CONFIDENTIAL

SECRETARY OF STATE FOR NORTHERN IRELAND

D/F with Treasury, FCO, MoD, PU comments

AT 29/10

PRIME MINISTER

SHORT BROTHERS PLC

In his letter of 26 September to Barney Hayhoe about Shorts' bid for new work on the Boeing 737, Rhodes Boyson indicated that I would be writing to colleagues about a number of issues relating to Shorts. We have authorised the company to lodge their bid with Boeing on the revised basis we recommended. I now wish to seek your and colleagues' approval to:-

(a) Shorts' bid for the RAF trainer contract;

(b) their proposal for a small manufacturing facility in West Belfast; and

(c) adjustment of the company's EFL.

RAF TRAINER CONTRACT

2. Bids for this contract were due by 1 October but, given the size of the contract and the need to consider the company's wider cash difficulties Shorts were told that it would not be possible to authorise their bid by that date and they have lodged a conditional bid dependent on subsequent Government approval. The terms were improved following initial examination by my officials and management consultants, Touche Ross - see Annex A. Since the company do not produce their own trainer design, they have obtained a licence from the Brazilian aerospace company, Embreer, to produce the Tucano aircraft and this collaboration, especially with one of Shorts' main competitors, should be encouraged. The RAF contract would provide Shorts with military aircraft work, a development we have always considered important in our privatisation plans; and would fit into Shorts' projected work pattern after the SD360 has reached its sales peak. I know too that Geoffrey Howe regards Shorts' winning the contract as an important step in fostering our relations with Brazil, not only from the trade viewpoint, but also in the context of the Falklands.

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3./...

3. On central assumptions the contract would provide a healthy rate of return of 13.5% - the sort of return we are seeking in the run-up to privatisation - and the terms are reasonably robust against the major sensitivities. Should the company be successful in winning this order together with their Boeing 737 and V2500 bids, it would exceed its cash provision for new orders (details in Annex B) but I believe that new contracts should be assessed on their own merits, particularly as there can be no certainty that Shorts will win the Boeing and V2500 work.

4. I consider that we should authorise Shorts' revised bid for the RAF trainer as it now stands, together with the level of assistance set out in paragraph 5 of Annex A. In doing so, I am conscious of a number of other factors relating to Shorts as set out below.

<u>WEST BELFAST FACILITY</u>

5. The company propose to set up a small manufacturing facility in West Belfast (details in Annex C). Shorts have over the past two years been faced with strong accusations by the Irish National Caucus, an Irish-American pro-republican pressure group in the USA, of alleged discrimination in recruitment. This campaign focussed on the USAF order but is also aimed at Shorts' other products. Our Washington Embassy, together with the Friends of Ireland, have joined Shorts in rebutting the INC's claims, but they have advised that Shorts should make a tangible gesture of good intent in the recruitment field. This view has been reinforced by advice from the US Embassies in London and Dublin and the US Consulate General in Belfast. (It is highly relevant here that many Catholics are reluctant to travel to work in East Belfast where Shorts' principal facility is located.) Strongly encouraged by Jim Prior, Shorts have planned to set up a unit in West Belfast employing some 200 people to manufacture components currently sub-contracted to other companies outside Northern Ireland and there have already been widespread public references to the prospect of this development. While it is certainly not essential to the Company's production needs to open a West Belfast facility it would substantially advance Shorts' commercial prospects if it were to contribute to the company winning the second and third tranches (48 planes) of the USAF order (which will require the

endorsement/...

endorsement of Congress) and other civilian sales. I have looked at this proposition carefully, and at first with some scepticism, but am convinced that it is needed primarily as a means to protect Shorts' important market prospects in the USA. It will also bring some industrial employment to the West Belfast blackspot and on these grounds I wish to support the proposal together with the level of assistance detailed in paragraph 2 of Annex C.

ADJUSTMENT OF EFL

6. When reviewing Shorts' 1983 Corporate Plan in February of this year, colleagues set a cumulative external funding limit of £87m (profit £5m) at 31 March 1985. This figure was to be adjusted if Shorts won the EDSA contract from the US Air Force and an annex to the Corporate Plan anticipated a cash benefit of £8m in 1984/85. The contract was awarded to Shorts in March.

