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MINISTRY OF DEFENCE WHITEHALL LONDON SW1 2HB

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MO 26/3/3L

30 August 1985

*NBPN.*  
*JRS*  
*6/99.*

*Des Horn*

Many thanks for your letter of 31st July responding to mine of 30th May on the options for the privatisation of Vickers Shipbuilding and Engineering Limited (VSEL).

I am glad to note that British Shipbuilders and Lazards have now been able to devise a method of privatising VSEL which offers the prospect of significantly enhancing the proceeds from the sale, and avoids the difficulties involved in a Government acquisition and leaseback of the assets created by the Shipbuilding Facilities Project or, indeed, in the alternative which I suggested of the retention of a Government shareholding. I note too your reluctance to rule out the leasing option at this stage. But the fact remains that the PES provision required to support the leasing option has not been made. It is to be hoped, therefore, that British Shipbuilders and Lazards pursue the revised plan with vigour and successfully.

I am copying this letter to the Prime Minister, the Chief Secretary to the Treasury and to Sir Robert Armstrong.

*Yours ever*  
*Michael Heseltine*

Michael Heseltine

The Rt Hon Norman Tebbit MP



Privatisation: Econ. Pol.

PG-12





*C. 100*

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Norman Tebbit Esq MP  
The Secretary of State for Trade and Industry  
Department of Trade and Industry  
1-19 Victoria Street  
LONDON  
SW1H 0ET

16 August 1985

*WBM*

*Dear Norman,*

**PRIVATISATION OF VICKERS SHIPBUILDING AND ENGINEERING LTD**

I have seen your letter of 31 July to Michael Heseltine with proposals for handling the sale of VSEL.

I agree that we should not commit ourselves at this stage to any specific option for dealing with bids for VSEL which might be thought to be too low. I also note that you would be reluctant to rule out a leasing option at this stage. Such an option would be very unattractive from a public expenditure point of view as it both reduces proceeds and increases Government expenditure in the period following the sale. I should be surprised if when the time comes for a decision we do not find that other options are preferable.

I am sending copies of this letter to those who received yours.

*John Moore*  
**JOHN MOORE**



Privatisation: Econ 101, A12.





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MSM AT 31/7

CC NO



DEPARTMENT OF TRADE AND INDUSTRY  
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DW317

Secretary of State for Trade and Industry

31 July 1985

The Rt Hon Michael Heseltine MP  
Secretary of State for Defence  
Ministry of Defence  
Main Building  
Whitehall  
LONDON  
SW1

Dear Michael,

**PRIVATISATION OF THE WARSHIP YARDS : THE SUBMARINE FACILITIES PROJECT AT VICKERS SHIPBUILDING AND ENGINEERING LTD**

In your letter of 30 May on this subject you explained that you were not attracted to the idea that the Government should lease the new Submarine Facilities at Vickers Shipbuilding and Engineering Ltd (VSEL) to the new owners as a means of overcoming and presentational difficulties which could arise if the sale proceeds from VSEL were conspicuously less than the public money invested in the Submarine Facilities Project (SFP). You suggested instead that the Government might retain a shareholding commensurate with the shortfall.

2. My officials therefore asked British Shipbuilders (BS) and their financial advisers, Lazards, to see if an idea on these lines could provide a solution. Their conclusion, with which my own financial advisers agree, is that a more attractive variant would be a profit sharing arrangement. Officials from here, MoD and Treasury discussed this at a meeting with BS and Lazards last week. It was agreed that the best way of tackling the problem would be a two stage approach:

- (i) bids should be invited for the purchase of VSEL and Cammell Laird on the basis of documents to be issued in September without mentioning any special arrangement for dealing with the SFP or for any anticipated "shortfall" in the sale proceeds;

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(ii) if we judge those initial bids to be embarrassingly low, BS and Lazards will suggest to purchasers that they might raise their effective price by agreeing to some kind of profit sharing arrangement under which BS would receive a share of any profits (possibly confined to profits on non-competitive submarine contracts for MoD) in excess of defined levels (in Lazards' example, BS would receive some £8m between 1898 and 1996 on the basis of present profit forecasts).

3. Such an approach if successful could clearly lead to significant further proceeds and would not have the disadvantage of falling short of our original intentions of complete privatisation (as would be the case for both the leasing option and the retention by the Government of a share-holding). Nor is it likely to be financially less attractive than either of the other options.

