

PREM 19/1279



Confidential filing

The future of Ross Royce.

INDUSTRIAL POLICY

Part 1: July 1979

Part 2: November 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
15.11.79		2.3.81		16.11.83			
20.11.79		20.3.81					
21.11.79		16.5.81		13.2.84			
21.11.79		19.5.81		8.3.81			
7.12.79		1.6.81		16.3.84			
23.1.80		26.4.82		2.4.84			
29.1.80		6.5.82		6/1/84			
30.1.80		10.8.82					
11.3.80		1.9.82					
12.3.80		25.11.82		12.4.84			
16.6.80		18.1.83					
12.8.80		17.3.83					
6.10.80		25.3.83					
		26.7.83					
		27.7.82					
10.10.80							
2.12.80							
18.2.81							

PREM 19/1279

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● PART 2 ends:-

AT to Sir William Duncan 27.3.84.

PART 3 begins:-

PM to Sir William Duncan 2.4.84

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(A)(83) 3 rd Meeting, only item	27/07/1983
E(A)(83) 5	20/07/1983
MISC 25(80) 9	23/09/1980
MISC 22(80) 1 st Meeting, only item	12/03/1980
MISC 22(80) 1	10/03/1980
MISC 22(79) 4 th Meeting (1) Limited Circulation Anx	15/11/1979
MISC 22(79) 4 th Meeting	15/11/1979

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB (CABINET OFFICE) CLASSES**

Signed *J. Gray*

Date *23/9/2013*

PREM Records Team

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

House of Commons HANSARD, 21 November 1979, columns 388 to 398: National Enterprise Board and Rolls Royce

Signed

J. Gray

Date

23/9/2013

PREM Records Team

Roms Royce



File SLH
GR?
cc BY

10 DOWNING STREET

From the Private Secretary

27 March 1984

Thank you for your letter of 26 March which I have put before the Prime Minister. I will be in touch again when she has had an opportunity to consider it.

ANDREW TURNBULL

Sir William Duncan CBE

ROLLS-ROYCE LIMITED



Chairman's Office

65 Buckingham Gate, LONDON SW1E 6AT
Telex: 918091 Telephone: 01-222 9020

March 26 1984

The Rt Hon Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

cc 137
2.5 m
leave financing for
his 70% —

Dear Prime Minister,

Following the announcement in February that formal approval had been given by HMG to the five-nation V2500 project, I have been in discussion with the Secretary of State for Trade & Industry on the level of launch aid to be provided by Rolls-Royce. The most recent offer falls well short of the Company's requirements, and is only about half of the proportion of launch costs which normally has been funded by HMG in the past for viable civil aviation projects.

Since I took over as Chairman of Rolls-Royce twelve months ago, my priority has been to establish a realistic plan under which the Company could return to sustainable profitability, and thus be able to offer at least a 50% shareholding to the private sector within four years. This was a key objective put to me by HMG when I accepted nomination for the Chairmanship of the Company in the summer of 1982, and one which I readily accepted.

The actions since taken to achieve this major objective include:

- (i) reduction of the investment risk and sharing of costs in civil aero engine projects by entering into collaborative deals with United Technologies (and Japanese, German and Italian associates) on the V2500 project, and with General Electric on their CF6-80 engine and Rolls-Royce's -535E4;
- (ii) agreement in principle with GEC on a joint company to exploit gas turbines for industrial power generation;
- (iii) discussion and thus far agreement with European collaborators on the new European fighter and engine and on helicopter engine developments;
- (iv) continued reductions in Rolls-Royce's manpower;
- (v) cuts in expenditure on research and development, in part made possible by (ii) above;

cont.....

- (vi) further modernisation of the Company's facilities, notably on new manufacturing methods;
- (vii) establishment of a new management structure which more clearly identifies responsibility for profitability and cost control below the level of Chairman/Chief Executive.

These policies should result in the following financial prospects, excluding launch aid for the V2500:

	£ million (out-turn money)			
	1984	1985	1986	1987
Turnover	1,403	1,651	1,900	2,300
Profit/(Loss) after tax	(8)	(3)	104	228
Cash generated/(required)	(12)	(14)	53	119
Shareholders funds				
HMG equity	508	508	508	508
Reserves	(216)	(219)	(115)	113
	<u>292</u>	<u>289</u>	<u>393</u>	<u>621</u>
	<u><u>382</u></u>	<u><u>396</u></u>	<u><u>343</u></u>	<u><u>224</u></u>
Borrowings (net)	382	396	343	224
Gearing*	131%	137%	87%	36%

*Borrowings ÷ shareholders funds

Whilst these figures show a progressive improvement, they nevertheless show that until 1987 the equity investment by HMG is diluted by losses carried forward from earlier years, and the gearing ratio is commercially unsatisfactory. Inevitably, the latter years are much less certain and I am bound to say that it is quite unlikely that better results can be achieved. In particular, 1987 has many more downside risks than upside potential. Furthermore, there are significant hazards which apply to all the figures:

cont.....

- (i) the results would worsen if the pound strengthens against the dollar, eg \$1.60 : £ in 1987 instead of the assumed \$1.50 : £ would lower cash and profit by some £40 million;
- (ii) they depend significantly on budgetary decisions on purchases by MoD representing annually approximately £500 million of turnover and £40 million on profit/cash;
- (iii) turnover, profit and cash would be substantially less if the assumed recovery in Civil business is further delayed, and if major overseas military programmes (eg Pegasus for the AV8B in the USA) totalling £200 million a year in 1984 and 1985, and rising to £400 million thereafter, are not confirmed.

My judgement is that the Company will need to achieve financial results - profit, positive reserves and gearing - even better than shown in the years 1984-1986 for a convincing prospectus to be written which would return us to the private sector. The provision of launch aid for the V2500 on the following scale significantly improves the prospects of achieving that objective:

	£ million (out-turn money)					
	1984	1985	1986	1987	1988/89	
Requested V2500 support	10	30	50	20	25	£135 million
	10	30	20			

This represents 50% of the estimated UK share of total launch costs expressed in out-turn money, a level which I consider is fully justified in the following circumstances:

- (a) availability of approximately 50% support for the V2500 was always assumed when, with HMG's encouragement, the collaborative arrangements were negotiated in 1982/83, and there was no indication until much more recently that this was in doubt;
- (b) contribution by HMG of approximately 50% of launch costs for viable projects (and the V2500 is generally accepted to be a good project) has been HMG's position for over 20 years;
- (c) an HMG contribution of that proportion (and of a substantially larger amount) has been provided to British Aerospace on the A320; and Westland have had much the same sum for their helicopter projects;
- (d) such aid is accepted internationally, and is the most substantial way in which HMG can support this high technology industry against its competitors, all with their respective large Government assistance: no other form of finance has the same favourable effect on the profit and loss account;

cont.....

- (e) the Company is not seeking launch aid for its other new Civil projects, eg the Tay, the deal with GE.

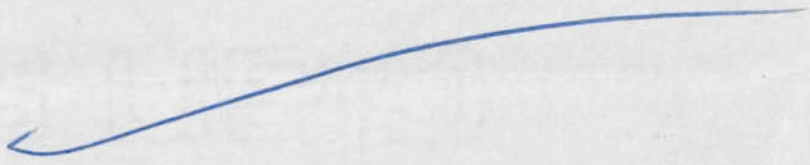
I understand from the Secretary of State that so far HMG is prepared to provide the amounts assumed above for 1984 and 1985, plus up to £20 million for 1986. This amounts to £60 million which is less than a quarter of the estimated total launch costs.

I saw no alternative with so much at stake on the two Civil collaboration deals, but to accept announcement of HMG's public support in principle on the V2500, with the details of aid to be negotiated later. I believe strongly that if the Government does not provide funding for a bigger proportion of V2500 launch costs, with recovery by levy providing a 5% real rate of return to HMG, the Company cannot meet the policy objectives which have been set of privatisation in the lifetime of this Parliament and will be penalised for the efforts it is making to improve profit and cash.

I have already discussed these issues with the Secretary of State, to whom I am copying this letter, and I do hope now to have the opportunity of discussing this situation with you.

Yours sincerely

Bill Duncan



27 FEB 1984





JU24

Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215) 5422
GTN 215)
(Switchboard) 215 7877

26 March 1984

NBRM

AT 26/3

APPOINTMENTS IN CONFIDENCE

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

D. Nigel,

ROLLS-ROYCE: PERFORMANCE RELATED BONUS SCHEME

Thank you for your letter of 8 March on this subject. The point you make about the possibility of a bonus for an executive whose performance is sub-standard is one which my officials had already raised with the company. Sir William Duncan's view is that if people fall short of satisfactory performance it is their basic salaries or their jobs themselves which should be adjusted. While you may not regard this as a complete rebuttal of your point, it does indicate that Rolls-Royce have thought about the issue which is, as you say, one on which they are not formally obliged to consult us. In addition, I understand that for 1984 only the corporate element of the scheme will operate, i.e all personal performance elements will be set as 1, so that the maximum bonus possible will be 12½% of salary. I understand that this results at least partly from the difficulty of establishing criteria for evaluating individual performance while the new company organisation is still settling down.

2 In view of all these factors, I intend to write to Sir William along the lines of the attached draft. I should be glad to know if you are content with this.

3 I am copying this letter to the other members of E(NI) and to Sir Robert Armstrong.

NORMAN TEBBIT

JU25

DRAFT LETTER TO

Sir William Duncan CBE
Rolls-Royce Limited
65 Buckingham Gate
London SW1E 6AT

APPOINTMENTS IN CONFIDENCE

PERFORMANCE RELATED BONUS SCHEME

Mr Warrington wrote to my officials on 3 January 1984 and subsequently on 11 January about the proposed performance related bonus scheme. I am replying, since this is a subject in which I have taken a personal interest.

I am happy to approve the scheme insofar as it applies to your own salary, and I note your intention to apply it also to certain senior staff. There is, however, one point which has emerged in our consideration of the scheme. This is that under the scheme as currently proposed an executive whose individual performance was less than satisfactory could still receive a bonus related to the company's overall performance. I know that you feel that the way to cope with unsatisfactory performance is not primarily through the bonus scheme, and also that only the corporate element of the scheme will operate in 1984. Nevertheless, I should be grateful if you could look again at this point in determining the future development of the scheme.

NORMAN TEBBIT

Ind Pol. : Future of RR : PRC

26 APR 1984

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ECNO



NIBPM AD 9/3

Treasury Chambers, Parliament Street, SW1P 3AG
 01-233 3000

8 March 1984

The Rt Hon Norman Tebbit MP
 Secretary of State for Trade and Industry
 Department of Trade and Industry
 1-19 Victoria Street
 LONDON SW1

John Norman

ROLLS-ROYCE: PERFORMANCE RELATED BONUS SCHEME

You wrote to me on 13 February, with details of Rolls-Royce's proposals for a performance related bonus scheme. You will subsequently have seen Nick Ridley's letter of 28 February raising some more general points on which I shall be replying separately.

*will require
 14 required*

I welcome the introduction of an incentive element into the pay of the company's senior staff, and I have no objection to the scheme's basic structure which relates the bonus to both company and individual performance. However, I am doubtful about one important detail. Setting the PPE indicator base at one would enable an executive whose individual performance was sub-standard nonetheless to get a bonus related to the company's overall performance. This problem could be overcome if the PPE base were set at zero; an executive who had not performed well would then get no bonus at all.

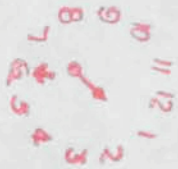
I appreciate that the company are only formally obliged to consult you about Sir Willian Duncan's pay and that this element of the scheme would not apply to him. Nevertheless, I think the point is still worth making to Rolls-Royce and I hope you will be able to persuade them to amend the scheme as I have suggested.

Copies of this letter go to the other members of E(NI) and to Sir Robert Armstrong.

*John Norman
 Nigel Lawson*

NIGEL LAWSON

Ind Poi Rows Royce A2



9
MAY 1984



JU645

Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY

1-19 VICTORIA STREET

LONDON SW1H 0ET

Telephone (Direct dialling) 01-215 5422

GTN 215

(Switchboard) 215 7877

13 February 1984

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

D Nigel

ROLLS-ROYCE: PERFORMANCE RELATED BONUS SCHEME

Under the arrangements which Patrick Jenkin and Geoffrey Howe agreed at the beginning of 1982, Rolls-Royce Ltd are required to consult me on the remuneration of the highest paid officer of the company (currently Sir William Duncan), but not on any other executive pay. When Sir William Duncan was appointed, it was agreed and announced in Parliament (20 April, 1983) that a performance-related bonus scheme would be introduced which would allow him to earn a bonus of up to £25,000 on a basic salary of £125,000. Rolls-Royce have now submitted such a scheme for my approval. A copy of the scheme is attached; some further details obtained in correspondence with Rolls-Royce are reflected in what follows.

The scheme is intended to apply to all executive directors and about 20 other senior executives, although it is only in the case of Sir William that our approval is required. It has two elements:

- i a Corporate Performance Element (CPE), which will be the same (as a percentage of salary) for each member of the plan;
- ii a Personal Performance Element (PPE) dependent on personal achievement.

The CPE will be expressed as a percentage of salary in the range $2\frac{1}{2}$ - $12\frac{1}{2}$ %, and will be determined by reference to the financial duty which we set for the company. The intention is that set levels of achievement above the agreed objective should trigger CPEs within the given range. If these levels of achievement are not met, then clearly the CPE would be zero.

The PPE for each executive will be a number in the range 1-2 which will be determined by personal achievement in relation to job description. Indicative examples prepared by RR's consultants demonstrate that PPEs can be set in a sensible and reasonably objective way. A fixed PPE multiplier may be set for



some executives whose functions do not lend themselves readily to objective setting, including the Chairman, whose PPE will be set at 2.

The PPE and CPE multiply together, so that

$$\text{Bonus} = \text{Salary} \times \text{CPE} \times \text{PPE}$$

and the bonus will thus lie between 0 and 25% of salary. One consequence of this structure is that no bonuses at all will be paid unless the company as a whole surpasses the target we set for it. In Sir William's case a maximum figure of £25,000 would be set. I believe that this is a reasonable basis for a scheme.

I have been assured by the Chairman that the non-executive members of the Board will have a formal and full role to play in the operation of the scheme when the restructuring of the non-executive membership is completed this year. With this clear involvement of the non-executives from 1985 onwards I believe I should give RR the clearance required for the early introduction of the new arrangements.

Unless you or E(NI) colleagues, to whom I am copying this letter, see reason to object, therefore, I propose to approve the scheme (insofar as it applies to Sir William Duncan) with a formal role for the non-executive directors.

g m
Norman

NORMAN TEBBIT

13 APR 1984

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8 4 3
7 6 5 4

STAFF IN CONFIDENCE

PERFORMANCE RELATED BONUS FOR SENIOR EXECUTIVES

1. The objective of the bonus plan is to improve corporate performance and therefore only those senior executives whose personal contribution has, or should have, a direct affect on corporate policy or results will be included.
2. At the level of management to be covered, the basic salaries should be such as to compensate fully for good performance. These basic salaries are assumed to be at the appropriate levels in relation to the market place. The performance related element will therefore apply only to the achievement of significantly better than satisfactory results. The quantum of benefit will itself be significant for such performance, with a ceiling. Any bonus payment will be at least 5% of base pay and the ceiling will be 25%.
3. The coverage is to be the Chairman, other executive Board members (currently six) plus a maximum of twenty other senior executives who report direct to Board members and are closely associated with the policies and actions of those Board members. (Executive positions likely to be covered are annexed).
4. The bonus will be comprised of two elements:
 - i) a Corporate Performance Element (CPE) - constant in salary percentage terms for all members of the plan;
 - ii) a Personal Performance Element (PPE) - dependent upon personal achievement measured by clearly identified factors related to the executive's personal job function.
5. The CPE will be related to how well the Company itself performs in relation to objectives set for it. Agreement between the Company and HMG of a financial duty based on a simple percentage of average net operating assets and a percentage return on net operating assets would offer a simple and appropriate method of assessing performance. Alternatively, if other measures of overall Company performance are agreed with HMG these would be the basis. The concept of quantification of CPE would be for each level of achievement above the agreed financial duty objective to trigger a CPE salary percentage in the range of 2½% to 12½%.
6. The PPE would then be based upon a single or multi factor measurement of personal achievement and would represent a multiplier in the range of 1 to 2. When determined, this multiplier would be applied to the CPE percentage to establish the actual percentage of base pay as a total bonus for each executive. All executives would receive the formula produced CPE percentage which itself would never be less than 50% of the executive's total bonus: it may in fact be appropriate in the initial period of the plan for the CPE percentage to be a higher proportion, say 75%, of the total bonus.

7. In the case of the Chairman, as his performance can only be assessed for this purpose by reference to total corporate performance, his PPE multiplier will be fixed at 2. His personal total bonus range would therefore be 5% to 25%, dependent upon the CPE percentage.
8. A similar fixed PPE multiplier will be appropriate to other executives whose job functions do not lend themselves readily to objective setting. Such cases do not need to have a fixed multiplier of 2, but could be in the range of 1 to 2 according to seniority. The recent reorganisation of management structure will, however, enable appropriate personal objectives to be set and thus the establishment of a personal performance formula to determine individual PPE multipliers. The criteria upon which such objective setting is based will include profit achievement, loss control, productivity, cash control, manpower objectives within the various cost centres and for which the individual executives are responsible.
9. The Chairman will be responsible for setting the formula by which the CPE percentage is determined as soon as the financial duty for the year in question is agreed with the Department of Trade and Industry. The PPE objective setting will involve each executive personally, principally between the person to whom an individual reports and that individual. All proposed PPE formulae will be reviewed by the Chairman in consultation as appropriate, before being agreed.
10. The plan will relate to the financial year commencing 1st January 1984. Its implementation will take place during the first quarter of 1984. The details of its coverage beyond the Board will be confidential.

2nd January 1984

EXAMPLES OF LIKELY COVERAGE OF BONUS PLAN

All executive members of the Board

Operations Director - Civil Engine Group

Commercial Director - Civil Engine Group

Operations Director - Military Engine Group

Marketing Director - Military Engine Group

Director of Design - Corporate Engineering Group

Director of Advanced Technology - Corporate Engineering Group

Director of Purchasing - Supply Group

Director of Manufacturing Technology - Supply Group

Director of Manufacturing Operations - Supply Group

Company Treasurer - Finance

Director of Repair and Overhaul

Director of Corporate Strategy

Director of Personnel

Company Secretary

Director of New Business - Corporate Engineering Group

Director Industrial and Marine Group

Director of Engineering - Civil Engine Group

Director of Systems and Computing



STAFF IN CONFIDENCE

ANNEX C.

ROLLS-ROYCE LIMITED

65 Buckingham Gate, London SW1E 6AT, England
Telex: 918091
Telephone: 01-222 9020

11th January 1984

P.J. Casey Esq.,
Department of Trade & Industry,
Ashdown House,
123 Victoria Street,
London SW1E 6RB.

9 11/1
Dear Peter,

Performance Related Bonus Scheme

Reference your letter of 9th January, I hope the comments below clarify matters.

First, as I indicated, the PPEs have yet to be finalised and will vary from post to post. However, I think the appendix to this letter, which was part of the consultant's report on the scheme, indicates the sort of approach (we believe the consultant has been over elaborate but will be adjusting, with his assistance, the principles he has used).

Second, the scheme would not be implemented without the formal approval of the Board's five non-executive directors. Furthermore, although the operation of the bonus scheme is in the hands of the Chairman initially, he is in course of consulting the non-executive Board members fully on the scheme, in advance of formal Board approval to ensure all are in support. Looking further ahead, the Chairman is at present restructuring the non-executive membership, as you know, and at this stage he is not ready to have a formal remuneration committee of non-executive directors. However, this is planned for establishment during 1984 and will then deal with remuneration of the Board and most senior executives, including operation of the bonus scheme. The role of non-executives was not detailed in the letter and note I sent you, but you can assume that by referring to an earlier decision of the Board in the cover letter this means the Board will act formally on adoption of the scheme; and that the mention of appropriate consultation in paragraph 9 of the note means consultation and agreement with the non-executive directors. The Chairman agrees fully with the comments you made about the importance of the non-executive directors.

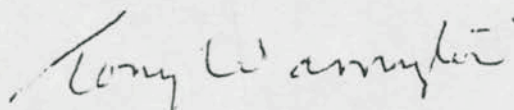
Continued...

Third, there is the issue of the emphasis, for the first year at least, on the importance of the Company's overall performance compared with an individual's performance. Although the new structure of management is aimed at greater individual responsibility, there is a long way to go in accounting and other terms in establishing the new structure, while at the same time ensuring responsibility for the well being of the Company as a whole is not lessened. Similarly, in at least the first year, there is no doubt that the Chairman's own contribution is crucial and therefore would put the limit to what bonuses others might achieve.

It is relevant to repeat the comment in the paper that the basic salaries, without bonus, are assumed to be at the appropriate levels in relation to the market place. These basic salaries have been assessed in relation to the greater responsibilities in the new organisation, with its smaller number of executive members, and in relation to both Hay assessments and remuneration in engineering firms generally. They are now appropriate to the market place, and the bonus scheme will only relate to achievement of significantly better than satisfactory results, a hard task, particularly in the coming year; and if people fall short of satisfactory their basic salaries or jobs themselves will be adjusted accordingly.

Finally, as regards the maximum bonus appropriate to the Chairman, the formula in his contract did say a bonus of up to 25% but we did agree separately to express this as up to £25,000. I have discussed this with the Chairman and we will put the ceiling of the scheme in the following terms: "the ceiling will be £25,000".

Yours sincerely,



A. Warrington

PPE FACTORS - DIRECTOR SUPPLY

Based upon the attached Job Description we would advise that the following factors would be appropriate as a measurement of personal performance. The percentages are given merely as examples and will need further consideration.

	<u>PPE % Multiplier</u>	
	<u>Reduced Performance</u>	<u>Maximum for Factor</u>
<u>Purely objective factors</u>		
1. Job Description Item 3:		
Cash Limits not exceeded		50%
+1%	45%	
+2%	40%	
+3%	35%	
By more than 3%	0%	
2. Job Description Item 8:		
Profit Objectives:-		
-5% to +5%	5%	
+5% to +10%	10%	
+10% to +20%	15%	
over +20%		20%
<u>Factors with some element of subjectivity</u>		
3. Job Description Item 2:		
Achievement of all agreed time, quality and cost objectives for delivery to Business Groups		30%
Time failure up to 5%	20%	
by more than 5%	0%	
Costs up by up to 5%	20%	
by more than 5%	0%	
Quality failure	0%	
		----- 100% -----

For factor 3 the overall performance of the supply function may be objectively measured by comparison with whatever existing management control statistics are available, e.g. standard reject rates or standard costings. If necessary such standards could be evaluated or, for example, a management time control structure developed which might reflect contractual penalty clauses for late delivery which the Business Groups may have with their customers.

This type of non-financial factor can be measured objectively but such objectivity leads to measurement complexity. To reduce such complexity it would be necessary to introduce some element of subjectivity which must be introduced only as a matter of corporate philosophy. Subjectivity can be applied by higher management (e.g. by the Chairman in the case of board members) or by "peer group" judgement (e.g. in the case of the Supply Director by his "customers" the directors of the Business Groups).

In the setting of the objectives for any factor there may be genuine disagreement over the level of the objective itself between the individual and his manager (either party thinking the other's view is too optimistic or too cautious). This problem may be solved by adopting a matrix technique which could adjust the PPE percentage multiplier for each factor depending on both results and the view taken by the individual executive of each objective. An example of such a matrix is as follows:-

Objective considered appropriate by Director or supply expressed as a percentage of the Chairman's objective	Actual Results achieved as a %age of objective considered appropriate by Chairman				
	80%	90%	100%	110%	120%
80%	40%	60%	85%	100%	105%
90%	30%	75%	90%	105%	110%
100%	20%	70%	100%	110%	115%
110%	0%	55%	95%	115%	120%
120%	0%	40%	90%	110%	125%

The percentages shown would be applied to the PPE %age multiplier shown for the specific factor.

If this matrix technique is applied the commitment of executives to the introduction of a performance related element in their remuneration package is likely to be enhanced. Its application in the example shown could however increase the PPE factor to a maximum of 125% thus lifting the bonus ceiling to 28.125% of salary. This can of course be eliminated by applying a maximum PPE factor of 100%, even though the matrix applies to individual factors.

ACCOUNTABILITY STATEMENT

DIRECTOR - SUPPLY

Purpose of Job

To direct the provision of the components required by the Civil and Military Engine Groups. To oversee the Company's Industrial and Marine activities.

In addition he will be responsible for the Company's Employee Relations activities and for the administration of those sites solely concerned with Supply activities.

Reports to

Chairman

Principal Accountabilities

1. Manage all the manufacturing and purchasing activities of the Company for aero components.
2. Deliver components ordered by the Business Groups at the required time and quality and at a cost which is comparable to world-wide levels, and to plan a capability in keeping with the Business Groups' requirements.
3. Manage the Supply Group within cash limits agreed with the Chairman.
4. Provide Personnel, Employee Relations and Site Services for all personnel on Supply only sites.
5. Operate within the framework set by relevant legislation and by Corporate policies. Seek advice from the appropriate Corporate professional head on the appraisal and salary reviews of senior personnel and agreement on senior appointments.
6. Define the corporate Employee Relations and Administration policies and co-ordinate their execution, excluding Organisational and Management Development.
7. Provide a Building, Plant and Equipment service for each Site.

10.08.83

8. Oversee the Rolls-Royce Limited Industrial and Marine business, define its financial, commercial and technological performance goals and monitor their achievement.
9. Develop and maintain an organisational structure suited to the needs of the allocated tasks and staffed by competent individuals whose performance objectives are clearly defined.

PPE FACTORS - DIRECTOR CORPORATE ENGINEERING

The same general comments apply to this case stated on the Factor Sheet for the Director Supply and this sheet should be read in conjunction with those general comments.

PPE % Multiplier

Reduced Maximum
Performance for Factor

Purely objective factors

1. Job Description Item 1:

Achieved within + or -1% of budget		35%
+ or -2% of budget	30%	
+ or -3% of budget	25%	

2. Job Description Item 4:

Achievement of financial return objectives on specified opportunities agreed with Chairman		20%
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Factors with some element of subjectivity

3. Job Description Item 2:

Achievement of specified new project developments to an objective agreed with the Chairman		30%
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4. Job Description Item 8:

100% compliance with all air-worthiness procedures within agreed time scales		5%
--	--	----

5. Job Description Item 10:

100% compliance with Company's requirements		5%
---	--	----

6. Job Description Item 13:

100% implementation of Product Assurance policies		5%
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ACCOUNTABILITY STATEMENT

DIRECTOR - CORPORATE ENGINEERING

Purpose of Job

To direct the advancement of the Company's technology base and the development of new product concepts. To be the technical authority for the Company's products and the test facilities required for their development. To be the authority for Engineering appointments and the most effective use of Engineering resources. To contribute to the formulation of the Company's Product Strategy.

In addition he will be responsible for the Company's Product Assurance activities.

Reports to

Chairman

Principal Accountabilities

1. Formulate and direct the Research, Technology and Advanced Engineering programmes necessary to improve the Company's technology and manufacturing competitiveness within agreed budgets.
2. Direct the development of new projects up to the stage where engineering responsibility can be transferred and they have been allocated as committed projects to one of the Engine Groups. Agree with the Business Groups the Engineering content of all project business plans. Provide technical resource and assistance to the Business Groups.
3. Carry the formal responsibility for Design with the attendant Authority throughout the Company.
4. Seek opportunities outside the aero engine field for the Company to obtain a financial return on its existing investment in aero engine technology.
5. Define the forward Engineering, Computing, Experimental and Test resources needed to satisfy the total Company Engineering programme.
6. Direct the formulation and approval of the forward plans for all Engineering and associated computing and test facility capital investments.
7. Formulate budgets and plans for the Corporate Engineering Group, monitor progress towards programme objectives and conformity to agreed costs.

6. Define Engineering policies, procedures and standards and audit compliance. Ensure compliance with all appropriate airworthiness procedures.
9. Define the present and future Company requirements for professional engineers and within the framework of the Corporate Personnel policies ensure arrangements for their sourcing, professional development and succession. Review the professional performance of Engineering staff throughout the Company, advise on the appraisal and salary reviews of senior Engineering personnel and agree appointments.
10. Conduct engineering audits of major new Company commitments or initiatives and reviews of major project problems and ensure that the professional engineering standards of the activities in the Business groups (including Industrial and Marine) meet the Company's requirements.
11. Operate within the framework set by relevant legislation and by Corporate policies. Seek advice from the appropriate Corporate professional head on the appraisal and salary reviews of senior personnel and agreement on senior appointments.
12. Promote the Company's image in technology.
13. Establish Product Assurance policies for the Company and assure their implementation.
14. Develop and maintain an organisational structure suited to the allocated tasks and staffed by competent individuals whose performance objectives are clearly defined.

.....
Chairman

IND. POL.
Future of R. Reyle
p62.



MJ

10 DOWNING STREET

From the Private Secretary

16 November 1983

Dear Callum,

Rolls Royce RB 211-535 Engine Programme

The Prime Minister has seen your Secretary of State's minute of 7 November. She is content with the terms of the proposed written Parliamentary Question on the launch aid to be provided for the development of the E4 engine.

I am copying this letter to the Private Secretaries to members of EA and to Richard Hatfield (Cabinet Office).

*Yours sincerely
Andrew Turnbull*

ANDREW TURNBULL

Callum McCarthy Esq
Department of Trade and Industry.

CONFIDENTIAL

Lo



JF4757

Prime Minister

① *see no*

Mr Tebbit wishes to announce this tomorrow Wednesday. It has been agreed with Treasury.

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Content?

PRIME MINISTER

ROLLS ROYCE RB 211-535 ENGINE PROGRAMME

Yes not ^{AT} 15/11

At E(A) on 27 July 1983 (E(A)(83)3rd) my predecessor presented a Memorandum (E(A)(83)5) on the question of launch aid for the RB 211-535 E4 engine. The Sub-Committee approved in principle the provision of launch aid, and gave Cecil Parkinson a mandate to establish the appropriate minimum assistance in negotiation with Sir William Duncan, the Chairman of Rolls-Royce, and to seek to agree with the Chief Secretary the public expenditure aspects.

2 Cecil took a strong personal interest in this issue, and himself conducted two meetings with Sir William, who then reluctantly put in a revised bid of £85m (as against the original request for £102m at outturn prices). I shared Cecil's conclusion however that we should cut back this figure still more sharply in view of the public expenditure position. I am convinced that the lower sum I have now agreed on with Peter Rees - £70m in outturn prices - does indeed represent the minimum launch aid assistance which would be appropriate.

3 Following these negotiations, it has fallen to me to settle with Peter Rees how the public expenditure aspects should be handled. We have agreed that £60m should be



provided in the current financial year, of which £45m will be found from the Contingency Reserve and £15m from savings elsewhere in my Department's budget, this provision being made in the Winter Supplementary Estimates. Only the final £10m will be included in the Public Expenditure Survey (for 1984/85).

4 It is an inevitable consequence of establishing a minimum figure by negotiation that the assistance finally agreed may not derive in any simple way from the total project spend. However, you will wish to know that the agreed assistance represents only approximately one-third of the incremental costs of the E4 development between 1982 and 1986, bringing our total contribution to the overall RB 211-535 project from 1979 onwards to some 47% of launch costs.

5 I propose with your agreement to announce this assistance by means of a written Parliamentary Question in the near future, making it clear that it is expected that we shall recover this new sum in real terms by means of a levy on sales of the E4 engine.

6 I am copying this letter to all Members of E(A) and to Sir Robert Armstrong.

NT
N T

7 November 1983

Ind Pol,
Rolls Royce,
PT 2



APR 8 1951



NO 16

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P.01078

PRIME MINISTER

Rolls Royce RB211 - 535 Engine Programme
(E(A)(83)5)

BACKGROUND

This memorandum by the Secretary of State for Trade and Industry, with an accompanying note by officials, seeks approval for launch aid for a development of the Rolls Royce (RR) RB 211 -535 jet engine. ("Launch aid" is Government financial assistance towards the capital costs of an aerospace project, usually recoverable by means of a levy on sales).

2. There are two main versions of the RB 211 engine:

i. The -524 This is intended for large aircraft such as the Lockheed Tristar and the Boeing 747. Both the main American manufacturers - Pratt and Whitney (PW) and General Electric (GE) - have similar engines. The -524 is a poor third in the market: the Tristar programme has been terminated; PW and GE have markedly stronger positions in the 747 market; and the -524 is not well suited to the new wide-bodied twin-engined aircraft (Airbus 300 and 310; Boeing 767).

ii. The -535 This is a smaller derivative of the -524. Its only application at present is powering the Boeing 757, for which the original version of the -535 was "lead engine". The initial US competition came from GE, who subsequently withdrew. But PW entered the competition with a brand new design (the PW 2037). To match the performance guarantees offered on this engine by PW, RR were obliged to produce an improvement of the -535, known as the RB 211 -535 E 4. It is this version which is the subject of E(A)(83)5.

3. RR have applied for £102 million of launch aid, spread over the years 1983 to 1985. The Secretary of State for Trade and Industry, while supporting the

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application in principle, does not ask for a specific figure, but seeks authority to "provide only the minimum figure which will restore RR's cash flow to a level where the company can proceed with both the E 4 and its rationalisation programme". Trade and Industry officials (paragraph 51 of the note by officials) suggest that £89 million should be maximum.

4. The Secretary of State asks that the launch aid he negotiates should be financed from the Contingency Reserve, in other words, that he should not be required to find offsetting savings elsewhere in his programme.

5. Treasury officials oppose any launch aid, on the grounds that the project is not viable. The assessment by officials suggests that the proposed E 4 development will earn at least the 5 per cent real rate of return regarded as the acceptable minimum for public sector projects and should therefore be regarded as viable. However the Treasury argue that, although it is not usual when assessing additions to existing projects to take into account the earlier "sunk costs", it is relevant to look at the -535 programme as a whole. The earlier versions of the -535 engine generated virtually no income and this, in their view, raises the possibility that the investment on the E 4 project could also be lost.

MAIN ISSUES

6. The main issues before the Sub-Committee are as follows:

- i. Should the Government allow RR to continue with the E 4 or require cancellation?
- ii. If the Government allows the project to continue, should it provide launch aid?
- iii. If launch aid is provided, what should be its maximum amount?
- iv. Should the amount eventually agreed be provided from the Contingency Reserve?

Continue or cancel?

7. If Ministers consider that the project is not viable, then the logical course is to require RR to cancel it. The main considerations here are:

- a. the viability of the project; and
- b. the implications of cancellation for RR's strategy.

Viability

8. The assessment in the note by officials suggests that on most plausible scenarios, the E 4 development should earn a satisfactory rate of return. It would therefore usually be accepted as viable. The counter arguments which the Sub-Committee may wish to consider are as follows.

- i. Risk All aerospace projects are risky; and the possibility of significantly less favourable outcomes than those considered in the note by officials cannot be ignored. For example, PW might be able to achieve substantial further technical improvements at low cost; or the Boeing 757 might sell badly. On the other hand, things could go more favourably than assumed. PW might run into serious technical trouble; or new applications for the - 535 might emerge.
- ii. Need for more money later Historical experience suggests strongly that further injections of cash will be needed for the - 535 programme in order to secure further technical advances. This point is discussed at some length in paragraph 15 of the note by officials. On the other hand, if PW spend more money to improve their engine, they will need to recover it through a higher price. RR will then be able to increase their price. It therefore seems reasonable to accept that further money will probably be needed for the - 535 programme, but not to assume a priori that such money cannot secure an economic return.
- iii. Money already lost on the - 535 project It is undeniable that the original - 535 engine has made no money. But that investment is already lost. The case for the additional expenditure on the E 4 project has to be

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looked at on its own merits. Past experience properly suggests that future sales forecasts should be viewed with considerable scepticism. But after making all proper allowances the report by officials suggests that the additional expenditure on the E 4 project should earn a satisfactory rate of return.

Strategy

9. The effect of cancelling the E 4 would almost certainly be that RR would pull out of the market for large civil aero-engines. As noted earlier, the prospects for the - 524 version of the RB 211 are poor; and the original version of the - 535 would not sell in competition against the PW 2037. RR should be able to make a living in other sectors of the engine market, though no doubt on a significantly smaller scale than now. But the Sub-Committee will wish to assess the effects on RR's commercial standing if they pulled out of a competition in which they have only one opponent and a strong position as suppliers of the lead engine.

Launch aid

10. If the Sub-Committee decides that it would not be right to require RR to cancel, the question of launch aid arises. The Treasury argue that it is a proper posture for the Government to put the onus of continuing with the project on RR who would then have to try and accommodate it within their cash limits and financial targets by reducing or postponing lower priority activities.

11. By common consent however the E 4 project is vital to the future of RR, which is wholly owned by the Government. If it succeeds the company will have maintained its position as a major producer of civil aero-engines. If it fails the company will be in serious trouble. To allow the project to continue without providing adequate resources would seem to be the worst of all worlds.

12. It could be argued that there is a case for at least delaying a decision until the new Chairman and Chief Executive, Sir William Duncan, has been able to reassess RR's product strategy. RR have gone ahead with the E 4, even though there has been no answer to their request for launch aid since February 1982; and it is most improbable that they would stop now. If they have no assurance of



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launch aid, they may be more likely to take a realistic and rigorous view of other priorities. Against that, it may be argued that RR have already been subjected to serious delay and that it would be wrong to ask them to continue against a background of financial uncertainty.

13. A possible compromise, if the Sub-Committee favours giving launch aid, might be to tell RR that the Government is in principle willing to give aid but will not decide the amount until it has been able to review the company's prospects on the basis of the review of product strategy to be completed in the autumn.

Amount

14. If the Sub-Committee agrees that launch aid should be given, but regards a general assurance to that effect as insufficient, it will be necessary to give the Secretary of State for Trade and Industry negotiating guidelines. You will not wish the Sub-Committee to discuss the detailed figuring. But it might be as well to establish the general basis for the negotiations.

15. In effect, the Secretary of State for Trade and Industry wishes to negotiate with RR as if it were a private sector company, with a view to giving the minimum amount of launch aid consistent with a prudent commercial approach to cash flow and balance sheet ratios. At official level, the Treasury have argued on occasion for a radically different approach: bridging the gap between agreed capital requirements and internal resources, as if RR were a nationalised industry. This would mean a significant change in policy towards RR, which has so far been regarded as eligible for assistance on the same footing as a private sector aerospace undertaking. It might also be difficult to reconcile with the aim of privatisation.

Contingency Reserve

16. The Secretary of State for Trade and Industry proposes that whatever launch aid may eventually be agreed should be found from the Contingency Reserve - that is, that he should not be required to find any offsetting savings from within the rest of his public expenditure programme. The Treasury argue that any expenditure should be accommodated within the Department's existing baseline. You will probably wish to ask the Secretary of State to resolve this with the Chief Secretary, Treasury as part of the bilateral discussions agreed by the Cabinet for the next stage of the Public Expenditure Survey.

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Community implications

17. Because launch aid is repayable, the Government does not regard it as a State aid or notifiable as such to the Commission. Neither we nor our other European partners usually notify assistance for aerospace projects.

HANDLING

18. You will wish to ask the Secretary of State for Trade and Industry to introduce his memorandum and the Chief Secretary, Treasury to reply. The Foreign and Commonwealth Secretary can advise on the international implications of a decision to cancel the E 4. The Secretary of State for Defence will have views both on the technical aspects of the programme and the effects of cancellation on RR's military business. The CPRS have been active in investigating the programme; and Mr Sparrow will be able to advise the Sub-Committee both from that standpoint and as the Chairman of the Official Group on Rolls Royce (MISC 25). The Attorney General has been invited to deal with any legal points.

