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COMPENSATION AND PRIVATISATION OF SHIPBUILDING

Memorandum by the Secretary of State for Industry

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1. We are encountering great difficulties on compensation for the nationalised shipbuilding and aircraft companies. Those 14 companies whose values declined between the reference period and vesting day have settled. But six companies, British Aircraft Corporation (BAC), (Vickers and General Electric Company (GEC)), Vosper, Yarrow, Brooke Marine and Hall Russell, are strongly pressing the Government to change the terms of compensation. The value of all these six companies in the three years between the reference period set by the Nationalisation Act for the purpose of valuation and vesting day rose strongly and the differential between the reference period value and the possible vesting day value has produced a sense of outrage. The issue of compensation is also closely linked with the determination of policy on privatisation.

THE OPTIONS

2. The possible options can be summarised as:

i. To change the compensation terms of the 1977 Act and not to privatise.

ii. To try to meet the unfairness of the compensation terms by offering the warship yards back to the previous owners at compensation values.

iii. To offer the yards back at market value.

iv. As variants of ii. and iii. to offer up to 75 per cent of the equity of the yards with the Government retaining a minimum of 25 per cent to prevent foreign control.

v. To accept the recommendations of the Minister of State for Industry to the Ministerial Committee on Economic Strategy, Sub-Committee on Economic Affairs that privatisation should not proceed this year and that there should be no change in the basis of compensation.

3. These options are discussed below but the considerations attaching to each are summarised in the matrix at Annex A.

SHOULD THE TERMS OF COMPENSATION BE CHANGED (OPTION i)?

4. Any new legislation to change the terms of compensation would be retrospective and would create a whole new range of problems and fresh unfairness. It would be resented by the thousands who sold their shares in Vickers, Yarrow and Vosper on the basis of the previous terms of compensation. It would cost at least £130 million to give a choice of an alternative and later reference period. Reversing the compensation terms of a previous Parliament would set a precedent. I would not recommend exchanging one hornet's nest for another, particularly at such a cost to the Exchequer.

OFFER BACK AT COMPENSATION VALUE OR MARKET VALUE (OPTIONS ii and iii)?

5. These options involve privatisation of British Shipbuilders (BS) and the substantial adverse effects including disruption of the industry are discussed in paragraphs 13-15. As will be seen from Annex B the previous owners have expressed some interest, in principle, in repurchasing but without much enthusiasm and subject to the proviso that the sale price is related to the compensation to be paid. It will be noted that Vosper in particular envisaged the formation of a warship division as an intermediate step before the company is offered back to the original owners because of probable trade union reaction.

6. A sale at compensation value would be an arbitrary figure which took no account of the changes in asset value since vesting or in future prospects. We should be criticised for selling below market value at the expense of the taxpayer and it would encourage further the Opposition to threaten to renationalise at arbitrary and penal levels. The attitude of the Opposition could make it impossible to float British Aerospace and damage our general privatisation programme.

7. It would be no defence to argue that, with compensation not being settled, the yards in question could be handed back to the former owners on the basis that 'the contract' for their takeover by the State has not been implemented. There is no legal basis for such an argument. The yards are vested in BS through an Act of Parliament which also sets out the basis for compensation, but the transfer of title has taken place regardless of the fact that compensation remains to be assessed. Arbitration is provided for if compensation cannot be agreed.

8. On top of these difficulties we must expect other former owners, apart from the warshipbuilders, to demand comparable treatment. There could be even one or two instances in the shipbuilding industry which would add to uncertainties. I should certainly expect the former owners of BAC (Vickers and GEC) to lobby hard with Sir Arnold Weinstock to the fore. We could not give them the same treatment because their previous undertakings are no longer discrete businesses within British Aerospace and we are committed to denationalising them as a single unit. Nevertheless, the argument could well influence the outstanding compensation negotiations about BAC which have come very close to settlement.

9. If, however, we sell back the yards following negotiations on an estimated market value based on merchant bank advice, the difficulties will be considerably mitigated but not altogether removed. Unless the yards are sold by flotation, there is no demonstrable market value and the Opposition will, no doubt, suspect that the sale price to the previous owners will have been affected by other considerations.

10. Preliminary indications of market value are that the result may not be very different in some cases from compensation value, as illustrated at Annex C. In some cases, of course, the differential could be sufficient to bring sharply back into focus the 'inadequate' level of compensation.

