

Confidential Filing

The proposed merger of
GEC and Plessey : possible
referral to the Monopolies and
Mergers Commission

GOVERNMENT

MACHINERY

January 1986.

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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NOTE FOR THE RECORD

PRIME MINISTER'S MEETING WITH LORD WEINSTOCK AND THE RIGHT HONOURABLE JAMES PRIOR MP.

The Prime Minister had a talk this evening with Lord Weinstock and James Prior at their request.

Lord Weinstock said that he had no doubt that the Government could win the next election even if with a reduced majority. Most people were too well off to want to change. There was always a risk of some unforeseen embarrassment or slip-up which would affect the Government's prospects. If at any time the Prime Minister wanted his help he was always there. In retrospect it was a pity that she had not contacted him over the Westland affair. GEC had been misled into joining the European Consortium on the understanding that this was what the Government as a whole wanted. The Prime Minister made no comment.

Lord Weinstock continued that the nuclear accident at Chernobyl must greatly have complicated the Government's plans for further nuclear power stations. There were no votes in nuclear power. But if a decision was not taken shortly to go ahead with building Sizewell, GEC would have to close their Larne factory which had been making heavy losses for many years.

Lord Weinstock said that there were still serious problems over Rihand power station in India. NEI had shown they were utterly incapable of constructing a power station. They were still unable to give a completion date: indeed it was unclear whether they were able to build the power station at all. Their failure had ruined the reputation of British Industry in India and more widely. In particular it had sabotaged GEC's chances of winning the order for Rihand 2.

Lord Weinstock gave a long disquisition on the failings of the Ministry of Defence over Nimrod. The MOD had set unrealistic specifications to begin with and subsequently constantly changed them. GEC's main error had been not to pull out of the project altogether three years ago. However, he did not want to rake over the past (which he subsequently did at length). His main concern was that the MOD now appeared to be positively determined not to give GEC the order. Considerable progress had been made in the last few weeks in upgrading the computer and installing a filter to make the radar work better. He was confident that GEC could build it within the specified time and cost if they were allowed to do so. It would still be cheaper than AWACS. But the RAF were making no effort to get acquainted with GEC's recent work.

The Prime Minister said that the history of the Nimrod project had been appalling and a terrible disgrace for Britain. GEC was responsible for other failures too such as the FOXBAT radar for Tornado (Lord Weinstock contested this). Nonetheless her preference would still be to see a British solution if it could be achieved at the right cost and at the right time. But the RAF could not be left without an adequate AEW capability any longer. Lord Weinstock said that it would be helpful if the Prime Minister could leave the MOD in no doubt of her preference for a British solution. He was confident that GEC could now deliver at a fixed price and with penalties if they failed to deliver on time. He added that he had been concerned to learn that the MOD's original deadline for tenders was to be extended to accommodate Grumann. Everyone should be forced to play by the same rules. The Prime Minister said that she would investigate this. Lord Weinstock subsequently suggested to me that the Prime Minister might nominate someone such as Sir Robin Nicholson to inspect the recent work done by GEC at Nimrod and give an opinion on it.

Finally Lord Weinstock mentioned his concern at the antagonistic relationship developing between British industry

and the MOD as a result of application of the MOD's competitive procurement policy. He assumed that it was not the Government's policy to make the United Kingdom dependent upon foreign supplies of defence equipment.

C.D.P.

Charles Powell

10 June 1986

JALAUZ

PRIME MINISTER

MEETING WITH LORD WEINSTOCK AND THE RT. HON. JAMES PRIOR

Arnold Weinstock and Jim Prior are coming in for a quiet private chat tomorrow evening at their own request. We are not publicising the meeting but these things have a way of leaking out. I think therefore that you ought to have me present in case questions are ever raised about what was said.

The subjects which they have said they want to touch on are:

(i) Nuclear (PWR) Power Their message here will be the need to go ahead with the building of Sizewell and the ordering of further nuclear power stations lest we lose the ability to build them altogether - given that it is so long since we last placed an order.

(ii) Proposed merger of GEC and Plessey This has been referred to the Monopolies Commission. In my view you should refuse to discuss it with them. I attach behind a copy of a note which Nick Owen did on the merger, pointing out the risks.

