2. Prime Minister -

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This is the first note prepared by the Treasury.

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Defence.

MO 20/9/1/1

20th October 1980

Dear Clive,

NEW STATESMAN ARTICLE ON IMS LTD

I reported in my letter of 17th October the assurances we had received from IMS about the legality of their action following the accusations in the New Statesman. We agreed that I would let you have a note on the allegations themselves, principally that IMS have "cooked the Accounts" in order to present a misleading impression of their financial status, and that IMS have, with the agreement of the Ministry of Defence, indulged in bribery.

The position on the Accounts is that 1979 was the first year in which IMS felt the full loss of Iranian business which was reflected in a reduction in turnover from £245M in 1978 to £38M in 1979. It is not surprising that with this loss of business the draft accounts showed a small trading loss of some half a million pounds. However, this was more than offset by interest of about £7M earned on deposits held and it was decided by the Board of Directors, with the concurrence of the Auditors, that this was best shown as a positive net entry of £6,556,000 profit before tax. This was consistent with the presentation for 1978 which showed a net loss of £12,440,000 (the latter entry was however supplemented by sub-entries which showed, inter alia, interest receivable on depositions). It was decided this year by the IMS Board that it was presentationally preferable to show a single clear figure in the body of the accounts with certain necessary sub-entries relegated to the Notes to the account. We are satisfied that this was not with the intention, as claimed by the New Statesman, of misleading MPs and the public and we understand that IMS have been assured by their auditors that there was nothing improper in this method of presentation.

C A Whitmore Esq

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The accusations that IMS have, with the agreement of the Ministry of Defence, indulged in bribery rests on the evidence of the cheque that was paid to an Account in a Swiss bank. The payment was part of a fee that was paid on the sale of Chieftain tanks to Kuwait (the contract was signed in 1975). It was to a Company which represents IMS in a number of countries in the Gulf. The fee was 3½% which by Middle East standards is very low and well within the guidelines. It is emphasised that the payment was to a legitimate Company and that it can in no sense be described as a bribe. The payment was made into a Swiss bank account at the request of the Kuwaiti Company. There is nothing unusual in this, nor is there anything sinister in the fact that it was paid into a Swiss Account.

/ IMS work to very clear guidelines (copy at Annex A) on the employment of agents and the payment of commission. These guidelines were issued by our Accounting Officer to the Head of Defence Sales in 1977. You will see from the first sentence of paragraph 4 that IMS (then called Millbank Technical Services) are required to observe these principles when acting on our behalf.

As to the other allegations in the article:

a. there is reference to the financial situation on the Iranian tank deal. You will recall that this was relevant to the pricing of the sale of tanks to Jordan was under consideration (my Secretary of State's minute of 31st July last year to the Prime Minister). Briefly the legal opinion is that because the Iranians repudiated the contract any equipment manufactured under that contract and not delivered to Iran belongs to HMG. We still have to negotiate a settlement with the Iranians but it is likely that the Iranians will receive very little if anything as a refund from their advance payments;

b. the article states that the Public Accounts Committee discovered that the MOD was losing on its weapon sales because we did not make sure that our customers paid up. The true situation is that the MOD does make a "profit" on those defence sales that pass through our Votes: although we have some bad payers the amount involved is comparatively small and almost all is eventually paid;

c. reference is also made to a statement made by Sir Lester Suffield a former HDS that MTS (i.e. the fore runner of IMS) and the MOD had offered payments

to Government officials on at least one occasion. There was one occasion on which such a payment was contemplated but it was never made because it came within the definition of a bribe;

d. there is mention of Sir Shapoor Reporter. He represented MTS and a number of British firms in Iran. He did so openly and his commission of 1 to 1½% was extremely modest by normal standards e.g. the French paid a 26% commission on the sale of tanks to Saudi Arabia. Once again there was no question of bribery - to the best of our knowledge the money went into the Pahlavi Foundation and not to any Iranian officials;

e. there is also a reference to the Randel case. Colonel Randel was convicted of accepting bribes from Racal. The court fully acknowledged that there was no MTS/IMS/Defence Sales involvement in this;

f. mention is also made of an IMS deal with Saudi Arabia involving an Agent called Fustock (really Fustuq). There has been no such deal.

A final comment is that there has been some selective editing of various documents that have found their way to the New Statesman for example a quotation is given from a letter from IMS to the MOD written when the first draft accounts were submitted. The article records that the letter states "it would be appreciated if the information were not widely circulated within the MOD". It omits the words that introduced this statement namely "Pending approval of the IMS Directors". Thus the false impression is given that there was something to hide.

I am copying this letter to Paul Lever (FCO), Stuart Hampson (Department of Trade), Richard Prescott (Paymaster General's Office) and to David Wright (Cabinet Office).

Yours ever,

David Omand

(D B OMAND)

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DIRECTIVE FROM PUS TO HDS

The general principles of conduct for all public servants, whether uniformed or civilian, are laid down in relevant manuals (eg Queen's Regulations, Non-Industrial Civilian Staff Regulations) and apply to all MOD servants in whatever capacity they may be employed.

2. In view of the current interest in the general subject of special commissions and similar arrangements in relation to commercial and business deals and the importance of maintaining strict standards in the Defence Sales field for which we are publicly accountable, there is a need for some special guidance which should be followed by Defence Sales Staff in this difficult and sensitive area. It will be for you to decide the details of arrangements to be made within this guidance, consulting me in difficult or abnormal cases.

3. Although there may well be political and strategic returns from Defence Sales the object is primarily to produce economic benefits by improving the UK balance of payments, providing employment and, where equipment is used by the UK forces as well as being exported, by reducing the unit costs of such equipment with benefit to the Defence Budget. Against this background, staff of the Defence Sales Organisation are to take particular care to observe the following principles:

a. Public money is not to be used for illegal or improper purposes.

b. Officials must not engage in, or encourage, illegal or improper actions; this requirement covers relations with representatives of United Kingdom firms as well as with nationals of other countries.

c. Defence Sales are to avoid so far as possible the direct employment of agents. If agents must be employed then:

(1) The agent should be reputable in the area in which he is operating.

(2) The fee or commission paid to an agent should not in any case exceed the normal level for the area; and where the fee or commission is 10 per cent or more, or where, though it is less than 10 per cent, the total payment would appear excessive in relation to the lawful and proper work which the agent undertakes in the area in which he operates, the agent should not be engaged without reference to me.

4. The same principles are to be observed in respect of arrangements made by Millbank Technical Services when acting on behalf of MOD. Arrangements may also be necessary in the context of Government-to-Government deals where MOD is in a back-to-back relationship with a United Kingdom firm. In such cases staff of the DSO should be generally guided, as appropriate, by the principles set out in paragraph 3. Additionally, in those cases when the UK firm seeks MOD authority for a fee or commission to be included in the price, the DSO should obtain assurances in writing from the UK firm concerned that:

a. The agents to whom the payments are made are reputable companies or individuals.

b. The firm regard the agents' services as providing an adequate return for the payments which are made to them; and

c. To the best of the firm's knowledge the appropriate authorities in the customer Government accept the position of the agents in relation to the contract.

5. In all the above what is "illegal" or "improper" will depend in the last resort on the law and practice of the country or countries concerned, and it is for the foreign government to determine what are acceptable standards within its jurisdiction. But where these standards are less restrictive than those applied within the UK, any relaxation of UK standards should be applied by us with great caution.

F.C.

FRANK COOPER
PUS

23/9/77