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10 DOWNING STREET

From the Private Secretary

2 March 1981

Dear Ian

FUTURE OF ROLLS ROYCE

The Prime Minister held a meeting this morning to discuss your Secretary of State's minute of 17 February. Mr. Tebbit, joined later by your Secretary of State and Mr. Farrow, represented your Department. The Chancellor of the Exchequer, the Secretary of State for Defence, Sir Robert Armstrong and Mr. Ibbs were also present.

Your Ministers explained the international position in the aero-engine business. At the present stage Pratt & Whitney were in an exposed position as a result of the guarantees offered to support sales of their PW2037 engine. The time might therefore be suitable to consider the possibility of Rolls Royce collaborating with one of its two competitors. There was a window of time to consider this. The opportunity was likely to be past by the end of May, as Rolls Royce would by then have to reach a decision on collaboration with the Japanese for the RJ500. Under U.S. law, Pratt & Whitney were obliged to offer terms to other American airlines no worse than those they had already offered. On this basis, if they provided many more guarantees, they could well find themselves forced to seek to put Rolls Royce out of business.

Against this background, Warburgs had made contact with the Department of Industry in conversations between Sir Eric Roll and Sir Peter Carey, suggesting that they might act as a broker to bring together Rolls Royce and Pratt & Whitney, allowing contacts to be opened with neither party needing to take an initiative. There were also reports that General Electric had recently approached Rolls Royce about possible collaboration, although Lord McFadzean claimed that these approaches did not cover the main aero-engine business. This required clarification.

Your Secretary of State said that he was seeking the Prime Minister's authority to raise these matters with Lord McFadzean, on the basis that the colleagues present at the meeting all felt it worth putting to him the proposition that possibilities of collaboration with Pratt & Whitney should be pursued.

/The Chancellor

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The Chancellor emphasised the scale of the Government's existing financial commitment to Rolls Royce. He considered that Ministers had every reason to seek a partnership if one could be found. The Secretary of State for Defence said that he had always favoured a link with Pratt & Whitney. General Electric's French links made an arrangement with them less practicable, but any link with the American company would have to be approached with the most careful preparation. The role of Warburgs seemed irrelevant to the main issue.

After a broad discussion of the issues, the Prime Minister agreed that your Secretary of State should see Lord McFadzean to test his reaction to the prospect of contact with Pratt & Whitney. It will be helpful if Mr. Tebbit could also attend that meeting, which would therefore need to be rearranged in view of his commitments in Brussels on 3 March. The discussion should be on the basis that the Government saw signs of an unacceptable financial outlook for Rolls Royce: at this point, Warburgs had come forward with their suggestion: he had therefore been authorised to explore this with Lord McFadzean. The Prime Minister added that the tactical approach to any discussion with Pratt & Whitney, or with General Electric, would be critical, but this aspect would need to be examined further by Ministers in the light of Lord McFadzean's response to your Secretary of State.

I am sending copies of this letter to Peter Mason in your Department, John Wiggins (HM Treasury), Brian Norbury (Ministry of Defence), David Wright (Cabinet Office) and Gerry Spence (Central Policy Review Staff).

Yours ever

Mike Paterson

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