

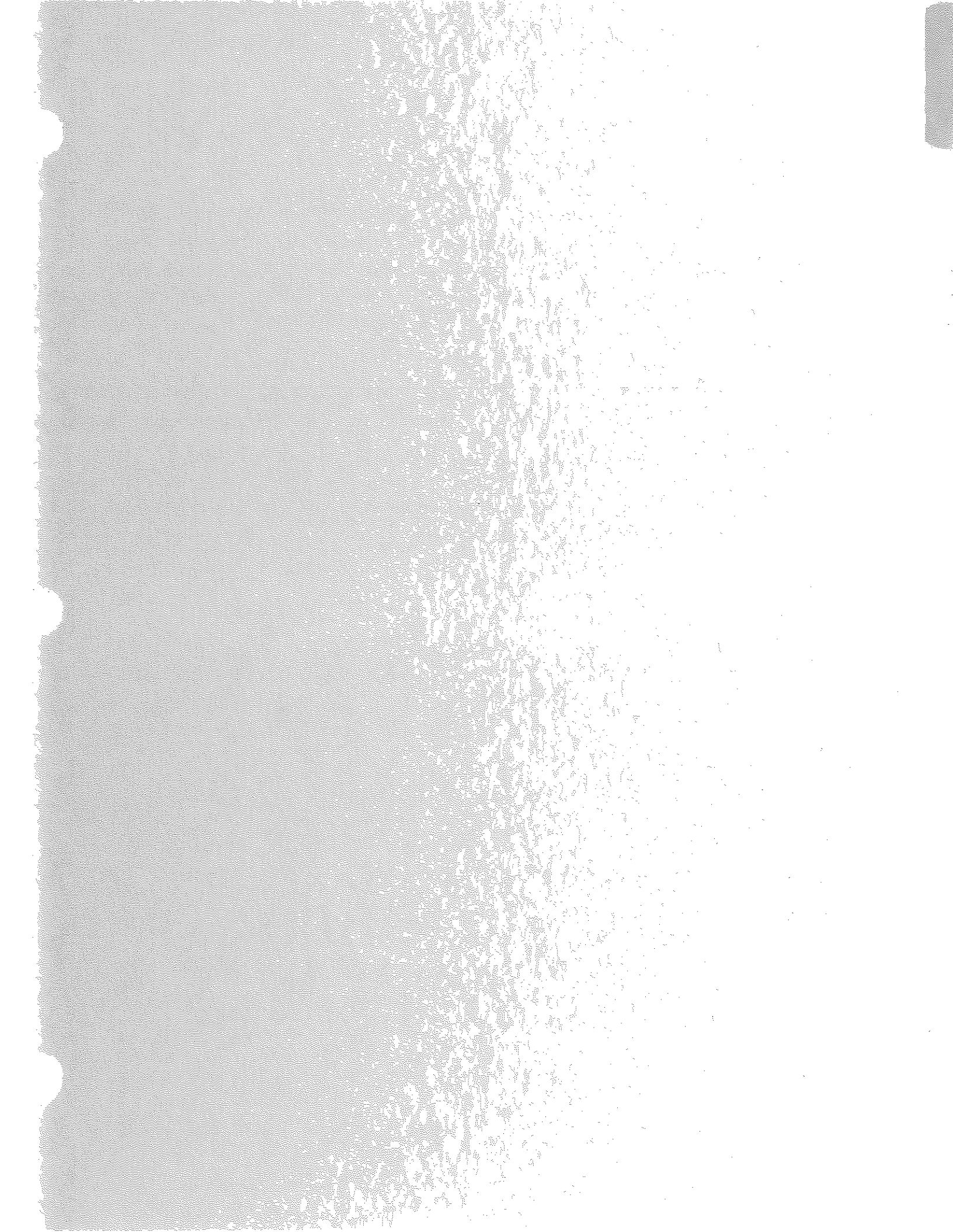
DOCUMENTS IN SUPPORT OF THE TESTIMONY OF

Norman SPECTOR

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Karlheinz Schreiber

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PERSONAL CONFIDENTIAL FOR HIS EYES ONLY

27 August 1990

The Right Hon. Brian Mulroney, P.C., M.P.
Prime Minister of Canada
Ottawa, Ontario
K1A 0A2

Dear Prime Minister:

First, let me thank you for the telephone conversation last week and I hope that your mother's birthday celebration was a happy event for she and all of your family. As you know, I am going back to Germany this week to celebrate with my mother on the occasion of her seventy-ninth birthday.

In an age as our mothers are, we are fortunate to celebrate every year with them.

Before my departure I wanted to pass on some information which I believe important.

The meeting which I had with Stanley Hartt and Elmer was very interesting and in my opinion it was very productive.

The visit of Winfried Haastert and his colleagues from the Thyssen Industrie AG Supervisory Board was very positive in their understanding of the promising out-look for establishing our new Canadian factory in Nova Scotia.

Karlheinz Schreiber

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**PERSONAL CONFIDENTIAL
FOR HIS EYES ONLY**

2

I passed on your regards as you had requested during our telephone conversation and this was both very appreciated and respectfully acknowledged in return.

This group has travelled onward to Los Angeles for project discussions after last week's award to Thyssen for the high speed rail link between Los Angeles and Las Vegas, selecting Thyssen's Magnetic Levitation train which will provide a 500 km/hour connection between the two cities.

Observing Canada has been among the first nations to respond to the Iraqi invasion of Kuwait, I believe it will be of interest to know I have arranged, at the request of the U.S. Government, for the immediate supply to the US forces from West German army inventory, 10 Fox NBC reconnaissance vehicles (capable of chemical detection and protected operation in a chemical warfare environment) and an additional option for 20 more of these vehicles. As you may be aware, neither Canada nor the US have any such anti-chemical vehicles in inventory.

The US has now asked for the Fox chemical protected personnel carriers as well. It now appears the U.S. may request all available vehicles. Before we agree to such a US request, I am offering to make such vehicles available to Canada should Canadian forces be deployed to a land base in a region threatened by chemical warfare.

If such is your desire, I would need to know as soon as possible.

I trust this is helpful to you.

As regards the Mohawk situation, I have been concerned for years and have expressed this concern, about the known fact that certain Canadian Native groups received training in East German terrorist training camps, and I have reason to believe that some such group may be in possession of armour-piercing weapons. There are 1 Shilo, Manitoba, at the Training Camp, a number of Mardé personnel carriers vehicle, which offer protection against such weapons. They are being used for training the German forces

there. I could arrange, either from our company, or on a Na country to country basis, to make these vehicles immediate available to your forces.

Karlheinz Schreiber

Suite 908, 350 Sparks Street, Ottawa, Ontario
Telephone: (613) 563-3321 Fax: (613) 563-7648

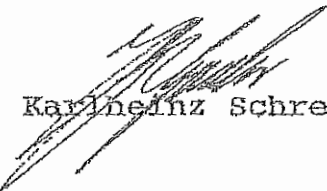
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I trust this may be helpful to you as well.

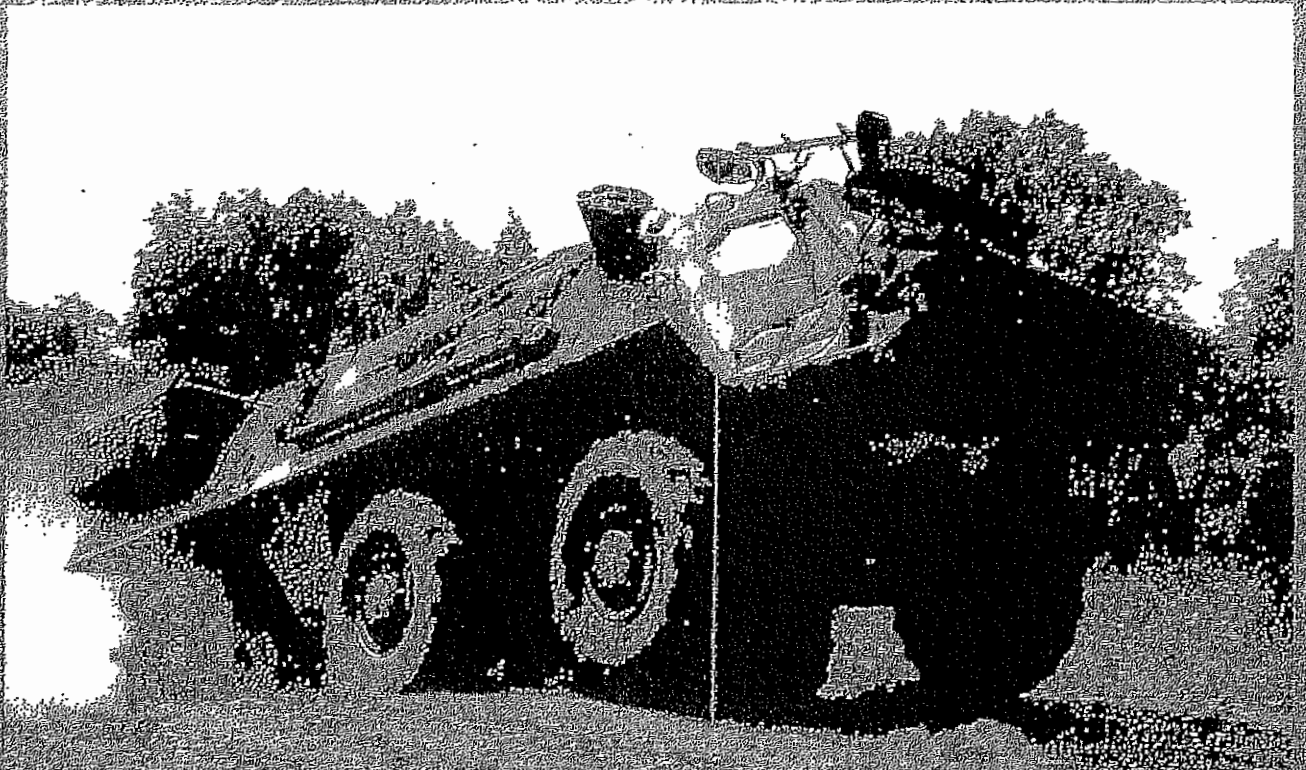
Hopefully, these conflicts will be resolved peacefully, but I wanted you to know that I am available to help in this way should it be necessary.

Sincerely,



Karlheinz Schreiber

P.S. I am enclosing info on these vehicles. Obviously I am not trying to "sell" Canada anything by this offer, merely arranging to have the vehicle loaned to Canada to help protect Canadian soldiers.



NUCLEAR, BIOLOGICAL, CHEMICAL RECONNAISSANCE SYSTEM (NBCRS)



THYSSEN HENSCHEL

GENERAL DYNAMICS
Land Systems Division



WORLD CLASS TEAM

GENERAL DYNAMICS AND THYSSEN HENSCHEL HAVE TEAMED TO MEET THE U.S. ARMY'S IMMEDIATE OPERATIONAL NEED TO COUNTER THE GROWING NBC THREAT.

Airland Battle doctrine requires continuous operations on the contaminated battlefield. The ability to quickly detect, identify, and quantify a wide variety of contaminants, coupled with the ability to rapidly communicate this information to friendly forces, could decide the outcome of the conflict. That operational capability is missing today.

An operational vehicle system that can respond to this need is available now from a proven industrial team of General Dynamics Land Systems and Thyssen Henschel.

The FOX NBC Reconnaissance System (NBCRS) is the only operational system of its kind in the free world. Thyssen Henschel has produced more than 140 FOX NBCRS configured vehicles that are currently fielded and used by the West Germany Army. In addition, over 1000 FOX combat, combat support, and combat service support vehicles have been produced and fielded to support NATO forces.

The FOX NBCRS is a highly mobile, amphibious wheeled vehicle, tailored to meet the operational requirements for NBC Reconnaissance on the current battlefield. It is the only operational NBC Reconnaissance System in use by NATO forces today.

The FOX NBCRS is already playing a key role in the defense of Europe.

Thyssen Henschel has a long history of combat vehicle development and production. Today the company designs and builds some of the most sophisticated armored combat, communications, missile, and command systems for the West German Army and other NATO allies.

General Dynamics brings the experience of decades of design, integration, and production of defense systems. GD has designed, built, and supports a wide range of advanced weapon systems including the F-16 aircraft, the Stinger Missile, and the M1 series Main Battle Tank.

The combined resources of this team has resulted in a program to provide a proven NBCRS system that meets today's requirements with planned growth for future NBC defense requirements. The proposed program offers a low risk approach, based on using an NBCRS that has been fielded and in operation since 1984.

The baseline NBCRS will be expanded during a system improvement program that is based on current Army combat vehicle command and control electronics technology as well as the latest NBC detection technology.

TRANSITIONING NATO TECHNOLOGY INTO THE U.S. ARMY PRODUCTION BASE

The FOX NBCRS meets today's demand for a high performance armored vehicle tailored to accomplish the NBC Reconnaissance Mission.

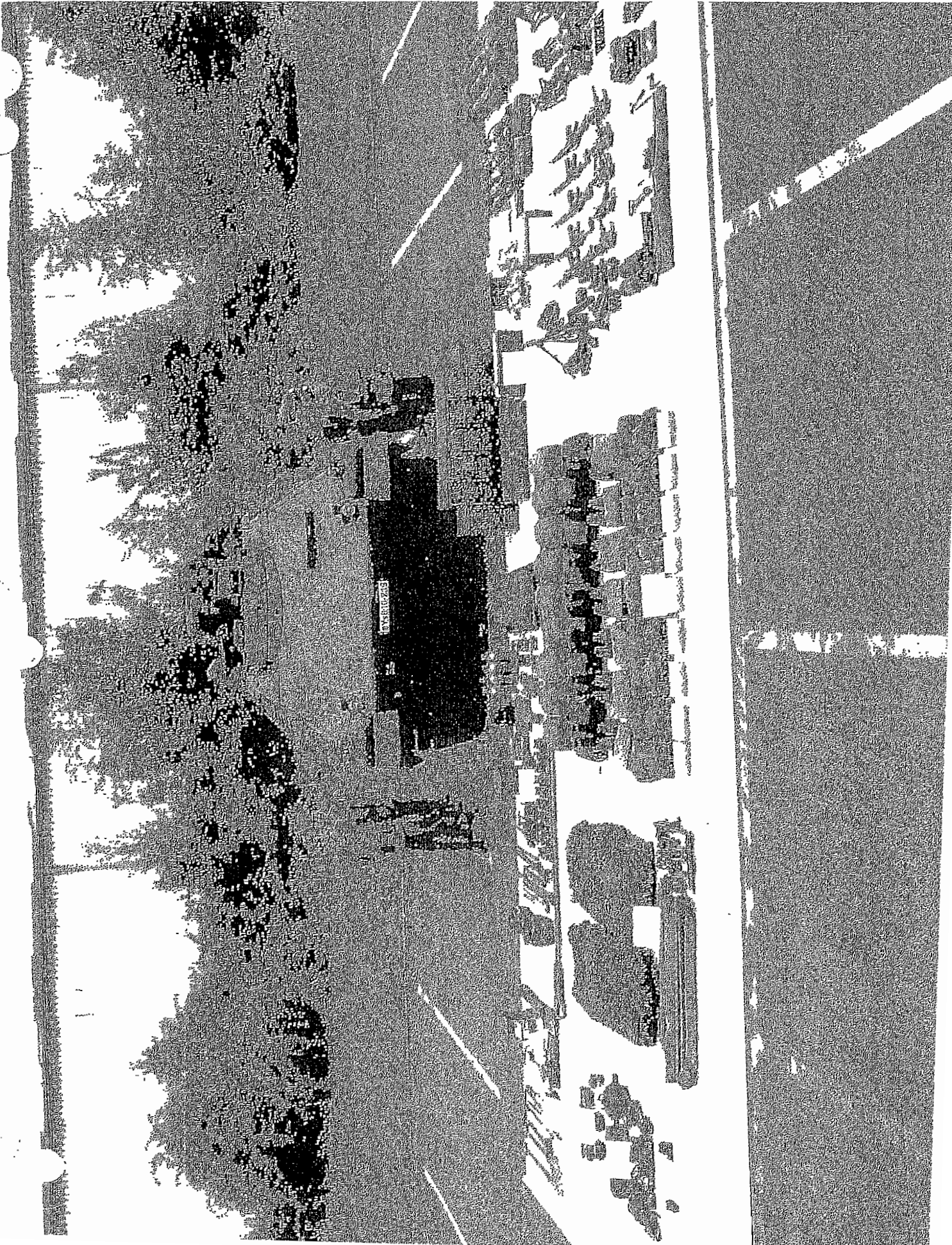
The FOX system is fully developed and proven. The integrated Non-developmental Item (NDI) nuclear, and chemical detection, identification, location, and marking system is currently playing a role in the defense of Western Europe. The current FOX system provides a baseline for evolutionary improvement with low technical risk.

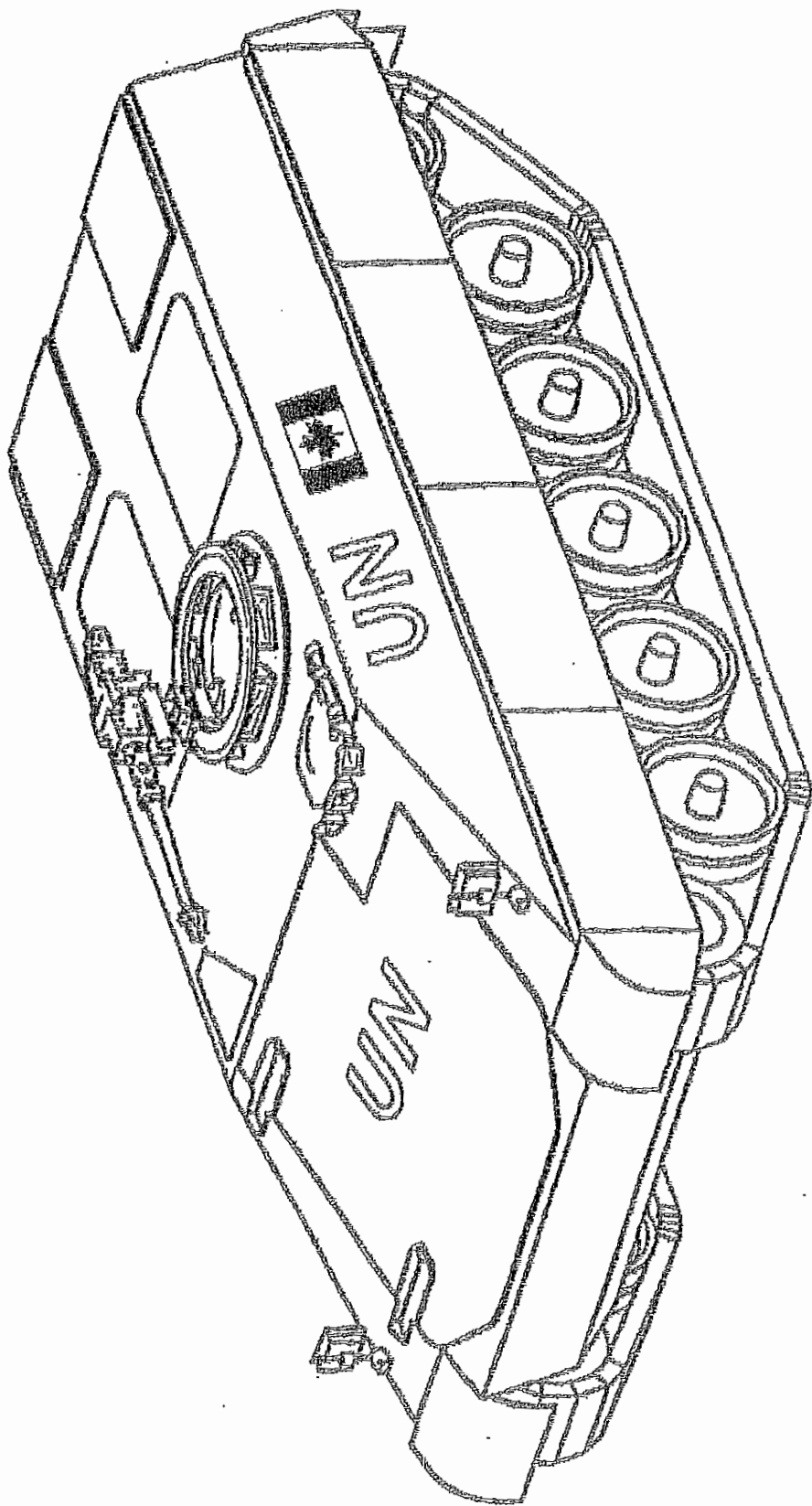
For full rate production, the FOX NBCRS will integrate all of the developed and tested

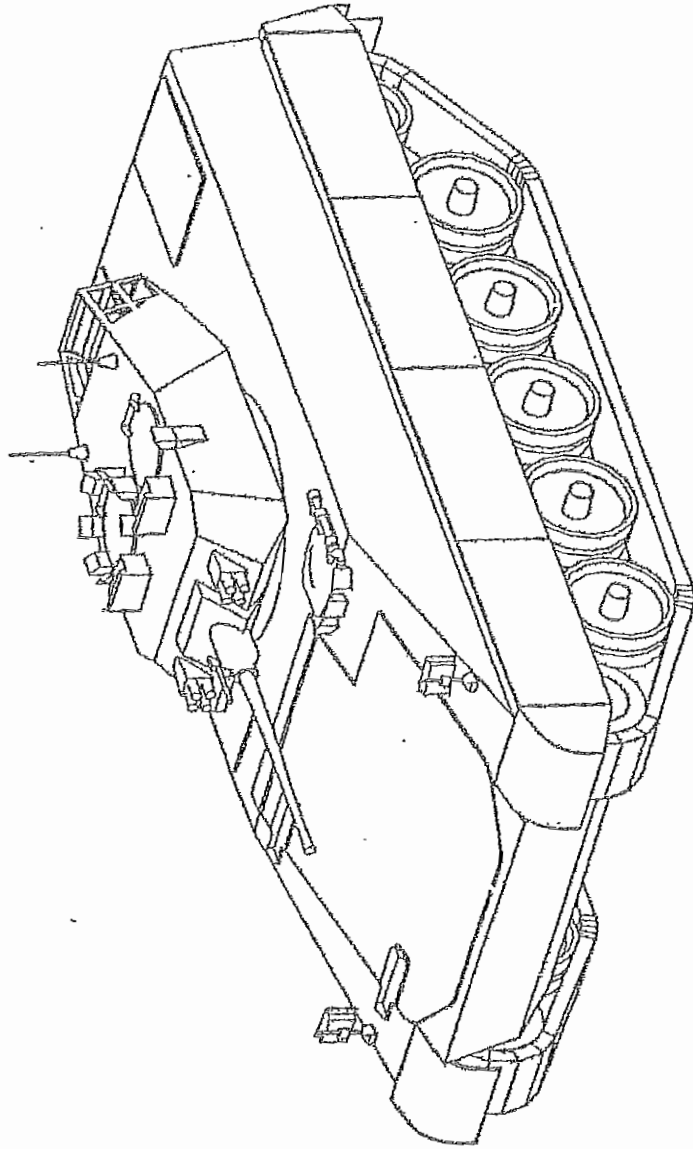
improvements necessary to provide a mobile standoff sensing capability for detecting, identifying, and reporting all NBC threats.

The improved FOX will be based on an electronics architecture that will integrate all NBC detectors, the Position - Navigation (Pos/Nav) system, and meteorological sensors, with a digital burst communications capability via an integrated computer processing unit.

System upgrades can be retrofitted to the current FOX NBCRS with no degradation to system performance or RAM characteristics.

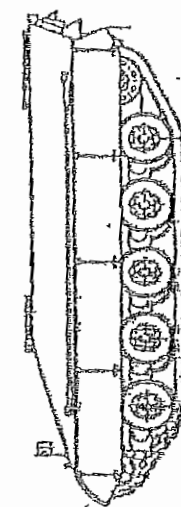






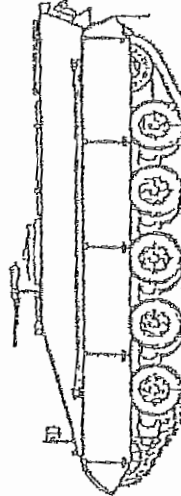
TH 495

WITH TURRET LAV 25 MM



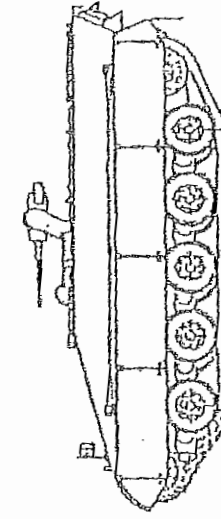
T.H. 495

HUNTER



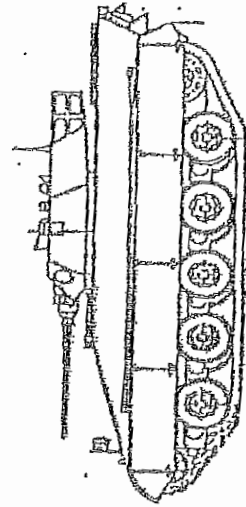
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INFANTRY-VEHICLE, WITH MG 7.62 PIN-MOUNTED



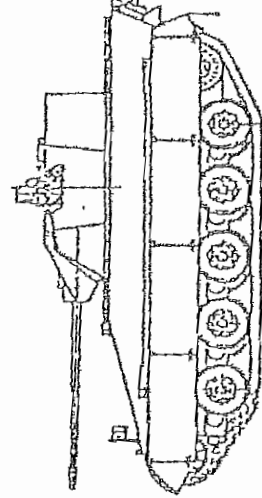
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INFANTRY-VEHICLE, WITH MG 12.7 CUPOLA



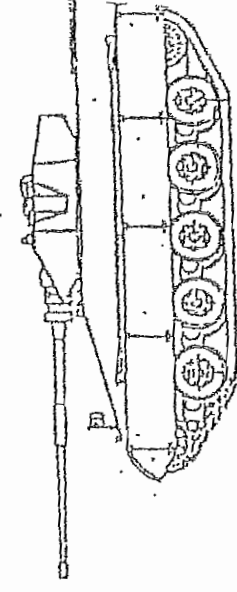
T.H. 495

INFANTRY-FIGHTING-VEHICLE, WITH MAIN GUN 25 MM



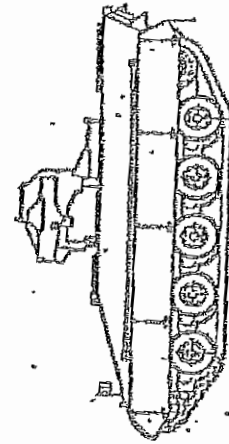
T.H. 495

INFANTRY-FIGHTING-VEHICLE, WITH MAIN GUN 35/50 MM



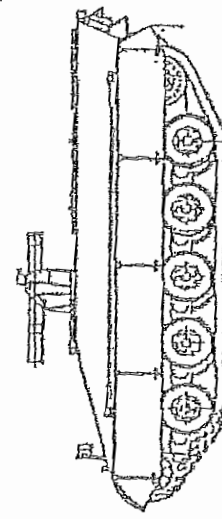
T.H. 495

INFANTRY-FIGHTING-VEHICLE, WITH BK 60 MM



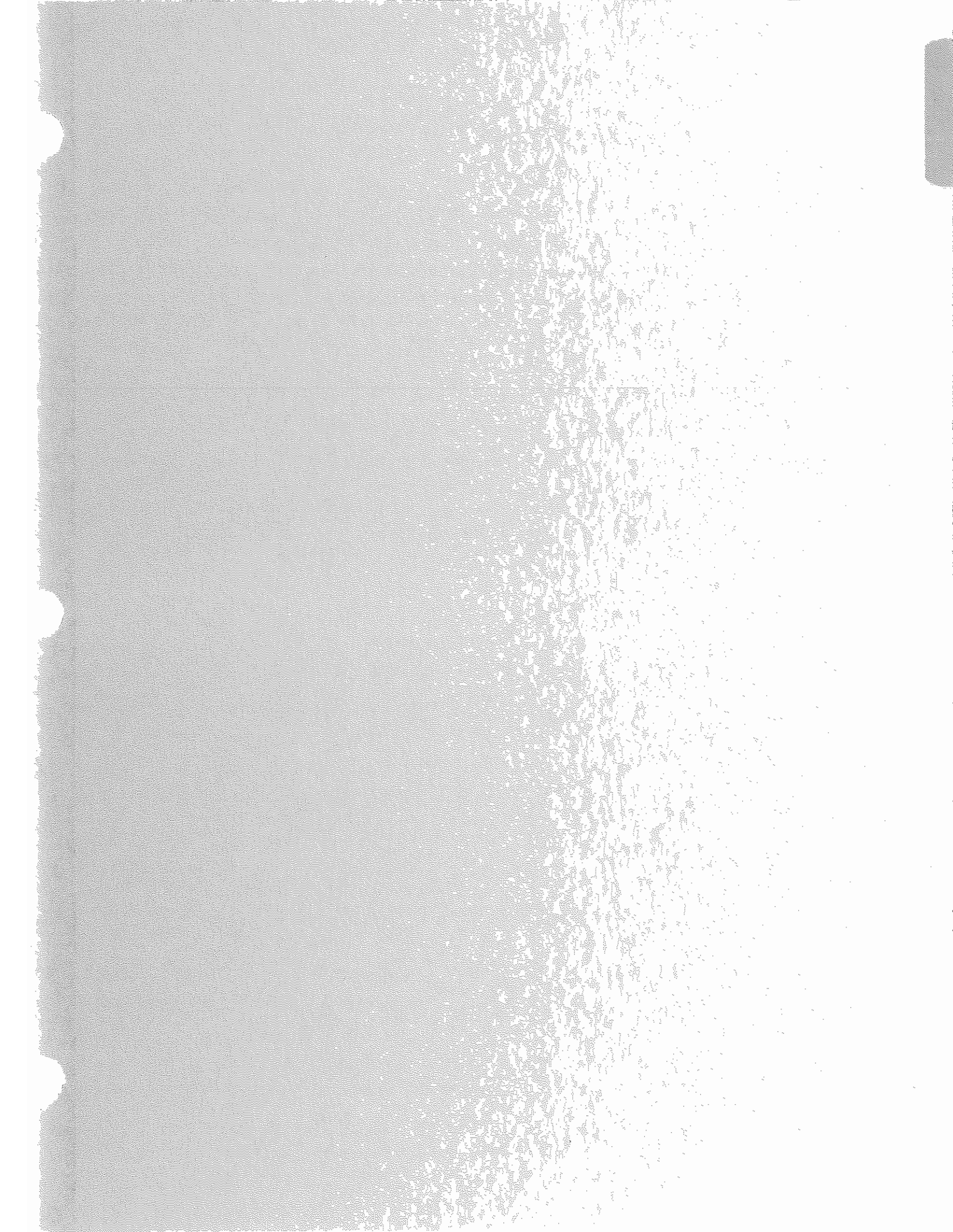
T.H. 495

INFANTRY-VEHICLE, WITH ARMOURD LAUNCHING CURSOR FOR THE 50M MISSILE SYSTEM



T.H. 495

TANK HUNTER, WITH TOW-LAUNCHER



Karlheinz Schreiber

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CONFIDENTIAL, FOR HIS EYES ONLY

10 October 1990

The Right Hon. Brian Mulroney, P.C., M.P.
Prime Minister of Canada
Ottawa, Ont.
K1A 0A2

Dear Prime Minister:

Many thanks for the most enjoyable meeting we had last month. What a great pleasure to recognize that old friends never change.

Congratulations on your great success in New York. I would like to inform you that you have been the only conference speaker who was shown on the television in Germany and Switzerland. I received several comments from friends in Europe who applauded your remarkable statements and their plainly evident sincerity.

I wish you could see Canada from an overseas perspective, where the country is viewed at such an advanced stage of evolution that the Prime Minister can turn to the issues that are truly important to this world, such as our children, our environment and our commitment to keep peace. Witnessing your leadership in this role from Germany reminded me of this and brings me to encourage you with all of my best wishes.

Turning back to discussions of our meeting last week, I would like to share some further thoughts which I have had on those matters.

In my opinion, the greatest opportunity for Canada is to achieve growth in the export of finished products. I am most familiar with the trade between Canada and Germany and while I am delighted to find Canadian exports to Germany in 1989 increased by 20.1%, I note the largest portion of that growth has been in unfinished resources.

Karlheinz Schreiber

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CONFIDENTIAL, FOR HIS EYES ONLY

Therefore, the remaining challenge is to increase the proportion of finished products. I am confident that I can help you in meeting this challenge, but before I can do this, I must have in place the right tools with which to work. I should not withhold from you the fact that I face increasing pressure due to the newest development, where earliest production is urgently required. I am not able to explain to the United States customer why their vehicles should be manufactured in Canada where we have so far found no business with the Canadian Forces.

What is needed as soon as possible is the signed MOU as proposed by Minister MacKay, to solve the aforementioned problems as well as bring new and vital long-term activities in Trenton.

Thank you, and please be assured that I will do everything I can to meet your goals.

With best personal regards,


Karlheinz Schreiber



CLERK OF THE PRIVY COUNCIL AND
SECRETARY TO THE CABINET



GREFFIER DU CONSEIL PRIVÉ ET
SECRÉTAIRE DU CABINET

SECRET

OCT 31 1990

MEMORANDUM TO NORMAN SPECTOR

Attached are two notes on Thyssen/Bear Head Industries, prepared for the Prime Minister during the summer, which may be useful as background for your November 1 meeting with Ministers McKnight and MacKay. (We understand that Cliff Mackay, ISTC, and Rob Gillespie and General Ray of DND will also attend.)

The situation with respect to DND's readiness to move forward on the contract has not changed since the summer and Mr. McKnight can be expected to reinforce his opposition to:

- o a non-competitive process;
- o being forced to move on this project ahead of development of a new Defence Policy;
- o the financial burden which would be imposed by moving the combat vehicle project forward; and
- o technical and operational difficulties with the Thyssen project.

Mr. MacKay for his part can be expected to stress the importance to the Atlantic economy of this contract. He may express some frustration over the length of time which has elapsed since it first began in 1985 and since the July 1988 signing of an Understanding in Principle with Bear Head Industries by Ministers of Regional Industrial Expansion, ACOA and National Defence. In this Understanding, which DND understands Mr. MacKay has renewed, Thyssen undertook to proceed with construction of the Bear Head plant in Cape Breton if DND ordered 250 armoured personnel carriers. Bear Head was recently quoted in the press that it would consider establishing its plant in the United States if a Canadian order were not forthcoming.

Any pressure to move on this project comes from the company and from ACOA. Once you have heard Mr. McKnight's and Mr. MacKay's views, you might wish to ask Mr. MacKay how he would handle the launch of a major project for Cape Breton, supported through tax incentives, at the same time he has launched an independent review of Enterprise Cape Breton. Depending upon any direction from the PM, you might wish to indicate that the issue of how to proceed on this project should be reviewed by ministers as soon as possible and the result conveyed to Thyssen, which certainly has a legitimate complaint over the long delay in decision making. Messrs. Mazankowski, Bouchard, McKnight, Wilson and MacKay could be asked to examine whether to proceed with the Thyssen procurement on a sole-sources basis, essentially for regional development reasons, and what would be the impact on defence policy and operations.

*original signed
by P. Tellier*

Paul M. Tellier

attachments

Billings/Bilodeau/de



SECRET

August 10/90

MEMORANDUM FOR THE PRIME MINISTER

Thyssen/Bear Head Industries

In my July 11 memorandum to you (attached), I outlined the status of Thyssen's Bear Head Industries project and possible next steps. This note provides additional information from the Department of National Defence (DND) on the major issues surrounding this project, including the process to be followed if this project is to go forward in the near future.

ISSUES

Defence Policy:

- o Canada's Defence Policy is being reworked in light of the dramatic changes in international relations and recent budget cuts. This Policy forms the fundamental framework for equipment purchases and until it is developed and approved, it would be difficult to assess the impact of the Thyssen project on other priorities, or indeed to assess whether the Thyssen-type product is still required.

DND Operational Needs:

- o DND's current plans for the acquisition of combat vehicles calls for the purchase, starting in 1996, of at least 735 vehicles involving three variants on a common chassis.

- o A comparison between the Thyssen vehicle and postulated essential Canadian requirements indicates that the current Thyssen vehicle would not meet basic performance criteria. For example, combat vehicles must be air-transportable by Canada's air fleet. The air transportability of the Thyssen vehicle by the C-130 is questionable due to its large size. The Thyssen vehicle would also be ranked as not particularly appealing on battlefield mobility and crew protection (which is not consistent with the strong case made by Thyssen on the impenetrability of its vehicle).
- o A further essential requirement for DND is to have a common chassis for its combat vehicles so that, over time, it will have a fleet which is more economical and efficient to maintain and operate than its current fleet of mixed vehicles. While Thyssen indicates that it is prepared to compete for the balance of the combat vehicle program, the proposal to sole-source the initial 250 vehicles would eliminate DND's flexibility for the balance of the fleet unless it were prepared to accept the burden of continuing with a mixed fleet.

DND Budget:

- o DND's current plan would see the vehicles purchased over 15 years starting in 1996. At this time, there is a short-fall of some \$700 million in funds available for the vehicle program which a directed purchase from Thyssen would exacerbate, since their unit cost is higher than competing models.
- o Under the Thyssen proposal, production would begin approximately 12 months after a deal is signed, so that federal expenditures could begin as early as 1992-93, some four years earlier than anticipated. DND has no significant funds budgeted for this project before 1997-98. (250 Thyssen vehicles and associated spares would cost at least \$450 million.)
- o A decision to buy Thyssen carriers could be at the expense of programs in advanced stages of development such as Arctic Sub-Surface Surveillance, new Shipborne Aircraft, updates to the Aurora Reconnaissance Aircraft, Naval Reserve Vessels, Northern Terrain Vehicles and the Tactical Command Control and Communications System.

- o There is wide-spread international interest by companies in the DND combat vehicle purchase so that DND is anticipating significant value for money benefits from a competitive bidding process.

Industrial Impact:

- o The \$70 million Thyssen investment is estimated to create 500 direct jobs in Cape Breton and Thyssen hopes to capture a portion of the U.S. Defense market as well as Canadian sales. This will put them in direct competition with Canada's existing armoured vehicle manufacturer, the Diesel Division of GM Canada (DDGM) located in London. Since GM already has significant surplus production capacity, creation of additional capacity would exacerbate the situation and jeopardize the longer term prospects of DDGM, by intensifying competition in a market where the evolving global situation is already dramatically affecting demand.

Process:

- o Assuming the Government were to decide to proceed with the Thyssen procurement, the process would be as follows: 1) development of a Multi-Role Combat Vehicle (MRCV) Program for approval by Cabinet plus approval of authority for a non-competitive, sole-sourced contract to Bear Head for 250 vehicles; and 2) necessary Treasury Board program and contract approvals. DND notes that the development of the Program and receipt of these approvals could take until Spring 1991 if this Program is to be developed in the context of the Defence Policy Review rather than ahead of it.

Comment

Mr. McKnight is strongly opposed to this project on financial, policy and operational grounds:

- On the financial side, the Department can not absorb the additional costs of moving the combat vehicle purchase forward. (DND has also been asked to find \$150 million for MIL's losses on the frigates and Trump destroyer refits.)

- On the policy side, a procurement from Thyssen at this time would pre-empt the development of a coherent Defence Policy based on new international and budget realities. This could, from the very start, undermine the whole process. In addition, the program would go against stated Government policy which has established the pre-eminence of operational requirements, competition, fairness and accessibility as major policy cornerstones of the federal procurement process.

- There is material on DND's files assessing the technical and operational aspects of the Thyssen proposal so that proceeding with this project would run the risk of contradicting internal DND advice.

Nonetheless, Thyssen can be expected to continue to press for an early decision. As suggested in my July 11th note, if you are not ready to call a decision, you could ask Messrs. Mazankowski, Bouchard, McKnight, Wilson and MacKay to examine whether the Government should proceed with the Thyssen procurement on a sole-source basis, essentially for regional development reasons, given the major impact the project would have on defence policy and operations.

I would be pleased to discuss this with you at your convenience.

Original
Signed By

Paul M. Tellier

attachment



SECRET

July 11/90

MEMORANDUM TO THE PRIME MINISTER

Thyssen/Bear Head Industries

BACKGROUND

As you had requested, I met recently with Elmer MacKay and Karlheinz Schreiber, Chairman of Bear Head Industries Ltd., to discuss the Thyssen initiative. Mr. Schreiber described the history of this initiative which started in 1985 as a result of the request made by Sinclair Stevens, to West German business people to consider investing in Canada. Following this request, discussions started with Thyssen about the possible construction of an industrial facility in Cape Breton to assemble armoured vehicles, other metal products and environmental protection equipment. This led Thyssen to set up Bear Head Industries to pursue the initiative and to conduct the discussions.

In July of 1988, the Ministers of Regional Industrial Expansion, National Defence and the Minister in charge of ACOA signed an Understanding in Principle with Bear Head Industries which outlined the areas on which discussions had been held up to that time and understandings reached. For its part, Thyssen undertook, if it received an order for 250 Armoured Personnel Carriers, to proceed with the construction of the Bear Head Plant in Cape Breton.

As the discussions have been going on for almost 6 years, Mr. Schreiber feels that the Government should now come to a decision so the project can either be pursued or dropped by the company. I agreed that we were fast reaching decision time and, although a number of major and difficult issues are raised by the project, the Government should come to a decision sooner, rather than later, if it is the case that there is political will to pursue the project. I told my visitors that I would be speaking with you upon your return from the Houston Summit.

CONSIDERATIONS

In arriving at a decision about this project you will want to weigh the following factors:

1. Defence Equipment Requirements

Although it recognizes that its current armoured troop carriers are obsolete and are vulnerable to piercing in some limited close range conditions by certain high powered arms, the Department of National Defence is only in the very early phase of assessing its needs for a Multi-Role Carrier Vehicle (MRCV). This means that under the current schedule, a contract for MRCVs could be awarded by 1995-96 assuming no major changes in Defence policy or budgetary circumstances. Taking an earlier decision to procure 250 armoured carriers sourced from Thyssen would therefore mean a major shift in defence procurement priorities that could affect other priorities and contracts in an already very tight Department of National Defence budget.

2. Industrial and Economic Benefits

The commitment made by Thyssen is to invest \$70 million in the short term. The project would create 500 direct jobs, and Bear Head Industries would have access to Thyssen technology. The Understanding in Principle signed in 1988 stated that the Government would also assist the project with its regular programs in force at the time the project proceeds. This means that half or more of the capital costs could be covered by federal grants and tax credits available in Cape Breton.

Additional benefits could result from the fact that Thyssen and General Dynamics have formed a partnership. A North American location could allow Thyssen to have significant access to United States defence procurement. Bear Head Industries could also proceed to a second phase of the project into civilian production.

The benefits are potentially significant but remain only partially quantified at this time. A full business plan would have to be considered in order to assess the long run benefits and the cost to government in terms of direct procurement and subsidies.

SECRET

A new facility set up in Cape Breton would compete with General Motors in London. You will recall that the Government had awarded General Motors a \$201 million contract for 199 Light Armoured Vehicles in 1989. GM is quite successfully competing in this field having obtained an important contract in Saudi Arabia. Also, a heavily subsidized facility in Cape Breton may raise concern in the U.S. about unfair competition. However we understand from Mr. Schreiber that the U.S. Defence authorities have no concerns about a Canadian location for such a facility.

3. Export Controls

Bear Head Industries' future success would be dependant on exports to the U.S. and to other countries. The possibility has been raised that the West Germans themselves could procure some MRCVs from such a facility. However, not all exports would be to NATO countries and the Government must be prepared to address some difficult export control issues in the event the plant were established in Canada and if orders are received from Middle East countries for example.

COMMENT

An investment of this size, in a depressed region, by a West German company of this stature would be a positive signal about Canada as a place to invest. At a time when Canada is attempting to give a business as usual signal to foreign investors, this would be a reassuring message. However, if the project is less than fully successful, it may simply add to current overcapacity in the sector where GM is operating below its capacity level.

As noted above, pursuing the Thyssen project at this time would require a redirection of the Defence procurement program which would be disruptive and controversial. Exports of Thyssen products from Canada to sensitive countries could potentially be opposed by Mr. Clark on foreign policy grounds. Given these difficult policy issues, the Government's decision should essentially depend on whether the deal is a sufficiently good one from the economic and industrial dimensions and whether it will be worth the cost of assisting it through procurement and subsidies. To make this judgment, a full business plan should be requested from Thyssen, and an analysis of this and the project's costs and benefits would need to be undertaken thoroughly.

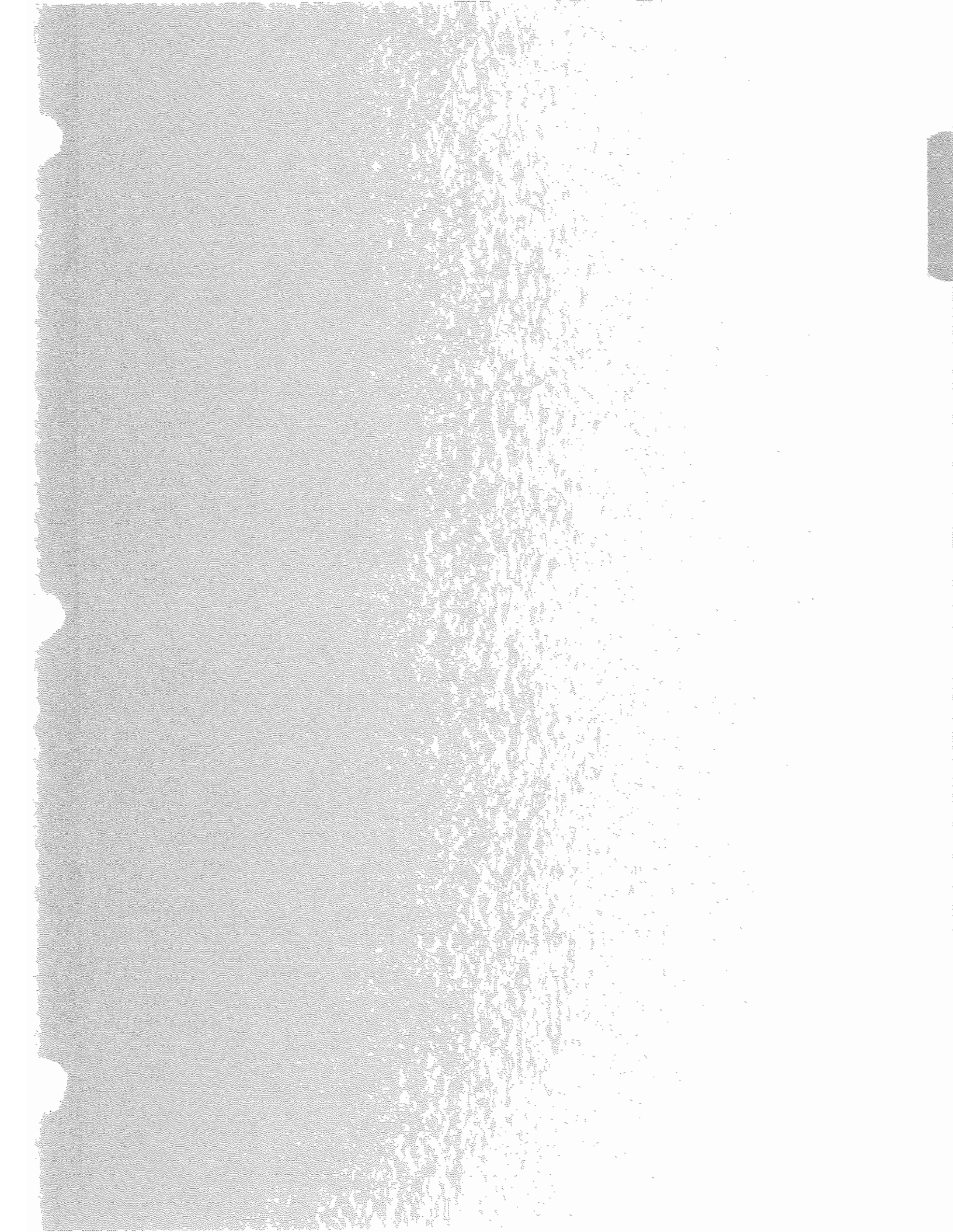
Should you feel a project proposal should be developed for consideration by Cabinet, you may wish to:

1. ask Mr. McKnight to prepare a proposal on a possible sole-source contract and to outline its policy, budgetary and operating implications for DND;
2. ask Messrs. Bouchard and MacKay to assess the proposal from the economic and industrial points of view, as well as the likely cost of the project through subsidies and tax credits; and
3. ask Mr. Mazankowski to chair a meeting to examine all aspects of the proposal and to report to you.

I would be pleased to discuss this with you at your convenience.



