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PRIME MINISTER

In view of the tax loss point I leave this decision to the Treasury and DTI. ~~Agreed~~ MT

SCOTT LITHGOW

Mr. Lamont's letter to the Chief Secretary reports on DTI's analysis of the conditional agreement reached between BS and Trafalgar House. This shows that renegotiation of the contract and completion by BS is the most expensive option; closure would cost BS around £53 million; sale to TH would cost BS around £48 million. Although the difference is not large, it indicates that the TH deal is the cheapest of the three courses.

The Policy Unit has looked at the proposal and has identified a number of points at which the terms could be tightened up in favour of BS but, while we could suggest these to DTI, we should also take note of Mr. Lamont's warning against tinkering with particular components of the agreement.

To assess the cost to the Exchequer, as opposed to BS, one needs also to take account of:

(i) use of tax losses by TH which represent a loss of revenue to the Exchequer;

(ii) savings to the Exchequer from keeping an additional 1,250 men at work.

Would the same apply to Bechtel vice the wider use referred to on p.3 of the letter?

DTI conclude that the benefit of (ii) is greater than the cost of (i).

Thus, on balance, the deal looks favourable to the Exchequer but there are two presentational points to be considered:

(i) TH are proposing to lease some of the assets, giving an appearance of lack of long-term commitment;

(ii) the fact that TH have hammered out an agreement much faster than anyone else can give the impression of a cosy deal. (An illustration of this is the thoroughly offensive letter from the STUC which I suggest should receive a Private Secretary reply

/ rebutting

rebutting the suggestions made and reiterating the assurances given in the House yesterday.)

Mr. Lamont proposes giving informal approval to the TH deal on the condition that the door is still open for other offers. He will need, however, to impose a deadline.

Agree, subject to colleagues, to the line suggested by Mr. Lamont, provided -

(i) TH are pressed to buy rather than least assets;

(ii) a reasonable time limit is specified for the submission of other offers?

AT

10 February 1984

NBPM
AT. 16/2

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

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Norman Lamont Esq MP
Minister of State for Industry
Department of Trade and Industry
1 Victoria Street
LONDON
SW1

15 February 1984

Dear Norman,

SCOTT LITHGOW

Thank you for sending me a copy of your letter of 10 February to Peter Rees about the conditional agreement between British Shipbuilders and Trafalgar House for the sale to the latter of Scott Lithgow. I have since seen Arthur Cockfield's minute to the Prime Minister of 13 February.

On terms, I agree with Arthur that the papers before us are far from clear on what the proposals will cost BS and TH. Certainly, if the TH deal goes through we shall be attacked for having sold too cheaply - from the history of this affair it is likely to be the automatic reaction of our opponents in almost any circumstances. Nevertheless, I am sure that the best course is to support its terms, on the basis that our principal aim is to get a new operation going and unless a better offer emerges we will be prepared to approve the agreement. But I do hope you will elucidate some of the points raised in Arthur's letter.

One aspect of the arrangement with TH concerns me. They are going to take over SL as a going concern, including all SL's extensive land holdings at Greenock and Port Glasgow, part of which at least (the former Scott's yards at Greenock which built naval vessels) do not, from what TH told us when we met them on 13 February, figure in their plans for the development of SL as an offshore yard which would be based on the main Lithgow yard at Port Glasgow. I have already made several public references to my intention to initiate a programme of redevelopment and rehabilitation along the Firth of Clyde waterfront, and it would be a serious matter if this programme could be frustrated by lack of cooperation from TH or difficulty over price, at some point in the future, in respect of land they held but did not require for their offshore business. I suggest therefore that the option for TH to purchase the SL assets for £8m at the end of the initial lease from BS (pre-condition (d) of the TH letter of 7 February to BS) should be modified to the extent that SL's land holdings would be reviewed, if they decide to exercise their option, in the light of the company's operational needs, and any surplus to those needs would be retained by BS for disposal in accordance with the redevelopment programme.

Turning to the question of the other parties who have declared an interest in SL, it is of course going to be difficult to keep TH in play, and at the same time not frighten away the others. What you propose seems a satisfactory way of achieving this given that our overriding interests must be to find new management for SL. But it remains important that if Howard Doris and the Bechtel-led consortium are seriously interested they should be given a full opportunity to put in an offer. We should be open to serious and legitimate criticism if that were not the case, and I hope you will impress on Mr Day the need to give these others a fair crack of the whip, above all now that Britoil have relaxed their timetable. The best way of achieving this would be to make it known that if Bechtel and Howard Doris intend to put in offers they should do so by a certain date. That date could be one settled with BS and Britoil as meeting the requirements of both.

I am sending copies of this letter to the Prime Minister, Peter Rees, Michael Heseltine, Peter Walker and to Sir Robert Armstrong.

Yours ever,

George.

NAT IND: Shipbuilding: Pt6.

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DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ

Direct Line 01-211 3290
Switchboard 01-211 3000

THE MINISTER OF STATE

NBPM
AT
14/2

cc NO

Norman Lamont Esq MP
Minister of State for Industry
Department of Trade & Industry
1 Victoria Street
LONDON
SW1H OET

14 February 1984

Dear Norman

with AT?

