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P.01386

PRIME MINISTER

Harland and Wolff Limited
(E(NI)(84)11)

BACKGROUND

A
When the Ministerial Sub-Committee on Nationalised Industries last discussed Harland and Wolff (H & W) in February (E(NI)(84)2nd Meeting, Item 2) they decided:

- to note, without endorsing, H & W's future strategy proposals, which included an aim to secure orders for a wider range of vessel types and sizes;
- that H & W should continue to seek orders on terms similar to those available to British Shipbuilders (BS) including a normal maximum intensity of 30 per cent for assistance from the Intervention Fund;
- to note that H & W and consultants were examining the feasibility of a smaller yard strategy;
- to set a provisional External Financing Limit (EFL) for H & W of £37.5 million for 1984/85;
- to seek European Community (EC) agreement to a maximum intensity of assistance from the Intervention Fund for bulk carriers over 70,000 deadweight tons (dwt) of 35 per cent, at a level of £20 million per annum.

B
2. In his minute to you of 28 August, the previous Secretary of State for Northern Ireland reported that H & W had signed a letter of intent with British Petroleum (BP) for the construction of a new design of vessel known as SWOPS (Single Well Oil Production System). SWOPS is a 54,000 dwt vessel which will be used to exploit marginal

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seabed oil deposits. The contract price for the vessel is £77 million, excluding owner extras, but including incentive payments of £7.5 million for timely delivery. The proposed subsidy is just over 36 per cent of the contract price, including full incentive payments. It will be slightly higher if soft finance is made available on the full contract price (note 3 to Annex A to E(NI)(84)11), and significantly higher, as a proportion of the price, if delivery is late so that the full incentive payments are not made.

3. The BP order would not provide production work at H & W until mid/late 1985. After completion of four Blue Star ships for delivery in 1985, and the conversion of a container ship for the Ministry of Defence (MoD), H & W's order book is virtually bare. There will therefore be a gap in H & W's workload, at an estimated cost of at least £11 million for keeping the workforce together, unless another order, involving early steelwork, is secured quickly. The only suitable order currently in prospect is from the British Steel Corporation (BSC) for a 173,000 dwt bulk carrier. The terms for this ship would involve a subsidy of just under £14 million, or 48.9 per cent of the selling price. The Secretary of State for Northern Ireland's memorandum, E(NI)(84)11, makes it clear that he sees the two orders as an inter-dependendent package. Taken together, the total subsidy level is just under 40 per cent, assuming the orders are completed on time.

4. Assistance for the BP order requires European Community approval; the position of the BSC order is less clear.

Proposals

5. The Secretary of State for Northern Ireland asks the Sub-Committee:
- a. to authorise H & W to enter into the proposed contracts with BP and BSC;
 - b. to agree that, in return, H & W be instructed to live within its 1984/85 EFL of £37.5 million, and to base its 1985/86 and



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and 1986/87 plans on the availability of maximum public support of £35 million and £30 million respectively and to look for ways of reducing these figures;

c. to postpone a final decision on 1985/86 support levels until H & W's updated business assessment and an analysis of the small yard strategy become available;

d. to agree to notify the BP order to the Commission, but not the BSC order, pending a review by officials.

C
6. In his minute to you of 5 September (commenting on Mr Prior's earlier minute), the Chief Secretary, Treasury expressed concern about the level of subsidy involved. He points out that if delivery dates are not met this will be well above the levels which Ministers agreed in February. He also argues that acceptance of the orders would preclude adoption of the smaller yard strategy for two years. He therefore proposes:

a. an examination of the scope for renegotiating these orders, and for finding alternative work;

b. if this is impracticable, approving the orders only in return for explicit and quantified improvements to H & W's productivity and EFL targets;

c. agreement on a contingency plan for a smaller yard, or closure, to be activated by agreed criteria.

MAIN ISSUES

7. There is little doubt that the subsidy level involved in the package is higher than the Government would ideally like. The average over the two orders, nearly 40 per cent, is greater than the levels agreed last February - 30 per cent for BS and H & W, and 35 per cent for H & W's larger bulk carriers (relevant only to the BSC order). The main issues are:



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- i. whether the orders should be accepted on the terms proposed;
- ii. if so, whether further improvements in H & W's financial performance should be made a condition of approval;
- iii. the timing of further work on the smaller yard option;
- iv. whether to notify the orders to the Commission.

