

PREM19

72

INDUSTRIAL POLICY

(Future of Rolls-Royce)

PREM 19/72

PART 1 ends:-

Siv R.T.A to Pm (A0660) 14.11.79

PART 2 begins:-

S/S Ind to Pm 13.11.79.

Cabinet / Cabinet Committee Documents

[illegible]

Signed AWayland

Date 31 October 2009

PREM Records Team

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Top copy
Ind bot - NEB
May 1979

Ref. A0660

PRIME MINISTER

MISC 22: Future of the National Enterprise Board

The paper before the meeting is Sir Keith Joseph's minute to you of 13th November and its attachment. MISC 22 was of course originally set up to handle the problems of Rolls-Royce. Sir Keith's minute extends, and indeed shifts, the immediate issue to the future of the present members of the National Enterprise Board. (We have not on this occasion invited Mr. Pym because his interests are really confined to Rolls-Royce alone.)

2. You are familiar with the background and I need not rehearse it. The immediate dilemma is one of politics and personalities. The key elements are:-

- (a) Sir Kenneth Keith has agreed to leave the chairmanship of Rolls-Royce early in the New Year.
- (b) Sir Frank McFadzean has agreed to replace him in that role.
- (c) The Government has decided that Rolls-Royce should be removed from the tutelage of the NEB once the necessary powers are available, after the passage of the Industry Bill. Sir Frank McFadzean's acceptance of the Rolls-Royce chairmanship is dependent on this happening.
- (d) The NEB have said semi-publicly that they will resign if Rolls-Royce is taken away from them.
- (e) British Leyland want to jump on the Rolls-Royce bandwagon and also escape the tutelage of the NEB. Since Sir Keith Joseph's minute was written he has discussed the relationship of BL and the NEB with the BL Board. You will want a report on this meeting. Our understanding is that they confirmed their belief that, irrespective of personalities, it is an organisational mistake to subject one high-powered group of businessmen to the tutelage of another (it also adds an unnecessary link to the chain of responsibility: as present events demonstrate, the major political decisions about appointments and finance have to be taken by the Government, and the interposition of the NEB cannot relieve them of

that responsibility). They did not threaten to resign but it is relevant that, unlike the Rolls-Royce Board, that of BL is good and their views should carry weight.

- (f) Sir Keith Joseph's minute implies that the retention of NEB control over Rolls-Royce is being elevated by the TUC into an issue of principle with threats of a withdrawal from the National Economic Development Council and its machinery if their attitude does not prevail. Since Sir Keith Joseph's minute was written the Economic Committee of the TUC has met - this morning - and a report of their attitude will be available either tonight or at tomorrow's meeting.

3. Although the immediate issues are those of personality (with Sir Leslie Murphy cast in the role of "chief villain") there are underlying and very important issues of public administration. It is agreed that Rolls-Royce should depend directly on the Department of Industry. Given the prospects of that company, especially under a new Chairman, this may not be too onerous a cross for Government to bear. But BL's problems are more horrendous and immediate. If the Government is to lose the buffer of NEB and take direct responsibility for that company, it needs to do so with its eyes wide open.

4. Equally, it will be important not to lose sight of the implications of the Government's decisions on the future of the NEB itself. Without both Rolls-Royce and BL it will be a very different animal - much diminished - from that envisaged by the Government in the summer. The Committee may decide that this does not matter. But it should do so as a conscious decision about good administration and not simply as a by-blow of the resolution of personality clashes.

5. This being said, the fact remains that the immediate problems are of personality. Matters have got to the point where important (or self-important) groups of powerful men are striking attitudes in public and are too freely seeking to get their way by threats of resignation. Such threats are as dangerous to Government as any other form of blackmail because, if acceded to, they diminish the Government's authority to run its own show in its own way through individuals of its own choice.

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6. The questions the Group will have to resolve, therefore, are:-

- (a) Is it prepared to stick to its earlier decision that Rolls-Royce should be extracted from the NEB? Sir Frank McFadzean was reported at an earlier meeting as saying that either this or the removal of Sir Leslie Murphy were the conditions of his acceptance of the chairmanship. Have matters gone too far for the latter to be still a viable option?
- (b) If the answer to (a) is that the earlier decision stands, does the Group agree that it has no option but to accept the resignation of the NEB if offered - and indeed, given their semi-public posturing, has the NEB any choice but to resign? The question of "good order and discipline" is probably paramount here.
- (c) Is the Group prepared to call the TUC's bluff on the NEDC? It would obviously be hard for the TUC to defend the withdrawal of co-operation on the grounds that it did not like the Government's, and Parliament's, decisions about the management structure of public assets. It would be equally hard for the Government to appear to give in to TUC pressure on a matter wholly within the Government's competence.
- (d) Are the Government prepared to accept direct responsibility for BL? Or would they prefer, if it could be arranged, that the present BL/NEB relationship should be maintained under a revamped NEB despite the wishes of the BL Board?
- (e) If the NEB does go, how quickly can it be replaced, and if so, by whom? (This is a secondary issue but worthy of urgent attention if an awkward hiatus with BL is to be avoided in the interval before the Industry Bill becomes law.)
- (f) If the remorseless logic of (a), (b) and (c) above is unacceptable, is there any way the Government can extricate itself with honour?

HANDLING

7. You will want to ask the Secretary of State for Industry to explain the present position, including a report on his talks with the BL Board and for him and/or the Secretary of State for Employment to report on the attitude of the TUC. Thereafter you may want to concentrate discussion on the points I have identified in the preceding paragraph.

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CONCLUSION

8. Subject to discussion, the most likely outcome is that the Secretary of State for Industry will be invited to confirm to the NEB the decision that Rolls-Royce is to be removed from their responsibility and tell them that if they feel obliged to resign on this account, so be it. The Group may also wish to invite the Secretaries of State for Industry and for Employment to contact the TUC, explain the Government's position and invite them to weigh carefully the consequences of over-reacting to a situation where they have no locus.

ROBERT ARMSTRONG

14th November, 1979

Top copy
Ind ltr- NEB
May 79

PRIME MINISTER

FUTURE OF THE NATIONAL ENTERPRISE BOARD

Keith Joseph sent me a copy of his minute to you of 13 November. I should like to set down, before we meet in MISC 22, what seem to me to be the main considerations we should have in mind in considering this problem.

First, the immediate flash-point (today's meeting of the TUC Economic Committee) has been safely passed. Len Murray's attitude, and his influence on David Basnett, seem to have been wholly helpful.

Secondly, Rolls Royce (and BL for that matter) cannot legally be subtracted from NEB until the Industry Bill has been passed into law, and this is unlikely to be before next April at the earliest.

Thirdly, we do not want to have to find a replacement for McFadzean as Chairman of Rolls Royce if we can help it, even though the present problem seems to be aggravated by his unreadiness to compromise: nor do we want to be faced with a TUC walk-out from the NEDC and the Sector Working Parties, still less a complete breach between it and the Government. (You yourself made this point to Geoffrey Howe, Keith Joseph and me on 8 November). I should add that, when I spoke to Len Murray again this afternoon he made it clear that he remained of the view that the removal of Rolls Royce from the NEB would have repercussions beyond the resignation of the NEB Board, - ie no TUC nominees for a reconstituted Board and very probably a TUC withdrawal from other bodies such as NEDC.

In the light of all this, I do not see that we are under any obligation to take speedy decisions, or that any point of principle would be threatened if we managed to achieve a compromise whereby the Rolls Royce Board and the NEB stopped snarling at each other and allowed considerations of the national interest to take precedence over their

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personal feelings. What has passed over the last week must have been grist to the mill of Rolls's two US rivals. When McFadzean and Murphy and their colleagues come to realise this in their calmer moments it ought to be possible to get them all to arrive at some sort of armistice - whether by an exchange of directors between the two Boards or some right of direct access to Keith Joseph for McFadzean or whatever. But the immediate need is to get both Boards to stop sounding off and to start thinking constructively for a change.

I am sending copies of this minute to our colleagues in MISC 22, and to Sir Robert Armstrong and Sir Kenneth Berrill.

Laufair

J P

Approved by the Secretary
of State and signed in
his absence

14 November 1979



PRIME MINISTER

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Prime Minister

Paper for Misc 22
on Thursday morning.

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13/11

Top copy had P57
NEB - May 1979

FUTURE OF THE NATIONAL ENTERPRISE BOARD

1 We are discussing the future of the National Enterprise Board in MISC 22 on 15 November. I attach the paper summarizing the position but this is necessarily incomplete because we do not yet know what will happen at the meeting of the TUC Economic Committee on Wednesday morning. Jim Prior and I met David Basnett earlier today and he is unlikely to act precipitately tomorrow.

2 The present position is that we have secured the agreement of Sir Kenneth Keith to leave the Chairmanship of Rolls Royce early in the New Year and we have secured the agreement of Sir Frank McFadzean to replace him. We have not found a way of achieving our preferred solution for GEC to assist in sorting out Rolls Royce's production and finance problems. I have told the NEB Board that we intend to remove Rolls Royce from their jurisdiction as soon as we obtain the powers to arrange this. Our intention in this respect has now become public knowledge as has the intention of the NEB to resign en masse if we go ahead with our plan.

3 What is at issue in the present situation is, on the one hand, the possible repercussion on the NEDC of our going ahead with our proposals and, on the other, the certainty that we shall do considerable damage to our credibility over a range of issues if we are seen to back down in the face of the threat of the NEB to resign.

I am copying this minute to the other members of MISC 22, to Sir Robert Armstrong and to Sir Kenneth Berrill.

PCM

PP^{KJ}
13 November 1979

Department of Industry
Ashdown House
123 Victoria Street
London SW1

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



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THE FUTURE OF THE NATIONAL ENTERPRISE BOARD (NEB)

NOTE BY THE SECRETARY OF STATE FOR INDUSTRY

1 I referred in my paper (MISC(79)1) to the risk of resignations from the Board of the NEB in dealing with the Rolls Royce (RR) issue. The Board of the NEB have now made clear their intention to resign if the Government proceed with their proposal to remove RR from NEB ownership.

2 The Chairman of the NEB has been active in seeking support for his position and the General Secretary of the TUC has advised us that there is pressure from present and past trade union members of the NEB for the TUC to withdraw from cooperation in the National Economic Development Council and the various Economic Development Committees.

Evaluation of the NEB Position

3 The NEB recognise that, if RR is withdrawn from its ownership, the Board of the British Leyland (BL) will press very hard for the same treatment. They may also recognise that, if a choice has to be made between the loss of the BL Board and that of the NEB on this issue, I would have to choose in favour of the BL Board.

4 While some of the industrial members of the NEB Board appear ready to exert a restraining influence on Sir Leslie Murphy in his public criticisms of RR and complaints about lack of Government support over the last year, they will feel an obligation to resign with him.

The Position of British Leyland

5 In logic BL should not be part of the NEB; a company of its size needs a board of the highest calibre and such a board will not accept the supervision of another external board of businessmen. We are fortunate in the case of BL in having a board of the necessary calibre and I am advised that there had been strong pressure from within its membership for a direct relationship with the Department

/well before...



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well before we took our decision on RR.

6 I shall nevertheless seek, in the interests of compromise, to persuade the board of BL when I meet them later today to accept continuation of the NEB shareholding on the grounds that the special considerations for a direct Government shareholding in RR do not apply in their case. It must be expected, however, that they will press their case hard and I consider it essential to retain the services of this board.

A New Chairman for Rolls Royce

7 Sir Frank McFadzean remains willing to accept the Chairmanship of Rolls Royce but is strongly resistant to any compromise with the NEB. He had independently, as a member of the board of RR during recent weeks, reached the conclusion that the relationship with the NEB was wrong, and he shares Sir Kenneth Keith's appraisal of the Chairmanship of the NEB.

Possible Compromises

8 I have reviewed several possible compromises:-

- a. arrangements for the NEB to retain a shareholding in RR carrying special rights;
- b. leaving RR in the NEB but with Sir Frank McFadzean taking the chairmanship of the NEB when Sir Leslie Murphy retires as well as the chairmanship of RR;
- c. a range of possible devices for deferring a decision pending a review and in the meantime insulating the present Chairman of the NEB as far as possible from the affairs of RR and BL.

9 It is hard to see how the first of these could be formulated in a way that would be acceptable both to the NEB and to Sir Frank McFadzean. The second would overload Sir Frank McFadzean; the problems of RR are so great they need his undivided attention. While at an earlier stage he himself raised the possibility of the dual role, this was on the assumption that Sir Leslie Murphy would

/leave the...



leave the NEB quickly, a possibility we must discount. The third range of possibilities all suffer from the disadvantages of continuing a running sore and of distracting the top managements of RR and BL from their central task of improving the performance of their companies.

10 Moreover, face-saving compromises of this kind would be seen as a surrender by the Government to the pressures that the NEB had been able to bring to bear on them and there would be no offsetting benefit to public funds through improved management of RR or BL.