7. Shorts have a good record over recent years of adhering to EFLs but have now advised the Department that their limit at 31 March 1985 is likely to be £95m (profit £2.5m) for the following two reasons:-

(a) they expect the cash benefit from the EDSA contract to be only £1m in the current year because of the late award of the contract (March 1984 as opposed to November/ December 1983) and a lower payment by USAF than had been expected. The eventual amount of the benefit received in this year will not be known until nearer March when the USAF payments can be forecast with more certainty. I propose therefore to continue to press Shorts to obtain the speediest possible payments from USAF and I will report again on this when we consider the company's Corporate Plan at the beginning of 1985;

(b) they currently forecast a shortfall in the number of SD360 deliveries this year (30 as against 36) resulting in a loss of income of some £15m; the market position will be closely monitored as the year progresses. The reason for the shortfall is flatness in the commuter aircraft market, particularly in the US, said to be due to consolidation of airline operators and uncertainty over high interest rates. Against this shortfall in income, the company has identified savings which would result from additional measures taken to reduce financial requirements.

8. An overshoot in EFL of this magnitude this year is of course serious. In the longer term, however, the delayed EDSA receipts will be received and will improve next year's cash flow while the SD360 production programme can be tailored to accommodate the lost sales. The company claim that by March 1986 their EFL on trading account should be at about the same level as forecast in the 1983 Corporate plan. We shall however have to examine carefully, in the context of the next Plan, whether this year's shortfall in SD360 deliveries does not herald a longer-term reduction in sales prospects. It is worth noting that over the past five years the company has completely transformed its performances and that despite this current setback, they still expect to break through to profitability this year and aircraft sales are at their highest level in recent years.

9. I have reviewed the action necessary to keep the company to their current financing limits. It is clear that withdrawal from new projects (S14 missile, V2500 engine nacelle, Boeing 737 components, etc) would produce insufficient savings and would seriously jeopardise the company's future strategy including privatisation. The only alternative would be to cut back on aircraft production permanently now and I believe that this would be premature. I would be most reluctant to take a decision of this long-term nature immediately before the submission by the company of their 1984 Corporate Plan which we will discuss early in the New Year.

10. I propose, therefore, to adjust Shorts' EFL on a provisional basis to £95m (to be met by bank borrowings, not additional public expenditure). This would have to be subject to review in the course of the current financial year when the position on EDSA receipts and SD360 sales should be clearer. The new Corporate Plan will focus mainly on long-term prospects and identify the best way forward for

the company consistent with minimising calls on public expenditure and achieving privatisation. Our consideration of the Corporate Plan will give us a further opportunity to review this year's EFL.

MISSILE SALE TO JORDAN

11. I have noted the outcome of the OD discussion on 16 October of credit terms for Jordan. My officials are now considering how this can be implemented in a way which will ensure that Shorts are treated equally with other companies participating in the Jordanian deal. I will also wish to consider the impact of OD's decision on Shorts' future EFL and profitability, and in particular how it might affect prospects for privatisation.

12. The proposed solution (that part of the cost of the necessary soft credit might have to be absorbed by Shorts or be met from the Northern Ireland block) seems to introduce an entirely new principle into export credit finance. Whilst we may have to accept such an outcome in the circumstances of this particular deal, I would not be happy to accept it as a new principle. If it were to be applied more generally I believe we would need to consider giving collective consideration to the principles involved and I hope we would have an opportunity to discuss fully any further development on these lines.

RECOMMENDATIONS

13. I recommend we:

(i) authorise Shorts to proceed with their bid for the RAF trainer project and agree to the provision of £2.6m towards design, development and labour learning costs;

(ii) approve Shorts' proposal to set up a manufacturing unit in West Belfast and agree to the provision of £2.026m discretionary assistance;

(iii) provisionally adjust Shorts' EFL to £95m at 31 March 1985

and/...

set a revised profit target of £2.5m with these figures to be reviewed when we consider the 1984 Corporate Plan.

