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DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
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From the Minister of State for Industry

Norman Lamont MP

Prime Minister

Closure is now £4 million cheaper than the TH deal. This is within the premium of £5 million which Policy Unit suggested was acceptable. Agree the deal should be endorsed?

AT 26/3

Yes mt

CONFIDENTIAL

Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

26 March 1984

Dear Peter

SCOTT LITHGOW

I wrote to you on 23 March telling you of the latest state of play in the negotiations with Trafalgar House (TH). Briefly a satisfactory deal had been reached but for one fundamental disagreement. TH were insisting that BS should accept a contingent liability for costs which might arise in the event of late delivery by TH of the Britoil rig, if the delay could be attributed to design faults occurring during BS' period of ownership. I told you that I regarded this as unacceptable and was proposing to make this clear to TH in no uncertain terms.

Eric Parker of Trafalgar House was duly informed of my position on Friday morning. In response he instructed his negotiators to reopen talks with BS immediately. BS were of course also aware of our position and the need to negotiate extremely toughly on this point. After lengthy talks on Friday, a deal was concluded under which BS would buy out the contingent liability (a maximum of £120m you will recall) for £6m in cash. The BS Board is now prepared to recommend the deal to the Government on the basis I described in my last letter plus this new arrangement on design liability. I do not expect to receive a formal request for approval until tomorrow but, in order to make rapid progress, I am informing you and colleagues now of what BS have told my Department will be involved.

I should also add that in the earlier negotiations BS have also been able to take account of the various points you and colleagues raised on the original Heads of Agreement. In particular TH are now going to buy the land outright, with payment deferred for 3 years. Moreover they have I understand reached an agreement with the SDA designed to ensure that surplus land will be made available and at a price reflecting its value within the £8m they are paying for the assets. I also see no problems with the defence contracts currently with the yard, which will be fully honoured by the new owners.

The figures as seen from the purely BS standpoint now appear slightly less favourable, moving to £71m for the TH deal against £67m for closure. But the underlying calculations - which have been made available to your officials - inevitably rely on a number of assumptions, especially on the cancellation side. In particular the estimates of the extra costs of completing the BP rig and the SOV in the situation of a yard run-down could well be understated. In this light I think it is best to consider the costs of the two options - accepting the TH deal or closing the yard - to be broadly in balance.

From our standpoint we must of course also consider the wider PSBR implications: on the one hand, TH will gain a valuable tax shelter, while on the other closure would give rise to extra redundancy, SRPS and unemployment benefit and lost tax revenue costs to Government.

Our officials considered the tax shelter point in the context of the earlier Heads of Agreement. They agreed that SL's past tax losses, which will be useable only against future SL profits, would represent a relatively small cost to the Treasury. The important item is £60m or so losses on existing contracts likely to be incurred after completion of the deal and which TH will be able to use for group relief. We estimated before the budget that these would give rise to a PSBR cost of about £12m. Clearly they will now be less valuable, though the figure is difficult to calculate given the phased reduction of Corporation Tax.

On the other side of the equation are the extra costs arising on closure from extra redundancies. TH envisage a core workforce of about 1250. Our officials agreed that the PSBR costs of the loss of those 1250 jobs, depending upon the profile of reabsorption into the economy of the unemployed one assumes, lie between £24m and £38m.

These sort of calculations are inevitably speculative. But they strongly suggest that from the wider PSBR standpoint the balance of advantage lies clearly in the direction of the TH deal. And beyond the direct financial implications, there are of course the wider advantages of retaining a substantial number of jobs in Inverclyde and of retaining valuable offshore capacity.

My conclusion is therefore that we should accept this deal. The news that it has been reached will inevitably break very soon. Provided colleagues agree that it is acceptable, we must move very quickly to give our formal approval if we are to reap what political capital is to be had from the resurrection of the yard. Unless I hear to the contrary from colleagues by close of play tomorrow, I therefore propose that Norman Tebbit gives his formal approval on Wednesday morning. I would then propose to make a statement to the House on Wednesday afternoon, provided that this is acceptable to John Biffen.

