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MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-~~936 7002~~ 218 6169

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John Cardine

You wrote to Richard Mottram about Mr Neville Trotter's appointment to see the Prime Minister tomorrow. Mr John Lee will attend, and I attach a brief for the meeting.

The Ministry of Defence has not yet finalised its negotiations to seek as low a price as it would like for the AOR vessel and further reductions are being explored. The latest figures will be given to you by telephone nearer to the time of the meeting.

In these circumstances, it is particularly important that neither Swan Hunters nor Harland & Wolff know their position in the competition and I shall be grateful if the brief can be safeguarded accordingly.

Copies of this letter go to Michael Gilbertson (DTI) and Philip Wynn Owen (Treasury).

*Yours sincerely
D J Woodhead*

(D J WOODHEAD)
APS/S of S

Caroline Ryder
No 10 Downing Street

PRIME MINISTER'S MEETING WITH NEVILLE TROTTER MP

POINTS TO MAKE

1. Orders for warships will be decided on price and technical merit.

2. There is over-capacity in the warshipbuilding industry and almost all yards are in areas of high unemployment.

3. Auxiliary Oiler Replenishment Vessel (AOR)

Decisions have yet to be taken on the AOR competition. Government policy is that Harland & Wolff should not be offered guarantees or subsidies in connection with tenders for warships. Swan Hunters have had:

- a. the advantage of undertaking the original concept studies for the Ministry of Defence, and
- b. an opportunity to re-tender after privatisation

4. Type 23 Frigates

The offer of a Type 23 Frigate is still open but Swan Hunters must reduce their price to a competitive level.

PRIME MINISTER'S BRIEFING WITH NEVILLE TROTTER MP

BACKGROUND

1. As part of the Government's programme to privatise the warshipbuilding yards of British Shipbuilders, Swan Hunter Shipbuilders (SHS) was purchased by a management buy-out team in January 1986.

SHS CURRENT PROGRAMME

2. The Firm's current programme of work is:

	<u>Launch Date</u>	<u>Completion Date</u>
TYPE 22-09 (HMS SHEFFIELD)	26 March 86	November 87
TYPE 22-10 (HMS COVENTRY)	April 86	February 88
TYPE 22-14 (HMS CHATHAM)	August 87	September 89
RFA SIR GALAHAD	November 86	July 87

These dates have been amended in the light of last year's strike action at the Firm.

FUTURE WORK

3. SHS has tendered for the design and build of the first two Auxiliary Oiler Replenishment (AOR) Vessels and for the build of the next three Type 23 Frigates (02, 03 and 04).

AOR

4. The AOR is a "one-stop" Replenishment Vessel for the support of the Front Line Fleet. It will be capable of simultaneous replenishment at sea of stores, fuel and ammunition, and will also provide support facilities for helicopters on Type 23 Frigates. Because of the value of its cargo (£150m, including embarked helicopters), it needs a self-defence capability.

5. SHS and Harland & Wolff (H&W) have submitted tenders for the design and build of the AOR. Defence Ministers have not yet reached a final decision but H&W are emerging as clear winners of the competition. Apart from price, their design, prepared with the support of specialist design agencies, is technically superior. This has been confirmed by an independent commercial assessment. H&W have offered earlier delivery and are more compliant with the Ministry of Defence's contract conditions.

6. On price, the SHS tender for a first of class ship that meets the Ministry of Defence requirement in full was much higher than the H&W tender. The Ministry of Defence's target price was £122M. SHS has offered (post privatisation) a design for £126M but for a ship with a significantly reduced capability, eg on survivability after damage.

7. In his letter of 27 February, Mr Trotter implies that the H&W tender for the AOR is subsidised and SHS will be at a disadvantage. The Northern Ireland Office has, however, made it quite clear that it is not Government policy to offer guarantees or subsidies to H&W in relation to specific tenders for Naval Vessels when there is competition with other UK Warship Yards for the contract (Hansard 20 February, col 274, copy attached).

8. Depending on the Northern Ireland Secretary's advice on the current situation in the Province, the Ministry of Defence is likely to order AOR-01 this month. Decisions on timing of the order for AOR-02 will be delayed because of defence budget pressures.