14. I am copying this minute to E(A) colleagues, Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

N D Ward
Private Secretary
for DH
(Approved by the Secretary of State and signed in his absence in Belfast)

Rec'd 29/10.

te

ANNEX A

SHORT BROTHERS PLC

TERMS OF RAF TRAINER BID

The Project

1. MOD(PE) has invited bids from four aircraft manufacturers for possible replacement for the Jet Provost RAF Trainer. The contract will be for 130 two-seat trainers, with an option for a further 15 aircraft and ancillary equipment. Shorts does not have a trainer in production but the company has teamed up with Embraer of Brazil who have developed the successful Tucano trainer. Shorts has entered into an agreement with Embraer to produce the Tucano in Northern Ireland if the bid to MOD(PE) is successful. The agreement also covers further collaboration work on aircraft, but the Tucano is seen as central to the future development of joint venture work with Embraer. Such collaboration will probably be necessary if Shorts is to remain in airframe production.

Financial Forecasts

2. Deliveries

145 aircraft to the RAF in the period to 1993, peaking at 32 in 1989/90. In addition Shorts hopes to sell a further 75 aircraft to overseas customers in the same period which will result in peak sales of 45 aircraft in 1989/90 and 1990/91. Touche Ross consider this delivery pattern to be within production capabilities.

Price

£815,000 for RAF at 1984 prices;
£930,000 for overseas sales.

Exchange Rate

£1 = $1.50.

Internal Rate of Return

13.5% at current prices.

Risks and Sensitivities

3. The major sensitivities are as follows:-

(a) Exchange rate

The forecasts use a central exchange rate of $1.50. The Company estimates that each aircraft will contain $350,000 of materials sourced in the USA and the contract will contain a clause enabling Shorts to recover extra sterling costs if the exchange rate remains as low as $1.25. Below $1.25, Shorts will have to absorb sterling cost increases but the contract will yield an IRR in excess of 5% as long as the exchange rate exceeds $1.10.

(b) Level of deliveries

If overseas sales rise to 100 aircraft, the IRR will be 16%; if overseas sales are only 50 aircraft, the IRR will fall to 10%. Shorts estimate that sales could easily be in the range 100-150 aircraft. The world market for trainers over the next 10 years could be as high as 1400 aircraft according to Touche Ross.

(c) Rate of overhead recovery

The Company proposes to establish a separate assembly production operation for the Trainer and the estimated overhead recovery rate for this operation is 300%, lower than the estimated company rate for 1984/85 of 336%. This rate is expected to fall to 325% eventually. The concept of charging separate rates for different areas of work has been advocated by Binder Hamlyn Fry, consultants appointed by Shorts to advise on overhead recovery. If overheads necessitate a recovery rate of 325%, the IRR will fall to 10.5%; if a recovery rate of 275% is justified, the IRR will be 16%.

(d) Cost overruns

The selling price of the aircraft to the MOD yields only a small margin to Shorts after charging full overheads and the IRR will fall below 5% if costs overrun by 5% or more. However, the aircraft being offered is based on the Embraer EMB312 Tucano, already in service with the Brazilian Air

Force and the proposed modifications are well within Shorts capabilities. The contract contains the usual cost escalation clauses.

Employment

4. Peaks at 695 in 1988/89 and 1989/90.

Level of Assistance Proposed

5.

	1985/86	1986/87	1987/88	1988/89	Total
	£m	£m	£m	£m	£m
Capital Grant	0.6	0.9	0.5	-	2.0
Design, Development and Labour Learning Grants (25% of expenditure)	0.7	1.3	0.5	0.1	2.6
					4.6

EC Calculation

NGE = 60.0% (limit 75%)

CPJ = £4,302 (limit £7,443)

Officials have agreed that the aid proposed need not be notified to the Commission, largely because it falls within the agreed limits of regional assistance.