#### PREVENTION OF FOREIGN CONTROL (Option iv)

11. We need to consider whether to take steps to prevent subsequent sale of the warshipbuilders by the previous owners to foreign buyers. This would involve inter alia the retention of a minimum Government 25 per cent shareholding following the pattern envisaged for British Aerospace.

12. Such a step could be helpful in attracting moderate opinion and would be seen as desirable particularly in the case of Vickers with the involvement in Trident. However, such a step could make it harder to satisfy the previous owners.

#### SHOULD WE DEFER PRIVATISATION WITHOUT ANY CHANGE IN COMPENSATION TERMS (OPTION v)?

13. The options on sale to the previous owners involve immediate privatisation and are also inextricably linked with future policy on the shipbuilding industry. The adverse consequences of immediate privatisation which we would have to reckon with are in brief:

- i. An adverse effect on the Public Sector Borrowing Requirement of some £50 million because the advance payments of the warshipbuilders (£76 million) held on deposit by BS far outweigh possible disposal value.

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ii. Serious disruption of the industry which could cost a further £50 million, and aggravation of the difficulties in handling any further contraction of the industry in areas of already very high unemployment.

iii. The Opposition could regard the legislation as so controversial that it would probably adopt delaying tactics over the whole Government programme and we would, therefore, have to resort to frequent use of the guillotine.

14. The new Chairman of BS has stressed that sale of the warship business would render the prospect of returning to viability the remaining part of the industry unlikely of achievement. In his view there would be immediate resignations from the Board, and acceleration of the loss of key personnel, the withdrawal of co-operation by the unions and a further decline of the industry with serious implications for the marine equipment industry whose stability is already threatened.

CONCLUSION

15. While I fully appreciate the deep seated sense of grievance felt by former owners whose assets rose in value before vesting day, I see no acceptable way of changing the terms of compensation. The disadvantage of immediate privatisation seem to me so overwhelming as to preclude any early offer back of former yards.

16. I therefore seek my colleagues' agreement to announcing a deferment of privatisation with no change in the terms of compensation either through an oral statement or written Parliamentary Question on the lines set out at Annex D.

K J

Department of Industry

29 July 1980

	Options		Statement timing	Legislation needed	Financial costs	Political costs	Disruption risk	Grievances met/created
	Compensation	Privatisation						
(i)	Change terms of 1977 Act	No	After Recess	Yes Controversial	At least additional £130M	Set precedent for over- turning retro- spectively compensation terms approved by Parliament; one set of unfairness exchanged for another.	Small, but handling of further contraction due to finan- cial pressures more difficult.	Satisfy previous owners. Anger shareholders who had sold on previous basis
(ii)	No change	Offer back at compensation related values.	Before Recess	-do-	Diff. between compensa- tion & re- payment of deposits held by BS (£76m) + disruption costs	Dangerous precedent, threats of renationali- sation at penal levels, endanger BAe de- nationalisa- tion.	Great; at £50m for 3 month delay. BS Board resignations, loss of key personnel, loss of union co-operation on restruct- uring and productivity. Adverse impact on merchant & defence pro- gramme incl. Trident. Additional redundancies. Adverse impact on marine equipment industry.	Possibly satisfy some previous owners but dissatisfy previous owners of BAe.
(iii)	-do-	Offer back at market related values	-do-	-do-	Diff. between market value and deposits held by BS - say £50m + disruption costs.	Threat of re- nationalisation.	Less likely than (ii) to satisfy some previous owners but still dis- satisfy others.	
(iv)	-do-	75% of (ii) and (iii)	-do-	-do-	Disrup- tion costs + repayment of deposits but only 75% of sale value.	As in (ii) & (iii)	As in (ii) and (iii)	
(v)	-do-	Not this year	-do-	No	-	Implementation of Manifesto commit- ment to privatise deferred, and compensation grievance drags on.	None	No grievances met. No new grievances created.

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VIEWS OF PREVIOUS OWNERS - EXTRACTS FROM LETTERSVosper

"There are a number of ways to achieve privatisation, but in view of the timescales envisaged and current objections from the Trade Unions to de-nationalise, there might be merit in undertaking this operation in two parts:-

- 1 To form a separate Company to control the three lead Warship Yards and this Company would be responsible direct to the Department of Industry or the Ministry of Defence. This would still be a nationalised organisation, somewhat similar to Aerospace. The Directors of the Controlling Company would in the main be from Industry and the Company would operate a central Marketing and Sales Organisation and also co-ordinate design work undertaken in each yard.
- 2 Subsequently to return the Warshipbuilding Industry to the private sector in which respect the following options are submitted for consideration:-
  - a Offer each Company back to the original owners on a mutually agreed basis which would be related to the amount of compensation ultimately received and the then financial circumstances of the companies.
  - b To offer shares to the public in the Controlling Company referred to in (1) above, either wholly or if preferred a "BP" arrangement.
  - c As (b), but for each company separately."

