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19 July 1984

CABINET

WARSHIPBUILDING PRIVATISATION

Memorandum by the Secretary of State for Trade and Industry

INTRODUCTION

At their 15th Meeting the Ministerial Steering Committee on Economic Strategy Sub-Committee on Economic Affairs (E(A)) agreed that the privatisation of warshipbuilding should be referred to Cabinet and that E(A) should, beforehand, consider the prospects for merchant shipbuilding capacity. E(A) on 18 July will discuss a paper on merchant shipbuilding (E(A)(84) 43) and I will be able on 19 July to report the outcome as it affects warshipbuilding. On warshipbuilding, we need to decide when and how to privatise the warshipbuilding interests of British Shipbuilders (BS) and how to deal with overcapacity. The procedure to be followed by the Ministry of Defence (MOD) in placing orders for two Type 22 frigates will be crucial in defining the future of the industry under whatever ownership.

PRIVATISATION

2. We have a Manifesto commitment to privatise a "substantial part" of BS. In practice, this means concentrating on warshipbuilding. Potential purchasers with whom we have held discussions have made clear that they would be severely deterred by any prospects of having to compete with nationalised warshipyards particularly any based in politically sensitive areas. Schroder Wagg agree. We must recognise therefore that privatisation of BS on an appreciable scale means privatisation of all the warshipbuilders which are not closed.

3. The yards affected, their current order book and present and potential capacity are shown at Annex B (which also includes Harland and Wolff). Annex C shows MOD's expected pattern of orders. Two of the affected yards, Swan Hunter and Cammell Laird (CL), have in the past employed significant numbers of non-warship work. BS in their Corporate Plan consider that while Swan Hunter is competitive for warshipbuilding, it is uncompetitive for merchant shipbuilding (with current employment of 3,800) from which it should withdraw leading to substantial redundancies. Similarly BS consider that CL has no favourable prospects for further offshore work and should concentrate, if it survives at all, on MOD work.

4. I set out my views and recommendations on the handling and timing of privatisation in E(A)(84) 23, discussed at E(A)(84) 11th Meeting. Those agreed are summarised in Annex A. I now ask colleagues to agree that we should proceed to privatise BS's warship operations as described in Annex A. Overcapacity will have to be dealt with anyway; it does not affect the principle of privatisation, and we must not allow it further to delay the process of privatisation.

#### THE CAPACITY PROBLEM AND THE TYPE 22 FRIGATES

5. E(A)(84) 11th Meeting initially agreed that the Government's defence plans required a healthy, competitive warshipbuilding industry, for which it would be essential to deal with overcapacity. I subsequently circulated (Annex D attached) a statement on BS's preferred strategy for warshipbuilding. This confirmed that their preferred strategy would be to concentrate warshipbuilding in Vickers, Yarrow and Swan Hunter, that CL should close on completing its present order book, and that Vosper Thornycroft should cease steel ship construction at Woolston and concentrate on glass reinforced plastic construction there. This accords with Schroder's advice. Although E(A) agreed that the problem of overcapacity had to be dealt with we are not agreed on the scale of the problem, principally because of a difference of view on export prospects. The Secretary of State for Defence believes that the gap demonstrated in the graph at Annex C could be partially filled by exports, merchant work and refits. In view of the industry's record, I regard this as an unrealistically optimistic view. Most members of E(A) considered it most unlikely that exports could be won at realistic prices on any scale likely to diminish the problem of overcapacity in warshipbuilding. I continue to believe therefore that we must allow the warship sector to contract from five yards to four.

6. We have to choose whether we should allow BS to follow their preferred strategy and to allow CL to close, or whether MOD should place an order for a Type 22 frigate with CL. Although this does not accord with BS's preferred strategy, BS have set out in Annex D and Annex E an alternative strategy which would permit CL to take a Type 22 order but which requires a commitment from the CL workforce and a commitment from MOD to another order (conversion of the Balder London).

7. Although at one point the CL workforce appeared to be moving to accept commitments of the sort BS would seek from them, the industrial relations problems at CL have recently worsened: work has now been stopped on the two remaining jobs in the yard. Local union officials say that before the industrial action is lifted the threat of redundancy must be removed and a number of other conditions must be met. The Chairman of BS, Mr Day, has now written to me saying that the action casts even greater doubt over the possibility of achieving the scenario for the survival of CL; that to place an order unconditionally with CL in the present circumstances would be interpreted as ceding to blackmail; and that it would totally undermine the authority of BS management and the credibility of its industrial relations strategy. If Ministers do

wish to place a contract with CL, he considers it vitally important that the award of contract should be made publicly subject to unequivocal acceptance by the workforce of -

a. reduction to a core level of employment, determined by BS, by means of selective compulsory redundancy as a means of retaining a balance of skills amongst the best employees;

b. full and immediate commitment from all employees to implementation of the local phase V agreement on improved working practices and productivity; and

c. an agreement that there should be no further disputes or stoppages by employees outside procedure.

