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PART F

CHANCELLOR'S 1988 PAPERS ON THE SHIPBUILDING INDUSTRY

PO -CH /NL/0187
PART F

Begins: 19/9/88

Ends: 7/11/88 (CONTINUED)

DD: 25 years

6/9/95

dti

the department for Enterprise

CONFIDENTIAL

The Hon. Alan Clark MP
Minister for Trade

The Rt Hon Tom King MP
Secretary of State for
Northern Ireland
Whitehall
London SW1A 2AZ

CHIEF SECRETARY
REC. 20 SEP 1988
ACTION Mr AH White
COPIES TO CX/Mr Anson
Mr Monck, Mr Burgner.
Miss Peirson, Mr Bottrill.
Mr Gtr Jones, Mr Call

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Our ref WO7AEL
Your ref
Date 19 September 1988

Dear Tom

HARLAND & WOLFF - TIKKOO CRUISE LINER

At our meeting on 14 September I said that I would consider whether ECGD could take a 25% risk if Tikkoo, as he claimed, could raise commercial finance (equity/loans) for the balance of 75% of the purchase price of the vessel on the basis of a first mortgage as security for the commercial money. We thought it unlikely that Tikkoo would be able to raise this amount of finance but, if he could not the failure of the project would then lie at his door rather than ECGD's.

ECGD would be reluctant to take on an unsecured risk of this nature. The only way they could possibly consider doing so would be on the basis of their new project financing facility under which they rely on the profitability of the project to secure part of their risk. However, before they give any indication of cover under this facility they must have full information on the proposed financing structure of the project, including the amount and timing of equity to be subscribed by investors, and a firm indication that one of the bank lenders is prepared to take 10% of the commercial risk for its own account.

This is in fact the information which ECGD has been trying to obtain from Hambros for some time. However, by effectively turning the argument away from a valuation of the mortgage I think this approach would tie in quite sensibly with the tactics you want to adopt on this case, in that the onus will then be on the department for Enterprise

The Rt Hon Tom King MP September 1988

Tikkoo and the bank to come up with a proper commercial basis for funding the project and any inability to do so will make them responsible for any possible failure of the project.

I must, however, warn you that it is by no means certain that ECGD will be able to do this business on a project financing basis, as it will have to meet all the criteria which they apply to such cases. It will also not solve the recourse problems which I explained in my letter of 29 July to Peter Viggers, nor will it solve the problem over the need fully to secure ECGD's risk during the building period which I also explained in that letter.

I suggest that your officials and mine now get together to try to work out the details.

I am copying this letter to Tony Newton and John Major.

ALAN CLARK

CH/EXCHEQUER
REC. 23 SEP 1988
ACTION FST
COPIES TO

23/9

PMP

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

LORD PRIVY SEAL

22 September 1988

Dear Francis,

REVIEW OF MERGERS POLICY

Following receipt of a copy of your minute to the Prime Minister of 5 August, my Private Secretary wrote to yours to indicate my initial reservations about setting aside hybrid instrument procedure on divestment Orders. I have now had the opportunity to consider this matter further and, as your proposals are now to be brought to E(A), you may find it helpful if I set out my views.

On such an important piece of legislation as the forthcoming Companies Bill and in what will be a busy session it would, in my view, be a great pity if we found that debate was needlessly diverted into procedural matters and this, I fear, is what could happen if you proceed with your amendment on divestment Orders.

I get the impression from your minute and from your Private Secretary's letter to Paul Gray of 16 September that since 1956 very few divestment Orders have in fact been made. Indeed I am advised that only two schedule 8 Orders seem ever to have been petitioned against - the Solus Petrol (No.2) Order 1966 and the Regulation of Prices (Tranquillising Drugs) (No.2) Order 1973. The first of these lapsed following agreement between the parties and the second was ordered by the House not to be referred, because it was felt that the findings of the MMC could not be faulted. Even if such Orders were to be petitioned against in the future the chances are that on the 1973 precedent the House might decide not to remit them to a Select Committee. I imagine that, more often than not, the threat of the exercise of the order-making power is sufficient to achieve divestment. The existence of the hybrid instrument procedure does not, at least on the face of it, seem to have materially affected the effective exercise of the powers up to now.

It is true that matters will normally have been fully explored by the MMC before the Order is laid but prior inquiry is not in itself inconsistent with private legislation procedure - Special Procedure Orders will invariably have been subject to public inquiry, for example. And you yourself concede that you will sometimes wish to make divestment Orders as an alternative to a reference to the MMC - in which case, there will of course have been no prior examination.

I particularly want to advise caution in this matter because when the Labour Government tried to exclude the hybrid procedure from applying in a number of bills in the late 1970s the House gave them a very rough ride. I have in mind here the proceedings on the Offshore Petroleum Development (Scotland) Bill in 1975 and the Local Government (Scotland) Bill 1977 when Gordon Campbell led the charge. As a result , the then Government were obliged to withdraw their proposals and introduce the expedited hybrid instrument procedure instead. Many of our own backbenchers will recall those days and our proceduralists will certainly wish to become involved too! Furthermore, while there are, it is true, a few precedents for disapplying the procedure they do not in their subject matter rest happily with what is now being proposed; nor I must emphasise, did they disapply a procedure which had already applied in a particular circumstance for a considerable number of years (which is what you now propose to do).

All in all, I really do wonder whether we may not be going out of our way to look for trouble so far as divestment Orders are concerned and whether in the circumstances we should not let matters lie.

I am sending a copy of this letter to the Prime Minister, members of E(A), James MacKay, Douglas Hurd, John Wakeham and Sir Robin Butler.

Yours sincerely

BELSTEAD

The Hon Francis Maude MP

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the department for Enterprise

CONFIDENTIAL

CHIEF SECRETARY
REC. 22 SEP 1988
ACTION Mr Guy.
COPIES TO CX, FST, Sir P Middleton
Mr Anson, Mr Monck
Mr Moore, Mrs Brown
Mr Waller, Mr A M White
Mr Rutnam

To:

PRIME MINISTER

From:

TONY NEWTON

22 September 1988

BRITISH SHIPBUILDERS AND THE NORTH EAST

1. Since taking up my new responsibilities I have visited a number of inner cities to get a feel for myself of their problems and the progress that has been made in overcoming them. Yesterday, as part of this process, I visited Sunderland, including North East Shipbuilders Limited (NESL), and Newcastle. This minute reports what I saw there, brings you up to date on developments at NESL, and seeks your support and that of colleagues in preparing a number of measures for announcement in the event that I have to decide, probably before the end of October, that NESL must close.

TN3AAB

Inner Cities

2. I visited three inner cities projects in Sunderland and Newcastle. They had all received support from our City Action Team. The projects were very impressive and included setting up a new training course at Wearside College to help provide multi-skilled technicians, the Microelectronic Applications Research Institute facility in Sunderland which brings together the polytechnic, the university, industry and the local authority in what is now a profitable organisation for high technology research and training, and a managed workspace project in the centre of Newcastle which was set up by the local Enterprise Agency using Community Programme employees and now offers accommodation for up to 17 start-up companies.

3. The private sector is playing an important part in all these projects. The CBI, through its Newcastle Initiative, is taking a key role in promoting new enterprise in the city. We have already succeeded in attracting many new industries to the area - not just big companies like Nissan but also many start-ups and service companies. I was impressed by the commitment of the private sector to regenerating the community. I am sure this owes much to our resolve to help create a new environment in which people can work and prosper. I am convinced we can build on this but there are still major problems to be tackled, one of the main ones being the future of NESL at Sunderland.

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NESL

4. I spent yesterday morning touring the yard with the British Shipbuilders Chairman, John Lister, and meeting the unions and management. I also made a point of seeing the Sunderland Chamber of Commerce and other leading businessmen in the community since, in the event of the yard having to close, we will want to look to them to play a major part in helping Sunderland build on the new industrial base that is developing there.

5. Morale is evidently very low. The last two Danish ferries are nearing completion and there is no further work. 450 of the workforce of about 2,500 have been laid off and a number of the younger and better trained employees have left to seek work elsewhere. I was urged to do all that I could to save the yard, including letting BS take the order for 10 cargo ships for Cuba. I made clear, however, that there could be no question of going back on the policy we announced in July and in particular that NESL must be sold before we will provide Intervention Fund support for further orders.

6. BS have announced that 30 September is the deadline for bids for NESL. There are four potential bidders. John Lister has told me, however, that while he expects to receive two or possibly three formal bids by the deadline, he is not hopeful that any of them will be credible. I

therefore anticipate that I may have to announce, probably towards the end of October, that the yards will have to close.

7. This will have a significant impact on the local community. BS is still one of Sunderland's main employers. Unemployment has fallen by 2.3% in the past year but still stands at 16.6%, with pockets reaching as high as 50%. The shipyards dominate the community, both physically and because of the long history of shipbuilding there. It will take a major effort to overcome this but I believe it can be done.

Package of Measures for Sunderland

8. At a meeting you chaired with the colleagues most concerned on 31 March, it was agreed that we should be ready to announce a package of measures in the event of NESL closing. My predecessor told the House on 21 July that we would introduce such a package. David Young and I are discussing with John Major in the current PES round the precise level of funding. I hope very much that, as previously agreed by colleagues, the package will include measures for counselling, retraining, advance factory facilities and other enterprise measures to stimulate alternative employment opportunities.

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9. I know that Nick Ridley has in mind to announce a new Enterprise Zone for the area. I think this will have a major beneficial effect and is an essential complement to the other measures I have in mind. During my visit yesterday, I was most impressed by the work which the UDC has already carried out. I understand that a major business park project which the UDC is currently considering may depend for its success on a marginal adjustment of the proposed EZ boundary. I hope this can be overcome.

10. I am sure there are other initiatives, some of which may already have been announced, that could be either extended to include, or specifically targeted on, the area that would be affected by the NESL closure. I should like all colleagues to whom I am copying this minute to consider what they could do that would enable further positive announcements to be made towards the end of next month. If we are to help develop Sunderland's new industrial base successfully then I think it is essential that we try to co-ordinate and bring forward as many of our activities as possible at this crucial time.

11. I am copying this minute to members of E(UP) and Paul Channon and to Sir Robin Butler.

Peter Smith

PP TN

(Approved by the Chancellor and signed in his absence)

TN3AAB

the department for Enterprise

CONFIDENTIAL

To: CHIEF SECRETARY

From:

BRITISH SHIPBUILDERS AND THE NORTH EAST

there, brings you up to date on developments at NESL, and

TN3AAB

iae2.sc/Stevens/1988 PES

CONFIDENTIAL

BF 3019

26/9/88

CHIEF SECRETARY TO THE TREASURY

1988 PUBLIC EXPENDITURE SURVEY: TRADE AND INDUSTRY

Note of a meeting held in the Chief Secretary's room, HM Treasury at 10.00 am on Tuesday 20 September. Present:

Chief Secretary	Secretary of State for Trade and Industry
Mr Monck	Chancellor of the Duchy of Lancaster
Mr Burgner	Sir B Hayes
Mrs Brown	Mr Knighton
Mr Waller	Mr Durie
Mr Hansford	Mr Priddle
Mr MacAuslan	Mr Coates
Ms Roberts	Mr Hosker
Mr Stevens	
Mr Rutnam	Minister of State, Scottish Office
Mr Call	Mr Morrison
Miss Evans	Director General of Fair Trading
	Mr Lane OFT

OFFICE OF FAIR TRADING

The Director General of Fair Trading said the Government was committed to a number of measures, including changes in the control of mergers and restrictive trade practices, intended to improve the operation of markets. These measures placed new responsibilities on the DGFT and the resources required to meet these represented a large part of his bid. The bid also reflected the continued increase in demand for consumer credit licences, which had increased by one-third in the current year; and the need to increase spending on consumer education. Finally the bid allowed for a pay assumption of 8½ per cent for each year of the

Survey period; other costs were assumed to rise by 4½ per cent a year. He believed that the management plan had fully met the Cabinet's requirement for efficiency savings of at least 1½ per cent a year.

2 The Chief Secretary said he regarded the management plan as a good piece of work, but he was anxious that the efficiency gains identified should be seen to be achieved. He was not clear whether these would result in cash savings, or whether they would enable OFT to meet additional work with fewer resources than would otherwise be required. He noted with concern the very high pay assumption. On efficiency gains, Mr Lane confirmed that these would result in OFT meeting an increasing workload with a lower level of resources than would otherwise be required. The Director General acknowledged that the pay assumption was large and he hoped that in the event an increase of this order would not be required. However, he regarded the assumption as realistic. It was based on the increase in average earnings in April 1988 and since then the rate of increase had risen.

3 The Chief Secretary asked if the Director General could quantify the amount included within his bid resulting from the changes in merger control and whether the bid took account of the agreement with Francis Maude to introduce charges. He also referred to the substantial increase in the planned level of spending on publications - the bid allowed for an increase in 1989-90 of more than 50 per cent on the current year. The Director General said that some £245,000 of his bid was on account of mergers in the first full year of operation, including the extra administrative costs resulting from the introduction of charges. He confirmed that his bid did not take account of receipts. On publications much of the increase resulted from extra spending on consumer education, which was mainly directed at schools.

4 The Chief Secretary asked how the changes in consumer credit licensing proposed by Mr Maude had been taken into account in the bid. He understood that Mr Maude had indicated the changes would be "resource neutral", but it was not clear whether this meant

costs would continue at the present level or would be the same as if growth in demand for licences had continued to grow unchecked. The Director General said the bid was based on existing policy and took no account of the changes proposed by Mr Maude. Many aspects of these remained to be settled. Although the number of licences in issue would reduce substantially they would be renewed more frequently. The Director General would also have new investigatory powers. It was not clear precisely what these would cover, but he knew from experience they were likely to place a heavy demand on resources.

5 Finally the Chief Secretary noted that a large proportion of OFT staff were located in the City and asked what thought had been given to relocation. The Director General said this would be a priority task for the new CIR unit being established within the OFT and he expected a study to be ready in 1990-91. He believed it made sense for OFT staff dealing with mergers to remain in the City, but had an open mind about the location of the rest of the Office.

6 The Chief Secretary thanked the Director General and said he would reflect on what he had said and write to him shortly.

EXPORT CREDIT GUARANTEES DEPARTMENT

7 It was noted this was the subject of correspondence between the Chief Secretary and the Secretary of State and would not be discussed at the bilateral.

DEPARTMENT OF TRADE AND INDUSTRY

8 Opening the discussion the Chief Secretary referred to the Cabinet remit on public expenditure. Although the underlying economy was strong, recent events had made it all the more important to keep firm control of spending. There were two general points to be taken into account in considering the DTI programme. First there was a remit from E(ST) to identify science and technology savings to fund increased spending on basic science. Large parts of the DTI

programme were on science and technology and any agreement on these would be subject to the views of E(ST). Second, improved industrial profitability made it possible for industry to fund increased R&D and investment. This pointed to a reduction in government spending in these areas, in the same way as the level of spending on employment programmes was being reduced as unemployment fell. He would wish to review progress on the Enterprise Initiative in the 1989 Survey. He had last year agreed exceptional flexibility to reallocate provision between different parts of the DTI programme, because of the major changes in the programme following the ending of RDGs. Now these changes were largely in place this flexibility was no longer justified. The Secretary of State noted the Chief Secretary's opening remarks. On the case for reducing DTI spending as industrial performance improved, he said the reverse was true. As industry expanded so the demands placed on the Department also grew. He hoped it would be possible to retain some flexibility to reallocate between programmes before figures for the PEWP were settled.

Regional Development Grants

9 The Secretary of State said the bids on RDGs were all estimating changes and assumed ending the 2 month waiting period in the current year. If this was not agreed the increases in later years would be higher than the present bids. He was prepared to meet the additional cost in the current year from ending the waiting period in England from within his agreed Estimates. The Chief Secretary said this was helpful. The Secretary of State for Scotland was also keen that the waiting period should end in the current financial year. He too had indicated he would be prepared to meet the cost from within his agreed programme. However, this was something on which the agreement of all these spending departments was needed and the Chief Secretary had yet to meet Mr Walker. He would consider the proposal further following that meeting.

Regional Selective Assistance

10 The Secretary of State noted that commitment limiting for RSA had been agreed last year, but not cash limiting. The Chief Secretary had asked him to accept cash limiting for RSA but he could do so only if there were additions to his RSA baseline of £12.3/13.1/13.4m in 1991-92. The **Chief Secretary** said that with commitment limiting in place it was difficult to see why a safety margin of £40 million over the Survey period was required to implement cash limiting. The Secretary of State said that under commitment limiting he was able to adjust the administrative criteria for RSA to deal with longer term changes in the level of demand and thus keep commitments within agreed limits. This was not an effective method of dealing with variations in year, which could be up to 10 per cent of total spending. These were largely outside the Department's control because they depended on the timing of expenditure by those to whom the commitment had been given. The Chief Secretary said he would reflect on this.

11 The Secretary of State said the bid of £10 million in 1991-92 arose from the latest forecast of RSA commitments based on existing criteria. The Chief Secretary noted that the Secretary of State had decided not to allocate additional funds to RSA last year and suggested this was the reason for the forecast overspend. The Secretary of State said this was not the case. The RSA baseline for 1991-92 was based on the provision for 1990-91, uprated in the usual way. There was no difficulty about keeping within baseline for 1990-91. The addition in 1991-92 reflected increased demand in that year. The only way it would have been possible to have a 1991-92 baseline sufficiently large to cover this would have been to over allocate in 1990-91.

Grants under Section 8, Industry Act 1970

12 The Chief Secretary referred to the agreement in March of this year to provide support to Carnon and said he had given no commitment to provide additional funds for this. In the absence of a rescue package a call would have been made on guarantees

which would have constituted a charge on the DTI programme. He was not, therefore, prepared to accept this bid. The Secretary of State said this would cause serious difficulty for him.

Other Estimating Changes

13 The Chief Secretary noted there were estimating changes on three schemes, the Exchange Risk Guarantee Scheme, the Business Improvement Scheme, and the Iron and Steel Employees Readaptation Benefits Scheme. Together these amounted to £0.8 million in 1989-90 and £4.9 million in 1990-91 and there was a reduction of £2.5 million in 1991-92. It was agreed that the Secretary of State would meet the increase of £0.8 million in 1989-90 from within his agreed programme, and that no adjustment would be made in respect of the later years; which would be considered in the 1989 Survey. The Secretary of State said the bid on the Home Shipbuilding Credit Guarantee Scheme resulted from an increase in Treasury interest rate assumptions. He hoped the Chief Secretary would accept this bid. The Chief Secretary said he would reflect on this.

EIEC

14 The Secretary of State accepted the Chief Secretary's proposal for a reduction of £2 million a year in the grant-in-aid to the EIEC.

Shipbuilding Intervention Fund

15 The Chancellor of the Duchy said there were three parts to the bid: £13 million in each year for IF support for the new owners of Govan; £10 million in each year for IF grants to NESL (£7 million) and Appledore (£3 million) assuming successful sale of these yards to the private sector; finally £4.6/5.6/5.6 million for grants to existing private sector shipyards already eligible for IF support. The Chief Secretary said he was prepared to accept the bid for Govan. On NESL and Appledore he was not clear what the likely timing of the sales would be. The Chancellor of the Duchy said that the prospects for Appledore were good, but the

position of NESL was less certain.

16 He noted that if the sales did not go ahead remedial measures would be required at the same cost. The Chief Secretary said it was clearly understood that the cost of remedial measures would be met from within the Department's programme. It was agreed that the part of the bid which related to IF support for NESL and Appledore should be set aside and considered again when the position was clearer.

17 The Chief Secretary asked about the assumptions underlying the bid for IF support for existing private sector yards. Mr Coates said this related to a small number of yards including Cochranes and Dunstons (Humberside) and McTay (Birkenhead) which, up to now had often relied on MoD orders, but would need to build subsidised merchant vessels if they were to stay in business. The bid assumed grant at the appropriate levels for the types of vessel concerned (18-20 per cent) which were below the EC maximum of 28 per cent. The Chief Secretary said the agreed policy was to secure a tapering of this percentage. It was confirmed that the bid did not allow for this.

Mineral Stockpile

18 The Secretary of State said he was able to offer disposals from the stockpile which would yield receipts of £3 million in 1989-90, but he could not offer anything more. The Chief Secretary said he was prepared to accept this but would want to return to later years in the 1989 Survey.

Innovation

19 The Chief Secretary said he could not accept the bid of £28.6 million in 1991-92 to reinstate the reduction in the DTI programme under the EUROPES arrangements, following agreement on a new EC R&D Framework. The Secretary of State said the UK had no option but to participate in this new programme and that the EUROPES rules would present serious difficulties in future as the level of EC spending, which represented doubtful value for money,

grew and national schemes were cut back to compensate. However, he was prepared to reduce his bid in 1991-92 to £15 million and offer savings of £10 million in 1989-90 and £5m in 1990-91.

20 The Chief Secretary said he welcomed this offer but considered there was scope for further savings. He understood there was a history of underspending on this programme and asked how this came about. Mr Durie said that following overspending in 1984-85 support for innovation had been reviewed and the criteria tightened. Underspending in recent years have been of the order of £30 million and recent changes in DTI programmes meant underspending was also likely in the current year, but this was not expected to continue. The Chief Secretary said if this was the case how did the Department expect to achieve the savings which had just been offered. Mr Durie said this would be through a general tightening of criteria and the elimination of "marginal" projects.

21 The Chief Secretary said the recent increase in R&D spending by industry suggested there should a reduction in government spending in this area. The Secretary of State agreed. His new programmes provided for substantially lower spending in this area compared with recent years. The emphasis had shifted away from single project support towards promoting collaborative R&D e.g. through EUREKA. The Chief Secretary said he would reflect on the Secretary of State's offer.

Space

22 The Chief Secretary said that agreement to UK participation in Columbus had been on the basis that the cost would be met from within the DTI programme, and referred to correspondence with the Prime Minister in April. The Secretary of State said this was not his understanding of the position but he would reflect on the correspondence , and on his position.

Aeroengine R&D

23 The Secretary of State said that a substantial proportion of the Department's budget for Aeroengine R&D was already committed. Part (£5/7/7m) was for UK participation in the European Transonic Wind Tunnel and there was also a commitment to spend £11 million in 1989-90 (less in later years) on work at RAE. The Chief Secretary said the whole of this budget, including the spending at RAE, came under the auspices of E(ST) from which there was a remit to secure savings on industrial R&D to fund basic science. He did not accept that interdepartmental commitments to fund work could override this. The Secretary of State noted that he had a statutory duty under the Civil Aviation Act to encourage R&D in this area, but agreed to consider the scope for some reduction in provision.

Research Establishments

24 The Chief Secretary accepted the bid for VAT on the REs building programme arising from the recent ECJ decision. The Secretary of State said that his plans to privatise NEL were running into difficulties and he was now seriously considering whether it should be closed. He would be discussing this with the Secretary of State for Scotland and the position should be clearer by mid-October, but he noted there would be costs associated with closure.

25 The Chief Secretary said that following the review, the work of the three REs not considered suitable for privatisation had been redirected, and in particular it was now the objective to reduce substantially the proportion of work industrially relevant and strategic work . He also noted that the Secretary of State had identified all three as early candidates for agency status. Both of these factors suggested there should be scope for considerable savings. The Secretary of State said this was an issue to be considered in the context of the REs corporate plans. He believed it would be possible to achieve savings through better

targeting and improved value for money. He was happy to flag this up as an issue to be considered in the 1989 Survey. The Chief Secretary said it was important to show a commitment now to achieving these. The Secretary of State said, on the assumption that NEL was privatised, and the cost of this was covered by transfer from elsewhere in his programme, he could offer savings of £1/4/5m. Following discussion he agreed to reflect and consider whether he was able to offer further savings.

Rolls Royce

26 The Chief Secretary said it was unsatisfactory that uncertainty over this potentially large item of expenditure, should over hang the Survey discussions. He was extremely sceptical about the need to provide additional funds to Rolls Royce. The Secretary of State said he agreed with this, but consideration of the Rolls Royce application had as yet been completed and he could not formally respond to Rolls Royce until this was received. It was agreed that the Secretary of State would propose to Rolls Royce a firm deadline for providing the further information which was required and consider whether it would be possible to set a dealine in time for the issue to be resolved during the Survey.

Relocation

27 The Secretary of State said he was about to embark on a substantial programme of relocation. He had been encouraged in this by the Treasury, and the objective was to achieve running costs savings. The major part of the bid was for the cost of a new building for the Patent Office at Newport. Part of this (£7 million in 1990-91 and £4 million in 1991-92) could be met from the existing baseline, but there was no scope for finding further savings. The Chief Secretary said that he would reflect on this, He sympathised with aspects of the Secretary of State's case.

Computers

28 The Secretary of State noted there were two main elements in this bid, an optical disc system for CRO and the provision of

personal computers for staff at Grade 7 level and above, from which he expected substantial efficiency gains. The Chief Secretary asked what was involved in the CRO project and what stage this had reached in the Department's internal evaluation process. The Secretary of State said he would provide this information.

Running Costs

29 The Secretary of State accepted the Chief Secretary's proposal for a reduction of 100 each year in the Department's manpower plans. The consequential reduction in the running costs bid was £1.6/1.8/2m.

30 The Chief Secretary said he was disappointed that the DTI management plan offered only the minimum 1½ per cent efficiency savings. It was difficult to see how this lined up with the Secretary of State's proposals for turning large parts of the Department into agencies. Nor did the plan specify how the 1½ per cent efficiency savings were to be achieved. In principle the substantial planned move to agency status should mean it would be possible to achieve efficiency gains significantly above the minimum. Mr Durie said the plan had been prepared before the proposals for granting agency status had been developed and there had been no request for the plan to be updated. The Chief Secretary said a number of departments had revised their plans to include an increased level of efficiency gains. The Secretary of State said he would reflect on this.

