

PRIME MINISTER

RO plc

Papers:

- A Cabinet Office brief
- B Note on how a decision either way might be presented
- C Minute from the Solicitor General on the legal issues
- D Minute by Mr. Tebbit
- E Articles from the Sunday Times
- F Note by the Policy Unit
- G Minute by Mr. Younger
- H Internal DTI briefing
- I Note by MOD on alternatives to flotation

If the decision goes against flotation it will be important to decide what is said about the next steps. Mr. Unwin proposes a full paper followed by discussion. The MOD (Flag B) assume that the Challenger contract would be placed with RO but Vickers and possibly other companies would have the chance to buy Leeds plus the Challenger contract.

Whatever the next steps MOD will still need to be able to say, possibly by 20 June, what is to happen on the ARRV contract. The Government risks looking incompetent if there is a row later in the month about the ARRV, and MOD's blunder catches the headlines. (The present RO management, deprived of the higher salaries and share options likely to follow privatisation and with the task possibly of breaking up their company, will not be disposed to help solve the problem of the IPR necessary for Vickers to build the ARRV. Mr. Younger may need to talk persuasively to Lord King.)

DN

16 June 1986

he will be marketing head of transport and financial services, the fastest expanding part of the £350m company. At BA, Jewson had led a team to change the flag carrier's image in the eyes of the British travel industry and was closely identified with the new marketing strategy of Colin Marshall, the airline's chief executive. In this role, he had close contact with his new employer, which is BA's second

quits

biggest business travel agency. BA and Jewson yesterday denied suggestions that Jewson's departure was linked to reports of discontent among senior managers over the airline's strategy, as privatisation slips further into the future. There is also said to have been disappointment at the

along," he says. The responsibilities, particularly in the new financial services sector at Hogg Robinson, are far wider than those at BA, he says. Jewson left BA immediately on handing in his resignation 10 days ago. He was last week being entertained at Royal Ascot by his new employers, although his official starting date is said to be early next month.

Ian Williams

table, to be published this week. Coopers' fee income reached nearly £120m last year, and the table is expected to show a £6m lead over Peat Marwick Mitchell. Traditionally all accountants publish their figures together, but this year's league will attract more interest than ever because of growing competition and the moves by accountants into new business areas, such as consultancy.

over last year. The biggest growth area, up by a third, was in consultancy, which now accounts for more than a quarter of income. The company has almost doubled its income since 1983, when Brandon Gough took over as senior partner. The table is also expected to show that another two accountants join Coopers and Peat Marwick with incomes of over £100m for the first time - third place Price Waterhouse, with around £109m, and Deloitte Haskins

£80m. Gough now intends to step up his campaign for a bigger role for auditors in finding fraud and helping regulate the City. "The accountancy profession has appeared rather negative," he says. "We will putting on the pressure to see improvements. I can see no one else who is going to help," he adds. "We believe we can make more use of the auditors' knowledge and experience."

Jet power game gives Mrs T a hands-off test

THE PRIME minister was emphatic last week that British Airways is to be allowed to make a decision on merit about which manufacturer's jet engines it would buy to power its next generation of Boeing 747s.

This is exactly what one would expect the prime minister to say. One of the best reasons for privatising state industries is to remove their decision-making sufficiently far from political interference. It is a particularly sensitive point with BA, for British state airlines have lived under a constant regime of interference - to such an extent that when one aviation minister was foolish enough to claim he would not interfere with the old BOAC airline's decision-making, its chairman had his words framed and mounted on his office wall. To no effect, of course.

But as anyone who has been involved with this sort of process knows, these distortions are invariably damaging. Not just to the buyer but often to the supplier and frequently the national economy.

When British European Airways was told to buy its new short-haul jets from Hawker Siddeley, the airline, in a sullen mood, insisted that the design was too large. It would place the order only if Hawker scaled the size down. So the Trident aircraft, originally conceived to the same dimensions as the Boeing 727 (which was to become one of the world's best-selling jets), was shrunk to a size that made it unappealing to most other airlines.

Shortly after ordering it, BEA decided that it was indeed too small. Unfortunately, as the size had shrunk, Rolls-Royce had dropped a plan to build an engine, the Medway, that would have powered the super Trident, and instead decided to make do with the smaller Spey. If you have ever wondered why the final stretched version of the Trident had to have an extra fourth boost engine in the tail for take-off, this is the reason.