CONCLUSIONS

19. You will wish the Sub-Committee to reach conclusions on the following.

i. Should the Government allow Rolls Royce to continue to develop the RB 211 - 535 E 4, or require cancellation?

ii. If it does not require cancellation, should it be prepared in principle, to offer launch aid?

iii. If so, is it willing to allow the Secretary of State for Trade and Industry now to negotiate an amount of launch aid? Within what limits? Or should a decision on the amount wait until Sir William Duncan has completed his review of strategy?

iv. Should any launch aid for the E 4 be a charge on the Contingency Reserve as proposed in E(A)(83)5? Or should this be pursued by the Secretary of State for Trade and Industry and the Chief Secretary, Treasury, in their bilateral public expenditure discussions.

P L GREGSON

26 July 1983

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Qa 06425

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Prime Minister

MUS 26/7

To: PRIME MINISTER

From: JOHN SPARROW


26 July 1983

MS

Rolls-Royce RB211-535E4 Engine

1. On 26 May I chaired a meeting of the official committee MISC 25 on this subject. With the exception of the Treasury, which reserved its position, the meeting supported completion of the development of the E4 engine and the negotiation of launch aid between DTI and Rolls-Royce. This minute gives you my own view, having listened to the arguments at MISC 25.
2. I very much doubt whether it will make sense for Rolls-Royce to "go it alone" with a completely new venture in the large aero-engine business. But this cannot be settled until the new Chairman has made his long-term strategy presentation in September. In any event no convincing case has been made for instructing Rolls-Royce to pull out of the 535-E4 programme now, with certification less than 6 months away; that would be tantamount to taking the company out of the big aero-engine business for good (even as a partner with another leading manufacturer). It would make privatisation impossible for the foreseeable future and might even call into question the Company's ability to survive at all. Besides I am satisfied that there are good prospects for the commercial and technical success of the E4 variant of the 535 engine.
3. Launch aid needs to be strictly on the commercial merits of the case put forward. Rolls' claim for launch aid is reasonable. Obviously from the public expenditure point of view the smaller the sum the better but we should not overlook the contribution which a reasonably generous decision could make to the objective of privatising the company.
4. It is worth bearing in mind that, so long as the Government remains the owner of and banker to Rolls-Royce, actual expenditure on the E4 engine

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will be a Government liability. Thus it is not worth spending too much time arguing whether other methods of financing the programme are preferable to launch aid.

5. I am sending a copy of this minute only to Sir Robert Armstrong.

JS.

Prime Minister

To see X

cc Mr. Mount O/R

PLS 26/7

MR. SCHOLAR

ROLLS ROYCE RB.211 535 ENGINE DEVELOPMENT

It will be difficult for Ministers not to approve the continuation of the RB.211 programme to complete the E4 version, in view of the sums already spent, commitments to customers and the implications for privatisation. But support ought not to be provided on the scale or on the terms which Rolls Royce request. Rolls Royce are asking for launch aid of £102 million, almost as much as the cost of completing the E4 version - £120 million. This is surely an unacceptable basis for supporting any activity.

Some alternative options are:

1. Letting Rolls Royce finance the E4 itself, at the expense of less promising projects (if such there be).
2. To offer Rolls Royce just sufficient launch aid to cover the projected loss in 1984 (£40 million).
3. Negotiating with Rolls Royce in much the same way in which DTI negotiates selective financial assistance with other companies, ie offering launch aid which is judged to be just sufficient to persuade Rolls Royce to complete the development work. In selective assistance cases, the level of grant invariably turns out to be around 10% of project costs. An upper limit of 15% or 20% might be used in the present case; this would imply additional launch aid of £10-20 million.

The Chancellor will probably press for (1) in E(A) with (2) as a fall-back. I would suggest option (3) since it would treat Rolls Royce on all fours with the rest of manufacturing industry, rather than as an expensive 'pet', and puts the onus of risk where it belongs, on management. If this option were adopted Mr. Parkinson might be asked to negotiate within an upper limit of, say, £20 million.

N.O.
NICHOLAS OWEN
26 July 1983

PRIME MINISTER

The Attorney General will be present to deal with David Wilson's

RB211 - 535E4 ENGINE PROGRAMME

fraud worry.

MUS 26/7

You asked to see again the graphs, charts and notes which were provided during the presentation to you in October, 1979, about aid to Rolls Royce. These are attached.

I have picked out one or two points of particular interest now:-

- (i) You were told in 1979 that "with the 535, Rolls would benefit from its efforts to establish a market for the RB211 family and it has a good chance - according to Boeing - of getting half the market" (Flag A). Note that RR's and DTI's estimate has fallen to 40% (paragraph 17 of the paper by officials); the Treasury estimate (paragraph 24) is for 35%.
- (ii) You were given (Flag B) a pre-tax profits forecast, dated August 1979, as follows:

1979	£	-34 m.
1980	£	-45 m.
1981	£	4 m.
1982	£	66 m.
1983	£	66 m.

outturn

What was the actual outline? Note that a pre-tax profits forecast with the same kind of profile is being offered to you now:

assuming launch aid:

1983	£	-23 m.
1984	£	9 m.
1985	£	37 m.
1986	£	176 m.
1987	£	256 m.

assuming no launch aid:

1983	£	-67 m.
1984	£	-42 m.
1985	£	30 m.
1986	£	176 m.
1987	£	256 m.

(These profits are out of ^{an annual} turn-over of some £1½ b.)

/ (iii)

- (iii) It is also worthwhile looking at paragraphs 18-23 of the Annex to the October 1979 notes (Flag C) which set out the economic case for the RB211 - 535. How many of these assumptions have been proved wrong by events?

MCS

Please see, too, note by Lord Cockfield
(Flag E)

25 July 1983



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Prime Minister

Sir I. Berrill and
Dol officials forward

him closely in

this
presentation.

ROLLS-ROYCE

PRESENTATION TO THE PRIME MINISTER, 16 OCTOBER 1979

TL
1979

1 The Company

CHART 1 To put Rolls in context, it is a company with a turnover last year of £760 million, broadly comparable by that yardstick with firms like Tube Investments, Babcock and Wilcox, and British Oxygen, ranking sixtieth in the British industrial league table.

CHART 2 Worldwide it employs 59,000, of whom 56,600 are in the UK. The main centres are Derby and Bristol. Its profit record, with £12 million in 1978 and £20 million (before tax) the year before has been poor on a capital employed of some £360 million. More to its credit, 47 per cent of its output is exported and it is in the top ten of British exporters.

GEC, which is worth a mention at this point, has a turnover and payroll about three times that of Rolls-Royce and a profitability of 10 to 20 times as much.

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CHART 3A 2 The Company's products

Rolls is overwhelmingly in the aero-engine business, and its main subsidiary activity - the industrial and marine division which GEC would like to acquire - is concerned with modifying aero-engines for industrial and naval purposes.

There is also a small, but in defence terms extremely important, nuclear business making the power plant for nuclear submarines.

Turning back to the main aero-engine business, it divides at present roughly 53% to 47% between military and civil engines. Although Rolls complain strongly about the level of profitability allowed by the Ministry of Defence on the military engines, this is quietly profitable and useful profits are made on overseas sales. Rolls, for example, claim to have done very well over the sale of Jaguars to India at the turn of the year.

Within the civil engine market, where all the Company's problems have arisen, there are two main products,

first the Spey engine, introduced 15 years ago, on which there is a good and profitable spares business as well as a fairly well maintained volume of sales of new engines, eg on the BAe 111 on which a deal has been concluded with the Romanians and on a new American business jet (Grumman Gulfstream III).

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But the Spey is now on the way out, and one of the major questions for the future is whether Rolls should develop a replacement - the 432 - in collaboration with the Japanese. The Boeing Company, the biggest and most powerful civil aircraft company in the world, are enthusiastic about this proposed new engine which they would like to see providing a new power plant for one of the most important of their family of aircraft (the 737). That however is a major decision for the future.

The second major civil engine is the RB 211, a much larger engine developed in the late 1960s to power the new big wide-bodied jets. It is this engine that caused the collapse of the Company in 1971 and which is the cause of the Company's present serious problems. The importance of the engine to the Company and the family of engines being derived from it can be judged from Rolls-Royce's view that the size range covered will account for 70 per cent of the demand, by value, for commercial engines.

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3 The RB 211

CHART 3B Turning specifically to the RB 211, this is a broad name for a whole family of engines derived from the same engine core.

Its early history was one of technical problems, including the failure of the carbon fibre technology which it was hoped would give it some advantage over its two American rivals. Moreover, with the collapse, and all the hiatus that this caused, Rolls fell two years behind the American companies in the development and upgrading of the engine to meet the greater thrust requirements of the wide-bodied jets as they increased in size and range.

This two-year handicap has cost Rolls dearly in financial terms because in marketing its engines it has had to undertake when getting some key orders to match the more advanced performance standards of its rivals by undertaking to retrofit the engine originally supplied by an improved version when it was available; or to compensate in other ways eg attractive pricing and concessions. Rolls had to do this to keep in the business at all. It still has extensive refitting commitments which will be particularly heavy in 1981 and '82.

But the technical competitive situation is now much improved. The new versions of the RB 211 - 524 which have been under development and will be coming into the service over the next two years are regarded by the Ministry of Defence, who monitor the technical progress of the RB 211 as comparing satisfactorily with their competitors. For instance the Rolls engines have superior fuel consumption and are likely to retain this advantage. This becomes more important as fuel prices rise and acts as a counterweight to the thrust and weight advantages of the competition. Overall we now have a product recognised as technically competitive in the market place.



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The last Government in mid-1978 gave authority for the production of a major new derivative of the RB 211 engine - the 535. For the first time, Rolls is in front of its rivals and indeed the signs are that one of the two Americans will not enter the field. It has been ordered by the first two airlines buying the new Boeing 757 aircraft and Boeing consider that Rolls should be able to take half the world market for their new aeroplane with this engine. The Ministry of Defence advise that from the technical point of view all is going well and the development of the engine is on schedule. While the Department of Industry has more cautiously assumed that Rolls will only get 40 per cent of the market and take a more cautious view of the sales potential of the 757 than either Boeing or Rolls-Royce, this engine is a major opportunity for the Company.

Much of the credit for re-establishing Rolls, and in particular for convincing Boeing that the 535 should be the launch engine on their new aircraft, goes to Sir Kenneth Keith.



CHART 4

4 The Special Features of the Aero-Engine Business

In thinking about the RR 211, it is worth noting the special characteristics of the aerospace business.

1 The high capital cost of a new engine - even a derivative engine like the RB 211-535 is expected to cost up to £300 million.

2 High technological risk, fortunately much less for a derivative engine like the 535.

3 The long term scale; 5 years is a reasonable ball-park figure for the development of a new engine with a subsequent life of say 20 years, and with spares well beyond that.

4 The importance of spares: it is reasonable to expect to sell about one and a half times the value of the original engine in terms of spares and these are where the profits are sought.

CHART 5

5 Finally, for any company in aerospace not based in the United States, high vulnerability to movements in exchange rates and relative rates of inflation. A combination of relatively high rates of inflation and a strengthening currency is extremely punishing for any aerospace company in Europe, as the French and German Governments have found in underwriting their industries against all the effects of currency movements in connection with their Airbus venture.

CHART 6



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A

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5 The Implications of these Special Features

These characteristics have a number of important consequences:

First no airline is willing to buy an aero-engine unless it can be sure of spares for the lifetime of the aircraft, and given the advantages of commonality unless it is confident that the engine will be available for repeat orders and will be kept abreast of developments. The ability to offer a family of engines with common parts is another important plus.

The converse of this is that any doubts about the future of an aeroengine maker means that it is out of the running; that is why the Government in 1971 had to undertake that the RB 211 would be supported throughout its service life.

Second market share is crucial if the huge costs of development are to be met. For the reasons already mentioned airlines are reluctant to become committed to a new supplier and for a company like Rolls with a less developed engine seeking to build up in the US market, which dominates the scene, the task was daunting. Rolls have had to buy market share and it is a fair argument that securing market share is as much part of the cost of entry as the development and tooling for a new engine. Rolls still has the smallest market share and this is a serious weakness. With the 535 it will benefit from the efforts by Rolls to establish a market for the RB 211 family, and it has a good chance - according to Boeing - of getting half the market.

CHART 7

CHART 8

Finally this is a business that involves large resources and large foreign exchange risks, especially for a European company. However, these factors, combined with the long learning curve, have the compensating advantage that entry by newcomers (or re-entry by those who have given up) is very slow, and very costly.



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6 The Future Prospects

Finance

CHART 9A There is the daunting financial prospect already presented to Ministers, with an increase of some £640 million on the cash requirements previously notified to Government, up to 1983; an immediate prospect of substantial losses, and a return to profitability in the period only if the exchange rate falls. Moreover, CHART 9B the combination of a rapid appreciation of sterling, a market upturn in the aerospace business generally and higher than expected inflation has changed the prospects for Rolls very quickly during the course of this year.

CHART 9C As set out in the paper previously circulated to Ministers, about half of the rest in cash requirement derives from the increased inventory Rolls needs to sustain the increased volume of business they have secured or have in prospect.

These figures can be improved, as both Rolls-Royce and the NEB recognise, by economies and improved performance: they could no less be improved, or made worse, by movements in the exchange rate and relative rates of inflation. The former is a matter for good management: the second is - for the Company - an unknown and it is for the Government as owner to decide whether or not the risk can be accepted.

Markets

CHART 10 But if the forecasts being made throughout the world aerospace industry has any validity, a well managed aerospace company has a large and expanding market opportunity. This is not based simply on an extrapolation of past rates of market growth; there is a huge replacement requirement in the mid to late 80s deriving from aircraft that are reaching the end of their lives or which will need new engines if they are to carry on.

Summary

We have a tragic situation in which a buyer's market has turned into something more resembling a seller's market but where through movement in the exchange rate and erosion of cost standards during



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the depression years we could hardly be in a worse position to take advantage of the boom. But if we miss this boom, in what is a famine and feast business, Rolls will lose, perhaps for a decade, the opportunity to secure market share upon which its long term prospects depend so heavily.

With North Sea oil the odds are that the exchange rate will keep at a level which will make Rolls an indifferent prospect for at least five years and perhaps for the decade; but if we pull out now:-

- i) we shall lose the benefit of the large expenditure over the last decade to establish Rolls as one of the three major world civil aeroengine builders.
- ii) re-entry would be slow and extremely costly - perhaps impossibly so because by then the French and conceivably the Japanese would have taken our position. Moreover, this is the kind of business, now that we have established technical equivalence with the Americans and a lead on the new engine, in which Britain ought to have a future if we have a well managed company.

CHART 11 7 The Strategic Alternatives

The alternatives which face the company:-

- 1 Immediate withdrawal from the RB 211 - this is a course that Rolls advise would cost billions of pounds in compensation payments, particularly to airlines but also to Lockheed and to some extent Boeing.
- 2 Progressive withdrawal - a policy with various permutations each of which would need to be analysed but all of them involving losses which would need to be quantified.
- 3 Carrying on with no change - a high risk policy as recent events have shown.



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4 Carrying on with new management and new policy directives from the Government - the course recommended by the Secretary of State for Industry. These policy directives might include seeking a partnership with another manufacturer since it is arguable that there is only room for two major civil aeroengine manufacturers. The French have already entered the field as a subordinate partner of GE; the Japanese are seeking hard to get in and there is a risk of the numbers being actually increased. There is much to be said for Rolls entering into a larger grouping. Pratt and Whitney have indicated that they would be interested in acquiring a blocking shareholding in Rolls Royce - 26% or more - and as mentioned before the Japanese would like to link up with Rolls-Royce to manufacture a new engine.

But the time for any negotiation with Pratt is not yet: they would not be interested in Rolls in its present state. The policy here may be to keep Pratt interested but to play for time while the company is brought into better shape.

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ROLLS ROYCE - THE FACTUAL BACKGROUND

Introduction

1. The present Rolls Royce company was set up in 1971 as a 100% government-owned company to take over the gas turbine engine business of the old Rolls Company when it went into receivership. In 1972, its first full year of business, its turnover was £375m. In 1978 the turnover had grown to £763m, split roughly as follows

	%
military aircraft engines	40
civil aircraft engines	40
helicopter engines	5
industrial and marine engines	12*
nuclear engines for submarines	3

Total	100

Although in the period turnover appears to have grown, in fact when allowance is made for the change in the value of money there has been no growth. Exports have risen from 36% of turnover in 1972 to 47% in 1978. ^{UK} employment fell from 63,282 in 1972 to 56,600 in 1978 but has now started to rise.

2. The collapse of the old company was caused entirely by problems with the RB211 engine which was being developed as the centrepiece of the civil engine business. Then as now the military engine business, and the helicopter, marine and nuclear businesses which are also almost exclusively for defence purposes, both domestic and for export, were profitable. For this reason this paper deals primarily with the civil aeroengine business. This makes up less than half the total business at present, but it is expected to grow to about 60% by the mid-1980s, and to two thirds of the total in the 1990s.

Civil Aeroengine Business

3. In the 1960s technical developments opened the possibility of building much

* includes a substantial value of basic engines bought from Aeroengine Division

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larger and more efficient jet engines. In the USA the two leading companies, Pratt and Whitney and General Electric, developed such engines initially for military transports. In the UK there was no comparable military requirement and Rolls Royce, the only other producer in the world of large engines, decided to develop the RB211 as a purely civil venture, recognising that if it did not its civil business would eventually be lost to the US. As new aircraft were designed to exploit these engines the RB211 was chosen by Lockheed as the engine for the L1011 Tristar. It was the insolvency arising from the development of this engine which caused the collapse of the old Rolls Royce company. The crisis was caused primarily by inability to meet the development timetable.

4. The new Rolls Royce company set up by the Government successfully fulfilled the original RB211 contract, and has since been engaged in a competitive battle with Pratt and Whitney and General Electric in the market for these large engines. Each of the three has extended the power range of its basic design, and has progressively improved the fuel economy, and Rolls Royce has in addition been seeking to make good a time lag of some two years which grew out of its collapse and the parallel crisis at Lockheed. A description of the RB211 family of engines, their costs and markets is annexed.

...
Present Market Position

5. There is a wealth of evidence to suggest that in technical terms the RB211 is now fully competitive with its US rivals. A recent technical evaluation based on Boeing data demonstrates clearly that the RB211-524 is now and is likely to remain for several years the most economical engine for the Boeing 747, and Boeing is going to certificate its new 757 aircraft first of all with the RB211-535. For some other applications such as the European Airbus the US engines have advantages. Nevertheless the broad conclusion that the RB211 at least matches its competitors is well established and confirmed by sales success. Rolls' other civil engines are now near the end of their commercial lives and it is thus increasingly dependent on the RB211, though it has two new and smaller designs one at least of which it would like to launch if market conditions justify it and capital is available.

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6. The technical success of the RB211 has not been paralleled on the financial side. While the completion of the initial contract for Lockheed was achieved within the cost estimates made at the time of the rescue in 1971, the cost of matching the continued technical developments of the competition has been high and Rolls Royce has had a very much smaller market share over which to spread the costs. Furthermore the big potential advantage of lower UK wage rates has been offset by lower productivity. Assessment of the real commercial prospects for the RB211 family is bedevilled by uncertainties over future exchange rates. World aerospace business is largely priced in dollars, and Rolls Royce are obliged to price their engines similarly. Variations in the exchange rate thus directly affect sales revenue and cash flow, and affect profitability still more drastically. Uncertainties about future exchange and relative inflation rates overshadow the other factors in prospective profitability. The importance of these factors has always been made clear by Rolls Royce. For example in their 5 year forecast for 1979-83 Rolls Royce explained that the changes in their assumptions about UK and US inflation compared with their forecast of a year earlier, and about the exchange rate, reduced their profits over the 5 year period by £300 million. (In the 1978 plan they assumed an exchange rate declining from £1.65 to £1.36 over 5 years, in 1979 they assumed a constant rate of £1.80). As is set out in more detail below, further revision to the assumptions when the forecast was updated during 1979 reduced the profit projection by a further £167 million. The sensitivity to exchange rate fluctuations will increase in the coming years with the growth of the RB211 business.

Rolls' Financial Position

7. In late 1978 Rolls Royce prepared a 5 year forecast which took account of the Government's approval during the year of the launch of the RB211-535 and the further development of the RB211-524. After adjustments for certain proposals which were not approved the forecast was as follows -

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RR FORECASTS 1979/83 BASED ON ORIGINAL FYF

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>TOTAL</u>
<u>Profit before tax</u>	(53)	(28)	(34)	(13)	59	(69)
<u>Cash flow</u>						
Operating profit & depreciation	97	127	125	143	222	714
Launch aid ⁽¹⁾	-	-	-	-	-	-
PV R&D ⁽¹⁾	(131)	(120)	(113)	(102)	(98)	(564)
Growth in inventories	(86)	(50)	(45)	(65)	(52)	(298)
Capital programme	(42)	(51)	(56)	(56)	(62)	(267)
Interest	(12)	(13)	(15)	(17)	(18)	(75)
Other	49	12	16	30	7	114
<u>TOTAL CASH FLOW</u>	<u>(125)</u>	<u>(95)</u>	<u>(88)</u>	<u>(67)</u>	<u>(1)</u>	<u>(376)</u>

(1) This table is constructed without provision for launch aid or other financial support, and thus includes the whole cost of the -535 launch and -524 growth programme on PV R&D. It assumes a constant exchange rate of \$1.80, and is in outturn prices.

8. Both Rolls Royce and the NEB believed that it would be damaging for Rolls' commercial standing for the large sums required for the RB211-524 further development and the launch of the RB211-535 to be provided as conventional capital since the capital would not earn a return for several years. It was therefore decided by the last Government to provide launch aid over a 5 year period totalling £192 million at 1978 survey prices, which is likely to be some £250 million at outturn prices, leaving some £126 million to be funded by the NEB or by commercial borrowing. (Launch aid is not shown in the balance sheet, but is credited to the profit and loss account.) Provision was made for the launching aid to be recovered by a levy on future engine sales. Simultaneously a financial duty was set, by agreement with NEB and Rolls Royce, to secure a rate of return at Rolls Royce of 10% on capital employed by 1981 and a progressive increase thereafter.

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9. By the middle of 1979 it became clear to the Department that critical assumptions underlying the five year forecast were no longer realistic. The exchange rate had appreciated rapidly, the rate of UK inflation was increasing rapidly, and Rolls Royce had indicated that, as a result of increasing world demand, they had greatly increased their sales expectations for the 1980s. In view of the clear implications for Rolls' financing needs the Secretary of State for Industry asked Sir Leslie Murphy in June to provide updated forecasts. These were submitted at the end of July and after further subsequent updating showed the following picture.

LATEST RR FORECASTS 1979-83

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>TOTAL</u>
<u>Profit before tax</u>	(39)	(52)	(10)	60	61	20
<hr/>						
<u>Cash flow</u>						
Operating profit & depreciation	49	75	68	122	220	534
Launch aid	69	54	72	43	12	250
PV R&D	(127)	(124)	(112)	(106)	(98)	(567)
Growth in inventories	(110)	(175)	(116)	(116)	(144)	(661)
Capital programme	(44)	(48)	(81)	(83)	(79)	(335)
Interest	(12)	(16)	(27)	(30)	(30)	(115)
Other	36	18	2	12	61	129
<hr/>						
TOTAL CASH FLOW	(139)	(216)	(194)	(158)	(58)	(765)
<hr/>						

NB These totals assume no waivers of levies due to HMG. The Annex to the Officials Paper incorporated Rolls Royce's assumption that 50% of levies would be waived, the effect of which was to improve profits and cash flow in that table by £29 million over the 5 years.

10. It was emphasised that the figures were an interim update only, and that this made the later years particularly uncertain. A full revision of the forecasts will be completed later this year.

COMMERCIAL IN CONFIDENCE

CONFIDENTIAL

11. In broad summary the changes were

<u>Cash flow</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1979/83</u> <u>Total</u>	<u>1979/83</u> ⁽³⁾ <u>Total</u> (no waiver)
December 78 ⁽¹⁾	(51)	(34)	(10)	(18)	16	(97)	(126)
August 79 ⁽²⁾	(134)	(209)	(188)	(152)	(53)	(736)	(765)
Difference	(83)	(175)	(178)	(134)	(69)	(639)	(639)
<u>Profit (pre-tax)</u>							
December 78 ⁽¹⁾	21	33	44	36	76	210	181
August 79 ⁽²⁾	(34)	(45)	(4)	66	66	49	20
Difference	(55)	(78)	(48)	30	(10)	(161)	(161)

(1) These data assume the provision of £250m launch aid from HMG, but do not take account of 1979 Budget changes.

(2) These forecasts also assume £250m launch aid, and take account of minor revisions to the 1980 figures as presented end-July, as documented on 17 August 1979.

(3) All these annual forecasts assumed a 50% waiver of RB211-524 levies; without any waiver both cash flow and profits would be worse by £29m over the 5 year period. The final column illustrates the effect of assuming no levy waivers.

12. As has been explained in the note annexed to MISC 22(79)1 these dramatic revisions of the figures can be accounted for by

- a) the increase in working and fixed capital requirements needed to support the greatly increased forecast of new engine and spares sales over the period;
- b) the increase in the estimate of UK inflation in 1979 from 8% to 17%, and in 1980 from 8% to 12%;

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c) revision of the assumed exchange rate from \$1.80 throughout to -

1979	\$2.10
1980	\$2.00
1981	\$1.95
1982	\$1.90
1983	\$1.85

The contribution of each of these to the total is as follows

MAJOR CAUSES OF INCREASE IN CASH NEEDS

	<u>1979/83 (£m)</u>	<u>Effect on:-</u>
<u>Exchange rate</u>	167	Profit/cash
<u>Inflation on:-</u>		
extra capital expenditure	18	Cash
inventory	<u>150</u>	Cash
	168	
<u>Growth in demand</u>		
add. capital expenditure	73	Cash
inventory	<u>230</u>	Cash
	<u>303</u>	
 TOTAL	 638	

13. The NEB, however, do not accept a number of the assumptions underlying the financial projections produced by Rolls Royce. They have queried the sales forecasts, notably with regard to the RB211, both because they consider they are over-optimistic, in terms of the present order position, and also because, in their view, sales concessions and retrofits which are not already committed should not be offered to potential customers (this could lead to a reduction in sales achievements). The NEB's view is that Rolls Royce should only work on the assumption of the sales forecasts in the original 1979/83 Five Year Forecast, and on this basis there would be significant savings on

COMMERCIAL IN CONFIDENCE

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inventory and capital expenditure. The NEB also believe that significant economies could and should be made in other areas, notably PV R&D expenditure. On the basis of the NEB analysis, a reduction of up to £250 million in the total cash requirements over the 5 year period could be achievable.

14. The validity of the NEB analysis is not accepted by Rolls Royce. Although sales optimism has been a feature of Rolls Royce forecasts in the past, the present rate of order intake tends to confirm Rolls Royce's views. Further orders have been received - against offers made months ago - since the updated forecasts were provided, eg TAP (the Portuguese National Airline) has ordered 3 Lockheed L1011-500s with 2 options and Saudia Airlines have told Rolls Royce that they will be ordering 6 RR powered 747s. In fact Rolls Royce production is now fully committed throughout 1981. It is therefore difficult to see how the company can keep to its original sales forecast. Likewise the inventory and capital expenditure programme could not in Rolls Royce's view be reduced.

15. The updated forecasts set out above are less reliable than the full new forecast for 1980-1985 which will be available later this year. Even that, however, will be subject to a very wide uncertainty. The critical effect of exchange rates and UK and US inflation rates, which are outside the company's control, has already been described. There are, however, a number of factors within the control of management which could have major effects within a five year period, and increasingly looking ahead for a longer period as is necessary for this business. There are grounds for thinking that there may be scope for further increases in prices, there is scope for curtailing the aggressive commercial approach which has been deliberately used to increase market share, there is substantial scope for increased productivity in manufacturing, and there is scope for greater selectivity in new projects and more collaboration with other manufacturers - a course on which the existing management has already started. It is difficult to assess how far profitability can be increased by a more commercially motivated management. The policies carried out since 1971 have created a technical reputation for the RB211 and the confidence of aircraft manufacturers, particularly Boeing, and of airlines, such that the sales potential is now great, but the ability of the present leadership to control costs so as to make those sales profitable is in doubt.

COMMERCIAL IN CONFIDENCE

CONFIDENTIAL

Summary

16. (1) Rolls Royce's civil business is now very heavily dependent on the RB211 family of engines;
- (2) The RB211-524 is now fully established as at least a technical match for the competing US engines. The RB211-535 will not enter service until 1982, but will be available some 8-12 months before its only American competitor;
- (3) The RB211 has not so far been profitable, and the prospect for its becoming so is very heavily dependent on the view taken of the exchange rate;
- (4) Rolls Royce's productivity compares unfavourably with that of its US competitors, but it is very difficult to estimate the realistic prospect for improvement with improved management;
- (5) Rolls Royce has been through a period of very high marketing costs in order to increase its market share. There should be scope for greatly reducing this and perhaps increasing selling prices now that the -524 is fully established, but a similar expensive marketing phase is likely to be faced for the -535;
- (6) Rolls Royce has striven to compete in almost every sector of the gas turbine market. There should be substantial scope for economy and raising profitability by limiting the scope of activity.

Air Division
12 October 1979

THE RB211

1 There are a number of versions of this engine, each of which has been developed for specific applications.

RB211 -22

2. This is the original high by-pass engine of 42,000 lbs thrust developed by RR for the Lockheed L1011 Tristar. Its mounting costs caused the company's bankruptcy in 1971.
3. As part of the company rescue, the Government agreed in 1971 to finance RR in the development and production of the engine, and undertook to Lockheed to enable RR to maintain the necessary support facilities throughout the life of the engine.
4. The Government paid for virtually all the costs of development and production of the first 555 engines - the number then under contract - and in return took the receipts on the first 555 and a levy of 7% on the sales value of all engines, thereafter, (excluding spares). Any further costs eg in-service-development (ISD) were to be met by RR.
- 5 The net costs of development and production of the -22, ie taking into account production receipts but not levies, were estimated in 1972 at £170m at 1972 prices. The 555th engine was delivered in April 1979, and the actual net cost was £169m in actual money paid. Taking account of inflation, the actual costs were significantly less than predicted in 1971.
- 6 Although there will be further sales of the -22 as existing Lockheed customers expand their fleets, these are expected to be very limited, since most versions of the Tristar now require the higher thrust versions of the RB211 (see below). There will, however, be a large continuing business in the provision of spares. At the same time continuing development expenditure of the order of £5 million per year is required to improve the reliability of the engine, and maintain RR's standing with its customers.
- 7 The -22 is now in service with 147 aircraft in 10 airlines.

RB211 -524

- 8 The -524 is a higher thrust version of the RB211. It was launched in 1974 to meet Lockheed's requirements for a 48,000 lbs thrust engine (designated -524B) to improve the range and payload of the Tristar. In approving the project, Ministers were aware that there were substantial risks, that it would lead to RR demands for still higher thrust versions and that the economics of the



project were uncertain. Also in 1974, approval was given to a 50,000 lbs thrust version for the Boeing 747 (-524B2); this was to provide a basis for RR to capture a wider market, initially through British Airways. Unlike the Tristar where the RB211 was, and still is the only engine on offer, the Boeing 747 was well established with engines from both RR's main competitors, General Electric and Pratt and Whitney. As the third engine option on offer, it was recognised that RR would have a difficult competitive struggle to extend its BA bridgehead on the B747.

- 9 The result of the decisions on the Lockheed, and Boeing adaptations of the RB211 -524 was a Government commitment to contribute £26.3m in launch aid towards the development costs of the Lockheed version, and £8.9m towards the Boeing version, both sums representing about 50% of the estimated development cost and both subject to a cost escalation - inflation formula. It was also recognised that further thrust development of the engine might be required to meet airline needs; in particular, BA anticipated a requirement for 53,000 lbs by 1982.
- 10 The Government, therefore, agreed in principle to contribute up to a further £12.3m on similar terms if such a programme was necessary. As with the -22, the Government intended to recover its contribution by a 7% levy on engine sales.

RB211 -524 Development

- 11 Airframe manufacturers and airlines are constantly requiring higher power and greater fuel economy from their engines. RR, therefore, proposed and the previous Government approved at the beginning of the year new C and D versions of the engine at respectively 51,500 lbs and 53,000 lbs to be available in 1980 and 1981. Both GE and P & W have already engines in service at this thrust. The development programme also included a B4 version at 50,000 lbs designed to have significantly improved fuel consumption compared with earlier versions. All these versions are now in development and are contractually committed to airlines. The total cost of the development was estimated to be £110m. An even higher thrust version (the -524G at 55,000 lbs) has not yet been approved.
- 12 RR's financial forecast in 1978 for the future of the -524 programme as a whole, showed a DCF rate of return of 11% on the assumption of an exchange rate of \$1.70:£ over the lifetime of the project - some 20 years. In assessing the programme, the Government also looked at alternative assumptions of \$1.80 and \$1.95 for the exchange rate and slightly fewer sales, which reduced the expected DCF return to 4% and to a small negative rate respectively. Taking account of employment and balance of payment effects, however, improved the return to the national economy by about 3.5% in each case.

COMMERCIAL IN CONFIDENCE



13. Although the financial analysis showed, at best, only a modest return and considerable sensitivity to exchange rate fluctuations, it was recognised that further development of the -524 was crucial to RR's position as a civil aero-engine supplier, and in view of existing HMG commitments to the engine, the proposed development was approved. It is proceeding very satisfactorily.
14. The -524 is in service with 26 aircraft of five airlines; RR have taken orders to supply a further 73 aircraft with 13 airlines with options on a further 54. Amongst these airlines are some of the most influential airlines in the world; the Pan Am purchase of 12 -524 powered L1011 -500s (the long range version) and Qantas' decision to buy -524D4 powered Boeing 747 after a long standing commitment to Pratt and Whitney represent major breakthroughs.
- RB211 -535
15. The -535 is a derivative of the RB211 -22, with a thrust of about 37,000 lbs, and is designed for application to new medium size (140-190 seat) aircraft such as the Boeing 757.
16. Approval was given to full launch of the engine in August 1978 after careful assessment by the NEB and HMG of the technical and commercial prospects, especially bearing in mind the difficult development problems encountered on the -524.
17. The costs of development were estimated by RR at £250m (1978 prices) including a contingency of £50m. HMG, in assessing the project added, on technical advice from MOD a further £50m contingency. A technical assessment by MOD(PE) generally endorsed RR's claim that as a derivative engine the technology involved in developing the engine is of low risk. After more than a years development work both costs and development are on schedule.
18. The economic case for the -535 rested largely on the commitment from Boeing to use the -535 as the engine to be certified first on the Boeing 757 supported by initial orders for 40 aircraft from British Airways and Eastern Airlines. General Electric with a derivative engine, the CF-32 will also be certified, but some 8-12 months behind RR while Pratt and Whitney appeared unlikely to compete - a view which remains valid. The -535 is due to be certificated in the Spring of 1981.
19. On this basis RR assumed that the -535 could achieve over 40% of Boeing 757 sales estimated to be between 1000 and 1500 over the next 15 years. DOI market estimates were somewhat less optimistic by about 20 per cent due mainly to the expectation that other manufacturers would launch aircraft similar to the Boeing 757. Nevertheless they confirmed that the -535 represented the best opportunity to expand RR's share of the civil aero-engine market and secure the company's market position in the next generation of aircraft.



20. RR estimated that the discounted rate of return over the lifetime of the project was between 10.9% and 11.5%. These estimates were based on a number of assumptions of which the two most critical were, the exchange rate and engine selling price. RR assumed an exchange rate over the next twenty years of $\text{£}1.70:\text{£}$. At the time the estimates were prepared, this was roughly the existing exchange rate. However, it was thought prudent on Treasury advice to consider an exchange rate of $\text{£}1.80:\text{£}$; this reduced the DCF return to 6.1%. Allowing for the lower DOI estimates of sales and the additional development cost contingency, the rate of return was estimated to be 1.8%. Taking into account balance of payment and employment effect, the national DCF return was 3.8% at $\text{£}1.80$ and 6.4% at $\text{£}1.70$.
21. Notwithstanding the modest DCF return expected, it was considered that the -535 was essential to RR's future in the civil aero-engine business and indeed represented an opportunity to exploit the hard won and expensive position achieved by RR in the big engine league.
22. Although orders for RR powered 757s beyond those of Eastern Airlines and BA have not yet followed, Boeing remains firmly optimistic that some 1500 will be sold and foresees a possible 50% share of RR. DOI market estimates remain of the view that 1000 units can be expected, and that RR could obtain a 40% share of them although so far no competitive aircraft has been launched. The financial return will, however, depend heavily on the exchange rate prevailing.
23. The Government undertook in March this year to provide $\text{£}250\text{m}$ of launch aid for the -524 and -535 development programmes. The $\text{£}250\text{m}$ represents about 70% of RR's estimated development costs, but about 50% of official estimates of those costs and is in escalated money. In PES terms the launch aid amounts to $\text{£}192\text{m}$ (1977 PES) and unlike the earlier support does not provide for the Government to pay a percentage of the actual development costs ie if RR have to spend more in real terms, this must be found from within the company's own resources. The Government's contribution would be recovered by levies if the company achieves its sales forecast and if the exchange rate over the 20 year life of the project did not average more than $\text{£}2.00$.

THE TECHNICAL COMPETITIVENESS OF THE RB211-5241. INTRODUCTION

In MOD(PE) assessments of the RB211-524 project during its development, attention has been paid to the question of how the engine was likely to turn out relatively to its US competitors in terms of important technical aspects such as fuel consumption, weight and service reliability. The purpose of this note is to present an up-to-date comparison in the light of information now available, and to look also at how the later versions of the 524 are likely to be placed. Attention is particularly directed to the Boeing 747 application, where the three major engine manufacturers are in direct competition.

Much of the material used here has been gathered from a variety of sources by Rolls Royce, and in view of this the 'Commercial In Confidence' marking of this note deserves emphasis.

2. THE CURRENT SITUATION2.1 Comparisons of Specific Air Range

The Specific Air Range (SAR - commonly quoted in nautical miles per gallon) is a standard measure of fuel economy at specified conditions of flight speed, altitude and aircraft weight. Thus if these three parameters are maintained constant when comparing SAR's for a given aircraft type fitted with alternative engines, the results will take account both of basic engine performance differences and of installation effects, but will not show the effect on overall fuel consumption of differences of engine weight. It is appropriate to consider this weight effect separately, at a later stage.

Boeing have carried out flight tests of the 747 aircraft enabling SAR comparisons to be made between the Pratt & Whitney, General Electric and Rolls Royce engines at Mach 0.84, 35000ft, at 630,000lb aircraft weight. These are shown in Table 1 below, taking the RB211-524B2 engine - the current standard for British Airways Boeing 747 deliveries - as the datum.

Table I

SAR Test Results - New Engines

Engine	Relative SAR, %
RR RB211-524B2	Datum
GE CF6-50E	-2.8
GE CF6-50E2	-1.3
P&W JT9D-7J	-0.9
P&W JT9D-70A	-1.7
P&W JT9D-7Q	-1.3

An important point to be made concerning the above figures is that essentially new engines (lives of around 50 hours) were used for the flight tests. Differences in the performance deterioration of the different engines in long-term service operation are therefore not included; the additional effect of this factor on the comparison of engines in airline service is considered separately below.

