

Prime Minister

JF1253

PRIME MINISTER

CUNARD/ACL ORDER

*We must discuss
further. Chancellor,
P.S. G.M. chief whip.**PA*

John Nott made the interesting and constructive suggestion in Cabinet on Thursday that the Ministry of Defence might find some money as a contribution towards bridging the gap between the BS bid and the Far Eastern competitors.

flag A

2 The size of the gap is, on Cunard's figures set out in the attached Table A, over \$20m after BS have taken full account in their bid of the Intervention Fund (including Shipbuilders' Relief) and the Home Credit Scheme which together already amount to a subsidy of 30.5% of the contract price. However, while we have not established Cunard's negotiating position, it is clear from the figures set out in the attached Table B that the gap could be covered at appreciably less cost either through interest free loans over 10 years (possibly £7m, equal to 15% of contract price, would be sufficient) or possibly a grant of, say, around £5m or perhaps a little less. These devices provide a stream of income to Cunard, and leave the contract price unchanged for the purposes of tax allowances and credit. The suggested MOD contribution would have to be used to close the gap; it would not buy modifications and would have to be justified as ensuring availability of the ship for MOD purposes.

flag B



3 Against this background we have very urgently examined whether an MOD contribution toward bridging the gap would help BS secure the order.

4 The attached Note by the Ministry of Defence, of whose contents John Nott is aware, concludes that a contribution purely to ensure the availability of the ship would not be justified, since on the present design of the ship, other ships would be equally or more suitable for uses in exercises and the contribution would not enhance the military value of the ship.

5 Officials have therefore considered whether John Nott's offer could be useful in the form of a transfer of £3.5m from the Defence Vote to the Department of Industry to apply a further subsidy for this order. The suggestion would be that this Department would state in Parliament that in view of the excellent service of the Atlantic Conveyor in the Falklands and taking account of the Defence considerations in having modern ships of the Cunard/ACL type available in any future conflict, a transfer was being made to apply a further subsidy for this order.

6 I have considered this suggestion carefully, but, despite its manifest political attractions, I hesitate to recommend it. Any such statement would advertise to the Commission that the

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Government is giving additional help to secure the order; the Commission and other Member States would strongly suspect that the £3.5m was merely an additional subsidy not justified by Defence considerations; they would be likely to open a procedure against the United Kingdom which would stop at least all the civil aid on this order while the Commission explored the issue further and came to a definitive view; we would find it very difficult to explain to the Commission how the additional subsidy was justified on Defence grounds.

7 If therefore we regard it as essential on political grounds to subsidise the order it is a question of attempting to do it secretly through an interest-free loan from BS to Cunard of around £7m - the solution rejected by E(EA) at their meeting on 14 July. It would involve massive subsidies of well over 40% and in view of the widespread publicity on this order we could not hope to keep it secret; this would give rise to very difficult international implications. I therefore see no grounds for changing the decision of E(EA).

8 Unless, therefore, John Nott is prepared, despite the arguments in the MOD's Note, to make a contribution direct to Cunard in one of the ways suggested in paragraph 2 above, I do not see how we can utilise MOD money to secure the order for BS.



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9 On the present timetable Cunard are due to discuss a possible Letter of Intent with the Japanese and the Koreans on Monday and Tuesday with a view to announcing placing the order towards the end of next week. I have seen Len Murray's letter to you asking you to see a delegation on this, and I would recommend you to see them. While you would not be able to quote the detailed prices, you would be able to give a general indication of the price and delivery gap, and explain the difficulties of adding to the very considerable support which we already give to shipbuilding.

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10 Copies of this letter go to members of the Cabinet, the Chief Whip and to Sir Robert Armstrong.

Caroline Verley

*BR PJ (approved by the Secretary
of State
and signed
in his absence)*
23 July 1982

Department of Industry
Ashdown House
123 Victoria Street

COMPARATIVE BIDS CUNARD/ACL LATEST PRICES

	<u>Cash</u>	<u>PDV of Cash</u>	<u>\$M</u> <u>Credit charges</u>	<u>Supervision</u>	<u>Positioning</u>	<u>Total</u> <u>PDV</u>
BS ^(a)	79.061 (£45.7m)	65.9	5.5	0.5	-	71.9
Korea	50	44.6	0.9	1.1	1.1	47.7
Japan	54	47.6	1.0	0.8	1.0	50.4
France ^(b)	69.85	65.0	3.1	0.5	-	68.6

(a) BS delivery improved to August 1984 26 months on assumption that they will gain technical cooperation from Swedes.