Export Promotion

31 The Chief Secretary said he had indicated he wanted to discuss this in the current Survey. He understood that DTI officials had produced a report which recommended a move to full cost recovery for a large proportion of export promotion services. He regarded reductions in provision as the first call on savings flowing from this review. The Secretary of State said that achieving savings depended on co-operation from the FCO. Pilot studies were in progress, the results of which would be known by

Easter. The Chief Secretary said he hoped some net reduction in this programme could be made on account. The Secretary of State agreed to reflect on this. The Chief Secretary agreed to respond to the Secretary of State's letter of 25 July, on the proposed national export counselling service.

Publicity

32 The Chief Secretary said he had already had extensive discussions with the Secretary of State about his plans for publicity. He remained concerned about this,in particular the need for continued high spending on the Single Market and Enterprise Initiative campaigns. The Secretary of State said spending on Single Market Campaign was intended to decline to £7/6/6.3m, although spending on the Enterprise Initiative was expected to rise to £15-16 million by 1991-92.

EUROPES non-R&D and other

33 It was agreed that these items would be considered in further discussions.

Conclusion

34 Summing up the Chief Secretary said the Secretary of State had agreed to reflect on a number of issues, and he hoped that he would be able to write fairly quickly. The Chief Secretary added that he in turn would reflect on the points raised by the Secretary of State and would consider the best way to take discussions forward in the light of the Secretary of State's letter.

NATIONALISED INDUSTRIES

British Shipbuilders

35 The Chief Secretary had accepted Lord Young's IFR bid and it was agreed there was no need to discuss this.

Post Office

36 The Chancellor of the Duchy said he had difficulty with the Chief Secretary's proposed reductions of (£-55/-55/-60m) from the IFR bid. He had looked with the Post Office at possible reductions in the capital investment bid to reflect MMC's recommendations on Counters' refurbishment and could offer (£-5/-6/-7m) rather than the (£-15/-15/-15m) sought. But the Chief Secretary's proposed reductions of (£-40/-40/-45m) for cost efficiency were unrealistic. The effects of the recent strike on PO plans were uncertain. There had been some cost savings but against that there was a potential significant loss of revenue. As an illustration, 1 per cent of lost growth would equate to £20 million lost revenue a year although the effects could be more substantial. Nevertheless he could offer (£-5/-10/-5m), reserving his position on where these savings might be found.

37 The Chief Secretary said he could not accept The Chancellor of the Duchy's offer. The PO capital investment bid was huge. Much of it would earn a reasonable return and was worth supporting. But he believed that the Treasury proposal was realistic in the context of the overall investment programme. It would still allow a 40 per cent increase over baseline - which compared very favourably with other public sector programmes. He must therefore press for the whole of the modest reduction he had proposed. On cost reductions, apart from his comments on the effects of the strike, the Chancellor of the Duchy had not rebutted the realism of the Treasury's proposal. It was possible that the after effects of the strike might affect the first year of the IFR period (although this had yet to be demonstrated) but he did not believe that any immediate fall-off in revenue would necessarily flow through to later years. It would be undesirable to relax the pressures on PO efficiency. Maintaining the level of real unit cost reductions achieved in the Letters business in the last six years would imply future savings of (£-40/-56/-92m). The Treasury proposal assumed a considerably slower rate, even after

taking account of the possibility of a 1 per cent loss of revenue in each year. He therefore asked the Chancellor of the Duchy to reconsider.

38 The Chancellor of the Duchy agreed to do so. He would be as helpful as possible bearing in mind the current problems of the PO management. Part of the cause of recent industrial unrest resulted from the considerable pressure on industrial relations from management's measures to improve business efficiency. He would have to judge how far that pressure could be sustained. He would also want to consider how far any additional efficiency gains should be used to benefit the customer.

39 The Chief Secretary said it was important to reach a settlement on the basis of the best available information, even if this could not take full account of about the effects of strike. He would await further proposals but emphasised that, he had no choice but to press for the maximum savings possible.

Carys Evans

MISS C EVANS
(Private Secretary)

H M Treasury
26 September 1988

Treasury Distribution:
PS/Chancellor
Sir Peter Middleton
Mr Anson

Have we seen minutes of x yet?

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

CHIEF SECRETARY
REC. 26 SEP 1988
ACTION Mr Burgner
COPIES TO CX, Sir P Middleton, Mr Anson, Mr Phillips, Mr Waller, Mr MacAuslan, Mr Monck, Mr Luce, Mr Turnbull, Mr Gaell.

2

Department of Trade and Industry

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Rt Hon John Major Esq MP
Chief Secretary
HM Treasury
Parliament St
London SW1

Direct line 215 5422
Our ref LQ1AGK
Your ref
Date 26 September 1988

Dear Chief Secretary,

1988 PUBLIC EXPENDITURE SURVEY

1. At our bilateral meeting on 20 September I undertook to write to you on several points, and we each agreed to reflect further on a number of issues. This letter sets out my response on the points about which you wanted further information, and the results of my reflection on what you said at our meeting. I have since seen your letter to me of 22 September, and I confirm that it sets out the main points agreed at our bilateral, subject to some minor points of detail covered below.

INTERVENTION FUND

2. Your letter notes that we agreed to set on one side the NESL/Appledore element of my bid. (£10m in each PES year). This goes somewhat further on Appledore than we were ready to do, but we are prepared to withdraw this element of the bid, provided that you agree to increase DTI provision in future by the amount of any IF subsequently agreed for these yards, and to increase BS's provision by the cost of any remedial measures subeqently agreed.

INNOVATION

3. You noted that support for innovation had been underspent in the past, and you asked for details. The former Science and Technology budget was actually overspent in 1983/84, and as a result a moratorium was introduced to avoid future overspends. This restriction, and the initial uncertainties arising with the 1984/85 policy changes, led to an underspend of some £24m in 1985/86. In 1986/87 the underspend fell to

about £10m - about 5% on a budget of over £200m. Last year, however, the underspend rose considerably to nearly £50m: the major review of policy, the subsequent changes and our move to zero-based budgeting inevitably led to this substantial underspend.

4. I do not accept therefore that this underspending will persist in the future against the substantial reduction in my innovation budget and the establishment of my new policies to which industry is now responding well. Since January I have approved expenditure on new measures totalling over £200m on LINK and Advanced Technology programmes, EUREKA projects and technology transfer support. In addition I have over £150m in "pipeline" expenditure from further LINK and Advanced Technology programmes under consideration and from propoals for EUREKA support. Moreover, as you know, the changes I have already made in our support for innovation go exactly in the direction which E(ST) discussions require. And l have already agreed to absorb a EUROPES cut of £28.6m over the PES period: the implications of EUROPES are even more difficult in the long term.

SPACE

5. You said that you had been surprised by this bid, given the Ministerial correspondence on Columbus. As I said at our meeting, my bids are perfectly consistent with Kenneth Clarke's minute of 11 April to the Prime Minister. We regarded your reply as a statement of your position which we would sort out during the PES process, and I duly signalled my bids on space in my letter to you of 25 May. As I said at our meeting, the bid figures are the absolute minimum needed to implement the collective decision on Columbus: indeed the 1989/90 figure understates the amount needed now that the industry contribution of £1.5m in that year towards Columbus will not be provided. The figures are also very modest by comparison with earlier expectations of a sharp rise in expenditure on space.

AIRCRAFT AND AEROENGINE R&D

6. I agreed to look further at expenditure on this budget, other than that already legally committed on the European Transonic Windtunnel (ETW), and in particular to consider the possibility of a reduction in the money spent at RAE. I pointed out, however, that this budget had already been cut back significantly; leaving aside the ETW, we are now spending some £20m a Year, as compared with nearly £40m a few years ago.

7. We make firm commitments to RAE on an annual basis only. However, because of the long-term nature of the work undertaken there, and the need to integrate our plans with those of MOD, that part of our A & AE baseline which is geared to work at RAE (£11.1m, £10.6m, £11.2m) is taken into account for the long-term planning of a rolling programme of research at RAE. Budget cuts in recent years have pruned back work in the sectors which we part-support to what we (and RAE) consider the minimum viable level for the civil interest. A further budget cut would probably mean pulling out of one of those sectors (avionics; aeroengines; airframes - aerodynamics, materials and structures). The effect on the UK civil aircraft technology base would be very serious, and we would lose the benefit of technology transfer from military to civil programmes. There would also be serious implications for RAE.

8. The remainder of the A and Ae budget (£10.8m, £10.2m and £10.7m) is geared to support for relevant R&D work by industry and universities. A good deal of this is already legally committed, particularly in the first year (£6.4m, £3.6m, £1.6m). This part of the budget has also been cut back in recent years. Your officials have had a copy of the report of the thoroughgoing review which we made of this expenditure. I have accepted the main recommendation which is that this budget should continue at its present level. While I expect to be making changes as a result of this review to improve value for money and to bring our support more into line with general innovation policy, the industry, as you well know, has a number of special features. These merit special support measures. The long lead times and scale of the required financial outlays give rise to substantial risks. Many of our foreign competitors are already supported far more extensively by their governments than our industry by us. Moreoever there are substantial benefits from the programme which do not accrue to the companies themselves, such as the benefit of preventing a US monopoly of civil aircraft and aeroengines.

RESEARCH ESTABLISHMENTS

9. Although I made clear that it was too early to judge what savings might accrue from the move of the Research Establishments (REs) to agency status, I agreed to consider two points which you raised in connection with the recent Central Unit review.

10. First, you questioned whether there would be any savings as a result of the recommendation in the review that strategic research should be restricted to 10% of work carried out at

REs. The relevant recommendation actually states that "Each RE should be permitted, as at present, to spend up to 10% of the full economic cost of research carried out for DTI (but not other work) on strategic research". As this makes clear, this is a continuation of their permitted activities, and no savings arise as a result of the recommendation.

11. Second, you questioned whether the review's recommendation on industrially relevant R&D would lead to any savings. The review did not rule out industrially relevant R&D in future: what it recommended was that any such R&D should only be carried out if it met a number of conditions: it should be related to work for statutory regulatory or policy reasons; should take the form of club activity; should be restricted to 50% DTI funding at most; and should be restricted in total to 10% of the full economic cost of each RE. NEL apart, this affects only WSL. WSL has taken on more repayment work on environmental issues, mainly for other Departments, as recommended in the review, so I do not anticipate that there will be running cost savings. But this repayment work will mean extra income for WSL which I am prepared to use to reduce my bid for REs capital by £0.5m in 1989/90 and #1m in each of the remaining PES years.

12. I indicated that I would be prepared to give up NEL's running cost and capital provision on condition that an appropriate transfer is made from running cost provision to programme for transitional funding, and adjusted later as necessary to reflect whatever level of funding is agreed. On this basis, I said I could offer £1m, £4m and £5m. This offer of course depends on NEL privatision taking place : I shall be writing to you separately about this when the situation is clearer.

ROLLS ROYCE

13. I agreed that it would be a good idea to set Rolls Royce a deadline for the provision of the information which we need to appraise their launch aid application, even though it is hard to see how such a deadline will enable an appraisal to be completed before the current PES discussions are concluded. I think that this can reasonably be done at official level. My officials will be in touch with yours about the terms of the approach to the company.

COMPUTERS

14. You asked about the CRO computer project. This concerned the use of image technology for document management and for

making company information available to the public. A detailed specification is now being produced: when fully defined, the project will be submitted to the Treasury for approval.

RUNNING COSTS

15. Our officials have been in touch about the reduction in my running cost bid associated with my acceptance of your proposal for a reduction of 100 in my manpower plans, and I am now able to increase this from the £1.6m, £1.8m and £2.0m which I offered at our meeting to £2.0m, £2.2m and £2.4m.

16. You raised the question of the steep rise in rent for Companies House in City Road. City Road is currently extremely cheap, the accommodation charging being £6.30 a square foot. We understand from PSA that the landlord has floated a possible rent rise of 700 per cent for the rent review in 1990/91. This is reflected in our accommodation bid for 1991/92, which includes £4.5m in respect of City Road. Given that the rent reivew is some way off, and that its eventual outcome is stil uncertain I am prepared to drop this £4.5m bid, although I must point out that I shall need to reinstate it in a future PES round, unless a lower increase can be negotiated, or unless - which is most unlikely - other premises can be found for 1991/92 onward which would be cheaper, bearing in mind that most of the occupants of City Road - notably the Companies Registration Office and the Insolvency disqualification and prosecution unit - need to be in the City.

17. I note your comments about the Department's - Management Plan, which our officials have now discussed briefly. I can confirm that I am looking to the Department to secure the efficiency gains set out in the Plan. I recognise that a substantial move to agencies should lead to increased efficiency gains, and these will be reflected in future Management Plans as detailed proposals for agencies are developed.

EXPORTS/EXPO 92

18. As you will see from my separate letter to the Prime Minister about EXPO'92, I believe that the Department will have to find £9m over the next four years for this exhibition.

We will also need PES transfers of the £7m from the FCO and associated running costs already agreed and of £9m from the Department of Employment. I propose to find the money in the main from my existing export-services baseline. I am afraid that this does mean that I will be unable to agree to any cut in this baseline for 1989/90 and, as expenditure builds up, I will need an increase of £2m in 1991/92.

CONCLUSION

19. At our meeting on 20 September, I made a number of significant bid reductions in an effort to reach a settlement with you. I had hoped that you would feel able immediately to agree to a settlement in the light of those concessions.

20. In the interests of reaching a settlement, and acknowledging your concern about E(ST), I am however prepared to reduce my bids for innovation, spa aircraft and aeroengine R&D by a total of £6m in each of the PES years. I will need to consider how to allocate these reductions between these three budgets. I must stress that this is the most that I could accept in the E(ST) area, and that I am not prepared to agree to any further reductions here, given my real difficulties in abosrbing this reduction.

21. I believe that with ese concessions my bid is fully sustainable especially if you consider that but for factors outside my control it is now below the original baseline. I hope you will now agree to settle at this level. This leaves us with baselines of £135m, £1308m and £1165m.

22. We will reply separately on your points on the Post Office's IFR.

Yours Sincerely,

(Approved by the Secretary of State
and signed in his absence).

iae2.sc/docs/1988 PES

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FROM: M A WALLER

DATE: 28 September 1988

CHIEF SECRETARY

cc. Chancellor
Mr Anson
Mr Monck
Mr Phillips
Mr Turnbull
Mr Hansford
Mr MacAuslan
Mr Stevens
Ms Roberts
Mr Parkinson
Mr Call
Mr Tyrie

DTI 1988 PES: LORD YOUNG'S LETTER

1. Lord Young's letter of 26 September reports back on his conclusions on the issues which he agreed to consider at your bilateral discussion. The results in terms of concrete reductions are disappointing. This minute analyses where we stand now on the DTI programme in the light of Lord Young's response and suggests how you might proceed from here.

Lord Young's response

2. A revised briefing table is attached which shows the latest position, taking account of the further reductions offered in Lord Young's letter (the forecast outcome has not yet been updated). The main points to note are:

(i) On his innovation, space and aeroengine R&D budgets he has offered only a further reduction of 6/6/6 to be allocated as he sees fit. This brings the total changes proposed on these three budgets to -9.4/-8.2/+11.3, the last year being a pared down bid for EUROPES. This compares with budgeted figures of £308m and £325m in years 1 and 2 of the Survey i.e. cuts of some 3% and 2.5% respectively. In practice this will probably leave the space bid and the aeroengine R&D baseline pretty much intact since, despite his claims to the contrary, there is still likely to be some degree of underspend on the innovation/technology transfer budget. For the <u>Research Establishments</u> he has only offered an additional -0.5/-1/-1 on account of higher (DoE financed) receipts at Warren Spring Laboratory, giving total reductions of -1.5/-5/-6. Virtually all of this is dependent on NEL privatisation: he has not indicated what savings/costs might be associated with NEL closure if the privatisation falls through. He has offered nothing on account of the proposed move to agency status for the other three research establishments.

(ii) On <u>running costs</u>, he has adjusted upwards marginally the money savings from 100 manpower cut but has offered nothing on account of efficiency savings or the shift to agency status for the majority of his department (though some of the savings from NEL privatisation may feed through into a lower running cost total for the department). He has also withdrawn the Companies House rent bid for 1991-92 (£4.5m) but signals the possibility of a bid next year - which seems likely given his view that most of the occupants of the building need to be in the city.

(iii) On <u>exports</u>, again Lord Young offers nothing from the review, praying in aid the EXPO '92 commitment for which he now enters a 1991-92 bid of £2m despite the PM's instruction that the project should be financed from existing DTI and DEmp resources. Moreover, his EXPO bid assumes PES transfers of £7m from the FCO and £9m from the DEmp. The FCO transfer runs contrary to the No 10 instructions and must be highly doubtful anyway, because no money has been set aside and you are seeking to reduce the FCO bids anyway.

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(iv) On the Intervention Fund, he challenges (probably rightly) whether he agreed to withdraw the Appledore element of the bid and offers to do so only on the condition that you undertake to meet any IF costs subsequently agreed and to increase BS's provision to meet the cost of any remedial measures agreed. The former proviso is acceptable but the latter is not since it violates your clear condition that any remedial measures must be met from existing resources.

Assessment

3. The current aggregate position and the path to it is broadly as follows:

	1989-90	1990-91	1991-92
			£ million
. Existing Baseline	1281.9	1222.5	1225.5
. Lord Young's original bids	+110.1	+120.8	- 19.9
- Bilateral changes	- 28.4	- 27.7	- 29.9
- Lord Young's letter	- 6.9	- 7.4	- 9.9
. Revised bids	+ 74.8	+ 85.7	- 59.7
. Proposed baseline (I)	1356.7	1308.2	1165.8
. Forecast Outcome (II)	1342.2	1301.2	1143.4
. Difference (I-II)	+ 14.5	+ 6.5	+ 22.4

4. Thus Lord Young has offered you only an additional reduction of 7/7/10 following his reflection on your bilateral discussions. We are now 14/7/22 adrift of our forecast outcome. This discrepancy is not large in absolute terms but, as you will

recall, this outcome was not adjusted to take account of the decision you took to take a tougher line on Lord Young's programme with the object of getting him close to baseline by ceding only the RDG estimating change and a small amount on account of relocation and running cost pressures.

5. You will also wish to reflect on whether:

(i) the Science and Technology position on Lord Young's programme is acceptable, both in relation to aggregate arithmetic/value for money and E(ST)'s likely stance. On the former point, there are compelling arguments for seeking a better outcome in terms of industry's improved profitability, the general move away from single company support; the need to sharpen priorities and to wean the Aerospace sector off dependence on state subsidies thereby releasing scarce scientific and engineering talent to more productive uses . Given the total budgeted sums involved a further cut (e.g. 30/20/20) should be feasible but difficult. The savings would have to come from a major cut in the aeroengine R&D budget and a further reduction on innovation and the REs spending programme. Lord Young will no doubt contest it strongly, not least because of the EUROPES squeeze and the possible impact on the technology transfer element of his Enterprise Initiative. On E(ST) the Assessment Office have informally indicated that they would regard Lord Young's current position as unsatisfactory, particularly in relation to the aeroengine R&D and Innovation budgets, and would therefore brief the Prime Minister to press for further savings in these areas.

(ii) you wish to secure further reductions in running costs which are still growing by 9.6/4.2/2.5%. We think there is a case for you seeking to squeeze the first year growth further, particularly given Lord Young has yet to offer anything on account of his substantial proposals to move some 70% of the department over to agency status.

6. Against this background we think you should reject Lord Young's current proposals and press him for further reductions in his programme. To get back to baseline (excluding the launch aid estimating reductions for 1991-92) would require savings of 75/80/53 but you have already conceded some 22/20/17 (IF, IREs VAT, HSCGS). A very ambitious but justifiable target would therefore be to aim for pressing Lord Young to absorb 40/30/30, with a fallback of say 30/20/20. The fallback would give Lord Young bids of 45/66/33, ie allowing the RDG estimating change with something over for relocation etc; still a very tight settlement.

Next Steps/Tactics

7. While there remains a gap to close, we do not see the programme as a Star Chamber candidate. If you agree, this leaves 3 main options. In descending order of preference these are: (i) for you to write to Lord Young pressing him for further savings; (ii) to invite Lord Young to an informal meeting to discuss his bids; and (iii) a second round bilateral. Another formal bilateral seems unlikely to elicit much movement and we think you would need to prepare the ground for any informal meeting by responding to Lord Young's letter. Hence we favour a letter on the lines of the attached draft. This does not float any counter bids. But you may think it tactically helpfully to indicate to Lord Young the scale of the reductions you are seeking, perhaps in a telephone conversation or in the margins of Cabinet.

8. The letter assumes that you are not prepared to pay the price Lord Young has set for agreeing to RSA cash limiting but that you signal willingness to countenance some degree of flexibility in return for Lord Young moving back much closer to baseline on his non-estimating bids. (In the first instance it would be tactically wise to restrict any such concessions to

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changes between PES and the PEWP where in practice departments have some leeway already). The draft leaves the door open on both these issues, however, since they may well offer scope for trade off in any settlement you attempt to reach with Lord Young. Moreover, in the case of RSA cash limiting, you have yet to hold a bilateral with Mr Walker and it would therefore be sensible to leave this issue undecided until you have seen him.

9. We should be grateful to know whether you are content to write along these lines but, time pressures permitting, you may wish to discuss the options with us.

M A WALLER

ind.rj Sept Waller.28

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DRAFT LETTER FROM THE CHIEF SECRETARY TO THE SECRETARY OF STATE FOR TRADE AND INDUSTRY

1988 PUBLIC EXPENDITURE SURVEY

1. Thank you for your letter of 26 September setting out your response to a number of points on which you had agreed to reflect at our recent bilateral. I am grateful for the constructive way you have approached these issues. We have made some useful progress but the additional savings offered in your letter only total £7/7/10m over the three Survey years. I, therefore, fear there is a long way to go to reach what I would regard as a satisfactory settlement.

2. On the points raised in your letter, I am sorry if there was any misunderstanding about our agreement on the Intervention Fund. I am grateful for you agreeing to withdraw the Appledore element of the bid and I am prepared to consider the need for an increased DTI provision for IF in the event of privatisation of NESL/ Appledore. But, as I made clear at the bilateral, I cannot agree to providing additional resources for any remedial measures - these must come from within your existing programmes.

3. On innovation, space and aircraft and aeroengine R&D, I naturally welcome your offer of further reduction of £6m a year to be allocated between these three budgets. And the small reduction on the Research Establishment's capital programme is, of course, helpful. But, as I indicated at the bilateral, this is an area of industrial support where significant reductions in expenditure are justified, both in relation to the greatly improved financial position of industry and the need to transfer resources to basic science. Even with the additional reductions proposed in your letter, the total reductions on the science and technology

elements of your programmes for years 1 and 2 of the Survey only amount to some £11m and £13m respectively. (The 1991-92 change of course involves an increase.). I do not feel this is an outcome I could commend to E(ST) nor do I think they would find it acceptable. I believe that there remains a strong case on value for money and realism grounds for a further reduction in the innovation budget. And I was particularly disappointed by your response on Aircraft and Aeroengine R&D. We really must prevail on the small number of very large firms in this sector to carry the burden of R&D costs and to wean them off their dependence on state subsidies. This would be in line with the Government's overall approach to economic policy. (I note what you say about other countries' practices in this area but, as we saw in the Dowty case, these major companies can usually be persuaded to stand on their own feet if we take a firm line.)

4. I was disappointed too that you did not feel able to offer anything further from the research establishments budgets on account of savings resulting from the proposed shift to agency status. The major part of the reduction you have offered in this area is conditional on NEL privatisation. If, unfortunately, this did not come off then this would add back £10m to your baseline over the Survey period. I must ask that, should privatisation not be possible, you undertake to deliver a similar volume of savings from the RE budget and also press you for greater savings on the PES capital budget.

5. On <u>running costs</u> the increased money savings from the agreed manpower reduction are helpful, as in your withdrawal of the Companies House bid for rent increase in 1991-92. But I am sorry that you feel unable to offer any further reduction on account of your proposals for the major shift to agency status. This leaves your running costs increasing at 9.6/4.2/2.5% respectively over the Survey period - the year 1 figure is well in excess of those which we have agreed in Cabinet for Government as a whole.

6. On <u>exports</u>, I note that if we are unable to offer any savings arising from your review, primarily because of the additional costs associated with EXPO '92 for which you have bid for an extra £2m in the last year of the Survey. This bid assumes PES

transfers of £7m for the FCO and £9m from the Department of Employment. The Prime Minister's Private Secretary's letter of 16 September made it clear, however, that the costs of the EXPO Pavilion would need to be met from within DTI's and DE's existing resources. In the light of the No 10 instructions I could not agree to any transfer from the FCO programme on account of EXPO even if had a provision been made. Against this background I will not press in this Survey for savings on export services but only on the understanding that no additional resources will be made available for EXPO '92.

7. As I indicated in my letter of 22 September, I have now reflected on the outstanding points which I agreed to consider following the bilateral and your response to the points listed in my letter. These include the position on RSA cash limiting, section 8 assistance, science and technology and the capital costs of your proposed relocation plans. The key issue here is clearly where we stand on the aggregate figures for your programme. Given the very difficult Survey prospects this year, I do not feel that the overall totals currently on the table are an acceptable basis for a PES settlement. I must therefore continue to press you for further reductions to your bids which will bring your provisions much closer to baseline (excluding, of course, your launch aid estimating changes). As I have already indicated, I would particularly wish to see further substantial reductions in the science and technology and running costs elements of your programmes. I recognise that this might require some element of flexibility in the allocation of resources between individual elements of your programmes of the sort we discussed at the bilateral. At the same time, I would need to be assured that this was underpinned by effective financial control of the sort which RSA cash limiting would offer.