Table I shows that when the engines are new, the current production 524B2 engine has a small measure of superiority in SAR at given aircraft weight over competing engines that are currently available. This is broadly in accordance with the expectations we expressed in our earlier assessment reports - for example, that of April 1976. As indicated in those assessments, we believe that this competitive edge derives largely from an advantage that the RB211 holds in its installation performance. Recent evidence, in the form of comparisons made by Rolls Royce of the Boeing SAR test figures with predictions based on basic engine performance data, supports this view. The short, compact, 3-shaft design of engine allows interference drag between nacelle and wing in an underwing installation to be minimised. There is also evidence that the short conical-shaped afterbody used now on RB211 engines is very efficient aerodynamically. Another, more general, factor which should favour Rolls Royce is the more integrated approach to installation design which tends to result when the engine manufacturer takes responsibility for the powerplant as a whole, and not just the flange-to-flange engine.

It is of interest to note that the JT9D-7Q, which represents an attempt by P&W to produce a generally 'cleaned-up' version of the 70A, has so far fallen short of its target. Estimates for this new variant had suggested that it would show an SAR marginally better than the 524B2

We now turn to the effect of performance deterioration in service. The evidence here shows an appreciable spread, coming as it does from a variety of airlines with different flight operations, maintenance practices, etc. However, the overall picture in both 22B and 524 versions, shows to advantage relative to the American engines. For example, available data from British Airways and Quantas indicates that JT9D-7 engines have suffered sfc increases in the region of 4 to 5% in the course of several thousand hours operation, while RB211-524 experience to date suggests a figure of 1 to 2%. Taking a conservative estimate in the light of current evidence, we propose to use here a differential of 2% in favour of the RB211-524 to compare SAR's for typical airline operations when the engines are no longer new. Table II therefore shows such a comparison, derived from Table I simply by increasing the SAR differences relative to the 524B2 by 2%.

Table II

Table II

SAR Comparison Allowing for Deterioration

Engine	Relative SAR, %
211-524B2	Datum
CF6-50E	-4.8
CF6-50E2	-3.3
JT9D-7J	-2.9
JT9D-70A	-3.7
JT9D-7Q	-3.3

It is appropriate to note here that both Pratt & Whitney and General Electric recognise that their large turbofans compare poorly with previous generations of civil jet engines in terms of performance deterioration rates, and are making strenuous efforts to bring about improvements in later versions.

2.2 Weight and Thrust

It is in these two areas that the RB211 compares less favourably with its rivals. It is heavier than the US engines, and up to now has lagged behind in terms of maximum rated thrust levels. Either or both of these factors can be significant depending on the aircraft duty pattern, and they operate additively to produce important penalties in range/payload capability under certain limiting airfield conditions. Although such conditions (high temperature, high altitude and/or relatively short runway) may apply for only a small minority of operations, their demands may exert a crucial influence on an airline's choice of equipment.

Quantifying first the more straightforward effects of a powerplant weight penalty on fuel consumption, an approximate exchange rate applicable to Boeing 747 operation is that 10,000lb increase of shipset weight is equivalent to 1.6% decrease in cruise SAR, as a consequence of the higher cruise thrust requirement. We can therefore now take the SAR figures of Tables I and II (which, as indicated earlier, are for constant weight) and adjust them approximately to allow for the differences in shipset powerplant weight.

Table III

SAR Comparisons Adjusted for Powerplant Weight Differences

Engine	Relative Operational Empty Weight (OEW), lb	Relative SAR, % New Engines (from Table I)	Relative SAR, % Deteriorated Engines (from Table II)
211-524B2	Datum*	Datum	Datum
CF6-50E	-6130	- 1.8	- 3.8
CF6-50E2	-5860	- 0.4	- 2.4
JT9D-7J	-11820	+ 1.0	- 1.0
JT9D-70A	-2030	- 1.4	- 3.4
JT9D-7Q	-8730	+ 0.1	- 1.9

* Total 'below nylon' shipset weight for 211-524B2 is 55600lb.

It should be emphasised that these comparisons apply to cruise conditions. The total quantity of fuel consumed in a mission is also affected by other factors - e.g. climb rating, sfc's during descent and hold, etc. Nevertheless, the above table gives a rough impression of the relative fuel consumption for typical operations.

Where the take-off weight (TOW) is not restricted by maximum aircraft design weight or airfield limitations, an engine type requiring extra fuel for a given operation simply entails an increase in TOW. The penalty associated with the less economical engine then appears essentially as an increased fuel cost. Where the take-off is limiting, however, the situation becomes more complex. Provided the aircraft is not on its maximum design weight limit, the TOW allowable will depend on the available take-off thrust. The payload that can be carried is then determined by the combination of engine weight, fuel needed for the mission, and engine thrust rating. A high engine thrust rating, combined with an advantage in engine weight, can outweigh a disadvantage in fuel economy, enabling a greater payload to be taken. This is where some of the US engines currently score against the RB211-524B2. Although needing more fuel for the mission, their higher thrust/lower engine weight combination gives a better payload on these take-off limited missions. For a Boeing 747 operating from an 11,000ft runway at sea level, 90°F, 1% increase in take-off thrust will allow 4000lb increase in TOW. Thus the higher thrust versions of the American engines allow considerably greater TOW's than the 524B2. This, taken in conjunction with their lower weights, more than offsets their extra fuel requirement. Table IV carries the comparison through to show the approximate relative payloads for take-off for a 5000 n.m. stage at the airfield conditions quoted above.

Table IV

<u>Relative Payloads, 5000 n.m., 11,000ft runway, sea level, 90°F, new engine</u>		
Engine	Take-off thrust rating, lb	Relative Payload, lb
211-524B2	50,000	Datum (= 93,900lb)
CF6-50E	52,500	+ 13,700
CF6-50E2	52,500	+ 17,100
JT9D-7J	50,000	- 3,700
JT9D-70A	53,000	+ 14,700
JT9D-7Q	53,000	+ 22,700

In the context of such operations as that considered above, the value of the imminent clearance of the 524C2 rating at 51,500lb thrust is very apparent. This will improve the relative position of the 524 in the above table by 7200lb. Comments are made later on the further developments in thrust which are in hand for the RB211 and the American engines.

2.3 Other Factors

The technical competitiveness of the RB211-524 is affected by a number of factors additional to those dealt with already. Environmental characteristics being roughly similar between the competing engines, the significant remaining differences fall largely under the headings of reliability and of robustness in service.

The reliability of the RB211-524, as measured by the standard indices of removal rates, in-flight shutdown rates and aborted take-off rates is not yet as good as some of its competitors, and intensive efforts are being made to improve the situation. On the other hand, the engine has, like the RB211-22B, a good reputation for robustness in terms of resistance to foreign object damage, containment characteristics, etc. These qualities, taken together with the lesser performance deterioration in service discussed earlier, reflect the good mechanical strength and rigidity of the engine. They can be regarded as representing the beneficial side of the greater weight of the RB211 relative to its competitors.

3. THE 1982/84 SITUATION

During the period 1982 to 1984, further versions of the engines, currently under development by Rolls Royce and by the US manufacturers, will enter service.

In the context of the Boeing 747 the significant new versions of the RB211-524 in this timescale are the 524C2 and the 524D4. The 524C2, already referred to in Section 2.2, is essentially an uprating of the 524B2 to give 51500lb take-off thrust with an unchanged cruise fuel consumption. Type testing is currently in progress and the engine is due for delivery later this year. The 524D4 involves much more extensive change, including a new higher performance fan and a new IP/LP turbine module, to give 53000lb take-off thrust together with cruise s.f.c. 4.8% better than the 524B2. Largely through the introduction of a lighter thrust reverser system, total ship set powerplant weight for a Boeing 747 is estimated to be 960lb less than for the 524B2. The D4 engine is due for certification in Spring 1981, with entry to service in 1982.

P & W and GE are also developing their engines to reduce s.f.c. and weight, and to increase take-off thrust. The relevant GE engines are the CF6-80 series, based on the 50 series but involving major changes including extensive structural and aerodynamic redesign in the turbine area. These engines will thus be both shorter and substantially lighter than the 50 series. The 80B is aimed at a take-off thrust of 54000lb, and a cruise s.f.c. 2% better than the 50E2. Certification is to be in Autumn 1981 with production deliveries in early 1982. A later version, the 80C, has targets of 56000lb take-off thrust and a further 2% s.f.c. improvement; the certification date is not at present known, but we understand that entry to service is planned for late 1983. Pratt & Whitney developments for the Boeing 747

are the JT9D-7R4G and -7R4H. Take-off thrust targets are 54000lb for the 7R4G, and 56000lb for the 7R4H. Both engines are aimed at a cruise s.f.c. improvement relative to the JT9D-7Q brochure level of 1%, which is equivalent to 2.5% improvement over the level actually achieved on the 7Q up to now as implied by the Boeing SAR measurements quoted in Table I. Certification dates for these P & W engines are understood to be July 1981 for the 7R4G and January 1982 for the 7R4H.

It will be noted that the 211-524D4 engine is due to enter service in the early part of this 1982/84 period. Rolls Royce have expressed the belief that this will give them a useful marketing advantage over the later American engines.

Estimates of the relative capability of 747 aircraft powered by these improved engines are made below, using the approach of Section 2 and now taking the RB211-524D4 as the datum. In making these estimates, the assumption is made that the figures quoted above, which apply of course to the engines when new, are achieved. Current development progress on the RB211 is encouraging, and on the evidence available so far we believe the 524D4 targets should be reached or closely approached. Very little is known of how the Americans are faring. Doubtless they have their share of development problems, but it would be unwise to assume at this stage that their targets will not finally be met. Regarding the question of performance deterioration in service, it has already been noted that it is a major objective of both US firms to reduce their deterioration rate. Nevertheless, this is easier said than done and Rolls Royce may well continue to enjoy a competitive edge in this area for some time to come. We therefore assign an advantage of 1% to Rolls Royce in the comparisons below for deteriorated engines - i.e. half the advantage used in the comparisons of Section 2.

3.1 Specific Air Range

Estimates of the relative SAR position for the future engine versions are presented below. These have been derived by applying the target s.f.c. improvements quoted above to the relativities established by Boeing flight test on the current engines, given in Table I. An additional adjustment made in the case of the CF6-80 engines is a further credit of 1% in recognition of the prospect that the shortening of these engines relative to the CF6-50 series may give some benefit in reduced installation drag.

Table V
Estimates of Relative SAR, 1982/84

Engine	Relative SAR, % New Engines	Relative SAR, % Deteriorated Engines
211-524D4	Datum	Datum
CF6-80B	- 3.1	- 4.1
CF6-80C	- 1.1	- 2.1
JT9D-7R 4G) JT9D-7R 4H)	- 3.6	- 4.6

/Tho

The above estimates, like those of Tables I and II, are for a given aircraft cruise weight.

3.2 Effects of Weight and Thrust

All three manufacturers are seeking substantial weight reductions in their development programmes. The prospect is therefore that the US engines will continue to hold a significant advantage relative to the RB211 in this respect. Table VI shows the differences of quoted shipset weights and the estimated relative SAR position after allowing for those differences.

Table VI

SAR Comparisons Adjusted for Powerplant Weight Differences

Engine	Relative shipset powerplant weight, lb.	Relative SAR, % New Engines (from Table V)	Relative SAR, % Deteriorated Engines (from Table V)
211-524D4	Datum	Datum	Datum
CF6-80B	- 8000	- 1.8	- 2.8
CF6-80C	- 6360	- 0.1	- 1.1
JT9D-7R 4G	- 8810	- 2.2	- 3.2
JT9D-7R 4H	- 8490	- 2.3	- 3.3

The estimates of Tables V and VI suggest that the RB211 will continue to hold some advantage in fuel consumption over the US engines in future Boeing 747 applications, though it may be closely challenged by the CF6-80C. It will be appreciated that the above estimates must involve significant uncertainty at this stage. The actual technical achievements of the three competing manufacturers over the next few years remain to be seen. However, it is relevant to state here our view that the degree of risk associated with the US engine developments is at least as great as that for the RB211-524 D4.

It is also appropriate to mention an important indication from the airline world of confidence in the RB211-524 D4 engine, in the form of a decision by Qantas to change over from P & W to RR engines for all its future Boeing 747's. It is unusual for an operator to change to a different engine supplier within a fleet of a given aircraft type. The fact that Qantas, an experienced long-range international airline which pays considerable attention to fuel consumption and technical performance generally, has made this move, can be regarded as a heartening sign of the potential future for the RB211-524 D4.

We now turn again to the question of thrust capability, whose importance in regard to payload under limiting take-off conditions was outlined in Section 2.2. With the US manufacturers raising the thrust of their engines still further, the RB211-524 D4 at 53000lb will still be at a disadvantage relative to the competition.

This can be illustrated by again considering payloads for the 5000 n.m. operation used in the comparison of current engines in Table IV.

Table VII

<u>Relative Payloads, 5000 n.m., 11,000ft runway, sea level, 90°F, new engines</u>		
Engine	Take-off thrust rating, lb	Relative Payload, lb
211-524D4	53,000	Datum
CF6-80B	54,000	+ 2500
CF6-80C	56,000	+ 9200
JT9D-7R 4G	54,000	+ 2700
JT9D-7R 4H	56,000	+ 6100

These relative payloads are the resultants of the thrust, weight and fuel consumption differences between the engines. The comparison indicates a distinct advantage in revenue carrying capability in this type of operation if a thrust in the region of 56,000lb is available.

It is also relevant to look at the benefit of increased thrust in terms of the maximum take-off weight that can be used. For the airfield conditions taken for Table VII, a 53,000lb thrust rating will just allow take-off at the current Boeing 747 maximum, namely 820,000lb. We understand that a version of the aircraft with a TOW of 833,000lb is now the subject of negotiation with airlines, and that still further increases are under consideration. Clearly, greater thrust levels than 53,000lb are needed to exploit such aircraft fully.

We believe that the question of how far to take the RB211, in terms of thrust, calls for further appraisal. The extent of its commercial disadvantage relative to the US engines if not developed beyond the 524D4 is not easy to assess, depending as it does upon the evolving needs of the Boeing 747. Nevertheless, the comparisons outlined above suggest that a significant incentive is emerging to move towards something like the 524G version, projected by Rolls Royce to achieve 55,000 lb within the existing powerplant nacelle size. The 524G design should be reviewed in the light of experience gained since it was schemed, and the possible attraction of going to some intermediate stage which would require a lower investment deserves study. An important element of any uprating would of course be the hollow titanium fan, where Rolls Royce appear to have a technical lead over the Americans and which offers benefits in both weight and performance.

3.3 Other Factors

Mention was made under this heading in Section 2.3 of the good reputation that the RB211 currently enjoys for resistance to foreign object damage, and general mechanical robustness. As these attributes are closely connected with the overall mechanical design of the engine, we believe there is a good chance that future RB211 versions will continue to show some advantage in this area over their US rivals

4. CONCLUSIONS

- (a) At present the RB211-524 shows a small but useful advantage in fuel consumption over its competitors in Boeing 747 applications. The prospect is that this will still be the case when developed versions of all the engines have entered service in 1982/84.
- (b) While this advantage in fuel consumption is an asset whose value will increase if fuel prices continue to rise, it can be counterbalanced in the marketplace by the combination of higher engine weight and lower take-off thrust which limits the payload of RB211-powered 747's under certain critical airfield conditions.
- (c) In view of these payload limitations, the case for proceeding with further development of the RB211-524 series to thrust ratings higher than 53,000lb requires consideration. This assessment is not easy, and depends on the predicted evolution of the Boeing 747 aircraft and its pattern of usage.
- (d) Increasing take-off and climb thrust ratings is likely to be a more fruitful path of long-term development than attempting major weight reduction on the basic engine. The RB211 has a good reputation for mechanical robustness and this asset should not be hazarded.

Commercial in Confidence

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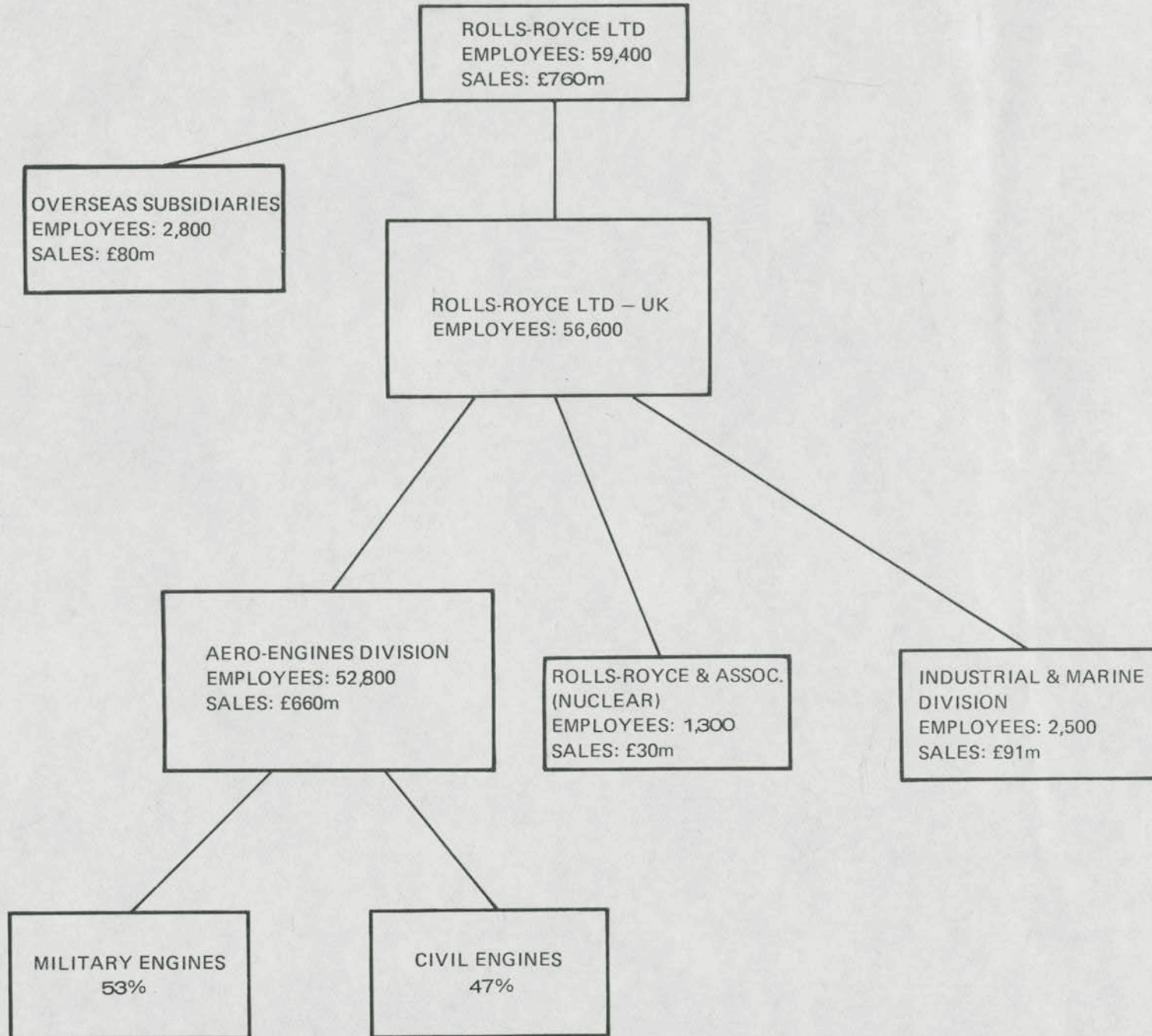
ROLLS ROYCE - PRESENTATION TO THE PRIME MINISTER

16 OCTOBER 1979

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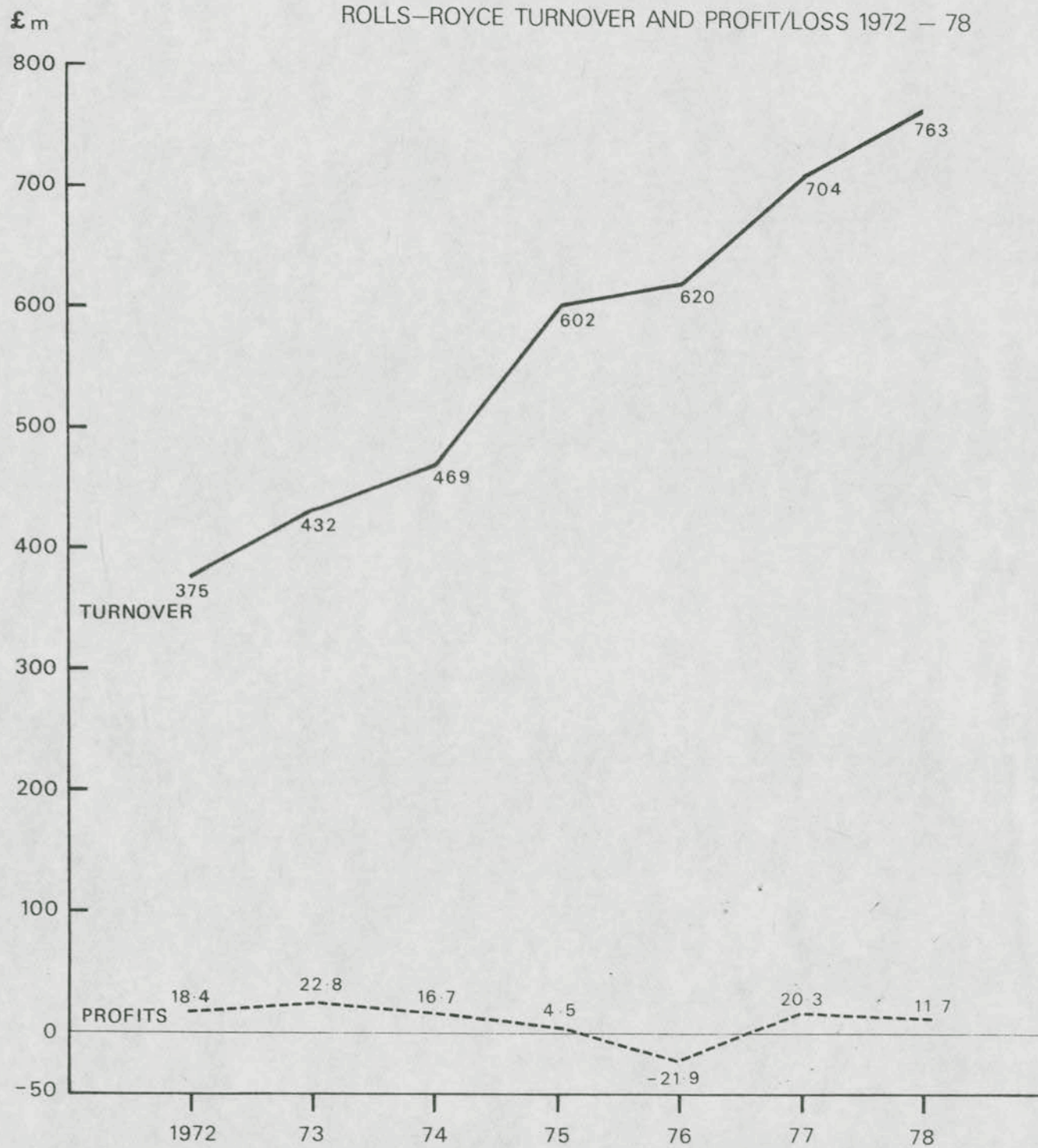
STRUCTURE OF ROLLS ROYCE

Fig. 1



ROLLS-ROYCE TURNOVER AND PROFIT/LOSS 1972 - 78

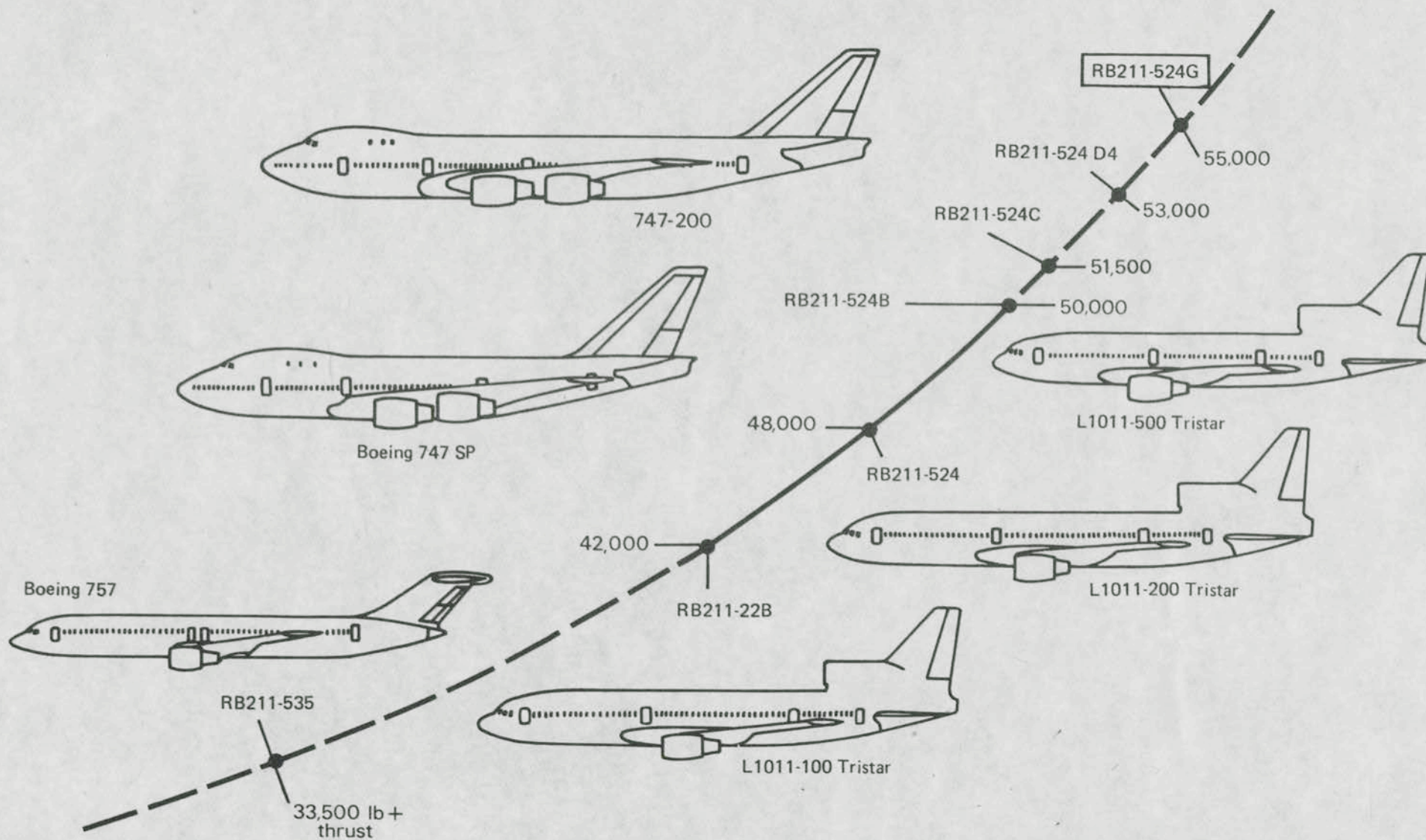
Fig. 2

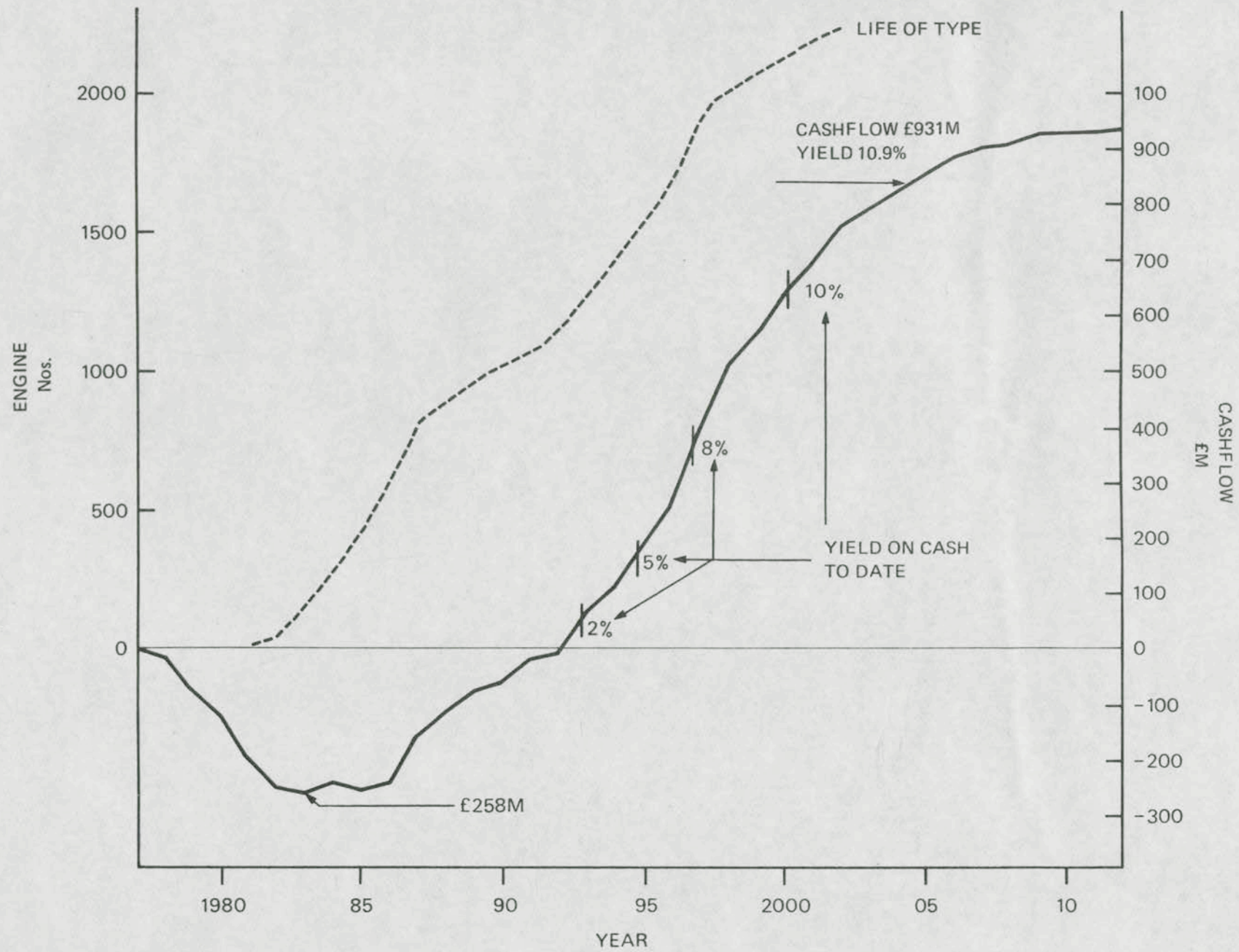


ROLLS-ROYCE - RANGE OF ENGINES

Fig. 3A

		<u>SERVICE ENTRY</u>	<u>MAIN AIRCRAFT APPLICATIONS</u>	<u>1978 % OF AERO- ENGINE SALES</u>
<u>RB211</u>	-22	1972	TRI-STAR	9
	-524	1977	TRI-STAR/B747	12
	-535	1981	B757	UNDER DEVELOPMENT
<u>SPEY</u>		1964	BAC 1-11/TRIDENT F28/PHANTOM	17
<u>RB199</u>		1979	TORNADO	5
<u>ADOUR</u>		1972	JAGUAR/HAWK	5
<u>PEGASUS</u>		1969	HARRIER/AV8A	4
<u>GEM</u>		1976	LYNX(HELICOPTER)	3
<u>OTHER (Including):</u>				
DART)	1953	Including a high proportion of spares	45
VIPER)	1953		
OLYMPUS)	1956		
TYNE)	1960		
AVON)	1951		



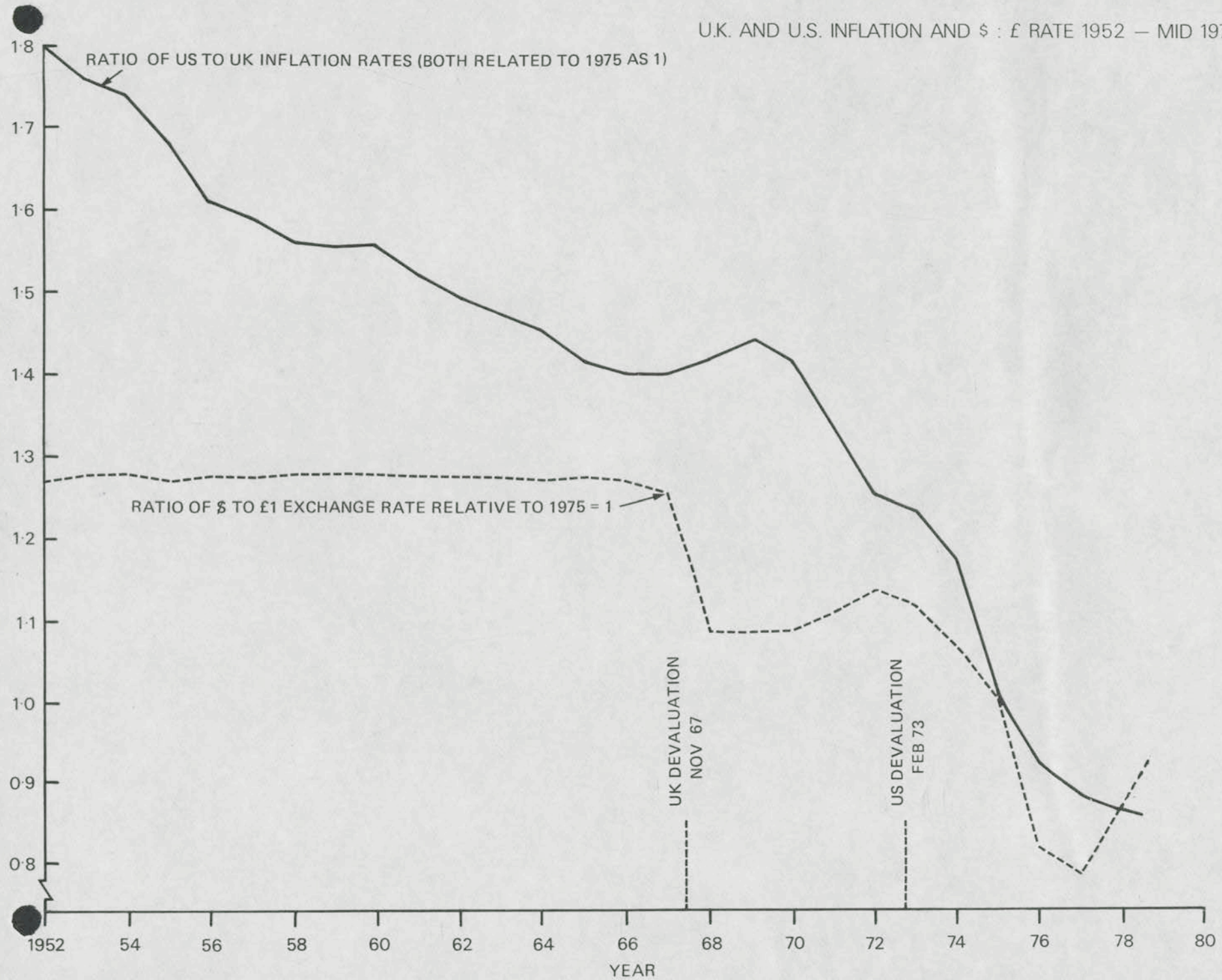


EFFECT OF EXCHANGE RATE ON PROFITS/LOSSES

Fig. 5

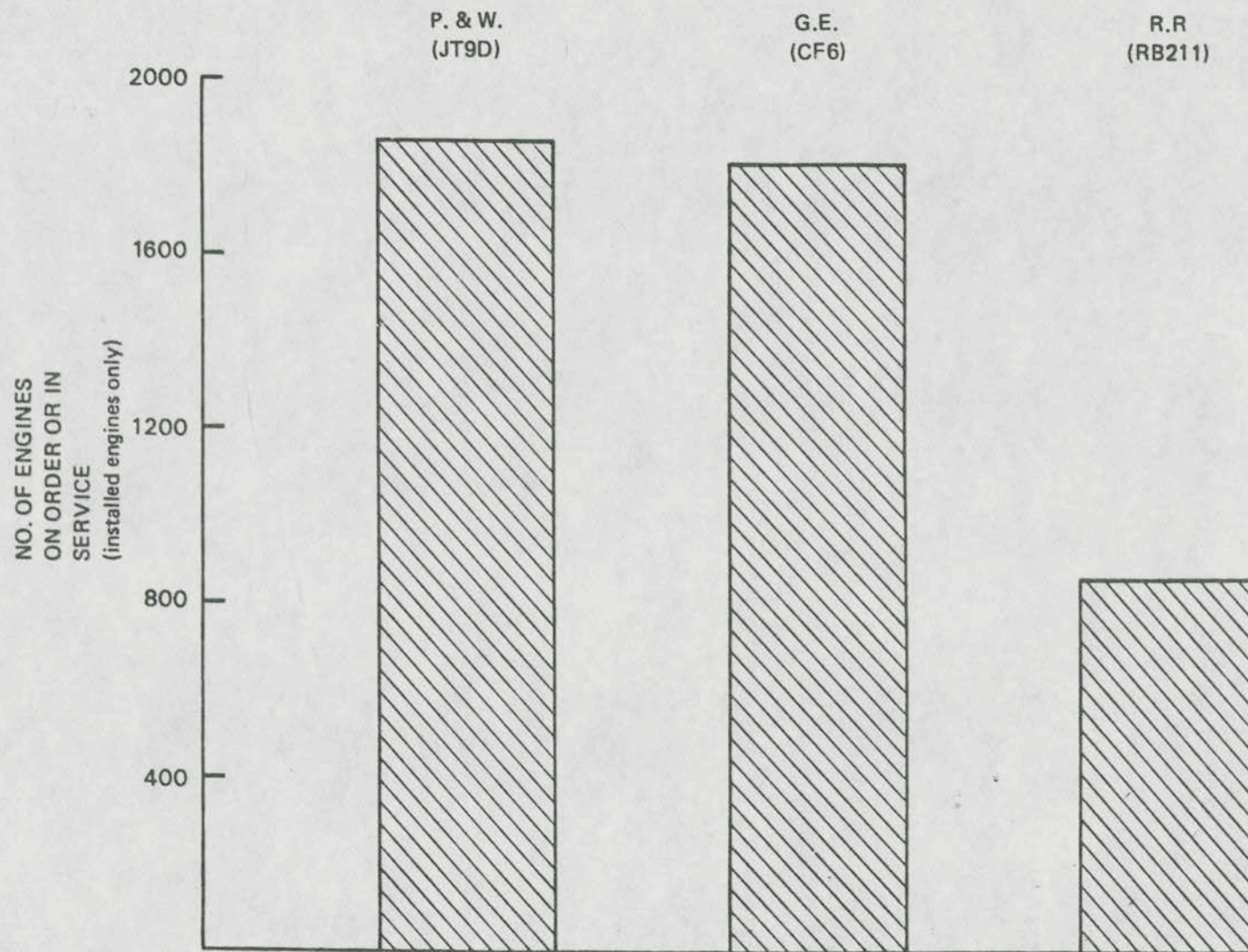
		(£ Millions)	
		<u>£1.80</u>	<u>£2.10</u>
1979	PROFITS / (LOSSES)	(9)	(39)
1983	PROFITS / (LOSSES)	85	(59)

IN 1983 EVERY ONE CENT VARIATION
IN THE STERLING/DOLLAR EXCHANGE
RATE AFFECTS ROLLS-ROYCE'S CASH
FLOW AND PROFITS BY £4.8m.



