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SECRETARY OF STATE (B&L)

cc PS/PUS (B&L)
① PS/Sir K Bloomfield ✓ 28/9
Mr Semple ① DED
Mr Gibson
Mr McDonnell
Mr Thomson
Mr Caldwell
Mr McConnell, ESL
Mr Murphy
Mr Greer
MC

E(A) MEETING ON 6 OCTOBER

I attach an advanced copy of the E(A) paper on Shorts and H&W.

This is subject to alteration particularly as I am meeting Mr Rodney Lund this evening to discuss the modus operandi.

PETER VIGGERS

28 September 1988

✓ Approved by the Minister
and signed in his absence 7

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To: 1. PS/Mr Viggers (B&L) - M
2. PS/Secretary of State (B&L)

From: D Fell, DED

cc PS/PUS (B&L) - M
PS/Sir K Bloomfield
Mr Sample
Mr Gibson
Mr McDonnell
Mr Thomson
Mr Caldwell
Mr McConnell, ESL - M
Mr Murphy
Mr Greer

E(A) MEETING ON 6 OCTOBER

INTRODUCTION

1. The Secretary of State is to report back to his colleagues on 6 October with proposals for returning Shorts to the private sector. It has been suggested that the papers should also report progress on H & W and Mackies.
2. Attached are draft contributions to the E(A) Memorandum on Shorts and H & W for consideration by the Secretary of State. The draft on Shorts takes into account the views of DFP, NIO and the initial comments of HM Treasury.

SHORTS

3. The paper seeks to give a broad indication of the plans for the privatisation of Shorts and will have attached as an Annex the 'modus operandi' as agreed with the company. Kleinwort Benson have confirmed the view that this will not be an easy privatisation given the company's poor financial record, problems with aircraft production activity, etc and the E(A) Memorandum reflects this view.
4. It is also necessary for E(A) to agree an EFL for 1988-89. The company's latest forecast is for an end year EFR of £70 million (£82 million forecast in Chairman's June review less £12 million savings identified recently). The current

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level of in-year borrowings is £114 million and, given difficulties with SD360 and missile sales, officials have reservations about Shorts' ability to live within an end-year figure of £70m. However, it appears appropriate to use this figure to maintain pressure on the company though the Secretary of State will wish to alert his colleagues to his reservations.

HARLAND AND WOLFF

4. Also attached is a draft of a contribution to the composite paper briefly setting out progress on the privatisation of Harland and Wolff. The draft contribution has been agreed with NIO and DFP but not yet cleared with HMT. This contribution proposes an EFL for Harland and Wolff for 1988/89 of £62.3 million. ~~[This is marginally higher than the company was predicting earlier and we are urgently seeking cost savings by the company.]~~

MACKIES

5. I understand that it is also intended that the paper should outline the position on Mackies and that IDB is submitting a contribution separately.

David Fell

DAVID FELL

27 September 1988

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LEFT NO 3

SHORT BROTHERS PLC

MEMORANDUM BY THE SECRETARY OF STATE FOR E(A) ON 6 OCTOBER 1988

PRIVATISATION

1. At our meeting on 13 July I undertook to report back in September with my proposals for returning Shorts to the private sector.
2. We announced to the House on 21 July our readiness to consider suitable proposals that might lead to the sale of Shorts. I have agreed with the Board that the company will, if possible, be sold as a single unit, but if this objective is not achievable on acceptable terms within a reasonable time other options will be considered.
3. Realistically disposal can be achieved only by sale to a company or consortium in the aerospace industry therefore it makes sense to utilise the company's knowledge of the industry and the Chairman's previous experience of privatisation at the National Bus Company while, of course, retaining ultimate responsibility for the exercise. I have decided therefore to involve the company as much as possible in the process. Attached at Annex A is a [draft] memorandum

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which sets out the proposed working arrangements for the sale process.

