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FM PEKING

OFFICIALS' REPORT (23 DEC)

TO DESKBY 230930Z DTI

TELNO INDUS 328

ON FRENCH FINANCIAL

OF 230713Z DECEMBER 85

INFO IMMEDIATE PARIS, BTC HONG KONG CONCESSIONS

FOR DOBBIE FROM ALTY

GUANGDONG NUCLEAR PROJECT

1. IN FURTHER DISCUSSION WITH THE FRENCH ON THE TERMS OF THEIR MOU, THE FOLLOWING DETAILS EMERGED:

A) PREMIUM: ON THE CONTRACT PREMIUM, THE FRENCH HAD TOLD THE CHINESE THAT THEY HAD ALREADY REDUCED THE DECLARED FIGURE OF 2.3 PERCENT OF CONTRACT PRICE TO JUST UNDER 1 PERCENT TO ASSIST FRAMATOME DURING THE PRICE NEGOTIATIONS. AS THE PRICES HAD BEEN AGREED BETWEEN MINISTERS, NO FURTHER DISCUSSION WAS NEEDED. THUS IN CHINESE EYES THE FRENCH HAVE REDUCED BOTH CONTRACT PREMIUM AND CREDIT PREMIUM (THOUGH THE FRENCH TOLD US THAT 1 PERCENT WAS IN FACT THE CORRECT FIGURE UNDER THEIR SYSTEM FOR CONTRACT PREMIUM.). THESE PREMIUM CONCESSIONS HAD BEEN MADE CONDITIONAL ON THEIR BEING EXCEPTIONAL FOR THE FRAMATOME AND EDF CONTRACTS FOR GUANGDONG (IE NOT CIVIL WORKS CONTRACTS OR, BY IMPLICATION, ANY OTHER PROJECT).

B) LOCAL COSTS: THE FRENCH HAD REFUSED TO COVER COSTS ALREADY INCURRED.

HOWEVER, THEY HAD AGREED TO COVER 200 M FF OF LOCAL COSTS CONNECTED WITH THE CIVIL WORKS FOR THE NUCLEAR ISLAND, PROVIDING THESE WERE CARRIED OUT UNDER A CONTRACT WITH A FRENCH COMPANY, OR CONSORTIUM LED BY A FRENCH COMPANY. THEY HAD ALSO AGREED TO COVER LOCAL COSTS OF THE ERECTION CONTRACT, PROVIDING AGAIN THIS WAS A CONTRACT WITH A FRENCH COMPANY (PROBABLY BUT NOT NECESSARILY FRAMATOME).

THERE WERE THEREFORE THREE ELEMENTS OF LOCALS COVERED: (1) GENUINE LOCALS IN FRAMATOME'S CONTRACT SEMICOLON (2) 200 M FF CIVIL WORKS SEMICOLON (3) LOCAL COSTS FOR THE ERECTION CONTRACT. ALTOGETHER THESE WOULD AMOUNT TO OVER 15 PERCENT OF FRAMATOME'S CONTRACT. THE FRENCH HAD TOLD THE CHINESE THAT THE CIVIL CONTRACTS AND FUEL CONTRACTS WOULD ATTRACT NORMAL OECD TERMS.

C) BALANCE OF PLANT: THE FRENCH HAD AGREED TO EXTEND THE PERIOD OF AVAILABILITY FOR B.O.P. ITEMS FROM 2 YEARS FROM CONTRACT SIGNATURE TO 4 YEARS.

D) REIMBURSIBLE ITEMS: A MINOR POINT RELATING TO THE EDF CONTRACT: THE CHINESE WISHED ITEMS SUCH AS AIRLINE TICKETS BROUGHT FOR ENGINEERS TO BE COVERED BY THE LOAN, BUT, AS SUCH ITEMS WERE UNPREDICTABLE, THEY DID NOT WISH TO MAKE A DOWN-PAYMENT. THE FRENCH HAD AGREED THAT SUCH ITEMS COULD BE INCLUDED IF NECESSARY IN THE B.O.P./CONTINGENCY ARRANGEMENTS. THIS ISSUE HAS NOT BEEN RAISED WITH GEC, NOR DOES IT APPLY TO THE FRAMATOME CONTRACT.

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E. BANK FEES: THE FRENCH DID NOT KNOW WHAT REDUCTION HAD BEEN OFFERED BUT ESTIMATED IT AT 50 PERCENT.

