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The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AQ

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5147
Our ref
Your ref
Date 23 June 1988

Dear John,

with PS?

BRITISH SHIPBUILDERS

Thank you for your letter of 22 June. As a result of the further negotiations which took place between British Shipbuilders, my officials and Kvaerner yesterday, I am able to provide assurances on a number of the points you raise. First, however, you will wish to be aware of developments in the proposed financing package.

The annex to my letter of 21 June explained that the build costs of the first four ships remained to be confirmed but were likely to be £160m, implying Intervention Fund support with a present value of £37m (£45m cash). In the event, Kvaerner presented detailed costings totalling approximately £175m, implying IF with a present value of £43m. The costings were scrutinised by BS and my officials who had to concede that they were fully justified and to have withheld support at 28% would have meant going back on our decision to offer IF at current levels. Against this we were, however, able to negotiate a reduction of £2m in present value in the contribution to the investment programme and did not have to use any of the £1m final concession I thought might have been necessary. The result, in present value terms, is a total package of £68m compared to the original mandate of £80m.

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Turning to the points in your letter, you will wish to note that, as a result of a further concession extracted in the final negotiations, the IF terms we are proposing are entirely conventional, with no generosity for the first four new orders from Kvaerner. You state that the prices will not be determined at arms-length and that there is scope for abuse. As I explained in the annex to my previous letter, there is a significant degree of scrutiny of orders both through the non-executive members of the Kvaerner Shipping Board as well as by Havtor Management, the partner in placing the orders. More importantly, however, we yesterday secured Kvaerner's agreement to an independent scrutiny by a firm to be appointed by my Department of their comparative prices from overseas yards as well as a post-audit check of the costs of building the ships. Any over-estimate identified as a result of these checks will be clawed back and Kvaerner will only be able to keep one half of any productivity gains that will be achieved.

You expressed concern that the costs of IF support of future orders at Govan is not quantified. My letter did of course draw specific attention to this. I can assure you that we have avoided making any commitment to Kvaerner as to the availability of future IF support. All that we have been prepared to agree to is that we would look at any applications they might make in the light of whatever regime exists in the UK at that time. It will therefore be for decision in due course whether we continue to be guided by whatever European Commission limit exists or, as you say, act unilaterally.

I have to say that I do not regard this as a particularly satisfactory deal. As I have made abundantly clear throughout, my preference has been to bring IF support to an early end. In the event, however, we have a proposal which, as Malcolm Rifkind notes in his letter of 22 June, will leave us with a continuing industry employing a substantial workforce in an area of high relative unemployment. As I said in my previous letter, we will also avoid any trade difficulties with China and there is the prospect of further investment in future by a major engineering company.

I am copying this letter to the Prime Minister, Nigel Lawson, George Younger, Malcolm Rifkind and Tom King and to Sir Robin Butler.

ever,

KENNETH CLARKE

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P.S. This deal is not in the form which you and I always agreed upon as our first choice but I think it is in line with the collective decision that our colleagues reached.

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