

CCBB
B/UP



COMMERCIAL IN CONFIDENCE

P 02108

PRIME MINISTER

MS

Flotation of Royal Ordnance plc
(ad hoc Meeting at 10.45 am on Tuesday, 17 June)

CONCLUSIONS

You will wish to decide:

- (a) whether, in view of the further considerations set out in the Defence Secretary's minute of 13 June, the flotation of Royal Ordnance (RO) plc should still proceed (the original date was 16 July; the Chancellor of the Exchequer has now found a further 6 days;
- (b) if not, what alternative course should be pursued;
- (c) how either of the above decisions, or any variant, should be publicly presented.

MAIN ISSUES

- 2. Mr Younger's minute of 13 June does not add a great deal to the earlier papers, although it clarifies some of the previous points in dispute. In sum, he still on balance favours flotation this summer; but is ready to pursue his recommended alternative option of placing a non-competitive contract with RO and seeking to sell the RO factories at Leeds and Nottingham to Vickers, if colleagues so wish.
- 3. The one constant in the argument seems to be that flotation this summer is simply not possible unless the seventh Challenger order is placed with RO on a non-competitive basis. The key prior issue for Ministers, therefore, is whether the Government

could defend such an award.

4. The main arguments advanced for it - apart, of course, from the fact that it is a necessary condition of early flotation - are:-

(i) it would give a keen price and good value for money. This may be so. But it cannot be proved without a competition. Nor is the fact that it is 10 per cent below a previously high price necessarily very meaningful. That previous price reflected high overheads; and according to the DTI Vickers have already undertaken that they can match the Leeds price for 20 of the tanks; if they had the whole order they might quote lower;

(ii) going out to competition would cause serious delay. It is certainly ~~true~~ that there would be some delay - paragraph 6 of the paper with Mr Younger's letter says that if a competition were initiated now a contract could not be awarded for 6 months at best. But some delay may have to be the price of sticking to the (now) much vaunted MOD principle of competitive procurement; and there is some reason to believe that, if given the opportunity, Vickers could accelerate the process;

(iii) unless RO get the order, Vickers will not be given the intellectual property rights (IPR) necessary for execution of their ARRIV contract. This seems to be a disreputable argument. As paragraph 10 of the MOD note (last sentence) euphemistically acknowledges, RO should never have been given this hold over Vickers in the first place. It seems extraordinary to have given the ARRIV contract to Vickers a year ago, and then to have vested in their competitor, RO, vital IPR necessary for the execution of that contract. Given the general view that the senior management of the RO is incompetent, dismissal by the Defence Secretary should surely not be ruled out in the last resort if RO refused to release these rights.

5. The case for awarding the Challenger contract non-competitively to RO is, therefore, at best open to question for the reasons summarised above. A further weighty - perhaps the key - consideration is, of course, whether the Government could stand the criticism in Parliament and elsewhere if it did go ahead on a non competitive basis. We are assured that Vickers would strongly contest the decision, possibly in the courts. The trailers in yesterday's Sunday Times suggest that they are limbering up to do so. I understand that the Attorney General is likely to advise that awarding the contract non-competitively prior to flotation would not necessarily be illegal. I think, however, that this is on the assumption that the Ministry of Defence could convince the courts that their action was fully justified (on grounds of cost, efficiency etc). But the issue seems to be primarily a political one. Could the Government afford to be caught up in another row involving the MOD, DTI and a medium sized defence contractor? You will wish to have your colleagues' further views on this. As for the legal aspect, the sorry IPR story could add to the problems and to the Government's discomfiture, especially since we are told that Vickers would challenge certain aspects of this in the courts.

Alternative Options

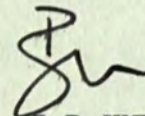
6. If you decide that, in view of the above considerations, flotation next month is still not feasible, you will want the meeting to consider the alternatives. I suggest that this should only be a preliminary discussion. Mr Younger's minute assumes that there is only one viable alternative - placing a non-competitive contract for the Challengers with RO on the terms already negotiated and seeking to sell the Leeds and Nottingham RO factories to Vickers on that basis. This may be so, but there may be other options at least worth some further consideration. Some of these were set out very briefly in the attachment to the letter from the Defence Secretary's office of 11 June (ie keep RO intact and float later, sell the whole company to a private buyer, and sell off in bits). You may think that before any final decisions are taken, these ought to be explored more fully, perhaps on the

basis of a fuller paper by MOD in consultation with DTI and the Treasury.

7. It is true, of course, that if flotation does not go forward next month, MOD will be left with an inefficient dependant with a continuing drain on public funds. But in this situation hand wringing alone is no good; MOD must make even greater efforts to improve efficiency and performance at RO until it can be floated or otherwise disposed of later. A further paper by MOD on alternative options should cover this also.

HANDLING

8. You will wish to invite the Secretary of State for Defence to speak to his minute of 13 June, and the Chancellor of the Exchequer to add any further comments on the prospective flotation. The Secretary of State for Trade and Industry will wish to speak on Vickers and on competition policy generally; and you will no doubt wish to invite the Lord President of the Council and the Chancellor of the Duchy of Lancaster to say whether the Defence Secretary's new note has changed their views on the politics of what is proposed.


J B UNWIN