CABINET

CONCLUSIONS of a Meeting of the Cabinet held at 10 Downing Street, S.W.1, on Tuesday, 2 February, 1971, at 10 a.m.

Present:
The Right Hon. EDWARD HEATH, M.P., Prime Minister

The Right Hon. REGINALD MAULDING, M.P., Secretary of State for the Home Department

The Right Hon. LORD HAILSHAM OF ST. MARYLEBONE, Lord Chancellor

The Right Hon. WILLIAM WHITEWALL, M.P., Lord President of the Council

The Right Hon. Sir KEITH JOSEPH, M.P., Secretary of State for Social Services

The Right Hon. MARGARET THATCHER, M.P., Secretary of State for Education and Science

The Right Hon. THE EARL JELLICOE, Lord Privy Seal

The Right Hon. PETER THOMAS, Q.C., M.P., Secretary of State for Wales

The Right Hon. FREDERICK CORFIELD, M.P., Minister of Aviation Supply

The Right Hon. FRANCIS PYM, M.P., Parliamentary Secretary, Treasury

The Right Hon. SIR ALEC DOUGLAS-HOME, M.P., Secretary of State for Foreign and Commonwealth Affairs

The Right Hon. ANTHONY BARBER, M.P., Chancellor of the Exchequer

The Right Hon. LORD CARRINGTON, Secretary of State for Defence

The Right Hon. ROBERT CARR, M.P., Secretary of State for Employment

The Right Hon. GORDON CAMPBELL, M.P., Secretary of State for Scotland

The Right Hon. PETER WALKER, M.P., Secretary of State for the Environment

The Right Hon. JAMES PRIOR, M.P., Minister of Agriculture, Fisheries and Food

The Right Hon. JOHN DAVIES, M.P., Secretary of State for Trade and Industry and President of the Board of Trade

The following were also present:

Mr. MAURICE MACMILLAN, M.P., Chief Secretary, Treasury

The Right Hon. SIR PETER RAWLINSON, Q.C., M.P., Attorney-General
Secretariat:

Sir Burke Trend
Mr. P. E. Thornton
Mr. N. F. Cairncross
Mr. J. Crocker
Mr. B. G. Tucker
Miss S. W. Fogarty

CONTENTS

<table>
<thead>
<tr>
<th>Item</th>
<th>Subject</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Economic Affairs</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Rolls-Royce</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Upper Clyde Shipbuilders</td>
<td>10</td>
</tr>
</tbody>
</table>
The Prime Minister said that there had been extremely serious developments affecting the future of Rolls-Royce which had been considered at a number of meetings since the previous Thursday by a small group of Ministers under his chairmanship (GEN 16).

The Cabinet would recall that in the previous autumn Rolls-Royce had informed the Government that they required an additional £60 million to complete development of the RB 211-22 engine for the Lockheed trijet-aircraft which was due to enter service in November 1971. In November 1970 the Government had agreed to provide an additional £42 million by way of launching aid; and the banks had agreed to increase the company’s overdraft facilities by £18 million. This additional provision was subject to verification of the need for it by an independent accountant appointed by the Government, Sir Henry Benson of Cooper Brothers. None of this money had in fact been paid over to Rolls-Royce. The Board of Rolls-Royce had met on the previous Wednesday and had decided that the RB 211 engine could not be produced within the time and price specified in the contract; that the cost of developing the engine would be far in excess of the £60 million requested last autumn and that they would be liable to a very heavy indemnity to Lockheeds for failure to produce on time. The Board had accordingly decided to abandon development of the RB 211 and had decided that the company was in consequence no longer solvent and that a Receiver and Manager should be appointed by the Trustees to the Debenture Holders during the course of the present week (almost certainly on Wednesday, 3 February). When this decision of the Board became known to the Government, the small group of Ministers under his chairmanship had considered the following alternative courses of action:

