dti

the department for Enterprise

Charles Powell
Note.
PRCG 13/5

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Paul Gray

You may like to see this, which has reached me on a personal net.

CDP 12/5.

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Our ref
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Date 11 May 1988

Dear Charles,

UNITED TECHNOLOGIES CORPORATION: WESTLAND AND ROLLS-ROYCE

You may be interested to see the attached record of recent coversations. I am sorry it is rather long.

Yours sincerely,

John Michell

M J MICHELL

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888-207

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To: **PS/CHANCELLOR OF THE DUCHY**

cc PS/Secretary of State
Sir Brian Hayes
Mr R Williams

From: **M J MICHELL**
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11 May 1988

UNITED TECHNOLOGIES CORPORATION: WESTLAND AND ROLLS-ROYCE

I was visited at his request on 11 May by a senior executive of the United Technologies Corporation (UTC), Mr Colin Green. He wanted to talk about Westland and Rolls-Royce.

WESTLAND

2 Mr Green said UTC had always seen their investment in Westland as part of a wider strategy of European involvement. They were broadly content with it on that basis: for example it had enabled them to move closer to other European helicopter companies. UTC admired the way the Westland management had carried through the cost-cutting exercise in 1986/87. However, it was now time to turn to strategic thinking on the market side.

3 UTC saw the EH101 as the key to Westland's future success in helicopters. They were willing and prepared to put management and engineering effort into helping the project overcome its current difficulties, which they did not see as fundamental. Indeed they considered the current problems were typical of any helicopter programme, including their own. They felt the MoD were exaggerating the problems and were not making helpful proposals.

4 UTC felt Sir John Cuckney had been resistant to an increased level of Sikorsky managerial involvement because UTC were only a relatively small shareholder. They were now of a mind to insist, at least, that a Sikorsky engineering team be put into Westland initially for say 3 months to help the

Westland management get a better control of the programme. But UTC wished to know

i whether it was true that there were doubts about HMG's commitment to the EH101, as had been rumoured.

ii whether there would be political sensitivities in their proposed move.

5 I said I could not speak authoritatively for the MoD. However my understanding was that the EH101 was regarded as a strategically essential system, and it was this fact that underlay the MoD's very considerable and justified concern about the management of the project and the financial and managerial capability of Westland. I believed the MoD would welcome any move by UTC to help the programme, indeed the MoD might well wish UTC to go further.

6 For the DTI, I said we were also concerned about the programme which was our most speculative current launch aid investment. However, we had no present intention to withdraw from it and probably would not do so as long as the MoD continued to support it. Our long-term civil market assessment remained favourable. Mr Green confirmed this was also UTC's assessment and said we should not be concerned at the present lack of prospective commercial orders.

7 On the political side, I said I thought it most unlikely that some strengthening of the Westland middle management by Sikorsky would cause any problem. I reminded Mr Green that many (including myself) had expressed surprise on several occasions since 1985/6 that UTC had not done this before: indeed their own policy seemed to have changed several times. Mr Green referred again to the difficult relationship between Sir John Cuckney and the top management of UTC.

Restructuring of Westland

8 Mr Green said that although UTC's immediate concern was the EH101, they were also dissatisfied more generally with the situation at Westland. While full of admiration for Sir John Cuckney's achievements, they were basically unhappy with the concept of a non-executive Chairman who they perceived to have no real knowledge of the strategic issues of the helicopter industry, yet a man so powerful and prestigious, because of the history, that all decisions were concentrated in his hands. UTC wanted the Westland Board to be more "industrially professional". In recent discussions they had found Sir John Cuckney receptive to this.

9 UTC were aware of the GKN proposal, and were provisionally happy with it. Mr Green himself was going on to talk to GKN. They had no objection to a stronger partner coming into Westland. They understood GKN at present was the only contender. UTC would wish to consider whether there were other candidates (though they would not favour British Aerospace), but appreciated there could be sensitivites about a non-British company playing such a role.

10 UTC had considered their own position with some care. Their basic interest was in long-term project and technology co-operation with Westland. They were not interested in equity participation for its own sake, and had taken the equity position in 1986 only as the most convenient means at the time to increase their involvement with Westland. If this relationship strengthened, they might well at some stage withdraw from equity participation (This is not the first time UTC have said this to me: Mr Paul said it early in 1987).

11 Two alternative possibilities had been considered:

i An increase in the UTC shareholding, possibly even an outright takeover bid. This was unlikely to be pursued, though not because of financial constraints ("we could buy it out of the petty cash"). But there would be legal problems in the US and, UTC assumed, political problems in the UK, neither of which they wanted. (As a variant of this possibility, Mr Green discussed a possible idea of UTC disposing of Sikorsky's civil business, thus removing the legal constraints on Sikorsky executives being appointed to positions on the Westland Board)

ii A possible scheme to "take Westland private" by means of a group of, say, four or five companies, including UTC, buying out the Westland shareholders and controlling the company with stakes of around 20-30% each (rather like the British Aircraft Corporation pre-1977 which was owned by GEC, Vickers and Rolls-Royce). This scheme was not necessarily incompatible with the GKN approach which might indeed be a first step towards it. Although at one time UTC had thought of promoting this scheme straightaway, they were now of a mind to "go with the GKN approach", subject to their discussions with that company.

12 I said I thought the degree of any political sensitivity to the possible scheme at (ii) above would depend on the extent to which Westland was perceived as remaining under UK control.

If UTC were the only non-British member of such a controlling group, with a share between 20 and 30%, my personal view was that would be unlikely to cause fundamental difficulties, although this would be an issue for Ministers to address.

ROLLS-ROYCE

13 Turning to Rolls-Royce (who are partners of Pratt and Whitney, another UTC subsidiary, on the V.2500) Mr Green spoke of UTC's concerns about Rolls-Royce's apparent lack of strategic direction and doubts about whether they had the financial strength to maintain what appeared to be their present ambitions. I am afraid to say UTC's concerns are somewhat similar to the views I expressed in my minute of 12 February.

14 Mr Green spoke at some length of the determination of UTC, under their new Chairman, to respond to the aggressive market success of GE. Specifically, he asked whether I thought there was any possibility of Pratt and Whitney being permitted to take a share in the EJ200. They perceived this engine as being "capable of improvement" into a real world competitor against the GE F404, though at present there seemed a danger it would not be. (As I have mentioned to the Chancellor before, this was an area of some discussion between ourselves and the MoD in 1985).

15 I said this was a matter for Rolls-Royce and the MoD and their respective European partners. (Personally I would see considerable merit in any proposals at least being explored, because of the basic concerns about Rolls-Royce expressed in my earlier minute. Whether Pratt and Whitney is the right US partner to bring in, if there is to be one, would be a major question but one for a later stage. However, as you know Rolls-Royce does not share my concerns and is unlikely to respond positively to a Pratt and Whitney approach. Nevertheless I would propose to talk to Rolls-Royce and MoD colleagues about this).

16 On the V.2500, UTC's view was that, despite current problems, it was essential to stick with the programme and apply determined effort to improving the sales prospects.

17 On the question of a Rolls-Royce shareholding, Mr Green made clear UTC remained very interested in acquiring a stake in Rolls-Royce. He said UTC, with some reluctance, had accepted the advice of previous DTI Ministers against this in 1987, but

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they were now reconsidering. (I think we should take account of this in considering our strategy in response to the current European Commission pressure on the 15% limit. If the limit is increased, the outcome could well be that significant stakes are acquired by US companies.)

John Michell

M J MICHELL