations would be base-load and the private investors would have to be aware of the size of the nuclear programme which the government was going to carry out.

Conclusion

It would be a pity to let individual personalities ruin a major privatisation opportunity. It is vital that competition is the cornerstone of a privatised electricity and coal industry. Splitting the CEGB and selling the open-cast and successful mining areas would create the right degree of competition and raise substantial proceeds for the government.

J. Redwood

Devonport Dockyard

3.32 pm

The Parliamentary Under-Secretary of State for Defence Procurement (Mr. Archie Hamilton): With permission, Mr. Speaker, I should like to make a statement on the Devonport dockyard.

My right hon. Friend the Secretary of State announced yesterday, in following up an answer to a question from my hon. Friend the Member for South Ribble (Mr. Atkins) that the Government are now satisfied that there exists the basis for an advantageous contract to be placed for the future operation of Devonport dockyard with Devonport Management Limited, which is a company formed by Brown and Root (UK) Limited, the Weir Group plc and Barclays de Zoete Wedd Ltd. I am sorry that the *Official Report* has not yet printed my right hon. Friend's answer. However, I did write yesterday to those Members most concerned.

All three companies in the consortium are British but Brown and Root is a United Kingdom subsidiary of the United States Halliburton company. As the hon. Member for Clackmannan (Mr. O'Neill) will recall from our discussions of the Dockyard Services Bill that the upper limit which we set for foreign shareholding in the companies bidding for the contracts was 30 per cent. In determining whether a particular shareholding should be considered foreign, account is taken of the parent companies. On that basis, Brown and Root's share in Devonport Management Ltd. has been set at 30 per cent.

The House will recall that, in our paper to the trade unions of 4 December, we announced our preferred contractor for Rosyth. My right hon. Friend is at this moment chairing a meeting with general secretaries of eight unions to hear their views on that paper, before he takes a final decision.

In forwarding the paper on Devonport to the unions yesterday, my right hon. Friend proposed a meeting with them on 13 February to discuss that paper. No contract has yet been placed, and my right hon. Friend has said that he will do so only when the unions have had an opportunity to give him their views.

Mr. Martin J. O'Neill (Clackmannan): I am grateful to the Minister for making that statement. I wish that he had been able to do so for Rosyth as well when the occasion arose. However, we are disappointed—and I am sure I speak not only for Opposition Members but for the people of Devonport, whom I imagine will not be represented here this afternoon. None of us is convinced by any of the claims made by the Government on the future of the dockyards. Will the Minister confirm the story in the *Western Mail* this morning that the number of redundancies likely to follow the change of contractor will be about 4,000?

Will the Minister further confirm that, although Brown and Root has only a 30 per cent. share, that is the highest possible share that it could have, given that it is American-owned, and that its secondary position in the consortium is little better than a financial fiction, as everyone knows that it will be the lead in the contractor consortium? Will the hon. Gentleman elucidate and give some information on why the Lazard group withdrew at the last possible minute—only yesterday morning—from the consortium, and was replaced by Barclays de Zoete Wedd?

Does the Minister recognise that the work force at Devonport will be angered almost beyond belief by that American takeover of their yard, and that those are loyal men, who have served their Queen and country for decades, and who resent being reduced to the level of chattel slaves, to be handed over to the Americans? That is what the transfer of undertakings involves. It is the selling of the work force; it is nothing more nor less than that. It will be opposed, as it has been throughout the campaign by both the work force and Opposition Members.

Mr. Hamilton: I shall deal first with the withdrawal of Lazard from the consortium. That must be the concern of the consortium—it must be up to the consortium to decide who its financial backers are. However, there have been changes in the make-up of all the different consortia that have been bidding for the contract.

On foreign control, as I said, we set the level of foreign shareholding for companies bidding for the dockyard contract at 30 per cent. If a foreign shareholding exceeds that level, my right hon. Friend the Secretary of State will have the power, under the contract, to act where circumstances are contrary to the essential interests of security. My right hon. Friend could terminate the contract if he felt that to be necessary. However, we do not say that a 29 per cent. shareholding would be acceptable in all cases or that a 31 per cent. shareholding would be unacceptable. We can think of examples where even a tiny foreign shareholding would be unacceptable and where a shareholding above 30 per cent. would be acceptable.

Protection of security has always been and always will be a paramount consideration. Devonport Management Ltd is a list X company. That means that, in order to undertake classified defence work, the company has to satisfy the Government's stringent security, physical and personnel requirements, which have existed under successive Governments. There are, of course, many foreign firms that satisfy the Government's security rules.

On manpower levels, in the paper that we issued on the Government-owned plc option in September, we said that, under that option, there were likely to be reductions over a seven-year period of some 5,000 jobs in Devonport and 1,200 jobs in Rosyth. Obviously, those calculations were based on assumptions about possible improvements in efficiency and on forecasts of the amount of unallocated naval and commercial work that the company might secure. It is of significance that the preferred contractors at Devonport believe that, under their management, reductions will be measurably less.

Mr. Keith Speed (Ashford): My hon. Friend will be aware that under the Admiral Rickover rules, non-United States citizens are not allowed to have any contact with United States navy nuclear propulsion systems. Is it correct that under the contractual arrangements that my hon. Friend has announced, there is a possibility that not only United States companies but United States citizens will be relating directly to our nuclear propulsion systems, and the SSN refitting capability at Devonport dockyard, and thus will be at a considerable advantage from a defence and commercial point of view compared with United Kingdom citizens and the United States nuclear propulsion system, with which we are not allowed to have any interface at all?

process of pressure that we can bring to bear on Vietnam under which conditions will so improve in that country, for example, with the withdrawal of Vietnamese troops from Cambodia, that it might be possible to suggest that refugees could go back. If they were sent back at present I am sure that no one would object more strongly than the hon. Gentleman.

Mr. Hamilton: United States personnel might be involved, but they would be security cleared.

Mr. John Cartwright (Woolwich): Will the Minister assure the House that the proposed vesting date of 1 April for the takeover by the new contractors is not set in stone? If, as seems highly unlikely, all the complicated transitional arrangements are completed by that date, will the hon. Gentleman assure the House that he will delay the takeover until all the problems can be properly sorted out?

Mr. Hamilton: I can assure the hon. Gentleman that the vesting day is 6 April. We have every hope of being able to meet that date.

Sir Peter Emery (Honiton): Will my hon. Friend assure the House that the major concern of Her Majesty's Government is the essential and successful future operation of the dockyard in relation to the work that has to be carried out? If that is the case, has not Brown and Root played a major part in other British developments, particularly in the North sea? It is an expert in this area. Can my hon. Friend give an assurance that, when considering the future work force, those who are already employed will be given, as far as possible, first preference for the jobs that have to be filled?

Mr. Hamilton: Yes, of course I can give my hon. Friend that assurance. It is quite true that Brown and Root is bringing in great expertise from outside. If we consider the development of the oil potential of the western approaches, I am sure that this will be of enormous benefit to Devonport. It will remain the most important dockyard dealing with Royal Navy refits, which still remain an absolutely essential part of our capacity to keep our ships afloat.

Mr. Michael Foot (Blaenau Gwent): Will the hon. Gentleman take into account the fact that this proposal, as originally put to the House of Commons, was bitterly opposed in different parts of the House and that it would have been all the more bitterly opposed at Second Reading and during the other stages if it had been suggested then that a very powerful foreign holding was to play a part in the final result? The hon. Gentleman referred to the meeting with the unions. In the light of the Government's humiliating defeat when this measure went through the House of Commons and the other place, will he give an absolute assurance that, if the work force is still opposed to this proposition, the Government will not go ahead with it, at least until the electorate has had a chance to pronounce upon it? The people of this country are not prepared to see Devonport dockyard handed over to profiteers and people who will not be able to serve the country as they have done for generations.

Mr. Hamilton: I cannot give the right hon. Gentleman that assurance. The House has made its position quite clear on this issue. I am afraid that I do not go down the road of sharing his paranoia of anything to do with the Americans. I believe that Brown and Root will have a great contribution to make to the management of these dockyards.

Mr. Robert Hicks (Cornwall, South-East): Is my hon. Friend aware that the Plymouth sub-region already has very severe economic and social problems, sadly comparable to those in any part of the United Kingdom? In view of this increased job loss, what efforts will his Department make to alleviate the position, in terms of job training and the attraction of alternative industry to the area? Does my hon. Friend not agree that his Department — not just the Departments of Employment and of Trade and Industry—has a responsibility, in view of the decision that has been taken this week?

Mr. Hamilton: I sympathise with my hon. Friend on that point. But the difficulty is that the work load in the Devonport dockyard is falling. Therefore, I do not think that it is the job of the Ministry of Defence to subsidise jobs in Plymouth. The fact is that my right hon. Friends the Secretaries of State for Employment and for Trade and Industry are mainly concerned with Government support for the area. I believe, however, that the preferred contractor whom we have selected will provide the best possible opportunities for work to be brought into the dockyard.

Mr. Gordon Brown (Dunfermline, East): Are we now to have Trident courtesy of the American Government, helicopters courtesy of Sikorsky, early warning aircraft courtesy of Boeing, and the refit of the majority of our naval frigates and submarines courtesy of Brown and Root of Delaware? Will the Minister tell us exactly how many jobs will be put at risk by subordinating the interests of national security to those of commercial gain? Will he not realise even at this late stage that the defences of this country should be under the control of this country?

Mr. Hamilton: I do not believe that the United States would feel that it is subordinating its national interests by accepting weapons systems from here. There is a two-way trade, and I welcome it.

Mr. Robert Atkins (South Ribble): As one whose great great great grandfather was party to building the Plymouth-Devonport dockyard and as, therefore, I have an interest in it, may I ask my hon. Friend to confirm that the contract that his right hon. Friend has negotiated is a very tight one, giving the company the responsibility to find the money for redundancies and to ensure that there is not an excessive profit on non-competitive naval work? Will my hon. Friend also confirm that this contract, if it is completed, will provide, through the company. A much wider range of job opportunities, in that the company will have much wider world wide support, which will enable it to put contracts the dockyard's way?

Mr. Hamilton: That is absolutely true. The dockyards will be much more competitive if they become more efficient, because they will be able to get work from outside. I am convinced that Brown and Root has every opportunity to bring in such work. It is worth making the point that the combined savings of the two dockyards at Devonport and Rosyth will be about £320 million over 10 years.

Mr. Dick Douglas (Dunfermline, West): Will the Minister take cognisance of the point made by his hon. Friend the Member for Ashford (Mr. Speed) about the personnel who may be in control of this consortium? What information can he give the House about the dominant role that Brown and Root will play in the selection of top personnel? Will he ensure that these top personnel are United Kingdom citizens so that vital information is not leaked across the Atlantic to a company that is highly engaged in defence contracts, especially in the Houston area? Will he not confirm that, despite all the protestations of unions and others, the Government have rolled on in

[Mr. Dick Douglas]

their merry way with the idea of keeping to the vesting date of 1 April 1987 that they originally had in mind and that the whole process of consultation has been nothing but a farce?

Mr. Hamilton: The process of consultation has not been a farce. The unions have had six weeks in which to consult their members and that was on an extended timetable which the unions proposed. I understand that they have finished their consultations in Rosyth. It is unfortunate that they left their Devonport consultations until the last of these six weeks. Be that as it may, last week's weather may have made consultations more difficult. In the circumstances, we are prepared at today's meeting to consider Rosyth and the preferred contracter for it that we announced in December. We shall shortly issue a further paper on Devonport about the way negotiations have proceeded there and we shall invite the unions' views on that when they have considered that paper. I hope the House will agree that this is a sensible way to proceed.

Mr. Gerrard Neale (Cornwall, North): I regret that I cannot report to the House the occupation of my great great grandfather. There is a common view in Devon and Cornwall about the need for a good future for Devonport, but there is no common view that what my hon. Friend is doing is wrong. Many people feel that it is perfectly sensible for him to look into proposals of this kind, which offer a better guarantee for the introduction of new work to the dockyard.

Mr. Hamilton: That is really the significant point, and I am grateful to my hon. Friend for making it. If the Devonport dockyard remains in the ownership of the taxpayer as a Government-owned plc, there will be significant job losses—5,000 of them in Devonport. The deal that we have made with Brown and Root says that the job losses will be somewhat less and the company offers the opportunity of bringing in more work.

Mr. Tam Dalyell (Linlithgow): It would not be doing the Minister an injustice to suggest that he was a bit vague about the whole matter of foreign shareholdings. He said that it might be 29 per cent. and that that might not be acceptable, but that 31 per cent. might be all right. How do the Government know the exact foreign shareholding, given that there are nominee shareholders, which may make it difficult to know the percentage? Is not this all a bit of a farce?

Mr. Hamilton: It is not at all a farce. There is always difficulty about knowing precisely the number of shareholders in any company, but we will do our best to monitor that.

Mr. Patrick Nicholls (Teignbridge): Does my hon. Friend agree that the immoderate way in which American involvement is attacked by the Opposition will cause a great deal of fear to the many tens of thousands of people in Britain who derive their living from working for American companies or for companies with American involvement? Does he also agree that the 45 per cent. of the shares held by Barclays de Zoete Wedd would be available for take-up by British companies, including the local dockyard management consortium, and that that shows that the overwhelming influence will be national and not international or American?

Mr. Hamilton: I can certainly confirm that. The Barclays de Zoete Wedd holding is 45 per cent. and, with the agreement of the Government, some or indeed all of that may be made available to British companies and, I hope, employees as well.

Mr. D. N. Campbell-Savours (Workington): Will not the people of Plymouth be very angry tonight when they find out that not a single Member of Parliament from Plymouth is in the Chamber when D-day, D for Devonport, is being debated? When the Minister says that fewer jobs will be lost, will he give us a time-scale? The Minister said that the in-house offer was a loss of 5,000 jobs over seven years. Is it not possible that 4,000 jobs will go within two years under the proposals that the government have accepted? Can we have a straight answer to that question?

Mr. Hamilton: The scale of job losses and what period they are spread over are confidential matters between the Government and the contractor. I am afraid that I am unable to answer for the people of Plymouth.

