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Prime Minister

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CONFIDENTIAL

PRIME MINISTER

This proposes taking a highly commercial decision at breakneck speed. I cannot see (nor can Mr Greyson) the urgency. Should Mr Jenkin be asked to bring this to an early meeting of E (i.e. after Easter)?

Yes

MLs 31/3

In Patrick Jenkin's absence abroad I wish to inform you of the latest developments over System X which require urgent consideration. I have spoken to Patrick on the telephone, who is also anxious that we proceed quickly on this issue, and that we do not necessarily delay consideration of it for his return.

The Chairman of British Telecom has been concerned for some time about the arrangements for the development, manufacture and sale of the System X range of new digital telephone exchanges. He is concerned that the present arrangements will not ensure a viable UK involvement in future world markets for this equipment. We agree with this assessment.

System X is the heart of the modern telecommunications network which BT is installing during this decade and beyond. By the late 1980s BT will be spending some £400 million per annum on procurement of System X; already its development costs for BT have reached some £200 million. For BT's expenditure to be contained it is vital that System X is competitive in world markets.

System X is run as a collaborative venture between BT and the three manufacturers GEC, STC and Plessey. This grouping was considered necessary because of the scale of System X development. Our manufacturers are small by world standards and have lacked the technical expertise to develop such equipment independently of BT. To set the telecom capabilities of the UK companies in perspective, Annex A compares them to their major international competitors. Although System X is good technically, it is unlikely to be a commercial success because the existing arrangements require that all decisions are taken on the basis of consensus. There is no focus of executive authority, and inadequate cooperation between the companies, each of which makes vital elements of the exchange. Furthermore, economies of scale are essential; these cannot be achieved with three independent companies.

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System X concerns Government for two reasons. First, BT is operating, as a result of our liberalisation policies, in an increasingly competitive environment. It can no longer afford to prop up an uncompetitive supplying industry. Nor is it appropriate that it should be so closely involved in the development of equipment - at present the programme is entirely BT-funded. Secondly, we have been asked for support for exports. There is a jointly owned export marketing company, British Telecommunications Systems (BTS); it has no executive authority nor the resources to take the inevitable risks of exporting. Export sales in any country are undertaken by one of the companies acting as lead contractor. I am convinced that System X needs a single authority responsible for all aspects of exporting. This view is shared by Christopher Chataway, the Chairman of BTS.

We have been asked for support to fund the further development of export additions to the basic System X. There will also inevitably be a need for support of individual export projects. The cost may well amount to about £25 million in addition to ECGD and ATP finance. I have made it clear to the industry that funding of the export variants will not be available to them while the existing arrangements continue.

There are the following options :

(a) Do nothing. This has the advantage of minimum disruption. If we refused support for exports there would be no immediate Exchequer cost, but no substantial export orders would be won. BT would either have to procure uncompetitive equipment or buy exchanges developed overseas. This would lead to the slow death of the heart of the telecommunications equipment industry. Some 30,000 jobs could be at risk;

(b) Let the market decide. By 1984 each company will be able to make System X on its own. They could compete for BT and export business. However, the market is far from perfect. BT would effectively remain a monopsonist. Exports would require substantial Government support. In the meantime, duplication of development and production will require additional public money. The likelihood is that all three of our companies would go to the wall during the mid-1980s, leaving BT having to buy foreign equipment.

(c) The companies could give BTS executive authority to export and provide it with the resources to do so. This is an initially attractive option which in theory minimises



disruption. BTS would need authority to override the sectional interests of the individual companies and sufficient capital provided by the companies to bear the risks involved in exporting. The three companies are, however, not prepared to agree to this. Moreover, at home we would still be left with a fragmented manufacturing and development base.

(d) A merger of System X interests of the three manufacturers to form a company with full responsibility for System X. This would give Britain a world scale company with control over development and production. Government would help with the funding of exports. This is perhaps the most attractive option, but again none of the companies appears ready to concede control. Personality differences between the companies mean that this would be very difficult to achieve in an acceptable timescale, and there is the danger that any merger would only turn out to be cosmetic, with the individual units retaining their original identities and corporate loyalties. Obviously, rationalisation would result in some job losses;

(e) Merger of the System X interests of two of the manufacturers. This option has some of the attractions of (d) and reduces the practical problems. Although having the attraction of reducing the number of companies to two, this option does little to resolve the economy of scale problems, and the divided control of System X would remain. Inevitably in time the smaller of the two companies would cease to be viable. Only STC show any interest in this option. BT doubt that any merger would be effective.