The terms of the orders

BP order

8. I understand that the Treasury accept that, although high, the level of subsidy for the BP order, if it is delivered on time, is reasonably consistent with what E(NI) agreed in February. However, the figure rises to 45.8 per cent, near the Blue Star level, if delivery dates are not met. The Chief Secretary will probably argue that the chances of an overrun are quite high, since SWOPS is a completely new design. Mr Hurd's memorandum stresses, in paragraph 5, the advantages of the deal's structure, which involves BP bearing the risk on the novel specialist offshore equipment, and he is satisfied that H & W can deliver to time. The Sub-Committee may nevertheless wish to probe the scope for persuading BP to accept more of the risk, for example on the dynamic positioning equipment.

BSC order

9. The proposed level of subsidy for the BSC order - 48.9 per cent - seems clearly higher than agreed by E(NI) in February, even for bulk carriers. It is not clear whether this order, which is a repeat of one in 1982, has been out to tender. The bulk carrier sector is a particularly competitive one, although not so depressed as some other areas, and Mr Hurd holds out no prospect of improvement in the order terms. The Sub-Committee may wish to consider whether there would be any implications for BS of accepting such a high level of subsidy on this order, although BS do not build very large bulk carriers. Is it worth paying such a high price to keep H & W's workload going until

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work starts on the BP order? The other option would be to continue to see whether an alternative intermediate order could be secured at lower subsidy and, if not, to accept the cost of leaving the workforce idle during the gap in work. The quantifiable cost (£11 million) is less than the subsidy on the BSC order (£14 million). There would however be adverse effects on productivity.

Benefits of accepting the orders

10. Ministers have accepted that the case for the preservation of H & W rests on political and social grounds. Failure to secure these orders (or alternatives) would almost certainly lead to a sharp, major run-down of the workforce to the point where closure would be seen as inevitable. The signature of the letter of intent for the BP order is public knowledge; the collapse of the order would be bound to attract considerable attention, particularly in the light of Ministerial changes in the Province.

11. Mr Hurd sees the BP order as consistent with H & W's strategy of securing orders for a wider range of vessels. If successful, it could give H & W an advantage in securing further work of this type. Over £40 million of sub-contracts for other United Kingdom (UK) companies are involved.

H & W's future financial performance

12. There is unlikely to be much disagreement that H & W should be pressed to continue with its cost-cutting efforts. Mr Hurd proposes to hold H & W to its provisional 1984/85 EFL of £37.5 million, and to instruct Mr Parker, H & W's Chairman, to budget for a cash requirement at or below £35 million in 1985/86 and £30 million in 1986/87. As demonstrated in Annex C of E(NI)(84)11, this represents a continuing reduction in funding levels, and is below the level proposed in H & W's corporate plan. The Chief Secretary may however be looking for greater savings, and might press for more clearly defined productivity targets.

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Smaller yard strategy

13. Work on the smaller yard strategy favoured by the Chief Secretary was originally to have been completed by mid-Summer, but has been delayed by work on the BP and BSC orders. Other members of the Sub-Committee may share the Chief Secretary's disappointment that the study is still not available, and wish to press Mr Hurd to agree to an earlier target for completion than his suggestion of "by Christmas". It seems unlikely that the study can now be completed in time for the Sub-Committee to consider this option in detail before taking final decisions on the BP and BSC orders.

14. Although Mr Hurd says that this timescale will allow decisions on the study to influence final decisions on H & W's funding for 1985/86, acceptance of these two orders will in practice, as the Chief Secretary argues, restrict any effective moves towards a smaller yard until 1986-87. Does the Sub-Committee accept Mr Hurd's argument that the two new orders will provide an opportunity to lay detailed plans for controlled implementation of any rundown?

EC dimension

15. The Sub-Committee will probably be content to accept Mr Hurd's proposal that officials should examine the question of notification of the BSC order. There seems no alternative to notifying the BP order.

HANDLING

16. You will wish to ask the Secretary of State for Northern Ireland to introduce his paper. The Chief Secretary, Treasury could then be invited to explain his concerns on public expenditure. The Secretary of State for Trade and Industry may wish to comment on the implications for British Shipbuilders. The Secretary of State for Energy may have views on the importance of the SWOPS technology, and the likelihood of BP being prepared to renegotiate.

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CONCLUSIONS

17. You will wish the Sub-Committee to reach conclusions on the following:

i. Whether the BP and BSC orders should, at least in principle, be accepted.

ii. Whether any attempt should be made to negotiate improved terms for either or both orders.

iii. If the orders are approved in principle, whether to make approval conditional on acceptance by H & W of improved productivity and/or EFL targets, and, if so, what those targets should be.

iv. Whether the deadline for completion of the smaller yard study should be Christmas, or some earlier date.

v. Whether to notify the BP order to the Commission, but defer notification of the BSC order pending further study by officials.

PLG

P L GREGSON

17 September 1984

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