JOHN MAJOR

BRIEFING TA[redacted]
DEPARTMENT OF TRADE AND INDUSTRY

To be Revised

	88-89	89-90	90-91	91-92	£million
Expenditure baselines	1,284.0	1,281.9	1,222.5	1,225.5	
(Per cent change on previous year)		-0.2	-4.6	0.2	

	Bid			HMT opening			Fallback			Forecast Outcome		
	89-90	90-91	91-92	89-90	90-91	91-92	89-90	90-91	91-92	89-90	90-91	91-92
1. RDG's	13.0	41.6	-13.8	0.0	0.0	0.0				13.0	41.6	-13.8
2. RSA	0.0	0.0	10.0	0.0	0.0	0.0				0.0	0.0	10.0
3. National Selective Assistance	4.2	1.8	-6.0	0.0	0.0	0.0				2.0	1.0	-6.0
4. Innovation S&T	-16.0	-11.0	9.0	0.0	0.0	0.0				0.0	0.0	10.0
5. Space S&T	6.6	2.8	2.3	0.0	0.0	0.0				0.0	0.0	0.0
6. Publicity	4.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0	0.0
7. Major works (capital)	21.4	13.3	1.6	0.0	0.0	0.0				13.1	10.3	1.6
8. Computers (capital)	4.6	3.5	3.5	0.0	0.0	0.0		**NONE AT**		3.0	2.0	2.0
9. Running costs	20.0	24.3	24.9	0.0	0.0	0.0				20.0	24.0	25.0
10. Relocation costs (capital)	0.2	0.1	1.0	0.0	0.0	0.0		**FIRST**		0.2	0.1	1.0
11. Other services	1.5	1.0	1.0	0.0	0.0	0.0				0.0	0.0	0.0
12. EUROPES Non-R&D	1.6	0.0	0.0	0.0	0.0	0.0		**MEETING**		0.0	0.0	0.0
13. ERGS (estimating change)	0.0	0.0	0.0	0.0	0.0	0.0				0.8	0.8	0.5
14. BIS (estimating change)	0.0	0.0	0.0	0.0	0.0	0.0				1.6	1.4	-2.3
15. ISERBS (estimating change)	0.0	0.0	0.0	0.0	0.0	0.0				-1.6	2.7	-0.9
16. Research Estabs.(VAT)	1.3	1.4	1.5	0.0	0.0	0.0				1.3	1.4	1.5
17. HSCGS	3.6	0.2	-2.9	0.0	0.0	0.0				3.6	0.2	-2.9
18. Shipbuilding Intervention Fund	17.6	18.6	18.6	0.0	0.0	0.0				17.6	18.6	18.6
19. Exports	0.0	0.0	2.0									
TOTAL	**83.6**	**97.6**	**52.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**74.6**	**104.1**	**44.3**
B. DEPT PROPOSED REDUCTIONS												
1. Launch aid S&T	-0.1	-2.1	-101.3	-0.1	-2.1	-101.3	-0.1	-2.1	-101.3	-0.1	-2.1	-101.3
2. In Plant Training Scheme	-0.2	0.0	0.0	-0.2	0.0	0.0	-0.2	0.0	0.0	-0.2	0.0	0.0
3. Miscellaneous Support	-1.5	-1.7	-1.8	-1.5	-1.7	-1.8	-1.5	-1.7	-1.8	-1.5	-1.7	-1.8
4. Trade cooperation	-0.2	-0.1	0.0	-0.2	-0.1	0.0	-0.2	-0.1	0.0	-0.2	-0.1	0.0
5. Regulation of Trade	-0.3	-0.8	-1.3	-0.3	-0.8	-1.3	-0.3	-0.8	-1.3	-0.3	-0.8	-1.3
6. Other receipts	0.0	-0.2	0.0	0.0	-0.2	0.0	0.0	-0.2	0.0	0.0	-0.2	0.0
TOTAL	**-2.3**	**-4.9**	**-104.4**	**-2.3**	**-4.9**	**-104.4**	**-2.3**	**-4.9**	**-104.4**	**-2.3**	**-4.9**	**-104.4**
C. HMT PROPOSED REDUCTIONS												
1. Innovation+	0.0	0.0	0.0	-15.0	-15.0	0.0	-15.0	-15.0	0.0	-5.0	-5.0	0.0
1a. Mineral stockpile	-3.0	0.0	0.0	-3.0	-5.0	-5.0	0.0	0.0	0.0	0.0	0.0	0.0
2. EIEC	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0
3. Aeroengine R&D+	0.0	0.0	0.0	-27.0	-28.0	-29.0	-27.0	-28.0	-29.0	-5.0	-10.0	-15.0
4. Research Establishments	-1.5	-5.0	-6.0	-3.0	-6.0	-10.0	-3.0	-6.0	-10.0	0.0	-3.0	-5.0
TOTAL	**-6.5**	**-7.0**	**-8.0**	**-50.0**	**-56.0**	**-46.0**	**-47.0**	**-51.0**	**-41.0**	**-12.0**	**-20.0**	**-22.0**
+ included in A4												
TOTALS	**74.8**	**85.7**	**-59.7**	**-52.3**	**-60.9**	**-150.4**	**-49.3**	**-55.9**	**-145.4**	**60.3**	**79.2**	**-82.1**
Implied net change from baseline												
Implied New programme	1,356.7	1,308.2	1,165.8	1,229.6	1,161.6	1,075.1	1,232.6	1,166.6	1,080.1	1,342.2	1,301.7	1,143.4
(Per cent change on previous year)	5.7	-3.6	-10.9	-4.2	-5.5	-7.4	-4.0	-5.4	-7.4	4.5	-3.0	-12.2

BRIEFING TA
DEPARTMENT OF TRADE AND INDUSTRY

RUNNING COSTS **£million**

	1988-89	1989-90	1990-91	1991-92
Baselines	288.0	295.7	304.5	312.2
(change on previous year)		2.7%	3.0%	2.5%
(increase per man year)		3.1%	3.7%	2.9%

	Bid			HMT opening position			Fallback			Forecast Outcome		
	89-90	90-91	91-92	89-90	90-91	91-92	89-90	90-91	91-92	89-90	90-91	91-92
Implied net change from baseline	20.0	24.3	24.9	0.0	0.0	0.0	NONE AT FIRST MEETING			20.0	24.0	25.0
(of which: A9 Running costs	20.0	24.3	24.9	0.0	0.0	0.0	NONE AT FIRST MEETING			20.0	24.0	25.0
Implied new running cost total	**315.7**	**328.8**	**337.1**	**295.7**	**304.5**	**312.2**	**295.7**	**304.5**	**312.2**	**315.7**	**328.5**	**337.2**
(% Change on previous year)	9.6	4.2	2.5	2.7	3.0	2.5	2.7	3.0	2.5	9.6	4.1	2.6
% Increase per man year	11.0	4.9	3.4	3.9	3.7	3.4	3.1	3.7	3.4	10.1	4.8	3.5

MANPOWER IN GROSS RUNNING COSTS

	1988-89	1989-90	1990-91	1991-92
Present plans	11,799	11,749	11,669	11,618
Department's bids		-100.0	-100.0	-149.0
HMT opening position		0.0	0.0	0.0
Fallback		0.0	0.0	-49.0
Forecast outcome		-100.0	-100.0	-149.0

MANPOWER OUTSIDE GROSS RUNNING COSTS CONTROL

	1988-89	1989-90	1990-91	1991-92
Present plans	1,081	1,081	1,081	1,081
Department's bids		0.0	0.0	0.0
HMT opening position		0.0	0.0	0.0
Fallback		0.0	0.0	0.0
Forecast outcome		0.0	0.0	0.0

cst.ps/1jm29.9./let

CONFIDENTIAL

cc:
Chancellor
Mr Anson
Mr Monck
Mr Phillips
Mr Turnbull
Mr Hansford
Mr MacAuslan
Mr Waller
Mr Stevens
Ms Roberts
Mr Parkinson
Mr Call
Mr Tyrie

CHIEF SECRETARY TO THE TREASURY

Bf 3/10

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1H OET

29 September 1988

Dear Secretary of State,

1988 PUBLIC EXPENDITURE SURVEY:DTI

Thank you for your letter of 26 September setting out your response to a number of points on which you had agreed to reflect at our recent bilateral. I am grateful for the constructive way you have approached these issues. We have made some useful progress but the additional savings offered in your letter only total £7/7/10 million over the three Survey years. I, therefore, fear there is a long way to go to reach what I would regard as a satisfactory settlement.

On the points raised in your letter, I am sorry if there was any misunderstanding about our agreement on the Intervention Fund. I am grateful for you agreeing to withdraw the Appledore element of the bid and I am prepared to consider the need for increased DTI provision for IF in the event of privatisation of NESL/ Appledore. But, as I made clear at the bilateral, I cannot agree to providing additional resources for any remedial measures - these must come from within your existing programmes.

On innovation, space and aircraft and aeroengine R & D, I naturally welcome your offer of further reduction of £6 million a year to be allocated between these three budgets. And the small reduction on the Research Establishment's capital programme is, of course, helpful. But, as I indicated at the bilateral, this is an area of industrial support where significant reductions in expenditure are justified, both in relation to the greatly improved financial position of industry and the need to transfer resources to basic science. Even with the additional reductions proposed in your letter, the total reductions on the science and technology elements of your programmes for years 1 and 2 of the Survey only amount to some £11 million and £13 million respectively. (The 1991-92 change of course involves an increase). I do not feel this is an outcome I could commend to E(ST) nor do I think they would find it acceptable. I believe that there remains a strong case on value for money and realism grounds for a further reduction in the innovation budget. And I was particularly disappointed by your response on Aircraft and Aeroengine R & D. We really must prevail on the small number of very large firms in this sector to carry the burden of R & D costs and to wean them off their dependence on state subsidies. This would be in line with the Government's overall approach to economic policy. (I note what you say about other countries' practices in this area but, as we saw in the Dowty case, these major companies can usually be persuaded to stand on their own feet if we take a firm line.)

I was disappointed too that you did not feel able to offer anything further from the research establishments budgets on account of savings resulting from the proposed shift to agency status. The major part of the reduction you have offered in this area is conditional on NEL privatisation. If, unfortunately, this did not come off then this would add back £10 million to your baseline over the Survey period. I must ask that, should privatisation not be possible, you undertake to deliver a similar volume of savings from the RE budget and also press you for greater savings on the PES capital budget.

On running costs the increased money savings from the agreed manpower reduction are helpful, as is your withdrawal of the Companies House bid for rent increase in 1991-92. But I am sorry that you feel unable to offer any further reduction on account of your proposals for the major shift to agency status. This leaves your running costs increasing at 9.6/4.2/2.5 per cent respectively over the Survey period - the year 1 figure is well in excess of those which we have agreed in Cabinet for Government as a whole.

On exports, I note that if we are unable to offer any savings arising from your review, primarily because of the additional costs associated with EXPO '92 for which you have bid for an extra £2 million in the last year of the Survey. This bid assumes PES transfers of £7 million for the FCO and £9 million from the Department of Employment. The Prime Minister's Private Secretary's letter of 16 September made it clear, however, that the costs of the EXPO Pavilion would need to be met from within DTI's and DE's existing resources. In the light of the No.10 instructions I could not agree to any transfer from the FCO programme on account of EXPO even if provision had been made. Against this background I will not press in the Survey for savings on export services but only on the understanding that no additional resources will be made available for EXPO '92.

As I indicated in my letter of 22 September, I have now reflected on the outstanding points which I agreed to consider following the bilateral and your response to the points listed in my letter. These include the position on RSA cash limiting, Section 8 assistance, science and technology and the capital costs of your proposed relocation plans. The key issue here is clearly where we stand on the aggregate figures for your programme. Given the very difficult Survey prospects this year, I do not feel that the overall totals currently on the table are an acceptable basis for a PES settlement. I must therefore continue to press you for further reductions to your bids which will bring your provisions much closer to baseline (excluding, of course, your launch aid estimating changes). As I have already indicated, I would particularly wish to see further substantial reductions in the science and technology and running costs elements of your programmes. I recognise that this might require some element of flexibility in the allocation of resources between individual elements, of your programmes of the sort we discussed at the bilateral. At the same time, I would need to be assured that this was underpinned by effective financial control of the sort which RSA cash limiting would offer.

Yours sincerely,

P Waless

pp JOHN MAJOR

[Approved by the Chief Secretary and signed on his behalf.]

dti
the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

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

Paul Gray Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

CH/EXCHEQUER
REC. 4 OCT 1988
ACTION CST
COPIES TO

✓ 4/10

Direct line 215 5423
Our ref PS1BMK
Your ref
Date 3 October 1988

Dear Paul

AMENDMENTS TO THE FAIR TRADING ACT : ORDER MAKING POWERS

In advance of Thursday's E(A), you told me the Prime Minister would welcome more details about how the proposed powers would work.

... I attach the existing powers in Schedule 8 of the Act. It is proposed that these powers should be made more general, so that the Secretary of State may impose any prohibitions or requirements relating to the carrying on of any business if he considers them requisite for the purpose of remedying or preventing the adverse effects specified in an MMC report. Part I of Schedule 8 would give examples of the types of Order which could be made, but these examples would be without prejudice to the generality of the Order-making powers.

The existing general provision in paragraph 12, applies only to prospective mergers; in effect it would be extended to mergers which have already taken place and to monopolies. This would make it possible to make an Order imposing prohibitions, restrictions or requirements where a merger has already taken place, or on a monopolist or on someone carrying on an anti-competitive practice.

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Precisely how these powers will be framed is of course for Parliamentary Counsel. Their effect will be to avoid having to fit the terms of our Orders to the very detailed provisions of the existing Schedule, which may not always be entirely suitable. This process takes time (particularly valuable legal advisers' time) and leaves scope for the powers to be challenged. It may be helpful to illustrate this with some examples, showing the kind of problems we have faced in the past.

Implementing the MMC Reports on White Salt and Animal Waste by order would have involved going beyond the scope of the present powers. For white salt, the difficulty related to the formula governing prices to be charged by the monopolists, allowing the formula to be varied by the DGFT to reflect changing circumstances. For animal waste, we needed to ensure that enough information was provided to monitor whether the abuses identified had been eliminated. In the event, in both cases, the parties were willing to agree to undertakings incorporating the necessary provisions, but if they had not been prepared to do so, we could not have enforced this by Order. Our inability to use the threat of an Order also made it more difficult to bring the negotiations to a rapid conclusion.

In the Ferruzzi/British Sugar case, we were unable, under the present powers, to stop Ferruzzi exercising their voting rights pending divestment of their existing holding, as we should have wished. Another problem which arose when Berisford's first took over British Sugar was that we could not require them by order to carry on the business in a separate subsidiary and provide accurate accounting information.

In the recent case of the Cinema Films Order, to implement the MMC's report we wanted to require distributors to make popular films available to competing cinemas after a "first run" of 28 days. The way we are having to do this is prohibit agreements (under paragraph 1 of the Schedule) whereby the films are supplied to cinemas in circumstances where they are shown at a first run cinema, and not shown at a competing cinema, for 28 days, and are then not made available to any competing cinema which wants it. This makes the Order rather complicated.

As the previous examples show, it is usually been found possible to achieve the desired result in another way, although often not the most straightforward one. But this is often at the cost of much detailed negotiation, involving delay in rectifying the problem, and taking up the time of administrators and legal advisers. There are only a few examples of a process which, to a greater or lesser extend, has to be gone through on every case, so the cumulative effect is quite large. It would be unsatisfactory to to the powers piecemeal, as has been done before, or further gaps could come to light later. Whilst rationalising the powers will not make a great deal of difference in terms of their practical effect, it should help to shorten and simplify the process, thus saving time and resources. I hope that on this basis the Sub-Committee will be prepared to agree to the change that the Secretary of State proposes.

I am copying this letter to Private Secretaries to the members of E(A) and to Sir Robin Butler.

Yours

Jeremy Godfrey

JEREMY GODFREY
Private Secretary

X ANNEX A

SCH. 7

PART III

GOODS PARTLY EXCLUDED IN RELATION TO NORTHERN IRELAND ONLY

Description of goods	*Form of supply excluded*
14. Live pigs.	Supply for slaughter.
15. Fresh uncured carcases or parts of carcases of pigs.	Supply otherwise than by way of retail sale.

Sections 56, 73, 74, 77, 89 and 91.

SCHEDULE 8

POWERS EXERCISABLE BY ORDERS UNDER SECTIONS 56 AND 73

PART I

POWERS EXERCISABLE IN ALL CASES

1. Subject to paragraph 3 of this Schedule, an order under section 56 or section 73 of this Act (in this Schedule referred to as an " order ") may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order, to make or to carry out any such agreement as may be specified or described in the order.

2. Subject to the next following paragraph, an order may require any party to any such agreement as may be specified or described in the order to terminate the agreement within such time as may be so specified, either wholly or to such extent as may be so specified.

3.—(1) An order shall not by virtue of paragraph 1 of this Schedule declare it to be unlawful to make any agreement in so far as, if made, it would be an agreement to which Part I of the Act of 1956 would apply.

(2) An order shall not by virtue of paragraph 1 or paragraph 2 of this Schedule declare it to be unlawful to carry out, or require any person to terminate, an agreement in so far as it is an agreement to which Part I of the Act of 1956 applies.

(3) An order shall not by virtue of either of those paragraphs declare it to be unlawful to make or to carry out, or require any person to terminate, an agreement in so far as, if made, it would relate, or (as the case may be) in so far as it relates, to the terms and conditions of employment of any workers, or to the physical conditions in which any workers are required to work.

(4) In this paragraph " terms and conditions of employment " has the meaning assigned to it by section 167(1) of the Industrial Relations Act 1971. 1971 c. 72.

4. An order may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order, to withhold or to agree to withhold or to threaten to withhold, or to procure others to withhold or to agree to withhold or threaten to withhold, from any such persons as may be specified

or described in the order, any supplies or services so specified or described or any orders for such supplies or services (whether the withholding is absolute or is to be effectual only in particular circumstances). SCH. 8

5. An order may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order, to require, as a condition of the supplying of goods or services to any person,—

(*a*) the buying of any goods, or

(*b*) the making of any payment in respect of services other than the goods or services supplied, or

(*c*) the doing of any other such matter as may be specified or described in the order.

6. An order may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order,—

(*a*) to discriminate in any manner specified or described in the order between any persons in the prices charged for goods or services so specified or described, or

(*b*) to do anything so specified or described which appears to the appropriate Minister to amount to such discrimination,

or to procure others to do any of the things mentioned in sub-paragraph (*a*) or sub-paragraph (*b*) of this paragraph.

7. An order may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order,—

(*a*) to give or agree to give in other ways any such preference in respect of the supply of goods or services, or the giving of orders for goods or services, as may be specified or described in the order, or

(*b*) to do anything so specified or described which appears to the appropriate Minister to amount to giving such preference,

or to procure others to do any of the things mentioned in sub-paragraph (*a*) or sub-paragraph (*b*) of this paragraph.

8. An order may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order, to charge for goods or services supplied prices differing from those in any published list or notification, or to do anything specified or described in the order which appears to the appropriate Minister to amount to charging such prices.

9. An order may require a person supplying goods or services to publish a list of or otherwise notify prices, with or without such further information as may be specified or described in the order.

10.—(1) Subject to the following provisions of this paragraph, an order may, to such extent and in such circumstances as may be provided by or under the order, regulate the prices to be charged for any goods or services specified or described in the order.

SCH. 8

(2) An order shall not exercise the power conferred by the preceding sub-paragraph in respect of goods or services of any description unless the matters specified in the relevant report as being those which in the opinion of the Commission operate, or may be expected to operate, against the public interest relate, or include matters relating, to the prices charged for goods or services of that description.

(3) In this paragraph "the relevant report", in relation to an order, means the report of the Commission in consequence of which the order is made, in the form in which that report is laid before Parliament.

11. An order may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order, for any person, by publication or otherwise, to notify, to persons supplying goods or services, prices recommended or suggested as appropriate to be charged by those persons for those goods or services.

12.—(1) An order may prohibit or restrict the acquisition by any person of the whole or part of the undertaking or assets of another person's business, or the doing of anything which will or may have a result to which this paragraph applies, or may require that, if such an acquisition is made or anything is done which has such a result, the persons concerned or any of them shall thereafter observe any prohibitions or restrictions imposed by or under the order.

(2) This paragraph applies to any result which consists in two or more bodies corporate becoming interconnected bodies corporate.

(3) Where an order is made in consequence of a report of the Commission under section 72 of this Act, or is made under section 74 of this Act, this paragraph also applies to any result (other than that specified in sub-paragraph (2) of this paragraph) which, in accordance with section 65 of this Act, consists in two or more enterprises ceasing to be distinct enterprises.

13. In this Part of this Schedule "the appropriate Minister", in relation to an order, means the Minister by whom the order is made.

PART II

POWERS EXERCISABLE EXCEPT IN CASES FALLING WITHIN SECTION 56(6)

14. An order may provide for the division of any business by the sale of any part of the undertaking or assets or otherwise (for which purpose all the activities carried on by way of business by any one person or by any two or more interconnected bodies corporate may be treated as a single business), or for the division of any group of interconnected bodies corporate, and for all such matters as may be necessary to effect or take account of the division, including—

(*a*) the transfer or vesting of property, rights, liabilities or obligations;

(*b*) the adjustment of contracts, whether by discharge or reduction of any liability or obligation or otherwise ; Sch. 8

(*c*) the creation, allotment, surrender or cancellation of any shares, stock or securities ;

(*d*) the formation or winding up of a company or other association, corporate or unincorporate, or the amendment of the memorandum and articles or other instruments regulating any company or association ;

(*e*) the extent to which, and the circumstances in which, provisions of the order affecting a company or association in its share capital, constitution or other matters may be altered by the company or association, and the registration under any enactment of the order by companies or associations so affected ;

(*f*) the continuation, with any necessary change of parties, of any legal proceedings.

15. In relation to an order under section 73 of this Act, the reference in paragraph 14 of this Schedule to the division of a business as mentioned in that paragraph shall be construed as including a reference to the separation, by the sale of any part of any undertaking or assets concerned or other means, of enterprises which are under common control otherwise than by reason of their being enterprises of interconnected bodies corporate.

SCHEDULE 9

Section 91.

Procedure Preliminary to Laying Draft of Order to which Section 91(1) Applies

1. The provisions of this Schedule shall have effect where the Secretary of State proposes to lay before Parliament a draft of any such order as is mentioned in section 91(1) of this Act.

2. The Secretary of State shall cause notice of his intention to lay a draft of the order before Parliament to be published in the London Gazette, the Edinburgh Gazette and the Belfast Gazette and in two or more daily newspapers (other than local newspapers), and shall not lay a draft of the order until the end of the period of forty-two days beginning with the day on which the publication of the notice in accordance with this paragraph is completed.

3. A notice under this Schedule shall—

(*a*) state that it is proposed to lay a draft of the order before Parliament ;

(*b*) indicate the nature of the provisions to be embodied in the order ;

(*c*) name a place where a copy of the draft will be available to be seen at all reasonable times ; and

(*d*) state that any person whose interests are likely to be affected by the order, and who is desirous of making representations in respect of it, should do so in writing (stating his interest

~~BF 6/10~~

dti

the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

~~are there more~~ more recent pps?

Rt Hon John Major MP
Chief Secretary
HM Treasury
Treasury Chambers
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

CHIEF SECRETARY	
REC.	- 4 OCT 1988
ACTION	Mr Gray
COPIES TO	CST, FST, Sir P Middleton, Mr Anson, Mr Monck, Mr Moore, Mrs Brown, Mr Waller, Mr Ann White, Mr Rutnam, Mr Turnbull, Mr Burgner,

Direct line 215 5147

Our ref

Your ref

Date 4 October 1988

Dear Chief Secretary,

Surely we wd not allow NESL to take the Cuban order?

DTI PES 1988: SHIPBUILDING

David Young and I will be resuming discussion with you tomorrow morning. In the meantime I have seen your letter of 29 September and wish to register my concern over your proposed treatment of shipbuilding and in particular the remedial package for Sunderland in the event that the BS yards on the River Wear were to close.

At an earlier stage in our discussions we were prepared to take the question of Intervention Fund support for NESL and the smaller BS yards together with the alternative remedial measures programme should disposal not succeed. Given the likely build programme for the Cuban order, I included £7m a year for NESL in my private sector IF bid. This was slightly more than the annual cost over the PES period of the £20m remedial package for Sunderland agreed at the Prime Minister's meeting on 31 March.

You now want to set the package against our existing programmes, re-opening the question of where it should properly fall. In my view there is no question as to the answer. Like the previous British Shipbuilders Enterprise Limited, the cost of the package should fall against British Shipbuilders EFL.

Indeed not. But we have not ruled out a future private sector owner taking on the order (+ getting IF support). (In fact, it was agreed at the bilateral that no BS yards could take on any new orders except as a part of a sale arrangement to the private sector).

Thanks

TN4ABV

AF 7/10

In the meantime we have learned that the Cubans would want a new owner of NESL to provide their ships in an accelerated build programme. BS also now have four bids for the yard. The total amount of IF envisaged for the Cuban order is still £30m but it now seems likely that £28m of this would fall within the PES period, with an annual pattern of £8m, £10m and £10m. I shall, of course, still need £3m a year for IF for the smaller BS yards, Appledore and Ferguson. I therefore believe I should make a firm bid of £11m, £13m and £13m for IF for the BS yards still to be sold.