8. The Secretary of State for Defence has argued that the MOD should be allowed to place an order for a single Type 22 frigate with CL because their tenders have been the lowest submitted. He argued that it would be wrong to force CL to go through a third round of tenders when they had clearly won the first two rounds in open competition. But CL only won the first round because they assumed that the yard's overheads would be spread over other work. This was optimistic at the time and the particular assumption is now clearly wrong. CL's latest management accounts show that the yard anticipates a loss of some £7.4 million on the contract. I regard it as quite unacceptable for CL to take an order on this basis, especially when the tenders have expired. Not only would this be unfair to other BS yards but it is also a matter which Her Majesty's Government, as owner and financier of BS, could not ignore. BS have also indicated that even a contract on the basis of the January 1984 tender would need to be "subject to a number of difficult contractual points being agreed between BS and MOD". In particular, I still agree with those at E(A) who argued that CL must tender at a price which is designed to avoid the risk of CL making a loss; and that, should CL win the tender, any cost overruns should be borne by the Defence budget and not by the Department of Trade and Industry or by the contingency reserve.

9. There are, however, more important considerations. If CL win an order for a Type 22 frigate, it will be at the expense of another yard, probably one better regarded by BS. This will mean further redundancies, possibly in the North East, an area already hit hard by unemployment and which will suffer further with the continuing contraction of BS merchant shipbuilding and enginebuilding activities under their Corporate Plan.

10. I remain opposed to keeping CL open artificially by granting them a Type 22 frigate order without further competition. The arguments all point in the direction of allowing all the yards to retender, with a realistic present view of overheads. If CL lose this competition, I believe it should be allowed to close. If CL win one or both orders buyers should be sought for it as for the other warshipyards. We would have to recognise, however, that if CL did remain open, overcapacity would remain with gratuitous risk to the successful privatisation of the whole warship operation.

RECOMMENDATION

11. I recommend that -

a. we should now agree to honour our Manifesto commitment on shipbuilding by requesting British Shipbuilders to privatise their warshipbuilding interests in the way described in Annex A;

b. the Ministry of Defence should invite CL, Swan Hunter and Vosper Thornycroft to retender for two Type 22 frigates as described in paragraph 10 above.

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Department of Trade and Industry

16 July 1984

## MEANS OF PRIVATISATION OF BS'S WARSHIPBUILDING INTERESTS

1. This annex considers the issues on privatisation.

Sale Proceeds

2. I do not have an estimate of the likely proceeds of any disposal route which is robust enough to offer with any confidence. But, as a very rough guide to the order of magnitude, Schroders estimated that floating four of the five together might raise £75 - 100 m. But we will probably have to continue funding the construction of Vickers' new Submarine Facility. A £45m Eurobond will also have to be repaid early.

Disposal Method

3. We have to decide on the best means of disposal, on who should be responsible for the negotiation and on the timing of disposal. On the first, the main options are:

- (i) to dispose of all the saleable yards as a group by flotation;
- (ii) to sell Vickers separately and float the other three;

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(iii) to sell the yards to individual buyers, some individually and some of necessity grouped together.

4. Flotation (i.e. options i and ii) would have the presentational benefit of being a sale open to all. But it would leave MoD with monopoly suppliers. Any attempt to counter criticism of these, e.g. by indicating that MoD might look abroad, or to the rump of BS, or increasingly to Harland and Wolff, to provide competition would damage the flotation's prospects of success.

5. The attractions of disposal to individual buyers are that competition would be preserved and that disposal could take place with more speed. There are two main drawbacks:

- it runs the risk of resulting in only incomplete privatisation. If we follow this route we must therefore be prepared to see some yards grouped together if they are not saleable separately. We may also need to contemplate selling yards at realistically low prices if that is the only way to get them into the private sector. There would be obvious criticisms;
- whether or not the price is a realistically low one, individual disposals will open the way to allegations that public assets are being sold off cheaply to the Government's supporters. The criticisms of the Trafalgar

House bid for Scott Lithgow illustrate the kind of attack we must expect. To counter this we will need to arrange, and be able to demonstrate, that the various packages are open to bids from all comers. We will also need to make it clear that there is no link whatever between the sale price and the question of nationalisation compensation.