Thank you for letting me see a copy of your letter of 10 February to Peter Rees.

So far as the Department of Energy is concerned our main preoccupation is to see re-created at Scott Lithgow a capacity to construct mobile offshore structures competitively and for the Britoil rig to be completed there and brought into service as soon as possible.

We share your view, therefore, that while all options should be kept open, not least because the key to success lies with Britoil rather than Government, we should give strong consideration to Trafalgar House who have the necessary financial and industrial muscle and who will give the venture an essentially British character. But I consider it vital that Trafalgar House - or any other successful candidate - should establish an association with a company (for example Gotaverken (GVA)) who will provide the project management and design expertise lacking in Scott Lithgow's operations so far. Trafalgar House on their own would not command customer confidence and I have no doubt that, to satisfy Britoil, a clear association with someone like GVA will be necessary. But such involvement should be on a long term basis; the new look Scott Lithgow must not become a one-order yard.

Subject to my concern about the acquisition by Trafalgar House of the necessary management skills I am content to see matters proceed in the way you describe.

I am copying this letter to the Prime Minister, Michael Heseltine, George Younger, Lord Cockfield and Sir Robert Armstrong.

Yours ever

Alick

ALICK BUCHANAN-SMITH

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NAT IND
Shipbuilding
pt6

14 FEB 1984

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ECNO

NBPM
AT 13/2

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 6328 (Direct Dialling)
01-218 9000 (Switchboard)

PARLIAMENTARY UNDER-SECRETARY OF STATE
FOR DEFENCE PROCUREMENT

USofS(DP) 7/1

13 February 1984

Dear Norman.

— with AT?

You sent Michael Heseltine a copy of your letter of 10th February to Peter Rees in which you sought agreement to a line to be taken with British Shipbuilders over their conditional deal with Trafalgar House on the acquisition of Scott Lithgow.

In Michael Heseltine's absence overseas, I am writing to confirm that we are content with your proposed line. I was glad to note from your letter that Scott Lithgow under new ownership would continue existing contracts (including those with MOD) on their existing basis. My officials have already proposed to yours that this should be made explicit in the agreement between British Shipbuilders and Trafalgar House, as I see from the BS letter of 8th February is now the case with the BP rig contract. Our vessel, HMS Challenger, has already suffered considerable time and financial overruns and this aspect coupled with the importance of it to us in strategic terms explains our concern.

I am copying this letter to the Prime Minister, the Secretaries of State for Energy and for Scotland, the Chief Secretary, Treasury, and to Sir Robert Armstrong.

with kind regards.
Even
John.

(JOHN LEE)

Norman Lamont Esq MP
Minister of State for Industry
Department of Trade & Industry
1-19 Victoria Street
London SW1H 0ET

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Shipbuilding Pt6

13 FEB 1984

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Chancellor of the Duchy of Lancaster

PRIME MINISTER

SCOTT LITHGOW AND TRAGALFAR HOUSE

1. It is impossible to judge the merits of this proposition without much more information than we have been given.

2. We need as a minimum a statement showing in detail what assets are being sold, what British Shipbuilders is receiving - or paying - and what liabilities it is retaining. Similarly we need to know what Trafalgar House is getting and what it is paying for it.

3. It would be valuable also to have pro-forma balance sheets showing the position on the existing basis immediately before the Completion Date - expected to be in March - and on the new basis immediately after the Completion Date.

I would imagine that Trafalgar House have drawn up such balance sheets - the figure of £12 m quoted as the Purchase Price in paragraph 3 of the Heads of Agreement won't have been plucked out of thin air. British Shipbuilders may also have drawn up such balance sheets. If they have not they certainly ought to have done.

4. I suspect that the deal is very advantageous to Trafalgar House. For (apparently) £12 m they get all the assets, other than the fixed assets which are leased to them free of charge with an option to purchase, plus tax losses which may be as much as £150 m. The £12 m is a net figure in that it has been struck <u>after</u> deducting the expected loss to date on both the Britoil rig and the BP semi submersible. Effectively Trafalgar House's risk is limited to this £12 m: if the venture fails it would simply allow Scott Lithgow to go into liquidation. If the venture succeeds, it could make a great deal of money.

5. From British Shipbuilders' point of view the attraction of the deal is that it allows it to "get out from under" with a small net cash receipt. There will of course be massive write offs; but these would have occurred anyway if the yard were closed down. And some jobs will be saved - a card of some, if limited, value in dealing with the Unions elsewhere. I can well understand Graham Day seizing what appeared to be a lifeline where otherwise all was lost.

6. None of this however answers the question whether the Trafalgar House deal is the best available, or indeed whether better terms could not have been secured from Trafalgar House. It is claimed that the deal had to be concluded because of a time limit set by Britoil: but that time limit does not appear to be as pressing as originally alleged.

7. It is said that in cash terms the Trafalgar House deal would save £5 m compared with closing down. No evidence is produced to support this claim or the figure. Having regard to the large sums involved, a "difference" of as little as £5 m must be viewed with scepticism.

