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DEFENCE COMMITTEE

19 February 1986

Dear Sir Brian,

I have delayed replying to your letter of 12 February attaching extracts from the documents of 4 and 18 October 1985 pending the Committee's consideration of those documents.

As I told your office earlier today the Committee this morning decided to publish the unclassified parts of the memoranda. I enclose a copy of the press release which was issued this afternoon. You will see that the Committee also re-published the summaries which you provided with your letter to me of 4 February.

The Committee have asked me to say that they believe that the documents speak for themselves, and that they will wish to make reference to these matters in their Report on their present inquiry.

Yours sincerely,
Robert Rogers

Robert Rogers
Clerk to the Committee

Sir Brian Hayes KCB
Permanent Secretary
Department of Trade & Industry
1 Victoria Street
SW1

cc. Sir Robert Armstrong
Sir Clive Whitmore
✓ Sir Antony Acland
→ Nigel Wicks
David Morris
Murdo MacLean



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DEFENCE COMMITTEE

INFORMATION FOR THE PRESS

At their meeting this morning the Defence Committee decided to publish the attached memoranda supplied on 12 February by Sir Brian Hayes, Permanent Secretary at the Department of Trade and Industry.

These memoranda consist of extensive extracts from the then Secretary of State for Trade and Industry's minute of 4 October 1985 to the Prime Minister about Westland plc, and from a letter sent by Mr Brittan's Private Secretary to Mr Heseltine's Private Secretary on 18 October 1985, reporting a discussion between Mr Brittan and Sir John Cuckney on 17 October 1985.

A small amount of classified information has been excluded from this published version.

These documents have been reported to the House.

Also attached are the summaries of these documents, which were submitted to the Committee by Sir Brian Hayes on 4 February.

19 February 1986

EXTRACTS FROM A MINUTE DATED 4 OCTOBER 1985 FROM MR LEON BRITTAN, THEN SECRETARY OF STATE FOR TRADE AND INDUSTRY, TO THE PRIME MINISTER

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BACKGROUND

2 Following the Price Waterhouse review of the company's position, Sir John Cuckney put to my Department and to the Ministry of Defence proposals for a financial reconstruction which he believed was an essential first step in a strategy for the company's future viability. The main features of this package were:

- (i) New capital to be raised for existing shareholders and a new large minority shareholder, possibly Sikorsky or a European company, with whom Westland are in discussion.
- (ii) Westland's banks to convert a substantial portion of overdraft into equity.
- (iii) The Government to underwrite 45 sales of the W30-160 helicopter in order to avoid a crippling write-off of inventory against shareholders' funds for the financial year ending 30 September 1985.



3 Officials have reviewed these proposals and the underlying financial position with Westland's staff and advisers. They have concluded:

- a) The proposed package would indeed provide a reasonable prospect of securing the company's viability in the medium term.
- b) At the other extreme, if no action is taken, receivership is likely to be unavoidable.
- c) It might be possible to construct an adequate package on the same basis as that proposed by the company, but involving a smaller number of W30-160 sales - perhaps only the 21 aircraft for the Indian Oil and Natural Gas Corporation (ONGC). This could only be substantiated, however, by discussion with the company's bankers. Annex A gives a summary of the company's financial position and the impact of a reconstruction package.

4 I do not believe that an underwriting of sales on the scale proposed by Westland would be justified. However I believe there may be a case, for the reasons set out below, for underwriting the sale of 21 helicopters if there remain good prospects of concluding the Indian order. If we decided to adopt this approach, I would envisage asking Westland to negotiate with their banks and potential partners on the assumption of firm sales of 21 W30-160s. I would say that if a reconstruction package could be put together on that basis, and if by the end of November discussions with the Indians were still in the Government's judgement active though unconcluded, the Government would be prepared to consider underwriting the sale of the 21 aircraft. However a final decision would only be made at the time in the light of an up-to-date assessment of the prospects of obtaining the ONGC order.



5 I believe Government participation in a reconstruction package should be conditional on the following assurances from Westland:

- that they would continue to participate in the EH101 programme.
- that the W30-300 programme would continue at least until the MOD's procurement timetable becomes clear in 1986.
- that they would continue to provide spares and support for the existing MOD helicopter fleet.
- that in the event of Government underwriting the company would continue to use its best endeavours to sell the aircraft.