6. Because of the attractions of the possible preservation of some competition and because it promises to be a quicker route I propose that we should go for sale to industrial buyers. However, recognising the risk that it might not achieve full privatisation (or privatisation producing unacceptably low proceeds), and also to strengthen our negotiating hand, we should simultaneously take the necessary steps to prepare for a possible public flotation.

#### Handling and Timing

7. It is our responsibility to decide what is to be sold. But I propose that we hand over the detailed task of negotiating sales to the Chairman of BS, Mr Day, who has shown his negotiating ability with Scott Lithgow, and who is fully committed to privatisation. We will need to give Mr Day unequivocal and detailed instructions about the principles we wish to see adopted - e.g. on scope, methods, and speed. Subject to Mr Day's views, I believe we should require him to make substantial progress towards completing the sales, on satisfactory terms, by March 1985 or by the end of 1985 if a flotation proves necessary.

Summary

8. I therefore recommend that we should agree now to transfer all warshipbuilding to the private sector, and that we should achieve this by instructing British Shipbuilders to take the lead in the disposal negotiations, that they should seek to sell the yards individually or in groups, but that we should simultaneously prepare for a possible public flotation, and that we should require BS to make substantial progress towards completing sales by March 1985 or by the end of 1985 if flotation proves necessary.

13 July 1984



1. British Shipbuilders

Key Facts: The Five Large Warshipbuilders:

<u>Yard</u>	<u>Description</u>	<u>Current Employment</u>	<u>Completion of Current Order Book</u>
Cammell Laird	Merseyside Frigates: Offshore rigs:	) 1704*	Dec 84
Swan Hunter	Tyneside Frigates: Merchant Ships:	3530 3800	Jan 88
Vosper Thornycroft	Southampton Frigates & GRP (glass reinforced plastic) vessels, such as minesweepers: Merchant:	3800 630	Mar 85
Yarrow	Glasgow Frigates & GRP vessels:	5520	Dec 87
Vickers	Barrow Submarines: Engineering	8220 4200	Building Trident Subs into 1990s

\*From completion of current round of redundancies



2. WARSHIPBUILDING CAPACITY

(excluding submarine building at Vickers)

<u>UK Capacity from 1986 (a)</u>	Minimum Capacity	Maximum Possible Capacity
Cammell Laird (b)	1.5	2
Swan Hunter	2.5	2.5
Vosper Thornycroft	0.5	0.5
Yarrow (c)	1.5	2.0
	---	---
	6.0	7.0
ADD (if H&W bids for AOR)		
Harland & Wolff	1.0	1.0
	---	---
	7.0	8.0
<u>Demand (a)</u>		
Orders pa (Average of 1985 - 1990)		
Frigates	3	3
AORs	1	1
	-	-
	4	4

Further demand might be generated from exports, refits, merchant work and second stream submarine building.

Notes

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- (a) 1 AOR build time approx = 1 Frigate
- (b) 2 now, decreasing to 1.5 if yard restructured
- (c) 1.5 now, increasing to 2 if module hall built