4. A number of enquiries have been received although certain of these are for parts of the company rather than the company as a whole. An initial information pack on the company will be issued to companies expressing an interest. Subsequently a more detailed sales memorandum will be issued to those considered to offer the best prospects for a successful sale. The aim will be to hold detailed negotiations with the front-runners early in 1989, with the sale being agreed if possible by the end of March 1989. This timescale would be most suitable as the Chief Secretary has indicated his preference for any necessary financial restructuring to be carried out in this financial year.
5. The company and its advisers (Barclays de Zoete Wedd) have proposed that an initial injection of funds is made to restore the company's capital base and improve viability while the sale process is in train. I have asked my officials and our merchant bank advisers (Kleinwort Benson) to examine the company's proposals. Once their comments have been received and considered I shall consult with the Chief Secretary. We will of course have to bear in mind the likely strong interest of the European Commission in the matter not only because of the BAe/Rover experience but also

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implications for competition policy given the likely sizeable injection of funds.

6. But this is only an initial injection. The company's aircraft production activity, which accounts for over 40% of its total workforce, presents a particular problem for potential buyers. Accordingly, to persuade a suitable purchaser to both take over the company and continue this activity will require further substantial financial incentives. Merchant bank advisers are also assessing the alternative cost of a rapid rundown of the business.

EFL

7. In July I reported a serious cash problem in the company and, since then, I have been pressing the Chairman and the Board to take action to stem the outflow of funds. To date the company has identified possible in-year savings amounting to £12m in a predicted end-year EFR of £82m. However sales prospects for the SD360 and export missiles continue to cause concern and consequently these savings could well be wiped out. While I still continue to demand further savings we have to recognise that the long cycle time of the aerospace industry makes short term savings very difficult to achieve.

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8. The in-year ERF is now' [] and the company's latest forecast is that it will peak at some £131m in November. In spite of this, the company continues to maintain its forecast of £70m (£82m as projected in the Chairman's June review less £12m savings). Although colleagues will agree that this appears 'very optimistic and we must recognise the unlikelihood of it being achieved, there is merit in seeking to force the company to keep to its own target. I propose, therefore, that we set an EFL of £70m.

RECOMMENDATIONS

9. I recommend that colleagues:-

(1) note the proposals for carrying forward the privatisation of Shorts;

(2) agree to set an EFL of £70m for 1988-89.

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REVISED MODUS OPERANDI

1. The Government has agreed that Short Brothers plc will, if possible, be sold to the private sector as a single unit, and the Government and the Board will work closely together to achieve this objective. If either the Government or the Board considers that this objective is not achievable on acceptable terms within a reasonable time, they will discuss other options.
2. This memorandum sets out the proposed working arrangements between ~~with~~ the Chairman and the Board of Shorts, and ~~also~~ the Government. These arrangements will be operated subject at all times to the requirements (as determined by Government in its absolute discretion) of public and parliamentary accountability.
3. The procedures have been drawn up on the basis that neither management nor members of the Board will have any financial or other interest in the purchase of the company. If such an interest occurs, or appears likely to occur, the Board will immediately inform Government.
4. The method of executing the sale, the criteria by which the purchaser will be selected, and the terms of any sale agreement will be agreed by the Board with the Government. The Government and Board will determine the timetable along with their advisers.
5. Both the Government and the Board will keep the other party fully informed as the sale process proceeds.
6. The Board will be responsible, in accordance with arrangements agreed with Government, for publicising the sale. The Board may also, subject to prior agreement with Government, make direct approaches to potentially interested parties. Such approaches will also be made by

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the Board to such parties as Government considers appropriate.