To avoid this sort of mess, it would be a good thing if the prime minister stuck to her word and let BA take its pick of the offerings



COMMENT
Roger Eglin
BUSINESS NEWS
EDITOR

from General Electric and Pratt & Whitney in America and Rolls-Royce. Of course it would be a tremendous boost to the forthcoming privatisation of RR if it could fold orders from BA worth well over £1 billion during the rest of this century into its sale prospectus.

Yet though such an order would look good, this is a short-term view. If Rolls needs this sort of help now to beat off P&W and GE, what sort of faith can shareholders be expected to have in its prospects? After privatisation, when Rolls comes up against its American rivals, and this applies to most of the big contracts, there will be no kindly government minder.

The signs are that Rolls can look after itself. Its chairman, Sir

Francis Tombs, is happy to compete on merit. Earlier this month he demonstrated this by winning a £350m launching order for the engine now in question - the latest version of the RB211, the D4D - from Cathay Pacific. The Hong Kong based airline is already a big RR customer, but for its new-generation Boeing 747-400s Cathay could have switched to one of the American suppliers. That it did not is the sort of open-market testimony Rolls needs.

In the contest for the BA order, Rolls has an each-way bet, for it has a 15% share in the GE engine, a share that will one day rise to 25%. The point of this link was that, faced with a number of costly engine projects to back, Rolls decided to make the best of its resources by throwing in its lot with GE on the really big engines.

But in the meantime the RB211 goes from strength to strength. At relatively modest cost, Rolls claims it can power all foreseeable developments of the 747-400, which looks like becoming the main 747 for the 1990s. Providing

P&W doesn't get the order, Rolls does not lose completely.

Yet who started the leak, which certainly seems premature, that BA was about to buy from GE? Well, who most opposes privatisation, would be happy to embarrass Mrs Thatcher and believes that Rolls should get the order quite irrespective of whether its engines are the best? It does not seem coincidental that last week the unions began campaigning against the privatisation of Rolls and that there are those who would happily stop the sale of both Rolls and BA.

But what will happen to Mrs Thatcher's convictions if it looks as if the order might actually be going to GE? I leave you with the example of ROFs, a story spelled out in this week's Business News. Royal Ordnance seemed too commercially unappetising to privatise. So what has the government done but awarded it a £100m tank contract without so much as a pretence of competition. What was that about politicians not interfering?

For a copy
Conder Pro
Name
Company
Address

**CON
PRO
Build**

IPLEXIUS
SIMULTANEOUS COMPUTING
• TEL: SWINDON 0793 614110 •



War over £100m tank deal

by Philip Beresford



Angry: Plastow

THE impending privatisation of Royal Ordnance, the Ministry of Defence's bomb and bullet maker, is threatened by a damaging row over competition in defence procurement.

Private-sector defence contractors are furious that Royal Ordnance is to be awarded a £100m order for 76 Challenger tanks without any competition — an order that would make it more attractive for investors.

Sir David Plastow, Vickers chief executive, says: "If the order goes to Royal Ordnance, that will be totally indefensible. The government has given a positive commitment to competitive tendering. They can't have their cake and eat it too."

Vickers will fight hard. It can point to a recent government decision to award an order for a naval supply vessel to Harland & Wolff of Belfast in preference to Swan Hunter on the Tyne after competitive tendering. That cost Swan Hunter 825 jobs.

The Challenger contract, to equip a seventh regiment in Germany, is likely to be announced at the opening of the British Army Equipment Exhibition at Aldershot next Sunday.

The flotation of Royal Ordnance, by which the government hopes to raise £150m, is scheduled for the second half of July. Royal Ordnance executives and their City advisers, Cazenove and Kleinwort Grieveson, have been working round the clock to meet this deadline, imposed at the insistence of the prime minister.

For privatisation to be a success, the City sees the Challenger order as vital. The order book of the Leeds Royal Ordnance factory, where the Challenger is built,

would otherwise be empty at the end of next year. Of the 300 Challengers ordered hitherto, the factory has already produced 200.

Equipping the seventh regiment would provide nearly a year's extra work, giving Leeds more time to diversify into new products such as bridge-laying vehicles.

The latest order is seen as a "big chunk of business, which if it went elsewhere would mean having to close Leeds, if a purely commercial decision was taken", according to one City observer.

He says: "It is generally agreed in the City that Royal Ordnance is being sold a bit early. It has not had that long as a commercial organisation. All the management can do in the prospectus is point out that progress is going in the right direction."