2. THE FRENCH HAD SIGNED TWO DOCUMENTS WITH THE CHINESE: A SHORT ONE COVERING THE TWO POINTS MENTIONED BETWEEN MME GRESSON AND LI PENG (PREMIUM AND LOCALS) SEMICOLON AND ANOTHER WHICH ACTED AS A SUMMARY OF THE FINAL FINANCIAL OFFER.

3. COMMENT: THE FRENCH POSITION ON PREMIUM IS THUS MORE DIFFICULT THAN EARLIER THOUGHT, AS THE TOTAL REDUCTION UNCLUDES CONTRACT AND CREDIT ELEMENTS SEMICOLON I ESTIMATE TOTAL REDUCTION AS ABOUT 45 PERCENT, FROM 4.6 PERCENT OF LOAN VALUE TO ABOUT 2.6 PERCENT. WE CAN OF COURSE ARGUE THAT GEC'S CONTRACT PREMIUM HAS ALREADY BEEN REDUCED. I SHALL ASK GEC TO TELEX LATEST CONTRACT BREAKDOWN FIGURES TO RUGBY TODAY TO BE PASSED TO DTI TO PERMIT OUR PREMIUM CALCULATIONS TO BE DONE. PLEASE ALERT SURY KHATRI WHO HAS THE COMPUTER WITH HIM AT HOME (TEL 349 9868 OR 349 9580). PENTECOST AND I ARE RETURNING TODAY. I PROPOSE WE MEET DOBBIE AND BENJAMIN TOMORROW AT 11.30 AM IN BENJAMIN'S OFFICE. WE SHALL RING ON ARRIVAL IN LONDON TO CONFIRM.

4. PENTECOST AND SHEPHERD ALSO SAW MADAME HUANG OF BANK OF CHINA THIS MORNING. SHE SAID THAT INVITATIONS WOULD BE ISSUED TO THE GOVERNMENT TEAM TO RETURN, ONCE THE GEC/JVC NEGOTIATIONS HAD BEEN STILED. ON FINANCIAL DEMANDS, SHE MENTIONED PREMIUM, WHICH SHE SAID WAS MOST CRITICAL SEMICOLON AGREEMENT TO BEAR FINANCE COSTS IF GEC EQUIPMENT WAS UNRELIABLE (WHICH SHE SAID WAS A CHINESE GOVERNMENT REQUIRMENT, NOT JUST A JVC POINT) SEMICOLON AND THE INTEREST RATE DIFFERENTIAL OF 0.35 PERCENT, WHICH SHE SAID WAS A JVC POINT BUT WHICH HMG COULD IGNORE AS FAR AS BOC WAS CONCERNED. PENTECOST WILL BE ABLE TO PROVIDE FURTHER DETAILS TOMORROW (HE HAS NOW LEFT PEKING).

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AMBASSADOR'S REPORT OF 23 DEC

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TO DESKBY 230900Z DTI

TELNO INDUS 329

OF 230747Z DECEMBER 85

INFO DESKEY 230900Z DTI (OTTER), INFO DESKBY 230900 FCO

INFO IMMEDIATE BTC HONG KONG

INFO PRIORITY PARIS

MY TELNO INDUS 327, PARAGRAPH 5, AND YOUR TELNO INDUS 330, PARAGRAPH 4: GUANGDONG NUCLEAR PROJECT

1. I THINK THAT WE ARE NOW GENUINELY AT A POINT OF CRISIS. A FLASE, OR ILL-TIMED, MOVE COULD PUT THE SUCCESSFUL OUTCOME TO GEC'S NEGOTIATIONS WITH THE JVC AT RISK.

2. A SERIOUS PROBLEM ARISES OVER TIMING. THE JVC'S POSITION, CONFIRMED IN A LETTER FROM PAN TO DAVIDSON THIS MORNING IS THAT, IF GEC CANNOT OFFER A PRICE REDUCTION OF POUNDS 10.4 MILLION (I.E. POUNDS 4.9 MILLION ON TOP OF THE REDUCTIONS OFFERED SINCE DAVIDSON RETURNED TO PEKING) NOW, A NEGOTIATION ON A NEW FOOTING (I.E. ITEM BY ITEM AND WITH THE BASE PRICE OF POUNDS 210 MILLION SUBJECT TO CHANGE) WILL HAVE TO BEGIN IN SHENZHEN, IN THE NEW YEAR. GEC'S POSITION, WHICH HAS BEEN MADE CLEAR TO THE JVC, IS THAT A NEGOTIATION IN SHENZHEN ON A NEW FOOTING IS NOT (REPEAT NOT) TO BE CONTEMPLATED AND THAT IT WILL BE VERY DIFFICULT INDEED FOR THEM TO BRIDGE THE REMAINING GAP BY OFFERING YET ANOTHER PRICE CUT. IN THIS SITUATION, SOMETHING WILL HAVE TO HAPPEN BEFORE THE NEW YEAR IF THE NEGOTIATION IS NOT TO FAIL.