TYPE 23 FRIGATES

9. SHS has submitted a single tender for Type 23-02 and a tender in competition with other shipyards for 23-03 and 04. The single tender only for 23-02 was announced by the then Defence Secretary on 28 January 1985 following the award of a Type 22 Frigate Contract to Cammell Laird (Hansard col 21 refers, copy attached). The order is subject to satisfactory agreement on price and contract conditions.

10. SHS tenders for 02 and 03-04 are very high in relation to the other tenders. All firms have been invited to retender by early April. SHS, who will be re-tendering with a first bid from the new management, have been advised that their tenders were high.

COMPETITION POLICY

11. It is the Ministry of Defence's policy to place orders for warships on the basis of price and technical merit following competition. Exceptionally, wider factors were taken into account in inviting a single tender for Type 23-02. With Vickers/Cammell Laird, SHS, Vospers, Yarrow Shipbuilders, Scott Lithgow and H&W competing for naval orders, there is significant over-capacity in the warshipbuilding yards at present. The Ministry of Defence alone does not have sufficient orders in its future programme (which is in any case under pressure) to sustain the present size of the industry. It therefore seems inevitable that, without an increase in orders (eg for export), some of these yards will have to close with significant job losses.

12. SHS has, in recent years, transferred from a very large group with a minority interest in warshipbuilding to only two shipyard sites now building solely for the Ministry of Defence. The firm completed its last merchant ship in January 1985. Failure to win the AOR order will put retention of the SHS Design and Drawing Offices at risk. If they also fail to win frigate orders their viability is doubtful, but splitting the AOR order would be especially expensive because two first of class costs would be involved in addition to SHS higher price. SHS capacity is not essential to the RN Warshipbuilding Programme and there is no case for disturbing the natural results of competition to sustain the yard.

13. Unemployment in the SHS Travel to work area is 68,040 (19%)
and for H&W it is 62,118 (18.3%).

HANSARD EXTRACT - 20 FEBRUARY 1986

WRITTEN ANSWERS - COLUMN 271

Harland and Wolff

Mr. Sayeed asked the Secretary of State for Northern Ireland what is his policy in offering guarantees or subsidies to Harland and Wolff in relation to specific tenders for warships or naval vessels to be built in the United Kingdom when Harland and Wolff would be in competition with other United Kingdom warship yards for the contract.

Dr. Boyson: It is Government policy not to offer guarantees or subsidies to Harland and Wolff in relation to specific tenders for warships or naval vessels when there is competition from other United Kingdom warship yards for the contract.

Frigate (Orders)

3.32 pm

The Secretary of State for Defence (Mr. Michael Heseltine): As the House knows, I have been considering the results of a tendering exercise for two type 22 frigates for the Royal Navy. Cammell Laird, Swan Hunter and Vosper Thornycroft were each invited to tender for these warships—one, the fourth replacement for warships lost in the South Atlantic, and the other an addition to the naval programme which I authorised in 1983.

The tendering process has been unusually protracted, for several reasons. I have been concerned to obtain the best available prices and tauter contract terms than we have been accustomed to in this area of defence procurement. The earlier tender replies did not adequately contribute to this objective, and it was not possible to take a decision on the order before the validity of the tenders expired. A final round of tendering was initiated in late July last year. The results of this round met several of the concerns to which I have referred, and, as with the earlier rounds, showed that the competition had been close and keenly fought.

The House will be aware that the decision on the orders for the frigates has important implications for each of the competing yards. I have considered the implications carefully, in consultation with my ministerial colleagues.

At this point, I should say that the deplorable and unnecessary industrial action which occurred last summer at Cammell Laird would, as I made clear at the time, had it continued, have excluded the yard from further consideration in the competition. The courage and determination shown by the moderate element of the work force at Cammell Laird, in the face of the intimidatory behaviour of their former work colleagues, has averted the almost certain closure of the yard at an early date.

The cheapest solution from the point of defence procurement would be to place the order for both ships with one yard, but, in the light of the wider and relevant factors involved, I have decided that an order for one type 22 frigate will be placed with Cammell Laird and for the second with Swan Hunter, and I am prepared to authorised the necessary expenditure. This offers the prospect of survival of Cammell Laird as a major warship builder; without such a contract the yard would have closed. I hope that the yard will succeed in obtaining other business in the short as well as the long term.