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SHORTS - NEW WORK PROVISION

Profitability

	1984/85	1985/86	1986/87	1987/88
	£m	£m	£m	£m
Corporate Plan Unallocated New Work Provision	2.6	2.5	2.9	4.0
V2500	(0.4)	(1.9)	(3.3)	(1.2)
Boeing 737	-	-	0.7	0.8
RAF Trainer	-	-	0.2	1.3

Cash Requirement

	1984/85	1985/86	1986/87	1987/88
Corporate Plan Unallocated New Work Provision	9.2	6.3	11.5	13.6
V2500	(1.0)	(3.0)	(5.9)	(1.9)
Boeing 737	(0.2)	(2.3)	(1.6)	2.6
RAF Trainer	-	(5.8)	(10.4)	(3.6)

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WEST BELFAST FACILITY

Background

1. Shorts have proposed the setting-up of a small composite manufacturing facility in the vacant De Lorean factory in West Belfast. The facility will employ some 200 people in producing a range of glass reinforced plastic (GRP) items currently purchased from sub-contractors but which can be made by well-established methods and do not require a highly-skilled workforce.

2. The Industrial Development Board (IDB) has examined the proposal and is prepared to offer a package of assistance on the lines normally offered for investment in West Belfast. Details of the offer are as follows:

50% grant on capital expenditure of £3,830,000
Employment Grant of £4,500 per job on 200 jobs
Interest Relief Grant of £360,000
Normal Training Grants

Financial Appraisal

3. The following table based on a starting date of 1 October 1984 sets out the principal financial and manpower implications of the project over the next four years:

	1984/85	1985/86	1986/87	1987/88
Cash Requirement - £000	(968)	(2,350)	(21)	125
Discretionary Grants - £000	48	985	478	301
Net Cash Flow - £000	(920)	(1,365)	457	426
Employment	10	112	162	200

Since project start-up will now be well after the assumed date, cash spend this year will be very limited.

The cashflow after grant shows an Internal Rate of Return of less than 5% over 10 years.

Assessment

4. The company's proposals have been assessed by the Department's advisers Touche Ross (TR). In their assessment TR have indicated that on purely financial terms the project is not attractive. Expansion on Shorts' existing Queen's Island site in East Belfast would be cheaper to equip and perhaps easier to manage. However if allowance is made for the high level of discretionary grants available for industrial development in West Belfast, there is only a relatively small difference in cash flow between the Queen's Island and West Belfast options and the latter offers a positive return, albeit less than 5%. The Queen's Island option shows negative returns both before and after discretionary grants.

5. The most important advantage of the West Belfast facility is that it defuses the criticisms about employment practices which Shorts have faced from the Irish National Caucus thereby offering prospects of enhanced sales (or at least avoidance of lost sales). TR have estimated that if the West Belfast facility were to improve SD360 sales by just 3 aircraft in 10 years this would raise the IRR to over 5%.

6. TR's appraisal shows that when the facility is fully operational its cost should not exceed the amounts currently paid by Shorts to its sub-contractors. A private sector company in circumstances such as those facing Shorts would in TR's view, establish such a facility.

Conclusion

7. The West Belfast facility is not particularly attractive in strict financial terms and without the IDB aid package it is not commendable in financial terms. Over the first four years of the project non-discretionary grants total £1.3m and discretionary grants £1.8m. However TR have indicated that the project requires only a small increase in (or retention of) sales to justify the investment and they have concluded that the facility will reduce substantially the risks to sales.

The proposal offers the prospect of 200 jobs in West Belfast at a cost-per-job of £10,130 which is within the Northern Ireland delegated limits for West Belfast.

8. This positive initiative is strongly welcomed by our Embassy in Washington who see it as an important step towards countering Irish National Caucus allegations of unfair employment practices by Shorts. It is also considered a sensible advancement towards maximising sales in the US.

EC Calculation

9. NGE = 69.7% (limit 75%)
CPJ = £12,135 (limit £7,443)

Officials have agreed that the aid proposed need not be notified to the Commission as it falls within Regional Aid criteria.

