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PRIME MINISTER

MS

WESTLANDS

I attach a joint paper by DTI and MOD officials. It assembles all the information, but doesn't actually take us much further forward.

Hard on the heels of the paper has come a note from Mr. Heseltine, revealing that he has just (?) discovered that BAe would be ready to join a European consortium, thus making it less 'foreign'.

Westland's own assessment of the European offer is in paragraphs 12 and 13. While the financial arrangements are as good, if not better, than the Sikorsky offer, the promises of additional work are pretty hypothetical. The only decision actually required by Ministers is whether:

- a) to accept the National Armaments' Directors' recommendation (thus ditching the Sikorsky bid);
- b) to reject it (opening the way for Westland to do what they want, ie accept Sikorsky's offer); or
- c) let it lie on the table. This would have the same effect as a), ie it would block the Sikorsky bid.

It is hard to find anything in this analysis which justifies overriding Westland's commercial judgement in favour of the Sikorsky offer. I think you ought to push through b) above, that is rejection of the NADs' recommendation.

C.D.P.
C.D. Powell
5 December 1985

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PS/ Secretary of State for Trade and Industry

5 December 1985

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Prime Minister

Charles Powell Esq
Private Secretary to the
Prime Minister
10 Downing Street
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*CDD
5/xii*

Dear Charles,

WESTLANDS

In your letter to me earlier today you reported the outcome of the Ministerial meeting convened this morning to discuss Westlands. It was decided that a paper should be produced to serve as a basis for a further discussion tomorrow morning.

I attach this paper which has been prepared jointly by officials here and at the Ministry of Defence. It has been seen by neither the Secretary of State for Defence nor my own Secretary of State.

I am copying this letter and attachment to Richard Mottram (Ministry of Defence), Joan MacNaughton, (Lord President's Office), Colin Budd (Foreign and Commonwealth Office), Richard Broadbent, (Chief Secretary's Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office) and Michael Stark (Cabinet Office).

Yours sincerely,

John Mogg

J F MOGG
Private Secretary

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WESTLANDS: POSSIBLE RECONSTRUCTION PACKAGES

Note by DTI and MoD officials

SIKORSKY/FIAT PROPOSALS

Financial arrangements

1 Sikorsky/Fiat would take 29.9% of the issued shares following a rights issue and conversion of bank debt. Their initial investment would be of the order of £20 million. They would also have an option to acquire a limited number of further shares, at a substantially higher price, which could bring their holding up to 35-40%. This subsequent investment might be something over £10 million. The arrangements between Sikorsky and Fiat would be such that Sikorsky could always control a majority of their joint holding.

2 Westland will also issue loan stock to Sikorsky as part of its payment for the licence to manufacture Blackhawk (see paragraph 6 below).

3 Sikorsky/Fiat would have the following special rights as shareholders:

- to nominate directors in proportion to their shareholding.
- to veto increases in share capital, changes to Memorandum and Articles of Association and alterations in the company's borrowing limits.

4 The consent of Sikorsky, as holder of the loan stock, would be required for major acquisitions or significant changes in the activities of the Westland group.

5 There would be a letter of understanding between Sikorsky and Westland to the effect that Westland's helicopter business would be adequately funded to Sikorsky's satisfaction before resources were made available for the establishment or development of non-helicopter activities.

Products

6 Westland would take a licence to manufacture Blackhawk helicopters in the UK. Such helicopters would have a 60-70% UK content, taking into account the Rolls-Royce engine and avionic systems. The scale of manufacture would depend on orders. Marketing would be divided geographically - Sikorsky taking e.g. United States, China, Japan, Korea, Saudi Arabia; Westland taking e.g. Europe, India, elsewhere in the Far East. Both Westland and Sikorsky see a potential market for this category of helicopter of 750 aircraft in Europe alone over the next 15 years, excluding France. (MoD officials' assessment is that the market is somewhat smaller.)