Mr. Marlow (Northampton, North): As I understand that NATO, which includes the United States, has kept the peace for the past 40 years or more, why is it that the knee-jerk reaction of the Opposition is one of rampant, paranoid, negative and spiteful hostility to the United States?

Mr. Hamilton: As my hon. Friend says, it is remarkable that we are keen to attract American investment into Britain, but when a good company comes in to take over the management of this dockyard, there is this extraordinary reaction, which will do nothing but damage to the prospects for jobs in this country.

2770/019

COMMERCIAL IN CONFIDENCE

cc: BG.

Treasury Chambers, Parliament Street, SW1P 3AG

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

NBPM.

20 January 1987

Dear George,

COMMERCIAL MANAGEMENT OF THE ROYAL DOCKYARDS

Thank you for your helpful letter of 9 January explaining the background to the agreement negotiated with Babcock Thorn, your preferred contractor, at Rosyth which gives some protection to Babcock Thorn in the event of serious strike action in the early part of the contract.

I accept that revealing this contingent liability to Parliament under the usual procedures could, as you point out, lead to political difficulties at this stage. In view of the sensitive nature of the agreement I agree with your suggestion to report it instead by a personal letter to the Chairman of the Public Accounts Committee.

Your letter of 19 January to the Prime Minister reports that you have accepted a similar arrangement with your preferred contractor at Devonport. In the circumstances, I would be content for this second contingent liability to be reported to Parliament in the same way as for that at Rosyth.

We discussed on the telephone yesterday the Devonport situation. I raised earlier the issue of excess capacity at Devonport. In the light of the considerable cost now estimated of maintaining such capacity, I am glad to have your assurance that genuine redundant capacity will be removed at the earliest opportunity.

I am copying this letter to members of E(A), Michael Havers, Patrick Mayhew and Sir Robert Armstrong.

Yours ever,

JM

JOHN MacGREGOR

ECON POL: Privatisation Pt 15.

cc SG

Prime Minister
The first paragraph gives the only important information in this minute.
DRN
19/1

MO 10/2E

PRIME MINISTER

MANAGEMENT OF THE ROYAL DOCKYARDS

In my minute of 1st December I informed you and E(A) colleagues that there existed the basis of an advantageous contract to be placed for the future operation of Rosyth Dockyard with Babcock Thorn Ltd. I am writing to let you know that I am now in a similar position for Devonport; I am satisfied that commercial management is now an entirely credible option for Devonport on the basis of a contract with Devonport Management Ltd (DML), the consortium of Brown and Root Ltd, the Weir Group and Lazard Defence Management Ltd. I intend to announce this by means of a written Parliamentary Answer tomorrow (20th January).

The Contract

2. DML has displayed the necessary ability, professionalism and enthusiasm for the task, and we have agreed satisfactory contractual terms, which are very close to those already negotiated for Rosyth. These include satisfactory arrangements for the protection of the Company in the event of significant industrial disruption; the terms are different - and somewhat more generous than for Rosyth - in that the Company will only be liable for the first £0.25M in the first two years of the contract and for £2.5M

in the third and fourth years. This, I feel, is legitimate because of the greater scale of rundown in numbers at Devonport, and thus the greater risk of strike action.

3. The foreign control provisions of the Tender are fully observed in that Brown & Root (UK) will only control 30% of the equity; but the company will play the major role in the future Dockyard operation. Whilst this is acceptable, I believe their bid would be further strengthened by the inclusion of a third major British industrial company; once DML is announced as our preferred contractor, I believe we may well see such a move, as Lazards have always made it clear that they would be happy to dispose of all or part of their holding in DML to a British company acceptable to my Department. Such a change would also help in improving the parent company level guarantees to the operation of the consortium; at present Brown & Root have not been able to secure formal backing from the Halliburton Company in the United States. Our negotiators will continue to press for this - they may not succeed but this would not be critical to a decision to proceed.

4. On personnel issues, the arrangements negotiated are entirely satisfactory, and in line with those agreed at Rosyth. During negotiations, we have been impressed with the quality of the DML team and the nominations made to key posts in the Dockyard operation give confidence for the future. In addition, although DML have had little opportunity to gain a full understanding of the

nature of the Dockyard operation, they have shown that they are fast learners and fully appreciate the nature of the financial risks they are accepting.

5. In terms of value for money, we have compared the costs of continued Ministry of Defence management with those of a Government-owned plc and the potential contracts with DML and Devonport Operations Ltd (DOL), the Foster Wheeler led consortium; the state of negotiations with Devonport Dockyard Ltd (DDL), the local management initiative have meant that a similar assessment has not been possible for their operation - but their approach to efficiency improvements and commercial work would result in a less attractive set of figures than those for DOL.

SAVINGS OVER CONTINUED MOD MANAGEMENT (£M)

	86/87	87/88	88/89	89/90	90/91	91/92	92/93	93/94	TOTAL
GO plc	-6.7	-8.9	-6.2	5.0	30.2	31.6	39.2	34.1	118.3
DML	-6.7	-19.2	-6.3	15.9	23.9	34.1	38.1	43.3	123.1
DOL	-6.7	-18.7	-14.7	5.7	21.5	22.4	33.2	39.2	81.9

These figures are less well substantiated than the comparable set for Rosyth because neither of the two Devonport bidders has as good an understanding of the current cost structure; in addition the Government-owned plc (GO plc) figures have been prepared by Coopers

& Lybrand on the basis of an optimistic business plan. I am therefore satisfied that there is a real prospect of value for money from the proposed contract with DML and am also satisfied that the GO plc operation would yield a smaller benefit than the figures above might suggest; taken with the philosophical objections to a GO plc operation, I see no reason to contemplate adopting such a solution at Devonport.

6. The costings also include a small element for the costs associated with under-utilised strategic capacity; this did not feature in the Rosyth costings, because the naval load there was broadly in line with capacity. In Devonport, this is not the case and I have judged it prudent to make a specific allowance for this; without it the Dockyard would not be competitive - and we should face additional redundancy costs if the contractor failed to secure competitive naval and commercial work. I am, however, satisfied that this does not represent a subsidy to the contractor - and will ensure that every effort is made to remove any genuinely redundant capacity at the earliest opportunity.

7. Full details of the proposed contractual arrangements have been provided to officials in the Treasury and the Department of Trade and Industry - as was done for the Rosyth contract - and are I believe generally accepted.

The Unsuccessful Bidders

8. As far as the unsuccessful competitors are concerned, there remain at the end important weaknesses in DOL and DDL. The DOL consortium is particularly unstable and has insufficient financial support and lacks parent company guarantees; in addition it has refused to stand behind its proposals for commercial work and for efficiency improvements by accepting any substantial financial risk from failure to perform.

9. DDL, the local management initiative, has undeniably been revitalised by the arrival of Hill Samuel, and commands considerable local support, but lacks the essential entrepreneurial spirit and background that is central to the introduction of commercial management. They have, however, performed very creditably and you will wish to note that DML wish to associate DDL with the future operation: Mr David Johnston, the Managing Director of Devonport Dockyard and currently the Chairman of DDL, will be offered the post of Joint Managing Director with responsibility for operations, and other Directors of DDL will also be offered posts; there may also be some equity involvement by DDL.

The Timetable

10. I have invited the Trade Unions to give me any final views they may have on the way ahead for Rosyth on Wednesday 21st January

so that I may authorise the signature of a Rosyth contract by Monday 26th January. I intend to tell them beforehand, in terms similar to those used for Rosyth, of the preferred contractor for Devonport and to announce that also to Parliament. I shall need to allow them a short period to consider this information, but would aim to complete the process for Devonport to allow signature in the week beginning 9th February.

11. There are compelling practical arguments for avoiding further delay. We have already eaten heavily into the planned three-month period of parallel running of the Dockyards by the contractor and the existing management before Vesting Day, which we must hold at 6th April this year; at best, there now remain less than two months at Rosyth, and a shorter period than that at Devonport. There remains a threat of legal action by the Unions but our legal advice is that we would be in a strong position to defend any action in the Courts; certainly I am satisfied that the threat itself provides no reason for further delay.

12. I attach for your and colleagues' information the Parliamentary Question and Answer for Tuesday 20th January announcing DML as the preferred contractor for Devonport and a copy of the consultative paper that I shall issue to the Trade Unions, the workforce and Parliament at the same time.

13. I am sending copies of this minute to all members of E(A), to the Law Officers, and to Sir Robert Armstrong.

G.H.

Ministry of Defence

19th January 1987

PARLIAMENTARY QUESTION (WRITTEN)

To ask the Secretary of State for Defence whether he is yet able to make an announcement on the future of Devonport Dockyard.

ANSWER

(Mr Younger)

I am now satisfied that there exists the basis for an advantageous contract to be placed for the future operation of Devonport Dockyard with Devonport Management Ltd, a consortium formed by Brown & Root (UK) Ltd, the Weir Group plc and Lazard Defence Management Ltd.

Under arrangements that have been negotiated to date, such a contract could offer the possibility of saving some £123 million over the seven year Term Contract, with the prospect of annual savings thereafter of about £40 million under any subsequent contract. As with our preferred contractor for Rosyth Dockyard, Babcock Thorn Ltd, the contract with Devonport Management Ltd would encourage improvements in efficiency and enable the contractor to compete for commercial and naval work with no possibility of cross-subsidy from the core programme of naval refitting.

As my hon Friend knows, when I announced our preferred contractor for Rosyth Dockyard on 4th December [Hansard vol. 106 cols. 771/2] I provided the Trades Unions with a full paper setting out the arguments in favour of commercial management, which I believe are valid both for Rosyth and Devonport, and providing information on the preferred contractor for Rosyth Dockyard. I have invited Trades Union representatives to meet me again on 21st January before I take a final decision on the future management arrangements for Rosyth Dockyard, and I have today provided further information to the Trades Unions summarising the main aspects of the draft contract arrangements negotiated with Devonport Management Limited. I will consider with the Trades Unions the question of additional time for them to make representations to me in respect of this latest paper before I take a final decision on the placing of a contract for the future operation of Devonport Dockyard.

A copy of my latest paper for the Trades Unions has been placed in the Library of the House.

THE FUTURE MANAGEMENT OF DEVONPORT DOCKYARD

CONTRACT DEVELOPMENTS

1. Bids for the commercial operation of Devonport Dockyard were received at the end of August from three companies - Devonport Management Ltd (DML), Devonport Dockyard Ltd and Devonport Operations Ltd. The bids were evaluated during September by a team from the MOD, supported by consultants; in addition to written clarification, each company spent a day with the Tender Board, seeking to determine the overall credibility of their written proposals. All three bidders were judged to have submitted responsive bids; no one bid was judged to be significantly ahead of the others.

2. The subsequent process of contract negotiation and the meetings which took place with all three bidders were therefore of great importance, and the substance of the bids was explored in depth against the Invitation to Tender. After prolonged consideration the Department has concluded that the DML bid most nearly meets the Ministry's requirements set out in the Invitation to Tender, and demonstrates a clear understanding of the task and of the technical, personnel and commercial issues involved.

3. The Department has now taken the contract negotiation stage to a point where there exists a firm basis for signature. The contract is based on the draft, circulated to the Trades Unions in April this year. DML is a consortium of Brown and Root, the Weir Group and Lazard Defence Management Ltd. The Parent Companies would be parties to the Term Contract and satisfactory warranties and performance guarantees have been provided. The foreign control provisions fully meet the Department's requirements, as set out in the Invitation to Tender.

4. Under the Invitation to Tender, bidders were required to respond with various pricing elements:

for defined packages of planned maintenance
for Weighted Average Hourly Rates (WAHR)
for tariff rates.

The responses to the Tender were affected by difficulties of access to the Dockyard and to the detailed information needed to prepare a realistic price bid in the time available. All bidders for Devonport responded to the pricing questionnaire but it was clear from the outset that considerable further work would be needed to ensure that prices paid for work in the first year of the Term Contract were soundly based. It was also clear that the Dockyard accounting system, now being installed to meet the legal obligations of a Companies' Act company, would need further development even after Vesting Day to support fully a regime of fixed pricing for refit work.

5. In the period up to Vesting Day, agreement will be reached on WAHR and Tariff Rates to be applied in the first year of the contract; there will be a shift to risk pricing, based on agreed rates, at the earliest opportunity to a timetable dependent on progress in developing the necessary commercial data base and systems.

6. The Term Contract does not, of itself, lead to the flow of money to the contractor; all work, and payments therefore, will be carried out under Project Contracts - the details of which were set out in the draft Contract. Under standard departmental practice, there is a wide variety of methods of pricing and several will be applied to Naval work. Under all of these, the Department has full right of access to the books of the contractor and, through a sequence of post costing and audit, can satisfy itself that prices charged are fair and reasonable - and, more to the point, do not lead to an overall profit in excess of that

appropriate to the application of the Government Profit Formula. For work in hand on Vesting Day, pricing will generally be on the basis of WAHRs, with a fixed fee; small projects arising soon after Vesting Day will be priced on a risk basis and over a period all projects entering the Dockyard will move to that basis.

7. On page 4 of their paper of November 1987, the Trade Unions voiced a fear that 'fixed price contracts cannot work in a situation where as much as 50 per cent of the total work package is likely to be in respect of emergent or unforeseen work'. In the Secretary of State's paper of 4 December the point was made that this is not borne out by the experience of the Department in the two comparator refits under COMPEX. Overall we judge that some 75% or more of all work will be capable of specification in advance; the pricing of the remainder will be carried out on the spot by the local organisation of DGSR, the Superintendent Ships, based on the agreed rates for the year in question.

8. These rates will be calculated on the basis of the work to be performed and the facilities used, in a way that will ensure that there is no cross subsidy as between core and competitive Defence work and between Defence work and commercial business.

9. The procedure for determining rates on an annual basis will take full account of improvements in efficiency and reduction in overheads achieved and planned.

10. Future employment levels are not built into the contract, since they are dependent on at least five variables:

the size of the core programme
the degree of efficiency improvements secured
the volume of the unallocated programme
the proportion of the unallocated programme won in competition
the amount of commercial work secured.