4. But I must warn that we cannot be sure at this stage that BS and Lazards will be able to persuade a purchaser to go down this route. Much will depend on whether there is competition for VSEL and how keen potential purchasers are to acquire it. We may well find that a purchaser will prefer some other option, not excluding the possibility of a leasing arrangement for the SFP. While BS and Lazards will discourage potential purchasers from pursuing the leasing option, I am reluctant to rule it out altogether and we may have to reconsider it in the autumn in the light of developments. My officials will continue to keep closely in touch with yours and Treasury officials as the sale proceeds.

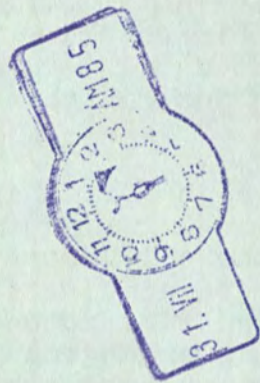
5. I am copying this letter to the Prime Minister, the Chief Secretary and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read 'Norman Tebbit', written in a cursive style.

NORMAN TEBBIT



Econ. Pol : Privatisation R12







1. EDP  
2. NBPM

AT  
3/6

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000  
DIRECT DIALLING 01-218 2111/3

MO 26/3/3

30th May 1985

*De Horn*

*attached*

Many thanks for your letter of 21st March about the privatisation of Vickers (VSEL, Barrow). I am sorry for the delay in replying.

I can see that a presentational problem may arise if, as Lazards suggest, VSEL were to fetch only £55M net, conspicuously less than the public money invested. You explain that we could put up a reasonably good public defence; and it may be that the selling price could be talked up somewhat. Nevertheless I have looked carefully at your alternative under which my Department would take ownership of the SFP and lease it to the privatised VSEL.

Unfortunately the leasing option is financially unattractive. For the first 2 to 3 years, extra and uncovenanted public expenditure would be required, because I certainly could not finance the completion of the SFP within my Department's PES totals. In the later years, submarine prices would be reduced since the SFP would not feature in VSEL's asset base; on the other hand, any leasing charge for the SFP would put prices back up, such charges being an allowable cost under the profit formula. As regards the non-financial arguments, I do not think we can sustain the line that the SFP has to be Government-owned because it is a national asset for building RN nuclear submarines.

The Rt Hon Norman Tebbit MP





Under the leasing option the Government would own some of the facilities scattered throughout the Barrow yard and VSEL would own the rest; neither could build submarines without the other. In any event, critics would be quick to point out that until 1977 VSEL was wholly owned in the private sector, carrying out essentially the same business.

I have considered carefully, therefore, whether it might be possible to achieve the objective of your leasing suggestion in a slightly different way. Instead of taking ownership of the SFP, the Government could simply retain a shareholding in the business commensurate with the public investment in the SFP, to the extent that privatisation proceeds fell short of this together with the value of the other assets at Barrow. The buyer of the yard would acquire the assets of the company, less the Government shareholding; complete the SFP; and assume responsibility for the repayment or refinancing of the loans. In return the investor would acquire a shareholding of equivalent value. On this basis, the Government shareholding should be a minority one. A detailed proposal for the capital structure of the business would of course have to be worked up by British Shipbuilders' merchant bank advisers, Lazards.

The advantages of this alternative over the one suggested in your letter seem to me to be:-

- a. the effect on public expenditure totals should be neutral rather than adverse;
- b. the administrative not to say policy encumbrance involved in bringing industrial assets more firmly under Government ownership will be avoided;
- c. there would be the possibility of obtaining remuneration of the Government shareholding, either from the outset, on the basis that the actual profits would be likely to exceed those assumed in the valuation; or after the first 5 years, the limit of the period judged by Lazards as likely to be taken into account by a prospective purchaser.





d. (subject to c) there would be the possibility subsequently of selling the Government shareholding in part or wholly for a reasonable price once, for example, the commercial uncertainties of the Trident programme had been resolved by the placing of orders. (Whereas Lazards' assessment is that the sale of £100M worth of assets would add only £20M to privatisation proceeds).

Both your alternative and, to a less extent I would have thought, the one addressed in this letter, risk being criticised as falling short of our original intentions. But so does any change of policy.

I am copying this letter to the Prime Minister, the Chancellor of the Exchequer and other members of E(A) and Sir Robert Armstrong.

*Yes*  
*ew*  
A handwritten signature in dark ink, consisting of several vertical strokes and a horizontal line at the bottom, resembling the letters 'M' and 'H'.

Michael Heseltine



Privatsekretariat Pt 12

23 JUN 1966

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