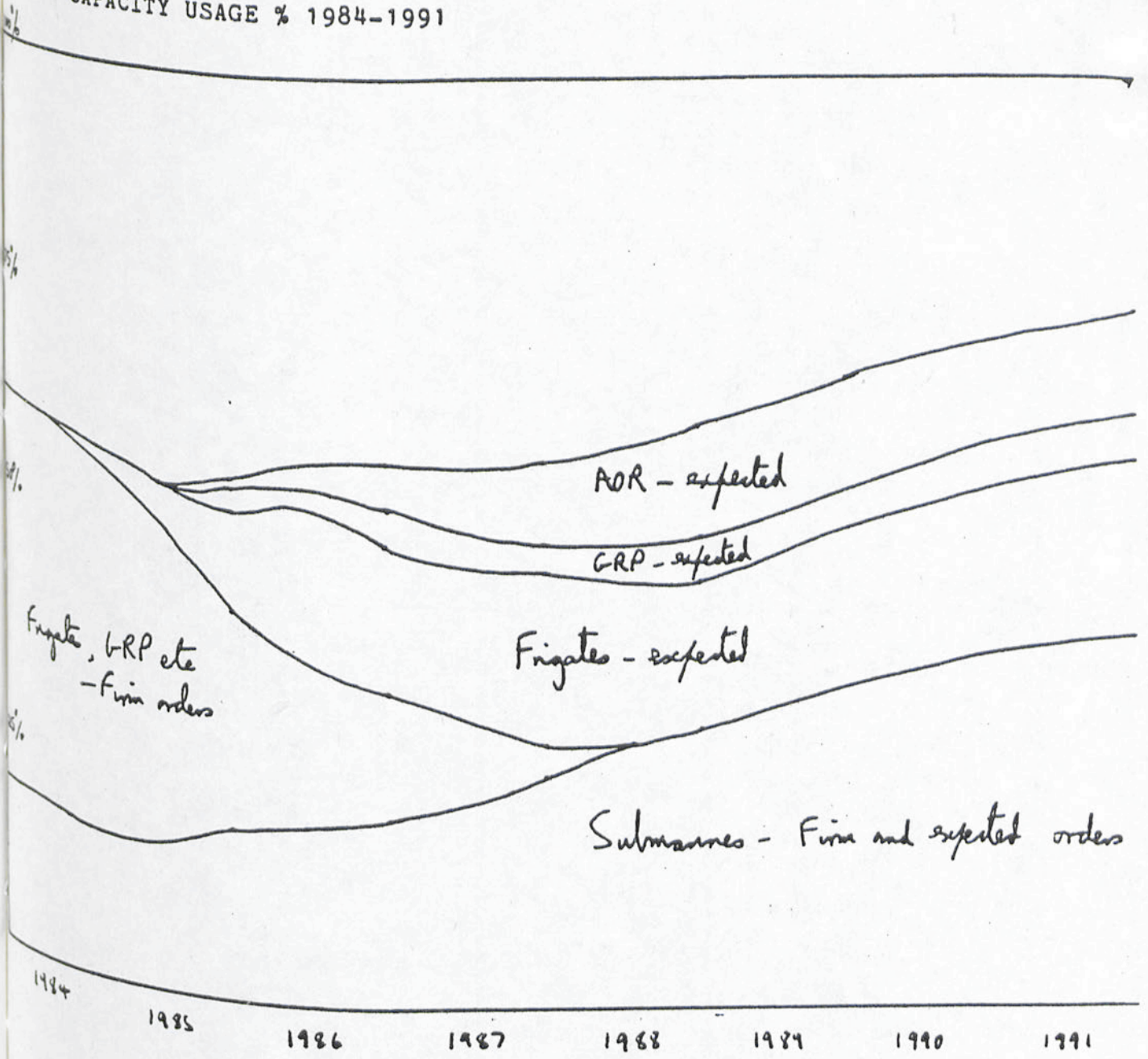
DTI

11 July 1984

WARSHIPBUILDING

ANNEX C

CAPACITY USAGE % 1984-1991



Note: This graph assumes all expected RN new construction work is divided amongst British Shipbuilders' yards. In practice there may also be export, refit or merchant orders. On the other hand, Harland and Wolff will also be tendering for warship orders.

DTI  
1 May 1984

STATEMENT OF BRITISH SHIPBUILDERS VIEWS (AGREED WITH BS)

WARSHIPBUILDING

1. This note describes British Shipbuilders' preferred strategy for the future of the warshipbuilding industry, sets out the place that CL occupies in that strategy and indicates the possible consequences for other yards if CL is retained as a warshipbuilder.

Preferred Strategy and role of CL

2. In the light of what British Shipbuilders (BS) know of MOD's future order plans, BS recognises that there is excess capacity, especially given Harland and Wolff's increasing presence in the market for Royal Fleet Auxiliary orders, conversions and refits.

3. Given this excess capacity, BS' preferred strategy would be to concentrate warshipbuilding in Vickers, Yarrow and Swan Hunter. With the completion of the existing MOD orderbook at Cammell Laird and in the absence of further alternative work, the yard would close. Vosper-Thornycroft would cease steel ship construction at Woolston and concentrate at that location on GRP supported by some refit work.

Alternative Strategy

4. However, BS faces at this time an extremely volatile IR situation, with significant cost implications, which has to be handled against a backdrop of widespread industrial unrest nationally. BS have recently secured agreement in all yards except VT(UK) and Vosper Shiprepair to a wide-ranging productivity agreement. BS need a period to build on these agreements and to implement changes in working practices. The MOD, the principal customer on whom the future of Cammell Laird depends and the owners (HMG) are regarded, by the workforce, as very closely identified. It is, therefore, difficult to present convincingly the argument that the market is walking away from CL.