Yarrow

"In regard to the denationalisation issue, there are a number of ways by which this objective could be achieved and they are given purely as a basis for discussion and without knowledge of the present financial circumstances of Yarrow (Shipbuilders) Limited and their future prospects. Yarrow and Company's favoured choice would be re-acquisition of Yarrow (Shipbuilders) Limited as a wholly-owned subsidiary for a mutually agreed price not greater than the amount of compensation ultimately received. If the Government wished to retain some public sector participation or to allow Trades Unions and employees to have a proportion of the equity, this would be a matter for negotiation but Yarrow and Company would wish to retain more than 75%.

If the Government preferred a "BP-type" arrangement involving a formal grouping of the three principal warshipbuilders within a holding company, Yarrow and Company would be willing under certain conditions to subscribe for a proportion of the equity of such a company. The three previous owners should have a prior option to subscribe for agreed proportions of the equity capital, at a share price bearing the same relationship to present net asset values as the compensation settlements will bear to net asset values at vesting date.



Within this framework arrangements could be made for the Government to retain a minority interest and to make shares available on subscription to Trades Unions, employees and the public."

Vickers

"On the assumption that the activities of the warshipbuilders are not inextricably interwoven with the remainder of the industry, and subject to suitable safeguards on the allocation of future naval orders, I feel that urgent consideration ought to be given to hiving off this sector to private industry. I have no strong views as to whether this should be a complete offer, or whether it should be on the lines of the proposed British Aerospace placing.

I would submit that there is a very strong case in equity for respecting the position of the former owners by offering them pre-emptive rights which would take account of the price at which the assets were acquired from them in the first place.

I do understand that this proposition is fraught with difficulties and certain to arouse opposition from Trades Unions and others, nevertheless, there is a mandate to do so and there is for the time being sufficient relevant management to make it successful."



Company	S R Claim £m	DOI existing offer £m	DOI final offer £m	Possible offer by Ministerial Discretion £m	Rothschilds present valuation (i) £m
Vickers	16.7 <sup>(ii)</sup>	12.21 <sup>(ii)</sup>	-	-	13 - 32.5
Vosper	35.4	4.5	4.8	4.8	4.8 - 12.0
Yarrow	12	4.6	5	6	5.2 - 13.0
Brook Marine	4.5	1.25	1.45	1.5	- (iii)
Hall Russell	3.5	1	1.25	1.7	- (iii)

- (i) Rothschild valuations are based on simplifying assumptions and are, therefore, to be regarded as theoretical possibilities not professional valuations. Rothschilds have serious reservations whether the market would adopt these assumptions, which include profitability and loading remaining as at present, and have advised, informally, that the market would be likely to work to the bottom of the range.
- (ii) Arbitration claim and offer.
- (iii) Since Hall Russell and Brook Marine are not forecast to make profits in 1980/81 and are likely to make a loss on an inflation adjusted basis Rothschilds believe it is unrealistic to expect to be able to float them separately

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DRAFT STATEMENT ON COMPENSATION AND PRIVATISATION

The House will know that the Government has been considering whether now is the appropriate time to announce proposals to introduce private sector capital into shipbuilding and shiprepair. This review was begun when there were some signs of recovery in the market and there was still a reasonable expectation that BS would be able to get on course for their financial limits this year without the need for substantial corrective action. As I told the House last week these hopes have been disappointed. There are still considerable uncertainties surrounding the industry and the Chairman has advised us that to introduce private capital at the present time would make substantially more difficult his task in making the Corporation viable and inevitably delay the time when viability is achieved. We have accordingly decided to defer proceeding at this stage.

2 Generally the only part of BS which could have attracted private capital at the present time are the specialist warshipbuilders. I have received many representations about the yards from the previous owners on the unfairness of the compensation terms laid down in the 1977 Nationalisation Act. While in Opposition, we strongly criticised these provisions and rightly so. However, the introduction of amending legislation would create new difficulties and fresh unfairness for the shareholders who sold on the basis of the present terms. In the light of these difficulties and after the most careful and sympathetic consideration of the representations made to me, I have with reluctance concluded that we cannot change the present compensation provisions.