(iii) The competitive tendering policy of MOD GEC are in many cases sole supplier to the MOD. Over the years they have developed a rather comfortable relationship and presumably do not appreciate the cold draft of competitive tendering which Peter Levene is introducing. I am not aware of any specific complaints on their side. But on your part

(iv) Nimrod You will want to leave them in no doubt that the Government are serious about weighing all the options. In the light of what has happened, we cannot but be

sceptical on GEC/Marconi's ability to deliver.

(v) Diesels for British Rail Lord Weinstock is likely to complain that British Rail will seek tenders from the US for Class 38 Diesel Locomotives for pulling freight trains - as well as from domestic manufacturers. This has not been done before. But BR have given domestic manufacturers advance notice of requirements so that they can prepare designs and compete on equal terms.

(vi) British Telecom GEC do not like the fact that Sir George Jefferson is seeking tenders for British Telecom equipment from outside the United Kingdom as well as from established suppliers.

(vii) Aid/Trade I do not think GEC can have many complaints here. They are major users of ATP, soft loans and ECGD credit. There are some useful figures from Peter Warry in the folder.

Please also see the note by Mr. Warry.

C D P:

(C.D. POWELL)

9 June 1986

CCB/UP

PRIME MINISTER

9 June 1986

GEC

Over 90% of GEC's business is quasi public sector, ranging from traffic lights and hospital equipment to power stations, railway engines, telephone exchanges and defence. They are experts in getting Government to take the risk whilst they make the easy money. Their lobbying team is well supported by former Ministers and DTI officials.

In each product sector, the basic strategy is the same, to become the dominant or sole British supplier, keeping out foreigners and new entrants. But whilst this may be good for GEC, it has not necessarily been good for the customer or the UK.

On the Nimrod, GEC promised Callaghan that they would meet the specification "at the right time and at least as effectively as AWACS". It [Nimrod] will cost notably less". Whatever the faults in the MoD, it is GEC who made the promise. The Foxbat Radar for the Tornado and the Tiger Fish Torpedo are other examples of how GEC have compromised national defence.

Others have also suffered: British Rail and their high-speed trains; British Telecom who are now buying Swedish telephone exchanges to keep GEC honest. The South of

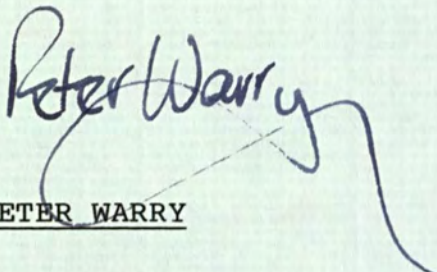
Scotland Electricity Board do not wish to be railroaded into a PWR reactor whose main attraction cynics claim is the American license which allows GEC to manufacture something it couldn't design itself.

Despite GEC's billion pound cash mountain, they have successfully cornered some 10% of total ECGD finance and receive roughly £20 million a year of DTI discretionary support in addition to regional development grants. But all this money has produced little innovation and GEC continue to spend proportionately less in this area than their competitors.

Lessons

1. GEC already get more than their fair share of the Government handouts, until they become more innovative and start satisfying their customers, there can be no case for giving them more.
2. For so long as we take a nationalistic attitude to defence procurement, it is vital that wherever possible there are at least two British suppliers. On the evidence to date, any savings through having a single supplier are swamped by the abuse of the monopoly position.

3. Whilst size is helpful in international competition,
GEC's main interests are non-competitive domestic
business and subsidised exports.


PETER WARRY



10 DOWNING STREET

From the Private Secretary

12 May 1986

When you wrote to the Prime Minister on 1 May you suggested that you and Arnold Weinstock might come in for a quiet half hour one evening.

BF // The Prime Minister would be delighted to see you and suggests 1730 on 10 June.

(Charles Powell)

The Rt. Hon. James Prior, M.P.

l

MRS RYDER

Please see Jim Prior's letter attached.
He and Arnold Weinstock want to have a
quiet half an hour with her one evening.
The Prime Minister has agreed. You will
want to find time in the diary.

CDP

CDP

DM.
Compromised
for 17³⁰ on
10 June
CR

2 May 1986

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mb R115

FROM THE CHAIRMAN
THE RT. HON. JAMES PRIOR, MP

Margaret

Aka Margaret.

