



CONFIDENTIAL

1 a line very shorty with and must work Govt do re-consider decision will be better than

NO

Prime Minister

There would be fierce criticism of this.

mes/s/s

PRIME MINISTER

BRITISH TELECOM PURCHASE OF SWEDISH TELECOMMUNICATIONS EQUIPMENT

Sir George Jefferson has informed me that BT intend to purchase significant quantities of digital telephone exchanges from the Swedish manufacturer L M Ericsson. The Ericsson exchanges are directly competitive with our own System X and would be manufactured at the factory which they own jointly with Thorn-EMI in Scunthorpe. An additional 730 jobs would be created but some of these would be at the expense of jobs in GEC and Plessey. BT's action is likely to attract criticism both within Parliament and in the industry.

and from the fact.

2 At the end of last year we agreed to a major restructuring of the arrangements for the development and manufacture of System X. STC left the consortium and BT handed over the design authority to Plessey with GEC acting as a sub-contractor. Market sharing is being replaced by competitive procurement between Plessey and GEC. These arrangements are beginning to work. Plessey now have the development programme back on course and the first volume orders have been placed by BT. However, Plessey have inherited a programme which, under BT's supervision, underwent several fundamental design changes and was slipping badly behind the revised target completion dates. Whilst that slippage seems to have been stopped, - indeed there has been some clawback - it



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is impossible for Plessey to complete such a major programme before the end of next year, although some exchanges will be delivered this year.

3 BT recognise that the promised delivery dates are the best that can be achieved in the circumstances but they consider that this performance is inadequate to meet their own commercial needs. BT intend to respond to competition by introducing digital switching into the major business centres well in advance of Mercury and propose to start the installation of digital exchanges in July next year. The System X development programme should be well advanced by that date and the British suppliers argue that they could meet BT's requirements. However, these timescales would allow for no margin of error in the development programme and would not permit the inevitable bugs to be sorted out on trial exchanges. BT feel therefore that the risk of placing themselves solely in the hands of Plessey and GEC is unacceptable. They also point out that France, Germany and the USA have all chosen at least two switching systems to spread the risk and ensure genuine competition. BT's proposal is that whilst limited deliveries of System X should start this year they should in parallel begin volume deliveries from Ericsson which would build up to a plateau in 1987. Thereafter they anticipate that Ericsson would supply 10% of their requirements with GEC and Plessey competing for the remaining 90%. There is of course no guarantee that the Ericsson share would be held at 10%. BT have also



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negotiated some limited reciprocal opportunities for GEC and Plessey, including an opportunity to sell to the Ericsson operated telephone company in Argentina and an agreement not immediately to enter the US market for certain types of exchanges.

4 I have told Sir George Jefferson that this proposal is unwelcome to the Government. For his part he has made it clear to me that his Board is determined to see the early introduction of a second system to compete with System X. If we were to refuse to accept this proposal Sir George would be likely to bide his time until BT cease to be a nationalised industry when we would have no formal powers to prevent BT going ahead. Meanwhile, BT could continue discussions with Ericsson with a view to ensuring that the proposed delivery dates could still be met.

5 There is some substance to BT's case. The performance of GEC and Plessey is likely to be improved if the BT market is not wholly guaranteed to them. They need incentives to become more competitive and attack world markets. Whilst BT are exaggerating the threat of competition from Mercury it is hard to argue that they should not behave in a thoroughly commercial manner now that they are losing their monopoly. Furthermore, business users would benefit from the most rapid rate of network modernisation that is possible.



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6 On the other hand, BT must bear a substantial part of the blame for the delays in the System X development programme. They cannot now be allowed to walk away from that responsibility. This order will do serious damage to System X's international reputation at a time when we are on the shortlist for winning a major order in India. BT's reputation amongst other PTT's is high and this move will improve Ericsson's standing whilst raising doubts about BT's commitment to System X. Both Plessey and GEC are likely to criticise BT and the Government publicly. All this will provide ammunition for critics of the BT Bill who have argued the liberalisation and privatisation threaten the supply industry.

