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Northern Ireland Office
Stormont Castle
Belfast BT4 3ST

BR
LME HMT
response
AT 10/11

Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON

10 November 1983

Handwritten signature

HARLAND AND WOLFF LTD: BLUE STAR LINE ORDER

In July E(NI) colleagues agreed that I should authorise Harland & Wolff Ltd (H&W) to take orders for three refrigerated cargo ships to be leased by the Blue Star Line and that I should clear terms for the remaining vessel with colleagues. The average subsidy implied for the three ships amounted to 46.5% of selling price.

Building contracts have now been signed for the first two ships. For the third ship, however, it subsequently emerged that the lessors, Investors in Industry (III), and Blue Star could not come to terms on the basis described to Ministers and III sought a level of subsidy of over 50%; the bank consortium offering terms for the fourth ship sought over 55%. I made it clear that I could not contemplate such proposals for either vessel and I insisted on improvements. H&W have therefore been engaged in intensive re-negotiations. This involved a rejection of the bank consortium's terms so that they have withdrawn leaving H&W negotiating with III for the financing of both ships.

The terms now proposed for ships 3 and 4 are set out in Annex A; they show a very marked improvement over those until recently requested by III while remaining more expensive than the level agreed for the third ship last July and involving, at a nil net cost to government, an extension in the indemnity arrangements sought by III

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from H&W (details in Annex B). The improvement arises partly from a favourable shift in III's position. But H&W have themselves been able to reduce their costs on all four ships by some £1m by securing lower than estimated prices from component suppliers; these savings have reduced the subsidy level agreed last July for the first two ships. The Department of Economic Development have retained PA Consulting Services who have verified that these savings either have been or can be secured in materials purchases.

I believe that H&W should now be authorised to clinch the order for the remaining 2 ships on the terms outlined. The total subsidy for all four vessels, taking account of the improvements secured on ships 1 and 2, would now be £31.32m - less than £1m more than the sum would have been if the final ship had been contracted on the terms colleagues accepted last July for the third ship. The average subsidy, compared with the level agreed for three vessels, would rise by 0.7%. There would be no impact on the agreed EFL for 1983/84.

In the absence of other firm order prospects (though H&W are energetically seeking orders and the recently announced licensing agreement with the Japanese company IHI is welcome, though it does not in itself constitute new orders) I am firmly of the view that the full 4-ship order is the minimum necessary to enable the new leadership at H&W to pursue their efficiency drive effectively. The full order would also enable the Government to avoid the human and financial costs associated with either a 2 or 3 ship order. These would include early lay-offs of up to 1,000 men, an additional cash requirement of up to £7.3m on top of the external financing already agreed for the Company in 1983-84, and extra cash costs in 1984-85. In light of the very strong case for maintaining employment at H&W on social and political grounds, I am sure colleagues will agree that the alternatives to taking the full order for four ships at the minimal additional subsidy required are unacceptable.

H&W must press ahead quickly with the work on the third and fourth ships if they are to ensure maximum savings on construction costs.



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Therefore, if you and colleagues are content I intend to authorise the company to settle the orders on the terms described within the next week. I would be grateful for views by close of play on 15 November.

A copy of this letter goes to the Prime Minister, other E(NI) colleagues, the Foreign and Commonwealth Secretary and Sir Robert Armstrong.

A handwritten signature in cursive script, appearing to be 'G. Brown', written in dark ink on the paper.

HARLAND AND WOLFF LIMITED
BLUE STAR LINE ORDER

	SHIP 3		SHIP 4	
	£m	% of Price	£m	% of Price
1. Construction Cost - Note 1	20.1		19.2	
2. Contract Price	17.4		16.2	
3. Intervention Fund - Note 1	2.36	13.6	2.67	16.5
4. Shipbuilders' Relief	0.35	2.0	0.32	2.0
5. Interest Subsidy on S. 10 loans (NPV)	1.54	8.9	1.53	9.4
6. Soft Credit (NPV) - Note 2	1.71	9.8	1.48	9.1
7. Interest Indemnity (NPV)	1.25	7.2	1.10	6.8
8. Interest Free Loans	1.39	8.0	0.97	6.0
TOTAL SUBSIDY (3-8)	8.60	49.5	8.07	49.8

NOTES:

1. These items reflect the reduction in material costs of £250,000 per vessel described at paragraph 4 of the memorandum. So far as ships 1 and 2 are concerned, the effect of the material savings is to reduce the estimated construction cost per vessel to £19.45m; the intervention fund aid per vessel to £2.70m (16.5% of contract price) and the total subsidy to £7.325m per vessel (44.7% of contract price). Taken with the subsidy levels for ships 3 and 4 shown above, this gives a total subsidy for the four ships of £31.32m; 47.2% of total contract price. In comparison, Ministers approved a subsidy level of 46.5% for 3 ships in July.

2. The soft credit terms follow lines previously agreed. Interest charges would be subsidised on the difference between commercial lending rates and 4.56%, and the loans would have a life of 15 years, including what amounts to an initial 5-year moratorium.

HARLAND AND WOLFF LIMITED
BLUE STAR LINE ORDER

HARLAND AND WOLFF INDEMNITIES

1. Terms approved by Ministers in July 1983 for the third ship (then referred to as ship no 4) included the offering by H&W to III of an indemnity of last resort against liabilities which might accrue on the early termination of the leasing agreement. In effect, the indemnity is against cash shortfalls being suffered by III in the event of the value of its second charge on the vessel and recourse against the assets of Frederick Leyland/Blue Star being insufficient to cover its exposure. For the third ship the guarantee was expected to have a theoretical maximum of £7.29m (of which £3.79m would immediately be repaid to Government as tax leaving a net outlay of £3.5m) and for the fourth ship it would be £5.2m - net £2.5m. An examination of the risk revealed that an unlikely concatenation of events would be needed to require any payment under this indemnity.
2. The submission to Ministers also recognised that, in the event of an early termination of the leasing agreements, the interest free loans advanced by H&W to III (see Annex A) would be repaid at a discounted value ie III would not be required to pay back the full amount of the loans. Lawyers acting for III now believe that the amounts by which the loan repayments would be reduced might be regarded by the Inland Revenue as receipts in the hands of III and, therefore, taxable, and III have sought an indemnity against this tax liability should it arise. H&W and its lawyers have produced a possible solution to meet the difficulty. This is being discussed but it is thought unlikely that III will agree that it fully meets their concerns and so

be prepared to relax their request for an indemnity. It should be noted that, in the event of this indemnity having to be met, the net cost to government would be nil, since any monies paid by H&W to III would be collected by the Inland Revenue.

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AT 18/11

Co NO

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon James Prior MP
Secretary of State for Northern Ireland
Northern Ireland Office
Whitehall
LONDON
SW1P 3AJ

18 November 1983

Dear Secretary of State,

HARLAND AND WOLFF: BLUE STAR LINE ORDER

Thank you for your letter of 10 November.

Although E(NI) last July expressed its dislike of the terms, then on offer, and insisted that they were not to be repeated, I agree with you that there is little alternative but to accept the further deterioration - if that will secure this deal. On the assumption that the new terms are sufficient, I am prepared to agree that you should authorise the company to settle.

I am copying this letter to the recipients of yours.

yours sincerely

for PETER REES

(approved by the Chief Secretary & signed in his absence)

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Nat Ind Shipbuilding
P+S

18 NOV 1983

