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Press Office
R

PRIME MINISTER

HONG KONG: CASTLE PEAK B POWER STATION

I am very glad to report that the negotiations in Hong Kong have gone well and that the negotiating committee which conducted the discussions on behalf of China Light and Power (CLP) and their partners, Esso Eastern, has recommended to the respective Boards that the UK offer should be accepted. Final clearance may take a few days, but Esso hope Board approval will be given by 27 March which would allow a Letter of Intent to be signed before the end of the month.

During the discussion, CLP again showed the tough bargaining attitude experienced during the previous negotiations for the Castle Peak A Station and Transmission contracts. They were assisted on this occasion by two teams of international consultants (from the USA and Switzerland) and they queried the UK prices for a large number of items whose combined value amounted to over 60% of the total. The equipment suppliers were forced to make a number of price adjustments and in all a price reduction of about £28 million was agreed. Most of the reductions were made by Babcock Power because the GEC Turbine Generators' prices were, according to the consultants, much more competitive.



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From the Government side the only concessions made were those agreed by Ministers in respect of consultancy services (these will now cost about £13.5 million which is well below the limit of £20 million agreed at the meeting of EX on 21 January) and the reduction of Cost Escalation premium to 1%. Capitalisation of interest which was agreed at EX on 9 March was not offered.

When informing the UK team of their decision to accept the offer, the CLP/Esso negotiators stressed that they would be severely embarrassed if any premature disclosure took place before Board approval was obtained. It has therefore been agreed with them that publicity arrangements should be carefully coordinated. This is the largest export order for power generating equipment that UK firms have ever won (about £550 million and likely to reach over £600 million with variations), and will provide over 34,000 man years of employment, the majority of which are in the assisted areas. I have no doubt that we should ensure the maximum publicity is given to this achievement. We shall be considering further how this can best be done in consultation with the companies, CLP and Esso Eastern. But the most likely timing is an announcement on 30 March simultaneously here in London and in Hong Kong, where Peter Carrington will be visiting the Castle Peak site on that day.

I am copying this letter to Members of EX Committee, George Younger, Humphrey Atkins, and Sir Robert Armstrong.

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23 MAR 1987



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Hong Kong
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10 DOWNING STREET

PRIME MINISTER

Confirmation from Sir Keith, that barring a last minute hitch, we have won the Castle Peak B contract without the additional concessions which were agreed at the last meeting of EX Committee. The contract still has to be endorsed by the Esso Eastern Board; until it has been, no announcement can be made. It is hoped that the contract can be announced on 30 March when Lord Carrington will be visiting Hong Kong.

T2

T.P. Lankester

24 March 1981

Handwritten: Hong Kong TPL 1/13

PRIME MINISTER

Handwritten: MS. Hay Kap

Castle Peak B

Kenneth Baker told you that we have won the Castle Peak B order. This was news to us. However, I have now spoken to the Department of Industry who tell me that the order appears to have been won without the further concessions that were agreed could be given at the last meeting of Ex. The Department and the companies don't yet have absolutely firm confirmation that the order has been secured; therefore, nothing should be said about it for the time being.

Keith Joseph will be minuting you reporting the outcome of the negotiations on Monday.

T. P. LANKESTER

20 March, 1981.



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of the Director
PRIME MINISTER

CASTLE PEAK "B" STATION, HONG KONG

At EX on Monday (EX(81)2nd) Cecil Parkinson and I were invited to reconsider the case for any further subsidy measures beyond the capitalisation of interest agreed at the meeting. We were invited to consult the Chairman of GEC with a view to persuading GEC to finance any further concession on the price offered.

2 Officials here have talked to GEC, and in addition to Babcocks since the latter are in fact responsible for more than 50% of the total contract price. Officials have also kept in continuing touch with the negotiations in Hong Kong.

3 Briefly, the negotiations in Hong Kong have concentrated upon the hardware prices: the CLP/Exxon side, advised by an American consultant, have challenged more than 60% of the price items. Between them the British companies have conceded more than £20 million to keep within the range of what CLP/Exxon argue as internationally competitive. So far, therefore, the contract prices appear to be moving towards agreement, though further pressures from the customer cannot be ruled out. Negotiations on the financing terms are under way.

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Prime Minister

*Sir Keith has decided -
at least for the moment -
not to press for the
cost escalation concession.
He says GEC may be
able to get the contract
without it. R*

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4 In officials' discussions with GEC and Babcocks the companies have pointed out that ECGD's Cost Escalation Scheme was drawn up in such a way as to provide an incentive to companies using the Scheme to control their costs by requiring them to meet 10% of the total cost of increases above the threshold. At a threshold of 7%, with inflation at 11%, the company's contribution over the whole order would be some £15 million. In the course of undertaking a hardware cost-cutting exercise, with possibly further demands from the customer to come, the companies were understandably reluctant to take on further liabilities, which would not arise if the hardware negotiations broke down. This seems a not unreasonable approach given the state of the negotiations.

5 CLP/Exxon have not intimated formally that they wish to question the Cost Escalation threshold. Obviously, until they do, the question of adjusting the threshold from 7% to 5%, at a net present value cost to the Government of £16 million, does not arise. From the outset it was envisaged that no concession would be made until demonstrably necessary.

6 In view of the concern of colleagues, our negotiators in Hong Kong will make no move on the Cost Escalation threshold issue. If it becomes crucial our negotiators are reasonably

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sure that they could hold a final decision until Ministers can be contacted. If the issue does become crucial I shall press the companies again. For the moment, therefore, I would not press this, though I would wish to keep open the alternative of returning to colleagues if the threshold issue becomes the lynchpin for securing the order and if I cannot persuade the companies to bridge the entire gap or most of it.

7 The project remains of great industrial importance, with implications ranging far wider than Hong Kong itself; it would preserve good quality employment in the areas of highest unemployment in the United Kingdom; and its failure would have serious implications for the prospects of British industry in Hong Kong, an aspect particularly stressed by Sir Murray Maclellan when he called on me yesterday. I very much appreciate the readiness of colleagues to accept the capitalisation of interest.

8 I am copying this to Members of EX and to Sir Robert Armstrong.

Catherine Bell

PP

K J

12 March 1981

(Approved by the
Secretary of State and
signed in his absence)

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