8. The more important point is that it is admitted the Bechtel have shown "serious interest". It is clear that British Shipbuilders regard themselves as morally committed to Trafalgar House. We simply cannot accept this. The Bechtel interest must be pursued. Quite apart from the money, Bechtel have a very high managerial reputation and that with their world wide operations could make their involvement of real advantage to the UK economy. They may have to be given a time limit: but I would expect them to respond very quickly if they thought any offer they made would be seriously considered.

9. The same applies to Howard-Doris and anyone else who shows a serious interest.

10. I very much doubt whether Trafalgar House would pull out in a huff if we opened up talks with other people. The deal they have

tentatively concluded is so advantageous to them that they may threaten: but they are unlikely to act. On our side, our position would be indefensible unless we had made quite certain that the present Trafalgar House deal was the best obtainable - either from Trafalgar House or anyone else.

A.C.

A C
13 February 1984

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DEPARTMENT OF TRADE AND INDUSTRY
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From the Minister of State for Industry

Norman Lamont MP

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1P 3AG

10 February 1984

Dear Peter

SCOTT LITHGOW

As colleagues are aware, Trafalgar House (TH) have concluded a conditional agreement with British Shipbuilders (BS) for the acquisition of Scott Lithgow (SL). I attach copies of TH's letter of 7 February, containing heads of agreement, together with BS's letter of 8 February containing some clarifications. (Officials of Departments concerned have already had copies of these documents). We need to decide urgently whether there is anything in the proposed deal that we should take exception to, and also, in the light of the political furore that the agreement has attracted, what attitude BS should be advised to take towards other potential bidders for SL.

I should make it clear that the documents as they stand have no legal effect. The agreement is conditional on the approval of BS's Board, TH's Board, and, where necessary, HMG. It will of course be essential that Britoil too are satisfied about the competence of any buyer and on the revised terms on which their contract is to be completed.

While Norman Tebbit will have to give his approval to the terms of any disposal of SL when we have a completed and agreed deal, it is important that we should let BS and TH know at once if there is anything in the proposed deal that would cause HMG difficulty.

Shorn of its complications, the proposed deal transfers the assets of SL and the existing contracts on a "clean slate" basis, writing off losses and liabilities. However the clean slate basis makes certain assumptions about the likely future losses on existing contracts, including the Britoil contract.

On the Britoil contract the yardstick adopted has been BS' potential loss if cancellation goes through. BS' exposure is limited to the equivalent of this amount. Any additional losses (which could well arise unless TH's performance is very good) will be the responsibility of TH. The deal envisages that the fixed assets of SL should be retained by BS and leased to SL for the first three years, with TH having an option to buy them for the sum of £8 million.

Continuation of the Britoil work will involve new contractual arrangements with Britoil. Under the proposed deal SL would continue the other existing contracts (with MOD and BP) on their existing basis.

My officials have discussed with BS the costs of the various options. Renegotiation of the contract and completion by BS (which the BS Board have ruled out on commercial grounds) remains clearly the most expensive. In cash terms to BS sale to TH works out marginally (perhaps £5 million) cheaper than cancellation and subsequent closure of the yard. Broadly a comparison on a PSBR cost basis of the TH sale versus closure appears to show that sale to TH would be more advantageous. The PSBR costs of redundancies following cancellation appear to outweigh the estimated PSBR costs of the utilisation of some of the tax losses included in the deal. Because of the phasing of various payments and receipts the TH deal would be more costly than cancellation in 1983/4 in EFL terms, the balance being recouped in subsequent years.

In the heads of agreement TH are seeking certain undertakings or commitments from the Government. These are contained in paragraph 1(e) of the heads of agreement. It is not entirely clear what comfort TH are expecting, but we clearly cannot give a binding commitment in advance that the various expenditures would be eligible for RDG or selective financial assistance support. Short of this we can of course provide TH with such further guidance as they may be in need of, including the effect of the changes set out in the White Paper on Regional Industrial Development (Cmnd 9111), including the important change in RDG treatment for expenditure after November 1985. As regards item 1(f), I do not imagine that this will cause any difficulty in practice and TH should be encouraged to make contact with the Office of Fair Trading to institute clearance proceedings as soon as possible.

An element of the deal that is clearly important to TH is the acquisition of SL's tax losses (paragraph 8 of the heads of agreement). Such acquisition is a normal practice, and I see no impediment in it. As I understand it tax losses arising before the takeover would be usable only against future profits arising in SL itself. Inherent in the deal will be certain tax losses which will arise from the completion of the various contracts in train - perhaps about £50 million - and these will, I believe, be usable in the TH Group more widely.

Viewed in isolation, therefore, and subject to the points we need to make on paragraph 1(e) of the Heads of Agreement, I see nothing in the proposed deal that we should take exception to, and in the light of the comparative costs of cancellation, the preservation of employment, and the preservation of offshore rig building capability, I believe that we should look favourably upon it. If colleagues have any major points to make on the Heads of Agreement they will no doubt let me know. I believe strongly however that we should resist the temptation to tinker with this or that element if an alteration is not fundamental to the Government's attitude to the deal.

