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TK/400/5/25/11

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504/10

cc T J H Downing S.E.
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M M Baker D.I.
J E N
P J Kiteakt H.M.I. D.M.
S A Robson H.M.I. P.B.

(1) Mr Benjamin
At long last, but
no mention of offset.

(2) Mr P... Please
copy to Mr P... OT4
28/10

(Received in P.P.2 M...)
28/10.)

21 October 1985

SALE OF TORNADO, HAWK AND PC-9 TO SAUDI ARABIA

At the EGC meeting on 20 September, I undertook to write about the proposed sale of aircraft to Saudi Arabia.

As you will have seen widely reported, the deal comprises 48 Tornado IDS, 24 Tornado ADV, 30 Hawk and 30 PC-9 aircraft (the last named being built in Switzerland, but fitted out to Saudi specifications by BAe, who are handling the sale). As I reported to EGC, the total value of the deal will be of the order of £3 bn to £4 bn or more: this will comprise in very round terms about one third aircraft, one third weapons and one third training and support equipment.

... The Saudi Minister of Defence and Aviation, Prince Sultan bin Abdul-Aziz and the Secretary of State, Mr Heseltine signed on 26 September at Lancaster House, an initial MOU which did little more than launch the negotiations on the project. We deliberately avoided the term 'letter of intent' or similar title; we wanted the document (copy attached) to constitute a binding commitment on both sides to begin negotiations in earnest, and on the Saudi side to begin payment. We have not yet agreed on a schedule of payments; the Saudis are aware of our need of a large sum, possibly as much as £500,000, by the end of the year to finance the work that has already been done which includes the 20 Tornado IDS aircraft diverted from RAF stock. Annex A to the MOU is designed to facilitate the start of funding of the project.

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Negotiations have not yet begun on the individual LOAs (using the American terminology) which will comprise the elements of the main MOU and form the basis of the contracts which we shall place with British Aerospace. (A BAe/MoD team has however just returned from Riyadh after reaching broad agreement on a timetable for the negotiations). Nor have the Saudis told us yet exactly how the deal is to be financed; the only word on that so far is that the Saudi authorities have told us that it will be paid for entirely in oil. We hope in concert with BP, Shell, BAe and the Department of Energy to thrash this out with the Saudi Petroleum Ministry, Petromin, very soon. We await a summons to Riyadh.

One thing is however clear - we have made no offer of cover or any official support for the financing of the deal, nor have the Saudis given any indication that they expect us to do so.

I hope that this is enough to reassure you that the aircraft sale will be handled essentially like the other contracts that we run on behalf of the RSAF and the Saudi National Guard, the main difference being that the project will be funded by the sale of oil, rather than through the Saudi MODA budget. Another interesting aspect of the deal is that since it will be spread over a long period, the formula under which the deal is struck must provide for a (as yet undefined) sum of money to be generated, rather than for a quantity of oil at a fixed price. Clearly no one is in a position to make any fixed price deals in the present state of the market. In this respect, if in no other, the aircraft deal is unique.

I leave you to copy this to other members of EGC as you see fit.

John Smith
[Signature]

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