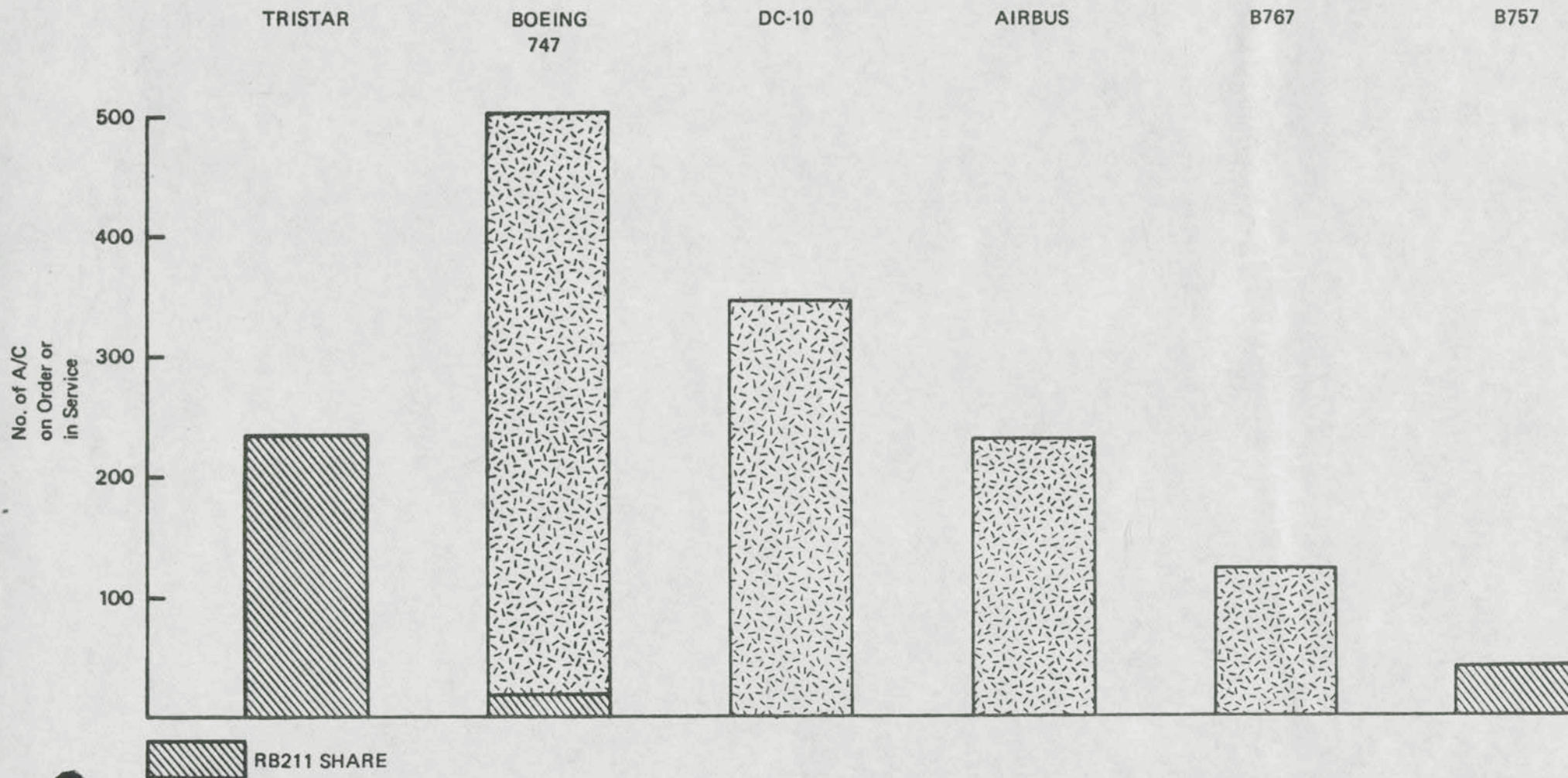
MARKET SHARE OF ROLLS-ROYCE AND COMPETITORS IN BIG ENGINES

Fig. 7



AIRCRAFT SALES AND RB 211 SHARE

Fig. 8



CHANGES IN ROLLS-ROYCE FORECASTS OF CASH FLOW AND PROFITS

B

Fig. 9A

	(£ Millions)						
<u>CASH FLOW</u>	1979	1980	1981	1982	1983	1979/83 TOTAL	1979/83 <u>TOTAL</u> (NO WAIVER)
DECEMBER 78	(51)	(34)	(10)	(18)	16	(97)	(126)
AUGUST 79	(134)	(209)	(188)	(152)	(53)	(736)	(765)
DIFFERENCE	(83)	(175)	(178)	(134)	(69)	(639)	(639)
<hr/>							
<u>PROFIT (PRE-TAX)</u>							
DECEMBER 78	21	33	44	36	76	210	181
AUGUST 79	(34)	(45)	(4)	66	66	49	20
DIFFERENCE	(55)	(78)	(48)	30	(10)	(161)	(161)

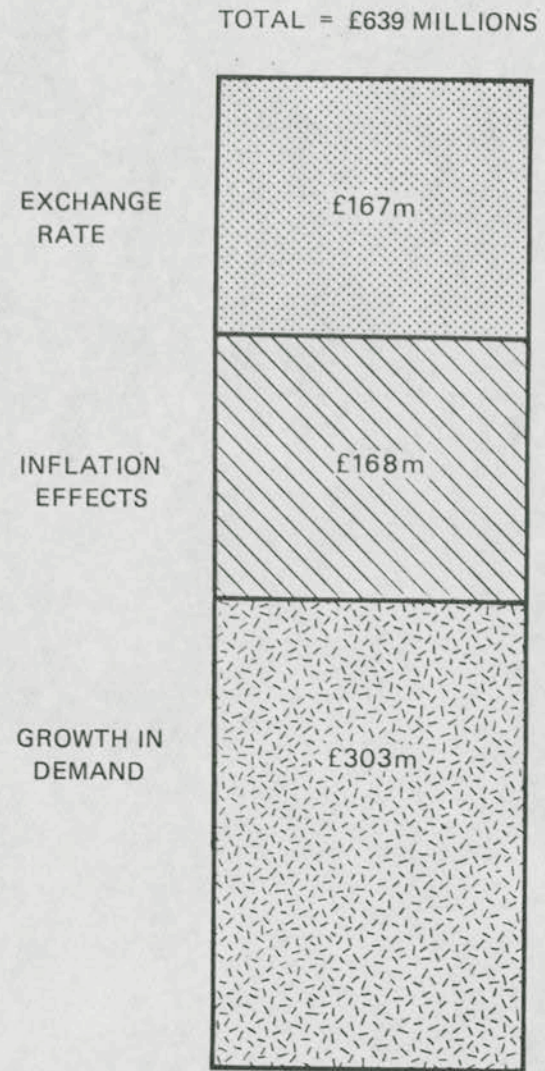
LATEST ROLLS—ROYCE FORECASTS 1979 — 83

Fig. 9B

<u>CASH FLOW</u>	(£ Millions)					
	1979	1980	1981	1982	1983	TOTAL
OPERATING PROFIT & DEPRECIATION	49	75	68	122	220	534
LAUNCH AID	69	54	72	43	12	250
PV R & D	(127)	(124)	(112)	(106)	(98)	(567)
GROWTH IN INVENTORIES	(110)	(175)	(116)	(116)	(144)	(661)
CAPITAL PROGRAMME	(44)	(48)	(81)	(83)	(79)	(335)
INTEREST	(12)	(16)	(27)	(30)	(30)	(115)
OTHER	36	18	2	12	61	129
TOTAL	(139)	(216)	(194)	(158)	(58)	(765)
PROFIT BEFORE TAX	(39)	(52)	(10)	60	61	20

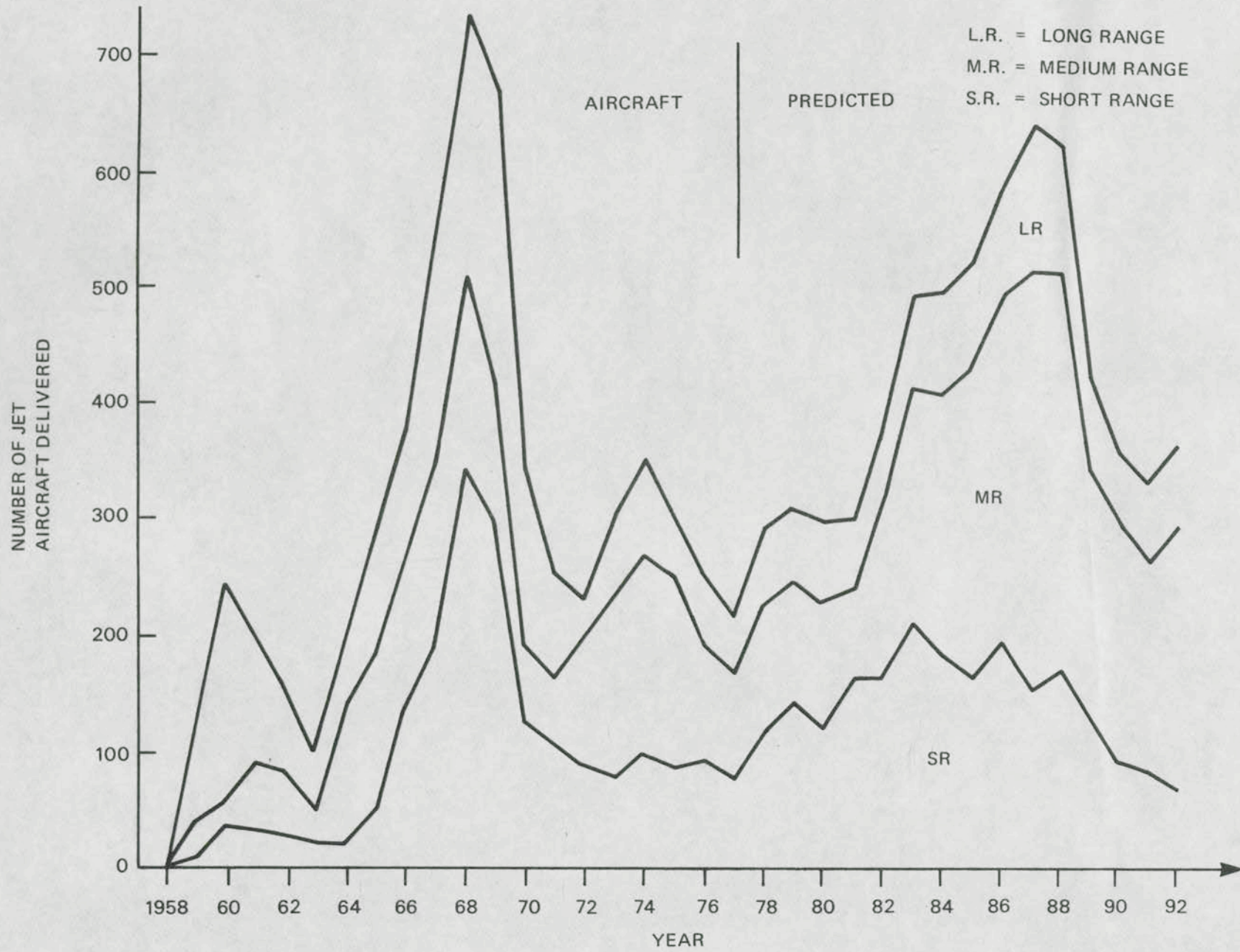
CAUSES OF INCREASED CASH REQUIREMENTS IN UP-DATED FORECAST

Fig. 9C



JET AIRCRAFT DELIVERIES BY YEAR

Fig. 10



IMMEDIATE WITHDRAWAL FROM RB211

PROGRESSIVE WITHDRAWAL

NO CHANGE

NEW MANAGEMENT AND NEW POLICY DIRECTIVES



Prime Minister

MS 25/7

PRIME MINISTER

ROLLS ROYCE

1. It would be wrong to take a decision on this before the new Chairman's Corporate Strategic Plan is available in September. Until we have that plan, we do not know what the long term future of the Company is. That must surely be the condition precedent of any decision.
2. An earlier version of the Plan was presented last December by the previous Chairman but was withdrawn following the change in chairmanship.

The present Chairman, Sir William Duncan, may argue that he cannot finalise his Strategic Plan until he knows whether he will get launch aid. That argument is misconceived. If, as stated in the papers, Sir William Duncan regards the E4 as "an indispensable part of the strategy", his right course is to draw up his strategy on that basis. Unless he does so, Government has no means of telling, even if launch aid is given and the E4 goes ahead, whether or not the Company has an effective long term future. The figures given in paragraph 43 of the Note by Officials are not good enough for this purpose - particularly as it is admitted that they will "be superseded by Sir William Duncan's review".

3. Nowhere are the facts clearly set out. Nor is any attempt made anywhere to bring the figures together in a proper coherent manner. The position would appear to be as follows. In 1978 agreement was reached on the development of a C-type engine for which the Government provided launch aid of £211 m. The cost of development is not stated but appears to have been £394 m. These figures are all at 1981 prices. In 1980 because of competition from Pratt and Whitney it was decided to develop this engine further to form the E type. The cost of this was to be met wholly by the Company. In 1982 it was decided to develop the E type further and it is in respect of this further development that launch aid is now requested. The position is summarised below.

Original C type programme agreed in 1978

Cost £394 m. Launch Aid £211 m

First E type programme approved December 1980

Cost £65 m. No Launch Aid - Cost to be met by Company

Extended E type programme

Extra cost £111 m. Launch Aid requested £83 m

Total cost of fully developed E type ie C plus E £570 m.

Launch Aid agreed or requested £296 m

All at 1981 prices

4. There is a further problem about the figures, mainly that MoD estimate the total cost of "development of the improved E4 [as] likely to [be] £325 m compared with the Company's estimate of £298 m". It is not at all clear how or where these figures fit into those given above.
5. The C type was developed specifically to power the new Boeing 757. In late 1980, Pratt and Whitney announced the development of an engine of advanced design, frankly intended to push Rolls Royce out of the market. The first E type programme, approved in December 1980, was Rolls Royce's response. But the improvement was not sufficient and, in 1982 Rolls decided that further enhancement of the E type engine was necessary.

Some C type engines have been delivered. Further engines of this type will no doubt still be delivered. No figures are given. But it is highly unlikely that the C programme looked at in isolation will remotely have paid off. The E programme really has no separate existence: it has grown out of the C programme and could not have existed independently. From the point of view of judging commercial success, the whole programme needs to be looked at as an entity. On this basis the Treasury are right in putting the real rate of return at 5% or less, as opposed to the 7% to 10% given by the Department of Trade and Industry.

6. But this is not the end of the story. The simple truth is that a great deal of the money sunk into the C programme has been abortive. How much we do not know. Nevertheless, so much money has already been committed to the venture that the real issue now is whether we should dip our hand further into our pocket to save the benefit of what has already been spent. If one does a calculation on this basis, and if one assumes that the project will ultimately succeed, it is almost bound to show a profit - as indeed it does. This follows almost inevitably from the fact that one is taking the incremental cost and comparing it with the total yield from the project: and the assumption of success removes the element of risk.
7. My own view is that, without this engine, Rolls Royce faces a bleak and unpromising future. The engine is due to fly on test "this summer". This I would have thought is absolutely crucial. But if the test programme is successful and the new Corporate Strategic Plan is satisfactory, I would think we should then go ahead. But we are certainly in no position to take such a decision now.
8. On a more mundane level, I suspect also that Rolls Royce may be asking for too much. The £65 m cost for the original E type programme was to be found wholly by the Company. Despite this, the Company are now throwing this in with the extra £111 cost for the extended E type programme and claiming launch aid in respect of the total of £176 m. (The launch aid claimed is £85 m, which is about 50% of the £176 m: up rated to current prices, this then becomes £102 m.) The figure ought to - and no doubt could - be scaled down. This needs to be investigated.

A.C.

A C

25 July 1983



JU144

PERSONAL
AND CONFIDENTIAL

Prime Minister

D

PRIME MINISTER

ROLLS ROYCE RB 211 - 535 ENGINE PROGRAMME

In my paper for E(A) I seek colleagues' approval to negotiate launch aid with Rolls Royce for the E4 improved version of the RB211 engine.

2 Rolls Royce approached the Government for launch aid in a proper and timely manner in February 1982. There were numerous delays within Government in deciding the matter, and Rolls Royce pressed ahead with development, bearing the costs itself. It had to respond quickly and competitively to the improvements being offered by American engine manufacturers. As a result, it has today what promises to be a thoroughly competitive engine due for certification by the end of this year. It should go into service on the Boeing 757 by late next year.

3 As you will know that aircraft has much the brightest sales prospects amongst the new generation of jet airliners, which is why Pratt & Whitney has tried to oust RR as the provider of the engines, and why RR is having to improve the version of this engine which Boeing is already using.

4 My first reaction to the request for Government aid for the E4 was to think that since the engine is now in an advanced stage of development, there was no need for us to pay RR launch aid. That



first reaction was wrong for a number of reasons.

5 First, RR had every reason to believe that it would receive launch aid, or at least be told that it would not, long before now.

6 Second, in its profit, cash flow and balance sheet projections, RR has included an amount of launch aid.

On whose authority?

7 Third, if we are, as I am determined, to privatise RR during this Parliament, RR will have to have this engine which is expected to account for almost 20% of its sales. Its own cash flow will not sustain the further £175m which it needs to complete the engine.

8 It is a vicious circle. Without the launch aid RR cannot complete the engine. Without the engine, RR has little prospect of viability. Without viability, we have no prospect of selling RR. Therefore, RR remains with us, and I and my successors continue to have annual arguments with the Treasury.

We shall get them after privatisation if there is no alternative.

9 I am convinced that it would now be politically impossible to cancel this project, as I understand Treasury officials believe we could. The engine is an excellent one, it is near to certification and the Government's inability to give a decision over a prolonged period would be bound to be the cause of much unfavourable comment.

no-one will buy RR.



10 Obviously, I regret that only days after the Cabinet discussion I have to put forward this proposal. I spoke to the Chancellor about it on Wednesday and explained the position.

11 The problem is not new. In the past it has just been deferred, and must now be cleared up.

C.P.

CP

22 July 1983

Not long after I came to No. 10, Pol put on
a presentation about aid to R-R. May 1 2
See again the graphs & charts notes about
that presentation. I keen to remember if-

PRIME MINISTER

RB211 - 535 ENGINE PROGRAMME

I attach

future if only more grants present-
in the m.b.

i) A minute from Cecil Parkinson arguing for launch aid for
the E4 improved version of this engine - Flag D.

ii) Flag E. A note from David Wolfson with his worry about
the way in which the paper for EA has been written - and, by
implication with a warning about how the conclusion of the
meeting should be phrased if it is decided to go ahead.

iii) Flag C. A note to me, on a personal basis, by Mr. Young,
who is about to join the Policy Unit.

(currently CPRS)

iv) Flag F Mr. Parkinson's EA paper itself.

May I put an alternative view to those expressed in this paper?

The RB211 project has had a disastrous record. The original
development led to bankruptcy in 1971. Since then several versions
have been developed with over £1b worth of Government money. None
have been commercially successful. The E4 project is designed to
bail out the earlier 'C' version which has cost over £35m and which
will have to be completely written off.

E4 is the engine for only one aircraft - the Boeing 757. Sales
prospects are uncertain, and the E4 will be in competition with the
Pratt and Witney 2037.

Why can Rolls not finance the project within existing resources
and delete items of lower priority? This is what any company in the
private sector would have to do if its banker and shareholder refused
to finance a doubtful project.

/ There are

Advice from
Lord Wolfson
Please mb

There are doubts about Rolls' bid being pitched at £120m.
£10m is a backdated claim for money spent in 1982. Rolls are
forecasting cash surpluses in 1983 and 1984 even if they receive only
half their launch aid money.

Privatisation is unlikely before 1987. By ^{then} ~~even~~ 1983/84 results
will be academic.

There is no public expenditure provision for this, so
agreement to it will mean deeper cuts elsewhere.

MCS

22 July 1983:



22nd July 1983

To: MR SCHOLAR

From: R YOUNG

cc: Mr Mount

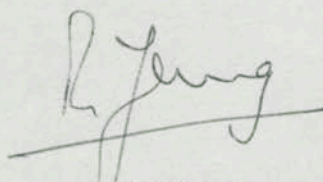
Rolls Royce RB 211 - 535 E4 Engine

Decisions are sought on whether Rolls Royce should be authorized to complete the development of the E4 engine and, if so, whether launch aid support should be provided.

Ideally, neither decision should be taken until the new Chairman of Rolls Royce delivers his strategy proposals in the Autumn. But the Chairman had already indicated to Patrick Jenkin before the Election that he regards the E4 engine as indispensable to Rolls' future and obtained an undertaking that Government decisions would be sought ahead of the strategy review. Although Rolls might chafe at a non-decision next week, they can continue the development programme piecemeal, and it is therefore open to Cabinet to insist on the strategy presentation before reaching decisions on E4.

Between now and the end of the century, a high proportion (between 60% and 80%) of demand for engines for civil aircraft above 'feeder lines' level is expected to be in the sector covered by the RB 211. If Rolls do not compete in that sector, the loss of scale which they will eventually suffer will undermine the rest of their business. If they compete successfully in it, they will recoup at least some of the losses accumulated on the RB 211 programme as a whole. Profitability of the E4 project will be a long term affair and cannot be guaranteed, but the Secretary of State for Trade and Industry is right to suggest that Rolls without the E4 engine will be difficult to privatise.

Launch aid is a separate matter, and one which will require hard negotiation between DTI and the company. DTI must be careful not to pitch launch aid support at a level which enables the company to take a relaxed view of its other financial targets.


R YOUNG

10 DOWNING STREET

Michael Scholar.
From David Wolfson.

I have outlined in red the statements which, taken separately or together, suggest to me that Launch Aid is being given for the wrong reason. The facilitisation of Privatisation is a bad reason for it. Launch Aid should stand or fall on the investment arguments, and the paper had plenty of those. I believe that decisions will be made on those arguments, but the contnets of this paper are potentially damaging.

Prime Minister

David is worried that, if leaked later, this would be used to argue that the government was privatising RR on a false prospectus: because we have "window-dressed" RR's accounts by giving launch aid just to make it an attractive prospect to buy.

I find this hard to understand. Why shouldn't we write off RR's debts, or give it aid, publicly, to help sell it?

It is the alternative - even with launch aid.

MS 22/7

Not typed
min. tel
box



Michael

We spoke. This is
better than nothing

ie (a) it won't sell

but (b) they don't need the
money even if they go
ahead.

& (c) any cost here will
squeeze out something
else if we LSTJ to
our PES plans

J.

1. RB 211 project has a disastrous record. The original development led to RR's 1971 bankruptcy. Since then several versions have been developed with over £1 billion of Government money. None have been commercially successful. The E4 project is designed to bail out the earlier 'C' version which has cost over £350m and which will have to be completely written off.

2. The E4 is the engine for only one aircraft - Boeing 757. Sales prospects are uncertain. The E4 will be in competition with the Pratt and Whitney 2037. Pratts are likely to respond to the E4 and if Pratts improve their engine then Rolls will have to spend even more money.

3. Rolls claim that they are too far on with the project to cancel now. If so, they should finance it within existing resources and delete items of lower priority. This is what any company in the private sector would have to do if its banker and shareholder refused to finance a doubtful project. DTI's argument that Rolls are cash constrained amounts to saying that they should be given some cash to stay within their cash targets.

4. RR's bid for £102m is ridiculous. £10m is a backdated claim for money spent in 1982 - the development work has already been financed. Rolls are forecasting cash surpluses in 1983 and 1984 even if they only receive half their launch aid bid. They could breakeven in cash in 1983 and 1984 with about £40m launch aid in the 2 years.

5. DTI argue that failure to give launch aid will add to losses in 1983 and 1984 and make privatisation move difficult. Privatisation is unlikely before 1987. By then 1983-4 results will be academic.

6. PES provision for this - zero

see ^{also} paras 30, 47, 48 ^{of} note by officials

NO
Zard [initials]



JF3103

PS/ Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

28 March 1983

2

Prime Minister

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Rolls-Royce loss of

£133m - £20m worse

than forecast.

ms 29/3

ROLLS-ROYCE LIMITED

Jonathan Spencer wrote to you on 25 November 1982 to let you know of some developments in Rolls-Royce's financial position. We have now heard that the company's preliminary results for 1982 will be announced on Wednesday next, 30 March and my Secretary of State thinks the Prime Minister will wish to know the main points of this announcement.

... 2 I attach a copy of the draft Profit and Loss Account, which shows an overall net loss of £133 million. Net restructuring costs were £38 million, but this figure is net of that part of the costs which can be recovered on MOD contracts; the gross restructuring costs were in fact £58 million. The pre-tax loss (£129 million) is some £20 million worse than forecast in Jonathan's earlier letter. There have been, as one might expect, a number of changes from earlier predictions. The main adverse variances are: increased provision for surplus stock following reductions in planned production (£12 million); other effects of declining workload, eg suppliers' cancellation charges (£20 million); increased exchange rate losses on dollar borrowings (£10 million) and non-realisation of launch aid requested for the RB211-535E4 engine (£10 million). These are offset by a number of favourable variances, for example improved gross margins (£5 million), lower warranty payments and reduced tooling costs (£10 million).

3 The company's cash outflow for the year was £85 million, against a cash limit of £100 million. Within this total \$65 million of short term dollar borrowings were repaid. The company's manpower at the end of the year was 7,580 lower than at end 1981, and a further reduction of some 5,500 is planned for 1983.



COMMERCIAL IN CONFIDENCE

4 My Secretary of State hopes to write to colleagues shortly about Rolls-Royce's financial targets for 1983 and 1984. However, the Prime Minister may wish to know that the company's operating plan and budget shows a pre-tax loss of £56 million in 1983 and a profit of £3 million in 1984 after restructuring costs of £60 million and £41 million respectively. Because of the strenuous efforts it is making to reduce working capital the company expects a positive cash flow in each year. The Government's target that Rolls-Royce should be independent of public funding except for launch aid and R&D support is thus likely to be met.

5 Sir William Duncan formally takes up the Chairmanship on 1 April. In his early months, he intends to undertake a thorough review of the company's strategy and organisation. On the basis of this, my Secretary of State expects that a clearer view of the company's policy and prospects in the medium-term will be possible than hitherto.

6 I am sending copies of this letter to the Private Secretaries to the Secretary of State for Foreign and Commonwealth Affairs, the Chancellor of the Exchequer, the Secretaries of State for Defence and Trade, Sir Robert Armstrong and John Sparrow.

Yours sincerely

Steve Nicklen

STEPHEN NICKLEN
Private Secretary

Encl

Profit and Loss Account

for the year ended December 31, 1982

Consolidated

	1982	1981
	£m	£m
Turnover	<u>1493</u>	<u>1443</u>
Operating profit	87	128
Research and development (net)	(131)	(64)
Financial expenses	<u>(47)</u>	<u>(46)</u>
Profit (loss) before taxation	(91)	18
Taxation	(3)	(3)
Profit (loss) after taxation	<u>(94)</u>	<u>15</u>
Attributable to minority shareholders	(1)	(1)
Extraordinary item - net restructuring costs	<u>(38)</u>	<u>(17)</u>
Net profit (loss) attributable to Rolls-Royce Limited	<u>(133)</u>	<u>(3)</u>

End of: Raha Loge Pt 2

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1988

Prime Minister²

MS 17/3

PRIME MINISTER

ROLLS ROYCE: COLLABORATION

You may well have seen recent press reports covering collaborative discussions between Rolls Royce (RR), Pratt and Whitney (P&W) and companies in Japan, Germany and Italy about developing a new family of engines. It might be helpful therefore if I summarise the present position.

2 Negotiations between the companies have been under way for some time, and in recent weeks have made encouraging progress, leading to the signature of an inter-company agreement in Derby last Friday. This agreement to develop new powerplants for 150 seat aircraft is, however, subject to ratification by all the company Boards and thereafter by the Governments involved. A deadline of 30 June has been set for this.

3 This is encouraging news, since, as you will know, it has long been our view that any major new engine development for the airline market is unlikely to be commercially viable without the involvement of one of the major US engine firms. We have stressed this view, in confidence, to RR many times, and it is to their credit that they have been able to persuade P&W to accept a balanced partnership arrangement.



4 However, I am having to make it clear to RR that the Government cannot consider making any commitment to the project until we are presented with a full business case to evaluate. This will need to cover the technical definition of the engine, the markets to which it is tailored, and its commercial prospects. We have not yet received such a case, nor any request for launch aid.

5 You should also be aware that there are several other major hurdles to clear. These include the acceptability of the proposed arrangements to the Japanese Government, the US Administration's attitudes towards third country sales and technology transfers, and, possibly most seriously, US anti-trust challenges. My officials will be in touch with those concerned in other Departments about various aspects of the collaborative arrangements in due course. But it appears to me that the deadline of 30 June, which the companies have put forward, is highly optimistic given all the issues still ahead of us.

6 Copies go to Geoffrey Howe, Francis Pym, Michael Heseltine, Arthur Cockfield, Sir Robert Armstrong and John Sparrow.

PJ

P J

17 March 1983



With the Compliments of

CENTRAL POLICY REVIEW
STAFF

Cabinet Office
Whitehall London
SW1A 2AS

Telephone or

233 8589



CABINET OFFICE
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

Qa 06219

From: John Sparrow

D Saunders Esq
Private Secretary
Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1E 6RB

18 January 1983

Dear David

Rolls-Royce

Mr Sparrow has read a copy of your letter of 12 January to Margaret O'Mara and asked me to let you know he would like to attend the presentation by Rolls-Royce you are currently trying to arrange.

Copies of this letter go to the recipients of yours.

Yours sincerely
Gerry Spence

G B Spence
Private Secretary

*Encl Ref
cc 50*

NBPM

ms 181

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Rolls Royce pt 2

18 JAN 1988

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JF2419

PS/ Secretary of State for Industry

Prime Minister (2)

Ms 1571

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

12 January 1983

Miss M O'Mara
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Dear Margaret

ROLLS-ROYCE

Thank you for your letter of 6 December. My Secretary of State is much in favour of a presentation by Rolls-Royce. The idea had already been floated with the company and we are now seeking to fix a date in the second half of February.

2 The Company's Corporate Strategic Plan 1982-91 was only received in the Department on 17 December and the Operating Plan and Budget 1983/84 is not expected before the middle of this month. The Company's various project proposals also need careful scrutiny. A presentation in the second half of the month therefore looks to be a realistic objective and I will be in touch with you shortly (and with the offices of other Ministers who have expressed an interest in the presentation) about a precise date.

3 My Secretary of State would not propose to comment at this stage on your references to the loss which Rolls-Royce is expected to make this year, nor indeed to comment about the level of current RB211 sales. The Chancellor might however care to see the enclosed copy of the letter which Lord McFadzean sent to the Secretary of State covering the company's Corporate Strategic Plan. It shows how the company's own latest estimate of its 1982 loss as £114m has been arrived at.

4 Copies of this letter go to recipients of yours.

Yours sincerely
David Saunders
DAVID SAUNDERS
Private Secretary

ROLLS-ROYCE LIMITED



Chairman's Office

65 Buckingham Gate, LONDON SW1E 6AT
 Telex: 918091 Telephone: 01-222 9020

The Rt. Hon. Patrick Jenkin, M.P.,
 Secretary of State for Industry,
 Ashdown House,
 123 Victoria Street,
 LONDON SW1H 0ET.

RECEIVED IN
 17 DEC 1982
 SECRETARY OF STATE
 FOR INDUSTRY'S OFFICE

Mr Baker W/oe/c
 PLEASE BY:
 6/1/83
 17th December 1982
PS/NI
PS/JS
PS/Sec
Mr Craft
Mr Hudson

Dear Patrick,

Attached is the Company's corporate strategic assessment for 1982-91. It has been approved by the Board.

Currently Rolls-Royce is meeting, and expects to continue to meet, its cash but, in the short run, not its profit, target. On the latter our latest estimate for 1982 is as follows:-

	1982 <u>£m</u>	1981 <u>£m</u>
Turnover	1,524	1,443
Profit before research and development and financial expenses	99	128
Research and development charge	(119)	(64)
Financial expenses	(46)	(46)
Profit (loss) before taxation	(66)	18
Taxation	(4)	(3)
Profit (loss) after taxation	(70)	15
Attributable to minority shareholders	(1)	(1)
Extraordinary item (net restructuring costs)	(43)	(17)
Net (loss) attributable to Rolls-Royce Limited	(114)	(3)

The main factors contributing to the adverse change are:-

- (i) The severe recession in the civil aerospace industry is expected to result in sales of engines, modules and spares being £84m. below budget with a further decline anticipated in 1983;

.../...

- (ii) Research and Development charges at £119m. will be £55m. above last year. This is a combination of higher expenditure on development - mainly the 535 - and a lower contribution from Government. Although charged to revenue, this expenditure represents investment in the development of new and improved engines;
- (iii) Net restructuring costs at £43m. will be some £26m. higher than in 1981. Manpower reduction programmes will have decreased the workforce by 13,000 (23%) in two years; just over 7,000 of this total will have left in the current year. A further reduction of 5/6,000 is planned for 1983. By 1984 the savings in costs as a result of these reductions, and changes in working practices, should be of the order of £175m. per annum.

Military business, which is over half the Company's turnover, remains satisfactory in the short to medium term but in the longer term will be heavily dependent on the launch of the ACA. On the civil side, the RB211-524 engine will be adversely affected by the termination of the Lockheed L1011 programme. The only other outlet is on the 747, where the 524 is still the most fuel efficient engine in service, and an attempt is being made to establish it also on one of the wide bodied twins. However, the success of the newer RB211-535 engine is fundamental for the future of Rolls-Royce in the civil engine market.

The Company plans to continue tight cost control and efficiency improvements, including the additional manpower reductions. New production methods, including multi-machine manning and the robotisation of turbine blade manufacture, are being introduced.

A number of scenarios are put forward. Unless the recovery of the market warrants more optimistic targets, the Company proposes to adopt the most conservative scenario. This postulates the maintenance of the Company's resource base and investment in R & D at the minimum level judged necessary to enable the Company to meet its commitments in the near term and to meet demand when this picks up again.

Extended collaboration is a feature of the strategy and in the case of civil engines we shall continue to seek a suitable arrangement with Pratt & Whitney or, failing that, with General Electric. However, the current market scene makes it less likely that the proposed RJ500 collaboration will proceed in the short term. Plans for other collaborative projects, including the RTM322 for the EH101 helicopter, are described in the document.

Find Pol
Rolls Royce, AZ

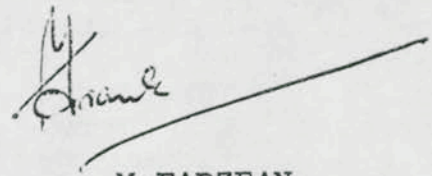
The Company seeks:-

- (i) Your general acceptance of the objectives set out in the attached document;
- (ii) Early acceptance by HMG of the request for further Civil Aviation Act funding to complete development of the -535 engine to the E4 standard, a committed development which is of crucial importance to the future of the Company;
- (iii) Confirmation of the availability of funding for suitable new civil engine projects with an estimated return on investment in excess of 5% in real terms.

The document is unavoidably somewhat lengthy but we hope you will find time to study it, particularly the summary section I, section III and the key financial projections in section IV.

Following preliminary detailed analysis with your officials, we look forward to discussing the main issues with you and with any of your colleagues whom you may wish to participate.

Yours ever,



McFADZEAN

13 JAN 1967

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CONFIDENTIAL

cc JV
Ind PJ



Foreign and Commonwealth Office

London SW1A 2AH

17 December 1982

mf

Prime Minister

2

MS 20/12

Acw Spencer

ROLLS ROYCE

Mr Rifkind was interested to see Miss O'Mara's letter of 6 December to you about Rolls Royce, reporting recent comments by the Chancellor on the Company's prospects. He agrees that a presentation by Lord McFadzean and Mr Duncan to Ministers in early February would be helpful, and would like to attend if his commitments allow this.

Mr Rifkind has noted the Chancellor's reaction to the probable extent of Rolls Royce's losses this year. He suggests that we should bear in mind that, whatever reservations there may be about the long term future of the Company, it is important not to give any hint of them outside Government. While Rolls Royce are engaged in important collaboration negotiations with Pratt & Whitney and the Japanese, in an attempt to satisfy the requirement of Ministers that they should work with a leading US Company, any implication that the British Government lacks confidence in them could seriously weaken their position and precipitate the damaging effects we want to avoid.

Yms em

John Macgregor

J M Macgregor
Private Secretary to
Malcolm Rifkind MP

Jonathan Spencer Esq
Private Secretary to the
Secretary of State for Industry
Department of Industry

CONFIDENTIAL

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ok JV



Prime Minister (2)

Ms 7/12

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

6 December 1982

Jonathan Spencer, Esq.,
Private Secretary to the
Secretary of State for Industry
Department of Industry

Dear Jonathan,

ROLLS-ROYCE

The Chancellor has seen your letter of 25 November to Michael Scholar about Rolls-Royce's current financial situation, and is very concerned about developments. He understands that the loss this year could exceed £130 million.

At the same time the company is pursuing an application for further launch aid towards the RB 211-535 E4 project. The disappointing performance of the RB 211 programme is of course the main reason for Rolls' present difficulties and, with the company forecasting even lower RB 211 sales next year, no improvement is in sight.

The Chancellor feels that against this background, it will be difficult to justify further launch aid. He thinks it would be useful if Lord McFadzean and Mr. Duncan could provide a presentation to Ministers on the company's future plans, which might pay special attention to the prospective return on the E4 project and the alternative courses open to the company if the Government were to decide against providing launch aid.

I understand that Treasury officials have raised this possibility with officials in your Department and that an early February date has been provisionally suggested for the presentation. The Chancellor would be grateful if arrangements could be put in hand as soon as possible.

Copies of this letter go to the Private Secretaries to the Prime Minister, the Secretaries of State for Foreign and Commonwealth Affairs, Defence and Trade, and to Sir Robert Armstrong and Mr. Sparrow.

Yours sincerely,

Margaret O'Mara

MISS M. O'MARA

CONFIDENTIAL

Ind Pol

Rolls Royce

-7 DEC 1982



010
COMMERCIAL IN CONFIDENCE



JF2103
PS/ Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

25 November 1982

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Prime Minister

£109m loss for

Rolls.

Dear Michael,

ms 25/11

ROLLS-ROYCE

I am writing to let you know of recent developments in Rolls-Royce's financial position. My Secretary of State thinks the Prime Minister will wish to be aware of the impact of the airline recession on Rolls' sales and finances as well as the steps which the company have been taking to adjust to the situation.

2 The deepening of the world-wide airline recession has inevitably led to significant reductions in Rolls' sales of civil engines and spares. To counter this down-turn, the company is effecting offsetting savings and improvements; in particular manpower will soon be 7200 lower than at end 1981 and further cuts are planned in 1983.

