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MO 26/16/1

11th April 1983

N. B. P. R.

A. J. C. 4/4

EH 101

Thank you for your letter of 24 March. I note what you say and am grateful for the approval you have given. My officials will keep yours closely informed of the progress of events on the Italian side.

I very much support Patrick Jenkin's comments in his letter of 30 March about the insufficiency of your figure of £26M as an offer for launch aid. There is inevitably interaction between the funding arrangements for the various elements of an integrated programme such as that proposed for EH101, and I fear that an unrealistically low offer of launch assistance on the commercial side could well lead Westlands to withdraw from the incentive contractual arrangements which we on the Defence side have been negotiating, with Treasury and DOI support, or to demand a higher safety factor by increasing the level of the target price. Since in the development phase the block of work covered by these incentive provisions includes the basic technology items common to all versions of the helicopter the loss of this spur to efficiency on the part of the company would in my view be detrimental to the Government's overall interests in the programme.

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The Rt Hon Leon Brittan QC MP

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I accept of course that what constitutes an appropriate level of launch assistance is primarily a matter for you and Patrick to decide. I simply wish to make the point that if we are not careful we shall find ourselves attempting to secure one advantage at the expense of another of equal or greater value: what we need is a reasonable overall balance.

I am copying this letter to the recipients of yours.

Yes Sir
[Handwritten signature]

Michael Heseltine

DEFENCE
Budget Pt 9.

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JF3114
Secretary of State for Industry

DEPARTMENT OF INDUSTRY
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30 March 1983

The Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

N. S. P. R.

A. J. C. $\frac{31}{3}$

P. C.

Dear Leon,

EH101 LAUNCH AID

I am glad to see from your letter of 24 March that you agree that the EH101 is a viable programme and that some launch aid is justified. Yet I am very disappointed to find that you have heavily discounted the arguments I advanced for a realistic opening offer to Westland.

2 Against the background of the Westland 30 launch aid arrangements I think you are being unrealistic in believing that Westland should be able to make do with £26m, ie 12.5% of their estimated costs. At the MISC 25 discussion last month the majority opinion, shared by the CPRS, was that we should aim to agree launch aid support in the region of 50-75% of that being sought by the company, and that our opening offer should be 50%. As Michael Heseltine has pointed out, under-financing the programme is the surest way of condemning the EH101 to failure, and, I think, of ensuring we do not get any return on the taxpayers' money.

3 In the meantime, we are losing valuable time and I have therefore instructed my officials to open negotiations with Westland to find out whether your figure of £26m is as you put it a feasible option. If not we shall need to get back to you very promptly, particularly since your fall-back proposition - that a 12.5% contribution towards the costs of this commercial programme entitles HMG to a five per cent real rate of return, but that a 25% contribution (ie £53m) demands a real return of ten per cent - will require careful consideration if we are not to find ourselves changing the nature of launch aid.

44 Meanwhile ...



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4 Meanwhile, in the light of paragraph 4 of your letter of 24 March to Michael Heseltine, I consider it appropriate to respond positively to a fresh invitation by my Italian counterpart, Signor Pandolfi, to visit Rome towards the end of next month to sign a conditional Memorandum of Understanding.

5 Although my Department has no PES provision for any new launch investment I will, of course, examine the extent to which it may prove possible to absorb the additional expenditure from my existing PES provision. But I am sure you will understand that, as we agreed at our PES bilateral last September, I must reserve the right to press for access to the Contingency Reserve if necessary when we see the outcome of negotiations with Westlands.

6 I am copying this letter to recipients of yours.

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Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
 Secretary of State
 Ministry of Defence
 Main Building
 Whitehall
 London SW1A 2HB

N. S. P. R

AR 25/3

24 March 1983

Michael,

THE EH101 MEDIUM HELICOPTER

Thank you for your letter dated 15 March. I have also seen, and will be responding to separately, Patrick Jenkin's of 11 March.

Your detailed explanation of the defence operational case for this helicopter was helpful. I note that there is provision in the Long Term Costings for the full, estimated, MOD development and production costs. However, this is a major new project, with significant industrial and international interest and a large degree of risk, financial and otherwise. I would have found a collective discussion, perhaps in OD, useful; but if the others to whom your letter was copied are content, we can try to cover the defence issues in correspondence.

