



File DA

10 DOWNING STREET

From the Principal Private Secretary

MR. GREGSON
CABINET OFFICE

Type 22 Frigates

The Prime Minister has seen your minute of 18 January to Mr. Turnbull (P.01475) and she has agreed that the note by officials on Type 22 Frigates should be circulated to Cabinet under cover of a note by the Secretary of the Cabinet on the Prime Minister's instructions if Mr. Tebbit does not circulate it himself. The Prime Minister has pointed out that the Secretary of State for Defence may challenge the basis of the figures in paragraph 3 of the attachment on the grounds that the terms of the tender allowed other tenderers to spread their overheads by bidding for both ships but did not allow Cammell Laird to do so since they tendered only for one.

You may like to take account of this point in the Prime Minister's brief for the discussions.

RAS

21 January 1985

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P.01475

Prime Minister
Agree X?

AT
18/1

MR TURNBULL

TYPE 22 FRIGATES

X | As you will see from Mr Wiggins's minute attached, it seems very likely that the factual note by officials on Type 22 Frigates will be submitted to the Cabinet by the Secretary of State for Trade and Industry (in view of the reluctance of the Secretary of State for Defence to do so). In the much less likely event that Mr Tebbit prefers not to table the note by officials, the only way of bringing it before the Cabinet would be under cover of a note by the Secretary of the Cabinet saying that the Prime Minister had asked him to circulate it. Could you kindly ascertain, on a contingent basis, whether the Prime Minister would be content for this to be done, should it prove necessary?

CONQUEROR

Pg

P L GREGSON

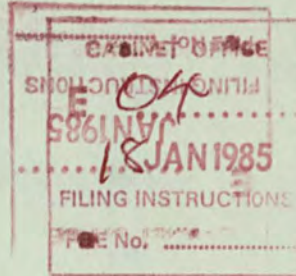
18 January 1985

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1. MR GREGSON ¹⁸⁶
2. MR TURNBULL



cc Mr Dart

TYPE 22 FRIGATES

Cabinet is to discuss the placing of the orders for two Type 22 frigates on 24 January. This question was previously discussed at E(A) on 10 May and 20 June, 1984, and at Cabinet on 19 July 1984.

2. In the first two rounds of tendering, the yard submitting the lowest tenders was Cammell Laird; but these tenders over-estimated the extent to which the yard's overheads could be spread over other work, and it is now clear that had an order been placed with this yard, BS would have incurred a substantial loss. However, before a decision could be taken to place such an order, the yard was occupied by part of the work-force, and Ministers decided that there could be no question of placing public sector orders there for the time being. Despite the continuation of an official 'strike', the occupation has been ended and most of the labour force have returned to work, accepting at the same time substantial redundancies.

3. In accordance with the Cabinet decision of 19 July, there was a third round of tendering for the two frigate orders. On this occasion the lowest tenderer was Swan Hunter, and the natural course would now be for the two orders to be placed with that yard. However, the



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Secretary of State for Defence, having in mind his earlier responsibilities as Minister for Merseyside and also the fact that the Cammell Laird workforce had been encouraged to end their disruption by the prospect of further orders, proposed in his minute of 18 December to the Prime Minister that Swan Hunter and Cammell Laird should receive one order each. (Rationalisation and redundancies which have already occurred at Cammell Laird have eliminated any possibility that the yard could build both frigates).

4. It is hard to resist the conclusion that there is excess capacity in UK warship building yards. Some of this spare capacity may be absorbed by export orders and/or civil work, but the view of most Ministers has been that one yard will have to close if the others are to be successfully privatised. Wherever the orders are placed, 1200 redundancies will be required at one or other yards, although there are some prospects of securing other work as a stop-gap which would postpone at any rate half of these.

5. Leaving aside the prospect of other work, giving both orders to Swan Hunter would mean 1200 redundancies at Cammell Laird; splitting the orders between the two yards would mean 1200 redundancies at Swan Hunter. Splitting the orders would mean an additional £7 million costs directly falling on MOD, with a reduction in the privatisation proceeds from Swan Hunter of about £20 million and a further £20 million required as a cash injection to keep Cammell Laird going. There would also be some additional unrecovered overhead costs at both Cammell Laird and Swan Hunter, which would be roughly equivalent to the net costs of closing Cammell Laird and selling the facility if both orders went to Swan Hunter.



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6. Possible palliative action at Cammell Laird includes the conversion there of the Balder London for MOD at an extra cost (ie. in excess of what would result from a competitive tender) of £2 to £3 million, which would provide work for 300 people for a year. DTI have suggested that a submarine refit could provide work for a similar number for up to two years, at about double this cost - but MOD say they have no such work available. A further possibility would be for BS to offer whatever subsidies were needed to secure some major merchant vessel conversion work for the yard, at the same sort of annual cost.