The Costs of Proceeding as Proposed

11 If we proceed and in consequence the NEB board resign, the risks we run are:

- a attacks by the ex-Chairman of the NEB on RR management and on the previous and present holders of my office for not dismissing Sir Kenneth Keith;
- b the possible loss of TUC involvement in the NEDC and its Committees;
- c conceivably, some worker reaction in RR or BL.

12 The first could be damaging to the business of RR and could be pursued with bitterness. The personality element in the criticisms would make the issues of particular interest to the press and the PAC (or some other Parliamentary Committee) might mount a detailed investigation extending over a considerable period. But part of the damage has already been done. Moreover Sir Leslie Murphy will bring upon himself much criticism too.

13 We can help the General Secretary of the TUC by deferring a decision until after the meeting of the TUC Economic Committee on 14 November, by making clear that any arrangements for the management of RR and BL shareholding have no relevance to the issue of returning the companies to the private sector, and by making clear that our

/decision....



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4.

decision is not based upon judgements on the competence of the NEB. Withdrawal of the TUC from NEDC activity would be seen as disproportionate to the magnitude of the issue.

14 While the NEB has made warning noises about worker reaction in RR and BL, the managements of both companies discount the likelihood of any significant worker opposition to the removal of their companies from the NEB. If the trades union movement were, however, to make this a major issue, the risk of strong worker opposition is obviously increased. Even so RR do not foresee significant strike action and I shall be taking further soundings of BL.

Conclusion

15 I am myself strongly opposed to conceding to the pressures being placed upon us by the NEB Board but I suggest we take a final decision at our meeting following a final assessment of the TUC implications of a decision to proceed.

KJ



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✓ *Mr. Luff*
Mr. Ingham

M. M. M.

R
B. G.

13 November 1979

Dear Ian

ROLLS ROYCE AND THE NEB

Your Secretary of State and mine saw David Basnett at Caxton House this morning to discuss the current situation.

Sir Keith Joseph made it clear to Mr Basnett that the primary objective of the steps taken so far had been to effect a satisfactory re-organisation of the top management of Rolls Royce with the minimum of recriminations. The departure of Sir Kenneth Keith and the separation of RR from the NEB has seemed the best way to achieve this. The management of NEB and its quality was not at issue, and there had been no intention of discourtesy to the Board in the way the matter had been handled. He was well aware that the NEB were dissatisfied with the RR management and he hoped that the changes that the Government had in mind would serve to improve the situation.

There could be little doubt that it was somewhat strange to have one strong board on top of another as was the case at present. However, he would be considering the various options further and consulting colleagues about them.

Mr Basnett said that the NEB had been aware of the unsatisfactory situation at RR for some time. They had been anxious to remove Sir Kenneth Keith and appoint a chief executive of proven ability. The NEB had been restrained by successive Governments from doing this, while Sir Kenneth Keith had been allowed to ignore his memorandum of agreement with the NEB and make major moves vis a vis the Government without consultation with the Board. Moreover the Government appeared to be endorsing RR's expression of no confidence in the NEB by considering the appointment of a new RR Chairman without consulting it. In his view the logic was to have the NEB looking after all "lame ducks" including Rolls-Royce and British Leyland. There remained little doubt in his mind that if RR was removed from the NEB the Board would resign en masse.



In response to a question from Mr Prior about how the current conflict might be resolved, Mr Basnett quoted with approval the NEB's suggestion of interlocking board membership between the NEB and RR. He wondered if there was any mileage in bringing Sir Frank McFazdean (whom he knew to be the Government's choice) and Sir Leslie Murphy together for a talk about the situation; the ideal solution would be for Sir Frank to waive his objections to working with the NEB. He had to say moreover that the NEB did not altogether have confidence in Sir Frank, as the right man for the job, particularly in view of his age and state of health.

The meeting concluded with Sir Keith Joseph emphasising the continuing role he saw for the NEB and the overriding importance of securing the future satisfactorily for Rolls Royce. It was agreed that Mr Prior would get in touch again with Mr Basnett when the Government had considered the matter further.

I am sending a copy of this letter to Tony Battishill (Treasury) and Tim Lankester (No 10).

*Yours sincerely
I A W Fair*

I A W FAIR
Principal Private
Secretary

11 NOV 1979





g/ Mr. Dymally
Mr. Walker

Prime Minister

Report on today's
mtg with Murray.

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

Sir Keith to
consider further
compromise
alternatives.

9th November 1979

amb

(Today's FT editorial
at 11.55 is worth
glancing at)

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9/11

Dear Sir,

ROLLS ROYCE AND THE NEB

Following the meeting which the Prime Minister held last night, the Chancellor, with the Secretaries of State for Industry and Employment, saw the General Secretary of the TUC at the Treasury this morning to talk about Rolls Royce and the NEB.

The Chancellor began by assuring Mr. Murray that Ministers were anxious to find an acceptable solution which would avoid unfortunate wider repercussions. The Secretary of State for Industry said that he had written to Sir Leslie Murphy assuring him that he had intended no discourtesy to the NEB Board in the necessarily short notice they received about the proposals for Rolls Royce; nor in reaching that decision had he intended any implied criticism of their prior management of that company. The source of the problem lay in the history of constant conflict between the NEB Board and the Board of Rolls Royce. He had no wish to dismiss Sir Kenneth Keith or Sir Leslie Murphy, even if he had the power to do so. In view of the clash of personalities, and the apparent intractability of the two sides, he had reached the conclusion that the route of separation was the only viable one. He had made it clear that he wanted to keep the NEB in existence, though with diminished powers. He had certainly not intended a chance remark about the lengthy involvement of the NEB in Rolls Royce's affairs to be taken as criticism of Sir Leslie Murphy, or of the other members of his Board. He had told them of his plans for Rolls Royce as soon as he had been able to do so. He hoped he had removed any misunderstanding on the part of Sir Leslie Murphy or Mr. Basnett. He faced the prospect of a similar situation developing over British Leyland, but he hoped to avoid having to take that company out of the NEB as well.

Mr. Murray said that he had not gained the impression that Mr. Basnett and the other NEB Directors were complaining

/of different

T. Lankester, Esq.,
No.10, Downing Street



of perfunctory treatment; but they felt very strongly that removal of Rolls Royce from the NEB when the Industry Act became law would be seen as a vote of no confidence in their management and, in effect, a slap in the face. Mr. Murray was personally not in a position to judge the internal management issues. His major preoccupation was to prevent the matter escalating in such a way that TUC involvement in the NEDC was threatened. Mr. Basnett had been very angry. He had wanted to propose, at a meeting of the TUC Economic Committee on Wednesday, 14th November, that the TUC should withdraw from the Sector Working Parties and the little Neddies. Mr. Murray had been very worried about this, both because he had been dealing with similar rumblings from certain other members of the TUC General Council and because of trouble with Mr. Harry Urwin over the threatened end to the Hotel and Catering EDC. The latter difficulty had been, he thought, successfully deflected by discussion at Wednesday's full NEDC meeting, but Mr. Murray was obviously fearful of an alliance of hostility towards NEDC formed by Mr. Urwin and Mr. Basnett, which others might seek to foster. If the matter got out of hand, it would not only threaten sensible tripartite discussion with the Government and the CBI, but also risk infecting developing contacts between the CBI and the TUC. Mr. Murray said he had also spoken about the Rolls Royce issue with Sir Leslie Murphy; whilst Mr. Murray retained an affection for the NEB he was more concerned to find a way of averting the wider repercussions he had described. He had tried to persuade Mr. Basnett to hold his hand and not to raise the issue at the meeting of the Economic Committee. He hoped he had succeeded.

Ministers endorsed Mr. Murray's wish to find a way of cooling the present situation, and of at least avoiding precipitate action before the Economic Committee met the following week. The Secretary of State for Industry said that he was desperately anxious to avoid any action which could affect the good name of Rolls Royce. Nor did he wish to lose Sir Leslie Murphy or the rest of the NEB Board. But Rolls Royce had to have the reinforcement of new management which the NEB Board itself had wanted for some time. If the only solution involved resignation of the NEB Board, he stood ready to invite the individual members to re-consider, or to invite new members to take their place. Mr. Murray said that he was certain that no trades union representative would accept such an invitation in those circumstances.

/Mr. Murray



Mr. Murray said he understood the Industry Secretary's position. He knew about the problem of personalities. Nevertheless he felt there must exist some formula which would enable resolution of the conflicting considerations. The Chancellor wondered whether a solution might lie in some kind of arrangement under which Rolls Royce became an associated company of the NEB, with representation on the Board for NEB directors, or, if this was too direct a relationship, for directors recommended by NEB. There might also be some continuing shareholding presence. The Secretary of State for Industry said that the idea of part-time directors on the Rolls Royce Board recommended by the NEB could be looked at; but he was clear that Sir Frank McFadzean would not accept an arrangement under which he was directly accountable in any way to the NEB. Sir Frank required to be explicitly assured that the situation would be satisfactory once the Industry Act came into force, even though Sir Leslie Murphy would be leaving the NEB in eight months time.

After further discussion on these lines, the Secretary of State for Industry undertook to consider further whether, despite the exhaustive examination already given to the problem, a compromise basis could be found which would allow the main parties concerned to co-exist in a new relationship. He was under no illusions about the magnitude of the task, and he did not wish to raise false expectations that such an outcome was possible. Mr. Murray said he would be glad to help in whatever way he could as an intermediary. With Ministers' agreement, he would report their conversation to Mr. Basnett, urging him to reflect further on the wisdom of escalating the matter at the TUC Economic Committee Meeting. He would also urge him with his fellow NEB Directors to address themselves to the search for a formula which might form the basis for a solution. If Mr. Basnett wished to talk to Ministers direct himself, he should be asked to contact the Secretary of State for Employment, who would then arrange for a meeting with the Secretary of State for Industry and himself or the Chancellor. It was crucially important to buy further time and to ensure that no-one acted precipitately.

The Chancellor thanked Mr. Murray for giving up his time and for his offer of further help.

I am sending a copy of this letter to Ian Ellison (Department of Industry), and to Ian Fair (Department of Employment).

Yours m.
A.M.W. Battishill

(A.M.W. BATTISHILL)



NOV 1979

CONFIDENTIAL

How to control Rolls-Royce

ROLLS-ROYCE is one of the world's three leading aero-engine builders. As a large exporter in a high-technology business, it is an asset to British industry. But its national importance does not mean that it is exempt from commercial considerations. It is not entitled to an endless supply of taxpayers' money in the hope that in 10, 20 or 30 years' time it may make an adequate return on the investment. Ideally it should be returned to the private sector, just like its two U.S. competitors, but the enormous costs associated with the RB-211 programme and other new engine developments preclude that solution for some time to come. Thus it is even more important that, while Rolls-Royce remains in the public sector, it should be subject to strict financial controls, with clear profit targets and clear limits on its access to public money.

Resentment

The last Government gave the National Enterprise Board the task of supervising Rolls-Royce—a decision which was resented by the management of the company, which preferred to deal directly with the Department of Industry. The argument was that a commercially-minded organisation like the NEB was more likely to impose the necessary disciplines than civil servants. Earlier this year, shortly before the election, the Government instructed the NEB to secure by 1981 a rate of return of 10 per cent on capital employed in Rolls-Royce and a progressive increase thereafter. This was not an unduly demanding target, but it at least gave the company and the NEB a framework in which its performance and its requirements for new funds could be assessed.

Since then the financial performance of Rolls-Royce has been badly hit by the strength of sterling, and the chairman of the NEB has been openly critical of the company's management. It now appears that the Conservative Government is considering a change in the control arrangements, taking the job away from the NEB and returning it to the Department of Industry.

While the change would obviously be welcomed by the management of Rolls-Royce, it is not clear what else it would

achieve. It seems hardly possible that Mrs. Margaret Thatcher and Sir Keith Joseph wish to relax the financial controls over the company or to make funds available to it on less onerous terms. One assumes that they would be even more determined than their predecessors to restore Rolls-Royce to financial viability, even if that involved a contraction in the size of its development programme.

Have Ministers persuaded themselves—or been persuaded—that the civil servants would be better at monitoring the company than the NEB? This would be a strange view to hold in the light of Whitehall's performance in the period before the Rolls-Royce bankruptcy. The criticism of the company today is that while it is good at selling engines, its internal financial controls are weak. On the face of it, the NEB is more likely to tackle these weaknesses and to enforce the necessary management changes than the Department of Industry.

It would be regrettable if the Government is considering this step out of a desire to clip the wings of the National Enterprise Board. However much Conservatives may dislike the creature, it is performing certain tasks which have to be performed somewhere in the government machine. Ministers presumably do not want to repeat the error of the last Tory Government, which was to abolish the Industrial Reorganisation Corporation, only to re-create it later in another guise.

Cash-hungry

No doubt there are other ways of supervising Rolls-Royce than through the National Enterprise Board and perhaps the Government sees the transfer from the NEB as the first step in a plan to provide a new financial basis for the company's operations. But whatever the control arrangements are, they have got to be strict. The fact that personal relations between the chairmen of the NEB and the company have been poor is not necessarily a bad thing. Rolls-Royce is likely to remain one of the most cash-hungry of all public sector enterprises. Its commercial and technological ambitions have to be kept under a tight rein.