(f) One company to have sole responsibility for System X at home and abroad. Plessey has proposed this and it is the course which BT supports. Plessey's plan of action envisages:

- i) the development with BT's cooperation of the next generation of System X, and as a concomitant to this,
- ii) completion of their plans to acquire a US telecommunications company from which to attack the large North American market. They have identified the company and require a decision quickly - if possible before Easter - as other companies are showing an interest in it.

This plan could provide effective management of System X, and would give Plessey the chance to become a world-league



company. The other companies could, if they wished, act as subcontractors, but would be gradually phased out of the exchange business with inevitable job losses, although these would be mitigated by the redistribution of work on other BT contracts. This is in many ways the cleanest solution.

My doubts centre round weaknesses in Plessey's management (although STC's and GEC's managements are no better). There would be a major political row inspired by the other two companies. However, if BT made clear that this was their desired course I have no doubt that all three companies would offer to take the lead.

BT and I are loath to intervene, but large sums of public money are at stake. If nothing is done, slow death is inevitable. Some major change is essential and can only be carried through by BT if they have the full support of Government. The Chairman of BT has made it clear that he considers (f) the only feasible option. He intends to invite each company to submit proposals urgently along these lines. He would want to put this to the three company chairmen before Easter, giving them some two weeks to respond. BT will then give one company the management responsibility for System X and place all future orders for System X with them. However, to apply competitive pressure, part of BT's requirement would be put out to open tender. It is possible that a British company could win this order, thereby reducing their job losses in the UK. Government export assistance would have to be concentrated on the System X company.

Sir George Jefferson has asked for the Government's full backing in the course he proposes to take. I therefore seek colleagues' approval to my agreeing to BT's proposals. Clearly these discussions could have major commercial implications for all the companies involved, not least on the Stock Exchange. We therefore need to consider this matter urgently.

I am copying this to Members of E Committee and to Sir Robert Armstrong.

*K.S.*

KENNETH BAKER

30 March 1982

M35/M35ACZ

## Annex A

## MAIN SWITCHING - WORLD MARKET POSITION (HISTORICAL)

DIGITAL ORDER INTAKE  
(MILLION LINES)

2.3

WESTERN ELECTRIC - USA

20%

1.0

INTERNATIONAL TELEPHONE &amp; TELEGRAPH (ITT) - USA

12%

2.9

LMERICSSON - SWEDEN

7%

0.5

SIEMENS - GERMANY

6%

0.7

GENERAL TELEPHONE & ELECTRONICS (GTE)  
- USA

6%

NIPPON ELECTRIC Co. (NEC)  
- JAPAN

4%

OKI - JAPAN

4%

HITACHI - JAPAN

4%

FUJITSU - JAPAN

4%

2.0

THOMSON/CSF  
- FRANCE

3%

7.7

CIT/ALCATEL  
- FRANCE

3%

4.9

NORTHERN TELECOM  
- CANADA

3%

PLESSEY - UK

3%

GEC - UK

2%

ITALTEL -  
ITALY

2%

PHILIPS -  
HOLLAND

2%

STROM-  
BERG  
CARLSON  
- USA

1%

ALL OTHERS

15%

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CF. pl bf 13/7  
MCS 5/7

PRIME MINISTER

SYSTEM X

I attach, as you requested, the papers on System X which we were discussing earlier this afternoon.

The first we heard of the proposal to reorganise the handling of the development of System X was Kenneth Baker's minute to you of 30 March. Mr. Baker reported BT support for the proposal that one company - Plessey - should have sole responsibility for System X at home and abroad and he expressed some doubts about Plessey's management, but sought colleagues' approval to agreeing to BT's proposals. He sought this as a matter of urgency.

We suggested that this be discussed at E(TP) and this happened on 22 April. You were recorded as summing-up in the following terms:-

"THE PRIME MINISTER, summing up the discussion, said that the Sub-Committee agreed that the present arrangements for developing, producing and selling System X were unsatisfactory. They therefore welcomed the Minister of State's proposal that he should authorise BT to seek proposals from GEC, Plessey and STC for a single focus for management responsibility for System X. There should however be no suggestion that the Government had decided on any particular way of reorganising work on System X, still less that the Government took the view that one particular company should become solely responsible for future work. The best way forward might well be that proposed by the Minister of State; but the companies might come up with other possible schemes; and the wider implications of giving sole responsibility for work on System X to one company would have to be properly examined before any decision could be taken. The Minister of State

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should report to the Sub-Committee on BT's discussions with the System X manufacturers, if possible before the Summer Recess."