7. Officials of MOD, DTI, Treasury and the No 10 Policy Unit have prepared the attached note which summarises the facts of the present position. The Secretary of State for Defence has refused to be associated with this note in any way, and insists instead on standing on his minute of 18 December to the Prime Minister. DTI officials expect Mr Tebbit to agree to circulate the note by officials (but omitting any mention of MOD), under cover of a short paper by himself. This would be a convenient way of putting facts before members of the Cabinet.

JW

A J WIGGINS

18 January, 1985

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THE ORDER FOR TYPE 22 FRIGATES 13 AND 14
NOTE BY OFFICIALS

Introduction

1 The purpose of this note is to provide factual background and forecasts bearing on the allocation of the orders for Type 22 frigates 13 and 14. It has been agreed between officials of MOD, Treasury, DTI and the NO 10 Policy Unit. For the most part it concentrates on a comparison of the effect of:

Course (a) placing both orders with Swan Hunter; and

Course (b) splitting the orders between Cammell Laird and Swan Hunter.

Direct Costs

2 In accordance with Cabinet's decision on 19 July 1984, the Ministry of Defence sought fresh tenders for the two ships from Cammell Laird, Swan Hunter, and Vosper Thornycroft. Tenders were returned on 15 September. Swan Hunter and Vosper Thornycroft bid for an order for both ships or either one of them. Cammell Laird tendered for one or other ship but not both. The results of the tendering process may be summarised as follows:

	£m	
2 ships from Swan Hunter	139.4	Course (a)
2 ships from Vosper Thornycroft	140.9	
1 ship from Vosper Thornycroft and 1 from Swan Hunter	145.2	
1 ship from Cammell Laird and 1 from Swan Hunter	145.5	Course (b)
1 ship from cammell Laird and 1 from Vosper Thornycroft	147.2	

In addition, MOD would incur extra costs of about £1M if the order were split. The total extra direct costs of course (b) over course (a) are thus about £7M.

Indirect Costs

3 When considering indirect costs and redundancies, assumptions need to be made about the level of other work and the allocation of overheads. In providing figures therefore, BS have assumed the same allocation of overheads as was used in the tenders submitted to MOD. Under course (a), unless special action were taken (see para 8 below), BS would close Cammell Laird within two or three months. They would propose to move HMS Edinburgh to another ship-or dock-yard for final fitting out. Under course (b) there would probably be an under-recovery of overheads at Cammell Laird, of some £10m over 1985/6 and 1986/7 together; BS expect Swan Hunter to incur extra under-recovered overheads of £5M in 1985/6 and 1986/7 together with higher figures in later years.

Redundancies

4 In February, Swan Hunter will employ 5,200 after the current round of 2,100 redundancies is completed. Cammell Laird currently employ 1,700 after implementing 1,600 redundancies in 1984. Both yards are likely to have to declare a further 500 redundancies in 1985 whatever course is chosen.

The yard that does not win the second order will have to declare some 1,200 further redundancies, resulting in Cammell Laird's case in closure. The cost of the 1,200 redundancies will be some £6½M under the Shipbuilding Redundancy Payment Scheme (SRPS).

Unemployment

5 3 of the 4 Swan Hunter yards are in the Newcastle travel to work area (TTWA). Cammell Laird is in the Wirral and Chester

TTWA. Unemployment rates are as follows:

Average of 12 months
to December 1984

December 84

Wirral and Chester	17.9%	18.2%
Newcastle	17.9%	18.0%

Unemployment rates in the adjacent TTWAs are as follows
(1 Swan Hunter yard is in the South Tyneside TTWA):

Liverpool	20.6%
South Tyneside	24.5%

Industrial Relations

6 In recent years there has been considerable industrial disruption at Cammell Laird. The percentage of man hours lost due to strikes and stoppages at Cammell Laird has been above the BS average. CL has lost over 1.3% of possible man hours each year since 1981/2. It lost nearly 4% in 1983/4. The comparable figures for Swan Hunter have never risen above 0.4%. In July 1984 the Cammell Laird workforce were laid off as a result of industrial action over compulsory redundancies and some of them occupied the work in the yard. 37 sitters-in were jailed in October. As a result of an unofficial Back to Work Committee the workforce on 9 November unanimously rejected a strike call, and over 90% of them are currently at work. At Swan Hunter, the workforce have accepted the current round of redundancies without industrial action and against union advice. Although the "strike" at Cammell Laird remains official, the national union conference (SNC) recently made a low key request to the Minister of State for Industry (Mr Lamont) for a Type 22 frigate order to be placed with Cammell Laird. Both yards have agreed to implement the British Shipbuilders Phase V wage agreement incorporating new working practices.