I wanted you to know before you depart for S. Korea and Tokio, how much your presence and your speech were appreciated on Friday evening. Everyone I have spoken to since the dinner has been complimentary about the warmth and quality of your speech and how well all our efforts fitted together. In some respects they were wondering how we would react to each other, and I think they were pleased!

When you are back home to bid

it might be worthwhile for Arnold and myself
^{not} to have a quiet half hour with you one
evening. There are a number of important

issues in the manufacturing sector - for instance

Nuclear (P.W.P) power, tickets for B.R., the

competitive tendering policy of M.O.D. and of course

C.C.C. (Karey). Please accept we would not be

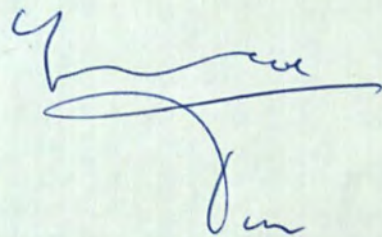
bothering you but it might be useful for you to have

our background views.

We were delighted to have Denis as well,
and the evening was a resounding success. Again


thank you so much for all you have done for us,

and good luck.



E. R.
SRWANE

cc Mr. Wicks


PRIME MINISTER

GEC

Jim Prior spoke to me today to reinforce Arnold Weinstock's request for a meeting. It was clear from the general tenor of his remarks that the purpose of the meeting would be to try to restore GEC's standing in your eyes.

Mr. Prior said that GEC wanted you to understand why they had got involved in the Westland affair. They had done so only after Sir Clive Whitmore had come to see them on Mr. Heseltine's instructions, to say that it was vital for GEC to support British Aerospace. They had not realised at the time that the affair was likely to be controversial. They had subsequently taken a very low profile. They did not now want the Government's attitude towards the company to be coloured by misunderstanding of GEC's motives. There were then several comments to the effect "please tell the Prime Minister that we are not as bad as she thinks", "I know she'll be angry with me for voting against the Government on rate support", etc. All in all a very defensive performance.

I commented only that I had no reason at all to think that you had any hostile feelings towards GEC, indeed the contrary; and that the notion that you would bear a grudge about Mr. Prior's vote was far-fetched.

Mr. Prior ended by pressing me to find an early date for Lord Weinstock to see you.

C.D.P.

(C. D. POWELL)

22 January 1986

CCB/UP

CONFIDENTIAL

MARKET-SENSITIVE

NBPM.

PRIME MINISTER

17 January 1986

PROPOSED MERGER OF GEC AND PLESSEY

The Director General of the Office of Fair Trading has recommended to Leon Brittan that this proposal should be referred to the MMC.

In our view, this is the right course to follow. The merger is so significant, and would diminish competition in so many important markets that it requires proper examination.

GEC has argued that there is a critical size which electronics firms have to achieve to be competitive internationally, in respect of research and manufacturing cost; and that a merger with Plessey is necessary to achieve this. GEC can also point to the need to rationalise the two companies' capacity to product electronic exchanges (System X).

If the merger only concerned the two companies' telecoms interests, the DG of the OFT judged that there might not be a need for a reference. Although the two dominate the UK telecommunications markets (together they account for 80% of public switching equipment, 60% of private switching equipment, 30% of telephones and key systems, 60% of transmission equipment), BT has shown itself robust in its willingness to look abroad (eg, to Thorn Ericcson). The crux of the matter is the two companies' dominance of defence

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electronics markets, where importing is not an easy option (we import only 10% of our defence equipment) because of patriotic sentiment, concerns about retaining important technologies, and, of course, powerful industrial lobbying (which the merger could only intensify). GEC and Plessey account for over one third of the entire defence electronics equipment budget of £3.3 billion. Together they supply around 90% of MoD's underwater systems, 80-90% of the radar, and 50-60% of combat radios.

With level real defence expenditure from now on, MoD will need to secure keener prices for its equipment to meet the Soviet threat: MoD need alternative bidders to achieve this. Ferranti, Racal and Thorn are also significant competitors, but for major electronics projects, MoD will look to GEC and Plessey to take the lead in offering alternative technical solutions to defence problems. Under Peter Levene, the proportion of new MoD orders which is obtained by competition has risen sharply (from 47% in the half year to October 1984 to 70% in the corresponding period in 1985). Peter Levene is rightly concerned that GEC and Plessey remain independent so that he can sustain the policy.