The contractor and the Department will discuss the programme of work in the Dockyard on a quarterly basis. At the same time the Department will also review with the contractor the requirements for strategic capacity; in reaching a decision on this DGSR will be guided by the requirement to retain a full capacity, capable of meeting the needs of the Royal Navy during the current Term Contract and beyond.

11. As with Rosyth and Babcock Thorn, an attractive feature of the bid is the plan to secure an increasing volume of commercial work for the Dockyard. One important result of this would, of course, be to secure higher levels of employment and thus reduce the number of redundancies. Under the GOplc option, the Department forecast future employment levels - on assumptions of efficiency improvements, and success in winning unallocated and commercial work, which suggested that employment levels in Devonport might fall over the period of the Term Contract from 11460 to 6340; the forecasts by DML are commercially confidential but are judged to be realistic and somewhat higher than a GO plc. In matching the levels of employment to the declining Naval load and projected efficiency improvements, the contractor will seek to minimise compulsory redundancies - but it may not be possible to avoid these entirely; redundancy payments will take full account of previous service in the public sector and will be calculated on the basis of equivalent Civil Service rates, unless a new scheme has been negotiated and agreed with the Trades Unions.

12. *Contract Annexes of Personnel Significance*
In the draft Contract circulated in April, several Annexes were blank, as their content could only be determined either in the light of the response of bidders to the Invitation to Tender or shortly before Vesting Day. The Department's proposals in the ITT have been generally accepted by DML and the final texts of the Contract Annexes are now being prepared; all protect the current conditions of employment of the workforce.

Pensions: DML have accepted the proposed pension arrangements for transferred staff as set out in the draft Term Contract, including the provision of indexation

and the other constraints designed to protect the scheme; the Government Actuary will be the actuary to the transferred members' pension fund.

Annex 9: Particulars of the Employees: to be consistent with the Statutory Instrument, called for under the Dockyard Services Act, and now tabled in Parliament.

Annex 11: Pay Arrangements: will reflect the transfer of the CPRO to contractor and the use of the Civil Service non-industrial pay service for a period after Vesting Day; non-industrial pay would then transfer to the Dockyard pay computer

Annex 16: Sports, Welfare, Catering and Occupational Health: will reflect the continuation of participation in Civil Service Sports, Social and Health Associations, the provision of Welfare Services using existing welfare personnel on repayment and a continuation, on repayment, of current Occupational Health and Hygiene services; the Annex will also cover the arrangements for catering under which the Dockyard contractor will take over the catering organisation in the Naval Base

Annex 17: List of Loan or Seconded Personnel: in the Draft Contract this covered Employers Liability Insurance, which is now fully covered in the Contract; Annex 17 will list seconded Naval personnel

Annex 27: Drawing Office/Technical Support: these services will be provided by the contractor, using Dockyard staff transferred into the Dockyard Company on Vesting Day

Annex 31: Materiel Supply: the contractor will make use of DGST(N) services for a 'get you in' period for the provision of 'Contractor Supplied Materiel' as defined in the ITT; any subsequent change will follow negotiation with DGST(N) and will be the subject of consultation with the Trades Unions at an appropriate time

Annex 32: Marine Services: the contractor will now be bound to use the harbour berthing and movements package, provided by DMS(N) as a 'get you in' service, for the duration of the Term Contract.

13. *Transitional Arrangements*
A separate Services Contract is being negotiated to cover the resources employed between signature of the Term Contract and Vesting Day in meeting a series of objectives designed to complete the preparation of the Dockyard for commercial management. This contract can be extended for a period of up to 6 months if Vesting Day is delayed, after which there will be a mutual right to terminate the Term Contract.

VALUE FOR MONEY

14. DML have projected their Business Plan for Devonport, based on the lower programme of Naval work identified in the Invitation to Tender together with their assumptions about commercial and other Naval work likely to be gained in open competition, in financial terms across the 7-year Term Contract period. This has been scrutinised by both MOD staff and Coopers and Lybrand, and is in accordance with the package of measures negotiated with DML. Other costs to the MOD of transferring Devonport to commercial management, such as initial setting-up costs and an appropriate share of the customer organisation, have been computed based on the latest information and assumptions available.

15. In order to demonstrate the value for money of commercialisation, it has been necessary to establish a baseline of continued MOD management, taking into account the workforce and level of productivity likely to be achieved by April 1987 and an assessment of the further

improvements in productivity and efficiency which might reasonably be expected over the Term Contract period, taking account of past experience. The same programme of Naval work has been assumed for the Dockyard as in the DML Business Plan (core plus other competitive Naval work). Dockyard costs have been assessed using the normal Treasury full resource cost conventions as applied in the existing Dockyard Management Accounts and published Dockyard Operating Accounts.

16. The full details of the costings must remain in commercial confidence but will be released to the Public Accounts Committee, together with comparable details for Rosyth. The expected savings for the Devonport Dockyard operation, year by year, are as follows:

Savings over continued MOD management (£m)

	86/87	87/88	88/89	89/90	90/91	91/92	92/93	93/94	TOTAL
GO plc	-6.7	-8.9	-6.2	5.0	30.2	31.6	39.2	34.1	118.3
DML	-6.7	-19.2	-6.3	15.9	23.9	34.1	38.1	43.3	123.1

On the same basis, a Trading Fund would yield a rather lower return than that expected to accrue from a GO plc. The GO plc figures, which apparently offer savings comparable to those from DML, represent the scenario of a GO plc operating with the full range of commercial and financial freedoms. This is highly optimistic, and in practice more modest savings would be likely.

17. Costs in year 1 represent a proportionate share for Devonport of the overall costs of establishing commercial management during the period since July 1985. Cost elements included in this calculation are:

- the commercial accounting system: the bulk would be required under any system of management - additional cost attributable to Devonport £2m
- refit specification writing - all needed for any system
- consultancy support - share attributable to Devonport £2.7m
- staff build up pre-Vesting Day - share attributable to Devonport £0.47m
- contractor's costs.

18. The first 4 years of the Term Contract period will be dedicated to obtaining the necessary improvements in productivity and efficiency; balancing the size of the workforce against load; and achieving a competitive position from which to capture a reasonable share of commercial and other Naval work. Thereafter we look for continuing annual savings of about £40M. This would depend on the total annual load anticipated by DML in the last few years of their current Business Plan being maintained, but would take no account of any further improvements in efficiency which might be achievable.

19. The savings identified above are savings in Exchequer terms throughout the period. The Defence budget will meet the costs of future pensions; the contractor's and employees' contributions to the fully funded pension schemes will be recovered from the MOD (and from any other customer of the Dockyards) as part of the overhead element of contract pricing. The total contribution rate falling to the MOD is forecast at about £12m in the latter part of the Term Contract period and the Department can then expect to see a significant annual benefit to the Defence Budget, which should continue into the second Term Contract and beyond. The financial consequences for the Defence budget in the early years have been taken fully into account in determining the total cash allocation for Defence in the Public Expenditure Survey round.

20. Earlier assessments of the savings likely to accrue from the introduction of commercial management, which were presented to the PAC, used a baseline of 1.4.85 for loading and costs,

and predicated efficiency improvements of 30% in accordance with advice given by Mr Peter Levene to the previous Secretary of State. Since then Dockyard numbers have reduced; some improvement in productivity has taken place; the programme of work now planned is significantly different from that envisaged in 1985; and the Levene assumptions have been replaced by the package of specific measures negotiated with DML.

Issued on 20 January 1987 by:

THE DOCKYARD PLANNING TEAM, MINISTRY OF DEFENCE
ROOM 3/01, STANDARD HOUSE, 28 NORTHUMBERLAND AVENUE,
LONDON. WC2N 5JA
Telephone: 01 - 218 4743/4482

ECON POL

PRIVATISATION

PT15

10 DOWNING STREET

Thanks on MB

From the Private Secretary

Prime Minister

You asked about future privatisations.

The Treasury have pencilled in:

1987-88	1988-89
– BAA	– 2nd tranche BT (£2.2 bn)
– Rolls Royce	– 1st of water authorities
– 2nd tranche BA	– 3rd tranche British Gas (£1.6 bn)
– British Gas debt repayment	– Some tiddlers
– 2nd tranche British Gas equity (£1.8 bn)	– ? electricity.
– ? BP Shares	
– BT preference shares redemption.	

DRN
15/1

nbpm

CCBG

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Douglas Hurd CBE MP
Secretary of State
Home Office
50 Queen Anne's Gate
LONDON SW1H 9AT

12 January 1987

Dear Douglas,

USING PRIVATE ENTERPRISE IN GOVERNMENT pt 14

John MacGregor wrote to you on 23 September enclosing a copy of the central report from the Efficiency Unit and the 1985-86 annual review by the Treasury on progress to date.

He proposed that Departments should report to the Central Unit on Purchasing (CUP) on the actions they have decided to take on Recommendations 4 and 6 in the report. In brief, these required Departments to establish programmes for reviewing all their activities in order to identify those areas suitable for competitive tendering. Target areas should then be selected according to priority so that management resources can be most effectively allocated to annual competitive tendering programmes. This report should be with the CUP by Friday, 13 February.

The CUP has now issued to all Departments the detailed guidelines on competitive tendering and contracting out to which John MacGregor referred in his letter. They have included two forms to assist Departments in reporting their action plans in this area. I enclose a copy of the CUP's management overview, which should provide you and your senior officials with an outline of the main principles involved in competitive tendering.

I shall take a close interest in the CUP's feedback on Departments' targets and achievements in this important area, as I know will John MacGregor. I am sure that you will want to take a personal interest in this whole topic and to ensure that your Department sets challenging targets.

I am sending copies of this letter to the Prime Minister, Ministers in charge of Departments, Sir Robert Armstrong and Sir Robin Ibbs.

Yours ever

Peter

PETER BROOKE

CENTRAL UNIT ON PURCHASING
Cabinet Office/Treasury Joint Unit

Standard House
27 Northumberland Avenue
London WC2N 5AL

Contact point
(01) 210 6739

COMPETITIVE TENDERING & CONTRACTING OUT MANAGEMENT OVERVIEW

Why use Competitive Tendering?
The Report on using private enterprise in Government (published by HMSO on 14 October 1986) concluded that competitive tendering has proved a successful means of promoting efficiency in the Civil Service and should be continued. The review said that the objectives of the policy should be restated to emphasise the aim of achieving value for money from using competition. It also concluded that practical guidance should be prepared to help managers and others in departments to get the most out of competitive tendering and, as appropriate, from contracting out services.

What is Competitive Tendering?
It is the means by which to test and evaluate the potential to use private sector contractors to provide a service that has historically been undertaken from within Government resources. The aim is to establish whether private sector contractors are able to provide a satisfactory level and standard of service more cost effectively than can be achieved in-house.

When should Competitive Tendering be used?
There are no limits to the nature of activity which can be considered for competitive tendering. In the first instance the process is initiated purely by the commercial consideration of whether, on known comparative data, the private sector is able to provide the service required more cost effectively. Issues such as the operational, financial and personnel implications of contracting out the service, or alternatively of improving the cost effectiveness of the in-house service rather than contracting out, emerge from the detailed evaluation process. Departments will wish to concentrate at first on activities that consume the greatest resources (running costs or capital investment) or where the work is peripheral to the department's main objectives.

How is Competitive Tendering implemented?
First, by appointing a manager who will see through each stage of the process, drawing on specialist advice from within and without the department as required. The size and complexity of work to put to competition will dictate whether the manager needs to be employed **exclusively** on the competitive tendering task. Advice on the manager's input to, and predictable peaks of, the activity is provided in detailed guidance by the Central Unit on Purchasing.

Second, by drawing up a detailed specification of the work that needs to be done. This act alone provides the opportunity to assess:
(a) Whether the activity or service is needed at all. If so, whether in its present form.
(b) What level and quality of service is necessary and most cost effective.
(c) What cost savings can be achieved in the in-house operation.

The specification is then issued to selected private sector companies to bid to provide the service.

What are the main stages?
(a) REVIEW of the potential for improvement by putting the in-house activity to competition.
(b) DEVELOPMENT of a specification and outline contract documents.
(c) EVALUATION of competing bids.

When to Contract Out?
If the process of competitive tendering indicates that it is practicable and cost effective to put the service to the private sector, proceed with:
(a) PROCUREMENT and
(b) AWARD of the contract.