I have secured a copy of a letter with which BT communicated this decision to the three companies. This is attached at Flag A. You will see that it is a flat-footed and obtuse letter. We expected from the start that the whole initiative would cause trouble with the industry. Mr. Baker's minute said "there would be a major political row inspired by the other two companies". But the BT letter of 18 May seems almost designed to exacerbate the difficulties. It is certainly a long way away from the terms of the E(TP) discussion.

It was also agreed by E(TP) on 22 April that the results of the consultations with the companies should be reported back by Mr. Baker to E(TP), if possible before the Summer Recess. I am enquiring about how soon Mr. Baker can make this report. Perhaps the best way forward would be for him to report to an early meeting of E(TP)?

MCS

I had letter  
see S of S and  
Kenneth Baker  
about this  
mb

5 July 1982

British

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COMMERCIAL IN STRICTEST CONFIDENCE

Mr J Samson  
STC Ltd, 190 Strand, WC2

Mr W D Morton  
GEC, Telephone Works, Coventry

Mr D H Pitcher  
Plessey, Edge Lane, Liverpool

*Zi*  
18 May 1982

*Dear Doug,*

As you know the Government has recently been reviewing the organisation and prospects for System X and has held discussions with all parties concerned. They have recently notified us of their conclusions.

I understand that there was a strong view in industry that a major international business in public switching systems could only be built on a highly efficient production base with an output considerably larger than that currently available to any of our 3 existing suppliers and that the existing collaborative arrangements were less than satisfactory. The Government has told us that they are anxious for the UK to establish a strong position in world markets and they are ready to give financial and political support to achieve this objective. They are however only willing to do so if the industrial base is concentrated so that it has the scale necessary to give it the possibility of success, and if the management arrangements are changed to introduce strong unitary management. Accordingly the Secretary of State has asked BT to revise its plans to secure this result.

These objectives of the Government are consistent with BT's own needs. It remains our wish and intention to purchase System X on a large scale for use in the UK network subject to acceptable price, performance and delivery. However, in the competitive environment that we now face it is imperative that the switching equipment that we buy is highly cost-effective when judged against the best that the world can offer. We are not prepared to be party to domestic arrangements that do less than this.

The Minister of State has accordingly invited us to consider placing all of our System X business with a single company in order that it should be in a position to establish an adequate base in the UK.



We have in mind therefore to place an initial single contract with one company for the supply of approximately 70% of our inland digital public exchange orders over the next three years. This contract would also include an option to increase the volume of supply above this level. I invite you to put your proposals to me for giving effect to this concept. I shall be looking in your reply for full information on the production facilities that you would make available, the approach you would apply to securing international business, and the reasons why you feel your company should be entrusted with this responsibility.

We recognise that the two companies who are not selected - which I will call companies B and C - will face a period of readjustment of their business as System X comes into volume production, and I propose to discuss with them ways in which we may help them through this period. These discussions could include a review of the whole field of our other telecommunications purchases to see if there are ways open to us to offer additional business to B and C for a transitional period, perhaps by transferring some business from Company A.

I turn now to the development situation. Many System X development contracts are in progress and BT will expect all companies to complete the work for which they have contracted within the agreed timescales, and to pass over all the resultant information promptly in the established manner. It may well be that it would be appropriate to appoint Company A as prime contractor for the remaining development process, but this would be for discussion. As you know so far BT has met the whole cost of the development of System X. When these new arrangements come into operation I propose to ask company A to fund 50% of future switching system development expenditure, all existing development contracts would however continue to be 100% funded by BT.

These new arrangements would of course eventually result effectively in a single large volume indigenous switching supplier to BT. You will wish to know that to provide a competitive yard-stick against which to monitor the performance of company A we would intend to offer a proportion of our switching business to international tender, but subject to the British company developing into a competitive supplier we would expect this proportion to be small.

The decision to invite proposals along these lines was not taken lightly, and we recognise that there will be many difficulties to overcome during the transition phase. However I am sure that you will share the view that the worst possible situation for the industry would be uncertainty and I hope you will join with us in securing a speedy and clearcut resolution of the way ahead, which will lay the foundations for enduring export success and a reliable supply for British Telecom.

