



Copy to:

PS/Chancellor of the
Exchequer
PS/Foreign Secretary
PS/Trade Secretary

MINISTRY OF DEFENCE
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Telephone 01-~~9381022~~ 218 2111/3

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31st August 1982

MS

Dear John,

051 LUDA CLASS REFIT: CHINA

Your letter of 5th August to the Chinese Ambassador referred to his discussions with the Prime Minister over the inclusion of levy in the prices submitted to China for the Luda Refit Programme. You indicated that the Government was prepared "to consider constructively how in the specialised circumstances of this Project the levy might be reduced or waived in the interests of securing a settlement satisfactory to both parties".

Since your letter we have had further talks about this and have been able to agree on the removal of the levy from the prices and its replacement by a profit sharing agreement between the Government and Industry. Industry has also accepted these proposals. The effect of the decision on prices will depend on the final outcome of the contract discussions between UK Industry and the Chinese Government, but we expect it to lead to a price reduction of some £2.5M in the total programme cost of about £120M.

Although we have always viewed the 051 programme as a single project, two major contracts are involved: one with British Shipbuilders for the supply of Sea Dart, valued at about £70M; and the other with Vosper Thornycroft for the integration of the equipment fit into the Luda Class Destroyers, valued at about £50M. Discussions on both contracts are proceeding with the aim of possibly reaching final agreement in advance of the Prime Minister's visit.

The main outstanding problem concerns the Vosper Thornycroft price where the difference between the two sides is currently about £6M. The Ministry of Defence offered to examine the prices quoted by both British Aerospace and Vosper Thornycroft to see if these are fair and reasonable. This exercise has been done and we are satisfied that the profit margin and charges are fair. Indeed in the case of the Vosper's contract the profit sought by the company is

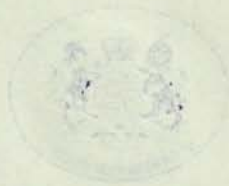
A J Coles Esq



substantially below what the Ministry would expect to allow in a fixed price contract of the same value, despite our view that the contract carries substantial technical and commercial risks. We hope that, with the benefit of these official assurances and the waiver of the levy, the Chinese will be more amenable and that the gap can be bridged. However, because the major benefits of the levy waiver apply to the British Aerospace contract, where price is not a major issue, we are anxious to make the concession on levy conditional on a satisfactory outcome of the negotiations on both contracts. We are informing the Chinese Government, therefore, of our willingness in principle to waive levy at a saving to them of some £2.5M, subject to the successful conclusion of negotiations with both British Aerospace and Vosper Thornycroft. The fact that this has been replaced by a profit sharing arrangement between the Ministry of Defence and the companies concerned should be kept discreet and is not being revealed to the Chinese.

Yours ever,

J. E. Ridley
(J E RIDLEY)(MISS)



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