(i) To accept cancellation of the RB 211 but to take over the company, accepting all its debts and obligations. The total estimated liabilities of the company consisted of £55 million to the Debenture Holders and secured creditors; £60 million to the clearing and merchant banks; £10 million to the Industrial Reorganisation Corporation; and about £70 million to trade creditors, making a total of some £195 million. In addition there would be a liability of somewhere between £40 million and perhaps £300 million to Lockheeds for breach of contract. This course would involve the Government in an open-ended commitment to meet the company’s obligations, which could total as much as £500 million.
(ii) To allow the appointment of a Receiver and Manager by the Trustees to the Debenture Holders and to take no action. They had been advised that no British company would be prepared to buy Rolls-Royce; and even if, as seemed unlikely, a United States company were found ready to take it over, the consequential dependence of United Kingdom air defence on a foreign interest would be unacceptable. Failure on the part of the Government to take any action would probably result in disintegration of Rolls-Royce's present activities and assets. Apart from the Royal Air Force and the Royal Navy, 81 foreign air forces and 200 airlines were dependent on continuing supplies and servicing of Rolls-Royce engines and would be in the gravest difficulties if the company disintegrated.

(iii) To allow Rolls-Royce to be forced into a receivership and then immediately to negotiate with the Receiver for purchase by the Government of the necessary fixed and floating assets of the company required to protect defence and civil airline interests, i.e. to take over the assets of the aero engine and marine engine parts of the company, leaving the motor car, oil engine and computer parts to be disposed of by the Receiver or liquidator. A takeover of part of the assets in this way from the Receiver would avoid the assumption by the Government of any obligation for the existing debts of Rolls-Royce or for the RB 211 contract with Lockheed. The necessary assets would be taken over at a valuation and placed in a new company which would carry on the necessary supply and servicing of engines. Sir Henry Benson had advised that such a company should be able to operate profitably; and, if this proved to be the case, the company could in due course be handed back by the Government to private interests or merged with European companies. The cost to the Government of purchasing the assets and providing the necessary working capital might be about £200 million.

The Ministerial Group had decided that there was no practical alternative but to adopt the last course; and the Minister of Aviation Supply was now arranging for the drafting of the Bill which would be required to empower the Government to acquire these assets.

The consequences of these developments would be very serious both at home and in the United States. The failure to complete the RB 211 engine could well entail the termination of the Lockheed trijet project; and this in turn might render the Lockheed Corporation itself insolvent, with severe consequences not only for the United States economy but for the United States Government's defence procurement. He had accordingly warned President Nixon in strict confidence of the problems which would now face the two Governments as well as the two companies. The industrial implications of
the cessation of work on the RB 211 were also very serious in this country. It was expected that some 18,000 of the 21,000 employed on the project by Rolls-Royce would become redundant within a few weeks. There would be a heavy impact on employment in Glasgow, where the male unemployment rate was already approaching 10 per cent and the difficulties of Upper Clyde Shipbuilders Limited (UCS) and Yarrow Shipbuilders Limited (YSL) had still to be resolved. If UCS and YSL also went into liquidation at the same time as work on the RB 211 engine was brought to an end, the combined effect would be to raise the male unemployment rate in Glasgow to about 15 per cent. Moreover, it was estimated that at least 20,000 further redundancies would occur amongst companies supplying material for the RB 211 programme.