You have not questioned that this money should be found in the event of sale in view of the considerable savings from our dismembering of BS during the PES period and beyond. In the event that none of the bids for NESL proves satisfactory it is clearly right that the lesser sum of £20m for the agreed package for Sunderland should also be found from the savings on BS EFL, and that the door should remain open for Appledore to be treated similarly in what I hope is the unlikely event that negotiations for the disposal of the yard do not succeed. The package was, after all, part of the same policy decision as the rundown of BS. You will also, I am sure, be mindful of the continuing Exchequer costs that the package will help to avoid should closure prove necessary.

Yours sincerely,

Peter Smith

PP TONY NEWTON

(Approved by the Chancellor and signed in his absence)

TN4ABV

Folder for E(A).

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CH/EXCHEQUER
REC. - 4 OCT 1988 4/10
ACTION Mrs M E BROWN
COPIES TO CST, FST, SIR P MIDDLETON, MR ANSON, MR MONCK, MR BURGNER, MR MOORE, MR SEDGEWICK, MR BONNEY, MR MEYRICK, MR MORTIMER, MR TARKOWSKI, MR TYRIE, MR CALL

PRIME MINISTER

NITRATES

We will be discussing the nitrates paper co-ordinated by the Cabinet Office on Thursday. I have been very impressed by a leaflet recently put out by Rothamsted Experimental Station, which has been involved in nitrogen research for well over a century. I thought colleagues would like to see this paper in advance of our meeting and therefore enclose copies.

Although concise, this leaflet is backed up by a lot of detailed work on, for example, long term organic nitrogen levels in the soil. It does not necessarily represent the last word and the AFRC and its Institutes are doing much further work. It is however important that we should take account of the latest developments in research in this area.

I am copying this letter and the Rothamsted leaflet to the other members of E(A) and Sir Robin Butler.

JM

JOHN MacGREGOR
4 October 1988

for C(I) FOLDER

FROM: A M WHITE
DATE: 4 OCTOBER 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Sir A Wilson
Mr H Phillips
Mr Monck
Miss Peirson
Mr Robson
Mr Mountfield
Mr Turnbull
Mr Richardson
Mrs Burnhams
Mr Call

E(A)(88)46

In his paper, the Secretary of State brings colleagues up to date with developments on Mackies, Harland and Wolff and Shorts, since discussions on their futures took place at E(A) on 13 July. A supplementary note by NI officials summarises the background to the proposals Mr King makes for EFLs for Harlands and Shorts. I attach detailed briefing on each of the three companies.

JAMES MACKIE AND SONS LTD

It was agreed at E(A) that the Secretary of State could offer a Government dowry to a private sector buyer of Mackies. Mr King reports that interest has been shown by a number of companies, and negotiations with one - Howdens, a Glasgow-based engineering concern with interests in Belfast - is looking promising. He also reports an improvement in the company's cash flow situation which has allowed the level of Government bank guarantees to be reduced to £2m having been increased for two months to £2.75m.

Line to take

1. Note the latest position and ask to be consulted soon about any dowry package.

2. Note that bank guarantees are down to £2m and ask to be kept closely in touch with the company's financial position.

HARLAND AND WOLFF PLC

At E(A) it was agreed that the Secretary of State should pursue the negotiations for the sale of Harlands to Mr Tikkoo and to any other interested parties. Tikkoo's subsequent proposals were totally unacceptable and while Mr King has made a counter proposal, he thinks it unlikely that Mr Tikkoo will find them acceptable. Even if Mr Tikkoo did accept them as a basis for further negotiation, he will face major problems in financing the acquisition of the yard and the Ultimate Dream cruise liner which is integral to his plans for the yard.

Mr King refers to the interest in acquiring Harlands shown by two other concerns - Bulk Transport Ltd. and UM Holdings - but he gives no indication of how credible he regards either of these to be. Mr King also seeks approval to set an EFL for the company of £62.3m for the year.

Line to take

1. You should argue that it is imperative that the yard's future be decided soon as its performance continues to deteriorate. If transfer of the yard to private ownership does not turn out to be a solution, it will be necessary to revert to the original plan for a gradual rundown to closure with agreed measures in place to ensure that the last two contracts are completed to the revised production schedules and costs.

2. The negotiations on Mr Tikkoo's possible acquisition of Harlands need to be brought to an early conclusion. A deadline should be set for Mr Tikkoo's response to the counter-offer and a decision made soon after that on whether to proceed with negotiations.

3. Likewise, you should say that the proposals from the other possible purchasers should be fully and urgently assessed to decide whether either should be pursued further.

4. Agree that an EFL of £62.3m should be set for 1988/89, but press for steps to be taken to reverse the deterioration in the company's performance.

SHORT BROTHERS PLC

E(A) asked Mr King to report back with his proposals for the earliest privatisation of Shorts. His paper outlines the steps that have been taken but progress so far has been too slow for specific proposals to have come forward.

He also seeks approval to set an EFL for the company of £70m for 1988/89. This looks extremely ambitious but the company argues that progress payments from contracts yet to be signed and recent favourable movements in the exchange rate, together with savings in capital and R&D expenditure and overheads, will reduce the original corporate plan estimate of £82m by £12m.

Line to take

1. You should argue that the company's position is looking increasingly fragile and the sooner the uncertainty is ended and the company is in the hands of commercial management, the better it will be for the company, for the workforce, and for the Government.

2. For those reasons, the aim should be to return Shorts to the private sector before the end of March 1989, preferably as a single entity but if that cannot be achieved, by the separate sales of parts of the company. If that aim is to be achieved, there will need to be a significant increase in the pace of events. Mr King should set a detailed timetable for the transfer of Shorts to private ownership during this financial year.

3. While you accept that the company should play a role in the privatisation process, the Government cannot delegate its accountability for taxpayers' money and Ministers must clearly determine how the privatisation is handled and how it is achieved.

4. [If despite best endeavours, it looks likely that the company will not be sold during this financial year, we should consider if any of the cost could be brought forward.]

5. Agree an EFL of £70m for the year.

AMW

A M WHITE

ANNEX 1

JAMES MACKIE AND SONS LIMITED

Mr King's paper reports on the progress that has been made towards attracting a private sector investor in Mackies.

2. E(A) had agreed that limited action could be taken to secure the survival of the company while discussions on longer term measures continued. Bank guarantees for £2m were increased temporarily to £2.75m during August and September, but, following an improvement in Mackies' cash flow position, guarantees for October have been reduced to £2m. The position will continue to be reviewed on a monthly basis.

3. A number of companies have shown some interest in Mackies. The front runner is Howdens, a Glasgow-based engineering company who took over an East Belfast company last year. We understand that Mr Viggers is about to write to the Financial Secretary outlining the package of assistance which is under discussion with Howdens. It involves a total investment in the company of £30m of which the Government would provide £18.75m (£8.25m in the form of capital grant, £7.5m revenue assistance payable over five years mostly in the form of employment grants, and a loan of £3m).

4. Lummus Industries, an American company are also continuing to show an interest but they have not yet made a formal proposal. They will be encouraged to do so if negotiations with Howdens reach a satisfactory stage in order to introduce an element of competition.

ANNEX 2

HARLANDS AND WOLFF PLC

Mr King's paper gives details of the three companies which have shown the interest in the acquisition of the shipyard.

Tikkoo Cruise Lines (TCL)

2. TCL were invited to make a bid for the company after it was decided not to allow Harland and Wolff to build the P3000 cruise liner while the company remained in public ownership. The proposal subsequently made by TCL involved a cost to the Government well in excess of the estimated £240m closure costs for the yard, and was clearly unacceptable.

3. The P3000 project has received extensive publicity, particularly in Northern Ireland where it has been presented as the means of safeguarding the future of the yard and its remaining 3500 jobs. Mr King is anxious that a decision not to proceed with the P3000 is seen to be Mr Tikoo's especially against the background that the French might be willing to offer Mr Tikkoo the terms he had originally sought for the P3000 order. Mr King decided to put forward a counter-offer which would meet the parameters agreed by E(A) on 13 July for the disposal of the yard. We were consulted about the specific terms - total value £180m - and were satisfied that as well as being within the closure costs, they were consistent with the terms agreed with Kvaerner for the purchase of Govan.

4. As Mr King points out in his paper, the counter-offer is unlikely to be acceptable to TCL. But even if it were, because of the risky nature of the project, Mr Tikkoo is unlikely to be able to obtain the financial backing he will need if ECGD are to offer even limited support. Mr King met the Minister for Trade on 14 September to discuss the extent of the cover ECGD would be prepared to offer. Mr Clark confirmed in his letter of 19 September that ECGD would be reluctant to take on an unsecured

risk of this nature, and if the scheme was to be considered under their new project financing facility, 75% of the cover for the project would have to be taken up by commercial parties. ECGD are discussing the financial arrangements with TCL's advisers Hambros Bank.

5. If the privatisation of the company is not to be delayed it may be necessary to set a deadline after which it will be assumed that Mr Tikkoo is not a serious contender for the acquisition of the shipyard. Mr King should be asked for his assessment of the prospects of finding another buyer for Harlands if TCL drop out.

Bulk Transport Ltd (BT)

6. Interest in the company has been shown by BT and discussions with their merchant bankers have begun although no formal proposals have yet been made. NI officials are assessing the viability of BT's plan to build four large crude carriers with an option on a further two.

UM Holdings AS (UM)

7. UM a Turkish Group with shipping and petrochemical interests, who had initially considered the acquisition of NESL, have also registered an interest in the yard. They are looking for a suitable yard to build tankers and bulk carriers. Enquiries are being made by NI officials into the managerial capability and financial strength of the company .

Cash flow

8. Mr King reports in his paper on the current cash flow position of the company and seeks agreement to an EFL of £62.3m for 1988-89. The company have managed to keep within their own target of £25m for the first six months of the year and earlier figures had indicated that the EFR for the year would be just over

£50m. But, despite the announcment that a wide-ranging agreement on working practices had been signed with the trade unions, productivity continues to worsen. Further slippages in the work programme for the SWOPS vessel for BP currently in production, and the continuing difficulties with MOD over the delay in delivery of their air training ship, make it likely that payments totalling £9.3m may not be made by the end of the year. An EFL of £62.3m is a more realistic estimate of the end of year position (this includes £8.5m for redundancy payments following the recent announcement of 550 redundancies by March 1989).

ANNEX 3

SHORT BROS PLC

The Secretary of State's paper outlines the progress which has been made since E(A) agreed on 13 July that Shorts should be privatised at the earliest opportunity.

2. The preparations for the return of Shorts to the private sector got off to a poor start (Mr Sharratt's note to the Paymaster General of 17 August). But now Mr King has appointed Kleinwort Benson as his merchant banker advisers - Shorts having previously appointed Barclays de Zoete Wedd as theirs.

3. Treasury officials have been consulted about the modus operandi which spells out the working arrangements for the privatisation between the Government and Shorts Board. Mr King wishes to involve the company as much as possible in the privatisation process. This was to a large extent forced on him by the false start and while I have accepted that there is a role for the company to play, I have asked for a number of amendments to be made to the modus operandi so that it makes it clear that the Government retains responsibility for the handling of the sale.

4. In his paper Mr King recognises the Chief Secretary's preference for meeting the cost of the sale (estimated at £300-400m) from this year's Reserve. He says that his aim is for negotiations with interested parties to take place early in the new year, with a view to concluding the sale by the end of March 1989. Little progress has been made so far, and if this timescale stands any chance of being met, Mr King will need to determine a detailed timetable as soon as possible and adhere to it. Under pressure, NI officials have now agreed to set up a steering group on which the Treasury will be represented. Its purpose will be to monitor and where possible expedite progress on the privatisation of the company. The first meeting of the steering group is to take place on 12 October.

5. Shorts have now put forward proposals for recapitalisation of the company. This would take the form of an immediate cash injection from the Government of £300m, which the company considers would improve their trading position and provide much needed confidence in the company. The proposal is at present being assessed by Kleinwort Benson and we will be consulted about this shortly.

6. At this stage, it would be unwise to commit the Government to that expenditure until a clearer picture emerges of the terms that might be required to secure a satisfactory privatisation of Shorts. In order to avoid a series of payments being considered separately, and to minimise the cost to the Government of the disposal of Shorts, the recapitalisation of the company, including the extinguishing of their outstanding debts - currently standing at £300m - should be considered as part of the negotiations for the sale. It will also be necessary to consider what view the European Commission might take of this level of Government assistance before any decision is taken.

7. Although our aim is to secure the sale of Shorts before the end of the financial year, there is a real risk that it will take longer. One way of ensuring that part of the cost is met from the 1988/89 Reserve would be to replace the company's short term borrowing requirements from commercial sources with direct public expenditure. Mr King's paper confirms that this option is being considered, and it is something we will wish to consider further when detailed negotiations have commenced.

8. The company's trading position remains disappointing and there is considerable concern about its failure to secure forecast orders for aircraft and missiles. The cash requirement is expected to reach a peak of £131m in November but despite this the company maintains it can achieve an EFR for the year of £70m, which takes into account expected savings of £12m from the implementation of an austerity programme. Mr King states that short term savings would be difficult to achieve and admits that the target is unlikely to be met, but suggests it would be a good discipline for the company if their target is accepted as the EFL; and perhaps

more importantly, that it is made clear that they were expected to keep within it. While I share his pessimism of the company achieving this target, and past experience backs up this assessment, I recommend that you should agree to the EFL proposed.

CONFIDENTIAL

SECRETARY OF STATE FOR EMPLOYMENT

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CHIEF SECRETARY
REC. -6 OCT 1988
ACTION Mr Gray
COPIES TO Cx FST, Sir P Middleton, Mr Anson, Mr Monck, Mr Moore, Mrs Brown, Mr Waller, Mr AM White, Mr Rutnam.

The Rt Hon Tony Newton OBE MP
Chancellor of the Duchy of Lancaster
and Minister of Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1E 0ET

4 October 1988

Dear Tony.

BRITISH SHIPBUILDERS AND THE NORTH EAST

In your minute of 22 September to the Prime Minister you reported on the prospects for NESL in Sunderland and requested contributions for a package of measures in case of a large redundancy there.

My Department is, as you know, already heavily involved in the contingency planning. The Employment Service is standing by to provide employment counselling and Jobclubs, and its Local Enterprise Agency Projects Fund will also be available for specific projects; the Training Agency will offer training and re-training courses; and the Small Firms Service will support the new enterprise company and provide counselling and help for those interested in starting their own businesses, via the Enterprise Allowance Scheme if appropriate.

If therefore the worst comes to the worst and this redundancy takes place, the services of the Employment Department Group will be readily available to the redundant workers.

I am copying this letter to the Prime Minister, the members of E(UP), Paul Channon, and Sir Robin Butler.

Yours ever,
Norman Fowler

NORMAN FOWLER

CONFIDENTIAL

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FROM: MRS M E BROWN

DATE: 5 October 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Burgner
Mr Moore
Mr Sedgewick
Mr Bonney
Mr Meyrick
Mr S Wood
Mr Mortimer
Mr Tarkowski
Mr Tyrie
Mr Call

NITRATES REPORT: E(A) MEETING ON 6 OCTOBER

1. E(A)(88)42 is the report of an interdepartmental group of officials on which Mr Bonney, Mr Meyrick and I represented the Treasury. The Group was set up to consider the options for dealing with nitrates in drinking water. It recommends:

(i) a package of long-term measures, under which water authorities would be responsible for deciding the appropriate combination of <u>remedial</u> and <u>preventive</u> measures in individual locations;

(ii) a package of short-term measures focussing on agreed programmes of expenditure on water treatment, in order to avert infraction proceedings by the EC and to provide reassurance in privatisation prospectuses.

2. You are <u>recommended</u> to agree the main recommendations (summarised in paragraphs 7-13 of the cover note). But there are some points on which Treasury interests differ from those of MAFF and DOE, where you will want to get the right emphasis. These

include the weight to be given to the polluter pays principle (including the possibility of introducing an EC tax on fertilisers), and the extent to which expenditure on water treatment needs to be committed before privatisation.

3. Mr MacGregor has circulated (minute of 4 October) a pamphlet by the Rothamsted research station saying that nitrate fertilisers - properly applied - are not the main cause of the drinking water problem. This does not affect the Group's conclusions and does not invalidate the idea of a nitrates tax.

Background

4.. The Group was set up after the E(A) meeting in February which considered DOE's proposal for a White Paper on water quality. The idea of a White Paper was postponed. Discussion centred on the expenditure implications of complying with EC drinking water directives, which specify the maximum acceptable concentrations of a number of substances. The EC is threatening legal action against the UK for failing to achieve 100% compliance with the directives. In most cases, enhanced capital expenditure by the water authorities is the only solution. But in the case of nitrates, there is a balance to be struck between prevention through measures to restrict the use of nitrates by farmers; and treatment of already-polluted water by the water authorities. DOE and MAFF had failed to agree on an appropriate combination of measures, and the Group was set up to resolve this.

5.. The report finds that the problem of nitrate in drinking water is growing, and that the EC Commission is likely to take infraction proceedings against the UK if remedial programmes are not agreed with them. Medical advice is that it would be acceptable for the nitrate limit to be based on average concentrations over a period, rather than on absolute compliance all the time, which the directive requires at present. But the Chief Medical Officer believes every effort must be made to keep below the limit, and he would not support any attempt to abandon this aim.

6.. The Group therefore concludes that in the short term increased expenditure on water treatment is inevitable. But it recommends increased attention to restrictions on agriculture for the longer-term. There is a choice between light restrictions over a wide area (basically, applying existing codes of good farming practice) and a range of measures including changing land use, eg. from arable to pasture. Restrictions could be voluntary or compulsory, with or without compensation

7. The rest of this brief summaries the key issues, and recommends a line to take on each of the questions posed in the Cabinet Office's cover note.

8. **Key issues**

(i) Costs

These are summarised in annex F of the paper. Over the period to 2040 the net present value of the water engineering options might be about £185-220 million. The agricultural restrictions might cost some £230-440 million over the same period (based on loss to farmers), but only about £100-155 million when the savings in agricultural support payments resulting from reduced farming activity are taken into account. The gross costs would fall on water consumers; but any compensation payments from Government to the water authorities in respect of agricultural restrictions count as public expenditure (though we would expect to satisfy ourselves that this was fully offset by savings in agricultural expenditure). !
The figures given above are crucially dependant on assumptions about future world prices. They suggest, however, that there is no case on resource cost grounds for going slow on preventive, agricultural, solutions.

(ii) The polluter pays principle

Treasury representatives argued hard in the Group for a polluter pays solution. The only real possibility is a tax on nitrate fertilisers, which would have to be Community-wide. This could in theory involve a tax levied throughout the EC according to common rules, but with the proceeds going to national exchequers to fund domestic public expenditure; or a new EC "own resource" to fund expenditure from the EC budget. Although the Group did not explore these alternatives, our own preliminary view is that of the two the former would be preferable as offering greater national control over the resultant expenditure and as being more in keeping with our general aim of restraining growth in the Community budget. The tax would have to be set at a penal rate to reduce the use of nitrate fertilisers substantially. If set at a lower rate, its main value would be to provide revenue to finance expenditure on water treatments, whilst still having some deterrent affect.

The Group concludes that there is unlikely to be rapid progress to achieving a nitrates tax, even if it were considered desirable on general EC grounds. However, the Commission is currently preparing a new nitrates directive which is likely to focus on measures to deter farmers from using nitrates, and it would be open to the UK to press for a tax in that context. You may want to explore this at the meeting, although DTI and MAFF Ministers are unlikely to be keen. A new EC tax or levy - especially if treated as an EC "own resource" - may also be unwelcome to the Prime Minister. But there is no reason to reject the idea in principle, and an EC based solution would avoid problems of discriminating against UK farmers.

(iii) The EC context

The report concludes that, in order to avoid legal action, the UK must demonstrate to the Commission that it has expenditure programmes for water treatment in hand, which will greatly improve its compliance with the nitrates directive by, say, 1995. We have been concerned that DOE may place too much emphasis on agreeing such programmes rapidly with the Commission. Other European countries (many of which also seem to be breaching nitrate standards) are managing to hold off the Commission with more general assurances of the programmes of action which they have in hand. Were it not for privatisation, we would be urging DOE to slow down their talks with the Commission, and concentrate on persuading the Commission to revise the nitrates directive so that tests were based on average rather than absolute compliance. We would then hope that somewhat smaller expenditure programmes could eventually be agreed. This issue does, of course, have wider implications because of the potential £2 billion or so expenditure needed to comply with all the drinking water directives.

9.. However, DOE have argued that privatisation prospectuses must include firm information about plans for dealing with the nitrates problem. We do not dispute this. However, we believe that (a) the water authorities may be over-egging their estimates of expenditure needed on this problem; and (b) DOE may not be taking a tough enough stance in their negotiations with the Commission to agree acceptable programmes. We also think DOE are not giving enough weight to the fact that the costs of compliance with EC directives can be passed straight to customers under the new price regulation regime: this should reassure investors, even if there are remaining uncertainties on costs at the time of privatisation.

10.. We recommend you to make these points at the meeting, and to urge DOE to continue the pressure for revising the nitrates directive.

(iv) Voluntary v. Compulsory restrictions

The Group recommends a preference for voluntary restrictions on farmers but with compulsory powers available as a fallback. We recommend that you accept this, although it inevitably means that compensation would have to be paid to persuade farmers to join any voluntary scheme which went beyond conforming to the code of good agricultural practice. It would therefore be important to stipulate:

> (a) that compulsory powers (which exist in the present legislation but have never been used) be retained as a reserve power to prevent farmers bidding up compensation rates to unreasonable levels (of management agreements under the Wildlife and Countryside Act); and

(b) that any Government contributions to compensation payments should be strictly limited to the extent of any measurable savings in CAP support expenditure (ie they should be neutral in PES terms). The details of any compensation schemes (eg whether existing schemes can be adapted) would need to be considered in detail before any announcements are made.

(v) Who decides?

The Group recommends that decisions on appropriate action must be taken on a local basis; and that the water authorities are the only bodies able to take such decisions. We agree. But there is a question whether it is appropriate for water plc's after privatisation to exercise compulsory purchase powers and, if appropriate, award compensation. Mr Ridley set up the National Rivers Authority specifically to ensure that the privatised water authorities would not exercise quasi-Governmental powers. Moreover, investors will not welcome the prospect of water companies taking on bureaucratic and probably controversial tasks. We recommend you to suggest that it would be more appropriate for the NRA (or DOE or MAFF) to execute decisions about land use restrictions, where these are recommended and paid for by water companies.

(vi) Need for a public statement?

A statement at some point in the next few months will be necessary, both to announce the Government's general approach; to get this on the record for privatisation prospectus purposes; and to give maximum publicity to the Government's efforts to improve farming practices. The current interest in green issues, reinforced by the Prime Minister's speech to the Royal Society last week, may lead to pressure for a very quick statement. We recommend you to argue against that. Further work on the approach to farming restrictions may be needed after the meeting. It will also be important to ensure that a properly coordinated line is taken by MAFF and DoE. We suggest that Mr Ridley and Mr MacGregor should be asked to prepare a draft joint statement reflecting the conclusions of the meeting, and to circulate it to colleagues with their recommendations on how and when it should be deployed. As far as we are aware DoE have dropped the idea of a White Paper on drinking water quality for the time being. But you will want to establish how any statement on nitrates would fit into other public statements on pollution issues.

[Background: there have been a number of press reports recently about the nitrates problem, including two articles in "Farmers Weekly" which featured in the Today programme last Friday. These leak the results of studies by MAFF and DoE, which support the Nitrates Group's conclusion that different mixes of agricultural and water treatment solutions will be appropriate in different locations. They also question the medical dangers of high concentrations of nitrates: the points made are taken into account in the Chief Medical Officer's advice which is included in the Nitrates Group's Report].

Recommendations

11.. The Prime Minister will be briefed to go through the questions in paragraphs 7-13 of the cover note. Our recommendations are as follows:

7a How far to apply the polluter pays principle

as effective on agriculture output

Get agreement to further consideration of a community-wide nitrates tax, with a view to including it (though probably not as an EC own resource) either in the new nitrates directive or as a free-standing measure;

7b Whether agricultural restrictions should be voluntary or compulsory

Accept preference for voluntary restrictions, beefed up by education and publicity for farmers (funded from existing PES programmes). But agree that compulsory powers should continue to be available as a fall-back.

7c Whether farmers should received compensation for restrictions

Compensation should only be paid if restrictions go beyond complying with code of good agricultural practice. Should not rule out tightening up provisions in code (without compensation) if research suggests this would be justified.

7d Whether there should be a Government contribution to the cost of restrictions (ie. payments to water plc's towards compensation they pay to farmers).

Stress that a nitrates tax would be the logical means of financing the cost of compensation. But agree to further work by officials to consider the options. Essential that any Government contribution should not exceed measurable savings in CAP support expenditure.

8a An enhanced publicity and education programme for farmers

Support provided that costs absorbed within existing MAFF PES programme.

8b continuing research

Accept, provided that costs absorbed within existing MAFF PES programme (ie. Mr MacGregor withdraws his late PES bid).

8c review of Government agricultural schemes

No objection provided that costs of any enhancements to existing schemes at least matched by measurable savings on CAP support expenditure. Treasury officials should be involved in the review.

10-12 Dealing with the EC

Agree that the UK should try to make the present limit more flexible - probably by applying it to average concentrations over a period. Agree that meanwhile the UK should try to agree expenditure programmes with the Commission - but the aim should be to keep these to a minimum.

