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MINISTRY OF DEFENCE
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MO 26/9/15

20th December 1979

Dear Mike

DEFENCE CONTRACTS WITH IRAN

/ I attach a memorandum which my Secretary of State has prepared in consultation with the Lord Privy Seal setting out the current situation on our defence contracts with Iran.

My Secretary of State would welcome the Prime Minister's endorsement, and that of his colleagues in OD Committee and the Secretaries of State for Industry and Employment to whose Private Secretaries I am sending copies of the memorandum, of the recommendations which it contains. A copy also goes to Martin Vile.

Yours sincerely

(J D S DAWSON)
Jonathan Dawson

Agreed out

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20th December 1979

CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

DEFENCE CONTRACTS WITH IRAN

Memorandum by the Secretary of State for Defence
and the Lord Privy Seal

1. We last considered this subject when the Defence Secretary wrote to the Foreign Secretary on 7th June 1979 outlining proposals for dealing with extant defence contracts. These proposals were accepted and Ministers agreed that negotiations should continue with the Iranians aimed at recovering monies due and to renewing business subject to their making satisfactory financial arrangements: a shipment of ammunition was foreseen as a test of their intentions.
2. International Military Services Ltd (IMS) and MOD officials have proceeded accordingly in the succeeding months ably supported by the Ambassador and his staff without whose help and advice the progress achieved would not have been made. During the last visit to Iran in late October, MOD officials formed the view that the Islamic Ministry of National Defence (IMND) and the Armed Forces were showing signs of returning to something like normal and were anxious to take delivery of ammunition and spares. A summary of the position reached on these and other IMS contracts is attached at Annex A and the position on defence contracts in the public and private sector is attached at Annex B. Departments principally concerned have been kept informed of developments.
3. No progress has been made in the settlement of debts to IMS and MOD which amount to some £71M. Throughout the months the Iranians have repeated their policy of honouring these debts and for our part, IMS and MOD officials during visits, and the Ambassador at every opportunity, have stressed the importance attached by the UK Government to such settlement. We have not made the continuation of extant contracts conditional on the settlement of all debts as we were anxious to give the new Iranian administration time to settle down. Indeed we envisaged that the re-establishment of a business-like relationship on extant contracts (which we were on the brink of achieving) would have put us in a stronger position to achieve a satisfactory settlement. The collection of these debts is of great importance to the Defence Budget, but we think it is undesirable to make any new approach to the problem until matters have resolved themselves in Iran.

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4. As letters of credit covering spares into 1980 had been taken out, we delivered to the Iranians early in November their first consignment of spares since supplies were stopped in December 1978. Next, under normal condition we would have delivered a quantity of tank ammunition (for which there is no other outlet) because the Iranians have made some additional payments and have re-opened most of the necessary letters of credit.

5. Soon after the seizure of the American Embassy (followed the next day by the temporary occupation of the British Embassy), we were told by Washington that the Americans intended to impose an embargo on the supply of arms. The Pentagon made an announcement to the Press on 8th November that shipment of \$305M spare parts (for which the Iranians had already paid) would be halted until the hostages were released although they have not announced any general arms embargo. Since then, the Germans, although not major suppliers, have also stopped deliveries of spare parts. The Italians are now expected to take similar action as a result of American pressure and the French have made a similar commitment although they have no major contracts with Iran.

6. On 7th November officials of FCO and MOD agreed that because of the US Embassy position any further shipments to Iran would be withheld. Ministers of these departments subsequently agreed that while we should do nothing at this stage to alert the Iranians that we were not complying with our contractual obligations to them, we should employ "go slow" tactics and avoid any shipments or further negotiations with them for the present. It was also agreed that the Ambassador should avoid taking the negotiations on Yarrow support ships and ammunition further and, if pressed by the Iranians should refer back for instructions. If IMS or MOD officials were approached by the Iranians it was agreed that they would refer to manufacturing, administrative and transport delays. If the Iranians pressed their enquiries, officials would feel at liberty to draw attention to the outstanding debts.

7. We think it likely that the Iranian officials with whom discussions have been held will be aware that to press us on these matters could only lead to mutual embarrassment and it is thought likely that a period of silence will ensue until the position of the US hostages is resolved. The Iranians are dependent on us for the supply of spares for their UK supplied armoured fighting vehicles.

8. There has been some press interest but we have taken the line that no shipments have taken place since early November and none are in immediate prospect.