I have written in the same terms to Jeff Samson of STC and Des Pitcher of Plessey. I would be glad to have your proposals by 17 June.

Yours sincerely

*J S Whyte*

J S WHYTE

Copy to: Rt. Hon. Christopher Chataway

3rd June, 1982

IN STRICTEST CONFIDENCE

Dear Patrick,

I am writing to you following the receipt by my colleague W. D. Morton, Managing Director of GEC Telecommunications Ltd., of a letter from British Telecom about System X. It says that you have made Government support for the Telecommunications industry conditional upon "the industrial base" being "concentrated", and "management arrangements" changed. And the Minister of State has invited BT to place all its System X business with a single company. BT accordingly has it in mind to place a single initial contract for 70 per cent of its digital inland public exchange orders over the next three years and to put the rest to tender from overseas suppliers.

I daresay you have read the letter in question, but I enclose a copy in case you haven't seen it. Our Telecommunications Company will naturally respond with an offer as requested by BT, and GEC is, of course, by far the best equipped company in the UK to fill such a role. I might add that our commitment to telecommunications is such that GEC will guarantee to provide the Telecommunications company for all practical purposes with unlimited resources of finance, technological, managerial and marketing skills, and would support the activity with the GEC worldwide organisation, including our companies in the United States, to which further additions may be expected in the course of time.

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The wish to purchase System X for the UK network on a cost effective basis and to see System X established in a strong position in world markets is entirely laudable. But notwithstanding the strength of our claim to undertake the whole UK industrial function, I have to tell you that the implications of the proposal to do this by depriving two of the three participating firms of access to the telephone switching business of BT are horrendous, and very far from guaranteed to achieve the desired objects.

I suppose one should not be surprised that the proposals imply the total rejection of all the System X arrangements and objectives mutually nurtured and established between BT and the industry over the last twelve years, or that they are based on subjective and highly questionable assumptions, since that is typical of bureaucratic attempts to get involved in industrial structuring. The form book indicates that the odds are very, very long against any DOI nap selection coming off. At any rate, long before its implementation can be complete, the proposed course could easily bring about the virtual collapse of the System X development programme. The present development needs the collaboration of all three parties for some time to bring an acceptable system into service. Upon two of them being told that they have no future in the field, would you expect them to press on urgently with their effort and to continue to invest capital, skill and managerial expertise at the required level in a business from which they are to be excluded? There is also the question of how, within a short time, it would be possible to concentrate the presently dispersed technological effort into a single unit. What degree of eagerness and collaboration would you expect from the two losers?

The BT letter talks of a "strong view in industry" that we cannot produce System X unless the scale of output is much larger than is available to any particular supplier, and that the existing collaborative arrangements are less than satisfactory. I don't know who holds that "strong view", but the fact is that very little to do with BT, either in its present or its previous Post Office incarnation, is satisfactory, and

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this has been the case for over thirty years. It was the Post Office which destroyed the British manufacturers' export markets and, in due course, their export potential. It was the Post Office which would not allow us to bring modern Crossbar switching into the network in 1963/64. It was the Post Office which in 1973 produced a surprise agreement with STC which resulted in the mistaken adoption of the TXE reed relay system. It was BT which insisted on the collaborative shared arrangements which we are now told are inconsistent with its own needs. It was BT which in 1966 would not support GEC's development work on computer control for telephone exchanges, and it was GEC which carried on with it, successfully, at its own risk until its subsequent adoption by the Post Office. It was BT which insisted on a specification for System X which they were warned by GEC (and possibly others) was unnecessarily wasteful and inefficient, as well as unsaleable abroad, so that what we are now talking about is not System X as conceived, but Mark II as modified at considerable expense. And it was GEC, at considerable cost, which eliminated, after it bought AEI, obsolete capacity then being maintained at the expense of the Post Office with a backward looking development programme. Incidentally, GEC was rewarded by seeing part of the traditionally AEI share of the business going to to its competitors.

I freely acknowledge that recently, very recently, things at BT have improved a great deal. But that august organisation cannot expect to be allowed to slough off its gargantuan shortcomings by visiting upon its suppliers the consequences of its innumerable sins of omission and commission over many years under governments of both major political parties.