If the deal is to go ahead two major hurdles have to be surmounted by TH. The first is the renegotiation with Britoil of new contractual arrangements. The second is securing the agreement of the SL workforce to the deal and the changed terms and conditions that will stem from it. Both these hurdles may present significant difficulty, but, other things being equal, ought not to be insurmountable.

The 29 February deadline set in the Heads of Agreement was no doubt conditioned by the understanding that this was Britoil's cut-off point. Sir Phillip Shelbourne yesterday morning told me that Britoil are in fact now prepared to extend this date to the end of March.

All the above relates to the TH deal viewed in isolation. But we cannot ignore, and nor will Britoil ignore, the presence of other contenders, even though only one of these - Bechtel - has so far shown anything like serious interest. The probable next contender - Howard Doris - made contact with BS only on Wednesday. We need to balance two conflicting considerations here. Clearly in the interests of fairness and public accountability we do not want to exclude anyone with a genuine and serious interest from the field. On the other hand in pursuing the very much stronger interest shown by TH, BS have been acting entirely correctly and commercially. The TH deal has now reached an advanced stage, and it would be unfortunate indeed if it foundered and the interest expressed by the other potential contenders turned out to be nugatory. The BS Chairman, Mr Graham Day, takes the view very strongly that we should stick to the TH deal and not do anything that would put it in jeopardy. This is entirely understandable, but we have to take account of the wider considerations.

In these circumstances I believe that in responding to BS on the TH deal we should make it clear that our broad and informal approval cannot preclude the Secretary of State's consideration of, and preference for, a better deal if one should come along; that we fully recognised the importance of keeping alive the bird in the hand of the TH deal; that at least while Britoil are considering the TH proposals it would be commercially right (and certainly presentationally necessary) for BS to consider approaches by other contenders. Britoil themselves will certainly want to look at other contenders, although they do not have many weeks if they wish to have their rig by the 1986 season. BS will need to keep in close touch with my Department as the negotiations proceed. We have to satisfy both the needs of public accountability and of commercial reality. But given the advanced stage that negotiations have reached, it would be entirely right, if and when Britoil are satisfied, for BS to conclude the deal with Trafalgar House.

Unless I hear from you and other colleagues to the contrary by 3.00 pm on Monday I propose to advise BS on the lines I have set out above.

I am copying this letter to the Prime Minister, Michael Heseltine, Peter Walker, George Younger and Sir Robert Armstrong.

I have asked for a copy to be sent to Lord Cockfield

Yours ever

Norman

NORMAN LAMONT

PUBLIC LIMITED COMPANY

1 BERKELEY STREET · LONDON W1X 6NN

Eric W. Parker,
Group Chief Executive

EWP/IF/SAH/TB

STRICTLY CONFIDENTIAL

SUBJECT TO CONTRACT

J.G. Day Esq.,
Chairman and Chief Executive,
British Shipbuilders,
197 Knightsbridge,
London, SW7 1RB.

7th February 1984

Dear Mr. Day,

Scott Lithgow Limited

Further to the recent meetings between representatives of this Company and of British Shipbuilders ("BS") I set out the basis upon which, subject to approval by the Board of Trafalgar House Public Limited Company, we would be prepared to purchase from BS the whole of the share capital of Scott Lithgow.

By way of background we explained to you that over the last ten years we have steadily increased our involvement in the offshore oil and gas industry. Within the Trafalgar House Group we have the largest topside manufacturing facilities in Europe in our Cleveland and Redpath Offshore operations on Teesside. Also, through Lawrence-Allison, we have worldwide involvement in engineering and project management. Recently we have acquired substantial interests in oil and gas exploration and production both in the UK and USA.

We firmly believe that technology in the North Sea and in fact around the World is moving towards production systems which could be readily manufactured by Scott Lithgow. It is for this reason we are prepared to make the very considerable management efforts and sacrifices to ensure that Scott Lithgow not only completes the Britoil contract but also becomes a credible long term construction company in the offshore market.

We believe that with our offshore construction capabilities and the experience we gained in successfully taking Redpath Dorman Long from the public sector to the private sector some two years ago, Trafalgar is uniquely qualified to cope with the problems of Scott Lithgow.

...... / Cont 2

1. Pre-Conditions

The following must be completed to our satisfaction as pre-conditions of the completion of any agreement:-

(a) agreement of a new contract or the amendment of the previous contract between, inter alia, Lloyds Leasing and Scott Lithgow for the completion of the Britoil/Ben Odeco rig by Scott Lithgow ("the New Contract"). The agreement between us will be terminated if Trafalgar and Scott Lithgow are unable to agree terms with Britoil which will enable Scott Lithgow to complete the Britoil contract at a cost not exceeding the Contract sum under the Terminated Britoil Contract plus an amount not exceeding £64m;

(b) agreement of acceptable working practices, levels of remuneration and terms of employment for all Scott Lithgow employees;

(c) agreement as to the basis of selection for redundancy and the terms of redundancy payments for employees;

(d) purchase of the fixed assets owned by Scott Lithgow by BS. Such fixed assets together with any other land, plant and equipment used by Scott Lithgow in its business shall be leased back to, or continue to be leased or used by, Scott Lithgow at a total cost to Scott Lithgow of £1 per annum for the period required to complete the contracts existing at Completion and in any event for a minimum period of three years.