ANNEX D

ADJUSTMENT TO EFL AND PROFIT TARGETS AT 31 MARCH 1985

1. EFL adjustment recommended by Shorts' Board

Target set by Ministers	(87)
Adjustment for EDSA (as put forward by Shorts)	1
Loss of income from 6 SD360 sales	(15)
Net Savings to be achieved by Shorts	6
Revised EFL target	95

2. Measures and associated savings required to reduce revised EFL

(a) Cessation of work on new projects such as S14 (the high speed missile), the V2500 engine nacelle, the Boeing 737 prospect, the RAF trainer prospect and other development work.
Saving in 1984/85 - £2m,

(b) immediate further cut back in aircraft production programme so that the EFL stays within a limit of £90m in 1984/85. This would require 1,000 lay offs from now until 31 March 1985. The impact in 1985/86 would be to reduce SD330 and SD360 deliveries from 50 to 26 and increase EFL from £90m to £119m.
Saving in 1984/85 - £5m.

(c) immediate cut back in aircraft production programme so that the EFL stays within a limit of £87m in 1984/85. This would require 1,200 lay offs from now until 31 March 1985. The impact in 1985/86 would be to reduce SD330 and SD360 deliveries from 50 to 22 and increase EFL from £90m to £125m.
Saving in 1984/85 - £8m.

3. Profit adjustment recommended by Shorts' Board

Target set by Ministers	5.0
Adjustment for EDSA (as put forward by Shorts)	0.5
Loss of margin from 6 SD360 sales	(3.0)
Revised profit target	2.5

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E(A): Minister without portfolio. HMT D/Energy SO WO DoE LPSO | DTI D/Emp MAFF CSO, HMT D.Trans DLO CO

10 DOWNING STREET

From the Private Secretary

15 November, 1984

bc PW

Short Brothers PLC

The Prime Minister has seen your Secretary of State's minute of 29 October, and comments from the Secretary of State for Defence, the Chief Secretary and Mr. Pattie. She agrees that Shorts should be authorised to proceed with their bid for the RAF trainer contract and that Shorts' proposal to set up a manufacturing unit in West Belfast should be approved. She recognises the force of the point made in Mr. Pattie's letter about the way in which this development is justified. The Prime Minister agrees that the 1984/85 EFL should be increased to £95 million, but on the understanding that an offsetting adjustment is made to the 1985/86 EFL.

I am copying this letter to Private Secretaries to members of E(A) and to Len Appleyard (Foreign and Commonwealth Office), Richard Mottram (Ministry of Defence) and Richard Hatfield (Cabinet Office).

ANDREW TURNBULL

Graham Sandiford, Esq.,
Northern Ireland Office

CONFIDENTIAL

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PRIME MINISTER

SHORT BROTHERS PLC

Mr. Hurd seeks the approval of colleagues for:

(i) authorisation for Short's to make a revised bid for the RAF training contract;

(ii) Their proposal for a small manufacturing facility in West Belfast, in an effort to head off criticism in the US about the sectarian bias in the company;

(iii) An increase in the 1984-85 EFL of £8 million.

On (i) there is general agreement from colleagues. Mr. Heseltine has commented that if Short's do revise the terms of the bid they have lodged provisionally, other bidders would have to be given an opportunity to revise their bids.

On (ii) there is grudging acceptance although DTI recommend emphasis on the commercial justification for this development (such as there is) rather than the more intangible benefits perceived in the US market. If this is not done they fear criticism from those who currently undertake this business as sub-contractors.

On (iii) the Treasury are prepared to see an extension of the EFL provided an excess this year is offset next.

Agree Mr. Hurd's proposals, subject to these caveats?

AT

Yes md

14 November 1984

CC/NO

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 5147
(Switchboard) 215 7877

*From the Minister of State
for Industry and Information Technology*

GEOFFREY PATTIE MP

Rt Hon Douglas Hurd CBE
Secretary of State for
Northern Ireland
Northern Ireland Office
Whitehall
LONDON
SW1A 2AZ

12 November 1984

Dear Douglas

SHORT BROS PLC

with AT

I have seen a copy of your recent minute to the Prime Minister on Shorts, and I am broadly content with the recommendations in paragraph 13 of your minute. However, I have a number of comments on your proposals.

We must clearly concentrate on the terms of Shorts' RAF Trainer bid at this stage, rather than the wider aspects to which you refer. On the face of it, the bid offers a reasonable rate of return and I see no strong reason to require amendments at this stage. It remains to be seen how Shorts' bid will compare with those of its competitors for this contract.