I am copying this letter to the Prime Minister, Peter Walker, Michael Heseltine, George Younger, John Biffen, Arthur Cockfield, Tom King, John Wakeham, Lord Denham and Sir Robert Armstrong.

Yours ever

Norman

NORMAN LAMONT

Nat Ind: Shipbuilding Pt6.

CONFIDENTIAL

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CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Norman Lamont MP
Department of Trade & Industry
1 Victoria Street
LONDON
SW1E 6RB

28/3

27 March 1984

Dear Norman

SCOTT LITHGOW

Thank you for your letters of 23 and 26 March setting out the revised terms proposed for the disposal of Scott Lithgow to Trafalgar House (TH) and Howard Doris.

I am naturally concerned to see that the estimated cost of closure has risen by over £36 million since the provisional terms were agreed in early February. Whereas I would have thought that this should have enabled BS to improve the benefit of disposing of Scott Lithgow to TH, I note with even more concern that the cash injection to achieve this deal has risen even faster (by £45 million) so that a benefit to BS foreseen in February has now become a deficiency of £3½ million. However, I accept that there is still a significant benefit to the PSBR in the revised terms rather than closing the yard. I therefore agree that we should accept the deal on the terms now proposed.

I am copying this letter to the recipients of yours.

Yours ever
Peter

PETER REES

CONFIDENTIAL

27 FEB 1984

CC NO.

CABINET OFFICE.
WHITEHALL, LONDON SW1A 2AS

Chancellor of the Duchy of Lancaster

26 March 1984

NBPM

AT 26/3

Dear Peter,

SCOTT LITHGOW

This is just to say that I entirely support Norman Lamont in saying - in his letter to you of 23 March - that we ought to stand out against Trafalgar House's demand that British Shipbuilders should accept responsibility for further contingent liabilities which could amount to £120 m.

My view of the deal generally is that it is unduly generous to Tragalgar House in the sense that their downside risk is very small and their potential upside gain very large. But that much we can swallow because of the employment aspects - something Trafalgar House are no doubt trading on. But there is a limit to the extent to which we should allow ourselves to be squeezed.

I am sending copies of this letter to the other recipients of Norman's letter to you.

Yours,
Arthur

COCKFIELD

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
H M Treasury
Parliament Street
London SW1

NAT IND PT 6

Shipbuilding

CCNO

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From the Minister of State for Industry

Norman Lamont MP

CONFIDENTIAL

Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

23 March 1984

Dear Peter

SCOTT LITHGOW

I wrote to you on 10 February, setting out the then state of play on BS' negotiations for the sale of Scott Lithgow. (I subsequently wrote to Arthur Cockfield (17 February) setting out in more detail the basis of the provisional figuring that BS had put to us on a proposed deal with Trafalgar House (TH).)

Since then, other potential buyers have expressed some interest but have dropped out; and Howard Doris has agreed to participate in the Trafalgar House bid.

The other main development over this period has been that BP, for whom BS are building another rig at Scott Lithgow, have threatened cancellation of their contract if it is not renegotiated (my letters of 3 and 15 February to Alick Buchanan-Smith). BS are still negotiating but their present view is that renegotiation of the BP contract will be the cheaper option: they estimate that a renegotiated delivery date, plus some other adjustments to the contract, will cost in the region of £15m. This figure is not taken into account in the figuring in the rest of this letter: I shall be reporting further on BP when the situation is clearer.

BS have negotiated hard with TH over the last few weeks, and are now almost at the stage of a final agreement - with one important issue unresolved, to which I return below. I understand that TH are in a position to sign a contract with Britoil, when negotiations with BS are complete.

On the basis that they have now reached, the comparative costs of the TH deal versus closure of SL are:

	TH	Closure	
£m	65	67	precious little difference.

