



FCS/83/132

Amend
not

The Foreign Secretary considers that we should not notify the European Commission our aid for a commercial dockyard in Gibraltar.

A.J.C. 18/7

SECRETARY OF STATE FOR DEFENCECommercialisation of the Gibraltar Dockyard and the Community

1. As you know, we have been discussing with the Gibraltar Government a grant in aid of about £25 million to help them establish a commercial ship repair yard there following the closure of the Naval dockyard, and I have been considering what we should do about notifying this aid to the European Commission. We shall have to be prepared to move swiftly after the talks are concluded, and the detailed content of an agreement is unlikely to affect the pros and cons of notification. I therefore think that we should address this issue now.
2. When this subject was discussed in OD on 4 November last year, Ministers then accepted that notification and Commission consent would be needed. There is no doubt that notification would be consistent with our normal practice, and our normal interpretation of the relevant Community rules. But this aid is indispensable to our plans for Gibraltar's future and it would be politically impossible for us to allow the Community to get in its way. The question is whether we can minimise the risks of this happening by notifying or by not notifying. I believe that the arguments are fairly finely balanced, but that - exceptionally - it would in this case be right for us not to notify.
3. The arguments which have led me to this conclusion are set out in detail in the attached paper by officials. The position is that Gibraltar is, for this purpose, within the area of application of the EEC Treaty. Though a reasonable

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case can be made to the contrary (and is in the attached paper), there is little doubt that the proposed aid constitutes a State Aid which should be notified to the Commission. But notification would almost certainly lead to lengthy Commission scrutiny of the aid and delays for the dockyard project, even if one takes into account the extra time provided by the delay in commercialisation now being discussed with the Gibraltarians. Nor can we ever guarantee the outcome of the Commission's scrutiny 100%. There is the further risk that notification could complicate negotiations over our plans to aid British Shipbuilders, which we shall need to clear with the Commission in the autumn.

4. This increases, in the unique circumstances of this particular project, the attractions of non-notification. Although it will clearly be impossible to avoid publicity for the aid, if the Commission do pick it up (and there is just a chance that they might not) they might well choose not to act in view of its obvious political sensitivity. If, however, we were challenged by the Commission about the aid, there are, as I have said, arguments which could be used to justify non-notification; and if the Commission insisted on notification we could deploy the kind of arguments also set out in the attached paper to justify the aid. We should then be in no worse a situation than if we had notified: indeed our tactical position vis-a-vis the Commission would be the stronger for not having conceded from the outset that the aid was notifiable, and this might to some extent ease the task of persuading the Commission to allow the aid. The risk - very slight in my view - would exist in the case of non-notification, as in the case of notification, that in spite of all our representations the Commission would decide that the aid was not justified, particularly if there were complaints from other Member States. There is, in the case of non-notification only, also the risk that the Commission could require aid already disbursed to be repaid. But this would be unprecedented and I judge the risk a very slight one.



5. There are risks and uncertainties and potentially serious difficulties in whatever course of action we choose. But although the safest course legally would be to notify, I have come to the conclusion that on balance the way of proceeding least likely to cause difficulty and delay (and commercial damage for the yard) would be not to notify. I would stress that this course of action would be exceptional; that it lessens but does not obviate the risk that the Commission might open an Article 93(2) procedure; and that, in the worst case, we might find ourselves illegally providing state aids to Gibraltar while proceedings were being taken against us in the European Court. In that event (the likelihood of which I rate very low) it would be necessary for the investment to go ahead in defiance of the Commission and/or the Court.

6. I am copying this minute to other members of OD, to Timothy Raison and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'J.H.', is located in the lower right quadrant of the page.



Commercialisation of the Gibraltar Dockyard: EC Aspects

Introduction

1. We need to decide whether or not to notify to the European Commission our plan to provide about £28 million grant in aid to help the Gibraltar Government establish a commercial ship repair yard following the closure of the Naval dockyard. Details of the package of support measures are annexed to this paper.

2. Gibraltar is part of the Community by virtue of being a European territory for whose external relations the UK is responsible and, with certain exceptions, the Treaty of Rome applies to it. Under Article 93(3) the Commission should be informed of any plans to give aid so that they can decide whether the aid would distort competition and thus be contrary to the Community interest. If they so decide, they are required under Article 93(2) to ban it and, if necessary, to launch infraction proceedings leading to the European Court. As aid to ship repair is covered by the EC's Fifth Shipbuilding Directive, and given the current over-capacity in the ship repair sector, the Commission could certainly claim to have a legitimate interest in the aid.