On the West Belfast facility, it seems clear that this is distinctly marginal in financial terms. I am also a little concerned about the implications for those sub-contractors who will lose business as a result of this development. You do not indicate in your letter to what extent mainland UK companies will be affected, but I imagine that some, if not most, are based in Great Britain. Your, and Shorts', response to any criticism from these companies will clearly need to emphasise the commercial justification for this development, rather than the more intangible benefits perceived in the US market. In any case, I should have thought the latter aspect should not be overplayed at present if Shorts are to avoid cynical comment in the US.

The EFL overshoot is certainly serious. I note what you say about the drawbacks inherent in possible short-term measures to mitigate or avoid such an overshoot, and I therefore agree that Shorts' EFL should be adjusted as you propose on a provisional basis. However, the situation serves to reinforce the need for a very careful examination of the strategic options open to Shorts. We should, in my view, lose no opportunity to press on Shorts the

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need for them to present realistic options in the forthcoming Corporate Plan, in particular regarding aircraft manufacture.

Finally, on the question of the possible sale of missiles to Jordan, I note that OD invited my Secretary of State to review the present arrangements for meeting large credit requirements implicit in potential arms sales of this size. Officials in Projects and Export Policy Division here are working on this and your officials may like to make contact with them in view of your interest in the principles involved.

A copy of this letter goes to the Prime Minister, E(A) colleagues, Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

One further point - the company is very identified with Phil Foreman now in his sixties. I would like to see evidence of the development of a management succession strategy by Shorts.

Yours ever

GEOFFREY PATTIE

Geoffrey

13 NOV 1984

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MR TURNBULL 12 November 1984

SHORT BROTHERS PLC

Shorts want approval to compete for the new RAF trainer and need £2.6 million of discretionary assistance if they win the contract. The aircraft will be made under license from the Brazilian company Embraer. The two companies have agreed very modest royalty arrangements (total cost for fulfilling the RAF order is only £9 million) but ought also to fix in advance exactly how export opportunities will be divided.

The project shows a highly optimistic 13½% rate of return and at the peak will provide 695 jobs. All the assistance is within the Northern Ireland Office budget and although arguably we are subsidising our own competition, the money has been provided to give this advantage to Northern Ireland. The project is important for the privatisation of Shorts and we would recommend support.

Shorts also want £2 million of discretionary grants (also within Northern Ireland budget), to establish a manufacturing facility in West Belfast employing 200 people in response to US pressure. They nearly lost the EDSA contract for the US Air Force through accusations of discrimination against Catholics. Our Washington Embassy recommend the proposal, and although it is unlikley ever to be commercial, we also reluctantly support it.

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As a separate issue Shorts also want their EFL for 1984/5 raising by £8 million to £95 million. This is mainly because they have sold only 30 instead of the planned 36 SD360 aircraft this year. The resultant revenue loss is £15 million, but unless manufacture of the 6 unsold aircraft is fully completed, the cash loss will be less. Any increase in this year's EFL must be fully offset by a reduction in that for 1985/6 when the stockpiled aircraft are sold.

Peter Warry

PETER WARRY

CONFIDENTIAL

C/NO

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MO 26/11

PRIME MINISTER

SHORT BROTHERS PLC

The Northern Ireland Secretary copied to me his recent minute about Short Brothers plc. I should like to comment on two of the issues he raises.

2. The question of the Future Basic Trainer for the RAF does of course come within my responsibilities. The current position is that tenders have been received in respect of the four contenders on the shortlist; apart from the Shorts/Embraer Tucano these are the Pilatus/BAe PC9, the Australian Aircraft Consortium/Westlands A20 and the Firecracker NDN-IT. The tenders are now undergoing a full technical and financial analysis and I hope to reach a decision around the turn of the year. I appreciate that colleagues have an interest in the outcome of this competition and they will of course be kept informed.