3 At the beginning of 1982 Rolls-Royce budgeted for a loss of £44 million in 1982 (after providing for manpower restructuring costs of £46 million) and this was taken into account in the Government's approval of their operating plan and budget and in the Government's decisions on the funding of the company. Rolls' latest quarterly forecasts indicate a worsening of the loss figure from £44 million to £109 million after making provision for exchange rate losses on dollar borrowings (£27 million) and for manpower restructuring costs (£59 million).

4 The Government set the company a cash limit of £100 million in 1982 and this will still be achieved with a small margin to spare. The Government's other target for the company is that, apart from launch aid, it should be independent of public funding in calendar year 1983. The company's own publicly stated plans have assumed profitability in 1983 and thereafter. With no improvements in prospect in international trading, the company



COMMERCIAL IN CONFIDENCE

will be hard pressed to achieve these targets in 1983. Our quarterly finance monitoring meeting with the company's finance director on 30 November will show whether and how the company propose to achieve the targets.

5 In the light of this appreciation of the company's position in 1983, my Secretary of State intends to obtain Mr Duncan's first assessment of the company's future prospects. (As Chairman-designate, Mr Duncan, is already taking a very close interest in the company's affairs. He is receiving Board and executive committee papers and is visiting all the company's UK sites). He will then report to colleagues on the options open to the company and the implications for the achievement of the targets.

6 I am sending copies of this letter to the Private Secretaries to the Secretary of State for Foreign and Commonwealth Affairs, the Chancellor of the Exchequer, the Secretary of States for Defence and Trade, Sir Robert Armstrong and John Sparrow.

Yours sincerely,

Jonathan Spencer

J P SPENCER
Private Secretary

CONFIDENTIAL

Prime Minister (4) JHV

res 1/9



DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 5902
SWITCHBOARD 01-212 7676

From the
Minister of State
Norman Lamont MP

The Rt Hon Douglas Hurd CBE MP
Minister of State
Foreign and Commonwealth Office
London
SW1A 2AH

/ September 1982

Dear Douglas

ROLLS-ROYCE

Thank you for your letter of 10 August about the possible effect of the draft objectives we are setting the company on its future independence. I trust that they will not be interpreted by the new chairman in a way which will lead to the situation described in the second paragraph of your letter. Given what I know of Rolls' normal determination to be independent I would be surprised if that proved to be the case.

I nonetheless take your points about the possible political implications of too close collaboration by Rolls-Royce with one or other of the American companies. But it is also important to recognise that Rolls is unlikely to return to a permanent position of profitability unless it ceases to meet competition in the civil engine field, head-on. The company must, rather, try to collaborate and share the costs and risks involved of new engine projects, with others. The American companies are mentioned in the draft objectives because they are the dominant competitors and because they probably offer the best prospects for successful collaboration. But, having said that, there would be nothing to prevent Rolls-Royce collaborating with European and/or Japanese companies over a particular project if it were concluded that it was a commercially sensible thing to do. The RJ500 project, for example, began as an Anglo-Japanese project and there could well be others in the future.

I am copying this letter to the Prime Minister, Geoffrey Howe, John Nott, John Sparrow and Sir Robert Armstrong.

*Yours
Norman*

NORMAN LAMONT

CONFIDENTIAL

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CONFIDENTIAL



Foreign and Commonwealth Office

London SW1A 2AH

10 August 1982

Ind. Pol.

From The Minister of State

Rt Hon Douglas Hurd CBE MP

cc
Mr WJ
Dear Secretary of State

ROLLS-ROYCE

with J. Polks
I have seen the letter dated 2 August from No 10 to your Private Secretary giving the Prime Minister's approval to your proposals for Mr Duncan's conditions of service. In general we, too, are happy with the proposals in your minute of 29 July to the Prime Minister. But there is one point on which, in Francis Pym's absence, I would like to comment.

We all want Rolls-Royce to be a successful and profitable competitor in the international market, capable of being returned to the private sector in the not too distant future. To do that, Rolls-Royce must be prepared, on occasion, to collaborate with its main American competitors. But Rolls-Royce must not, I suggest, allow itself to get into a relationship in which it is the permanent junior partner of one of those competitors, with no substantial commercial contacts with the second main American aeroengine company, or with other manufacturers in Europe or Japan. There is a risk that the dominance of the American partner would quickly reduce Rolls-Royce's freedom of manoeuvre over decisions vital for its own future, including its ability to maintain independent military and marine engine production; and at the same time increasingly limit Rolls-Royce's attractiveness as a collaborative partner to other manufacturers. Today's junior partner might rapidly become tomorrow's tied sub-contractor.

Such a development would not go unnoticed in Europe and Japan, where significant efforts are being made to build up aeroengine industries and where Rolls-Royce is seen as a potential leading partner in such efforts. You will recall that, at last year's Anglo/French Summit, President Mitterrand expressed interest in great collaboration between Rolls-Royce and the French company SNECMA (the French would probably like to see such collaboration result in a Franco-British engine for the new Airbus, though co-operation in the military field might, in our view, be more productive). And Rolls-Royce have for some time been working with a Japanese consortium on a new civil aeroengine - something which has stood them in good stead in their current negotiations with Pratt and Whitney for collaboration in the same field.

/The

Rt Hon Patrick Jenkin MP
Secretary of State for Industry

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CONFIDENTIAL

- 2 -

The implications of Rolls-Royce's willingness and ability to contribute to the development of a major and viable aeroengine industry outside the United States are not confined to the aviation world. Rolls-Royce's attitudes, with those of one or two other major British companies (ICL and ICI, for instance), are seen as a touchstone of the UK's good intentions over industrial collaboration generally. This point was made quite forcibly by the Japanese to our Embassy in Tokyo earlier in the year when Rolls-Royce seemed inclined to ignore Japanese interests in their search for an American partner.

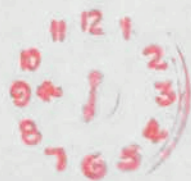
I hope, therefore, that the policy of collaboration with the United States competition set out in the Objectives paper will not adversely affect Rolls-Royce's independence or its ability to collaborate with non-American interests.

I am copying this letter to the Prime Minister and to Geoffrey Howe, John Nott, John Sparrow and Sir Robert Armstrong.

Yours sincerely
Stephen Langford

Approved by Mr Hurd
and signed for him in
his absence by his
Private Secretary

10 AUG 1962



Top copy filed
on Apyt 6 pages

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File 116

10 DOWNING STREET

From the Private Secretary

2 August 1982

The Prime Minister has seen your Secretary of State's minute of 29 July about the Chairmanship of Rolls Royce and has agreed to his proposal that Mr. Bill Duncan should take on the role of non-executive Director on the Board of Rolls Royce with a view to becoming Chairman next year. She has commented that the offer by Mr. Frank McFadzean to remain until any significant redundancies are announced is a generous one. The Prime Minister has also approved your Secretary of State's proposals for Mr. Duncan's conditions of service.

I am copying this letter to John Kerr (H.M. Treasury), Brian Fall (Foreign and Commonwealth Office), David Omand (Ministry of Defence), Gerry Spence (CPRS) and Richard Hatfield (Cabinet Office).

S

RECEIVED

Jonathan Spencer, Esq.,
Department of Industry.

CONFIDENTIAL

MT

① Steel or John Brown



DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 5902
SWITCHBOARD 01-212 7676

From the
Minister of State

② Cruise Shipping
are you up-to-date

PS/Norman Lamont MP

③ Enlargement
Italy, Lebanon

John Coles Esq
Private Secretary to the
Prime Minister
10 Downing St
London SW1

2 July 1982

Dear John,

PRIME MINISTER'S VISIT TO ITALY

We understand from Rolls Royce that during the Prime Minister's visit to Italy next week the Italian Government are likely to mention Rolls Royce's campaign to obtain Alitalia orders for RB211-535 engines on Boeing 757 aircraft.

As it is important to Rolls Royce's world-wide campaign that they should obtain the Alitalia order, we would suggest that the Prime Minister should raise this with the Italians even if the Italians themselves do not mention it. A suitable briefing note for this purpose is attached.

Yours sincerely
Cecily

CECILY MORGAN
Private Secretary

very important - new
collaborative programme

↳ Littori Messagerie
to replace Sealeys
Need to exploit commercial
opportunities for Dept of Ind.

Do not release
Do not release

Very important for Westlands.

Sea Harrier - Through desk Cecily
Giuseppe Caribaldi

10.

The Rolls-Royce RB211 in the Boeing 757 for Alitalia

1. Alitalia, the Italian state-owned airline, are considering purchase of 15 Boeing 757 aircraft with either the RB211-535 or the Pratt & Whitney 2037 engines. Alitalia's decision is of significant strategic importance to Rolls-Royce (RR) in the current depressed state of the airline market because the order is substantial and a quick purchase of the 535 could prompt Pratt & Whitney to withdraw the 2037.
2. A statement to Italian Ministers in support of the 535 programme would assist the Rolls-Royce campaign.

Background

3. The 535 is the launch engine for the Boeing 757 180-seat short/medium haul airplane and first production models will be delivered to British Airways and Eastern Airlines at the end of this year. The 2037 is available by the end of 1984.
5. To date 7 of the 8 customers for the 757 have chosen the 535 rather than the 2037.
6. Alitalia are evaluating aircraft to replace their DC9 and 727 fleets. They are concentrating on choice between the DC9-80 (a new version of this aircraft with a US engine) and the 757. They may prefer to defer a decision. RR, and Boeing, are pressing for a quick purchase.
7. To this end, RR is proposing to Alitalia a unique financing package which is only able to be offered for a short period. Boeing are also making an extremely attractive offer.
8. There is no conflict with any other British product as Alitalia have already purchased the A300B.
9. RR accordingly need a decision from Alitalia and the Italian Government by the end of July. It will be to the advantage of the Italians to give very serious consideration to the RR offer.
10. A favourable outcome will guarantee sales for RR of at least £135 million on engines and spares for the initial 15 aircraft and there should be at least 10 more Alitalia aircraft. The Alitalia decision should also result in substantial sales to other airlines and could result in the 535 achieving a monopoly on the Boeing 757.

Airbus A320 and Italian Participation

The French Government are currently trying to interest the Italians in taking a share in the development and production of the Airbus A320 project. The French are trying to make Italian participation in this project dependent on Alitalia's

placing an order for A320's. It is not clear at present how Alitalia would reconcile purchase of A320's with the purchase of Boeing 757 aircraft, since there is an overlap between the two aircraft types.

Line to Take

If the Prime Minister is asked whether the UK Government is backing Rolls Royce at the expense of the A320 project, her answer should be:-

1 The choice of aircraft type is entirely commercial for Alitalia to decide. If Alitalia has to decide in favour of Boeing 757 at the expense of A320, this is Alitalia's affair. But if so, we hope Alitalia will specify the RR engine rather than the P&W 2037.

2 BAe (and the UK Government) as an existing partner in the Airbus Consortium are intensely interested in the A320 project. But like our German partners the UK has not yet reached a decision on the viability of the project and on the extent of UK Government financial support for BAe through launch aid.

3 [If necessary] Italian participation in the A320 project is a matter for all the Airbus Industry partners (UK, Germany as well as France) to decide in the light of current discussions [in Paris on 5/6 July] with the Italians. The decision is primarily a commercial one, to be taken by the industrial partners concerned. [It is therefore premature for me to take a view on possible Italian participation].

Handbook Commerce

① Lebanon

- West Beirut
Am. Embassy
Photo on
boats
No-man
land

Fairly steady

10,000

553

Red. off

Economy

Will to make every
effort. apparently
attempts stability

Subscriber
Investment

②

Europe / U.S.

Steel / Shipbuilding
major investment.

Not keeping
solutions

Danger economy of UK
Government interpretation

15 JUL 1982

12 11 22 33 44 55 66 77 88 99

③ Spain

Intergovernmental

Netto

Industries

Pound 'horror' -

H. I. B.

Problem emerges
Europe Community.

17-11

12/16

④

CONFIDENTIAL

JH 499



Prime Minister (2)

Ms 14/5

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

12 May 1982

Lord Belstead
Minister of State
Foreign and Commonwealth Office
London SW1

Dear John,

ROLLS ROYCE COLLABORATION

- will request if required

Thank you for your letter of 30 April concerning the state of negotiations between RR, their Japanese partners and prospective US partners on the RJ500. I saw Frank McFadzean on Friday 30 April and expressed some concern at the reports which we have been receiving and the apparent danger that RR would find itself without a partner at all. Subsequently, the company had further talks with GE and then discussed the situation at their Executive Committee meeting on 4 May. The upshot of these deliberations is that Rolls Royce have now informed Pratt & Whitney that they will continue the negotiations with them for collaboration on the RJ500 along with their existing Japanese partners. Rolls' Japanese partners have been told of their decision as have GE. The Embassy in Tokyo has also been notified. Although we cannot be certain of the outcome of the negotiations, it does appear that RR have a firm objective and we will not have damaged our position with the Japanese.

I am copying this letter to the Prime Minister, Geoffrey Howe, John Nott, Norman Tebbit, Arthur Cockfield and Sir Robert Armstrong.

Your ever
Patrice



COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SW1A 0AA

01-219 5469 (Direct Line)/5778/5779

01-219 3000 (Switchboard)

R27/4
Industry

✓
MJP

INDUSTRY AND TRADE COMMITTEE

Information for the Press

Representatives of Rolls-Royce Limited, led by their Chairman, Lord McFadzean of Kelvininside, will give evidence to the Industry and Trade Committee on Wednesday 28 April at 10.45 a.m. in Committee Room 16 as part of the Committee's inquiry into the current state and future prospects of the Company.

G. Cubie,
R. Lloyd Thomas,

Clerks to the Committee.

26 April 1982

of Duguid

Confidential

Ld RJ 2



MINISTER OF STATE FOR DEFENCE
WHITEHALL LONDON SW1A 2HB

Telephone 01-218 6621 (Direct Dialling)
01-218 9000 (Switchboard)

D/MIN/TT/1/4

1st June 1981

Prime Minister

You should perhaps be aware of this personal view from Ld. Tebbit.

Dear Norman

I have followed the correspondence which started with Keith Joseph's minute of 8th May to the Prime Minister about Rolls Royce's plans to collaborate with the Japanese on the RJ 500. I note that the Prime Minister has endorsed Keith's proposals, but I feel I should set out my personal views for the record.

RJ
..
1/6

While I previously supported talks between Rolls Royce and one of the two US engine manufacturers with a view to a long term association, the idea that the current agreement with the Japanese should form the basis for further discussions with the American firms does not seem logical.

I believe this could largely negate the beneficial effects of collaboration with the Japanese. I understand that it is not the intention to encourage Rolls Royce to participate both with the Japanese and the US for the immediate programme, but there is a real risk of giving the impression to the Japanese that our confidence in Rolls Royce is low.

If, as a result of this, the Japanese withdraw from the arrangement, Rolls Royce would have to negotiate with the American companies from a position of weakness.

/ Conversely ...

Norman Tebbit Esq., MP

Conversely, a successful development of the Japanese partnership would put Rolls Royce in a strong position, and if it was still considered correct to press for partnership with a US firm, Rolls Royce would then be able to negotiate on a better basis.

I therefore believe that Rolls Royce should be encouraged to pursue the proposed association with the Japanese quite separately from further discussions with the Americans. I believe that the trouble with Rolls is still commercial management rather than technical ability. We cannot afford to lose the technology.

Copies of this letter go to members of MISC 22, Sir Robert Armstrong and Robin Ibbs.

yours truly
Tom

Lord Trenchard

1861 JUN 1981

1861 JUN 1981

1861 JUN 1981

SECRET

TOTAL COPIES 11.....



COPY NO. 2
DEPARTMENT OF INDUSTRY

ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

5

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

19 May 1981

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

Ind Pd

Dear Geoffrey,

R
19/5

ROLLS-ROYCE

Thank you for your letter of 14 May about the relationship between the RJ500 and the issue of wider collaboration between RR and Pratt and Whitney. I ~~certainly~~ recognise the link between the RJ500 and the discussions about a wider association between RR and one of its US competitors. I shall certainly be drawing this point to Frank McFadzean's attention when I convey to him the Government's response on the RJ500.

Copies of this letter go to the Prime Minister, Sir Robert Armstrong and Robin Ibbs.

Ever,
Kevin

SECRET

19 MAY 1981



CONFIDENTIAL *Sub Pol* *SS*



cc FCO
DN
DOT
DM
MOD
HMT
CO
CPRS

Mr Duguid

10 DOWNING STREET

CF file

From the Private Secretary

15 May 1981

Dear Sir,

Rolls Royce: RJ500

The Prime Minister has now considered your Secretary of State's minute of 8 May. She has also seen the Secretary of State for Employment's minute of 13 May, the Chancellor of the Exchequer's letter of 14 May and Robin Ibbs' note of 12 May.

The Prime Minister has noted that the Secretary of State for Employment is unhappy with the suggestion that approval of the full launch of the RJ500 will not be given unless Rolls Royce are able to demonstrate that there will be participation by one of the major US companies. However, she is not persuaded by his argument; on the contrary, she accepts, like the Chancellor, that collaboration with one of the US companies is likely to be crucial. Accordingly, she endorses your Secretary of State's proposals.

I am sending a copy of this letter to Private Secretaries to members of MISC 22, Sir Robert Armstrong and Robin Ibbs.

[Handwritten signature]

I.K.C. Ellison, Esq.,
Department of Industry.

Tim Lohr.

CONFIDENTIAL

[Handwritten mark]



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

14 May 1981

The Rt. Hon. Sir Keith Joseph, MP.,
Secretary of State for Industry

Dr Kim

ROLLS ROYCE: RJ500

I have seen your minute of 8 May to the Prime Minister, and the subsequent minute from Mr. Ibbs of the CPRS which confirms that your proposals reflect discussion among all the Departments concerned. I too am content for you to write to Lord McFadzean in the terms you propose. I place particular emphasis upon Rolls Royce containing additional expenditure on the RJ500 within their existing cash limit. I note that in his letter to you Lord McFadzean said that he would aim to do so, and I am sure that we should encourage him in this aim.

I have also now seen Jim Prior's minute of 13 May questioning whether you are right to plan to tell Lord McFadzean that it is unlikely we could approve full launch unless there was substantial progress towards involving one of the two major US aeroengine manufacturers. I strongly support your plan. All the evidence suggests that although there will probably be a market for the RJ500 type of engine, this market could not support three competitors on a viable basis; and all the RB211 experience suggests that Rolls Royce as the smallest and weakest of the three would be likely to come off worst. Hence the importance of their doing a deal with a major American manufacturer and eliminating one of the potential competing engines. Like Mr. Ibbs, I think that we have to put this squarely to Lord McFadzean: to do otherwise would only encourage false hopes that we would willingly contemplate substantial investment in a programme, which, as you have pointed out, would be extremely risky without some US, as well as Japanese, involvement.

I am copying this letter to the Prime Minister, other members of MISC 22, Sir Robert Armstrong, and Mr. Ibbs.

G
Howe

GEOFFREY HOWE

1800 W
14 MAY 1991

cc Mr Ingham

CONFIDENTIAL



PRIME MINISTER

ROLLS ROYCE

In his minute to you of 8 May Keith Joseph sought our agreement to the terms of his reply to Lord McFadzean's letter to him of 9 April about Rolls Royce's collaboration agreement with the Japanese. I must confess that I am deeply uneasy about the line he recommends. It seems to me that it entails letting their United States competitors decide whether Rolls Royce is to survive as a manufacturer of civil engines or not.

Of course I can claim no detailed knowledge of this highly specialised business. I do not suppose that even McFadzean would pretend to be an aero engine expert. But his considered advice as Chairman is that "it is vital that we retain the Japanese collaboration", and that this collaboration "is uniquely favourable to Rolls Royce, and we could not again negotiate anything like it if the present arrangement were frustrated. In answer to this Keith proposes to tell McFadzean that it is most improbable that the Government would agree to the launch of any version of the RJ500 unless Rolls Royce can induce one of their US competitors to participate. That is, if Pratt and Whitney and General Electric refuse to collaborate, or even simply spin out the negotiations, or if the Japanese do not want a tripartite arrangement, Rolls Royce will be condemned to run down its civil aeroengine business. If we are to withdraw from this sort of advanced technology, which must form the basis of our future prosperity, there can indeed be no hope for us.

I quite see that if the Japanese themselves favour a tripartite arrangement, and are happy to explore the possibility in conjunction with Rolls Royce, there could well be advantage in investigating it - without allowing the Americans to spin out the negotiations to our detriment. But I am strongly opposed to our putting the sort of pistol to Rolls Royce's head envisaged in paragraph 8(c) of Keith's minute.

I am copying this minute to members of MISC 22 and to Sir Robert Armstrong.

13 JP
May 1981

13 MAY 1981

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Prime Minister
Mr Ibbs and the Chancellor (Flag B)
fully endorse Sir Keir's
proposals. But Mr Prior (Flag C)
dislikes the suggestion that full
launch will not go ahead
unless RR arrange some
collaboration with the American
companies. Support Sir Keir?

Qa 05366

To: MR LANKESTER
From: J R IBBS

Yes no

Rolls-Royce: RJ500

Flag A

1. I endorse the appraisal and recommendations in the minute of 8 May from the Secretary of State for Industry. This matter has been reviewed by the official group, MISC 25, under my chairmanship. We had the opportunity to hear the views of the Company from Mr Raeburn, the Deputy Chairman, and two of his colleagues. The Secretary of State's minute is in line with the conclusions we subsequently reached. In particular we were convinced that Rolls-Royce needs to be in this sector of the market if it is to maintain a viable position in the commercial engine business overall.

12
14/5

2. Market prospects in this sector are evolving all the time. Boeing is developing its B737-300. McDonnell Douglas, possibly with Fokker, are responding with a new design. A Japanese airframe manufacturer is likely to seek involvement in one of these projects. There is the further prospect of a comparable aeroplane from Airbus Industrie, the A320. These developments suggest that the main market may be for a larger thrust engine (around 27,000 lbs) rather than for the smaller version (21,000 lbs), which forms the basis of the collaborative agreement with the Japanese. This means that the agreement as it stands is not satisfactory. The need to reconsider the position creates an opportunity to explore the broader questions of collaboration with one of the American companies, either with or without the Japanese.

3. Even though this sector appears to be expanding, its growth is likely to be at the expense of other sectors; moreover, Rolls-Royce, the weakest of the main suppliers, could not finance the project on its own. Collaboration with an American company is likely to be the only way of achieving a sufficient market share that would ensure that the project is profitable.

CONFIDENTIAL

4. The Company will be resistant to the suggestion of collaboration with an American company, largely for historical and personal reasons. If the possibility is to be properly explored it will be necessary for the Government to be absolutely firm with the Chairman.

5. I am sending copies of this minute to members of MISC 22 and to Sir Robert Armstrong.

JR/

12 May 1981

A



*ce/royal
letters*

*CFO/roy will be
committing*

*Mr ash
CPAS if
this will
be committing.*

*BE
13/5*

PRIME MINISTER

ROLLS-ROYCE: RJ500

In January 1980, the Government agreed that Rolls-Royce could sign an agreement with three Japanese companies, Ishikawajima, Kawasaki and Mitsubishi, to collaborate on the design, development and launch of a new aero-engine called the RJ500 aimed at the 100-120 seater aircraft market. The Government indicated, and RR accepted, that this did not imply a commitment to full launch of the engine which would need to be justified after consideration of the full technical, market and financial appraisals. In December 1980, the company presented the results of these appraisals to the Department and asked for an indication that, in principle, the Government would approve full launch in due course. However, RR themselves pointed out that market requirements appeared to be changing and that the engine configuration might have to be changed to cover a larger sized aircraft. After inter-departmental consultation, I replied that the case put forward by RR was not satisfactory bearing in mind the substantial uncertainties about the market and in particular the apparently optimistic assumption by RR that they would have to compete with only one of their US rivals GE and P&W. While being permitted modest expenditure on continuing preliminary work up to the end of May, the company were asked to reconsider the project.

2 The Chairman has now written the enclosed letter setting out the company's latest views. In essence, the company admit that,



if anything, uncertainties about the project are now greater partly because it seems probable that the market would prefer both an engine of about the original size (21,000 lbs) and a larger one of 27,000 lbs. As yet there is no clear idea of the relative share of the total market these engines would take, partly because the joint RR/Japanese company have yet to agree on the basic design configuration and partly because RR now accept that both P&W and GE may be in either or both of the market segments for which the RJ500 is aimed. The Chairman is, therefore, requesting approval for expenditure of £10 million in the remainder of the year on further pre-launch development.

3 Before we accept what seems to be a relatively easy decision to postpone the main decision for a few months, a number of important implications of the RR proposal need to be recognised.

4 The company have themselves pointed out that a new engine such as the RJ500 is crucial to their long term survival in the civil aero-engine market, since a decision to opt out of such a major market would be regarded by their competitors and customers as a sign that RR were likely to withdraw from the civil business - an extremely damaging blow to their credibility. We shall, therefore, be faced towards the end of this year, after RR's further work, with a stark decision: either to accept launch of a new engine or family of engines at a cost of some £350 million, probably involving the continuation of the bitter competition



with both GE and P&W which has been instrumental in RR's financial problems; or a scenario which involves RR ending their collaboration with Japan, opting out of the RJ500 market and beginning a gradual rundown of the civil aero-engine business.

5 However, the present uncertainties surrounding the RJ500 project, identified by the Chairman, do provide us with a limited period in which to explore the prospect of a further alternative, namely the involvement of either P&W or GE in the project. There are a number of reasons for suggesting that this is worth considering -

- (a) although the market is so large that both GE and P&W are almost certain to enter, neither is, as yet, committed to a particular engine or partnership;
- (b) the Japanese themselves have authority and funding to launch only the smaller version of the engine. Thus RR's agreement with the Japanese will in any event need some re-negotiation to encompass the higher thrust version;
- (c) at the same time, if the agreement is continued beyond the end of May, the Japanese will be legally debarred from collaborating with others without RR's permission.



6 As you know, there are also wider considerations. RR is the weakest company in an industry dominated by the two US giants, GE and P&W, who are backed by the massive US defence programmes and the huge domestic market for aircraft, and RR's long term prospects for viability as a separate company are doubtful. We are encouraging RR to explore the prospects for securing a profitable business in co-operation or association with one of the US firms.

7 Rolls-Royce are reluctant to do this and we must recognise that such a strategy will have to overcome not only formidable practical difficulties but also the pride and personalities involved. RR will therefore resist also the idea of seeking a US partner on the RJ500 and we must accept that there will be genuine difficulties such as US anti-trust laws, existing bitter competition and practical difficulties of involving a further company in the existing RR/Japanese venture. But I am quite sure that we must take this opportunity to see whether there is such an alternative, which could also lead to the sort of wider association with a major US company which I believe to be crucial to a viable long term future for RR. Moreover, such an opportunity is unlikely to occur again.

Major new engine developments are rare; if RR becomes committed to the RJ500 project without American involvement, the prospects for a wider association will be substantially diminished. I would be reluctant to envisage the expenditure of



large sums of public money in an extremely risky venture, unless I was satisfied that ways of reducing both the costs and risks had been thoroughly examined. I shall need to take a firm line with the Chairman, and in particular resist the idea that bringing another partner to the project will involve too many 'prima donnas'.

8 Subject to your agreement and that of colleagues, I would, therefore propose to respond to the Chairman's letter in the following terms:

- (a) In view of the continuing uncertainties underlined in the Chairman's letter of 9 April, the Government accepts that a full launch proposal by the company or commitment by the Government is not feasible at this time.
- (b) Given the market developments outlined by the company it is understandable that they wish to ensure that the RJ500 is designed in such a way as to meet the full range of market requirements if necessary developing higher and lower thrust versions. The Government believes that any decision to support or approve launch of any version of the RJ500 will need to be taken on the basis of an appraisal of the technical marketing and financial prospects for that



version and any other anticipated versions of the RJ500 project, and subject to the qualifications set out in the next paragraph.

- (c) The Government notes that under the present collaboration agreement with the Japanese their participation in the higher thrust version is not completely assured. Before agreeing to launch any version of the engine the Government would expect the Japanese commitment to the programme as a whole to have been clarified. Moreover, given the commercial dangers of competing with both P&W and GE, it is most improbable that the Government would consider any approval of any launch decision at 6 above, unless RR were able to demonstrate that one or more versions of the RJ500 will also involve participation by one of the major US companies.

- (d) On this basis and understanding, the company has authority to proceed with development funding for the remainder of this year at the rate set out in the Chairman's letter.


- (e) The Government welcomes and attaches great importance to the Chairman's objective of containing this expenditure within the RR cash limit. The Department would want to be



informed as early as possible if this objective was not going to be achieved, and any extension of the company's cash limit would be dependent on evidence of progress towards the wider collaboration set out above.

9. If the above is acceptable to you and to colleagues, I would aim to send a reply on these lines to Lord MacFadzean no later than 14 May.

10. I am copying this letter to members of MISC 22 and Sir Robert Armstrong.

for 
K J

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

Department of Industry

8 May 1981

ROLLS-ROYCE LIMITED



BY HAND

 SECRETARY OF STATE
FOR INDUSTRY'S OFFICE

The Rt. Hon. Sir Keith Joseph, M.P.
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

TO Mr Maynard	COPIES TO
FOR ADVICE (AND	Ps/NT
DRAFT REPLY IF	Ps/mm
APPROPRIATE)	Ps/sec
PLEASE BY:	Mr Croft
	Mr Carron
	Mr Young
65 Buckingham Gate, LONDON SW1E 6BA	
Telex 918091 Telephone: 01-222 9020	
ABAP	

9 April 1981

Dear Keith,

RJ 500

TO	FOR ADVICE (AND
COPIES TO	DRAFT REPLY IF
	APPROPRIATE)
	PLEASE BY:

At our meeting on 6 April I mentioned to you the changes which were taking place in the market and in relation to our collaborators and why we are now seeking an interim decision by you on the RJ 500 programme.

2. Our policy stems from these key strategic facts:

- (i) the 120 to 160 seat aircraft for which the RJ 500 is conceived is the only major sector of the civil airlines market for which a modern fuel-efficient aircraft has not yet been launched, and this market is substantial;
- (ii) it is vital that we retain the Japanese collaboration, because the Japanese will emerge as the major supplier of aircraft and engines to the developing nations of the Far East; are determined to participate in a new aircraft; have a large civil airline requirement themselves and influence others; and, if not allied with us, will link with GE (General Electric) or PWA (Pratt & Whitney Aircraft), to our detriment;
- (iii) our basic agreement with the Japanese is uniquely favourable to RR and we could not again negotiate anything like it, if the present arrangement were frustrated;
- (iv) without the RJ 500, RR's civil turbofan engines will have a severely limited future

3. The present arrangements with our Japanese partners provide that the parties have to agree, not later than 31 May, the result of review of the specification of the engine together with the relevant work programme for 1981, and the partners have to advise each other that funding is available for this programme

otherwise the basic agreement lapses unless some means is found to extend the deadline. We know the Japanese are being wooed hard by PWA (and probably GE as well); in particular MHI, the most powerful company in the Japanese partnership, albeit with only a small share in the project, are being tempted by PWA who are casting doubts on our ability to develop a new engine. In order to obviate any risk of RR being supplanted, as well as for the reasons explained below, we are most anxious for RR to be able to complete the agreement on the work programme as quickly as possible and thereby protect the basic agreement.

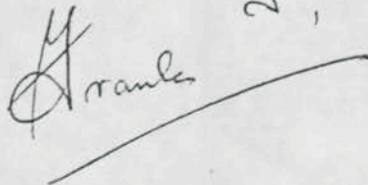
4. Once continuation of the collaboration is assured we and our partners can pursue significant improvements in design of the engine. The original (RB 432) concept for the RJ 500 was for a relatively simple low cost engine, derived from work done on an engine aimed at the business jet market (RB 401). Since then the much greater importance of fuel costs and the anticipation of competitive pressure have led to the need to design a much more sophisticated engine emphasising fuel economy. Thus current work with the Japanese is on a high technology engine of 21,000 lb. thrust aimed at a 120/130 seat aircraft, but with a core and other features which will meet the need for a higher thrust engine such as is likely to be required for a 150/160 seat aircraft.
5. Boeing has now launched the 737-300 to meet the smaller category of aircraft, to be powered initially by the GE/SNECMA CFM 56-3 engine. Boeing, Airbus Industrie, Fokker, the Japanese industry and Douglas are all contemplating new designs of larger 150 seat aircraft, either alone or in combination, and we expect two new aircraft to emerge from this work.
6. Whilst this seems to us the most likely outcome, another possibility is that the 737-300 will be so successful that for some years to come no larger aircraft will be launched and there will then be a large market for this smaller type of aircraft. A third possibility is that sales of the 737-300 will be limited and not warrant the installation of an alternative engine and that the lion's share of the market will then go to the larger aircraft. RR's objective is to be prepared for these possibilities.
7. The position of our competitors is as follows:
 - (a) GE in collaboration with SNECMA have said the CFM 56-3, the 20/21,000 lb. thrust version of the existing engine, is launched on the 737-300 and have announced plans for another higher thrust version which would be virtually a new engine. We do not consider the CFM 56-3 will be competitive with a new engine such as the RJ 500. As the CFM commitments thus far require substantial further investment, there must also be some doubt whether GE will

in the end see a sufficient market in 150/160 seats to justify a new engine.

- (b) PWA have announced plans, with MTU and Fiat, to produce a 26,000 lbs. thrust engine. But if this is a derivative of the PW 2037 (at 37,000 lbs. thrust), it will not be competitive, e.g. on fuel consumption, with a new engine; and if it is to be a scaled version of the PW 2037 or some other form of new engine, PWA will have major problems in launching it at the same time as their PW 2037 programme.
8. We believe this will mean that the RJ 500 is unlikely initially to face more than one competitor in each of the two market segments if such emerge. Our plan therefore is to be able to offer the 21,000 lbs. thrust version for the 737-300, at a launch cost to RR of £200/250m. The higher thrust version, at an additional development cost of £70/100m, would depend on how the market develops.
9. As to profitability, our current estimates of costs and prices indicate that we should be able to achieve a real rate of return in excess of 5% in the light of our confidence in the size of the market and in our ability to design and make an engine at a fully competitive cost.
10. Against this background, there are two outstanding issues with our partners:
- (1) the Japanese approach to their own Government has so far been based on a 21,000 lbs. project, although they have agreed to an engine design with a core suitable for the larger application also. Our first task therefore is to help the Japanese to convince their own Government that the approach as outlined earlier makes market sense and to offer them the opportunity to participate in the larger engine, if it is made, something which we are not obliged to do under the terms of our basic agreement: they, like RR, would face the problem of financing the additional investment;
- (2) however the potentially more contentious issue is that hitherto the collaboration has been based on a two-shaft engine design. After a careful review, we now see significant advantages to RR in designing the RJ 500 as a three-shaft engine like the RB 211. Both concepts will be competitive technically and in terms of cost. The Japanese are aware that we have been taking a hard look at a three-shaft alternative, but they themselves have hitherto been committed to the two-shaft concept and it may be difficult to persuade them to accept a three-shaft

design. We hope to convince them but cannot be certain of success. Should we fail we should wish to continue with the design of the two-shaft RJ 500.

11. So as to ensure that there is no excuse for delay on the part of the Japanese in confirming the agreement for this year's work programme, we judge that we cannot start serious discussions on the eventual higher thrust version of the engine, or any discussions at all on the three-shaft concept until we have eliminated the potential 31 May break-point.
12. The question of full launch of an engine for a first application would then revert to the terms of our basic agreement with the Japanese, i.e. we must jointly decide between now and the end of this year if suitable conditions exist for completing the so-called "launch certificate"; if not, a further postponement would need to be agreed.
13. In this situation we need HMG's support for the work programme after May to proceed to end 1981 at a spend of up to £1½m a month. We would aim to contain this amount within the existing cash limit, although some increase might be needed. Also, if this course is agreed, we would subsequently seek your assistance to have some part of this expenditure, which is principally on demonstrator work, financed by grant or equity rather than loans.
14. Our objective in the coming months is to be able to offer both of these engines to prospective airframe customers on the understanding that these engine programmes will proceed provided that certain launch conditions to be mutually agreed are met.
15. In the light of the situation I explained to you earlier this week, as amplified in this letter, I hope you will agree that it would not have been appropriate or possible to submit a detailed RJ 500 project proposal, as originally contemplated.
16. As the immediate issue is the risk we run of losing the Japanese partnership whose terms are uniquely favourable to RR, I also hope very much that you can give us the required support before we have our next joint Board meeting in Tokyo on 7 May.

Yours sincerely


McFadzean



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10 DOWNING STREET

PRIME MINISTER

Keith Joseph has seen Frank McFadzean, who has responded - reasonably enough - that if Pratt and Whitney have a proposal, they should put it direct to him.

T. P. LANKESTER

A handwritten signature in dark ink, appearing to be 'T.P.L.' or similar, written in a cursive style.

20 March, 1981.

S E C R E T



PRIME MINISTER

ROLLS-ROYCE

As agreed at our meeting on 2 March I have put to Lord McFadzean the proposal from Warburgs that there should be discussion between Rolls-Royce and Pratt and Whitney about the possibility of some association between the two companies. Before I did so, Warburgs had further confirmed that Harry Gray, the Chairman of United Technologies, Pratt and Whitney's parent company, would be ready to come to London for a discussion if it were to be confirmed that there appeared to be value in his doing so.

2 Lord McFadzean was somewhat sceptical about the real intentions underlying Pratt & Whitney's reported interest. I emphasised to him, however, that the Government was concerned about the prospects of a continuing financial burden for taxpayers if Rolls-Royce continued to engage their American rivals in head-on competition and also underlined the limited prospects on the defence side of the business. He agreed, therefore, to reflect on whether he would be willing to meet Mr Gray and suggested that the Government should tell Warburgs that, if Mr Gray had a proposition to make, he should make contact with Rolls Royce direct. He is, however, inclined to defer the approach until another potential sale to a US airline had been completed.

3 I am seeing Lord McFadzean again on 23 March and intend to tell him that I propose to speak to Warburgs as he suggested without further delay. I shall also make clear to him that the Government

/would ...

S E C R E T

S E C R E T



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would wish him to discuss in advance the objectives he would have in mind, in any discussion with Pratt and Whitney and to keep us in touch with subsequent developments.

4 I am copying this minute to the Chancellor of the Exchequer, the Secretary of State for Defence, Sir Robert Armstrong and Robin Ibbs.

KJ

K J

20 March 1981

Department of Industry
Ashdown House
123 Victoria Street

S E C R E T

19 MAR 1981

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10 DOWNING STREET

From the Private Secretary

2 March 1981

Dear Ian

FUTURE OF ROLLS ROYCE

The Prime Minister held a meeting this morning to discuss your Secretary of State's minute of 17 February. Mr. Tebbit, joined later by your Secretary of State and Mr. Farrow, represented your Department. The Chancellor of the Exchequer, the Secretary of State for Defence, Sir Robert Armstrong and Mr. Ibbs were also present.

Your Ministers explained the international position in the aero-engine business. At the present stage Pratt & Whitney were in an exposed position as a result of the guarantees offered to support sales of their PW2037 engine. The time might therefore be suitable to consider the possibility of Rolls Royce collaborating with one of its two competitors. There was a window of time to consider this. The opportunity was likely to be past by the end of May, as Rolls Royce would by then have to reach a decision on collaboration with the Japanese for the RJ500. Under U.S. law, Pratt & Whitney were obliged to offer terms to other American airlines no worse than those they had already offered. On this basis, if they provided many more guarantees, they could well find themselves forced to seek to put Rolls Royce out of business.