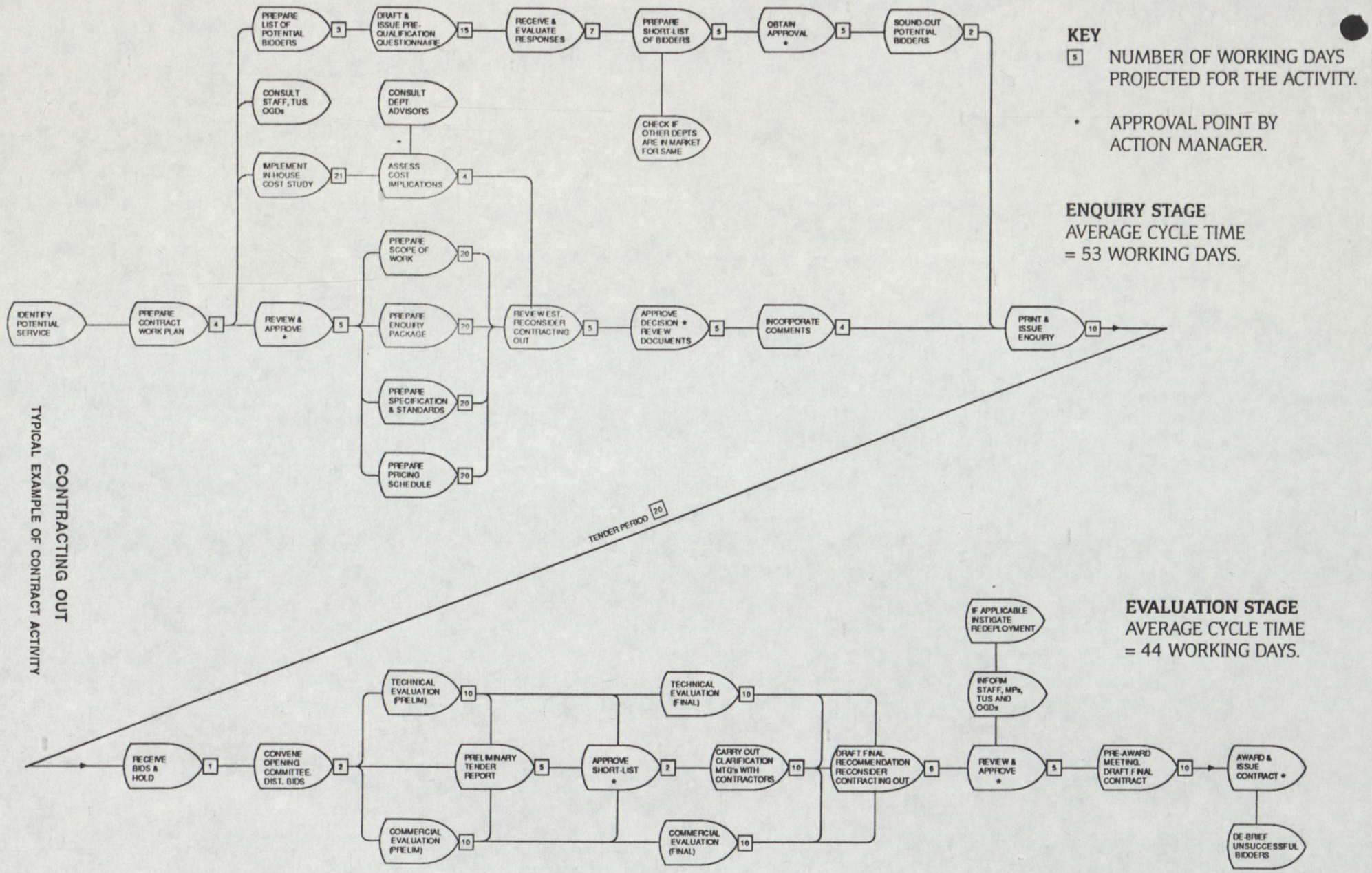
What are the advantages of Contracting Out?
Provision of the service by a specialist private sector company should improve efficiency and provide greater value for money and release in-house staff and resources for other purposes.

Guidance on Competitive Tendering and Contracting Out
In conjunction with HM Treasury and the Management and Personnel Office, the Central Unit on Purchasing has produced detailed, practical guidance for managers. The guidance contains principles on every element of the process, from strategic and policy issues through to the practicalities of working with a contractor. Part 1 of the guidance concentrates on taking the manager through each element. Part 2 contains detailed guidance to finance, personnel and contracts staff who will assist the manager in the process. The guidance is inevitably of a general nature. Departments will wish to adapt it to meet their own needs and format. Departments will wish also to issue instructions on how they intend to promulgate and practise the policy of competitive tendering

December 1986

The diagram overleaf summarises the activites addressed within the full guidance notes. For managers' information, these include the average time for the individual task to be undertaken.

CUP REFERENCE: PSPG 3.2.2.



CONTRACTING OUT
TYPICAL EXAMPLE OF CONTRACT ACTIVITY

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TYPICAL EXAMPLE OF CONTRACT ACTIVITY

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Privatisation: Econ Pol.
Pt 15.

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

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

MO 10/2V

9th January 1987

Dear John,

NBPM,

COMMERCIAL MANAGEMENT OF THE ROYAL DOCKYARDS

In your letter of 4th December agreeing that we should go ahead with the announcement of a winner for the Rosyth contract, you said that my Department should report the agreement to fund the contractor under certain conditions in the event of strike action to Parliament as a contingent liability, rather than to the National Audit Office.

I believe that this view may have been based on a lack of clarity in the explanation I gave in my minute of 1st December. I believe it would be politically extremely awkward at this stage should we have to identify in public the side agreement with Babcock Thorn as a formal contingent liability.

Under the proposed Term Contract itself, there is no flow of money from the Department to the contractor. He will earn his money from individual Project Contracts for each package of work

The Rt Hon John MacGregor OBE MP

as it arises. These Project Contracts will contain an agreed payment regime, based on stage payments against achieved milestones. Should the contractor face substantial strike action, then he will be unable to achieve individual stage payments under Project Contracts but will, nevertheless, be incurring indirect and possibly some direct expenditure against each project. He could therefore incur substantial cash flow problems if we do not have a mechanism to assist him in the period up to 30th June 1988. What is proposed is in essence an agreement to make payments, in the event of a strike, aimed at meeting his otherwise unmet expenditure through stage payments under Project Contracts. In this sense, we would simply be paying him on a different basis for work that he would actually have done on our behalf.

The second provision that we have put forward would provide a degree of additional payment to the contractor for costs incurred as a result of industrial action which do not ultimately get recovered as part of stage payments due under each Project Contract. It could be argued that these are contingent liabilities, but we judge that the overall volume of them is likely to be low, both absolutely and in relation to the annual Dockyard turnover - at most of the order of hundreds of thousands; indeed, in the financial year in question my Department would almost certainly spend less than the Estimates provision should there be a major strike, and less than it would if industrial relations proceeded on a more even keel. I feel strongly that to identify

them to Parliament at this stage would not only generate a political storm that we would do better to avoid, but would at the same time make more likely the very event we are seeking to avoid.

By releasing the information to the National Audit Office as I suggested, we will ensure that the proper conventions are observed; but, if you feel that some more direct approach in the Parliamentary chain was more appropriate, I suggest that a personal letter to the Chairman of the Public Accounts Committee would be sufficient.

I am sending copies of this letter to members of E(A), Michael Havers, Patrick Mayhew and to Sir Robert Armstrong.

Yours ever,

George

George Younger

Econ Pol

PRIVATISATION

PTTS

CCBG

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Rt Hon John Moore MP
Secretary of State for Transport
2 Marsham Street
LONDON
SW1P 3EB

MBPM

22 December 1986

Dear John,

OBJECTIVES FOR THE SCOTTISH TRANSPORT GROUP

Thank you for your letters of 17 November and ~~1~~ 22 December, which raise the question of the future structure and ownership of the Scottish Bus Group (SBG). This issue has also been referred to by Nicholas Ridley and Norman Tebbit.

As you know, we made clear in the White Paper of July 1984 that we did not propose for the time being to change the ownership of SBG. This followed discussion at E(A) on 16 May 1984, when George Younger said that he had no plans for the privatisation of SBG meantime, although he would be prepared to consider the matter further in the light of experience with the National Bus Company (NBC).

I have an entirely open mind as regards the future ownership of SBG, but like George Younger I would want to take any decision in the light of available relevant experience. There are problems in privatising transport undertakings, in the remoter parts of the country especially. I am aware, for example, that we failed to find buyers for the 8 CAA aerodromes in the Highlands and Islands, even though we made it clear that we would continue to pay subsidy towards their operation.

What I should find useful, if you would be good enough to provide it, would be a commentary on your experience so far with the programme of disposals of NBC subsidiaries, with as much detail as you can furnish about the nature of the packages offered for sale, the financial terms, and the response so far, particularly in the remoter areas. I should also like to know how you see the prospects for further sales in 1987.

As regards the presentational problems which colleagues feel have arisen over the different line being taken in Scotland, I agree that a lot of attention has focussed on the situation in central Glasgow. The problem there has been, however, not a failure of competition but an apparent excess of it. In any case, the situation has settled down a lot (as the TRRL information brings out) and the remaining congestion will shortly be the subject of an inquiry before the Traffic Commissioner.

We have given a lot of thought to the best means of ensuring that SBG does not behave in an anti-competitive fashion, both by ensuring that the

MJH01901.126

municipals have been able to provide genuine competition, and by placing checks on the SBG's own conduct (in particular of its financial affairs). I enclose a copy of my letter to John MacGregor which sets out the steps that I propose should be taken, including the reference of SBG to the Monopolies and Mergers Commission late in 1987.

I repeat that I am entirely open on the question of privatising SBG, and I look forward to receiving from you the information which will help me to consider the matter further.

I am sending copies of this letter to members of E(NI) and to Sir Robert Armstrong.

Yours ever,

MALCOLM RIFKIND

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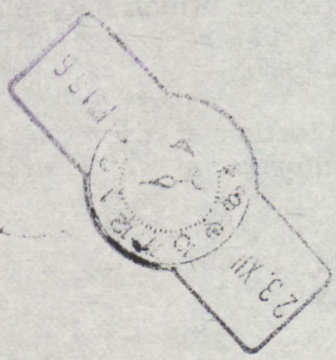

CSBG

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

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

22 December 1986

Dear John,

SCOTTISH TRANSPORT GROUP: CORPORATE PLAN REVIEW AND OBJECTIVES

Thank you for your letter of ~~1~~ 22 December. I have also seen John Moore's letter of the same date and Nicholas Ridley's of 9 December.

I agree that the Scottish Bus Group (SBG) must not be allowed to abuse their strong position in certain parts of the Scottish bus market. I therefore welcome the enquiries which the Office of Fair Trading are currently making into complaints about SBG's activities, particularly in Glasgow. At the moment it seems unlikely that these enquiries will develop into a major investigation: and accordingly I agree with what Paul Channon has now confirmed as his view, that SBG should be the subject of a Monopolies and Mergers Commission reference in late 1987. This should prove a healthy discipline for the Group.

On the Scottish Transport Group (STG) objectives for their bus enterprise, I do think that having regard to Scottish circumstances some reference to the maintenance of rural services is necessary but I do not attach great importance to the actual wording. I hope that it would meet points raised by my colleagues if I re-drafted the bus objectives to read as follows:

"OBJECTIVES

The Group's strategic objectives in the provision of bus services should be as follows:

MJH01801.126

1. To manage its bus operations as it would do in the interests of private shareholders seeking in particular to retain customer goodwill and to provide efficient profitable services.

2. Subject to objective 1, to provide services in rural areas both through the development of commercial opportunities and in participation in the tendering process, consistent with the framework for achievement of operational objectives set out below.

3. To explore and develop potential new markets and new methods of service provision."

Both you and John Moore query the absence of an objective to eliminate cross-subsidy among SBG's operating companies. As you know, I have received what I regard as valuable assurances from SBG on this point. I would not, however, wish to include them as objectives, because an objective is something which the Group is to strive after, whereas cross-subsidy between one company and another is something which can and should be outlawed from the start. Nevertheless, I agree that I could usefully build in a reference to these assurances (and the monitoring which I have instituted to secure compliance with them) by way of a preamble to the objectives. It will be helpful, in that context, to be able to refer to the Group's own guidance document of September 1986, which records that financial dealings between SBG and subsidiary companies will be at arms length and that undertakings have been given on the elimination of cross-subsidy between companies.

As far as performance aims are concerned, I expect shortly to receive the comments of STG on the proposals I have put to them. I would then be happy that these should be the subject of discussions between our officials.

I regret that the objectives I propose for CalMac were omitted from my letter of 20 November. I now enclose these and would be grateful to your agreement to them and to those for the bus enterprise, subject to the changes I have proposed in this letter.

I have written separately to John Moore about the questions which he and other colleagues have raised on the future structure and ownership of SBG.

Copies of this letter, and of my letter to John Moore, go to members of E(NI) and to Sir Robert Armstrong.

Yours ever,

Malcolm

MALCOLM RIFKIND

MJH01801.126

ECON POL : Privatisation PTIS

CCBG

CALEDONIAN MACBRAYNE

OBJECTIVES

In relation to its ferry services the Group should pursue the following strategic objectives:-

1. To provide services as approved by the Secretary of State in terms of his Undertaking with Caledonian MacBrayne and to make appropriate financial and investment provision for the continuity of these services.

2. To provide economically and efficiently a level and pattern of service which strikes an appropriate balance between costs and revenue and takes due account of local requirements.

3. To exploit opportunities for the development of services for the benefit of both Caledonian MacBrayne and the communities served, having particular regard to the Government's commitment to the economic development of these communities.

4. To seek to develop commercial opportunities outwith the approved (subsidised) services where these opportunities can be met within existing capacity and agreed capital investment programmes.

FRAMEWORK FOR ACHIEVEMENT OF OBJECTIVES

In seeking to achieve these objectives Caledonian MacBrayne's plans and actions should be governed by the following operational policies:-

1. The need to contain deficit subsidy.

2. The achievement of the financial target set by Government.

3. The achievement of performance aims agreed with Government.

4. The requirement to make proper appraisal of investments.

5. The establishment of a challenging system of cost control including targets for year on year reductions in unit costs.

6. The need to take account of the social and economic needs of the communities served when making decisions on service provision.

7. The provision of regular information to Government in a form suitable for monitoring performance on targets and financial results.

CC PS

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

9 December 1986

The Rt Hon Malcolm Rifkind MP
Scottish Office
Dover House
Whitehall
LONDON
SW1

Dear Malcolm

NBPM

The Scottish Transport Group

I have read the further comments on this issue from John Moore and Norman Tebbit. I agree with both of them but I would like to make one further point.

I said in my previous letter that the situation in Scotland could be used to discredit the bus policy as a whole. The bus policy has been prayed in aid by both sides of the House in debates on the proposed competitive tendering legislation. I need hardly add therefore that I am concerned that the problems in Scotland may well be used against us during the passage of that bill.

I am copying this to other members of E(NI) and to Sir Robert Armstrong.

Yours ever

Nicholas

NICHOLAS RIDLEY

ECON POL
PRIVATISATION
PT 15

CONSERVATIVE PARTY NEWS SERVICE

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RT HON PAUL CHANNON MP

Release Time: 1830 hrs Monday 8 December 1986 725/86

Speech by Rt Hon Paul Channon MP (Southend West), Secretary of State for Trade and Industry, to the Bow Group at Westminster on Monday, 8 December 1986.