3. IT IS POSSIBLE THAT PAN WILL APPROACH DAVIDSON WITH A FRESH PROPOSAL AFTER LI PENG'S RETURN FROM MOSCOW, WHICH IS STILL EXPECTED TODAY (23 DECEMBER). BUT IT IS MORE LIKELY THAT HE WILL NOT. IN ANY CASE, DAVIDSON IS NOT PARTICULARLY KEEN THAT IT SHOULD BE LEFT TO LI PENG TO CUT THE GORDIAN KNOT. HE DOES NOT THINK THAT THIS WOULD BE A GOOD STARTING POINT FOR COOPERATION IN THE FUTURE BETWEEN GEC AND THE JVC. DAVIDSON IS NOT PREPARED TO SEEK A FURTHER MEETING WITH PAN UNLESS THE LATTER INDICATES (E.G. THROUGH CATER) THAT HE IS READY TO NEGOTIATE; I.E. NOT JUST TO STAND PAT ON ITS POSITION AS DESCRIBED ABOVE.

4. I CAN THINK OF THREE POSSIBLE KINDS OF POLITICAL INITIATIVE:

(A) A FURTHER MESSAGE FROM THE PRIME MINISTER TO ZHAO ZIYANG OR FROM MR BRITAN TO LI PENG SEMICOLON

(B) AN OFFER BY A SENIOR BRITISH MINISTER TO VISIT CHINA FOR EARLY DISCUSSIONS WITH LI PENG AND OTHER SENIOR CHINESE CONCERNED SEMICOLON AND

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(c)



(C) AN APPROACH BY ME TO LI PENG, ON INSTRUCTIONS, WITH SOMETHING TO SAY BOTH ABOUT THE POSITION OF THE BRITISH GOVERNMENT AND ABOUT GEC'S POSITION.

THERE COULD OF COURSE BE VARIOUS PERMUTATIONS AMONG THESE THREE COURSES.

5. I DO NOT THINK THAT EITHER (A) OR (C) WOULD BE USEFUL UNLESS SOMETHING NEW COULD BE SAID ABOUT THE FINANCIAL NEGOTIATION AND (REPEAT AND) ABOUT GEC'S POSITION. ON THE FINANCIAL NEGOTIATION, PENTECOST HAD A MEETING THIS MORNING WITH MADAME HUANG OF THE BANK OF CHINA. SHE TOLD HIM THAT THE BANK OF CHINA INTENDED TO INVITE THE BRITISH NEGOTIATING TEAM TO RETURN TO PEKING AS SOON AS GEC HAD REACHED AGREEMENT WITH THE JVC. SHE INDICATED, HOWEVER, THAT THE BANK OF CHINA WAS NOT EXPECTING A RESUMED NEGOTIATION TO BEGIN BEFORE THE NEW YEAR. ON THE SUBSTANCE, SHE SAID THAT THERE WERE THREE REMAINING ISSUES: THE PREMIUM SEMICOLON A GUARANTEE SEMICOLON AND THE INTEREST RATE. ON THE PREMIUM, SHE SAID THAT THE FRENCH, WHO HAD ALWAYS OFFERED A LOWER PREMIUM THAN THE BRITISH, HAD NOW CONCEDED A PREMIUM WHICH WAS LOWER STILL. ON A GUARANTEE, SHE SAID THAT THIS WAS A MATTER WHICH CONCERNED GOVERNMENTS AS WELL AS THE COMMERCIAL PARTIES. ON THE INTEREST RATE, SHE SAID THAT THE JVC STILL WANTED A DISCOUNT OF 0.35 PERCENT ON THE CONSENSUS RATE AT ANY LEVEL, BUT THAT THE BANK OF CHINA HAD DECIDED NOT TO PRESS FOR THIS. IN REPLY, PENTECOST POCKETED WHAT MADAME HUANG HAD SAID ABOUT THE INTEREST RATE AND SPOKE TO HIS BRIEF ON THE OTHER TWO ISSUES.