13 Privatisation

Agree that prospectuses will need to give information on the cost and timescale of complying with the nitrates directive. But point out that if some uncertainty remains at the time of privatisation, investors will be reassured by the cost pass-through provision of the price regulation regime. So DOE should bargain toughly with the Commission.

12. This brief is agreed with IAE, E1 and EC Divisions.

Mary Brown

MRS M E BROWN

I think that some of the arguments are more clearly set out here than in Lord Young's paper and letter. He may therefore need support to carry his proposals. TJBurr 5/10

FROM: EDNA YOUNG
DATE: 5 October 1988

1. MR ~~BURR~~
2. CHANCELLOR

cc Financial Secretary
Sir P Middleton
Mr Monck
Mr Burgner
Mr Waller
Mr Stevens
Mr Tyrie
Mr Call

E(A), 6 OCTOBER: REVIEW OF MERGERS POLICY

1. You are attending E(A) on 6 October. The Prime Minister will be in the chair.

E(A)(88)43: AMENDMENTS TO THE FAIR TRADING ACT 1973

Memorandum by the Secretary of State for Trade and Industry
(Supplemented by his Private Secretary's letter of 3 October)

Proposals

1. E(A) is invited to agree to:

(i) a broader order-making power enabling the Secretary of State to take whatever action may be necessary to remedy (or prevent) adverse effects found by the MMC;

(ii) a proposed new offence of providing false or misleading information to the OFT under the new voluntary pre-notification procedure.

Line to take

2. (i) Order-making powers

- Agree with Lord Young that **present powers** too inflexible to cover all eventualities. Right that Government should be able to take action where MMC reaches adverse finding.

- **For competition reasons**, must ensure that legal powers in useful form.

- **Examples** in Lord Young's paper (as supplemented by his Private Secretary's letter) indicate sort of problems we now face. Business climate has changed. Companies less willing to give undertakings. So past experience that accommodation can generally be reached not necessarily accurate guide for future.

- **KIO** case in point. MMC recommended that, until divestment had been completed, Government of Kuwait's voting rights should be restricted to 9.9%. But no powers to enforce if they refuse.

- (If colleagues are content) therefore support proposal.

- (If others criticise proposed new powers as too sweeping) would be worth considering again whether extra, **more specific** powers could be added. Suggest further paper by officials.

(ii) New Offence

- **Support** proposal. If new voluntary pre-notification procedure is to work, clearly sensible to penalise those who seek to abuse it by deliberately supplying false information.

Background

3. In September 1987, E(A) agreed the main conclusions of the review of mergers policy. The DTI Blue Paper on mergers policy was published in March, and the DTI (with our support) have secured space for the necessary legislative changes in the next session. The main changes agreed were:

(i) Voluntary pre-notification. This is a new procedure to speed up the process. Where companies chose to pre-notify a proposed merger, the OFT would have to respond within a set period, failing which the merger would automatically be cleared.

(ii) Statutory undertaking. These will permit **statutory** enforcement of undertakings given by the parties to the DGFT and the Secretary of State to avoid references to the MMC.

(iii) Speeding up procedures. The changes in this area will cut the time taken to process cases to 4-5 months (8 months at present). The minimum number of MMC Commissioners dealing with a case will also be cut from 5 to 3.

(iv) Charging. It has been agreed in principle that bidding companies should be charged for the cost of OFT and MMC investigations.

4. Mr Maude wrote to colleagues on 5 August proposing three further changes:

(i) Order-making powers

The Secretary of State's current powers to remedy adverse effects found by the MMC are very detailed but not comprehensive. Mr Maude proposed a new broad power to impose prohibitions or requirements as considered necessary to remedy (or prevent) such adverse effects. This would give the DTI more flexibility in preventing something which the MMC had found to be against the public interest. At present the DTI have to become involved in lengthy, not always satisfactory negotiations with the companies involved. Undertakings, for instance, can take up to 3 years to negotiate, thus giving monopolists ample time to abuse a position of market power. Moreover it is difficult to monitor compliance with the undertakings given.

There are clear competition policy advantages in this proposal, and the Financial Secretary indicated support for it in his letter to Mr Maude of 31 August. The Prime Minister, however, had reservations about it, and suggested discussion at E(A). It is not clear whether her concern arises from the possible reaction to the taking of such broad powers, or the possible abuse of them by a future government.

If it is not possible to reach agreement to Lord Young's proposal, a fallback position might be to suggest that he look again at the possibility of extra <u>specific</u> powers to plug the gaps.

(ii) <u>New Offence</u>

Although this too might be presented as draconian, it is clearly right to prevent abuse of the new voluntary pre-notification procedure. In his letter of 31 August to Mr Maude the Financial Secretary supported this proposal to which the Home Secretary has also agreed in principle (his letter of 19 August). This proposal seems likely to go through without difficulty.

(iii) <u>Hybrid instrument procedure for divestment orders</u>

At present divestment orders are subject to affirmative resolutions of both Houses, with those adversely affected having the right to petition the Lords (the so-called hybrid procedure). The DTI had proposed to remove this right, on the grounds that during the 42 day consultation period those affected would continue to be able to make representations which the Secretary of State would be bound to consider. The Prime Minister had reservations about this proposal, as did the Lord Privy Seal, who wrote to Mr Maude on 22 September advising that this was likely to give rise to considerable difficulties in the Lords. In consequence Lord Young has now withdrawn the proposal.

Edna Young

EDNA YOUNG

I agree with all this (this is what we have been saying for 8 months [illegible]) except the piecemeal. For simplicity, sell Shorts just as it is to a single [illegible] [illegible] & let [illegible] [illegible]

Ch. This is George Guise's brief for the PM. After E(A), he telephoned and suggested you might like to see it.
[illegible] 6/10

PRIME MINISTER 5 OCTOBER 1988

MACKIES/HARLANDS/SHORTS

Mackies

It is good to hear that there is one potential buyer showing some enthusiasm. Any viable deal will probably require Government funding which can only be justified on political grounds. Furthermore it is essential that it is a genuinely private solution which emerges. One earlier proposal placed a commercial bank in the false position of appearing to finance Mackies while its risks were totally underwritten by government. This is merely disguised nationalisation and Tom King should be disabused that any final solution of that kind will be acceptable.

The original Government investment mentioned was £20 million in order to render the business 'commercially viable'. Your own proposal was to tranche any Government investment so that the benefits of the initial amount would have to become evident before anything further was ventured. It might be appropriate to remind Tom King of that in any encouraging remarks that are made. Nevertheless Mackies appears to be the brightest spot in a very gloomy picture.

Harlands

It is no surprise that the Tikkoo deal is proving hollow. It was most improbable that Tikkoo could make economic good out of Harlands without enormous Government subsidies. His background gives no indication that he could become a chief executive capable of giving Harlands hope of real economic viability. Further dealings with Tikkoo seem both a waste of time and a diversion of effort. It is unlikely that he can raise private financial backing of the scale required. The Northern Ireland Office should now press on with those other possibilities which the paper mentions under a strict time limit of about two months to produce something viable.

Tom King should be warned against a hastily cobbled deal which technically privatises Harlands without solving any of the yard's underlying problems. This will only rebound on the Government, probably at an awkward time. Far better to face up to closure of Harlands in a planned manner if a genuine sale cannot be achieved in the immediate future. As an interim measure I understand the Treasury will not object to the proposed EFL of £62.3 million.

Shorts

The NIO paper glosses over a major row which Tom King and Paul Viggers have been having with the Shorts Chairman, Rodney Lund. Lund is totally opposed to piecemeal privatisation despite the fact that the only part of the business which has attracted any interest is the missile division. When the Government's intention to sell Shorts was announced in July, Lund accused Viggers of giving a 'totally misleading government briefing' in which management was openly criticised. There was a subsequent vitriolic exchange when Lund even threatened to sue for defamatory statements. - see Annexure A from Lund to King dated 20 July.

Lund further argues that any proposal to sell the missiles division separately (valuations indicate an order of £70 million) will lead to an immediate sit-in by unions at the Aircraft and Aerostructure plant leading to massive liabilities for non-delivery to Boeing. Lund claims that Government has an obligation to meet Shorts' debts because of an assurance given in Parliament by a previous Northern Ireland Secretary of State (cf - the Varley-Marshall assurances for Rover.) He suggests that the downside risk to Government in pursuing a separate sale of the missile division could therefore be over a billion pounds! The Treasury are highly sceptical about this.

There is no commercial logic in binding the successful missile business, which is physically separate from Shorts main factory with no commonality of manufacture or cross costing benefits, to the heavily loss making aircraft and aerostructure business. The missile division has a turnover of £80 million and 1,500 employees. Its performance is variable but it is basically profitable and has been valued at £70 million. With the Starstreak missile under development, it has a secure medium term future.

By contrast the aircraft (turnover £90 million) and aerostructure (turnover £70 million) activities operate from a single site employing 6,200 people and sharing common resources and facilities. This business is unprofitable and poorly equipped. Shorts management argue that it can only become viable after developing a new short range aircraft - the FJX. This would be a twin jet capable of transporting 44 passengers up to 1,760 kilometres.

Gross investment for this project has been estimated at £500 million of which Shorts would carry £180 million after allowing for investment by partners and sub-contractors. Shorts would want half to be financed by Government launch aid as well as immediate debt restructuring of £300 million for the company overall. This constitutes the nearly £400 million Government investment mentioned in the last E(A) paper which King did <u>not</u> support. Such an amount is of the same order as closure costs and would be in total contravention of Brussels' position on State aid. It is the old Rover argument. Give us the capital for new models and we will set the business right.

You may not wish to bring all this out at E(A) but it is important to be aware of the atmosphere in which King has delegated the privatisation of Shorts to its Chairman and Board as set out in Paragraph 11 of the NIO paper.

Conclusion and Recommendation on Shorts

There has been a very bad relationship between the Shorts Chairman and Northern Ireland Ministers. Instead of firing Lund, Tom King has handed him the business to sell. This is a very high risk strategy, particularly as Shorts is the largest employer in Northern Ireland.

In strict commercial terms the obvious solution is to sell the missile business to a company like Ferranti who have shown interest. Sale of the aerostructures business should also be attempted, perhaps to a consortium of its customers. However, the aircraft business is not viable without a massive Government dowry and the commercial solution must be closure.

It may be that we have no alternative but to stay with Lund for the immediate future, because there may be no one better to take the job. However you should test this assumption very carefully, either with Tom King privately or, if appropriate, during E(A). In my experience, whenever the shareholder abandons its business to a potentially hostile management, no good results. It would be far better if responsibility for privatising the company could be separated from its present management.

George Guise

GEORGE GUISE

SECRET

ANNEX A

SHORTS

Rodney Lund

RL/CMH

July 20, 1988

The Rt. Hon. Tom King MP
Secretary of State for
Northern Ireland
Northern Ireland Office
Old Admiralty Building
Whitehall
LONDON SW1A 2AZ

Dear Secretary of State,

I hardly have to tell you how utterly dismayed I am about the recent leakages to the Press of information confidential to this Company and to read the quite extraordinary and defamatory statements about the Management. A reasonable man might wonder if there was some wish to sabotage the Company.

I think you will agree that the damage to the Company is so serious that I have no option but to write to the Prime Minister for help which I have done today.

Most damaging of all to the Company are the press statements that we have lost £85m in the first quarter. Suddenly the most horrendous thought crosses my mind. Can it be that you have been wrongly briefed? The pre-interest loss for Shorts for the first quarter is in fact some £10m - and this is traditionally our worst quarter. The £85m is simply a measure of our peak cashflow operational requirement and is not unusual for this time of the year.

When we last met I could not understand your remarks about massive haemorrhaging because I knew our quarterly results would not be too far off target. Is it possible that you really thought we had lost £85m? Certainly whoever leaked this confidential figure to the Press must have thought so. It would scare me too much if I thought that recent decisions about the Company might have been predicated by someone in the system who did not know the difference between profit and cashflow.

I enclose a copy of a letter from our lawyers to Mr. Viggers which is self explanatory.

Yours sincerely

Rodney Lund

SHORT BROTHERS PLC
Glen House Stag Place Victoria London SW1E 5AG

SECRET

Action:

DEPARTMENT OF ECONOMIC DEVELOPMENT

NETHERLEIGH
MASSEY AVENUE
BELFAST
BT4 2JP

FINANCIAL SECRETARY
REC. -6 OCT 1988
ACTION Mr. A. M. White
COPIES TO PPS, CST, Mr. Anson
Mr. March
Miss Peirson
Mr. Barton Mr Call.

-6 OCT 1988

Telephone 63244

The Rt Hon Norman Lamont MP
Financial Secretary to
 the Treasury
Treasury
Parliament Street
LONDON
SW1P 3AG

5th October 1988

Dear Norman,

JAMES MACKIE AND SONS LIMITED

Colleagues agreed at E(A) on 13 July that we should keep Treasury colleagues informed on the progress of negotiations on any dowry proposals that might evolve in discussions with potential private sector investors in this company in West Belfast.

I am glad to report that there has been some encouraging progress with two of the several companies identified as potential interests. The companies concerned are the Howden Group and Lummus Industries Inc, an American interest.

Negotiations with Howdens are at the more advanced stage. Although not yet finalised, discussions are now centering on a substantial but largely conventional package of assistance involving selective capital grants, revenue assistance and a minimal loan element which will be payable at the outset.

This package, totalling £18.75m, is judged to be the minimum necessary to ensure Howdens continuing interest in a takeover and represents a substantial improvement over the £20m cost of the wholly public sector approach previously rejected by E(A). An added advantage is that the package keeps us comfortably within existing NGE ceilings for Northern Ireland thus avoiding potential EC complications.

A detailed business plan is yet to be received from Howdens however and we also await a formal proposal from Lummus. When these have been received and assessed we can decide on the relative merit of those two proposals and, move towards finalising a deal. We will, of course, keep colleagues closely informed as negotiations progress and will consult formally with the Chancellor before finalising agreement on any possible dowry package.

In the meantime, consistent with the views of E(A), I have taken steps to ensure the continued trading of the company while negotiations continue, through the extension, until the end of October 1988, of the existing bank guarantees up to a reduced limit of £2m.

Yours ever,

Peter

PETER VIGGERS
Parliamentary Under
Secretary of State

dti

the department for Enterprise

Ch/ nb shipbuilding (also letter behind) Mpw Pmp

CONFIDENTIAL

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon John Major MP
Chief Secretary to the
Treasury
Treasury Chambers
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

for Sdm!

CHIEF SECRETARY	
REC.	- 6 OCT 1988
ACTION	Mr Burgner,
COPIES TO	Cx, Sir P. Middleton Mr Anson, Mr Phillips, Mr Waller, Mr MacAuslan, Mr Monck, Mr Luce, Mr Turnbull, Mr Call.

Direct line 215 5422
Our ref DW2ATH
Your ref
Date 6 October 1988

Dear Chief Secretary,

1988 PUBLIC EXPENDITURE SURVEY

At our meeting this morning you asked me to consider whether I could find further savings of £30m, £20m and £30m in the three survey years. I told you that I did not believe reductions on this scale would be feasible, but that I would make a final examination of my programmes to see what might be possible.

As a result of this further examination I have concluded that the most I can offer is £15m, £10m and £15m. I am therefore prepared to settle on the following baselines, which I trust will be acceptable to you.

£ million		
1989/90	1990/91	1991/92
1,342	1,298	1,150

I set out below the way in which I would propose to allocate these further reductions.

Regional selective assistance

I will reduce my bid by £3 million in 1991/92, resulting in changes to the baseline: 0; 0; +£7 million.

National selective assistance (section 8)

I will reduce my bid by £2 million in 1989/90 and £1 million in each remaining year, leaving changes of +£2.2m; +£0.8m; -£7.0m.

Innovation

I am prepared to make further reductions of £5m, £2.5m and £1m. I will also for the time being allocate the £6m a year reduction offered in my 26 September letter to the innovation line, although I reserve the right to reallocate it subsequently to aircraft and aero-engine R&D or space. These changes, together with those agreed at our meeting on 20 September, mean that my baseline will change as follows -£21.0m; -£13.5m; +£8.0m.

Particularly in view of the impact of the EUROPES arrangements, these figures may impose significant restrictions on our programmes for encouraging innovation.

Aircraft and aero engine R&D

I am reluctantly prepared to agree reductions of £1.5m in 1990/91 and £3.0m in 1991/92.

Computers

Although it will further retard desirable investment for the future, I will reduce my bids by £1.0m in each year leaving baseline changes of +£3.6m; +£2.5m; +£2.5m.

Running costs

In view of your anxiety to see some further reduction in this area, I am prepared to reduce my bid by £2m in each year. This will have to be met by an even tighter squeeze on general administrative expenditure. The resulting baseline changes including the reductions in my bids already agreed are +£18.0m; +£22.3m; +£22.9m.

Europes non R&D

I will reduce my bid to replace the EUROPES offset by £1.0m in 1989/90, giving a baseline change of +£0.6m in that year.

Publicity

I have reviewed my publicity budget, particularly in view of the possible scope for reducing expenditure on single market publicity after this year. In the light of that I am prepared to withdraw my bid for 1989-90, and to offer reductions of £2.0m in 1990-91 and £4.0m in 1991-92.

CONFIDENTIAL

The attached table summarises these further reductions, and shows the resulting baselines for the relevant programmes. I am satisfied that this is the very most I can offer. The net reductions in S&T expenditure, taking together innovation, space, aircraft and aero-engine R&D, launch aid and Research Establishments including the conditional NEL reductions (see below) are £16.0m in 1989-90, £19.3m in 1990-91 and £100m in 1991-92. You will appreciate that I have had effectively to cut my innovation programmes by a further £30m over the PES period to accommodate the reduced baseline resulting from EUROPES. I believe it would be right for you to draw attention to this when you report to E(ST).

I should also register the following points in relation to the settlement.

Regional Development Grant

I understand you have now agreed that the waiting period should be lifted. All the figures are on this assumption.

NEL

The baselines I can now agree take account of the conditional reductions of £1m, £4m and £5m which I offered at our meeting on 20 September. I must emphasise that these reductions remain conditional on developments affecting NEL, which we may need to discuss collectively in the near future. I am determined to achieve savings here but it would be unwise now to be firm about the precise figures.

Shipbuilding

You have undertaken to increase my provision from the Reserve to meet the cost of any intervention fund support that may be agreed for newly-privatised yards. You will be discussing further the question of funding possible remedial measures with Tony Newton. I must however emphasise that we have no spare resources for such measures, particularly in the light of the reductions contained in this letter.

EXPO 92

In considering the overall level of reductions I can offer, I have been mindful of the need to make a success of EXPO 92. I shall have to contain significant costs for this within my programmes even after taking account of the prospective PES transfers from FCO and the Department of Employment and the additional provision of £2m for which I have bid in 1991-92.

Rolls-Royce

As agreed, my officials have told Rolls-Royce that their application will be regarded as having lapsed on 14 October unless the company has by then provided the corporate financial information we require. I understand that Francis Tombs is aiming to meet this deadline.

Post Office

Finally, I should record the agreement reached on the Post Office's EFL. You and Tony Newton agreed bid reductions of £20m, £26m and £22m, which mean changes to the current baselines of +£7m, +£2m and -£22m, and he has discretion about exactly how these reductions are to be found. He made clear that he is likely to have to come back to you about these figures when we have a clearer idea of the costs of the recent strike.

Yours sincerely

N. R. [signature]

(approved by the Secretary of State and signed in his absence)

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

Ch/ Mr Viggers letter arrived after E(A)

FROM: MRS T C BURNHAMS
DATE: 6 OCTOBER 1988

MW 6/10

1. MR WHITE

2. FINANCIAL SECRETARY

JS 6/10

cc Chancellor
Chief Secretary
Mr Anson
Mr Monck
Miss Peirson
Mr Call

JAMES MACKIE AND SONS LIMITED

In his letter of 5 October Mr Viggers reports the progress that has been made to find a private sector investor for Mackies.

2. Two companies in particular have shown an interest in Mackies and negotiations with the Howden Group have reached the stage of discussing a package of Government assistance. Mr Viggers indicates that assistance totalling £18.75m is likely to be necessary if the Group are to go ahead with the takeover of Mackies. This would be within the £20m cost of the public sector rescue of the company which the Secretary of State had proposed, and which had been rejected by E(A).

3. I understand the package under discussion would involve a total investment in the company of £30m with Government assistance being in the form of selective capital grants (£8.25m), revenue assistance- mostly employment grants- payable over five years (£7.5m), and an up front loan of £3m. As Mr Viggers points out such a package would be within the EC ceiling for net grant equivalent (NGE). It would however involve a cost per job of £25,900.

4. The second company Lummus Industries have not yet put forward any formal proposals.

5. Mr Viggers' letter also confirms that the bank guarantees, which had increased to £2.75m for August and September, have now been reduced to £2m for October. Mr White's submission to you of 8 September reported on the cash flow situation at Mackies and concluded that the help afforded to Mackies fully reflected E(A)'s agreement that limited action could be taken while discussions on longer term measures continued.

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

6. Mackies was one of the subjects discussed at E(A) this morning, and I understand that there was some indication that Howden's Glasgow business was experiencing financial difficulties. The Secretary of State was asked to consult the Chancellor about the size, nature and phasing of any dowry.

7. I recommend you should reply to Mr Viggers noting that the Chancellor will be consulted before any agreement is made for a package of assistance with the company willing to invest in Mackies. I attach a draft reply which you may like to consider.

Teresa Burnhams.

TERESA BURNHAMS

DRAFT LETTER FROM FINANCIAL SECRETARY TO

P. VIGGERS ESQ MP
PARLIAMENTARY UNDER SECRETARY OF STATE
NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

JAMES MACKIE AND SONS LIMITED

Thank you for your letter of 5 October in which you bring me up to date on progress to find a private sector company to invest in Mackies.

It is encouraging that there are two companies who have shown an interest, and that negotiations with the Howden Group have advanced so far. I note that you will be consulting the Chancellor before any dowry package is finalised.

I agree that the present bank guarantees are consistent with E(A)'s agreement that limited action could be taken to ensure the company's survival while discussions over longer-term measures continued. I would be grateful if you will keep me in touch with any deterioration in the company's financial position.

iae2.sc/docs/PES 88

CONFIDENTIAL

cc Mr Anson, Mr Monck
Mr Phillips, Mrs Case
Mr Turnbull, Mr Mansfield
Mr MacAuslan, Mr Walker
Mr Turie, Mr Call

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1H OET

7 October 1988

Dear Secretary of State,

1988 PUBLIC EXPENDITURE SURVEY: DTI PROGRAMMES AND POST OFFICE EFL

I am grateful for your letter of 6 October responding so promptly and constructively to the request I put to you on Wednesday for further savings of £30/20/30 million over the three Survey years.

I am naturally disappointed that you have not felt able to come any further to meet me on the totals. Nonetheless, I believe we now have the basis for an acceptable settlement subject to E(ST). But I am concerned about the uncertainty surrounding the savings on NEL. Privatisation, on which your saving of 1/4/5 was based, has now fallen through. I note what you say in your letter about delivery of these savings being conditional on developments affecting NEL. I could not accept a position where these savings were in doubt or, indeed, there was a threat of increased costs in the early Survey period as a result, for example, of an accelerated run down of staff at the NEL with associated redundancy costs. In these circumstances I must make it clear that, should savings from NEL be delayed, I would expect you to find offsets elsewhere in the science and technology elements of your programme.

There is also outstanding the question of financing the shipbuilding remedial measures which as yet I have been unable to discuss with Tony Newton . I will be in touch with Tony separately on this but expect that we will be able to reach a mutually acceptable settlement.

If one of the bids for NESL does turn out to be acceptable, and the yard is successfully privatised, the case for remedial measures will of course have to be re-examined. In that event, I have indicated that I would certainly be sympathetic to your need for increased provision for any Intervention Fund support that may be agreed for a privatised NESL, as for Appledore; though access to the Reserve can never be guaranteed. In any event, the PF needs of the privatised yards will have to be taken into account when assessing the case for disposal.

Science and Technology

As you know, I will have to report to E(ST) on our settlement. Including the further reductions offered in your letter of 6 October and the IREs VAT bid, the total change to the Science and Technology element of your programme is -15/-16/+3 (excluding launch aid). The derivation of these figures is shown in the attached table which I hope we can agree as a basis for my report to E(ST). I shall be reporting the position we have reached in the context of an overall excess of S&T increases over the savings available and their disagreement must remain a possibility.

RSA Cash Limiting

Though we did not discuss this yesterday, my officials have spoken to yours about the possibility of your agreeing to cash limiting RSA in return for some easement in the overall settlement total on account of the forecasting problems you outlined at our first bilateral. I understand, however, that you are not willing to agree to the introduction of cash limiting for anything less than the 12/13/13 of which you bid at the bilateral. By contrast both Malcolm Rifkind and Peter Walker are prepared to agree to the introduction of RSA cash limiting without that being conditional on corresponding increases in their RSA baselines. I hope, therefore, that you will be prepared to come some way to meet me on this to avoid postponing resolution of this issue further. Perhaps you could let me have your further reflection on this.

Post Office

I confirm our agreement to reductions in your bid of £20 million, £26 million and £22 million, which mean changes to the current baselines of +£7 million, +£2 million and -£22 million. I made clear, and Tony Newton accepted, that I was only prepared to agree this settlement on condition that the Post Office thoroughly revise their plans in line with it. I hope Tony will let me know how he decides to apportion the reductions between operating costs and investment. As far as the strike is concerned, I made it clear that if there was any question of reopening the settlement I would have no choice but to reopen discussion of the level of investment.

