



10 DOWNING STREET

Prime Minister!

These letters do not
make the decision any
easier.

The main question seems
to me to relate to X,

If Leeds would close
if a competition is wanted,
or if there is a serious risk,
privatisation should probably
go ahead, I suggest. That
point could then be made
in the Government's defence =
(though the North East
would still protest).

If Leeds would probably

not close, the possible
political costs of awarding
the challenges on a
non-competitive basis
loom much larger and I
would recommend that
privatisation should not
go ahead.

DWS
11/6.

GCPW



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MO 10/4E

11th June 1986

Dear David,

FLOTATION OF ROYAL ORDNANCE PLC

At the meeting of Ministers this afternoon the acceptability of placing a non-competitive order with Royal Ordnance for a Seventh Regiment of Challenger tanks was questioned. I understand that the concern was that objection to this might be raised on the grounds that the order was being placed simply to facilitate flotation.

X | It is true that flotation cannot take place without this order. But if flotation were to be cancelled, the MOD would still wish to proceed with it. There is a clear operational requirement to enhance BAOR's armoured capability and an order on Leeds is the quickest way of achieving this. To mount a competition would impose a delay of up to 12 months to allow time for a data package to be produced and tenders to be prepared (Vickers have never built Challenger). A delay of this order could lead to large redundancies at Leeds with the likelihood that the factory would close, leaving Vickers as a monopoly supplier.

Apart from these factors there are two good reasons why MOD would wish to place the order with Royal Ordnance. The price achieved in negotiation is a good one, representing a 10% reduction in real terms from earlier orders; and, as part of the contract, a cap will also be placed on the price of the 5th and 6th Regiments which are currently open-ended. Secondly, the contract will enable us to resolve an awkward problem over our intended £60 million contract with Vickers for Challenger Armoured Repair and Recovery Vehicle. Royal Ordnance own the Intellectual Property Rights in the Challenger design on terms similar to those that apply to other defence contractors. This

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would allow Royal Ordnance to impede Vickers' performance of the ARRV contract since they have been able to claim that their rights have been infringed as MOD has access to these rights only for the purpose of competitive production of an existing design and not for competitive development of a derivative. Even as sole shareholder, the Secretary of State cannot direct the Directors to act in a way that they would regard as damaging to the interests of the Company, eg by giving up IPR. As part of the Challenger contract, however, Royal Ordnance have agreed to waive their rights in relation to the ARRV. Failure to place the contract with Royal Ordnance would lose us these price and IPR advantages. Moreover, the Vickers tender for ARRV - which has been extended several times at our request because of the uncertainties - is due to expire at the end of this week and unless we are in a position to place a contract by then (which means resolving the IPR problem) we are likely to lose that price also.

The merchant bank, stockbroker and legal advisers assisting with the flotation process are aware of the proposal to place the Challenger contract non-competitively: the Stock Exchange has seen a copy of the draft prospectus. None of them has raised any legal or quasi-legal objections: indeed the advisers are most keen for the order to be placed. Ministers wished, however, to have the benefit of the Attorney-General's advice and I am therefore sending a copy of this letter (with a copy of Lord Trefgarne's earlier minute) to his office in case he takes a different view.

I am also sending copies to the Private Secretaries to the Lord President, the Chancellor of the Duchy of Lancaster, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Financial Secretary and to the Secretary of the Cabinet.

(RICHARD HATFIELD)
Acting APS/S of S