

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE - MARKET SENSITIVE

PRIME MINISTER

WESTLAND

The struggle has continued over the weekend. MOD and DTI officials agreed a draft paper for E(A) at about 7.00 pm on Friday night. But Mr. Heseltine put a block on it, summoned the officials to his office and had it redrafted. The result is attached. Mr. Brittan, although furious at Mr. Heseltine's intervention, has agreed the paper. However, I understand that Mr. Heseltine may put in a separate paper early tomorrow in the form of a minute to you.

Mr. Heseltine has also conjured up another couple of new ideas over the weekend.

- (i) the French Defence Minister is said to have telephoned to offer to place unspecified sub-contract work on Super Puma with Westland provided it is not sold to Sikorsky; and
- (ii) Mr. Heseltine has recalled that earlier this year DTI wanted to use Ariane rather than the space shuttle to launch the European space package. This was turned down on the grounds that it was some £6 million or so more expensive than the space shuttle. Mr. Heseltine now suggests that we agree after all to use Ariane provided that the French then use the £6 million to place yet more orders for Super Puma.

In the face of all this figure skating, DTI look positively flat-footed. It now turns out that next Wednesday's deadline for Westland is not quite so dead as was alleged and they may in fact have a little more time in hand, perhaps until just before Christmas. This will weaken Mr. Brittan's hand in pressing for an early decision.

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I have advised DTI to speak to Sir John Cuckney tomorrow and make sure that all the facts are on the table at tomorrow afternoon's discussion. I have tried to explore exactly why he is so averse to the European option. I understand this is because he believes Westland need a serious long term partner so that it can start up a sensible research and development programme. He feels that Sikorsky offer this while the European option is just a bridging operation for a brief period after which the same problems will emerge again.

Mr. Heseltine is, I think, likely to press hard for a further postponement of a decision and possibly to suggest that the matter be referred to Cabinet on Thursday (though I have no hard evidence for this last point).

C.D.P.

(CHARLES POWELL)

8 December 1985

WESTLAND

NOTE BY DTI AND MOD OFFICIALS

Background

Westland Helicopters provide an indigenous design, development and manufacturing capability producing helicopters for both the military and the civil markets. The British Ministry of Defence is much their largest customer.

2. Westland has had a long association with the Sikorsky company of the United States and has developed and built a number of helicopters under licence from Sikorsky including the Wessex and Sea King. In recent years, however, the company has embarked on a strategy of developing its own designs for both the civil and military markets.

3. On the military side, the company has substantial long-term prospects built around the development and production of the Anglo/Italian EH101 helicopter and possible participation in a collaborative Anglo/Italian battlefield helicopter. The company is also participating in a five-nation feasibility study into a tactical transport helicopter for the 1990s (NH90). This collaborative approach reflects a Memorandum of Understanding signed in 1978 by the United Kingdom, France, Germany and Italy

under which each of the Governments agreed to make every effort to meet their needs with helicopters developed jointly in Europe.

4. Production loading for military helicopters over the next few years is limited however, although there is continuing Ministry of Defence design and development business and support for their existing fleet.

5. On the civil side, Westland have put their hopes in the civil version of the EH101 and the W30 series developed with DTI launch aid. However, the W30 has not fulfilled its market expectations, although it is now expected that a long awaited order from India will be confirmed in early 1986.

6. Westland are in serious financial difficulties. It is essential that they announce a reconstruction package at the same time as they announce their annual results. Otherwise the company would be in breach of its borrowing limits and would be forced into receivership. Westland had planned to announce their results on 11th December. They have now put this back to 19th December implying that all elements of the reconstruction package need to be in place on 18th December. There is no legal or Stock Exchange requirement to publish on 19th December, but the company and its advisers believe any further delay would involve a severe risk of a fall in the share price to a level below that at which the reconstruction can be effected.

The Alternative Proposals

7. In order to secure the company's future, Westland has sought a financial injection by the purchase of its shares by an outsider; a rights issue; the conversion by the banks of loans to equity; and co-operation which would bring new products to assist over production loading and over the Company's longer term viability. There are two proposals on offer: one from Sikorsky/Fiat on which the detailed financial negotiations are far advanced; the other a more recent proposal from a consortium of the companies associated with Westland in their collaborative ventures (Aerospatiale, MBB and Agusta). The European consortium have told the Ministry of Defence that they feel Westland have been reluctant to pursue detailed financial discussions with the consortium, although initial discussions have been held. The Board of British Aerospace are considering the possibility of associating themselves with the proposal from the European consortium.

8. Sikorsky/Fiat have offered:

a. an initial investment of the order of £20 million to take a 29.9% stake, coupled with an option to acquire further shares to bring their holding up to 35-40%. The arrangements between Sikorsky and Fiat are such that Sikorsky could always control a majority of their joint holding.

b. on the product side Westland would be granted a licence to manufacture the Sikorsky Black Hawk helicopter in the United Kingdom. The licence would be paid for by the issue of loan stock to Sikorsky. The Black Hawk is a light transport helicopter developed in the 1970s. Marketing would be divided geographically between Sikorsky and Westland, with Westland given the European market and certain other countries. There is no provision for purchase of Black Hawk in the British defence budget and no other requirements are foreseen by the Ministry of Defence in other major European countries.

c. joint working parties aimed at improving productivity in Westland. Westland foresees substantial improvements coming from their ability to draw upon Sikorsky's management expertise.