In conclusion, I am grateful for the constructive way you have approached our PES discussions. I am sure we now have the basis for a settlement, subject to the concerns I have outlined above about NEL and also to the outcome of E(ST)'s consideration of the overall S&T picture.

Yours sincerely,

P. Waller

PP JOHN MAJOR

[Approved by the Chief Secretary and signed in his absence.]

iae2.sc/docs/DTI Tab

6/10/88

DEPARTMENT OF TRADE AND INDUSTRY: SCIENCE AND TECHNOLOGY

	1989-90	1990-91	1991-92
Innovation (1)	- 15	- 7.5	14
Space (2)	6.6	2.8	2.3
Aircraft and aeroengine R&D (3)	-	- 1.5	- 3.0
Additional Savings (29/9) on (1) to (3)	- 6	- 6	- 6
Further savings (6 October letter)	- 5.0	- 2.5	- 1.0
Research establishments			
DTI Bid for VAT	1.3	1.4	1.5
Savings	- 1.5	- 5	- 6
Total (excluding launch aid)	- 14.6	- 15.8	+ 2.8
Launch aid	- 0.1	- 2.1	-101.3
Total (including launch aid)	- 14.7	- 17.9	- 98.5

PPS p1

dti

the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Jonathan

Is piece on shipbuilding (over) interesting. I have not seen CST -> Newton of 10/10. Have you.
MP

No.

The Rt Hon John Major MP
Chief Secretary to the Treasury
Treasury Chambers
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

CHIEF SEC

REC.

ACTION Mr Burgner

COPIES TO Cx, Sir P Middleton, Mr Anson, Mr Phillips, Mr Walker, Mr MacAuslan, Mr Monck, Mr Luce, Mr Turnbull, Mr Call

Direct line 215 5422
Our ref DW1AOZ
Your ref
Date 10 October 1988

Clerks! pl find CST of 10/10 on ships.
M.

Dear Chief Secretary

1988 PUBLIC EXPENDITURE SURVEY

Thank you for your letter of 7 October. I am glad you agree that we now have the basis for a settlement. I deal below with the specific points raised in your letter.

NEL

I do not believe that your concern about the savings on NEL is likely to prove justified in practice. All the options I am now considering can be expected to secure savings of the order we have agreed. However the future of NEL is still subject to collective consideration by colleagues, following my letter of 6 October, and I do not think it would be right for me to commit myself to find offsetting savings if, in the event, we decided on a more expensive course than I now envisage. I think we must leave it that the baseline reflects the provisional savings, but that I reserve the right to seek additional provision should a collective decision make this necessary.

dti

the department for Enterprise

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Shipbuilding

I am grateful for what you say on Intervention Fund support for a privatised NESL and for Appledore. While I recognise the principle that access to the Reserve can never be guaranteed, you for your part will understand that I have no room left in my reduced programmes to meet these requirements, and I anticipate that in the event they would therefore need to be met from the Reserve.

There is every prospect that we may need to call upon this understanding in the case of Appledore. In the case of NESL, there must however be a strong possibility that we shall rather be looking at a programme of remedial measures, on which we now have your helpful letter of 10 October to Tony Newton.

I am prepared to countenance a reduction in the total cost of the package in the PES years from £20m to £18m, which I believe can be done without prejudice to the scale of the operation which colleagues thought was appropriate, particularly by close scrutiny of administration costs. I am also prepared to take care of the advance factory element of the package without seeking any extra funds for the EIEC. This would reduce my requirement for new money for the package to £4m, £3.5m and £3m in the PES period.

This proposal is slightly different in structure to yours, but I think it represents a splitting of the costs in a way which is more than favourable to the Treasury, given the past misunderstandings about the funding of the package: it is also helpful to the Treasury in terms of phasing. As you well know, we have no spare resources for the Sunderland package. I therefore hope you will accept this proposal.

There is no provision in these figures for remedial measures for Appledore, since we are expecting the yard to be sold. If it is not, I may need to return to the question of such measures for Appledore.

Science and Technology

I confirm the totals for the change in the Science and Technology element of my programmes excluding launch aid. On the table I should just point out that the figures in the line entitled "Further savings (6 October letter)" are included in the first line, "Innovation". The totals relect that. I understand that you need to report to E(ST) on the overall outcome.

dti

the department for Enterprise

CONFIDENTIAL

RSA Cash Limiting

For the reasons Tony Newton has explained to you, we should prefer that RSA should remain non-cash limited. I am afraid I could not agree to the introduction of cash limiting unless my baseline were increased by the figures you mention, £12m/£13m/£13m.

Finally, I should reiterate that my Department's baselines will need to be increased following PES transfers from FCO and the Department of Employment in relation to EXPO 92. My officials will be in touch with yours about the details.

I hope we can agree that our 1988 PES discussions are now concluded on the basis of this correspondence.

Yours sincerely,

N. R. [illegible]

(approved by the Secretary of State and signed in his absence)

the Enterprise initiative

cst.ps/14jm10.10

CONFIDENTIAL

CHIEF SECRETARY TO THE TREASURY

PMP

cc:
Chancellor
FST
Sir Peter Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Burgner
Mr Turnbull
Mrs Brown
Mr W Guy
Mr Waller
Mr A M White
Mr Rutnam
Mr Tyrie
Mr Call

Treasury Chambers, Parliament Street, SW1P

The Rt Hon Tony Newton OBE MP
Chancellor of the Duchy of Lancaster
and Minister of Trade and Industry
1 - 19 Victoria Street
London
SW1H OET

11 October 1988

Dear Chancellor of the Duchy,

APPLEDORE FERGUSON SHIPBUILDERS LTD: DEVON YARD

Thank you for your letter of 23 September on Clark Kincaid. I am grateful for your assurances, which are relevant to the Devon yard of Appledore Ferguson, about which you wrote to me on 6 September. Our officials have been in touch about the costings of disposal of Appledore to Langham Industries, and as BS are now beginning negotiations you will wish to be aware of the reservations I have about the basis of those costings.

In your letter of 6 September you quoted a likely cost of closure of about £8 million, which you compared with a cost of about £2.1 million for disposal, suggested by the outline bid from Langham's. Clearly the actual cost of disposal is something which will emerge from negotiations, and as agreed you will be seeking independent advice on the cost of closure by a competent liquidator. But in the meantime I have to sound the warning that my officials do not agree with the figures produced by BS which seem to (a) exclude from disposal costs an allowance for future Intervention Fund support and the tax losses which will be inherited and which also seem to (b) include within closure costs allowances both for liquidated damages in respect of existing work and overgenerous closure bonuses.

For clarity, the attached table summarises the closure and disposal costs as estimated by BS, and alternative bases which I believe are more justifiable and which suggest that closure would be significantly cheaper than disposal. I should welcome your comments on this. I hope that in the meantime we can avoid expectations that the disposal of Appledore rather than its closure is inevitable, and that in due course we shall have the opportunity to consider the options together without the sort of timing pressure which there was in discussions about Govan and the new order for Clark Kincaid, which was not helpful to either of us.

Yours sincerely

P. Wallace

pp JOHN MAJOR

[Approved by the Chief Secretary and signed in his absence.]

Estimated closure costs

	BS/DTI	Possible alternative
Continuing outgoings up to completion of existing work (net)	4.8	4.8
Redundancy costs	6.5	6.5
Closure bonuses	2.5	1.5
Liquidated damages	1.0	-
Net proceeds from property sale	(4.0)	(4.0)
Less overheads common to disposal option	(1.6)	(1.6)
Rounding	0.8	-
TOTAL	10.0	7.2

Possible Costs of Disposal

Net cost exclusive of IF and tax losses	2.1	2.1
IF (based on £3m per year, DTI PES bid, discounted at 10 per cent; assuming no IF beyond PES period)	?	7.5
Tax losses, estimated at p.v. of 'few £00,000 by DTI'	?	0.4
TOTAL	2.1 +?	10.0

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

The Rt Hon Tony Newton OBE MP
Chancellor of the Duchy of Lancaster
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1

CHIEF SECRETARY
REC. 18 OCT 1988
ACTION Mr Gray
COPIES TO CST, FST, Sir P Middleton, Mr Anson, Mr Monck, Mr Moore, Mrs Brown, Mr Waller, Mr A M White, Mr Rutnam.

18 October 1988

Dear Tony,

BRITISH SHIPBUILDERS AND THE NORTH EAST

You sent me a copy of your minute of 22 September to the Prime Minister about your recent visit to North East Shipbuilders Limited.

There is one matter arising from your report on which I would be grateful for your co-operation. The package of remedial measures you have been preparing for use if NESL closes includes an enterprise company. Kenneth Clarke envisaged this as a British Shipbuilders subsidiary, but was not prepared to let it operate in Scotland unless I funded the Scottish operations. It is of course not my responsibility to fund remedial measures which are so specific to a particular industry for which another colleague is responsible. If it becomes necessary to set up an enterprise company, however, it will be difficult for any of us to defend its absence from Scotland if it is established as a BS subsidiary and in due course there are job losses at any BS or former BS operation in Scotland. There are various initiatives in the shipbuilding areas in Scotland which I may use to deal with the wider effects in the local economies concerned. I would have preferred to have had the enterprise company to help directly with counselling and retraining for those who may lose their jobs but not if I have to fund it at the expense of my own programmes. I would therefore suggest that, if you proceed with the enterprise company proposals, you set it up as an independent company specific to the NESL position and not associated with British Shipbuilders. This would contain the political pressures on both you and me to extend its work to Scotland in the future. If you find you cannot do this then I would have to insist that the resources of the company should be available - without any additional contribution from Scottish Office funds - to assist with the consequences of British Shipbuilders redundancies throughout the United Kingdom.

I also want to comment on John Major's letter of 28 September to Nicholas Ridley about the enterprise zone proposal for Sunderland. John says he expects this to be the last zone to be designated. When we reviewed our policy on this matter last year, however, it was agreed to retain enterprise zones as one option for dealing with particularly severe difficulties, and I certainly intend to keep that option open if a major closure were to arise in the future in Scotland. In addition, I might well consider an extension of the zone in Inverclyde if there are unfavourable developments in relation to the disposal of the BS subsidiaries there.

Copies of this letter go to the Prime Minister, the members of E(UP) and to Sir Robin Butler.

Yours ever,

Malcolm

MALCOLM RIFKIND

CONFIDENTIAL

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon Anthony Newton MP
Chancellor of the Duchy of Lancaster
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H OET

CHIEF SECRETARY
REC. 24 OCT 1988
ACTION Mr Gray
COPIES TO CX, FST, Sir P Middleton, Mr Anson, Mr Monck, Mr Moore, Miss Brown, Mr Waller, Mr Annwinter, Mr Call, Mr Rutnam

24 October 1988

Dear Tony

NORTH EAST SHIPBUILDERS LTD (NESL) SUNDERLAND

You copied to me your minute of 22 September to the Prime Minister following your visit to Sunderland. I shall do all I reasonably can within my existing resources to bring relevant programmes to bear on regenerating Sunderland if closure becomes inevitable.

If it does become necessary for you to make a statement outlining a package of measures to assist Sunderland I am sure it would be right to include a reference in that statement to the Enterprise Zone (EZ) which we agreed earlier should be established in the event of closure and which I firmly intend to proceed with. The legal procedures for this are complex and include getting clearance from the European Commission as the first step; their agreement cannot be taken for granted. I suggest therefore that your statement says no more than that I am urgently consulting the European Commission on a proposal to establish an EZ in Sunderland. We shall not be able to say anything more until I have cleared my lines with Brussels when I would aim to make a more detailed announcement setting out my proposals for the Zone.

I would also like to raise with you the future of the land currently occupied by the NESL shipyards. I understand that you take the view that, in the event of total closure, priority should be given to clearing the yards rather than letting them remain as a relic of a past industrial age. I can see the force of that and I want to be helpful if I can. We must not however underestimate the time such a clearance operation might take or the costs that could be involved. The shipyards lie in the UDC area but no provision for their clearance has been made in the UDC's budget or indeed in any of my other programmes, nor is there any prospect that I could find resources for this purpose from within the public expenditure totals I have now agreed with John Major. I assume that you are in a similar position.

There is an important related point concerning the land to be designated as an EZ. Treasury have agreed an EZ of up to 150 acres. We have reviewed our earlier proposals and have now firmly identified about 110 acres of vacant land suitable for inclusion in the EZ. The shipyards cover some 100 acres of land. At this

100%

stage, it is unclear how quickly the sites would be vacated. It is also not known how much of the shipyard land could be brought back into economic use at an acceptable cost, when this could take place and at what cost. My officials will discuss with Treasury whether, within the spirit of the earlier approval, sufficient developable land can be identified in the shipyards, to allow an extension of the EZ that could keep within a total of 150 acres. We would need to ensure that the public sector costs were not wholly out of proportion with the original proposals for the Zone and that there were good prospects of levering in substantial investment by the private sector.

Further work clearly needs to be done before any new commitments can be considered. We should make a virtue of that necessity. I would therefore like to suggest that your statement refers not only to the consideration of an EZ but also announces an urgent study of the future potential uses of the shipyard sites. The terms of reference of this study would be agreed between us. Subject to Treasury agreement, amongst other options to be considered we should include a possible extension of the EZ (to come into effect at a later date by a separate order) to cover appropriate areas of the shipyards. The UDC are the obvious body to organise this study which could be completed by the end of the year. Resource provision would properly be a matter for consideration in the 1989 PES round. Certainly I could give no commitment myself at this stage and I think we shall both need to look long and hard at the figures when we get them.

In view of Malcolm Rifkind's letter of 18 October, I should comment briefly on John Major's expectation in his letter of 28 September that the proposed Sunderland zone will be the last to be designated. The policy, which I announced early this year, certainly recognised that enterprise zones would only be designated in future in very exceptional circumstances where other, more cost-effective measures, were considered insufficient. We have agreed that Inverclyde and Sunderland are such cases. But we cannot rule out the possibility that other cases might arise and the option of using enterprise zone incentives must be retained – although I hope it will never be necessary again.

I am copying this letter to the Prime Minister, members of E(UP), Paul Channon and Sir Robin Butler.

Yours ever
Nicholas

NICHOLAS RIDLEY

dti

the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

pp3 pse.

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

CHIEF SECRETARY	
REC.	24 OCT 1988
ACTION	Mr Gray
COPIES TO	CX, FST, Sir P Middleton, Mr Anson, Mr Monck, Mr Moore, Mrs Brown, Mr Waller, Mr AM White, Mr Rittman, Mr Call.

Direct line 215 5147
Our ref
Your ref
Date 24 October 1988

Dear Chief Secretary,

BRITISH SHIPBUILDERS: NORTH EAST SHIPBUILDERS LIMITED

The closing date for bids for North East Shipbuilders Limited (NESL) was 30 September. You will be aware from my minute of 22 September to the Prime Minister that I had expected that none of the bids would prove satisfactory. This has indeed proved to be the case. It is just possible there may be further developments in the course of tomorrow but unless these are radically different from what has happened so far I see no alternative to announcing the closure of the NESL yards. I propose to do so in a statement in the House of Commons on Wednesday 26 October.

Bids Received

BS received four bids for NESL. Together with their advisers, Lazards, they examined each of the bids carefully and held meetings with each of the four bidders. John Lister has now written to me endorsing Lazards' conclusion that, on financial and commercial grounds, he could not recommend that any of the four bids should be accepted.

TN8AAG

None of the bids comes from a major industrial concern or similar group with significant resources. In an industry as cyclical as shipbuilding and with NESL having virtually no further work in hand, there must be a genuine doubt as to whether any of the bidders could withstand the difficult times that will inevitably come over the next few years. We have previously made clear that any sale must be expected to lead to a secure long term future for the yards. There can be no justification for prolonging the current uncertainty. On this basis alone, all four bids could be turned down.

In addition, there are significant further problems with each of the bids. One of them depends on securing licences from MAFF for deep sea dumping of waste. This would take time to obtain and in any event I understand MAFF have strong reservations. A second bid is from a small local ship repair operation who would want BS to sack all of its remaining 2,000 or so employees and would then recruit as required. Clearly this would give no real future for the vast majority of those who would be affected. The third bidder owns a successful but fairly small industrial group in the Midlands with interests in engineering and paper and carpet manufacture. He has no experience of shipbuilding, would want BS to make about one half of the workforce redundant and, like the other bidders, could give little assurance of further orders. Finally, there is a bid from a Dane who has links with the Danish entrepreneur Johansen who placed the abortive ferry order with NESL. He has experience in shipping and shipbuilding. He has, however, not revealed the full extent of his financial resources or those of his backers. This, together with his links with Johansen, does not inspire confidence. Again he would expect BS to make about one half of its workforce redundant.

My officials have been closely involved in considering the bids. They have also received comments from my Department's advisers, BZW. The conclusion, with which I agree, is to concur with the advice of BS and Lazards.

Cuban Order

The last two bids to which I have referred have also made it a condition that they secure an order from Cuba for ten new cargo vessels. At the end of last week, the Cubans informed us that they were looking for a letter of intent by 10 November. It is widely perceived in Sunderland that the future of the yard depends on the order being secured. The 10 November deadline reinforces the case for an early announcement.

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The Cubans also told us they would expect to pay no more than $16m per vessel (£9.2m). Our previous expectation had been that an acceptable price would be around £10m. Indeed, one of the bidders has assumed taking the order at £10.2m per vessel. It is not clear how far this is a negotiating position on the part of the Cubans but it makes it even clearer that BS would never have been successful in taking the order themselves. It also makes it less likely that a private sector bidder could have taken the order either.

European Aspects

I discussed the position with Commissioner Sutherland last week. He said that in his judgement at least two, and possibly all, of the four bids would be likely to require a formal procedure under the Treaty of Rome whereby Member States would receive details and be given an opportunity to raise objections. Such a procedure typically takes up to 6 months. This would of course last until well after the Cubans are requiring not only a letter of intent but also to have placed the order. Moreover, Sutherland's view is that two of the bids would almost certainly result in a negative decision after having been taken to a procedure.

When I saw Sutherland I pressed him to agree, in the context of the expected decision on NESL, to be as helpful as possible in clearing notification of the terms of the package of measures for Sutherland and the disposal of Appledore, Clark Kincaid and, if possible, Ferguson. He said that he would. There is therefore a reasonable prospect that all of these issues will have been cleared through the EC by about the end of the year.

Package of Measures

We agreed in the PES round details of funding a package of measures for Sunderland along the lines agreed at the Prime Minister's meeting on 31 March. As you know, the package includes counselling, training and placement services for all those who are made redundant at the yards, a set of enterprise activities on a more intensive scale than was associated with previous closures, and a programme of factory building to be funded and carried out by English Estates. In addition, we expect there to be an Enterprise Zone, although as Nick Ridley has explained in his letter to me of earlier today this is subject to approval by the European Commission. | belind

I shall present the package in very positive terms. We have taken the view that shipbuilding does not offer a secure long term future and we must emphasise the way in which the package

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the department for Enterprise

will promote the growth of new job opportunities. Here, as elsewhere, I am also keen to build on the role of the private sector. With my encouragement a group of Sunderland businessmen have been planning an initiative aimed at stressing the positive and forward-looking aspects of industrial and commercial opportunities and to come forward with specific announcements in the near future. I am glad to say that they have agreed to make the new enterprise company a joint venture with ourselves. The precise mechanism still remains to be decided but I hope it will be possible to set up an independent company not associated with BS, thus meeting the main concern in Malcolm Rifkind's letter to me of 18 October.

I trust you will be content for me to proceed with an announcement on 26 October.

I am copying this letter to the Prime Minister, Norman Fowler, Malcolm Rifkind, Tom King, Nicholas Ridley and John Wakeham and to Sir Robin Butler.

Yours sincerely,

Peter Smith

PP TONY NEWTON

(Approved by the Chancellor and signed in his absence)

TN8AAG

FROM: M ROMBERG
DATE: 25 OCTOBER 1988

1. MR ~~BURGNER~~ 25/10

2. CHIEF SECRETARY

cc PS/Chancellor
PS/FST
Sir P Middleton
Mr Anson
Mr Monck
Mr Waller or
Mr Parkinson or
Mr Moore
Mrs Brown
Mr MacAuslan
Mr A White
Mr Guy
Mr Rutnam

BRITISH SHIPBUILDERS AND THE NORTH EAST

1. Mr Newton's letter of 24 October reports that none of the bids for BS' NESL yard look likely to be successful. He means to announce very soon the closure of NESL. Mr Rifkind's letter to Mr Newton of 18 October comments on the package of remedial measures which Mr Newton has been preparing for use if NESL closes.

<u>NESL Closure</u>

2. Mr Newton's letter shows that none of the four bids received for NESL is satisfactory. The financial position of the bidders would not guarantee the yards' long-term future. There would be difficulties with the European Commission. And the Cuban order would introduce further complications: they are looking for a letter of intent by 10 November 1988 and a markedly lower price (£9.2m) than the £10m previously expected.

3. Although it is just possible that there will be further developments in the course of today, the likelihood is that the Sunderland yards will have to close. Mr Newton would wish to make an announcement in the House of Commons very soon, although we understand that the proposal to make the announcement tomorrow 26 October 1988 has been dropped. You will wish to support Mr Newton's line, subject to the text of the announcement being cleared with officials.

Remedial Measures

4. Mr Rifkind suggests that if Mr Newton proceeds with his enterprise company proposal, it should be set up as an independent company specific to the NESL position rather than as a BS subsidiary. This would help avoid any pressure for the company to operate in Scotland as a response to job losses at any BS operation there. Mr Rifkind wants to see the enterprise company disassociated from BS in this way because:

- only funding for enterprise company operations in England has so far been agreed (between you and Mr Newton)

- DTI have told the Scots that if the company were to be active in Scotland, DTI would not fund it there

- and the Scots feel that, if necessary, their existing employment initiatives can deal with any BS redundancies in Scotland.

5. For our part, we would agree that it is desirable to set up the company in such a way that any pressures for it to extend its activities beyond the North East are minimised. We would certainly not be prepared to offer the Scots access to the Reserve to fund the enterprise company for activities in Scotland, if DTI are not prepared to fund it. Mr Rifkind's proposal that the company should be separate from BS is, therefore, an attractive one.

6. There are also other reasons why we think this idea should be supported:

(i) soon all the BS subsidiaries will have been sold: it will be anomalous if the Corporation then has nothing to do <u>except</u> administer remedial measures though an enterprise company subsidiary;

(ii) we are worried that by entrusting these measures to BS, and its existing senior management, we shall not be able to exercise sufficient control over their implementation; and

(iii) as and when we want to wind BS up for good, we shall not want to have a decision delayed because the Corporation continues to be responsible for remedial measures (which may last beyond March 1992).

7. Mr Newton's letter of 24 October 1988 expresses the hope that DTI will be able to set up an independent company for the remedial activities. You will wish to encourage that hope. Mr Newton floats the idea that the company should be a joint venture with local private sector interests. You will wish to make the point that there should be a proper degree of control over implementation. The involvement of the private sector raises the possibility of reducing the public sector funding of the remedial measures. But given the difficulties of reaching the existing agreement and the small sums involved I do not recommend that you seek to re-open this issue.

8. Mr Rifkind goes on to say that, if the enterprise company cannot be separated from BS, the resources of the company should be available throughout the UK without any additional contribution from Scottish Office funds. You will wish to make clear that any extra funding should not be assumed from the Exchequer.

9. Mr Rifkind also argues that he intends to keep the option of enterprise zones open if a major closure were to arise in the future in Scotland, and that he may consider an extension of the zone in Inverclyde if there are unfavourable developments in

relation to BS subsidiaries there. You will wish to emphasise your concern about any such extension and restate the Government's policy of avoiding any general extension of the enterprise zone experiment.

10. A draft letter is attached.

11. This has been agreed with PE.

MR

M ROMBERG
IAE2/Ext.4662/114G

Draft letter from the Chief Secretary
To: Mr Newton

BRITISH SHIPBUILDERS AND THE NORTH EAST

Thank you for your letter of 24 October 1988. I have also seen a copy of Malcolm Rifkind's letter of 18 October 1988 to you.

I agree in principle with your decision that NESL must close, and that there should be an early announcement. I am content with the line you propose to take, subject to your officials clearing the text with mine.

I see some attractions in your and Malcolm's suggestion that the enterprise company should, if this is possible, be run as an entity that is separate from BS, and not as a subsidiary of the Corporation provided there are suitable powers available to DTI to establish such an independent company. It is clearly important to ensure that the company is seen to be a response to the particular employment problems of Wearside, following the closure of NESL, and not as a response to <u>all</u> the redundancies caused by closure of BS facilities. Your and Malcolm's proposal seems to be a way of achieving that.

I am also concerned to ensure that we exercise a proper degree of control over the implementation of these measures. This would, I think, also be easier to achieve if the company were a separate entity, reporting directly to your department, and not a subsidiary of BS.

Whatever form the company takes, I would not expect to make available additional Exchequer resources beyond those agreed in the Survey to fund enterprise company consequences of British Shipbuilders' redundancies throughout the UK.

As regards new or extended enterprise zones, it is announced Government policy that a general extension of the experiment is undesirable and it is important that we avoid undermining this policy. They have proved costly in the past and as I said earlier I would not expect further zones to be designated.

Copies of this letter go to the Prime Minister, Malcolm Rifkind, Members of E(UP) and to Sir Robin Butler.