7 We therefore have a difficult decision to make. The logic of our policies of encouraging BT to behave commercially means that the supplying industry can no longer expect to enjoy a captive home market. Past protection reared an industry which became increasingly uncompetitive and complacent. The suppliers are at last putting their house in order and Plessey in particular are aggressively establishing System X in the US market. Whilst I would have preferred to give the companies longer to adjust to the new environment I believe that System X should be expected to face competition at home - providing that there are satisfactory reciprocal arrangements to allow GEC and Plessey access to other markets. I therefore intend to ask Jeffrey Sterling (who as you know was involved in the

Those who ordered part of equipment - held GEC Plessey back. There is no way we can have done this with the industry. The decision



BT/GEC/Plessey/STC restructuring discussions last year, and has the confidence of the UK parties concerned) to hold talks with Ericsson with a view to extracting a much better reciprocal deal for British industry. I also propose to ask Sir George Jefferson to refrain from any public announcement while these talks are taking place. At the same time I shall with BT explore the possibility of finding an alternative supplier to Ericsson with a larger home market and consequently more obvious prospects of reciprocity. BT are already in discussion with Siemens in Germany but I would not rule out talks with either a French, US or Canadian company. However, BT are strongly of the opinion that only Ericsson can meet their delivery dates and I am consequently not hopeful of concluding a suitable deal with any other company.

8 I am copying this to other members of E(TP) and to Sir Robert Armstrong.

J. Spencer

MP P J

5 May 1983

PATRICK JENKIN

(approved by the Secretary of State
and signed in his absence)

Department of Industry

MAY 1983

Post & Telecom

Future of the Post office Pt

POST OFFICE
MAY 1983

COMMUNICATIONS

1983

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10 DOWNING STREET

From the Private Secretary

6 May 1983

Dear Jonathan,

British Telecom's purchase of
Swedish Telecommunications Equipment

B/F | The Prime Minister was grateful for your Secretary of State's minute of 5 May. Mrs. Thatcher strongly agrees with the views expressed in paragraph 6 of your Secretary of State's minute - that BT must bear a substantial part of the blame for the delays in the System X development programme, and cannot now be allowed to walk away from that responsibility. She has commented that if BT went ahead with the proposed course of action they would attract criticism, not only within Parliament and within the industry, but also from the Government. The Prime Minister hopes that Sir George Jefferson will reconsider his decision, and has indicated that if necessary, she would see Sir George herself.

I am copying this letter to the Private Secretaries to the other members of E(TP) and Sir Robert Armstrong.

Yours sincerely,

Michael Scholar

Jonathan Spencer, Esq.,
Department of Industry

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CC 210

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From the Secretary of State

Michael Scholar Esq
Private Secretary
10 Downing Street
London
SW1

Prime Minister
(Sir G Jefferson is
being asked to reconsider

16 May 1983
his decision.)

Dear Michael,

M/S 16/5

BRITISH TELECOM'S PROPOSED PURCHASE OF SWEDISH TELECOMMUNICATIONS EQUIPMENT

Thank you for my copy of your minute on this subject to Jonathan Spencer, dated 6 May.

There is more than an element of disingenuity in BT's current proposal, the effect of which is to penalise GEC and Plessey for delays which are significantly of BT's own making. In principle of course there is merit in introducing an element of competition into BT procurement - the oligopoly arrangements prevailing in the past have been a major factor in UK telecommunications companies' poor export performance. But this is a singularly ill-timed initiative in present circumstances.

Our immediate and pressing concern lies with the damage any announcement that BT is severing its special commitment to System X would have on the current efforts by GEC and Plessey to sell System X in India and China. Both campaigns are at a delicate stage, with key decisions imminent. The companies, with good support from BT, have played heavily on the fact that System X can depend on the continuing commitment of BT, ensuring high production volumes and state-of-the-art technical updating. The loss of this argument would very dangerously jeopardise the change of winning these two crucial orders. Beyond these immediate prospects Ericssons are probably the major international competitor for System X. The Swedish company would be bound to make the most of this apparent lack of confidence in all future sales.

If BT were to proceed down their present path, my Secretary of State is anxious that BT should make no public indication of their plans until definite decisions have been made. Even if the Ericsson deal should go ahead, it is imperative that BT should clearly reiterate their commitment to the UK industry and its products.

Copies of this go to the recipients of your letter.

Yours sincerely,

JOHN RHODES
Private Secretary

Part 1 Telegram
Future of P.O.
of B.T. Part 7

6 MAY 1983
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