Paul M. Tellier



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MEMORANDUM

1000-1 (DDIR 4)

Oct 90

ADM(Mat)

THYSSEN INDUSTRIES AG PROPOSAL
TO SUPPLY DND WITH 250 MULTI-ROLE
COMBAT VEHICLES (MRCV)

Refs: A. 1000-1 (DGSPDI) 24 Jul 90
B. 1000-1 (DDIR 4) Sep 90

1. Ref A covered a Briefing Note to the DM dealing with the Thyssen proposal to supply DND with 250 MRCV (the Thyssen Fox) via a sole-source directed contract as a prerequisite to their establishing a production facility for their Canadian subsidiary, Bear Head Industries Ltd., in Cape Breton. Ref B was an update of that briefing note and addition of an Executive Summary. It is understood that those Briefing Notes were used for sundry meetings between Ministers and/or senior officials.

2. Enclosed find a further update to that Briefing Note, together with a forwarding memo to DG Exec Sec for your approval and signature. The Briefing note, unchanged in substance from earlier iterations, is intended for use by MND and senior DND officials involved in the 1 Nov 90 meeting with the Honourable Elmer MacKay and Mr. Norman Spector.

3. It is our present understanding that the 1 Nov 90 meeting was prompted by MND's office and that its purpose is to make clear once and for all DND's opposition to a directed contract to Bear Head Industries. As a bonus, this meeting will draw Mr. Spector into the loop and equip him to run interference between lobbyists for BHI and the Prime Minister. It has been suggested that, while MND's office has been fighting the BHI proposal, some military

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staffs have been conveying the idea that they really would like the Thyssen vehicle if only they had the money; in short, the claim is made that mixed signals are being sent. There is no apparent basis for such a claim. CLDO has been tasked by GDS to attend the meeting and to present in unequivocal terms the user's view. We also understand that Cliff Mackay will be in attendance, as will Mr. Carl-Heinz Schrieber, Chairman of BHI.

4. DND's purpose in calling the meeting may not be entirely clear to ACOA. From staff level discussions, it is understood that Mr. MacKay has had a number of discussions with BHI on the matter, that he may have signed some re-iteration of the 1988 Understanding in Principle as recently as last August, that ACOA see the meeting as an opportunity to move the file along, and that their hope for the outcome of the meeting is agreement by MND to a directed and immediate contract to BHI.

5. The conclusion continues to be that the Department should strongly oppose a directed, sole-source contract to Thyssen/Bear Head Industries.

R.N. Sturgeon
CS
992-6523

Enclosures: 2

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R.N. Sturgeon
C5
992-6523

Enclosures: 2

Recommended for Signature:

ORIGINAL SIGNED BY

Col J.E.C. Lavoie/DDIR/998-7088

(Date)

ORIGINAL SIGNED BY

T.M. Williams/DGSPDI/992-5715

(Date)

ORIGINAL SIGNED BY:

MGen G.M. Beay/CLDO/990-8447

(Date)

ORIGINAL SIGNED BY

MGen W.R. Oldford/CEM/992-3676

(Date)

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NOTE TO FILE : DND MEETING CONCERNING BEARHEAD/THYSSEN PROPOSAL ON MRCV

(3(1)(d))

5 Nov 90

ATTENDEES

- LCOL E. Champagne, DDIR 4, 998-7081 Chair
- Dr. C. Cannizzo, DDIR 4-4, 998-7082 Secy
- Mr. P. Herring, DDIR 4-3, 990-6343
- LCOL M.S. Campbell, DMFP 4, 996-6354
- LCOL J. Trepanier, DCDS Coord Sec 3, 995-0757
- Mrs. M.C. Dupuis, PROC/FIN Mngr, 992-5872
- MAJ M.N.G. Hutton, DLR 3/PDMRCV, 996-5244
- COL W. Brewer, PM MRCV, 996-5244

PURPOSE

1. To coordinate work for ADM(Mat) tasking for the DND draft position paper on the possibility of a directed contract to Bearhead/Thyssen for over 200 MRCVs. This paper will ultimately become part of the Atlantic Canada Opportunities Agency's (ACOA) briefing for the Prime Minister's office.

BACKGROUND

2. LCOL Champagne opened the meeting by providing a briefing on the history on the Bearhead/Thyssen (BHI/T) issue and on the current tasking.
3. The current tasking arises from a meeting held 1 Nov 90, attended by MND, Elmer Mackay (ACOA Minister), Norman Spector (COS for Prime Minister), Peter Smith (VP, ACOA), ISTC political staff, ADM(Mat), and CLDO. From DND's perspective, this meeting was to put paid to the various efforts by BHI/T to inveigle a directed contract from DND, efforts dating back to 1984 as well as to bring Mr. Spector up to speed and on side. Unfortunately, the outcome was somewhat different. Mr. Spector directed that the Prime Minister's Office (PMO) wanted a briefing that provided the costs of going ahead, rather than arguments for not proceeding, as had been previously provided.
4. A follow-on meeting of ADM(Mat), Cliff Mackay, ADM at ISTC, and Peter Smith was held later that same day. They agreed to produce a paper for the PMO which would change the thrust to the costs of proceeding. (See enclosed letter Smith to Gillespie.)

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5. ACOA has the lead for preparing the brief for the PNO. While DND's preferred strategy is to withhold providing our input to ACOA until ACOA has received a business plan from BHI/T, this may not be tenable, and it is likely that our input will be provided next week, after approval by ADM(Mat), whether or not a business plan or formal proposal by BHI/T is available. Our input will be incorporated intact into the ACOA paper. The final ACOA brief will be signed by ACOA, ISTC, and DND (signing level TBA).

6. MND and ADM(Mat) have noted that it is imperative that we do not lose this one. The Department must speak with one voice. Thus, we must coordinate our response/input for ACOA within DND.

7. ADM(Mat) has noted the following points, inter alia, which should be incorporated into our analysis:

- a. re-present DND case, but with new angle;
- b. CR 90--ie, where we are now;
- c. fragility of MRCV program;
- d. effect on DPMS (what could be driven to the right; impact on other army programs; impact on other programs);
- e. existing cash flow;
- f. spares (be liberal in allowance);
- g. impact on industry; and
- h. problems (costs) of fleet rationalization; incremental costs to support mixed fleet.

Our format should divide the various costs into categories, ie: operational, financial, defence industrial base, defence policy review considerations, and international. AGREED.

8. While the latest BHI/T proposal is not clear, we should assume that the Jul 89 proposal holds: over 200 vehicles [assume 250 for purposes of this exercise] at a cost (contract) of \$250M, with production to begin in early 93.

9. The proposed site for the production facility has apparently been changed from Bearhead in Cape Breton to Central Nova. Thus, the Cape Breton investment tax credits are off the table.

10. ACOA's position is reportedly "judiciously sceptical". They would like to sponsor this project very much, but want to be sure of the long term viability of the facility (ie, no long term dependence on DND orders) and they want DND on side. ACOA's part in the exercise will be to analyze the

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business plan, as well as prepare the final paper. Contact: John McDowell.

11. ISTC's part will be to focus on tax issues, if any, and on the question of industrial base capacity in the sector. Contact: Leah Clark.

12. DGSPDI, Mr. M. Williams, joined the meeting briefly and made the following points:

- a. Mr. McDowell has written a section on operational costs based on his discussion with GEN Reay, CLDO, and will be faxing this to us;
- b. he should be informed that DND will write this section; we will not simply "comment" on his draft;
- c. the paper for the PM may have to be ready for Ops meeting in two weeks; and
- d. ADM(Mat) has given emphatic direction that everything to do with this subject is on very close hold and personnel involved are to refrain from discussing the matter except on a clear need to know basis.

DISCUSSION

13. The following points were raised:

- a. project cost for MRCV is \$2.5B already;
- b. to pull project into 93, would have to do PD today;
- c. splitting the project into 2 pieces (ie, the 250 then the remaining 485) would double such costs as technical manuals; everything would have to be done twice if some other company receives the contract for the remaining 485;
- d. could not achieve economies of scale on spares or anything else;
- e. competing the rest would tend to favour BHI/T from logistics/operational and cost points of view, so it really wouldn't be a competition afterall;

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- f. can't get a plant built and running in 2 years; would take 2 years to tool-up, man, and acquire materiel for an established production line; ie, at least 18 months to get proper steel;
 - g. this would reverse the order in which the Army needs the various variants: need Lynx replacement--the Recce Combat Vehicle (RCV)--NOW since no more support available; Fox fits the Infantry CV profile which we don't need for 6 years; if cash crunch comes and we have bought Fox, we could lose the RCV and the Armoured CV; Army has been working for years to get their new family of vehicles properly sequenced; and
 - h. how would this fit in with Defence Review?
14. The following simplifying assumptions were made:
- a. the "buy" would be 250 vehicles, Thyssen's Fox, for a contract cost of a minimum of \$250M in 89 dollars; this would translate into a project cost for this section of about, e.g., \$600M;
 - b. production would start in the latter half of FY 92/93;
 - c. a figure will be calculated for an estimated new total project cost; ie, current estimate is \$2.5B, but splitting it in this way would raise the cost to, e.g., \$3.0B; and
 - d. the results of a-c can then be fed into the DPMS analysis to provide some "what ifs", ie, what might have to be chopped/delayed/downsized to make room (ADM(Mat) suggested TCCCS as one example); a full scale analysis of the effects on the DPMS is clearly not possible in the time available, so we will have to make do with some dramatic, but justifiable, what ifs.
15. The following ACTION ITEMS were agreed:
- a. COL Brewer, MAJ Hutton and Mrs. Dupuis will provide a cost estimate for the directed contract project (ie, the 200 Fox) and for the new increased total project cost to LCOLs Trepanier and Campbell on 6 Nov, including a cash line;

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- b. LCOLs Trepanier and Campbell will conduct the DPMS analysis;
- c. Cannizzo will draft the section on "operational costs" and then go over it with MAJ Hutton on 6 Nov;
- d. persons in a and b above will provide appropriate paragraphs to Dr. Cannizzo for the "financial costs" section (on either 3 1/4 " floppy or 2" diskette in Word Perfect) NLT 1300 on Thurs, 8 Nov;
- e. we will have a progress meeting 0700 (still 0-dark-30 for some of us!) on Wed 7 Nov in DDIR Conference room, 6 NT (ITEM: who signs off when? ie, CS, CLDO before it goes to ADM(Mat), or can signoffs come before it goes to ACOA?)
- f. Cannizzo will draft the sections on "defence industrial base", "defence policy review " and "international" costs, and then put all the pieces together NLT morning of 9 Nov; and
- g. LCOL Champagne and COL Lavoie, DDIR, will review in the morning of 9 Nov, and the draft will be presented to DGSPDI on the afternoon of 9 Nov and thence to ADM(Mat).

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MEMORANDUM OF UNDERSTANDING

This Memorandum of Understanding is an expression of intent, but it is a condition precedent to the requirement to perform hereunder, that the parties enter into a more detailed contract, more specifically outlining their terms of agreement. The parties agree to proceed forthwith to finalize such contracts.

This document signed this day of between:

THE GOVERNMENT OF CANADA, as represented by:

i) the Minister responsible for the Atlantic Canada Opportunities Agency (hereinafter called "the ACOA Minister"),

ii) the Minister of National Defence (hereinafter called "the National Defence Minister"); and

BEAR HEAD INDUSTRIES LTD., a company incorporated under the laws of Nova Scotia, a subsidiary which is one hundred (100%) percent owned by Thyssen Industrie AG of the Federal Republic of Germany (hereinafter called "the Company").

WHEREAS the Government of Canada desires to foster the economic expansion and industrial development of Atlantic Canada;

WHEREAS the Company must have in place a North American heavy-industry manufacturing facility on an urgent basis, and desires to establish such a facility in the Province of Nova Scotia;

WHEREAS the Government of Canada recognizes that the proposed facility represents an important economic development and diversification of the industrial base of Nova Scotia; and

WHEREAS the Company and the Minister of the Atlantic Canada Opportunity Agency, and the Minister of National Defence, on September 27, 1988 signed the document known as an "Understanding in Principle", which stated in clause 6 that it would be replaced at a later date by this Memorandum of Understanding (hereinafter MOU);

1. In accordance with this MOU the Company shall establish a diversified heavy-industry manufacturing facility in the Province of Nova Scotia, which will:

a) create in Nova Scotia a new and diversified activity in the Canadian civilian and defence industrial base, with access to the

North American markets, under the Canada/United States Free Trade Agreement and the Defence Production Sharing Agreement;

b) transfer to the facility, all technology necessary for the establishment and development of this facility and its respective specialized products in both the civilian and defence sector;

c) to the greatest extent possible, source its requirements from, and promote the establishment of source capabilities small business enterprises located in Atlantic Canada;

d) employ a minimum of 500 people on a permanent, full-time basis and, where necessary, train these individuals in required skills and knowledge, utilizing, where appropriate, local educational facilities.

2. In accordance with this MOU, the Government of Canada, in order to facilitate the establishment of the Company's heavy-industry manufacturing activity in Nova Scotia, will:

a) enter into negotiations with the Province of Nova Scotia, to put in place financial arrangements for the co-funding of required physical infrastructure, up to a maximum value of \$15 million;

b) entertain an application by the Company to the Minister of National Revenue for duty remission on the importation of machinery, parts, and components for the manufacturing of vehicles, under the Machinery and Equipment Tariff Program, consistent with this program at the time of such importation; and

c) entertain an application by the Company to the Minister of Employment and Immigration for Government participatory funding, for initial employee training.

3. In recognition of the need to proceed urgently, the Government of Canada and the Company agree to adopt a two-phased approach to the establishment of the facility.

PHASE I

4. The Government of Canada and Company agree that in Phase I, the respective parties will undertake the following:

3

a) the Company

(i) the Company will proceed forthwith with the construction of an initial plant, requiring an estimated initial capital investment of \$68 million, to manufacture defence products for the North American markets;

(ii) the Company will sub-contract manufacturing of major components for supply to the Thyssen Henschel - General Dynamics Land Systems joint venture which has recently been awarded contracts for the supply of TPZ Fox armoured vehicles to the United States Army.

b) the Government of Canada:

(i) The Minister of National Defence, will place a sole sourced order with the Company for 250 Fox (TPZ Fuchs) Armoured Personnel Carriers, from Canadian production at the Company's Nova Scotia facility.

[BHI estimates the cost for these 250 vehicles at approximately \$210 million Canadian, based on current and previous sales to the German and U.S. Armies. After DND specifications are established, final price will be determined using the principle of open audit of costs and agreed profit.]

provided the Company:

- a) manufactures in its Nova Scotia facility, these vehicles from its entire technology range according to the operational requirements of the Government of Canada,
- b) meets the Government's requirements for quality, delivery, and logistic support, including personnel training,
- c) provides acceptable regional and industrial benefits;
- d) agrees to announce and proceed immediately with construction of it's plant with the following schedule:

- Nov. 1990: Contract signed with Government of Canada
- Jan. 1991: Engineering finalization and commencement of construction contracts.
- Oct. 1992: Plant in operation and staffed.
- Oct. 1993: - Commencement of delivery of vehicle
- Commencement of Phase II diversification.
- May 1995: Completion of delivery of vehicles.

e) BHI agrees that DND may, until September 1991, cancel all or part of its order and replace it with an order of corresponding value for Multi Role Combat Vehicles (TH495 category).

PHASE II

5. The Government of Canada and Company further agree that in Phase II, the respective parties will undertake the following:

a) the Company

(i) the Company will proceed not later than twelve (12) months after the commencement of production under Phase I, with diversification into heavy civilian manufacturing production targeted at Canadian and international markets, for environmental protection technology; and

(ii) the Company will provide within six (6) months after the commencement of production under Phase I, financial details including product and market projections associated with Phase II; and

(iii) should Phase II not be proceeded with, the Company will reimburse the Government of Canada for a portion, to be determined in subsequent negotiations, of the infrastructure assistance provided under paragraph 2 (a) above, in the event that the employment level of 400 people for Phase I is not sustained for 5 years.

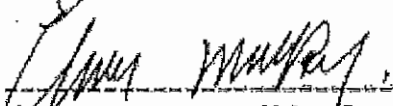
b) the Government of Canada:

the ACOA Minister, will consider assistance to the Company, under established regional and industrial development programming, consistent with such programs at the time the project becomes eligible for such assistance.

6. In recognition of the very considerable financial, technical, and other capabilities realized by Bear Head Industries, as a wholly-owned subsidiary of Thyssen Industrie AG, and the importance of such capabilities to the Government of Canada, by copy of the enclosed agreement between Thyssen Industrie AG and Bear Head Industries, Bear Head Industries hereby discloses a commitment by its parent to retain its one hundred percent ownership in Bear Head Industries, for a period of at least five years in duration, commencing from the date of the award of the contract (noted in paragraph 4b (i) above) to Bear Head Industries.

Should Thyssen Industrie AG wish to divest, in whole or in part, its holdings of Bear Head Industries, prior to 5 years, Bear Head Industries will in advance seek written consent from ACOA, and will remit to the Government of Canada a sum equal to fifty percent of the aggregate value of the federal contribution to infrastructure (noted in paragraph 2a above).

THE GOVERNMENT OF CANADA



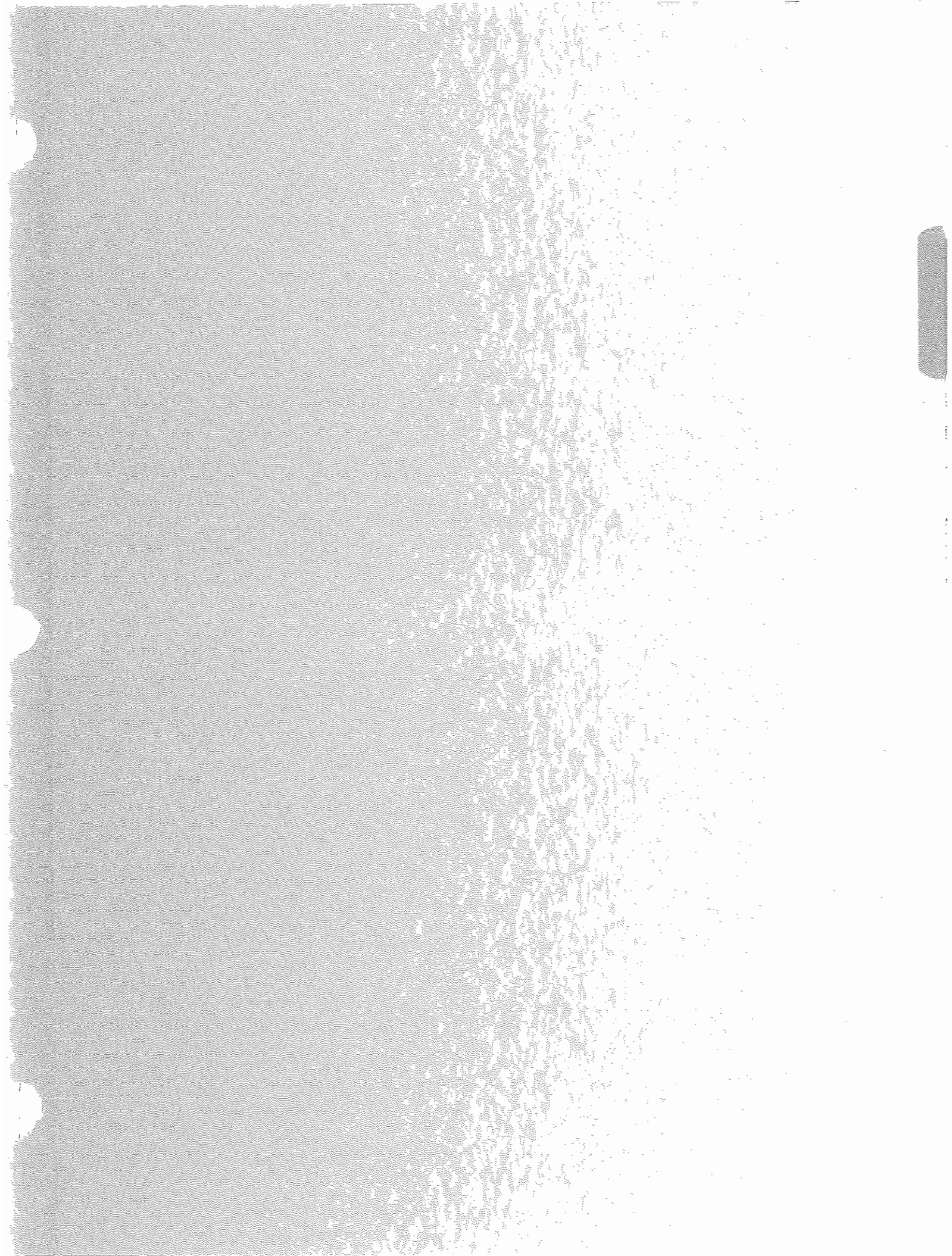
Minister responsible for the
Atlantic Canada Opportunities Agency

Minister of National Defence

BEAR HEAD INDUSTRIES LIMITED



Mr. Karlheinz Schreiber, Chairman



**J.C. MACKAY
OFFICE OF THE ADM
INDUSTRY & TECHNOLOGY**

INDUSTRY, SCIENCE & TECHNOLOGY

**235 QUEEN STREET, 10TH FLOOR EAST
OTTAWA, ONTARIO
K1A 0H5**

Date: 5-11-90

Please deliver to:

B. Russell

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902-426-2624

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2 + cover

Sender's Name:

Louise Andrada

Remarks:

Signature:

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Atlantic Canada Opportunities Agency

Agence de promotion économique du Canada atlantique

Stamp: 1987-10-18 07654

November 2, 1990

BITC Bar Head

OSWEGO DISTRICT OFFICE
100 Queen Street
P.O. Box 1887
Oswego, Ontario
K1P 5R5

Mr. Rob Gillespie
ADM (Material)
National Defence Headquarters
101 Colonel By Drive
Ottawa, Ontario
K0A 1K2

Mr. Cliff Mackay
ADM (Ind. Technology)
187C
225 Queen Street
10th Fl. East Tower
Ottawa, Ontario

Dear Gentlemen:

Following our meeting of November 1st, and further to our telephone conversation, this will confirm agreement that ACOA will take the lead in preparing a brief but comprehensive paper, within the next 10 days, which could be considered by Ministers.

The purpose of the paper is to articulate clearly what the company's intentions now are, what the conditions would be to locate in Canada, and to outline the necessary level of assistance from both the federal and provincial governments.

As agreed, DND will provide a complete description of operational requirements, (including national delivery times lines, estimated project cost, etc.) and in point form, outline the circumstances which would make this initiative doable. This, along with input from DIST on the BITC and sector implications, will be required because as mentioned at the meeting, the proposal is not necessarily tied to the original BITC. ACOA will undertake to clarify the company's position, and to outline the federal and provincial assistance required by the company. Finally, each of these blocks of information will be consolidated by ACOA, so that the issue may be presented to Ministers for a decision by the Government on the disposition of this file.

I understand General Reay will be out of the country for three weeks starting Tuesday next. Since he has been working on this file and attended the meeting of November 1st, it is essential that his input be sought prior to his departure in order to

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address the points raised at the meeting by the Ministers and Norman Spence. In this regard, since I have assigned John McDowall of my staff to write this document, I would appreciate General Reay being available to meet with John on Monday, at a mutually convenient time, to ensure that the document accurately reflects the points raised at the meeting.

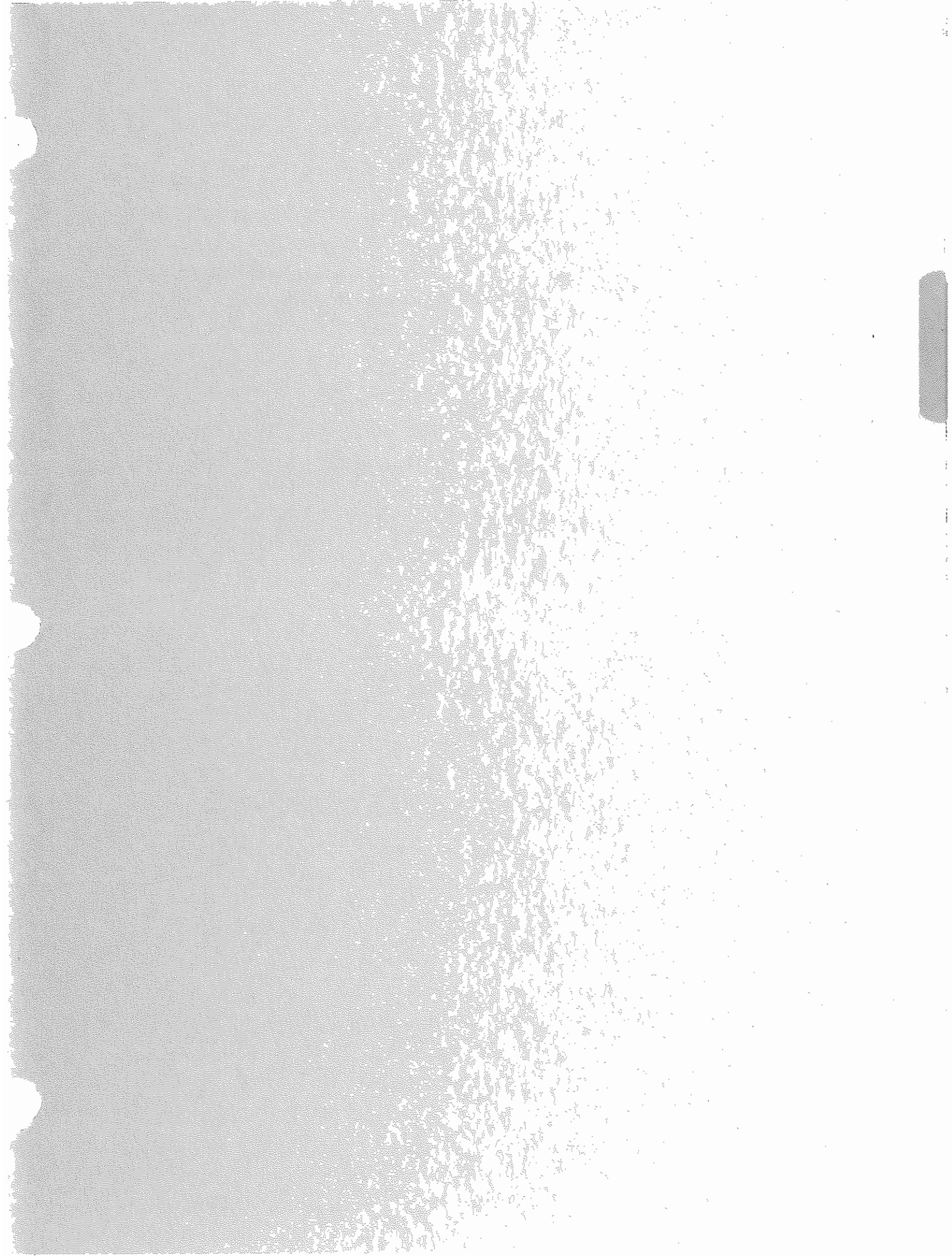
As you have suggested, John will work with Mike Williams, DND, and the appropriate DIST staff members, to complete this document, which I expect will be completed within the 10 day time frame as requested at the meeting yesterday.

Thanks for your cooperation.



Peter R. Smith

OTT/SOC/GCS
22227016



Karlheinz Schreiber

Suite 808, 350 Sparks Street, Ottawa, Ontario
Telephone: (613) 563-3321 Fax: (613) 563-7328

9 November 1990

Mr. Norman Spector
Chief of Staff
Prime Minister's Office
Room 231
Langevin Bldg.
Ottawa, Ont.
K1A 0A2


Dear Mr. Spector:

I did not want to leave Canada today without expressing my pleasure in having met you this morning. I found our exchange of view to have been very positive, especially in our discussion of Canada's economic opportunities. The frankness of that discussion was certainly appreciated.

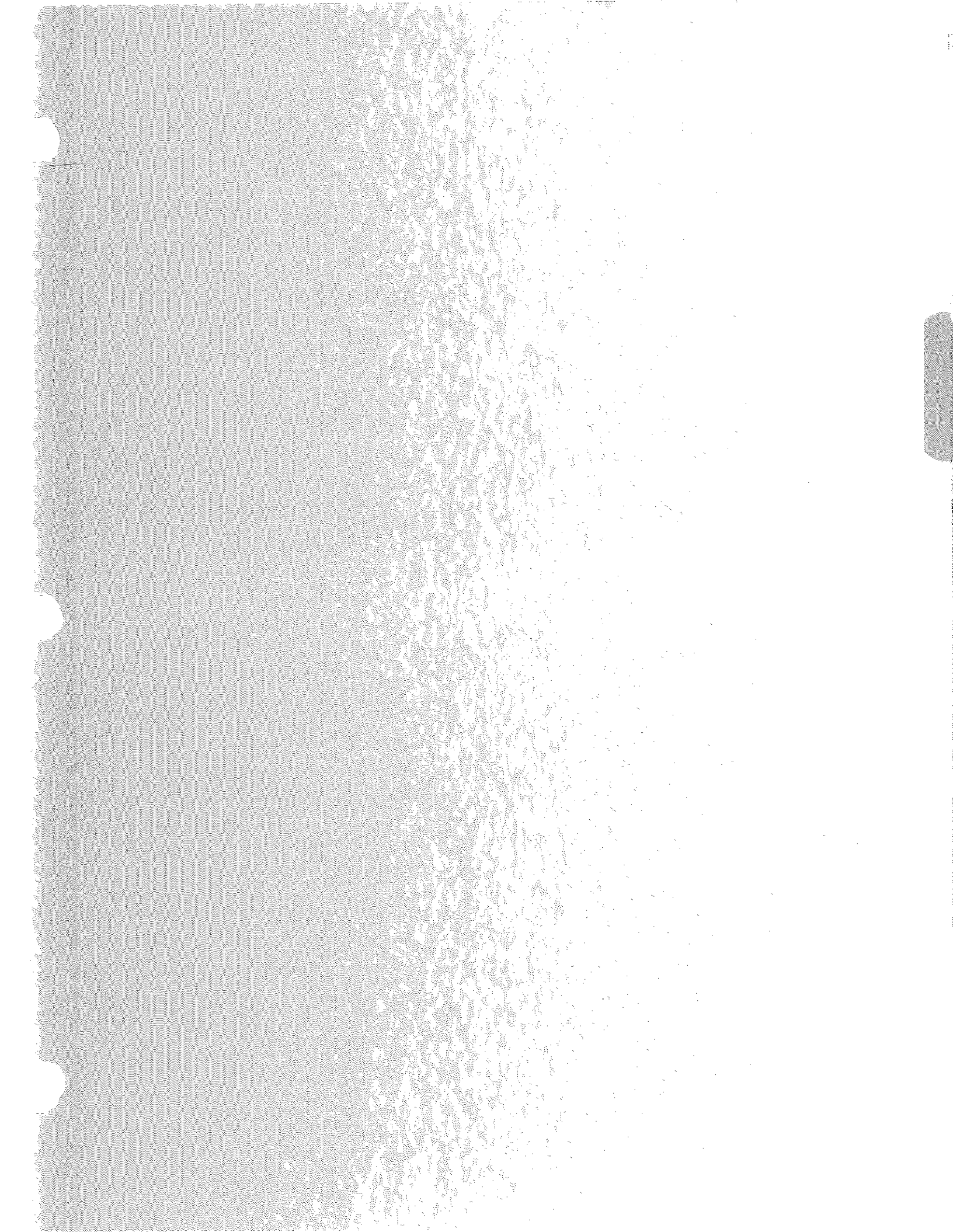
I believe I have found some understanding of how difficult your job is, to progress the objectives of the Government when faced with Federal bureaucracy and the Senate.

In closing, I wish you every success. My plans are to return to Ottawa in late November and I hope to see you again at that time, but should you wish to speak with me before then please do not hesitate to call.

Best regards,



Karlheinz Schreiber





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ASSISTANT DEPUTY MINISTER (MATERIEL)
SOUS-MINISTRE ADJOINT (MATÉRIELS)

SECRET

DM

THYSSEN FOLLOW-UP

- ACOA is bringing the original and only copy of the "Business plan" over for me to read at 2 p.m. this afternoon.
- In arranging this last night with Peter Smith, I was informed that the draft MC (that paper that we have received from ACOA) had been circulated yesterday to at least PCO, TBS and SSC (maybe also DEA) along with a draft RD! This was done just in case Mr. Mackay decides to walk the paper in to Cabinet Committee in the "next week to ten days" without the DND portion.
- I have spoken to both TBS (O'Connor) and PCO (Billings) to clarify their views and to ensure they understood what we are doing. Billings, in fact, called me before I could call them. They have issued a blunt message to ACOA to withdraw all copies and shred them. ACOA is being informed that they are way out of line. PCO has spoken to Spector and clarified his expectations which are a joint paper to go to the PMO before anybody starts tabling MCs.

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ASSISTANT DEPUTY MINISTER (MATERIEL)
SOUS-MINISTRE ADJOINT (MATÉRIELS)

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- I indicated again to Jane that this as a proposal' would have drastic consequences for DND and that if pushed much harder in the current fashion may require you to speak to the Clerk. I did not lay out the points that you might make that we discussed yesterday, i.e. serious exposure to ridicule on several fronts, etc., etc. She said they understand that this is a very difficult issue for DND and will insist on due process.
- Bottom line - we are continuing to get a suitable paper prepared as soon as possible (end of next week?). I will let you know if I see any further developments which would suggest your intervention is required.

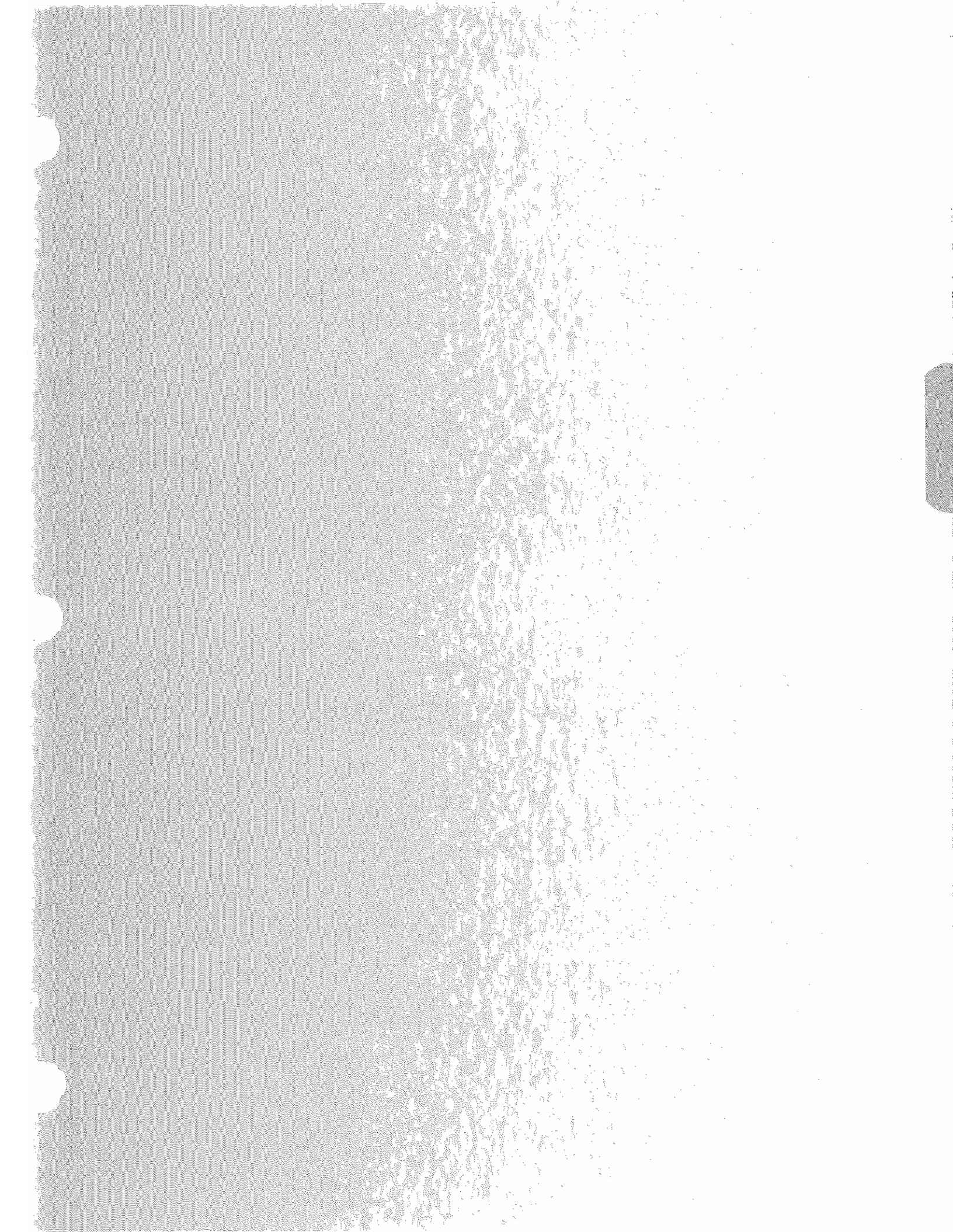
cc: CS

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COPIE ORIGINALE SIGNÉE PAR
R. D. GILLESPIE

R.D. Gillespie
992-6622

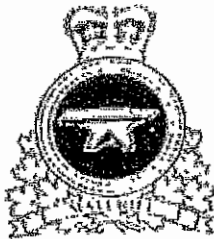
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ASSISTANT DEPUTY MINISTER (MATERIEL)
SOUS-MINISTRE ADJOINT (MATÉRIELS)

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CS

BNI

Further to the note that we sent this morning, Jane Billings from PCO called. They realized yesterday when they received the paper plus a draft RD that this was being distributed all over town. They are currently contacting ACOA and all recipients of the paper with the exception of DND, who is involved in writing it, instructing withdrawal and shredding of the copies including the RD. They have also spoken to Spector to confirm that this is not what he expected to happen. It is not. He is expecting a joint paper which would be something that went to the PMO before anybody started writing submissions. Bottom line - ACOA is receiving a very blunt message from PCO. We are continuing on our current track.

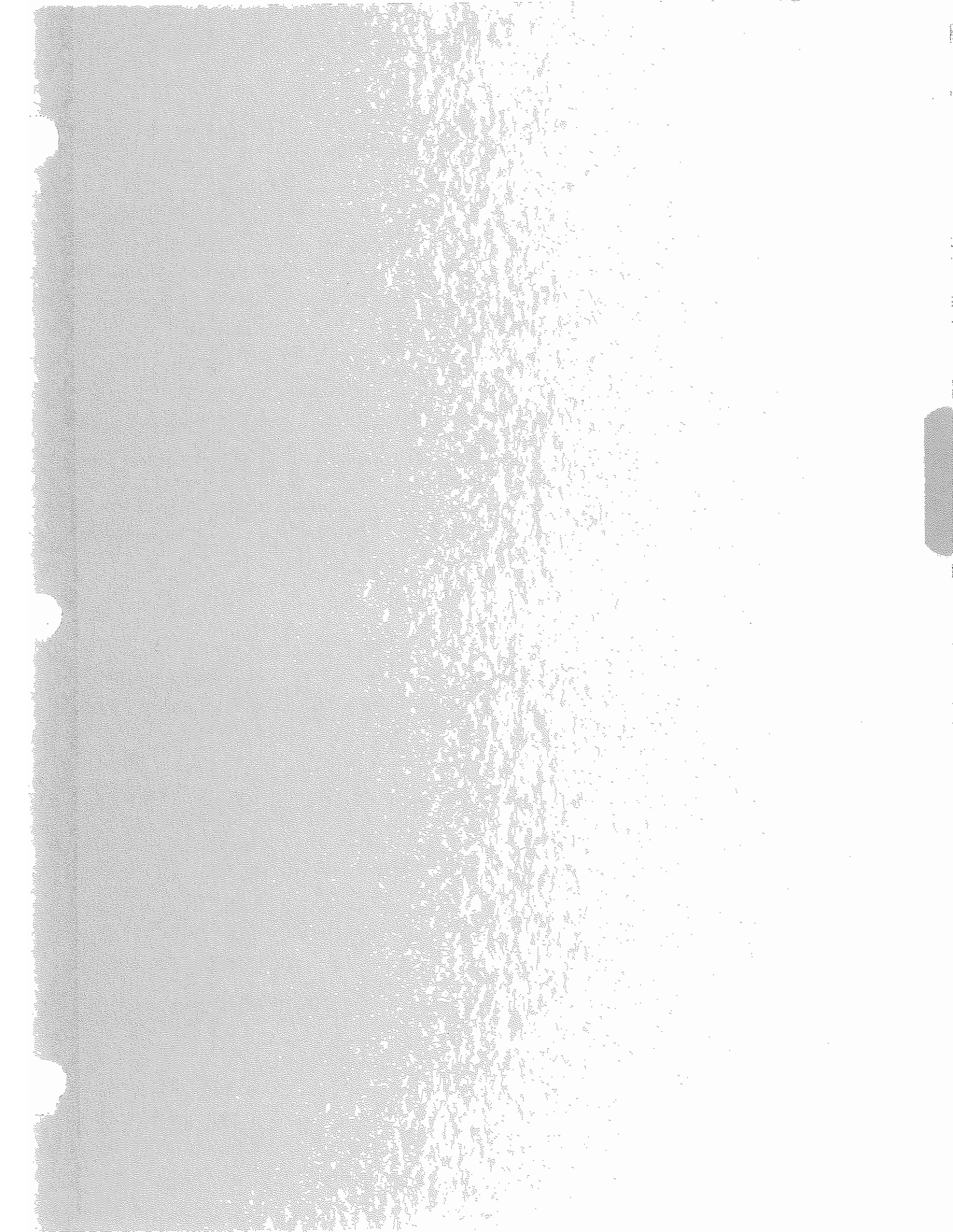
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DDIR 4.
Noted - thank you
I E C. Lotchin
DDIR / DND
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R. D. GILLESPIE

R.D. Gillespie
992-6622

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National Defence

Deputy Minister

National Defence Headquarters
Ottawa, Canada
K1A 0K2

~~SECRET~~

Défense nationale

Sous-ministre

Quartier général de la Défense nationale
Ottawa, Canada
K1A 0K2

5 December 1990

The Minister

**DND PORTION OF THE ACOA
COORDINATED PAPER ON THYSSEN PROPOSAL**

1. Enclosed please find a copy of the DND portion of the ACOA coordinated paper on the Thyssen proposal for a directed contract from DND for the FOX Infantry Combat Vehicle (ICV). This paper clearly depicts the costs and consequences of proceeding with the proposal.
2. Not until last Friday did ACOA provide the Thyssen proposal to us. Unfortunately, it is not really a proposal but merely some sketchy ideas about vehicle acquisition within a rather sparse business plan. Nevertheless, we have conducted our analysis as best we can. It has been reviewed extensively within the Department, and has DCDS and ADM(Mat) concurrence.
3. The main concerns that I have with the Thyssen proposal (which are expounded upon in the paper) include:
 - a. the timing is inappropriate as DND is in the midst of a policy review which will change the structure and the roles of our army;
 - b. since FOX does not fit our operational requirements, we would have to reverse priorities for replacement of army vehicles. This would result in further review and revision of army roles and structure, combat deficiencies, and unscheduled operations and maintenance costs;
 - c. once training, logistics support, infrastructure, etc are considered, a contract price of \$290M for 250 vehicles translates into a total Infantry Combat Vehicle project cost for 93/94 - 97/98 of \$725M, and an additional \$130M in operations and maintenance over the next decade;

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- d. when factored into the Defence Services Program, the amount of unavailable capital is \$655M in the 93/94 - 97/98 period. This money is not available in DND's existing reference levels without major dislocations of the Defence Services Program (ie, deferment, cancellation, or downsizing of such projects as TCCCS and/or Northern Terrain Vehicle;
- e. we would distort the desired mix of the three variants (infantry, combat and recce combat) of this vehicle family. In essence, we would acquire 44 more FOX ICVs than we need. In doing so, we would use 50% of the funds available (as opposed to our planned 14%) for the total family purchase to acquire only one of the three vehicle types in the family. We would be left with the option either to buy fewer of the remaining two vehicle types or to look elsewhere in the DSP for funding; and,
- f. exacerbation of existing overcapacity in the vehicle sector of the defence industrial base.

4. I understand the Minister for ACOA, Mr. Elmer Mackay, has arranged to have this topic placed on the agenda of the Operations Committee for Tuesday, December 11, 1990.

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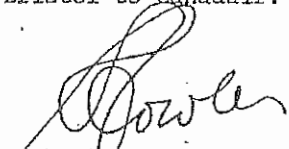
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5. As this issue is going ahead, with your concurrence we will provide our analysis to ACOA, so that as lead department they may prepare the requisite Cabinet documents. Our staff are standing by to work with ACOA on this.

6. I must advise you, however, that I believe that a decision to proceed with this directed contract to Thyssen would result in a more significant and far-reaching controversy than that which followed the decision to move the CF-18 maintenance contract from Bristol to Canadair.



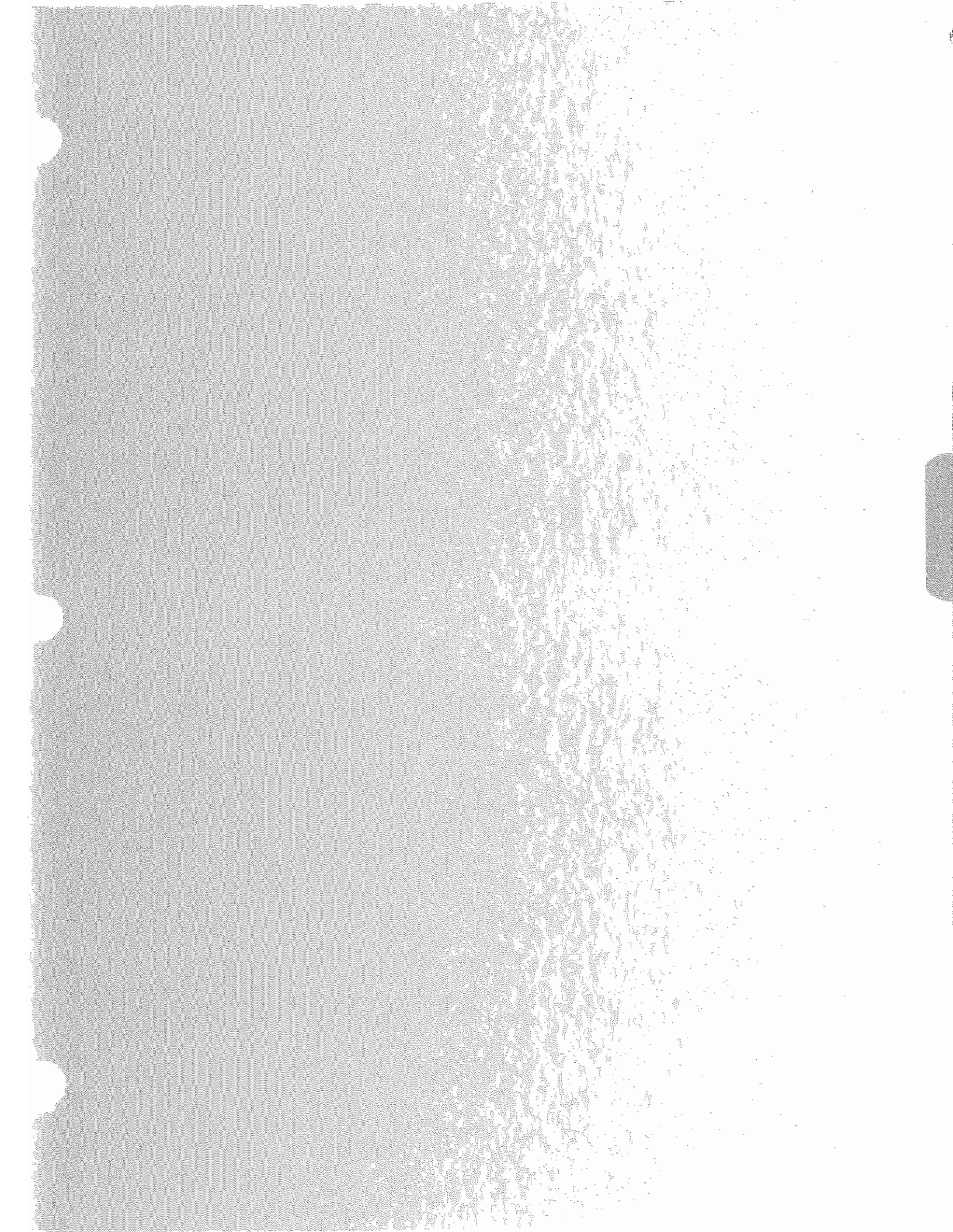
Robert R. Fowler

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National Defence

Défense nationale

Deputy Minister

Sous-ministre **SECRET**

National Defence Headquarters
Ottawa, Canada
K1A 0K2

Quartier général de la Défense nationale
Ottawa, Canada
K1A 0K2

7 December 1990

Mr. Peter B. Lesaux
President
Atlantic Canada Opportunities Agency
4th Floor
60 Queen Street
Ottawa, Ontario
K1P 5Y7

Dear Mr. Lesaux: *Pete,*

Attached please find the Department of National Defence's analysis of the unsolicited Thyssen proposal for a directed contract for 250 FOX vehicles. We have taken a serious and searching look at this proposal, what it would cost and what actions we would have to take to implement it.