The 1985 accounts, to be published next week, will show profits of around £25m against a £31m loss for the nine months to the end of December 1984.

Vickers is keen to win the Challenger order for its new tank factory at Newcastle upon Tyne, where unemployment is well over 20%.

The orders war, page 63

insists on right to contract

Fitch: 'clear conflict of interest'

collaborator and see how Terence expect to work for the firm, for e with which he to go into if he expects at me to do stundesign work by and privy to the confidences and client. I regard mazing naivety."

is a conflict of interest but, they argue, such conflicts are inherent in the retail trade and had already been recognised and reconciled in the run-up to Burton's bid for Debenhams.

There is also puzzlement as to why Halpern's board seems to think that it is all right for Conran to design the Burton shops — which are in intense competition with BHS for tailoring — but not to redesign Debenhams.

Halpern believes that comparison is spurious. "How can I give the BHS

chairman the design contract for a competitive group of stores in the same high street marketplace — particularly since Debenhams and BHS are both large-scale retailers searching for a successful new identity?"

Halpern outlined his proposals in a letter to Conran, but has received a dusty response.

The Storehouse argument is likely to be that Halpern has clear obligations to Conran and that Burton should state whether it intends to honour them.

'd sell-off'

Suresh Karadia

Breakfast glamour

BREAKFAST television TV-am is to be promoted as a "glamour stock" when it goes public on the USM next month, and is likely to be valued at well over £50m.

Forecast growth prospects for the company will aim to highlight the difference in potential earnings between



On track in the orders war

Mark Ellidge

● Britain's tank industry rumbles on. PHILIP BERESFORD finds Vickers is still in the field with guns blazing

SPORTS Tank may sound a contradiction in terms, but this combination of streamlined agility and solid mass is the impression given to one observer by the speed and acceleration of the 45mph Vickers Mark 5 tank.

Due to be unveiled next week at the British Army Equipment Exhibition, the Mark 5 packs the punch of a heavyweight with its 105mm gun. Yet it is a mere stripling by tank standards, at under 20 tonnes, half the weight of a conventional tank.

For Vickers, the Mark 5 is the culmination of a long campaign to strengthen its defence systems business. Today it is best known for its Rolls-Royce car business, which accounted for a third of group profits of £45m last year. In the same period the defence business produced £6.2m profit on a turnover of £69.5m.

Seventy years ago, Vickers built the first tanks for the British Army. The Spitfire and Wellington bomber were Vickers' second world war winners. War was a profitable business, which led to a famous stock market report in 1945: "Vickers fell on fears of peace."

The centre of the Vickers arms empire was Newcastle upon Tyne, where 75,000 people were employed along the Scotswood Road in 1918. Today, Vickers Defence Systems is still there, busy churning out tanks for armies round the world — but in very different conditions.

A new £7.5m purpose built factory was opened in 1982 on the banks of the Tyne, to replace 29 old and inefficient buildings. Overheads were slashed by 40%, while the



Setting their sights: Vickers' Denis Durling (left) and FMC's Bob Douglas sample the new generation Mark 5

workforce shrank from 1250 to 750. Since moving, Vickers has been trying to "change traditional attitudes" according to Denis Durling, operations director at the plant.

For one thing, out went seven "caste" canteens (with strict segregation of directors, secretaries and blue collar staff) to be replaced by a single staff cafeteria.

Flexibility between the traditional trades was a rarity in the hard-bitten industrial world of the North East, but Durling is trying to break down demarcation lines between fitters and electricians or fabricators and welders.

The revamp cut Vickers' cost base dramatically. "The new plant can make a profit on a very small number of vehicles," says Sir David Plastow, Vickers chief executive. Durling estimates that he can break even by

building one or two tanks a month. Many of the large machine tools in the enormous factory (the largest in Europe under a single roof) can easily be moved to suit the widely differing orders from round the world.

The changes came just in time. Durling reckons that had Vickers not made the move when it did, "I doubt we'd still be in business."

The cosy days where the Ministry of Defence would phone up to order 1,000 Centurion tanks on a non-competitive contract have long gone. Vickers now has to fight hard for any domestic orders, and these are few and far between as the Army shrinks in either size or budget.

Last year Vickers chalked up a coup when it won a £60m order for Challenger armoured recovery tanks

from the MoD against stiff competition from Royal Ordnance.