FILE

Ind Pol. BK

Subject.

10 DOWNING STREET

CC HMT	MOD
D/M	D/N
CO	D/T
FCO	Berrill
HMT	

From the Private Secretary

9 November 1979

Your Secretary of State came to see the Prime Minister last night to report to her on the day's developments over Rolls Royce. The Chancellor of the Exchequer and the Secretary of State for Employment were also present. Sir Keith Joseph said that, following his discussion with Sir Kenneth Keith (reported in your letter of 6 November), he had seen Sir Leslie Murphy, who was strongly opposed to the proposal to take Rolls Royce out of the NEB when the Industry Bill came into force. Sir Leslie appeared to have misrepresented Sir Keith's position when reporting it to his NEB colleagues. Sir Keith had corrected this when seven members of the NEB Board came to see him. They strongly supported Sir Leslie Murphy, however. All declared their intention to resign with Sir Leslie. Sir Keith had said that he would consider their representations to him, and then see Sir Leslie again.

The Chancellor of the Exchequer reported that Sir John Methven had been to see him, following a conversation between Sir John and Mr. Len Murray. Mr. Murray was anxious to find a way of making it possible for the union members of NEB to avoid resignation. Sir John was of the view that Mr. Murray would value the opening up of contacts to allow a search for a compromise. The Chancellor said that his personal impression was that Mr. Murray might be able to persuade his union colleagues to accept a sensible arrangement on Rolls Royce which would not set a precedent leading to the removal of British Leyland from NEB. The Secretary of State for Employment said that he had had a number of conversations with Mr. Murray in the course of the day. Mr. David Basnett was reported to be extremely concerned about the NEB situation. Mr. Murray foresaw a risk of union withdrawal from many national forums if the Rolls Royce/NEB situation led to resignations. Mr. Murray had pointed to the positive contribution of the unions to the work of the NEB and also to Lord Scanlon's efforts over the British Leyland ballot. Mr. Murray needed help, and also needed time to work for a compromise.

/The Prime Minister

The Prime Minister recognised that the current problems were essentially personality issues. Now Sir Frank McFadzean had made it clear that he would not take over the Rolls Royce Chairmanship whilst links with NEB under Sir Leslie Murphy's Chairmanship remained, there were still several options. Rolls Royce could be taken out of the NEB, as proposed, or ways might be found of persuading the present NEB Chairman to leave the organisation, which might make it possible for Rolls Royce and NEB to continue to work together. Precipitate decisions should be avoided. It would obviously be helpful to keep in touch with Mr. Murray. It was important to find the approach which would avoid the risk of union withdrawal from the NEB and possibly from other organisations. Mr. Prior should speak to Mr. Murray early today paving the way for a meeting of the Chancellor of the Exchequer and the Secretary of State for Industry with Mr. Murray. It would be preferable to make this one with Mr. Murray alone. Ministers should also pursue contacts with individual members of the NEB to seek ways of avoiding mass resignation. It would be necessary for Ministers to be in touch again before final decisions were reached.

I am sending copies of this letter to Martin Hall (HM Treasury), Ian Fair (Department of Employment), the Private Secretaries to members of MISC 22 and to Martin Vile (Cabinet Office).

M. A. PATTISON

Ian Ellison, Esq.,
Department of Industry

KRB

PM seen
PRIME MINISTER

Rolls Royce and the NEB

Sir Keith Joseph would like to see you about this tonight.

As you know, Sir Keith saw the NEB Board yesterday and told them of the Government's intention to take Rolls Royce out of the NEB's responsibility. They said they would resign if this decision was not reconsidered. They pressed Sir Keith to consider a compromise solution: this would be that two NEB Board members would join the Rolls Royce Board, Frank McFadzean would join the NEB Board, and Leslie Murphy would undertake to stand back from overseeing the company.

Sir Keith's Permanent Secretary saw Frank McFadzean today, and it seems that the "compromise solution" is a non-starter. McFadzean is not prepared to go along with it and says that Murphy should be allowed to resign. He has suggested that he himself should become Chairman of the NEB until the Industry Bill is passed and Rolls Royce can be taken out of the NEB's responsibility, and that Sir Kenneth Keith should stay on until that time - i.e. March next year. During this time, McFadzean would familiarise himself with the Rolls Royce operation and recruit a management team. He also has in mind a possible consultancy arrangement with Boeing as a substitute for the GEC consultancy which we were thinking of. He would then take over the Chairmanship of Rolls Royce from Kenneth Keith, and relinquish the Chairmanship of the NEB.

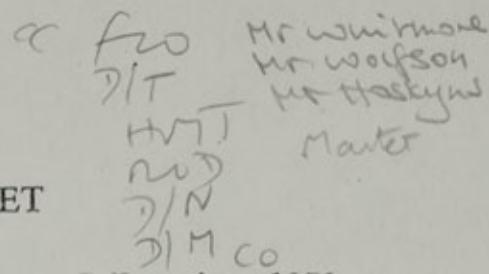
An alternative would be for Leslie Murphy to resign along with his Board, and for Frank McFadzean to take over Rolls Royce on 1 January as suggested earlier. A new Chairman (someone other than McFadzean) would be appointed simultaneously to the NEB. However, I understand that McFadzean and Keith have talked and would regard this solution as unacceptable - because, in these circumstances, Keith's retirement would look like a victory for the NEB.

I understand that Sir Keith Joseph wants your agreement to this approach. However, Mr. Prior is worried. Len Murray has been in touch with ^{him} ~~me~~ today and has said that if Rolls Royce is taken out of the NEB, the trade unions will cause trouble - and, in particular, they will retaliate by withdrawing their membership of such things as the NEDC. However, it is clear that McFadzean will not work under the NEB and therefore I cannot see how we can meet Murray's objections. Mr. Prior will just have to mollify Murray somehow - it would be very damaging if the trade unions did pull out of NEDC in my opinion.

Mr. Prior has asked if he can join your meeting with Sir Keith Joseph.

R.

8 November 1979



From the Private Secretary

7 November 1979

Subject.

Sir Kenneth said that he had met the Secretary of State that morning to discuss the future chairmanship of Rolls Royce. He himself had come to the conclusion that it was time to retire from the chairmanship. He had successfully built up the company so that it now had a strong order book and an impressive reputation throughout the world. But major problems remained to be solved concerning production and cost control. He had never claimed to be strong on production management, and the problems of the company had been exacerbated by the failure to recruit a strong production executive. Various attempts to attract a top man with an engineering background had failed. There was no doubt, in his view, that the first priority for a new chairman was to find a suitable candidate for chief executive. As regards his own successor, he was very content with the proposal that Sir Frank McFadzean should become chairman; he envisaged handing over on 1 January 1980. It would be important to explain to Rolls Royce's customers in the USA, particularly Boeing, the circumstances of the hand-over; but he had no doubt that they would be impressed with the choice of Sir Frank. Sir Kenneth then voiced his criticisms of the NEB, and welcomed the proposal that Rolls Royce should be removed from their responsibility and made responsible directly to the Secretary of State. He was most anxious that his departure from the company should not appear as a victory for the NEB.

/ Sir Kenneth

- 2 -

Sir Kenneth went on to make two further points. Firstly, he hoped that Rolls Royce would be allowed to sign an agreement with the Japanese to collaborate with the development of the RB432 engine. With this agreement, Rolls Royce should be able to secure a good position in the Far Eastern market; if the agreement did not go ahead, the Japanese would almost certainly enter into talks with General Electric. The cost of the development programme to Rolls Royce should not be great, and the commitment would be subject to review each year. Secondly, he hoped that the Government would make efforts to persuade the US Government to buy the Advanced Harrier. He had called on the US Deputy Secretary of Defence and the Secretary of the Navy when he had visited Washington recently, and they seemed keen to buy this aircraft. But the Administration would need pushing further, and he hoped that the Prime Minister would mention the matter to President Carter when she visited Washington in December.

The Prime Minister said that the Government were very grateful for all that Sir Kenneth had achieved as chairman. They accepted that, if Sir Kenneth wished to retire at the end of the year, he should do so. Out of recognition for his services, she intended to give a dinner for Sir Kenneth some time in the New Year. She noted the points which Sir Kenneth had made about the 432 engine and the Advanced Harrier, which he would no doubt discuss further with the Secretary of State, and also the point about the NEB.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), Stuart Hampson (Department of Trade), Tony Battishill (H.M. Treasury), Brian Norbury (Ministry of Defence), Bill Burroughs (Department of Energy), Ian Fair (Department of Employment) and Martin Vile (Cabinet Office).

T. P. LANKESTER

Ian Ellison, Esq.,
Department of Industry.

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DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

PS/ Secretary of State for Industry

6 November 1979

Tim Lankester Esq
Private Secretary to the Prime Minister *PM's office*
10 Downing Street
LONDON SW1

Dear Tim

*This is a report on
Keith Joseph's meeting with
Sir Kenneth Keith this morning -
which went well.*

Since I wrote to you last night, my Secretary of State has seen Sir Kenneth Keith, Sir Frank McFadzean and Sir Leslie Murphy. *12 67*

The discussion with Sir Kenneth Keith settled that he will leave Rolls Royce on 1 January 1980 and that he would be succeeded by Sir Frank McFadzean of whom Sir Kenneth warmly approves. Sir Kenneth's worry is about his personal position; he is anxious that there should appear to be no victory for Sir Leslie Murphy and that there should be no suggestion that his departure from Rolls Royce is in any way a quid pro quo for taking Rolls Royce out of the NEB. My Secretary of State thinks that the way to achieve this is to separate the announcement of the release of Rolls Royce from the NEB from the announcement of Sir Kenneth Keith's departure by a week to 10 days (if this proves feasible in the light of the NEB's reaction described below).

The meeting with Sir Frank McFadzean confirmed that he does not really want Sir Kenneth Keith to have any continuing role at Rolls Royce. There is the possibility of a retainer, but the matter will be settled between Sir Kenneth Keith and Sir Frank McFadzean without our further intervention. Sir Frank remains resolutely opposed to a direct GEC involvement, but he is willing to consider the possible appointment of Mr Morgan as Chief Executive. Mr Morgan's name has coincidentally been mentioned by the head hunters employed by Rolls Royce to find a Chief Executive.

The discussion with Sir Leslie Murphy at which he was told of the decision to take Rolls Royce out of the NEB was difficult. Sir Leslie, whilst saying that he would not resign himself, regards the decision as a vote of no confidence in the NEB. Although he personally approves of Sir Frank McFadzean, he will require a direction before formally agreeing to his appointment

/as

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as Chairman of Rolls Royce. He commented that the arrangement had an appearance of a "Tory plot" and he has asked the Secretary of State to see the entire NEB at a formal meeting. He has also threatened to release to the press a lengthy document criticising Rolls Royce and carrying the implication that the NEB was ineffective because it has not had backing from successive administrations. My Secretary of State refrained from being drawn into debate, but did point out that Rolls Royce had been the NEB's responsibility for some $3\frac{1}{2}$ years.

The position for the meeting this evening is therefore that Sir Kenneth Keith is fully prepared for what the Prime Minister has to say to him. He does not now wish to discuss the Japanese question or the RB432. The need is to soothe and to reassure him. My Secretary of State hopes the Prime Minister will offer Sir Kenneth a dinner to mark his leaving Rolls Royce and hint at other possible delights in prospect.

Yours we

Ian

I K C ELLISON
Private Secretary



- 6 NOV 1979



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Ind Pd.

Ref: A0570

PRIME MINISTER

Rolls Royce

(Minutes to you dated 1 November from the Secretary of State for Industry and 2 November from the Chancellor of the Exchequer, are relevant.)

Background

When MISC 22 last discussed the Rolls Royce situation on 18 October (MISC 22(79) 2nd Meeting) the Group agreed among other matters:

- that if possible the expertise of Sir Arnold Weinstock and the GEC management should be made available to Rolls Royce;
- that you, together with a few colleagues should meet Sir Arnold Weinstock and discuss the situation with him;
- that subsequently Sir Keith Joseph should sound out Sir Kenneth Keith on his attitude to the proposed arrangements.

2. The meetings with Sir Arnold Weinstock and Sir Kenneth Keith have now taken place. Sir Keith Joseph's minute to you of 1 November reports the outcome of his meeting with Sir Kenneth Keith but extends also into the future relationship of British Leyland with the NEB. In addition it records Sir Frank McFadzean's conditions for accepting the Chairmanship of Rolls Royce, including rejection of the idea of using GEC as consultants; and raises the possibility of 'securing the resignation of Sir Leslie Murphy'.

/3. The Chancellor

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3. The Chancellor, in his minute of 2 November expresses concern that the way matters are developing represents a major shift from that discussed in MISC 22 - especially as regards the involvement of GEC - and questions whether Sir Frank McFadzean is the best available Chairman for Rolls Royce.