Unfortunately, Rolls-Royce had given no prior warning to Lockheeds of these developments; and the Chairman of the latter company was arriving that day for a meeting with the Board of Rolls-Royce with no prior knowledge of the situation. In the circumstances it seemed likely that Lockheeds might ask for some time in which to consider the position; but in the end they could only save the position of Rolls-Royce by agreeing both to defer the delivery and to increase the price of the RB 211 engines. It seemed certain that, even if they were ultimately able to devise some solution on these lines, they would not be able to provide the immediate assurances which were required if the Board of Rolls-Royce were not to incur the legal risk of continuing to trade when they knew that they were insolvent. Similarly, if the Government provided any temporary financial assistance, they would become liable for the total debts of the company. Sir Henry Benson had been attending all the Board meetings of the company and keeping in close touch with the Minister of Aviation Supply. When the company was put in the hands of a Receiver, which would probably be on 3 February, they would issue a statement, the contents of which were the subject of discussion between the Board and the Minister of Aviation Supply. The latter would make a statement to the House of Commons, on present plans, on 3 February, explaining the Government’s intention to carry out the course which he had described. The Minister had also requested a statement from Rolls-Royce of the action, if any, which the company wished the Government to take on their behalf in present circumstances. They had not so far made any request for Government assistance; and it was very important that their position in this respect should be absolutely clear. Finally, the Chairman of Rolls-Royce had agreed to call an Extraordinary General Meeting of the company in order to pass a special resolution requesting the Secretary
the Minister of Aviation Supply said that he agreed that there was no practical alternative to the conclusions reached by the Ministerial Group. He was nevertheless concerned about the lack of advance notice to Lockheeds of the developments and about the fact that they would be given no time before the appointment of a Receiver on the following day to consider possible solutions to their problem. On the other hand Rolls-Royce clearly could not continue trading if they were insolvent, as they must be presumed to be in the absence of some completely unexpected offer from Lockheeds in the course of that day, involving not only major revision of the original contract for the RB 211 but also provision of their immediate cash needs. But, if a Receiver were appointed on the following day, it would still be possible for Lockheeds to negotiate with him suitable arrangements to continue development and production of the RB 211 if this was their wish and they could offer him acceptable terms. The Cabinet should be aware that, in addition to redundancies created in companies supplying Rolls-Royce, very serious financial problems would be created for some of Rolls-Royce's trade creditors. Lucas Limited, for example, were not merely owed some £4 million for supplies but had made an investment of £16 million especially for production of parts for the RB 211. A number of other suppliers, including Short Bros. in Northern Ireland and Scottish Aviation, would be very seriously affected financially and might no longer be considered credit-worthy by their bankers.

For these companies the fact that the existing credit ceiling would not prevent bank loans to companies satisfying the normal banking criteria of credit-worthiness would be no comfort. As for the failure of Rolls-Royce to produce the RB 211 on time, there was a consensus of view among technical experts that the development of this new engine by Rolls-Royce had run into no exceptional difficulties. The root of the matter lay in the fact that Rolls-Royce had signed an agreement with Lockheeds which did not allow adequate margins of time and costs to solve the problems which were inevitable in any new technological development on this scale. Rolls-Royce believed now that, given additional finance, they might be able to complete development of the RB 211 engine in a further six months. But other experts thought that it might take a year: and in fact no one could guarantee precisely how long it would take. A year’s delay would be extremely damaging for Lockheeds, who were already finding it difficult to compete successfully for orders with the DC 10 and who,
if the RB 211 engine was not available, would face the problem of substituting American engines in their trijet, a process which would involve a complete redesign of the tail section of the aircraft.

The Rolls-Royce Board had made it clear to him that they had not asked for any further Government financial assistance because they considered that it would not be sensible for them to do so. He had asked the Board to inform him accordingly in writing.

In discussion, there was general recognition that, if the Board of Rolls-Royce considered the company insolvent, they were in duty bound to cease trading and to ask the Trustees to the Debenture Holders to appoint a Receiver and Manager. New proposals from Lockheed to renegotiate the RB 211 contract and to forgo any claim on Rolls-Royce for penalties for late delivery of the engine would justify the Board in continuing to trade only if they themselves were satisfied that, as a result, the company had a reasonable prospect of again becoming solvent and of meeting their liabilities to their creditors in full. Although section 332 of the Companies Act, 1948, did not bind the Crown, it had been the consistent advice of the Law Officers to successive Governments that the Crown should act as if it were so bound; and neither the Crown nor Lockheeds could afford to advance the moneys which, failing the appointment of a Receiver and Manager, Rolls-Royce needed in order to meet current expenses without incurring an unlimited liability for the company’s present and future debts. In face of the conditional decisions already reached by the Board it would be improper for the Government to seek to persuade them to continue in business or to show any readiness to provide further funds in order to keep the RB 211 project alive.