3. The risk of challenge from the Commission exists independently of whether we notify or not. We shall have to be prepared if necessary to bring great political pressure to bear to ensure either that the Commission do not open a formal procedure under Article 93(2), or that if they do, they bring it to a close without instituting infraction proceedings. We should have to stress:

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- i) the unique political problems arising from Spanish efforts to undermine Gibraltar's economy;
- ii) the disproportionate effect of the unemployment which would follow a closure of the naval dockyard without anything to replace it;
- iii) the disastrous effects on confidence in and commercial viability of the new yard if a procedure was opened and aid was expected to stop;
- iv) the fact that there will be no physical increase in capacity; although the handover from naval to civilian use could be counted as an increase in commercial capacity, there would be no net increase in total capacity in the Community in view of the closures of naval dockyards both in Gibraltar and the UK.

4. The strong likelihood is that, in the face of such pressure, the Commission would not open infraction proceedings. We must nonetheless be prepared for the worst case - an adverse judgement by the Commission, if necessary supported by the European Court, that we make no, or no further, payments to Gibraltar. Given the indispensability of the aid to Gibraltar's future, it is hard to conceive that we could comply with such a judgement.

5. This leaves the further decision of whether we can best minimise the likelihood of obstruction and delay by the Commission to our plans in Gibraltar by notifying or not notifying.

THE OPTIONS

6. There are three options:

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- a) to notify;
- b) not to notify; and
- c) not to notify, but to try to square the Commission informally in advance.

a) Notification

7. Notification is, quite rightly, our normal practice, which is why when the subject was discussed in OD on 4 November 1982 it was accepted by the Committee that notification and Commission consent would be needed.

8. But to notify would lead to difficulties and delay. Whilst no doubt appreciating the political justification for the aid, the Commission would feel bound, if the aid was thus formally drawn to their attention, to scrutinise the case thoroughly and could well decide to open a formal procedure which would involve consulting other Member states. Our own scrupulousness would earn us little credit. Clearance of the aid would be further complicated if other Member States raised objections. It could be many months before the Commission felt able to close the procedure; and as long as the procedure remained open no aid could legally be paid to the Gibraltar Government. It is true that no capital investment will be started until the intended management company have negotiated satisfactory labour contracts with the dockyard workforce, a difficult task which could take some months. There is other preparatory work which could be undertaken during this period: invitations to tender, legislation to establish the commercial company. Nonetheless, we need to avoid a situation in which, once these preparatory

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steps have been completed, we should still be precluded from releasing funds for capital expenditure to set up the commercial yard, which will be an essential element in sustaining the Gibraltar economy when the naval yard is closed. Delay and uncertainty could jeopardise the commercial prospects of the yard. We cannot guarantee that the Commission's decision would in the end be favourable (though experience suggests that it very probably would be).

9. All this would be taking place at about the same time as we would be asking the Commission for approval of aid to British Shipbuilders. Our efforts to persuade the Commission to approve the Gibraltar aid might well use up credit which we shall need for the British Shipbuilders case.

10. It could be argued that the delay of six months offered to the Gibraltar Government before commercialisation of the dockyard (or any other delay which might be negotiated) provides time enough to go through the hoops of notification. Once the Gibraltar Government has agreed to commercialisation, and agreed a date for closure of the naval dockyard and thus a vesting day for commercialisation, satisfactory agreements will have to be made with the workforce about working practices. Once all this has been done, the Gibraltar Government will expect, and we shall be ready to make, capital and other disbursements for conversion work to begin: the notification process could still prevent us from starting these payments. And with the start of commercialisation delayed, it would be more difficult to persuade the Commission to close any formal procedure quickly, so that the scope for other Member States to make trouble might be protracted.

/B



B. Non-Notification

11. Against this background, and given the rather special nature of the aid to Gibraltar, it is worth considering the alternative of non-notification.