Against this background, Warburgs had made contact with the Department of Industry in conversations between Sir Eric Roll and Sir Peter Carey, suggesting that they might act as a broker to bring together Rolls Royce and Pratt & Whitney, allowing contacts to be opened with neither party needing to take an initiative. There were also reports that General Electric had recently approached Rolls Royce about possible collaboration, although Lord McFadzean claimed that these approaches did not cover the main aero-engine business. This required clarification.

Your Secretary of State said that he was seeking the Prime Minister's authority to raise these matters with Lord McFadzean, on the basis that the colleagues present at the meeting all felt it worth putting to him the proposition that possibilities of collaboration with Pratt & Whitney should be pursued.

/The Chancellor

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- 2 -

The Chancellor emphasised the scale of the Government's existing financial commitment to Rolls Royce. He considered that Ministers had every reason to seek a partnership if one could be found. The Secretary of State for Defence said that he had always favoured a link with Pratt & Whitney. General Electric's French links made an arrangement with them less practicable, but any link with the American company would have to be approached with the most careful preparation. The role of Warburgs seemed irrelevant to the main issue.

After a broad discussion of the issues, the Prime Minister agreed that your Secretary of State should see Lord McFadzean to test his reaction to the prospect of contact with Pratt & Whitney. It will be helpful if Mr. Tebbit could also attend that meeting, which would therefore need to be rearranged in view of his commitments in Brussels on 3 March. The discussion should be on the basis that the Government saw signs of an unacceptable financial outlook for Rolls Royce: at this point, Warburgs had come forward with their suggestion: he had therefore been authorised to explore this with Lord McFadzean. The Prime Minister added that the tactical approach to any discussion with Pratt & Whitney, or with General Electric, would be critical, but this aspect would need to be examined further by Ministers in the light of Lord McFadzean's response to your Secretary of State.

I am sending copies of this letter to Peter Mason in your Department, John Wiggins (HM Treasury), Brian Norbury (Ministry of Defence), David Wright (Cabinet Office) and Gerry Spence (Central Policy Review Staff).

Yours ever

Mike Paterson

I.K.C. Ellison, Esq.,
Department of Industry.

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For Mem 2 meeting

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P.0426

MR LANKESTER

FUTURE OF ROLLS ROYCE

You asked for a quick reaction to Sir Keith Joseph's minute of 17 February to the Prime Minister about Rolls Royce. This note has been discussed and agreed with Robin Ibbs.

2. The Secretary of State reports that Rolls Royce are now locked in a fierce competitive battle with Pratt & Whitney (P&W) which is adding substantially to the risks and financial pressures which they already faced. This competition is reflected not only in lost orders which Rolls Royce had a good expectation of achieving, but also in heavy guarantees given by P&W to their customers that their engines will be more fuel-efficient than the Rolls Royce alternatives. P&W's exposure on this account is believed to lie between $\frac{1}{2}$ billion dollars and a billion dollars in respect of contracts so far taken. In the midst of this situation the Department of Industry has been approached by Warburgs, acting on behalf of P&W, with the suggestion that an association with Rolls Royce might be attractive to the American company - though with no indication whatever of what form such an association might take. Sir Keith Joseph has little doubt that Rolls Royce, and Lord McFadzean in particular, would strenuously oppose such a deal - not least because previous experience of co-operation between Rolls Royce and P&W has not been happy. And indeed there is a suspicion that the approach is only being made since such talks could assist P&W in destroying confidence in Rolls Royce's future.

3. Nevertheless, Sir Keith Joseph sees the possibility of an association between the two companies as a possible alternative to either continuing and substantial Government support or to the possible competitive defeat of Rolls Royce driving them from the civil aerospace market. He is due to meet Lord McFadzean on 23 February and, subject to your views, would propose to float the idea of an association with P&W. But before doing so he would like guidance on how far he should go in pressing Rolls Royce to adopt a constructive response to the P&W approach.

now postponed

R.

4. There are difficult issues of judgement here. On the one hand, collaboration could reduce the vulnerability of public funds either to supporting Rolls Royce in the competitive battle or to the costs of substantial rundown if the battle is lost or conceded. On the other hand, the politics of appearing to deliver Rolls Royce, and its industrial expertise, into the hands of an American competitor are not easy. Nor can we be certain, in the present state of knowledge, who would win the competitive battle, bearing in mind both P&W's exposure to their guarantees and technical uncertainty about whether Rolls Royce or P&W have chosen the best long-term route to successful engines.

5. There is also the danger that exploratory talks, however delicately conducted, might slip over imperceptibly into real negotiations. If this were to happen it would be essential that Rolls Royce had worked out in advance a clear idea of what the options were for them - sale to P&W, merger with P&W, joint ventures on particular projects and so on - and related questions like the vulnerability of any deal to American anti-trust regulations. It is less easy for the Government to be clear about its reaction to particular proposals before their shape has become apparent. But this too would have to be established before any commitments were made.

6. In short, it is difficult to fault Sir Keith Joseph's recommendation that, given the approach from Warburgs, there should be some direct contact between Rolls Royce and P&W. On the other hand, it would also seem essential that before such talks take place (particularly if they involve Lord McFadzean himself) Rolls Royce should clarify their minds as to what is on and what is not on, both from their point of view and from that of Ministers. In other words it may be right to urge Lord McFadzean to talk to P&W; but it would be very important to remain totally uncommitted until Rolls Royce had assessed the merits of whatever P&W had put forward and he had cleared his lines with Ministers.



P Le CHEMINANT

Cabinet Office

18 February 1981

- 2 -



PRIME MINISTER

FUTURE OF ROLLS ROYCE

1 We accepted last year (MISC 22 (80)1) Lord McFadzean's broad strategy for Rolls-Royce (RR) on the understanding that it would allow the company to become profitable and that it would dispense with the need for additional public funds, apart from launching costs from time to time, by the end of 1982.

2 We recognised that there were substantial risks and in particular there was always a danger that RR could be severely squeezed. RR is the smallest of the three major aero-engine companies in a market which is uncomfortably small for three competitors. RR's rivals, General Electric (GE) and the Pratt and Whitney (P&W) subsidiary of United Technologies, are much larger and more widely based companies; United Technologies itself is the tenth largest industrial company in the United States. The civil market is dominated by US airlines and US airframe companies while the military market is dominated by American defence procurement. The continuing strength of sterling further underlines the risks. But the technical and marketing success of the RB211-535 engine on the Boeing 757 aircraft suggested that Lord McFadzean's strategy was well worth attempting.

3 The world recession has, however, significantly affected airline orders. RR has unexpectedly found itself competing with a new P&W engine (the PW2037) on the Boeing 757 and has failed to win two major orders from Delta and American Airlines. This and the loss,



again to P&W, of the contract to supply the engines on the Airbus A300s ordered by Saudia has underlined the risks in Lord McFadzean's strategy and in particular the risks of being the smallest of the engine producers in the market. RR needs to respond soon to these developments. A decision will also be required within a few months on whether RR should be permitted to proceed with its Japanese partners on a new engine, the RJ500, which is also likely to meet head-on competition from both the US companies. Inevitably the RJ500 would require more public money and we ought to look at the alternatives before the Government becomes committed.

4 The alternatives are stark. It is likely that a continuation of RR's existing go-it-alone strategy will mean continuing expense for the taxpayer and cut-throat competition with the large US companies. On the other hand, it has always been clear that it would be almost impossible for RR to achieve a gradual and cheap withdrawal from the civil market because, if there were any doubt about RR's long term future in the business, there would be a rapid collapse in customer confidence at great cost to the taxpayer.

5 Events may now, however, have given us a relatively fleeting third option based on some sort of association between P&W and RR that might perhaps be acceptable politically, financially and even to RR itself. The new option arises because, in order to break into the market for the engines for the Boeing 757 aircraft, in which RR had a head start, P&W have given extravagant guarantees about the extent to which their new engine will improve on the fuel

/efficiency ...



efficiency of the RB 211-535 engine. If the two companies continue in head-on competition and the RB 211-535 enters service with sufficient fuel economy for the P&W guarantees on the PW 2037 to be called, the cost to P&W would be between £½ and £1 billion in respect of contracts taken so far. P&W's commercial strategy appears to be based on the assumption that they can prevent the RB 211-535 (except in its earliest version) from entering airline service, thereby preventing their guarantees being called. P&W are bending every effort to undermine RR's position by, for example, casting doubt upon our willingness as a Government to back RR until the RB 211-535 enters production. No doubt P&W hope to recover the cost of this strategy in the less competitive market which would result from the elimination of RR as a competitor. This is a high risk strategy and the extent of P&W's exposure means that United Technologies may be more willing than previously to agree to terms for an association which we could accept.

6 There is every prospect of continuing competitive battles between the companies, which will ensure that neither company will secure the return on investment it would otherwise expect. Moreover, if RR and its Japanese partners launch the RJ500 engine, this would lock RR into still wider headlong competition with P&W. The costs of RR's go-it-alone course cannot be quantified but on past experience they would be high and the prospects of any return is at best uncertain. I think that in these circumstances it would be right to explore the possibility of an alternative strategy based on an association between RR and P&W.

7 Quite independently, the Department of Industry has been approached

/by ...



by Warburgs acting on behalf of P&W with the suggestion that an association with RR might be attractive to P&W. Warburgs have suggested such a link might form a basis for privatisation of RR but their thinking on this point has been only rudimentary so far.

8 There are obvious drawbacks to such a proposal. I have little doubt that RR, and Lord McFadzean in particular, would strenuously oppose a deal; they would see it as the end to their independence and would expect P&W to be the senior partner. There is the significant UK defence interest to be taken into account. There is also no assurance that a reasonable deal can be struck. To have any chance of success we would need to convince P&W, and their parent company, United Technologies, that, in the absence of a reasonable deal, the Government would back RR to the hilt in their competitive strategy and that the RB 211-535 will indeed go into service with sufficient fuel efficiency for the P&W guarantees for their PW2037 engine to be called (but we are in effect committed to such expenditure already). It is also a course which involves a major risk, since P&W could leak it to RR's customers as part of their strategy of destroying confidence in RR's future; indeed P&W may have approached Warburgs with precisely this idea in mind. There are also severe doubts as to whether RR could in practice secure a stake in any new company which would be politically acceptable without huge costs to the UK taxpayer. I am clear, however, that, if we do not take this chance, we shall be locked into a continuing competitive battle between RR and their American rivals which is unlikely to show us a good return



on investment and which could in the end force RR out of the civil aerospace market at high cost financially and politically. I am sure, therefore, that we should at least try to examine the idea seriously.

9 I have arranged to see Lord McFadzean on 23 February when I propose to put the idea to him. In all the circumstances, however, I would expect him to need considerable persuasion to approach the issues constructively. When Norman Tebbit and I meet you on Wednesday, I shall want to explore with you how far we should press this idea.

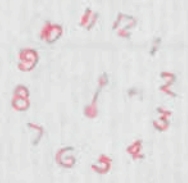
10 I am sending copies of this minute to the Chancellor of the Exchequer, the Secretary of State for Defence, to Sir Robert Armstrong and Robin Ibbs.

KJ

Department of Industry
Ashdown House
123 Victoria Street

17^{K J} February 1981

17 FEB 1981



Wed 18.2.81

W, CAN

PRIME MINISTER

c.c. Mr. Whitmore
Mr. Lankester ✓

The Secretary of State for Industry and Mr. Tebbit would like to come to see you for fifteen minutes next week, to discuss a meeting they are having on Monday 23 February with Lord McFadzean to discuss the future policy for Rolls Royce.

CAROLINE STEPHENS

11 February 1981



The Foreign Secretary decided
to write.

Mr. P. M. 4/11

Foreign and Commonwealth Office

London SW1A 2AH

2 December 1980

I have asked P. M.
to make a very
brief to the Treasury.

Prime Minister
To be aware of the problem.

Dear Sir,

Rolls Royce and Airbus

Lord Carrington has been faced with a somewhat awkward request from RR, at board level, that he should send a message of support to the appropriate Saudi Minister (Prince Sultan) backing RR's efforts to have the RB 211 engine chosen for the Airbuses that the Saudis are said to be on the point of ordering. Your Secretary of State minuted to the Prime Minister on the subject on 30 September.

As you know the value of the order would be substantial: £100 million initially with the prospect of a further £150 million for follow-up orders with Saudia. Also at stake is RR's position as sole supplier of engines to Saudi Arabian Airlines hitherto. Furthermore this may be RR's last chance of launching their engines on the Airbus with significant prospects of further business in the Middle East and elsewhere.

For all these reasons Lord Carrington is disposed to do what he can to help Rolls Royce. A personal message to Prince Sultan, whom he knows well, might help to tilt the balance in RR's favour although we understand that Pratt and Whitney are currently making the running with a very attractive financial package.

The complication arises from the negotiations with our Airbus Industrie partners on the production financing arrangements which would be needed if Rolls won the order, and which are explained in your Secretary of State's minute. Lord Carrington understands why this tiresome problem cannot be resolved until the contract is secured since it would be impossible to force our partners to negotiate on a hypothetical case. But he is concerned at the risk that HMG might find the conditions unacceptable at the end of these further negotiations and RR would therefore be prevented from carrying out the contract. The consequences for Anglo/Saudi relations and his own standing with Saudi Ministers if he had sent a personal message would obviously be unfortunate.

It is clearly not reasonable to ask that Ministers

/should



should give a blanket assurance that if the AI negotiations did not go our way, HMG would cover the additional costs of fulfilling the contract. But before taking a final decision Lord Carrington would be grateful for your Secretary of State's urgent comments on whether the risks of him acting as proposed are acceptable. I should be grateful for a reply by close of play on 3 December.

I am copying this to Michael Alexander, who may also wish to comment.

For ear

GGH

(G G H Walden)
Private Secretary

I K C Ellison Esq
Department of Industry



72 DEC 1980



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From the Secretary of State

CONFIDENTIAL

Ian Ellison Esq
Private Secretary to the
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
London, SW1E 6RB

R

17/10

10 October 1980

Dear Ian

ROLLS ROYCE AND AIRBUS

My Secretary of State does not wish to reopen the question of the letter to Lord McFadzean for which the Prime Minister's approval was given in Tim Lankester's letter of 6 October. He has, however, asked me to pass on a comment which might be of general relevance to similar cases in the future.

Saudi opinion of British industry in general will hardly be enhanced by Rolls Royce - a seller - approaching a potential major buyer and laying down the circumstances and conditions which will determine whether a sale might take place. He would have thought it preferable to have decided whether in the last resort the Government would be prepared to underwrite the costs so that Rolls Royce could press their case without any strings; it would have then been up to the Saudis to negotiate with Airbus Industrie and for the Government and British Aerospace to extract the best deal possible from the airbus partners.

I am copying this letter to Tim Lankester (Number 10) and to Robin Ibbs.

Yours sincerely,

Stuart Hampson

S HAMPSON
Private Secretary

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CONFIDENTIAL



PRIME MINISTER

ROLLS-ROYCE CORPORATE PLAN

Following your suggestion, Adam Butler and I had a discussion with Frank McFadzean about the Rolls-Royce Corporate Plan on Friday 12 September. In advance of the meeting, I had written setting out the main points of the Government's preliminary view on the Plan as set out in my minute of 6 August.

In the discussion, I re-iterated that so far as the Company's Civil Aero-engine business was concerned, I accepted that - on the basis of the improved financial projections shown in the Plan - continued exploitation of the RB211 should be the cornerstone of the Company's commercial strategy. There was certainly no other obvious alternative. For this strategy to be effective, however, Rolls-Royce would have to remain competitive and at the same ^{time} improve profitability. It was clear, moreover, that both would be dependent on the Company's plans to improve its productivity. I also emphasised the importance the Government attached to the Company's objective of breaking-even in cash flow terms by 1983.

Frank McFadzean accepted the Government position, but pointed out that the forecast of break-even by 1983 was made on the basis of an exchange rate of \$2.20 : £ rather than the current rate of \$2.40 : £. Moreover, differential inflation rates between the UK and US affected Rolls-Royce and their anticipated cash requirements for 1981 and 1982 were now looking much higher. He nonetheless accepted that he had,

/somehow ...

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C.C. A. Dugard

Prime Minister

Sir Keith's report -
back on his
discussion, with
Frank McFadzean :
reasonably satisfactory.

B.
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somehow, to manage the Company back to the level of profitability laid down in the Plan. He also agreed that the Company had to eliminate waste and flabbiness and, at the same time, to keep tight control on suppliers and sub-contractors whose contribution to Rolls' business was considerable. Indeed increased efficiency among suppliers, who contribute over 70% of Rolls' manufacturing stocks, is as crucial to Rolls' success as improvements in Rolls' own productivity.

We discussed the Company's proposed joint venture with a group of Japanese firms to manufacture and market a new engine (RJ500) for medium-sized medium-haul jets. Although we have allowed the Company to go ahead and to explore a collaborative arrangement with Japan, I expressed the Government's doubts about the viability of the prospect and invited Rolls to consider whether it would not be wiser to examine a link with Pratt and Whitney. Lord McFadzean was not in favour; he thought it was most unlikely that Pratt and Whitney themselves would be in competition with the RJ500 or the GE SNECMA engine, which is also being developed. Discussions were, moreover, so far advanced with the Japanese that they were unlikely to be willing to extend the partnership. In any event, the timescale would not allow a round of discussions with P & W if the launch timetable were to be met. I am not inclined to interfere with Frank McFadzean's own judgment of RR's commercial strategy. The Government will, of course, have the opportunity to consider the project as a whole when RR seek approval to enter into a launch commitment or additional funding is required.

/I ...



I also pressed on Lord McFadzean the desirability of the Company shedding some of its peripheral activities including those to do with nuclear power, industrial and marine engines, and helicopter engines. While a decision on the latter must await the MOD's review of their requirement, the conclusion which the Company has reached on its industrial and marine side is that it would not generate significant savings. He nevertheless gave me an undertaking that he would keep the points in mind. The nuclear business needs to be thought of in the context of the nuclear power plant industry as a whole.

With the exception of the RJ500, where I believe we must, for the moment, accept Frank McFadzean's judgment, it seems clear that the Company accepts the response of the Government to the Corporate Plan. I would propose to follow up my discussion with a letter underlining the points to which the Government attached importance, in particular, the need to demonstrate in the Company's Operating Plans that the financial objectives will be achieved.

I am sending copies of this minute to members of MISC 22, Robin Ibbs and Sir Robert Armstrong.

KJ

K J

6 October 1980

Department of Industry
Ashdown House
123 Victoria Street



incl Post

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

6 October 1980

The Rt. Hon. Sir Keith Joseph, Bt., MP.,
Secretary of State for Industry

R

Yw

Don Kirk

ROLLS ROYCE AND AIRBUS

Flag A

I have considered your minute of 30 September to the Prime Minister and as you already know I have no objections to the terms of the letter which you wish to send to the Chairman of Rolls Royce. It seems to me right, as you suggest, that there should be no HMG commitment until we have some further idea of the likely outcome of the discussions on the Airbus Industrie financing systems. On this aspect of the problem, I understand that Saudia want a new version of the Airbus, the A300-600, which has not yet been authorised by the member Governments. This could prove a bargaining counter, and I would suggest that our approval for developing the -600 should not be given before we have had a chance of assessing progress in the engine financing negotiations.

If this venture does go ahead Rolls Royce should be pressed very hard to reassess their priorities and meet any costs to them from within their existing investment planning totals. Given the present extremely difficult public expenditure problems we face I must say now that John Biffen and I would find it very difficult to accept that any of the extra costs to RR or British Aerospace should entail an addition to total public expenditure provision.

I am copying the letter to the Prime Minister and the other recipients of your minute of 30 September.

[Handwritten signature]

GEOFFREY HOWE

6 OCT 1980



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10, DOWNING STREET

From the Private Secretary

6 October 1980

Rolls Royce and Airbus

Your Secretary of State minuted the Prime Minister on 30 September on the above subject. This is just to confirm that the Prime Minister was content with his proposal to write to Lord McFadzean subject to the amendments to the draft proposed by Robin Ibbs in his minute of 2 October (a copy of which you received).

I am sending a copy of this letter to George Walden (Foreign and Commonwealth Office), John Wiggins (HM Treasury), Bryan Norbury (Ministry of Defence), Richard Dykes (Department of Employment), Stuart Hampson (Department of Trade), Julian West (Department of Energy), David Wright (Cabinet Office) and Gerry Spence (Mr. Ibbs' Office).

T. P. LANKESTER

Ian Ellison, Esq.,
Department of Industry

CONFIDENTIAL

2/8



10 DOWNING STREET

Tun

I have told Industry
that letter as
amended by 10/10
can now go. (They
are in a hurry as
McFidyeau is leaving
for Saudi Arabia)

Yours

CONFIDENTIAL

Prime Ministry
All Departments are agreed that this contract is worth pursuing (though RR will have to re-order their priorities). The CPAs have suggested a slight strengthening of the proposed letter to Frank MacFadzean, which seems sensible.
Content?

Qa 05144

To: PRIME MINISTER
From: J R IBBS

After letter & Ph. 14th amendments - not

Rolls Royce and Airbus

Flug A

1. As the Secretary of State for Industry records in his minute of 30 September to you, the interdepartmental group of officials under my chairmanship has considered this question. I do not dissent from the recommendations of the Secretary of State which embrace the main caveats recommended by officials, but wish to bring one or two points to your attention and to make some suggestions on the draft of the letter to Lord McFadzean.

*12
2/10*

2. The commercial case from Rolls Royce's point of view for fitting their engines on the Airbus seems to be sound on the basis of the figures provided by the company, although there must as always be some elements of risk and uncertainty. Also, while it is broadly consistent with the general commercial strategy set out in their recent corporate plan, it is not consistent with their financial strategy. Indeed, they are asking for further finance (of the order of up to £30 million over four years) and it is reasonable that Rolls Royce should meet this by re-ordering their priorities. There is also the possibility - not mentioned in the Secretary of State's minute - for some financing from the Saudis in return for a share of future profits. This would ease the financing burden and should be encouraged, provided suitable terms could be negotiated.

*i.e. they will have to cut back somewhere else.
12*

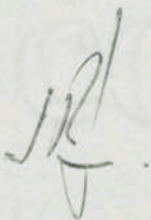
3. Because of the complicated financing arrangements within Airbus Industrie, consequential costs from fitting Rolls Royce engines would fall to British Aerospace. These are uncertain but could be quite large (perhaps as much as £7 million per annum as a form of subsidy plus costs for financing additional working capital). With a more equitable financing system in Airbus Industrie this would be shared by all the partners in the consortium. Every effort should be made to persuade the French and German partners to agree to change the system. Unless this can be achieved the Rolls Royce project would not from an overall viewpoint be financially acceptable.

CONFIDENTIAL

4. It would be wrong at this stage to prevent Rolls Royce from undertaking preliminary negotiations for the Saudia contract. However, it is important that, right from the beginning, both Rolls Royce and the Saudis understand clearly that no agreement can be completed until the financial arrangements within Airbus Industrie have been renegotiated to our satisfaction. For this reason I suggest that Rolls Royce be invited to secure the Saudis' preference for their engines subject to further negotiation. Support from the FCO will be necessary to explain the position fully to the Saudis. It is important to ensure that the responsibility for any subsequent failure falls to the Airbus Industrie consortium and not ourselves and that, if necessary, we could withdraw with the minimum of diplomatic embarrassment.

5. In the light of these comments I attach suggested amendments to the draft letter to Lord McFadzean.

6. I am sending copies of this minute to the Foreign Secretary, the Chancellor of the Exchequer, the Secretaries of State for Industry, Defence, Employment, Trade and Energy, and to Sir Robert Armstrong.



2 October 1980

Att

ROLLS ROYCE AND AIRBUS

Suggested amendments for the draft letter from the Secretary of State for Industry to Lord McFadzean.

Paragraph 3, the first sentence to read:

'I appreciate the strong reasons behind your desire to pursue the Saudia Airbus contract and recognise that it is broadly consistent with the commercial strategy set out in the recent corporate plan.'

Paragraph 3, add to end:

'I note that there is a possibility of Saudia^{Airbus}/contributing 50 per cent of the cost of the certification programme on a risk sharing basis. I am content for you to pursue this further to see whether acceptable terms can be negotiated.'

Paragraph 4, add to end:

'It is essential that the Saudis should understand that if you persuade them to express a preference for the RB211 engine, implementation of this will depend upon satisfactory negotiations between Rolls Royce and Airbus Industrie and also between British Aerospace and its Airbus Industrie partners.'

CONFIDENTIAL

2 OCT 1980

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PRIME MINISTER

ROLLS ROYCE AND AIRBUS

Rolls-Royce foresee a reasonable chance of persuading the Saudi Arabian airline to choose the RB211, rather than the competing US engines, to power a large number of European Airbuses which it has decided to buy. In principle, such a link between Rolls-Royce and Airbus is very desirable, but it does raise some difficult issues. These have been considered by an interdepartmental group of officials under the chairmanship of Robin Ibbs, who are in agreement that Rolls should be authorised to go ahead in competing for this order, but in view of the seriousness of the issues, I am writing to make sure that you and other colleagues are content.

Having studied the officials' report (MISC 25 (80) 9), it seems clear to me that the commercial and financial case for authorising RR to proceed is compelling even if, as is assumed, Rolls-Royce have to fund the cost of developing the pylon by which their engine would be attached to the aircraft. However, there is a major problem, arising from the financial arrangements, of additional costs to Airbus Industrie (AI) that, under the present AI system, could be expected to fall either on British Aerospace or on the Government. These could in the extreme range up to an annual subsidy of £18 million and a need to provide finance for work in progress of £69 million and thus outweigh the commercial benefits to Rolls-Royce and the political benefits of demonstrating our commitment to a European aerospace industry and providing positive evidence of an improved relationship with Saudi Arabia.

/My...



My own conclusion is that we have no alternative but to take the matter step by step. Since it is clear that the outcome of the negotiations with our Airbus Industrie partners will not be known for some considerable time and, indeed, will be difficult to urge forward until RR have been positively selected by Saudia for their Airbus purchase, we should allow RR to enter the competition on the understanding that:

- a) a final decision will depend on the contractual details between RR and AI and between AI and its partners;
- b) we do not accept that all the RR launch costs should be met by Government.

This will permit us to see whether, in fact, RR can secure the Saudia order, allow more time for negotiations with the AI partners on changes in the financing system and ensure that if, at the end of the day, the financial outcome is still unacceptable, at least some of the blame can be laid on the intransigence of our French and German partners. It will also clearly be necessary to ensure that the Saudis understand what we are doing, so that a withdrawal of all RR offers does minimum damage to our relations. I would suggest that officials from the Department of Industry and the FCO should liaise closely on this.

... If you are content, I would propose to write to Frank McFadzean in the terms of the attached draft. I would, of course, consult colleagues again before any commitments were undertaken and in the



light of the proposals made by RR and the negotiations on the AI financing system.

I am sending copies of this minute to the Foreign Secretary, the Chancellor of the Exchequer, the Secretaries of State for Defence, Employment, Trade and Energy, Sir Robert Armstrong and Robin Ibbs.

KJ

K J

30 September 1980

Department of Industry
Ashdown House
123 Victoria Street
London SW1



DRAFT LETTER FOR THE SECRETARY OF STATE FOR INDUSTRY TO SEND TO:

Lord McFadzean of Kelvinside
Rolls-Royce Ltd
65 Buckingham Gate
LONDON
SW1E 6AT

ROLLS-ROYCE AND AIRBUS

You wrote to me on 30 July concerning the opportunity to launch the RB211 on the Airbus.

I have now been able to give thought to the issues involved and to consult my colleagues.

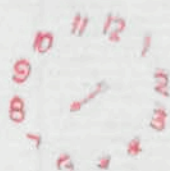
I fully recognise the strong commercial reasons behind your desire to pursue the Saudia Airbus contract and recognise that it is consistent with the strategy set out in the recent Corporate Plan. Moreover, the financial return from the expected investment more than meets the guidelines we have discussed for RR projects. I agree, therefore, that the company should pursue the Saudia contract, although in doing so but I must emphasise that I cannot at this stage accept the additional costs to RR from the programme will be met by Government. Given the priority which you obviously give to securing an outlet for the RB211 on the Airbus, I would expect that the company would endeavour to forego other expenditure of lesser priority in order to contribute to investment. No doubt this can be examined in the context of the Company's operating plan when this is put to the Department.



As I think you may be aware, the financial arrangements for the Airbus programme are such that use of the Rolls-Royce engine might have financial implications for British Aerospace. The nature of the implications will, of course, have to be resolved by those concerned in the Airbus programme, and is not, as such, a matter for Rolls-Royce. You should know, however, that the question could have important consequences for the UK interest in the Airbus programme, and a satisfactory outcome to it will be necessary before contracts can be concluded between Airbus Industrie and Rolls-Royce. We shall, of course, be using our influence within the Airbus programme to try to secure such a satisfactory outcome, but for the moment it is a hurdle that is still to be crossed.

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Finally, in view of the complex nature of the issues and HMG's involvement in the Airbus programme, I would be grateful if you would keep me closely in touch with developments. Likewise, if I or officials in the Department could be of assistance to you, especially in negotiations with Saudia, I am very willing to help.

30 SEP 1980



12 August 1980

ROLLS ROYCE

The Prime Minister has seen Cecily Morgan's letter to me of 11 August. She is content that Rolls Royce should be notified officially of the Government's reactions to their Corporate Plan at this stage, and is glad to see that arrangements will be made for an early meeting with Sir Frank McFadzean.

NJS

Peter Stredder, Esq.,
Department of Industry.

SP

CONFIDENTIAL

BKT



FCO
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BNS
6

10 DOWNING STREET

From the Private Secretary

11 August 1980

Rolls Royce

The Prime Minister has seen your Secretary of State's minute of 6 August and the Chancellor of the Exchequer's minute of 8 August. She is content with the proposals set out in your Secretary of State's minute.

As I told your office this morning, she has also commented that it would seem to her to be sensible for one or more Ministers to discuss these matters with Sir Frank McFadzean personally at this stage. I am not clear whether this has already happened, but I should be glad if the Prime Minister's suggestion could be considered.

I am copying this letter to the Private Secretaries to the other members of MISC 22 and to David Wright and Gerry Spence (Cabinet Office)

N. J. SANDERS

Ian Ellison, Esq.,
Department of Industry

CONFIDENTIAL

HT

PRIME MINISTER



DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

11 August 1980

Nick Sanders Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

To see. It would

be sensible to notify RR
officially at this stage
and meet Sir F McFadzean
later. Contact?

Dear Nick,

Yes Mr

We spoke about the Prime Minister's suggestion that Sir Keith Joseph should invite Sir Frank McFadzean to call on him for a discussion about his Company's Corporate Plan rather than formally to write to him giving the Government's initial thoughts on it. I will of course put the Prime Minister's suggestion to the Secretary of State as soon as possible.

MS
11/8

2 Officials here nonetheless believe that it is desirable to formally record the Government's immediate reaction to the Plan. It will, in any event, be three or four weeks before a meeting could be arranged and meanwhile Rolls Royce itself will wish to begin work on its two year operating plan - details of which we require by the early Autumn if decisions about funding in 1981 and 1982 are to be taken in time to meet estimates timetables. In drawing up that operating plan it is desirable that the Company should have our comments on the long term Corporate Plan especially as it affects cash flow and profitability objectives.

3 Such a letter would, moreover, provide a useful basis for a discussion of the Corporate Plan when Sir Keith and Sir Frank meet.

Yours sincerely,
Cecily

CECILY MORGAN
Private Secretary

COMMUNICATIONS SECTION

11 AUG 1980

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COMMUNICATIONS SECTION
UNITED STATES AIR FORCE
WRIGHT-PATTERSON AIR FORCE BASE
DAYTON, OHIO 45433

FORM 3-78

Yes - but has anyone
seen Frank DeFazio
I would be amused
to discuss these
matters with him.
ref.

Prudential

Mr Ibbs and the Chairman
(at Play A) suggest that
we should accept the
recommendations
proposed at Play B
and the proposals
for further work.

Qa 05103

To: MR LANKESTER

From: J R IBBS

Rolls-Royce

Content ?

1. I have read the minute from the Secretary of State for Industry dated 6 August. As Chairman of the Committee of Officials which examined the plan I should like to comment briefly as follows.
2. The purpose of the plan is to indicate the Company's broad strategy for the next ten years and to provide a framework within which actual results, operating plans, and requests for funding can be viewed. The main features are approximately constant business on military engines and rapid build-up in the next few years on civil engines, most of which is covered already by firm orders. Continuing technical development of the main RB211 range of engines is envisaged, particularly on fuel economy and reliability, but the only major new move proposed is the development and introduction of a new middle range civil engine, the RJ500, on which feasibility studies are at present being carried out jointly with the Japanese. The plan also covers some relatively peripheral matters notably the future of the Company's industrial and marine division, its helicopter and small engine business, and its nuclear activities.
3. It is regrettable that although asked by the Secretary of State to provide information on alternative policies, and subsequently pressed again by the Committee of Officials about this, the Company has put forward information on only one strategy. However, I think it is reasonable to deduce from the available facts that the only significantly different alternative that might deserve consideration would be curtailment of development of the civil business. I believe that would mean giving up aspirations to be a world-scale producer of aero engines and would imply a subsequent reduction in engineering skills, as well as meaning that much of the effort since 1971 would prove fruitless. Such curtailment needs

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CONFIDENTIAL

to be borne in mind as a real possibility but it would be premature to decide on it now, particularly when a new Chairman is prepared to nail his colours to the proposed strategy and to an ambitious target of improvement in immediate performance.

4. As usual the central question is financial and as with some other ten year plans a familiar feature is cash absorption in the immediate future but attractive returns in the latter part of the period. However, these later figures are highly speculative and cannot really be regarded as adequate justification for the ten year strategy. Another familiar feature is that the short term projection shows a sharp improvement compared with the track record. I believe that the sensible course of action will be to monitor the trend of figures for the next one or two years to see whether short term improvement is achieved and whether the trend supports the credibility of the long term target. In this the Company's objective of being cash positive in 1983 is obviously a key marker. (At present this assumes that levies on past launching aid would be waived which the Government has not agreed.)

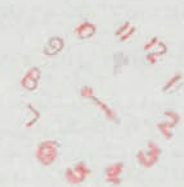
5. The report by officials points out the risks that surround the strategy and disappointingly the plan includes no assessment of the likelihood of these difficulties occurring, although it does indicate for the main ones what the effects might be. The existence of these risks underlines the need for very close monitoring. My own view is that there must be very considerable doubt about whether the Company will achieve the 1983 cash target and that there is a strong possibility that they will continue to need external support well into the decade.

6. Overall my conclusion is that the Prime Minister should respond to the plan in the terms recommended by officials as summarised in paragraph 13 of their report. In particular general support in principle for the broad strategy proposed by the Company should be qualified in that unless the short term figures for the next year or two display a trend in line with that projected in the plan, a radically less ambitious strategy will have to be examined. The first test will be the two year operating plan due in the Autumn.

7. I am sending a copy of this minute to Sir Robert Armstrong.

8 August 1980

- 8 AUG 1980





Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

ROLLS ROYCE'S LONG TERM STRATEGY

I have seen Keith Joseph's minute of 6 August and the report by officials on the Rolls Royce Corporate plan. I am concerned at the Company's reluctance to consider alternatives in the civil engine business, particularly since we are being invited to endorse the strategy without at this stage being given a firm estimate of the cost. I agree therefore with the recommendation of officials that acceptance of the strategy must be conditional upon demonstration in the operating plan due in the autumn that there is a realistic prospect of hitting the Corporate Plan target of break-even by 1983. The assumptions underlying the operating plan will require careful scrutiny and the Company must be left in no doubt that we will require a reassessment of the strategy if the targets cannot be met.

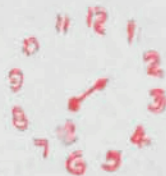
2. I agree that our previous warning on the R500 should be repeated and that the Company should be pressed to explore the possibility of linking with Pratt and Whitney on any new intermediate size engine. I am content that Keith Joseph and officials should pursue the possibilities of disposing of peripheral activities.

3. I am copying this letter to members of MISC 22, Robin Ibbs and Robert Armstrong.

(G.H.)

8 August 1980

- 8 AUG 1980





DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

7 August 1980

Tim Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

P. J. Smith

Dear Tim

ms

12

ROLLS ROYCE

7/18

... You may be interested to see the text of the inspired question which my Secretary of State will be answering today on Jeff Rooker's allegations against Rolls Royce.

*Yours sincerely
Catherine Bell*

CATHERINE BELL
Private Secretary

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ROLLS ROYCE IQ

..... To ask the Secretary of State for Industry if he will make a statement about Rolls Royce contract procedures.

"On the basis of evidence available to me I see nothing which reflects discredit on the Company.

Rolls Royce, my Hon Friend and I have all asked the Hon Member for Birmingham (Perry Bar) to supply further evidence to support his allegations but he has declined to do so.

As the House will be aware Rolls Royce have investigated them and have concluded that there is no substance in the Hon Member's allegations and the persons referred to by him as witnesses have not supported the allegations."

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hd Rn



PRIME MINISTER

I have now received from Sir Frank McFadzean the Rolls Royce Corporate Plan incorporating their long term strategy which we agreed at MISC 22 (3rd Meeting) that I should seek. The Plan has been considered by an interdepartmental group of officials under the chairmanship of the Director General of the Central Policy Review Staff. I enclose a copy of the report which this group has prepared.

2 It is clear that Rolls Royce did not explore fully the possibility of radical alternatives to their present policies. So far as their present engines are concerned, however, the choice is effectively between continued exploitation, which will involve work to keep pace with their competitors, or fairly quickly dropping out of the civil market. It would be fine if our current support leads to a high technology winner that quickly becomes profitable - as the Plan assumes. However the Plan does not explain in detail how this is to be achieved. We shall need to study the Operating Plan due this autumn to reach a judgment; and we shall have to insist on profit.

3 So far as starting on a wholly new engine type is concerned, I think that officials are right to conclude that we should ensure that the company really review all the options fully - including a partnership with Pratt and Whitney as well as the Japanese on an engine to meet the market at which the RJ500 is aimed.

4 I accept that the possible divesting of helicopter engines and of nuclear activities should be considered when the studies referred to have been completed.

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5 So far as the Industrial and Marine Engine business is concerned, I propose to discuss with Sir Frank McFadzean the scope for some sort of partnership with a private sector concern. This is a course Rolls Royce themselves favoured earlier and one that seems to me more realistic than outright sale.

6 I should be glad to know whether you, and the other members of MISC 22 to whom I am copying this minute, agree to my giving a first response to the corporate plan on the lines recommended by officials and my own views set out above.

7 I am sending additional copies of this minute to Sir Robert Armstrong and Mr Ibbs.

KJ

K J

6 August 1980

Department of Industry
Ashdown House
123 Victoria Street

CONFIDENTIAL



ROLLS ROYCE'S LONG TERM STRATEGY

1 Introduction

As agreed earlier this year (MISC22 (80) 3rd Meeting) the new Chairman of Rolls Royce was requested to submit a report on the Company's long term strategy which was to examine alternative policies that could be adopted to ensure both a viable future and a much reduced dependence on public funds. In addition to examining specified ways of achieving that objective he was also asked to consider the possibility of the Company disposing of some of its peripheral activities. The strategic plan was submitted last month to the Secretary of State for Industry. This report sets out officials' comments on the major issues of the plan, sets out recommendations for the Government's initial response, and proposes further work to be carried out with the Company.