The "case" for a single System X supplier is stated on three assumptions:

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- (1) that the prospective production base of any one existing supplier is inadequate to achieve cost-effectiveness;
- (ii) that the existing collaborative development arrangements are less than satisfactory; and
- (iii) that the existing export arrangements through BTS and the lead contractors are unlikely to meet with success in world markets.

As to (1) above, certainly, in theory, production costs are lower at higher volume, provided all other things are equal. But all other things rarely are equal. When advanced production and test equipment are used on a multi-shift basis, and factory and other overheads are correctly structured, the cost benefits of increased volume become, after a given point, relatively unimportant. Of course, the bought-in parts comprise a substantial proportion of total cost in capital electronics equipment, but here too benefits are available to a large company such as GEC using its total purchasing power to good purpose. In general, the difference in cost effectiveness between a well-run business and a not-so-well-run business is, beyond a certain level, likely to be greater than economies available merely from increment in volume.

The concept of a single UK supplier of System X to BT, and the abolition of UK competition, contrasts sharply with BT's current practice with regard to standardised designs of transmission equipment. BT's total purchases of transmission equipment are substantially less than of switching. Yet BT purchase 140 Mbt. line systems from two manufacturers, digital multiplex equipment from three manufacturers, TEPI(E) 30-channel PCM from potentially four manufacturers, and are planning the development of standardised fibre optic systems with three equipment manufacturers and three fibre/cable manufacturers. Are we going to see another hare-brained notion for "re-structuring" the design and manufacture of transmission systems like that suggested for System X? Is this what is meant in the reference to "transitional measures"?

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As to (ii), the successful joint BT/Plessey/GEC programme with Monarch, for which GEC has secured a three-year contract in New Zealand against worldwide competition, shows quite clearly that a product can be standardised and produced competitively by two UK suppliers working in collaboration.

We may also observe the four manufacturers in Japan who collaborated with one another and the NTT to develop a digital switching system for Japan, and have elected to develop - or are already developing - their own individual systems for export.

Having said all that, let me concede at once that the existing collaborative development arrangements are not wholly satisfactory. They reflect the problems of the past, the need to put to work and train a large number of engineers with hardware and software skills, the problems of defining standards, applications and sub-systems and managing on a multi-unit, multi-site basis. There is some bureaucracy, some duplication and genuinely held differences of view about technical aspects of the development programme. But for all the defects of these arrangements, they were evolved as the best way to handle the job in the circumstances obtaining, and it should be remembered that none of the firms had at the time sufficient development resources to do the whole thing alone. Nor in any circumstances would BT have allowed them to do so. The arrangements can certainly be improved, but to make any major change before the SEP development programmes for BT and export have been realised would have unforeseeable consequences. I have already referred to this, but nearly all the engineers presently engaged in this massive programme throughout the industry will be needed for the continuing development and cost reduction of System X. The potential destruction of this invaluable resource would be irretrievable.

So far as (iii) above is concerned, the arrangements have provided a vehicle for the promotion of System X as a UK system, and a mechanism to offer

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earlier deliveries than would have been obtainable if we had waited until full information transfer had taken place between the companies. These arrangements will undoubtedly need to be changed in due course, but there is no point in doing it in such a way as to undermine the considerable efforts made by the participating firms and BTS to lay the foundations for overseas business for System X. It is also worth noting the enormous improvement in recent months in the level of constructive collaboration between the companies to enable each of us to quote overseas.

In general terms, the DOI proposal would decide quite arbitrarily and for all time (for practical purposes) the structure of development and manufacture of switching equipment, based on a system which does not yet exist, the early manifestation of which has been produced in limited quantities and multilaterally, and when no one UK manufacturer has yet had a chance to demonstrate its full capability to produce the whole system. Presently employed and still expanding resources would be scrapped on the basis of your subjective judgement of one manufacturer's capability as against another's, and on that manufacturer's promise of future performance from limited experience. And even if that choice were right today, it would have to stay right for ever, or, to follow the other element of your proposal, there would be no important UK telecommunications industry at all.

This would be the absolute negation of competition; it would be the ultimate triumph of corporatism imposing monopoly supply on a monopoly supplier; it runs entirely counter to the proposition that competition benefits the customer.

The offer of up to thirty per cent of the switching business to international tender is also remarkable. No other PT authority has behaved with such generosity as to reserve a material part of its business for foreign firms at the expense of its own, even without having first excluded from the business two out of three of its suppliers; and, of course, if BT does not reward foreign tenderers with contracts, they will soon cease to tender.