WHEN, IN MANY YEARS TIME, THE HISTORY OF MRS THATCHER'S GOVERNMENT COMES TO BE WRITTEN, IT WILL BE HARD TO SINGLE OUT ANY ONE THING AS BEING OUR GREATEST AND MOST LASTING ACHIEVEMENT. ALREADY, SUCH CHANGES AS THE TAMING OF THE TRADE UNION MILITANTS, THE CONQUEST OF INFLATION AND THE RE-ESTABLISHMENT OF BRITAIN'S REPUTATION IN THE WORLD HAVE HAD A PROFOUND AND FAR-REACHING EFFECT ON THE NATION'S FUTURE.

BUT THERE IS ONE OTHER POLICY WHICH MUST ALSO BE A STRONG CHALLENGER FOR THE TITLE AND IN THE LONGER TERM, MAY PROVE EVEN MORE SIGNIFICANT. THAT IS PRIVATISATION.

FOR FORTY YEARS, OUR COUNTRY HAD SEEN A STEADY AND REMORSELESS GROWTH IN THE SIZE AND POWER OF THE STATE. ALTHOUGH THERE WERE ONE OR TWO ATTEMPTS TO REVERSE IT SUCH AS THE DENATIONALISATION OF THE STEEL INDUSTRY BY WINSTON CHURCHILL AND THE SALE OF THOMAS COOK'S TRAVEL AGENCY AND THE CARLISLE STATE BREWERIES BY EDWARD HEATH, IT WAS BEGINNING TO SEEM THAT THE RATCHET COULD NOT BE STOPPED AND THAT THE STATE SECTOR WOULD CONTINUE INEXORABLY TO GROW.

/.. It was that

Printed and published by Conservative Central Office, 32 Smith Square, London SW1P 3HH

IT WAS THAT CHALLENGE WHICH FACED THE INCOMING CONSERVATIVE GOVERNMENT IN 1979. AND YET, AT THAT TIME, PRIVATISATION WAS BARELY A GLEAM IN THE EYE. NOBODY COULD ACCUSE US THEN OF SETTING AMBITIOUS TARGETS.

'THE RIGHT APPROACH', THE DOCUMENT WHICH FIRST SET DOWN THE PHILOSOPHY OF THIS GOVERNMENT IN 1976, CONCENTRATED ON THE NEED TO RE-ESTABLISH FINANCIAL AND COMMERCIAL DISCIPLINE IN THE NATIONALISED INDUSTRIES. ALMOST AS AN AFTER THOUGHT, IT WENT ON TO SAY THAT: "IN SOME CASES IT MAY ALSO BE APPROPRIATE TO SELL BACK TO PRIVATE ENTERPRISE ASSETS OR ACTIVITIES WHERE WILLING BUYERS CAN BE FOUND".

THREE YEARS LATER, THE MANIFESTO IN 1979 WAS ALMOST AS CIRCUMSPECT: WHILE PROMISING TO SELL BACK TO PRIVATE OWNERSHIP THE AEROSPACE AND SHIPBUILDING INDUSTRIES AND TO SELL SHARES IN THE NATIONAL FREIGHT CORPORATION, FOR THE REST OF THE NATIONALISED SECTOR, OUR AMBITIONS WERE LIMITED TO PROMISING TO INTERFERE LESS WITH MANAGEMENT AND TO SET A CLEARER FINANCIAL DISCIPLINE.

THE POSITION TODAY IS ALL THE MORE REMARKABLE GIVEN THIS TENTATIVE START. SINCE 1979, SOME THIRTEEN MAJOR BUSINESSES, EMPLOYING CLOSE TO 500,000 PEOPLE, HAVE BEEN RETURNED TO THE PRIVATE SECTOR.

/.. By the end

BY THE END OF NEXT YEAR, ALMOST HALF OF WHAT WAS IN THE STATE COMMERCIAL SECTOR IN 1979 WILL HAVE BEEN TRANSFERRED TO THE PRIVATE SECTOR. YET EACH TIME THE OPPOSITION TOLD US IT WOULD BE A FLOP, THAT IT WAS NOT POSSIBLE TO HAVE A PRIVATE TELEPHONE COMPANY OR A GAS COMPANY, THAT NOBODY WOULD WANT TO BUY. EACH TIME THEY HAVE BEEN PROVED DRAMATICALLY WRONG.

VERY FEW OF US IN 1979 EVEN DARED HOPE THAT WE COULD ACHIEVE SO MUCH, BUT AFTER EACH SUCCESS OUR DETERMINATION AND BELIEF HAS GROWN. WHAT WAS ONCE UNTHINKABLE FIRST BECAME POSSIBLE AND IS NOW A REALITY.

OF COURSE, OUR OPPONENTS HAVE SOUGHT TO PORTRAY US AS IDEOLOGUES, FANATICALLY WEDDED TO THE CAUSE OF PRIVATE OWNERSHIP WITH LITTLE THOUGHT OF WHAT IS MOST APPROPRIATE IN EACH INDIVIDUAL CASE. THE ALLIANCE IN PARTICULAR LIKE TO COMPARE US WITH THE LABOUR PARTY - EACH EXTREMISTS FOLLOWING SOME IRRELEVANT DOGMA. NOTHING COULD BE FURTHER FROM THE TRUTH.

THE CONSERVATIVE PARTY HAS NO CLAUSE FOUR. WE SUPPORT PRIVATISATION BECAUSE IN CASE AFTER CASE, IT HAS BEEN SHOWN TO WORK. AND THE TRUTH IS THAT PRIVATE OWNERSHIP IS NEARLY ALWAYS MORE APPROPRIATE, MORE EFFICIENT AND MORE SUCCESSFUL THAN OWNERSHIP BY THE STATE. IT IS THE LABOUR PARTY WHO ARE

/.. blind to the

BLIND TO THE EVIDENCE. THEY REMAIN COMMITTED TO THE CAUSE OF NATIONALISATION, EVEN IF BY ANOTHER NAME, DESPITE THE OVERWHELMING PROOF THAT STATE OWNERSHIP DOES NOT SUCCEED. IT IS NOT A COINCIDENCE THAT SO MANY INDUSTRIES OWNED BY THE STATE HAVE HAD A RECORD OF EVER-MOUNTING LOSSES. AND IT IS EASY TO UNDERSTAND WHY.

NATIONALISATION REMAINS A EUPHEMISM FOR BUREAUCRACY AND INEFFICIENCY. COMMERCIAL DECISIONS ARE TAKEN FIRST BY MANAGEMENT, THEN AGAIN BY CIVIL SERVANTS AND FINALLY BY POLITICIANS FOR A THIRD TIME. AND OFTEN, BY THE TIME THE SPONSORING DIVISION, THE TREASURY AND THE GOVERNMENT HAVE GIVEN THEIR STAMP OF APPROVAL, THE OPPORTUNITY HAS PAST, IT IS TOO LATE AND THE COMPETITION HAVE MOVED IN. NO WONDER THAT THOSE ACTUALLY CHARGED WITH RUNNING THE NATIONALISED INDUSTRIES CANNOT WAIT FOR THEIR TURN FOR PRIVATISATION TO COME AROUND.

IN ADDITION, UNDER STATE OWNERSHIP, COMMERCIAL LOGIC MAY BECOME SECONDARY TO POLITICAL NEEDS. SO THAT DECISIONS WHICH ARE IN THE BEST INTERESTS OF THE INDUSTRY AND ITS EMPLOYEE GET PUT OFF, OR WORSE OVER-RULED, AS A RESULT OF POLITICAL PRESSURE.

OF COURSE, IT IS RIGHT THAT ENTERPRISES OWNED BY THE STATE AND IN WHICH THE TAX-PAYER HAS INVESTED SO MUCH SHOULD BE

/.. accountable to Parliament

ACCOUNTABLE TO PARLIAMENT. BUT THIS TOO CAN BE HARMFUL TO THE INDUSTRY. NOT ONLY IS MUCH MANAGEMENT TIME WASTED IN SERVICING PARLIAMENT'S DEMANDS BUT OCCASIONALLY PARLIAMENTARY SCRUTINY MAY LEAD TO INFORMATION HAVING TO BE DIVULGED WHICH IS COMMERCIALLY CONFIDENTIAL AND DAMAGING TO THE BUSINESS. IT IS NO WONDER THAT NATIONALISED INDUSTRIES' COMPETITORS ARE SUCH KEEN READERS OF PARLIAMENTARY PROCEEDINGS.

MOREOVER, IN THE STATE-OWNED COMPANIES THEMSELVES, MANAGEMENT AND WORKFORCE ARE PROTECTED BY THE KNOWLEDGE THAT THE STATE STANDS BEHIND THEM AND THAT THE TAXPAYER WILL ALWAYS BAIL THEM OUT, WHATEVER THE SIZE OF THE LOSSES. SHELTERED FROM MARKET FORCES, THEY HAVE NO NEED TO WORRY ABOUT SATISFYING THEIR LONG-SUFFERING CUSTOMERS ON PRICE, ON QUALITY AND ON DELIVERY ON TIME.

I HAVE BEEN SECRETARY OF STATE FOR TRADE AND INDUSTRY FOR ONLY NINE MONTHS, BUT ALREADY MY EXPERIENCE OF TRYING TO OVERSEE THE NATIONALISED INDUSTRIES FOR WHICH THE DTI HAS RESPONSIBILITY HAS CONVINCED ME THAT NATIONALISATION DOES NOT AND CAN NEVER WORK. POLITICIANS AND BUREAUCRATS CAN NEVER HOPE TO DO BETTER THAN COMMERCIAL MANAGEMENT OPERATING IN A FREE MARKET.

OF COURSE, PRIVATISATION DOES NOT GUARANTEE A COMPANY'S SUCCESS. MANY OF OUR INDUSTRIES PROBLEMS WILL REMAIN

/.. whether in the

WHETHER IN THE PRIVATE OR THE PUBLIC SECTOR. BUT THE REQUIREMENT TO SURVIVE IN THE MARKET PLACE BRINGS AN INSECURITY WHICH AT LEAST PROVIDES THE INCENTIVE TO TACKLE THOSE PROBLEMS.

AND BY REMOVING THE GOVERNMENT'S GUARANTEE TO MEET ITS LOSSES, AN ENTERPRISE WILL HAVE A FAR BETTER CHANCE OF ACHIEVING SUCCESS. JUST LOOK AT WHAT HAS HAPPENED. THE NATIONAL FREIGHT CONSORTIUM, WHICH BARELY BROKE EVEN IN ITS LAST YEAR BEFORE PRIVATISATION, RECORDED PRE-TAX PROFITS 70 PER CENT UP ON LAST YEAR AND UP 6 TIMES SINCE PRIVATISATION.

CABLE AND WIRELESS PRE-TAX PROFITS ARE NOW FOUR TIMES WHAT THEY WERE BEFORE PRIVATISATION. AMERSHAM INTERNATIONAL'S PROFITS HAVE DOUBLED AND BRITISH AEROSPACE'S TRIPLED. AND JAGUAR, AT ONE TIME ALMOST WRITTEN OFF, SHOWED PRE-TAX PROFITS UP 33 PER CENT LAST YEAR, OUTPUT AT RECORD LEVELS AND 1,100 NEW JOBS.

IN MANY CASES, THE INTRODUCTION OF COMPETITION ALONE HAS HAD REMARKABLE EFFECTS. BUT OCCASIONALLY IT MAY NOT BE POSSIBLE AND SO ALTERNATIVE METHODS MUST BE FOUND. IN THE CASES OF BOTH BRITISH TELECOM AND BRITISH GAS, REGULATORY BODIES, OFTEL AND OFGAS, HAVE BEEN SET UP TO ENSURE THAT THERE IS NO ABUSE OF THE COMPANIES' MONOPOLY POSITIONS.

/.. Of course,

OF COURSE, BRITISH TELECOM ALSO HAS NOW TO COMPETE WITH MERCURY IN CERTAIN SECTORS. BUT, IN ADDITION, IT IS FORCED UNDER THE LEGISLATION TO REDUCE ITS PRICES BY AN OVERALL AVERAGE OF 3 PER CENT IN REAL TERMS EVERY YEAR. AS A RESULT, BT'S PRICES HAVE FALLEN BY 8.5 PER CENT IN REAL TERMS SINCE PRIVATISATION. AND BY CREATING REGULATORY BODIES AND INCLUDING REQUIREMENTS SUCH AS THIS IN THE LEGISLATION, THE DANGER OF MONOPOLY ABUSE IS CONSIDERABLY LESS THAN IF THE COMPANIES HAD REMAINED IN THE PUBLIC SECTOR.

IT IS ALSO OCCASIONALLY SUGGESTED THAT CERTAIN INDUSTRIES HAVE A STRATEGIC SIGNIFICANCE AND THUS MUST BE OWNED BY THE STATE. BUT ONCE AGAIN PROVISION CAN BE MADE TO PROTECT THE NATIONAL INTEREST WITHOUT REQUIRING OWNERSHIP BY THE STATE.

IN BRITISH TELECOM, BRITISH GAS, BRITISH AEROSPACE, BRITOIL, CABLE AND WIRELESS, AND SOME OTHERS, THE GOVERNMENT HAS RETAINED A 'SPECIAL' OR GOLDEN SHARE. THE PRECISE TERMS OF THIS SHARE VARY BETWEEN COMPANIES BUT IT CAN BE USED TO PREVENT THE COMPANY FROM PASSING INTO FOREIGN OWNERSHIP, TO LIMIT INDIVIDUAL HOLDINGS, OR TO IMPOSE ANY OTHER CONSTRAINTS THAT THE GOVERNMENT BELIEVE TO BE IN THE NATIONAL INTEREST.

/.. of course

OF COURSE, PRIVATISATION HAS MANY USEFUL SIDE BENEFITS. I IMAGINE THAT THE £5 BILLION WHICH THE CHANCELLOR EXPECTS TO RECEIVE BETWEEN 1987/88 AND 1989/90 WILL COME IN HANDY. BUT THE OTHER GREAT RESULT OF OUR PRIVATISATION PROGRAMME HAS BEEN THE ENORMOUS BOOST IT HAS GIVEN TO WIDER SHARE OWNERSHIP.