POSSIBLE BENEFITS OF GOVERNMENT UNDERWRITING

6 I would not argue that supporting Westland should be a priority use of resources from a purely industrial point of view. Although Westland is the only UK helicopter manufacturer it is not central to the aerospace industry. Moreover, while other UK companies (notably Rolls Royce) have important business with Westland, my Department is not aware of any which is financially dependent on Westland's continued existence.

7 Nor is there a strong argument that the proposed package will improve the chances of my Department's launch aid being recovered. It would not of itself guarantee continuation of the W30-300 programme (on which £38m of the agreed £41m launch aid has been paid). That would still critically depend, I believe, on an MOD launch order. If the programme were terminated, even after a capital reconstruction, it seems unlikely that much of



the launch aid could be recovered without serious financial damage to the company. The package should secure the continuation of the EH101 programme, but only £5m of the agreed £60m launch aid for this project has so far been paid.

8 I believe the remaining arguments are:

- i) Military: that it is essential to secure support for the existing helicopter fleet and desirable to preserve an indigenous source of design, development and supply. It is of course for Michael Heseltine to advise on the strength of this argument.
- ii) International: that it will be damaging to the UK's relations with India if, after the diplomatic efforts of the last year, Westland cannot now conclude the contract for the ONCC.
- iii) Political: that if the Government does not help it will be blamed for allowing the company to go into receivership.



FOREIGN OWNERSHIP

9 At present the company most likely to be willing to take a large minority shareholding appears to be Sikorsky. No solution involving a British company is on the cards. Westland are in contact with MBB, Aerospacial and Agusta and I believe they should be encouraged to pursue the possibility of a European solution. The prospects of a European solution being developed within the timescale do not seem to be good, but I should like to get a better assessment of those prospects before responding formally to Westland's proposals. However, if it emerged that a solution involving Sikorsky was the only realistic option I do not believe we should reject the package solely on that ground, provided we obtained the assurances from the company outlined in paragraph 5 above.

FINANCE

10 It is an important feature of the approach I have outlined that the Government would only agree to underwrite W30-160 sales if it assessed the prospects of concluding the Indian order as good - in other words, if the risk of the Government incurring expenditure as a result of the underwriting was acceptable. Nonetheless, I have reluctantly concluded that I could not use any of my Department's agreed PES allocation to meet any expenditure that might result : the industrial argument for giving Westland further assistance do not justify the use of my Department's very scarce and indeed decreasing financial resources

RECEIVERSHIP

11 If the Government decided not to participate in a package of the sort I have discussed, the company would probably go into receivership. It is by no means certain that such an outcome would be damaging to essential national interests, or more costly to the Government than participation in a reconstruction package.



The difficulty is that receivership would create an uncontrolled situation whose outcome was unpredictable.

12 Much would depend on whether a purchaser could be found for key parts of the business - continuing Lynx and Sea King production, the EH101 programme and the provision of spares and support. If so, the Government's essential procurement interests would be safeguarded. Such an outcome appears possible in view of the interest British Aerospace have expressed in acquiring certain parts of the business in the event of receivership.

13 However there would be potential costs to the Government. The Receiver might demand Government funding of his operations in order to keep the helicopter business going while a purchaser was sought. There would be indirect costs, for example associated with ECOD exposure and redundancies.

And if no purchaser could be found, receivership might result in the UK's participation in the EH101 and production of Lynx and Sea King being ended and the provision of spares and support for the current MOD helicopter fleet being jeopardised.

14 I believe it is a fairly fine judgement whether the risks involved in receivership are worth taking. On balance, I believe it would be preferable to agree to participate in a reconstruction package if the conditions I have outlined were met.

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CONCLUSION

19 I recommend that our initial response to Westland should be to urge them to pursue discussions with possible European partners urgently. We should decide in the light of those discussions whether to indicate to Westland, on the lines set out in paragraphs 4 and 5 of this minute, the Government's possible willingness to participate in a reconstruction package. It will, in any event, be desirable to indicate our position to the company reasonably promptly - and certainly well in advance of the November deadline - both so that the company knows where it stands and to ensure that no question arises of a breach of Companies Act obligations.