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You might wish to refer to the study carried out in the early 70's, under the aegis of the Advisory Group on Systems Definitions, which indicated that the costs of using alternative switching systems in the UK network would be very high; indeed, the conclusion was central to the decision to have one basic digital system, from which arose the collaborative development of System X. Nothing has changed in the meantime to invalidate the conclusion.

In making his proposals to BT, the Minister of State cannot conceivably have taken into account, or he has failed to appreciate, the knock-on effects of eliminating in due course two suppliers of telephone exchange equipment. It is not impossible that such manufacturers may be encouraged to give up the greater part, or even all of their telecommunications business, including transmission and telephone instruments. Side effects might well be felt in PABX's. This would have fundamental consequences in the field of Information Technology, and in due course, on solid state components. There would be potential overspill into defence equipment capability and the whole field of electronics technology.

I have not yet dealt with the employment aspects of the proposals, and their political implications. I realise that the impact on jobs may not be immediate, but you are deluded if you believe it would be long delayed. Can you then seriously propose when there are in this country three million unemployed to offer up to thirty per cent of a nationally owned undertaking's purchases to foreigners? Do you think there will be no repercussions from the companies, and the Trades Unions representing their people, who are to be excluded, and who must inevitably in due course shut down factories and sack workers? Do you believe that investment on the part of those dispossessed companies in the communications and electronics fields will continue unaffected by the very fact that a Conservative government is even capable of allowing such administrative arbitrariness in a decision so drastic and far reaching as this one?

And do you not think that someone, somewhere, will notice that the need for such a decision has been invented by your Department?

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The dangers of the Minister of State's proposed cure are in fact so much greater than the effects of the supposed disease, even if it exists, that to persist with it would be the height of foolishness. The proper way to proceed is to make available now to all three suppliers all necessary information to enable all of them to produce the whole of System X, or any improved derivative of it. Then let them compete, at home and abroad. The industry will by that route arrive at a condition of health and efficiency, backed by adequate investment in plant and technology. That will be better than the route to ruin proposed in BT's letter.

Lord Weinstock

The Rt. Hon. Patrick Jenkin, MP.,  
Secretary of State,  
Department of Industry,  
Ashdown House,  
123, Victoria Street,  
LONDON, SW1E 6RB.



P.0722

PRIME MINISTERSystem X

E(TP)(82)3 and 4

## BACKGROUND

This item of business is concerned mainly with the structure and future of the telecommunications supply industry rather than the development of the telecommunications network.

2. System X is a system of digital telephone exchanges developed by British Telecommunications (BT) in collaboration with GEC, Plessey and STC. Each company is responsible for developing part of the total system, with development costs borne by BT. One of them acts as lead contractor in each export market, and has to bear all the costs and risks of exporting while only receiving part of any profits.

3. On present plans BT will purchase System X equipment worth some £5 billion over the next decade. No export sales have yet been agreed (recent press reports of a possible sale to China have yet to be confirmed).

4. In E(TP)(82)3 the Minister of State, Department of Industry argues that although System X is technically sound the division of responsibility among three companies is seriously holding back progress; and that without a clearer focus for the development, production and sale of System X, the telecommunications supply industry is unlikely to achieve success in world markets. If the Government lets this situation continue BT will have either to purchase British equipment which is uncompetitive because of costly triplication of development and production and small production runs; or buy exchanges developed overseas.

5. Mr Baker therefore discusses four ways in which responsibility for developing or at least exporting System X could be unified. He dismisses three.

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- (a) Make British Telecommunications Systems (BTS), a jointly owned export market company, responsible for export sales. But this would reduce the three manufacturers' control over their own activities; Plessey, STC and GEC, who would have to provide BTS with substantial capital, would not agree. In any case development and manufacturing would still be fragmented.
- (b) A merger of the three manufacturers. But it would inevitably be difficult and take a long time to rationalise the three companies satisfactorily - and there are serious personal rivalries between the top management of GEC and Plessey.
- (c) A merger of the System X interests of two of the companies. There would still be practical problems in bringing about a merger; and control of System X would still be divided. But Mr Baker takes the view that this option would be more likely to work than the previous two.

