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MW

Prime Minister ②
To note and await
an approval from the Heseltine
MR TURNBULL AT 27/4 CONFIDENTIAL

27 April 1984

FUTURE OF THE ROYAL DOCKYARDS

We support Peter Levene's proposals which are an imaginative and determined attempt to bring commercial reality into the Royal Dockyards.

We have followed Peter's investigations with great interest and have discussed his conclusions with him.

His proposals for contractor management are designed to enable the Dockyards to meet the operational needs of the Fleet better and at less cost. In particular they will establish a degree of competitive and commercial discipline and introduce a customer-supplier relationship between the Fleet and the Dockyards.

However, we do have two concerns with the contractor management concept.

Firstly, we would wish the contractor to have an appropriate degree of commercial responsibilities for the assets which would remain in Government hands. We suggest that the contractor should lease the assets at commercially negotiated rates and have a significant voice in capital investment and strategic planning.

Secondly, we are unclear whether these proposals would optimise the use of available capacity for ship refits in both the dockyards and the warship yards. It will be important to maximise that part of the Navy's programme which would be open to competition from the contractor managed dockyards and the private sector.

The problems in the Dockyards require a radical solution. Although these proposals will not be easy to implement, they are greatly to be preferred to the alternative option of a Trading Fund. This would retain the Dockyards in the Civil Service and reduce the prospects of effective commercial pressures.

Nevertheless, there is a more radical approach to the problem. A complete transfer to the private sector would be the logical outcome of a desire to introduce commercial and market disciplines.

Privatisation would be complex but not much more so than the present proposals. The question of the sale of "strategic" assets can be exaggerated as our policy on the Royal Ordnance Factories has shown. We also do not consider that the question of unplanned work of high naval priority is an insurmountable difficulty, particularly as it accounts for only 6% of the normal programme.

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Conclusion

Peter Levene should be given every encouragement to develop his concept in more detail. However, we recommend that the option of privatisation should also be considered further.

DLP

DAVID PASCALL

MINADH



10 DOWNING STREET

From the Private Secretary

8 May 1984

Future of the Royal Dockyards

BF 1

This letter is to confirm that, following a conversation between them, the Prime Minister is content that your Secretary of State should develop the Levene proposals for the Royal Dockyards, consulting industry as necessary. She looks forward to seeing a paper for Ministerial discussion in due course.

I am copying this letter to Callum McCarthy (Department of Trade and Industry), David Normington (Department of Employment), John Graham (Scottish Office), John Gieve (Chief Secretary's Office), Henry Steel (Law Officers' Department) and Richard Hatfield (Cabinet Office).

Andrew Turnbull

Nick Evans, Esq.,
Ministry of Defence.

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SH



10 DOWNING STREET

From the Private Secretary

Prime Minister ①

I understand Mr Heseltine spoke to you about this. Can I confirm that you were content that he should develop the Levene proposals, consulting industry (ie potential contractors) as necessary, leading to a paper for Ministerial discussion?

AT
4/5

Yes
no

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cc

DP

cc PE



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-~~938X02X~~ 218 2111/3

MO 10/2

26th April 1984

Dear John,

FUTURE OF THE ROYAL DOCKYARDS

Mr Heseltine has been considering the future of the Royal Dockyards in light of a report which has been produced by Mr Peter Levene, his Personal Adviser. I attach a self-explanatory minute which he has written to the Chief Secretary to the Treasury which sets out the current state of play. Mr Heseltine would like to have the Prime Minister's initial reaction to these proposals on an informal basis. I should therefore be grateful if you could show this letter to the Prime Minister and let her know that Mr Heseltine would like to have a quick word with her about it, possibly in the margins of one of the meetings next week.

Yours ever
Nick Evans

(N H R EVANS)

A J Coles Esq

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MO 10/2

CHIEF SECRETARY TO THE TREASURY

FUTURE OF THE ROYAL DOCKYARDS

I was grateful to you for your agreement, in your letter of 1st February, to put the refits of two warships out to contract as a first step towards opening up more of the work to the private sector. I have delayed writing to you about my further plans for the future of the Royal Dockyards until Peter Levene had produced his report and I had had time to consider it. You and your officials will, however, already be aware informally of Peter's ideas. I have now had an opportunity to consider the way ahead.