4. The main problem with the discussion of these issues will be to disentangle the various threads and to ensure that major decisions are not taken without adequate preparation. In particular:-

← (a) You might seek agreement at the outset that the proposal to transfer B.L. from NEB to the Department of Industry is extraneous to the Rolls Royce issues and should be the subject of a reasoned and separate submission by Sir Keith Joseph. (Obvious questions are whether the ~~rump~~ of the NEB would be viable; whether, given the difficult position of B.L. - much more delicate and urgent than R.R. - the Government might not welcome NEB as at least a short-term buffer; and whether this is the right moment to add a further dimension of uncertainty to the B.L. position.)

(b) You will want views on whether Sir Frank McFadzean's conditions are acceptable (or changeable) - the ~~apparent~~ aversion to GEC being the most at variance with past thinking - and whether in the light of this, and the Chancellor doubts it, he should still be regarded as a potential Chairman for R.R.

/(c) You will

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(c) You will particularly want a collective view on whether the management structure which might emerge from Sir Keith Joseph's latest ideas meets the needs of the situation.

(d) You will want to sound colleagues on the proposition that Sir Leslie Murphy should go. It being relevant that this is posed as an alternative to the transfer of R.R. to Industry - which is already agreed.

Handling

5. You should ask the Secretary of State for Industry to explain the current situation and the Chancellor to explain his worries. Thereafter the discussion might focuss on the four main issues set out above.

Conclusion

6. Apart from seeking a separate paper on B.L. the conclusion will depend on the course of discussion.

R.A.
AP

ROBERT ARMSTRONG

5 November 1979.

CONFIDENTIAL

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6/11/79



DEPARTMENT OF INDUSTRY

ASHDOWN HOUSE

123 VICTORIA STREET

LONDON SW1E 6RB

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PS/*Secretary of State for Industry*

5 November 1979

Tim Lankester Esq
Private Secretary to the Prime Minister
10 Downing Street
London SW1

Dear Tim

... I enclose a brief for the Prime Minister's talk with Sir Kenneth Keith on Tuesday 6 November. My Secretary of State is seeing Sir Kenneth Keith, Sir Frank McFadzean and Sir Leslie Murphy in the course of the morning and I will send you supplementary briefing early in the afternoon.

Yours ever

lan

I K C ELLISON
Private Secretary



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PRIME MINISTER'S TALK WITH SIR KENNETH KEITH ON TUESDAY 6 NOVEMBER 1979

Purpose

- i to respond to Sir Kenneth Keith's wish to have a talk with the Prime Minister;
- ii to secure his resignation from the Chairmanship of Rolls Royce by agreement and with honour.

Background

Sir Kenneth Keith told Sir Keith Joseph last Wednesday at Derby that in a sense he had "shot his bolt", that he had never pretended to be an expert in manufacture and that if he could think of someone who knows that side he would make way for him and accept an international sales consultancy role. But he is a mercurial person, subject to changes of mood, and there is always a possibility that he will have changed his mind, particularly if he sees a future ahead without the encumbrance of the NEB.

Points to bear in mind

- i Sir Kenneth Keith has the strongest antipathy to Sir Leslie Murphy in particular and to the NEB in general. This means that his resignation will only be achieved if it is clearly seen by him to be none of Murphy's doing, and if this is clear to the world at large too. It also means that to tell him in confidence of the Government's decision to take RR out of the NEB will be some compensation for his loss of the Chairmanship.
- ii Sir Kenneth Keith is a proud man who will respond to visible signs of recognition. For example, a dinner given by the Prime Minister to mark his departure from Rolls Royce would help;
- iii Sir Keith Joseph will have seen him on the morning of the Prime Minister's talk, to prepare the way, and further briefing will be given in the light of that discussion;



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- iv it will be best to concentrate on Sir Kenneth Keith's own personal position, but if he introduces discussion on candidates for the succession it could be useful to mention that the Government has in mind Sir Frank McFadzean.

✓ Sir Keith Joseph will mention this if it seems opportune in the morning ✓

Conduct of the meeting

Depending on how the morning's discussion with Sir Keith Joseph has gone, it might be best to begin by inviting Sir Kenneth Keith to give the Prime Minister his assessment of the company's present position and the way ahead. He might also be invited to give his views on the NEB.

Subject to the risk of changes of mood mentioned above, there is a good chance that Sir Kenneth Keith will respond by indicating his willingness to go and, if so, that makes the discussion correspondingly easier.

Facts and Figures

A short note is annexed (Annex 1) summarising some of the facts on Rolls Royce with which the Prime Minister is already broadly familiar.

Collaboration with Japan

Sir Kenneth Keith wishes to raise this. A note is enclosed at Annex II.

Points to make in discussion

- i warm recognition of what Sir Kenneth Keith has achieved since, at the request of Lord Carrington, he took over the Chairmanship of Rolls Royce following the collapse in 1971; no-one could have devoted himself more wholeheartedly to the task and the nation recognises this;
- ii acknowledge that the company has not been helped in its task by the Labour Government's decision to transfer the Government's ownership of the company to the NEB and tell



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Sir Kenneth Keith in strict confidence, for his own information only and not that of any of his colleagues, that the Government intends to announce shortly its decision to take Rolls Royce out of the NEB - the only alternative would be to secure the resignation of Sir Leslie Murphy;

[It may be necessary to say something broadly indicative of the Government's thinking during the Industry Bill Debate on Tuesday, but the Government must control the handling of this delicate matter.]

- iii returning to Rolls Royce, congratulate Sir Kenneth Keith on achieving the launch order position for the new 535 engine in the new Boeing 757 medium range, medium size, passenger airliner. This was very much a personal achievement of Sir Kenneth Keith;
- iv while welcoming this, express the Government's concern about the scale of the company's financial problems. In the normal way a shareholder accepts the need to finance the cost of increased inventory when business expands, but unfortunately, with movements in the exchange rate, the past effects of inflation, and the difficulty of improving productivity, Rolls is facing some heavy losses in the period immediately ahead;
- v we know that Sir Kenneth Keith sees the critical issue facing the company, now that he has re-established it in the market place, as the successful management of a huge expansion in the production of the RB211 family of engines without increasing the labour force and with a major reduction in costs;
- vi the Government thinks this analysis is absolutely right and the Prime Minister has had a report from Sir Keith Joseph of the private talk he had with Sir Kenneth Keith last Wednesday at Derby;



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- vii the Government accepts the wisdom of Sir Kenneth Keith's view that the skills required for this new stage in the company's progress might best come from a new Chairman;
- viii naturally the Government would want to mark the change in the Chairmanship by some public recognition of Sir Kenneth Keith's contribution; [The Prime Minister might sound him about a dinner in his honour at No 10]
- ix end with recognition that Sir Kenneth Keith has been motivated throughout by a sense of public duty and the Government will remember this.

Notes for Supplementaries

A Continuing Role for Sir Kenneth Keith

Sir Frank McFadzean does not want any future involvement in the company for Sir Kenneth Keith. But he would be prepared to offer him a retainer for a consultancy on the sales side, although he has indicated in strict confidence to us that little if any use would be made of Sir Kenneth.

Candidates for the Chairmanship

Sir Kenneth Keith may have ideas of his own on the Chairmanship. He thinks highly of John King of Babcock & Wilcox and also of Sir Arthur Knight, until recently Chairman of Courtaulds, and also until recently on the board of Rolls Royce. If he mentioned them the Prime Minister might warmly recognise their abilities but indicate that King is not really a production specialist while Sir Arthur Knight is too much of an intellectual in manner for the aircraft industry. The Prime Minister might, however, say that both will be considered for public appointments.

The American Version of the Harrier - AV8B

Sir Kenneth Keith is very keen for the RAF to adopt the advanced version of the Harrier (the AV8B), developed by the Americans. This is to help persuade the Americans to adopt the aircraft.



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Rolls have a lot to gain from this because the engine would be manufactured here. For British Aerospace the issue is not so clear-cut because a substantial part - yet to be defined - of the airframe would be made in America.

If Sir Kenneth Keith raises this the Prime Minister need only take note.

Department of Industry

5 November 1979



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ANNEX 1

KEY FACTS AND FIGURES

Employees number 59,400 (56,600 in the UK), most of whom work in the Aeroengine Division, whose main locations are Derby (civil engines, especially RB211), and Bristol (mainly military engines). Other locations include Coventry (industrial and marine engines), Glasgow and Leavesden (helicopter engines).

Turnover in 1978 was £760 million, of which £660 million was from the sale of aeroengines (53% military, 47% civil).

Exports accounted for 45% (£340 million) of turnover. The company showed a profit of £11.7 million (before tax, after interest) on capital employed of £364 million. The company's latest forecast cash requirement is £765 million for the years 1979/83; £139 million in 1979, £216 million in 1980). These figures are after allowing for £250 million launch aid on RB211-535 and RB211-524.

The company forecast a loss of £34 million this year; this is likely to be worse as a result of the engineering strike. The forecast loss next year is £45 million.

Rolls Royce Board

Chairman: Sir Kenneth Keith

Vice-Chairmen: Donald Pepper
Ashley Raeburn CBE

Directors: Sir George Burton
Sir St John Elstob CBE
Dennis Head CBE
Samuel Higginbottom (resident in USA)
Sir Frank McFadzean
Peter Moloney
Marshal of the Royal Air Force Sir Denis Spotswood GCB
CBE DSO DFC
Sir Peter Thornton KCB
Air Chief Marshal Sir Neil Wheeler GCB CBE DSO DFC AFC
Raymond Whitfield



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ANNEX 2

RB432 AND JAPAN

Sir Kenneth Keith may refer to the proposed development, in collaboration with Japan of the RB432.

/seat

This engine, of about 20,000lbs thrust is aimed at the market for 100-130/aircraft, a market in which RR has achieved a reasonable share in the past with the successful Spey engine. Possible applications of the engine are the Fokker F29, a re-engined Boeing 737 and a Japanese project. None of these is yet certain.

Current RR estimates of the cost of the RB432 development is £300m over a 5-6 year period.

Because of the heavy financial commitments on development of the RB211 -524 and -535, RR have for some time recognised that new projects could only be launched in collaboration - a trend which is now widespread throughout the aerospace industry. Since the Japanese Government has a clear commitment to build up its aero-engine industry with the help of foreign technology, RR see advantage in harnessing Japanese funds to their project, assuring a secure market for the engine in Japan and possibly in a number of Far East countries, and pre-empting Japanese collaboration with RR's main competitors.

The company have, however, recognised the main danger of such collaboration in the permanent transfer of technology to Japan. They have, therefore, extracted in the proposed collaboration agreement, a commitment from the Japanese to involve RR in any further aero-engine projects based on the technology of the RB432. The terms of this are such as to exclude Japan from development of any aero-engines other than the large high by-pass engines such as the RB211 (which it is most unlikely they would want to do) without RR having the option to participate.

The proposed agreement between RR and Japan envisages two stages; initial launch in which the two sides further define the engine and establish the market, and full launch at which stage both sides would need their Governments' approval and must have established a source of funding.



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The Japanese are anxious to get RR's signature to the proposed agreement before the end of the month, because the Japanese request for funding goes before the Diet in December.

The company have been told, however, that in present circumstances Ministers are anxious to have more time to consider the implications of collaboration with Japan.

Line to Take (If subject raised)

- 1 The proposed agreement is of considerable importance for the long term strategy of the company. It would be helpful to have more time to study the implications.
- 2 Ask Sir Kenneth Keith to explain the reasons for the urgency of signature. Is it essential for the Japanese to have signature before the matter goes to the Diet?

Department of Industry

5 November 1979

CONFIDENTIAL



*Consim - pls,
2*

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

*PM agreed but
there should be a meeting of
MISC 22
R. 4/11*

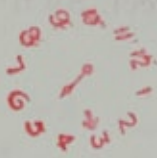
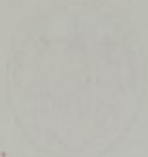
ROLLS ROYCE

I have seen Keith Joseph's minute of 1st November. The suggestion that he should attempt to secure the resignation of Sir Leslie Murphy, and/or plan on taking back Rolls Royce (and perhaps British Leyland) from the NEB when the Industry Bill becomes law, does not worry me. I am however concerned that the new management arrangements for Rolls Royce which are emerging seem radically different from those which we discussed last month in MISC 22, when great importance was attached to the involvement of a GEC team, and this was seen as a pre-requisite for the preparation of a strategy to deal with the Company's cash flow crisis. And I should like to be sure, before arrangements are finalised with him, that Sir Frank McFadzean really is the best available candidate for the demanding task of seeing Rolls Royce through a prolonged period of major difficulties. I wonder too whether the role envisaged for Sir Kenneth Keith implies a sufficient involvement.

2. When MISC 22 last met you suggested that the Group might re-convene when meetings with Sir Arnold Weinstock and Sir Kenneth Keith had taken place. Now that we have reached that stage, I would welcome another meeting before Keith Joseph takes the action proposed in his minute. Copies of this one go to him and the other members of MISC 22, as well as to Sir Robert Armstrong and Sir Kenneth Berrill. In view of his interest, a copy also goes to Francis Pym

[Signature]
(G.H.)

