



MINISTRY OF DEFENCE
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9th December 1986

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Dear Andrew,

ALARM

Thank you for your letter of 1st December to John Howe.

Our concern over a sale of Royal Ordnance (RO) to British Aerospace (BAe) while responsibility for the ALARM motor problem remains unsettled stems from the indemnity we have given to RO. I emphasise the word "responsibility" because it is this rather than the technical problem which gives rise to our concern over this aspect of the ALARM position.

In the event that BAe make a claim against RO - and they have already indicated their intention to do so - any eventual settlement would have to be funded by the Ministry of Defence. It would therefore be important to ensure that the claim was resisted robustly and any settlement to be paid from public funds kept to a minimum; but we would be heavily dependent on RO in such negotiations. They have all the relevant information as well as all the technical expertise which may need to be drawn upon in contesting BAe's claim. It would, in our view, be extremely difficult to be sure that we were getting the best service out of RO in helping us to resist this claim if they were owned by BAe.

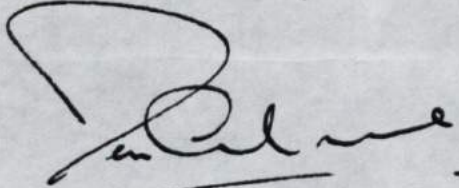
This is not to say that we cannot sell RO to BAe. If BAe were to propose an acceptable arrangement which relieved us of our present open-ended liability in relation to RO, then our objection to a sale would be removed. We are in discussion with BAe about the sort of package they are willing to propose but it is too soon to say whether the problem can be resolved within the timescale to which we are working on privatisation. Nor is the company in any doubt about the nature of our concern.

Andrew Lansley Esq
 Private Secretary to
 Chancellor of the Duchy of Lancaster



/ I enclose a copy of a letter which the Minister of State for Defence Procurement, Lord Trefgarne, wrote to Sir Austin Pearce on 9th September and in which he makes clear our position.

I am sending a copy of this letter to the Private Secretaries to other members of OD to the Chief Secretary, and to Sir Robert Armstrong.

Yes indeed


(I C F ANDREWS)
Private Secretary

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Minister of State
for Defence Procurement

D/MIN/DGT/6/5/3

MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HS

Telephone 01-218 8821 (Direct Dialling)
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9 September 1986

Dear Sir Austin,

Thank you for your letter of 28th August about which you have since spoken to George Younger.

I am sorry that we have not made clear the logic of the position set out in my earlier letter. Our problem is one of practicality. It is clear to us that we could not treat negotiations to sell Royal Ordnance in a vacuum separately from our discussions on ALARM. The fact is that BAe has informed us of claims it intends to press against the MOD as well as against RO and it is clear that both we and RO will have to defend those claims. Moreover, I should tell you that HM Government has indemnified RO against third party claims over Nuthatch and RO has agreed to fight claims vigorously to protect our position. There are, therefore, real practical problems in BAe taking over control of RO while the ALARM position is unresolved and possible legal action outstanding. It would clearly be very difficult for us to rely on a company which was wholly owned by BAe to defend our financial interests against a BAe claim.

This is not in any sense meant as a threat. I emphasise that we see the problem as one of practicality.

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Sir Austin Pearce CBE

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It would also be difficult for us to disclose to BAe, in any negotiation over the sale of RO, information which might prejudice RO's defence against a BAe claim over Nuthatch. A final but important issue for us is that, even if we were to reach a settlement over ALARM and to sell RO to BAe, the public presentation could be difficult. We would have to be ready to defend against accusations that we had sold out the taxpayer's interest just to get rid of RO.

In the light of what I have said, I hope you can now understand our difficulty. If, against this background, BAe still wish to maintain their interest in acquiring RO, and incurring the associated costs of preparing a bid, we are prepared to include you on the list of bidders. If you confirm your interest to me, I will instruct Rothschilds to add BAe to the list of those who will receive the Selling Memorandum in the next week or two.

If you wish to speak to me tonight before your meeting tomorrow, my home telephone number is Woking 68165.

*Your sincerely,
David Trefgarne.*

Lord Trefgarne

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