12. This too is not without risks:

(a) Should we be challenged in the Community after we had started disbursing the aid, we should be legally obliged to stop disbursements. The Commission could even require the repayment of aid already disbursed, but this would be unprecedented. Even refraining from further disbursements would, however, cause serious problems. An interruption to work once started would be much more damaging than a delayed start, especially in the first year of operation before the No 1 Dock is ready to take the high value work promised by large ships. Moreover, if investment were interrupted by Commission procedure or Court proceedings, we would be exposed to PAC criticism for incurring nugatory expenditure. If, therefore, we decide to proceed without notification it would be essential also to decide now that the project must go ahead without interruption, if necessary in defiance of the Commission and the European Court;

(b) Non-notification would not necessarily guarantee that there would not be complications for British Shipbuilders. If we were challenged as to why we had not notified while the British Shipbuilders' aid was still being considered, the atmosphere of the latter case would be soured.

13. Against this, there are clear practical advantages in not notifying. We should be able to proceed with the aid on schedule; we should be facing no greater risk of incurring an adverse decision than if we had notified; and we should be in a better tactical position and with a better choice of arguments to deploy to justify the aid if we were challenged.

14. First of all, there is a chance - although perhaps not a very large one - that the Commission would turn a completely blind eye. They are unlikely to remain wholly unaware of the aid; UKREP had a very informal word with a Commission official about it some months ago, and it is quite likely that they



would read about it in the trade press (eg Lloyds List). But Gibraltar is not an area on which the Commission's attention is normally focussed and they might feel under no obligation to be concerned with what goes on there unless it were brought forcefully to their attention. UKREP Brussels have therefore advised that the risk of a challenge from the Commission or Member States will be much affected by the amount of publicity given to the aid and to HMG's role in the dockyard commercialisation in the UK press. Publicity at the time of agreement with Gibraltar is unavoidable; although it should die down considerably before any money is actually spent. There has already been Parliamentary interest, and Sir J Hassan will need to work hard to sell any package on the dockyard to opinion in Gibraltar. Gibraltar's southern Mediterranean neighbours, France, Italy (and probably Greece too) aid their own ship repair yards and are not strongly placed to complain, but they are all potential competitors and could see a commercial interest in challenging the aid. (Spain, with a still greater motive for making trouble, is not yet a member of the Community).

15. We should therefore have to be ready to deal with the Commission challenge, and to have ready some plausible reasons for not having notified. We believe there are three main arguments on which we could draw as appropriate. These are, in descending order of effectiveness:

(i) the continuing defence role of the dockyard, since it would continue to provide certain services for adjoining naval base and other defence interests on Gibraltar including refitting of harbour craft and other MOD vessels and possibly docking facilities for nuclear submarines. There is also the intention to allocate a substantial volume of Royal Fleet Auxilliary work to the commercial yard in its early years;



(ii) the fact that this was a normal commercial investment by the Government in a Government-owned enterprise which was expected to break even after a few years (the Government of Gibraltar can be considered to be the equivalent of HMG for Community purposes);

(iii) the fact that this was ODA money and should therefore be seen as normal development aid (this may not easily be used in conjunction with (ii) above.

16.. If, however, the Commission were unconvinced by those arguments, and insisted on taking the matter further, we should be willing to provide the Commission with details of the project; while, if necessary, bringing pressure to bear to prevent the opening of a formal procedure in exactly the same way as we should if we had notified. We should then have lost little by having failed to do so.



C. Inform the Commission of our intention not to notify

17. This would be a hybrid course of action between notification and non-notification. The objective would be to secure an assurance from the Commission that they would not make trouble, without incurring the delay involved in formal notification. But however sympathetic the Commission were, they would have to reserve their position on the action they might need to take if another Member State complained about the aid, and we should make it a good deal more difficult for them simply to turn a blind eye to it. They could well insist that we notified the aid forthwith. This option does not therefore offer obvious advantages over the others considered.

Conclusion

18. Whatever we do has risks and uncertainties. We have always believed that at the end of the day we could clear the aid through the Commission on the strength of our political case. But recent events have shown that the Commissioner responsible for state aids, Mr Andriessen, can be highly resistant to political arguments. We must therefore be cautious about the outcome, whether or not we notify. Non-notification improves the chance that the Commission will not take proceedings against us which would delay the start of the project and give us a better hand to argue if the Commission did start proceedings. There could be the problem that, with proceedings started, we should be under legal pressure to stop disbursements already in train. But the Commission would be unlikely to take drastic action against us for continuing the programme unless they also intended to find against us on the substantive issue in any case. Against this background the right course seems on balance to be not to notify; to be ready to argue the political case strongly with the Commission should they challenge us; and to decide now to proceed in any event to the completion of the investment.