2 November 1979



2 NOV 1979

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Prime Minister



*✓ Inhibition
Mr Hoskins*

PRIME MINISTER

Keith

ROLLS ROYCE

*✓ If you have a
Chairman, you have
to take his advice!
should not mess the
Rolls Royce problem. ~~Let solution too hard.~~
You might lose Frank
out*

*It worries me that the
use of SEC in support
of Morgan is fading away.
Would you like a quick
meeting of MISC 22, or
are you content with
Sir Keith's proposals as
they stand? My own feeling
is that another
meeting is
desirable.*

This is to report progress since we last discussed the Rolls Royce problem.

I saw Sir Kenneth Keith yesterday, and I am glad to tell you that he is ready to step down if we can find a suitable Chairman. He would like to have some continued association with the Company, possibly as a part-time consultant for say two years, making perhaps two tours of clients a year.

*Will
see
not*

He did, however, express a strong wish to have thirty minutes with you to discuss the Company's problems and its relationship with the NEB and also to explain to you why the Company and the UK would benefit from a partnership with the Japanese over a possible new engine.

I recommend that you should see him out of courtesy to the service he has given over the last seven years - admittedly using for recent sales exchange rate assumptions which he shared with the Bank and ICI - and in so doing to settle in principle his departure from the Chairmanship. I would like to see him move completely out beyond the power to intervene.

Since we last spoke I have also had a further talk with Sir Frank McFadzean, who has recently, on Sir Kenneth's invitation, joined

/the ...

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APPOINTMENTS IN CONFIDENCE



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the Rolls Royce Board. He is now willing to accept the Chairmanship of Rolls Royce without also having the Chairmanship of the NEB. Sir Frank made only two conditions. First, either I announce that Rolls Royce is to be withdrawn from the NEB or that the NEB Chairman ceases to be Sir Leslie Murphy; second that his appointment can be managed without acrimony with Sir Kenneth Keith. From what I have said above, the second point should not be a problem.

I have given Sir Frank the name of Mr Morgan as my recommended candidate for the post of Chief Executive and he has agreed to consider him. But, to my disappointment, he came down against the appointment of GEC as consultants in support of Mr Morgan.

I would still have very much preferred - in the light of the huge losses that Rolls Royce may face - my original proposal to harness GEC. Anything short of this is very much a second best and could cost us dearly. As you know sums of hundreds of millions may be at stake. I therefore propose to see Sir Frank McFadzean again early next week to explain to him the position I have reached with Sir Kenneth Keith, and to press him to reconsider his view on the employment of GEC in the consultancy role. As a fall-back position I propose to urge on him that he should be willing to accept the use of GEC if he has not been able to get together a satisfactory management team within three months of his appointment. I will report the outcome to you. I will also keep Sir Armond Weinstock informed,

/since ...

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3

since he has been so helpful and, of course, employs Morgan.

Turning to the NEB; it is not only Rolls Royce that wishes to get out. The Board of British Leyland, though not Sir Michael Edwardes himself, strongly desires to work to the Department direct and to be free of the NEB. If I take Rolls Royce out of the NEB, the pressures for the same treatment for British Leyland ^{- so long as it survives -} will be extremely strong.

I shall need to have a further talk with Sir Michael Edwardes and Sir Frank McFadzean as well as speak to Sir Leslie Murphy himself before I form a final view. I would, therefore, welcome your agreement to my resolving this issue either by securing the resignation of Sir Leslie Murphy - I have no power to dismiss him - or by removing Rolls Royce from the NEB, or removing both Rolls Royce and British Leyland from the NEB.

I am copying this to the members of MISC 22 Committee, Sir Robert Armstrong and Sir Kenneth Berrill.

KJ

K J

1 November 1979

Department of Industry
123 Victoria Street
London SW1



1 - NOV 1979



SECRET

13.



Ind PDI

cc Martin Vile
David Wolfson
John Hoskyns

JS

Copy: Miss Porter

10 DOWNING STREET

From the Private Secretary

29 October 1979

ROLLS ROYCE

When Sir Keith Joseph called on the Prime Minister this afternoon, he reported briefly on Rolls Royce. Following the Prime Minister's meeting with Sir Arnold Weinstock last week, Sir Arnold had telephoned to confirm that GEC were very willing to assist Rolls Royce on the lines proposed at the meeting; but he felt that the arrangement was unlikely to work. In particular, if Mr. Morgan became Chief Executive, it seemed unlikely that he would either wish or be able to call in GEC as consultants, and it also seemed very unlikely that he would get on with Sir Kenneth Keith.

Against this background, he (Sir Keith) had seen Sir Frank McFadzean and had asked him on a totally non-committal basis if he would be interested in the chairmanship of Rolls Royce. Sir Frank had said that he would be interested in principle, and that he would also be interested in combining the job with the chairmanship of the NEB. He had not told him about the plan to bring in Morgan and GEC; this would still be a possibility, though as an alternative McFadzean might himself bring in a top Engineering Executive of his own choice.

The Prime Minister said that she was content for Sir Keith to sound out McFadzean further, but she did not think it would be possible for him to combine the chairmanship of Rolls Royce with that of the NEB as long as Rolls Royce reported to the NEB. This would surely involve a conflict of interest. Sir Keith said that he would consider this point further.

T. P. LANKESTER

KRP

Ian Ellison, Esq.,
Department of Industry.

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copy on: Ind. Pol, Sept 79,
British Leyland.

cc: Miss Porter

PRIME MINISTER

Meeting with Sir Keith Joseph

Sir Keith wants to bring you up-to-date with his proposals for Rolls Royce. I understand that he has had discussions with Frank McFadzean, who, as you know, is on the Rolls Royce board. The possibility of moving Sir Kenneth Keith out altogether - and, for example, taking up the STC chairmanship - seems to be a runner now.

Sir Keith will also want to discuss his proposed statement on British Leyland. I have passed your comments on the draft to the Department; but I understand Sir Keith still wishes to go ahead. He thinks that to confirm the previous administration's 1977 assurance, after the ballot is announced, will look like panicking - and certainly more than giving it before the announcement. This seems questionable. But in any case, Sir Keith's guess is that the vote will go in favour of the Edwardes plan. In view of that, and since any statement reiterating the 1977 assurance is likely to be misrepresented, it would seem best to say nothing.

R.

29 October 1979

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Extract

RECORD OF A MEETING IN THE PRIME MINISTER'S ROOM AT THE HOUSE OF
COMMONS AT 2130 ON TUESDAY 23 OCTOBER 1979

Present:

Prime Minister

Sir Arnold Weinstock

Secretary of State for Industry

Sir Kenneth Bond

Secretary of State for ~~Trade~~

Mr. Lewis

Mr. T. P. Lankester

Energy

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on the current situation unless a proper arms-length relationship were established between CEGB and NNC. GEC would use its best endeavours to provide management to NNC so that it could fulfil its proper function; once NNC's competence had been built up, GEC would like to give up their supervisory role.

Rolls Royce

Sir Keith Joseph said that Sir Arnold was familiar with the current problems which Rolls Royce were facing. In brief, the RB2-11 engine had had to be sold at a low price in order to break into the American market; this price had been denominated in dollars and the exchange rate assumptions had proved false; and this problem had been exacerbated by poor productivity and inadequate cost control by management. Sir Kenneth Keith had made an important contribution to the company as a salesman, but his performance as a manager - and he admitted this himself - had been far less successful. The Government were hoping that GEC would be willing to let Mr. Morgan become Chief Executive of Rolls Royce, with the possibility of GEC providing management assistance on a consultancy basis as well. The Government thought it would be best not to impose a GEC consultancy upon Rolls Royce immediately since this might lead to a mass resignation of the Rolls Royce Board. It would be better for Mr. Morgan to assess the company's needs first, and then persuade the Board that GEC management assistance would be helpful. The position of Sir Kenneth Keith would in any case cause problems, since it seemed unlikely that he and Mr. Morgan would be compatible. It might be possible to promote Sir Kenneth to the Presidency of the company after a few months; but again it would be necessary to move delicately if a confrontation with the Board, and with Sir Kenneth himself, was to be avoided. Such a confrontation would be bad for customer confidence. There was also the question of Rolls Royce's relationship with the NEB: the Government had it in mind to make the Department of Industry directly responsible for the company again.

Sir Keith went on to say that he understood that GEC were interested in purchasing Rolls' Industrial and Marine Division and also perhaps its nuclear interests. But Ministers had concluded that it would not be wise politically, nor would it be

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commercially beneficial to either company, if either of these acquisitions were to go ahead at a time when GEC were taking on management responsibilities for Rolls Royce. However, assuming GEC went along with the Government's proposals, the option of acquiring these two parts of the Rolls Royce business would remain open for some later stage.

The Prime Minister reiterated that it was important to maintain an arms-length relationship between GEC and Rolls Royce. She would also like to be sure that GEC were able to take on the proposed responsibility for Rolls Royce, as well as playing a bigger role in the nuclear industry.

Sir Arnold Weinstock replied that the Government were absolutely right to rule out the option of taking Rolls Royce out of the aero-engine business; although the company's performance had been very poor in terms of profitability, nonetheless it would be very unwise to throw away this technology. The question was: how to improve Rolls Royce's performance? He had no doubt that, with better management, its performance could be improved. GEC would be prepared to assist on the lines suggested by Sir Keith Joseph, and he did not foresee any difficulty in doing this as well as providing a greater management input to NNC. But he was sure that Mr. Morgan would not get on with Sir Kenneth Keith, and it was therefore essential to find an early exit for him - at least from management responsibilities. He had heard that Sir Kenneth had been offered the chairmanship of STC, and wondered whether this would not provide a satisfactory alternative to his remaining with Rolls Royce. Also, Morgan would not be able to achieve success on his own: he would need help from Stanhope Gate, though he (Sir Arnold) understood that it should be for Morgan to ask for this support rather than having it imposed by the Government.

He accepted that there would be a presentational problem if GEC were now to acquire any of Rolls' interests, and that an arms-length relationship between the two companies was needed. However, this difficulty might not have arisen if GEC had been able to proceed with its ideas for splitting its own business. For some time, he had been considering splitting GEC into smaller companies. For

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example, he would have liked to hive-off Schreiber/Hotpoint so as to make it stand on its own feet. Similarly, he had considered the idea of hiving-off GEC's power engineering business and merging it with Rolls Royce's power engineering sections. If this latter plan had been viable, the presentational difficulty of GEC acquiring parts of Rolls Royce - while also providing management - might not have arisen. However, the plans for splitting GEC were made impossible by current tax legislation, which meant that shareholders in the newly formed companies would be liable to capital gains and income tax when they exchanged GEC shares for shares in the new companies.

Sir Arnold made the following further points:

- (i) GEC were interested in other acquisitions from the public sector - particularly Cable and Wireless and British Aerospace.
- (ii) If GEC were to help Rolls Royce, they would not be prepared to tolerate the unfair competition which Rolls Royce were engaged in on the gas turbine side. They had set up a joint company with a US company, Coopers, and were tendering on a loss-making basis at GEC's expense. Similarly, GEC/Marconi were having difficulties with unfair competition on the electronics side from British Aerospace. He hoped that the Government would make sure that these unfair practices were stopped. (Sir Keith asked Sir Arnold to send him further information on them.)
- (iii) He begged the Government not to give unnecessary publicity to credit and other arrangements provided to GEC by departments. The French Government was much less public in the assistance with which it provided companies: he hoped their practice could be followed in the UK. The previous Government had too often caused problems for GEC by publicising the assistance which they had provided.

The Prime Minister said that she was very grateful to Sir Arnold and his colleagues for coming and for agreeing in essence with the

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Government's proposals in relation to both the nuclear industry and Rolls Royce. She noted the points which Sir Arnold had raised and asked that he should not take any action on Rolls Royce before either she or Sir Keith had first seen Sir Kenneth Keith. Sir Arnold readily agreed to this.

The meeting finished at 11.15 p.m.

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24 October 1979

Distribution: Private Secretaries to:

The Foreign and Commonwealth Secretary
The Secretary of State for Industry
The Secretary of State for Trade
The Chancellor of the Exchequer
The Secretary of State for Defence
The Secretary of State for Energy
The Secretary of State for Employment
Sir John Hunt

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SUMMARY OF MINISTERIAL DISCUSSION AT MISC 22(79)2nd MEETING

The Ministerial discussion ^{on 18 October} ~~yesterday~~ may be summarised as follows:

Objective

To improve the management of Rolls Royce as a matter of urgency.

Constraints

- 1 Maintain consumer confidence and avoid financial costs of a crisis of confidence.
- 2 Retain Sir Kenneth Keith in a role which does not involve him in day to day management.

Method

If possible by making the expertise of Sir Arnold Weinstock and the GEC management team available to Rolls Royce; including the provision of a chief executive.