5. BS has therefore to consider whether there is a case, on commercial grounds, for handling this situation in a different way. The judgement is finely balanced. The Corporation has however come to the view that the commercial interest of the rest of its business requires it to explore an alternative which would make it easier to handle the CL problem. The alternative strategy has been described in

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 Annex E

6. BS emphasise that, if the Trade Union and the CL workforce were not prepared to accede to or implement the conditions set out in part (i) of Annex B then BS would not be prepared to allow the yard to undertake any MOD work and there would then be little alternative to closure of the yard. This emphasis on the need for commitment by the workforce (including the implementation of the productivity agreement, acceptance of selective compulsory redundancy etc) places responsibility for securing a future for the Birkenhead facility firmly and visibly in their hands. BS believes that the preconditions may not be accepted in which case the consequent closure of Cammell Laird would then be seen to be the fault of neither BS nor HMG. If BS have to move towards closure disruption will hamper delivery of the rig and destroyer currently under construction.

7. If the conditions were accepted by the workforce, the outcome, although not preferred by BS, would not be unacceptable. The yard would at least be put onto a sounder footing (although this is only a short term concern, as CL would go out of BS with privatisation).

Effect on other warship yards if Cammell Laird retained as a warshipbuilder

8. This is difficult to access with any certainty. There are other factors which would have greater impact on the other yards, and which are as yet unknown eg the placing by the MOD of the AORs and the T23 orders. The main@enance of capacity at Birkenhead would however divert orders from other yards, and hence could reduce their profitability (or increase their losses). Swan Hunter, VT(UK) and Yarrow could be affected depending on how future MOD orders are placed. While there will be some indeterminable impact on the prospects for privatisation they are not in BS's view severely reduced. BS recognize, however, that the proceeds from the disposal of these yards would be reduced if CL were retained as a warshipbuilder.

9. The effect on Vickers of Cammell Laird being attached to it are also difficult to predict. Potential purchasers may well be attracted by the synergy of the combined Vickers/Cammell facility eg the ability to place overload on Vickers submarine work in Birkenhead and the capacity to compete in surface warships. They could however be deterred by Cammell Laird's poor financial performance (even with a T22 and refit work) and the reputation of its workforce. Combining Cammell Laird with Vickers could therefore reduce the sale price of Vickers.

Disposal of CL as a separate entity

10 An alternative to closure, at least in theory, would be disposal of CL as a separate entity to a third party. BS has pursued this and is aware of two possibly interested parties. It is however far too early to plan on the assumption that negotiations, which have not begun, would reach a successful conclusion. Moreover the third parties might wish to acquire the asset following closure or may not be interested unless there were some assurance of an appropriate and continuing workload to match the lower levels of employment which are now inevitable. Actions needed to achieve these lower levels have already been put in hand, being necessary whichever option for the future of CL is adopted.

SUMMARY

11 The optimum solution to the overcapacity in warshipbuilding with BS is the removal of Cammell Laird and the Woolston yard of VT(UK) from steel warshipbuilding. The alternative scenario for Cammell Laird was devised as a means of resolving short term difficulties with the least possible risks to BS of costly industrial relations problems. If, as is probable, the necessary prerequisite factors for the strategy are not accepted, it will at least produce a more acceptable route to closure.

SBP1  
31 May 1984

CAMMELL LAIRD SURVIVAL STRATEGY

This note describes the steps needed in BS' view to secure the survival of CL as a division of Vickers Shipbuilding and Engineering Limited:

- i) Commitment from the workforce, including acceptance of:
  - a) selective compulsory redundancy as a means of reducing the workforce to core levels whilst retaining a balance of skills amongst the best employees;
  - b) implementation of the recently secured local agreement on improved working practices and productivity;
  - c) no further disputes or stoppages (outside procedure);
  
- ii) Commitment from MOD, including:
  - a) the Balder London conversion (non-competitive contract);
  - b) A Type 22 (contract based on January 1984 tender - competitive contract terms);following which CL could compete for a submarine (Otter) refit and a follow on T2400 conventional submarine, either or both of which could be replaced by a second Type 22.
  
- iii) Restructuring the business:
  - a) severe curtailment of site area, surplus buildings and equipment to achieve savings on rates, maintenance, running costs etc;
  - b) restriction of activity at Birkenhead to a production facility only with all design,

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and most administration and other support services being provided by Vickers Shipbuilding and Engineering Limited in Barrow. The Companies Act status of Cammell Laird would be removed, though the name would probably be retained as part of VSEL.

DTI  
31 May 1984

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