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CEB/S
B/W



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB

Telephone 01-930 7022

16th June 1986

Dear David,

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ROYAL ORDNANCE

The Prime Minister asked for material to illustrate the way in which either a decision to proceed with flotation, or a decision to cancel flotation and proceed with the alternative route discussed in Mr Younger's minute of 13th June, might best be presented publicly. This is attached.

I am copying this letter to the Private Secretaries to the Lord President, the Chancellor of the Exchequer, the Chancellor of the Duchy of Lancaster, the Secretary of State for Trade and Industry, the Attorney General and Sir Robert Armstrong.

Yours sincerely,
John Howe.

(J F HOWE)

David Norgrove Esq
10 Downing Street

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ARGUMENTS TO USE IF FLOTATION GOES AHEAD

1. General. Royal Ordnance plc is a commercial company which belongs in the private sector. It needs to become more efficient and this can best be achieved through the application of commercial disciplines, free from public sector constraints.
2. Timing. The sooner commercial disciplines begin to bite the better.
3. CHALLENGER. All previous orders have been with Royal Ordnance. The terms we have obtained in negotiating a non-competitive contract with Royal Ordnance provide excellent value for money. We have agreed a keen price not only for the 7th Regiment but also for the 5th and 6th Regiments, together with satisfactory delivery dates.
4. Lack of Competition. Competition only one way of achieving value for money. In this case we believe we have achieved value for money without competition. Competition now would lose the terms we have negotiated with Royal Ordnance.
5. Legality. No impediment to non-competitive contract either generally or in context of flotation. Prospectus will make clear that contract has been awarded non-competitively.

6. Vickers.

a. Recognise their disappointment and concern. Hope they will discuss with privatised Royal Ordnance possibility for rationalisation of UK tank manufacturing capability.

b. If Vickers consider the Scheme which vested assets in Royal Ordnance damaged their interests they can have recourse to HMG under the Ordnance Factory and Military Services Act.

7. Featherbedding RO. Royal Ordnance is in transition between Trading Fund status and commercial viability. Necessarily the full impact of competition policy has to be staged so that it becomes the efficient contractor that we wish to see.

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ARGUMENTS TO USE IF FLOTATION IS CANCELLED

1. General. Flotation in 1986 was an ambitious target which presented a major challenge to the Company and to HMG. In the event we have decided that although Royal Ordnance has made substantial progress in the process of transforming itself into a fully fledged commercial entity, this has not been taken for enough to provide the basis for a successful flotation, which will secure a satisfactory return for the taxpayer.

2. Way Ahead. We have always recognised and made clear that there is more than one approach to privatisation of Royal Ordnance. We have now decided that a direct sale of the Company's tank factory at Leeds and possibly the whole of its Weapons and Fighting Vehicles Division will be a sensible first step towards privatisation. We shall be seeking bids from Vickers [and other manufacturers of Armoured Fighting Vehicles] to this end. Options for the privatisation of the rest of Royal Ordnance will be considered further, with flotation as a residual whole a possibility. This approach will secure greater rationalisation of the UK's Armoured Fighting Vehicle manufacturing capability and strengthen our ability to compete and collaborate internationally

3. Lack of Competition. Competition only one way of achieving value for money. In this case we believe we have achieved value for money without competition. Competition now would lose the terms we have negotiated with Royal Ordnance.

4. Giving in to Vickers' pressure. Not at all. The CHALLENGER contract will be placed with Royal Ordnance but Vickers [and other companies] will have the chance to bid for the purchase of Leeds plus CHALLENGER contract. If they succeed they can determine on commercial grounds the division of work between Leeds and Newcastle. Our approach secures value for money in tank procurement and promotes industrial rationalisation.