Swan Hunter, which is a much larger firm and is implementing a large redundancy programme at the moment, could face further substantial redundancies even with the order which I have just announced. The Government wish to do what they reasonably can to prevent this. Last autumn we embarked on the construction of a new class of frigate, the type 23, and negotiated a first order at Yarrow on the Clyde. I have decided to negotiate an order for the second type 23 frigate at Swan Hunter as soon as this can sensibly be done, and subject to satisfactory agreement on price and other contract terms. I will expect the price for this frigate to reflect the economies obtainable with an order for two frigates rather than one; and to be competitive. In order to establish this, tenders will be invited for the third type 23 order in the same time scale from all United Kingdom yards capable of carrying out the work.

Mr. Denzil Davies (Llanelli): The Secretary of State's statement will obviously be welcomed both by the Royal Navy and by the two warship yards which have been given orders to build the three new frigates. It will be welcomed especially because it seems likely that this will be one of the last statements on major equipment orders in defence which the Government will make in this Parliament. From now on it is likely to be cancellations all the way.

The statement has an air of desperation about it. The Secretary of State is desperate because the Treasury will demand, if we read the public expenditure White Paper correctly, larger and larger cuts in defence. He is desperate also because the cost of Trident over the past months has increased by about £200 million a month. For the Secretary of State to talk about "tauter contract terms" is cynical and ridiculous. When are we to see tauter contract terms for Trident, the costs of which have doubled under the Government?

Why was there delay in placing the order, especially for type 22 frigates, the first one of which will be a replacement for the one lost in the Falklands war? Why does the Secretary of State not make it clear that the delay stems from budgetary problems in his Department and not from industrial problems at the yards? What will be the cost of a type 23 frigate? Some of us remember that one of the reasons for closing Chatham dockyard was that type 23 frigates would be disposable vessels and would cost about £70 million. What is the cost of a type 23 frigate now? If the type 23 is not to be disposable after all, is the right hon. Gentleman satisfied that the Royal Navy, after he and his business partner, Mr. Levene, have finished with it, will have the necessary dockyard facilities to refit the types 22 and 23 and all the other warships of the Royal Navy?

Mr. Heseltine: I suppose that the House will sympathise with the right hon. Gentleman for talking about everything except the subject of the statement. I shall answer the relevant questions that he put to me. The delay of which he spoke has nothing to do with any budgetary problems in my Department. Anyone who has any idea of the considerations that have been brought to this matter will know that. The approximate price of a type 23 frigate now is about £110 million. We shall ensure that there are adequate servicing and repair facilities. Our problem is one of over-supply of facilities, rather than under-supply.

The House will perhaps judge the sincerity of the right hon. Gentleman's contribution to my statement against the background of the Government having increased defence expenditure in real terms by £3 billion a year, while the Labour party was committed to reducing it by a third as soon as it came to power.

Sir Antony Buck (Colchester, North): Is my right hon. Friend aware that most of us on the Conservative Benches will welcome his statement, which will certainly end the uncertainty about these matters? When are the type 22s likely to go into service with the Royal Navy? Similarly, when will the type 23s, which will be following thereafter go into service?

Mr. Heseltine: I am grateful to my hon. and learned Friend. As a rule of thumb, one can broadly assume that an order takes four to five years—probably nearer four years—to complete. That will give my hon. and learned Friend and the House the answer to his question.

MERCHANT SHIPBUILDING IN THE NORTH EAST

1. Merchant shipbuilding in the North East is concentrated on 3 British Shipbuilders (BS) yards - two on Wearside (Austin & Pickersgill and Sunderland Shipbuilders, at Sunderland) and the other on Teeside (Smith Dock at Middlesbrough).

2. BS recently announced that these three companies would be brought under common management to form a new BS company - North East Shipbuilders Ltd. Under this plan Austin & Pickersgill and Sunderland Shipbuilders will merge on 1 April and Smiths Dock will join the group in the summer of this year. The merger is primarily an efficiency measure to help reduce overhead costs, accelerate the sharing of services, and provide greater efficiency to helping to adjust to market conditions. The formation of this company is not viewed as a prelude to further redundancies. No further redundancies (beyond those already announced - see para 4) or yard closures are currently planned.

3. As with all merchant yards at present in the face of a continuing and deteriorating slump in the world market, these yards are desperately seeking new orders, although all currently have work until the end of 1986.

4. Their combined employment is currently a little over 4,500. redundancy programmes have been initiated at Austin & Pickersgill and Sunderland Shipbuilders over recent months. Some 200 redundancies have yet to be effected from the earlier programmes.