Constraints on Method

- 1 To seek to secure GEC assistance without preconditions about sales to GEC of the Rolls IMD and nuclear interests.
- 2 To avoid prejudicing decisions on the future of the nuclear industry and overburdening GEC senior management.

Process

- 1 Prime Minister and two Secretaries of State to see Sir Arnold Weinstock.
- 2 Secretary of State for Industry subsequently to see Sir Kenneth Keith.



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Position of Sir Kenneth Keith

<u>Alternatives:</u>	President	} concentrating on sales and customer relations
	Non-executive, part-time Chairman	

Constraints:

- 1 Weinstock considers that Morgan as Chief Executive could not work with Keith, except as President.
- 2 But as yet we have not settled on an alternative to Keith. A GEC man (like Sir Kenneth Bond) would add to the appearance of a GEC take-over and compound the difficulties over conflict of interest in relation to any possible future sales to GEC. Mr Ashley Raeburn, recently promoted to Vice Chairman on the RR board would be willing to take the job, but not if Keith is outraged and as a professional he would want to make up his own mind about Morgan and the GEC.
- 3 The more drastic the immediate change the greater the difficulty of getting the co-operation of Sir Kenneth Keith.

Conclusion

- 1 Preferred Choice: Aim to elevate Keith immediately to presidency and consult Sir Frank McFadzean (part-time RR board member for whom Raeburn worked in Shell) about chairmanship - himself or Raeburn.
- 2 As fall back: Against the possibility that an immediate solution in this way is not available seek Weinstock's agreement to fall back position in which
 - i) Keith becomes non-executive part-time chairman when Morgan arrives;
 - ii) Keith moves to presidency after 3-6 months.



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Status of Mr Morgan

Alternatives Rolls employee who severs links with GEC.
Secondment from GEC.

Constraints Mr Morgan's views, which are unknown.

Comment

Unless Mr Morgan severs his links with GEC no-one will have confidence that any subsequent negotiations on disposals of parts of or the whole of Rolls-Royce to GEC would be on an arm's length basis.

Conclusion

It is in the interests of Government and GEC that Mr Morgan should sever links with GEC and he should be offered a sufficiently attractive contract to induce him to accept that.

Note The employment of Mr Morgan derives from the Department of Industry's proposal that GEC should be employed to provide consultancy services. As part of such an arrangement GEC would provide a chief executive.

If the use of GEC as consultants were to be abandoned there would be no particular reason for employing Mr Morgan except that he has a good reputation as a tough engineering manager with a sufficiently distinguished record as an engineer to command respect among Rolls Royce engineers and a proven record as a managing director.

Rolls Royce have employed consultants to find a chief executive and their work has progressed to the point of identifying two possibilities, but their quality and availability is uncertain.



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Role of GEC - Beyond providing Mr Morgan

Alternatives

- 1 No role.
- 2 Employed immediately after Mr Morgan's appointment to provide a consultancy service to Rolls Royce.
- 3 Agree with GEC that they would be ready to provide such a service to Rolls Royce (or to the Government) at some later stage if asked, but a decision on this to be deferred until Rolls severs formal connection with the NEB after legislation.

Comment

The DoI advise that one man cannot come to grips with the problems of Rolls Royce as quickly or effectively as a chief executive with the backing of the GEC's top management team at Stanhope Gate. The employment of GEC would be a good public justification for the removal of Rolls Royce from the control of the NEB: Parliament would have no reason to think that the DoI unaided would be more effective than the NEB in controlling Rolls Royce. A justification to Parliament of the removal of the NEB in terms of the breakdown in relations between Sir Leslie Murphy and Sir Kenneth Keith and as being the only way of retaining two distinguished public servants while true, is likely to lead to the same treatment being sought by British Leyland.

On the other hand, the employment of GEC could well be seen by the board of Rolls Royce as an expression of no confidence by the Government and if they accept GEC at all, it may be only after the chief executive has established himself and convinced his colleagues of the need.

Conclusion

Given that a determined effort should be made to persuade the Rolls Royce board that the use of GEC is in the best interests



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of the company, but recognising that it may be impossible without unacceptable resignations from the Rolls Royce board,

- (i) seek to secure Sir Arnold Weinstock's co-operation in all of the three possibilities but with 2 and 3, in that order, being preferred;
- (ii) seek Weinstock's help with Sir Kenneth Keith in getting 2 or, as a fallback, 3, noting that GEC's role is consultancy, not management.



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Disposals to GEC

Options

- 1 In accordance with anxieties expressed in the MISC 22 Committee, a firm decision against sales to GEC of Rolls Royce interests.
- 2 No negotiation now, and no commitment to future negotiations, but statement of intention to return Rolls or parts of it to the private sector in due course and recognition of GEC's potential interest in IMD and nuclear by provision in any consultancy contract that it will not extend to these two businesses so as to avoid future difficulties over conflict of interest.
- 3 Subject to the willingness of the MISC 22 Committee, explore with Sir Arnold Weinstock the possibility of a jointly owned RR/GEC company for industrial and marine engines, under GEC management.

Comment

GEC very much want IMD and previously made this a condition which, subject to Ministerial decisions, DoI officials had indicated should be acceptable, and which they considered had industrial logic from the UK point of view.

Disposal has so far been resisted by Sir Kenneth Keith and could be an obstacle to his concurrence.

Conclusion

In view of the strong Ministerial anxieties on this point, to seek to secure GEC co-operation to course 2 above, plus the nuclear decision, and an assurance that their role in RR will not weigh against them in any future acquisition they may envisage. (The last of these is crucial to GEC, but they should not be given any commitment on BAe where there are strong arguments against: Cable and Wireless is a possibility, but no more than that.)

The possibility of course 3 is to be put to the MISC 22 Committee as a compromise.



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Other Possibilities for Sir Kenneth Keith

Options

- 1 Public recognition.
- 2 Vice-chairmanship of GEC.
- 3 Chairmanship of Cable and Wireless.
- 4 A wider aerospace role.

Comment

Keith wants public recognition: he will want it even more if he is not to be seen as having failed at Rolls Royce.

Other appointments could be part of that public recognition.

The Vice-chairmanship of GEC has been offered to us by Sir Arnold Weinstock, but this probably falls if the IMD possibility is not for negotiation. Other Ministers may have been anxious about it.

The Chairmanship of Cable and Wireless is a much smaller job, but extremely important and difficult for the next two years. The new Chairman has the task of swinging a hostile board round to a changed view on disposals, to conduct very difficult but crucial negotiations with overseas Governments about concessions, and manage a sale of shares in Hong Kong and the UK. Keith has many of the qualities for a job of this kind.

Keith could be one of the two proposed Government nominees on the privatised BAe board, but the DoT are against Government direction in British Airways. The potential for a wider role in aerospace is therefore limited.

Conclusion

- 1 Keith could be useful with Cable and Wireless and the job is important. It does not match his aspirations but the offer could help to reassure him even if he did not accept it.
- 2 Tell Sir Arnold Weinstock that a Vice-chairmanship for Keith on his board is not wanted.

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PRIME MINISTER

Rolls-Royce
(MISC 22(79) 1 and 2)

BACKGROUND

The Group had its first discussion of the Rolls-Royce situation on 8th October without reaching any conclusions. Since then you have had the Department of Industry/CPRS presentation - the material for which has now been circulated to colleagues as MISC 22(79) 2. The conclusion you drew from the presentation was, I think, that the only real option is for Rolls-Royce to carry on with its existing strategy but for the Government to seek to bring about major improvements in its performance. With Sir Keith Joseph apparently sharing this view there is little likelihood of other colleagues dissenting from it. The main questions for the meeting therefore are of procedure and tactics as discussed in Sir Keith Joseph's original paper (MISC 22(79) 1).

2. There is however an additional point. You and your colleagues have already touched on the question of whether even GEC can effectively take on all of the work which events seem to be pushing in their direction. The Department of Energy have today brought to our attention the possible conflict between a heavy involvement of GEC in Rolls-Royce and their ambitions to engage GEC more closely in the new and large nuclear programme they will be bringing to E shortly (and which will involve sharply cutting back the role of the CEGB). There is no real way for Ministers to guess independently whether GEC can handle both tasks. The simplest solution might be for Sir Keith Joseph to ask Sir Arnold Weinstock whether he is satisfied that taking on Rolls-Royce will not diminish his interest, and the part his Company might play, in any expanded nuclear programme which the Government may decide upon. His answer would set the scene for Ministers further discussions on Rolls-Royce and the nuclear programme over the next week or so.

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HANDLING

3. You might care to open the discussion by telling those colleagues who were not present of the conclusions you have drawn from Tuesday's factual presentation and to see whether any of them disagree. If not, you might then revert to the recommendations in Sir Keith Joseph's original MISC 22(79) 1 and take colleagues through them seriatim. They were -

- A. "Informing the Company that resources on the scale they have estimated will not be available and of my management proposals":
It is for consideration whether the Company should also be told that, subject to greatly improved efficiency of operation, the Government is prepared to back their strategy.
- B. "Parallel action with the NEB who would also be told of my intention to return Rolls-Royce to Government ownership":
- C. "Subject to the outcome of A and B above, immediate installation of a more effective management by harnessing the skills of GEC, who would provide a Chief Executive for Rolls-Royce and put the resources of their top management group, under Sir Arnold Weinstock, behind him":
This is the key immediate issue. Provided the Group are prepared to agree in principle Sir Keith Joseph might be authorised to consult Rolls-Royce, the NEB and Sir Arnold Weinstock. The Group will no doubt prefer to reserve a final decision until the outcome of these consultations is known.
- D. "With the help of GEC, not only to secure more effective day-to-day management of the Company but also to make the earliest possible assessment of the extent to which the Company's cash requirement can be reduced, to settle the Company's future strategy and determine whether, and if so how, it will be possible over a measurable period to put the Company in a posture for return to private ownership":
The point to stress here is that future strategy is for the Government and the Company. The role of GEC is to provide information relevant to the production of the strategy, not to determine the strategy as such.

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- E. "Immediately arrange for a small group of officials to advise Ministers on the interim guidance that should be given to GEC and subsequently to report to Ministers a long term strategy":

A Group, under Sir Kenneth Berrill, is ready to start work as soon as Ministers give them the green light.

- F. "Confirm to GEC that their involvement in Rolls at our request would not of itself tell against them in Government consideration of acquisitions they may wish to make":

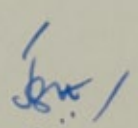
Sir Keith Joseph's talks with Sir Arnold Weinstock will show whether this formula is enough to obtain his co-operation. If not, the Group will face a difficult decision at a later meeting because the higher the GEC price for co-operation the less easy will the arrangement be to defend in public.

- G. "Authorise negotiations with GEC over the sale of Rolls industrial and marine business, and its nuclear activities subject to the Ministry of Defence being satisfied about the safeguarding of their interests":

There are two issues - the timing of any sale to GEC of IMD where last time some of your colleagues thought there would be advantage in making any sales before GEC were given a management role; and the separate question of the sale of Rolls-Royce's nuclear activities.

CONCLUSIONS

4. Subject to discussion you will want to record conclusions - including, where appropriate, conclusions to defer a decision - on each of Sir Keith Joseph's seven recommendations. You will also want to ask the Committee to meet again as soon as Sir Keith Joseph has completed the necessary round of consultations.


John Hunt

17th October 1979

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10 DOWNING STREET

From the Private Secretary

16 October 1979

The Prime Minister held a meeting this morning at 0830 hours to consider the current situation and prospects of Rolls Royce. The following were present: your Secretary of State, Sir Peter Carey, Mr. R. Dearing, Mr. K. Farrow (all from your Department), Sir John Hunt and Mr. P. le Cheminant (Cabinet Office) and Sir Kenneth Berrill.

The meeting took the form of a presentation mainly by Sir Kenneth Berrill and Mr. Dearing. This followed closely the text which Mr. Dearing left after the meeting and which will be circulated to MISC 22 along with other background material on the company. The presentation was aided by a number of charts, which will also be circulated to MISC 22.

The following points came up in discussion which were additional to the text referred to above:

(i) In response to a question from the Prime Minister about the losses on the RB211, it was explained that there were no production losses as such. The point was that production profits were not large enough to cover the heavy R and D expenditure with the result that overall profitability was totally inadequate. There was certainly scope for improved productivity, which was only about half that of the US aero engine manufacturers. Productivity at Rolls Royce in the 1970s had fallen because they had been unwilling to shed skilled labour at a time when demand was flat. Rolls Royce's latest Plan assumed a 25% productivity improvement for blue collar workers. This was not enough, especially if it was necessary to pay for the productivity increases in higher wages. The purpose of bringing in new management, as the Secretary of State proposed, was to achieve much better productivity and thereby bring the company into profitability earlier and on a more substantial scale. Although it was clear that the company were making inadequate profits on their production overall, it was less clear which production centres were the relatively good and bad performers. The Department of Industry would try to obtain further information on this.