But it is the export market where Vickers has scored heavily in recent years. Despite third world debt problems and competition from an expanding band of tank manufacturers, Vickers has more than held its own. "We export 95% of our output and there hasn't been a single year when we've not made a profit," says Brian Truman, Defence Systems' marketing manager.

The Nigerian army has been equipped with a brigade of Vickers Mark 3 tanks, while Durling is hoping for a large order for an African country, which should provide at least three years' work.

A whole range of tanks and armoured cars has been developed, frequently with

overseas collaborators. Turrets for both tanks and cars are also part of the projects.

The Brazilians, West Germans, Americans and even the Chinese are partners for one or more Vickers vehicles. It is an American company, the FMC Corporation, which has partnered Vickers in developing the Mark 5.

FMC, one of the largest armoured vehicle builders in the west, recognised that the small orders for 25-50 vehicles, such as those likely to come for the Mark 5 from Far Eastern or Arab customers, would be impossible to build economically on its huge production lines. So it came to Vickers, which can build these small batches cheaply and quickly.

Vickers has also proved its ability to handle any job by developing the prototype for the "sports tank" in a record 11 months.



CCBJOP

CONFIDENTIAL
COMMERCIAL-IN-CONFIDENCE

P 02104

From: J B UNWIN
13 June 1986

Prime Minister

*The Q and A briefing
below is well worth reading.*

MR NORNGROVE

ROYAL ORDNANCE FLOTATION

*DNW
13/6.*

You may like to have at hand the attached notes that I have obtained (since yesterday's meeting) from the DTI.

2. No doubt they also simplify the issues in some respects, but they clearly establish that, if MOD wanted to, it would be possible to go out to open competition for the Challenger order. You will note that the armoured recovery vehicle which Vickers are making already has the same hull as the complete tank.

3. I very much agree also with the comment in these notes on the IPRs. Apart from the fact that it is arguable that the IPRs derived from the Vickers 1960 design of the Chieftan tank in the first place, MOD should never have assigned the IPRs to the ROF with the result of giving the latter in effect a veto on Vickers completion of the armoured recovery vehicle contract.

J B Unwin
J B UNWIN

1426

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE



TO: PS/Mr Morrison

cc PS/Secretary of State
PS/Mr Pattie
PS/Sir B Hayes
Mr Mountfield
Mr Treadgold
Mr Cochlin
Mr Simpson NERO

FROM: Richard Brown
V1
Room 271
Ashdown House
212-6598
12 June 1986

0721

ROYAL ORDNANCE FLOTATION

I attach briefing in the form of issues and answers to the letters of 11 June from APS/Secretary of State Defence to No 10.

A handwritten signature in cursive script that reads "Richard Brown".

RICHARD BROWN

Mr Morrison

To see

*JPCW
12/6*



ORDER FOR 7th CHALLENGER REGIMENT

Q Competition for 7th Regiment would result in unacceptable 12 month delay while data package produced.

A No. There may be 10,000 detailed drawings, but for a tender Vickers only need 500-600 "assembly drawings". They already have 2-300 as they won the competition against Leeds for the Challenger armoured recovery vehicle which has the same hull as the complete tank.

Certain items (gun, armour) have prices which are given, so there is no tender and the turret itself was developed from a Vickers design in the first place. Vickers have assembled an 80% quote already and think that additional drawings from Leeds could issue within 1 month.

Q ROF price is good in any case.

A You will never know how good without competition. It is 10% below a previously high price which reflects excessive overheads. Vickers have already committed to MOD(MGO) that they will match the Leeds price for just 20 of the 90 vehicles. If they had the whole order they might well quote lower. Remember that they won the ARRV order against Leeds.

The prices for the 5th & 6th Regiments would be higher though, if the order went to Vickers for the 7th.

Q Leeds own the intellectual property rights (IPR) on ARRV but would do a deal if they got the 7th Regiment order.

A This would be to compound one felony with another. Leeds should never have been given the IPRs by MOD in the first place and Vickers could have a legal claim against them. To do a deal with ROFs to escape from past errors is corrupt. To justify non competitive tendering on this basis is unacceptable.

Q The City would support non competitive tendering.

A Of course they would. But the Government has a wider public duty and will have to defend its decision publicly.

All of these issues would be solved if Vickers bought ROF Leeds.



ALTERNATIVES TO FLOTATION

DETATCH LEEDS

Q Feasible within 6 months.