2. Peter's proposals envisage contractor management of the dockyards, whereby companies would tender for a multi-year (probably 4-year) contract for a major proportion of the repair/refit programme. The contractor would engage his own personnel mainly from the existing dockyard workforce, and the fixed assets, the plant, machinery and real estate, though operated by the contractor, would remain in government hands. The remainder of the programme would be left for open competition between the dockyard contractor and others in the private sector.

3. The scheme would involve complex contractual arrangements with whoever took over the dockyards. They would need to cover all eventualities including unplanned work of high priority, historically 6% of the total programme, which the Navy will need to know can be accommodated, and uncompleted work which might need to be transferred from an outgoing contractor to his successor. The contractor's performance would be monitored regularly. By opting for a fixed term contract, which could be renewed if the contractor's performance were satisfactory, but which could be put out to wider competition



if it were not, and by aiming to maximise the proportion of the contract which would be on a fixed price basis, Peter argues that the competitive pressures will provide much better value for money for our dockyard expenditure.

4. There are some points in Peter's report about which I need further advice. But subject to their financial and political practicability, I favour the general thrust of his proposals. They offer several fundamental advantages which earlier studies have not been able to combine. They would effectively separate the operation of the Dockyards from the MOD and establish the clear customer/supplier relationship we have all been groping for. They would give the managers of the Dockyards real freedom to manage. They would enable commercial management skills to be brought in. And they would introduce an element of competition into the warship refitting business. An arrangement of this sort, if the difficulties of moving towards it can be resolved, would in my view be greatly preferable to a Trading Fund, which would keep the organisation within the Civil Service, with all the rigidities which this entails. Peter Levene believes that gains of at least 20% in efficiency should be realisable in the longer term; though obviously they are not precisely quantifiable in advance.

5. The difficulties which I have mentioned lie chiefly with the workforce. I am advised that we do not have the legal power to make the workforce redundant in order to give an incoming contractor the freedom to re-engage them on new terms and conditions. In any case, redundancy on this scale would be very expensive and is, I believe, politically unacceptable. We would need to think in terms of transferring the majority of the labour force on their existing conditions (including a new pension scheme) and removing their entitlement to redundancy compensation on leaving the Civil Service by means of legislation (the ROFs may provide a precedent).. The pension liability for previous service would need to be addressed, as would compensation for detriment, if any, in the incoming contractor's pension arrangements, compared with the Civil Service scheme. In the case of the ROFs, this could involve a front-end technical payment of up to £250M, but my intention



would be to avoid such a payment in the present case. Instead I would wish to have the liability carried within the public sector on a running basis, to be redeemed when the employees concerned left dockyard service. The efficiency gains will depend to a considerable extent on changing the working practices, if not the conditions, of the workforce and the new contractor would have to negotiate these away at whatever price he could secure. Of course we would hope to secure efficiency gains between now and when the agency arrangements took effect and it has to be recognised that the incoming contractor would be likely to be unwilling to take on a workforce of the present size. Some reduction of the workforce would therefore be necessary in the period before the contractor took over but it has to be recognised that this would be necessary any way, with or without the Levene proposals. Finally, to guarantee the continuance of the Dockyards in the event of a contractor failing, it would be necessary for the Government to accept a contingent liability to cover the interregnum until a successor could be found.

6. These are real problems which would have to be discussed with potential contractors and with the Trade Unions (on whose co-operation we would have to rely to keep the work programme going during the change over) but only after we have an agreed political view on the way ahead. I do not believe that they are by any means insoluble; and Peter Levene's preliminary soundings indicate that there will be a good deal of interest on the part of industry. I would therefore now like to make rapid progress towards having public discussions about introducing arrangements on the lines of those which Peter Levene has sketched out, and which are entirely consistent with our general philosophy. As a next step, I would like to propose that our officials and those of other Departments concerned should get together to prepare a paper for a collective Ministerial discussion. Financial, personnel and legislative implications are clearly critical. We also need to have a clear idea of the timetable which may have to spread out over several years.

7. I am sending a copy of this minute to the Secretaries of State for Trade and Industry, Employment, Scotland, to the Attorney General and to Sir Robert Armstrong.

Ministry of Defence