2 The plan sets out the broad strategy which the Company proposes to follow over the next decade. It is not designed to seek approval for specific new projects nor for specific sums of money. Separate submissions will be made in relation to major projects when the Company wishes to enter firm commitments, and approval of funding will have to await more concrete operating plans which the Company will draw up to implement its overall strategy. Ministers accordingly need at this stage to consider whether the broad strategy is acceptable as a basis for the preparation of an operating plan for the next 2 years in the light of the broad financial prospects which the Company foresee.

Summary of Company's Proposed Strategy

3 More than half of the Company's business at present is in military engines. They foresee limited prospects for growth in this side of their business over the next decade. However they foresee buoyant demand for civil engines and consider that the

/strong ...



strong technical reputation which the RB211 has established over the last decade and particularly its current fuel efficiency compared with its competitors makes them well placed to expand the civil side of their business. The rapid growth in sales shown in the first two years of the forecast (but not thereafter) are virtually covered already by firm orders. But they are clear that the continued exploitation of the RB211 family during this period will require progressive developments to keep it abreast of the competition and to keep in line with the developing needs of the customers. They conclude, however, that for this strategy to be acceptable the business will have to become profitable, which will require raising productivity to the levels of their US competitors. The central feature of their plan, therefore, is the continued exploitation and development of the RB211, together with an ambitious set of measures designed to reduce the real cost of the engine compared with its competition.

4 In addition the Company foresee that to retain their position in the size of engine below the RB211 family they will need to introduce during the decade a new engine to replace the Spey, and, as endorsed by Ministers last winter (MISC22(79)4th Meeting), are working with the Japanese on pre-launch feasibility studies for this engine, designated RJ500.

5 In the plan the Company set themselves an objective to break even in cash flow terms after 1982 on the assumption that launch aid will be separately provided for major new developments, such as the RJ500. Despite this objective the plan does not demonstrate that it can be achieved, because it does not attempt to provide a cash flow forecast for the 10 year period. It provides a broad projection at constant economic conditions (i.e without forecasting price changes) and assuming a constant £2.20 exchange rate. It is also on the basis of the continued waiver up to 1984 - to which the Government have not agreed - of levies to recoup earlier launch aid on RB211 sales. Figures on this simplified

/basis ...



basis show break even from 1983 after allowing for launch aid of £16m in that year for the planned RF500, with an increasing surplus in subsequent years. The Company believes that a broadly similar picture would remain after making reasonable assumptions for inflation, but the detailed work necessary to substantiate this has not yet been carried out. A proper judgement of the Company's financial prospects must depend on the completion of such forecasts allowing for inflation. So far such forecasts have only been attempted on a provisional basis for 1981 and 1982. These forecast for 1981 and 1982 after allowing for inflation (but still at \$2.20 exchange rate) shows a requirement for continuing substantial external finance in those years (provisionally put at roughly £250 million over the 2 year period). A fuller summary of the plan and of the financial projections is attached in the Annex (see especially paras 5 and 6). This provisional external financing requirement compares with the £270 million which has been committed for 1980.

Alternative Strategies

6 While the strategy examines the scope for making existing policies more profitable, it does not identify an alternative strategy for maintaining its civil business. Although we have pressed them on this point, Rolls conclude that any variant of their policy for the RB211 which still maintained that sector of their business would be more expensive than their present strategy; the only alternative in their view is a progressive withdrawal from the civil engine business.

Views of Officials on Overall Strategy

7 If the Company's existing civil business is to be maintained, officials accept the basic feature of the Company's conclusion that there is little alternative to continued exploitation of the RB211 family of engines. The Company has extensive commitments for this family of engines which could not be broken without putting its whole future in question. If the RB211 family is to be successfully exploited it is realistic to foresee a need

/for ...



for continued improvements to the family through the decade. Officials do, however, recommend that the Company should give deeper consideration than it appears they have done to the possibility of collaboration on the proposed new intermediate engine with Pratt and Whitney as well as with the Japanese. This issue is covered in more detail in paragraph 10 below.

8 There are, however, very substantial risks to the success of the Company's strategy. First it is very sensitive to the future of the dollar/sterling exchange rate. Their forecast of progressive improvement in financial results is based on an exchange rate of \$2.20, which may be unrealistically low for the earlier years. Second, they are vulnerable to inflation in this country being higher than in the United States, although the projection is based on inflation in both countries being at the same level. Although they are pursuing policies to reduce their sensitivity to the exchange rate this and comparative inflation rates will remain critical factors for the Company. Third, there are risks to their sales. We do not take serious issue with Rolls' assessment of their sales prospects, except for the RJ500, which we consider are too optimistic. We accept that there is no present reason to foresee major technical changes which would invalidate the market prospect. But any of their sales forecasts could be affected by unexpected developments in airline demand, for example if the recession proved deeper than expected or if Lockheed suffered a serious financial crisis. Finally, the plan assumes striking improvements in productivity, especially bearing in mind that two-thirds of manufacturing costs will be borne by sub-contracts. No allowance is made for internal or external industrial disputes. (A fuller assessment of these risks is contained in the Annex). There is thus no guarantee that their objective of break-even in cash flow terms by 1983 will be met.

*Of course
this is obvious.*

*There can't
be a guarantee*

9 Officials advise, therefore, that the major issue for Ministers is whether the financial prospects set out in the Annex, taking

/account ...



account of the risks, are an acceptable basis for the Company to continue to exploit its RB211 family of engines. The alternative would be the progressive withdrawal from their civil business, which, in the Company's view, would put their military capability at risk in the longer term. The Company have indicated that there is no lower-risk strategy which would meet the objective of remaining a world-scale manufacturer of aero-engines.

However there is a significant risk that they will not meet their annual figures for profitability and cash flow implied by the financial projections in the plan.

Recommendation 1. We should accept in principle the Company's strategy of continued exploitation of the RB211 family. But the Company should be told now that their detailed plan due in the autumn must substantiate the objectives for cash flow and profitability which they have set themselves in the Corporate Plan.

RJ500

10 The major development foreseen by the Company in the next decade is a new intermediate sized engine in collaboration with Japan. This would inevitably involve very acute competition with the two major US competitors, General Electric and Pratt and Whitney. We have considerable doubts whether the market is large enough to sustain three competing designs. We also see it to be in the long term national interest for Rolls to try to work towards an alliance with one of the US majors, rather than continue in direct competition. Such collaboration with the US is being pursued successfully by the French. The resources required for aero-engine development are so large as to make it doubtful whether the UK can expect to preserve an independent role in the long term. Since Rolls Royce already have collaborative agreement with Pratt and Whitney on the Pegasus military engine, and since there seems no scope for collaboration on an intermediate engine with General Electric, who, in collaboration with the French, already have a new engine of this size, it seems right to explore

/thoroughly ...



thoroughly all prospects of producing any new intermediate engine in conjunction with Pratt and Whitney as well as the Japanese.

Recommendation 2. Ministers should repeat their previous warning to Rolls-Royce that they are doubtful whether Rolls' present plan for the RJ500 will prove acceptable, and should ask the Company to explore and report on the possibility of linking with Pratt and Whitney as well as the Japanese for any new engine in this class.

Peripheral Activities

11 The strategic plan considers the possibility of disposing of each of the three parts of the business which could most easily be separated - the Industrial and Marine Division (IMD), the helicopter and small engine business, and the nuclear activities.

- a IMD. The Company argue that disposal of IMD would not be practicable because of the very close inter-relationship with its gas turbine business, and reject the idea of closing down the industrial business. We think this should be studied further.
- b Helicopters and Small Engines. The Company are of the view that it is beneficial to their business for them to produce helicopter as well as fixed-wing aero-engines provided that the future volume of business will be sufficient. The proceeds from disposal would in any event be insignificant. The size of their future market in this field is very dependent on decisions by the Ministry of Defence, who are their largest customer. MOD are reviewing their future requirements, and it is not possible to take decisions on the future of this part of the business until that review has been completed.
- c Nuclear business. The Company regard this as a possibility for disposal. Officials of the Department of Energy, in conjunction with the Department of Industry and Ministry of Defence, are considering whether there is a case for

/bringing ...



bringing these companies valued at almost £7m by Rolls Royce, into the civil nuclear industry while protecting defence interests.

We recommend that this exercise should continue separately with a view to consulting Ministers in due course.

Recommendation 3. Further consideration should be given to possible disposal of IMD and helicopter and nuclear businesses.

Further Work

12 The strategic plan raised a number of detailed points about future financing arrangements, control of military exports and other matters. These do not require decisions at this stage, and it is recommended that they be pursued individually outside the framework of the corporate plan.

13 Among the issues requiring further study is the consideration of a new financial duty on the Company, to replace that previously set on the NEB. (This was for a return on capital of 10% by 1981 with a progressive increase thereafter). This can be best considered on the basis of the operating plan to be submitted by the Company later in the year.

Summary of Recommendations and issues for consideration

Recommendation 1. We should accept in principle the Company's strategy of continued exploitation of the RB211 family. But the Company should be told now that their detailed plan due in the autumn must substantiate the objectives for cash flow and profitability which they have set themselves in the corporate plan.

Recommendation 2. Ministers should repeat their previous warning to Rolls Royce that they are doubtful whether Rolls' present plans for the RJ500 will prove acceptable, and should ask the Company to explore and report on the possibility of linking with Pratt and Whitney as well as the Japanese for any new engine in this class.

/Recommendation 3 ...



Recommendation 3 Further consideration should be given to possible disposal of IMD and the helicopter and nuclear businesses following further work.

Ind P.D.
P.M. Smith 2

MS.

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PRIME MINISTER

ROLLS ROYCE FINANCING: CLAIM ON THE CONTINGENCY RESERVE

MISC 22 decided on 12 March that Rolls Royce should be enabled to secure a further £140 million in 1980, in addition to the £40 million already allowed for in our public expenditure plans. They were to raise as much as possible from the private sector. The Chancellor was invited to report to Cabinet colleagues at the appropriate time - which has now come - on the implications for the Contingency Reserve of the residual amount.

2. I understand that Rolls Royce expect to raise an additional £50 million in the private sector. Keith Joseph intends to discuss with Frank McFadzean the possibility of their raising rather more. He will seek to secure agreement to £75 million; it would be unrealistic to expect them to go any higher.

3. On the assumption that £75 million can be raised in the private sector, the residual call on public funds is £61 million at outturn prices (£51 million at 1980 Survey prices). The DOI have submitted a Supplementary Estimate for this sum. I am satisfied that there is no scope for finding it by specific savings on other DOI Votes. I am accordingly prepared to accept it as a call on the Contingency Reserve, and to allow the Supplementary Estimate. 65?

4. Although we were aware of the potential Rolls Royce bid when deciding on the Reserve for 1980/81, a call of this size remains unwelcome, and reinforces the need to keep a strict control on all spending programmes.

5. I am copying this minute to other Cabinet colleagues and to the Minister of Transport and to Sir Robert Armstrong and Mr Ibbs.

W. J. B.

CONFIDENTIAL

ms
Ind (P)

Ref. A01663

PRIME MINISTER

Rolls-Royce Financing

(MISC 22(80) 1)

BACKGROUND

This paper by Sir Kenneth Berrill recommends funding Rolls-Royce for the 1980-81 financial year, so that they can carry out their corporate plan for the time being, while Sir Frank McFadzean reviews their strategy. He is due to report on this by the summer.

2. There is only £10 million in PESC for Rolls-Royce in 1980-81 (after allowing repayment of loans). Rolls-Royce now want a further £140 million. The difference is caused by high levels of inflation, the exchange rate and Rolls-Royce's working capital, all of which were discussed by Ministers last autumn.

Rolls-Royce are assuming they will obtain a further £90 million of funding from the private sector during the year. Officials are recommending that Rolls-Royce should try to increase further their borrowing from the private sector so as to reduce the extra direct Government expenditure if possible to below the £140 million. But if they fail to do so, it means a maximum of £122 million (i.e. £140 million at 1980 Survey prices) from the Contingency Reserve.

3. Officials from all Departments broadly agree about the need for this interim funding. Without it, there would be a hiatus in financing until Sir Frank McFadzean had reviewed his strategy; and any resulting publicly expressed doubts about Rolls-Royce's future could be damaging for customer confidence and Rolls-Royce's order position. Also, because of the long lead times in ordering, it is unlikely in any case that Sir Frank's review will make much difference to next year's funding requirements, since these largely represent commitments which Rolls-Royce entered into over the last two to three years.

HANDLING

4. After asking Sir Kenneth Berrill to introduce his paper, you will want colleagues' views - particularly those of Sir Keith Joseph and the Chancellor - on:-

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- (a) Sir Frank McFadzean's review. Are there any pointers to his likely conclusions? Is he likely to propose any radical changes of direction? One such change has already been introduced, namely Rolls-Royce no longer take on orders unless on average these break even at \$2.20 to the pound. Do Ministers agree that he should be asked to cover the specific points mentioned in paragraph 9 of Sir Kenneth Berrill's paper?
- (b) Financial risks. Rolls-Royce are bound to remain vulnerable to changes in the exchange rate and inflation, because of tough American competition. They could be vulnerable to strike action because of the need to increase production levels to meet buoyant demand. What is Sir Keith Joseph able to report on Sir Frank McFadzean's general view of these risks?
- (c) Short-term funding. Has the Chancellor any comments on the implications for the Contingency Reserve? What are the real prospects of Rolls-Royce increasing their borrowing from the private sector?

CONCLUSIONS

5. You may like to record conclusions on each of the recommendations A-G at the end of Sir Kenneth Berrill's paper. In particular you may want to agree -
- (i) That the potential call of £122 million on the Contingency Reserve for 1980-81 should be accepted - though the precise figure will depend on further discussions between Sir Keith Joseph and Treasury Ministers and how much more Rolls-Royce can borrow from the private sector.
- (ii) On any specific pointers which might be given to Sir Frank McFadzean about the elements Ministers would want him to cover in his review (e.g. as in paragraph 9 of the paper).

REA

ROBERT ARMSTRONG

11th March, 1980

CONFIDENTIAL



Ind P87

CONFIDENTIAL

MBM

MO 26/8/1

R

30/1

Prime Minister

ROLLS ROYCE: COLLABORATIVE AGREEMENT WITH JAPAN

I have seen Sir Kenneth Berrill's note to you dated 23rd January about the proposed agreement between Rolls Royce and the Japanese on the RB 432 engine.

I accept that Rolls Royce should be allowed to take the next step and bring the "initial phase" agreement into force and endorse the recommendations in his note.

I am sending copies of this minute to the members of MISC 22, to Sir Kenneth Berrill and to Sir Robert Armstrong.

JK

30th January 1980

CONFIDENTIAL

CONDIREX

30 JAN 1980



Tuh

Thompson
Th.

This letter was actually sent to Sir Frank Mc Fudgean yesterday. Although his letter was dated 29/1 the copies were dated 25/1.

Steve

30. 1. 80.

CONFIDENTIAL



Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

29 January 1980

r. 30/1

Sir Frank McFadzean
Chairman
Rolls Royce Ltd
65 Buckingham Gate
London SW1

CF

please ask Dol if his
letter was really

12

sent on

25 Jan
Z

3/1

Dear Frank.

Following signature of the Rolls Royce/Japan Collaboration Agreement and an examination of the information provided by the Company on the prospects for the collaborative development of the RB432, the Government is content that the Agreement on the Initial Launch Phase should enter into force.

I recognise that the Board of Rolls Royce has not yet taken any decisions whether it wishes to go beyond the Initial Launch Phase. You will equally appreciate that this approval does not imply in any way that the Government will give authority for full development of the engine. I think I should add that taking into account the very great uncertainties of the aero-engine business, on the information so far available to me the prospective rate of return from the project does not look adequately attractive.

Leon

Kear

Copied to
Misc 22

30 JAN 1980





Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Prime Minister

The Chancellor agrees with this project; but like you, wants to keep our commitment to a minimum.

R.
29/1.

PRIME MINISTER

ROLLS ROYCE: COLLABORATIVE AGREEMENT
WITH JAPAN

I have seen a copy of Sir Kenneth Berrill's minute to you of 23rd January about the collaborative RB 432 project with the Japanese.

2. I agree with the recommendations that Rolls Royce should be authorised to carry out the initial stage. But given the doubts about the ^{viability} ~~validity~~ of the project we must continue to ensure that Rolls Royce, the Japanese Government, and Japanese industrial participants are left in no doubt that our decision whether or not eventually to proceed with full launch will depend solely on the strength of the economic case made out.

3. I am copying this minute to the other Members of MISC 22 and to Sir Robert Armstrong and Sir Kenneth Berrill.

(G.H.)

28 January, 1980

CONFIDENTIAL

January 29, 1950
100-100000

29 JAN 1950



CONFIDENTIAL

W.

CONFIDENTIAL

cc master

Ind Pol



10 DOWNING STREET

From the Principal Private Secretary

28 January 1980

ROLLS ROYCE: COLLABORATIVE AGREEMENT WITH JAPAN

When your Secretary of State called upon the Prime Minister this morning to discuss Sir Kenneth Berrill's minute of 23 January 1980 about the proposed agreement between Rolls Royce and the Japanese on the RB 432 engine, he said that the decision which the Government was being asked to take now was a very limited one. All that was sought was authority for Rolls Royce to bring into force the initial stage of the agreement. There was no commitment whatever on the Government's part to the full launch phase of the project. What Ministers were being asked to agree to was as cautious a toe in the water as was possible.

The Prime Minister said even so, she was worried about the vagueness of both the cost and time estimates for the initial launch phase. Sir Kenneth Berrill's minute said that the cost would be "around £5m-£10m" and that the phase would last "initially until the end of 1980, though it could well be extended into late 1981".

Sir Keith Joseph said that it was not possible to be precise at present about how long the initial launch phase would last partly because it turned on how long Boeing and Fokker took to reach their own conclusions about the size of the market for the engine. He would consider, in the light of the Prime Minister's comments, whether the draft letter for him to send to the Chairman of Rolls Royce could be strengthened to make it even clearer that the Government was in no way committed to the full launch phase of the project.

The Prime Minister said that on this basis she was ready to agree that Rolls Royce should be authorised to go ahead with the initial phase agreement.

I am sending copies of this letter to the Private Secretaries to the other members of MISC.22 and to David Wright.

C. A. WHITMORE

I.K.C. Ellison, Esq.

CONFIDENTIAL

RP.

✓ See Mr Dupont
Would K.T. have
brief discussion with
me about this
P.M.

Prime Minister had Poll
Agree subject to
Other Ministers' views?
(This project was
mentioned in the
RR discussions last
Oct/Nov/Dec)

CONFIDENTIAL

Qa 04407

To: PRIME MINISTER
From: SIR KENNETH BERRILL

Rolls Royce: Collaborative Agreement with Japan

1. This note recommends that Rolls Royce should be authorised to carry out the initial stage of their proposed agreement with the Japanese on the RB 432 engine. It is suggested that this authorisation be agreed subject to the views of Ministers on this note. 24/1

Background

2. You will recall that Ministers briefly discussed collaboration with Japan on the 432 in MISC 22 in November. You then agreed that, subject to further examination by officials, Rolls Royce should be allowed to take the next step so as to keep options open for the new management. Since then an Official Group under my chairmanship has looked at the proposals in more detail. The main background points to the proposals are:

(a) The Government will not have to decide on the expensive 'full launch' phase of the project until probably well into 1981. What is at issue now is the initial launch phase costing Rolls Royce around £5m.-£10m. Rolls Royce and the Japanese signed an agreement in December, but the agreement will not come into force unless Government approval on both sides is signified by 31 January. The agreement is in two parts. The first is for an 'initial launch phase' which covers technical developments and work to establish whether there is a market to justify full development. This phase will last initially until the end of 1980, though it could well be extended into late 1981. The date when the manufacturers will wish to move from this preliminary phase to the subsequent 'full launch phase' will depend on when the airframe manufacturers confirm they will use the engine: under the agreement at least one airframe manufacturer must do this before full launch begins. In addition, both Rolls Royce and the Japanese must each be satisfied of the project's viability and have secured the necessary finance.



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(b) Rolls Royce's preliminary market assessment suggests there is a need for a new engine for use in 120-160 seat aircraft. The main customers for the engine so far identified are Boeing (in a new version of the Boeing 737) and Fokker (the latter through their own collaboration with the Japanese in development of a new aircraft - the F29). Boeing and Fokker will each be carrying out their own studies over the next few months; so by late 1980 the size of the market for the engine should become clearer. Rolls Royce's present assumption is that they will get their engine in 50 per cent of the Boeing 737s sold and in up to 65 per cent of the Fokker aircraft. Rolls are also assuming significant sales to the Chinese. Rolls are assuming that the remaining engine sales to Boeing and Fokker will be met by General Electric, in collaboration with SNECMA: Pratt & Whitney are unlikely to enter the market.

(c) The basis of funding the project is that Rolls Royce and the Japanese each pay 50 per cent of the costs. If the project eventually goes into 'full launch' the total negative cash flow for Rolls Royce on the 432 is estimated at about £150m. over the next five years. But the present issue is not the £150m. but the expenditure needed to reach a position of greater clarity about the prospects for the project - the initial launch phase. In 1980 the initial launch phase is likely to cost Rolls Royce about £4m. (of which, however, about £3m. is planned to be spent anyway, largely on component research, and already provided for in the company's advanced engineering budget). If the initial launch phase were extended into 1981, Rolls might need to spend a further £5m.-£6m. in this phase, particularly on long-lead materials if an entry into service date of early 1987 were needed. Alternatively, if Boeing wanted to accelerate the timetable for their 737 aircraft, Rolls might commit an extra £3m. this year in addition to the £4m.

(d) During the initial phase the transfer of technology to the Japanese will be fairly limited. If the full launch goes ahead, Rolls will be 'compensated' for the technology transfer, mainly in the form of guaranteed participation in future Japanese engine projects.


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Assessment

3. Rolls Royce's estimates at this stage show a discounted cash flow rate of return from the whole project of 5.7 per cent, though this is no more than a working assessment so far. The Board of Rolls Royce have explicitly stated that while they regard the figures as adequate to justify a decision to enter the initial launch phase, the estimates are not firm enough to be the basis for more substantial decisions and have not been approved by it. Although this figure exceeds (just) the Required Rate of Return for nationalised industries, we would look for a higher figure for a project subject to such uncertainty. Rolls argue that some of the assumptions on which it is based - e.g. warranty and manufacturing costs - are pessimistic, so the actual rate could be higher. Against this the market assessment must be regarded as speculative at this stage, particularly the projected sales to the Chinese. The actual rate of return is also sensitive to changes in the exchange rate - though Rolls Royce's estimates assume, as we asked them to, a rate of \$2 to £1.

4. However, the question which at present arises is whether the agreement should be allowed to enter into force, and the initial phase thus be started on the understanding - as laid down in the agreement - that a separate decision would be needed before embarking on the full launch phase. Officials consider they should be so authorised. This is partly in order to keep options open for the new management - a point already endorsed by Ministers. But, in addition, the initial period will give time for the market prospects - and especially Boeing's intentions - to become very much clearer as a result of the separate work being conducted by the airframe manufacturers. During this period the estimates will probably be revised in any case. It also seems valuable to preserve the principle of co-operation with Japan in this field. Finally, there is no obvious alternative means of keeping the project alive. By nursing the prospects of the 432 together with the additional market prospects provided by Japanese investment, Rolls Royce's negotiating position may be strengthened in any future discussions about collaboration in other areas with the American manufacturers.

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Conclusions

5. We therefore recommend that Rolls Royce should be authorised to bring the 'initial phase' agreement into force, making clear that this is without any commitment to the full launch phase and that they will have to make out a stronger case before authorisation for the full launch phase would be given. (A draft letter of authorisation for the Secretary of State for Industry to send to Rolls Royce is annexed.)
6. We shall be seeking Ministerial decisions on the Rolls Royce Corporate Plan as a whole in about a month's time.
7. I am sending copies of this minute to the members of MISC 22, and to Sir Robert Armstrong.

KR

23 January 1980

Att



CONFIDENTIAL

DRAFT LETTER FOR THE SECRETARY OF STATE FOR INDUSTRY TO SEND TO
THE CHAIRMAN OF ROLLS ROYCE

Following signature of the Rolls Royce/Japan Collaboration Agreement and an examination of the information provided by the Company on the prospects for the collaborative development of the RB432, the Government is content that the Agreement on the Initial Launch Phase should enter into force.

I recognise that the Board of Rolls Royce has not yet taken any decisions whether it wishes to go beyond the Initial Launch Phase. You will equally appreciate that this approval does not imply in any way that the Government will give authority for full development of the engine. I think I should add that taking into account the very great uncertainties of the aero-engine business, on the information so far available to me the prospective rate of return from the project does not look adequately attractive.

CONFIDENTIAL



submit to
Mason

12/19/79

AMB

had Pledge

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

PS/ Secretary of State for Industry

7 December 1979

Tim Lankester Esq
Private Secretary to the Prime Minister
10 Downing Street
LONDON SW1

Prime Minister

I think this is a storm
in a tea-cup. But you
should be aware that Sir
Keith will have to reveal
that you met Sir Kenneth Keith
(see Fla/A).

Dear Tim

We spoke earlier today about the problems posed by Gerald Kaufman's Priority Written PQ for answer on Monday asking the Secretary of State for full details of his meetings with Sir Kenneth Keith. As you know, there has been a great deal of Opposition interest in the extent to which the Secretary of State may have broken the written concordat between the NEB, Rolls Royce and the Government which required the NEB to be informed of all meetings between the Chairman of Rolls Royce and Ministers. I attach a paper setting out in detail the exchanges which have taken place on the floor of the House and in the Standing Committee.

Since you met him to discuss his departure, I don't think it can be said to have been in breach of the concordat.

those two

In fact, it is arguable that all but two meetings between the Secretary of State and Sir Kenneth Keith - those which took place on the morning of 6 November and the afternoon of 7 November - fell within the concordat and/were in any case defensible since they concerned the proposed resignation of Sir Kenneth. However, the terms of Mr Kaufman's PQ are such that I feel sure that my Secretary of State will feel obliged also to refer to his presence at the meeting between the Prime Minister and Sir Kenneth on the afternoon of 6 November. I attach a draft of the reply to Mr Kaufman's PQ which is being submitted to my Secretary of State for approval. You should, I think, be aware that knowledge of the Prime Minister's meeting with Sir Kenneth could give rise to criticism, since it is also possible that this could be regarded as falling outside the terms of the concordat; we would suggest that in response to this we should stress that the meeting concerned Sir Kenneth Keith's personal position only.

12/19/79

Yours sincerely

Peter Mason

MATTERS RAISED IN EARLY DAY MOTION 249

A. Meetings with Sir Kenneth Keith

The Secretary of State has had the following exchanges in the House:-

Statement on 21 November

In questions following the initial statement Mr Silkin asked

"... will the right hon. Gentleman now tell us how many discussions, minuted or unminuted, he has had with the chairman of Rolls-Royce without the chairman of the NEB having been invited?"

The Secretary of State replied

"I was asked how many times I have seen the chairman of Rolls-Royce on his own. I saw him when he came to confirm to me what he had told my permanent secretary a year ago, namely, that he wanted to bring to an end his responsibility for Rolls-Royce at about the end of this year."

Mr Silkin further asked

".. how many meetings and discussions have there been without an invitation being given to the chairman of the NEB?"

The Secretary of State replied

"I said that I had had only one meeting privately with the chairman of Rolls-Royce. Of course, one meets both the chairman of the Board and the chairman of Rolls-Royce on occasions other than private meetings."

Supply Day debate, 26 November

Mr Silkin further asked

"I refer especially to the part of it which confirms that, whenever the chairman of Rolls-Royce seeks a meeting with the Secretary of State, the chairman of the National Enterprise Board has a right to be present. That is obvious if they are discussing Rolls-Royce matters. That is why I dismiss from my mind the answer given me by the right hon. Gentleman. I probed him twice, but he never properly replied. He merely told me that he had had a private meeting with the chairman of Rolls-Royce. He said that that was to discuss chairmanship. I believe that the chairman of Rolls-Royce had intimated to the permanent secretary - I am not certain whether he should have told the permanent secretary without telling the chairman of the NEB - that that is what the private meeting was about.

What the Secretary of State did not tell me was how many meetings he had alone without the chairman of the National Enterprise Board having been invited but with civil servants present on a minuted basis. It is important that we should know that information."

The Secretary of State replied

"I was asked whether I had given the House full information about any private meetings that I might have had with Sir Kenneth Keith in breach of - "

Mr John Silkin: "Not private."

Secretary of State: " - about any meetings that I might have had with Sir Kenneth Keith in breach of the memorandum of understanding. I have here to correct an error. I told the House under questioning last week that I had had one such meeting with Sir Kenneth Keith. I was wrong. I had two such meetings with Sir Kenneth Keith. I had a private lunch with Sir Kenneth Keith in addition to that. However, that had no relationship whatever to the NEB. I had a private lunch at which I was told something about the business. It was not relevant in any way to the subject that we are discussing, whereas one of the two meetings that I had, which was attended for part of the time by one civil servant, did have as its theme the position of Sir Kenneth Keith as chairman of Rolls-Royce and his determination, as he previously warned my permanent Secretary, to leave that office at about the end of this year.

Mr Silkin: "The real point of the question is the memorandum of agreement - was the chairman of the NEB invited?"

Secretary of State: "No, he was not. These were two specific meetings about the proposed resignation of Sir Kenneth Keith. He was not invited. I was, perhaps - I am not sure - in breach of the memorandum of understanding. I may have been. But it had nothing to do with the relationship between Rolls-Royce and the NEB; it was about the personal decision of Sir Kenneth Keith."

Standing Committee E, 27 November

Mr Silkin again asked

"The Rt. hon. Gentleman has said in answer to a question from me - no doubt mature reflection and consultation with his officials and his diary have refreshed his memory - that he had three meetings, which included a lunch, with the chairman of Rolls-Royce without the chairman of the National Enterprise Board being invited. The background to my questioning is that there was a written agreement between the NEB and Rolls-Royce - between the holding company and the subsidiary company - that on no occasion would a meeting take place between the Secretary of State and the chairman of Rolls-Royce at which Rolls-Royce business was to be discussed.

Clearly it was discussed on two of those occasions, though the Secretary of State assures us that it was not discussed at the lunch."

The Secretary of State replied

"Secondly, the Rt. hon. Gentleman asked me about my apparent breach of the concordat that I inherited from my predecessor with the chairman of the NEB and the chairman of Rolls-Royce, that each should be invited to join in any

discussion when Rolls-Royce business was to be discussed. Much depends, in the interpretation of what I did, on the interpretation of the words 'when Rolls-Royce business was to be discussed.'

In fact, the three occasions on which I met Sir Kenneth Keith without having warned Sir Leslie Murphy that I was going to do so, or inviting him to attend, were occasions on which Rolls-Royce came into the discussion, certainly, but not in relation to the NEB. On two of those occasions I met Sir Kenneth Keith in my office, the first being the occasion of his proposed resignation and the second being that of my receipt from him of his resignation letter.

Inasmuch as Rolls-Royce was and is a subsidiary of the NEB, his resignation and the exact timing of it were conceivably within the range of subjects that might have been thought to fall within the concordat. On the other hand, I interpreted that concordat as referring specifically to the relationship between the NEB and Rolls-Royce, and to the business of Rolls-Royce as it fell to be monitored by the NEB. The fact that it was the personal position of Sir Kenneth Keith that was the subject of those two discussions entitled me, I thought at the time - I am open to other people's judgment on this - to regard them as not falling within the concordat.

I ask the Rt. hon. Gentleman and his hon. Friend to dismiss the lunch altogether from this context. It was an occasion that replaced a planned visit by me to Derby that had to be cancelled, and during it we discussed the marketing of Rolls-Royce products and the situation of Rolls-Royce customers. I was simply put in the picture about the context within which Rolls-Royce does its work. There can be no question but that the lunch fell clearly outside the concordat.

The two private discussions may conceivably be held to be within the concordat, in which case I acknowledge that there was a breach, though I interpreted it in the other way."

Record of Meetings

It will be seen that the Secretary of State has been asked a number of slightly different questions. There have been seven meetings with the Secretary of State of which the Department has knowledge.

- (1) Meeting at DOI on 23 May. Sir Leslie Murphy was informed of this meeting, which was of an introductory nature, and agreed to its taking place without his being present. It seems entirely in line with the spirit of the questions to ignore this meeting. It was clearly not in breach of the concordat.
- (2) Meeting at DOI on 1 August to discuss Rolls-Royce's financial prospects. Sir Leslie Murphy was present. It was clearly not in breach of the concordat.
- (3) Lunch at RR on 19 September. The House has been fully informed of this.
- (4) Meeting in Derby on 31 October. The Secretary of State visited Derby accompanying Chairman Hua. An official was present at Derby but not when Sir Kenneth Keith took the opportunity of the Secretary of State's presence to indicate his willingness to stand down. The Secretary of State probably

intended his reference on 21 November to "occasions other than private meetings" to cover this visit.

- (5) Meeting at DOI on 6 November to discuss Sir Kenneth's intention to resign. The House has been informed.
- (6) Presence at PM's meeting on 6 November at which the PM was informed of Sir Kenneth's intention to resign. This is not covered by any of the answers and the fact that the Prime Minister met Sir Kenneth officially has not been made public.
- (7) Meeting at DOI on 7 November at which Sir Kenneth handed over his letter of resignation. The House has been informed.

The questions put to the Secretary of State have been about meetings which he has had with Sir Kenneth, but the concordat refers to meetings "with a Minister". Apart from the meeting with the Prime Minister referred to above Mr Butler had a lunch with Sir Kenneth on 4 October, and this is referred to in Sir Kenneth's letter to the Secretary of State of 4 October which the Secretary of State has been asked to publish. We know that Sir Kenneth Keith has also had meetings or lunches with a number of ministers from other departments.

DOI

ORDER

HOUSE OF COMMONS PARLIAMENTARY QUESTION

P.B. No

ORAL)
PRIORITY WRITTEN (W))
ORDINARY WRITTEN)

ANSWER ON MONDAY 10/12/79

FILE TO BE RETURNED NOT LATER THAN 4PM 7/12/79

First Published on 6/12/2957

ACTION OFFICER Mr MAYNARD AIRL

Party

LAB

Copied to :

MINISTER ANSWERING. Michael Marshall

File ref

Department of Industry

P.Q. No.

121 W Mr Gerald Kaufman (Manchester, Ardwick): To ask the Secretary of State for Industry, on how many occasions since 4th May he has met Sir Kenneth Keith; what were the dates, places and purposes of these meetings; and at which of them Sir Leslie Murphy or some other representative of the National Enterprise Board has been present.

Since 4 May I have met Sir Kenneth Keith on the following occasions:-

- 1) On 23 May I met Sir Kenneth at DOI; our talk was of an introductory nature, with the knowledge of the Chairman of the NEB.
2) On 1 August I held a meeting at DOI to discuss Rolls Royce's financial prospects at which Sir Leslie Murphy and Sir Kenneth Keith were both present.
3) On 19 September I lunched with Sir Kenneth Keith at Rolls Royce's office; this replaced a visit I had been due to make to the company's Derby factory, but was postponed, due to the engineers industrial dispute.
4) On 31 October I accompanied Chairman Hua on his visit to Rolls Royce Derby at which Sir Kenneth Keith was present.

Notes for supplementaries required for all oral questions
Notes for supplementaries not required for written questions

OFFICIAL APPROVAL BY

MINISTERIAL APPROVAL BY

ORAL/WRITTEN ANSWER

CJF 7/12/79

P.U.S.S. / /

given on

Minister / /

see OFFICIAL REPORT

Sec of State / /

Column (s)

- 5) On 6 November I met Sir Kenneth Keith at DOI to discuss his intention to give up the Chairmanship of Rolls Royce. Later in the day I was also present at a meeting at No ^{The House of Commons} ~~40 Downing Street~~ when Sir Kenneth informed the Prime Minister of his intention to give up the Chairmanship.
- 6) On 7 November I met Sir Kenneth Keith at DOI again in connection with his departure.

7 DEC 1979



IL. Incl
P51
R. 2/27/79



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889113 PO SW GT
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299992 PO TS G
B150 1704 LONDON TELEX 107

THE RIGHT HONORABLE MRS MARGARET THATCHER PRIME MINISTER OF THE
UNITED KINGDOM 10 DOWNING STREET
LONDON

ORIG SENT TO SIR KENNETH KEITH 11/16/79 I LEARNED OF YOUR FORTHCOMING
RESIGNATION FROM ROLLS-ROYCE ~~WHILE~~ WHILE IN CAIRO NOW THAT I
HAVE RETURNED TO BURBANK I HASTEN TO TELEX YOU MY DEEPEST
SENTIMENTS EXPRESSED AS FOLLOWS ROLLS-ROYCES LOSS IS EQUALLY OUR
LOSS YOUR LEADERSHIP HAS BEEN BOLD VISIONARY FORTHRIGHT AND
ESSENTIAL THE UNITED KINGDOM SHOULD BE EXTREMELY PROUD OF YOU
ACCOMPLISHMENTS IN TURN LOCKHEED IS VERY GRATEFUL FOR THAT LEADERSHIP
YOUR SUPPORT AND MOST OF ALL YOUR FRIENDSHIP MOST SINCERELY
ROY A ANDERSON CHAIRMAN OF THE BOARD LOCKHEED CORPORATION
BURBANK CALIFORNIA

COL 11/16/79

299992 PO TS G
889113 PO SW G

*Ind M. cc 1nd PSL
NEB - May 79*



DEPARTMENT OF INDUSTRY
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PS/*Secretary of State for Industry*

21 November 1979

Tim Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW 1

*the 1st
in context.
R
2/11*

Dear Tim

NEB AND ROLLS ROYCE

As promised, I enclose a copy of the statement which my Secretary of State intends to make to Parliament this afternoon. In addition, you will wish to be aware that my Secretary of State is speaking personally to each member of the resigning Board in order to maintain personal contacts. He also intends to write to Mr Murray at the TUC emphasising his hope that the repercussions on relations between the Government and the trade union movement will not be too adversely affected by today's decisions.

I am copying this letter and enclosures to the Private Secretaries of MISC 22, John Wilson (in view of his Secretary of State's First Order PQs this afternoon), Petra Laidlaw, Charles Cumming-Bruce and Martin Vile.

*Yours ever
Peter*

PETER MASON
Private Secretary



TEXT OF A STATEMENT BY THE RT HON SIR KEITH JOSEPH BT MP,
SECRETARY OF STATE FOR INDUSTRY, WEDNESDAY 21 NOVEMBER 1979.

With permission Mr Speaker, I should like to make a statement on the relationship between the National Enterprise Board and Rolls Royce.

I have had in recent months to consider the relationship between the NEB and Rolls Royce in the light of evidence of some friction over a considerable period. I have concluded that the friction is not a passing problem of personalities or a difference of opinion on the management of the Company but is inherent in the relationship and would tend to survive a change of management.

in all probability

Rolls Royce is a company of a scale and importance such that the supervision of its Board by another board, however eminent and accomplished, is bound to give rise to strain.

Moreover it is a company with which inescapably Government has exceptionally close connections and where important decisions lie directly with Government.

I therefore decided that in view of these two considerations, from which there is no escape, it would not be right to paper over the cracks but rather to plan to remove the source of the difficulty. Clause 2 of the Industry Bill now before the House will give me power to direct the NEB to transfer its shareholdings in Rolls Royce to the Secretary of State, and I told the NEB of my intention to make such an order as soon as the Bill becomes law. This decision was in no sense whatsoever a reflection on the members of the NEB or their staff. Rather, it is a judgement that the role they had been given in relation to this major company was in the last analysis not an appropriate one.

/When I expressed ...



When I expressed to the NEB my intention I was told categorically that were I to adhere to my proposal all the members of the Board would resign. I was asked to re-consider. This I did.