Unfortunately, our analysis clearly shows that the FOX is not the right vehicle for our forces. It is not air-transportable in a C-130 Hercules aircraft; it would not provide us with the necessary fleet rationalization of a "family" of like vehicles; it would result in significantly fewer vehicles for the army; and would result in purchasing the infantry variant before it is required, instead of replacing other obsolete variants.
(See attachment paras 11-15)

At this point we can not really consider the TH 495 as an alternative to the FOX. The TH 495 is still on the drawing board and constitutes an untested and unproven design. (See attachment paras 16 and 17)

Based on the information about the proposal contained in the business plan, our analysis indicates that the net impact on the defence budget of acquiring 250 FOX would be over \$765 Million (90/91 dollars). This is net of the funds available for such vehicles in the current defence program. During the acquisition phase (1993/94 - 97/98),

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this buy would create a requirement for \$655 Million (90/91 dollars) in unforeseen capital cash flow in this period. (See attachment paras 24 - 27) We are simply not able to identify how such an amount could be diverted from the other elements of the Defence Services Program without causing costly and disruptive dislocation to existing plans, contracts and projects. Indeed, even were such an amount of money available from sources outside the Department of National Defence, we have, from our perception of defence priorities, much more pressing requirements on which that money should be spent. For example, projects such as TCCCS (the army radio program), NSA (the naval helicopter), and the Northern Terrain Vehicle are currently facing affordability problems.

I assure you that we have done our best to provide an objective analysis of the rather limited information available in the Thyssen proposal.

Yours sincerely,



Robert R. Fowler

Enclosure: 1

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National Defence

Défense nationale

Deputy Minister

Sous-ministre

National Defence Headquarters
Ottawa, Canada
K1A 0K2

Quartier général de la Défense nationale
Ottawa, Canada
K1A 0K2

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5 December 1990

The Minister

DND PORTION OF THE ACOA
COORDINATED PAPER ON THYSSEN PROPOSAL

1. Enclosed please find a copy of the DND portion of the ACOA coordinated paper on the Thyssen proposal for a directed contract from DND for the FOX Infantry Combat Vehicle (ICV). This paper clearly depicts the costs and consequences of proceeding with the proposal.
2. Not until last Friday did ACOA provide the Thyssen proposal to us. Unfortunately, it is not really a proposal but merely some sketchy ideas about vehicle acquisition within a rather sparse business plan. Nevertheless, we have conducted our analysis as best we can. It has been reviewed extensively within the Department, and has DCDS and ADM(Mat) concurrence.
3. The main concerns that I have with the Thyssen proposal (which are expounded upon in the paper) include:
 - a. the timing is inappropriate as DND is in the midst of a policy review which will change the structure and the roles of our army;
 - b. since FOX does not fit our operational requirements, we would have to reverse priorities for replacement of army vehicles. This would result in further review and revision of army roles and structure, combat deficiencies, and unscheduled operations and maintenance costs;
 - c. once training, logistics support, infrastructure, etc are considered, a contract price of \$290M for 250 vehicles translates into a total Infantry Combat Vehicle project cost for 93/94 - 97/98 of \$725M, and an additional \$130M in operations and maintenance over the next decade;

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- d. when factored into the Defence Services Program, the amount of unavailable capital is \$655M in the 93/94 - 97/98 period. This money is not available in DND's existing reference levels without major dislocations of the Defence Services Program (ie, deferment, cancellation, or downsizing of such projects as TCCCS and/or Northern Terrain Vehicle;
- e. we would distort the desired mix of the three variants (infantry, combat and recce combat) of this vehicle family. In essence, we would acquire 44 more FOX ICVs than we need. In doing so, we would use 50% of the funds available (as opposed to our planned 14%) for the total family purchase to acquire only one of the three vehicle types in the family. We would be left with the option either to buy fewer of the remaining two vehicle types or to look elsewhere in the DSP for funding; and,
- f. exacerbation of existing overcapacity in the vehicle sector of the defence industrial base.

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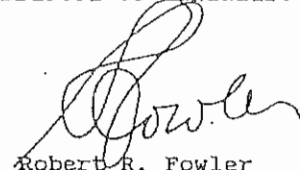
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Robert R. Fowler

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DND ANALYSIS OF THE THYSSEN PROPOSAL

1. While inadequate for all but general planning purposes due to lack of detail and narrow scope, the unsolicited Thyssen proposal for a directed, sole-source contract as contained in the paper provided to ACOA has been used as the basis for this analysis. The Thyssen proposal is for a directed contract for 250 TpZ 1 FOX vehicles, at a cost of \$290M (1990 dollars), with delivery beginning in FY 93/94. Within one year of signing such a contract, DND may, after negotiations with the company, switch the order and purchase an unspecified quantity of TH 495 vehicles for an unspecified price (see para 16).

2. In order to understand what would be required for DND to satisfy this request, it is important to understand the environment in which DND is currently operating.

THE DND ENVIRONMENT

3. The Department of National Defence (DND) is currently undergoing a "defence policy review". Due to the rapid and drastic changes in the security environment in the last several years, the policy set out in the 1987 White Paper requires change. The process for determining those changes is not yet complete.

4. Concurrent with the Defence Policy Review, we are also pursuing a major program review for determining the equipment requirements associated with the roles and missions defined by the new policy. The proposed Defence Policy and the associated capital program will not be considered by Cabinet until sometime in the new year.

5. In general terms, the new defence program, in reflecting more realistic future budget expectations, will reflect dramatic reductions in the capital program foreseen before the last two budgets. Even that reduced capital program is contingent upon government approval of major reductions in armed forces structure and supporting infrastructure. Otherwise the funding for capital will not be available and further capital program reductions will be necessary. Throughout the armed forces, there will be fewer equipments and significant rationalization of different types of similar equipments to yield the necessary savings in operations and maintenance costs.

6. This state of uncertainty affects all elements of our capital equipment program, including the equipment program for the Army. While the precise nature of DND's future army

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requirement is unknown pending finalization of the Defence Policy Review, DND planning is proceeding along the following lines:

- a. a shift towards a lighter, more mobile, more flexible army;
- b. a rationalization of army combat vehicles that will reduce the current inefficiencies inherent in a multi-type vehicle fleet; and
- c. fuller exploitation and integration of the Militia with the regular force.

7. These considerations have led to the formulation of the Multi-Role Combat Vehicle (MRCV) project. Over the next fifteen years, the future army will require seven to eight hundred Multi-Role Combat Vehicles (MRCV), in three primary variants, to replace, augment, and rationalize existing fleets only as their useful life expires. Thus, the requirement is to procure the variants in the following order: a Reconnaissance Combat Vehicle (RCV), the Armoured Combat Vehicle (ACV), and the Infantry Combat Vehicle (ICV). The department recently agreed in principle to such a project, so it could be inserted in the long term plan. No significant funding is available prior to the mid-1990s.

IMPACT ANALYSIS AND ACTIONS REQUIRED

8. The following sections outline as best as we can, given the imprecise nature of the information available, the impact of accepting the Thyssen proposal and what DND would have to do in order to proceed with the proposal. The remainder of this section is organized according to the primary areas of impact:

- a. operational requirements;
- b. defence budget;
- c. Defence Services Program;
- d. defence industrial base; and
- e. public relations.

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DND OPERATIONAL REQUIREMENTS

9. The next step is to define more clearly, over the next two years, the exact nature of the MRCV requirement. Not before then would the Minister of National Defence be in a position to demonstrate a fully-defined requirement and seek preliminary approval from Cabinet, including a procurement strategy.

10. At this time we do know that, in general terms:

- a. the MRCV must be highly mobile;
- b. the MRCV must provide a moderate level of protection;
- c. a family of vehicles is the preferred concept (ie, variants with a high degree of commonality, such as the chassis, spares, communications, etc.):
 - (1) Reconnaissance Combat Vehicle (RCV) to gather intelligence and to deny information to the enemy through direct fire,
 - (2) Armoured Combat Vehicle (ACV) to provide heavy direct fire support and to be part of the anti-armour capability,
 - (3) Infantry Combat Vehicle (ICV) to provide protected transport for infantry; and
- d. the vehicle must be transportable in C-130 Hercules aircraft (weight limit of 17.97 metric tonnes and a useable width of 2.87m).

11. The FOX probably would meet mobility requirements as it is a six wheeled vehicle of proven design offering good road and track mobility with reasonable off-road movement. In addition, the FOX appears to offer a reasonable degree of protection.

12. With regard to the family of vehicles requirement, although the FOX has a number of variants, these variants do not match our other requirements:

- a. while advertised as a nuclear, biological, chemical (NBC) reconnaissance vehicle, the FOX is not a normal recon vehicle. It is configured to

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hold equipment which could determine the extent of contaminated ground through ground reconnaissance and air monitoring. It would not fulfil our conventional RCV requirement, which entails penetration of enemy lines, and possibly denial by direct fire of friendly information to the enemy;

- b. Thyssen itself acknowledges that the LUCHS is its conventional recce vehicle;
- c. some modifications to other FOX variants might make it a candidate for the Armoured Combat Vehicle variant DND requires; and
- d. the FOX itself is an infantry combat vehicle, and as it currently exists, would be appropriate only for the Infantry Combat Vehicle (ICV) requirement.

Thus, the FOX is not suitable for the family of vehicles concept based on a single chassis with the particular variants DND has identified to meet the army's future needs. Several European and US manufacturers currently produce families of vehicles which do have our required variants, such as the Vickers Valkyr (UK), the Kraus-Maffei Puma (GER), and the Alvis Stormer (UK).

13. On the air-transportable requirement, the FOX weighs 17 metric tonnes, but with a width of 2.98m it is incapable of transport by the C-130 and therefore unsuitable for the new roles foreseen for the army. If the FOX were to be given a turret and cannon/gun to make it fit the ACV or RCV role, it would likely exceed the weight limitation of 17.97 metric tonnes. The LUCHS, the Thyssen recce vehicle, weighs 19.5 tonnes, making it too heavy to carry in a C-130.

14. To buy the FOX as the ICV first would mean that the necessary acquisition order of Recce Combat Vehicle, Armoured Combat Vehicle, and finally Infantry Combat Vehicle would be reversed. This would mean that we would be postponing replacement of those types of armoured vehicles which are nearing the end of their operationally useful and economic life (ie, the current recce and direct fire vehicles), and supplementing the existing infantry combat vehicle fleet before necessary. The vehicle requirement is based on projected future force structure; therefore, it would be difficult to absorb the FOX with existing force structures. This difficulty would be exacerbated by delivery

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of variants in the reverse order. The consequences of this action would be:

- a. need for increased operations and maintenance provisions (see para 22 below);
- b. need for trained personnel to operate and maintain the vehicles; and
- c. if we do not proceed with the purchase of a Recce Combat Vehicle as scheduled, we would be creating a combat deficiency as our current recce vehicle, the Lynx, will be operationally deficient after 1996.

15. The army would end up with fewer vehicles than they need and could otherwise afford. They would also end up with the wrong mix of the three variants (infantry, combat, and recce combat vehicles). Thyssen proposes to provide 250 FOX infantry combat vehicles (ICV), whereas the army requirement is only 206 such vehicles. Because of the additional costs of the Thyssen proposal (see below para 24), the ICV portion would consume over 50% of the funds available for the MRCV (rather than about 14% as is now projected). Since this purchase would satisfy only the requirement for the relatively less expensive ICV, the army would only be able to afford a maximum of 550 vehicles rather than the currently planned 735. This assumes a competitive, off-the-shelf buy of an existing vehicle which would meet our requirements but would be less capable and less expensive than an improved FOX variant or fully developed TH 495. The new mix would be 250 ICVs plus 300 armoured and recce combat vehicles, rather than the 206 ICVs with 529 ACVs and RCVs.

16. TH 495. The TH 495, suggested by Thyssen as an option suitable for discussion once the directed contract is let, is a conceptual vehicle existing on paper only. It eventually might promise to satisfy all the MRCV requirements. Intended as a tracked vehicle, it would offer reasonable mobility over all terrain. Its proposed dimensions and basic weight would indicate a suitability for the C-130 Hercules aircraft. The suggested family of variants would meet the MRCV principal requirements for a reconnaissance vehicle, a direct fire armoured vehicle, and/or infantry carrier. Furthermore, it has been suggested that the TH 495 would meet current anticipated protection requirements. Given the advertised characteristics of the TH 495, it is judged that the Thyssen vehicle could enter with good prospects, subject to price,

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the open competition in the period of 1994-95 to satisfy the Canadian MRCV requirements.

17. The Thyssen proposal, however, would have us begin planning to acquire the FOX, and then switch plans to accommodate the TH 495. The TH 495 is still on the drawing board and the development timeline for the TH 495 is optimistic in our view. Given that quantity, price, and specifications would be subject to negotiation, such a proposal makes little sense. It would double the disruption in the MRCV project and would require that we agree to purchase an unknown quantity of unproven vehicles for an unspecified price. Clearly, we are unable to calculate costs of this part of the proposal.

Actions required to proceed with the Thyssen proposal

18. If DND were directed to purchase the FOX vehicle according to the Thyssen proposal, we would have to take the following steps with regard to operational requirements:
- a. stop the process of defining the operational requirement for the ICV portion of the MRCV project and direct the army to use the Thyssen vehicle;
 - b. reverse the priorities for replacement of army combat vehicles;
 - c. reconfigure existing forces to take the vehicles and examine in particular the maintenance problems associated with early delivery;
 - d. review and revise the roles for the army foreseen in the current policy review to make them consistent with the limited transportability of the Thyssen vehicle; and
 - e. determine the feasibility and costs of meeting the Armoured Combat Vehicle and Recce Combat Vehicle requirements from the Thyssen product line OR plan for additional costs due to inefficiencies arising from a mixed fleet of vehicles (see below).

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BUDGET CONSIDERATIONS

Note: all dollar figures are 90/91 CY \$

Capital

19. Budgeted Defence Services Program project costs for the Infantry Combat Vehicle (ICV) portion of the MRCV project are currently estimated as follows:

- a. 206 vehicles at \$565K each = \$116M;
- b. \$116M times project factor of 2.5 = \$290M.

The project factor of 2.5 provides the total project cost, including the costs for the vehicle itself, project management, and integrated logistic support (initial provisioning for spares, training, technical data packages, etc.) Project factors are based on the complexity of individual projects and 2.5 is what has been estimated for the MRCV project.

20. The Thyssen FOX is an expensive vehicle compared to most other potential ICV contenders. Based on confirmation from ACOA officials, the Thyssen proposal for FOX is:

- a. 250 basic vehicles (not including normal project support costs - see para 19) at \$1.16M each = \$290M;
- b. \$290M times project factor of 2.5 = \$725M.

Not only is the Thyssen unit price almost twice as much, but Thyssen is proposing to supply 44 vehicles more than our requirement of 206 ICVs.

21. The increase in the total Infantry Combat Vehicle project cost that would be created by a directed buy of FOX is quite significant as detailed hereunder:

- Thyssen proposal:	\$725M
- Budgeted costs for competed ICV portion of MRCV	<u>\$290M</u>
Increase	\$435M

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Operations and Maintenance

22. Since these vehicles would be introduced to the current fleet nine years earlier than currently planned, and there is no corresponding retirement or reduction of other vehicles scheduled, some provision must be made to cover the unforecasted operating and maintenance costs. The least disruptive option for army operations is additional money. Based on a comparable project, we estimate that this buy would add another \$14.5M a year for 9 years or \$130M, before inflation, to the Operations and Maintenance (O & M) budget. An alternative would be to place the newly purchased FOX in storage. Another possibility would be to put other vehicles, such as trucks or the current M 113 fleet into storage. Both would be disruptive of ongoing army activity.

Inefficiencies

23. Financial expenses from the lost opportunity for economies of scale when several hundred vehicles are purchased in two or more separate buys (by increased per unit costs, inefficiencies in the purchase of spares, in stocking, storage, contracting and other such areas) could run to at least 10% of the MRCV project's cost (current estimate \$2,100 million) or an additional \$200M.

Summary of Costs

24. In summary, the additional costs of the Thyssen proposal, over and above those already budgeted for the ICV portion of the MRCV project, would include:

- a. \$435M in capital for the Infantry Combat Vehicle project;
- b. \$130M in unforecasted O & M for the additional vehicles; and
- c. \$200M for inefficiencies and lack of fleet rationalization;
- d. for a total of \$765M.

With the already scheduled \$290M for the ICV portion, the new total ICV cost under the Thyssen proposal would be \$1.1B.

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Actions required to proceed with the Thyssen proposal.

25. In order to proceed with the Thyssen proposal, all of the required funding has to be included in the defence budget in the appropriate years. This involves:

- a. bringing forward the originally scheduled costs of the ICV portion of the MRCV project of \$290M from 2001/02 - 2005/06 to the 1993/94 - 1997/98 period;
- b. finding a source for the additional \$435M in capital for project costs over the period 1993/94 to 1997/98 (para 21 above);
- c. finding a source for the additional \$135M in operations and maintenance funding over the period 1994/95 to 2003/04 (para 22 above); and
- d. absorbing the \$200M in inefficiencies over the life of the project (para 23 above).

26. Over the proposed Thyssen delivery period of 1993/94 to 1995/96, the Defence Services Program (DSP) contains only \$70M in funding for the entire MRCV program. Acceptance of the Thyssen proposal would thus require an additional \$480M in capital over this time frame, together with an additional \$175M over the subsequent two years to cover the remaining costs for integrated logistics support. This is a total of \$655M (the total ICV project cost under the Thyssen proposal of \$725M as described in para 20, minus the \$70M already allocated for the MRCV project).

27. In the absence of new funding, the impact on the capital program of having to absorb an additional \$480M over the delivery period (93/94 - 95/96) would be enormous. This is particularly true since these are years in which DND already has severe cash flow problems. The entire army capital program for this period totals \$1.4B for 51 projects addressing the replacement of obsolete equipments. The additional funds required equate to more than one-third of programmed funds, and for only one part of one project.

IMPACT ON THE DEFENCE SERVICES PROGRAM (DSP)

28. The Thyssen proposal to begin delivery by FY 93/94 would call for cash which is not available from within the current Capital Program plan. If the additional \$655M were not to be provided to DND, there would have to be

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massive displacement of well developed and higher priority programs.

29. Large army projects in this period are the Tactical Command and Control Communication Systems (TCCCS), the Northern Terrain Vehicle (NTV), the Utility Tactical Transport Helicopters, the Light Support Vehicle Wheeled, and plans to increase Reserve equipment and infrastructure.

30. TCCCS addresses the highest current army priority - new radios and communications. The winning proposal was recently approved by Cabinet but is unaffordable within the DND capital funding allocation for this project. We are currently reviewing the size of the requirement, negotiating with the contractor, and trying to find other projects which can be reduced to make TCCCS affordable.

31. Northern Terrain Vehicles are in the definition stage, and affordability will be addressed in early 1991 when this stage is completed.

32. It is, therefore, impossible to absorb the cost of the Thyssen proposal without creating capability gaps or deleting combat functions vital to general purpose land forces. Without outright cancellation of TCCCS as now defined, or NTV, plus deferrals/cancellations of other projects, DND could not proceed with the Thyssen proposal within funds currently budgeted for army equipment. Furthermore, projects in advanced stages in other environments--such as the Naval Reserve vessels, the New Shipborne Aircraft (NSA), new Search and Rescue Helicopters, support to the RCMP--would have to be adjusted as well. At the very least, some of these projects would have to be delayed, creating more combat deficiencies.

33. As many of the advanced projects are replacements for aging equipment, delaying implementation involves additional costs associated with life extension until such time as the equipment can be replaced. The continuation and expansion of O & M expenditure required for the maintenance of obsolete equipment cannot be estimated accurately, but could be on the order of hundreds of millions of dollars. For example, the relatively inexpensive 5/4 tonne truck (LSVW, Light Support Vehicle Wheeled) is currently being operated seven years past the end of its scheduled life; the O & M is in excess of \$30M per year. These additional expenditures would then create a ripple effect, displacing other projects further down the line.

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Actions Required to Proceed with the Thyssen Proposal

34. To implement the Thyssen proposal would require the following actions with regard to the Defence Services Program:

- a. cancel, downsize, or defer TCCCS (as currently planned), NTV, as well as other army projects;
- b. cancel, downsize, or defer projects in other environments, including the New Shipborne Aircraft, the Naval Reserve vessels and the Search and Rescue Helicopters;
- c. chart out second and third order effects and make additional adjustments in the O & M and capital programs; and
- d. revise roles and missions to take account of the combat deficiencies created by the DSP dislocations.

DEFENCE INDUSTRIAL BASE

35. A new military vehicle facility would exacerbate the existing, widely documented overcapacity in the sector, leading to any of the following impacts strictly from a DND point of view:

- a. increased demands on government from other suppliers for similar directed contracts and/or subsidies in the wake of lack of work; this could further distort our planned acquisitions;
- b. chronic layoffs and dislocation of sector personnel, leading to increased demands for government assistance; and
- c. relocation out of the country of existing and proven facilities, potentially disrupting our supply lines for existing vehicles and spares; and
- d. intensive competition which could lead to deliberate underbidding, with resultant contract difficulties and cost overruns and demands for government assistance.

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36. Defence industry would also be impacted in other sectors as the cancellations, downsizing, and deferrals of other projects occurred to make room for the additional costs and earlier funding of army combat vehicles. Many companies anticipating new contracts, after much definition work and expense, would be impacted in the electronics, aircraft, and shipbuilding sectors.

Actions required to proceed with the Thyssen proposal

37. To adjust to the effect of proceeding with the Thyssen proposal on the defence industrial base, we would have to:

- a. cancel or defer plans for affected projects;
- b. develop a sector rationalization policy and plan with Industry, Science, and Technology Canada, Department of Supply and Services, Atlantic Opportunities Canada Agency, and Western Diversification, including associated money to handle the various industry demands and needs;
- c. continue to monitor and adjust the DSP for follow-on disruptions.

IMPLICATIONS FOR PUBLIC RELATIONS VIS-A-VIS DND

38. Recent events such as the situation at Oka and the crisis in the Persian Gulf have created a reasonably positive environment for DND and the Forces. Maintaining it in light of major defence reductions which will be embodied in the new policy review will be a challenge. This directed procurement would create a strong negative public reaction based on:

- a. distorting the army program against a background of significant reductions in army structure in the new policy;
- b. increased costs of this project against a background of financial restraint;
- c. the impact on industrial overcapacity in the military vehicles sector; and
- d. the departure from the normal competitive process.

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Action Required to Proceed with the Thyssen Proposal

39. In order to counter the negative publicity, we would have to develop a defensive communications plan.

SUMMARY

40. In general, based on our knowledge to date, if DND were to be instructed to proceed with this proposal, the Department and the army would face a daunting task to fit the FOX into the MRCV project. DND's budget does not allow the increased costs to be taken from existing reference levels. In short, our points are as follows:

- a. the timing is inappropriate as DND is in the midst of a policy review which will change the structure and the roles of our army;
- b. DND would only be able to afford 550 of the 735 vehicles required, and with the wrong mix among the infantry, combat, and recce variants;
- c. since FOX does not fit our operational requirements, we would have to reverse priorities for replacement of army vehicles resulting in further review and revision of army roles and structure, combat deficiencies, and unscheduled operations and maintenance costs;
- d. once integrated logistics support, training, infrastructure, etc are considered, a contract price of \$290M translates into a project cost of \$725M, with an additional \$130M in operations and maintenance;
- e. once factored into the Defence Services Program, the amount of unavailable capital is \$655M in the 93/94 - 97/98 period, with an additional \$130M in O & M over the next decade;
- f. this money is not available in DND's existing reference levels without major dislocations of the Defence Services Program (ie, deferment, cancellation, or downsizing of such projects as TCCCS and/or Northern Terrain Vehicle; and
- g. exacerbation of existing overcapacity in the defence industrial base.

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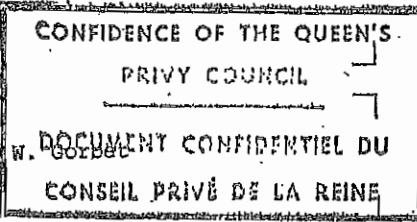


Mr. Wilson	6
Mr. McDermid	2
P.W. Gorbet	3
M. Caron	2
D. Dodge	1
I.E. Bennett	1
K. Norde	1
G.R.M. Anderson	1
General Director	1
ADMO	1
director	1
C.R.	1
D.D./S.D.	2
Pending Officer	1

Security classification	Classification de sécurité
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Originator / Téléphone number	Demandeur / N°
W. Wouters, 6-080	
Our file	Notre référence
Your file	Votre référence
Date	
December 7, 1990	

TO

The Minister



FROM
DE

Frederick W. Gorbet

SUBJECT
OBJET

Items for consideration at Operations Committee Meeting
Week of December 10 - 14, 1990

1. Given that you will be unable to attend the Operations Committee meetings next week, we have prepared the attached letter to Mr. Mazankowski for your signature, should you agree, which outlines your position on some of the items scheduled for discussion.

Newfoundland Dockyard Corporation

2. You will recall that Mr. Lewis presented this item at Operations Committee in October and was directed to examine proposals to privatize and return to Ministers with options for the future of the dockyard. We understand that Mr. Lewis will table an Aide-Memoire recommending that the privatization option be more fully explored through a Request for Proposals to purchase the dockyard. He would return to Cabinet at the end of April with an assessment of these proposals.

3. As discussed at a CMO on December 3, in our view closure of the dockyard and consideration of alternative use of the assets is the only option which would be consistent with the shipbuilding policy, since both ongoing government ownership and private sector ownership would probably require continued government subsidization and capital assistance. If Ministers insist on exploring the privatization options further, any proposal would need to be assessed against the cost of closure. Under any scenario, a source of funds for costs associated with the future of the dockyard must be identified from existing resources.

Northumberland Ferries Limited

4. Minister Lewis is seeking authority to have Northumberland Ferries Ltd. (NFL) build two vessels for the P.E.I - Nova Scotia ferry service, through a directed contract to Pictou Industries Ltd. The proposal involves a private sector financing arrangement which does not meet the disciplines applied to federal capital purchases. NFL would own the vessels but responsibility for the debt payment (principal and interest) would be guaranteed by Transport Canada through a long term operating agreement. Funding for this initiative is to be provided from "central reserves".

5. This issue was also discussed with you at the CMO of December 3. We would recommend that you oppose Minister Lewis's proposal. This approach would increase the government subsidy to NFL over and above the existing subsidy, but would not be supported by increased revenues (i.e. is not self supporting); would be more costly than direct government financing; and would involve no private sector risk. It is also not clear that there is a real need for two vessels to be built at this time. We would recommend, should Ministers wish to pursue the acquisition of one or more ferries, that financing arrangements be discussed at Treasury Board to ensure that the least-cost financing option is used and that a source of funds be identified.

6. We would also recommend, if possible, that a competitive process be followed for the procurement initiative. Should Ministers choose to sole-source this contract, we would not recommend that you oppose this approach, however it will then be critical to the shipbuilding policy that action on NDC not involve continued subsidization.

Quintette Financial Restructuring Plan

7. Quintette Coal is in financial difficulty and has submitted a restructuring plan to its creditors and contractors including two crown corporations, CMHC and CN Rail, and Ridley Terminals Inc., (RTI), 50% of the shares of which are owned by Canada Ports Corporation (CPC) (see Tab 3 in background briefing material).

8. The Aide-Mémoire outlines the implications of the Plan and recommends a federal strategy under which no extraordinary measures would be taken to bail-out the Quintette mine; CPC/RTI, CN Rail, and CMHC would negotiate in their best commercial interests. We support the proposed strategy. Recognizing that neither CPC/RTI or CMHC have the funds or the mandate to accept the Quintette proposal, Ministers will have to make the final decision based on the agencies' recommendations.

9. As the federal exposure is considerable, particularly on RTI, we are trying to place the onus on Transport Canada to

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source most of the necessary funds internally. Transport Canada is not anxious to take this responsibility and is therefore hesitant to take the lead on this issue. As such, Ministers may wish to clarify that the Minister of Transport is responsible for this issue as a whole as he is responsible for CPC and CN Rail. Were Mr. Epp to lead it could be perceived as the federal government viewing it as a mining issue, therefore implying assistance for the mine.

KAON Factory Proposal

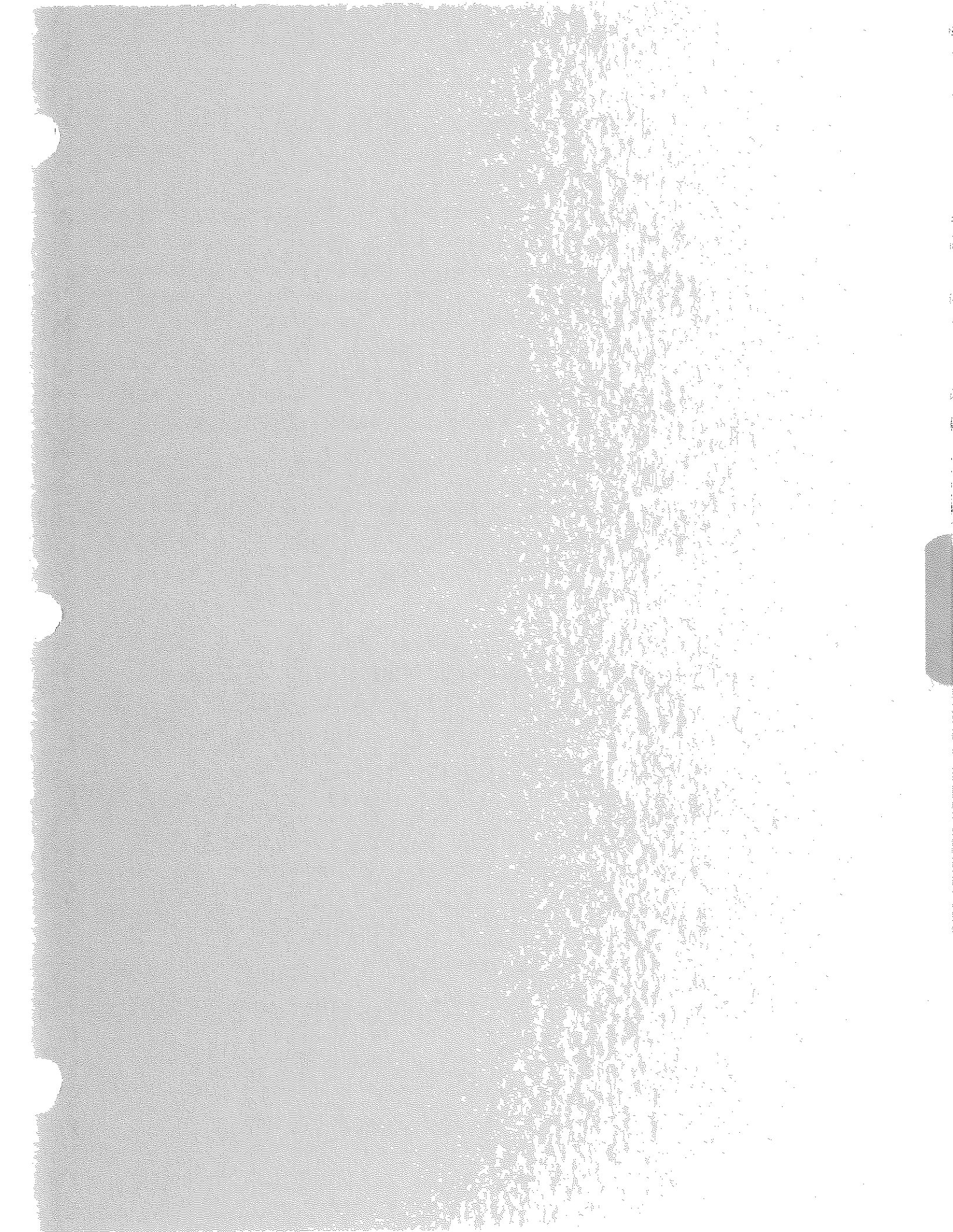
10. We are uncertain what specific issue will be discussed at Operations Committee, however, it will be important to continue to say no to this proposal. Most of the scientific community is urging us not to fund KAON; not heeding this advice when our fiscal constraints are particularly tight would be difficult to justify. Moreover, as you are aware, the Priorities Reserve Auction in September did not allocate funds to KAON, which should have settled this issue. However, an acceptable way of turning off the KAON pressure is needed. It might be proposed that making a low counter-offer to the province may be a graceful means of exit for the government. However, this approach could wrongly signal a willingness to fund KAON, encourage the province to keep the pressure on, and could lead us towards actually funding the project or compensating the province for not doing so.

Thyssen/Bear Head Industries

11. No document has been received as of writing. We understand that ACOA advocates directing a contract to Thyssen AG for procurement of 250 "FOX" light armoured vehicles at a cost of \$290M (\$1990) - \$358M (\$Budget year). In return, Thyssen would establish a heavy manufacturing facility in Nova Scotia - possibly in Pictou County, although earlier proposals indicated a Cape Breton location - to manufacture the vehicles and environmental products. Initial investment would be \$49M, with operations scheduled to begin in 1993-94. The federal and provincial governments would provide infrastructure assistance with a possible federal share of \$8.5M via ACOA.

12. The proposal raises serious concerns with respect to DND's procurement plans and we understand that Minister McKnight opposes it strongly. TBS indicates that expenditures for spares, training, and the like bring the total estimated costs of this proposal to more than \$700M. Overall, moreover, the project would require about \$500M more than can be accommodated within DND's current funding levels. We have suggested that you oppose placing any additional constraints on DND's procurement activities, and indicate that the project should proceed only if it is commercially viable and cost-effective, irrespective of the directed contract.

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CLERK OF THE PRIVY COUNCIL AND
SECRETARY TO THE CABINET



CHÉF DU CONSEIL PRIVÉ ET
SECRETAIRES DU CABINET

SECRET

December 10, 1990

MEMORANDUM FOR NORMAN SPECTOR

Thyssen/Bear Head Industries

Attached is an aide-memoire on Thyssen's Bear Head Industries proposal, prepared by the Atlantic Canada Opportunities Agency (ACOA) with input from National Defence, External Affairs and ISTC. The paper responds to the request you made when you met with Ministers MacKay and McKnight on November 1 for a joint paper describing what would be necessary for this project to go ahead in the near future.

SUMMARY

Thyssen is proposing that the Government purchase 250 of its TPZ "Fox" military vehicles, at a cost of \$290 million, by means of a directed contract, with delivery beginning in 1993/94. In order to produce these vehicles, Thyssen would invest \$61 million in building a new, major facility in Nova Scotia which would employ on average 600 persons over the next seven years. In addition to the directed contract, Thyssen is asking for \$12.2 million in federal and provincial assistance and tax credits. Thyssen is looking for a decision by the end of 1990.

ACOA is strongly supportive of the Thyssen proposal on the basis of anticipated regional benefits and argues that the proposal is commercially viable. It points out that the Government has used directed contracts on a number of occasions to support regional growth and development, although in this instance the contract would involve a "green field" or new establishment.

DND notes that going ahead with this proposal would involve: additional costs of \$765 million over and above the \$290 million already budgeted; the need to fit the Fox into the not-yet-completed defence policy, and the loss of the potential for fleet rationalization. On operational grounds, among other concerns DND has indicated that the Fox is not air transportable. The Thyssen proposal does include an option for DND to purchase its next generation TH 495 vehicle; however, this vehicle is still on the drawing board and has been neither tested nor costed.

The paper also reflects comments from ISTC, on the fit with industrial policy and the ability to maximize industrial benefits with a directed contract of this nature, and from External Affairs on the likely impact of such a purchase on relations with the United States on defence procurement. It should be noted that the line departments have provided input only; they have not signed off on the document.

Comment

As you requested, the aide-memoire does lay out what would be necessary for this project to go ahead: the price is very high, with DND purchasing equipment it basically does not want in a time-frame that does not suit its needs. Although ACOA views the resulting facility to be viable, DND feels that there is not enough information within the Thyssen business plan to justify this conclusion. (No other departments have seen the plan.) At approximately \$2 million per job, the Government would want to be very sure the plant would succeed.

I understand that you will be discussing with Mr. MacKay how to proceed on this project. He is very anxious to have this matter scheduled for Operations Committee in the near future, possibly on December 13. If this is the case, we will prepare more detailed briefing material for that meeting.


Paul H. Tellier

Attachment

Billings/Bilodeau/de

14.00

SECRET
10.12.90

THYSSEN/BEAR HEAD INDUSTRIES FACILITY IN NOVA SCOTIA

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ISSUE: Whether to support the proposal by Bear Head Industries Limited, (a subsidiary of Thyssen) for a directed contract in order to establish a heavy manufacturing facility in Nova Scotia.

PROPOSAL: Thyssen is seeking a directed contract for 250 of its TPZ "Fox" military vehicles, at a cost of \$290 million (1990 dollars), with delivery beginning in FY 1993/1994. Thyssen is targeting the DND multi-role combat vehicle (MRCV) project. Within one year of signing this contract, DND may, after negotiations with the company, switch the order and purchase instead an unspecified quantity of Thyssen's next-generation TH 495 vehicles for an unspecified price.

Thyssen is proposing to invest \$61 million by 1994 to construct a major facility in Nova Scotia to produce military vehicles, and environmental products. The company predicts employment will reach 300 by 1993/94, and average some 600 persons over the first seven years of operation. The company will support its facility with royalty-free technology transfer.

Thyssen is also seeking \$12.2 million of assistance for off-site infrastructure (to be cost-shared between the federal and Nova Scotia governments), and pro forma investment tax credits.

The company has indicated that it must reach a decision on whether or not to proceed by the end of 1990.

FINANCIAL IMPLICATIONS: Financial implications for the federal Government are very significant (about \$1.1 billion), comprising primarily funds already budgeted by DND for the program element (\$290 million, budgeted after the year 2000), incremental costs estimated by DND to support the Thyssen proposal (\$765 million), and the much smaller (approximately \$8 million) costs of federally-funded infrastructure. (All financial data below are provided in 1990/91 dollars.) Specifically, costs include:

- (1) expenditures on Thyssen contract for 250 vehicles: \$290 million;
- (2) DND's estimate of additional costs of Thyssen proposal over and above those already budgeted (\$290 million, after the year 2000) for infantry combat vehicle portion of MRCV project:
 - a) \$435 million in capital (spares, training, project management, etc.),
 - b) \$130 million in unforecasted O&M for the additional vehicles, and
 - c) \$200 million for inefficiencies and lack of fleet rationalization;

- (3) \$8 million for federally-funded infrastructure (sewer, rail, hydro, etc.), assuming the province of Nova Scotia bears remaining 30 percent, or \$3.6 million; and
- (4) pro-forma investment tax credits (maximum 15% of eligible investment for mainland Nova Scotia site).

DEPARTMENT OF NATIONAL DEFENCE (DND) PERSPECTIVE: The detailed assessment by DND of the proposal is included in Annex A.

In summary, DND indicates that if it were directed to proceed with the Thyssen proposal at this time, the department and the army would face a daunting task to fit the Fox (or the proposed TH 495) vehicles into a not-yet-complete policy and operational planning framework. Beyond considerations of the appropriateness of the vehicle for operational requirements, DND is seriously concerned about the affordability of this proposal in the context of other priorities; and its timing, given that the Defence Policy Review and associated capital program will not be considered by Cabinet until early next year.

DND indicates that the Fox is not the right vehicle for the Canadian Forces. The Fox is not air-transportable in a C-130 Hercules aircraft; it would not provide the necessary fleet rationalization of a "family" of like vehicles; it would result in significantly fewer vehicles (25% less than DND's minimum operational requirement) for the army; and would result in purchasing the infantry variant before it is required instead of replacing other obsolete variants. In addition, DND is unable at this time to consider the TH 495 since it is still on the drawing board and constitutes an untested and unproven design.

Although the Thyssen proposal is for 250 vehicles at a contract value assessed at \$290 million, on the basis of available business information, DND has determined that the net incremental impact on the defence budget of acquiring 250 Fox would be over \$765 million (90/91 dollars). (See para. #24 in detailed DND position, Annex A.)

During the acquisition phase (1993/94 - 97/98), this buy would create a requirement for \$655 million (90/91 dollars) in unforeseen capital cash flow, and DND is not able to identify how such an amount could be diverted from the other elements of the Defence Services Program without causing costly and disruptive dislocation to existing plans, contracts and projects. Indeed, even were such an amount of money available from sources outside DND, other priorities have much more pressing requirements on which that money should be spent. For example, previously-approved projects such as TCCCS (the army radio program, NSA (the naval helicopter), and the Northern Terrain Vehicle are currently facing affordability problems.

Finally, DND notes the exacerbation of existing overcapacity in the defence industrial base, and the likelihood of a strong negative public reaction.

ACOA PERSPECTIVE: Other departments have raised significant concerns regarding the affordability of the Thyssen proposal to DND; the perceived economic viability of the Nova Scotia facility; and the effects the Thyssen facility would have on Canada's existing military vehicle industry. Ministers will wish to consider these concerns in reaching a decision on the Thyssen proposal.

Accordingly, while the concerns raised by other departments are outlined elsewhere in this paper, the section below outlines the potential benefits to Canada and the Atlantic region arising from the Thyssen facility.

The proposed Nova Scotia facility would be a world-class manufacturing base, and offers tremendous benefits to the Atlantic region.

Thyssen is a huge world-class multinational with a major presence in Canada already (see Annex B). By locating a vehicle-manufacturing facility in Canada, Thyssen could gain access to the U.S. defence market, under the Canada-U.S. Defense Production Sharing Agreement. Moreover, a sale to the Canadian Forces would also enhance the company's credibility in marketing to U.S. armed forces.

Bear Head Industries (BHI) is a wholly-owned subsidiary of German-based Thyssen Industrie AG. BHI is incorporated in Nova Scotia, and, so far, operates a liaison office in Ottawa. BHI would be the only Canadian military vehicle producer which would use its own -- as opposed to licensed -- vehicle technology.

To date, Canada does not generally supply complete systems to the U.S., but has had a success with the General Motors light armoured vehicle. Military vehicles have posed virtually the sole opportunity for Canada to export "turn key" major military systems including vehicles, logistics support, ongoing maintenance, and so on. Canada has virtually no chance of successfully exporting a complete system in the other military, aerospace, and naval sectors. In general, Canada has tended to exploit niche subcomponent markets.

Thyssen's business plan so far -- prepared by Peat Marwick, and submitted to ACOA, on behalf of the Government -- indicates that the Nova Scotia facility will be economically viable, assuming market projections materialize. For detailed military and civilian revenue and market projections, see Annexes C and D respectively, and for descriptive detail, Annex E. (Should the

company provide more detailed financial projections, particularly on viability, this information would begin to address viability and marketing concerns raised by other departments.)

The company projects a net loss before taxes in each of 1991, and 1992, but robust income and cash flow generation thereafter. Despite its heavy investment, and early operating losses, the company forecasts the net present value of its Nova Scotia cash flow (including depreciation, and assuming a regional tax credit of 15%) at about \$14 million. (Employment forecasts are outlined in Annex F.)

Should the facility proceed, BHI would receive the necessary investment capital from its German parent, thus freeing the company from debt-service payments. All technology would be provided to the subsidiary BHI without royalties and licences.

Thyssen Industrie would transfer to BHI the full production technology for both the Fox and TH 495 vehicles, and undertake in Nova Scotia, future design, improvement, and development work in response to customer requirements. BHI would also receive the North American production mandate for the TH 495 (subject to joint production arrangements which may be required to compete successfully in the U.S.), and, the Canadian production mandate for both the Fox and TH 495 vehicles.

With respect to civilian production (see Annex D), the company only has firm projections for flue gas desulphurization projects, and as a result, other potential environmental revenues are not included. While further analysis is required, the company is, however, very optimistic that additional environmental revenues (municipal waste, composting, etc.) will also accrue, thus further strengthening its financial projections.

Should Thyssen successfully locate a major heavy-manufacturing facility in Atlantic Canada, buoyed by a robust German economy, other German investment in Canada would follow, from within the Thyssen group (for example, Thyssen Engineering's environmental technology), and possibly from other major German companies.

Thyssen has entered into an agreement with the Government of Nova Scotia in 1987 to provide land and a portion of infrastructure. Discussions with the provincial government have indicated that the provincial government will support the terms of the original agreement.

If directed by the Government of Canada, Thyssen would locate its facility on a "green-fields" site in mainland Nova Scotia, rather than the site originally contemplated in Cape Breton. As BHI has not developed precise sourcing for subcontracting, the direct and indirect regional benefits of the facility cannot be determined. However, since BHI will be supplying a military need, potential

suppliers must satisfy the Government's stringent quality assurance standards. Thyssen will actively promote source qualification in Cape Breton and elsewhere in the Atlantic region, (some of which have been identified and have already qualified under quality assurance) particularly with respect to small and medium-sized business. ACOA will aggressively assist in this regard through, for example, use of the Supplier Development element of the Action Program. Key vehicle subsystems to be sourced include automotive and electronics, and could be met by existing suppliers in Ontario, Quebec, Alberta, and British Columbia.

Moreover, in recent years, the Government of Canada has directed a number of military contracts, for regional development purposes, or to strengthen Canada's defence industrial base, or for DND operation requirements. These include:

- the production of northern terrain vehicles, a contract valued at up to \$200 million sole-sourced to Calgary-based Hagglunds-Foremost in 1988;
- the order for 199 armoured militia vehicles valued at about \$100 million directed to GM, in London, Ontario, in 1989;
- the award to Computing Devices Canada of a sole-sourced contract, worth about \$90 million, earlier this year, to produce fourteen shipboard electronic sub-systems used in the Canadian Patrol Frigates. As part of this package, CDC had earlier been granted about \$30 million by DND, to develop the system; and
- when in 1986, Litton Systems Canada Limited won the competed contract to modernize four Tribal class destroyers, under the TRUMP project, Litton was then directed to award a sole-source contract to the MIL (Davie) shipyard, in Lauzon, Quebec, for the first two ships. The value of this directed contract is estimated at \$175 million.

OTHER DEPARTMENTAL POSITIONS:

- Department of External Affairs: Based on information provided, DEA is concerned that Thyssen has not demonstrated long-term sustained economic viability through a detailed marketing plan, particularly for military markets. In this latter regard, DEA points out that both NATO and Warsaw Pact forces will have surplus military vehicles.

DEA is also concerned that by directing this major military purchase to a non-U.S. (i.e., German) source, particularly through establishment of a "green-field" site, Canada will irritate U.S. trade interests, and potentially threaten Canadian access to the large U.S. defence market. A fundamental tenet of our Defence Economic Relationship with the U.S. has been that, in return for access to their market, we would offer them the chance to compete to supply major requirements we could not meet domestically.

With respect to Thyssen's proposed environmental production, DEA notes that Canada has existing capacity in flue gas abatement (Joy Technologies, Kitchener, Ontario). Should Thyssen wish to pursue municipal organic composting opportunities, they could transfer the technology directly to the customer without the establishment of a Canadian facility.

- The Treasury Board Secretariat, supported by the Department of Finance, is concerned that the incremental costs of the Thyssen proposal, to be borne by the Department of National Defence, represent a very inefficient use of government resources at a time of fiscal restraint. Moreover, TBS and Finance have concerns that the Government is being asked to award this major contract to Thyssen on a sole-source basis, rather than following a competitive process.
- Department of Industry, Science and Technology Canada (ISTC). The Department of Industry, Science and Technology Canada notes that the military vehicle sector was initially established to supply the Department of National Defence (DND). Currently, two major companies are in production; Diesel Division - General Motors, (DDGM) in London, and UTDC, Kingston, Ontario. Both, DDGM and UTDC, rely on U.S. and Europe respectively for the supply of major components such as the power pack and suspension components, and use licensing arrangements to obtain the technology.

DDGM produces a family of light armoured wheeled vehicles in London, Ontario. DDGM has successfully supplied vehicles to DND and the U.S. Marine Corps. Following a couple of very slow years, the company was awarded the (DND) MILLAV contract July 1989 for 199 vehicles. Recently, the company signed an agreement with MOWAG of Switzerland for the delivery of approximately 400 LAV units to Saudi Arabia. This work should keep the company moderately busy until the mid 1990s. DDGM's long term plans are to become a viable supplier of light armoured tracked and wheeled vehicles.

Lavalin's recently acquired manufacturing division UTDC of Kingston, Ontario is currently producing heavy duty trucks for DND under license from Steyr of Austria. Production of the 1200 trucks has peaked, and employment is down to 250 employees. Layoffs are imminent. UTDC's long term plans are to supply DND with light support vehicles wheeled and light armoured vehicles.

Bombardier has completed two DND contracts; medium (MLVW) and light duty (Iltis) trucks and is currently not producing military trucks. Bombardier's long term plans in military vehicles is uncertain although the company has spare capacity at its Valcourt, Quebec plant. Hagglunds of Sweden and Canadian Foremost, to produce the northern terrain vehicle for DND, also known as the BV 206. Currently, the company is actively involved in the definition phase of the project.

Defence markets are expected to decline leading to major restructuring of both American and European defence industries. In Canada, a number of major Crown projects have been cancelled, others indefinitely delayed, and or drastically reduced in scope and budget dollars. Canada's NATO partners are facing similar conditions. Export potential is limited. Canada has overcapacity in the military vehicle sector and DND's limited and periodic acquisitions are not sufficient to justify additional capacity. Both of DDGM and UTDC, if they are to continue defence production, will need export sales.