On the other hand the appointment of a Receiver and Manager would allow the company’s incoming cash to be used to meet current expenses and would place a moratorium on further outgoings to its creditors. Provided that no creditor meanwhile forced the winding up of the company, the Receiver and Manager would be able to investigate further any proposal by Lockheeds to revise their contract in a manner which would make the RB 211 project viable and, if he thought fit, to conclude an agreement with Lockheeds to complete the engine. But the company’s lack of immediate cash made it difficult to see how any such arrangement could be concluded without substantial additional launching aid from the Government.

It was unsatisfactory that, despite Lockheed’s major interest in the completion of the RB 211 and the potentially severe consequences
to them of Rolls-Royce's failure, the latter had given them no prior intimation of the extent of their difficulties. It would be difficult for public opinion in this country and in the United States to understand why Lockheeds could be given no time now by the Board of Rolls-Royce to consider their position and to make proposals. Formally, however, this was justified by the fact that Rolls-Royce could not continue to trade when they were insolvent. The appointment of a Receiver and Manager was the only possible course in the circumstances; and the position of Rolls-Royce had already been reported to the Trustees to the Debenture Holders, who were deferring action only until the Board's discussion with Lockheed had taken place that day. In the light of that discussion, however, it might prove desirable in any subsequent Parliamentary statement by the Government to avoid giving the impression that the Board's decision to stop work on the RB 211 was irreversible. If there appeared to be any possibility that Lockheed would wish to try to secure continuance of work on the RB 211, the statement by the Government might be revised to make it clear that, in declaring an intention to acquire the assets of the aero engine and marine turbine divisions, the Government did not preclude the Receiver and Manager from negotiating a solution which might enable the company to be kept intact or, at any rate, to allow the RB 211 to continue. At the same time it would be necessary to avoid alterations in the draft statement which would have the effect of impairing the confidence of foreign Governments and airlines in the Government's resolve to ensure the continuity of supplies and servicing of the Rolls-Royce engines on which their aircraft were dependent or in our ability to continue with the international collaborative projects on which Rolls-Royce were currently engaged.

The Prime Minister, summing up the discussion, said that the Cabinet endorsed the conclusions reached by the Ministerial Group which had examined in detail the alternative courses now open to the Government. They agreed that the possibility of acquiring the whole of Rolls-Royce as a going concern must be dismissed. They also agreed that, when a Receiver and Manager was appointed, the Government could not simply stand back and leave it to chance whether some rescue operation could be arranged. Accordingly, the only tenable course, having regard to our defence and international interests, was for the Government, as soon as action to appoint a Receiver and Manager was taken, to state that they were ready to acquire the fixed and floating assets of the aero engine and marine turbine divisions of the company. Legislation to empower the Government to give effect to this intention, if necessary, was being prepared for urgent introduction. But the Cabinet would consider it a preferable outcome if it proved possible to reach an acceptable
arrangement with Lockheeds which would permit the RB 211 engine to be completed as a viable project. It was possible that the discussions with Lockheeds would enable the Board of Rolls-Royce or its successor, or the Receiver and Manager, to contemplate this course. Against that contingency an alternative version of the proposed Government statement should be drafted, making it clear that the Receiver and Manager would be in a position to negotiate with Lockheeds about the terms on which the RB 211 (and possibly the activities of Rolls-Royce as a whole) might be continued; but that, failing a solution on these lines, the Government would propose to acquire those assets of the company which were needed to ensure the continuance of activities important to our national defence, to our collaborative programmes with other countries and to the many air forces and civil airlines all over the world which relied on Rolls-Royce engines. The Ministerial Group would keep in close touch with further developments; and the Cabinet would be summoned at short notice, if necessary. It would be important that the public announcement of Rolls-Royce’s failure should be quickly followed by such action as it was possible for the Government to take to mitigate its adverse effects and to restore confidence. The Secretary of State for Employment would be taking steps to help to find alternative work for those becoming redundant; and the Chancellor of the Exchequer was in close touch with the Governor of the Bank of England about the effects on the Stock Exchange and the temporary assistance which might be provided by the banks for major creditors of the company who might need additional facilities. The secondary effects, for example upon Rolls-Royce’s subcontractors and other suppliers, could not yet be assessed in detail but would need sympathetic consideration. A preliminary examination had already been made of the additional measures of regional assistance which it might be possible to announce, particularly in relation to Scotland. If the expected announcement of the appointment of a Receiver for Rolls-Royce were made on or before 3 February, the Secretary of State for Scotland could announce in the course of the debate on that day in the House of Commons on Scottish economic planning that the Government would designate West Central Scotland as a Special Development Area.