FIRSTLY, IT HAS ALWAYS BEEN OUR POLICY TO ENCOURAGE EMPLOYEES TO OWN SHARES IN THEIR COMPANY. BY DOING SO, EMPLOYEES HAVE A REAL STAKE IN THE SUCCESS OF THE ENTERPRISE WITH ALL THE BENEFITS TO MORALE AND PRODUCTIVITY THAT BRINGS. THE RESULTS HAVE BEEN SPECTACULAR: 96% OF BT'S EMPLOYEES OWN SHARES IN THE COMPANY. 82.5 PER CENT OF THE NATIONAL FREIGHT CONSORTIUM IS OWNED BY ITS EMPLOYEES. AND THE TERMS OFFERED TO EMPLOYEES IN THE RECENT BRITISH GAS FLOTATION WERE THE MOST GENEROUS YET WITH EMPLOYEES BEING OFFERED FREE SHARES WORTH £70 PLUS £2 FOR EACH YEAR OF SERVICE AND SUBSTANTIAL DISCOUNTS ON LARGER PURCHASES.

NOR NEED IT JUST BE RESTRICTED TO THE EMPLOYEES. IN THE CASE OF VICKERS SHIPBUILDING ENGINEERING LTD, THE CONSORTIUM PURCHASING THE TWO YARDS OFFERED SHARES NOT JUST TO THE WORKFORCES AT EACH YARD BUT ALSO TO LOCAL RESIDENTS OF BARROW AND BIRKENHEAD THUS GIVING THE WHOLE COMMUNITY AN OPPORTUNITY OF A STAKE IN THE COMPANY.

/.. But secondly

BUT SECONDLY, THE PRIVATISATION PROGRAMME HAS RESULTED IN MILLIONS OF PEOPLE BECOMING SHAREHOLDERS FOR THE FIRST TIME IN THEIR LIVES. IT WAS EDEN WHO FIRST ARTICULATED THE CONSERVATIVE DREAM OF A 'PROPERTY-OWNING DEMOCRACY'. THAT DREAM IS NOW BEING ACHIEVED UNDER THIS GOVERNMENT, PRINCIPALLY AS A RESULT OF THE RIGHT-TO-BUY. TWENTY YEARS LATER, IAIN MACLEOD EXPANDED EDEN'S VISION TO THE CREATION OF A 'CAPITAL OWNING DEMOCRACY'. AND WE ARE NOW WELL ON THE ROAD TO THAT TOO.

IT IS ESTIMATED THAT SINCE 1979 THE NUMBER OF INDIVIDUAL SHAREHOLDERS HAS DOUBLED AND NOW STANDS AT AROUND 6 MILLION. AND THAT WAS BEFORE BRITISH GAS. IT IS OUR AIM TO SEE THAT FIGURE DOUBLED AGAIN DURING THE NEXT PARLIAMENT. THE STAKES ARE TREMENDOUSLY HIGH. FOR, THROUGH WIDER SHARE OWNERSHIP, WE CAN DESTROY ONCE AND FOR ALL THE CONCEPT OF THE 'TWO SIDES OF INDUSTRY' WHICH HAS DONE SO MUCH DAMAGE TO OUR ECONOMY.

IT WILL ENABLE US FINALLY TO DISMISS THE DESTRUCTIVE DOCTRINE OF THE INEVITABLE STRUGGLE BETWEEN CAPITAL AND LABOUR, FOR EVERYONE WILL HAVE THE OPPORTUNITY TO BECOME A CAPITALIST. AND BY DOING SO, WE WILL REMOVE THE CLASS DIVISIONS AND JEALOUSIES UPON WHICH SOCIALISM DEPENDS.

/.. However, we

HOWEVER, WE MUST ALSO BE CAREFUL TO ENSURE THAT THOSE WHO BUY SHARES FOR THE FIRST TIME UNDERSTAND WHAT THEY ARE DOING. ONE OF THE BENEFITS OF WIDER SHARE OWNERSHIP IS THAT PEOPLE TAKE A STAKE IN THE SUCCESS OF OUR INDUSTRY AND ARE THEREBY GIVEN AN IMPROVED UNDERSTANDING OF ITS IMPORTANCE. BUT SHARE PURCHASE IS NOT THE SAME AS PUTTING MONEY IN A BUILDING SOCIETY; NOR IS IT AN EASY AND FOOL-PROOF WAY OF MAKING A QUICK BUCK AND IT IS ESSENTIAL THAT THAT IMPRESSION DOES NOT TAKE HOLD.

SHARE OWNERSHIP OFFERS GREAT REWARDS BUT AT THE SAME TIME, IT ALSO CARRIES RISKS AND IT IS IMPORTANT THAT THAT IS UNDERSTOOD. DEMOCRACY REQUIRES KNOWLEDGE SO THAT THE PEOPLE CAN MAKE AN INFORMED CHOICE. A TRUE CAPITAL-OWNING DEMOCRACY REQUIRES THAT PEOPLE ALSO UNDERSTAND WHAT THEY ARE INVESTING IN.

THE GOVERNMENT'S PRIVATISATION PROGRAMME HAS BEEN MORE SUCCESSFUL THAN PERHAPS WE DARED HOPE. AND THE LEAD GIVEN BY BRITAIN IS NOW BEING FOLLOWED THROUGHOUT THE WORLD. IN FRANCE, THE GOVERNMENT HAS ANNOUNCED ITS INTENTION TO SELL 65 COMPANIES WITH AN ESTIMATED VALUE OF 200 BILLION FRANCS OVER THE NEXT FEW YEARS. IN SWEDEN, 15 COMPANIES HAVE ALREADY BEEN SOLD. IN JAPAN, NIPPON TELEGRAPH AND TELEPHONE IS SET FOR PRIVATISATION. ITALY, CANADA, GERMANY, MEXICO, ALL ARE FOLLOWING THE BRITISH EXAMPLE.

/.. And in

COMMERCIAL IN CONFIDENCE

VC.

C HMT DTI
LPO NIO CDL
LOD DIN DIM
CO. SO MAFF
WO CS, HMT
DOE Tpt
LPSO PGO

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

4 December 1986

Commercial Management of the Royal Dockyard

The Prime Minister has seen your Secretary of State's minute of 1 December about the negotiations on commercial management of the Royal Dockyards and is content, subject to the views of colleagues, with the draft announcement attached as Annex A to his minute.

I am sending copies of this letter to the Private Secretaries to members of E(A), Michael Saunders (Law Officers' Department) and Trevor Woolley (Cabinet Office).

(DAVID NORGROVE)

Ian Andrews, Esq.,
Ministry of Defence.

COMMERCIAL IN CONFIDENCE

SK/D13

CC/BG

Caxton House Tothill Street London SW1H 9NF

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The Rt Hon George Younger MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
LONDON
SW1 2HB

4 December 1986

Dear George,

COMMERCIAL MANAGEMENT OF THE ROYAL DOCKYARDS

I have seen your minute of 1 December to the Prime Minister and the attached draft of a written Parliamentary Question, stating that there exists a basis for an advantageous contract to be placed for the future operation of Rosyth Dockyard with Babcock Thorn Ltd.

I have no objection to the release today of the PQ and the reply to the trade unions.

The implication for employment will rank high in the public response to your announcement. I believe that the Babcock Thorn contract is likely to maintain employment at a higher level than alternatives such as a Government owned PLC. If so, it would be helpful if this were made known publicly.

It would also be helpful to be kept in touch with the likely employment implications, particularly in the case of Devonport.

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

Yours,

Norman

ECON POL Privatization MIS

CONFIDENTIAL

CCBG

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London
SW1A 2HB

NBPM

4 December 1986

Dear George,

DOCKYARDS: COMMERCIAL MANAGEMENT

I have seen your minute of ~~1~~ 4 December to the Prime Minister following up your progress report of 24 November seeking urgent agreement to the release on Thursday of a written PQ announcing Babcock Thorn as the winner at Rosyth, as well as your response to the trades union paper.

I am content with both courses of action you suggest.

You are not yet seeking agreement to the contract, but I should point out now that in agreeing to fund the contractor, under certain conditions, in the event of strike action you have accepted a contingent liability. As such, your Department should report this to Parliament rather than to the NAO as you suggest in paragraph 7 of your minute.

I am copying this letter to members of E(A), Michael Havers, Patrick Mayhew and Sir Robert Armstrong.

Yours ever,

JM

JOHN MacGREGOR

ECON POL Privatization PT15

CCBG

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
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Secretary of State for Trade and Industry

COMMERCIAL-IN-CONFIDENCE

3 December 1986

The Rt Hon George Younger MP
Secretary of State for Defence
Main Building
Whitehall
London SW1A 2HB

NBPM

Dear George,

COMMERCIAL MANAGEMENT OF THE ROYAL DOCKYARDS

File with DRN.

Thank you for copying to me your minute of 1 December to the Prime Minister.

I am pleased that you have concluded satisfactory negotiations for a commercial contract to manage the Royal Dockyard at Rosyth. I feel it important, however, that any announcement should seek to allay the fears of the private sector shiprepair yards who, as you know, are concerned that the Dockyards should not be able to compete unfairly against them.

I would like your announcement to state that "there will be no subsidisation of competitive MOD work or commercial work." I understand that this accords with assurances given to my Department by your officals and I hope it will present no difficulty.

I am copying this letter to the recipients of your minute.

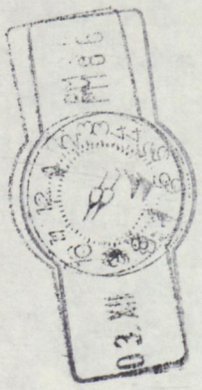
Yours,

Paul

PAUL CHANNON

JG3AHO

ECONPOL: Privatisation: PL-15.



PRIME MINISTER

COMMERCIAL MANAGEMENT OF THE ROYAL DOCKYARDS

Mr. Younger has sent you a long and tiresome minute about the position on the Royal Dockyards.

He wishes to make an announcement tomorrow, and this should ideally not be delayed in order to give maximum time for consultation with the trades unions as required by Lord Denning's clause.

The position in essence is that a satisfactory agreement with Babcock/Thorn has been reached for them to take over the running of Rosyth. There would be savings in exchequer terms, though additional costs to the defence budget in the first four or five years. The MOD would have to indemnify, beyond £4 million, costs incurred as the result of a strike. Mr. Younger believes the company would not sign unless MOD agreed to this last condition.

Negotiations on Devonport continue. If an agreement is not reached with one of the bidders a decision will be needed on whether to have one yard operated by a Government-owned plc and the other by Babcock/Thorn, or whether it would be better to adopt a Government-owned plc for both.

Mr. Younger's proposed announcement for tomorrow is in an annex to his minute. It says that there is the basis for a contract with Babcock/Thorn, that the trades unions will now be consulted further, and that negotiations on Devonport continue.

The Treasury and DTI are content with the proposed announcement. Agree that you are also content, subject to the views of colleagues?

DRN

3 December 1986

DAVID NORGROVE

CCBG

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Malcolm Rifkind MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
LONDON
SW1A 2AU

December 1986

NBPM.

Dear Malcolm.

OBJECTIVES FOR THE SCOTTISH TRANSPORT GROUP

Your letter of 20 November invited comments on the draft objectives for the Scottish Transport Group.

I am afraid that I find it impossible to see how these objectives can be reconciled with the aims of the Transport Act 1985. The main purpose of the Act is to give bus operators the freedom and incentive to run efficient, profitable services, and to leave to local authorities the responsibility for identifying and supporting socially desirable but unprofitable routes. The first draft objective invites SBG to provide "efficient, profitable" services and manage its bus operations "as it would do in the interests of private shareholders"; but the last objective requires them to "pursue the best possible standards in the provision of services and in employment practices, in support of the broader community interest". I am not clear what these words are intended to mean (are SBG?) but they seem to me to contradict or at least undermine the first objective. If SBG have to decide whether to operate on a particular route, which consideration are they to put first - efficient business management or the broader community interest, which virtually implies unprofitable operation.

I am also unhappy with the framework of operational policies. You said that you have had assurances from SBG that cross subsidy between their operating companies will not be allowed. So why not make this one of the main objectives? It would help to hold SBG to their word and would also reduce the risk of the sort of hidden cross subsidy mentioned in my letter of 17 November and in Nicholas Ridley's of 24 November, which would be very damaging to emerging competition in the bus market.

I must emphasise that I regard early privatisation as a realistic policy for the Scottish Bus Group. But until that happens it is essential that the Group should be forced to operate as a commercial business without abusing its size or public sector status. I am afraid that the draft objectives only increase my concern that this is not happening.

I am copying this to other members of E(NI) and to Sir Robert Armstrong.

Yours ever

John

JOHN MOORE

ECON POL

PRIVATISATION

PT 15

CC BG

B/f tomorrow, Wednesday, 3/12

MO 10/2L

PRIME MINISTER

COMMERCIAL MANAGEMENT OF THE ROYAL DOCKYARDS

As I anticipated in my minute of 24th November, I have now had a full report on the proposed contract for the management of Rosyth Dockyard. My judgement is that we would now be in a position to place a contract for Rosyth if it were not for two factors: the position concerning the potential contract for Devonport, and the Trades Union threat to take Court action over the process of consultation. I have also received the Trades Union paper, promised at my meeting with General Secretaries on 17th November; this contains no new points of any sort but I have prepared a full reply, which could be released at any time.

2. I am now writing to seek colleagues' agreement to my proposed course of action in the light of these factors, leading to the possibility of contract signature early in January.

The Rosyth Contract

3. Three bids were received for the Rosyth contract - from Babcock/Thorn, Balfour Beatty/Weir and the Press Offshore Group. Tender evaluation showed a clear advantage from the Babcock Thorn bid and contract negotiations have therefore concentrated on this. Full details have been circulated by my officials to the Treasury, the Department of Trade and Industry, the Property Services Agency and the Scottish Office.