7. Public announcements related to the sale will be made primarily by the Board subject to prior approval of the Government. The Government will consult the Company in advance with respect to all statements it intends to make about its privatisation, although Parliamentary pressure may require the Government to respond to questions without consultation. Should this occur the Board will be advised immediately of its content.
8. The Board will agree with the Government the detailed criteria by which offerors will be either rejected or selected at each stage. Government does however reserve the right to consider any offer which it considers to be appropriate.
9. All information will be passed to potential offerors by Kleinwort Benson and Barclays de Zoete Wedd jointly as financial advisers to the Government and the Board.
10. It is recognised that both the Government and the Board will have a role in the negotiations with potential purchasers. The respective roles will be determined at the time, subject at all times to the caveats included in paragraph 2. The Government will be responsible for all dealings with the European Commission.
11. It is recognised that in securing its objective of the sale of the Company to the private sector, Government shall have regard to its most cost-effective method of achieving a sale and that matters affecting this will be determined by Government. This does not imply that cost will be the sole determining influence in the selection of a purchaser.
12. The Board will prepare an initial information pack. This information pack will be agreed with Government and

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circulated to such, parties (as agreed by the Board with Government) as have shown an interest in the purchase of the Company either by direct contact or as a result of the agreed advertisement. Such respondents will be asked to submit expressions of interest to the Government and the Board via Kleinwort Benson or Barclays de Zoete Wedd, together with certain information on themselves and indicating their intentions were they to acquire the Company.

13. The Board will prepare a draft sale memorandum which will contain an outline description of the business, including its historic and current financial results. The structure and content of the memorandum will be agreed with Government and be drawn from the Accountant's Report which will be commissioned jointly by the Government and the Board. The cost of this exercise will be shared.
- 13A. The memorandum will be circulated to a list of prospective purchasers jointly selected by the Board and Government from those responding to the information pack (but see paragraph 6 above). Government does however reserve the right to send memorandum to other prospective purchasers which it considers appropriate. Offerors will be asked to submit formal proposals, with an indication of the price they are prepared to pay, subject to any conditions that they might put forward. The Chairman will copy all responses received by Shorts to Government.
14. Further detailed information on the Company will be supplied by the Board only to offerors that meet criteria agreed by the Board with the Government, and who will be expected to enter into negotiations on the basis of that information.

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E(A) ON 6 OCTOBER 1988

HARLAND AND WOLFF PLC

Privatisation

When we met on 13 July to discuss Harland & Wolff, colleagues endorsed the policy of trying to privatise the company and agreed that I could negotiate with prospective interested parties within the parameters of the Govan deal and for a cost not exceeding the cost of closure.

With the assistance of Lazard Brothers, my officials have been engaged in discussions with three interests:-

Tikkoo Cruise Lines (TCL) put forward a proposal which I consider totally unacceptable. We have, after consulting Treasury and other colleagues, put forward a counter proposal well within my negotiating parameters. In the unlikely event that TCL decides to accept, considerable difficulties remain because of the need for TCL to raise funding for the P3000 project and for the acquisition of the yard. Following a discussion with colleagues, ECGD has put to TCL alternatives as to how it could be involved, but we still await firm evidence of commercial backing for this project.

Bulk Transport Ltd (BT), a shipping company involved in crude oil transportation and backed by US, UK and Saudi Arabian interests, has submitted an outline proposal for an acquisition of the Yard. We have responded in general terms and along the lines agreed for TCL. Following discussions involving its merchant bankers, BT will be putting forward a firm proposal based on a programme of four very large crude carriers (VLCCs) with an option for two more.

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UM Holdings AS (UM) - a Turkish shipping and petrochemical company - has now appointed merchant bankers to draw up a proposal which would involve the building of tankers and bulk carriers.

EFL

Due to the uncertainty about the future strategy for H&W at the beginning of this financial year and the position regarding P3000, a formal EFL for 1988/89 was not set. As a control, however, the company was set an informal limit of £25m up to September 1988, to which it has adhered. Based on the company's latest financial projections and on my Department's monitoring of H&W's current contract performance, the total external funding required for 1988/89 is expected to be £62.3m. This is broadly similar to that for 1987/88 (£63.2 m). It is made up of £52.0m for trading, £8.4m for redundancies, and £1.7m borrowed *provided* commercially by the company under Government guarantee for work in progress on AOR.

I would ask colleagues to note the position on negotiations with prospective purchasers, and for their agreement to a formal EFL for H&W for 1988/89 of £62.3m.

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