9. Ministers of the Departments concerned will be consulted, once the situation at the US Embassy is resolved, before deliveries of arms are restarted.

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Recommendations

9. We invite our colleagues to:
 - a. take note of the position set out in this paper;
 - b. endorse the "go slow" tactics;
 - c. take note that Ministers principally concerned will be consulted before deliveries are restarted after the position of the American hostages is resolved.

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IRAN - CURRENT POSITION ON IMS/MOD DEFENCE CONTRACTSAmmunition

£19M worth of ammunition, for which there is no other outlet, is held in stock and, under arrangements made with the Iranians has been prepared for shipment. IMS should declare it ready for shipment when £2.9M is received and 9 letters of credit (LC) are extended and enhanced at a London bank. Since 21 November £2.5M has been received and action on 6 LCs has been confirmed. Outstanding action could be completed by the Iranians shortly in which case administrative delaying tactics will be used to prevent shipment but we will then be in breach of the arrangement made. Other orders for ammunition valued at £140M are held with delivery into 1983 but manufacture will not commence until the Iranians agree revised financial arrangements to cover the period of disruption. Recent enquiries from the Iranians about the basis of our proposals have not been answered and negotiations have been stopped.

Armoured Fighting Vehicle Spares

2. The Spares Support Arrangements (SSA) are controlled by a Joint Review Committee chaired by MOD and a resumption of periodic meetings was envisaged for December '79: this will be delayed. Financial arrangements for continuation of supplies have been agreed and with LCs extended to June 1980 the first supply of spares since the Revolution was made in early November: no further deliveries are being made. About £18M (current value) of stock owned by Iran, is also held in this country under SSA.

Tanks and Armoured Recovery Vehicles

3. Preparation of the termination account for tank project 4030 is in hand. Present indications are that a small credit may be due to Iran out of the £301M already paid. The Iranians have asked for delivery of the outstanding 50 Armoured Recovery Vehicles from the contract repudiated in February, 1979. Consideration of this and other engineering matters connected with their fleet of vehicles will not be progressed until a business-like relationship on spares and ammunition has been achieved.

Support Ships (Yarrow)

4. The contract for 4 ships originally ordered was terminated by UK in March '79 because of non-payment of claims by Iran. Following an Iranian request to reinstate 2 ships IMS, Yarrow and ECGD considered the position and HMA Tehran is now ready to engage in final negotiations on the price for 2 ships and cancellation charges at between £43M - £44M which would involve a further payment by the

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Iranians of about £8M before delivery. The Ambassador has been told not to pursue the matter at present. but he has now reported that the Iranians are requesting the reinstatement of all 4 ships at a price of £72M. No response is being made to this request at present.

Construction and Support Projects

5. Iran owe IMS some £52M in respect of construction projects at Bandar Abbas, Dorud and Esfahan and support contracts. The pursuit of these debts requires visits to Iran which, on the advice of HMA Tehran, are postponed on grounds of safety until the New Year. Under their agreement with Wimpey Laing on the Esfahan project, IMS are required to diligently pursue a debt of some £11M. If they are prevented from doing so for political reasons they could be liable to pay Wimpey Laing. It is thought, however, that the constructors will consider current events as being beyond IMS's control and will not press the matter.

Direct MOD Contracts

6. Some £7M is still owed by Iran for claims presented in respect of MOD contracts for Naval equipment, hydrographic surveys, training of Iranian personnel and loan of MOD personnel.

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IRAN - CURRENT POSITION ON
DEFENCE CONTRACTS WITH INDUSTRY

Fleet Replenishment Ship "KHARG" (Swan Hunter Shipbuilders Ltd)

The shipbuilder expects to complete rectification work on defects and contractors acceptance trials during February 1980. Naval overseeing of the construction has been undertaken. 120 Iranian personnel are at Newcastle waiting to take over the ship which can only happen when a final payment of some £11M is made. MOD assistance of Liaison Officers with sea trials and operational sea training using MOD facilities which could take 3 to 4 months from February 1980 has been arranged subject to prepayment.

Rapier (British Aerospace)

2. BAe have presented a termination account to Iran against which about £79M is outstanding. Iranian officials are pressing the contractor to send representatives out to Iran to discuss the termination claim and possible further aerospace requirements. They have asked MOD and FCO recently, through the Ambassador, to use their good offices to encourage BAe to comply. The Ambassador has advised that such visits should not be made at present and no action is in hand.

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