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CABINET

COMPENSATION AND PRIVATISATION OF SHIPBUILDING

Memorandum by the Secretary of State for Industry

1. I was invited to submit a further memorandum in consultation with the Secretary of State for the Environment and others concerned on the option of immediate privatisation at compensation value (CC(80) 31st Conclusions, Minute 6). Under this option the former owners of the warshipbuilding yards would be asked to choose between accepting their yards back at compensation value or accepting compensation on the basis of the present compensation provisions of the nationalisation Act. A variant of this is not to change the present compensation terms but to introduce legislation for privatisation and offer back at market value which in the most critical cases may not be far off the likely compensation price. The main alternative is a deferment of privatisation and no change in present compensation provisions.

CASE FOR IMMEDIATE OFFER AT COMPENSATION VALUE

2. The arguments in favour run as follows:

- i. The terms of nationalisation are an outrage representing, in the case of Vosper, one year's purchase of 1977 profits. Adverse financial consequences should be accepted to right such an injustice.
- ii. There should be no adjustment for any change in assets or market value under British Shipbuilders (BS). Equally, no assurances should be given to the former owners about future orders. The object is to offer the opportunity of restoring the position to what it was before the nationalisation Act.
- iii. Comparable treatment cannot be offered to Lord Weinstock in respect of the British Aircraft Corporation because the aircraft industry has become too integrated since nationalisation. This is not sufficient reason for refusing to deal with the grievances of the warshipbuilders where action is still possible.

iv. The offer should not be diluted by any retention of a Government shareholding to prevent foreign takeovers. The companies remained satisfactorily in private hands before nationalisation. In any event, reserve powers to prevent a foreign takeover exist under the Industry Act 1975.

v. British Shipbuilders' contention that privatisation should wait until BS is viable is a recipe for indefinite procrastination. There is no sign that BS would be attractive to any private investor in the foreseeable future, and if we wait there is every risk that the warshipbuilders will be infected with the same malaise as the merchant shipbuilders. Only restoration to private enterprise will make the companies competitive again in export markets, and this is all the more important because of the Ministry of Defence (Navy)'s reduced requirement for surface warships.

vi. If we hold our hand because of fears of disruption, it will be impossible to roll back the frontiers of socialism. The acceptance by the unions of the sale of British Rail's hotels shows what can be done in the present new climate.

THE CASE AGAINST IMMEDIATE PRIVATISATION AT COMPENSATION VALUE

3. The difficulties and disruption of immediate privatisation whether at compensation value or market value are set out in paragraph 8 but there are special difficulties attaching to offering back the yards at compensation value.

i. It ignores our duty to the taxpayer to realise the best price, and is no consolation to the thousands who sold shares in the companies concerned in the knowledge of the terms of compensation.

ii. It is an arbitrary valuation ignoring any changes in financial circumstances eg capital investment since the reference period. This will further encourage the Opposition to threaten to renationalise at an arbitrary and penal valuation which could put in jeopardy the flotation of British Aerospace and our general privatisation programme.

iii. It will compound the problems of dealing with the former owners of the British Aircraft Corporation who will see themselves deliberately discriminated against and with both the Burmah Oil Company and its shareholders who may draw comparisons with the Government's position on the ex-Burmah British Petroleum shareholding.

4. While the concept of handing back the yards at "compensation value" appears at first sight an attractive solution, implementation through the legislation required poses formidable problems. The nationalisation Act vested shares and the debentures of the companies with BS. The assets underlying the shares have changed. The taxpayer through BS have, for example, invested £30 million in the warshipbuilders, and the position under the debentures and long-term liabilities of the companies will also have changed. The situation cannot be restored to what it was before nationalisation.

5. If privatisation were to be at market value, the price would adjust for changes in the assets and liabilities since the reference period six years ago. However, if the sale were to be done at "compensation value", which will be represented by the Opposition as being substantially below market value, it appears essential to cover in the legislation what assets and liabilities are being disposed of. Even though no great difficulty should arise on the physical assets, the warship owners and Parliament would need to know such things as whether the tax allowances would remain with the companies or be taken by BS for Group Relief, the treatment of loans to and from BS, the apportionment of surpluses and liabilities under pension funds, the permitted level of dividends prior to sale, etc. It would be necessary for the Bill to have safeguarding provisions to prevent BS stripping the companies prior to sale. General powers would also need to be taken to recover payments on account on compensation together with provision for interest.