JOHN MAJOR

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the department for Enterprise

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 3AQ

CHIEF SECRETARY

REC.	25 OCT 1988
ACTION	Mr Gray
COPIES TO	CX, FST, Sir P Middleton, Mr Anson, Mr Monck, Mr Moore, Mrs Brown, Mr Waller, Mr Armitage, Mr Rutnam, Mr Call

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 25 October 1988

Dear Chief Secretary,

BRITISH SHIPBUILDERS: NORTH EAST SHIPBUILDERS LIMITED

In my letter of yesterday I said that I expected to announce the closure of the NESL yards tomorrow, Wednesday 26 October. I explained that only a last minute development of an unexpectedly significant kind would lead me to change this plan.

Last night British Shipbuilders received an unsolicited amendment to one of the bids which modified the terms in a way which could be presented by the bidder as a substantial improvement. An announcement tomorrow would be criticised as providing evidence that we had already made up our minds and were not even prepared to consider substantial improvements. This line is already being run hard in the local press in the North East and follows on the reported emergence of further possible orders the same bidder now anticipates from a member of his consortium.

Accordingly, I have asked John Lister to ensure that each of the bidders is given an opportunity to offer final amendments so that I can fairly claim that every avenue has been explored. The BS advisers, Lazards, have invited material by noon on Friday 28 October. This is with a view to a statement on Thursday 3 November.

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the department for Enterprise

I do not expect for one moment that I shall wish to change my conclusions from those set out in my letter of yesterday. I do however, think it is important to demonstrate that we are thoroughly exploring all the possibilities.

I should also emphasise that there is no prospect of any further delay beyond Thursday 3 November. As I reported yesterday, the Cubans, on whom two of the bidders are relying for a future workload for NESL, have asked for a letter of intent by 10 November. To wait until after 3 November would take us beyond when a preferred bidder would have sufficient time in which to provide the required letter.

I am copying this letter to the Prime Minister, Norman Fowler, Malcolm Rifkind, Tom King, Nicholas Ridley and John Wakeham and to Sir Robin Butler.

Yours sincerely,

Peter Smith

PP TONY NEWTON

(Approved by the Chancellor and signed in his absence)

OC4AAI

cst.ps/9jm26.10let

CONFIDENTIAL

cc:
PS/Chancellor
PS/FST
Sir Peter Middleton
Mr Anson
Mr Monck
Mr Burgner
Mr Romberg
Mr Waller
Mr Parkinson
Mr Moore
Mrs Brown
Mr MacAuslan
Mr A White
Mr Guy
Mr Rutnam

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P

The Rt Hon Tony Newton OBE MP
Chancellor of the Duchy of Lancaster
and Minister of Trade and Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1

26th October 1988

Dear Tony,

BRITISH SHIPBUILDERS AND THE NORTH EAST

Thank you for your letter of 24 October 1988. I have also seen a copy of Malcolm Rifkind's letter of 18 October 1988 to you.

I agree in principle with your decision that NESL must close, and that there should be an early announcement subject to the further consideration mentioned in your letter of yesterday. I am content with the line you propose to take, subject to your officials clearing the text with mine.

I see considerable attractions in your and Malcolm's suggestion that the enterprise company should, if this is possible, be run as an entity that is separate from BS, and not as a subsidiary of the Corporation provided there are suitable powers available to DTI to establish such an independent company. It is clearly important to ensure that the company is seen to be a response to the particular employment problems of Wearside, following the closure of NESL, and not as a response to <u>all</u> the redundancies caused by closure of BS facilities. Your and Malcolm's proposal seems to be a way of achieving that and I hope it can be implemented.

I am also concerned to ensure that we exercise a proper degree of control over the implementation of these measures. This would, I think, also be easier to achieve if the company were a separate entity, reporting directly to your department, and not a subsidiary of BS.

Whatever form the company takes, I would not expect to make available additional Exchequer resources beyond those agreed in the Survey to fund enterprise company consequences of British Shipbuilders' redundancies throughout the UK.

As regards new or extended enterprise zones, it is announced Government policy that a general extension of the experiment is undesirable and it is important that we avoid undermining this policy. They have proved costly in the past and as I said earlier I would not expect further zones to be designated.

I am copying this letter to the Prime Minister, Malcolm Rifkind, members of E(UP) and to Sir Robin Butler.

Yours Ever,

John

JOHN MAJOR

DEPARTMENT OF ECONOMIC DEVELOPMENT

NETHERLEIGH
MASSEY AVENUE
BELFAST
BT4 2JP

Telephone 63244

FINANCIAL SECRETARY
REC. 31 OCT 1988
ACTION Mr. A. M. White
COPIES TO PPS, CST
Mr. Anson, Mr. Monck
Miss. Peirson
Mrs. Buchanan Mr. Call

2

The Rt Hon Norman Lamont MP
Financial Secretary to
the Treasury
Treasury
Parliament Street
LONDON
SW1P 3AG

27th October 1988

Dear Norman,

JAMES MACKIE AND SONS LTD

I wrote to you on the 5 October to update you on the position on finding a private sector investor for Mackies.

Both Howdens and Lummus Industries Inc have now made offers to acquire Mackies. The Mackies Trustees have considered these offers and prefer the Howden approach. I am due to meet the Mackies Trustees on Tuesday 1 November. Currently we expect Howdens to make a formal proposal for IDB support within a month. IDB's formal offer should then be available in mid-December.

In view of the satisfactory progress which is now being made I have proposed that the existing Bank Guarantee of up to £2m should be extended from 31 October to 30 November.

Yours ever,

Peter.

PETER VIGGERS MP
Parliamentary Under
Secretary of State

CONFIDENTIAL

dti

the department for Enterprise

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

pps pse

Department of
Trade and Industry

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Rt Hon Malcolm Rifkind QC MP
Secretary of State
Scottish Office
Whitehall
LONDON
SW1A 2AU

CHIEF SECRETARY
REC. - 1 NOV 1988
ACTION Mr Gray
COPIES TO Cx, FST, Sir P Middleton, Mr Anson, Mr Monck, Mr Moore, Mrs Brown, Mr Waller, Mr Anthwaite, Mr Rutnam, Mr Call

Direct line 215 5147
Our ref
Your ref
Date 31 October 1988

Dear Malcolm,

BRITISH SHIPBUILDERS AND THE NORTH EAST

Thank you for your letter of 18 October. Although I fear the absence of suitable alternative powers may still mean my enterprise package for Sunderland will have to be provided through a subsidiary company of British Shipbuilders, I am quite clear that the new company will be limited in application to the area covered by Sunderland Borough Council and that it will not have a role elsewhere.

Nor will it be presented as connected with British Shipbuilders. All shades of opinion in Sunderland have stressed to me how important it is that my package should be divorced as far as possible from British Shipbuilders and be seen as home grown. To that end, I have it in mind to subsume the identity of the measures under the wing of an initiative for Sunderland being spearheaded by local business people. Given all this, and the key importance of the Sunderland yards for the town as perceived locally, I am confident that I shall be able to meet your concerns.

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the department for Enterprise

In the light of this I doubt there is any need to pursue the issue of funding possible remedial measures in Scotland. I should say, however, that my predecessor made abundantly clear on a number of occasions that this would be your responsibility. Having just settled a PES round where my bid for a package of measures related solely to Sunderland, I could not now consider diverting some of this to meet your concerns. If you do not think such measures would be sufficiently important to fund at the expense of your own programmes, that is your decision. But as I say, I hope this issue will not arise.

Copies of this letter go to the Prime Minister and the members of E(UP) and to Sir Robin Butler.

Yours ever,

Tony

TONY NEWTON

OC4ABI

CONFIDENTIAL AND COMMERCIAL IN CONFIDENCE

FROM: MRS T C BURNHAMS
DATE: 31 OCTOBER 1988

1 MR WHITE ✓ AW 31/10

2. FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Mr Anson
Mr Monck
Miss Peirson
Mr Call

JAMES MACKIE AND SONS LTD

In his letter of 27 October Mr Viggers reports the latest position in the search to find a private sector investor for Mackies,and on their financial position.

2. Mr Viggers mentioned the interest being shown in the company by the Howden Group and Lummus Industries in his letter of 5 October, and in his latest letter he confirms that both have made offers for Mackies. The Trustees of Mackies favour Howden's proposals and a formal application for IDB support is expected within a month.

3. In my minute of 6 October I explained that assistance totalling £18.75m was likely to be required by Howdens, and Mr Viggers accepted that the Chancellor would need to be formally consulted before any agreement was finalised. Mackies was one of the subjects for discussion at E(A) on 6 October and the Sub-Committee confirmed that the Chancellor should be consulted on the size, nature and phasing of the Government dowry which would form part of the rescue package. The Secretary of State was asked to report back to E(A) within two months if the matter had not been resolved.

4. In view of the advanced state of the negotiations, and in order to avoid any unnecessary delay in formally assessing the assistance package Howden's are proposing, I recommend that you should invite Mr Viggers to forward these details as soon as they are available. If the terms resemble those outlined to us previously by Northern Ireland officials, it would be a conventional financial assistance package and would be within the EC ceiling for net grant equivalent, but the cost per job is likely to exceed £25000.

5. Mr Viggers proposes that the current Bank Guarantees of £2m should be continued for a further month to the end of November. This accords with the agreement of E(A) that limited action should be taken to secure the survival of the company.

6. I attach a draft reply which notes the continuation of the existing Bank Guarantees for a further month, and asks for details of Howden's application for assistance as soon as possible.

Teresa Burnhams

TERESA BURNHAMS

DRAFT LETTER FROM FINANCIAL SECRETARY TO

P VIGGERS ESQ MP
PARLIAMENTARY UNDER SECRETARY OF STATE
NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SWIA 2AZ

JAMES MACKIE AND SONS LTD

Thank you for your letter of 27 October.

I am very pleased to hear that both Howdens and Lummus Industries have made offers to acquire Mackies, and that the financial problems of the company may be soon resolved.

As you know the future of Mackies was discussed at E(A) on 6 October and that it was agreed that the Chancellor should be consulted on the size, nature and phasing of any Government assistance. I note that you expect to receive a formal proposal for IDB assistance from Howdens (the company favoured by Mackies' Trustees) within a few weeks, and it would be helpful to receive full details of the proposed package as soon as possible.

Finally you propose to extend the existing Bank Guarantees until the end of November. It is reassuring that the position of the company has improved sufficiently so that the Guarantees do not need to exceed £2m, as they did in the summer, and it is to be hoped that they can be ended altogether before too long.

DEPARTMENT OF ECONOMIC DEVELOPMENT

NETHERLEIGH
MASSEY AVENUE
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BT4 2JP

Telephone 63244

FINANCIAL SECRETARY
REC. 31 OCT 1988
ACTION Mr. A. M. White
COPIES TO PPS, CST
Mr. Anson, Mr. Monck
Miss. Peirson →25/2
Mrs. Buchanan Mr. Call

The Rt Hon Norman Lamont MP
Financial Secretary to
the Treasury
Treasury
Parliament Street
LONDON
SW1P 3AG

27th October 1988

Dear Norman,

JAMES MACKIE AND SONS LTD

I wrote to you on the 5 October to update you on the position on finding a private sector investor for Mackies.

Both Howdens and Lummus Industries Inc have now made offers to acquire Mackies. The Mackies Trustees have considered these offers and prefer the Howden approach. I am due to meet the Mackies Trustees on Tuesday 1 November. Currently we expect Howdens to make a formal proposal for IDB support within a month. IDB's formal offer should then be available in mid-December.

In view of the satisfactory progress which is now being made I have proposed that the existing Bank Guarantee of up to £2m should be extended from 31 October to 30 November.

Yours ever,

Peter

PETER VIGGERS MP
Parliamentary Under
Secretary of State

COMMERCIAL IN CONFIDENCE

RS81FST.42

CC: Chancellor, CST, Mr Anson, Mr Monck, Mr White, Mrs T.C. Burnhams, Miss Peirson, Mr Call.

Treasury Chambers, Parliament Street, SW1P 3AG

P Viggers Esq. MP
Parliamentary Under Secretary of State
Northern Ireland Office
Whitehall
London SW1A 2AZ

31 October 1988

Dear Peter

JAMES MACKIE AND SONS LTD

Thank you for your letter of 27 October.

I am very pleased to hear that both Howdens and Lummus Industries have made offers to acquire Mackies, and that the financial problems of the company may soon be resolved.

As you know, the future of Mackies was discussed at E(A) on 6 October and it was agreed that the Chancellor should be consulted on the size, nature and phasing of any Government assistance. I note that you expect to receive a formal proposal for IDB assistance from Howdens (the company favoured by Mackies' Trustees) within a few weeks, and it would be helpful to receive full details of the proposed package as soon as possible.

Finally, you propose to extend the existing Bank Guarantees until the end of November. It is reassuring that the position of the company has improved sufficiently that the Guarantees do not need to exceed £2m, which they did in the summer. It is to be hoped that they can be ended altogether before too long.

How do the 2 offers compare?

NORMAN LAMONT

dti
the department for Enterprise

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

CHIEF SECRETARY
REC. - 1 NOV 1988
ACTION Mr Guy.
COPIES TO CX, Sir P Middleton
Mr Anson, Mr Monck
Mr Burgner, Mr Moore
Mrs Brown, Mr Turnbull
Mr Call.

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
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Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5147

Our ref
Your ref
Date 31 October 1988

Dear John.

APPLEDORE FERGUSON SHIPBUILDERS LTD: DEVON YARD

Thank you for your letter of 11 October.

My officials have studied the table of closure and disposal cost estimates produced by your officials. You mention the need for independent advice on the validity of the closure cost figures. Price Waterhouse, who endorsed the original closure cost estimate of £10m, are acting as our independent advisers. Their terms of reference as BS's auditors allow them to respond to requests from my Department on any aspect of the Corporation's business. Your officials were represented on the panel which appointed PW in June 1987, and will be aware of the terms of reference.

PW's assessment of the £10m closure cost estimate was that, in their view, it was a reasonable figure to use, given the difficulties of managing a closure. My officials asked PW for further advice following your letter. The result of this exchange is that, even allowing for an estimate by your officials that may be too stringent in a number of respects, the closure cost would still not be lower than £8.4m compared to disposal of £7.3m.

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dti

the department for Enterprise

I attach a copy of your table to which a further column has been added based on the most recent information. To take individual elements:

(a) <u>Liquidated damages and closure bonus</u>:

I understand your officials' estimate assumes a closure bonus of 13 weeks, in line with earlier closures. BS had made the not unreasonable assumption that 26 weeks would be necessary to contain severe industrial relations problems that could be expected against a background of the final major closure of the Corporation. BS are prepared to offer a thirteen weeks bonus if closure were to take place, but I note also that your officials have omitted any liquidated damages. This is presumably on the assumption that payment of any closure bonus would obviate the slippages in building programmes on the remaining ships which would make liquidated damages payable. I have to say that recent past experience at Smith's Dock, which was closed early in 1987, does not bear this out. Closure bonuses were promised, but there was still some slippage. Had the corporation then withdrawn the promised closure bonus, a very tricky industrial relations problem would have ensued. For this reason, PW contend that a minimum provision of £0.6m for liquidated damages should be retained.

(b) <u>Net proceeds from property sale</u>:

The £4m proceeds are rounded up from £3.6m. In terms of the magnitudes under consideration, this is a sizeable rounding. I think it reasonable to stick to the £3.6m figure.

(c) <u>Rounding</u>

This is more accurately described as contingency, but in fact contains £0.2m for Directors' redundancies, in the event of those Directors not being redeployed within the corporation. It is now highly unlikely that such redeployment would occur. At the least, this figure should therefore be £0.2m.

To turn to the disposal cost estimates, I note that you have allocated £0.4m to the present value of tax losses. These amount to £2m which, at a rate of 35%, would amount to a concession of £0.7m. BS now point out that it will be some years before these losses can be fully utilised and the present value is therefore likely to be negligible.

As regards the Intervention Fund requirements of the Appledore yard in private hands, my letter of 6 September anticipated that these payments should not be so excessive as to put disposal costs out of line with closure costs. I did not quote numbers at that time, because Langham Industries, the preferred bidder for Appledore,had given my officials only a very notional order pattern. The PES bid of £9m which you mention was prepared on a different basis, in order to provide an estimate. It merely represented the cost of continuing Intervention Fund at the rate hitherto drawn down by Appledore, and included £2.5m in respect of existing work, which would be payable whether or not the yard were sold.

My officials have now had further discussions with Langhams, whose current estimate of required IF, based on specific orders they are pursuing, is £2.5m per year, or £7.5m over the PES period. This would reduce to around £6m in present value terms. Furthermore this estimate is also likely to prove on the high side, because it assumes an IF rate commensurate with a maximum of 28% under the Sixth Directive. If the ceiling comes down below 28%, as we strongly expect, there is no reason why the support for Langhams' new orders should be as high as £2.5m per year. Also, Langhams are mindful of the need to obtain profitable orders, and they are therefore working to secure a licence to build naval vessels for overseas customers. Such orders would not qualify for IF.

Finally, my officials currently expect that the £2.1m cost of disposal to BS may turn out to be too high as there is a strong chance that BS will negotiate a buyout of employment terms and conditions at a lower cost than was anticipated. BS concluded an agreement on 26 October with the national unions in respect of Clark Kincaid and expect a similar agreement at Appledore. On this assumption, the cost to BS of disposing of Appledore would fall from £2.1m to £1.7m.

I should of course also point out that your costings make absolutely no allowance for continuing Exchequer costs in respect not only of those who would be made redundant in the event of closure but also additional unemployment resulting from the closure of sub-contractors and other related businesses. I know we have not normally taken these costs specifically into account but I do think we should not lose sight of them completely.

dti

the department for Enterprise

Negotiations between BS and Langhams, at which my officials are present, are proceeding satisfactorily. I can now clarify the point on Langham's financial strength which I mentioned to you in my letter of 6 September. Langhams have satisfied Lazards and BZW, respectively financial advisers to BS and my Department, that they have the financial resources at their disposal to cushion a reasonable shortfall in their plans to improve performance and achieve a regular workload in the yard.

I hope you will now be satisfied with the disposal of Appledore subject to final agreement among the parties and notification to the European Commission. I will of course advise you of any further significant changes.

Yours ever
Tony

TONY NEWTON

OC4ABG

Estimated closure costs

	BS/DTI	Possible alternative	Latest
Continuing outgoings up to completion of existing work (net)	4.8	4.8	4.8
Redundancy costs	6.5	6.5	6.5
Closure bonuses	2.5	1.5	1.5
Liquidated damages	1.0	-	0.6
Net proceeds from property sale	(4.0)	(4.0)	(3.6)
Less overheads common to disposal option	(1.6)	(1.6)	(1.6)
Rounding	0.8	-	0.2
TOTAL	10.0	7.2	8.4

Possible Costs of Disposal

Net cost exclusive of IF and tax losses	2.1	2.1	1.7
IF (based on £3m per year, DTI PES bid, discounted at 10 per cent; assuming no IF beyond PES period)	?	7.5	6.0
Tax losses, estimated at p.v. of 'few £00,000 by DTI'	?	0.4	0.0
TOTAL	2.1 +?	10.0	7.3

CHANCELLOR OF THE EXCHEQUER
HONI SOIT QUI MAL Y PENSE

Chy/

NESL

I understand that Mr Newton may make his statement on this next Tuesday. You may like to ask him about this when you see him this evening.

JS
3/11

That is what he has a mini - Moira can organise.

cst.ps/1jm2.11

CONFIDENTIAL

cc:
Chancellor
Mr Anson
Mr Monck
Mr Burgner
Mr Edwards
Mr Moore
Mr Turnbull
Ms Brown
Mr Waller
Mr Parkinson
Mr Romberg
Mr Richardson
Mr Wood
Mr Betenson
Mr Fellgett
Mr Guy
Dr Harding
Mr Michie
Mr Pegler
Mr Richard Timmins
Mr Call

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London
SW1P 3EB

2 November 1988

Dear Secretary of State

PROPOSED ENTERPRISE ZONE AT SUNDERLAND

Thank you for copying to me your letter of 24 October 1988 to Tony Newton.

We are agreed that there is to be an Enterprise Zone at Sunderland if the NESL yards close. I understand your and Tony's wish to use Enterprise Zone designation to assist in the regeneration of the shipyard sites. I would be willing to be flexible in the selection of sites to be designated: some shipyard sites may be included within the agreed 150 acre total. And I am content with your suggestion of a study commissioned by the UDC to report by the end of the year provided that the eventual Enterprise Zone is within the terms of the earlier proposal which I agreed, namely that there is a single designation of no more than 150 acres and the costs are met within existing provision.

I fully share your hope that it will never be necessary again to have to use Enterprise Zones. In order to buttress this policy stance I would hope you can avoid an extension of the designation of the Sunderland Enterprise Zone by instructing the UDC to complete this part of its study quickly. The test of Tony's initial announcement might then refer not only to the need to obtain EC clearance, but also to the need to await the UDC's study before agreeing on detailed boundaries.

I note that you suggest returning to the question of possible resources for clearance of the shipyard sites in the 1989 Survey. I would be willing to consider a proposal to re-adjust your priorities within the Urban Group to give the UDC additional resources if justified in order to undertake the reclamation of the shipyard sites. However, since we have only recently considered overall urban provision in the Survey, I believe you should plan on the basis that no additional resources from the Exchequer will be made available to cover these costs.

I am copying this letter to the Prime Minister, Tony Newton and other members of E(UP), Paul Channon and Sir Robin Butler.

Yours sincerely

Carys Evans

JOHN MAJOR

approved by the Chief Secretary and signed in his absence pe.sh.misc.bg.2.11

CONFIDENTIAL

I agree. It is difficult to argue for closure - but DTI must be forced to rep state tightly.
MEB 2/11

FROM: W GUY

DATE: 2 NOVEMBER 1988

1. MRS BROWN

2. CHIEF SECRETARY

cc: Chancellor
Financial Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Burgner
Mr Moore
Mr A M White
Mr Rutnam
Mr Call

APPLEDORE FERGUSON: DEVON YARD

I attach a draft reply to Mr Newton's letter of 31 October.

2. I hope it is largely self explanatory. The background is that Mr Newton originally compared a closure cost of £10 million with a cost of £2.1 million for disposal to a company called Langhams. You wrote on 11 October suggesting that actually disposal would cost £10 million and closure only £7.2 million. Mr Newton now says that disposal would cost £7.3 million, and his estimate of closure costs has come down from £10 million to £8.4 million. The gap thus stands at £1.1 million in favour of disposal.

3. But it is actually very finely balanced. If costs were incurred beyond the PES period, or if the net proceeds from land disposal under the closure option were higher, the balance would swing in favour of closure. There is a number of other points of doubt about the latest DTI costings, set out in the draft letter.

4. I have drafted on the assumption that in a case like this you will want Mr Newton to have the benefit of the doubt - I expect that closure of Appledore would be difficult politically. But I recommend that in that case we insist on a charge over the value of the land involved in the disposal, so that if it is cashed in eg, for redevelopment as a marina, the Exchequer takes the profit and not Langhams. (This might be very difficult for Langhams, who are probably relying on the asset value to arrange finance.)

Bill Guy

W GUY

CONFIDENTIAL

Draft letter to Mr Newton

APPLEDORE FERGUSON SHIPBUILDERS LIMITED: DEVON YARD

Thank you for your letter of 31 October.

I note the latest estimates from your Department which suggest that the cost of closure could be £8.4 million compared with a cost of £7.3 million if the yard is sold to Langhams.

I note also that Price Waterhouse, who originally endorsed a closure cost of £10 million, are now endorsing a significantly lower estimate in response to some fairly basic observations about what is involved. This does not make it easy to have confidence in ~~what they are now saying.~~ the latest estimate.

I have a number of points. First, the assumption by my officials that payment of closure bonuses would obviate liquidated damages was made on the strength inter alia of advice from BS, at a meeting attended by your officials, that it should not be necessary to allow for both bonuses and damages. And frankly, I find it a strange idea that we should pay sizeable bonuses to people, who would also be benefiting from the very ~~extraordinarily~~ generous BS redundancy terms, as a result of their ~~reward for~~ failing to complete work on time so that we had to pick up a bill for breaches of contracts.

I do ~~have to~~ wonder whether costs of the order ~~a properly commercial enterprise, faced with the kinds of issues we have here, would be contemplating the kinds of costs~~ which PW have now endorsed are commercially justified. Could not the existing work be transferred to other yards to mitigate the additional costs of £2.1 million which PW estimate it will cost to finish them at Appledore?

As to the cost of closure bonuses, £1.5 million was of course a rough estimate by my officials. Based on detailed information in the management accounts, I understand that ~~which~~ ~~from your officials~~ ~~do not dissent~~, the cost of a 13 week bonus should not exceed £1.3 million.

Turning to proceeds from disposal of the property, I believe that the figure of £3.6 million assumes costs of disposal and maintenance before disposal of some £1 million. This seems very high. I think it will in any case be essential for your Department to keep a charge on the property so that in the event of new owners cashing it in, we are not criticised.

On Intervention Fund costs, it is of course difficult to know what they would be if Langhams took on the yard. As you say, the EC may reduce the maximum support rate. This could mean that £2.5 million a year was on the high side. But on the other hand there could be costs beyond the PES period, which we should not ignore, unless the EC eliminates support by 1992 or we act unilaterally within the EC maximum. This would put your estimate of £6.0 million on the low side.

It seems to me that with the cost of closure bonuses lower by £0.2 million, set off against damages so that at most £0.4 million is allowed under that heading, then if the property disposal were assumed to raise £4.0 million net and the IF costs were put at only £6.5 million, we would be comparing a closure cost of £7.6 million with a disposal cost of £7.8 million. This assumes that Langhams do indeed negotiate down to a disposal cost of £1.7 million instead of £2.1 million.