EXTRACTS FROM A LETTER DATED 18 OCTOBER 1985 FROM MR BRITTAN'S
PRIVATE SECRETARY TO MR HESELTINE'S PRIVATE SECRETARY



3 Sir John also asked whether the Government would consider underwriting the Indian order. Mr Brittan replied that he was not now authorized to make any underwriting offer. Sir John also asked whether the Ministry of Defence would now pay Westland the £6m which they owed the company. Mr Brittan replied that that was a matter for MoD: however, he did undertake to pass on to Mr

Heseltine Sir John's concern.

4 Sir John said that he was well aware of the Government's preference for a European minority shareholder in Westland, and attached weight to that preference. He had now held talks with MBB, Aerospeciale and Agusta, invited them all to participate, and made it clear that Westland would consider any reasonable proposition. The interest of all three companies was totally negative: they were only interested in blocking Sikorsky. All three were also Government owned, loss-making, and suffering from excess capacity. Agusta appeared to be the most positive of the three, and had expressed interest in the possibility of coming in with United Technologies - i.e taking some part of a 29.9 per cent shareholding with them. But progress was slow and Agusta had yet to come forward with any definite proposals. To persuade the banks to convert debt into equity, it would be necessary to produce as positive and forward looking a prospectus as possible; and to bring about a deal in time, Westland needed a relatively quick decision. On both these counts, a deal with Sikorsky looked the best option, if not the only one.

5 The Secretary of State noted what Sir John said. He said that a European minority shareholder was in both the commercial and political interests of the Government. The Government therefore wished to be certain that a deal with Sikorsky was the best, or the only, option. The idea of Agusta coming in with Sikorsky was attractive, and he would be grateful if this could be pursued further. Sir John replied that he believed that he had fully discharged his responsibility to pursue the possibility of a European minority shareholder. He could not press the European companies further without importuning. In view of what Mr Brittan said, however, he would contact Agusta once more as a matter of urgency. But he believed that the only practicable solution in the end would be a deal with Sikorsky.



MR BRITTAN'S MINUTE OF 4 OCTOBER 1985

Mr Brittan's minute began by setting out the background. Westland had put to the DTI and MOD the company's proposals for a financial reconstruction necessary to put Westland on course to future viability. The main features were:

- i. the raising of new capital from existing shareholders and from a new outside minority shareholder, whether Sikorsky or a European source;
 - ii. the conversion of bank debt into equity;
 - iii. Government underwriting of 45 W.30-160 sales.
2. Mr Brittan reported that DTI and MOD officials considered that such a package would provide a reasonable prospect of viability; that if nothing were done, Westland would probably go into receivership; and that underwriting of only 21 helicopters, subject to discussion with the banks, might provide an adequate reconstruction package.
3. Mr Brittan said he considered underwriting 45 sales would be unjustified. He considered, however, that the company might be told that if by the end of November

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BOARD OF TRADE
BICENTENARY



contract discussions with the Indian Oil and Natural Gas Corporation for the sale of 21 W.30s were still active, although not finalised, the Government would at that stage be prepared to consider underwriting that number of aircraft. However he thought a decision should be taken at the time in the light of progress in India. In any event, the Government should only involve itself in a reconstruction package if satisfactory assurances were received from Westland on the continuation of collaborative and launch-aided projects and of support for Westland aircraft in service with British forces.

4. Mr Brittan went on to suggest that there were no industrial policy grounds for giving a high priority to support of Westland in considering the disposition of Government financial resources. He noted that the proposed reconstruction package would not in itself ensure continuation of the launch-aided W.30-300 programme: the critical factor here he believed would be a MOD launch order. On the other hand, the package should ensure the continuation of the EH101.

5. Mr Brittan then briefly noted that there were military, international and political considerations also to be taken into account.



6. Turning to the question of an overseas shareholder, Mr Brittan noted that at that stage Sikorsky appeared the company most likely to be prepared to come in. There were no proposals from British companies. Westland were in contact with MBB, Aerospatiale and Agusta. Mr Brittan considered Westland should be encouraged to pursue the possibility of a European solution. Although the prospects of such a solution in the time available seemed not to be good, he wanted to have a better assessment of the possibilities before responding to the proposals from the company. If, however, it became clear that Sikorsky was the only practical possibility he did not consider the company's proposals should be rejected on the sole ground that they involved an association with Sikorsky, provided the required assurances were given by the company.