6. The Minister of State's (and BT's) preferred approach is for one company to have sole responsibility for System X both at home and abroad. Mr Baker suggests that Plessey would be the most likely candidate: they have proposed this course; in practice they have the lion's share of current development work; and they plan to purchase a United States telecommunications company which would assist them in attacking the North American market. Whichever company was given responsibility for System X part (perhaps 30 per cent) of BT's switching requirement could go to open tender to preserve competition; and thus could probably be imported.

7. The Minister of State invites E(TP) to agree:

- i. that BT should invite proposals from each of the three companies that they should be given sole management responsibility for System X;
- ii. that BT should consider these proposals, allocate responsibility for System X to one company and place all their future orders for the System with that company;



iii. that Government support for the export of System X should be concentrated on the company which BT choose.

8. In E(TP)(82)4 the CPRS endorse the Minister of State's proposal (i). They recommend however that when BT have considered proposals from the three companies the Minister of State should report to the Sub-Committee again, assessing BT's recommendation.

#### MAIN ISSUES

9. E(TP) is likely to agree to the Minister of State's first proposal. GEC and STC may complain that it is unreasonable for BT, with Government support, to seek to alter existing arrangements, partly at the suggestion of Plessey; but Ministers can reasonably answer such criticism by saying that System X's continuing failure to win export orders and delays in the project mean that BT and the Government must examine its scope for changing the present arrangements.

10. The main question for E(TP) is therefore likely to be whether the Sub-Committee should endorse Mr Baker's proposals (ii) and (iii) or rather, as the CPRS propose, invite him to report back to E(TP) on BT's discussions with the companies. There is likely to be general support for the procedure which the CPRS recommend. But you will in any case want the Sub-Committee to discuss the main considerations which bear on decisions on System X and which the Minister of State would need to cover when reporting back.

11. The discussion should cover the following points.

(a) Other Possible Solutions

It may be suggested that the other options discussed in E(TP)(82)3 are not so unattractive as Mr Baker makes out; or that there are other possible solutions: for example a link up between one of the British producers and a foreign company. One of the results of BT's inviting proposals from GEC, STC and Plessey should however be to flush out any such ideas.



(b) Feasibility of the "one company" solution

There are two questions:

- (i) How well would the management of Plessey, GEC or STC cope with the additional problems caused by concentrating responsibility for System X in one company? Are there particular problems on the export side? (For example, press reports have suggested that STC has particularly good connections in China. What - continuing the example - would happen to such links if GEC or Plessey became solely responsible for System X?) If Plessey were the chosen company, would they be able to cope both with full responsibility for System X and with their proposed American takeover?
- (ii) What sort of price might the two companies which had to disengage from System X try to extract? How difficult could and might they make the necessary transfer of software and other information?

(c) BT procurement

Would competition procurement of say 30 per cent of BT switching equipment ensure that BT got good value for money from its System X purchases?

(d) BT and Government financial support

- (i) Would BT continue to pay the research and development costs of System X? As the CPRS point out, one implication of a more competitive approach to procurement seems to be that suppliers should pay their own research and development costs.
- (ii) Mr Baker argues that even a single company would need Government support for exports of System X, over and above normal ECGD and Aid and Trade Provision assistance. On what basis would such support have to be provided?



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(e) Wider industrial and political implications

How serious would be the "major political row" which Mr Baker fears might be caused if the Government and BT prosecuted the single company option? Are there not likely to be implications for the structure of the British electronics industry generally and should not the Government assess these carefully rather than leaving it to BT to take a narrow decision related to System X?

HANDLING

12. You will want the Minister of State, Department of Industry and Mr Sparrow to introduce their papers. The Chancellor of the Exchequer will wish to comment; so too, probably, will the Secretaries of State for Trade and Industry.

CONCLUSIONS

13. You will want to reach conclusions on the following points:

i. Does E(TP) agree that BT should be authorised to seek proposals from STC, GEC and Plessey that they should be given sole management responsibility for System X?

If so,

ii. Should BT also be authorised to allocate responsibility for System X with one company, with which it would in future place all future orders; and should Government assistance in support of System X be concentrated on that company?

Or

iii. Should the Minister of State report back to E(TP) before the summer recess on BT's discussion with the three companies?

14. If the Minister of State is to report back, what points should his report cover (probably those in paragraph 11 above and any others raised in discussion)?

*PLG*

P L GREGSON

21 April 1982

5

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Prime Minister (4) *Poste de la*

*Spencer's note*

Non-sequitur!