6. If the Bill were to be confined to the specialist warshipbuilders, Hall Russell and Brooke Marine, the risk of the Bill being declared hybrid would be great. If the Bill, to avoid hybridity, were to apply to all the shipbuilding and shiprepair companies of BS then the safeguarding provisions at least initially would have to apply to most of BS's operations. The warship owners and anyone else interested in having some or all of their assets back on such terms would need to know precisely what they were taking on before they took their decision on taking back the yards and implementation by an order subject to negative resolution directing BS to sell at a stated price.

7. A long and complex Bill would be needed, and it probably could not be ready for introduction much before Christmas. The warship owners and any other former owner interested would need time to study the provisions of the Bill and discuss them with the Department before making up their minds. There would thus be a long period of uncertainty and controversy for both the shipbuilding and shiprepair industries.

IMMEDIATE PRIVATISATION?

8. These considerations would appear to point strongly to any privatisation being based on market value which, in some cases, may be near compensation value particularly when the prospects for surface warships become public knowledge. However in my view, we should not proceed now

on privatisation against the advice of the Chairman of BS and the equipment suppliers, against the background of a prospect of further substantial contraction both on naval shipbuilding and on merchant shipbuilding in areas of very severe unemployment, with substantial effects also on the Public Sector Borrowing Requirement. Our immediate task is to handle the further contraction and cut BS's losses and cash requirements. The co-operation of the workforce, which the Confederation of Shipbuilding and Engineering Unions, supported by the middle management, would withdraw in the event of privatisation, will be essential.

NEED FOR STATEMENT

9. An announcement of Government policy before the Recess is essential on political and industrial grounds to end uncertainty. No statement could be made on a change in compensation provisions since it would take some months to work out the details of an agreed new formula for compensation and a premature announcement would fuel speculation. Similarly a statement that the Government would introduce legislation to hand back yards at compensation value would involve speculation and questions which we could not answer at this stage, and if colleagues should decide on this option a holding statement as at Annex A seems desirable. Draft statements on the other options are attached.

10. Colleagues are invited to decide between the following options on the basis that no change would be made in the compensation provisions under any option.

- a. Immediate privatisation of shipbuilding at compensation value giving first option to former owners of nationalised assets.
- b. Immediate privatisation at market value with first option for the former owners but with the question of a Government equity holding of a minimum 25 per cent subject to negotiation and further consideration.
- c. Deferment of immediate privatisation.

K J

Department of Industry

5 August 1980



NO COMPENSATION CHANGE - PRIVATISATION AT COMPENSATION VALUE

As the House will know, the Government has been considering whether to introduce private capital into the nationalised shipbuilding and shiprepair industries. We have consulted widely with those concerned and we have concluded that it would be in the best long term interests of these industries and the taxpayer to bring proposals before the House in the autumn to facilitate the introduction of private capital in accordance with our Manifesto commitment.

2 We recognise that in practice private buyers will only be interested immediately in the profitable warshipbuilders and possibly one or two shiprepair companies but in our view the restoration of private enterprise and the reintroduction of competition offer the best prospect of reinvigorating these sectors particularly in export markets, and the most hopeful outlook for employment.

3 Former owners will be given first option to purchase. We strongly criticised the compensation provisions of the 1977 Act and rightly so, and it is therefore proper that these owners should be given first option on the assets removed from them by nationalisation.

4 The Government has received representations from some former owners of yards that the terms of purchase should not be very different from the terms of compensation. The Government accepts that this might represent the most equitable solution and will be considering this point further. As a first step further merchant bank advice will be sought as to possible market values which in some cases could be at or near the compensation price.



NO CHANGE IN COMPENSATION PROVISIONS - PRIVATISATION AT MARKET VALUE

As the House will know, the Government has been considering whether to introduce private capital into the nationalised shipbuilding and shiprepair industries. We have consulted widely with those concerned and we have concluded that it would be in the best long term interests of these industries and the taxpayer to bring proposals before the House in the autumn to facilitate the introduction of private capital in accordance with our Manifesto commitment.

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3 Former owners will be given first option to purchase on the basis of negotiations at market value. It is right that they should have first option on the assets removed from by nationalisation. We shall be seeking further merchant bank advice on market value.

4 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 but the former owners will have first option to buy back their assets.



NO CHANGE IN COMPENSATION PROVISIONS - DEFERMENT OF 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.