Support Measures Relating to Commercial Dockyard in Gibraltar

1. Provision, through ODA, of funds limited to a total of £25 million to support the setting up of a dockyard if the Gibraltar Government confirm that they wish for such aid. Since the project's success depends crucially on improved productivity ODA will need to be sure that Appledores are fully satisfied that they have agreement with the workforce to efficient working practices which will provide the basis for a commercially viable operation.
2. Free transfer of dockyard land and buildings.
3. Work to be made available on Royal Fleet Auxiliary vessels over a three year period to the value of about £11 million. (Over and above the RFA work, there would be work worth about £0.75 - £1.0 million per year on naval harbour craft tenders).
4. Provision by MOD on a three year lease to Appledores of 46 houses/apartments for use by staff of the new commercial dockyard in order not to encroach on limited housing market.
5. MOD works programmes which are expected to provide significant new work for local contractors.
6. HMG will be prepared to review the land and houses required for defence purposes in Gibraltar and investigate the possible release of property not essential for defence. This will be related to a land use survey by the Gibraltar Government.
7. £13 million of development aid offered by ODA in December 1982 is now being committed to specific projects.
8. Generous redundancy payments and pensions on the same lines as those given to UK Public Service employees. (See attached examples of immediate cash payments ranging from £1,200 to over £12,000; in many cases pensions will be payable in addition to these lump sums).
9. A new agreement on the transfer of defence lands.

Controlled: Policy Pty



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FOREIGN AND COMMONWEALTH SECRETARY

AR 25/7

f.c.

Thank you for your minute of 15th July about commercialisation of the Gibraltar Dockyard and the European Community.

2. In the circumstances, and for the reasons you adduce, I agree that we should not notify the European Commission of our grant in aid for commercialisation.

3. I am copying this to the recipients of your minute.

Ministry of Defence

22nd July 1983

GIBRALTAR: Policy Pt 4

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10 DOWNING STREET

From the Private Secretary

19 July 1983

Commercialisation of the Gibraltar Dockyard and the
European Community

The Prime Minister has seen the minute of 15 July by the Foreign and Commonwealth Secretary to the Defence Secretary on this subject.

Subject to the views of other members of OD, the Prime Minister agrees that, for the reasons adduced by Sir Geoffrey Howe, we should not notify to the European Commission our grant in aid for a commercial ship repair yard in Gibraltar.

I am copying this letter to the Private Secretaries to other members of OD, the Minister for Overseas Development and Sir Robert Armstrong.

A. J. COLES

Roger Bone, Esq.,
Foreign and Commonwealth Office.

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

20 July 1983

Roger Bone Esq.
Foreign and Commonwealth Office

MB 20/7

h-a.

Dear Roger,

The Chancellor has seen the Secretary of State's minute to the Defence Secretary of the commercialisation of the Gibraltar Dockyard. He agrees that, in the special circumstances of this case, it would be right not to notify the European Commission of the grant in aid to help the Gibraltar Government to establish a commercial ship repair yard.

I am copying this letter to the Private Secretaries of other members of OD, the Minister for Overseas Development and Sir Robert Armstrong.

*Yours,
JCS*

MISS J C SIMPSON
Private Secretary

20 JUL 1961

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Secretary of State for Trade & Industry

3 August 1983

CONFIDENTIAL

The Rt Hon Michael Heseltine MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall SW1

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3/8-

Dear Michael,

COMMERCIALISATION OF THE GIBRALTAR DOCKYARD AND THE COMMUNITY

I support the view expressed in Geoffrey Howe's minute to you of 15 July 1983, that we should not notify the grant in aid. We shall shortly undertake a very difficult negotiation with the Commission over shipbuilding support generally. This could well be complicated by notification of a grant to create a commercial yard which will be competing with other member states' repair yards in the Mediterranean.

I am copying this letter to other members of OD, to Timothy Raison and to Sir Robert Armstrong.

Yours Ever,
Neil

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PERMISSION

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