PRIVATISATION OF HARLAND & WOLFF AND SHORTS

FURTHER MEMORANDUM BY THE DEPARTMENT OF ECONOMIC DEVELOPMENT

ESTIMATE OF LIKELY COST OF GOVERNMENT POLICY

HARLAND & WOLFF PLC

1. In July 1974, in anticipation of the company being taken into public ownership, Government gave an assurance to Harland and Wolff that in the last resort it would meet all the liabilities of the company to enable it to continue trading. This undertaking is confirmed by letter to the company each year and is referred to in its accounts. In contrast to Short Brothers plc, the company's borrowing is provided by the Government rather than by commercial banks although in conjunction with the conditions attached to the award of the AOR contract, the company has a bank overdraft facility (underwritten by Government) of £4.6m. At 31 March 1988, outstanding loans were £366m and the company showed other current and future liabilities of £90m in its accounts.

2. The basis of proposals which the Government has discussed with possible acquirers of the company is as follows:

   (a) Intervention aid on orders proposed: This varies depending on the nature and value of the orders in question but could be up to 26% of the admissible costs of building the vessels.

   (b) Assistance towards planned expenditure during a transitional period: Each proposal has contained specific restructuring and capital expenditure plans which have been the subject of detailed negotiation.

   In addition, the Government has offered to meet:-

   (c) Existing liabilities: This includes ship financing costs (for earlier ship buildings), and miscellaneous creditors, approximately £63m at 31 March 1988.

(d) Restructuring of Debt: Writing off the outstanding loans shown as £366m in the balance sheet at 31 March 1988 but now about £400m.

(e) Losses on Existing Contracts: The provision for prospective losses is shown in the accounts for 1987/88 as £27.9m, at 31 March 1988. Annex D of the Department's earlier Memorandum provides financial information on the SWOPS and AOR vessels. The company's latest internal forecast shows a further worsening of the loss position.

3. The cost of privatisation would depend upon the proposals made by a possible acquirer but would be influenced by the elements at (a) to (e) above. Until negotiations with interested parties are completed it will not be possible to assess the cost of privatisation.

4. The cost of closure would depend on a number of factors including the elements at (c) to (e) above plus the cost of redundancies and any further losses which could be incurred if productivity on the last of the yard's present orders declined further. It is, therefore, difficult to predict precise figures but for the purposes of setting parameters on negotiations with potential purchasers it has been assumed that the cost of closure could be in excess of £200m.

SHORT BROTHERS PLC

5. The Department of Economic Development has provided a number of direct guarantees to certain of Short's creditors, primarily banks lending funds and providing sales financing to the company. In addition to these specific guarantees, the Government has stated in Parliament that those dealing with the company could do so in the knowledge that in the last resort it would ensure that creditors had their claims

fully met. On 21 July 1988, the Government confirmed this commitment for the period leading up to privatisation. The Government intends to ensure that when Shorts is privatised it will have a capital structure which will enable it to operate without the need for these assurances, which will then be withdrawn so far as new obligations are concerned.

6. The Government accepts that in fulfilling the commitments made in Parliament, it takes responsibility for meeting the existing liabilities of Shorts, in the event that the company is unable to do so. However the purchaser of Shorts will be expected to make appropriate arrangements to assume responsibility for the commitments of Government to third parties in respect of Shorts' obligations. The liabilities of the company can be grouped into the following categories; borrowings, sales financing obligations, customers, suppliers and trade creditors, and other liabilities.

7. Each of these are considered briefly below.

(i) Borrowings

Total borrowings of the company at 31 March 1988 amounted to approximately £261m, of which some £55m had been guaranteed specifically by DED. There are no borrowings from Government.

(ii) Sales Financing Liabilities

Shorts has entered into a number of arrangements to enable the financing of sales of aircraft, primarily in the USA. Under these arrangements, aircraft are sold by Shorts to US financial institutions which lease the aircraft back to Shorts. Shorts then sub-leases the aircraft to airlines. The liabilities of Shorts to meet the head lease rentals to the financial institutions are directly underwritten by DED. The extent of any liabilities which would fall on

Government would depend on a number of matters but the theoretical maximum exposure under a "worst case" scenario where no sub-lease income was received and Shorts was unable to meet its head lease rentals, DED would be liable for some \$330m, although under certain conditions approximately \$100m of this could be claimed from a group of banks under a Citibank Syndicated Facility.

Thirty five aircraft are subject to non-US sales financing arrangements although these do not follow a standard pattern, and only one benefits from a direct DED guarantee. Due to the varied nature of these arrangements and differing termination clauses etc it is difficult to be precise about the contingent liability but the theoretical maximum could be in the region of £40m.

(iii) Customers

Shorts provides certain guarantees and warranties on its aircraft sales and in the event of the company being unable to meet these, there is the possibility that Government assurances might be called upon. All of the contracts with major aerospace customers contain standard provisions for their cancellation by those customers, with Shorts - and therefore ultimately HMG - being responsible to meet the costs incurred.

(iv) Suppliers

Most liabilities to trade creditors are short term and those existing at the date of privatisation are likely to be discharged within a short period thereafter. There are a number of longer term contracts (eg for the supply of engines) which carry penalty clauses in the event of termination.

(v) Other

Like most companies Shorts has other liabilities including leases related to plant and machinery, certain property obligations employees being made redundant etc.

8. The final cost to Government of privatising the company cannot be quantified in advance of discussion with interested parties of their proposals. The Government has made clear its intention to inject funds into the company in advance of a sale which will be applied initially in repayment of its borrowings (approximately £261m at March 1988) and used also to give the company a proper capital structure which will enable it to operate without Government assurances.

PUBLIC EXPENDITURE PROVISION

9. The outturn figures for 1987/88 and the current Public Expenditure Survey provision for Harland and Wolff and Shorts is as set out below (in £000's):-

	1987/88 outturn	1988/89	1989/90	1990/91	1991/92
Harland & Wolff	57,940	59,750	59,981	59,731	61,224
Shorts*	6,650	5,500	5,100	5,010	5,006

*In addition to this, Government underwrites substantial commercial borrowings by the company to enable it to continue trading. In the last financial year these borrowings increased by approximately £113m.

10. These amounts reflect the estimated cost of continuing the present arrangements and not the estimated cost of privatising Shorts, or of privatising (or closing) Harland and Wolff. This is because the cost of privatisation of

either company can be determined only after negotiation with potential purchasers or, in the case of closing Harland and Wolff if there is ultimately no purchase of the company, on the basis of phasing of rundown to closure.

11. Since the outcome could not be foreseen no firm estimates were possible and no provision was made in the 1988 Public Expenditure Survey. Therefore not only the likely scale of expenditure but also its timing, in as far as costs fall in 1988-89 or 1989-90, would necessitate a call on the Contingency Reserve; any such costs arising in later years will need to be considered in the relevant Public Expenditure Survey, including, as appropriate, the matter of whether the scale of the requirement would warrant addition to the NI Block. Payments would be made from DED Vote 2 Subhead B1.

Department of Economic Development

30 January 1989