Scott Lithgow shall have the option to repurchase such fixed assets as it previously owned at the end of the lease period at a price of £8m. If Scott Lithgow exercises this option it shall also acquire the benefit and the burden of all leases and licences to which it is a party which were previously covered by the payment of £1 per annum referred to above.

(e) our obtaining confirmation from the appropriate Government Department(s) that financial assistance will be provided in respect of:-

(i) capital expenditure on improvements we plan to carry out to the Scott Lithgow facilities. As indicated to you, our current estimate of such capital expenditure is £10m;

(ii) costs of retraining staff and hourly paid employees of Scott Lithgow;

(iii) purchase and installation of computer hardware and software systems in order to provide project management, material control and accounting information.

...... / Cont 3

(f) our obtaining confirmation from the Secretary of State that he does not propose to refer the acquisition to the Monopolies and Mergers Commission. In this connection I suggest that we make joint representations to the Office of Fair Trading as soon as possible.

Completion

Completion of the purchase and sale of the share capital of Scott Lithgow ("Completion") will take place within seven days of the fulfilment of the conditions referred to in 1 above. These must, in any event, be satisfied not later than the end of February 1984.

Purchase of Shares

Trafalgar (or one of its subsidiaries) will purchase the whole of the issued share capital of Scott Lithgow at a price equivalent to the aggregate value of its share capital and reserves ("the net asset value") disclosed by the accounts of Scott Lithgow to be drawn up as at Completion ("Completion Accounts").

If the net asset value revealed by the Completion Accounts is less than £12m, BS will subscribe at par in cash for shares in Scott Lithgow (which shares shall immediately be transferred to Trafalgar for no further consideration) in order to bring the net asset value upto £12m. Such subscription shall be made within seven days after the certification by the joint auditors of the Completion Accounts together with a payment of interest on the amount subscribed, calculated at a rate of 1% per annum over the National Westminster Bank base rate from the date of Completion to the date of payment, together with an amount equal to any Capital Duty payable by Scott Lithgow on the issue of such shares.

If the net asset value revealed by the Completion Accounts is more than £12m. Trafalgar will make a payment equal to the surplus to BS together with a payment of interest on that amount, calculated at a rate of 1% per annum over the National Westminster Bank base rate from the date of Completion to the date of payment. Such payment to be made within seven days after the certification by the joint auditors of the Completion Accounts.

4. Purchase Consideration

The purchase consideration will be paid on the following basis:-

At Completion	£ 3.0m
February 1985	3.0
February 1986	3.0
February 1987	3.0
	£12.0m

Interest will accrue on the deferred payments at a rate of 1% per annum over the National Westminster Bank base rate from the date of Completion to the date of payment. Trafalgar shall be entitled at any time without notice to pay the balance of the outstanding purchase price together with interest accrued (if any) to the date of such payment.

.... / Cont 4

5. Completion Accounts

Completion Accounts will be drawn up as at the date of Completion and will be jointly certified by Arthur Young McClelland Moores & Co. and Touche Ross & Co. ("the joint auditors"). The treatment in the Completion Accounts of certain items is dealt with below; otherwise the Completion Accounts will be prepared in accordance with good accounting practice and subject thereto upon the same bases as adopted by Scott Lithgow when drawing up their accounts at 31st March 1983:-

(a) the figures to be included in the Completion Accounts in respect of the contract between, inter alia, Lloyds Leasing and Scott Lithgow for the construction of the Britoil/Ben Odeco rig which has been terminated by Britoil ("the Terminated Britoil Contract") and New Contract will be agreed between us but in any event the provision in respect of the Terminated Britoil Contract shall not exceed £64m;

(b) the Completion Accounts will include:

(i) a provision in an amount to be agreed between us for redundancy costs expected to be incurred in the twelve months following Completion.

BS will use its best endeavours to obtain Government agreement for such amount to include provision for the payments equivalent to those provided under the Shipbuilding Redundancy Payments Scheme which it has been agreed will be paid to those employees of Scott Lithgow who are made redundant in the twelve months following Completion. If such agreement is not obtained then such payments will be made directly to the employees concerned by BS or the Government as and when incurred at no cost to Scott Lithgow.

(ii) a provision of £7m in respect of costs associated with the rationalisation and reorganisation of the facility and business of Scott Lithgow to be carried out after Completion.

(c) current assets (other than work-in-progress) will be included in the Completion Accounts at the lower of cost and net realisable value;

(d) (i) claims by Scott Lithgow (which have not been agreed and paid at Completion) will be included in the Completion Accounts on the same basis as was adopted in the 1983 Accounts of Scott Lithgow up to an aggregate maximum of £7.4m. An amount equivalent to the amount included in current assets in respect of such claims will be loaned by BS to Scott Lithgow interest free. Such loan will be repaid to BS as and when the claims are settled and the money received by Scott Lithgow on an item by item basis less reasonable costs incurred by Scott Lithgow in settling such claims.