Management

7 Joint working parties would be established aimed at improving productivity in Westland. Sikorsky's sales per employee are five times better than Westland, due partly but not entirely to greater volume of production. Westland foresee substantial improvements coming from Sikorsky's management expertise.

EUROPEAN CONSORTIUM PROPOSALS

8 We understand these proposals have been put forward on behalf of Aerospatiale and MBB, with the knowledge but not formal approval of Agusta.

All 3 are state owned

Financial proposals

9 The European partners have offered to subscribe up to £25 million of new equity in Westland and have indicated that they could increase that amount if necessary, perhaps to £40 million. They have said they are flexible on the exact form such an investment might take. They would, for example, consider the subsequent disposal of a substantial part of their holdings in the United Kingdom. Each partner would wish to be entitled to nominate a director to the Board.

10 Westland have not pursued more detailed financial discussions with the European companies, principally because they do not believe the product proposals put forward by the European consortium provide an adequate basis for such discussions.

Products

11 The European companies have given the following indications of possible provision of workload for Westland and participation in future collaborative projects:

- a) Strong support for the NH90
- b) Possible participation by Aerospatiale and MBB in the EH101, and possible procurement of that aircraft by the German Government after 1996.
- c) The intention to place additional work in Westland factories in the short term, including a possible increase in subcontract work from Aerospatiale of up to 25% (representing a maximum of £3 million per annum and an extra 90 jobs). However the European companies would not be prepared to allow any substantial information on the point to be included in a public document putting the proposals to shareholders.
- d) Possible participation by Westland in international government competitions for which Super Puma is a contender.



e) The possibility has been floated, without commitment, that a licence might be negotiated for manufacture of the A129 Mark I by Westland. However there is no prospect of completing such negotiations before a reconstruction package needs to be announced.

WESTLAND'S ASSESSMENT OF THE RELATIVE MERITS OF THE PROPOSALS

12 Westland believe the Sikorsky/Fiat proposal provides a combination of financial strength, product reinforcement in the coming few years when their existing programmes will not provide adequate work, and management strengthening. They emphasise in particular that the capital injection would come from large and successful private sector companies; and that through the Blackhawk licence they would have substantial opportunities for sales of a proven product with majority UK content.

13 It appears that the European companies would be able at least to match the financial terms of the Sikorsky/Fiat proposals, but Westland are concerned at the implications of this financial injection coming from companies which are state-owned or state-supported. They consider all the suggested areas of product collaboration and additional work to be uncertain and believe that even if a licence for manufacture of the A129 Mark I could be negotiated it would offer less good prospects than the Blackhawk. Nor do they see comparable management benefits to those accruing from a Sikorsky link.

INDUSTRIAL IMPLICATIONS

14 DTI officials consider that Westland would derive considerable financial and commercial strength from a link through Sikorsky with United Technologies, which would not be paralleled in a link with the European helicopter manufacturers. They also attach weight to the fact that Westland have negotiated firm arrangements through the Blackhawk licence, for potentially filling the gap in their workload before EH101 production begins, whereas the only concrete suggestion from the European companies at this stage is the offer to increase the amount of subcontract work placed by Aerospatiale in Westland. They believe that the arrangements negotiated by Sikorsky for control over extensions to Westland's business, and the proposed letter of understanding requiring adequate funding of Westland's helicopter business, indicate Sikorsky's intention that a substantial helicopter business should be maintained in the UK.

15 They note, however, that the Sikorsky/Fiat proposals involve the possibility of a more extensive overseas shareholding (up to 40%) than has so far been envisaged in discussions with the European companies; and that the



principal immediate motive of Sikorsky appears to be to obtain a substantial place in the European market for its Blackhawk helicopter.

16 Rolls-Royce have indicated to the Department that they believe a link between Westland and Sikorsky would strengthen their position in the small engine market. The RR/Turbomeca RTM 322 engine is being specified by Sikorsky for the growth Blackhawk and is also suitable for the basic Blackhawk. (The RTM 322 is also being bid for the EH101 and is seen by Rolls-Royce as having good opportunities for the NH90 and a single-engined version of the A129.) Rolls-Royce believe a link between Westland and Sikorsky/Fiat offers more advantage to them than the alternatives that have been suggested.