The Cabinet—

(1) Took note, with approval, of the Prime Minister’s summing up of their discussion.

(2) Invited the Minister of Aviation Supply, in consultation with the Chancellor of the Exchequer and the Secretary of State
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2. The Chancellor of the Exchequer said that the Cabinet had agreed in December that shipbuilding credit guarantees in respect of orders placed with Upper Clyde Shipbuilders Ltd. (UCS) should be resumed and the reconstruction of their public loans approved only if there was a realistic possibility of the injection of substantial funds in UCS from elsewhere, if arrangements were made for the early closure of the Clydebank Yard, and if Yarrow Shipbuilders Ltd. (YSL) were separated from UCS. The first two conditions had now been met in a way which the Ministerial Committee on Economic Policy (EPC) accepted as satisfactory. The third condition had, however, presented difficulties. The proposal had been that Yarrow and Co., who already owned a 49 per cent interest in YSL, would buy out the 51 per cent interest of UCS. It had now emerged that YSL expected to make a loss of £4½ million on six frigates (three for the Royal Navy and three for export). The preliminary investigation by Ministry of Defence accountants had shown that the firm would shortly run into a cash deficiency of the order at the maximum of £5 million and lasting at least to 1974. Unless YSL's difficulties were overcome the separation from UCS would be impossible; such a separation was a condition for agreement by shipowners to renegotiate upwards the prices of the ships being built for them by UCS; failing such agreement, UCS itself would be unable to continue trading after Wednesday, 3 February. Thus although in other respects UCS had done what the Cabinet required of them, they now risked being brought down by the financial difficulties of YSL. The closure of UCS and YSL would lead to some 20,000 direct and indirect redundancies, sufficient to raise the male unemployment rate in Glasgow to well above 10 per cent. The additional cost of completing elsewhere the Royal Navy vessels in the yard was estimated at £3½ million plus some extra running costs for old frigates which would have to be kept in service longer. The export contracts of YSL worth £40 million, including three frigates, would be similarly affected and might be lost to the United Kingdom. This might lead to a loss of confidence by foreign buyers in the ability of British warship builders to complete their contracts satisfactorily. While further investigation would be needed of the position, the preliminary assessment of the Ministry of Defence accountants was that to enable YSL to complete
their current contracts and to continue trading legally some £4½ million was required of which only some £2 million could be repaid by June 1974. Whether the firm could be profitable thereafter would require further investigation, but any help should only be given on condition that the financial management was reorganised. EPC had agreed that YSL must be kept in business, while recognising that this could be an awkward precedent. It was not possible to reach a decision at this stage as to how assistance of £4½ million could best be given, whether by loan, direct grant, renegotiation of the prices attached to the existing contracts, or a combination of these. This would have to be discussed urgently with the companies. However, it would be easier to present the decision publicly without embarrassment to the Government's general industrial policy if the contracts were renegotiated. In any event, any assistance must be justified publicly on the grounds of cost to the Defence Vote of completing the frigates elsewhere. In negotiating with the companies the main object would be to ensure that Yarrow and Co. were prepared to take over UCS's 51 per cent share of YSL and so fulfil the remaining condition for saving UCS. He hoped the Cabinet would endorse the conclusions of EPC that YSL should be maintained in business, and would authorise the Secretary of State for Defence and the Secretary of State for Trade and Industry, in consultation with the Solicitor-General and the Chief Secretary, Treasury, to negotiate the best possible arrangements with Yarrow and Co. in the course of the day.