...... / Cont 5

(ii) specific provisions to be agreed by the auditors will be included in the Completion Accounts on the same basis as was adopted in the 1983 accounts of Scott Lithgow in respect of notified claims against Scott Lithgow (other than claims covered by the provision in respect of the Terminated Britoil Contract referred to in 5(a) above). If the total amount paid by Scott Lithgow in respect of such claims (a) exceeds the aggregate of the specific provisions by more than £5m an amount equal to the excess over £5m will be paid by BS to Scott Lithgow (b) is more than £5m below the aggregate of the specific provisions an amount equal to the saving in excess of £5m shall be paid by Scott Lithgow to BS.

(e) other than in respect of (a) above work-in-progress will be included at the aggregate of the net realisable values of each of the contracts existing at Completion. In arriving at such values:-

(i) provisions shall be made in respect of claims by Scott Lithgow which have not been both agreed and paid prior to Completion in accordance with (d)(i) above;

(ii) fair and adequate provision shall be made for all known and potential claims from customers, suppliers, sub-contractors etc. in accordance with (d)(ii) above;

(iii) fair and adequate provision shall be made for future losses; in calculating the cost to complete the contracts existing at Completion (other than the Terminated Britoil Contract) a charge out rate of £14.50 per manhour shall be used to cover labour costs and overheads.

The joint auditors will employ such experts as they shall determine to assist in the certification of the Completion Accounts.

6. Warranties and Indemnities

We shall require BS to give full commercial and tax warranties and indemnities. We shall require full indemnities in respect of all claims and liabilities arising from events prior to Completion. In particular these indemnities will relate to:-

(i) all work (including design etc.) carried out prior to Completion for which Scott Lithgow is responsible save to the extent that a specific provision is made therefore in the Completion Accounts in accordance with 5(d)(ii) above;

(ii) any liabilities of Scott Lithgow to third parties other than Britoil arising out of the Terminated Britoil Contract, save to the extent that a specific provision is made therefore in the Completion Accounts;

...... / Cont 6

(iii) any losses, costs or damages which are incurred or increased as a consequence of the change in the ownership of Scott Lithgow.

Trafalgar will indemnify BS against claims by third parties against BS arising solely from the actions of Scott Lithgow after Completion in respect of the contracts in existence at Completion.

7. Bonds, Guarantees and Insurances

Any bonds or guarantees given by BS on behalf of Scott Lithgow in respect of contracts in existence at Completion will remain in force until contractual release. BS will maintain, at Scott Lithgow's cost, any existing professional indemnity insurance covering work carried out by Scott Lithgow.

We should like to explore with you the possibility of continuing other existing insurance policies after Completion.

8. Tax Losses

With regard to tax losses we shall require a warranty that Scott Lithgow will have available at Completion unutilised tax losses agreed by the Inland Revenue of not less than £77m for periods up to 31st March 1982 together with a tax loss of not less than £30m in respect of the year ended 31st March 1983, plus the tax loss to be agreed by the Inland Revenue for the period from 1st April 1983 to Completion.

BS will use their best endeavours:-

(i) to assist Trafalgar and Scott Lithgow to obtain the full benefit of the tax losses referred to above,

(ii) to ensure that such losses are not reduced under the provisions of S48 Finance Act 1981,

(iii) to ensure that the availability of such losses is not affected by the capital reorganisation referred to in 13 below.

9. Pensions

We require agreement from the relevant parties that all existing Scott Lithgow employees will be allowed to remain in the BS Pension Scheme for a period of twelve months after Completion. Thereafter, Scott Lithgow staff employees who remain would be required to join the Trafalgar House Group Pension Fund. We would like to explore the possibility of a transfer payment being made in respect of such staff employees from the BS Pension Schemes to the Trafalgar Fund as an alternative to their being granted deferred pensions under the BS Schemes. Hourly paid employees will become members of the State Scheme (with deferred pensions from the BS Schemes) as they are not eligible to join the Trafalgar Fund. Hourly paid employees will, however, participate in the Trafalgar House Group Life Assurance and Pension Plan, which provides life assurance cover on a non-contributory basis and allows members to supplement their State pension entitlement by paying additional voluntary contributions.

....../ Cont 7

Stamp Duty

We require BS to co-operate with us in a Stamp Duty saving scheme against an appropriate indemnity from us.

11. Professional Fees

Each party will bear its own costs in respect of its appointed auditors and solicitors. The cost of any experts employed by the joint auditors will be borne between us on a 50/50 basis.

12. Directors

At Completion such of the directors of Scott Lithgow as we shall require shall resign as directors without any claim for compensation etc. for loss of office. Such resignation will not affect a director's position as an employee of Scott Lithgow.

13. Loans from BS

We shall require all loans made by BS to Scott Lithgow, other than the loan referred to in 5(d)(i) above, to be eliminated from Scott Lithgow's balance sheet prior to Completion.

To the extent that the loans from BS relate to trading account items the loan will have to be repaid in cash; such cash to be raised by the subscription by BS for new shares in Scott Lithgow (the Capital Duty in respect of such new shares to be borne by BS). The balance of the loans from BS shall be waived before Completion.