3. The fact that the Shorts bid was conditional on Government approval does not hinder our consideration of their tender. But as Douglas Hurd will appreciate, should there be a requirement to amend the Shorts bid, then I would be obliged to give the other contenders an opportunity to submit revised proposals. This would almost certainly lead to a delay in the decision, and in view of the political sensitivity of this project that is something I would wish to avoid. I understand that Shorts have the capability and manufacturing capacity to undertake the work on the new trainer, especially in view of the reduced forecast of deliveries of the SD360. Beyond this, in

view of my role in the assessment of the various tenders, I believe I should leave to colleagues the question of authorising Shorts to proceed with their bid and the provision of Government assistance to this particular contender.

4. There are, however, two small points of detail in Annex A to the Northern Ireland Secretary's minute that I might mention. The figure of £815,000 per aircraft relates to Shorts' "recommended" standard of aircraft: the main quotation against the full specification in the tender is however, some £10,000 more per aircraft. This point, along with the "major sensitivities" set out in Annex A, would be for discussion with the Company during contract negotiations, should we decide to select the Tucano.

6. I am content with Douglas Hurd's other recommendations, but in the context of the External Funding Limit I should like to make one comment on a point raised in paragraph 9 of his minute. This related to withdrawal from future projects in which there is an important defence interest. As part of the policy to promote competition for defence contracts, I am concerned that the contract for the development of the High Velocity Missile (which Shorts call the S14) should be awarded after competitive tendering between Shorts and British Aerospace, on completion of their parallel project definition studies. If Shorts were forced to withdraw, it would clearly have important repercussions for this competition.

7. I am copying this minute to your E(A) colleagues, the Foreign and Commonwealth Secretary and to Sir Robert Armstrong.

Ministry of Defence
12th November 1984

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CHIEF SECRETARY TO THE TREASURY

FROM: CHIEF SECRETARY

DATE: 9 November 1984

PRIME MINISTER

SHORT BROTHERS PLC

Douglas Hurd sent me a copy of his (undated) minute to you.

RAF Trainer Contract

2 I agree that this looks the sort of collaborative venture on complete aircraft production that we want to see Shorts in, during the run- up to possible privatisation. It is the way the industry is going; and the downturn in market prospects for the company's own SD 360 commuter aircraft makes it timely. The terms of the deal, and the 13.5 per cent rate of return, look acceptable. There are significant risks, especially in respect of the production learning curve, which could lead to serious cost overruns if there is not tight management control. But the partly captive market makes it, in that respect, less risky than most Shorts projects; and, if other collaborative ventures ensue, new markets could be opened up for Shorts e.g. in Latin America. I am content to see this project go ahead.

West Belfast Facility

3 The proposal to set up a composites manufacturing facility in the old De Lorean factory in West Belfast looks weak on normal investment appraisal criteria, with an internal rate of return of only 4 per cent. The case for approving it turns on a judgement about the significant extra business with the USA which, for political reasons, it could help to stimulate. I accept that the advice from our Washington Embassy is categoric on this point; so on this occasion would not wish to object. But there is an element of political blackmail here, and I must say now that I could not agree to any further project whose sole justification turned on foreign pressure of this kind for investment on sectarian grounds.

CONFIDENTIAL

Adjustment of EFL

4 I agree with Douglas Hurd that an expected £8 million overshoot of Shorts' current EFL is serious. I note with concern that it is mainly due to worsening market conditions for commuter aircraft: we shall need to address the implications of that when we look at Shorts' corporate plan during the winter.

5 I accept that the expedients available to eliminate the excess would risk damaging Shorts' business in a way that would not help our aim of privatisation. But I think it no less important, in the light of that aim and of Shorts' move into profitability, that we treat EFLs as a real discipline on the company. I could only agree therefore to raise their (cumulative) EFL from £87 million to £95 million, as Douglas Hurd proposes, on the basis of an offsetting adjustment to their 1985-86 EFL: that is to say, that in setting their EFL for that year we treat the £90 million projected in their last corporate plan as a ceiling (subject only to factors outside the company's control arising after the present date), rather than raise that figure too by £8 million. I should also wish to stipulate that Northern Ireland Ministers should write to the company's management forthwith, urging a very firm line in their January 1985 pay negotiations and linking that explicitly to the company's EFL problems.

6 I am copying this minute to EA colleagues, Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

PR

PETER REES

IND POL: Short Pouros

Nov '80