



Prime Minister

Another procurement problem. No need to take a view yet. But we may have to cancel;

You are seeing defence secretary & Mr. Levene next month.

MO 26/7V

PRIME MINISTER

Another dreadful story Mrs.

ALARM

1. When we decided in Cabinet in July 1983 to choose the ALARM missile proposed by British Aerospace (BAe), in preference to the American HARM, to meet the Royal Air Force's requirement for a defence suppression weapon, my predecessor was invited, in consultation with the Chief Secretary, to arrange for the regular monitoring of the ALARM programme.

CD 26/21

2. As you know, significant problems have arisen in the development phase of this programme. These are expected to lead to delays in the missile's entry into service, could involve my Department in additional expenditure and, according to BAe, will entail a reduction in the missile's range which will affect some but not all of the operational roles for which the missile has been designed. The main problems concern the sub-contracted development of the rocket motor.

3. Although the prime contract awarded to BAe in 1983 is at a fixed price (£260M at present economic conditions), my Department is not immune from bearing the additional costs which



might emerge as a result of the motor development problems. BAe in turn placed a fixed price sub-contract on the Rocket Motor Executive (RME) (then part of the Ministry of Defence), for the development and production of the rocket motor. Although RME was transferred to Royal Ordnance in January 1985 under the Ordnance Factories and Military Services Act 1984, subsequent legal advice was that the terms of the transfer had applied only to the assets and benefits of the ALARM motor sub-contract, and that the liabilities under the sub-contract probably remained with the Ministry of Defence. If they did, the Department would be responsible for any delays and additional costs to the prime contractor that could be contributed to a failure on the part of the motor sub-contractor.

4. As the potential additional costs to Royal Ordnance of overcoming the motor development problems (and, separately, the liabilities Royal Ordnance might incur to BAe for the disruption of the ALARM programme stemming from these difficulties) would damage the prospects of a successful privatisation, I was obliged to give Royal Ordnance an indemnity. This formally accepted that the Ministry of Defence would be liable for successful claims for compensation by third parties, including BAe, against Royal Ordnance (except in certain limited circumstances of negligence) and also committed the Department to meeting any losses suffered by Royal Ordnance in excess of £19M on the motor sub-contract.



5. In normal circumstances, we would wish to enforce our contractual rights against BAe under the prime contract and to hold them responsible for taking the risks and bearing the additional cost of completing the ALARM programme, and, if necessary, of ultimate failure. But in this case, we in turn are liable to meet any claim which BAe might subsequently establish for the cost of delay, or of cancellation of the contract by the Ministry of Defence on account of the problems associated with the motor development. As it is, BAe have already given notice of a claim against both the Department and Royal Ordnance in respect of their additional costs resulting from these problems.

6. We are therefore in a position where we must negotiate with BAe as to whether the development of ALARM can still be achieved and where subsequent costs and risks might lie. Progress payments to the company were stopped on the instructions of Ministers on 15th July this year.

7. BAe made an initial proposal under which they would continue with the programme at an additional cost - to be borne by the Ministry of Defence - of £59M, but they did not show themselves prepared to take on all future risk. My officials rejected this approach since:



a. they were not convinced that the technical problems with the motor could be overcome within the timescales and at the costs that BAe envisaged;

b. uncertainties were also emerging in other areas of the development programme which might evolve into major problems. BAe have yet to accept these as problems which they would be liable to meet under the prime contract.

8. The company were then asked to submit, as a matter of urgency, a revised proposal which would return to the concept of a fixed price contract with all risk being borne by them. Further discussions with the company have subsequently taken place on the development of this proposal during which my officials have re-emphasised our expectations on these points. Later this month, when these proposals are forecast to be to hand, I shall be in a better position to begin to assess the costs and risks involved and whether it is in our best interests to proceed with ALARM, taking account of any sales prospects (such as to Saudi Arabia) which exist. One of the options we would have to consider would be that of cancellation in favour of an alternative solution.

9. I shall report again when I have formed a view. Meanwhile, you should know that BAe is one of the companies which have



expressed an interest in buying Royal Ordnance. They have been told that, although we are prepared to consider a bid, we should find it very difficult to complete a sale to them, while responsibility for the ALARM motor problem is unsettled. For this and other reasons, Sir Austin Pearce has recently said that they may not pursue their interest.

10. I am sending copies of this minute to other members of OD, to the Chief Secretary and to Sir Robert Armstrong.

A.Y.

Ministry of Defence

24th November 1986

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10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

27 November 1986

Dear John,

ALARM

The Prime Minister has noted with concern the Defence Secretary's minute of 24 November about the problems which have arisen over the ALARM programme. She will await a recommendation from the Defence Secretary.

I am copying this letter to the Private Secretaries to members of OD, the Private Secretary to the Chief Secretary and to Sir Robert Armstrong.

Yours sincerely
C. D. Powell

(C. D. POWELL)

John Howe, Esq.,
Ministry of Defence

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