DEFENCE IMPLICATIONS

17 MoD officials believe the defence interest lies in the maintenance of a UK capacity to design, develop, manufacture and support helicopters to meet the requirements of the Armed Forces. More specifically this involves the start shortly of the feasibility study into the Anglo-Italian battlefield helicopter (A129 Mark II), the feasibility study into the five-nation NATO tactical transport helicopter for the 1990s (NH90) the development and manufacture of the Anglo/Italian maritime and logistic transport helicopter (EH101), current and prospective production orders for Sea King and Lynx helicopters and support - post design services, servicing and spares - for the MoD's fleet of approximately 800 helicopters.

18 In addition, the defence interest lies in rationalising the European capacity to develop and produce helicopters to enable it better to supply the European Armed Forces and compete in the world market. Rationalisation of requirements is an important element in achieving the economic benefits of shared development, longer production runs and commonality on the battlefield. The three collaborative projects described above are designed to meet the three likely future major requirements, subject to the outcome of the current review of requirements in the medium and light support categories.

19 The Sikorsky proposal appears to offer the survival of the UK helicopter industry and indeed they have said that this is their intention, but it gives Sikorsky a position of considerable influence over the future of Westland. Their proposal with its essential element of Westland building Blackhawk under licence could well lead to the MoD coming under intense pressure to order the Blackhawk helicopter in the short term, for which there is no financial provision. This could have harmful consequences for the defence budget and would spell the end of the NH90 and hence collaboration and an independent European helicopter industry. MoD officials believe that in the longer term a Sikorsky takeover, or dominance of the company could lead to Westland being



slowly eased out of those activities that compete with Sikorsky or duplicate their activities eg design and development, with the company ending up solely manufacturing and supporting Sikorsky products for those markets where Westland has a better entree than Sikorsky. Westland, and /could in due course the European industry, /become little more than a manufacturing subsidiary of American helicopter companies with all the implications that has for the UK and European technological and industrial base and ability to compete in world markets. The short term benefits to Westland of potential Blackhawk work could be more than offset by long term loss of capability in the UK and increased vulnerability of the European industry and market to US penetration. These concerns are shared by our Allies.

20 The European proposal, on the other hand, states clearly that it is the partners wish that Westland should remain a strong and independent UK company participating fully with the partners in helicopter design, development production and sales. The European partners also wish to support the efforts of the national armament directors to achieve a joint battlefield helicopter programme for the period 1993/95 and its consequent economic and industrial benefits.

21 While Westland's interests may be served in the short term by co-operation with Sikorsky, it has to be recognised that both offers have long term implications for the UK and European industrial bases and the way that the requirements of the Armed Forces are met. While to Westland the Sikorsky proposal seems to offer a better deal in the short term, in the long term it would threaten the survival of the UK helicopter and European industry and undermine European attempts to achieve rationalisation of requirements and effective competition with the US in world markets. If Westland can survive commercially with either offer then the defence interest is better fostered by the European proposals.

DIPLOMATIC CONSEQUENCES

22 A decision by Westland to opt for an agreement with Sikorsky can be expected to attract critical comment from the French, German and Italian Governments that HMG, by allowing Westland to reject a competing offer from the three European manufacturers had turned its back on European cooperation in a vital field of high technology. Such criticism would, however, smack of self-interested special pleading and it would be open to Ministers to reject any such criticism on the grounds that a) strenuous efforts had been made to encourage European manufacturers to present proposals and these were only rejected when found to be inadequate and b) Westland, notably through the EH101 and the A129 Mark II projects remain firmly committed to European collaboration where this is viable.



If it was believed that HMG had forced Westland into a European solution it could be seen by the US Administration, as another example of unjustified trade protectionism.