4. The concept of a Term Contract to run the Dockyard is an unusual one and I believe it is to the considerable credit of our negotiators that they have succeeded in developing a contract that is in almost all respects a conventional Defence contract. In particular they have negotiated:

a. a satisfactory commitment to risk pricing;

b. an arrangement for the equitable sharing of performance improvements;

c. a satisfactory profit sharing arrangement;

d. payment arrangements which in the special circumstances of this contract are considered acceptable;

e. an equitable arrangement for the funding of redundancy costs that provides a real incentive to the Company to secure commercial work;

f. satisfactory arrangements for the protection of the Company in the event of significant industrial disruption, limited to the period up to 30th June 1988, which adequately protect our interests;

g. fair and reasonable terms and conditions of contracts; and

h. satisfactory arrangements for dealing with significant variations of load.

5. All the important issues arising from the terms and conditions of the Term and Project Contracts have been resolved satisfactorily. Although the precise wording of a small number of technical Clauses remain to be agreed between our respective solicitors, we do not expect any serious difficulty to arise in this process.

6. The provisions under f. above are particularly important to the Company, giving the current political climate of speculation over the date of the General Election and the opposition to the scheme itself. We have taken the view that the Company must win

the first battle with the Unions and cannot therefore be allowed to collapse either from lack of revenue in the early months of the contract or from significant under-recovery of overheads. We therefore intend to make payments, to avoid the company facing a serious cash flow problem, as soon as the Company incurs costs over £4 million not covered by normal stage payments, as a result of a strike. In addition we will meet any excess over £0.25 million of additional and otherwise unrecoverable costs incurred as a result of strike action. Both these support measures will be identified in a side exchange of letters and both will cease after the end of June 1988. The Company will be liable for all other consequences of industrial action throughout the seven year Term Contract.

7. Although we intend to handle this issue through an exchange of letters, rather than by a Contract clause, we will need to reveal the existence of the letters to [the National Audit Office] Parliament at an appropriate stage. The requirement from the company is, I am confident, not merely cosmetic; I do not believe they will sign without it. The agreement is therefore an essential part of the procedure for implementing Government policy and can be defended by the Departmental Accounting Officers.

8. I have naturally assessed the contract in terms of the potential it offers for value for money - as compared either with continued Ministry of Defence management or with a

Government-owned plc. The total return that we should secure over seven years from commercial management is some £38.5 million as against £15.2 million from the Government-owned plc. The annual pattern is forecast to be as follows:

Cost of production (£ million)

	86/87	87/88	88/89	89/90	90/91	91/92	92/93	93/94	TOTAL
Ministry of Defence Management		171.1	170.2	175.7	177.7	175.0	169.8	185.3	1224.8
Government-owned plc	3.4	178.0	180.1	171.8	168.0	167.3	162.3	178.7	1209.6
(saving	-3.4	-6.9	-9.9	3.9	9.7	7.7	7.5	6.6	15.2)
Babcock Thorn	3.4	179.0	175.5	173.9	170.6	162.4	154.6	166.9	1186.3
(saving	-3.4	-7.9	-5.3	1.8	7.1	12.6	15.2	18.4	38.5)

(86/87 - setting up costs only)

9. These savings are highly sensitive to the underlying assumptions. But my judgement is that, on any coherent set of assumptions, the ranking of the management options should not change. A full comparison cannot be made with the other two bidders, since we have not negotiated through to a complete contract with either of them; but at the Tender evaluation stage

Balfour Beatty Weir were judged to offer broadly the same level of value for money as Babcock Thorn, whilst the Press Offshore Group might prove at least 10% more costly. Over the period of the Term Contract as a whole the figures represent a modest total saving in Exchequer terms; but the rate of saving at the end of the contract period is much more substantial (and more uncertain) and it should offer the prospect of continuing worthwhile economy in the subsequent contract period.

10. The saving shown above are in Exchequer terms and are clearly worth having; in Defence budget terms, there will be additional costs for the first four or five years as we shall have to bear the additional cost of annual payments into the funded pension scheme - for which no compensation to the Defence budget has been obtained. But by the fifth year (1991/2) the savings will be somewhat higher than these costs, so the change to commercial management will also, in the end, provide a marginal financial saving to my Department, in addition to providing the other advantages which have always been available.

11. When I wrote to colleagues in July, I was somewhat pessimistic about the financial implications of the scheme. My calculations were then based on Mr Peter Levene's original projection of a 30% improvement in efficiency - against the

1984/85 level - and assumed that the Dockyard managements' own interim measures would yield 15% of this improvement by April 1987, leaving only the balance of 15% to be credited to commercial management. It now seems certain that the interim measures will provide only a 10% improvement by April 1987 - and Babcock Thorn are projecting, credibly I believe, a 30% improvement in direct production efficiency and a further 14% reduction in overheads together with additional economies in materiel usage. Taking these factors into account in the costings provides a more optimistic picture of the savings likely to accrue from the introduction of commercial management into Rosyth.

12. A Trading Fund - the preferred option of the Trades Unions - might secure marginally higher improvements in efficiency than would be available from continued Ministry of Defence management, but would otherwise offer little advantage. It would remain subject to Whitehall constraints, would provide only a token separation of customer of supplier, and would inevitably be able to price itself to profitability; in consequence it would be less competitive than outside industry and would fail to secure the additional work that is available to a commercially managed yard - and which would provide the Navy with better prices for its own work and mean that a larger and more efficient Dockyard was available for any emergency. There remains a final consideration: I do not believe any

Government would be able to allow free competition between a Trading Fund and the private sector (and, indeed, would not find it easy to accept the same with a Government-owned plc); the amount of commercial work that could be secured is thus likely to be very small.

Devonport

13. Three bids were received for Devonport - from Devonport Operations Ltd (led by Foster Wheeler), Devonport Management Ltd (led by Brown & Root) and Devonport Dockyard Ltd (the local management initiative). The two commercial bids were more attractive than the bid from DDL - but neither were as well developed as any of the three Rosyth bids. Negotiations have now started with the commercial bidders. The position with DDL is dynamic in that they have just come forward with financial backing from Hill Samuel to support their proposals; we now have to consider whether the disadvantages in the rest of their bid can be overcome. I shall not know whether we have the basis of a satisfactory contract for two or three weeks. If we do not, I shall then have to consider whether it is better to proceed with a commercial operation at Rosyth and a Government-owned plc at Devonport - or to forgo the advantages of commercial operation in Scotland by adopting a Government-owned plc solution for both yards.

The Trades Unions

14. Following the satisfactory completion of the contract negotiation for Rosyth, we are now in a position to tell the Unions of the broad nature of the contract arrangements, in so far as they affect their members. (I should note that the Unions have had the draft contract since April of this year, but have made virtually no comment on it; nor have they made any substantive response to our requests for views on the individual contractors - indeed the Industrial Trades Unions have refused any formal consultative meetings since July 1985 on the Royal Dockyards.) I also need to update them on the cost benefits from the scheme. I intend to include this additional information in my response to the Trades Unions' paper.

15. Further, I propose to tell the Trades Unions of the fact that there is now the basis of an acceptable contract with Babcock Thorn. In view of my undertaking to give them an opportunity to consider my reply to their paper and to take stock of the new information being provided, I intend to invite them to give me their views in time for me to be able to come to a final decision at the start of the New Year.

16. Colleagues will be aware that the currently announced timetable calls for contract signature for Rosyth by the end of November. Following their meeting with me, the Trades Unions

believe they have secured at least a month's delay in that event. And I believe that they do have to be given the opportunity to consider my Department's reply to their paper and the latest developments we now intend to put to them. They have undertaken to expedite the process of consultation and I shall of course press them to do just this - but, at the same time, they have to be given a reasonable timescale; the legal advice I have been given suggests that the period up to Christmas is a reasonable one to suggest to them in which to obtain their members' final views, with a meeting at General Secretary level shortly thereafter, if they so desire.

Recommendation

17. I therefore invite colleagues to give their urgent agreement to the following course of action:

a. the release of a written Parliamentary Question this Thursday explaining the position we have reached and naming Babcock Thorn as the preferred contractor, on the lines of the draft attached as Annex A to this minute;

b. the release, also on Thursday, of my reply to the Trades Unions on the lines set out in paragraphs 14 and 15 above - with copies to the Chairmen of the Public Accounts Committee and the House of Commons Defence Committee; and

c. subsequently, signature of the contract for Rosyth - a final decision on which I would intend to take in the light of the Trades Union response to my final consultative paper and the then current position over the Devonport contract negotiations.

18. I am sending copies of this minute to members of E(A), to the Law Officers, and to Sir Robert Armstrong.

GY.

Ministry of Defence

1st December 1986

Annex A

Draft Parliamentary Written Question

To ask the Secretary of State for Defence whether he will make a statement on the future management of the Royal Dockyards.

ANSWER (Mr Younger): I am now satisfied that there exists the basis for an advantageous contract to be placed for the future operation of Rosyth Dockyard with Babcock Thorn Ltd. Under the arrangements that have been negotiated to date, a contract could offer the possibility of saving some £38 million over the seven year Term Contract, with the prospect of annual savings exceeding £15 million a year thereafter under any subsequent contract. I have provided further information to the Trades Unions in a response to their paper of 24th November, and do not intend to take a final decision on the placing of a contract until I have taken account of any further Trades Union views and have satisfied myself that the continuing process of consultation with the Trades Unions has fully met my obligations under the Dockyard Services Act.

Negotiations for a contract for the operation of Devonport are continuing and I expect to be able to make a further announcement shortly.

A copy of my letter to the Trades Unions have been placed in the Library of the House.

ECON POL

PRIVATISATION

PT 15

001/2985

cc S/G

Treasury Chambers, Parliament Street, SW1P 3AG

NBPM.

The Rt Hon Malcolm Rifkind QC MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
London
SW1A 2AU

1 December 1986

Dear Malcolm,

SCOTTISH TRANSPORT GROUP: CORPORATE PLAN REVIEW AND 1985 PERFORMANCE REVIEW

You wrote to Nigel Lawson on ~~21~~ WILL REQUESTED IF REQUIRED October enclosing a copy of your Department's Review of the Scottish Transport Group's (STG) Corporate Plan and their financial and operational results for 1985. Since then Nicholas Ridley and John Moore have written to you with their comments and I have seen your further letter of 19 November, and Nicholas Ridley's reply of 24 November. I have also seen your letter of 20 November to Nigel proposing objectives for STG.

I share the concern expressed by Nicholas Ridley and John Moore that Scottish Bus Group (SBG) should not be allowed to abuse their dominant position in the deregulated market. At my officials' instigation, your Department included references in the Corporate Plan Review to the policy of no cross-subsidy and to the need to ensure SBG behave in a properly competitive manner, although officials here were not given the opportunity to agree the final version of the Review. I note however the assurance you give in your reply to Nicholas Ridley of 19 November that SDD are taking steps to ensure that cross subsidy is prevented and that you will be keeping a close watch on SBG's activities.

I agree with John Moore and Nicholas Ridley that in the context of bus deregulation, an early review of SBG's structure and ownership is highly desirable. When do you consider such a review would be feasible? I would also welcome an early reference - preferably in 1987 - of the SBG to the MMC .

On the ferry side, I certainly share your hope that the subsidy to CalMac will continue to fall in real terms. Given that the Performance Review (paragraph 27) makes it clear that you have advised CalMac to plan for increased revenue by fare rises in

ECON POL : Privatisation PTIS

real terms, this aim should be achievable.

I am frankly disappointed by the objectives you propose in your 20 November letter. As my officials have made clear, I have considerable doubts about the aim of maintaining rural bus services included as the second objective. These doubts are reinforced by the lack of any objective to eliminate cross subsidy between SBG's operating companies, as suggested by John Moore. Would not the objectives be much strengthened by the inclusion of the assurances you mention in your 19 November letter to Nicholas Ridley? I would also like to agree with you tough performance aims for STG as suggested earlier by my officials such as a reduction in costs per vehicle mile somewhat more ambitious than the 5 per cent real reduction by 1990 currently envisaged. Finally, what objectives do you propose for CalMac?

I am copying this letter to other members of E(NI) and to Sir Robert Armstrong.

Yours ever,

JM

JOHN MacGREGOR

MJ2COK

cc BG

CS, HMT
MAFF
D/M
CDL
DTI

LPSO.
DOE
WO.
SO
D/N
NIO
PGO
Ipr

10 DOWNING STREET

LONDON SW1A 2AA

28 November 1986

From the Private Secretary

COMMERCIAL MANAGEMENT OF THE ROYAL DOCKYARDS

The Prime Minister has seen your Secretary of State's minute of 24 November about the position on commercial management of the Royal Dockyards. She has noted that Mr Younger intends to minute again about the outcome of negotiations on Rosyth and at the same time to report the state of the negotiations on Devonport.

I am copying this letter to the Private Secretaries to the members of E(A), Michael Saunders (Law Officers' Department) and Trevor Woolley (Cabinet Office).

David Norgrove

John Howe Esq
Ministry of Defence

CCBH

CABINET OFFICE
WHITEHALL, LONDON SW1A 2AS

Chancellor of the Duchy of Lancaster

Tel No: 233 3299
7471

27th November 1986

The Rt Hon Malcolm Rifkind QC MP,
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
LONDON
SW1A 2AU

WBPM

D Malcom,

SCOTTISH TRANSPORT GROUP

I have followed with interest the correspondence which began with your letter of 21 October to Nigel Lawson and currently rests with Nicholas Ridley's letter of 24 November.

I have found the points made both by Nick Ridley and John Moore compelling, and strongly suggest that there should now be a collective re-consideration of whether the time has now arrived to privatize the Scottish Bus Group.

I will not reiterate the points put by Nick Ridley and John Moore, with which I agree, but I should emphasise that there is a wider political context.

The Government's measures to deregulate the bus industry are a success story; one from which I hope it will be possible to draw many good examples in the coming months, in just the way that John Moore did in his speech to the Conservative Political Centre on 25 October. But there are two ways in which action taken in Scotland can undermine that. First, if the actions of the SBG or public authorities acting in support of local bus services mean that the benefits of competition do not flow through to local services in the way that they should, and as has been demonstrated in England and Wales. In that event, damaging examples to our case will be found in Scotland. A potent instance of this is the way in which the apparent effect of deregulation on bus services in Glasgow was given such prominence in the press that it partly obscured the positive messages coming through at the same time all over the country.