At the company's request, ISTC has so far not had access to the business plan for the facility, ISTC has been unable to make assertions about the expected long-run viability of the facility or associated benefits related to jobs, technology, investment or exports. ISTC notes that the company should reach a decision on plant location, and thereby clarify its intentions regarding the potential use of the Cape Breton Investment Tax Credit.

The BHI proposal would increase Canada's current overcapacity in the military vehicles sector, and be contrary to ISTC's policy to discourage "green field" facilities in this sector. The proposal is also contrary to industrial benefits policy because it does not require, before acceptance of an offer, that the company provide detailed proposals with performance guarantees to be assessed against industrial benefit criteria as has been the case for other procurement.

Foreign companies may still be encouraged to invest in the military vehicles sector provided they offer significant technological and financial resources, teamed with Canadian companies to utilize existing manufacturing assets and jointly develop export markets. Teaming could broaden the product

range offered by Canadian industry, ensuring a range of advanced military and commercial products for export. New products and access to the global market place are essential to the well being of this sector.

NEXT STEPS: There is a need for further discussion of the proposal. Should Ministers wish to proceed with discussions, the following course of action could be pursued:

- meeting between Ministers MacKay, McKnight, and others as required;
- if agreement to proceed is not reached, formal notification from ACOA Minister to Thyssen, with negative outcome communicated to Thyssen before December 31, 1990;
- if agreement to proceed is reached, Ministers may wish to:
 - a) consider how best to address the funding shortfall identified by DND, and policy/timing concerns raised by the Defence Policy Review;
 - b) reach formal agreement by the Government to accept the concept of the Thyssen proposal, including the directed contract; and
 - c) communicate formally with the company in the affirmative, prior to December 31, 1990.

DND ANALYSIS OF THE THYSSEN PROPOSAL

1. While inadequate for all but general planning purposes due to lack of detail and narrow scope, the unsolicited Thyssen proposal for a directed, sole-source contract as contained in the paper provided to ACOA has been used as the basis for this analysis. The Thyssen proposal is for a directed contract for 250 TpZ 1 Fox vehicles, at a cost of \$290M (1990 dollars), with delivery beginning in FY 93/94. Within one year of signing such a contract, DND may, after negotiations with the company, switch the order and purchase an unspecified quantity of TH 495 vehicles for an unspecified price (see para 16).

2. In order to understand what would be required for DND to satisfy this request, it is important to understand the environment in which DND is currently operating.

THE DND ENVIRONMENT

3. The Department of National Defence (DND) is currently undergoing a "defence policy review". Due to the rapid and drastic changes in the security environment in the last several years, the policy set out in the 1987 White Paper requires change. The process for determining those changes is not yet complete.

4. Concurrent with the Defence Policy Review, we are also pursuing a major program review for determining the equipment requirements associated with the roles and missions defined by the new policy. The proposed Defence Policy and the associated capital program will not be considered by Cabinet until sometime in the new year.

5. In general terms, the new defence program, in reflecting more realistic future budget expectations, will reflect dramatic reductions in the capital program foreseen before the last two budgets. Even that reduced capital program is contingent upon government approval of major reductions in armed forces structure and supporting infrastructure. Otherwise the funding for capital will not be available and further capital program reductions will be necessary. Throughout the armed forces, there will be fewer equipments and significant rationalization of different types of similar equipments to yield the necessary savings in operations and maintenance costs:

6. This state of uncertainty affects all elements of our capital equipment program, including the equipment program for the Army. While the precise nature of DND's future army requirement is unknown pending finalization of the Defence Policy Review, DND planning is proceeding along the following lines:

ANNEX A

- a) a shift towards a lighter, more mobile, more flexible army;
- b) a rationalization of army combat vehicles that will reduce the current inefficiencies inherent in a multi-type vehicle fleet; and
- c) fuller exploitation and integration of the Militia with the regular force.

7. These considerations have led to the formulation of the Multi-Role Combat Vehicle (MRCV) project. Over the next fifteen years, the future army will require seven to eight hundred Multi-Role Combat Vehicles (MRCV), in three primary variants, to replace, augment, and rationalize existing fleets only as their useful life expires. Thus, the requirement is to procure the variants in the following order: a Reconnaissance Combat Vehicle (RCV), the Armoured Combat Vehicle (ACV), and the Infantry Combat Vehicle (ICV). The department recently agreed in principle to such a project, so it could be inserted in the long term plan. No significant funding is available prior to the mid-1990s.

IMPACT ANALYSIS AND ACTIONS REQUIRED

8. The following sections outline as best as we can, given the imprecise nature of the information available, the impact of accepting the Thyssen proposal and what DND would have to do in order to proceed with the proposal. The remainder of this section is organized according to the primary areas of impact:

- a) operational requirements;
- b) defence budget;
- c) Defence Services Program;
- d) defence industrial base; and
- e) public relations.

DND OPERATIONAL REQUIREMENTS

9. The next step is to define more clearly, over the next two years, the exact nature of the MRCV requirement. Not before then would the Minister of National Defence be in a position to demonstrate a fully-defined requirement and seek preliminary approval from Cabinet, including a procurement strategy.

ANNEX A

10. At this time we do know that, in general terms:
 - a) the MRCV must be highly mobile;
 - b) the MRCV must provide a moderate level of protection;
 - c) a family of vehicles is the preferred concept (ie, variants with a high degree of commonality, such as the chassis, spares, communications, etc.):
 - i) Reconnaissance Combat Vehicle (RCV) to gather intelligence and to deny information to the enemy through direct fire,
 - ii) Armoured Combat Vehicle (ACV) to provide heavy direct fire support and to be part of the anti-armour capability, and
 - iii) Infantry Combat Vehicle (ICV) to provide protected transport for infantry;
 - d) the vehicle must be transportable in C-130 Hercules aircraft (weight limit of 17.97 metric tonnes and a useable width of 2.87m).
11. The Fox probably would meet mobility requirements as it is a six wheeled vehicle of proven design offering good road and track mobility with reasonable off-road movement. In addition, the Fox appears to offer a reasonable degree of protection.
12. With regard to the family of vehicles requirement, although the Fox has a number of variants, these variants do not match our other requirements:
 - a) while advertised as a nuclear, biological, chemical (NBC) reconnaissance vehicle, the Fox is not a normal recce vehicle. It is configured to hold equipment which could determine the extent of contaminated ground through ground reconnaissance and air monitoring. It would not fulfil our conventional RCV requirement, which entails penetration of enemy lines, and possibly denial by direct fire of friendly information to the enemy;
 - b) Thyssen itself acknowledges that the LUCHS is its conventional recce vehicle;

ANNEX A

- c) some modifications to other Fox variants might make it a candidate for the Armoured Combat Vehicle variant DND requires; and
- d) the Fox itself is an infantry combat vehicle, and as it currently exists, would be appropriate only for the Infantry Combat Vehicle (ICV) requirement.

Thus, the Fox is not suitable for the family of vehicles concept based on a single chassis with the particular variants DND has identified to meet the army's future needs. Several European manufacturers currently produce families of vehicles which do have our required variants, such as the Vickers Valkyr (UK), the Kraus-Maffei Puma (GER), and the Alvis Stormer (UK).

13. On the air-transportable requirement, the Fox weighs 17 metric tonnes, but with a width of 2.98m it is incapable of transport by the C-130 and therefore unsuitable for the new roles foreseen for the army. If the Fox were to be given a turret and cannon/gun to make it fit the ACV or RCV role, it would likely exceed the weight limitation of 17.97 metric tonnes. The LUCHS, the Thyssen recce vehicle, weighs 19.5 tonnes, making it too heavy to carry in a C-130.

14. To buy the Fox as the ICV first would mean that the necessary acquisition order of Recce Combat Vehicle, Armoured Combat Vehicle, and finally Infantry Combat Vehicle would be reversed. This would mean that we would be postponing replacement of those types of armoured vehicles which are nearing the end of their operationally useful and economic life (ie, the current recce and direct fire vehicles), and supplementing the existing infantry combat vehicle fleet before necessary. The vehicle requirement is based on projected future force structure; therefore, it would be difficult to absorb the Fox with existing force structures. This difficulty would be exacerbated by delivery of variants in the reverse order. The consequences of this action would be:

- a) need for increased operations and maintenance provisions (see para 22 below);
- b) need for trained personnel to operate and maintain the vehicles; and

ANNEX A

- c) if we do not proceed with the purchase of a Recce Combat Vehicle as scheduled, we would be creating a combat deficiency as our current recce vehicle, the Lynx, will be operationally deficient after 1996.

15. The army would end up with fewer vehicles than they need and could otherwise afford. They would also end up with the wrong mix of the three variants (infantry, combat, and recce combat vehicles). Thyssen proposes to provide 250 Fox infantry combat vehicles (ICV), whereas the army requirement is only 206 such vehicles. Because of the additional costs of the Thyssen proposal (see below para 24), the ICV portion would consume over 50% of the funds available for the MRCV (rather than about 14% as is now projected). Since this purchase would satisfy only the requirement for the relatively less expensive ICV, the army would only be able to afford a maximum of 550 vehicles rather than the currently planned 735. This assumes a competitive, off-the-shelf buy of an existing vehicle which would meet our requirements but would be less expensive than an improved Fox variant or fully developed TH 495. The new mix would be 250 ICVs plus 300 armoured and recce combat vehicles, rather than the 206 ICVs with 529 ACVs and RCVs.

16. TH 495. The TH 495, suggested by Thyssen as an option suitable for discussion once the directed contract is let, is a conceptual vehicle existing on paper only. It eventually might promise to satisfy all the MRCV requirements. Intended as a tracked vehicle, it would offer reasonable mobility over all terrain. Its proposed dimensions and basic weight would indicate a suitability for the C-130 Hercules aircraft. The suggested family of variants would meet the MRCV principal requirements for a reconnaissance vehicle, a direct fire armoured vehicle, and/or infantry carrier. Furthermore, it has been suggested that the TH 495 would meet current anticipated protection requirements. Given the advertised characteristics of the TH 495, it is judged that the Thyssen vehicle could enter with good prospects, subject to price, the open competition in the period of 1994-95 to satisfy the Canadian MRCV requirements.

17. The Thyssen proposal, however, would have us begin planning to acquire the Fox, and then switch plans to accommodate the TH 495. The TH 495 is still on the drawing board and the development timeline for the TH 495 is optimistic in our view. Given that quantity, price, and specifications would be subject to negotiation, such a proposal makes little sense. It would double the disruption in the MRCV project and would require that we agree to purchase an unknown quantity of unproven vehicles for an unspecified price. Clearly, we are unable to calculate costs of this part of the proposal.

Actions required to proceed with the Thyssen proposal

18. If DND were directed to purchase the Fox vehicle according to the Thyssen proposal, we would have to take the following steps with regard to operational requirements:

- a) stop the process of defining the operational requirement for the ICV portion of the MRCV project and direct the army to use the Thyssen vehicle;
- b) reverse the priorities for replacement of army combat vehicles;
- c) reconfigure existing forces to take the vehicles and examine in particular the maintenance problems associated with early delivery;
- d) review and revise the roles for the army foreseen in the current policy review to make them consistent with the limited transportability of the Thyssen vehicle; and
- e) determine the feasibility and costs of meeting the Armoured Combat Vehicle and Recce Combat Vehicle requirements from the Thyssen product line OR plan for additional costs due to inefficiencies arising from a mixed fleet of vehicles (see below).

BUDGET CONSIDERATIONS

Note: all dollar figures are 90/91 CY \$

Capital

19. Budgeted Defence Services Program project costs for the Infantry Combat Vehicle (ICV) portion of the MRCV project are currently estimated as follows:

- a) 206 vehicles at \$565K each = \$116M;
- b) \$116M times project factor of 2.5 = \$290M.

The project factor of 2.5 provides the total project cost, including the costs for the vehicle itself, project management, and integrated logistic support (initial provisioning for spares, training, technical data packages, etc.) Project factors are based on the complexity of individual projects and 2.5 is what has been estimated for the MRCV project.

ANNEX A

20. The Thyssen Fox is an expensive vehicle compared to most other potential ICV contenders. Based on confirmation from ACOA officials, the Thyssen proposal for Fox is:

- a) 250 basic vehicles (not including normal project support costs - see para 19) at \$1.16M each = \$290M;
- b) \$290M times project factor of 2.5 = \$725M.

Not only is the Thyssen unit price almost twice as much, but Thyssen is proposing to supply 44 vehicles more than our requirement of 206 ICVs.

21. The increase in the total Infantry Combat Vehicle project cost that would be created by a directed buy of Fox is quite significant as detailed hereunder:

- Thyssen proposal:	\$725M
- Budgeted costs for competed ICV portion of MRCV	\$290M
Increase	\$435M

Operations and Maintenance

22. Since these vehicles would be introduced to the current fleet nine years earlier than currently planned, and there is no corresponding retirement or reduction of other vehicles scheduled, some provision must be made to cover the unforecasted operating and maintenance costs. The least disruptive option for army operations is additional money. Based on a comparable project, we estimate that this buy would add another \$14.5M a year for 9 years or \$130M, before inflation, to the Operations and Maintenance (O & M) budget. An alternative would be to place the newly purchased Fox in storage. Another possibility would be to put other vehicles, such as trucks or the current M 113 fleet into storage. Both would be disruptive of ongoing army activity.

Inefficiencies

23. Financial expenses from the lost opportunity for economies of scale when several hundred vehicles are purchased in two or more separate buys (by increased per unit costs, inefficiencies in the purchase of spares, in stocking, storage, contracting and other such areas) could run to at least 10% of the MRCV project's cost (current estimate \$2,100 million) or an additional \$200M.

Summary of Costs

24. In summary, the additional costs of the Thyssen proposal, over and above those already budgeted for the ICV portion of the MRCV project, would include:

- a) \$435M in capital for the Infantry Combat Vehicle project;
- b) \$130M in unforecasted O & M for the additional vehicles; and
- c) \$200M for inefficiencies and lack of fleet rationalization;
- d) for a total of \$765M.

With the already scheduled \$290M for the ICV portion, the new total ICV cost under the Thyssen proposal would be \$1.1B.

Actions required to proceed with the Thyssen proposal

25. In order to proceed with the Thyssen proposal, all of the required funding has to be included in the defence budget in the appropriate years. This involves:

- a) bringing forward the originally scheduled costs of the ICV portion of the MRCV project of \$290M from 2001/02 - 2005/06 to the 1993/94 - 1997/98 period;
- b) finding a source for the additional \$435M in capital for project costs over the period 1993/94 to 1997/98 (para 21 above);
- c) finding a source for the additional \$130M in operations and maintenance funding over the period 1994/95 to 2003/04 (para 22 above); and
- d) absorbing the \$200M in inefficiencies over the life of the project (para 23 above).

ANNEX A

26. Over the proposed Thyssen delivery period of 1993/94 to 1995/96, the Defence Services Program (DSP) contains only \$70M in funding for the entire MRCV program. Acceptance of the Thyssen proposal would thus require an additional \$480M in capital over this time frame, together with an additional \$175M over the subsequent two years to cover the remaining costs for integrated logistics support. This is a total of \$655M (the total ICV project cost under the Thyssen proposal of \$725M as described in para 20, minus the \$70M already allocated for the MRCV project).

27. In the absence of new funding, the impact on the capital program of having to absorb an additional \$480M over the delivery period (93/94 - 95/96) would be enormous. This is particularly true since these are years in which DND already has severe cash flow problems. The entire army capital program for this period totals \$1.4B for 51 projects addressing the replacement of obsolete equipments. The additional funds required equate to more than one-third of programmed funds, and for only one part of one project.

IMPACT ON THE DEFENCE SERVICES PROGRAM (DSP)

28. The Thyssen proposal to begin delivery by FY 93/94 would call for cash which is not available from within the current Capital Program plan. If the additional \$655M were not to be provided to DND, there would have to be massive displacement of well developed and higher priority programs.

29. Large army projects in this period are the Tactical Command and Control Communication Systems (TCCCS), the Northern Terrain Vehicle (NTV), the Utility Tactical Transport Helicopters, the Light Support Vehicle Wheeled, and plans to increase Reserve equipment and infrastructure.

30. TCCCS addresses the highest current army priority - new radios and communications. The winning proposal was recently approved by Cabinet but is unaffordable within the DND capital funding allocation for this project. We are currently reviewing the size of the requirement, negotiating with the contractor, and trying to find other projects which can be reduced to make TCCCS affordable.

31. Northern Terrain Vehicles are in the definition stage, and affordability will be addressed in early 1991 when this stage is completed.

ANNEX A

32. It is, therefore, impossible to absorb the cost of the Thyssen proposal without creating capability gaps or deleting combat functions vital to general purpose land forces. Without outright cancellation of TCCCS as now defined, or NTV, plus deferrals/cancellations of other projects, DND could not proceed with the Thyssen proposal within funds currently budgeted for army equipment. Furthermore, projects in advanced stages in other environments--such as the Naval Reserve vessels, the New Shipborne Aircraft (NSA), new Search and Rescue Helicopters, support to the RCMP--would have to be adjusted as well. At the very least, some of these projects would have to be delayed, creating more combat deficiencies.

33. As many of the advanced projects are replacements for aging equipment, delaying implementation involves additional costs associated with life extension until such time as the equipment can be replaced. The continuation and expansion of O & M expenditure required for the maintenance of obsolete equipment cannot be estimated accurately, but could be on the order of hundreds of millions of dollars. For example, the relatively inexpensive 5/4 tonne truck (LSVW, Light Support Vehicle Wheeled) is currently being operated seven years past the end of its scheduled life; the O & M is in excess of \$30M per year. These additional expenditures would then create a ripple effect, displacing other projects further down the line.

Actions Required to Proceed with the Thyssen Proposal

34. To implement the Thyssen proposal would require the following actions with regard to the Defence Services Program:

- a) cancel, downsize, or defer TCCCS (as currently planned), NTV, as well as other army projects;
- b) cancel, downsize, or defer projects in other environments, including the New Shipborne Aircraft, the Naval Reserve vessels and the Search and Rescue Helicopters;
- c) chart out second and third order effects and make additional adjustments in the O & M and capital programs; and
- d) revise roles and missions to take account of the combat deficiencies created by the DSP dislocations.

DEFENCE INDUSTRIAL BASE

35. A new military vehicle facility would exacerbate the existing, widely documented overcapacity in the sector, leading to any of the following impacts strictly from a DND point of view:

- a) increased demands on government from other suppliers for similar directed contracts and/or subsidies in the wake of lack of work; this could further distort our planned acquisitions;
- b) chronic layoffs and dislocation of sector personnel, leading to increased demands for government assistance; and
- c) relocation out of the country of existing and proven facilities, potentially disrupting our supply lines for existing vehicles and spares; and
- d) intensive competition which could lead to deliberate underbidding, with resultant contract difficulties and cost overruns and demands for government assistance.

36. Defence industry would also be impacted in other sectors as the cancellations, downsizing, and deferrals of other projects occurred to make room for the additional costs and earlier funding of army combat vehicles. Many companies anticipating new contracts, after much definition work and expense, would be impacted in the electronics, aircraft, and shipbuilding sectors.

Actions required to proceed with the Thyssen proposal

37. To adjust to the effect of proceeding with the Thyssen proposal on the defence industrial base, we would have to:

- a) cancel or defer plans for affected projects;
- b) develop a sector rationalization policy and plan with Industry, Science, and Technology Canada, Department of Supply and Services, Atlantic Canada Opportunities Agency, and Western Diversification, including associated money to handle the various industry demands and needs;
- c) continue to monitor and adjust the DSP for follow-on disruptions.

ANNEX A

IMPLICATIONS FOR PUBLIC RELATIONS VIS-A-VIS DND

38. Recent events such as the situation at Oka and the crisis in the Persian Gulf have created a reasonably positive environment for DND and the Forces. Maintaining it in light of major defence reductions which will be embodied in the new policy review will be a challenge. This directed procurement would create a strong negative public reaction based on:

- a) distorting the army program against a background of significant reductions in army structure in the new policy;
- b) increased costs of this project against a background of financial restraint;
- c) the impact on industrial overcapacity in the military vehicles sector; and
- d) the departure from the normal competitive process.

Action Required to Proceed with the Thyssen Proposal:

39. In order to counter the negative publicity, we would have to develop a defensive communications plan.

SUMMARY

40. In general, based on our knowledge to date, if DND were to be instructed to proceed with this proposal, the Department and the army would face a daunting task to fit the Fox into the MRCV project. DND's budget does not allow the increased costs to be taken from existing reference levels. In short, our points are as follows:

- a) the timing is inappropriate as DND is in the midst of a policy review which will change the structure and the roles of our army;
- b) DND would only be able to afford 550 of the 735 vehicles required, and with the wrong mix among the infantry, combat, and recce variants;
- c) since Fox does not fit our operational requirements, we would have to reverse priorities for replacement of army vehicles resulting in further review and revision of army roles and structure, combat deficiencies, and unscheduled operations and maintenance costs;

ANNEX A

- d) once integrated logistics support, training, infrastructure, etc are considered, a contract price of \$290M translates into a project cost of \$725M, with an additional \$130M in operations and maintenance;
- e) once factored into the Defence Services Program, the amount of unavailable capital is \$655M in the 93/94 - 97/98 period, with an additional \$130M in O & M over the next decade;
- f) this money is not available in DND's existing reference levels without major dislocations of the Defence Services Program (ie, deferment, cancellation, or downsizing of such projects as TCCCS and/or Northern Terrain Vehicle; and
- g) exacerbation of existing overcapacity in the defence industrial base.

THE COMPANY

Thyssen Industrie AG, based in Germany, is one of the world's largest industrial manufacturing companies with sales exceeding \$25 billion, and 136,000 employees world wide.

In Canada, Thyssen's holdings include:

- Budd Canada Inc., Kitchener (automobile parts);
- Northern Elevator Holdings Ltd., Toronto (elevators);
- Greening Donald Co. Ltd., Hamilton (metal fabrication);
- Thyssen Marathon Canada Ltd., Mississauga (steel importers);
- and
- Thyssen Canada Ltd., Rexdale (steel materials trading).

In all, Thyssen employs some 2,500 Canadians.

Thyssen's defence operations are centred in a subsidiary, Thyssen Henschel, annual revenues \$688 million, located in Kassel, Germany. From this facility, Thyssen produces a wide range of world-class armoured and military vehicles for use by NATO forces.

ANNEX C
SECRET

THYSSEN'S ESTIMATES OF FORECAST REVENUES FOR BHI
(\$Millions 1990)

Expected Vehicle	Revenues					Total Market Revenue	Estimated Probability of Winning	Total Probability Total Revenue
	93/94	94/95	95/96	96/97	97/98			
TPZ Fox	34.8	127.6	127.6	-	-	\$290	Directed	\$290
Canada								
TPZ Fox U.S. (NBC)	10	10	10	10	10	\$50	90%	\$45
U.S. National Guard	10	25	50	50	50	\$235	50%	\$118
ASV	750	8	16	30	30	\$114	40%	\$46
U.S. Air Force EOD + Others	200	9	9	9	9	\$45	35%	\$16
Armoured Gun System	120	67	133	200		\$400	40%	\$160
Europe (Norway/Germany)	1200	40	60	60	60	\$280	55%	\$154
Environment: Canada and U.S. (flue gas scrubber revenues only)	24	32	55	44	45	\$235 ¹		\$235
Total								\$1064

¹ Already discounted.

Thyssen's FGD wet-limestone treatment, which captures SO₂ emissions from coal-fired power stations, is leading-edge, and is currently in use in some 40 stations internationally. (More details on environmental markets are outlined in Annex C.)

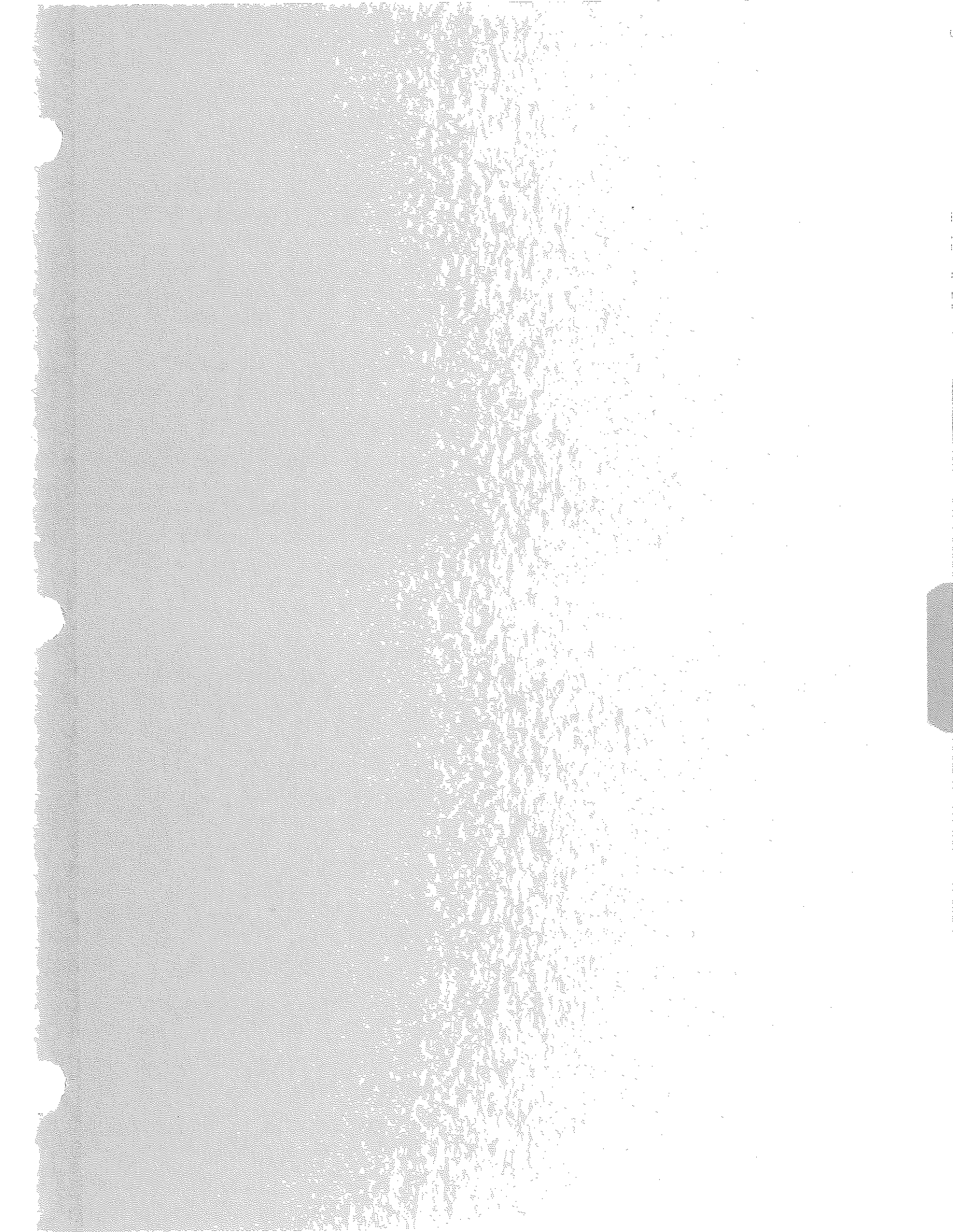
- In the future:

.. Based on market assessments, Thyssen will consider transferring "organic composting" technology for the treatment of municipal solid waste. Thyssen does not yet have firm market estimates in this area. The company is, however, pursuing contracts to address municipal waste treatment in Vancouver, Edmonton, Halifax, and Toronto. (Other products include airport loading bridges, material handling, specially mixers and machinery.)

ANNEX F
SECRET

EMPLOYMENT PROJECTIONS

	<u>1991/92</u>	<u>1992/93</u>	<u>1993/94</u>	<u>1994/95</u>	<u>1995/96</u>	<u>1996/97</u>	<u>1997/98</u>	<u>1998/99</u>	<u>1999/00</u>
Construction and Maintenance	50	200	100	50	50	30	30	30	30
Environmental	-	-	-	81	144	136	99	129	129
Defence	15	100	198	379	800	520	648	430	257
Total	65	300	298	510	994	686	777	589	416



RETURNED FROM PMO WITH NO COMMENTS (91-02-18)

CLERK OF THE PRIVY COUNCIL AND
SECRETARY TO THE CABINET



GREFFIER DU CONSEIL PRIVÉ ET
SECRÉTAIRE DU CABINET

SECRET

December 10, 1990

MEMORANDUM FOR NORMAN SPECTOR

Thyssen/Bear Head Industries

Attached is an aide-memoire on Thyssen's Bear Head Industries proposal, prepared by the Atlantic Canada Opportunities Agency (ACOA) with input from National Defence, External Affairs and ISTC. The paper responds to the request you made when you met with Ministers MacKay and McKnight on November 1 for a joint paper describing what would be necessary for this project to go ahead in the near future.

Summary

Thyssen is proposing that the Government purchase 250 of its TPZ "Fox" military vehicles, at a cost of \$290 million, by means of a directed contract, with delivery beginning in 1993/94. In order to produce these vehicles, Thyssen would invest \$61 million in building a new, major facility in Nova Scotia which would employ on average 600 persons over the next seven years. In addition to the directed contract, Thyssen is asking for \$12.2 million in federal and provincial assistance and tax credits. Thyssen is looking for a decision by the end of 1990.

ACOA is strongly supportive of the Thyssen proposal on the basis of anticipated regional benefits and argues that the proposal is commercially viable. It points out that the Government has used directed contracts on a number of occasions to support regional growth and development, although in this instance the contract would involve a "green field" or new establishment.

DND notes that going ahead with this proposal would involve: additional costs of \$765 million over and above the \$290 million already budgeted; the need to fit the Fox into the not-yet-completed defence policy, and the loss of the potential for fleet rationalization. On operational grounds, among other concerns DND has indicated that the Fox is not air transportable. The Thyssen proposal does include an option for DND to purchase its next generation TH 495 vehicle; however, this vehicle is still on the drawing board and has been neither tested nor costed.

The paper also reflects comments from ISTC, on the fit with industrial policy and the ability to maximize industrial benefits with a directed contract of this nature, and from External Affairs on the likely impact of such a purchase on relations with the United States on defence procurement. It should be noted that the line departments have provided input only; they have not signed off on the document.

Comment

As you requested, the aide-memoire does lay out what would be necessary for this project to go ahead: the price is very high, with DND purchasing equipment it basically does not want in a time-frame that does not suit its needs. Although ACOA views the resulting facility to be viable, DND feels that there is not enough information within the Thyssen business plan to justify this conclusion. (No other departments have seen the plan.) At approximately \$2 million per job, the Government would want to be very sure the plant would succeed.

I understand that you will be discussing with Mr. MacKay how to proceed on this project. He is very anxious to have this matter scheduled for Operations Committee in the near future, possibly on December 13. If this is the case, we will prepare more detailed briefing material for that meeting.



Paul M. Tellier

Attachment

Billings/Bilodeau/de

14:00

SECRET
10.12.90

THYSSEN/BEAR HEAD INDUSTRIES FACILITY IN NOVA SCOTIA

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ISSUE: Whether to support the proposal by Bear Head Industries Limited, (a subsidiary of Thyssen) for a directed contract in order to establish a heavy manufacturing facility in Nova Scotia.

PROPOSAL: Thyssen is seeking a directed contract for 250 of its TPZ "Fox" military vehicles, at a cost of \$290 million (1990 dollars), with delivery beginning in FY 1993/1994. Thyssen is targeting the DND multi-role combat vehicle (MRCV) project. Within one year of signing this contract, DND may, after negotiations with the company, switch the order and purchase instead an unspecified quantity of Thyssen's next-generation TH 495 vehicles for an unspecified price.

Thyssen is proposing to invest \$61 million by 1994 to construct a major facility in Nova Scotia to produce military vehicles, and environmental products. The company predicts employment will reach 300 by 1993/94, and average some 600 persons over the first seven years of operation. The company will support its facility with royalty-free technology transfer.

Thyssen is also seeking \$12.2 million of assistance for off-site infrastructure (to be cost-shared between the federal and Nova Scotia governments), and pro forma investment tax credits.

The company has indicated that it must reach a decision on whether or not to proceed by the end of 1990.

FINANCIAL IMPLICATIONS: Financial implications for the federal Government are very significant (about \$1.1 billion), comprising primarily funds already budgeted by DND for the program element (\$290 million, budgeted after the year 2000), incremental costs estimated by DND to support the Thyssen proposal (\$765 million), and the much smaller (approximately \$8 million) costs of federally-funded infrastructure. (All financial data below are provided in 1990/91 dollars.) Specifically, costs include:

- (1) expenditures on Thyssen contract for 250 vehicles: \$290 million;
- (2) DND's estimate of additional costs of Thyssen proposal over and above those already budgeted (\$290 million, after the year 2000) for infantry combat vehicle portion of MRCV project:
 - a) \$435 million in capital (spares, training, project management, etc.),
 - b) \$130 million in unforecasted O&M for the additional vehicles, and
 - c) \$200 million for inefficiencies and lack of fleet rationalization;

- (3) \$8 million for federally-funded infrastructure (sewer, rail, hydro, etc.), assuming the province of Nova Scotia bears remaining 30 percent, or \$3.6 million; and
- (4) pro-forma investment tax credits (maximum 15% of eligible investment for mainland Nova Scotia site).

DEPARTMENT OF NATIONAL DEFENCE (DND) PERSPECTIVE: The detailed assessment by DND of the proposal is included in Annex A.

In summary, DND indicates that if it were directed to proceed with the Thyssen proposal at this time, the department and the army would face a daunting task to fit the Fox (or the proposed TH 495) vehicles into a not-yet-complete policy and operational planning framework. Beyond considerations of the appropriateness of the vehicle for operational requirements, DND is seriously concerned about the affordability of this proposal in the context of other priorities; and its timing, given that the Defence Policy Review and associated capital program will not be considered by Cabinet until early next year.

DND indicates that the Fox is not the right vehicle for the Canadian Forces. The Fox is not air-transportable in a C-130 Hercules aircraft; it would not provide the necessary fleet rationalization of a "family" of like vehicles; it would result in significantly fewer vehicles (25% less than DND's minimum operational requirement) for the army; and would result in purchasing the infantry variant before it is required instead of replacing other obsolete variants. In addition, DND is unable at this time to consider the TH 495 since it is still on the drawing board and constitutes an untested and unproven design.

Although the Thyssen proposal is for 250 vehicles at a contract value assessed at \$290 million, on the basis of available business information, DND has determined that the net incremental impact on the defence budget of acquiring 250 Fox would be over \$765 million (90/91 dollars). (See para. #24 in detailed DND position, Annex A.)

During the acquisition phase (1993/94 - 97/98), this buy would create a requirement for \$655 million (90/91 dollars) in unforeseen capital cash flow, and DND is not able to identify how such an amount could be diverted from the other elements of the Defence Services Program without causing costly and disruptive dislocation to existing plans, contracts and projects. Indeed, even were such an amount of money available from sources outside DND, other priorities have much more pressing requirements on which that money should be spent. For example, previously-approved projects such as TCCCS (the army radio program, NSA (the naval helicopter), and the Northern Terrain Vehicle are currently facing affordability problems.

Finally, DND notes the exacerbation of existing overcapacity in the defence industrial base, and the likelihood of a strong negative public reaction.

ACOA PERSPECTIVE: Other departments have raised significant concerns regarding the affordability of the Thyssen proposal to DND; the perceived economic viability of the Nova Scotia facility; and the effects the Thyssen facility would have on Canada's existing military vehicle industry. Ministers will wish to consider these concerns in reaching a decision on the Thyssen proposal.

Accordingly, while the concerns raised by other departments are outlined elsewhere in this paper, the section below outlines the potential benefits to Canada and the Atlantic region arising from the Thyssen facility.

The proposed Nova Scotia facility would be a world-class manufacturing base, and offers tremendous benefits to the Atlantic region.

Thyssen is a huge world-class multinational with a major presence in Canada already (see Annex B). By locating a vehicle-manufacturing facility in Canada, Thyssen could gain access to the U.S. defence market, under the Canada-U.S. Defense Production Sharing Agreement. Moreover, a sale to the Canadian Forces would also enhance the company's credibility in marketing to U.S. armed forces.

Bear Head Industries (BHI) is a wholly-owned subsidiary of German-based Thyssen Industrie AG. BHI is incorporated in Nova Scotia, and, so far, operates a liaison office in Ottawa. BHI would be the only Canadian military vehicle producer which would use its own -- as opposed to licensed -- vehicle technology.

To date, Canada does not generally supply complete systems to the U.S., but has had a success with the General Motors light armoured vehicle. Military vehicles have posed virtually the sole opportunity for Canada to export "turn key" major military systems including vehicles, logistics support, ongoing maintenance, and so on. Canada has virtually no chance of successfully exporting a complete system in the other military, aerospace, and naval sectors. In general, Canada has tended to exploit niche subcomponent markets.

Thyssen's business plan so far -- prepared by Peat Marwick, and submitted to ACOA, on behalf of the Government -- indicates that the Nova Scotia facility will be economically viable, assuming market projections materialize. For detailed military and civilian revenue and market projections, see Annexes C and D respectively, and for descriptive detail, Annex E. (Should the

company provide more detailed financial projections, particularly on viability, this information would begin to address viability and marketing concerns raised by other departments.)

The company projects a net loss before taxes in each of 1991, and 1992, but robust income and cash flow generation thereafter. Despite its heavy investment, and early operating losses, the company forecasts the net present value of its Nova Scotia cash flow (including depreciation, and assuming a regional tax credit of 15%) at about \$14 million. (Employment forecasts are outlined in Annex F.)

Should the facility proceed, BHI would receive the necessary investment capital from its German parent, thus freeing the company from debt-service payments. All technology would be provided to the subsidiary BHI without royalties and licences.

Thyssen Industrie would transfer to BHI the full production technology for both the Fox and TH 495 vehicles, and undertake in Nova Scotia, future design, improvement, and development work in response to customer requirements. BHI would also receive the North American production mandate for the TH 495 (subject to joint production arrangements which may be required to compete successfully in the U.S.), and, the Canadian production mandate for both the Fox and TH 495 vehicles.

With respect to civilian production (see Annex D), the company only has firm projections for flue gas desulphurization projects, and as a result, other potential environmental revenues are not included. While further analysis is required, the company is, however, very optimistic that additional environmental revenues (municipal waste, composting, etc.) will also accrue, thus further strengthening its financial projections.

Should Thyssen successfully locate a major heavy-manufacturing facility in Atlantic Canada, buoyed by a robust German economy, other German investment in Canada would follow, from within the Thyssen group (for example, Thyssen Engineering's environmental technology), and possibly from other major German companies.

Thyssen has entered into an agreement with the Government of Nova Scotia in 1987 to provide land and a portion of infrastructure. Discussions with the provincial government have indicated that the provincial government will support the terms of the original agreement.

If directed by the Government of Canada, Thyssen would locate its facility on a "green-fields" site in mainland Nova Scotia, rather than the site originally contemplated in Cape Breton. As BHI has not developed precise sourcing for subcontracting, the direct and indirect regional benefits of the facility cannot be determined. However, since BHI will be supplying a military need, potential

suppliers must satisfy the Government's stringent quality assurance standards. Thyssen will actively promote source qualification in Cape Breton and elsewhere in the Atlantic region, (some of which have been identified and have already qualified under quality assurance) particularly with respect to small and medium-sized business. ACOA will aggressively assist in this regard through, for example, use of the Supplier Development element of the Action Program. Key vehicle subsystems to be sourced include automotive and electronics, and could be met by existing suppliers in Ontario, Québec, Alberta, and British Columbia.

Moreover, in recent years, the Government of Canada has directed a number of military contracts, for regional development purposes, or to strengthen Canada's defence industrial base, or for DND operation requirements. These include:

- the production of northern terrain vehicles, a contract valued at up to \$200 million sole-sourced to Calgary-based Hagglunds-Foremost in 1988;
- the order for 199 armoured militia vehicles valued at about \$100 million directed to GM, in London, Ontario, in 1989;
- the award to Computing Devices Canada of a sole-sourced contract, worth about \$90 million, earlier this year, to produce fourteen shipboard electronic sub-systems used in the Canadian Patrol Frigates. As part of this package, CDC had earlier been granted about \$30 million by DND, to develop the system; and
- when in 1986, Litton Systems Canada Limited won the competed contract to modernize four Tribal class destroyers, under the TRUMP project, Litton was then directed to award a sole-source contract to the MIL (Davie) shipyard, in Lauzon, Quebec, for the first two ships. The value of this directed contract is estimated at \$175 million.

OTHER DEPARTMENTAL POSITIONS:

- Department of External Affairs: Based on information provided, DEA is concerned that Thyssen has not demonstrated long-term sustained economic viability through a detailed marketing plan, particularly for military markets. In this latter regard, DEA points out that both NATO and Warsaw Pact forces will have surplus military vehicles.

DEA is also concerned that by directing this major military purchase to a non-U.S. (i.e. German) source, particularly through establishment of a "green-field" site, Canada will irritate U.S. trade interests, and potentially threaten Canadian access to the large U.S. defence market. A fundamental tenet of our Defence Economic Relationship with the U.S. has been that, in return for access to their market, we would offer them the chance to compete to supply major requirements we could not meet domestically.

With respect to Thyssen's proposed environmental production, DEA notes that Canada has existing capacity in flue gas abatement (Joy Technologies, Kitchener, Ontario). Should Thyssen wish to pursue municipal organic composting opportunities, they could transfer the technology directly to the customer without the establishment of a Canadian facility.

- The Treasury Board Secretariat, supported by the Department of Finance, is concerned that the incremental costs of the Thyssen proposal, to be borne by the Department of National Defence, represent a very inefficient use of government resources at a time of fiscal restraint. Moreover, TBS and Finance have concerns that the Government is being asked to award this major contract to Thyssen on a sole-source basis, rather than following a competitive process.
- Department of Industry, Science and Technology Canada (ISTC). The Department of Industry, Science and Technology Canada notes that the military vehicle sector was initially established to supply the Department of National Defence (DND). Currently, two major companies are in production; Diesel Division - General Motors, (DDGM) in London, and UTDC, Kingston, Ontario. Both, DDGM and UTDC, rely on U.S. and Europe respectively for the supply of major components such as the power pack and suspension components, and use licensing arrangements to obtain the technology.

DDGM produces a family of light armoured wheeled vehicles in London, Ontario. DDGM has successfully supplied vehicles to DND and the U.S. Marine Corps. Following a couple of very slow years, the company was awarded the (DND) MILLAV contract July 1989 for 199 vehicles. Recently, the company signed an agreement with MOWAG of Switzerland for the delivery of approximately 400 LAV units to Saudi Arabia. This work should keep the company moderately busy until the mid 1990s. DDGM's long term plans are to become a viable supplier of light armoured tracked and wheeled vehicles.

Lavalin's recently acquired manufacturing division UTDC of Kingston, Ontario is currently producing heavy duty trucks for DND under license from Steyr of Austria. Production of the 1200 trucks has peaked, and employment is down to 250 employees. Layoffs are imminent. UTDC's long term plans are to supply DND with light support vehicles wheeled and light armoured vehicles.

Bombardier has completed two DND contracts; medium (MLVW) and light duty (Iltis) trucks and is currently not producing military trucks. Bombardier's long term plans in military vehicles is uncertain although the company has spare capacity at its Valcourt, Quebec plant. Hagglunds of Sweden and Canadian Foremost, to produce the northern terrain vehicle for DND, also known as the BV 206. Currently, the company is actively involved in the definition phase of the project.

Defence markets are expected to decline leading to major restructuring of both American and European defence industries. In Canada, a number of major Crown projects have been cancelled, others indefinitely delayed, and or drastically reduced in scope and budget dollars. Canada's NATO partners are facing similar conditions. Export potential is limited. Canada has overcapacity in the military vehicle sector and DND's limited and periodic acquisitions are not sufficient to justify additional capacity. Both of DDGM and UTDC, if they are to continue defence production, will need export sales.

At the company's request, ISTC has so far not had access to the business plan for the facility, ISTC has been unable to make assertions about the expected long-run viability of the facility or associated benefits related to jobs, technology, investment or exports. ISTC notes that the company should reach a decision on plant location, and thereby clarify its intentions regarding the potential use of the Cape Breton Investment Tax Credit.

The BHI proposal would increase Canada's current overcapacity in the military vehicles sector, and be contrary to ISTC's policy to discourage "green field" facilities in this sector. The proposal is also contrary to industrial benefits policy because it does not require, before acceptance of an offer, that the company provide detailed proposals with performance guarantees to be assessed against industrial benefit criteria as has been the case for other procurement.

Foreign companies may still be encouraged to invest in the military vehicles sector provided they offer significant technological and financial resources, teamed with Canadian companies to utilize existing manufacturing assets and jointly develop export markets. Teaming could broaden the product

range offered by Canadian industry, ensuring a range of advanced military and commercial products for export. New products and access to the global market place are essential to the well being of this sector.

NEXT STEPS: There is a need for further discussion of the proposal. Should Ministers wish to proceed with discussions, the following course of action could be pursued:

- meeting between Ministers MacKay, McKnight, and others as required;
- if agreement to proceed is not reached, formal notification from ACOA Minister to Thyssen, with negative outcome communicated to Thyssen before December 31, 1990;
- if agreement to proceed is reached, Ministers may wish to:
 - a) consider how best to address the funding shortfall identified by DND, and policy/timing concerns raised by the Defence Policy Review;
 - b) reach formal agreement by the Government to accept the concept of the Thyssen proposal, including the directed contract; and
 - c) communicate formally with the company in the affirmative, prior to December 31, 1990.

DND ANALYSIS OF THE THYSSEN PROPOSAL

1. While inadequate for all but general planning purposes due to lack of detail and narrow scope, the unsolicited Thyssen proposal for a directed, sole-source contract as contained in the paper provided to ACOA has been used as the basis for this analysis. The Thyssen proposal is for a directed contract for 250 TpZ 1 Fox vehicles, at a cost of \$290M (1990 dollars), with delivery beginning in FY 93/94. Within one year of signing such a contract, DND may, after negotiations with the company, switch the order and purchase an unspecified quantity of TH 495 vehicles for an unspecified price (see para 16).

2. In order to understand what would be required for DND to satisfy this request, it is important to understand the environment in which DND is currently operating.

THE DND ENVIRONMENT

3. The Department of National Defence (DND) is currently undergoing a "defence policy review". Due to the rapid and drastic changes in the security environment in the last several years, the policy set out in the 1987 White Paper requires change. The process for determining those changes is not yet complete.

4. Concurrent with the Defence Policy Review, we are also pursuing a major program review for determining the equipment requirements associated with the roles and missions defined by the new policy. The proposed Defence Policy and the associated capital program will not be considered by Cabinet until sometime in the new year.

5. In general terms, the new defence program, in reflecting more realistic future budget expectations, will reflect dramatic reductions in the capital program foreseen before the last two budgets. Even that reduced capital program is contingent upon government approval of major reductions in armed forces structure and supporting infrastructure. Otherwise the funding for capital will not be available and further capital program reductions will be necessary. Throughout the armed forces, there will be fewer equipments and significant rationalization of different types of similar equipments to yield the necessary savings in operations and maintenance costs.

6. This state of uncertainty affects all elements of our capital equipment program, including the equipment program for the Army. While the precise nature of DND's future army requirement is unknown pending finalization of the Defence Policy Review, DND planning is proceeding along the following lines:

ANNEX A

- a) a shift towards a lighter, more mobile, more flexible army;
- b) a rationalization of army combat vehicles that will reduce the current inefficiencies inherent in a multi-type vehicle fleet; and
- c) fuller exploitation and integration of the Militia with the regular force.

7. These considerations have led to the formulation of the Multi-Role Combat Vehicle (MRCV) project. Over the next fifteen years, the future army will require seven to eight hundred Multi-Role Combat Vehicles (MRCV), in three primary variants, to replace, augment, and rationalize existing fleets only as their useful life expires. Thus, the requirement is to procure the variants in the following order: a Reconnaissance Combat Vehicle (RCV), the Armoured Combat Vehicle (ACV), and the Infantry Combat Vehicle (ICV). The department recently agreed in principle to such a project, so it could be inserted in the long term plan. No significant funding is available prior to the mid-1990s.

IMPACT ANALYSIS AND ACTIONS REQUIRED

8. The following sections outline as best as we can, given the imprecise nature of the information available, the impact of accepting the Thyssen proposal and what DND would have to do in order to proceed with the proposal. The remainder of this section is organized according to the primary areas of impact:

- a) operational requirements;
- b) defence budget;
- c) Defence Services Program;
- d) defence industrial base; and
- e) public relations.

DND OPERATIONAL REQUIREMENTS

9. The next step is to define more clearly, over the next two years, the exact nature of the MRCV requirement. Not before then would the Minister of National Defence be in a position to demonstrate a fully-defined requirement and seek preliminary approval from Cabinet, including a procurement strategy.

