DEPARTMENT OF FINANCE & PERSONNEL NORTHERN IRELAND

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STORMONT
BELFAST
BT4 3SW

Mr A M White
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

24 February 1989

Dear Alan

HARLAND AND WOLFF: E(A) PAPER

In case it has not reached you through any other route I attach a copy of the draft section of the E(A) paper which was submitted to NI Ministers last night.

Yours sincerely

B. Crawley

pp J H CALDWELL

cc Mr Ritchie

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DRAFT No.5

HARLAND AND WOLFF

MEMORANDUM BY THE SECRETARY OF STATE FOR NORTHERN IRELAND

1. At our meeting on 1 December [E(A)(88)15th] I undertook to report in two months on progress towards the privatisation of Harland and Wolff.

2. At that time my officials were engaged in discussions with UM Holding AS (UM), Bulk Transport (BT) and with a Harland and Wolff management-led buy-out based on either the construction of the Ultimate Dream or 7 Sealink ferries. E(A) agreed that I should explore all of these prospects fully and report back at the beginning of February.

3. Progress of existing contracts and the company's financial performance are set out at Annex A.

UM Holding AS (UM)

4. These negotiations have been terminated.

Bulk Transport (BT)

5. The former executives of Bulk Transport have now refined their proposal based on 3 ULCCs plus an option for 1 more but this assumes support above EC levels. The company has been asked to provide further information on a number of important aspects but I am not optimistic about a successful outcome.

Management/Employee Buy Out (MEBO)

6. At our last meeting I notified colleagues of a proposal by the Chairman of H & W, John Parker, and his two senior directors to initiate a management/employee buy-out (MEBO). Since then Mr Parker has been seeking the involvement of an industrial partner to add weight to the proposal and private sector participation in the necessary performance guarantees.

7. In the last few weeks Mr Fred Olsen, a leading Norwegian businessman, has announced his willingness to participate. Mr Olsen's interests include North Sea ferry and support services, and property and a joint venture in tankers with Citibank. He previously owned and ran the Aker shipyard in Norway and has moved in and out of the tanker market. He is also a Director of Timex.

8. I met Mr Olsen recently and he clearly has the shipbuilding and shipowning background and experience which makes him a credible backer for the MEBO. He has written confirming his support for the proposed MEBO and I am satisfied that his interest is genuine. He has committee himself to invest up to £12m in equity and would bring definite orders for 3 Suezmax Tankers and management talent to the Yard.

9. Given the strength and experience which Mr Olsen's involvement would add, the proposal represents prima facie the best opportunity I have yet had for securing the company's future. I would hope fairly quickly to settle in principle the terms of a deal with the Olsen/MEBO team and, subject to the agreement of colleagues, to come back to E(A) as soon as possible with

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a firm proposal, which, if approved by E(A) colleagues, could then be taken to the EC Commission. In the meantime my officials will be discussing further the terms of the proposal with the principals and then will discuss them with HM Treasury officials.

10. As I made clear in my previous submission if I cannot achieve a successful privatisation of Harland and Wolff the alternative is closure. Colleagues have indicated that the cost of disposal of the company (including liabilities reserved to Government in the event of a sale) should be contained within the overall closure cost. The calculation of closure costs in the Harland and Wolff situation is a complex exercise given the nature of the projects which remain to be completed, and any estimate must involve a number of subjective assumptions. However based on our discussions with the company and with our independent experts, Touche Ross, our best estimate of the cost of closing the yard lies in the range of £220m - £245m. This estimate has been discussed with Treasury officials and it is accepted as a justifiable estimate of the cost of closure. However this figure excludes any contingency to provide for further problems on SWOPS and AOR and possible disruption following any closure announcement. Touche have suggested a minimum contingency figure of £30m though they recognise that this is a very judgmental area. On this basis the overall cost could be in the region of £275m. A breakdown of the total figure is contained in Annex B. In the event of a decision to run down and close the yard costs would be phased over the period 1989-1992. While I will do all that I can to accommodate closure figures (or indeed the cost of an acceptable privatisation deal) from the provision for H&W currently contained within the Northern Ireland block the incidence of these costs may be such that this is not possible in particular years and I could not therefore rule out the possibility of a call on the Reserve.