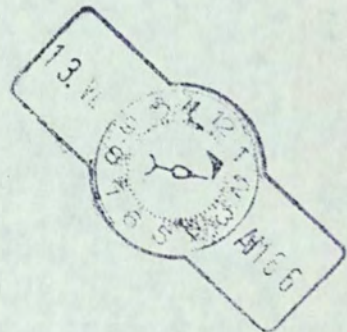
A Vickers prepared to make indicative offer within 1 month of receipt of financial information.

Other complications ?

- Redundancy costs would have to be worked out under flotation, continuation or Vickers sale; the same applies to pensions.
- the interrelationship between the various parts of the business should not be overstated; Vickers already market ROF made ammunition on an arms length basis.

Q The remainder of ROF would have to be regrouped and need a 2 year track record before it could be privatised.

A Why 2 years? It has no adequate profit track record at present. The major problem area is Leeds; this is where the overhead cost structure is excessive and redundancies needed; it is the low tech end of the business and ^{has} no long term future. Get rid of the millstone and the higher tech and more profitable areas of explosives, rocket launches etc would be much more attractive to the market generating a higher price and a smoother sale. Management, under Ministerial pressure, with Leeds and Nottingham removed, and with a more realistic privatisation objective in their sights could surely be motivated.



CC BCG
STOP.

MO 10/4V

PRIME MINISTERFLOTATION OF ROYAL ORDNANCE PLC

1. At our meeting yesterday reservations were expressed by you and a number of colleagues about my proposal to place with Royal Ordnance plc in the context of flotation a non-competitive order for a Seventh Regiment of Challenger tanks. You gave me the opportunity to come back to you on this issue with further advice. Nigel Lawson has agreed that Impact Day for flotation could be deferred by six days, so we have a little extra time to reach a final decision.

2. I attach a paper which draws together the factors relevant to reaching a decision on this order. My assessment is set out below.

3. Ministers decided last summer, against the advice of Defence Ministers, to privatise Royal Ordnance this July. We were subsequently advised by Rothschilds that flotation could not be achieved without an order in place for additional



Challengers. It was by then too late to hold a competition, since the result would not have been known in time to allow flotation. It therefore became inevitable that to meet flotation in July a non-competitive contract would have to be placed and the Chairman of Royal Ordnance was informed last October that he would receive such an order provided he could offer a good price and there was no other obstacle to flotation.

4. The terms we have negotiated with Royal Ordnance do, I believe, represent good value for money and I am anxious not to lose this advantage. I do, of course, recognise that the decision can be criticised and that Vickers in particular can be expected to make vociferous complaints. I do not, however, consider that to hold a competition at this stage represents a viable option. Nor is there any other order that I feel able to offer to Vickers on a non-competitive basis by way of compensation. If colleagues decide that the Vickers dimension of what I have proposed is not tolerable, the right way forward would, I believe, be to cancel flotation, place a non-competitive contract with Royal Ordnance on the terms negotiated and seek to sell the Royal Ordnance factories at Leeds and Nottingham to Vickers on that basis. This would preserve the advantages of the negotiated terms, leave it to Vickers to decide on a commercial basis the division of work between Leeds and Newcastle and directly promote the rationalisation of the UK tank manufacturing capability.



5. It needs to be remembered that Leeds and Nottingham are only two out of 16 Royal Ordnance factories, with at present no more than 15% of the total labour force and 20% of Company turnover. Sale of Leeds and Nottingham to Vickers would, therefore, leave us with the problem of what to do with the bulk of Royal Ordnance. Various options exist, but the front runner at present appears to be flotation of the residue once it has regrouped and established itself; this might not, however, be within the life of the present Parliament.

6. The arguments are finely balanced and need to be considered in the context of the broader issues addressed in David Trefgarne's minute of ¹⁰8th June. I am reluctant to give up the prospect of flotation this summer with all the manifest advantages it brings of putting Royal Ordnance in the private sector, where it belongs and will be under more effective pressure to become the efficient Company we wish to see. But I would be content to pursue the alternative option if colleagues wished.

7. I am sending copies of this minute and attachment 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 to Sir Robert Armstrong.

Ministry of Defence
13th June 1986

R. Trefgarne

Approved by the Secretary of State
and signed in his absence.



MO 10/4L

ROYAL ORDNANCE PLC AND VICKERSSeventh Challenger Regiment

1. The fundamental objective of our procurement policy is to secure value for money. To achieve this, competition will be applied wherever it is practicable and reasonable.