ANNEX A

10. At this time we do know that, in general terms:
 - a) the MRCV must be highly mobile;
 - b) the MRCV must provide a moderate level of protection;
 - c) a family of vehicles is the preferred concept (ie, variants with a high degree of commonality, such as the chassis, spares, communications, etc.):
 - i) Reconnaissance Combat Vehicle (RCV) to gather intelligence and to deny information to the enemy through direct fire,
 - ii) Armoured Combat Vehicle (ACV) to provide heavy direct fire support and to be part of the anti-armour capability, and
 - iii) Infantry Combat Vehicle (ICV) to provide protected transport for infantry;
 - d) the vehicle must be transportable in C-130 Hercules aircraft (weight limit of 17.97 metric tonnes and a useable width of 2.87m).
11. The Fox probably would meet mobility requirements as it is a six wheeled vehicle of proven design offering good road and track mobility with reasonable off-road movement. In addition, the Fox appears to offer a reasonable degree of protection.
12. With regard to the family of vehicles requirement, although the Fox has a number of variants, these variants do not match our other requirements:
 - a) while advertised as a nuclear, biological, chemical (NBC) reconnaissance vehicle, the Fox is not a normal recce vehicle. It is configured to hold equipment which could determine the extent of contaminated ground through ground reconnaissance and air monitoring. It would not fulfil our conventional RCV requirement, which entails penetration of enemy lines, and possibly denial by direct fire of friendly information to the enemy;
 - b) Thyssen itself acknowledges that the LUCHS is its conventional recce vehicle;

ANNEX A

- c) some modifications to other Fox variants might make it a candidate for the Armoured Combat Vehicle variant DND requires; and
- d) the Fox itself is an infantry combat vehicle, and as it currently exists, would be appropriate only for the Infantry Combat Vehicle (ICV) requirement.

Thus, the Fox is not suitable for the family of vehicles concept based on a single chassis with the particular variants DND has identified to meet the army's future needs. Several European manufacturers currently produce families of vehicles which do have our required variants, such as the Vickers Valkyr (UK), the Kraus-Maffei Puma (GER), and the Alvis Stormer (UK).

13. On the air-transportable requirement, the Fox weighs 17 metric tonnes, but with a width of 2.98m it is incapable of transport by the C-130 and therefore unsuitable for the new roles foreseen for the army. If the Fox were to be given a turret and cannon/gun to make it fit the ACV or RCV role, it would likely exceed the weight limitation of 17.97 metric tonnes. The LUCHS, the Thyssen recce vehicle, weighs 19.5 tonnes, making it too heavy to carry in a C-130.

14. To buy the Fox as the ICV first would mean that the necessary acquisition order of Recce Combat Vehicle, Armoured Combat Vehicle, and finally Infantry Combat Vehicle would be reversed. This would mean that we would be postponing replacement of those types of armoured vehicles which are nearing the end of their operationally useful and economic life (ie, the current recce and direct fire vehicles), and supplementing the existing infantry combat vehicle fleet before necessary. The vehicle requirement is based on projected future force structure; therefore, it would be difficult to absorb the Fox with existing force structures. This difficulty would be exacerbated by delivery of variants in the reverse order. The consequences of this action would be:

- a) need for increased operations and maintenance provisions (see para 22 below);
- b) need for trained personnel to operate and maintain the vehicles; and

ANNEX A

- c) if we do not proceed with the purchase of a Recce Combat Vehicle as scheduled, we would be creating a combat deficiency as our current recce vehicle, the Lynx, will be operationally deficient after 1996.

15. The army would end up with fewer vehicles than they need and could otherwise afford. They would also end up with the wrong mix of the three variants (infantry, combat, and recce combat vehicles). Thyssen proposes to provide 250 Fox infantry combat vehicles (ICV), whereas the army requirement is only 206 such vehicles. Because of the additional costs of the Thyssen proposal (see below para 24), the ICV portion would consume over 50% of the funds available for the MRCV (rather than about 14% as is now projected). Since this purchase would satisfy only the requirement for the relatively less expensive ICV, the army would only be able to afford a maximum of 550 vehicles rather than the currently planned 735. This assumes a competitive, off-the-shelf buy of an existing vehicle which would meet our requirements but would be less expensive than an improved Fox variant or fully developed TH 495. The new mix would be 250 ICVs plus 300 armoured and recce combat vehicles, rather than the 206 ICVs with 529 ACVs and RCVs.

16. TH 495. The TH 495, suggested by Thyssen as an option suitable for discussion once the directed contract is let, is a conceptual vehicle existing on paper only. It eventually might promise to satisfy all the MRCV requirements. Intended as a tracked vehicle, it would offer reasonable mobility over all terrain. Its proposed dimensions and basic weight would indicate a suitability for the C-130 Hercules aircraft. The suggested family of variants would meet the MRCV principal requirements for a reconnaissance vehicle, a direct fire armoured vehicle, and/or infantry carrier. Furthermore, it has been suggested that the TH 495 would meet current anticipated protection requirements. Given the advertised characteristics of the TH 495, it is judged that the Thyssen vehicle could enter with good prospects, subject to price, the open competition in the period of 1994-95 to satisfy the Canadian MRCV requirements.

17. The Thyssen proposal, however, would have us begin planning to acquire the Fox, and then switch plans to accommodate the TH 495. The TH 495 is still on the drawing board and the development timeline for the TH 495 is optimistic in our view. Given that quantity, price, and specifications would be subject to negotiation, such a proposal makes little sense. It would double the disruption in the MRCV project and would require that we agree to purchase an unknown quantity of unproven vehicles for an unspecified price. Clearly, we are unable to calculate costs of this part of the proposal.

ANNEX A

Actions required to proceed with the Thyssen proposal

18. If DND were directed to purchase the Fox vehicle according to the Thyssen proposal, we would have to take the following steps with regard to operational requirements:

- a) stop the process of defining the operational requirement for the ICV portion of the MRCV project and direct the army to use the Thyssen vehicle;
- b) reverse the priorities for replacement of army combat vehicles;
- c) reconfigure existing forces to take the vehicles and examine in particular the maintenance problems associated with early delivery;
- d) review and revise the roles for the army foreseen in the current policy review to make them consistent with the limited transportability of the Thyssen vehicle; and
- e) determine the feasibility and costs of meeting the Armoured Combat Vehicle and Recce Combat Vehicle requirements from the Thyssen product line OR plan for additional costs due to inefficiencies arising from a mixed fleet of vehicles (see below).

BUDGET CONSIDERATIONS

Note: all dollar figures are 90/91 CY \$

Capital

19. Budgeted Defence Services Program project costs for the Infantry Combat Vehicle (ICV) portion of the MRCV project are currently estimated as follows:

- a) 206 vehicles at \$565K each = \$116M;
- b) \$116M times project factor of 2.5 = \$290M.

The project factor of 2.5 provides the total project cost, including the costs for the vehicle itself, project management, and integrated logistic support (initial provisioning for spares, training, technical data packages, etc.) Project factors are based on the complexity of individual projects and 2.5 is what has been estimated for the MRCV project.

ANNEX A

20. The Thyssen Fox is an expensive vehicle compared to most other potential ICV contenders. Based on confirmation from ACOA officials, the Thyssen proposal for Fox is:

- a) 250 basic vehicles (not including normal project support costs - see para 19) at \$1.16M each = \$290M;
- b) \$290M times project factor of 2.5 = \$725M.

Not only is the Thyssen unit price almost twice as much, but Thyssen is proposing to supply 44 vehicles more than our requirement of 206 ICVs.

21. The increase in the total Infantry Combat Vehicle project cost that would be created by a directed buy of Fox is quite significant as detailed hereunder:

- Thyssen proposal:	\$725M
- Budgeted costs for competed ICV portion of MRCV	\$290M
Increase	\$435M

Operations and Maintenance

22. Since these vehicles would be introduced to the current fleet nine years earlier than currently planned, and there is no corresponding retirement or reduction of other vehicles scheduled, some provision must be made to cover the unforecasted operating and maintenance costs: The least disruptive option for army operations is additional money. Based on a comparable project, we estimate that this buy would add another \$14.5M a year for 9 years or \$130M, before inflation, to the Operations and Maintenance (O & M) budget. An alternative would be to place the newly purchased Fox in storage. Another possibility would be to put other vehicles, such as trucks or the current M 113 fleet into storage. Both would be disruptive of ongoing army activity.

Inefficiencies

23. Financial expenses from the lost opportunity for economies of scale when several hundred vehicles are purchased in two or more separate buys (by increased per unit costs, inefficiencies in the purchase of spares, in stocking, storage, contracting and other such areas) could run to at least 10% of the MRCV project's cost (current estimate \$2,100 million) or an additional \$200M.

Summary of Costs

24. In summary, the additional costs of the Thyssen proposal, over and above those already budgeted for the ICV portion of the MRCV project, would include:

- a) \$435M in capital for the Infantry Combat Vehicle project;
- b) \$130M in unforecasted O & M for the additional vehicles; and
- c) \$200M for inefficiencies and lack of fleet rationalization;
- d) for a total of \$765M.

With the already scheduled \$290M for the ICV portion, the new total ICV cost under the Thyssen proposal would be \$1.1B.

Actions required to proceed with the Thyssen proposal

25. In order to proceed with the Thyssen proposal, all of the required funding has to be included in the defence budget in the appropriate years. This involves:

- a) bringing forward the originally scheduled costs of the ICV portion of the MRCV project of \$290M from 2001/02 - 2005/06 to the 1993/94 - 1997/98 period;
- b) finding a source for the additional \$435M in capital for project costs over the period 1993/94 to 1997/98 (para 21 above);
- c) finding a source for the additional \$130M in operations and maintenance funding over the period 1994/95 to 2003/04 (para 22 above); and
- d) absorbing the \$200M in inefficiencies over the life of the project (para 23 above).

ANNEX A

26. Over the proposed Thyssen delivery period of 1993/94 to 1995/96, the Defence Services Program (DSP) contains only \$70M in funding for the entire MRCV program. Acceptance of the Thyssen proposal would thus require an additional \$480M in capital over this time frame, together with an additional \$175M over the subsequent two years to cover the remaining costs for integrated logistics support. This is a total of \$655M (the total ICV project cost under the Thyssen proposal of \$725M as described in para 20, minus the \$70M already allocated for the MRCV project).

27. In the absence of new funding, the impact on the capital program of having to absorb an additional \$480M over the delivery period (93/94 - 95/96) would be enormous. This is particularly true since these are years in which DND already has severe cash flow problems. The entire army capital program for this period totals \$1.4B for 51 projects addressing the replacement of obsolete equipments. The additional funds required equate to more than one-third of programmed funds, and for only one part of one project.

IMPACT ON THE DEFENCE SERVICES PROGRAM (DSP)

28. The Thyssen proposal to begin delivery by FY 93/94 would call for cash which is not available from within the current Capital Program plan. If the additional \$655M were not to be provided to DND, there would have to be massive displacement of well developed and higher priority programs.

29. Large army projects in this period are the Tactical Command and Control Communication Systems (TCCCS), the Northern Terrain Vehicle (NTV), the Utility Tactical Transport Helicopters, the Light Support Vehicle Wheeled, and plans to increase Reserve equipment and infrastructure.

30. TCCCS addresses the highest current army priority - new radios and communications. The winning proposal was recently approved by Cabinet but is unaffordable within the DND capital funding allocation for this project. We are currently reviewing the size of the requirement, negotiating with the contractor, and trying to find other projects which can be reduced to make TCCCS affordable.

31. Northern Terrain Vehicles are in the definition stage, and affordability will be addressed in early 1991 when this stage is completed.

ANNEX A

32. It is, therefore, impossible to absorb the cost of the Thyssen proposal without creating capability gaps or deleting combat functions vital to general purpose land forces. Without outright cancellation of TCCCS as now defined, or NTV, plus deferrals/cancellations of other projects, DND could not proceed with the Thyssen proposal within funds currently budgeted for army equipment. Furthermore, projects in advanced stages in other environments--such as the Naval Reserve vessels, the New Shipborne Aircraft (NSA), new Search and Rescue Helicopters, support to the RCMP--would have to be adjusted as well. At the very least, some of these projects would have to be delayed, creating more combat deficiencies.

33. As many of the advanced projects are replacements for aging equipment, delaying implementation involves additional costs associated with life extension until such time as the equipment can be replaced. The continuation and expansion of O & M expenditure required for the maintenance of obsolete equipment cannot be estimated accurately, but could be on the order of hundreds of millions of dollars. For example, the relatively inexpensive 5/4 tonne truck (LSVW, Light Support Vehicle Wheeled) is currently being operated seven years past the end of its scheduled life; the O & M is in excess of \$30M per year. These additional expenditures would then create a ripple effect, displacing other projects further down the line.

Actions Required to Proceed with the Thyssen Proposal

34. To implement the Thyssen proposal would require the following actions with regard to the Defence Services Program:

- a) cancel, downsize, or defer TCCCS (as currently planned), NTV, as well as other army projects;
- b) cancel, downsize, or defer projects in other environments, including the New Shipborne Aircraft, the Naval Reserve vessels and the Search and Rescue Helicopters;
- c) chart out second and third order effects and make additional adjustments in the O & M and capital programs; and
- d) revise roles and missions to take account of the combat deficiencies created by the DSP dislocations.

DEFENCE INDUSTRIAL BASE

35. A new military vehicle facility would exacerbate the existing, widely documented overcapacity in the sector, leading to any of the following impacts strictly from a DND point of view:

- a) increased demands on government from other suppliers for similar directed contracts and/or subsidies in the wake of lack of work; this could further distort our planned acquisitions;
- b) chronic layoffs and dislocation of sector personnel, leading to increased demands for government assistance; and
- c) relocation out of the country of existing and proven facilities, potentially disrupting our supply lines for existing vehicles and spares; and
- d) intensive competition which could lead to deliberate underbidding, with resultant contract difficulties and cost overruns and demands for government assistance.

36. Defence industry would also be impacted in other sectors as the cancellations, downsizing, and deferrals of other projects occurred to make room for the additional costs and earlier funding of army combat vehicles. Many companies anticipating new contracts, after much definition work and expense, would be impacted in the electronics, aircraft, and shipbuilding sectors.

Actions required to proceed with the Thyssen proposal

37. To adjust to the effect of proceeding with the Thyssen proposal on the defence industrial base, we would have to:

- a) cancel or defer plans for affected projects;
- b) develop a sector rationalization policy and plan with Industry, Science, and Technology Canada, Department of Supply and Services, Atlantic Canada Opportunities Agency, and Western Diversification, including associated money to handle the various industry demands and needs;
- c) continue to monitor and adjust the DSP for follow-on disruptions.

ANNEX A

IMPLICATIONS FOR PUBLIC RELATIONS VIS-A-VIS DND

38. Recent events such as the situation at Oka and the crisis in the Persian Gulf have created a reasonably positive environment for DND and the Forces. Maintaining it in light of major defence reductions which will be embodied in the new policy review will be a challenge. This directed procurement would create a strong negative public reaction based on:

- a) distorting the army program against a background of significant reductions in army structure in the new policy;
- b) increased costs of this project against a background of financial restraint;
- c) the impact on industrial overcapacity in the military vehicles sector; and
- d) the departure from the normal competitive process.

Action Required to Proceed with the Thyssen Proposal

39. In order to counter the negative publicity, we would have to develop a defensive communications plan.

SUMMARY

40. In general, based on our knowledge to date, if DND were to be instructed to proceed with this proposal, the Department and the army would face a daunting task to fit the Fox into the MRCV project. DND's budget does not allow the increased costs to be taken from existing reference levels. In short, our points are as follows:

- a) the timing is inappropriate as DND is in the midst of a policy review which will change the structure and the roles of our army;
- b) DND would only be able to afford 550 of the 735 vehicles required, and with the wrong mix among the infantry, combat, and recce variants;
- c) since Fox does not fit our operational requirements, we would have to reverse priorities for replacement of army vehicles resulting in further review and revision of army roles and structure, combat deficiencies, and unscheduled operations and maintenance costs;

ANNEX A

- d) once integrated logistics support, training, infrastructure, etc are considered, a contract price of \$290M translates into a project cost of \$725M, with an additional \$130M in operations and maintenance;
- e) once factored into the Defence Services Program, the amount of unavailable capital is \$655M in the 93/94 - 97/98 period, with an additional \$130M in O & M over the next decade;
- f) this money is not available in DND's existing reference levels without major dislocations of the Defence Services Program (ie, deferment, cancellation, or downsizing of such projects as TCCCS and/or Northern Terrain Vehicle; and
- g) exacerbation of existing overcapacity in the defence industrial base.

THE COMPANY

Thyssen Industrie AG, based in Germany, is one of the world's largest industrial manufacturing companies with sales exceeding \$25 billion, and 136,000 employees world wide.

In Canada, Thyssen's holdings include:

- Budd Canada Inc., Kitchener (automobile parts);
- Northern Elevator Holdings Ltd., Toronto (elevators);
- Greening Donald Co. Ltd., Hamilton (metal fabrication);
- Thyssen Marathon Canada Ltd., Mississauga (steel importers);
- and
- Thyssen Canada Ltd., Rexdale (steel materials trading).

In all, Thyssen employs some 2,500 Canadians.

Thyssen's defence operations are centred in a subsidiary, Thyssen Henschel, annual revenues \$688 million, located in Kassel, Germany. From this facility, Thyssen produces a wide range of world-class armoured and military vehicles for use by NATO forces.

THYSSEN'S ESTIMATES OF FORECAST REVENUES FOR BHI
(\$Millions 1990)

Expected Vehicle	Revenues				Total Market Revenue	Estimated Probability of Winning	Total Revenue
	93/94	94/95	95/96	96/97			
TPZ Fox.							
Canada	34.8	127.6	127.6	-	-	-	\$290 Directed \$290
TPZ Fox U.S. (NBC)	10	10	10	10	10	90%	\$ 45
U.S. National Guard	10	25	50	50	50	50%	\$118
ASV			8	16	30	30	\$114 40% \$ 46
U.S. Air Force EOD + Others			9	9	9	9	\$ 45 35% \$ 16
Armoured Gun System		67	133	200			\$400 40% \$160
Europe (Norway/Germany)		40	60	60	60	60	\$280 55% \$154
Environment: Canada and U.S. (flue gas scrubber revenues only)	24	32	55	44	45	.35	\$235 ¹
Total							\$1064

¹ Already discounted.

Thyssen's FGD wet-limestone treatment, which captures SO₂ emissions from coal-fired power stations, is leading-edge, and is currently in use in some 40 stations internationally. (More details on environmental markets are outlined in Annex C.)

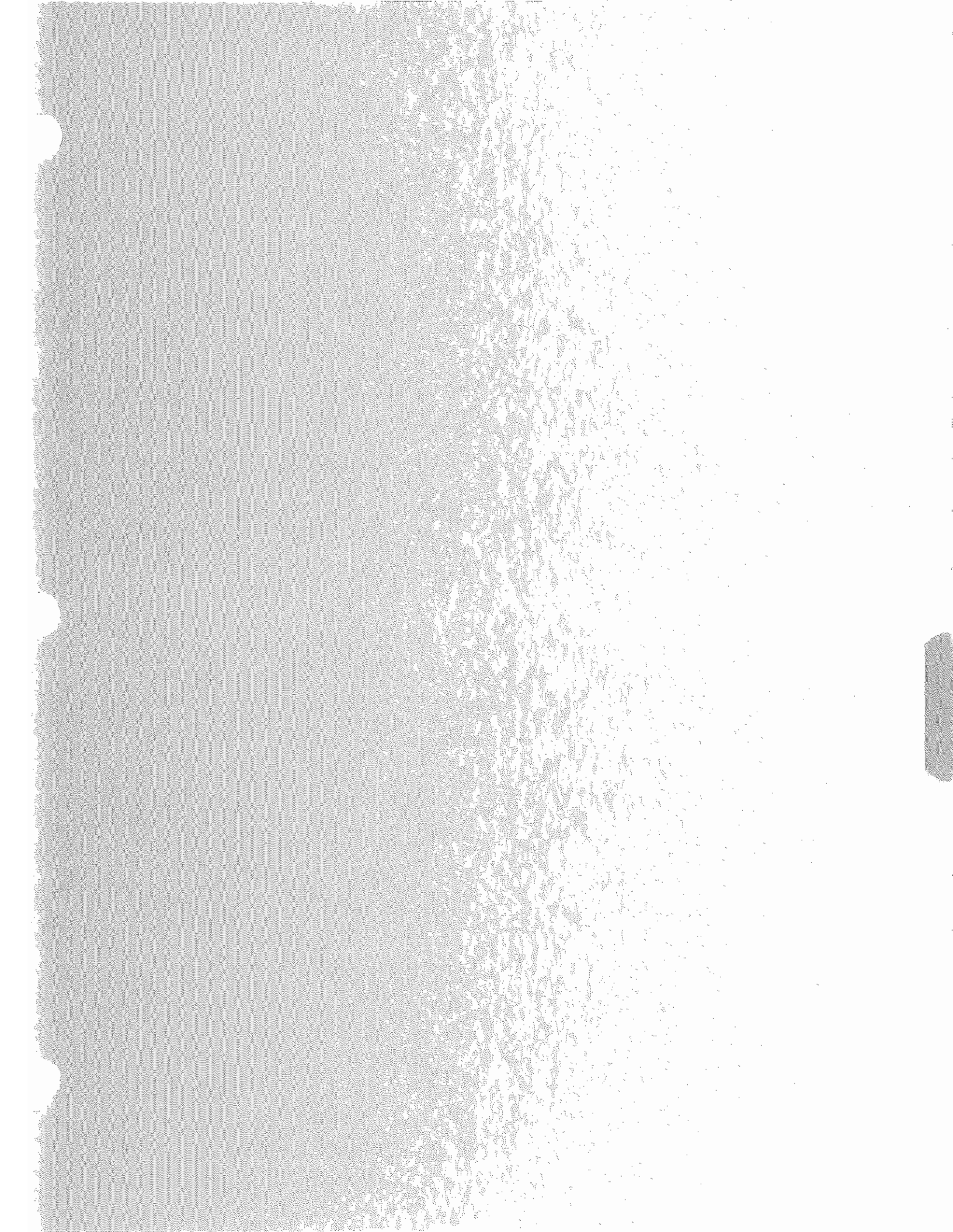
- In the future:

Based on market assessments, Thyssen will consider transferring "organic composting" technology for the treatment of municipal solid waste. Thyssen does not yet have firm market estimates in this area. The company is, however, pursuing contracts to address municipal waste treatment in Vancouver, Edmonton, Halifax, and Toronto. (Other products include airport loading bridges, material handling, specially mixers and machinery.)

ANNEX E
SECRET

EMPLOYMENT PROJECTIONS

	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Construction and Maintenance	50	200	100	50	50	30	30	30	30
Environmental	-	-	-	81	144	136	99	129	129
Defence	15	100	198	379	800	520	648	430	257
Total	65	300	298	510	994	686	777	589	416





Min. Wilson	6
Min. McDermid	2
I.W. Gorbel	2
M. Caron	2
D. Dodge	1
E.J. Bennett	1
E. Norrie	1
G.R.M. Anderson	1
General Director	1
ADMO	1
Director	1
C.R.	1
D.D./S.D.	1
Pending Officer	1

Security classification / Classification de sécurité

SECRET

Telephone / Téléphone
996-081

Our file / Notre référence
EDD-4095-03-6

Your file / Votre référence

Date
December 10, 1990

TO → The Minister

CONFIDENCE OF THE QUEEN'S
PRIVY COUNCIL

DOCUMENT CONFIDENTIEL DU
CONSEIL PRIVÉ DE LA REINE

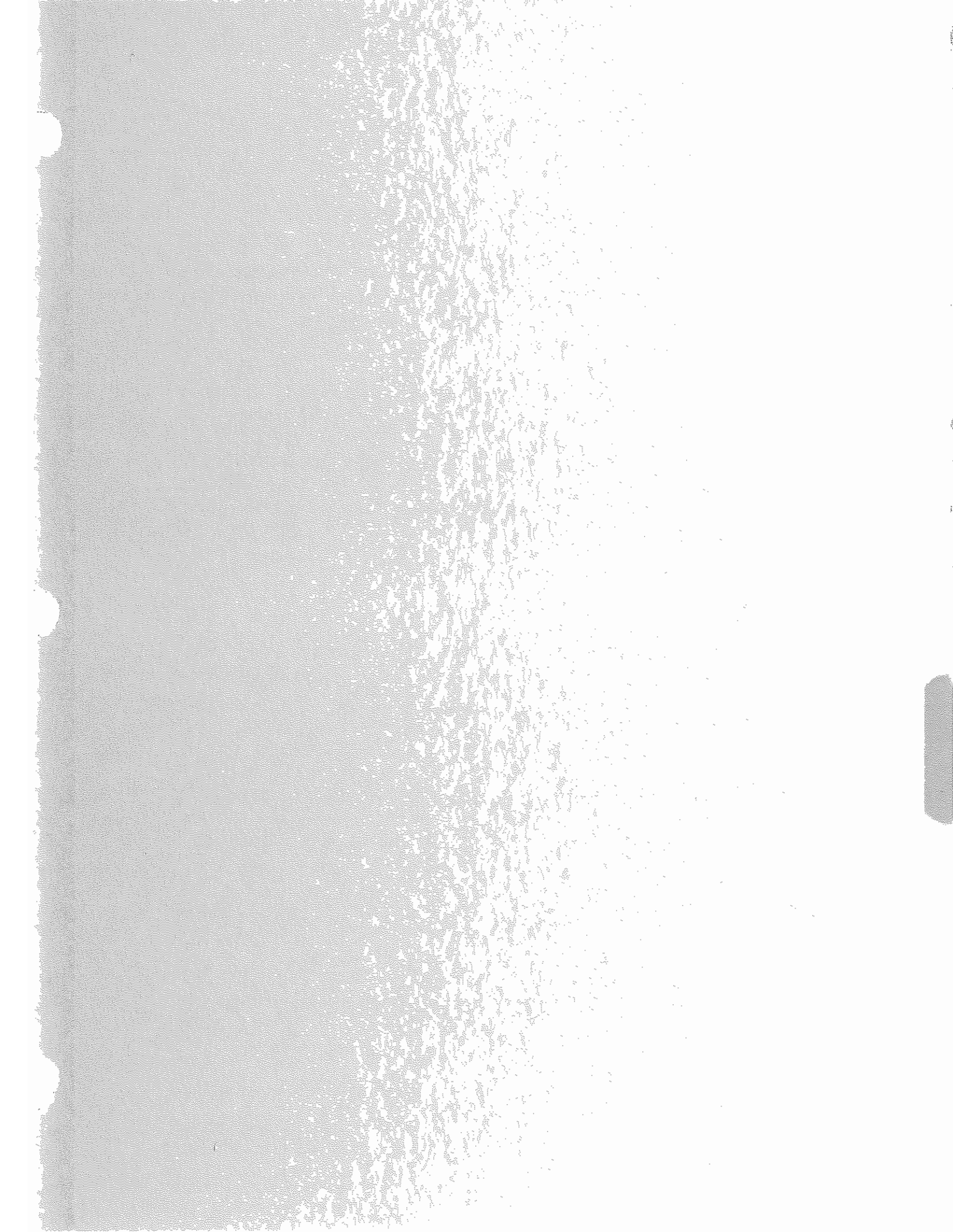
FROM DE Frederick Gorbel

SUBJECT
OBJET

THYSSEN/BEARHEAD: PROPOSED FACILITY IN NOVA SCOTIA

For Consideration By Operations Committee
Week of December 10, 1990

1. PCO indicates that the Thyssen proposal is not on the agenda for the Tuesday meeting of Operations Committee. Nonetheless, Mr. MacKay may wish to raise the issue for discussion on Tuesday or Thursday.
2. We are attaching a draft TBS memo and would endorse the position expressed by Board officials against the Thyssen proposal.
3. We have also indicated to ACOA that the Finance position presented in the Thyssen document should convey our concern that a directed contract would impose an additional layer of constraint on DND which is already examining its program under the assumption of no real growth in funding. We have also stated our objection to a directed contract as a condition for the establishment of the facility, which should be assessed on commercial merits, irrespective of directed procurement.
4. You will recall that you did not wish to bring this matter to Mr. Mazankowski's direct attention in your recent letter regarding possible items for Operations Committee during your absence.





MINISTER / MINISTRE
Ottawa, Ontario K1A 0A6

DEC 11 1990

SECRET

The Right Honourable Brian Mulroney
Prime Minister of Canada
Langevin Building
80 Wellington Street
Ottawa, Ontario
K1A 0A3

My Dear Prime Minister:

I am writing to seek your support for the proposal by Thyssen to establish an armoured-vehicle and, environmental-industries manufacturing facility in Nova Scotia.

As you know, after a period of some five years, the company is understandably anxious for the Government of Canada to reach agreement on their proposal, and I fully appreciate your interest in responding to the company prior to your visit to Germany scheduled for this January.

To revisit very briefly the status of the proposal, the company has indicated formally to the Government through ACOA, that it will establish a very significant (\$61 million) manufacturing facility in Nova Scotia, should DND purchase either 250 of its "Fox" vehicles for \$290 million (\$ 1990), or 207 of its next generation "TH 495" multi-role combat vehicles. (For your consideration, please find attached the first page of the Thyssen Aide Memoire which summarizes the company's proposal.)

As you may know, DND has assessed the proposal most thoroughly, and has concluded that the proposed purchase of the next-generation TH 495 vehicle could meet DND operational requirements (subject to price), but that if directed to purchase Fox vehicles, DND would have very significant problems -- particularly relating to funding -- to accommodate a mixed fleet, earlier than planned delivery, and so on.

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Canada

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While I, of course, respect the expert views of DND officials, I nevertheless share your concern that we not lose this excellent opportunity, through Thyssen, to attract to Canada world-class technology, and follow-on exports, and to reaffirm industrial ties to Germany, a country certain to fuel European, both east and west, economic growth into the next century.

Accordingly, after a series of last-minute negotiations with Thyssen, the company has agreed to address concerns raised by DND and others, by restructuring their proposal in a way in which I am hopeful can allow the initiative to be achieved. (I have attached a copy of their formal letter, outlining their commitments.)

Specifically, the company will offer DND 207 of its TH 495 vehicles, under the original funding envelop of \$290 million, with delivery to commence in 1994. By their own estimates, should it be accepted by the Government, this solution would immediately result in a savings to DND of some \$330 million in lower maintenance and other costs beyond the funding required to accept the Fox vehicle, and, at the same time, maximize the department's flexibility to plan its defence policy. In addition, Thyssen has worked, and will continue to work, most closely with the military on the development of this vehicle to ensure, unlike the existing Fox vehicle, that this next-generation fully meets Canada's operational needs. Finally, while the TH 495, as an vehicle under development, has not yet had time to be adopted by NATO forces as has the Fox, the TH 495 is being designed by Thyssen as the international peace-keeping vehicle, and can be marketed abroad accordingly, fully in keeping with Canada's export policy, and international reputation and principles.

Moreover, such a directed contract would, in my view, be fully in keeping with our Government's commitment, articulated in the Speech from the Throne two years ago, to ensuring, providing that operational requirements are met, that procurement promotes lasting regional economic development.

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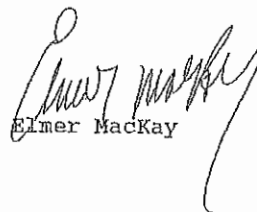
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Indeed, in this latter regard, and to support the activities of DND, I would be prepared, should the Thyssen proposal be accepted, and subject, of course, to the views of our colleague, the Honourable Michael Wilson, to allocate to DND the lion's share of ACOA's lapsing funds over the near and medium terms to allow DND to meet their obligations.

To summarize, I believe the decision facing the Government and DND is whether, on a directed contract basis, to purchase the Thyssen Fox vehicles; alternatively, whether to lose this excellent and unique opportunity; or lastly, whether DND -- with supplementary funding -- wishes to acquire a leading-edge peace-keeping vehicle, which DND will help design, produced by an excellent company, a vehicle which will support Canada's international and other obligations.

To conclude, Prime Minister, if you concur, it would be my intention on Thursday, December 13, to have the entire proposal, including the company's final offer, brought forward for discussion by Operations Ministers. Should we reach agreement, I would hope that a more formal decision could be reached by Cabinet later that morning, so that a formal communiqué could be issued from the Government to the company prior to year end.

Sincerely,



Elmer MacKay

Attachments

c.c. The Honourable W. McKnight

000290



E.M. for Desrosiers

English

French

Room 509
Confederation Building
House of Commons
Ottawa, Ontario
Canada K1A 0A6

Plèce 509
Édifice de la Confédération
Chambre des communes
Ottawa (Ontario)
Canada K1A 0A6

DEC 19 1990

SECRET

Mr. Norman Spector
Chief of Staff to the
Prime Minister
Room 231, Langevin Block
80 Wellington Street
Ottawa, Ontario
K1A 0A2

Dear Norman:

Last week, I received your personal assurances that the Thyssen issue would be considered imminently via an "alternative route", rather than being discussed at Operations as I and others had wished.

While the direction from your office has been uncertain, I am under the impression that our next steps in resolving the Thyssen issue include discussions between the Prime Minister and Michael Wilson on funding.

If DND purchases Thyssen's next-generation vehicle, under a directed contract of \$290 million, this would involve, by DND's own generous estimates, program funding of \$725 million (\$1990), not \$1 billion plus. Moreover, in light of the lasting and unique development for Nova Scotia to be gained, I am, as you know, fully prepared to use ACOA's lapsing funding to contribute to sourcing.

On timing, I would simply remind you that Thyssen - which has waited for five years, and was invited by our Government to locate in Canada - seeks a decision by year end. Moreover, I (as I'm sure you) would be most pleased if the Prime Minister was in a position to pronounce favourably on the Thyssen proposal during his visit to Germany next month.

I remain hopeful that you and others can shortly bring the Thyssen issue forward for discussion by Ministers, in order to meet the wishes of the company and our Government.

Yours sincerely,

MINISTER'S OFFICE
A. C. O. A.

DEC 21 1990

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BUREAU DU MINISTR.
A. P. E. C. A.

Canada

Elmer MacKay

Elmer MacKay

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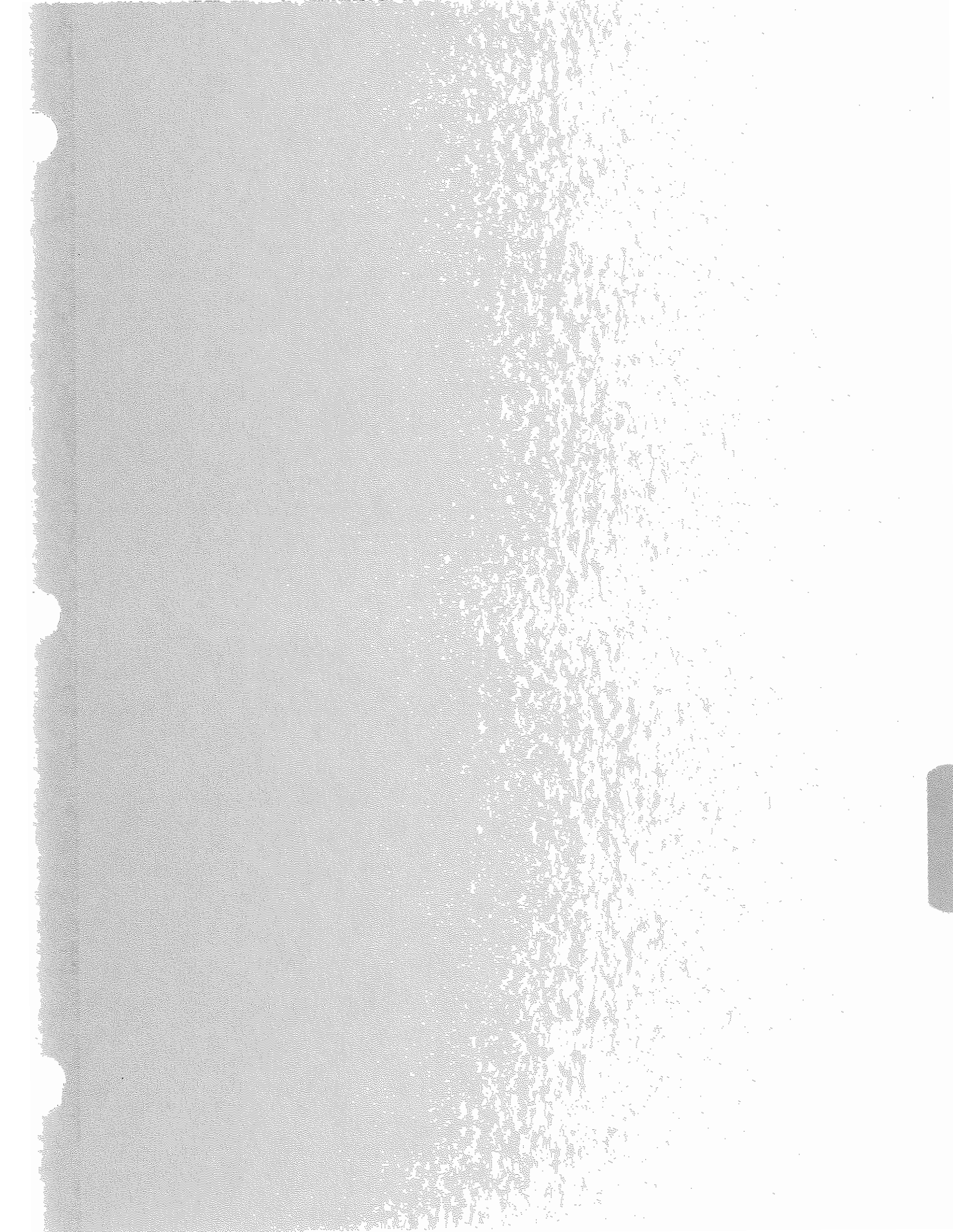
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Atlantic Canada
Opportunities
Agency

Agence de
promotion économique
du Canada atlantique

File
2635-T1
Secret

REQUEST FOR FACSIMILE TRANSMISSION
DEMANDE D'ENVOI PAR FAC-SIMILÉ

URGENT

ROUTINE
NORMAL

DATE RECEIVED - REÇU LE	LOG NO. - N° DE REGISTRE
DATE SENT - ENVOYÉ LE	SENDER'S FAX NO. - N° DU FAX DE L'EXPÉDITEUR

NO. OF PAGES FOR THIS TRANSMISSION
N° DE PAGES À TRANSMETTRE

1 page

3/1/91

TO - A

Peter Leamy 906-551-6295

THYSSEN

C.C. Wynne Polka

FROM - DE

Smith (McDowen)

REMARKS - COMMENTAIRES:

PLEASE: FOR YOUR INFORMATION

Minister's office indicate that no response ^{Mr.} from Specter has been received - I'll follow up with Mr Specter's staff tomorrow.

McDowen / Peter Smith

SIGNATURE

DATE



96-34-23



Atlantic Canada
Opportunities
Agency

Agence de
promotion économique
du Canada atlantique

Room 508
Confederation Building
House of Commons
Ottawa, Ontario
Canada K1A 6A8

Pièce 508
Bâtiment de la Confédération
Édifice des parlementaires
Ottawa (Ontario)
Canada K1A 6A8

DEC 19 1990

~~SECRET~~

Mr. Norman Spactor
Chief of Staff to the
Prime Minister
Room 231, Langevin Block
80 Wellington Street
Ottawa, Ontario
K1A 0A2

Dear Norman:

Last week, I received your personal assurances that the Thyssen issue would be considered imminently via an "alternative route", rather than being discussed at Operations as I and others had wished.

While the direction from your office has been uncertain, I am under the impression that our next steps in resolving the Thyssen issue include discussions between the Prime Minister and Michael Wilson on funding.

If DND purchases Thyssen's next-generation vehicle, under a directed contract of \$290 million, this would involve, by DND's own generous estimates, program funding of \$725 million (\$1990), not \$1 billion plus. Moreover, in light of the lasting and unique development for Nova Scotia to be gained, I am, as you know, fully prepared to use ACOA's lapsing funding to contribute to sourcing.

On timing, I would simply remind you that Thyssen - which has waited for five years, and was invited by our Government to locate in Canada - seeks a decision by year end. Moreover, I (as I'm sure you) would be most pleased if the Prime Minister was in a position to pronounce favourably on the Thyssen proposal during his visit to Germany next month.

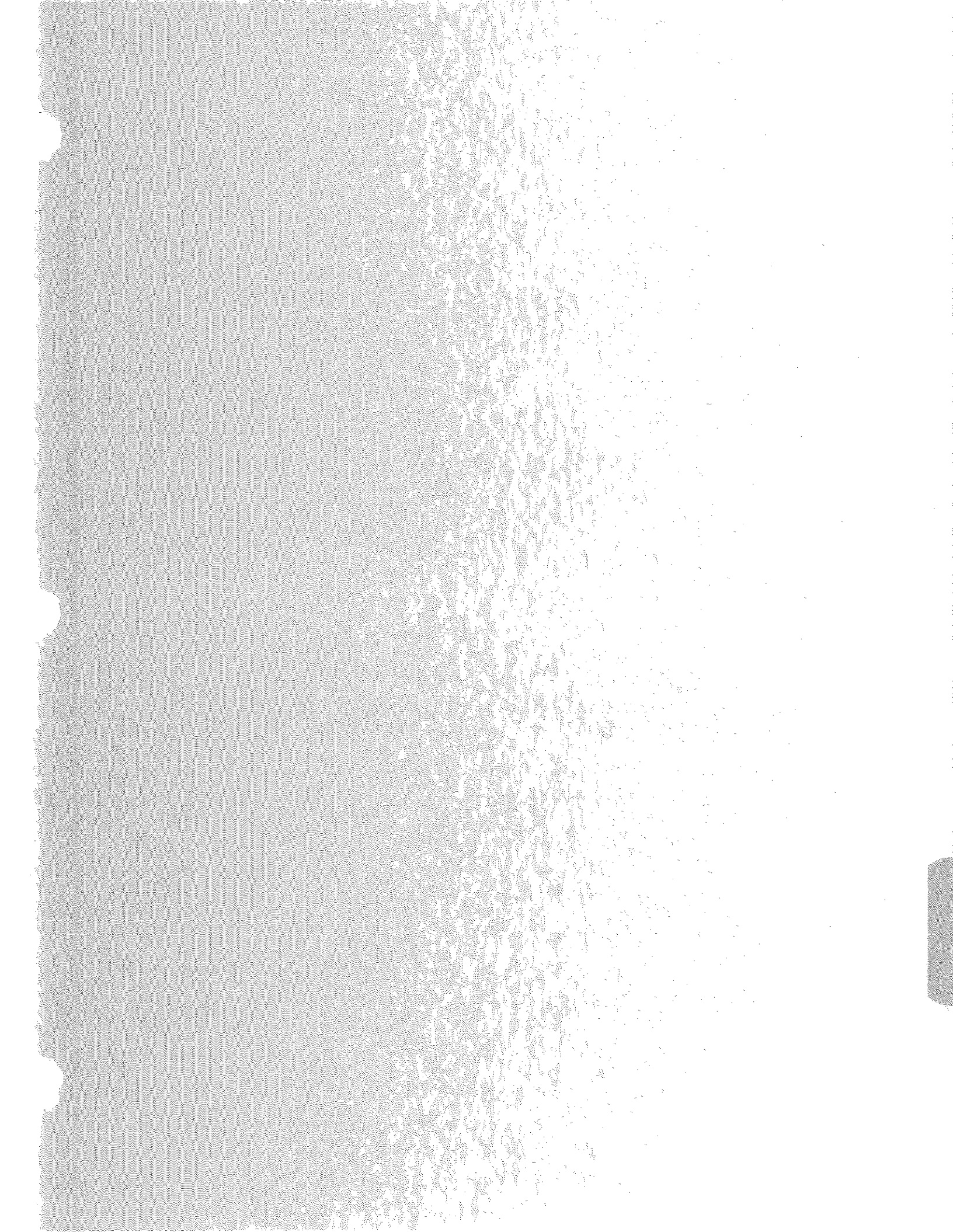
I remain hopeful that you and others can shortly bring the Thyssen issue forward for discussion by Ministers, in order to meet the wishes of the company and our Government.

Yours sincerely,

Einar Mackay

Canada





Atlantic Canada Opportunities Agency / Agence de promotion économique du Canada atlantique

cc JB MG A Mac G

Ottawa Office 4th Floor 60 Queen Street P.O. Box 1667 Postal Station "B" Ottawa, Ontario K1P 5R5

Bureau d'Ottawa 4e étage 60, rue Queen Casier postal 1667 Succursale "B" Ottawa (Ontario) K1P 5R5

January 9, 1991

Mr. William Rowat Assistant Secretary to the Cabinet (Economic Policy Committee) 85 Sparks Street Room 506, Blackburn Building Ottawa, Ontario K1A 0A3

Dear Mr. Rowat:

I am writing to express concern on the Thyssen/Bear Head Industries issue, regarding the January 9, 1991, version of the aide memoire, and in particular, DND's assessment of the costs associated with the company's next generation TH 495 vehicle.

While not wishing to challenge the expert advice being submitted to the Government by DND officials, I believe it important to draw attention to an apparent internal inconsistency in the DND analysis, which could result in a significant overestimate of the financial costs to the Government of effecting the directed contract sought by Thyssen.

As you may recall, it has consistently been the position of Thyssen that the new generation TH 495 vehicle -- under development -- would be designed and built in close collaboration with DND military experts, in order to ensure that DND's operational requirements are achieved.

The DND analysis (para 16) notes the advertised characteristics of the TH 495 vehicle could satisfy the potential operational requirements of the various groups of armoured vehicles proposed to be acquired by DND under the Multirole Combat Vehicle (MRCV) project.

However, when the TH 495 directed contract is costed by DND, the costing methodology assumes (paras 25-29, and 45c) that the vehicle (like the older Thyssen Fox vehicle) will only meet the infantry combat vehicle variant, thereby requiring DND to expend considerable additional funds (estimated by DND at \$115 million, and \$200 million respectively, for increased O&M and

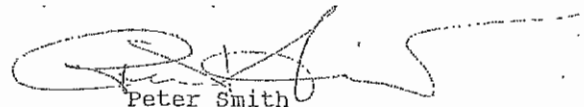
inefficiencies). Under this assumption, these potential costs would be incurred because the order of the vehicle purchases would have to be juggled by DND, and because the degree of fleet interoperabilities would suffer.

However, if the TH 495 vehicle potentially meets the operational requirements (known to date) of the entire range of vehicles to be purchased under MRCV project, then DND would not have to juggle its purchases, and the worries over fleet inoperability subside -- thereby reducing overall project costs, by DND's own estimates, by some \$300 million.

Accordingly, should our interpretation of this inconsistency prove correct, the TH 495 directed contract would indeed present a preferred option to the Government (over the Thyssen Fox directed contract), because it would in principle meet the needs of the military at a cost estimated by DND at approximately \$770 million, rather than the \$1,055 million estimated costs of acquiring the Thyssen Fox vehicle.

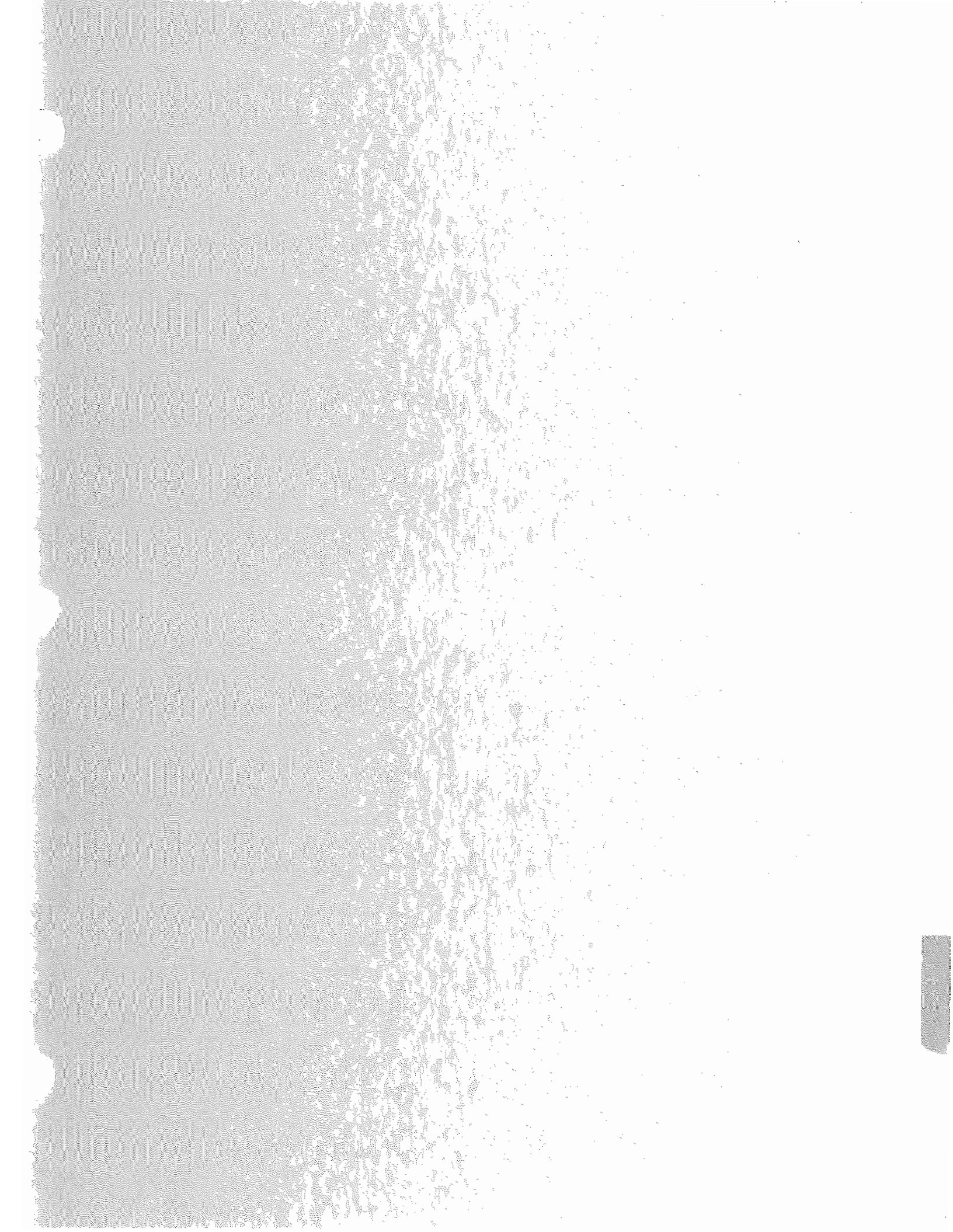
I trust that this letter will accompany the package of materials to be submitted by your staff to the Prime Minister's Office.