6. SO FAR AS GEC'S POSITION IS CONCERNED, I AM BOUND TO WONDER WHETHER THERE IS NOTHING WHICH THE BRITISH GOVERNMENT COULD DO TO HELP. ON 21 DECEMBER, CATER AGAIN SPOKE TO MEE ABOUT THE FREE SERVICES WHICH THE CEGB HAD PROVIDED IN RESPECT OF CASTLE PEAK A. I KNOW THAT YOU HAVE HITHERTO RULED OUT ANY POSSIBILITY OF A SIMILAR AGREEMENT IN RESPECT OF DAYA BAYM BUT I DO THINK THAT GEC ARE AT A POINT WHERE THEY WOULD VERY MUCH WELCOME ANY HELP FROM THE BRITISH GOVERNMENT WHICH MIGHT ALLOW THEM TO CLOSE OR REDUCE THE REMAINING GAP.

7. THESE FACTORS MEAN THAT THERE ARE PROS AND CONS TO EVERY POSSIBLE COURSE OF ACTION. MY OWN PREFERENCE, WEIGHING THESE FACTORS AS BEST I CAN, AND GIVEN THE SEASON OF THE YEAR, IS THAT I SHOULD BE INSTRUCTED TO SEEK A MEETING WITH LI PENG SEVERAL DAYS BEFORE THE NEW YEAR SEMICOLON THAT, AT SUCH A MEETING, I SHOULD CONVEY TO HIM A MESSAGE FROM MR BRITTAN ABOUT THE FINANCIAL NEGOTIATION (SEE BELOW) SEMICOLON AND THAT I SHOULD ALSO BE AUTHORISED TO TELL HIM THAT GEC CANNOT CONTEMPLATE A NEGOTIATION ON A NEW FOOTING IN SHENZHEN. WHETHER I COULD OR SHOULD SAY MORE TO HIM ABOUT GEC'S POSITION WOULD DEPEND ON WHETHER GEC CAN IN THE MEANTIME THINK OF ANY NEW WAY OF BRIDGING THE GAP AND ON WHETHER THE BRITISH GOVERNMENT CAN DO ANYTHING TO HELP THEM OVER THIS.

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8. ON THE FINANCIAL NEGOTIATION, I BELIEVE THAT I SHOULD AT THE MINIMUM BE AUTHORISED TO TELL LI PENG THAT THE BRITISH GOVERNMENT HAS TAKEN STOCK IN THE LIGHT OF THE SETTLEMENT REACHED BETWEEN THE FRENCH AND CHINESE GOVERNMENTS AND THAT BENJAMIN WOULD BE PREPARED TO RETURN TO PEKING AS SOON AS HE IS INVITED BY THE BANK OF CHINA TO DO THIS. IF I COULD ADD ANYTHING ENCOURAGING FOR THE CHINESE ON SUBSTANCE, THIS WOULD BE A VERY USEFUL BONUS.

9. I HAVE DISCUSSED THE TERMS OF THIS TELEGRAM WITH BOTH DAVIDSON AND ALTY. THEY ARE CONTENT. BUT DAVIDSON HAS ASKED ME TO ADD THAT, IN HIS BELIEF, BOTH THE CHINESE GOVERNMENT AND THE JVC WISH THE COMMERCIAL NEGOTIATION TO BE CONCLUDED BY THE END OF THIS YEAR. IN THE LIGHT OF THIS, AND GIVEN THAT THE IDEA OF A NEGOTIATION IN SHENZHEN ON A NEW FOOTING IS NOT ACCEPTABLE, HE BELIEVES THAT BOTH GEC AND THE BRITISH GOVERNMENT SHOULD THINK IN TERMS OF A TIMETABLE WHICH WOULD ALLOW GEC TO SIGN AN MOU WITH THE JVC BEFORE 1 JANUARY.

10. PENTECOST HAS LEFT PEKING. ALTY WILL BE LEAVING, BY LUFTHANSA, TO-NIGHT. HE IS RELEGRAPHING SEPARATELY ABOUT HIS TRAVEL PLANS AND ABOUT ADDITIONAL DETAILS THE FRENCH HAVE GIVEN HIM ON THEIR FINANCIAL PACKAGE. THESE REVEAL A PICTURE WHICH IS EVEN LESS EASY FOR US.

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