2. Until March 1984, while the ROFs were part of the Ministry of Defence, a 'preferred source' policy operated, under which orders for 262 Challenger tanks were placed. Subsequently non-competitive orders for a total of a further 82 tanks were placed on Royal Ordnance in June 1984 and June 1985. RO Leeds has a capacity to produce 120 tanks p.a.: on current plans the production rate will reduce to 44 p.a. and delivery of the 6th Regiment will be complete in July 1988. No significant work other than the 7th Regiment is thereafter in prospect.

3. Vickers, Newcastle, currently has the capability to build tanks at 40-50 p.a.. It has not hitherto manufactured Challenger.

4. There is a clear operational requirement for a 7th Challenger Regiment in BAOR. The case for going to competition between Royal Ordnance and Vickers was considered last autumn.



We were advised that it was essential for flotation of Royal Ordnance that the order should go to Leeds. Since the result of a competition was not expected to be available in time to allow final decisions on the planned flotation, it was decided to plan on a non-competitive order with Royal Ordnance.

5. The contractual terms agreed on this basis with Royal Ordnance:

- a. give a very keen price for the 7th Regiment (10% lower in real terms than previous orders);
- b. place a 'cap' on the price of the 5th and 6th Regiments;
- c. provide acceptable delivery rates;
- d. resolve the Challenger ARR V IPR problem (see 10-12 below).

6. If a competition were initiated now a contract could not be awarded for 6 months at best, assuming a very rapid response from Vickers and accelerated approval procedures within MOD. The implications of holding a competition now for the 7th Regiment would be:



- a. flotation could not take place as planned;
- b. a trough in production at Leeds would occur, leading to the certainty of extra costs and the possibility of major redundancies.
- c. the 'cap' on the price of the 5th and 6th Regiments would be lost and we would have to pay much of the increased overheads arising from b.
- d. delivery to BAOR of the 7th Regiment would be deferred and of the 5th and 6th Regiments disrupted.
- e. the agreed solution of the ARRV IPR problem would cease to be available.
- f. the lead time would be too long to help Vickers over what we understand to be an essentially short term difficulty.

Without holding a competition it is not possible to be certain that Vickers could not offer us a better price for a 7th Regiment. Their price would have to reflect the initial costs of producing a new type of equipment including the establishment (to meet the terms of an MOU with the US authorities) of a secure facility to assemble and fit Chobham armour, although the



pressure on them might be such that they would treat this as a "loss leader". But that would still leave us with the problems at b. c. d. and e. above. Competition at this stage would therefore almost certainly lead to extra cost and other problems for MOD, would not solve Vickers' problem and cannot really be a viable option.

7. An alternative proposition, which might meet Vickers' concerns, would be to seek rationalisation between Royal Ordnance and Vickers. Since without major export orders there will be no room for two UK tank manufacturers, rationalisation could well in any case take place in due course between Vickers and a privatised Royal Ordnance. We could, however, take positive steps towards this end by cancelling flotation and initiating negotiations with Vickers for the purchase of Leeds (and also probably RO Nottingham). In that case, unless the 7th Regiment order had been placed with Leeds and Vickers took it over, Vickers' negotiating position would be much too strong; and without it we should have lost the advantages of the negotiated contractual terms. Even with the contract in place, we could not expect Vickers to pay much, if anything, given the high costs of subsequently closing or running down Leeds (where employees are guaranteed Civil Service redundancy terms). If this approach were successful, we should need to give further consideration to options for handling the residue (some 80%) of Royal Ordnance.



Intellectual Property Rights (IPR)

8. To ensure Royal Ordnance's commercial viability and to facilitate privatisation, we sought to set the Company up as if it had been trading as a defence contractor for a period of years. We therefore vested Royal Ordnance with the IPR in the products manufactured by the ROFs on terms analogous to those that apply to all defence contractors under standard contract conditions. As a result we can mount a competition for the production of equipment in which Royal Ordnance own the IPR but not for the development of derivative equipment.

9. No IPR belonging to Vickers have been transferred to Royal Ordnance and the transfer of IPR to the Company was subject to the rights of third parties. The Ordnance Factories and Military Services Act provides for compensation to be paid by the MOD to third parties whose rights have been affected by the Scheme which transferred assets to Royal Ordnance.