Overcapacity

7 As demonstrated in the annex, the current capacity in the UK to build large surface warships is 7 to 8 frigate equivalents a

year against an anticipated MOD requirement for 4 (3 frigates and 1 large auxiliary). The only immediate export prospect is two frigates for Pakistan which Vosper Thornycroft hope to win. MOD will need a second submarine line at a maximum order rate of 1 frigate equivalent. If Yarrow or Cammell Laird were to win the submarine order and Vosper Thornycroft to win the Pakistan order, the available capacity for surface ships would fall to about 6 to 7 frigate equivalents against MOD requirements for 4. If Cammell Laird were to close and be sold as a facility, the capacity immediately available would fall on the same basis to 4 to 5 frigate equivalents, thus largely eliminating the overcapacity. It would be possible however for the new owners of Cammell Laird to attempt to re-enter the warship market.

Privatisation

8 Under course (a), BS estimate the closure costs to them (ie excluding SRPS) of Cammell Laird would be some £10M; they would then expect to sell Cammell Laird as a facility for a few million pounds. The net costs would be of the order of £5m. Under course (b), Cammell Laird would continue in existence at least for the 4 years required to build the frigate. Even so, because of the anticipated level of losses, and the need for further investment BS and Lazards believe that it could only be privatised if privatisation were accompanied by a cash injection of the order of £20m at least. Course (b) reduces Swan Hunter's profits by some £20m over the period with a comparable effect on privatisation proceeds.

Special Action for Cammell Laird

9 BS have considered in conjunction with Lazards whether special action at Cammell Laird would improve the position under either course. In particular, they have considered the effect of an award to Cammell Laird on a non-competitive basis of a contract for the conversion of the Balder London which would provide a certain work load for about one year. It could increase MOD's costs by some £2-3m. Under course (a) in BS's view, the award of a Balder London contract would be insufficient to prevent closure of Cammell Laird. However, if a further MOD

contract of a similar size to the Balder London conversion were awarded to Cammell Laird, BS believe that they may be able to sell the yard to someone in the offshore sector preserving at least temporarily up to about 700 jobs. But there can be no certainty that this would provide a future for Cammell Laird and MOD have been unable to identify a suitable potential contract. The costs of such action seem certain to exceed the costs of closure and disposal. Under course (b), the award of a contract for the Balder London would marginally improve the position of Cammell Laird and would defer some 300 redundancies. It would not however make the yard viable and it would only be sold with a very considerable dowry.

Summary comparison of effects of main alternatives

	COURSE (A) (both Frigates at Swan Hunter)	COURSE (B) (1 Frigate at Swan Hunter; 1 at Cammell Laird)
1 <u>Direct Costs</u>	-	Extra costs of £7m to MOD
2 <u>Indirect Costs</u>	-	Extra losses of some £1.5m at Swan Hunter and £5m at Cammell Laird in 1985/6. Effects in later years affect privatisation proceeds.
3 <u>Redundancies</u>	1,200 at Cammell Laird*	1,200 at Swan Hunter*
4 <u>Privatisation</u>	Closure of Cammell Laird and sale as a facility at a net cost of some £5m.	Reduction of Privatisation Proceeds at Swan Hunter of some £20m. Cash injection into Cammell Laird of at least £20m.

16.1.85

* In addition both yards are likely to have to declare a further 500 redundancies in 1985

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ANNEX

WARSHIPBUILDING CAPACITY

(excluding submarine building at Vickers)

<u>UK Capacity from 1986 (a)</u>	Minimum Capacity	Maximum Possible Capacity
Cammell Laird (b)	1.5	2
Swan Hunter	2.5	2.5
Vosper Thornycroft	0.5	0.5
Yarrow (c)	1.5	2.0
Harland & Wolff (AOR only)	<u>1.0</u>	<u>1.0</u>
	7.0	8.0

Demand (a)

Orders pa
(average of 1985 - 1990)

Frigates	3	3
AORs	<u>1</u>	<u>1</u>
	4	4

Further demand might be generated from exports, refits, merchant work and second stream submarine building.

Notes

- (a) 1 AOR build time approx = 1 Frigate
- (b) 2 now, decreasing to 1.5 if yard restructured
- (c) 1.5 now, increasing to 2 if module hall built.

DTI
15 JANUARY 1985