(b) The French prices are now out of date and the French are negotiating direct with CGM.





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THE GAP

Value of loan, interest free to Cunard, repayable at the end of 10 years

<u>Loan</u>	<u>Value \$M(A)</u>
£5m	16.9
£7m	23.7
£8m	27.1

Value over 10 years at outright grant

<u>Grant</u>	<u>Value \$M</u>
£3.5m	15.55
£7m	31.10

(A) Note:

Loans or grants to Cunard are invested by them to produce annual income. The value is calculated by discounting the annual income, and in the case of loans, subtracting the discounted value of the loan on repayment.

REPLACEMENT FOR THE ATLANTIC CONVEYOR

(Note by the Ministry of Defence)

We have examined further the justification for a direct contribution from Defence funds towards bridging the gap - currently assessed at £20m - between British Shipbuilders quotation and those of the overseas competitors. The approach we have considered is that, in return for our contribution, Cunard would give guarantees that the ship would be available for military use both in emergency and on a regular basis for annual exercises, with Cunard charges / for such use taking account of our contribution.

2. In her present design, which incorporates an unconventional tall girder structure on the weather - deck, the ship would not be suitable without substantial modification for use by helicopters or Harriers; nor would it be possible to move heavy vehicles or aircraft from her vehicle deck to her weather-deck. Also the stern door of her vehicle deck is being designed for use with specific port facilities on the North Atlantic routes which may restrict its use elsewhere. Discussions are currently in hand with Cunard at the technical level and without commitment on either side on the practicability and additional cost of introducing modifications into the design which would render the ship more suitable for military purposes.

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3. The usefulness of the ship, both in emergency and peacetime exercises has been considered in the following roles, recognising that, as she is planned for commercial operations on the North Atlantic routes, she should be available in a reasonable timescale:-

- a. a general support or convoy role to carry a variety of equipment and supplies in support of NATO or out of area tasks;
- b. in support of amphibious operations in the NATO area and world-wide when an ability to operate helicopters off her deck and to move heavy vehicles and aircraft from the vehicle to the weather-deck would be essential.

4. While the ship would clearly have a use in the convoy role (a above), there is no shortage at present of more suitable ships readily available from trade both for exercises and, as the Falklands operation demonstrated, in emergency by requisition or charter; and it would be difficult to justify paying money in advance to earmark a specific ship for this purpose.

5. For the amphibious task (b above), the ship would not be suitable in her presently planned configuration and other more suitable ships are available and more readily adaptable. The relatively minor modifications currently under discussion would improve her potential

/ military ...

military usefulness but not to a degree significantly greater than other ships likely to be available. If, however, more radical modifications to her design were feasible and acceptable to Cunard in relation to her commercial tasks, notably to provide limited space for helicopter operations and access between that and the vehicle deck, her guaranteed availability for exercises would make her a valuable reserve defence asset.

6. The cost of any modifications to make the ship a more useful naval asset (they might cost between £1m and £2m) would be additional to the present estimated cost of the ship. A defence contribution to cover the cost would not therefore in itself help to close the gap between the BS and foreign tenders. There is no technical or security reason which would require the modified design to be built in this country.

7. The issue therefore is whether a contribution to help bridge the gap in return for guarantees of availability would be justified against the military value of the ship as described above. Our conclusions are that in emergency the ship would be available, on her planned employment, for requisition and no contribution would be justifiable. In peacetime unless radical modifications were made to her (beyond those currently under discussion) other ships would be equally or more suitable for use in exercises and again

/ a contribution ...

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a contribution would not be justifiable. Even if radical modifications were feasible and acceptable, the possibilities of negotiating regular availability for exercise use would need to be explored with the firm before a case could be made for paying an advance premium by way of an immediate contribution to bridging the gap. Since any such contribution would be part compensation to Cunard to offset the additional cost of building in this country, it would not provide an assured basis for negotiating less than commercial rates for peacetime charter.