7. Mr Brittan then argued that if it were eventually agreed to offer underwriting, any contingent liability to Government funds should not be met from the DTI's financial resources which were very scarce and indeed decreasing.

8. Mr Brittan then considered the possible outcome of Westland going into receivership. He noted that the position would be uncontrolled and the outcome uncertain. A buyer might be found for certain parts of the business (for

1786
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BOARD OF TRADE
BICENTENARY



example British Aerospace had said they might consider an acquisition of some elements of Westland after receivership). But there could be costs to the Government via ECGD and redundancy payments; and there would be risks to existing projects, including collaborative projects. Mr Brittan concluded that on a balanced judgement, it would be preferable for the Government to take part in a reconstruction package, provided the required conditions were fulfilled, rather than allow Westland to go into receivership.

9. Mr Brittan then turned to the question of Mr Gandhi's forthcoming visit to the UK. He noted that the Government must continue to do all it could to help Westland obtain the Indian contract. If a reconstruction package were in place before Mr Gandhi's visit, he could be given firm assurances. However, recalling his own belief that it would be preferable to delay a response to the company until they had made more progress in discussions with possible European partners, Mr Brittan said in that event the Prime Minister would need to be briefed to answer a number of possible questions from Mr Gandhi. He suggested officials should put such briefing in hand.



10. In a concluding section, Mr Brittan summarised his recommendations. He recommended that the Government's initial response to Westland should be to urge the company to pursue discussions with possible European partners urgently. In the light of the outcome, the Government should then decide whether it was willing to participate in a reconstruction package. He noted that it was desirable to come to a decision reasonably quickly, and in any event well before the end of November.

11. Mr Brittan finally said the Prime Minister might wish to call a meeting, particularly to consider the forthcoming talks with Mr Gandhi.



MEETING BETWEEN THE SECRETARY OF STATE FOR TRADE AND
INDUSTRY (MR BRITTAN) AND SIR JOHN CUCKNEY, 17 OCTOBER 1985

It was agreed at a meeting of Ministers on 16 October that the Secretary of State for Trade and Industry should see Sir John Cuckney as soon as possible to explain the Government's position. The meeting took place on 17 October. Attached is a summary of a letter dated 18 October from Mr Brittan's Private Secretary to Mr Heseltine's Private Secretary, recording what was said at the meeting. The summary does not cover certain material in the letter which is commercially confidential.

Following normal practice with meetings of this kind, the Private Secretary's record was not put to Sir John Cuckney for his comment or agreement before it was issued.



Mr Brittan first told Sir John the Government's assessment of the prospects for securing an order from India for 21 W30-160 helicopters, in the light of the recent visit by the Indian Prime Minister.

Sir John asked whether the Government would consider underwriting the order. Mr Brittan said he was not now authorised to make any underwriting offer. Sir John also asked about the £6m which he said the Ministry of Defence owed the company. Mr Brittan said that was a matter for MOD, but undertook to pass on to the Secretary of State for Defence Sir John's concern.

Sir John said he was well aware of the Government's preference for a European minority shareholder in Westland, and attached weight to that preference. He had held talks with MBB, Aerospatiale and Agusta, invited them all to participate, and made it clear that Westland would consider any reasonable proposition. However he considered that the interest of all three companies was negative and that they were only interested in blocking Sikorsky. They were also Government-owned, loss-making and suffering from excess capacity. Agusta appeared to be the most positive and had expressed interest in taking a shareholding with United



Technologies, but they had not come forward with any definite proposals. To secure a reconstruction it would be necessary to produce a positive and forward-looking prospectus, and to secure a reconstruction in time, Westland needed a relatively quick decision. On both counts a deal with Sikorsky looked the best option if not the only one.

Mr Brittan noted what Sir John said. He said that a European minority shareholder was in both the commercial and political interests of the Government. The Government therefore wished to be certain that a deal with Sikorsky was the best, or only, option. The idea of Agusta coming in with Sikorsky was attractive and he would be grateful if this could be pursued further. Sir John said he believed he had fully discharged his responsibility to pursue the possibility of a European minority shareholder, but in view of what Mr Brittan had said he would contact Agusta again as a matter of urgency. However he believed the only practicable solution in the end would be a deal with Sikorsky.

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