The Secretary of State for Trade and Industry said that UCS had been able to meet those of the conditions set by the Government for the resumption of credit guarantees and the capital reconstruction which were within their control. They would, however, from the following day be unable to continue trading legally without assurances as to their future; moreover, they would have no cash to meet further wages. Yarrow and Co. Ltd. had contracted in July to buy UCS's 51 per cent share in YSL but had not ratified this agreement. The essential first step was to get them to agree to implement it. If that were done, it would be possible for UCS to carry on for a few days to enable negotiations to be concluded.

In discussion the following points were made:

(a) EPC had considered the possibility of a Government takeover of YSL, but had decided that it would be preferable to arrange for an additional sum of up to £4½ million to be made available.
(b) While it would be more consistent with the Government’s general industrial policy to allow YSL to go into liquidation and for the Government then to acquire the assets or arrange with the liquidator for the vessels to be completed, this was not practicable in the present situation without also forcing UCS and Yarrow and Co. Ltd. into liquidation with the most serious consequences for employment in Glasgow.

(c) It was argued that the renegotiation of existing orders might have repercussions on naval orders placed with other yards and that a loan might therefore be preferable. On the other hand, the renegotiation of the naval orders could be more clearly represented as a move by the Government to protect its own interests on the same basis as the commercial shipowners were doing in respect of their orders with UCS.

(d) Provision of assistance to YSL in any form would make it more difficult for the Government to defend their refusal to provide bridging loans for the Mersey Docks and Harbour Board (MDHB) and for that Board to get its new Bill through Parliament. It would also increase the pressure on the Government to assist other harbour authorities, notably the Clyde, who were unable to raise money on the market following the default by the MDHB on their January bonds.

(e) Further enquiries should be made to establish whether any other naval shipyards were likely to be in serious difficulty. The effect of the Government’s various decisions on the ability of public bodies generally to raise money on the market might also be considered further.

The Home Secretary, summing up the discussion, said that the Cabinet endorsed the conclusion of EPC that YSL should be kept in business. The Secretary of State for Defence and the Secretary of State for Trade and Industry, in consultation with the Solicitor-General and the Chief Secretary, Treasury, should negotiate with Yarrow and Co. the best possible solution, including the transfer to the latter of the 51 per cent shareholding in YSL currently held by UCS, within a total cost of £4 ½ million provided to YSL in grant, loan or renegotiated prices (preferably the last). If it were not practicable for them to consult the Cabinet further before final decisions had to be taken to prevent the liquidation of the UCS, they were authorised to settle on the best basis obtainable. The Secretary of State for Defence should give further consideration, in consultation with the Chancellor of the Exchequer, to the possibility of containing the additional expenditure required within the existing defence budget.
The EPC might give further consideration to the points recorded at (e) above.

The Cabinet—

(1) Took note with approval of the summing up of their discussion by the Home Secretary.

(2) Invited the Secretary of State for Defence and the Secretary of State for Trade and Industry, in consultation with the Chief Secretary, Treasury, and the Solicitor-General to negotiate with Yarrow and Co. Ltd. on the basis indicated in the summing up of the discussion and to report the outcome to the Prime Minister.

Cabinet Office,