9. The European companies have offered:

a. to subscribe, if necessary, up to £40 million of new equity.

b. an intention to place additional work in Westland factories in the short term; specifically a possible increase from Aerospatiale of some £3 million a year on their sub-contract work creating an extra 90 jobs (from ~~350~~ 40) has been mentioned.

c. possible participation by Westland in the Super Puma programme and in the manufacture under licence of the existing Al29 battlefield helicopter (manufactured by Agusta), if new orders could be won on either aircraft. There is no provision for the purchase of Super Puma in the British defence budget.

d. a re-affirmation of their commitment to the collaborative programmes at the battlefield level (see below), NH90 and EH101.

Report of the National Armaments Directors

10. Given that the proposals for European co-operation rest upon the commitment of European Governments, the four National Armaments Directors (NADs) of the countries concerned met on 29th November. They confirmed the commitment to the NH90 and EH101 programmes (with the German Government expressing for the first time an interest in purchases of EH101 helicopters) and at the battlefield level agreed to seek to rationalise existing requirements into a single common four-nation requirement (which for the United Kingdom could yield savings of £25 million on the development programme which would be used to fund production work to help tide Westland over). They recommended that helicopter requirements in the three specified classes should be covered solely in the future by helicopters designed and built in Europe.

this might be perceived by European Governments as a move to aid the Sikorsky proposal. In the Ministry of Defence's view, there is not only a direct risk that European companies would withdraw their work from Westland but there must also be an unquantifiable risk of consequences for other European co-operation, notably on the European Fighter Aircraft where France is currently seeking to redress the defeat she suffered when Germany joined the United Kingdom, Italy and Spain in proceeding to project definition on a four-nation project. In the DTI's view, such consequences are a matter for speculation at this stage.

DTI Launch Aid for W30-300

13. It seems likely that, following an arrangement with either Sikorsky/Fiat or a European consortium, 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.

Westland's Position

11. The Westland Board appear to favour the Sikorsky option because they are attracted to the opportunity to manufacture the Black Hawk and believe association with a major US manufacturer offers them better long term prospects of viability. They are concerned about the implications of the recommendation described at paragraph 10 above by the National Armaments Directors since, if accepted by HMG, they believe this would prevent the Sikorsky/Fiat arrangement going through because it would rule out future European purchases of Sikorsky helicopters. They therefore wish the British Government to reject the recommendation (although this would not, of course, stop the other European Governments accepting the recommendation.)

The possibility of taking no action on the recommendation would be acceptable to Westland only if the Government made clear that the recommendation was not under active consideration.

International Considerations

12. Both the German and French Governments see the Sikorsky stake as a thin end of a wedge under which Sikorsky would seek over the next 15-20 years to eliminate a European helicopter industry capable of competing with them on world markets. The Sikorsky bid could according to the German Defence Minister, Dr Woerner, spell the end of the European helicopter industry. If Her Majesty's Government fail to accept the NADs' recommendation

14. DTI and Treasury officials recommend that, in the event of termination of the launch aid contract by mutual agreement for technical, financial or managerial reasons or because the contractor does not perform his obligations under the contract, the Government should not enforce any right it may have to repayment of launch aid. An undertaking to this effect should be given as part of the implementation of a reconstruction package and is a necessary step before either negotiation can be concluded. The Government would retain its right to repayment in the event of the company going into receivership or being wound up before termination of the programme. (The precise terms will need to be agreed with the company and legal advisers). This recommendation will involve no increase in public expenditure.

Government Decisions

15. Ministers need to decide:

- a. whether a significant defence contractor should come under the effective control of overseas companies.
- b. whether to accept or reject the NADs recommendation.
- c. whether to agree not to enforce HMG's right to recover launch aid on the W30-300.

16. Before Ministers reach a decision on these issues, it would seem sensible for them to establish more clearly the reasons why Sir John Cuckney and his colleagues prefer the Sikorsky/Fiat bid, looking at:

- the financial implications.
- the management implications - where the attraction of bringing in Sikorsky's expertise needs to be set against the risk that Westland could be cut off from her European partners because of their fear that all technology developed by them would be transferred to the parent Company by the Sikorsky management bedded out at Westland.
- production loading in the medium term. What marketing surveys have been conducted to support Westland's forecasts for the Black Hawk? How do they face the fact that the Ministry of Defence has no intention of purchasing the Black Hawk or the Super Puma (the two existing contenders in this class)? Should they go the Sikorsky route, what are the implications for the work put their way by the European companies at present?

- looking to the longer term, their present plans include co-operation on the NH90 and the EH101 with the European companies. How do the Board think these companies will react to a Sikorsky/Fiat tie-up?

7th December 1985

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7th December 1985

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Dear Charles

WESTLAND HELICOPTERS

// In your letter of 6th December, you asked DTI and MOD to produce a joint paper which could be circulated to E(A). This has been prepared on the lines you and I discussed on the telephone. Two copies are attached.*

I am copying this letter and the attachment to John Mogg (DTI) and Michael Stark (Cabinet Office).

Yours etc.
Richard Mottram

(R C MOTTRAM)

* I am assuming the Cabinet Office will put it round under a suitable covering note by the Secretaries.

Charles Powell Esq
10 Downing Street

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