The position seems finely balanced to me. I do not wish to cause you difficulties out of proportion to the money involved, but we need to be able to defend ourselves against possible criticism of the BS disposal programme. I think it essential, as a minimum safeguard of our position~~s~~, that we do indeed limit the negative consideration for the yard to £1.7 million or less if possible, and that the terms include a charge on the value of the site. Beyond that, I should be grateful if my officials could see the terms of PW's assurance about the minimum closure costs which a competent liquidator could achieve.

On this basis, I would be content for negotiations with Langhams to move to a final position, but I would of course like my officials to have a chance to comment before commitments were made.

JOHN MAJOR

chex.rm/jmt/47 COMMERCIAL IN CONFIDENCE

FROM: J M G TAYLOR
DATE: 3 November 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
Mr Anson
Mr Monck
Miss Peirson
Mr A M White
Mrs Burnhams
Mr Call

JAMES MACKIE AND SONS LTED

The Chancellor has seen the Financial Secretary's letter of 31 October to the PUSS/NIO. He has asked how the two offers for Mackies, from Howdens and Lummus Industries, compare. I should be grateful for advice from ST.

J M G TAYLOR

CONFIDENTIAL

the department for Enterprise

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Department of Trade and Industry

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

CHIEF SECRETARY
REC. - 3 NOV 1988
TO Mr Burgner
CxFST Sir P Middleton
Mr Anson, Mr Monck,
Mr Walley, Mr Parkinson,
Mr Moore, Mrs Brown,
Mr MacAuslan, Mr A White
Mr Gray, Mr Romberg
Mr Rutnam.

Direct line 215 5147
Our ref
Your ref
Date 3 November 1988

Dear Chief Secretary,

BRITISH SHIPBUILDERS: NORTH EAST SHIPBUILDERS LTD

I promised the House on 26 October that every avenue would be explored before a decision on the future of North East Shipbuilders is made. There have been two further developments.

First, in the wake of unfruitful discussions in August between BS and two Japanese shipbuilders about NESL, a third has made contact with BS representatives in Japan. This yard is not part of an industrial group like its predecessors, but is privately owned by a major businessman who is to see BS representatives later this week. His shipbuilding people are said to be keen on making a bid.

While it would be very difficult to make a Statement announcing the closure of the yards in advance of such a meeting, I shall require very clear evidence of serious interest to delay matters further. On the other hand, if the interest proves serious, it could well cost less than the total cost to the Exchequer of closure.

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dti

the department for Enterprise

Second, although none of the original bids is satisfactory, Lloyds Bank is seeking to restructure the consortium they have supported with their Cuban interests in mind. They have already sought to involve Tate & Lyle, which has existing interests in shipbuilding and in Cuba. Again I shall not give credence to their efforts unless powerful evidence is forthcoming quickly that leads John Lister to believe he could make a positive recommendation about the consortium.

In view of these developments, I concluded that I could not make an announcement today as I had previously intended. I attach a copy of the on the record briefing used by the DTI press office today. I will keep you closely in touch with developments. I expect to write again early next week.

I am sending copies of this letter to the Prime Minister, with whom I discussed the position in the House on Tuesday night, John Wakeham and to Sir Robin Butler.

Yours sincerely,

Peter Smith

pp TONY NEWTON

(Approved by the Chancellor and signed in his absence)

OC5ABK

BRITISH SHIPBUILDERS

On the record briefing by DTI, 3 November

The evaluation of the bids, including in some cases revisions made late last week, has not yet been completed. BS are seeking additional information in respect of one of the bids. Moreover, the Department has been informed that further talks are due to take place shortly on the possibility of a Cuban order which could affect the assessment of the bids.

In these circumstances, BS and their advisers have not yet been able to provide Ministers with final advice. Ministers recognise that a decision needs to be taken as quickly as possible but are concerned to ensure that every avenue has been fully explored.

OC5ABE

COMMERCIAL IN CONFIDENCE

PPS PA (cm-bt.)

FROM: A M WHITE
DATE: 4 NOVEMBER 1988

CHANCELLOR

Thanks.

cc Chief Secretary
Financial Secretary
Mr Anson
Mr Monck
Miss Peirson
Mrs Burnhams
Mr Call

JAMES MACKIE AND SONS LTD

Your asked for advice about how the two offers for Mackies compare.

2. Neither we nor Northern Ireland officials have full details of the confidential negotiations that are taking place between Mackies' Trustees and the two companies interested in acquiring the business.

3. This is the inevitable consequence of the Government having no stake in Mackies itself.

4. The Secretary of State has been sustaining Mackies by guaranteeing part of its borrowing, thereby encouraging its bankers to leave its overdraft facilities in place so as to buy time to act as marriage broker.

5. This tactic has been successful in that two suitors have appeared, and the presence of the second, Lummus, has resulted in an improved offer to the Trustees for the shares of the company from the first, Howdens.

6. While we do not know the details of these offers, we understand that the Trustees are recommending Howdens' revised offer to the company's ultimate owners- the past and present employees of Mackies, who are the beneficiaries of the Trust. They did not feel able to recommend the Lummus offer, although we understand that Lummus are also considering making a second offer.

7. We also understand that a factor influencing the Trustees was doubt over whether Lummus, a company of about the same size as Mackies, had the necessary financial strength to take on Mackies and turn it round.

8. Your proposal to Mr King that he should use a "dowry" to create a reverse auction has been effective in that while both the bidding companies have been operating against the background of the same outline package of Government assistance to the "new Mackies", the cost of that package is less than the £20m that Mr King previously claimed was the minimum necessary. It also avoids any direct Government stake in the company, consisting of standard industrial support mechanisms available to any company carrying on business and industry in plant and equipment in Northern Ireland.

9. In terms of Howdens' plans for the new business, which are more developed than Lummus', the likely cost of assistance would be £18.75m made up of selective capital grants, employment grants and an up-front loan of about £3m.

10. Lummus' original offer would have resulted in a smaller business, with a resultant lower entitlement to assistance. But we do not know whether the revised offer they are considering making would increase the scale of the operation they originally had in mind.

11. A firm offer of assistance, which Mr Viggers is to clear with the Financial Secretary, will only be made when negotiations with the successful suitor have been concluded by Mackies' Trustees. Our expectation is that Howdens will acquire Mackies and the assistance package will be that outlined in paragraph 9, which we would regard as acceptable in the circumstances of this case, and which falls within EC limits.

AMW

A M WHITE

CONFIDENTIAL

FROM: M PARKINSON

DATE: 4 November 1988

1. MR WALLER
2. CHIEF SECRETARY

cc PS/Chancellor
PS/Sir Peter Middleton
Mr Anson
Mr Phillips
Mr Monck
Mr Burgner
Mr Turnbull
Mr Richardson
Mr A. White
Mr Guy
Mr Betenson
Mr Call

BRITISH SHIPBUILDERS AND THE NORTH EAST

1. Mr Newton has replied on 31 October to Mr Rifkind and Mr Ridley on various aspects of the remedial measures if the NESL shipyards close.

Sunderland Enterprise Company

2. Mr Rifkind had suggested that the proposed Enterprise Company should be independent rather than a subsidiary of British Shipbuilders to limit any precedent for Scotland. You wrote on 26 October supporting Mr Rifkind, subject to legislative powers being available. Mr Newton has replied that suitable alternative powers do not exist. We understand that DTI's lawyers have examined the possibilities thoroughly. However Mr Newton meets Mr Rifkind's main concerns by emphasising that the new company will be limited in application to the area covered by Sunderland Borough Council and that it will not be presented as connected with British Shipbuilders, but rather will be subsumed under the wing of an initiative for Sunderland being sponsored by local business people. He suggests that there is therefore no need to pursue the issue of funding possible remedial measures in Scotland, although warns that he would not be prepared to fund such measures if the issue did arise.

3. We do not recommend that you intervene further at this stage. We can pursue at official level the arrangements for establishing

the Enterprise Company to ensure that it is divorced as far as possible from British Shipbuilders and that satisfactory monitoring and control arrangements are established.

Enterprise Zone

4. Mr Ridley and Mr Newton are concerned to include some of the shipyard sites in the proposed Sunderland enterprise zone. Mr Romberg's submission of 31 October provided the background and recommended that you agree subject to having a single rather than an extended designation and subject to no additional overall PES resources for site reclamation. You wrote on 2 November to Mr Ridley.

5. In his reply to Mr Ridley, Mr Newton offers that BS should be prepared to cooperate in disposing of surplus facilities even though this may eventually result in marginally higher closure costs. He does not indicate clearly how this would be funded. If the site clearance is uncommercial, with costs exceeding disposal proceeds, this could lead to a higher BS external financing requirement, potentially a call on the Reserve. We would therefore wish to make clear that either BS site disposal should be on commercial terms, or, as with clearance by the UDC under Mr Ridley's programme, any higher closure costs should be absorbed within either DOE or DTI's existing provision.

6. A short draft letter is attached. Alternatively if you prefer a letter can be sent at official level.

7. This has been agreed with PE.

Mark Parkinson

M PARKINSON

CONFIDENTIAL

DRAFT LETTER FROM THE CHIEF SECRETARY TO MR NEWTON

I have seen a copy of your letter of 31 October to Nick Ridley.

I see no difficulty with British Shipbuilders cooperating in the clearance of the shipyard sites at Sunderland on the basis that the site clearance is to BS's commercial advantage in disposing of the yards, and that the costs of clearance are recovered in higher sale proceeds. If clearance cannot be done on this commercial basis, I would expect such costs to be met within your and Nick's existing provision, as I have already made clear in respect of any UDC costs within Nick's urban expenditure.

I am copying this letter to the Prime Minister, members of E(UP), Paul Channon and Sir Robin Butler.

CONFIDENTIAL

dti

the department for Enterprise

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon Nicholas Ridley MP
Secretary of State
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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Fax 01-222 2629

Direct line 215 5147
Our ref
Your ref
Date 31 October 1988

Mr Gray
CX, FST, Sir P Middleton
Mr Anson, Mr Monck, Mr Moore
Mrs Brown, Mr Waller
Mr AM White Mr Rutnam
Mr Call.

Dear Nick

NORTH EAST SHIPBUILDERS LTD SUNDERLAND

Thank you for your very helpful letter of 24 October.

I would certainly like to make reference to the establishment of the Enterprise Zone in the statement I now plan to make on 3 November. I also appreciate the caveat about your urgently consulting the European Commission. However, provided we are prepared to assure Peter Sutherland that we shall take steps to avoid windfall gains and that the Commission's principles on the cumulation of aids is observed, I am confident we should have no difficulty in securing the Commission's agreement. These were, I believe, conditions the Commission required in order to approve the Inverclyde Enterprise Zone.

Subject to these points, I have Peter Sutherland's assurance that he will do all he can to help, given the reduction in excess merchant shipbuilding capacity which closure of the shipyards would help to achieve.

You raise two related points about the future of the land presently occupied by the yards. Normal practice is for BS to meet the costs of disposal, including any necessary clearance, from disposal proceeds. I am prepared for BS to do this at

OC4ABH

Sunderland. But BS have always disposed of surplus facilities to their commercial advantage and you are suggesting a study on future uses for the sites, including the point about the two stage EZ.

I have no difficulty with a study which leads to well planned development in Sunderland. However, especially as you suggest it should be conducted by the UDC, I am sure it is best regarded and paid for as in the interests of your Department. In return, I am happy to put it to BS that they should be prepared to co-operate, even though this may eventually result in marginally higher closure costs.

I am copying this letter to the Prime Minister, members of E(UP), Paul Channon and Sir Robin Butler.

Tony

TONY NEWTON

OC4ABH

CONFIDENTIAL

dti

the department for Enterprise

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon Malcolm Rifkind QC MP
Secretary of State
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Mr Gray
Cx EST Sir P Middleton
Mr Anson, Mr Monck, Mr Moore,
Miss Brown, Mr Waller,
Mr AM White Mr Rutnam
Mr Call

Direct line 215 5147
Our ref
Your ref
Date 31 October 1988

Dear Malcolm,

BRITISH SHIPBUILDERS AND THE NORTH EAST

Thank you for your letter of 18 October. Although I fear the absence of suitable alternative powers may still mean my enterprise package for Sunderland will have to be provided through a subsidiary company of British Shipbuilders, I am quite clear that the new company will be limited in application to the area covered by Sunderland Borough Council and that it will not have a role elsewhere.

Nor will it be presented as connected with British Shipbuilders. All shades of opinion in Sunderland have stressed to me how important it is that my package should be divorced as far as possible from British Shipbuilders and be seen as home grown. To that end, I have it in mind to subsume the identity of the measures under the wing of an initiative for Sunderland being spearheaded by local business people. Given all this, and the key importance of the Sunderland yards for the town as perceived locally, I am confident that I shall be able to meet your concerns.

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In the light of this I doubt there is any need to pursue the issue of funding possible remedial measures in Scotland. I should say, however, that my predecessor made abundantly clear on a number of occasions that this would be your responsibility. Having just settled a PES round where my bid for a package of measures related solely to Sunderland, I could not now consider diverting some of this to meet your concerns. If you do not think such measures would be sufficiently important to fund at the expense of your own programmes, that is your decision. But as I say, I hope this issue will not arise.

Copies of this letter go to the Prime Minister and the members of E(UP) and to Sir Robin Butler.

Yours ever
Tony

TONY NEWTON

OC4ABI

chex.rm/jmt/64 **UNCLASSIFIED**

FROM: J M G TAYLOR
DATE: 7 November 1988

MR A M WHITE

cc **Chief Secretary**
Financial Secretary
Mr Anson
Mr Monck
Miss Peirson
Mrs Burnhams
Mr Call

JAMES MACKIE AND SONS LTD

The Chancellor was grateful for your note of 4 November.

J M G TAYLOR

CONFIDENTIAL AND COMMERCIAL IN CONFIDENCE

FROM: MRS T C BURNHAMS
DATE: 7 NOVEMBER 1988

1. MR WHITE AW 7/11

2. FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Sir P Middleton
Mr H Phillips
Mr Monck
Miss Peirson
Mrs Brown
Mr Call

You are to meet Mr Viggers, the Minister of State at the Northern Ireland Office, on Wednesday 9 November. I understand he wishes to discuss James Mackies, Harland and Wolff and other Northern Ireland issues.

2. I attach separate briefing on Mackies, Harland and Wolff PLC and Short Brothers PLC. It is surprising that Mr Viggers has not specified Shorts as a topic for discussion, as the aim is for the company's privatisation to take place within this financial year. You may therefore like to take the opportunity to discuss the latest position.

3. The Secretary of State reported progress on the search to find a private sector investor for Mackies, and on the privatisation of Shorts and Harlands at E(A) on 6 October, and was asked to report back again in December. He was asked also to keep Treasury Ministers in close touch with any developments. Mr Viggers is the Minister responsible for taking matters forward on all these issues.

4. Your letter of 31 October to Mr Viggers about suitors for Mackies asked for details of the Government assistance Howdens, the front runners,will be seeking. I understand Mr Viggers will be writing to you this week with further details and he may wish therefore to explain further the package under discusion. He will probably wish to convince you of the importance of the takeover to employment in West Belfast and the need for a speedy response from the Treasury. I understand IDB hope to evaluate the proposals by the middle of December and we would expect to be formally consulted soon after. There is no reason why we would not be able to respond quickly.

5. There has been little real progress so far with the two privatisations, and you will wish to reiterate the view of E(A) that urgent progress needs to be made, particularly on Shorts if the timetable is not to slip. On Harlands it can be regarded as good news that discussions with Mr Tikkoo have now ended, but an early assessment of the prospects of a sale to one of the other companies interested in the yard should be made.

6. It seems unlikely that either of these approaches will amount to a workable proposition, nor is it likely that the management buyout proposals being developed by Mr Parker- Harlands Chairman will be sufficiently well funded to make sense. It is therefore almost certain that, as E(A) envisaged, having explored these options Mr King will need to revert to the original rundown and closure of Harlands to end the drain on public funds that the company represents.

7. You may also like to ask Mr Viggers what plans there are for the privatisation of the Northern Ireland Electricity Service.

Teresa Burnhams

TERESA BURNHAMS

ANNEX 1

JAMES MACKIE AND SONS LTD

At E(A) on 13 July it was agreed that the Secretary of State should seek to find a private sector investor in Mackies rather than to mount a public sector rescue bid for the ailing company.

Background

2. Mackies is a long established privately owned West Belfast engineering company. It employs 1000 people in the manufacture of machinery for the textile industry. To increase its competitiveness and to ensure its survival the company maintained that it needed a minimum capital investment of £20m in new equipment and technology. Their plan was appraised by the IDB and the Secretary of State proposed a phased programme of Government funding.

3. The Chancellor was of the view that the option of a private sector takeover of the company should be explored further with the Government providing a dowry.

4. E(A) preferred the Chancellor's approach, and agreed that while the search for a suitor took place limited action could be taken to ensure the company's survival. This action took the form of guaranteeing part of the company's bank borrowing.

5. Two offers have now been made for the company. The most promising was from Howdens a Glasgow based engineering company who took over an East Belfast compny last year. Lummus Industries, an American Company also expressed an interest. The Trustees are recommending the offer from Howdens (which was improved after Lummus made a formal offer) to the past and present employees of the company who are the beneficiaries of the Trust, and thus the ultimate owners. We understand Lummus are considering a revised offer.

6. The negotiations which have taken place between Mackies' Trustees and the two companies have been confidential and therefore full details of the offers which have been made are not available. The factor that seems to have influenced the Trustees

in their decision was the doubts they had that Lummus, a company of about the same size as Mackies, would have the financial resources to take on Mackies and turn it round.

The Present Position

7. Howdens' plans for Mackies involve a total investment of £30m, and it is expected that Howdens will apply for £18.75m of Government assistance. This would be a conventional package of support available to any company carrying on business and industry in plant and equipment in Northern Ireland. The assistance will be in the form of selective capital grants(£8.25m), revenue assistance- mostly employment grants payable over five years(£7.5m), and an up-front loan of £3m. This approach avoids any direct Government stake in the company and is less than the £20m support the Secretary of State was recommending. We understand Howdens are to make a formal application for IDB assistance within the next few weeks and that an IDB assessment of their proposals for Mackies will be available by mid-December.

8. At E(A) on 6 October The Secretary of State was asked to consult the Chancellor on the size, nature and phasing of the Government dowry. He was also asked to consider, in consultation with the FCO and DTI, whether negotiations with the EC over the dowry were necessary. We understand that the package proposed would fall within EC limits.

9. Mr Viggers letter to you of 27 October confirmed that both Howdens and Lummus had made offers for the company, and that the existing bank guarantees for £2m were to be extended to the end of November. Your reply of 31 October asked for full details of the proposed Howdens' package as soon as possible. I understand this information will be provided this week.

Line to take

10. Any package of assistance would be sympathetically considered but it is essential to ensure that the business plan put forward by Howdens for Mackies will provide a viable future for the company. If Lummus were to put forward a revised offer which was more acceptable to Mackies' Trustees this should be considered on the same basis.

ANNEX 2

HARLAND AND WOLFF PLC

Mr Viggers announced in Parliament on 30 June that the Government will consider any proposals that might lead to the privatisation of Harland and Wolff.

Background

2.Harland and Wolff are due to complete work on the Auxiliary Order Replenishment vessel for the Ministry of Defence in 1990 and until Mr Tikkoo's proposal for the "Ultimate Dream" project was put forward there was no further work for the yard in prospect. The Government saw no future for Harland and Wolff in the public sector and at E(A) on 13 July it was agreed that the Secretary of State should pursue the negotiations for the sale of the company with Mr Tikkoo, as well as with any other private sector bidders who came forward. The parameters set for negotiations were that the total cost to the Government of the sale should not exceed the closure costs (estimated at £240m), and that the terms should be consistent with those agreed for the sale of Govan.

3. Mr Tikkoo's proposals for the acquisition of the yard proved unacceptable and following a counter-offer from Mr King, which was not acceptable to Mr Tikkoo, negotiations ended. This was announced on 19 October.

Present Position

4. Mr King reported to E(A) on 6 October that two further expressions of interest had been received. Bulk Transport Ltd. were considering whether they wished to build four very large crude carriers at Harlands, but were likely to require substantial Government support; and a Turkish company - UM Holdings AS- were also considering buying Harlands instead of establishing a new shipyard in Turkey. The Sub-Committee were clear that there had to be an end to the loss of public money at the yard and asked Mr King to report on the prospects for the company within two months. It has been agreed that Harlands will not be eligible to tender for future MOD orders while it remains in public ownership.

5. The Chairman of Harlands- John Parker has announced he is interested in mounting a management buyout and has it in mind to appoint Morgan Grenfell as his advisors. It is difficult to see how this could be a feasible proposition unless they could secure further orders for the yard, but there are rumours that Mr Parker may try to resurrect plans to build the " ultimate dream".

Line to take

6. Mr Viggers should be asked about the progress his officials have made in assessing the proposals put forward by the two outside companies who have expressed interest in the yard, and how this work is to be taken forward. He should also be asked if his officials have revised the initial estimate made for the cost of closure of the yard.

ANNEX 3

SHORT BROTHERS PLC

The trading performance of Shorts- an undersized competitor in the aerospace industry- has been poor for a number of years, and there was a marked deterioration in the last financial year.

Background

2. Last years performance was much worse than anticipated with a trading loss of £46m on a turnover of £250m. The cash requirement for the year proved to be £120m against an EFL of £52m. The company were found to have totally inadequate financial control and the Head of Finance and the Company Treasurer were dismissed.

3. A new Chairman Mr Lund was appointed earlier in the year and he was asked to produce his plan for the future direction and shape of the company. The main thrust of the Lund report was to advocate commitment to the FJX project, a new airliner to be developed in collaboration with as yet unsecured partners, plus a restructuring of the balance sheet to enable the business to be readied for privatisation in the 1990s. Mr King rejected the report. It is clear from official contact and from Mr Calls' note of his meeting with Richard Gordon that Shorts still regard the development of the FJX as presenting the best chance of ensuring the future profitability of the company.

4. The future of Shorts was discussed at E(A) on 13 July and it was agreed that the best course would be to privatise Shorts as it stood at the earliest date, and Mr King was asked to report back to E(A) in September. An announcement about the plan to privatise the company was made on 21 July.

Present Position

5. Shorts was discussed at E(A) on 6 October but Mr King could report little progress. A substantial ammount of interest had been shown in the acquisition of the company but some centred on the missiles division alone. Kleinwort Benson had been appointed as the Government's merchant banker advisors and discussions about the modus operandi, which spells out the working arrangements between the Government and Shorts, had taken place. Mr King wished to involve the company as much as possible, but the Treasury view

(which was endorsed by the Sub-Committee) was that while there was a role for the company to play, the Government could not delegate the accountability for taxpayers' money, and Ministers must clearly determine how the privatisation is to be handled, and how it is achieved.

6. Mr King was asked to provide a full report on the potential costs of the privatisation (including a description of Shorts' finances and the anticipated cost of disposal), and on any Government guarantees and Parliamentary assurances which had previously been given about the company's finances.

7. If Mr King's aim, of starting negotiations with interested parties early in the new year and concluding them by the end of the financial year, is to stand any chance of being met, a detailed timetable needs to be determined as soon as possible and adhered to. At our instigation a steering group of officials has been set up to monitor and where possible expedite progress on the privatisation. The first meeting of the group was held on 12 October, and the second is to held on 9 November; the Treasury is represented at the meetings.

8. Shorts have put forward proposals for recapitalisation of the company. This would take the form of an immediate cash injection from the Government of £300m, which the company considers would improve their trading position and provide much needed confidence. In our view it would be unwise to commit the Government to that expenditure until a clearer picture emerges of the terms that might be required to secure a satisfactory privatisation of Shorts. In order to avoid a series of payments being considered separately, and to minimise the cost to the Government of the disposal of Shorts, the recapitalisation of the company, including the extinguishing of their outstanding debts - currently standing at over £300m - should be considered as part of the negotiations for the sale. We understand that Kleinwort Benson share this view and Shorts have been told that their proposals would create difficulties with the EC, which they have accepted.

9. Although the aim is to secure the sale of Shorts before the end of the financial year, there is a real risk that it will take

longer. One way of ensuring that part of the cost is met from the 1988/89 Reserve would be to replace the company's short term borrowing requirements from commercial sources with direct public expenditure. Mr King's paper to E(A) confirmed that this option is being considered, and we are exploring the practicalities of this approach at official level.

Line to take

10. Mr Viggers should be asked to outline the progress that has been made towards the privatisation of Shorts, and for his views on whether a sale within this financial year is practicable.

cst.ps/10jm7.11

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CHIEF SECRETARY TO THE TREASURY

cc:
PS/Chancellor
PS/Sir Peter Middleton
Mr Anson
Mr Phillips
Mr Monck
Mr Burgner
Mr Turnbull
Mr Richardson
Mr Waller
Mr Parkinson
Mr A White
Mr Guy
Mr Betenson
Mr Call

Treasury Chambers, Parliament Street, SW

The Rt Hon Tony Newton OBE MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1H OET

7th November 1988

Dear Tony,

BRITISH SHIPBUILDERS AND THE NORTH EAST

I have seen a copy of your letter of 31 October to Nick Ridley.

I see no difficulty with British Shipbuilders co-operating in the clearance of the shipyard sites at Sunderland on the basis that the site clearance is to BS's commercial advantage in disposing of the yards, and that the costs of clearance are recovered in higher sale proceeds. If clearance cannot be done on this commercial basis, I would expect such costs to be met within your and Nick's existing provision, as I have already made clear in respect of any UDC costs within Nick's urban expenditure.

I am copying this letter to the Prime Minister, members of E(UP), Paul Channon and Sir Robin Butler.

Yours Ever, John

JOHN MAJOR