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EX Cttee: FCO
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10 DOWNING STREET

From the Private Secretary

28 August, 1984

GUANGDONG NUCLEAR PROJECT

The Prime Minister has now seen your Secretary of State's minute of 10 August about proposals for sharing financial sacrifices in the Guangdong Nuclear Project with GEC. She has also seen the Chancellor's minute of 22 August on the same subject.

The Prime Minister agrees with the proposals set out in your Secretary of State's minute for a profit sharing agreement with GEC. She further agrees that such arrangements should be regarded as exceptional although like the Chancellor she would not wish to rule them out altogether provided that they were overwhelmingly justified by circumstances.

I am sending a copy of this letter to the Private Secretaries to the members of EX and to Graham Sandiford (Northern Ireland Office) and Michael Reidy (Department of Energy).

(Timothy Flesher)

C. McCarthy, Esq.,
Department of Trade and Industry.

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Await Colleagues

PRIME MINISTER

GUANGDONG NUCLEAR PROJECT

SHARING FINANCIAL SACRIFICES WITH GEC

When we approved financial support for this project following EX on 29 February, we agreed that we should seek to ensure that HMG was not put in a position of making sacrifices to preserve GEC's margins. GEC have now agreed to enter into a profit sharing agreement with Government on this project, and to a post-contract review of contingencies.

2 GEC argued that competitive pressures would exercise their own disciplines on the margins eventually secured; that the project was long term and high risk; that our approval represented belated Government interference in their legitimate business; and that, in any event, the Government derived a revenue return from any profits that they eventually secure. This reaction, looking beyond the particular case, does raise genuine and major issues about our relations with industry.

3 Nevertheless, under our pressure and given the extent to which they are already committed to this project, GEC

have reluctantly accepted a formula to share profit, on a sliding scale related to the Government's financial support. The details are set out in the attached annex. Essentially, if, at the end of negotiations, we are pressed to the maximum level of concessionality agreed at EX on 29 February of 25 per cent, GEC in turn would give up half of any profit above the reference level of 3 per cent of contract value. Applied to the £270m base bid price they put forward on 15 March, the formula would bite on any margin in excess of £8.1m, well below GEC's profit target of £14.4m. In addition, it has been agreed that the actual use of the contingency margin will be audited when the contract has been completed and any short-fall shared.

4 I do not believe we can effectively press GEC any further, and I hope colleagues will feel able to agree urgently that we should proceed on this basis, given the advanced state of negotiations. However, I consider that we should regard this as a wholly exceptional arrangement. Good as my officials are, I would need many more and require them to be far more interventionist if this exercise became a common practice. A number of GEC's concerns are genuine: we are in danger of being drawn into wide ranging intervention in companies' legitimate pursuit of profitable business, of a complex character.

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Moreover, under a new sectoral agreement for nuclear power plant shortly to be brought in under the Consensus, all future projects will need to have higher interest rates and more rigorous constraints on financial support.

5 I am copying this minute and attachment to members of EX and to Jim Prior and Peter Walker.

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10 August 1984

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Department of Trade and Industry

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PROFIT SHARING AND CONTINGENCY ARRANGEMENTS WITH GEC ON THE GUANGDONG NUCLEAR PROJECT

A. Profit Sharing

The principle is that GEC would share the profit, in excess of 3% of their contract value, on a sliding scale related to financial support from HMG. The following exemplify this relationship:

	Financial Support from HMG (1)	Contribution from GEC (2)
PRESENT POSITION:	Financial support for export credit terms accompanying GEC's bid on 15 March 1984 equivalent to 15% concessionality for a sterling loan.	GEC are not required to share profit with HMG.
POSSIBLE POSITION AT CONCLUSION OF FINANCIAL NEGOTIATIONS WITH THE CUSTOMER:	(a) Financial support given by HMG equivalent to 20% concessionality.	GEC give up 25% of any profit or negotiating margin retained, in excess of 3% of the contract value.
	(b) Financial support given by HMG equivalent to 25% concessionality (ie maximum level of support authorised).	GEC give up 50% of any profit or negotiating margin retained, in excess of 3% of the contract value.

(1) Includes export credit support and any grants given by the Department of Trade and Industry under the Support for Innovation Scheme or by the Northern Ireland Industrial Development Board in support of the project, up to a limit on concessionality of 25%.

(2) GEC's bid on 15 March 1984 was constructed on a base price of £270m, including a negotiating margin of £6m and a profit target of £14.4m, respectively 2.2% and 5.3% of the base price (the base price excluded freight and insurance costs, variation orders, the cost of supervising the erection of plant and ECGD premium costs). The contract value may be subject to considerable change in the course of negotiation as changes are negotiated in GEC's scope of supply.

B. Contingency

In view of the fact that the use of contingency margins can only be determined in the light of events, it has been agreed that contingencies should be audited following completion of the contract and any surplus on contingency would be shared equally between HMG and GEC.