Yours sincerely,



Peter Smith
Vice-President

c.c. Rob Gillespie



CLERK OF THE PRIVY COUNCIL AND
SECRETARY TO THE CABINET



GREFFIER DU CONSEIL PRIVÉ ET
SECRETÉAIRE DU CABINET

SECRET

Jan 11 6 1991

MEMORANDUM FOR MR. NORMAN SPECTOR

Thyssen/Bear Head Industries

You will find attached, for information, a revised copy of the joint ACOA/DND Aide Memoire on the Thyssen proposal. It now reflects DND's preliminary analysis of the costs of Thyssen supplying DND with the TH 495 vehicle rather than the TPZ Fox.

Background

On December 10, 1990, we submitted to you an Aide Memoire on Thyssen, prepared jointly by ACOA and DND as requested at your November meeting with Ministers MacKay and McKnight.

On December 11, 1990, Thyssen submitted to ACOA a more specific proposal to allow DND at some later date to substitute a lower number, possibly 207, of the TH 495 vehicle (still on the drawing board) for the original proposal for 250 of the TPZ Fox vehicles at the same contract price of \$290 million. Although ACOA revised some of its portion of the Aide Memoire immediately (reflected in a December 12, 1990 version), DND has just provided its input and this is now incorporated in the attached document dated January 10, 1991.

Comment

The DND amendments in summary argue that the substitution of the TH 495 for the Fox makes no difference to the total cost of the acquisition (\$1.1 billion versus \$290 million budgeted). Although ACOA is of the view that this is overstated (see the attached correspondence), the bottom line is that the Thyssen proposal costs at least \$500 million (in ball park terms) more than was budgeted.

The bottom line from our perspective continues to be that this project is undesirable since it would involve DND acquiring a product that does not meet its requirements; in quantities larger than it requires; at a price higher than it can afford; in a time frame in advance of its needs, and for which a source of funds has not been identified. In addition, the longterm viability of the Thyssen plant in Nova Scotia appears questionable. Although the DND analysis of its needs appears based on facts, the ACOA analysis appears to have accepted the Thyssen proposal at face value, and in many areas, uses optimistic assumptions.

orig signed by

Paul M. Tellier

Attachments

MacGillivray/Rowat/eyd

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AIDE MEMOIRE
BEAR HEAD INDUSTRIES (THYSSEN)

ISSUE:

Whether to support the proposal by Bear Head Industries Limited (a wholly owned subsidiary of Thyssen Industrie AG) to establish a heavy manufacturing facility in Nova Scotia, based on a Canadian Government directed contract for 250 military vehicles for the Department of National Defence (DND).

BACKGROUND:

Thyssen Industrie AG, based in Germany, is one of the world's largest industrial manufacturing companies. In Canada, Thyssen Industrie AG employs approximately 2,500 at holdings that include:

- Budd Canada Inc., Kitchener Ont. (automotive parts);
- Northern Elevator Holdings Ltd., Toronto Ont. (elevators);
- Greening Donald Co. Ltd., Hamilton Ont. (metal fabrication);
- Thyssen Marathon Canada Ltd., Mississauga Ont. (steel importers).

Thyssen Industrie AG first declared interest in establishing a facility in Cape Breton in the mid-1980's.

In 1988, an Understanding in Principle (UIP) was signed between Bear Head Industries Ltd. and the Government of Canada, as represented by the Ministers responsible for the Atlantic Canada Opportunities Agency (ACOA), DND and the Department of Regional Industrial Expansion (DRIE). This UIP established that the company would be considered for participation in upcoming military vehicle procurements, and be considered for assistance under a number of funding mechanisms including federal-provincial infrastructure assistance, the Cape Breton Investment Tax Credit (CBITC) and, at a later stage, the Defence Industry Productivity Program. The financial details were to be worked out in reference to a business plan for military vehicle and commercial projects, to be provided later.

To date, Bear Head Industries has not put forward an acceptable business plan. This has made it impossible to assess its CBITC application which asks for consideration of a \$98 million investment.

At this time, the Bear Head Industries application is the only outstanding application under the CBITC program. As all expenditures must be made prior to December 31, 1992, it would seem unlikely that Bear Head will be in a position to benefit from the program.

In late 1990, a formal proposal based on a directed procurement to Bear Head Industries of light armoured vehicles was put forward under ACOA sponsorship. Discussions at the working level did not lead to the presentation of the proposal to Ministers.

The proposed procurement would be part of the Multirole Combat Vehicle Program (MRCV), which has been identified by DND, but is unfunded, and has no statement of operational requirement or affordability at this time. Project implementation is expected in 1996.

The Bear Head Industries proposal suggests the following benefits would flow from the project:

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- Creation of 600 direct jobs in a particularly depressed region;
- Development of a world class manufacturing base, supported by the diversified global infrastructure and financial base of one of the world's largest heavy manufacturers;
- Transfer of production technology in defence and environmental products, and production mandates;
- Provision of a high quality product to DND which meets its needs at a reasonable cost.

However, Bear Head Industries has not demonstrated the long term viability of the project, or developed an appropriate business plan. Plans for commercial product lines have not been adequately explored. This is particularly disturbing in light of declining global defence markets.

Canada currently has three major existing military vehicle producers competing for limited DND business, which is insufficient to sustain them (i.e. General Motors Diesel Division in London, Ontario, UTDC (Lavalin) in Kingston, Ontario and Bombardier Inc. in Valcourt, Quebec). In addition there are a number of specialty vehicle manufacturers, operating in niche markets. This situation, coupled with declining overall demand has led Industry Science and Technology Canada (ISTC) to an investment strategy for the sector which does not support greenfield investment. In view of the above, the federal government should not be supporting financially the establishment of another military producer in Canada.

Internationally, Bear Head Industries would be in direct competition with General Motors Diesel Division (DDGM), which produces Light Armoured Vehicles in London Ontario, for Canada, the U.S. and other countries. DDGM employs up to 700, and has received approximately \$40 million in federal assistance, largely in the form of repayable contributions.

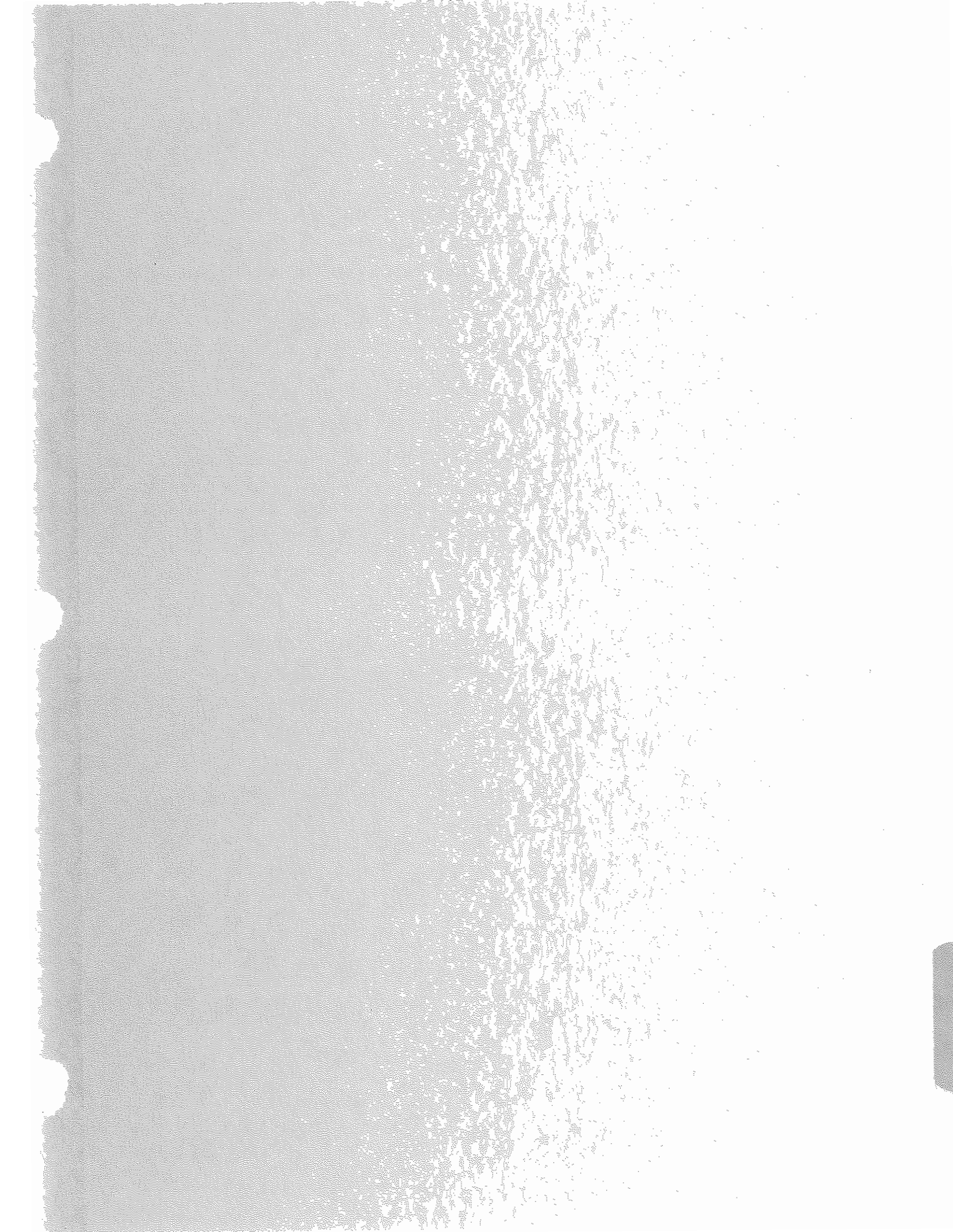
The appropriateness of a directed contract for 250 military vehicles has been reviewed by DND and the Thyssen proposal has been found to be unacceptable. Neither the vehicle proposed by Thyssen nor the timing of a proposed purchase meet DND's need at this time; it is not acceptable operationally; is unaffordable, and would impact adversely and severely on the ongoing defence policy review, and on other higher priority projects.

RECOMMENDED POSITION:

In view of the above considerations, it is recommended that the Bear Head Industries Ltd. proposal to establish a facility in response to a directed procurement not be supported. The company should be advised that the Cape Breton Investment Tax Credit file will be closed and that DND does not intend to proceed with the Multirole Combat Vehicle Program until 1996.

INTERDEPARTMENTAL CONSULTATIONS:

This document has been prepared in consultation with the Departments of Industry Science and Technology, National Defence and Finance. All three organizations fully support the recommended course of action.



SECRET

THYSSEN/BEAR HEAD INDUSTRIES PROPOSALS

CHRONOLOGY AND CURRENT STATUS

CHRONOLOGY

- 1987-first half 1988 - Thyssen holds discussions with Government of N.S., secures commitments of support, incorporates Bear Head Industries (BHI), and opens discussions with Federal departments and Ministers;
- 27 Sep 88 - Understanding in Principle (UIP) signed between company and Ministers of ACOA, DND, ISTC;
- 1989-1990 - numerous initiatives by company to secure directed contract. Briefing notes, meetings, etc;
- Oct 90 - formal proposal by Thyssen to ACOA to provide 250 Fox vehicles for \$290M; original briefing material by DGSPDI successively updated by DDIR;
- 1 Nov 90 - MND, Minister Mackay, and senior officials meet with Mr. Spector to discuss proposal. Tasking to prepare detailed paper for PMO;
- 7 Dec 90 - DND input provided to Mr. Lesaux of ACOA;
- 8-10 Dec 90 - ACOA produces joint paper and passes to PCO/PMO;
- 11 Dec 90 - ACOA receives letter from Thyssen clarifying details of TH 495 offer;
- 12 Dec 90 - ACOA (Smith) letter to DND ADM(Mat) conveying minimum details of Thyssen letter (actual letter not provided to DND);
- 14 Dec 90 - DDIR re-write of DND analysis paper taking into account TH 495 offer, together with line by line proposed amendments to ACOA part of paper, and supplementals, speaking notes, crib notes (costing) etc for MND use at possible Ops Committee, passed to DGSPDI;
- 20 Dec 90 - letter from Premier of NS to Prime Minister speaking of Canada-NS Cooperation Agreement on Industrial Development Opportunities and specifically asking for FM support for Thyssen project. DGSPDI intervention with FPRO and PCO to ensure non-committal response;

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- 9 Jan 91 - items from 14 Dec 90 bullet above (line by line amendments to ACOA paper and new DND analysis) passed by DGERDI to PCO (Billings), thence to ACOA; not clear if briefing material sent to MNE; ACOA calls DDIR to request diskettes (provided by DDIR); ACOA produces new discussion paper and passes to FMO/PCO (copy provided to DDIR on 15 Jan only after verbally requested. DDIR passes copies to CDDO, FM MRCV. Copy enclosed);
- 9 Jan 91 - letter from Peter Smith to Bill Rowat (PCO) saying there was an inconsistency in DND analysis re TH 495;
- 17 Jan 91 - rebuttal letter to PCO, copy Peter Smith, to ADM(Mat) for approval and signature.

CURRENT STATUS

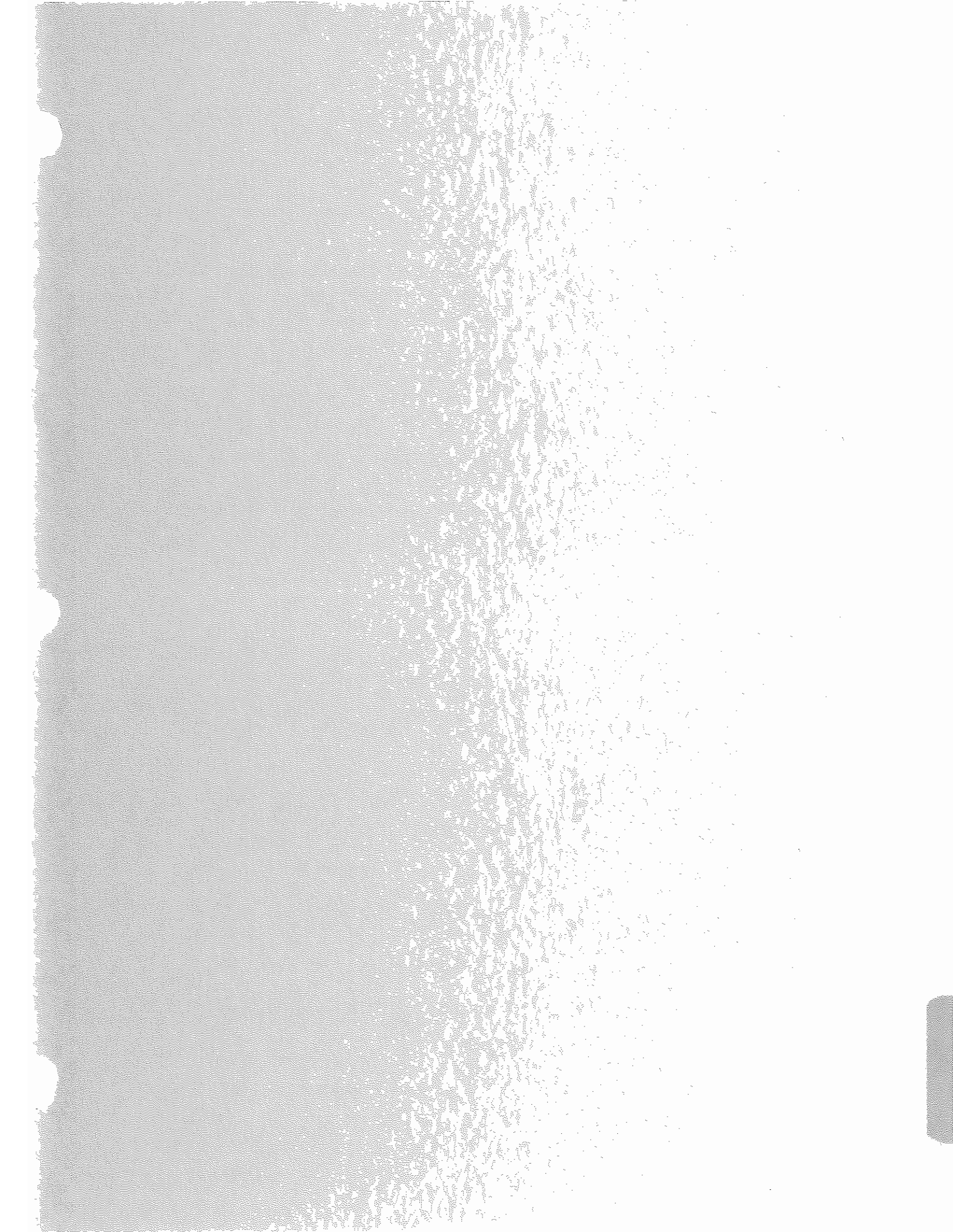
PCO (Billings and Gentles) best advice:

- 12 Dec 90 (approx) - discussion FM, Mackay (ACOA), Spector. FM expressed shock at cost of Thyssen proposal and asked Mackay to confirm numbers. Mackay accepted numbers were probably real. Spector advises Mackay not to push issue at present time. Mackay feels FMO has let him down i.e. purpose of 1 Nov meet was to force issue and this not done;
- no plans for matter to be discussed at Ops. Whether proposal dead, or to be handled outside of Ops not clear. She has asked the questions and may or may not get an answer. Only Spector knows;
- FM was to go to London in January and Mackay to FRG. Informal plan for FM to cross to FRG for possible meet with Thyssen. FM's trip cancelled.

CDDO (unconfirmed rumour)

- Gen Vance (ret'd) recommended to Thyssen that they back off, preserve remaining good will, and return to compete when time is right;
- FM has spoken by phone to Schreiber (Thyssen) within last 10 days.

SECRET



SECRET

National Defence	Défense nationale
Assistant Deputy Minister (Materiel)	Sous-ministre adjoint (Matériels)
National Defence Headquarters Ottawa, Canada K1A 0K2	Quartier général de la Défense nationale Ottawa, Canada K1A 0K2

28 January 1991

Mr. William Rowat
 Assistant Secretary to the Cabinet
 (Economic Policy Committee)
 85 Sparks Street
 Room 506, Blackburn Building
 Ottawa, Ontario
 K1A 0A3

ACOA / APECA	OTTAWA
RECEIVED / REÇU FEB 14 1991	
CORRESP # 000550	OK
DOC # 2635-72	

Dear Mr. Rowat:

I apologize for the delay in providing you comments on Mr. Peter Smith's letter of January 9, 1991 relating to the Thyssen/Bear Head Industries issue, in which he draws your attention to what he perceives to be an inconsistency in DND's evaluation of the Thyssen proposal relating to the developmental TH 495 vehicle. I also apologize for having to burden you with a resolution of technical matters in this fashion, but in the circumstances it appears to be the only way to deal with this issue.

The initial Thyssen proposal was based on the Fox, an Infantry Combat Vehicle (ICV), and our analysis focused on the Fox vehicle. Mention of the TH 495 in that proposal was cursory, i.e. DND had an option, once a directed contract for Fox was signed, to purchase an unspecified number of vehicles for an unspecified price.

On December 12, 1990, we were advised by letter from Mr. Smith of Thyssen's latest proposal of a fixed price for a set number of unspecified types of TH 495 vehicles. The precise wording used in ACOA's amended page one, attached to Mr. Smith's letter, was as follows "...within 12 months of signing the contract for the TPZ Fox vehicles, the company is prepared to allow DND to switch its order for the Fox and purchase instead 207 of Thyssen's next-generation TH 495 vehicles for the same total price of \$290 million". In our view, the implication throughout is that we are speaking of the ICV variant. That assumption is particularly valid since, when speaking of variants of a family of combat vehicles, the ICV is well-recognized as the fundamental or basic variant, with all other variants seen to be more complex, more expensive, and certainly requiring a longer design phase.

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Canada

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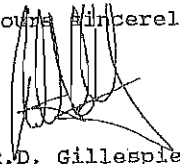
For purposes of our subsequent analysis, therefore, we assumed the Thyssen 495 fixed-price proposal to relate to the ICV. We accepted that since the TH 495 was a conceptual vehicle further variants i.e. Reconnaissance (RCV) and Armoured (ACV) could be designed subsequent to the ICV. Finally, we assumed that both the RCV and ACV variants, as is the case with all other families of combat vehicles, would be more expensive than the ICV variant cost of \$1.4 million/unit. It was never our assumption, as stated in Mr. Smith's letter to you, that the TH 495 would only meet the ICV variant.

In the absence of concrete information which would alter the logical assumption that the Thyssen 495 proposal relates to the ICV variant, the increased O & M costs of \$115 million are still valid as we would be procuring and operating an ICV some eight years before it is required.

With respect to the \$200 million incremental costs resulting from inefficiencies, this is entirely dependant on whether or not Thyssen would be successful in winning the contract for the remaining MRCV variants (i.e. that part of the project remaining after any initial directed contract to Thyssen). Should Thyssen win, we would not have a mixed fleet and the \$200 million in incremental costs would disappear. In the best of circumstances, it is possible that Thyssen would enjoy an advantage leading to the subsequent acquisition of the other two variants, thereby leading to a relatively homogeneous fleet. At the same time, it should be noted that DND would need some \$3.3 Billion to purchase our required number of vehicles from Thyssen as opposed to the \$2.1 Billion we have budgeted in the time frame 1995-96 to 2004-05. However, in the more likely case, there will have to be an open competition which would involve all factors including "affordability". Given the high cost we would pay for our initial vehicle through a directed contract to Thyssen (for whatever variant), the small amount of funds remaining to us for purchase of the final two variants, the consequent need to trade-off quality for quantity (low-cost), and the high cost of the Thyssen vehicle as compared to other contenders, it is doubtful in the extreme that Thyssen could be cost-competitive in any such competition. A mixed fleet would be the reality, and the increment of \$200 million for inefficiencies would stand.

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Yours sincerely,



R.D. Gillespie

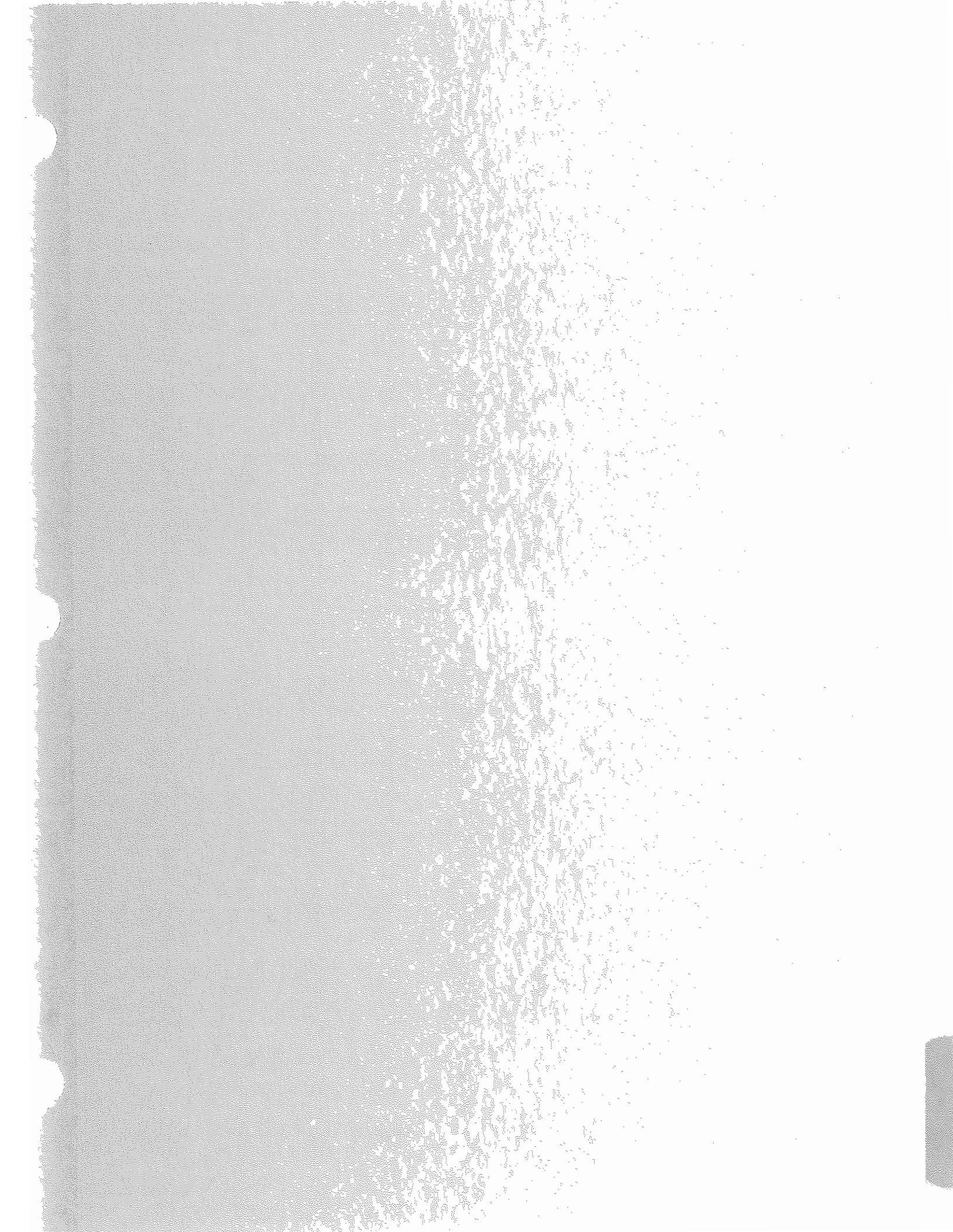
c.c. Mr. Peter Smith, ADOA

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CLERK OF THE PRIVY COUNCIL AND
SECRETARY TO THE CABINET



GREFFIER DU CONSEIL PRIVÉ ET
SECRÉTAIRE DU CABINET

SECRET

MAR 26 1991

MEMORANDUM FOR MR. NORMAN SPECTOR

Thyssen Bear Head Industries - Possible Call from
Karlheinz Schreiber

We understand that Karlheinz Schreiber of Thyssen/Bear Head Industries will be in Ottawa next week and may try to contact you. The purpose of this memorandum is to provide you with a status report on the proposed Thyssen project in Nova Scotia and apprise you of a possible linkage between this issue and that of the import and export of automatic weapons.

Status of Thyssen

As you may recall, Thyssen proposes to build a plant in Nova Scotia to produce between 207 and 250 new multi-role combat vehicles (MRCV's) for DND if it receives a directed sole source contract. Both Mr. MacKay and ACOA strongly support the proposal. DND has been strongly opposed for a number of reasons, including the cost. While Thyssen's contract price would be \$290 million, DND estimates the total cost at \$1.1 billion for which no source of funds has been identified. They also are concerned that the vehicles may not meet their requirements. Following a November meeting between Ministers MacKay and McKnight, ACOA and DND jointly authored an aide-mémoire on the subject which we forwarded to you in January (copy attached). There have been no developments since then. } 39(2)(a)(d)

Linkage to Weapons Controls

Currently there are restrictions in the Criminal Code and the Export and Import Permits Act preventing Canadian companies from exporting automatic weapons. As you are aware, contracts for two companies, Diemaco in Kitchener, and the Diesel Division of General Motors (DDGM) in London, are contingent on amendments to the legislation being obtained.

The import/export restrictions also affect the Thyssen proposal. The vehicles Thyssen would produce carry automatic weapons. Thyssen is assuming that they can secure export contracts for these MRCV's as well as for other weapons. The project's long term viability may rest on these exports which would be prevented by the existing legislative restrictions.

As a related issue, if the Thyssen project were to proceed, it would be a direct competitor of DDGM. DDGM is already making veiled threats that if the import/export amendments are not passed, it may undertake future contracts completely in the U.S. Awarding a sole source contract to Thyssen for the MRCV (when added to the export restrictions) could act as a catalyst causing DDGM to shift a significant portion of their operation, if not all, to the U.S.

Comment

As our previous note indicates, we have strong reservations about the Thyssen project because of the cost, the absence of a source of funds, the potential incompatibility with DND's operational requirements and the overall financial viability of the project. The continuance of export restrictions increases concerns about the project's viability.

Original Signed by
Originale signée par
PAUL M. TELLIER

Paul M. Tellier

Attachments

MacGillivray/Rowat/lde

DRAFT

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AIDE MEMOIRE
BEAR HEAD INDUSTRIES (THYSSEN)

ISSUE:

Whether to support the proposal by Bear Head Industries Limited (a wholly owned subsidiary of Thyssen Industrie AG) to establish a heavy manufacturing facility in Nova Scotia, based on a Canadian Government directed contract for 250 military vehicles for the Department of National Defence (DND).

BACKGROUND:

Thyssen Industrie AG, based in Germany, is one of the world's largest industrial manufacturing companies. In Canada, Thyssen Industrie AG employs approximately 2,500 at holdings that include:

- Budd Canada Inc., Kitchener Ont. (automotive parts);
- Northern Elevator Holdings Ltd., Toronto Ont. (elevators);
- Greening Donald Co. Ltd., Hamilton Ont. (metal fabrication);
- Thyssen Marathon Canada Ltd., Mississauga Ont. (steel importers).

Thyssen Industrie AG first declared interest in establishing a facility in Cape Breton in the mid-1980's.

In 1988, an Understanding in Principle (UIP) was signed between Bear Head Industries Ltd. and the Government of Canada, as represented by the Ministers responsible for the Atlantic Canada Opportunities Agency (ACOA), DND and the Department of Regional Industrial Expansion (DRIE). This UIP established that the company would be considered for participation in upcoming military vehicle procurements, and be considered for assistance under a number of funding mechanisms including federal-provincial infrastructure assistance, the Cape Breton Investment Tax Credit (CBITC) and, at a later stage, the Defence Industry Productivity Program. The financial details were to be worked out in reference to a business plan for military vehicle and commercial projects, to be provided later.

To date, Bear Head Industries has not put forward an acceptable business plan. This has made it impossible to assess its CBITC application which asks for consideration of a \$98 million investment.

At this time, the Bear Head Industries application is the only outstanding application under the CBITC program. As all expenditures must be made prior to December 31, 1992, it would seem unlikely that Bear Head will be in a position to benefit from the program.

In late 1990, a formal proposal based on a directed procurement to Bear Head Industries of light armoured vehicles was put forward under ACOA sponsorship. Discussions at the working level did not lead to the presentation of the proposal to Ministers.

The proposed procurement would be part of the Multirole Combat Vehicle Program (MRCV), which has been identified by DND, but is unfunded, and has no statement of operational requirement or affordability at this time. Project implementation is expected in 1996.

The Bear Head Industries proposal suggests the following benefits would flow from the project:

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- Creation of 600 direct jobs in a particularly depressed region;
- Development of a world class manufacturing base, supported by the diversified global infrastructure and financial base of one of the world's largest heavy manufacturers;
- Transfer of production technology in defence and environmental products, and production mandates;
- Provision of a high quality product to DND which meets its needs at a reasonable cost.

However, Bear Head Industries has not demonstrated the long term viability of the project, or developed an appropriate business plan. Plans for commercial product lines have not been adequately explored. This is particularly disturbing in light of declining global defence markets.

Canada currently has three major existing military vehicle producers competing for limited DND business, which is insufficient to sustain them (i.e. General Motors Diesel Division in London, Ontario, UTDC (Lavalin) in Kingston, Ontario and Bombardier Inc. in Valcourt, Quebec). In addition there are a number of specialty vehicle manufacturers, operating in niche markets. This situation, coupled with declining overall demand has led Industry Science and Technology Canada (ISTC) to an investment strategy for the sector which does not support greenfield investment. In view of the above, the federal government should not be supporting financially the establishment of another military producer in Canada.

Internationally, Bear Head Industries would be in direct competition with General Motors Diesel Division (DDGM), which produces Light Armoured Vehicles in London Ontario, for Canada, the U.S. and other countries. DDGM employs up to 700, and has received approximately \$40 million in federal assistance, largely in the form of repayable contributions.

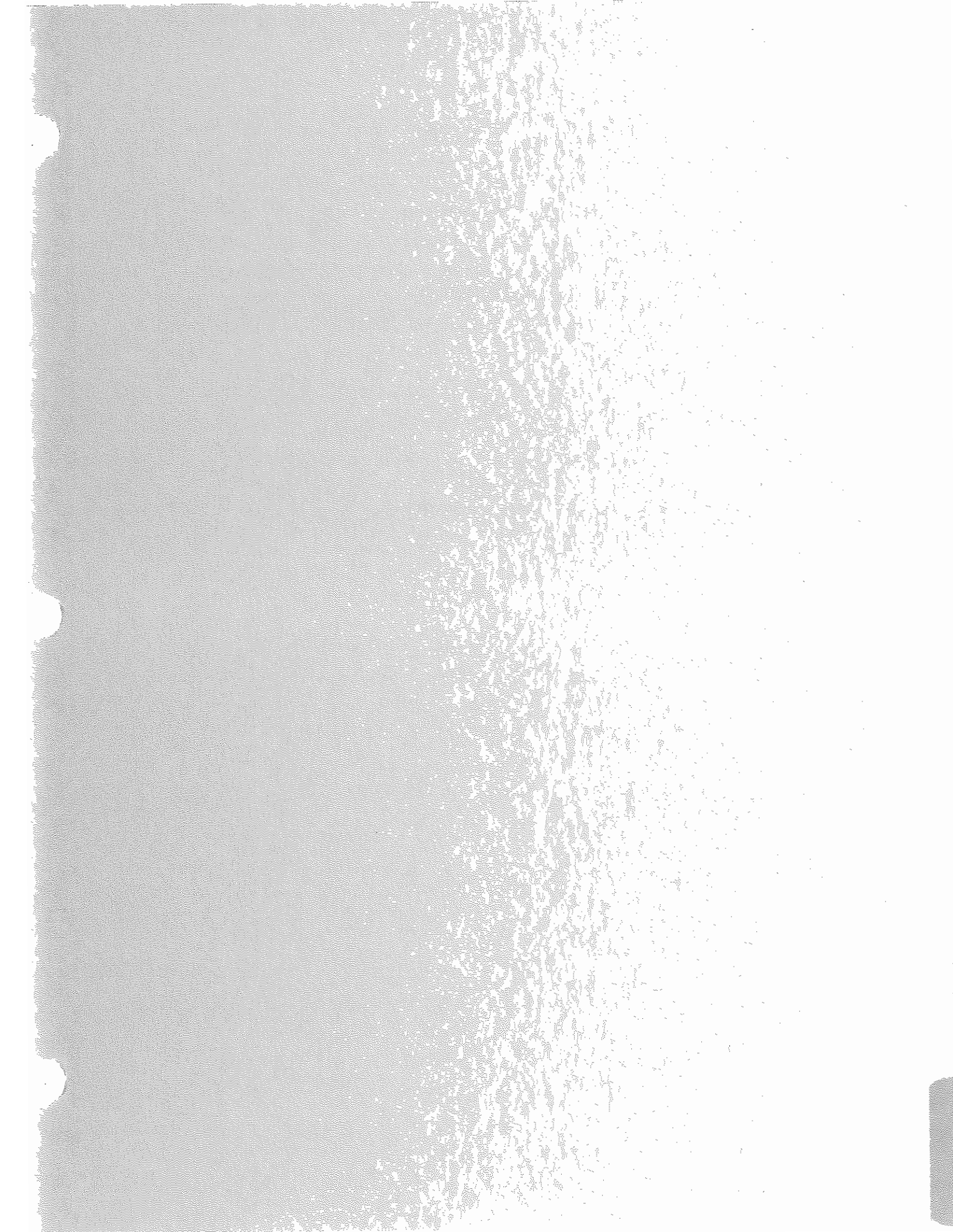
The appropriateness of a directed contract for 250 military vehicles has been reviewed by DND and the Thyssen proposal has been found to be unacceptable. Neither the vehicle proposed by Thyssen nor the timing of a proposed purchase meet DND's need at this time; it is not acceptable operationally, is unaffordable, and would impact adversely and severely on the ongoing defence policy review, and on other higher priority projects.

RECOMMENDED POSITION:

In view of the above considerations, it is recommended that the Bear Head Industries Ltd. proposal to establish a facility in response to a directed procurement not be supported. The company should be advised that the Cape Breton Investment Tax Credit file will be closed and that DND does not intend to proceed with the Multirole Combat Vehicle Program until 1996.

INTERDEPARTMENTAL CONSULTATIONS:

This document has been prepared in consultation with the Departments of Industry Science and Technology, National Defence and Finance. All three organizations fully support the recommended course of action.



Mr./M. Tellier
Mr./M. Sbortliffe
Mr./M. Wright
Mr./M. Bilodeau
Mr./M. Rowat
Ms./Mme Billings

SECRET

April 17, 1991

MEMORANDUM FOR MR. PAUL M. TELLIER

Analysis of the New Thyssen Proposal

On April 12, Mr. J.A. Doucet sent you a new proposal on behalf of Thyssen/Bearhead Industries. The purpose of this note is to give you an assessment of this new proposal.

Background

Thyssen is asking for a firm contract from DND for 250 light armoured vehicles and \$8 million in assistance from ACOA (plus \$4.2 million provincial) to establish a \$61 million manufacturing facility in Nova Scotia (believed to be in Pictou County).

The previous Thyssen proposal was for a \$290 million contract, either 207 of the new TH 495's or 250 of the less expensive existing Fox model. The latter are not well suited to DND's operational needs and the TH 495 exists in prototype form only, a source of concern to DND. Thyssen is now requesting a \$350 million contract for 250 of the TH 495 (Annex I compares the new proposal to the previous one.)

Using DND calculations the new proposal would cost \$875 million, inclusive of operations and maintenance (O&M), using the DND O&M factor of 2.5 (\$350 million times 2.5 -- we have documentation on this factor which DND views as "conservative"). Thyssen calculations include only \$101 million for O&M over 10 years, an implicit factor of about 1.3, for total project costs of \$451 million.

DND also estimates further costs of \$330 million, representing unforecasted O&M and inefficiencies due to a lack of fleet rationalization, raising their estimated total costs of acquiring 250 TH 495's to \$1205 million relative to a budgeted amount of \$290 million, which funding is not sourced. Some of

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*NO
we took it
out (it
was very
technical
- Bob*

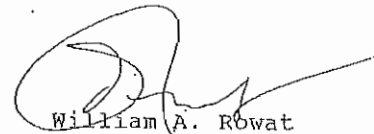
these extra costs come from Thyssen proposing to deliver the vehicles several years earlier than DND needs them. Thyssen has now indicated that it is prepared to be more flexible on the delivery date but has provided no specifics. With a firm DND contract, it would apparently go ahead with construction of the plant so as to fulfil a small U.S. contract it hopes to secure.

Comment

Nothing in the revised proposal alleviates any of our fundamental concerns about this project. It involves DND acquiring a product that has not been demonstrated to meet its requirements; in quantities larger than it requires; at a price higher than it can afford; in a time frame in advance of its needs, and for which a source of funds has not been identified.

One must also consider the regional balance question. Reductions in defence procurement are expected to be announced shortly, affecting Quebec, Ontario and the West. It would be difficult to explain moving forward on this project for Nova Scotia at the same time that plants in these other regions will have to close.

The U.S. is also reducing defence procurement, so the pressure to source its remaining procurements domestically will be heightened. We understand from our Washington Embassy that in this new environment Thyssen has a very low probability of winning many of the contracts it needs to make the Nova Scotia plant financially viable.



William A. Rowat

MacGillivray/lc

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To date, Bear Head Industries has not put forward an acceptable business plan. This has made it impossible to assess its CBITC application which asks for consideration of a \$98 million investment.

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- 2 -

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The appropriateness of a directed contract for 250 military vehicles has been reviewed by DND and the Thyssen proposal has been found to be unacceptable. Neither the vehicle proposed by Thyssen nor the timing of a proposed purchase meet DND's need at this time; it is not acceptable operationally, is unaffordable, and would impact adversely and severely on the ongoing defence policy review, and on other higher priority projects.

RECOMMENDED POSITION:

In view of the above considerations, it is recommended that the Bear Head Industries Ltd. proposal to establish a facility in response to a directed procurement not be supported. The company should be advised that the Cape Breton Investment Tax Credit file will be closed and that DND does not intend to proceed with the Multirole Combat Vehicle Program until 1996.

INTERDEPARTMENTAL CONSULTATIONS:

This document has been prepared in consultation with the Departments of Industry Science and Technology, National Defence and Finance. All three organizations fully support the recommended course of action.

Summary of Thyssen Proposal

New
Thyssen
Proposal
(April 12)

Previous
Thyssen
Proposal

DND
Budget

Number of vehicles	206	250	207	250
Model	---	Fox	TH495	TH495
Unit Cost	\$565,000	\$1.16 M	\$1.4 M	\$1.4 M
Capital Cost	\$116.4 M	\$290 M	\$290 M	\$350 M
Capital + OM*				
Factor	2.5	2.5	2.5	(Thyssen estimate) 1.289
Costs	\$290 M	\$725 M	\$725 M	(Thyssen estimate) \$451 M (DND estimate) \$875 M
DND estimate of contingencies, early delivery, and inefficiencies	n.a.	\$330 M	\$330 M	\$330 M
TOTAL	\$290 M	\$1055 M	\$1055 M	(Thyssen estimate) \$781 M (DND estimate) \$1205 M
Delivery Date Start	97-98	93-94	93-94	Flexible(?)

* Operation and maintenance e.g. training, inventory & replacement parts, etc.



Karlheinz Schreiber

Suite 908, 350 Sparks Street, Ottawa, Ontario
Telephone: (613) 563-3321 Fax: (613) 563-3321

PERSONAL AND CONFIDENTIAL
HIS EYES ONLY!

April 19, 1991

The Right Honourable
Brian Mulroney
Prime Minister of Canada
Langevin Block
80 Wellington Street
Ottawa, Ontario
K1A 0A2

Dear Prime Minister:

As a follow-up to our meeting of last week, I have noted a few items which I feel are important for you to be aware of.

Since you made it very clear in your statements what your principles are, and how much you care about your people and especially about the safety of your Armed Forces who serve them, I am more determined than even before to support you through pursuit of the Thyssen-BHI project.

Unfortunately, to fulfil this commitment to you, I think I have to help you to identify information which may have misled you on the Thyssen project. So far during my experience on this project, I have been frightened to think this may also occur on other initiatives.

Attached, you will find an "Aide Memoire", and comments in response to questions from the Minister of ACOA.

If you will allow me, I would suggest that you keep this all for your personal interest as I intend to table these attachments during my up-coming meetings with your officials.

I think there is no need for me to comment on the continuing meeting we had with Mr. Tellier after your departure, as I know, Fred will do this. Rather, let me lead your attention to items which you were interested in.

Karlheinz Schreiber

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In your presence, Mr. Tellier told you that DND could buy the appropriate MRCV for Canadian Forces for a price of \$500,000. This is just nonsense.

Stanley Hartt showed me a report from Paul Tellier, dated August 10, 1990, in which it was stated, "Mr. McKnight is strongly opposed to this project on financial, policy and operational grounds". This cannot be true, for Bill McKnight told me several times, in the presence of Elmer MacKay, that he would love to go for the project but that he unfortunately had insufficient funding in his department.

In the same document, General Motors Diesel Division in London, Ontario is described as successfully competing in the field of armoured vehicles and has obtained an important contract in Saudi Arabia. This is not true.

From information contained in a separate document prepared by ACOA in December 1990, I was asked by Minister MacKay to respond to comments from External Affairs, stating their concern that by directing a major military purchase to a non-US (i.e. German) source, Canada will initiate US trade interests and threaten access to the US defence market.

This comment is misleading, for the entire Thyssen-BHI project was described to the Under Secretary of the US Army and received his endorsement. This meeting took place in the presence of the Minister Counsellor of the Canadian Embassy.

If there are any doubts on your side, on the statements given to you by the Company, and the merits of the proposal, the Company is prepared to submit to an appraisal of these issues by an internationally recognized authority.


Lastly, about the comments of Mr. Fowler who told us from the beginning that we "are not going to get this project" and the equally unbelievable remarks of Lt. Gen Huddleston, I will only remind you of our discussion.

As an independent individual, and your true friend, I can only tell you, that in my opinion, the Thyssen project, realized in Canada, will be the best economic and political tool, I can possibly imagine.

I would appreciate if you could find the time that I could explain all this in greater detail.

Wishing you all the best and with

Warm regards,


Karlheinz Schreiber

AIDE MEMOIRE

1. Q: Is it in fact a stated policy of the Government to use DND Capital program spending to promote regional economic development?

A: Yes, as stated in the White Paper on Defence in June, 1987, and publicly declared Cabinet policy.

2. Q: Is it the intent of the Government to promote exports of products made in Canada, and within this goal promote the development and manufacture of products in Canada which can be successful in export markets?

A: Yes. All parties would agree that increased exports are vital to Canada's overall economic recovery, and future survival as a player in the global market.

3. Q: Is it agreed that the Canada-United States Free Trade Agreement (FTA) and Defence Production Sharing Agreement (DPSA) must be utilized as vital tools of entry to the US market by Canadian products?

A: Yes, otherwise the Mulroney Government's negotiation and implementation of the FTA is ignored.

4. Q: Should the branches of the Federal Government not support initiatives which specifically target the export market covered under the Canada-US Free Trade Agreement?

A: Yes, and the Thyssen BHI project is an example of such an initiative.

5. Q: Regarding the Army's MRCV project, relative to DND's overall program, one can observe that the Air Force is equipped with modern fighter jets, notably the CF 18, while the Navy has begun to receive their new frigates which will be followed by the NSA helicopters and the new minesweeper vessels. However, it appears the Army is left with obsolescent combat vehicles.

With this in mind, are there any significant changes to army equipment from the status described in testimony to the Senate Defence Committee, May 26, 1987 by then Commander of Mobile Command Gen. Jim Fox?

A: No, with respect to combat vehicles for the regular troops, no change has occurred.

6. Q: Did Army soldiers face the threat of injury from 7.62 AP (armour piercing)

ammunition while in their armoured personnel carriers during the "stand-off" with Native Canadians at Oka in 1990?

A: Yes, in fact the Leopard 1 main battle tank was deployed on the final approach to the barricades.

7. Q: Could Canadian soldiers also face threats as common as 7.62 AP ammunition penetrating their current armoured personnel carriers during assignments to UN peacekeeping missions, including the Gulf region?

A: Yes.

8. Q: Are the Canadian Forces presently able to deploy troops into a contaminated zone using vehicles with an integral NBC (Nuclear, Biological, Chemical) protective system?

A: No.

9. Q: Has the Canadian Army placed the Multi Role Combat Vehicle (MRCV) as their top priority in equipment requirements?

A: Yes.

10. Q: Is NATO (Nato Industrial Advisory Group - NIAG) working on a standard requirement for NATO nations along the lines of the MRCV requirements?

A: Yes.

11. Q: In light of the experience of the Gulf crisis, is this MRCV applicable to the future needs of our allies?

A: Yes.

12. Q: Are the parties involved aware that for example the German forces have no vehicle such as the MRCV suitable to their future participation in the planned NATO "rapid reaction forces", and will be seeking a new design?

A: Yes.

13. Q: Given Canada's international reputation as pioneers and leaders in the in the concept of UN peacekeeping, would a Canadian made vehicle not enjoy an ideal trade mark in the maple leaf?

A: Yes.

14. Q: Are the parties involved agreed that departure from the prospect of export potential as a necessary feature of the vehicle which is procured as Canada's MRCV may have serious negative consequences in the cost of operation and maintenance, due to the absence of inter-operability of such a vehicle among Canada's allies.

A: Yes.

15. Q: What are the essential characteristics in a peacekeeping and Multi Role Combat vehicle (MRCV)?

A:

- 1) air transportable in the Hercules C 130
- 2) armour protection against a minimum of 7.62 AP ammunition
- 3) protection from biological and chemical weapons
- 4) high mobility across a wide range of terrain
- 5) family concept in design, to include capability for reconnaissance, infantry transport, armoured combat and other variants
- 6) capacity for increased armour protection through in-field application of "modular add on armour", to meet threat in mid intensity conflict (eg. Gulf crisis)
- 7) suitable for deployment in internal security role (eg. Oka, 1990)

The Thyssen proposed vehicle (TH 495) is being developed to meet these requirements.