APR 1982

Foreign and Commonwealth Office

MCS 7/41

London SW1A 2AH



From the Parliamentary Under Secretary of State

6 April 1982

*[Handwritten signature]*

*Dear Kenneth,*

SYSTEM X

Thank you for copying to Peter Carrington your minute of 30 March to the Prime Minister about System X.

It is obviously important that we should have a strong indigenous manufacturer of digital telephone equipment. Digital exchanges will be the heart of future telecommunications systems and we must be able to manufacture and market them ourselves if our industry is to retain its present relatively strong position. I therefore agree to your proposal that Plessey should have sole responsibility for System X at home and abroad.

??

I am copying this minute to recipients of yours.

*Yours,  
David*

(Trefgarne)

Kenneth Baker Esq MP  
Minister of State  
Department of Industry  
Ashdown House  
123 Victoria Street  
London SW1

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10 DOWNING STREET

D/N		JD
CS,	HMT	D/M
PGO		DES
MOD		D/IND
DOE		HMT
NIO		FCO
CDL		HO
TRANSPORT		CO
TRADE		
MAFF		

*From the Private Secretary*

5 April, 1982.

*Dear Neil,*

System X

The Prime Minister has seen your Minister's minute of 30 March about the latest developments over System X.

The Prime Minister would be grateful if Industry Ministers would bring this matter for discussion at an early meeting of E(TP). The Prime Minister recognises that given the pressures of time this week, and absences next week, this meeting will be some weeks away.

I am sending copies of this letter to the Private Secretaries to the Members of E, and to David Wright (Cabinet Office).

*Yours sincerely,*

*Michael Scholar*

---

Neil McMillan, Esq.,  
Department of Industry.

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WJSV

2

Prime Minister

rus 6/4

*[Handwritten signature]*

PRIME MINISTER

SYSTEM X STRATEGY

*[Handwritten signature]*

I have seen Kenneth Baker's minute to you of 30 March recommending the adoption of Plessey as lead company for System X development and supply at home and overseas.

I agree that the current arrangements for marketing System X overseas are far from satisfactory and - while it raises a number of potentially serious problems - I consider his option (f) the most sensible of those presented to us. It is clearly vital that the situation be resolved without delay and I therefore endorse Kenneth's request for an early discussion.

I am copying this to members of E Committee and to Sir Robert Armstrong.

WJB

Department of Trade  
1 Victoria Street  
London, SW1H 0ET

WJB

5 April 1982

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CONFIDENTIAL

Prime Minister

(2)

I have already recorded  
your decision in this sense

MUS 5/4

5 April 1982

Qa 05880

To: PRIME MINISTER

From: JOHN SPARROW

*ms*

System X

*with MCS*

1. I have read Kenneth Baker's minute to you dated 30 March. I agree with the two general arguments underlying his minute: first, that for System X to be sold successfully abroad, we need a more authoritative marketing agency than BTS; and second, that for System X to be a satisfactory product, both for BT and in overseas markets, action must be taken to reduce its unit manufacturing costs. But I have grave doubts as to whether effectively selecting Plessey as the sole supplier is the appropriate solution. As well as sharing Kenneth Baker's reservations about the management of Plessey, I would expect strong and public protest both from STC and GEC and this itself cannot help the prospects for System X.

2. Any solution will depend for its success on acquiescence, however grudging, from the three major suppliers, and continued support from BT's Research Station at Martlesham, at least in the short term. The problem is to find a sufficient lever to achieve this acquiescence - and given such a lever, some version of options (c) and (d), merging the export and manufacturing interests, looks the most attractive, as Kenneth Baker implies.

3. These issues need exploring more fully and have clearly needed a full paper for some time. Plessey claim to want an urgent decision because of a planned acquisition. But it would be unwise to rush this decision, or indeed to take any irrevocable steps in the home market without being sure to accompany them with better export arrangements than exist at present.

4. Before a decision is put to Ministers I should like to see the following questions explored more fully:



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- what part does the Government need to play in improving the export prospects for System X;
- what should be the role of British Telecoms (including its Martlesham Research Station) in restructuring the telecommunications supplying industry.

5. Perhaps a paper could be prepared by the Official Committee on Telecommunications Policy (TPO) for Ministerial consideration. This may take a little time, but should come before the Ministerial Committee, E(TP), as soon as possible.

6. I am sending a copy of this minute to the members of E Committee and to Sir Robert Armstrong.

*Jan Sparrow*

CONQUEROR