14. Inter-Company Accounts

We require the inter-company accounts between BS and/or its subsidiaries and Scott Lithgow to be settled before the Completion Accounts are finalised other than in respect of current work. All disputes between BS and/or its subsidiaries and Scott Lithgow should be resolved and the results reflected in the Completion Accounts.

15. Computer Services

The central computer services of BS shall continue to be made available to Scott Lithgow for a period of upto twelve months after Completion on the existing termsagreed between Scott Lithgow and BS's computer division.

16. Scott Lithgow Name

BS will ensure that with effect from Completion the name Scott Lithgow will not be used by any companies or businesses within the BS group.

17. The Continuing Business of Scott Lithgow

From the date hereof and upto Completion the business of Scott Lithgow shall continue in the normal and proper course and we shall be consulted with regard to any material transactions prior to any commitment being made; this will include the settlement of claims, tendering for major contracts, capital commitments and any changes to employees' remuneration or other terms of service, other than in respect of the implementation at local level of the recent agreement reached at National level concerning working practices.

...... / Cont 8

In the event that the transaction is not completed we undertake that we will not make any use of any of the information which has been disclosed to us.

This letter supersedes our letter to you dated 26th January 1984.

Please indicate your agreement, subject to approval by the board of BS and any necessary Governmental approval, to the terms and conditions set out above by signing and returning the enclosed copy of this letter.

Yours sincerely,
For TRAFALGAR HOUSE PUBLIC
LIMITED COMPANY

E.W. Parker (Date : 7th February 1984)

enc.

We confirm our agreement, subject to the approvals referred to in the final paragraph, to the terms and conditions set out above.

For BRITISH SHIPBUILDERS

....

Chairman & Chief Executive

7 February 1984 (Date)

British Shipbuilders

J. Graham Day
Chairman & Chief Executive

197 Knightsbridge
London England SW7 1RB
Telephone: 01-581 1393
Telex: 8814702 BSBLDR G

8 February 1984

SUBJECT TO CONTRACT

Mr Eric Parker
Managing Director
Trafalgar House Plc
1, Berkeley Street
London W1N 6XX

Dear Sir,

SCOTT LITHGOW LIMITED

British Shipbuilders agreement to the terms of your offer letter of the 7th February 1984 is subject to clarification and agreement of the following points. For ease of reference, the points are numbered as in your offer letter:

1.d the sale and lease-back and the option to purchase the fixed assets will exclude those property assets specifically listed for potential disposal to third parties and already advised to Trafalgar House by Scott Lithgow;

5. the accounts of Scott Lithgow include a provision of £2.9m being the discounted net present value of the future liability under "interest make up" agreements entered into by British Shipbuilders on behalf of Scott Lithgow. Trafalgar House will advise British Shipbuilders if they wish to take over this liability or if they wish British Shipbuilders to retain it. In the latter event, the provision will be released by Scott Lithgow and the current account with British Shipbuilders increased by a like amount;

5.a the amount of £64m includes £7m for liquidated damages, being the maximum liability for such damages under contract 2002.

5.b(i) Trafalgar House will advise British Shipbuilders, before completion, of the number of Scott Lithgow employees who will be retained by them and for whom no redundancy provision will be made in the completion accounts. It is currently estimated that this number will be approximately 1250;

5.d(ii) the accounts of Scott Lithgow include normal guarantee provisions against completed contracts. These provisions must be exhausted on a contract by contract basis before Trafalgar House may make warranty claims against British Shipbuilders in respect of these contracts.

contd....

5.d(iii) contract 2001, "the BP Rig" will be treated in the completion accounts as a contract for physical completion. In the event of cancellation by BP, the effect will be dealt with by British Shipbuilders after consultation with Trafalgar House and the financial consequences of cancellation will be for British Shipbuilder's account and Scott Lithgow will be fully indemnified.

5.e(iii) the accounts of Scott Lithgow include a provision of £2.9m for liquidated damages being the maximum liability for such damages under contract 2001.

8. this warranty does not imply that such losses can be offset against future profits from Scott Lithgow's business and, further, Trafalgar House would not be entitled to make a claim under the warranty if such losses ceased to be available solely by reason of the capital reorganisation to be carried out in accordance with para 13 of your letter.

We have sent a copy of your offer letter of the 7th February and this response to the Department of Trade & Industry. This correspondence will then be used in early discussions with officials in order to obtain HMG's views on the structure of our proposed agreement. Dependent upon the outcome of such discussions, it is proposed to use your offer letter of the 7th February and this letter as a basis for the preparation of a draft contract.

Yours faithfully,

J G DAY

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

Copy Mr. Turnbull ✓
Mr. Redwood

Department of Industry & Trade
Ashdown House
123 Victoria Street
London SW1E 6RB
Telephone Direct Line 01-212
Switchboard 01-212 7676

D Connelly Esq
Scottish Industry Department
New St Andrew's House
St James Centre
EDINBURGH
EH1 3SZ

10 February 1984

Dear David

SCOTT LITHGOW: BS AND TRAFALGAR HOUSE (TH)

Norman Lamont will be writing round to colleagues today setting out the broad outline of the conditional BS/TH deal and recommending, in brief, that we look favourably on it and instruct Graham Day to pursue it as his prime objective, while not of course precluding other contenders from bidding.