Secondly, it will undermine the actions taken by Ministers in England and Wales if in the parallel case of Scotland, a broadly equivalent view is not taken of the means by which the bus industry can develop. For example, it is hard to reconcile John Moore's remarks in the same speech to which I referred, when he said:

> "It is not for a local planner or bureaucrat to decide whether a route is profitable. He can't possibly know whether it is.... .... whereas in 1985 the Greater Manchester Council Transport Committee had said that 90 per cent of routes in the area were in need of subsidy (in other words only 10 per cent were commercially viable), when the commercial registrations were completed it was found that the market's answer was that 56 per cent were commercially viable".

with the proposition in your letter of 19 November that because the SGB services have a very large rural component, this makes them particularly unattractive commercially. As Nick Ridley rightly says, that may be so, but it has been amply demonstrated in England and Wales that the right route to take is of privatisation, the elimination of cross-subsidy (with its consequent decline in service) and the use of open tender, where routes are genuinely not viable without subsidy. To persist as we do in Scotland implies two conflicting set of premises about how our bus services can be made more efficient and be encouraged to develop.

I am copying this letter to members of E(NI) and to Sir Robert Armstrong.

Yours
Norman

NORMAN TEBBIT

Privatisation: ECON POL

1715.

cc BG

B/F Thursday.

MO 10/2E

Prime Minister 2
For information.
DRN
27/11

PRIME MINISTER

COMMERCIAL MANAGEMENT OF THE ROYAL DOCKYARDS

I last reported to you on the proposals for the introduction of commercial management into Devonport and Rosyth Dockyards on 22nd July 1986. I am writing to bring you up to date on developments since then.

Contract Negotiations

2. On the contractual front, there has been good progress. For Rosyth, I am expecting to receive a submission early next week, reporting the outcome of negotiations with Babcock Thorn and seeking a final decision on contract signature. As soon as I have satisfied myself with the recommendations, I intend to minute again on the way ahead and seek your agreement to the proposed course of action; we could therefore be in a position to announce a decision early in December.

3. For Devonport, the three bids have been fully evaluated and contract negotiations have begun with the two commercial consortia - Devonport Operations Ltd, led by Foster Wheeler, and Devonport Management Ltd, led by Brown and Root. The management bid, Devonport Dockyard Ltd, has not yet succeeded in its search for

adequate financial backing and may shortly withdraw. The first round of contract negotiation will be completed this week and I will report on progress, in the context of my recommendation on the way ahead for Rosyth.

Employment Prospects

4. In September, we released the details of the likely employment levels that would follow from any decision to adopt a Government-owned plc for the Dockyards. The business plan assumptions for these held out the prospect of employment levels in Rosyth falling from 5,900 to some 4,700 and in Devonport from 11,500 to 6,500 over the early years of operation as Government-owned plcs; these reductions stem principally from the significant fall in the level of work available from the Royal Navy and to a lesser extent from efficiency improvements; they are not a consequence of Government-owned plc management as such. We argued that only through commercial management was there any prospect of improving on these figures (in that a commercially managed dockyard would be able to secure higher levels of efficiency and therefore win a higher percentage of the Navy's competitive programme of work and bring in commercial work on a more significant scale). The news of the potential job losses, particularly in Devonport, has of course not been welcomed - but I believe it has been generally beneficial to get the bad news out in the open.

The Trades Unions

5. The Trades Unions remain implacably opposed to the introduction of commercial management and are using every opportunity to delay implementation. The Industrial Trades Unions have refused to make use of my Dockyard Planning Team's consultative group since July 1985; the non-Industrials have done rather better - both at national and local level - but have recently concentrated on the issue of consultation itself rather than the substance of our proposals. In this they are seeking to exploit the possibility for delay opened up by Lord Denning's amendment to the Dockyard Services Act, which gives them the right to take action in the High Court or Court of Session over an alleged failure to inform and consult.

6. I met a group of General Secretaries and other representatives of the Dockyard industrial and non-industrial Trades Unions on Monday 17th November. They explained their reasons for preferring a Trading Fund within the civil service, arguing that this would enable the Government to meet its objectives of separating the customer from the supplier, giving local management the freedom to manage, and introducing the discipline of commercial accounting; whilst they suggested that commercial management presented risks to national security, particularly from the potential presence of foreign contractors in any winning consortium.

7. The Unions have had our response to all these points on many occasions. Nonetheless, when we met I agreed to examine the arguments that they are about to submit in writing - and to let them have a response in the following week with a commentary on their views and a restatement of the justification for our proposals. By the time this process is complete and the Unions have had a few days to consider our views, I hope that E(A) colleagues will have had an opportunity to come to a decision on the way ahead for Rosyth. I intend then to offer to meet the Unions again on the basis that I am about to announce a decision; we shall then see whether their threat of court action is a bluff.

8. In all this, we are of course taking legal advice; Counsel have been retained in England and Scotland so that we shall be able to respond quickly in the event of legal challenge. It will be important that any legal issue is determined rapidly if we are to have any prospect of having commercial operation in place by Vesting Day on 6th April 1987; if it is not, then there is a serious risk that the Dockyards will still be under threat of industrial unrest through the Summer. The objective of the opposition - both political and Trades Union - is to prevent the introduction of commercial management; their first step is to endeavour to bring about a delay to Vesting Day in the belief that by then we will be in the run-up to a General Election, which, they hope, will lead to the abandonment of the scheme. For my part, I

am sure that we need to remove uncertainty as soon as possible, not least in the interests of the workforce and of the Royal Navy, and should therefore hold firm to our timetable.

9. I am sending copies of this minute to members of E(A), to the Law Officers, and to Sir Robert Armstrong.

G.G.

Ministry of Defence

24th November 1986

ECON POL

PRIVATISATION

PT 15

cc BG

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

24 November 1986

The Rt Hon Malcolm Rifkind MP
Scottish Office
Dover House
Whitehall
LONDON
SW1

NBPM.

Dear Malcolm

Thank you for your letter of 19 November. I am afraid it did little to reassure me. I would make further points:

First you argue that services run by SBG have a large rural component which makes them unattractive commercially. That may be so, but surely that is completely irrelevant to the ownership of SBG? If they are running them uncommercially they should not be running them. They can be made commercial by the use of subsidy paid by local authorities on the basis of open tender. The implication of your argument is that these services are being supported by cross subsidy which is exactly what the bus policy was designed to get rid of as it is responsible for so much of the impoverishment of the market on good routes. I would point out that there are many rural areas in England where local authorities are making substantial savings and cross subsidy is being eliminated.

Second on the "assurances" about cross subsidy, I seem to remember being assured by the NBC that they were not cross subsidising their operations, but I also remember that it was quite impossible to be sure because much of the cross subsidy was not in the form of straight transfers of funds but in the apportionment of costs, pooled use of equipment and so on. As for the argument about loans, I would imagine a publicly owned company like the SBG can borrow at favourable rates of interest - another distortion of the market in its favour.

You argue that a 5% reduction in operating costs is unrealistic. I do not accept that it follows because most of the SBG now operates with a driver and no conductor that there is so little room for reduction in operating costs. I remember that an analysis was done of the operating costs of NBC subsidiaries and enormous variations in costs were found not because of different wage levels but partly because of different shift arrangements in different companies. Before the legislation was introduced an analysis was done for Surrey County Council in Guildford which found that private companies could save about 20% of the costs of the local NBC operation, not by reducing wages but by using staff time more effectively.

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PTS

I entirely support John Moore's suggestion that the behaviour of SBG in Glasgow should be subject to an MMC inquiry and I would suggest that it should certainly look at its competition and monopoly powers. I am very disappointed that you feel unable to refer them next year, I would urge again that your Department should consider a break up and sale of the SBG. I am concerned like John that the publicity given to the SBG's behaviour both now and in the event that they kill any competition may bring the bus policy into disrepute at a very sensitive time politically.

I am copying this letter to members of E(NI) and to Sir Robert Armstrong.

Why not just get ahead & privatize it?
The arguments you put forward are totally unconvincing!
Yours Tom

NICHOLAS RIDLEY

010

cc BG

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

20 November 1986

NBPM.

Dear Nigel,

OBJECTIVES FOR THE SCOTTISH TRANSPORT GROUP

I attach a draft of the objectives which I propose to set for the Scottish Transport Group (STG). This draft has been discussed with your officials and also with the Chairman of the STG Board. STG consider that the objectives should be confined to the general statements under the heading of "objectives", but I believe that it is necessary to set out a number of operational policies which the Group should follow in order to achieve these objectives since otherwise the way in which they are to be attained is insufficiently specific.

Unless colleagues have any comments I intend to write to the Chairman of the STG Board with these objectives.

I am sending copies of this letter to members of E(NI) and to Sir Robert Armstrong.

Yours ever,

Malcolm

MALCOLM RIFKIND

CML32401

OBJECTIVES FOR THE SCOTTISH TRANSPORT GROUP

The Group's function is to operate road passenger and ferry transport services in and to and from Scotland.

OBJECTIVES

The Group's strategic objectives in the provision of bus services should be as follows:-

1. To manage its bus operations as it would do in the interests of private shareholders seeking in particular to retain customer goodwill and to provide efficient profitable services.

2. Having regard to the bus group's important role in the provision of rural services, to maintain services in these areas both through the development of commercial opportunities and in participation in the tendering process, consistent with the framework for achievement of operational objectives set out below.

3. To explore and develop potential new markets and new methods of service provision.

4. To pursue the best possible standards in the provision of services and in employment practices, in support of the broader community interest.

FRAMEWORK FOR ACHIEVEMENT OF OBJECTIVES

In seeking to achieve the above objectives the Group's plans and actions should be consistent with the following operational policies:-

1. The achievement (year on year) of an adequate return on capital employed in accordance with the financial target set by the Secretary of State.

2. The establishment of a challenging system of cost control including targets for year on year reductions in unit costs.

3. The establishment of arrangements for the regular review of standards of service.

4. The achievement of performance aims agreed with Government.

5. The containment of external financing requirements within the limits set by Government.

6. The proper appraisal of new investments.

7. The provision of regular information to Government in a form suitable for monitoring performance in relation to target and financial limits.

cc BG

NEW ST. ANDREW'S HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

The Rt Hon Nicholas Ridley MP
Secretary of State for the Environment
2 Marsham Street
LONDON
SW1P 3EB

19 November 1986

NBPM.

Dear Nick,

Thank you for your letter of ~~29~~ October about the Scottish Transport Group's (STG) Corporate Plan Review.

You say that you had hoped that some consideration would be given in the period which has elapsed since the publication of the Buses White Paper in July 1984, to the future structure and ownership of the Scottish Bus Group (SBG). As you mention in your letter you agreed that there should be no change in the ownership of the SBG "at present", ie in the context of deregulation. The factors which led to that decision have not changed. The services run by SBG have a very large rural component, which makes them particularly unattractive commercially. My main pre-occupation at the moment is with the functioning of STG as a going concern and that is, in my view rightly, the thrust of the current corporate plan review.

As far as the structure is concerned, SBG in June 1985 reorganised its bus subsidiaries into smaller units (13 as against 6). You question the value of the assurances I have obtained on the question of cross-subsidy. These assurances are, first, that SBG's financial target - to seek an average annual return of 4% on average net fixed assets at current cost, adjusted to take account of capital grant on an historic cost basis over the period to 1990 - is to be applied to each of the 13 operating companies. This will apply equally to express services - a relatively small part of the total enterprise - as to the territorial companies. Arrangements are being established to allow regular financial monitoring by the Scottish Development Department. Second, any transfers of assets or loans, including short-term loans between subsidiary companies or between the holding company (SBG) and a subsidiary, are to be conducted at arm's length. Third, arrangements have been agreed in principle to ensure that lending by the Group to subsidiary companies will be on commercial terms. I consider that these are useful safeguards.

JSS02608

You express surprise about the projected increase in manpower of SBG in the first 2 years of deregulation. Given that our objective in the Buses White Paper was to reverse the decline of the bus industry we should not, I think, be too surprised if there are some increases in manpower in the industry. In this case the increases are mainly in the Strathclyde area where the municipal operation (Strathclyde PTC) has shed a large amount of labour from its higher cost operation in anticipation of deregulation. SBG has responded by increasing its activities and labour force, though not to the same extent as Strathclyde has contracted.

You question whether a 5% real reduction in operating costs per mile by 1990 is a tough target. Given the large component of a bus company's operation attributable to wages, and the fact that SBG now operates practically all of its buses with a driver and no conductor, the scope for operating cost reductions is bound to be limited and a 5% real terms reduction implies holding wage increases below the rate of inflation.

I am aware of the relatively strong position of SBG and I intend to keep a close watch on their activities. Moreover, I am not averse on principle to their being the subject of a reference under section 11 of the Competition Act 1980. As you know, we did not think that 1984 would be a good year for such a reference, given that they were preparing for deregulation. However 1987 will see them some way into deregulation and it might be an appropriate time for the Commission to look at their general efficiency - and, of course, the opportunity would arise also of looking into the questions of competition and use of monopoly powers. However, you may know the Office of Fair Trading (OFT) are investigating certain specific complaints about SBG and until it becomes clear that OFT's investigations are not going to impose significant burdens on SBG in 1987 I do not think it is possible to reach a decision on an MMC reference in that year.

Copies of this letter go to members of E(NI) and to Sir Robert Armstrong.

Yours ever,

MALCOM RIFKIND

JSS02608

ECON POL Privatization PT14

PART 14 ends:-

SS/DOE TO SS/SCOTLAND 29/10

PART 15 begins:-

SS/SCOTLAND TO SS/DOE 19/11

Grey Scale #13

C Y M

A 1 2 3 4 5 6 M 8 9 10 11 12 13 14 15 B 17 18 19

Inches 1 2 3

1 2 3 4 5 6 7 8

Centimetres

Colour Chart #13

Blue Cyan Green Yellow