Yesterday I told the Board that I did adhere to my proposal. The House knows that the Chairman, Sir Leslie Murphy, and all the members of the NEB have resigned from their posts. I have accepted their resignations with regret. The Board was composed of distinguished people from business and trades unions who co-operated together to serve the country with dedication. I hope this form of co-operation will become possible in the new Board.

The NEB has as the House knows important disposals to arrange and other continuing tasks to perform. It will have a catalytic investment role especially in connection with advanced technology and increasingly in partnership with the private sector; as well as its regional and small firms roles.

I am glad to tell the House that Sir Arthur Knight, Chairman of Courtaulds Ltd, has accepted my invitation to take over the Chairmanship of the NEB with immediate effect. Sir John King, Chairman of Babcock International Ltd, has accepted my invitation to become Deputy Chairman and five other persons have similarly indicated their willingness to serve:

Mr Robert Clayton - Technical Director of GEC

Mr Alec Dibbs - Deputy Chairman of National
Westminster Bank

Mr George Jefferson - Chairman and Chief
Executive of British
Aerospace, Dynamics Division

Mr Dennis Stevenson - Chairman of Peterlee and
Newton Aycliffe New Towns

Mr John Caines - Secretary to the NEB

I am deliberately leaving some places vacant. I have today written to the TUC about this.



3.

The House will wish to know that following the recent announcement that Sir Kenneth Keith wishes to retire from the chairmanship of Rolls Royce after 7 years service Sir Frank McFadzean has indicated his willingness to accept appointment as chairman.

CONFIDENTIAL



Ind PD
Original: Ind PD:
Copy: Ind PD:
National Enterprise Board:
May 1979

Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400
Switchboard 01-213 3000

Ian Ellison Esq
Private Secretary to the
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
LONDON SW1

IL
2/7

21 November 1979

Dear Ian

NEB

Now that it has been decided to leave BL with NEB the draft announcement attached to your Secretary of State's minute to the Prime Minister of 19 November will need to be amended.

I expect you will agree that this is not simply a matter of taking out the words "and BL" wherever they occur, since some of what is said in the draft about how inappropriate it would be to leave Rolls Royce with the NEB might well be held by critics to apply with almost equal force to BL. We therefore suggest that Sir Keith Joseph may also wish to leave out the last 6 lines of paragraph 1, the last two sentences of paragraph 2 and paragraph 5. I attach a revised version of the draft incorporating these amendments, though we recognise you may also be redrafting to take account of other developments such as the meeting last night with the NEB.

I am copying this letter to Tim Lankester at no 10, to the Private Secretaries to the other members of MSC 22 and to Sir Robert Armstrong.

Yours sincerely
Ian Fair

I A W FAIR
Private Secretary

DRAFT PARLIAMENTARY STATEMENT

NEB, ROLLS ROYCE AND BL

I informed the House of 19 July of my intention that the National Enterprise Board should have a continuing role in relation to companies such as Rolls Royce Ltd so long as no solution based on the private sector is available. Since then I have considered further the relationship between the NEB and Rolls Royce in the light of the evidence that the relationship has been strained, not only in recent months, but over a number of years. I have concluded that these strains are not simply a passing problem of personalities or of differences of view on a particular topic.

I have therefore decided that it would not be right to paper over the cracks caused by the strains which this relationship causes but rather to plan to remove the source of the difficulty. Clause 2 of the Industry Bill now before the House will give the power to direct the NEB to transfer its shareholdings in Rolls Royce to the Secretary of State, and I intend to make such an order as soon as the Bill becomes law.

I must inform the House that as a consequence of my decision the Chairman, Sir Leslie Murphy, and all the members of the NEB have today resigned from their posts. I have accepted their resignations with regret. The Board has distinguished businessmen and trade unionists who have cooperated together and served the country with skill and dedication. I hope this form of cooperation will be possible in the new Board.

Sir Arthur Knight has accepted my invitation to take over the Chairmanship - on a part-time basis - of the NEB with immediate effect, and Sir John King, (list of others) have accepted my invitation to become members.

Quite apart from its continuing responsibilities in respect of BL, the NEB has direct interests in about 70 companies. Some of the latter are ready now to depend wholly on the private sector and I expect the NEB will dispose of these holdings shortly, but for ^{the} others, longer will be needed before they are ready to depend fully on the market and in the meantime the NEB's role will be to encourage their development on sound commercial principles. In addition, as I announced on 19 July, the NEB will continue to have a catalytic investment role, in particular with the private sector, in advanced technologies, where the market has been reluctant to invest because of the adverse policies of our predecessors. Finally, they will maintain their regional and small firms roles particularly in areas of high unemployment.

For this purpose we shall need a strong NEB Board and I have every confidence in the ability of Sir Arthur Knight, his colleagues and the staff of the NEB to carry out these important functions.

21 NOV 1972

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Copy on Ind Pd :
 R National Enterprise Board
 May 1979.

TEXT OF A STATEMENT BY THE RT HON SIR KEITH JOSEPH BT MP,
 SECRETARY OF STATE FOR INDUSTRY, WEDNESDAY 21 NOVEMBER 1979.

With permission Mr Speaker, I should like to make a statement on the relationship between the National Enterprise Board and Rolls Royce.

I have had in recent months to consider the relationship between the NEB and Rolls Royce in the light of evidence of some friction over a considerable period. I have concluded that the friction is not a passing problem of personalities or a difference of opinion on the management of the Company but is inherent in the relationship and would tend to survive a change of management.

Rolls Royce is a company of a scale and importance such that the supervision of its Board by another board, however eminent and accomplished, is bound to give rise to strain.

Moreover it is a company with which inescapably Government has exceptionally close connections and where important decisions lie directly with Government.

I therefore decided that in view of these two considerations, from which there is no escape, it would not be right to paper over the cracks but rather to plan to remove the source of the difficulty. Clause 2 of the Industry Bill now before the House will give me power to direct the NEB to transfer its shareholdings in Rolls Royce to the Secretary of State, and I told the NEB of my intention to make such an order as soon as the Bill becomes law. This decision was in no sense whatsoever a reflection on the members of the NEB or their staff. Rather, it is a judgement that the role they had been given in relation to this major company was in the last analysis not an appropriate one.

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CONFIDENTIAL



Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

Ian Ellison Esq
Private Secretary to the
Secretary of State for Industry
Department of Industry
Ashdown House
LONDON SW1

20 November 1979

Dear Ian

As you know, my Secretary of State spoke to David Lea at the TUC (in Len Murray's absence) to tell him in confidence of the Government's intention to remove Rolls-Royce from the NEB. He suggested a meeting between your Secretary of State and Messrs Lea and Basnett tomorrow before there was any public announcement. Lea undertook to consult Basnett.

Mr Prior has now had a return call from Lea to say that when the story broke the TUC would be expressing its anger at the decision and saying that there could be "wider consequences." Particularly since David Basnett was going to Brussels tomorrow he did not think that a meeting tomorrow would be useful.

I am sending copies of this letter to Tim Lankester at No 10, to the Private Secretaries to the other members of MISC 22 and to Sir Robert Armstrong and Sir Kenneth Berrill.

Yours sincerely
Ian Fair

I A W FAIR

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copy on: Ind Pol!
National Enterprise Board
May 1979.
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*Original on: Ind Pol:
The National Enterprise
Board: May 1979.*

In sum

R. ...

PRIME MINISTER

NEB

Keith Joseph sent me a copy of his minute to you of 19 November. I see from this that he proposes to tell the NEB this evening that he intends to remove from it as soon as possible both Rolls Royce and BL.

You will recall that at MISC 22 on 15 November I expressed considerable misgivings about the proposal (as it then was) to announce that Rolls Royce would be removed from the NEB. The enhanced proposal including BL now before us strikes me as one with very far-reaching implications for the Government's relationship with the TUC. As Len Murray made clear to me last week (when we discussed RR alone) these would probably not be confined to the question of trade union representation on a reconstituted NEB. In view of this, I think it would be advisable for Keith to bring the matter to Cabinet before he goes any further, particularly at this critical stage in the BL saga.

If it were decided to go ahead this evening, I should need to speak at once to David Lea (in Len Murray's absence abroad), so that I can arrange for Keith to warn the TUC of what is afoot.

I am sending copies of this minute to members of MISC 22 and Sir Robert Armstrong and Sir Kenneth Berrill.

JP

20 November 1979

CONFIDENTIAL

File ~~TOP~~



Originated on: Ind fol:
The National Enterprise
Board: May 1976.

10 DOWNING STREET

From the Private Secretary

MR. CHURCHILL
CIVIL SERVICE DEPARTMENT

I enclose a copy of a minute which Sir Keith Joseph has sent the Prime Minister about the Chairmanship of Rolls Royce and the future of the NEB.

I believe you are aware of the proposal, which the Prime Minister supports, to appoint Sir Frank McFadzean to the Chairmanship of Rolls Royce but you do not appear to have been consulted on the proposed appointments to the NEB. I would be grateful for any reactions by 1700 hours today.

I have arranged for a copy of the minutes of the latest Ministerial meeting on Rolls Royce to be sent to you by the Cabinet Office.

T. P. LANKESTER

This has kept a copy

CSD - no comments
12
.. 29..

20 November 1979

CONFIDENTIAL



PRIME MINISTER

PM said -
no to BL
yes to org, etc.

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originated on: Ind AD:
The National Enterprise
Board: May 1979.

This is to report on action I have taken since we discussed the NEB and Rolls Royce in the MISC 22 Committee on 15 November.

The Chairmanship of Rolls Royce

Sir Frank McFadzean is now firmly ready to take the Chairmanship of RR and is content that this should be announced as soon as we choose.

We have urged him now that this is firmly settled to arrange to see our suggested candidate for the post of Chief Executive, Mr Morgan of GEC. While I agree with David Wolfson that it would be ideal if we could announce a new Chairman and Chief Executive together, and I will see that all possible haste is made, there can be no guarantee that Morgan and McFadzean will wish to team up, and I believe it essential now to end the speculation by making an announcement on Wednesday or Thursday.

The Future of the NEB

Sir Frank McFadzean remains firmly opposed to any link between RR and the NEB, even cross-directorship. Our further efforts on Friday to identify possible compromise solutions did not persuade him.

His view is that there is an organisational nonsense in making the board of a company as important as RR subordinate



to another board of businessmen, especially when the issues are so large that inescapably they have to be settled by Government. (I see that David Wolfson shares this view.) He attaches great weight to this board organisational issue. Thus there is no compromise I can offer the NEB which will prevent them resigning en masse.

The Board of BL, at a meeting I had with them last week, made much the same arguments for taking them out of the NEB. The Board would, though grudgingly, be willing to stay under the NEB, but only if the NEB's role was limited to that of shareholder rather than holding company.

Our interest is to have an undistracted BL Board plus access to all the information we require. To announce that, once we have the power, we shall take Rolls Royce out but leave BL in an NEB with a reduced role would distract the BL Board, be no service to us and stir up more trouble later. The only case for such an announcement or for undertaking to seek to persuade the BL Board to accept some such relationship would be to help Mr Murray with any TUC reaction to the Rolls Royce decision. *I think the right course is to be decisive and do what is both organisationally and conceptually right.*

A New NEB Board

I am glad to say that Sir Arthur Knight, who will retire as the Chairman of Courtaulds on 1 January, is ready to become the part-time Chairman of an NEB that excludes RR and



BL. He supports my view that the NEB should not have RR or BL under its control, and he can speak from the experience at an earlier stage of having been a part-time member of the RR Board. He would be prepared to accept immediate appointment. Sir John King, the Chairman of Babcock & Wilcox, is willing to serve immediately as part-time Deputy Chairman.

I would underpin the Chairman with a Chief Executive and for this post I have identified Mr Ian Halliday who could secure his release from his present employers - Leslie & Godwin (Holdings) Ltd - by mid-January. But of course before a final decision were taken on this he would need to be seen by the new Chairman. Pending the arrival of the Chief Executive the necessary full-time assistance to the Chairman could be provided by the present Secretary of the NEB, an Under-Secretary from the Department of Trade, who has now been with the NEB for 28 months and who would be appointed Deputy Chief Executive.

Trades Union Reactions

Our decision to accept the resignations of the present NEB Board will be unwelcome to the trades union movement. I do not anticipate problems with Lord Scanlon or John Lyons, who are the only unionists actually on the board, but David Basnett, whose term of office expires at midnight tonight, can be expected to cause difficulties. I am in touch separately with Jim Prior to determine the best way to limit adverse trades

/union ...



union reactions. I shall of course hold open the prospect of appointing trades unionists to the reconstituted Board.

The Next Steps

The Department of Industry is in the process of identifying new NEB members and I see no difficulty in securing a strong Board with several names being announced at the same time as the new Chairman. I take it that in these special circumstances colleagues will agree that the normal consultative arrangements can be cut short.

I shall be seeing the NEB to tell them my decision on Rolls Royce on Tuesday evening at 6 pm, and if my colleagues agree, I will also tell them my views on British Leyland.

... I enclose curriculum vitae on Mr Halliday and brief notes on Sir Arthur Knight and Sir John King who are, of course, well known industrialists.

... I also enclose a draft Parliamentary Statement.

I am sending copies of this minute to members of MISC 22 and to Sir Robert Armstrong.

PEM
PP K J
19 November 1979

Department of Industry
Ashdown House
123 Victoria Street
LONDON SW1

CURRICULUM VITAE

IAN FRANCIS HALLIDAY, MA, FCA

Address: (home) Little Thorpe
Finthorpe Lane
Huddersfield HD5 8TU Tel: (0484) 30311
(London) Flat 7
63 Haverstock Hill
London SW3 Tel: 01-722 3842

Date of birth: 16 November, 1927

Family: Married (1952)
two daughters (1955 and 1956)
one son (1963)

1946-49: Lincoln College, Oxford (Mathematics)

1949-51: National Service; Captain, REME;
Territorial Army from 1951 to 1956

1951-69: ARMITAGE & NORTON, Chartered Accountants
1954 - Qualified as Chartered Accountant
1957 - Became Partner. Major direct
responsibilities including Massey-
Ferguson UK Companies, Carrington
& Dewhurst Group (now Carrington
Viyella) and Allied Textile Co Ltd.

1970-74: ALLIED TEXTILE CO LTD
Finance Director on main Board.

1974-77: DEPARTMENT OF INDUSTRY
On secondment as Deputy Director of Industrial
Development Unit, responsible for the appraisal
of applications under the Industry Acts 1972
and 1975. This involved the assessment of
expenditure and investment projects over a
wide range of industries.

1977 to date: LESLIE & GODWIN (HOLDINGS) LTD
Finance Director on main Board of this public
Group of international insurance and reinsurance
Lloyd's brokers.

Sir Arthur Knight 62
Chairman, Courtaulds, since 1975 (retires 31.11.79)
Joined Courtaulds 1939 and entire career with them.

Sir John King 61
Chairman, Babcock and Wilcox
Director, American Chain
Chairman, British Nuclear Associates
Chairman, Dick Corporation
Director, S G Warburg International Holdings
Director, SKF(UK)



DRAFT PARLIAMENTARY STATEMENT

NEB, ROLLS ROYCE AND BL

I informed the House of 19 July of my intention that the National Enterprise Board should have a continuing role in relation to companies such as Rolls Royce Ltd so long as no solution based on the private sector is available. Since then I have considered further the relationship between the NEB and Rolls Royce in the light of the evidence that the relationship has been strained, not only in recent months, but over a number of years. I have concluded that these strains are not a passing problem of personalities or of differences of view on a particular topic, but are inherent in the relationship. Rolls Royce is a company of a scale and importance such that the supervision of its Board by another board of businessmen, however eminent and accomplished, is bound to give rise to strain. I am impressed by the fact that very similar problems arise over BL for exactly the same reason.

I have therefore decided that it would not be right to paper over the cracks caused by the strains which this relationship causes but rather to plan to remove the source of the difficulty. Clause 2 of the Industry Bill now before the House will give the power to direct the NEB to transfer its shareholdings in Rolls Royce and BL to the Secretary of State, and I intend to make such an order as soon as the Bill becomes law. This decision is in no

/sense ...



sense a reflection on the members of the NEB or their staff. Rather, it is a judgement that the role they had been given in relation to these two giant companies was in the last analysis not an appropriate one.

I must inform the House that as a consequence of my decision the Chairman, Sir Leslie Murphy, and all the members of the NEB have [today] resigned from their posts. I have accepted their resignations with regret. The Board has distinguished businessmen and trade unionists who have cooperated together and serve the country with skill and dedication. I hope this form of cooperation will be possible in the new Board.

Sir Arthur Knight has accepted my invitation to take over the Chairmanship - on a part-time basis - of the NEB with immediate effect, and [Sir John King, (list of others)] have accepted my invitation to become members.

It is my belief that the ending of the NEB's responsibility for these two giant companies will enable it to focus decisively on the new role which this Government sees for it.

The NEB has direct interests in about 70 companies. Some companies in the portfolio are ready now to depend wholly on the private sector and I expect the NEB will dispose of these holdings shortly, but for other, longer will be needed before they are ready to depend fully on the market and in the meantime



the NEB's role will be to encourage their development on sound commercial principles. In addition, as I announced on 19 July, the NEB will continue to have a catalytic investment role, in particular with the private sector, in advanced technologies, where the market has been reluctant to invest because of the adverse policies of our predecessors. Finally, they will maintain their regional and small firms roles particularly in areas of high unemployment.

For this purpose we shall need a strong NEB Board and I have every confidence in the ability of Sir Arthur Knight, his colleagues and the staff of the NEB to carry out these important functions.

Blund ~~cc~~ Mr. Wilson
 Mr. Keogh
 Mr. Ingham

Original ^{on} Ind. Bd.:

The National Enterprise
 Board: May 1979



10 DOWNING STREET

cc FCO
 HMT
 MOD
 D/ETUP
 D/T
 D/N
 BENIL
 CO

From the Private Secretary

19 November, 1979.

Dear Ian,

The Prime Minister has considered your Secretary of State's minute of 19 November about Rolls Royce and the future of the NEB. She has also seen the minute of today's date from the Secretary of State for Employment.

The Prime Minister is content for Sir Keith to inform the NEB this evening that Rolls Royce are to be taken out of their responsibility, and that this should be announced in the House tomorrow along with the naming of Sir Arthur Knight as the new Chairman of the NEB and other new board members if Sir Leslie Murphy and the present NEB Board members resign.

But she does not wish the NEB to be told that they are to lose British Leyland as well; nor should this be included in the statement in the House. She feels that it would be a mistake to remove British Leyland from the NEB's responsibility at the present time. This would, in her view, provoke a further row between British Leyland management and the trade unions, which British Leyland can ill afford at the moment; it would remove a "buffer" between Government and British Leyland which in present circumstances may be quite helpful; and it would make the NEB Board's position appear rather less unreasonable if they do decide to resign. But in any case, the Prime Minister considers that, before a decision is taken on the future relationship between British Leyland and the NEB, the matter will have to be discussed collectively.

I understand that Sir Keith proposes to announce the appointment of Sir Frank McFadzean in his statement. The Prime Minister has no objection to this, though she hopes that it may be possible to announce the appointment of Mr. Morgan as chief executive at the same time. While

she understands that it may not be possible to settle Mr. Morgan's appointment in time for the statement, she believes that the overall package would have greater credibility if the two appointments could be announced together.

I am sending copies of this letter to the Private Secretaries to the members of MISC 22, and to Martin Vile (Cabinet Office).

For en.

Tin Laker.

Ian Ellison, Esq.,
Department of Industry.

Sl.

PRIME MINISTER

PA

1

MS

WEDNESDAY'S BUSINESS: STATEMENT ON ROLLS ROYCE

Sir Keith Joseph has made a bid for a Statement in the House about Rolls Royce. The timing of events, as you well know, means that he could not make such a Statement on Tuesday and that Thursday would probably be too late, since the news will break on Wednesday morning.

Are you content that your speech at the opening of the Security Debate should be preceded by a Statement about Rolls Royce? I am sure that under normal circumstances such a Statement would be very desirable and that the House would resent being given the news in a Written Answer, but in the slightly peculiar circumstances of Wednesday I should be glad to have your own view before anyone goes ahead with preparations. Are you content for Sir Keith Joseph to make such a Statement?

MS

*Returned by les.
aw*

19 November 1979

CF

pls send
copy to

NOV 17 1979

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KBG).

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my comps. R

R.
copy

THE RIGHT HONORABLE MRS. MARGARET THATCHER PRIME MINISTER
OF THE UNITED KINGDOM 10 DOWNING STREET LONDON

Prime Minister
Copy of
telegram sent from
Lockheed chairman
to Sir K. Keith.

/ORIG SENT TO SIR KENNETH KEITH/

BT


116/79

R
19/12

I LEARNED OF YOUR FORTHCOMING RESIGNATION FROM ROLLS-ROYCE
WHILE IN CAIRO. NOW THAT I HAVE RETURNED TO BURBANK, I HASTEN
TO TELEX YOU MY DEEPEST SENTIMENTS EXPRESSED AS FOLLOWS:

ROLLS-ROYCE'S LOSS IS EQUALLY OUR LOSS. YOUR LEADERSHIP
HAS BEEN BOLD, VISIONARY, FORTHRIGHT,

[Handwritten signature]



LDT5846 THE PAGE02/48


AND ESSENTIAL. THE UNITED
KINGDOM SHOULD BE EXTREMELY PROUD OF YOUR ACCOMPLISHMENTS. IN
TURN, LOCKHEED IS VERY GRATEFUL FOR THAT LEADERSHIP, YOUR SUPPORT,
AND, MOST OF ALL, YOUR FRIENDSHIP.

MOST SINCERELY,

ROY A. ANDERSON
CHAIRMAN OF THE BOARD
LOCKHEED CORPORATION
BURBANK, CALIFORNIA

1115A AM

RELAYED 1 310P AM



COLL 1115A 1 310P

WESTERN UNION INTERNATIONAL INC.

1. MR LANKESTER
2. PRIME MINISTER

I strongly support
this approach.
P.

Ind, Bl
- Yes do send it to Keith
but it does not diminish
the authority given to
him by committee
members. ref.

Rolls Royce and the NEB

1. Are there reasons for pulling Rolls Royce out of the NEB?

Answer: Yes because

- (i) Rolls Royce is so big that it is slightly absurd for it to be a subsidiary of another company (NEB) which is itself in effect a nominee for the real decision-maker, owner, financier, which is Government.
- (ii) Rolls Royce (unlike British Leyland) has defence, aerospace and international governmental orientation for most of its product.

2. If logic suggests a direct reporting line to Government should Government be put off this by NEB opposition? Answer: No.

3. In presenting a decision which will upset the NEB and could create difficulties with the unions, to the harm of Rolls Royce and others, we should do better to show that we have thought through and resolved the fundamental Rolls Royce management problems in total.

4. There is a need for

(a) a non-executive Chairman of considerable national and international stature

- (i) to guide the Board and the Government and avoid becoming so committed to technology (à la Denning Pearson) as to be unable to see the real commercial situation.
- (ii) to deal with foreign Governments and corporations at top level and give them confidence in the viability of the company. To act as a diplomat as well as a businessman.

/(b) a full-time

(b) a full-time engineering-based Chief Executive to get production, cost control, etc. right. This is a massive job 12 hours a day, 7 days a week for a year or so.

5. If in presenting his plans Sir Keith Joseph can show that we have got both the Chairman and the Chief Executive lined up, ^{AND} that they are both men of substance and support the proposed reporting structure, the NEB resignations would look considerably more petulant and less justified.

6. I do not believe that this implies a delay beyond next week, if the two prospective appointees can be brought together urgently. If they do not reach agreement we have lost nothing when we go ahead with the first appointment and announce the new reporting arrangements. If they do reach agreement our position is considerably stronger.

IF YOU AGREE THE LOGIC, SHOULD I SEND THIS TO K.J.
WITH YOUR APPROVAL?

David Welfin

15 November 1979

CONFIDENTIAL

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10 DOWNING STREET

From the Private Secretary

15 November 1979

ROLLS ROYCE AND THE NEB

The Prime Minister has asked me to send you for Sir Keith Joseph's attention the enclosed note by Mr. David Wolfson on Rolls Royce and the NEB. The Prime Minister agrees with the general approach of this note, although she does not wish to diminish or change the authority which was given to Sir Keith by MISC 22 yesterday.

I am sending a copy of this letter and enclosure to Martin Vile (Cabinet Office).

T. P. LANKESTER

I.K. Ellison, Esq.,
Department of Industry.

BB

CONFIDENTIAL

1. MR LANKESTER
2. PRIME MINISTER

Rolls Royce and the NEB

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DW

15 November 1979

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PRIME MINISTER

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The National Enterprise Board:
May 1979

MISC 22: Future of the National Enterprise Board

The paper before the meeting is Sir Keith Joseph's minute to you of 13th November and its attachment. MISC 22 was of course originally set up to handle the problems of Rolls-Royce. Sir Keith's minute extends, and indeed shifts, the immediate issue to the future of the present members of the National Enterprise Board. (We have not on this occasion invited Mr. Pym because his interests are really confined to Rolls-Royce alone.)

2. You are familiar with the background and I need not rehearse it. The immediate dilemma is one of politics and personalities. The key elements are:-

- (a) Sir Kenneth Keith has agreed to leave the chairmanship of Rolls-Royce early in the New Year.
- (b) Sir Frank McFadzean has agreed to replace him in that role.
- (c) The Government has decided that Rolls-Royce should be removed from the tutelage of the NEB once the necessary powers are available, after the passage of the Industry Bill. Sir Frank McFadzean's acceptance of the Rolls-Royce chairmanship is dependent on this happening.
- (d) The NEB have said semi-publicly that they will resign if Rolls-Royce is taken away from them.
- (e) British Leyland want to jump on the Rolls-Royce bandwagon and also escape the tutelage of the NEB. Since Sir Keith Joseph's minute was written he has discussed the relationship of BL and the NEB with the BL Board. You will want a report on this meeting. Our understanding is that they confirmed their belief that, irrespective of personalities, it is an organisational mistake to subject one high-powered group of businessmen to the tutelage of another (it also adds an unnecessary link to the chain of responsibility: as present events demonstrate, the major political decisions about appointments and finance have to be taken by the Government, and the interposition of the NEB cannot relieve them of

a. Rolls Royce - July 79
Ind Bd.

that responsibility). They did not threaten to resign but it is relevant that, unlike the Rolls-Royce Board, that of BL is good and their views should carry weight.

- (f) Sir Keith Joseph's minute implies that the retention of NEB control over Rolls-Royce is being elevated by the TUC into an issue of principle with threats of a withdrawal from the National Economic Development Council and its machinery if their attitude does not prevail. Since Sir Keith Joseph's minute was written the Economic Committee of the TUC has met - this morning - and a report of their attitude will be available either tonight or at tomorrow's meeting.

3. Although the immediate issues are those of personality (with Sir Leslie Murphy cast in the role of "chief villain") there are underlying and very important issues of public administration. It is agreed that Rolls-Royce should depend directly on the Department of Industry. Given the prospects of that company, especially under a new Chairman, this may not be too onerous a cross for Government to bear. But BL's problems are more horrendous and immediate. If the Government is to lose the buffer of NEB and take direct responsibility for that company, it needs to do so with its eyes wide open.

4. Equally, it will be important not to lose sight of the implications of the Government's decisions on the future of the NEB itself. Without both Rolls-Royce and BL it will be a very different animal - much diminished - from that envisaged by the Government in the summer. The Committee may decide that this does not matter. But it should do so as a conscious decision about good administration and not simply as a by-blow of the resolution of personality clashes.

5. This being said, the fact remains that the immediate problems are of personality. Matters have got to the point where important (or self-important) groups of powerful men are striking attitudes in public and are too freely seeking to get their way by threats of resignation. Such threats are as dangerous to Government as any other form of blackmail because, if acceded to, they diminish the Government's authority to run its own show in its own way through individuals of its own choice.

6. The questions the Group will have to resolve, therefore, are:-
- (a) Is it prepared to stick to its earlier decision that Rolls-Royce should be extracted from the NEB? Sir Frank McFadzean was reported at an earlier meeting as saying that either this or the removal of Sir Leslie Murphy were the conditions of his acceptance of the chairmanship. Have matters gone too far for the latter to be still a viable option?
 - (b) If the answer to (a) is that the earlier decision stands, does the Group agree that it has no option but to accept the resignation of the NEB if offered - and indeed, given their semi-public posturing, has the NEB any choice but to resign? The question of "good order and discipline" is probably paramount here.
 - (c) Is the Group prepared to call the TUC's bluff on the NEDC? It would obviously be hard for the TUC to defend the withdrawal of co-operation on the grounds that it did not like the Government's, and Parliament's, decisions about the management structure of public assets. It would be equally hard for the Government to appear to give in to TUC pressure on a matter wholly within the Government's competence.
 - (d) Are the Government prepared to accept direct responsibility for BL? Or would they prefer, if it could be arranged, that the present BL/NEB relationship should be maintained under a revamped NEB despite the wishes of the BL Board?
 - (e) If the NEB does go, how quickly can it be replaced, and if so, by whom? (This is a secondary issue but worthy of urgent attention if an awkward hiatus with BL is to be avoided in the interval before the Industry Bill becomes law.)
 - (f) If the remorseless logic of (a), (b) and (c) above is unacceptable, is there any way the Government can extricate itself with honour?

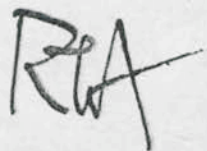
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7. You will want to ask the Secretary of State for Industry to explain the present position, including a report on his talks with the BL Board and for him and/or the Secretary of State for Employment to report on the attitude of the TUC. Thereafter you may want to concentrate discussion on the points I have identified in the preceding paragraph.

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CONCLUSION

8. Subject to discussion, the most likely outcome is that the Secretary of State for Industry will be invited to confirm to the NEB the decision that Rolls-Royce is to be removed from their responsibility and tell them that if they feel obliged to resign on this account, so be it. The Group may also wish to invite the Secretaries of State for Industry and for Employment to contact the TUC, explain the Government's position and invite them to weigh carefully the consequences of over-reacting to a situation where they have no locus.



ROBERT ARMSTRONG

14th November, 1979



PRIME MINISTER

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Mr. Hoffmann
Mr. Holroyde

Prime Minister

Paper for Misc 22
on Thursday morning

Original on: Ind PR:
National Enterprise Board:
May 1979.

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13/11

FUTURE OF THE NATIONAL ENTERPRISE BOARD

... 1 We are discussing the future of the National Enterprise Board in MISC 22 on 15 November. I attach the paper summarizing the position but this is necessarily incomplete because we do not yet know what will happen at the meeting of the TUC Economic Committee on Wednesday morning. Jim Prior and I met David Basnett earlier today and he is unlikely to act precipitately tomorrow.

2 The present position is that we have secured the agreement of Sir Kenneth Keith to leave the Chairmanship of Rolls Royce early in the New Year and we have secured the agreement of Sir Frank McFadzean to replace him. We have not found a way of achieving our preferred solution for GEC to assist in sorting out Rolls Royce's production and finance problems. I have told the NEB Board that we intend to remove Rolls Royce from their jurisdiction as soon as we obtain the powers to arrange this. Our intention in this respect has now become public knowledge as has the intention of the NEB to resign en masse if we go ahead with our plan.

3 What is at issue in the present situation is, on the one hand, the possible repercussion on the NEDC of our going ahead with our proposals and, on the other, the certainty that we shall do considerable damage to our credibility over a range of issues if we are seen to back down in the face of the threat of the NEB to resign.

I am copying this minute to the other members of MISC 22, to Sir Robert Armstrong and to Sir Kenneth Berrill.

PEM

PP^{KJ}
13 November 1979

Department of Industry
Ashdown House
123 Victoria Street
London SW1

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



THE FUTURE OF THE NATIONAL ENTERPRISE BOARD (NEB)

NOTE BY THE SECRETARY OF STATE FOR INDUSTRY

1 I referred in my paper (MISC(79)1) to the risk of resignations from the Board of the NEB in dealing with the Rolls Royce (RR) issue. The Board of the NEB have now made clear their intention to resign if the Government proceed with their proposal to remove RR from NEB ownership.

2 The Chairman of the NEB has been active in seeking support for his position and the General Secretary of the TUC has advised us that there is pressure from present and past trade union members of the NEB for the TUC to withdraw from cooperation in the National Economic Development Council and the various Economic Development Committees.

Evaluation of the NEB Position

3 The NEB recognise that, if RR is withdrawn from its ownership, the Board of the British Leyland (BL) will press very hard for the same treatment. They may also recognise that, if a choice has to be made between the loss of the BL Board and that of the NEB on this issue, I would have to choose in favour of the BL Board.

4 While some of the industrial members of the NEB Board appear ready to exert a restraining influence on Sir Leslie Murphy in his public criticisms of RR and complaints about lack of Government support over the last year, they will feel an obligation to resign with him.

The Position of British Leyland

5 In logic BL should not be part of the NEB; a company of its size needs a board of the highest calibre and such a board will not accept the supervision of another external board of businessmen. We are fortunate in the case of BL in having a board of the necessary calibre and I am advised that there had been strong pressure from within its membership for a direct relationship with the Department



well before we took our decision on RR.

6 I shall nevertheless seek, in the interests of compromise, to persuade the board of BL when I meet them later today to accept continuation of the NEB shareholding on the grounds that the special considerations for a direct Government shareholding in RR do not apply in their case. It must be expected, however, that they will press their case hard and I consider it essential to retain the services of this board.

A New Chairman for Rolls Royce

7 Sir Frank McFadzean remains willing to accept the Chairmanship of Rolls Royce but is strongly resistant to any compromise with the NEB. He had independently, as a member of the board of RR during recent weeks, reached the conclusion that the relationship with the NEB was wrong, and he shares Sir Kenneth Keith's appraisal of the Chairmanship of the NEB.

Possible Compromises

8 I have reviewed several possible compromises:-

- a. arrangements for the NEB to retain a shareholding in RR carrying special rights;
- b. leaving RR in the NEB but with Sir Frank McFadzean taking the chairmanship of the NEB when Sir Leslie Murphy retires as well as the chairmanship of RR;
- c. a range of possible devices for deferring a decision pending a review and in the meantime insulating the present Chairman of the NEB as far as possible from the affairs of RR and BL.

9 It is hard to see how the first of these could be formulated in a way that would be acceptable both to the NEB and to Sir Frank McFadzean. The second would overload Sir Frank McFadzean; the problems of RR are so great they need his undivided attention. While at an earlier stage he himself raised the possibility of the dual role, this was on the assumption that Sir Leslie Murphy would

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leave the NEB quickly, a possibility we must discount. The third range of possibilities all suffer from the disadvantages of continuing a running sore and of distracting the top managements of RR and BL from their central task of improving the performance of their companies.

10 Moreover, face-saving compromises of this kind would be seen as a surrender by the Government to the pressures that the NEB had been able to bring to bear on them and there would be no offsetting benefit to public funds through improved management of RR or BL.

The Costs of Proceeding as Proposed

11 If we proceed and in consequence the NEB board resign, the risks we run are:

- a attacks by the ex-Chairman of the NEB on RR management and on the previous and present holders of my office for not dismissing Sir Kenneth Keith;
- b the possible loss of TUC involvement in the NEDC and its Committees;
- c conceivably, some worker reaction in RR or BL.

12 The first could be damaging to the business of RR and could be pursued with bitterness. The personality element in the criticisms would make the issues of particular interest to the press and the PAC (or some other Parliamentary Committee) might mount a detailed investigation extending over a considerable period. But part of the damage has already been done. Moreover Sir Leslie Murphy will bring upon himself much criticism too.

13 We can help the General Secretary of the TUC by deferring a decision until after the meeting of the TUC Economic Committee on 14 November, by making clear that any arrangements for the management of RR and BL shareholding have no relevance to the issue of returning the companies to the private sector, and by making clear that our

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decision is not based upon judgements on the competence of the NEB. Withdrawal of the TUC from NEDC activity would be seen as disproportionate to the magnitude of the issue.

14 While the NEB has made warning noises about worker reaction in RR and BL, the managements of both companies discount the likelihood of any significant worker opposition to the removal of their companies from the NEB. If the trades union movement were, however, to make this a major issue, the risk of strong worker opposition is obviously increased. Even so RR do not foresee significant strike action and I shall be taking further soundings of BL.

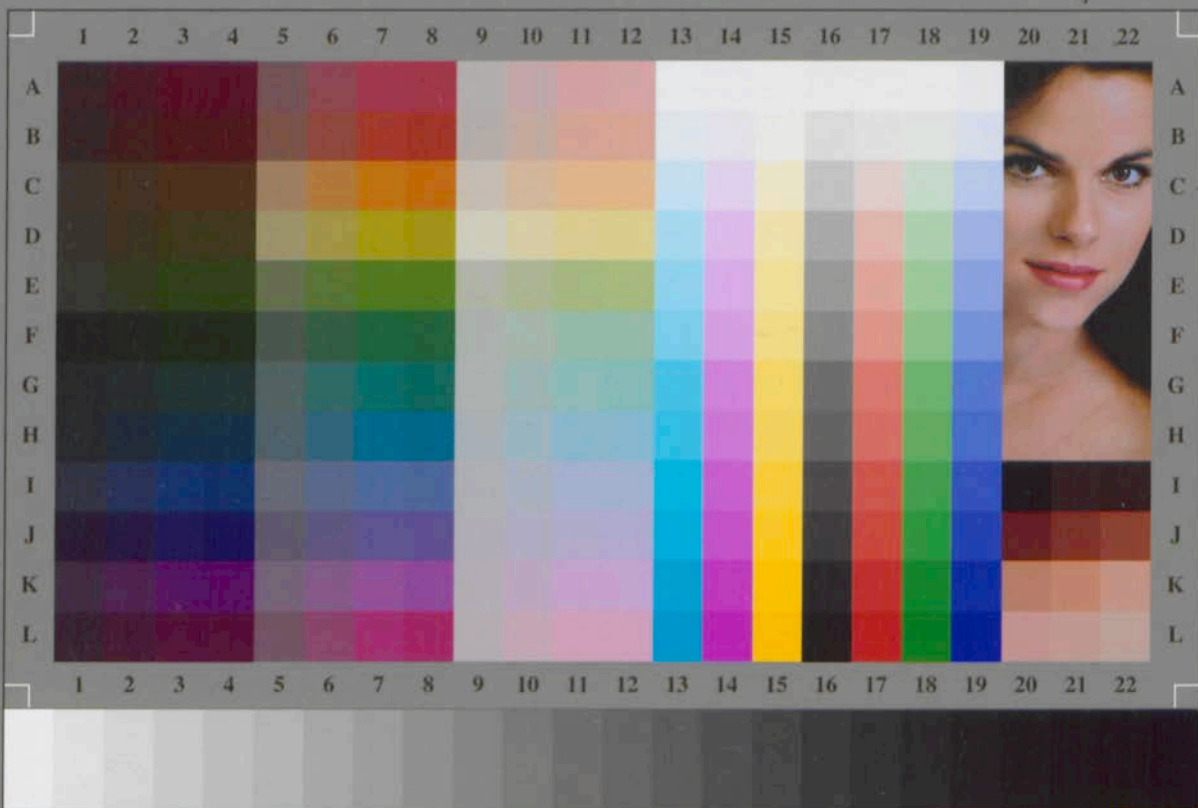
Conclusion

15 I am myself strongly opposed to conceding to the pressures being placed upon us by the NEB Board but I suggest we take a final decision at our meeting following a final assessment of the TUC implications of a decision to proceed.

KJ

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