(ii) In relation to the strategic alternatives, the Prime Minister asked whether there was scope for an immediate sale of the aero engine business to GEC. It was explained that GEC would only

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- 2 -

take over the business at the present time if it were handed over as a gift and in addition if they were given full compensation for the prospective losses. However, Sir Arnold Weinstock had indicated that GEC might be interested in purchasing the aero engine business at a later date after GEC management had come into the company and after they had been able to make their own assessment from inside.

(iii) The Prime Minister said that if the Government were to put additional funds into Rolls Royce, there was a case for asking the trade unions to put in their own funds as well.

(iv) Sir Keith Joseph said that a decision on his proposal to bring in GEC to manage Rolls Royce was now urgent. Sir Leslie Murphy was likely to be commenting on the position of the company in the near future, and the longer that a decision was delayed on measures to turn the company around, the worse this would be for customer confidence in Rolls Royce. Maintaining this confidence was absolutely crucial to the future of the company.

Summing up the discussion, the Prime Minister said that she herself was persuaded that the only real option was for the company to carry on with its existing strategy, but to bring about major improvements in performance. Compared with other industries, it was clear that the United Kingdom had a comparative advantage in aero engine building; and the alternative of withdrawing from the RB211 would be extremely costly. But even if Rolls Royce did manage to improve its performance, it would still absorb large amounts of public funds; consequently, there would need to be less spent on industries which did not have a future. A decision on Sir Keith Joseph's proposal to bring in GEC to manage Rolls Royce would need to be taken by Ministers collectively, and she would arrange for MISC 22 to be reconvened shortly.

I am sending a copy of this letter to Martin Vile, Cabinet Office.

Ian Ellison, Esq.,
Department of Industry

SECRET

PRIME MINISTER

MEETING ON ROLLS ROYCE

Sir Kenneth Berrill has suggested that tomorrow morning's meeting on Rolls Royce might begin with a presentation lasting 15-20 minutes designed to put to you and Sir Keith Joseph ^{the main} ~~germane~~ points about Rolls Royce's finances. He would do the first part of the presentation himself, and the second half would be done by Mr. Dearing, the Deputy Secretary in the Department of Industry who deals with Rolls Royce. They will support what they have to say with flip charts.

After the presentation they will try to answer your questions.

KMS.

15 October 1979

PRIME MINISTER

Rolls Royce

You said you would like to see Rolls Royce's accounts ~~of~~ ^{for} their last six financial years. These are attached. It is certainly hard work gleaning much information from these documents. One key point is that, while turnover has expanded steadily from £375m. in 1972 to £763m. in 1978, profit before taxation has fluctuated at between plus and minus £20m. So, the business has doubled in size, but profitability has been negligible; and from what we heard last week, it is now getting worse because of the combination of fixed price contracts expressed in dollars, a relatively high exchange rate and a relatively high inflation rate. (What was not explained last week was how much scope there is ~~in~~ ^{for} improved productivity.)

We have fixed a meeting for 8.30 a.m. on Tuesday morning when Sir Keith Joseph will bring his Permanent Secretary, Sir Peter Carey, and the two officials who have been most closely concerned with this issue - Mr Dearing and Mr Farrow - to give you a full factual briefing. They will not be sending a further paper; but they hope to give you a full scale presentation with the help of flip charts. We have arranged for Sir Kenneth Berrill and Peter le Cheminant also to come.

You can decide, in the light of this meeting, how you want to proceed: whether to reconvene MISC 22 or whether to have a session with Sir Kenneth Keith and other Rolls Royce people before a further meeting of MISC 22.

12.

12 October 1979



DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
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Secretary of State for Industry

9 October 1979

Tim Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
SW1

R. M. 11

Dear Tim

in folder behind file.

... I enclose copies of the last six Rolls Royce annual accounts. We hope to let you have further details about Rolls Royce's cash flow shortly.

Yours ever

Ian Ellison

IAN ELLISON
Private Secretary

DEPARTMENT OF INDUSTRY

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1-9 OCT 1979



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Ref. A0372

PRIME MINISTER

Future Arrangements for Rolls-Royce

(MISC 22(79) 1)

BACKGROUND

This paper by the Secretary of State for Industry reflects a good deal of discussion in which Cabinet Office, and in particular Sir Kenneth Berrill, have taken part. This does not mean that we necessarily agree with its conclusions but I hope we have helped to bring order into the presentation of a very complex situation.

2. There are really four interlinked issues:-

(a) The relationship between the Government, the NEB and Rolls-Royce.

As matters stand the NEB and Rolls-Royce are not on speaking terms (Sir Kenneth Keith is urging Sir Keith Joseph to sack Sir Leslie Murphy and vice versa).

(b) The quality of the Rolls-Royce management. It is common ground that the present management has lost control of the company.

Sir Kenneth Keith is an excellent salesman and has played a major part in pulling Rolls-Royce round after the trauma of 1971 but production-oriented management is missing.

(c) The financial prospects for the company. These are universally agreed to be unacceptable. On present figures Rolls-Royce is asking for nearly £1 billion over the next four years for a prospective profit of £20 million. Rolls-Royce, in common with much of British industry, has been hit by the strength of sterling - particularly so because in the civil aeroengine business, dominated as it is by the Americans, prices are quoted in dollars and the essential competition is American; by differential inflation in the United Kingdom as compared with the United States; and, paradoxically, because the boom in civil aircraft sales and Rolls-Royce's success in establishing its big civil engines in the civil

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aircraft market, requires substantial increases in working capital. Whatever management solution Ministers go for there will be very real difficulties in reducing substantially the figure for which Rolls-Royce are asking. The financial need arises mainly from the RB 211 family and we have commitments in varying degrees to Lockheeds, Boeing, British Airways, etc.

- (d) The disposal and/or privatisation of Rolls-Royce. There are two threads here - GEC's ambitions to buy parts of Rolls-Royce (notably on the industrial engine, marine engine and nuclear sides) and more generally, the company's poor profit expectations.

3. These problems do not all have to be solved at once but the management aspects are urgent - the private rows between NEB and Rolls-Royce could become public at any time. Moreover the solution of these problems links with disposals (if GEC are involved) and could, only too readily, provoke major questions affecting not only the future of Rolls-Royce but also our relations with the United States (where the fortunes of both Boeing and Lockheed are significantly dependent on Rolls-Royce's civil engine production) and have a very direct bearing on our defence capability. It is also relevant that Rolls-Royce is a major source of export earnings (£400 million a year) and one of our few engineering enterprises of world stature.

4. Sir Keith Joseph's proposals, summarised in paragraph 34 of his paper, constitute a coherent approach to these problems though his central recommendation about employing GEC to manage the company (and the price Sir Arnold Weinstock may exact for the help he gives) is likely to be politically very contentious. We do not yet know GEC's price but any price involving disposals carries the risk of charges of "asset-stripping". In addition there must be doubt about the extent to which GEC's management, however good, is capable of handling simultaneously the full range of Arnold Weinstock's ambitions (which appears to extend to BAe and Cable & Wireless as well as Rolls-Royce and further involvement in the nuclear business). There must also be doubt about whether the GEC proposal is the only way of coping with the managerial problem (both NEB and Sir Kenneth Keith have other ideas and the GEC solution may be welcome to neither); and given the United States and defence complications there

SECRET

are considerable presentational problems in any solution in a situation where, if the presentation goes wrong, the interests of the company and of the nation could be damaged.

5. There is no great urgency for a decision from the cash flow point of view: the reason why Sir Keith Joseph wants a very early decision is because the row between Murphy and Keith could come out into the open at any time. If the Group feel that they have insufficient information to go nap on the GEC solution, one possibility would be to ask a management consultant to report on Rolls-Royce's figures so that the Government may take decisions on the best strategy for Rolls-Royce before appointing a new manager to implement them.

HANDLING

6. You will want to ask the Secretary of State for Industry to introduce his paper. Thereafter the easiest course might be to run through his specific recommendations in paragraph 34. In doing so you might like to know that the "small group of officials" referred to in recommendation 5 has already been constituted, informally, under Sir Kenneth Berrill's chairmanship and, subject to the outcome of Ministerial discussion, is ready to work quickly on producing the necessary report. There has been some disagreement between the Department of Industry and the Treasury about whether Ministers should defer decisions until that report is available or whether the installation of the GEC management and the flow of information this would generate, is a necessary prerequisite to the production of an adequate report. The view we have taken is that the Official Committee should be asked to get on with it whatever view Ministers take on the management issue. If a flow of information from the company results from a Ministerial decision, well and good. If not there are other possibilities, eg. the employment of consultants, which could be brought into play.

CONCLUSIONS

7. The key decision is whether Sir Keith Joseph should be authorised to open discussions with Rolls-Royce, the NEB and Sir Arnold Weinstock on the lines he proposes. If so then recommendations 1 and 2 of paragraph 34 can be accepted. Recommendations 3 and 4 flow from the outcome of those consultations and the

SECRET

Group may want to have a report from Sir Keith Joseph about the reactions of the parties before taking a final decision. Recommendation 5 (setting up a small group of officials) can be endorsed at once. Recommendation 6 is a necessary part of an initial approach to GEC. Recommendation 7 needs to be reserved for further consideration when the initial soundings have been completed.

John Hunt

JOHN HUNT

5th October, 1979

cc Econ Pol. Engineering Pay
July 79

CONFIDENTIAL

2.

LD Pd.

From: Minister.

Ref. A0275

PRIME MINISTER

Sub.
2/ix.

ms

Two quite separate points relevant to your luncheon guests on Sunday.

Mr. Anthony Frodsham

Clearly you will want to give him moral support. There is no credible alternative to the line which the Federation are taking; and if they were to cave in it would be a very damaging precedent for pay claims this winter. On the other hand I have had some rather disturbing information this morning about the extent to which the cessation of work will hit some companies, including some big ones.

I think therefore there are two crucial questions to be put to Mr. Frodsham. Assuming there is no early settlement:-

- (i) What is the risk of some companies breaking ranks, or is he confident that a solid front will be maintained?
- (ii) Assuming a solid front is maintained, can he give any estimate of the possible consequences in terms of closures, bankruptcies, etc.?

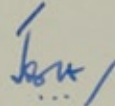
Sir Keith Joseph (but not for mentioning in front of Mr. Frodsham!)

✓ Sir Keith Joseph minuted you on 13th July about Rolls-Royce. I gather he is very nearly ready to minute you again and may take this opportunity for a private word. Briefly:-

- (a) The situation is nasty and deteriorating fast; some slimming down of Rolls-Royce, including plant closures, is inevitable irrespective of the present industrial dispute.
- (b) The transfer from NEB to direct ownership of the Department of Industry is sensible.
- (c) Considerable management restructuring is needed which will involve a new Chief Executive. The best course is probably to give GEC a contract to manage Rolls-Royce in which case Arnold Weinstock would probably put Mr. Morgan in as Chief Executive. Kenneth Keith would be given some honorary or part-time role connected with overseas marketing. The attraction for GEC in this is their interest in the gas turbine business of Rolls.

CONFIDENTIAL

Sir Keith Joseph will probably minute you and a few other colleagues directly concerned next week with a view to a decision before the Party Conference. I attach at Annex copies of the two options which the Department of Industry have been considering. It will be seen from the above that they are inclining towards option 1.


JOHN HUNT

21st September, 1979



OPTION 1

- 1 GEC employed to manage Rolls Royce. In addition to services of Stanhope Gate, GEC provide a Chief Executive, plus any small supporting team in the company, all of whom, including the Chief Executive, become employees of Rolls Royce.
- 2 GEC paid a fixed fee for services initially, but a performance related reward to be negotiated for the longer term.
- 3 Negotiation to take place on sale of industrial and marine business.
- 4 Sir Kenneth Keith to be on GEC main board plus ? honorary role in Rolls Royce and to discharge high level overseas marketing and customer relations job.



OPTION 3

The Minimum

- 1 Sir Kenneth Keith goes part-time with a selling/marketing representational function. Ideally he is not Chairman but President, with a seat on the board, but failing that he is part-time non-executive Chairman.
- 2 A new Chief Executive is appointed - say (Mr Morgan) from GEC - and the new man brings with him, if he wishes, two or three others.
- 3 GEC employed to provide such consultancy services as (Mr Morgan) decides he needs - in practice Stanhope Gate monitors performance and advises on all strategic issues.
- 4 The Rolls Royce board is strengthened by two or three heavyweight outsiders.
- 5 The possibility of a management contract for GEC is kept open when the shareholding is transferred to the Department.
- 6 Negotiations with GEC about the sale of the industrial and marine business.



DEPARTMENT OF TRADE

1 Victoria Street, London SW1H 0ET
Press Office: 01-215 5061
Out of hours: 01-215 7877

Seen by TL

Press notice

Ref: 367

September 13, 1979

BA TRISTARS ORDER

"An Unhappy Day to Announce Good News"

says John Nott

Mr John Nott, Secretary of State for Trade, speaking at Heathrow airport today before leaving on a three week official visit to the West Coast of the United States and Australasia said: "On my departure this morning for California - a market which is approximately the size of the United Kingdom as a whole - it is a matter of considerable pride that I can announce my approval of a further order for British Airways for the purchase of six Lockheed Tristar 200 aircraft - powered by Rolls Royce RB 211 engines.