IMPLICATIONS FOR W30

Sale of W30-160 - India

- 23 The Indian authorities have indicated that final agreement for the sale will be given in January. We believe Indian intention to proceed with the purchase is now firm and see no reasons why Westland collaborating with Sikorsky or the European partners should be more or less likely to put the contract in jeopardy.

DTI Launch Aid for the W30-300

24 It seems likely that under either proposal Westland would wish, for commercial and financial reasons, to terminate the W30-300 programme. If the company is in default of its obligations under the contract, it is liable to repay the launch aid it has received (nearly £40 million). Westland's auditors have said that they will qualify the 1985 accounts because of this contingent liability, and Lazard's have represented that such a qualification will prevent the implementation of a reconstruction package. It seems likely that Ministers will ultimately need to decide either:

- a) to undertake that the right to recover launch aid will not be enforced; or
- b) to risk the consequences of the accounts being qualified.

NADS RECOMMENDATIONS

25 The National Armaments Directors of France, Germany, Italy and the United Kingdom recommended to their Defence Ministers on 29 November that helicopter requirements in three specified classes should be covered solely in the future by helicopters designed and built in Europe. Acceptance of this recommendation would give comfort to the Aerospatiale/MBB/Agusta offer to Westlands by reassuring them that the UK MoD, like its European counterparts, would adopt helicopters of European origin to meet its requirements for Medium ASW and transport, light transport and light attack machines. It would also give wider credibility to the UK support for the objectives of the Independent European Programmes Group in terms of strengthening Europe's indigenous defence technology base.

26 Conversely acceptance of the recommendations is likely to prevent the Sikorsky/Fiat arrangement going through, because it would appear to rule out future European purchases of Sikorsky designed helicopters. If Westland were then unable to negotiate an arrangement with the European companies, receivership 999-80 would probably result.



27 In general terms the effects of rejection by the UK of the NADs' recommendation would naturally be the reverse of those described about Sikorsky and Fiat would be encouraged to believe that at the very least the UK MoD would be open to persuasion to purchase Blackhawk helicopters (and that other European countries might follow suit) and to participate via Sikorsky in the LHX project.

28 By the same token the European consortium would be very seriously discouraged. France in particular would see rejection of the NADs' recommendations as a clear abandonment by the UK of the Declaration of Principles on European Helicopter collaboration signed by Defence Ministers in 1978 (and amplified in a Memorandum of Understanding signed earlier this year). MoD officials believe that Germany would take the same serious view which could affect our relations with them on EFA; and that under French pressure it is quite likely that the European consortium would withdraw its offer for Westland. MoD officials also believe that France and Germany would be likely to seek to force an early decision by the UK on whether we intended to continue our participation in the 5 nation collaborative NH90 light transport helicopter project or to purchase Blackhawk.

29 Italian reaction to rejection of the NAD's recommendations would be less clear cut Italy being in the position of backing both horses. Italy's main concern would be to secure an assurance that the EH101 would continue - which would depend heavily upon the readiness of Sikorsky and Fiat to continue with the commercial elements of the EH101 programme, since the project is unlikely to be viable as a purely military programme. Whilst Italy would also undoubtedly prefer to continue with the proposed Anglo-Italian project to develop the A129 Mark 2 light attack helicopter she would certainly not be adverse to Fiat having a stake in the American LHX project if that were to materialise through a Fiat/Sikorsky holding in Westland. The Italian Government might also wish to encourage Fiat and Sikorsky to take a similar stake in Agusta (which is currently also losing money), although this is less certain at this stage.

30 To allow the NADs' recommendation, that helicopter requirements should be met solely from aircraft designed and built in Europe, simply to lie on the table would be likely to be interpreted by the European companies as being tantamount to its rejection. However this course would not remove the obstacle to implementation of an arrangement between Westland and Sikorsky. The existence of the recommendation would still need to be disclosed in any public document unless HMG had made it clear that they were not under active consideration.