16. Q: Is it agreed that these characteristics also meet the requirements of other armies?

A: Yes, very likely.

17. Q: If this is the case, will this not bring the Thyssen TH 495 vehicle significant export opportunity in these markets?

A: Yes.

18. Q: Is there an "off the shelf" vehicle existing from a western industrial country and selling at a price of \$500,000.00, which meets the Canadian MRCV requirement?

A: No, there is no such vehicle available for that price. Furthermore, to the Company's knowledge, no competitor is able to produce the vehicle needed to meet the Canadian MRCV requirement at the same quality and at a lesser price than has been offered.

19. Q: Is there another successful international manufacturer with an existing or developmental vehicle (which meets MRCV characteristics) who is willing to transfer their technology and the major share of future export production to Canada?

A: Unlikely.

20. Q: Moreover is there such a manufacturer who, in addition to Canadian production of this vehicle, will introduce a diversification of operations in the environmental protection sector and the variety of industrial activity similar to the Thyssen range of technology?

A: No.

If all will agree with these points made above, they will also agree that whichever manufacturer can enter the market first will secure a distinct advantage in this business.

The answers provided here are based upon internal knowledge and advice available to the Company, including our Canadian defence advisor Lt.Gen. Jack Vance (ret'd), who completed his service in the Canadian Forces in 1988 as VCDS.

To explain to those, to whom the MRCV concept is not a daily point of discussion, it is useful to observe the fundamental determinants of vehicle design which will define the elements of the end product:

Cargo door dimensions of the Hercules C 130 aircraft determine limits on a vehicles width and height

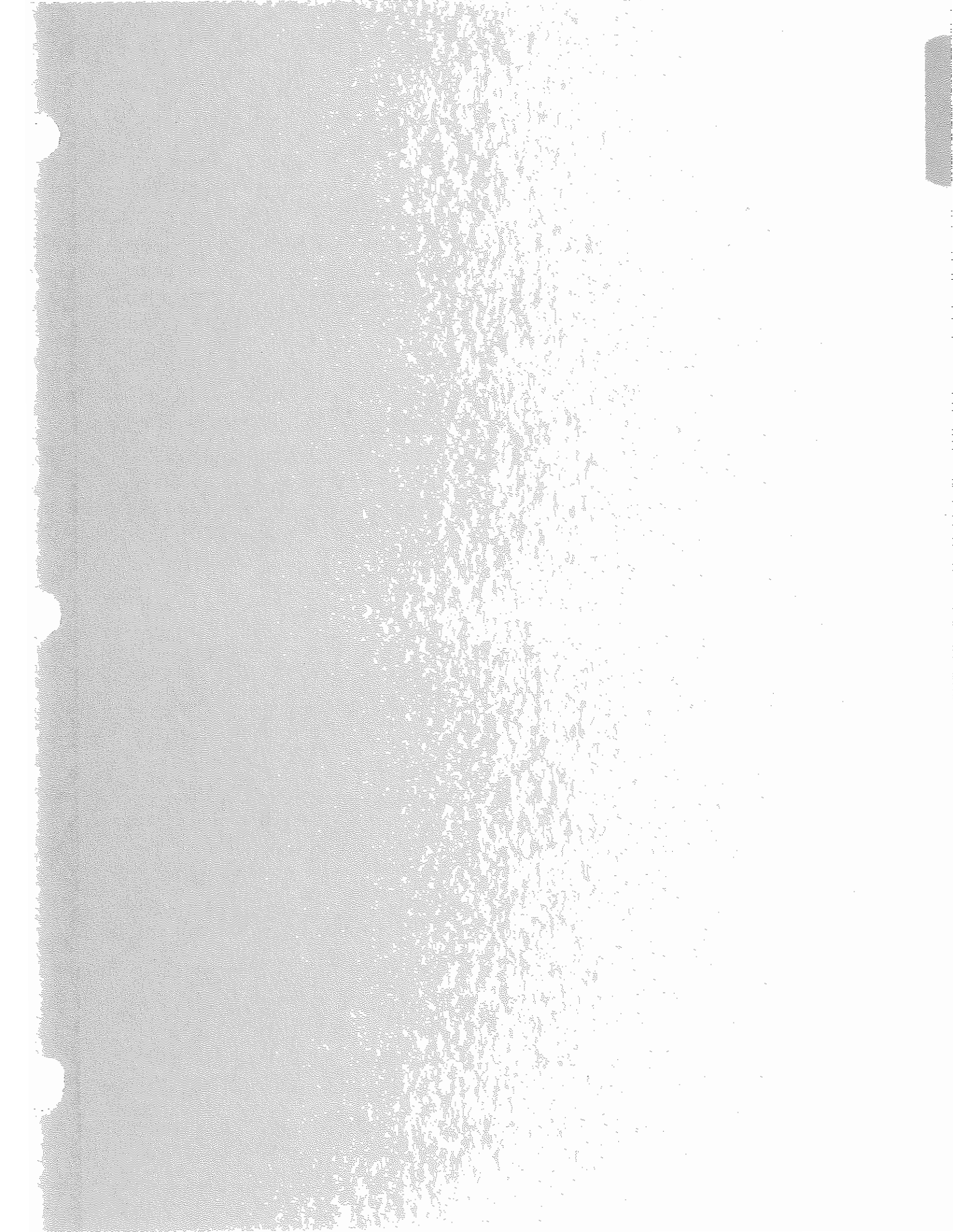
Lift capability of the aircraft determine limits on vehicle's transportation weight

Protection requirements dictate the amount of "add-on armour" and thus the operational weight of the vehicle.

Mobility requirements and the specified terrain determines the selection of power pack and wheels or tracks

After consideration of these key elements, the remaining specifications deal with equipment and systems needed to fulfil assigned rolls.

Since major assemblies and component prices are known and available within NATO, and since it is proposed to supply the vehicle on the basis of open audit - agreed profit basis, it should be agreed that there is nothing undisclosed in final costs on the vehicle.





BEAR HEAD INDUSTRIES LIMITED

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May 7, 1991

Paul Tellier
Clerk of the Privy Council and
Secretary to the Cabinet
Government of Canada
332 Langevin Block
80 Wellington St.
Ottawa, ON
K1A 0A3

Dear Mr. Tellier:

This letter follows from my meeting of April 10th with the Prime Minister, yourself and Fred Doucet.

At the conclusion of that meeting, it was understood that you would bring your personal leadership to the file and chair a meeting between Government and company officials as early as possible within one week's time.

It is now nearing a month since that meeting and I have received no word from you. Our consultant has informed me that, despite his attempts to reach you on three separate occasions, with messages left, no word has come from your office. At 1:45 Monday, May 6, I had my secretary call yours with a view to speaking with you. The secretary indicated that you would be calling back within 15 minutes. It is now a day later and no call has been received, therefore, the reason for this letter.

I recall vividly a statement made by our Prime Minister, during our April 10 meeting about how much he cares about the safety of our soldiers and his determination to ensure that at all times they be provided with appropriate equipment to perform their duties, whether this be domestic, peacekeeping or otherwise. The thrust of our company's initiative in Canada over the last six years has focused on this fundamental need as expressed by the military.

You will recall, along with the others in attendance, how perplexed I was during our



BEAR HEAD INDUSTRIES LIMITED

meeting of April 10th, why such a relatively simple proposition, motivated by an expressed real need, should create such compounded confusion. I had hoped that our meeting had resolved past confusion and set us finally on an action path. Since it now appears that inertia has set in again, I have no choice but to review for you once again the elements of this simple and straight-forward proposition.

The foundation of the proposition, first needs emphasizing:

- a) The proposition is to develop a manufacturing facility in a deprived area of Canada which would produce a technologically advanced multi-purpose military vehicle;
- b) The proposition further includes the production of a diversified array of environmental products and other product with international market mandates;
- c) The proposition also is to transfer technology to a technology starved area of the country.

It was these elements that prompted, Thyssen to react positively to an invitation by the Government of Canada six years ago. From the outset, Thyssen decided that it would proceed in its response only if the following elements would be put in place:

- a) a defined need expressed by Canada's military;
- b) a limited infrastructural assistance program to permit the installation of the manufacturing base; and
- c) a committed order for a relatively small percentage of the total complement of such vehicles on the basis that our offer would be equal to or better, all things considered, than that of any possible competitor.

During its six years the company desired, as it does today, to play by the rules, however shifting these became. Accordingly, we sought and painfully obtained an Understanding of Principle with the Government, which we considered to be a remarkable



BEAR HEAD INDUSTRIES LIMITED

accomplishment. It contained the background elements identified in this letter. We considered it a major accomplishment in that it contained the signatures of the three Ministers of the Crown most directly involved with the initiative.

It is significant to note that this Understanding in Principle resulted from many meetings with Government officials, Cabinet Ministers, industry partners, etc., and reflected a genuine will on the part of the Government to go forward, based in no small measure on two stated Government policies:

- a) The present Government's determination to use defence procurement as an instrument of regional industrial expansion; and
- b) To welcome foreign investment, providing such investment brought with it new technology, created new and full-time jobs and above all contained the prospect of new export markets.

Throughout this long period I have failed to understand what made this simple issue so complicated, particularly when one takes into account the principal parties involved in this frustrating initiative. These were:

The Prime Minister, who made it clear in his speeches that his Government had declared in its Cabinet Policy to use the industrial benefits associated with defence procurement to strengthen regional economies and overcome regional economic disparities. Furthermore, the Prime Minister made his personal position on the subject clear on April 10 during our meeting.

DRIE, through its Minister in 1985, first invited Thyssen to Canada and explained that the Government's highest priority would be to establish industrial jobs in the Cape Breton region to replace those lost in the closing of the heavy water plants. DRIE offered extensive assistance in the form of investment incentives including grants, tax credits, export assistance, promotion of sales to DND, etc.

External Affairs supported the initiatives of DRIE through the Canadian Ambassador to Bonn, meeting with the Chairman of Thyssen AG. to encourage the Thyssen's choice of Canada for our North American base of heavy industrial operations, as a



BEAR HEAD INDUSTRIES LIMITE

expansion to the 2,000 Thyssen employees already established in Canada. External Affairs further supported the Thyssen initiatives by assigning the Minister Counselor from the Washington embassy to accompany Thyssen executives when the Bear Head Industries concept was first presented to U.S. Pentagon officials. The Minister Counselor very forcefully represented the case of such a Canadian Thyssen facility being eligible for sales to the U.S. Department of Defence under the Canada-U.S. Defence Sharing Agreement, a position welcomed by the Undersecretary of the U.S. Army.

ACOA, since its establishment, has brought their strongest support as an advocate for the establishment of Bear Head Industries in Nova Scotia.

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BEAR HEAD INDUSTRIES LIMITE

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Whether we deal with another confrontation like Oka, or Canada's peacekeeping missions, Canada's soldiers have inadequate protection in their current light armoured vehicles to defend against either armour piercing ammunition, or biological and chemical weapons. You will agree that these represent real threats.

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BEAR HEAD INDUSTRIES LIMITE

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Indeed Thyssen now has a contract in place with the Government of the U.S. for the manufacturing of similar vehicles, which assembly line is transferable to Canada in full compliance with the Canada-U.S. Free Trade Agreement. At a time when the reverse seems to be occurring, it seems to me that this feature is worthy of considerable attention.

Sensitive to the need to be creative on the question of funding so as not to miss out on this early export opportunity, Thyssen is prepared to lease its vehicles or to provide bridge financing for the project until the Defence Services Program is able to kick in. It is understood, of course, that with this offer would come a directed order for 250 MRCVs to meet the early portion of DND's needs. We acknowledge that this directed order would have to meet all DND's specifications and requirements and would match or better the cost of any other comparable vehicle. In any event, it is our firm intent that costs be established on the basis of "open books" and an agreed profit margin.

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I have to request that you ensure that the Prime Minister and the relevant Ministers receive correct information regarding this project. I am requesting this because I have discovered statements which at the very least were incorrect and at worst may have been maliciously false. A case in point is a statement which you made to the Prime Minister to the effect that a vehicle which meets the requirement of the MRCV Program was available off the shelf for \$500,000.00. This statement is preposterous, and I trust you have corrected the record.

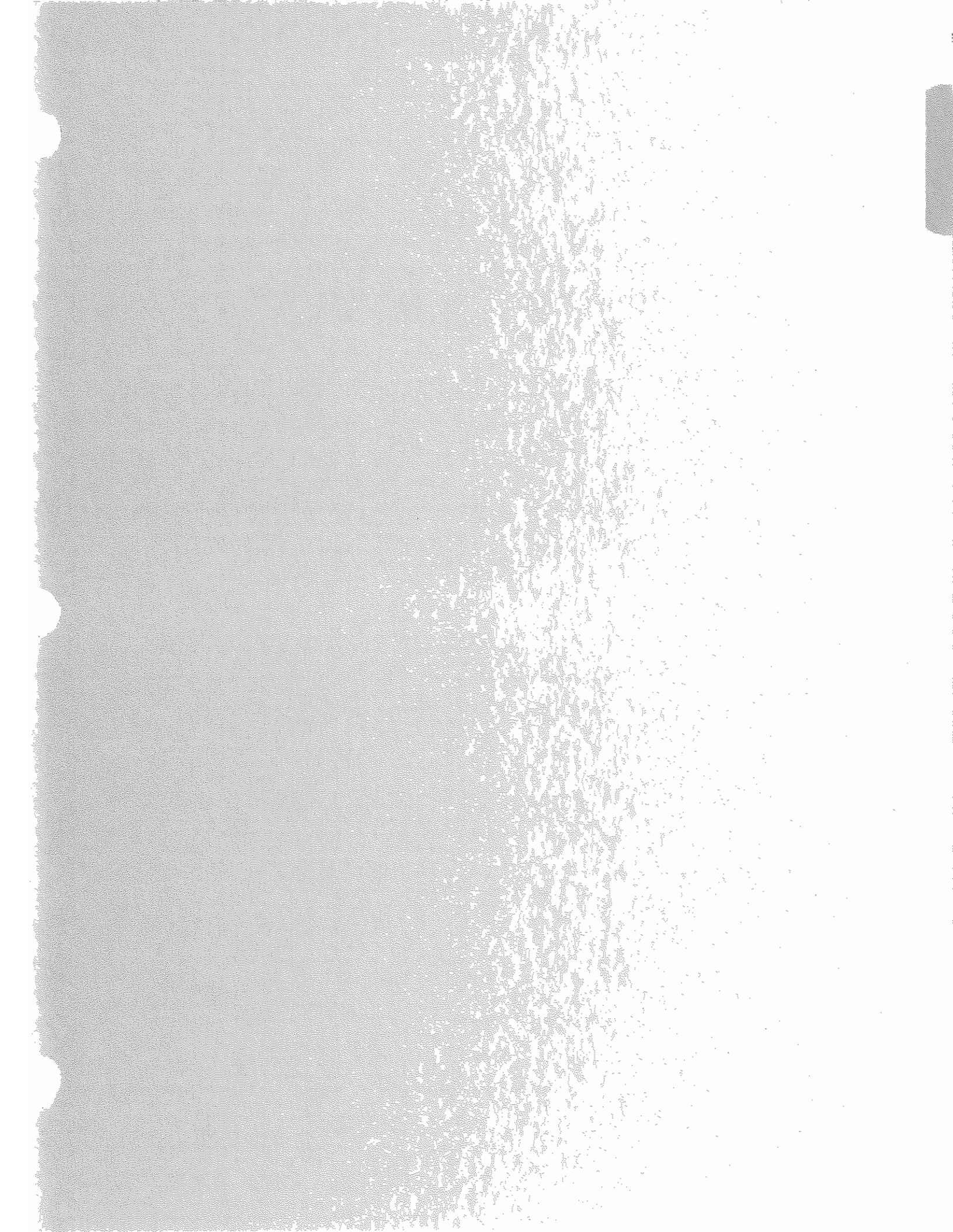
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Sincerely,



Karlheinz Schreiber
Chairman





BEAR HEAD INDUSTRIES LIMITE

Suite 908, 350 Sparks Street
Ottawa, Ont., Canada
K1R7S8

TELEPHONE(613)563-3321

TELEFAX (613) 563-7648

May 7, 1991

Paul Tellier
Clerk of the Privy Council and
Secretary to the Cabinet
Government of Canada
332 Langevin Block
80 Wellington St.
Ottawa, ON
K1A 0A3

PCO - FPRO BCP - BRFP
Original: 8470-5 <i>File</i>
Copies: _____
Ident: 91023

8-5-91
FR

Dear Mr. Tellier:

This letter follows from my meeting of April 10th with the Prime Minister, yourself and Fred Doucet.

not accurate

At the conclusion of that meeting, it was understood that you would bring your personal leadership to the file and chair a meeting between Government and company officials as early as possible within one week's time.

not accurate. Told Doucet would call back after my meeting would be over in approx 2 weeks

It is now nearing a month since that meeting and I have received no word from you. Our consultant has informed me that, despite his attempts to reach you on three separate occasions, with messages left, no word has come from your office. At 1:45 Monday, May 6, I had my secretary call yours with a view to speaking with you. The secretary indicated that you would be calling back within 15 minutes. It is now a day later and no call has been received, therefore, the reason for this letter.

I recall vividly a statement made by our Prime Minister, during our April 10 meeting about how much he cares about the safety of our soldiers and his determination to ensure that at all times they be provided with appropriate equipment to perform their duties, whether this be domestic, peacekeeping or otherwise. The thrust of our company's initiative in Canada over the last six years has focused on this fundamental need as expressed by the military.

You will recall, along with the others in attendance, how perplexed I was during our



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meeting of April 10th, why such a relatively simple proposition, motivated by an expressed real need, should create such compounded confusion. I had hoped that our meeting had resolved past confusion and set us finally on an action path. Since it now appears that inertia has set in again, I have no choice but to review for you once again the elements of this simple and straight-forward proposition.

The foundation of the proposition, first needs emphasizing:

- a) The proposition is to develop a manufacturing facility in a deprived area of Canada which would produce a technologically advanced multi-purpose military vehicle;
- b) The proposition further includes the production of a diversified array of environmental products and other product with international market mandates;
- c) The proposition also is to transfer technology to a technology starved area of the country.

It was these elements that prompted, Thyssen to react positively to an invitation by the Government of Canada six years ago. From the outset, Thyssen decided that it would proceed in its response only if the following elements would be put in place:

- a) a defined need expressed by Canada's military;
- b) a limited infrastructural assistance program to permit the installation of the manufacturing base; and
- c) a committed order for a relatively small percentage of the total complement of such vehicles on the basis that our offer would be equal to or better, all things considered, than that of any possible competitor.

During its six years the company desired, as it does today, to play by the rules, however shifting these became. Accordingly, we sought and painfully obtained an Understanding of Principle with the Government, which we considered to be a remarkable



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accomplishment. It contained the background elements identified in this letter. We considered it a major accomplishment in that it contained the signatures of the three Ministers of the Crown most directly involved with the initiative.

It is significant to note that this Understanding in Principle resulted from many meetings with Government officials, Cabinet Ministers, industry partners, etc., and reflected a genuine will on the part of the Government to go forward, based in no small measure on two stated Government policies:

- a) The present Government's determination to use defence procurement as an instrument of regional industrial expansion; and
- b) To welcome foreign investment, providing such investment brought with it new technology; created new and full-time jobs and above all contained the prospect of new export markets.

Throughout this long period I have failed to understand what made this simple issue so complicated, particularly when one takes into account the principal parties involved in this frustrating initiative. These were:

Not accurate

The Prime Minister, who made it clear in his speeches that his Government had declared in its Cabinet Policy to use the industrial benefits associated with defence procurement to strengthen regional economies and overcome regional economic disparities. Furthermore, the Prime Minister made his personal position on the subject clear on April 10 during our meeting.

DRIE, through its Minister in 1985, first invited Thyssen to Canada and explained that the Government's highest priority would be to establish industrial jobs in the Cape Breton region to replace those lost in the closing of the heavy water plants. DRIE offered extensive assistance in the form of investment incentives including grants, tax credits, export assistance, promotion of sales to DND, etc.

External Affairs supported the initiatives of DRIE through the Canadian Ambassador to Bonn, meeting with the Chairman of Thyssen AG. to encourage the Thyssen's choice of Canada for our North American base of heavy industrial operations, as a



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expansion to the 2,000 Thyssen employees already established in Canada. External Affairs further supported the Thyssen initiatives by assigning the Minister Counselor from the Washington embassy to accompany Thyssen executives when the Bear Head Industries concept was first presented to U.S. Pentagon officials. The Minister Counselor very forcefully represented the case of such a Canadian Thyssen facility being eligible for sales to the U.S. Department of Defence under the Canada-U.S. Defence Sharing Agreement, a position welcomed by the Undersecretary of the U.S. Army.

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The Province of Nova Scotia has been very much in favour of the project from the outset, having optioned land (through written agreement with the company), for a potential site. The Premier, while the Minister of Industry, has visited the Thyssen companies to personally reinforce the Province's desire to see the project realized.

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I never said this

With respect to our understanding of the Army's requirement for the MRCV and its priority in regard to protection deficiencies in the existing light armoured vehicle fleet, the company has sought every opportunity to discuss these issues directly with the user. Additionally, since August 1989, we have sought the most qualified Canadian military advice available to the Company, LGen. Jack Vance (Ret). His concern, shared by me and indeed the Prime Minister for the future of Canada's Army was one of the main reasons that he agreed to become the senior military advisor for this initiative.

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Sincerely,


Karlheinz Schreiber
Chairman

Perrin Beatty



BEAR HEAD INDUSTRIES LIMITED

Suite 908, 350 Sparks Street
Ottawa, Ont., Canada
K1R7S8

TELEPHONE (613) 563-3321

TELEFAX (613) 563-7648

Right Hon. Brian Mulroney
Prime Minister of Canada
House of Commons
Ottawa, ON
K1A 0A6

May 9, 1991

Dear Prime Minister:

When we met in your office on April 10, 1991, you asked me to keep you informed of matters around our project. The copy of the letter that I now enclose is intended to do that.

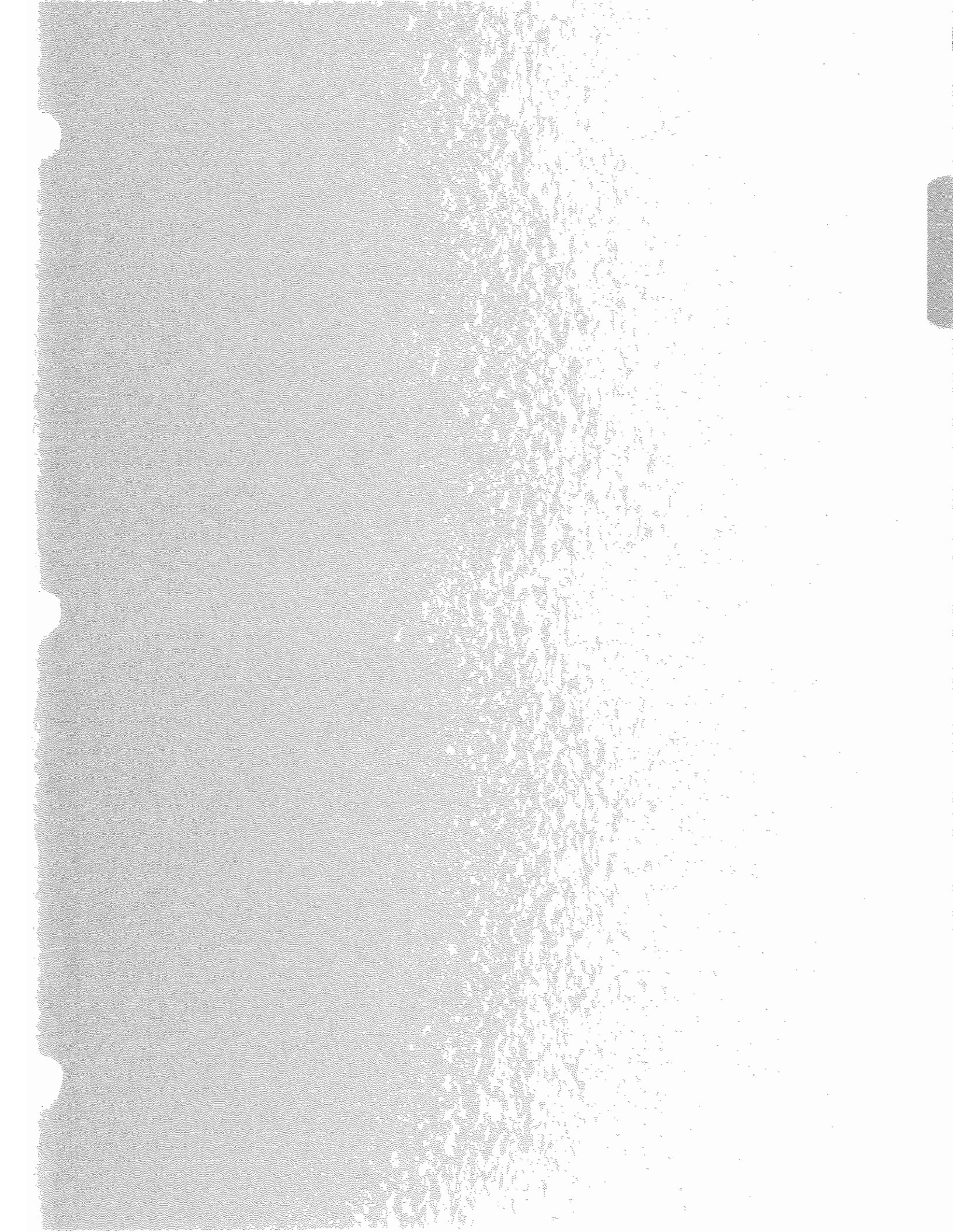
As you will sense readily, I continue to be astonished. I recall very well our breakfast meeting, when you told me how difficult it is to get things done. I understand the meaning of that statement more every day.

Yours sincerely,

Karlheinz Schreiber
Chairman

Enclosure

P.S. I trust your matter is finding a fast recovery.



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BRIEFING NOTE FOR THE MINISTER

SUBJECT: Thyssen Industries AG proposal for a directed contract to supply DND with 207-250 Light Armoured Vehicles

ISSUE

1. To inform the Minister on the subject.

BACKGROUND

2. Thyssen Industries AG, based in Germany, is one of the world's largest industrial manufacturing companies with annual sales exceeding \$30 billion, and 130,000 employees world wide. The Company's defence operations are centred in a subsidiary, Thyssen Henschel located in Kassel, Germany. From this facility, Thyssen produces a wide range of armoured and other military vehicles for domestic and export markets.

3. Thyssen has a number of Canadian commercial (non-defence) subsidiaries, all located in Ontario, employing a total of some 3,000 persons: Budd Canada Inc., (automobile parts); Northern Elevator Holdings Ltd., (elevators); Greening, Donald Co. Ltd., (metal fabrication); Thyssen Marathon Canada Ltd., (steel importers); Thyssen Canada Ltd., (steels material trading).

4. In early 1986, Thyssen Henschel submitted a proposal to the Government to establish a plant in Cape Breton, Nova Scotia to produce armoured vehicles for Middle East and North African countries; the proposal was withdrawn after some controversy ensued over the issue of export permits. In mid-1987, the Company elaborated a revised proposal to establish a heavy manufacturing facility with a mix of environmental and defence products (armoured vehicles) in Nova Scotia. At this time, the Company established a subsidiary, Bear Head Industries Ltd., currently incorporated in Nova Scotia but consisting only of a small liaison office

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in Ottawa, to permit the transfer of investment and technology to Canada in the event that the proposal would gain approval.

5. By March, 1988, the proposal had evolved into a more definitive submission whereby the planned heavy industry facility would be established in two phases: a first phase would be creation of a plant to produce military vehicles; the second phase, to commence later, would diversify the plant into production of industrial pollution control equipment. The Company predicted that employment would reach 300 by 1993/1994 and would average some 600 over the first seven years of operation.

6. In return for a Company investment over three years, (currently stated as \$61 million), Thyssen expected to receive some \$12 million in Federal/Provincial assistance for off-site infrastructure, and other benefits, i.e. Cape Breton Investment Tax Credits or pro-forma investment tax credits for a mainland Nova Scotia site, loans from the Defence Industries Productivity Program, ACOA financial support, duty remission on importation of machinery, parts and components, staff training allowances. Thyssen also expected to receive from DND a directed contract for 250 armoured vehicles.

7. In August/September 1988, discussions were held between the Company, and the Federal and Nova Scotia Governments. On 27 September an "Understanding in Principle" (UIP) based on a compromise between what Thyssen wanted and what the Government felt it could offer, was signed by Thyssen and, on behalf of the Government, by the ACOA, DRIE, and Defence Ministers. The only commitment made by MND was to consider participation of Thyssen/Bear Head Industries in DND's LAV procurement, planned for the mid-nineties. Notwithstanding that MND did not agree at any time to direct any procurement to Thyssen/Bear Head Industries, the Company

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began to focus all their efforts on securing a commitment by DND for a directed contract for armoured vehicles on the basis of the Company's need for an order to justify the initial investments needed to commence plant construction.

8. On 5 February 1990, the Deputy Minister of DND (Mr. Fowler), supported by CDS and senior Department officials, met with representatives of the Company, PCO, ISTC, BAITC, SSC, Finance, and ACOA. The main purpose of the meeting was to dispel any confusion that might exist and to make it clear that while the Government was naturally very interested in a large Thyssen investment in Nova Scotia, this would not be secured at any price. One price that could not be paid was a directed contract by DND which was engaged in a wide-ranging force structure study, which had no plans for a near-term buy of armoured vehicles, which was faced with funding problems necessitating careful prioritization of requirements and best value for money, and which emphasized that competition was the basis of procurement policy. A full resume of the meeting was then sent by MND to the Prime Minister's Office and to his colleague, the ACOA Minister, in the hope that the matter would be put to rest.

CURRENT STATUS

9. DND subsequently approved a preliminary planning proposal for the acquisition of at least 735 multi-role combat vehicles (MRCV) in three variants - Infantry, Reconnaissance, Armour at a total project cost of some \$2 billion (\$90-91) with implementation to commence in 1996. The period from 1991 through 1995 would be needed to refine quantities, establish affordability, specifications, etc.

10. In October 1990, Thyssen submitted a formal proposal to ACOA to provide 250 Thyssen "Fox" vehicles for \$290 million with first production in 1993 to meet part of

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the DND MRCV requirement. This resulted in a formal tasking by the Prime Minister's Office for a full evaluation of the proposal. While that evaluation was underway, Thyssen amended the proposal to offer either 250 Fox vehicles, or 207 of a new development vehicle, the TH 495, for the same price (\$290M).

11. The completed evaluation, comprised of detailed inputs from ACOA, DND and other concerned Departments, was forwarded to PCO/PMO in December 1990. Other Departments raised serious concerns regarding the long-term economic viability of the proposed facility (the Company has yet to provide a full business plan), the potential adverse impact on our defence production relations with USA (not letting USA compete), and the negative effects that such a facility would have on Canada's existing military vehicle industry, especially Diesel Division General Motors (DDGM). DND's extensive analysis confined itself to matters of operational impact and affordability; the principal conclusions were that:

- a. the timing is inappropriate as DND is in the midst of a policy review which will change the structure and the roles of the army;
- b. the Fox vehicle (an infantry combat vehicle) is operationally unacceptable as it does not fit into a Hercules aircraft for transport and it is not convertible into Reconnaissance or Armour variants;
- c. the TH 495 vehicle may be an acceptable candidate for competition once it is designed and built. At present it is a design concept only;
- d. the Thyssen base contract price for 250 Fox or 207 TH 495s does not include costs for integrated logistics support, training, project management, etc. When all these costs are taken into account,

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the base contract price of \$290 million translates into a project cost of \$725 million, with an additional \$130 million in operations and maintenance costs for Fox or \$115 million for the TH 495. To this must be added an additional \$200 million for inefficiencies linked with operation of a mixed fleet if the competition for the remaining 500 or so vehicles to be purchased were to be won by a different company. In brief, for the portion of the total vehicle buy that Thyssen wants directed to the Company, DND's cost would increase from a budget figure of \$290 million to an actual figure of some \$1.1 billion, an overall increase of \$765 million;

- e. since the Defence Services Program (DSP) only contains minimum development funds for MRCV before FY 96/97, moving the project forward to FY 93/94 and committing to the additional costs for a Thyssen vehicle, would result in an increased burden on the DSP for the period FY 93/94 - FY 97/98 of some \$655 million;
- f. that, in turn, would necessitate major dislocations of higher priority projects, i.e. deferment, cancellation or downsizing of such projects as Tactical Command and Control Communications System (TCCCS), Maritime Coastal Defence Vessels (MCDV) or the New Shipborne Aircraft (NSA).

12. Thus far in 1991, there has been little overt activity on the matter. Within the past two weeks, however, MGen Reay, Chief of Land Doctrine and Operations, at the request of CDS, has met with Mr. Tellier, Clerk of the Privy Council to dispel further misconceptions which have apparently arisen and to re-assert the DND position. It is

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understood that a formal Government response to Thyssen has not yet been sent, but that a negative reply is being formulated by PCO in cooperation with the Prime Minister's Office.

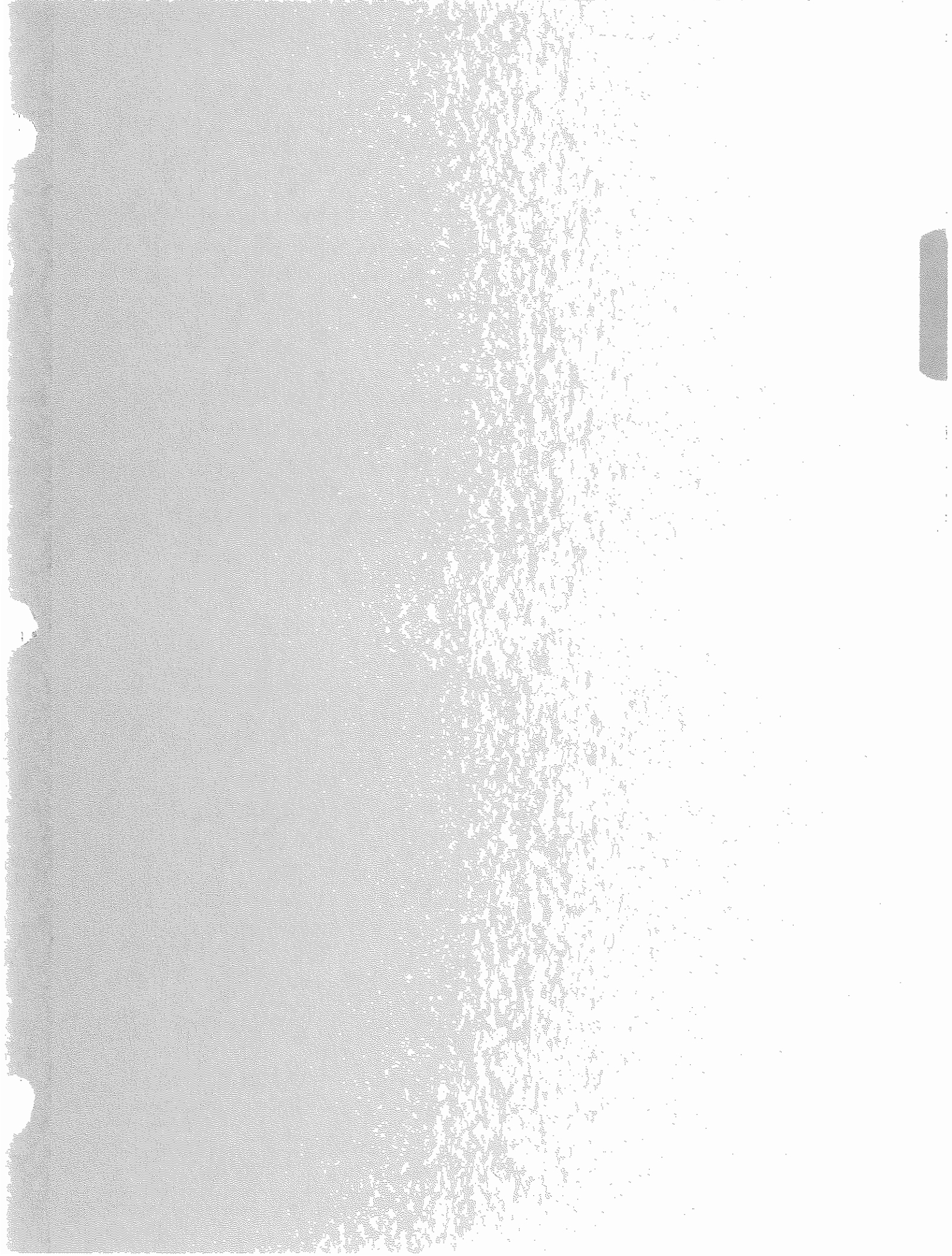
CONCLUSION

13. The Thyssen proposal to establish a heavy manufacturing facility in Nova Scotia, subject to a directed contract from DND for armoured vehicles, has occupied the attention of the Federal and Nova Scotia Governments for five years. While the goal of industrial development in the Atlantic Provinces, is universally supported, there is scepticism concerning Company projections for economic and employment impact, [REDACTED]
[REDACTED]
[REDACTED] and the demands of the Company upon DND are considered operationally unacceptable, unaffordable, and counter-productive to the Government's competitiveness initiatives.

Responsible Group Principal: R.D. Gillespie, ADM(Mat)

Prepared by: LCol E.D. Champagne, DDIR 4, 945-7100

Date Prepared: 13 May 91



CLERK OF THE PRIVY COUNCIL AND
SECRETARY TO THE CABINET



GREFFIER DU CONSEIL PRIVÉ ET
SECRÉTAIRE DU CABINET

May 17, 1991

Mr. Karlheinz Schreiber
Chairman
Thyssen Bear Head Industries Ltd.
350 Sparks Street
Suite 908
Ottawa, Ontario
K1R 7S8

Dear Mr. Schreiber,

I acknowledge your letter of May 7th.

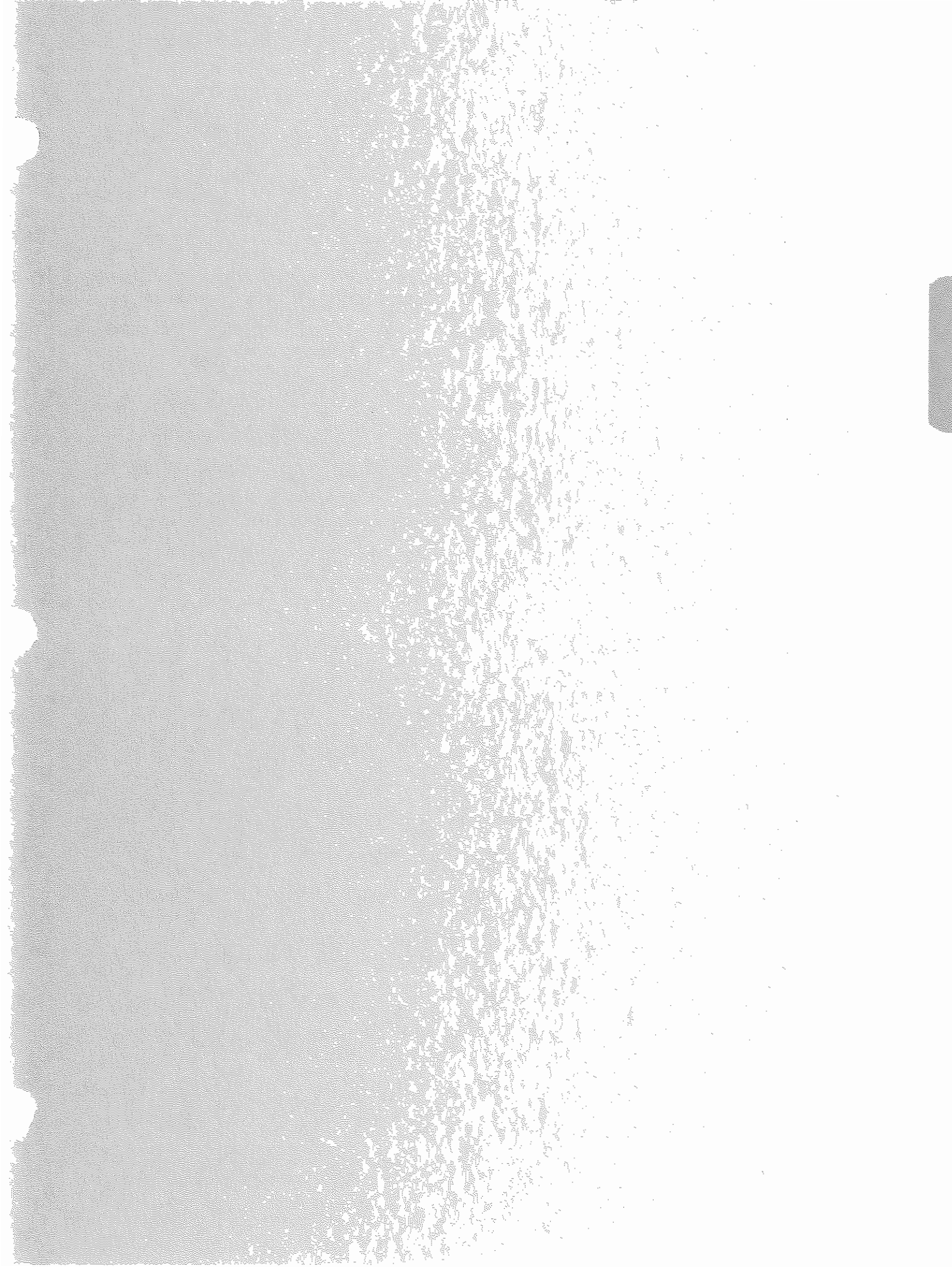
There are many statements in your letter which are either inaccurate, untrue or with which I do not agree. I do not think any useful purpose would be served at this point in getting involved in a lengthy exchange of correspondence. However, I do want to confirm with you that senior officials from the Department of National Defence will arrange a meeting, at your mutual convenience, the purpose of which will be to review your proposal and formally reply to it. I understand that you feel that you have never received a formal reply.

I sincerely hope that this meeting will clarify, to your entire satisfaction, any confusion that may still exist.

Yours sincerely,

A handwritten signature in cursive script, appearing to read "P. Tellier".

Paul M. Tellier



To: Wayne Wouters
c.c.: Richard Robillard

SECRET

EDD-

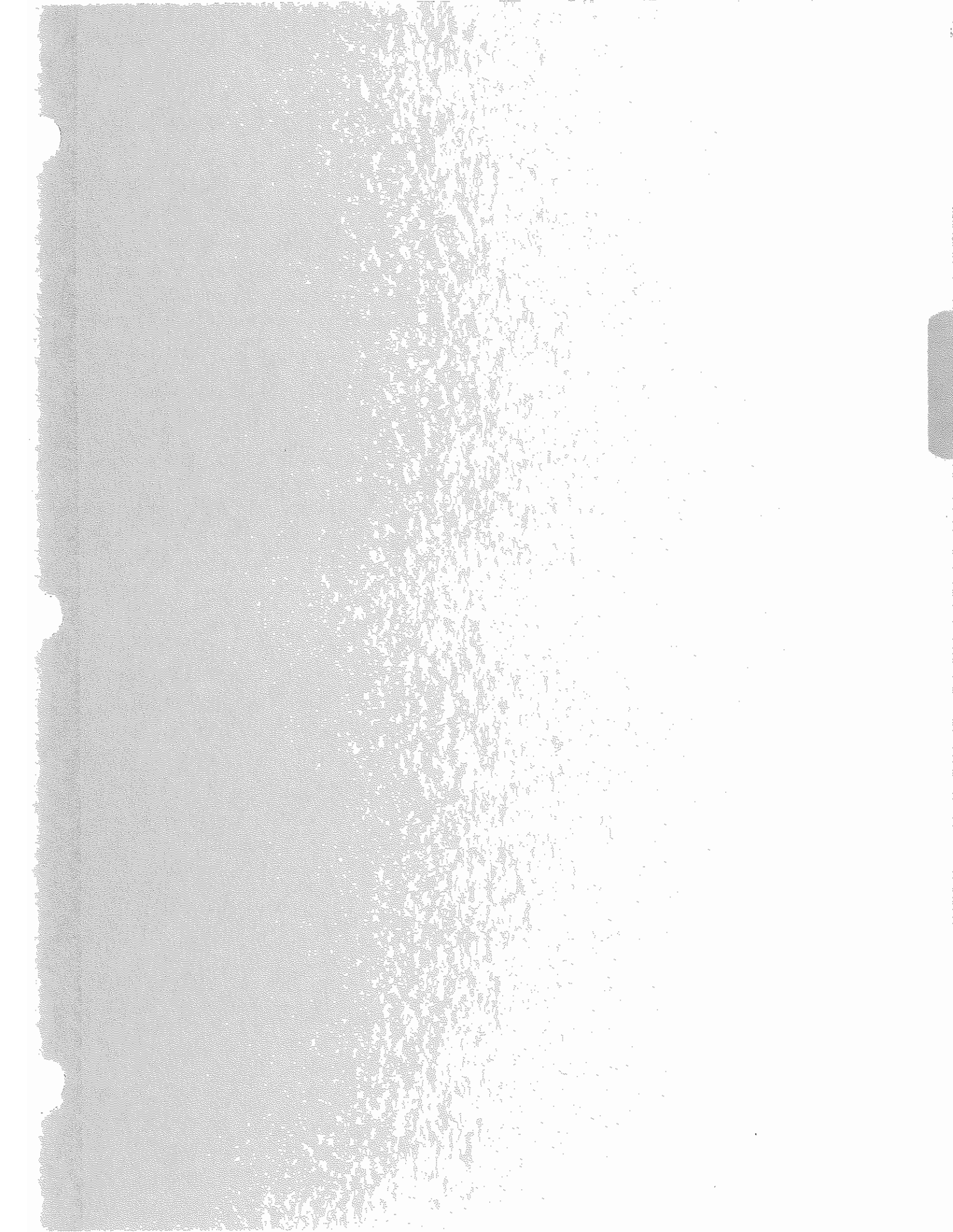
From: Jim Stanton

June 27, 1991

Thyssen/Bear Head Industries - Proposed Manufacturing Facility

1. You may recall that that Thyssen AG. proposed to establish a heavy manufacturing facility in Nova Scotia in anticipation of DND military vehicle procurement and assistance under a variety of mechanisms, including CBITC. In this connection, an Understanding in Principle was signed with the Canadian government in 1988 providing for development of a business plan by Thyssen.
2. Finance officials have strongly opposed the Thyssen project as interfering with the normal functioning of the procurement system in a major case, even requiring DND to alter the timing of major procurement plans and purchase military vehicles which may not be suitable for operational requirements. (Informally, I heard some months ago that, when the Prime Minister was briefed on the implications of the project, his support waned.) Further, the UIP committed us morally/politically and, according to our legal counsel, possibly legally to providing unspecified levels assistance should the project proceed.
3. Andre LaFond of ISTC has forwarded a draft Aide Memoire which states that Thyssen has not provided an acceptable business plan and, consequently, it has not been possible to assess the CBITC application. Thyssen is now the only outstanding application under the CBITC program and for which all expenditures must be made prior to December 31, 1992.
4. ISTC recommends that the Thyssen proposal not be supported. The company would be advised that the CBITC file will be closed and that DND does not intend to proceed with its Multirole Combat Vehicle Program until 1996. ISTC is seeking our (and DND's) agreement and I will confirm this to Lafond.] 39(2)(a)

F/W 2





Industry, Science and Technology Canada / Industrie, Sciences et Technologies Canada

Ottawa, Canada / K1A 0H5

8472-0

Row B.

JUL - 9 1991

Wilson would like to see this one brought forward to an Op. and see if killed once for all. Can we add to list plus to discuss agenda for exp. meeting?

SECRET With Attachment

Mr. W.A. Rowatt
Assistant Secretary to the Cabinet
Economic & Regional Development Policy Secretariat
Privy Council Office
85 Sparks Street
Blackburn Building, Room 506
Ottawa, Ontario
K1A 0A3

Dear Mr. Rowatt:

SUBJECT: AIDE-MÉMOIRE - BEAR HEAD INDUSTRIES INC.

Please find attached the final aide-mémoire on Bear Head Industries.

This aide-mémoire was prepared by ISTC, in consultation with the Departments of National Defence and Finance. An earlier draft was circulated on June 20, 1991, to Mr. Gillespie, Mr. Francino, and yourself. This version incorporates suggested changes.

Yours sincerely,

J.C. Mackay
J.C. Mackay
Senior Assistant Deputy Minister
Industry, Technology and Regional
Operations

Attachment

c.c. Mr. R.D. Gillespie
Mr. M. Francino
Mr. J.M. Banigan

AIDE MEMOIRE
BEAR HEAD INDUSTRIES (THYSSEN)ISSUE:

Whether to support the proposal by Bear Head Industries Limited (a wholly owned subsidiary of Thyssen Industrie AG) to establish a heavy manufacturing facility in Nova Scotia, based on a Canadian Government directed contract for 250 military vehicles for the Department of National Defence (DND).