Armoured Repair and Recovery Vehicle (ARRV)

10. A competition was set up in 1984 between the ROFs and Vickers for the development and initial production of a Challenger ARRV. At that time the IPR in Challenger were owned by MOD. The tenders were received in October 1984, and



awarded to Vickers in June 1985. By that time the IPR in Challenger had been vested in Royal Ordnance. Because of the terms under which MOD can use IPR (paragraph 8), the contract award to Vickers amounted to an infringement of Royal Ordnance's newly acquired rights. This was not appreciated at the time by MOD, and Royal Ordnance raised no objection until early 1986.

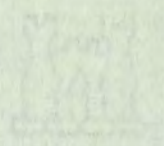
11. Notwithstanding the delay, Royal Ordnance's objection is considered valid. In order to secure redress they have declined to release the drawings necessary to enable Vickers to fulfil the terms of the ARR V contract. Vickers have now given us one further extension, until 20th June, to provide the drawings; otherwise they will feel entitled to renege on their contract (which is a good one for us). Royal Ordnance have agreed to release the drawings only if the contract for the 7th Challenger Regiment is placed with them. Separately as part of wider negotiations on the detailed arrangements for flotation, we have secured Royal Ordnance's agreement not to impede competitive procurement of subsequent ARR V requirements.

12. As sole shareholder the Secretary of State for Defence can make requests to the Directors of Royal Ordnance. The Directors have duties under the Companies Acts and general law to employees and creditors as well as to shareholders. So if they consider a request to be detrimental to the Company's interests, the Secretary of State cannot direct them to comply. His only



legal recourse is to dismiss the Directors and find compliant replacements who would take a different view.

CONQUEROR



cc B/UP

CONFIDENTIAL

PRIME MINISTER

13 June 1986

ROYAL ORDNANCE

Even though the Chancellor has been able to re-arrange things such that the RO float can be delayed by a week, it must still be considerably more risky to proceed now than it was last week. All the carefully laid timetable will need to be re-arranged and some elements, for example, the firepower demonstration for investors planned for next week will now have to take place before the RO 1985 accounts are published.

Selling the Leeds and Nottingham factories to Vickers would get over many of the difficulties: the Seventh Challenger Regiment could be ordered without competitive tender, without substantial delay, and without the threat of Leeds closing. If the order were given to Leeds prior to sale to Vickers then price-capping on the Fifth and Six Regiments could also be retained. In some respects this approach would give the MOD a better bargaining position because if Vickers failed to offer a satisfactory price then the MOD could threaten not to sell.

There is little interaction between Leeds and Nottingham and the rest of the RO so there should be little difficulty in detaching them. Indeed, because Leeds has had such a volatile performance record, separating it from the rest of the RO could actually improve the marketability of the residue, and without much need to regroup the RO or develop a new track record. Nevertheless politics and the absence of suitable slots are likely to make flotation impossible until beyond the next election.

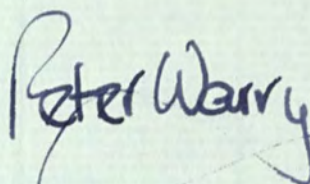
With Leeds and Nottingham sold to Vickers and perhaps some of the more attractive explosives interests sold to IMI/ICI (and even Enfield going as well), there will be an

CONFIDENTIAL

CONFIDENTIAL

unattractive rump. But often it is much easier to tackle the major industrial changes necessary in such a rump when its isolated, than when it can shelter behind the skirts of more profitable parts of an organisation

We believe that there is a good commercial case for selling off Leeds and Nottingham, for selling off other bits if buyers can be found, and then to concentrate on improving the rump.

A handwritten signature in blue ink that reads "Peter Warry". The signature is written in a cursive style with a long, sweeping underline that extends to the right.

PETER WARRY

PRIME MINISTER

RO PLC

Mr. Younger has asked for half an hour with you on Monday before the main meeting on Tuesday. He will bring with him the official who attended your last meeting (Mr. Nicholas Bevan).

Not to sell RO now would cause problems. The MOD aspects are set out in Mr. Younger's minute. After the postponement of BA it would also reinforce the impression that the privatisation programme was running into difficulties.

The question is whether those problems outweigh the opprobrium from selling the company on the back of a large non-competitive order which would look as if it damages a private sector company in the North East.

The decision is finely balanced, but my recommendation remains against going ahead.

DN

DAVID NORGROVE
13 JUNE 1986

There are three new notes
in this folder, all worth reading.
The last is some internal DTI
briefing.

DN

BM2AQY