The purpose of this note is to provide the background information you will need to brief your Minister.

At Annex A (only for those who have not yet received it) is a copy of the conditional agreement and a BS side letter registering some (fairly minor) caveats.

At Annex B is a schedule showing BS' calculation of the costs of the Trafalgar House deal and of the only current alternative, cancellation of the Britoil contract and closure of the yard.

The calculation is in four parts. Part A shows the present balance sheet deficit after writing off loans to SL by BS. It shows liabilities of £41m which have to be discharged either to conclude the TH deal or on closure. Part B assumes the current fixed asset value to be zero. Part C shows the various other costs incurred by each route. The "loan re debtors" is to cover claims from Britoil, ie the damages due on the rig contract. Part D shows the future income from the deal, falling post 1983/4. The bottom line is the net cash cost of the whole yard from end-December 1983.

We and Treasury colleagues have been through this complex arrangement in detail and we are satisfied that the figuring, some of which is of course a little speculative, is reasonable. If anything we think the closure costs may be a little understated.

We must also of course consider the wider PSBR implications. On the one hand TH will gain a valuable tax shelter from SL's losses, on the other closure would lead to extra redundancy, SRPS and unemployment benefit and lost tax revenue costs to Government. After discussion with the Treasury, we have concluded that SL's post tax losses, which will only be usable against future SL profits, will amount to an insignificant cost to the Treasury. The important item is the £50m or so losses on existing contracts likely to be incurred after the deal is struck, which TH will be able to use for group relief. We estimate that this will amount to a PSBR cost of £10m.

On the other side of the equations are the extra costs arising on closure from extra redundancies. TH intend that 1250 jobs will remain. At Annex C we have calculated the PSBR costs for the loss of these 1250, for two profiles of reabsorption of the unemployed a (slow) one over 5 years and a (fast) are over three years. The costs lie between £24m and £38m. This is clearly a speculative calculation, but it does strongly suggest that in the wider PSBR context the TH deal looks distinctly more favourable.

I hope you find this background helpful. Copies go to Bob Young (No 10), Richard Wilson and Alan Bell-Berry (Treasury), Callum Alexander (MOD), and Mr Allison (Energy).

Yours

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E P CAMERON

British Shipbuilders

J. Graham Day
Chairman & Chief Executive

197 Knightsbridge
London England SW7 1RB
Telephone: 01-581 1393
Telex: 8814702 BSBLDR G

8 February 1984

Mr Eric Parker
Managing Director
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1, Berkeley Street
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contd....

(e)
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Yours faithfully,

J G DAY

Annex B

		Trafalgar House	Closure
	Position as at P.9 Accounts		
A	Excess of Current Liabilities and Current Assets	90,192	90,192
	Add Group Relief receivable included as a current asset but to be offset against BS loan balances	11,063	11,063
		101,255	101,255
	Less BS Current Account	(60,569)	(60,569)
		40,686	40,686
B 1	Fixed Assets	Nil	Nil
C	Adjustments:		
	Redundancies	3,000	6,750
	Contingency (current Assets)	1,000	1,000
	Capital Duty	300	–
	Lease costs:		
	3 years charge	1,000	–
	Termination charge	–	2,400
	Current contracts:		
	SOV (753/700)	–	(2,000)
	BP Rig (2001)	–	3,000
	Britoil	3,100	3,100
	Loan re debtors	7,400	–
	Capital commitments	300	300
	Regional Development Grants repayable	–	1,000
	Under-recovery of overheads	–	2,000
	Reorganisation and retraining	7,000	–
	Funding of purchase price	12,000	–
	c/fwd	75,786	57,336

b/fwd	75,786	57,336
Future income		
Repayment of purchase price	(12,000)	-
Repayment of loan for debtors	(7,400)	-
Sale of Fixed Assets	(8,000)	(4,000)
	£48m	£53m

D)

Note:

(1) In a closure situation, might achieve better results from settling claims, but against this could be very considerably worse off if, on negotiating settlement of cancelled Britoil contract, we were forced to compromise on any recovery of OSE's.

(2) Cancellation of BP Rig 2001 much more likely in a closure situation.

(3) SRPS costs excluded from both calculations.

Annex C

PSBR COSTS - 1250 REDUNDANCIES

Profile 1 (Slow)

	Year 1	Year 2	Year 3
Unemployment benefit + lost tax revenue	9.049	8.390	6.934
SRPS cost @ £3.4 kpa	4.250	4.250	4.250
EPA costs @ £410 pa	0.513	0.513	0.513
	13.812	13.153	11.697

Profile 2 (Fast)

	Year 1	Year 2	Year 3
Unemployment benefit + lost tax revenue	6.381	3.170	0
SRPS cost	4.250	4.250	4.250
EPA cost	0.513	0.513	0.513
	11.144	7.933	4.763

SBP1
9 February 1984