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11. The future of Harland and Wolff is a matter of enormous public concern in Northern Ireland. All three main local party leaders have come to see me and subsequently to see the Prime Minister to stress the consequences of closure for the regional economy. It is therefore vital that I both explore and be seen to explore all the privatisation possibilities. The Olsen possibility will not be without difficulty. But what I must seek is a proposal for colleagues which conforms to the criteria of a sale on the Govan/Kvaerner structure and which should not exceed costs of closure. My aim remains to relieve the NI Block of the drain on resources to underpin Harland and Wolff, while at the same time ensuring that the undoubted potential of the Yard's assets can be realised under the enterprise and self-discipline of a private sector owner. This is a tough proposition, but the prize, if achieved, will be very great in economic and other terms. Should this prove beyond reach closure would have to occur after delivery of AOR01 (February 1991) and remedial measures put in hand.

12. I ask colleagues to note this state of negotiations with both potential purchasers of Harland and Wolff

TK

Northern Ireland Office
24 February 1989

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ANNEX A

CURRENT POSITION AT HARLAND AND WOLFF

Current Progress on Existing Orders

SWOPS

1. This contract was awarded by BP in March 1985. The ship is expected to be completed at Harland and Wolff in November 1989 with a final handover, following sea trials and testing over a well-head, six months later. The vessel is structurally complete and floating. Commissioning of the operating and control systems for both the ship and the oil production facility is under way and is approximately 30% complete. These systems are technically novel and complex and progress could prove to be difficult, adding to the problems already incurred. The contract price for SWOPS is £105.7m and the latest estimate of the cost of completion is £164.8m.

AOR

2. The contractual delivery date for the MOD ship is October 1990. The keel was laid in the building dock in August 1988 and 42% of the steelwork has been erected within the building dock. There are slippages in some drawing office work and in detailed electrical design although there have also been improvements against programme in other areas. Pre-outfitting is progressing albeit more slowly than hoped. The latest forecast delivery date for the ship is February 1991 (with a float-out expected in mid-October 1989). The contract price per AOR is £137.3m and the latest estimate of the cost of completion is £148.9m.

Redundancies

3. The company issued on 31 January an HR1 (formal notification of redundancies) for the period between 1 May and 1 December 1989, covering a total of 470 people, of which 400 are manual workers and 70 are white collar. This would reduce the Harland and Wolff workforce to approximately 2,600 by the end of the year. The company continues to report the loss of several qualified managers.

Current Trading Position/Cash Requirement

4. The company's December 1988 financial forecast showed a reduced cash requirement which was budgeted at £60.6m of £45.1m for the financial year 1988/89. This lower figure is however due to slippages in contracts and consequential reduced requirement for materials.

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ANNEX B

BREAKDOWN OF TOTAL FIGURE OF CLOSURE COSTS

		£m
1.	Cost to complete existing contracts	105
2.	Underutilisation of labour and unallocated overheads	30
3.	Redundancies (3,180 employees)	40
4.	Incentive payments (linked to programme milestones)	10
5.	Residual ship financing and leases	35
6.	General closure costs	25
		245
7.	Contingency	30
		275

NOTES

1. The £105m Cost to Complete (£20m for SWOPS and £85m for AOR) includes an additional £25m which Touche Ross estimate would be a direct consequence of reduced productivity following a closure announcement. This would result in a total loss for each contract of £65m for SWOPS and £90m for AOR against current estimates of £45m and £12m respectively.

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2. The figure of £30m is included to take account of surplus labour and unallocated overheads against an annual rate (which 3,180 employees) of approximately £40. This underutilisation is due to timing and operational difficulties in matching resources to the demands of the contracts.

3. The figure of £40m includes £4.5m for redundancies up to 31 March 1989. The balance of £35.5m is for a phased reduction of the workforce of 3,180. It includes payments of £8m under the state scheme.

4. It is anticipated that an incentive payment scheme (at an estimated cost of £10m) would be implemented to motivate the workforce towards the achievement of key production milestones.

5. The figure £35m represents liabilities under ship financing agreements for previous orders (£21m), an interest free loan under the current SWOPS contract (£8m) and the buy-out of the remainder of the Belfast Harbour Commissioners' leases (£6m).

6. An estimate of £25m has been included for general closure costs which would be incurred in dismantling machinery and securing, clearing and making safe the site.

7. A further estimate of £30m has been added as a contingency to take account of possible industrial unrest and disruption, wilful negligence and the risks of criminal damage.