



FROM THE
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FOR INDUSTRY AND
INFORMATION TECHNOLOGY

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22 April 1983

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Dear Minister,

STC AND THE TAT8 TRANSATLANTIC SUBMARINE TELECOMMUNICATIONS CABLE

A rather complex problem has arisen for STC (Standard Telephones and Cables Limited), the UK market leader in submarine telecommunications cabling, in its bidding for the proposed fibre optic transatlantic cable TAT8, which will come into service in 1988.

The normal practice for conventional submarine cable systems is to ask the supplier for a 2 year warranty. This STC has always provided; their conventional cable systems are in fact built with a 25 year life expectancy. STC has indeed been willing on frequent occasions to undertake replacement of parts outside the warranty period (dependent of course on the circumstances). For TAT8 however, at the insistence of AT&T - which is by far the largest shareholder in the consortium which will own TAT8 - the request for quotation has included a requirement for quotes involving 5 year and 10 year warranty periods in addition to the normal 2 years.

This requirement causes serious difficulties for STC for a number of reasons:

- (i) STC cannot ignore the requirement if its bid is to be compliant;
- (ii) if STC cannot put in an aggressive and compliant bid, their standing with P&Ts (many of which are members of the TAT8 consortium) will be seriously and adversely affected;
- (iii) the potential total liability implied is well in excess of STC's net worth and the company could not of itself take on the risk;



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(iv) possible market cover (which could be up to 50% of the liability) will not reduce the risk to one that STC could stand by itself;

(v) STC's competitors, Western Electric a wholly owned subsidiary of AT&T, and Submarcom, the nationalised French submarine cable company, do not share the same problems in carrying the risk. Western Electric has behind it the resources of AT&T (annual turnover in excess of Denmark's GNP); to this extent AT&T's motives in pressing for the 10 year warranty must be suspect. Submarcom, as a nationalised industry, will undoubtedly have French Government support if it bids.

I regard it as particularly important that STC bids, and bids realistically, for this contract. Fibre optic submarine telecommunications will rapidly replace conventional technology and will be the dominant technology for new transoceanic system by the turn of the decade. TAT8 will be the first transoceanic fibre-optic cable and those companies participating in this contract, especially as main contractor but also the subcontractors, will be in a very strong position when it comes to future business. The Government has already recognised the importance of this technology. Under the Fibre Optic Scheme we have given STC an understanding to provide up to £12½m to assist them in developing the technology. STC recognise that Western Electric, following the deregulation of AT&T, are poised to challenge them seriously in world markets; if they cannot bid aggressively for TAT8, their future market position could be seriously weakened.

It is also, of course, in BT's interest (they will own 22% of TAT8), and indeed other P&Ts, that there is effective competition for the TAT8 cable.

We have considered at length the basis on which we might support STC, having first made sure that they take full recourse to the commercial insurance market and make a realistic contribution from their own resources. At present, all STC require is an agreement in principle that the Government will be prepared, if necessary, to provide some residual contingent support; the precise nature of any such support will only be determined after contract award and much nearer to the time of operation of the cable.

STC are prepared to put in a bid with a reducing warranty requirement with time; they believe that they can argue that a bid on such terms would still be compliant and it would significantly reduce the liability in later years. Beyond

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commercial market insurance, from which they are expecting to cover at least 50% of the reducing liability, they will, out of their own resources, be prepared to meet liabilities of up to 10% of the contract cost. They are therefore looking to the Government to cover any remaining liability (which would reduce significantly with time and which would not come into play until the third year of operation, ie 1991).

I intend, subject to your agreement, to indicate to STC that the Government will in principle be prepared to provide such cover, if the need arises, subject to the following conditions:

(i) the maximum liability will be £50m in 1991 (year 3 of operation) and will decline in later years;

(ii) STC are to make maximum use of available market cover; we will need to establish a mechanism to ensure that this is done.

(iii) STC to use market cover and to make a realistic contribution from their own resources (probably up to 10% of contract value) before HMG's cover can be called ie HMG's support is last call cover;

(iv) a progressive reduction of the Government cover to be agreed with STC.

I would intend that the guarantee for this cover should be given under section V of the Science and Technology Act.

As I noted above, we need at present only indicate to STC our agreement in principle to provide such cover. Time is tight and STC's bid has to be in by 9 May. Their Board will have to consider our offer and I would therefore hope that you might be able to give your agreement to the course proposed by 29 April.

My officials have already sent details of this case to your officials; if there are any points of detail to be resolved, my officials will be immediately ready to discuss these.

Yours sincerely

Nick Nicholson

for KENNETH BAKER

approved by the Minister