There is, therefore, a judgement to be made. The arguments have not yet been examined fully. GEC has asserted, but has not demonstrated, that acquisition of Plessey will add to our industrial strength. It is not clear, for example, why merging the two companies' research will improve their performance. There is some value, as GEC acknowledge, in

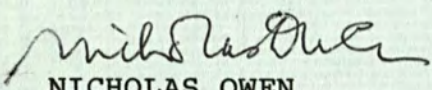
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retaining independent centres of research. No one would recommend merging the laboratories of Oxford and Cambridge. Neither company is without its faults. GEC seems unable to deliver working systems to the MoD on time, or to cost. It seeks easy pickings in protected markets, and is reluctant to take technical risks in competitive markets, even with its £1.5 billion cash mountain. Is GEC really qualified to remedy the deficiencies of Plessey? It will be argued by GEC that, in the international league of electronics companies, both companies are minnows, but will the marriage of two minnows produce a salmon? That question, surely is the task of the MMC.

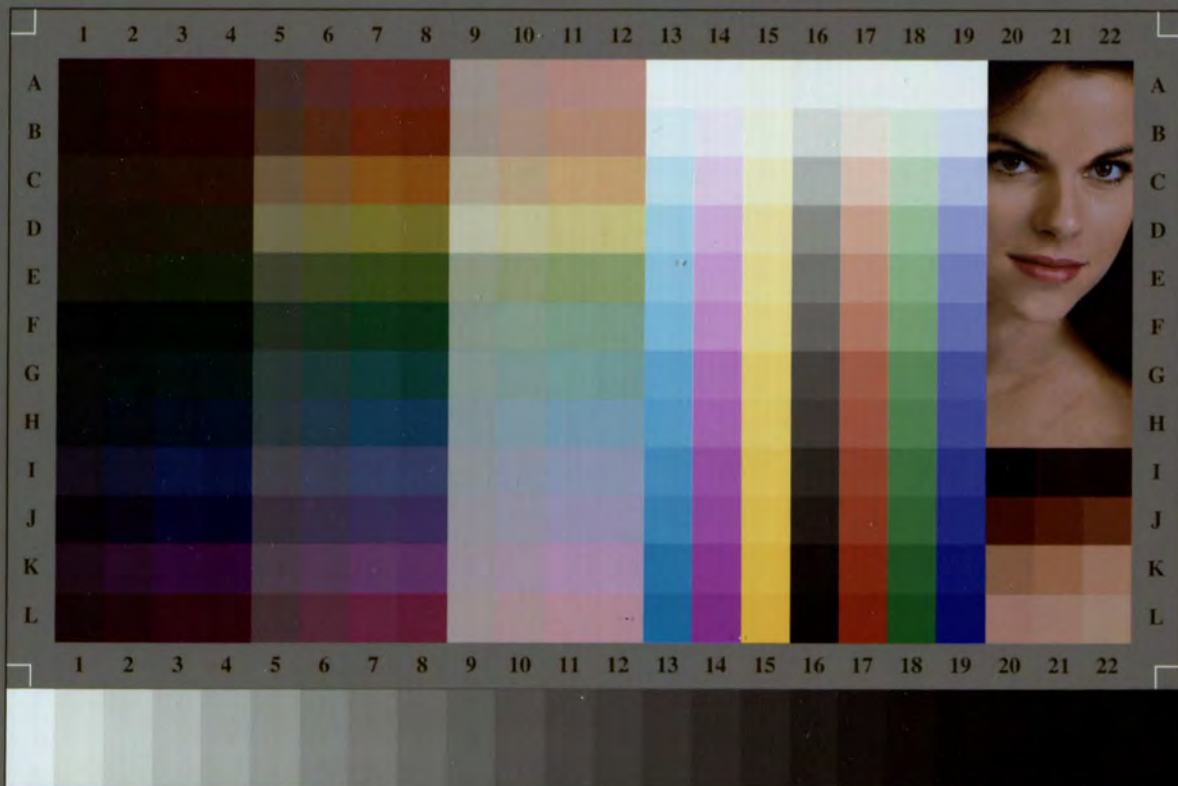
Leon Brittan ought, and probably will, accept the advice which Gordon Borrie has offered him.


NICHOLAS OWEN

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