The detailed figuring underlying these costings is set out in the Annex. My officials are briefing yours, and officials in Departments to whom this letter is copied, on the technical background to these figures.

The figures for closure and for the TH deal are now about £17m and £14m higher than the previous estimates respectively. This is partly because TH are driving a hard bargain on a number of points - such as the cost of meeting new safety standards - and partly because, in the event of closure, BS have now been advised that they would be liable to pay for so-called "owner-supplied equipment", which BS' advisers had previously believed to be a liability for Britoil.

The total sums involved are large, whether we approve the TH deal or allow SL to close. The balance, as things stand, is still just in favour of the TH deal. Financial provision for costs arising in 1983/4 will be met by the Supplementary Estimate recently agreed between our Departments.

However, we do not yet have a firm proposal from BS. This is because TH are insisting that BS should accept a contingent liability for costs which might arise if there was late delivery by TH which could be attributed to design faults that occurred during BS' ownership of SL. These costs, if they arose, could have two components:

- damages payable to Britoil, to a maximum of £30m;
- financial losses to TH arising from the sale value of the rig, if Britoil refused to accept it, being less than the contract price. At the most extreme, if the rig ultimately proved totally unsaleable, this figure could reach £90m.

The maximum exposure that TH want BS to accept is therefore £120m.

The BS Board are prepared to put forward a sale proposal based on the £65m figure. But they take the view that TH's demand that BS accept a contingent liability on this scale is unacceptable.

I entirely agree with this position. The TH demand is quite unacceptable. However, we have to recognise that, if both sides maintain their position, the deal may fall. I believe that, if TH refuse to shift to a more acceptable position, we should be prepared to see the proposed sale to TH fall through, rather than require BS to accept a large contingent liability.

A senior official of my Department is today speaking to Mr Eric Parker, the senior TH man involved in this negotiation, to make it clear:

- that I regard the TH position as unreasonable;

- and that the Government is prepared to see the deal fall rather than be forced into accepting a disproportionate share of TH's future liabilities.

I shall write again as soon as the position is clearer - which I hope will be very early next week. All the parties involved want to conclude a deal, if at all possible, before the end of this financial year.

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

Yours ever

Norman

NORMAN LAMONT

SCOTT LITHGOW

Financial Comparison of the Trafalgar House Proposal and Closure

	Trafalgar House Proposal	Closure
Position as at P~~8~~ 12 Accounts	£m	£m
Excess of Current Liabilities and Current Assets	81.7	81.7
Contingency Provision	18.6	18.6
Add Group Relief receivable included as a current asset but now to be written off	11.1	11.1
	111.4	111.4
Less BS Current Account	(83.2)	(83.2)
	28.2	28.2
Fixed Assets	-	-
Adjustments:		
Redundancies	3.0	6.0
Contingency (Current Assets)	1.0	1.0
Capital Duty	0.3	-
Plant & Equipment/Claims	7.3	-
Lease Costs:		
3 years charge	1.0	-
Termination charge	-	2.4
Current Contracts		
SOV (753/700)	-	(2.0)
BP Rig (2001)	-	3.0
Britoil	24.3	44.5
Loan re debtors	7.4	-
Capital commitments	0.8	0.3
Regional Development Grants repayable	-	1.0
Under-recovery of overheads	-	2.0
Reorganisation and retraining	7.0	-
Funding of purchase price	12.0	-
c/fwd	92.3	86.4

b/fwd	92.3	86.4
Future income		
Repayment of purchase price	12.0	-
Repayment of loan re debtors	7.4	-
Sale of Fixed Assets	8.0	4.0
OSE re sale	-	15.0
TOTAL	64.9	67.4

Note:

(i) SRPS costs are excluded from both calculations, these would be met directly by Government.

(ii) The figures do not take into account potential dilapidations on lease-hold properties.

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Shipbuilding