

1010

dti

the department for Enterprise

cc/b

**CONFIDENTIAL
COMMERCIAL IN CONFIDENCE**

The Rt. Hon. Tony Newton OBE, 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 3AG

**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
Our ref
Your ref
Date

215 5147

2 September 1988

NRBAH with

Treasury cabinet

*REC
1/9*

John John

BRITISH SHIPBUILDERS: CLARK KINCAID

My officials have presented to yours a case for Clark Kincaid to be allowed to take orders for two new engines so as to facilitate BS's disposal of the business on an advantageous basis. The engines are for the first two gas ships to be built at Govan under its new owners Kvaerner Industrier. BS are well advanced in their plans for privatising Clark Kincaid although it will not be possible to complete this before a decision is required on where the new engine orders are to be placed.

BS have received two sealed bids for Clark Kincaid, one from the management and one from a third party. A sale to either would cost approximately £5m. This compares to the cost of outright closure of approximately £10m, net of asset sale for alternative use although not including the cost of any remedial measures or continuing unemployment benefits for the 500 employees who would be made redundant.

BS are facing heavily subsidised Polish competition for the engine orders and would expect to have to take a contract loss of £1.45m. The total public sector cost of the sale of Clark Kincaid with the new orders would therefore be approximately

LS5AIP



the department for Enterprise

£6.5m. However, at least one and almost certainly both of the bids for the yard are conditional on the order being placed there, and even if in the one case it were not conditional then the bid would be reduced by more than the additional cost.

If this were the only choice facing us then I would have no hesitation in recommending that we allow Clark Kincaid to take the order and proceed with the sale to one of the bidders. At this stage, however, it is not possible to guarantee that the sale will be completed. All of the indications are that it will but final negotiations still need to take place. We would also need to secure agreement from Brussels. Officials are examining how the proposed terms for the order would meet our obligations under EC competition rules. They are also considering the timing of a notification to the Commission of the sale terms and, if necessary, of support for the order. I believe that given the difficulties of Inverclyde and the Commission's failure to protect enginebuilding in the EC from dumping from the Far East and Poland we would secure their agreement. If, however, the sale did not take place then there would be extra closure costs of £3.2m arising from the £1.45m contract loss on the engines and £1.7m of extra under-recoveries involved in keeping the facility open to complete them.

In my view we should still be prepared to accept this risk and allow Clark Kincaid to take the order. In reaching this conclusion, I have been influenced by the views of Lazards, who are advising BS. They have not yet completed their valuation of the bids for Clark Kincaid but their initial view is that either of them should provide a satisfactory basis for a sale. It is also important to see the future of Clark Kincaid in the context of our wider policy towards BS. In selling Govan to Kvaerner, we placed emphasis on the advantages of attracting inward investment to the UK and the expectation that Kvaerner would place more of their future orders here. I would agree that these orders should not be taken at any cost but our critics would no doubt maintain that a decision to close Clark Kincaid was evidence of our not having been committed to the policy for the disposal of Govan.

I know you are also aware of the difficult decisions that face us with respect to some of the other remaining BS yards. North East Shipbuilders is clearly going to be extremely difficult. In the present context, however, we must also consider the position of Ferguson at Port Glasgow where there is a strong likelihood that no satisfactory bid will be found for the yard which would then need to close with the loss of some 300 jobs. I think this could be presented against a satisfactory sale of Govan and Clark Kincaid but otherwise it would be much more difficult.



the department for Enterprise

I have of course carefully considered the other risks involved in allowing Clark Kincaid to take these orders before it is sold. In particular, some may argue that NESL and Ferguson should also be allowed to take orders prior to their disposal. We would have a strong case against this. The key point is that we have received sealed bids from two parties, both of which BS's merchant bank advisers have said look acceptable and would provide a suitable basis for final negotiation. This is not the case with any of the potential bidders for NESL who have publicly identified themselves so far. I would propose to ask BS to do everything possible to have reached preferred bidder stage and to have a Letter of Intent from the preferred bidder before the engine order was signed. Also, we could point out that over the past three years Clark Kincaid has actually made a small profit on enginebuilding contracts in contrast to the considerable contract losses on shipbuilding at both NESL and Ferguson. This of course also makes it more difficult for us not to allow Clark Kincaid to take the present orders.

I am copying this letter to the Prime Minister and Malcolm Rifkind and to Sir Robin Butler.

TONY NEWTON