"These Tristars will be part of British Airways new fleet, replacing outdated, noisy and less efficient planes.

"As well as providing modern, wide-body capacity, the Tristar will use much less fuel - an important priority for all airlines. They will help British Airways to keep its share of the growing international airline market".

Mr Nott is due to visit Lockheed's Palmdale plant where the Tristar is built and the Mountain View headquarters of the Fairchild Corporation, which is collaborating with GEC in establishing a micro-electronics plant on Merseyside. He commented:

"Lockheed is Rolls Royce's largest customer and - with Boeing - it provides among the most exciting opportunities for British technology in the 1980s. The market for aero-engines - particularly the United States domestic market - is a huge one, and the record of Rolls Royce in delivery is second to none. The reliability of its products and the capacity to deliver are rightfully matters of considerable British pride and satisfaction.

.../....

"As I depart to play my part, on behalf of British exports and technology, in this huge market, I am mindful of the dedication, enthusiasm and determination of thousands of skilled men on the shop floor at Rolls Royce. With the company's salesmen, middle management and senior management they have successfully sold this great British product in the toughest and most competitive market in the world.

"You can imagine my equal dismay - and concern - on behalf of my country and of its reputation abroad that on the very day of my departure Rolls Royce should be crippled by an absurd dispute which is being pursued by an overtime ban - and 'days of inaction' - apparently without a full test of opinion on the shop floor and in total disregard of the problems which face British exports in the developing recession in world trade.

"Already industrial action has destroyed jobs in a number of small industrial companies including a shipyard in St Ives.

"This tragic loss of employment among small business is a warning to the country. It is a warning to the suppliers of Rolls Royce. It is a warning to millions of hardworking union members that the time has come to stop this total and senseless disregard for jobs - and the future prosperity of their country. The shop floor must demand to be consulted - and loyalty to the unions must be tempered by determined independence and commonsense on the part of each and every worker.

"The Government is engaged in a determined effort to create the environment for new jobs and higher wages. Action of the kind now being taken cannot raise the living standards of union members. 'Days of inaction' do not produce more goods and services, for this is the only way of raising the take-home wage. How can pay generally increase if national output does not increase? There is no formula for higher pay with lower output, unless it is higher pay for some at the cost of unemployment for others. We will never prosper while commonsense and reality are ignored.

"What chance then is there that the dreaming and ranting, which characterise too many speeches by some union leaders, will give way to realism and a genuine two-way debate. In fact, the signs are not unhopeful. More and more union members are beginning to question their leaders' action. Men on the shop floor are asking: 'Why are we sabotaging our own jobs?' 'Why are we sabotaging our own future?' They know that they are undermining the tremendous reputation of British engineering and technology - represented by Rolls Royce - and thousands of jobs up and down the country in small engineering companies.

"This country still retains a world-wide reputation for engineering skill and excellence. As the Secretary of State for Trade I will play my part in selling Britain's products in the increasingly competitive conditions of the early 1980s.

"But neither I, nor any other salesman, can win and retain orders for British industry unless we can cease the kind of senseless action which is characterised by the current industrial disputes".



Prime Minister

1nd P02
5To note - a fair
point.PRIME MINISTERPM/79/68

out

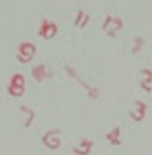
12
20/7Rolls Royce

1. Keith Joseph sent me a copy of his minute to you of 13 July about the proposal to put Rolls Royce under GEC managements: I have now seen your reply and Geoffrey Howe's comments.
2. I hope that in the course of the further studies now to be set in hand careful consideration will be given to the way in which any deal is ultimately presented. It will be important to ensure that any change in the management and ownership of Rolls Royce is made in such a way as to buttress not undermine international confidence in Rolls Royce's future under the new management. If the deal is allowed to appear as a salvage operation in which only the profitable parts of Rolls Royce were to survive, Rolls Royce's reliability as a supplier might be doubted. If the element of Government subsidy to Rolls Royce is exposed too clearly, the pressure for countervailing action in the United States would grow.
3. I am copying this minute to the Chancellor of the Exchequer, the Secretaries of State for Industry and for Defence and to Sir John Hunt.

C

(CARRINGTON)

19 JUL 1979





10 DOWNING STREET

From the Private Secretary

16 July 1979

Rolls Royce

The Prime Minister has considered your Secretary of State's minute of 13 July about Rolls Royce, and also the Chancellor of the Exchequer's minute of the same date.

The Prime Minister's initial view is that Sir Keith's proposals represent a promising way forward, despite all the difficulties that will be involved. She is content for him to embark on an urgent study to clarify the possibilities, and to consult as necessary with Sir Kenneth Keith and Sir Leslie Murphy. But she has emphasised that the study and consultation must be undertaken in the strictest confidence. The study should be conducted in consultation with the Treasury. It will be for later consideration whether it should be circulated to other Ministers for collective decision.

I am sending copies of this letter to Tony Battishill (H.M. Treasury), Paul Lever (Foreign and Commonwealth Office), Roger Facer (Ministry of Defence) and Martin Vile (Cabinet Office).

T. P. LANKESTER

A.A. Duguid, Esq.,
Department of Industry.

COMMERCIAL SECRET

P.071

MR WILE

I am content to embark on the same \$9.5 for

Including suggestion - we all know the difficulties of what Prime Minister

cc: Sir Kenneth Berrill
Mr Mountfield

It is impossible but it is the most hopeful suggestion I have seen yet. Provided

that confidence is retained ROLLS ROYCE
as has to be done with his study myself

Shall we proceed as suggested at X below?

Sir Keith Joseph's minute to the Prime Minister of 13 July canvasses the possibility that GEC might buy the whole of Rolls Royce, sell back to the Government the aero-engine business assets and then have a management contract with the Government to supervise the aero-engine business "with penalties and rewards dependent on performance." Sir Keith Joseph acknowledges that the proposal may not be feasible and that work will be necessary to clarify this. Before starting such work however he wants to have the Prime Minister's permission to inform Sir Kenneth Keith, the Chairman of Rolls Royce, and Sir Leslie Murphy, the Chairman of the NEB, of the GEC proposals.

2. There is little doubt that the suggestion made by Sir Arnold Weinstock should be examined - any proposal to dispose of Government-owned assets is welcome - and it follows that Sir Keith Joseph should be given the permission he seeks. At the same time it will be necessary to have a good deal more information before the Government can take decisions. Among the questions which spring to mind are:-

(a) How much might GEC pay for the non-aero engine business of Rolls Royce and is there a better-paying alternative?

(b) How practical is it to devise a "penalties and rewards" contract for GEC management in a situation where Rolls Royce will be losing a lot of money on the aero-engine business (unless the exchange rate falls) for which Government will continue to be responsible?

(c) What is the significance of the proposal that GEC should first buy the aero-engine business and then sell it back to Government? There would not seem to be much point in this manoeuvre unless they hope to sell back for more than ^{they} pay.

(d) How profitable is the Rolls Royce non-aero engine business? What rationalisation might follow from GEC acquisition? Are there likely to be any particular problems for the Government, eg in relation to competition policy?

(e) What is the ²inwardness of the apparent intention to integrate part of GEC's present activities with RR as a separate heavy electrical/gas turbine/aero-engine business which might later be put on the market as an independent company? On the face of it this cuts across the purity of the idea that GEC would manage the aero-engine business owned by the Government. Clarity is needed to make sure that the Government has adequate control over the public money which would continue to go to the aero-engine segment of the new organisation.

3. There could well be other problems in working out a practical solution. On the other hand if a realistic and defensible operation is possible which would reduce public expenditure and obtain an adequate price for Rolls Royce, there is much to commend the idea in principle. The need is for a good deal more information. As we understand it, Sir Keith Joseph is due to meet Sir Leslie Murphy on Monday evening to discuss the sale of some other NEB assets. The immediate question is whether he should be allowed also to float this idea in strict confidence or whether the proposal needs to be discussed by Ministers collectively first. But to do this might lose valuable time and the Prime Minister might think it preferable to allow Sir Keith Joseph to begin, without commitment, exploration both with Sir Leslie Murphy and Sir Kenneth Keith and simultaneously to ask the Secretary of State for Industry, in consultation with the Chancellor of the Exchequer, to prepare a quick appraisal of Sir Arnold Weinstock's ideas for consideration by Ministers in E(DL).



P Le CHEMINANT

13 July 1979



PRIME MINISTER

ROLLS ROYCE

TOTAL COPIES 13COPY No. 1

As you are aware, we face heavy losses in Rolls Royce for current contracts taken on low exchange rate assumptions. Kenneth Keith has been an indefatigable salesman but does not pretend to have the necessary skills for the tough management cost-control job now necessary if losses are to be minimised. NEB have been straining at the leash to put in a replacement for Kenneth Keith, between whom and Leslie Murphy relations are bad.

I do not consider that the right course is to leave Rolls Royce under the control of the NEB. I think the present rift between Keith and Murphy in part reflects the unsuitability of the NEB for this role, and that difficulty is likely to become greater as the role of the NEB in other areas is reduced. My Department has therefore had discussions with Sir Arnold Weinstock about the possibility of GEC taking a dominant role in supervising the management.

Weinstock has proposed that GEC should buy the whole of Rolls Royce but sell back to the Government the aero-engine business assets. He would then have a management contract with the Government to supervise the aero-engine business with penalties and rewards dependent on performance. The remaining parts of

/Rolls ...



Rolls Royce - industrial and marine engines and nuclear work - would be integrated with GEC's heavy electrical and power engineering business, with the aeroengine business also being a part of this group. Ultimately the shares of this heavy electrical/gas turbine/aero-engine business might be put on the market as an independent company with GEC shareholders being given preference.

Weinstock would provide a Managing Director for the aero-engine business (he has suggested a man known to my Department as an able manager), as well as of course controlling the enlarged power engineering business. Weinstock would be content for Keith to remain as Chairman in a non-executive role both at the aero-engine business and in the power-engineering company, and indeed to join the main board of GEC. This should help to effect the change without a major row.

Timing would be a problem, because it will not be possible to remove Rolls Royce from the NEB without legislation. But I hope it would be possible to persuade the NEB to accept the new GEC management without delay if it were made clear that Rolls would cease to be an NEB responsibility as soon as legislation was passed.

There may be serious difficulties in what Weinstock proposes. Most difficult is likely to be the negotiation of satisfactory terms for the sale of the Rolls Royce company to GEC and the buying back of the aero-engine business assets; we would need to

/use ...



use an arbitrator. For this reason I cannot at present be sure that the proposals will prove feasible. Before starting on the work necessary to clarify this, which will inevitably involve informing Sir Kenneth Keith and Sir Leslie Murphy of these plans, I should be glad to know that you are content to embark on this course. In my own view, it is the best chance we have of changing a situation which could become an intolerable financial burden to us. I should make clear that this approach will not eliminate the need for very large calls on public funds for Rolls Royce. Our predecessors had committed £192 million at 1977 prices in launch aid and provided for a further £100 million through the NEB during 1979-83, and the exchange rate appreciation means that much larger amounts would be needed to complete that programme. However, I have no doubt that the tight management for which GEC is known provides the best prospect of keeping a proper grip on this business and limiting the sums required.

I am sending copies of this letter to the Chancellor of the Exchequer, the Secretaries of State for Foreign and Commonwealth Affairs and for Defence and to Sir John Hunt.

16
K J

13 July 1979

Department of Industry
Ashdown House
123 Victoria Street
LONDON SW1

103 JUL 1979



SECRET



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

ROLLS ROYCE

I have seen Keith Joseph's minute to you of 13th July about the future of Rolls Royce.

2. While I agree in principle that the idea of removing Rolls Royce from the control of the NEB and putting the Company under GEC management should be examined in greater detail, the terms for such an arrangement will need very careful consideration indeed. Our objective must I think be to minimise the potential calls by Rolls Royce on public funds. Tighter management and better cost control are prerequisites to better performance. But these will not themselves deal with the fundamental financial problems now facing the Company. Moreover, there are obvious dangers in a solution which gives Arnold Weinstock the controlling interest in certain parts of Rolls Royce, leaving the Government to finance the other parts which may not perhaps be so profitable.
3. By all means, let the feasibility of the proposals be considered urgently but this should be without prejudice to the Government's position at this stage. I look forward to seeing a fuller appraisal of the proposed arrangements, together with an assessment of their financial consequences.

SECRET



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

4. I am copying this letter to Keith Joseph,
Peter Carrington, Francis Pym and Sir John Hunt.

A handwritten signature in dark ink, appearing to be "G.H." with a stylized flourish.

(G.H.)

13 July, 1979

113 JUL 1979



PART _____ ends:-



PART _____ 1 _____ begins:-

C of Ex to PM 13.7.79.

END

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