My first comment is on cost. I note your assurances that all potential alternatives have been explored, but fall far short of the RN's needs in the critical and essential anti-submarine role. I note also that the defence costs would be significantly higher without collaboration and the contribution expected from civil programme. But £1,100 million at current prices is a very expensive way of acquiring just 50 helicopters, whatever their capability. Even at this early stage, development is forecast to cost as much as production. Last year's Defence White Paper (Cmd 8529) comments unfavourably on the fact that, in the UK, projects generally start with a production to development ratio of 3:1 or 4:1 but, as development progresses and unforeseen costs rise, the ratio deteriorates to around 2:1. A major project which starts development with a ratio of 1:1 requires very careful consideration. I am sure that it will be given plenty of public attention over its life.

You mentioned the Treasury's concern about the Italian position. Neither I nor Treasury officials found the Italian Prime Minister's

comments odd. Rather, they sounded like a prudently cautious extract from an official brief which advised Signor Fanfani that he could not guarantee acquiescence of the Italian Parliament. Nor am I surprised that the Italian Defence and Industry Ministers should have struck a more optimistic note than their colleague. My main concern is that no action should be taken that could have the effect of reducing the UK's room for manoeuvre, or increasing its potential liability, should the timetable slip further. If you and Patrick Jenkin are convinced that signing a conditional inter-DOI MOU would not carry such risks, as well as being advisable tactically, I would not object.

I note that you are seeking approval for the UK defence budget share of the programme cost only on the basis that all of the other participants - the Italian MOD, the two Departments of Industry and Westland and Agusta - can also proceed. On the assumption therefore that a satisfactory agreement can be reached with Patrick Jenkin and Westlands on civil launch aid, and that the other colleagues to whom you copied your letter have no comment, I would have no objections to your indicating to the Italians that the UK would be in a position to launch full development as soon as their procedures were complete. If any of the partners were unable to proceed we would certainly need to look again very closely at this project, and I welcome your assurance that you would return to me and colleagues with fresh proposals. There must also be a risk of substantial further slippage and I would hope that in such circumstances you would also keep the cost-effectiveness of your proposals under review.

I have instructed Treasury officials to give yours the conditional approval that you seek on the normal basis.

Copies of this letter go to the recipients of yours.



LEON BRITTAN

24 MAR 1983





Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Patrick Jenkin MP
Secretary of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

N. L. P. R.

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24 March 1983

P. Patrick,

EH 101 HELICOPTER PROGRAMME

Thank you for your letter of 11 March about the civil aspects of this programme. I have also seen and am replying separately to Michael Heseltine's letter of 15 March about the defence aspects.

I agree that this is a viable programme and some launch aid is justified but I believe that the negotiations should be within a lower range than the one that you propose. My agreement to some launch aid would be conditional on the money being found from within your existing PES provision. I could not accept a claim on the Central Contingency Reserve for the sums involved.

I have studied the attachment to your letter which argues that an agreement with the company should be reached at a figure between £53 million and £79 million. I believe that a sum of £26 million should be sufficient. It would involve breaches of the ratios that Westlands have set themselves as internal targets during some years but those ratios are ultra-cautious and the company's profit forecasts are similarly cautious. The company is in the risk business and should be prepared to accept some deterioration from the ideal for the prospect of large future profits.

For these reasons I think that Westlands should be satisfied with launch aid of £26 million which would mean that the company would not make any contribution towards the project until 1986. I believe that our negotiators should try very hard to achieve this figure. If, however, it proves impossible to reach agreement at this figure I would be prepared to accept some upward movement provided that the increase in aid was matched by an increase in the real return to the Government. The most that I could accept would be launch aid of £53 million accompanied by a 10 per cent real rate of return, but before doing so, I would need to be persuaded that a lower figure was not a feasible option. In any event the funds would have to be from within your existing PES provision.

I am copying this letter to the recipients of yours.

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Leon
LEON BRITTON

24 MAR 1968