BACKGROUND:

Thyssen Industrie AG, based in Germany, is one of the world's largest industrial manufacturing companies. In Canada, Thyssen Industrie AG employs approximately 2,500 at holdings that include:

- Budd Canada Inc., Kitchener Ont. (automotive parts);
- Northern Elevator Holdings Ltd., Toronto Ont. (elevators);
- Greening Donald Co. Ltd., Hamilton Ont. (metal fabrication);
- Thyssen Marathon Canada Ltd., Mississauga Ont. (steel importers).

Thyssen Industrie AG first declared interest in establishing a facility in Cape Breton in the mid-1980's and established Bear Head Industries as its negotiating office. Bear Head Industries is incorporated in Nova Scotia but is located in Ottawa with a staff of approximately 10 people.

In 1988, an Understanding in Principle (UIP) was signed between Bear Head Industries Ltd. and the Government of Canada, as represented by the Ministers responsible for the Atlantic Canada Opportunities Agency (ACOA), DND and the Department of Regional Industrial Expansion (DRIE). This UIP established that the company would be considered for participation in upcoming military vehicle procurements, and be considered for assistance under a number of funding mechanisms including federal-provincial infrastructure assistance, the Cape Breton Investment Tax Credit (CBITC) and, at a later stage, the Defence Industry Productivity Program. The financial details were to be worked out in reference to a business plan for military vehicle and commercial projects, to be provided later.

To date, Bear Head Industries has not put forward an acceptable business plan. This has made it impossible to assess its CBITC application which asks for consideration of a \$98 million investment or to assess the long-term viability of the company.

At this time, the Bear Head Industries application is the only outstanding application under the CBITC program. As all expenditures must be made prior to December 31, 1992, it would seem unlikely that Bear Head will be in a position to benefit from the program.

In late 1990, a formal proposal based on a directed procurement by DND to Bear Head Industries of light armoured vehicles for delivery in 1993 was put forward under ACOA sponsorship. Discussions at the working level did not lead to the presentation of the proposal to Ministers.

The proposed procurement would be part of the Multirole Combat Vehicle Program (MRCV), which has been identified for planning and development by DND. This program is unfunded for definition or implementation, is not yet backed by an approved statement of operational requirement, and affordability in the medium term is not yet clear. Project implementation would not be before 1996.

Bear Head Industries proposal suggests the following benefits would flow from the project:

- Creation of 600 direct jobs in a particularly depressed region;
- Development of a world class manufacturing base, supported by the diversified global infrastructure and financial base of one of the world's largest heavy manufacturers;
- Transfer of production technology in defence and environmental products, and production mandates;
- Provision of a high quality product to DND which meets its needs at a reasonable cost.

However, Bear Head Industries has not demonstrated the long term viability of the project, or developed an appropriate business plan. Plans for commercial product lines have not been adequately explored. This is particularly disturbing in light of declining global defence markets.

Canada currently has three major existing military vehicle producers competing for limited DND business, which is insufficient to sustain them (i.e. General Motors Diesel Division in London, Ontario, UTDC (Lavalin) in Kingston, Ontario and Bombardier Inc. in Valcourt, Quebec). In addition there are a number of specialty vehicle manufacturers, operating in niche markets. This situation, coupled with declining overall demand has led Industry, Science and Technology Canada (ISTC) to an investment strategy for the sector which does not support greenfield investment. In view of the above, the federal government should not be supporting financially the establishment of another military producer in Canada.

Internationally, Bear Head Industries would be in direct competition with General Motors Diesel Division (DDGM), which produces Light Armoured Vehicles in London Ontario, for Canada, the U.S. and other countries. DDGM employs up to 700, and has received over \$30 million in federal assistance under the Defence Industry Productivity Program, partly in the form of repayable contributions.

The appropriateness of a directed contract for 250 military vehicles for delivery in 1993 has been reviewed by DND and the Thyssen proposal has been found to be unacceptable. Neither the vehicle proposed by Thyssen nor the timing of a proposed purchase meet DND's need at this time; it is not acceptable operationally, is unaffordable, and would impact adversely and severely on the ongoing force structure review, and on other higher priority projects.

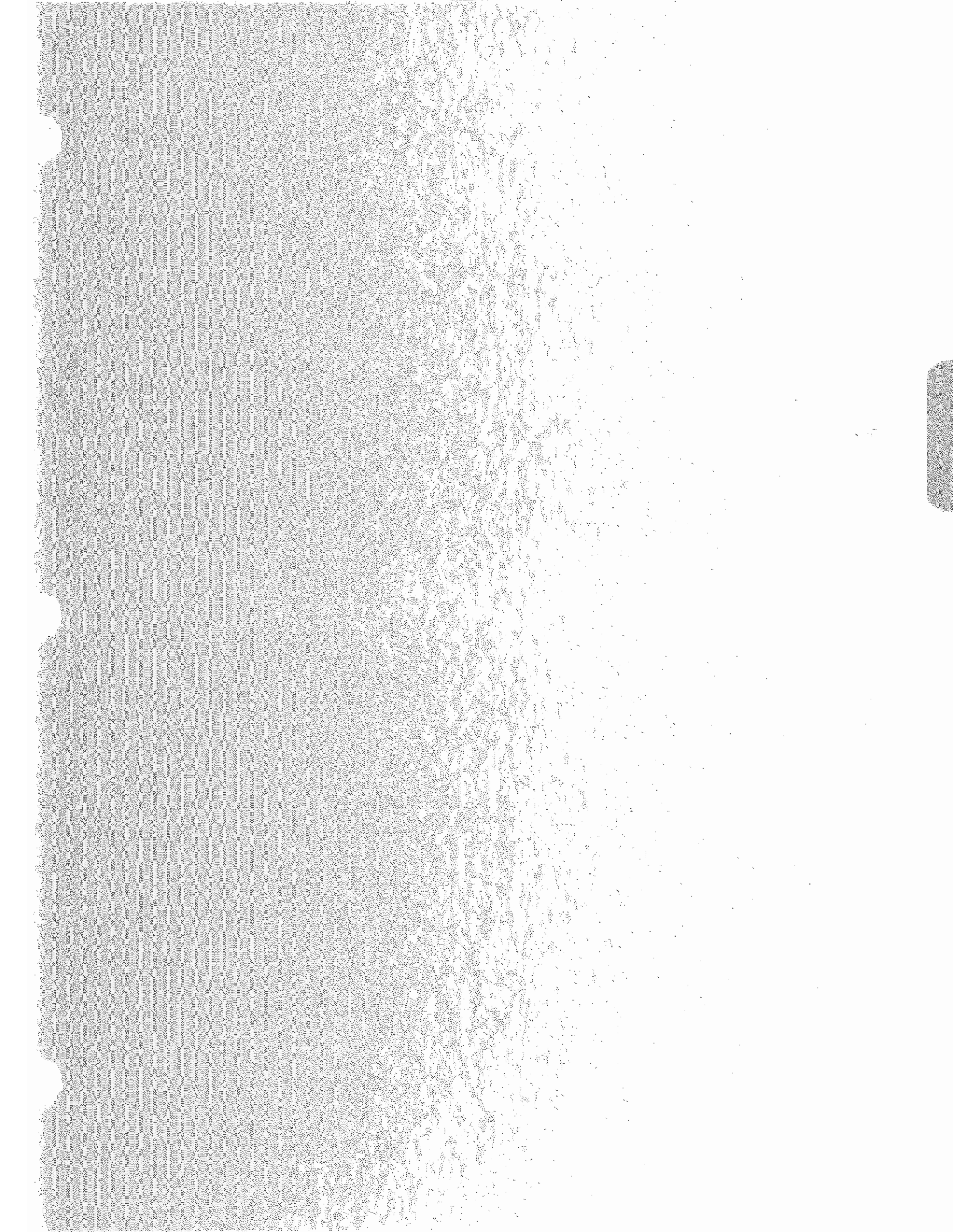
RECOMMENDED POSITION:

In view of the above considerations, it is recommended that the Bear Head Industries Ltd. proposal to establish a facility in response to a directed procurement not be supported. The company should be advised that the Cape Breton Investment Tax Credit file will be closed and that DND does not intend to proceed with the Multirole Combat Vehicle Project until 1996, and then only if the project is deemed affordable.

INTERDEPARTMENTAL CONSULTATIONS:

This document has been prepared in consultation with the Departments of Industry Science and Technology, National Defence and Finance. All three organizations fully support the recommended course of action.

July 9, 1991



SECRET

National Defence	Défense nationale
Assistant Deputy Minister (Materiel)	Sous-ministre adjoint (Materiel)
National Defence Headquarters Ottawa, Canada K1A 0K2	Quartier général de la Défense nationale Ottawa, Canada K1A 0K2

PCO-	BCP-
Original:	7-2-92
Copies:	
Ident:	


17 March 1992

Mr. R. Bilodeau
Deputy Secretary to the Cabinet (Operations)
Privy Council Office
Room 318, Langevin Block
80 Wellington Street
Ottawa, Ontario
K1A 0A3

Dear Mr. Bilodeau:

Further to your conversation with Bob Fowler, enclosed is a brief summary of the background to the Thyssen proposal, the rationale for the cancellation of the Multi-Role Combat Vehicle (MRCV) project, and the proposal to sole source a limited requirement for replacement reconnaissance vehicles to Diesel Division General Motors (DDGM). If we can be of any help in clarifying or elaborating on any of these points, please let me know.

Sincerely,


R.D. Gillespie

Enclosure: 1

c.c. Mr. R. Fowler, DM, DND
c.c. Gen A.J.G.D. de Chastelain, CDS, DND
c.c. BGen R. Gentles, PCO

Canada

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BRIEFING NOTE FOR MR. BILODEAU

SUBJECT: THYSSEN INDUSTRIES - REACTION TO DIRECTED
PROCUREMENT OF LAVS TO DDGM

ISSUE:

1. To provide Mr. Bilodeau with background information and discussion points regarding concerns which may be expressed by Thyssen Industries after the announcement of the cancellation of the MRCV project and the directed procurement to Diesel Division General Motors for a Lynx replacement.

BACKGROUND

2. Since early 1986 Thyssen Industries of Germany has been negotiating with the Government to establish a plant in Cape Breton, Nova Scotia to produce, inter alia, armoured vehicles under a directed contract from DND. On 27 Sep 88, an "Understanding in Principle" was signed (Flag A). The only commitment made by DND was to "consider participation of the Company in the Light Armoured Vehicle procurement program", planned for the mid-nineties, conditional upon the company meeting various DND requirements. In a follow-on letter to Senator Murray, the Defence Minister made clear that future funding could be an issue (Flag B).

3. Nevertheless, the Company continued its efforts to secure a commitment from DND for a directed contract for armoured vehicles on the basis of the Company's need for an order to justify the initial investments needed to commence plant construction. The acrimony surrounding this issue became so intense that on 5 Feb 90, The Deputy Minister of

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might exist and to make clear that while the Government was naturally very interested in a large Thyssen investment in Nova Scotia, National Defence needed to ensure best value for money in its procurements. (Flag C - Fowler letter to Tellier)

4. In Oct 90, Thyssen once again made a proposal, specifically for a directed contract for 250 FOX armoured vehicles for a supposed price of \$290M. DND analysis indicated that not only would the complete cost of the vehicles purchase be much higher, but that it would also translate into \$1 billion costs for the Department. After several iterations of the proposal, none of which altered the basic substance or cost, ACOA prepared an analysis of the proposal for PMO/PCO in Dec 91. While the Government did not formally respond to the Thyssen proposal at that time, it was recognized that Thyssen should be allowed to compete at the appropriate time for the MRCV project.

5. There were further attempts in Aug 91 to advance yet another variation on the same theme, this time in conjunction with Trenton Works. Once more, the analysis revealed that the proposal was simply not a sound way to proceed. In a letter to Mr. Schreiber, chairman of Thyssen BHI, Mr. Wilson, at that time Minister of ISTC, noted that MRCV was still unfunded for both definition and implementation purposes, that affordability in the medium term was not clear, and that it was not yet backed by an approved statement of operational requirement (Flag D).

6. Despite this long history, wherein Thyssen has been repeatedly warned of cost factors and the evolving

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CURRENT STATUS

MRCV

7. Three years of cutbacks, coupled with the recently announced reduction in the Department's budget of \$2.2B over the next five years, dictated that a major review of our planned projects be undertaken. [The concerns of Ministers Beatty and Wilson have proved well-founded. At a cost of \$2.4B, MRCV has become unaffordable.] 35(0)(c)

8. Moreover, the changing world situation, particularly the collapse of the USSR and Canada's subsequent pending withdrawal from Europe, necessitates a thorough review of our vehicle requirements. The MRCV project had established three variants of armoured vehicles requiring procurement in the following order of priority:

- a. Reconnaissance Vehicles;
- b. Direct Fire Support Vehicles; and
- c. Infantry Carriers.

9. Notwithstanding the financial need to cancel the MRCV project, there remains a critical requirement for the Land Forces to replace the current fleet of recce vehicles before they become unsupportable in 1996. The current Lynx recce vehicle was purchased in the mid 1960s, and spare parts will no longer be available by 1996. Failure to procure new recce vehicles by 1996 would result in either a lost combat capability or extensive use of operations and maintenance (O&M) funds to maintain the current fleet of Lynx vehicles. This is therefore the critical date for replacement.

10. While the requirement for Direct Fire Support

SECRET

11. The requirement for Infantry Carriers could be satisfied for the foreseeable future through the use of assets returning from Canadian Forces Europe.

Meeting the Recce Requirement

12. The need to replace our Lynx fleet by 1996 demands the use of a manufacturer which currently produces suitable vehicles. The only manufacturer of armoured vehicles in Canada is DDGM, which produces the Light Armoured Vehicle (LAV).

13. A directed procurement option would be the fastest and most reliable method of achieving a capability before the Lynx becomes unsupportable. The procurement of a LAV 25 (currently in production for U.S. and other forces) for the recce role would ensure that the lowest possible O&M, training, and life cycle costs are achieved.

14. It should also be recognized that DDGM is a strong and viable company in the defence industrial base, and has demonstrated its competitiveness in the increasingly demanding world market by winning contracts from the U.S. and from Saudi Arabia. As well, the Australians are expected to announce a contract to DDGM shortly. Purchasing a recce vehicle from DDGM would contribute to this Company's future successes, help to achieve economies of scale to keep costs down, and, from DND's perspective, enhance long term support of our vehicles.

POSSIBLE RESPONSES TO THYSSEN CONCERNS

- o As feared, MRCV has become unaffordable
- o Need to change acquisition plans for MRCV
- o Thyssen's right to compete was conditional on an

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downsizing in regular forces and therefore reduced equipment requirements

- o Due to these changed circumstances, as well as budget restrictions, the entire procurement environment which underlay the Understanding in Principle has altered
- o However, replacement of recce fleet required by 1996 due to unsupportability - time is critical factor
- o DDGM has existing production facility - minimal start up time
- o DDGM currently produces a vehicle which will meet the requirement (LAV 25)
- o Proven product - no long testing and evaluation period
- o Commonality with existing fleet - Militia vehicles
- o LAV 25 affordable and adaptable vehicle to meet budget constraints and evolving needs
- o Canadian company and high Canadian content
- o Canadian defence demands alone do not even support one manufacturer
- o Proven DDGM long term viability
 - assured O&M, logistics support
 - continued off shore sales of LAVs
 - not dependant on Government subsidies
- o World defence markets shrinking - in process of rationalizing/retrenchment of defence industry

10

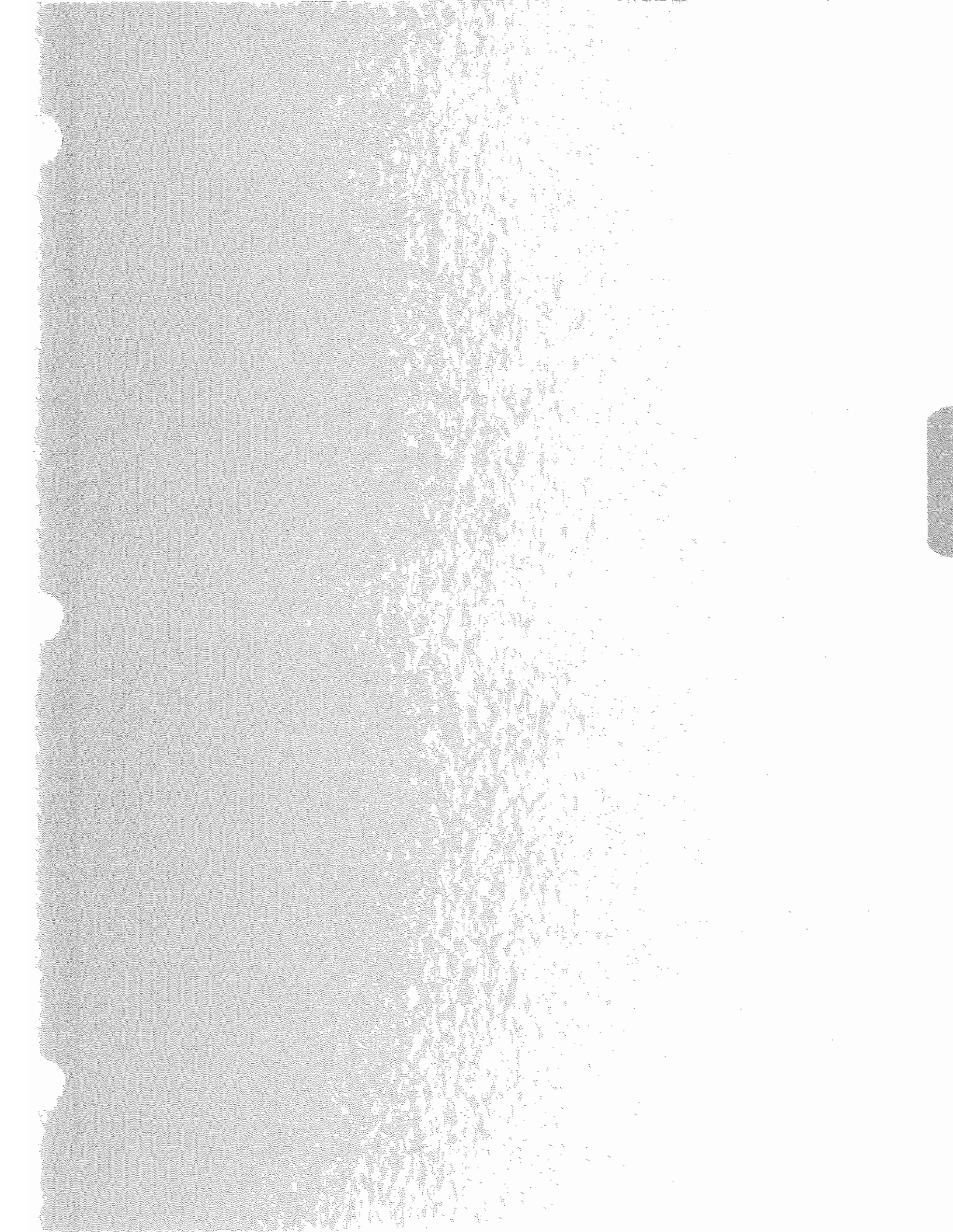
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15



Karlheinz Schreiber

Suite 908, 350 Sparks St., Ottawa, Ont. K1R 7S8
Telephone: (613) 563-3321 Fax: (613) 563-7648

May 6, 1992

The Right Honourable
Brian Mulroney
Prime Minister of Canada
Langevin Block
80 Wellington Street
Ottawa, Ont.
K1A 0A2

Dear Prime Minister:

I would like to thank you very much for finding the time to meet with me yesterday especially when you are so busy with the constitutional issue. I was also greatly heartened by your sympathetic understanding of the situation and your determination to set things in train.

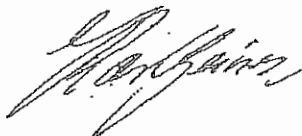
As you recommended, we are now working on a 2 page summary of the actions necessary to realize the project as you would like to see it. To deliver the exact figures will take a few days and we will present them to you next week. The activity we will engage in the next few days includes an investigation of the situation for establishment of the project in East Montreal.

I would also like to inform you that after the meeting with you, Elmer and I had a very good meeting with Marcel Masse and I expect to meet with him again next week.

With regard to your suggestion that we get together when you are in Munich, perhaps you would ask one of your staff to give me information on your program, so that my family and I can help you and your family to enjoy your visit to our home city.

I look forward to seeing you again next week.

Warm personal regards,





see y



021530198

BEAR HEAD INDUSTRIES LIMITED

Suite 908, 950 Sparks Street
Ottawa, Ont., Canada
K1R 7S8

TELEPHONE (613) 563-3321

TELEFAX (613) 563-7648
TELEX 053-3981 bhl ott

The Right Honorable
Brian Mulroney
Prime Minister of Canada
Langevin Block
80 Wellington Street
Ottawa, Ont.
K1A 0A2

22 May 1992

Dear Prime Minister,

As promised I write to keep you informed of recent events which have occurred as I proceed to realize our project by the method which I agreed with you during our last meeting.

I am pleased to confirm the very positive support we have received for our proposal from Hon. Jean Corbeil as expressed through M. Richard Le Lay his Chief of Staff. Furthermore, I understand that it is intent of Min. Corbeil to solicit the support of Min. Benoit Bouchard.

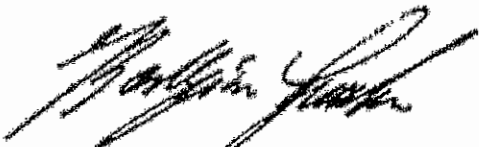
That position fits in parallel with support expressed by the Province of Québec and I find it encouraging.

More recently, as a result of my May 13, 1992, letter to Min. Masse, a delegation from our Company was invited on May 20th to discuss the involvement being requested of DND by the Company.

The outcome of that meeting was completely unhelpful and I am dismayed by the lack of co-operation and understanding of the important economic benefits which this proposal offers to Canada. You will see by the attached report of the meeting that the DND position has been to simply "stone-wall" the Company's proposal. Though not a complete surprise, it was even more negative than I expected. //

I have travelled to Germany for this week but will be back in Ottawa on May 31st. to resume my activity towards our project.

Most sincerely,



Karlheinz Schreiber
Chairman

Encl.



Returned from #110 4519192

CLERK OF THE PRIVY COUNCIL AND
SECRETARY TO THE CABINET



GREFFIER DU CONSEIL PRIVÉ ET
SECRETÉAIRE DU CABINET

SECRET

September 17, 1992

MEMORANDUM FOR MR. HUGH SEGAL

Thyssen BHI Peacekeeping Vehicle Proposal

This note provides an update on Thyssen BHI's proposal to build prototype peacekeeping vehicles at a new plant in east Montreal.

Background

- This spring, Thyssen Industries of Germany, which has made a number of proposals to the federal government since 1988 for financial assistance and directed defence contracts to build a new light armoured vehicle in Atlantic Canada, proposed a new directed contract from the Government to build eight prototype "peacekeeping" vehicles at a new plant in east Montreal. Thyssen was also seeking \$132 million from governments for the plant; in addition, DND was being asked to test the prototype vehicle.
- DND indicated that it did not require this type of vehicle and had no budget for it, although it would be willing to test and demonstrate it on a cost-recovery basis to assist the company. You will recall that, given the sensitivity of a new Quebec-based plant at this time, a letter was sent in July under your signature to company president, Mr. Karlheinz Schreiber suggesting that he contact the Honourable Michael Wilson to explore the suitability of various industrial development programs.

Update

- We are now advised by ISTC officials that Mr. Schreiber has not contacted Mr. Wilson nor anyone in his office or department. Thyssen representatives are understood, however, to be making the rounds of Quebec Ministers' offices with a revised proposal that seeks financial assistance for a plant in east Montreal. The new proposal targets new export markets in the U.S., Saudi Arabia, the U.K., France, and Germany but no longer seeks directed contracts from DND.
- We understand that Thyssen has made presentations over the last ten days to Ministers Masse, Bouchard, Charest and Corbeil, and was also to present a proposal to the Quebec government this week.


The New Proposal

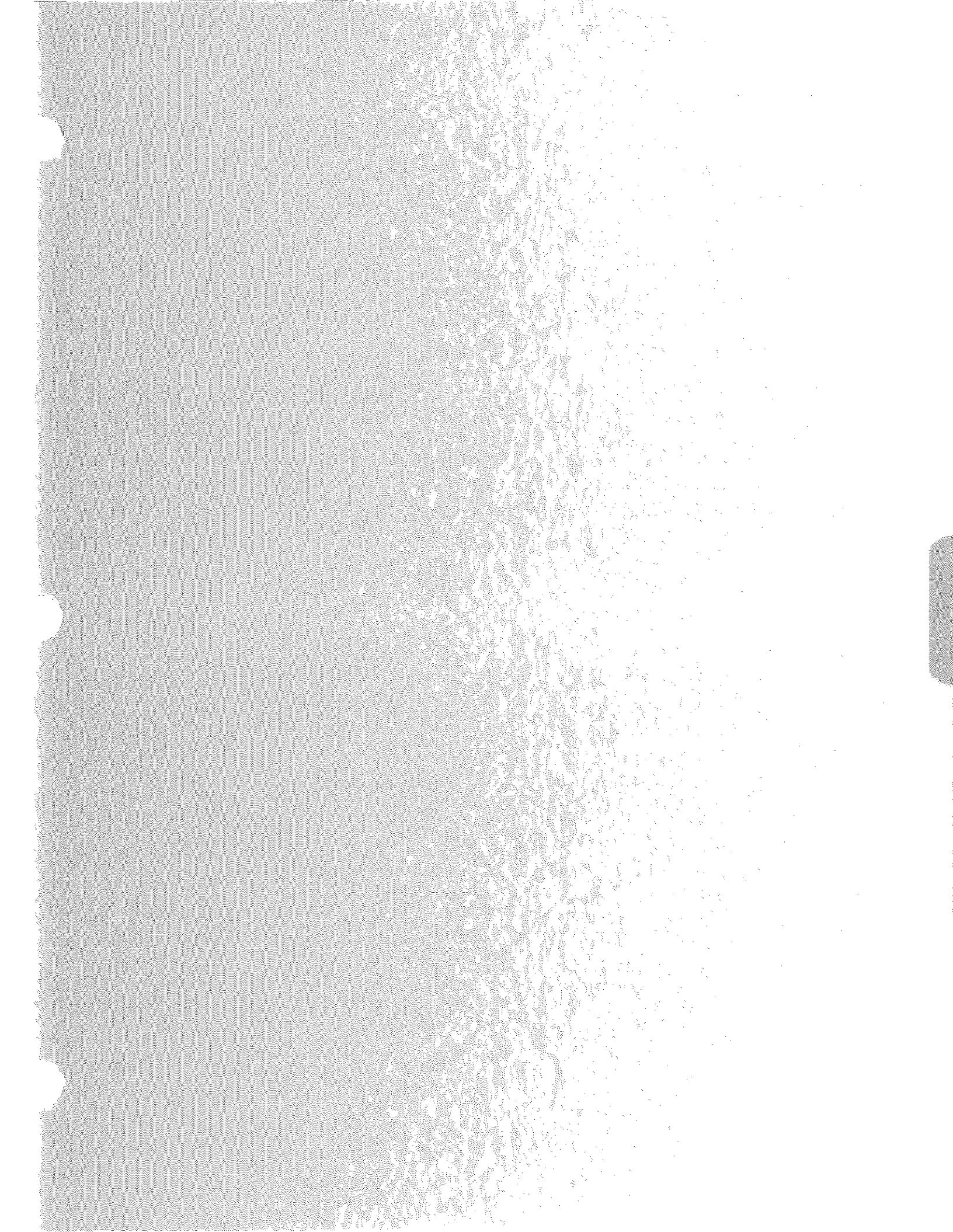
- Thyssen is understood to be prepared to put \$53 million into the project, of which \$40 million would be technology transfer benefits; it is seeking \$117 million from governments initially, and \$50 million when the plant is actually constructed. The firm has also made an unprecedented request that DND personnel work in the plant to assist in design and operational matters.
- ISTC analysts have indicated that there continues to be an oversupply of light-armoured vehicles in the western world. It is not clear whether Mr. Schreiber and his advisers would be aware that, despite the recent amendments to the Criminal Code and the Export and Import Permits Act, there might be less flexibility for a Canadian manufacturer to export such vehicles from Canada to any third world country with questionable human rights or military records, than would be the case in Germany.
- With Canadian restrictions on exports as well as highly competitive conventional markets for such vehicles, DND continues to have concerns that any new plant would soon be seeking directed contracts to assure its continued survival. ISTC also has concerns about the impact a second plant would have on the longer-term health of the current Canadian manufacturer of these vehicles, General Motors' Diesel Division in London, Ontario.
- (Mr. Masse is understood to be strongly supportive of this project and Mr. Corbeil informed us that other Québec Ministers are also supportive. Whether Mr. Bouchard would be prepared to recommend funding the proposal from FORDQ resources is not clear at this time.)

39(a)(c)

Comment

Both FPRO and PCO have some concerns about the political sensitivity, if a Thyssen project were to proceed in Quebec when an earlier related Thyssen proposal did not proceed in the Maritimes, particularly over the next few weeks. However, it is clear Quebec ministers consider this matter to be a high priority and officials are proceeding with its assessment. The project, as noted, is complex and will require significant ministerial discussion.


Glen Shortliffe



60 Queen Street
Ottawa K1P 5R5

September 20, 1995

I have been President of the Atlantic Canada Opportunities Agency since July 4, 1995. I was Chief of Staff in the Prime Minister's Office from September 1990 to February 1992.

Upon becoming Chief of Staff, aside from the 40 or so issues left over from the previous Chief of Staff, one of the first issues Prime Minister Mulroney asked me to look at was the Bear Head proposal. As I was later to experience, it was not unusual for Mr. Mulroney to ask either me or the Secretary to the Cabinet, Mr. Tellier, about a specific project, proposal or issue that was of interest to him. Mr. Mulroney appeared to be frustrated with the lack of progress on this file and mentioned to me that bureaucrats in DND were preventing progress on a project he said would come at no cost to the taxpayer, as a result of their preference for some other type of equipment. I came away with the understanding that Mr. Mulroney believed this was a sound proposal that was being blocked for unjustifiable reasons by some public servants in DND and, by asking me to look into this file, Mr. Mulroney was asking me to move it along to fruition.

The first thing I did was to sit down with Mr. Bob Fowler, the Deputy Minister of National Defence. As a former colleague, I was able to have a frank discussion with him about the project -- its merits and its shortcomings -- as well as the suggestion that some of his staff were blocking realization of this project because of their preferences for other equipment.

Mr. Fowler assured me that he had taken a look at this proposal from a professional perspective and had concluded that it was too costly and the equipment to be produced was not suitable for the need of the Canadian Armed Forces. Mr. Fowler said that he had heard the suggestions that certain officials in his Department were blocking the Bear Head proposal because they preferred other equipment and assured me this was not the case.


Based on this conversation, I decided to convene a meeting with some of the players involved in this file, including the two main Ministers -- the Minister of National Defence, Mr. McKnight, and Mr. Elmer McKay -- and a number of officials from DND and other public servants. After a period of general discussion, I asked the group to produce a commonly agreed-to piece of paper summarizing the annual costs of the proposal over a five year period. I set a deadline of a couple of weeks for the group to agree on the paper and transmit it to me.

The group did in fact produce the document. Upon receiving it, I checked with Mr. McKnight and Mr. McKay to ensure there was no disagreement on the bottom line which, as I recall it, was several hundred millions of dollars.

The first occasion I had to discuss the Bear Head proposal with Mr. Mulroney subsequent to receiving this bottom line report was on a Sunday when Mr. Mulroney and I were being driven to some event in Quebec, probably in the Gatineau. I can't recall whether I raised the issue or if Mr. Mulroney asked me about it, but the upshot of the discussion was that I informed Mr. Mulroney that contrary to his understanding that the project was at no cost to the taxpayer, in fact it carried with it a bottom line of several hundred millions of dollars. Mr. Mulroney appeared to be genuinely surprised by this revelation and repeated that he had been informed that this was a no-cost project to the taxpayer. He asked me to explain this discrepancy. I told him there was no disagreement between Mr. McKnight and Mr. McKay on the bottom line and that the government's fiscal framework required expenditures to be booked in the year in which they were incurred, notwithstanding any projections as to future royalties, sales, etc.

Mr. Mulroney appeared to accept this explanation after considering it and said something along the lines that "if that is the case, this project is dead". This conversation occurred entirely in the car and lasted approximately 5-10 minutes of a 45 minute car ride. This was the last I heard of this proposal.

The only other involvement I had with this proposal was a meeting with Karlheinz Schreiber in my office in the Langevin Building. I cannot remember the date of this meeting. Over coffee, Mr. Schreiber described to me the Thyssen proposal -- its merits and its advantages for Nova Scotia in particular. I listened to him attentively. I believe that I had agreed to meet with Mr. Schreiber at Mr. McKay's request. As Mr. McKay was the leading supporter of this proposal with the government, I agreed to meet with Mr. Schreiber.


Norman Spector



Afterword

NORMAN SPECTOR

Bill Kaplan set out in 1998 to write a book about a botched investigation into alleged criminal activity by Brian Mulroney. He ended up with a bestseller on his hands – *Presumed Guilty* – and having to write a second book to correct the first. As readers of *A Secret Trial* will appreciate, there's still no end to the questions about "Airbus" – itself convenient shorthand for two controversial procurement decisions and one that never got off the ground. Yet, in discovering the difficulty of ferreting out and telling the truth about this slice of history, Kaplan has uncovered how Canada works below the radar screen – at least as I've experienced during my career in government and the media. What emerges, however, is not what most of us learned in high school.

As I write these words in July 2004, I have yet to meet Kaplan, and I wouldn't recognize his voice if he phoned today. All our exchanges have been by email, beginning in 1997 when he interviewed me for *Presumed Guilty*. I was pleased when he sent me a complimentary copy of the book, but less pleased after reading his criticism of me. "What would you have done with the RCMP's request not to tell anyone about the investigation?" I asked. "I would have told my former boss," he replied, "out of loyalty."

That's where matters stood until Friday, November 6, 2003. Like hundreds of thousands of *Globe and Mail* readers, I was fascinated by Kaplan's front-page article about a secret trial involving Eurocopter. Having worked in Mulroney's office on Schreiber's "Bearhead" proposal to build light armoured vehicles in Cape Breton, I had a particular interest in the long exposé – and a nagging premonition about what was to come. A few days later, after finishing the series, I asked Kaplan whether he stood by his criticism, but probably should have resisted the temptation. Though he quickly conceded the point, he also asked for help with this book, *A Secret Trial* – for the sake of history, for the sake of the truth.

In the past, I'd resisted requests by several publishers to write my memoirs. In reviewing a collection of my Mideast columns published in 2003, Robert Fulford and Norman Webster asked for more of the autobiography contained in the introduction. Kaplan's request was timely, and it provided an interesting framework to explore media and government issues I'd been thinking about for many years. This afterword is my contribution to his book – and, more important, to history and the truth.

THE CONTEXT

Even after working for Brian Mulroney, I cannot say for certain why he wanted to be prime minister. He didn't seem to have strong ideological views, nor did he have any particular policy agenda. In the 1983 Tory leadership review, he campaigned against free trade and attacked Joe Clark for being weak on Québec; the rest, as they say, is history. The Conservative government's fiscal agenda, which Michael Wilson pursued during his long tenure as finance minister under Mulroney, was waiting in the deputy minister of finance's drawer when the Tories arrived in Ottawa the next year.

Winning was important, ego and social status were no doubt involved. From a modest background himself, Mulroney and his family had very expensive tastes. He was broke when he left office; according to a former colleague. In the words of another who stayed in touch, he did the stupidest thing in his life by accepting cash payments from Karlheinz Schreiber. Kaplan concludes that it's never been clear “why the money was paid or, put another way, what exactly Mulroney did to earn it.” However, he's troubled that though “no evidence has ever come forward, none whatsoever, that Mulroney had any improper involvement with Airbus, MBB, or Bearhead ... Mulroney went to great lengths to conceal his commercial relationship with Schreiber.”

Kaplan's outrage comes through as the story of the payments unfolds. The challenge he faced in exposing the truth was compounded, however, by an unlikely source – the media. What Kaplan learned about journalists may surprise many Canadians, particularly those who came of age during the Watergate era. What he uncovered, however, may help these baby boomers understand why their children and grandchildren, in addition to turning away from party politics, are tuning out the mainstream media.

Better at dishing it out than receiving it, many reporters, in my experience, tend to be notoriously thin-skinned and loath to admit

error. Ottawa-based journalists, who operate in a unique milieu, are a special class. Relative to the Canadian population, the parliamentary press gallery harbours disproportionately fewer Conservative and more NDP voters. Unlike Foreign Service officers, these journalists are not rotated to other postings before “going native” in the town that lives well off public spending. More than a few are married to, or in longstanding relationships with, senior government officials, so they have a personal reason to be anxious about a change in government.

Stevie Cameron, married to a senior public servant who had done well in Pierre Trudeau's Ottawa, was no exception in the press gallery when the Conservatives arrived in the Liberal town in 1984. At various points in my career I'd worked closely and well with her husband, David. I visited their home for dinner when I lived in Toronto. After reading her phenomenally successful book *On the Take*, I was puzzled why she had not asked to interview me about my experience as chief of staff to Brian Mulroney.¹ We had, after all, talked in 1986, and she had written about my appointment as secretary to the Cabinet for federal-provincial relations.²

Kaplan, who is by no means naïve, seems surprised at the difficulty he encountered in criticizing her. Even after she was outed, many of Cameron's colleagues circled the wagons to protect her. Ironically, they helped bury an explosive story about the former prime minister she had been stalking for years. Fortunately, in *Globe and Mail* editor-in-chief Edward Greenspon, Kaplan found a man of integrity. Canadians, in turn, owe Kaplan a debt of gratitude for his persistence and honesty.

An increasing number of Canadians are exiting the political system. Only 60 per cent of registered voters turned out in 2004, compared to 64 per cent in the 2000 federal election, 67 per cent in 1997, and nearly 70 per cent in 1993. Nearly all the decline is explained by apathy in the eighteen-to-twenty-four age bracket. Some analysts and interest groups, including the Law Reform Commission of Canada, attribute the decline to “wasted votes” and advocate various forms of proportional representation or preferential balloting. The Russian system, which requires that an election be re-run with new candidates if the turnout falls below 50 per cent, would more effectively force politicians to address Canadians' “pox on you all” attitude.

Voters are cynical because they think their votes don't matter.

They don't see the relevance of party politics to the issues that affect their daily lives. They see politicians promising to do one thing to get elected, and doing the opposite once safely ensconced in power. And they suspect that many politicians are more interested in advancing their private interests than the public interest. Once, politics was about doing good, and it still is for many; increasingly, however, it is about doing well — an arena for the ambitious to pursue personal quests for wealth, status, or power.

With improvements in pay and pensions — and opportunities to travel to pleasanter climes during increasingly frequent parliamentary adjournments — being elected to Parliament is, for many, the best job available. Nomination battles have become fiercely contested mass membership sign-up campaigns, sometimes featuring third-party payers in ethnic communities. Appointment to Cabinet puts you at the top of the social heap: wealthy, influential people and huge corporations or their lobbyists offer tickets to hockey and baseball games, or family stays at fishing lodges and vacation condos. Important political couples are invited to the best parties.

Unless one is personally wealthy, however, these lofty positions are temporary, and the politician knows it. In most careers, second place is not a bad showing; in politics, by contrast, it means you're a loser and potentially a bum. No more fine wine and restaurants; no more good-looking young aides to carry your bags. As former BC premier Bill Bennett told me more than once when I was working for him, people who had clamoured for the attention of his father, Premier W.A.C. Bennett, during the twenty years he was in office would cross the street rather than look him in the eye after he lost the 1972 election. Not surprisingly, a politician will do just about anything to postpone defeat, which is inevitable unless death or voluntary retirement intervene.

Pierre Trudeau was the last of our prime ministers to enter politics with a well-defined agenda. With the passage of time, Canadians increasingly came to disapprove of many of his foreign and domestic policies, but few ever doubted his integrity. Although he allowed his ministers to engage in the seamier side of patronage and he accepted gifts from anonymous donors to build the swimming pool at 24 Sussex Drive, no one ever suspected that he cut corners for personal benefit. Wealthy, charismatic, and intellectually gifted, he had no concerns about his political afterlife.

For his successors, politics has been about power more than principle. With what burning agenda did Jean Chrétien come to office? And what, after all, was the decade-long dispute between Paul Martin and Chrétien about? The power of the Prime Minister's Office is

enormous, and for many it's worth the huge expense of getting to the top. Paul Martin raised \$12 million from anonymous donors, whose names were disclosed only after Jean Chrétien announced his resignation. Money never seemed to be an issue for Chrétien, either, in his campaign to destabilize John Turner's leadership.

Over the years, money has become more important in politics, just as it has in society generally. As political discourse stresses image and emotions over ideas, policy takes a back seat to advertising and marketing. Politicians hire professional pollsters and advertising experts to help define their adversaries in negative terms. Election campaigns are run by highly skilled volunteers who, the day after the vote, transmogrify into high-priced lobbyists or receive lucrative government contracts.

Politicians like to hobnob with the rich; aside from their other attractions, they are the best source of campaign funds. Limiting corporate and union contributions — as have Manitoba, Québec, and more recently Ottawa — is an imperfect solution because big money will generally find a way around the rules. Politicians also seek out wealthy people because they've always got one eye on the day after an electoral defeat. A good job in the wings is a relief when, as is the case with many career politicians, they have no marketable skills. However, the relationship is symbiotic: the wealthy want government policy to favour them, and to protect them too: as a tiny minority unable to shelter under the language of human rights, they are vulnerable to various forms of expropriation by the masses, also known as voters.

The dominant figure at the intersection between power and money in Canada is Québec entrepreneur Paul Desmarais, our finest practitioner of the art of herding politicians. As chairman of Power Corporation, a multi-billion dollar company that ranks eleventh in assets and twelfth in sales in Canada, Desmarais has every reason to invest in politicians, with party stripe being of secondary consideration. At the same time, his role is a source of strain in a political system premised on the equality of citizens.

Brian Mulroney had done work for him as a labour lawyer, but Desmarais's connections with Jean Chrétien were even closer: they shared grandchildren from the marriage of France Chrétien to André Desmarais. Power Corporation executive John Rae ran Chrétien's election campaigns and was one of his closest confidants. Yet Paul Martin, who forced Chrétien from office, is also well connected to Desmarais. Martin began his business career at Power Corp in the 1960s, working for Maurice Strong, the company's president. Desmarais gave Martin the presidency of its subsidiary, Canada

Steamship Lines, and Martin and a partner eventually bought the company. Martin became a very rich man.

Paul Desmarais has survived two decades of stormy political waters, going about the business of acquiring wealth and adding ex-politicians and their aides to his stable. No wonder that, to many of my neighbours in British Columbia, the power elite in Canada looks like one big happy family.³

MY LIFE WITH BRIAN

I met Brian Mulroney once before going to work for him — if seeing him at the 1983 Grey Cup game qualifies as a meeting. I'm quite sure we did not exchange words, and I was surprised, three years later, when Paul Tellier, the Clerk of the Privy Council, asked if I'd be interested in coming to Ottawa to help with a major constitutional initiative.

In the 1984 election, Mulroney had promised to secure Quebec's consent to the Constitution, "with honour and enthusiasm." Now, just before the 1986 Premiers' Conference and my arrival in Ottawa, he wrote to the provincial premiers requesting that they defer "a more extensive revision of the constitution." They agreed and I, along with Lowell Murray, government leader in the Senate and minister of state for federal-provincial relations, was assigned to the case.⁴

In March 1987, after several cross-country tours, we advised Mulroney that a constitutional agreement could be achieved. However, Murray left our final briefing with Mulroney shaking his head at the prime minister's obvious lack of preparation. He persuaded Mulroney to have me sit at his side during the first ministers' meeting at Meech Lake on April 30, 1987, which turned out to be a very long but exciting day.

Mulroney was brilliant as a negotiator, alternating between letting others talk and cajoling them towards an agreement. On each of the issues, I pulled from an accordion file alternative drafts that Murray and I had prepared with the assistance of my excellent staff. Mulroney occasionally asked for clarification before passing the text around the table. Always he made it clear that he would not be leaving without an agreement. Advisers were kept out of the room, though the premiers were able to consult them over dinner. To the great surprise of journalists who had been waiting sceptically all day, shortly before 10 P.M. he announced a unanimous agreement in principle.

A few days later, Mulroney sent me to Montreal with my col-

league André Burelle — Trudeau's constitutional adviser and speech-writer during the 1980 Quebec referendum and subsequent constitutional discussions — to brief the former prime minister. We did not know how unpersuasive we had been until a few days later, when Trudeau published a scathing denunciation of the accord in both English and French.

As we worked with officials through May on the legal text of the Meech Lake agreement, I could sense the nervousness that Trudeau's intervention had caused in some provincial delegations. Mulroney invited the premiers to a meeting at the Langevin Building on June 2 to work out the remaining problems. After considerable pushing and pulling overnight, he ended with a unanimous agreement. To bring Ontario's David Peterson and Manitoba's Howard Pawley onside, however, he agreed to refer the accord to a parliamentary committee for public hearings. Changes would be accepted only if "egregious errors" were identified; still, New Brunswick premier Richard Hatfield, a veteran of past constitutional wars, sniffed the risk in the three-year ratification process and insisted that all governments commit to passing it "as soon as possible."

Mulroney remained engaged for about a month, until the first polling results arrived. I did not know it, but his entourage had been boasting about their man's historical accomplishment where Trudeau had failed. However, to their and Mulroney's chagrin, though the majority of Canadians supported the accord, the polls indicated that it was unlikely to sway their vote. Mulroney became less engaged and, with Peterson keeping his head down in the face of mounting opposition, Murray and I were left on our own to play defence.

Notwithstanding a doctorate in political science, I had much to learn, I discovered, about the depth of the cleavage between Canada's two solitudes, the power of the media, and the interaction between interest group and partisan politics. As I watched Chrétien use the accord to destabilize John Turner's leadership, and then to attack his rivals in the subsequent race, I also learned a great deal about the Liberal Party of Canada.

During the summer of public hearings, several journalists placed bets on when the government would accept amendments. Later, nervous premiers insisted they had three years to adopt the constitutional resolution, which was legally true, though unhelpful. In hindsight, I wonder whether Mulroney should have replaced Murray and me at this time. Both of us were acutely conscious of the fragile compromises that underlay it. I've always found it hard not

to give a straight answer to a straight question, and did not gladly suffer interest-group leaders – many of whom posed impossible worst-case analyses – after the accord was signed. Murray, a dour Cape Bretoner with an MPA from Queen's, is literate, considerate, and unflappable; however, his considerable strengths do not include public communication. Though he chaired the Cabinet Committee on Communications, the government did not undertake any advertising program, as it did in previous and subsequent federal initiatives of this kind.⁵

Increasingly, Mulroney was preoccupied with the negotiations that ultimately culminated in the Canada-U.S. free trade agreement. On the evening of Saturday, October 3, a small group of us gathered on the second floor of the Langevin Building for the final sprint. Just after midnight he asked me to inform the premiers that an agreement had been initiated by our negotiators in Washington. Peterson in Ontario was not pleased, and Pawley responded in Manitoba by dragging his feet on ratifying the Meech Lake resolution in his legislature.

Later that month Mulroney sent me to Fredericton to brief the new Liberal premier, Frank McKenna. In his election campaign against Hatfield, McKenna had promised to change the Meech Lake accord. He had also expressed misgivings about free trade, which, by that time, was a higher priority than Meech Lake for Mulroney. It may have been a coincidence, but in December 1987, two days after their premier had come out in support of the free trade agreement, the Irving-owned Saint John shipyard received a \$6 billion contract – without tender and over the objections of Quebec – to build an additional six frigates for the Canadian navy.

By then I enjoyed Mulroney's full confidence for having delivered provincial support for his government's two major initiatives – constitutional reform and free trade. In his entourage I was considered a "helpful" deputy – a category that included Ray Hession, the deputy minister of the Department of Supply and Services, which had procured twelve MBB helicopters for the Coast Guard. Colleagues who were less well positioned sometimes turned to me for assistance, including Undersecretary of State Jean Fournier, who arrived at my office one day in 1988 looking very anxious.

Senator Michel Cogger was pressuring Fournier to fund a computerized document translation system. After listening to his concerns about a system he thought was a dog, I handed him a draft speech Mulroney had reworked and suggested he feed it into the system. I promised Fournier I would show it to Mulroney if he ran into

any further difficulty telling Cogger that the government was not interested in the GigaText system. He was able to turn Cogger off; however, to the eventual chagrin of Saskatchewan taxpayers, Cogger's sales pitch moved to the government of their small, have-not province.

Shortly after the 1988 election, the Supreme Court struck down a Quebec law on the language of commercial signs. The minister responsible, Claude Ryan – a former Quebec Liberal leader and editor-in-chief of *Le Devoir* – insisted on using section 33 of the *Charter of Rights and Freedoms*, the notwithstanding clause, to foreclose any challenge to the replacement legislation. Sensing the landmines, Mulroney hesitated to condemn and ended up temporizing. Essentially, notwithstanding their public spats, I always felt that Mulroney's views on bilingualism were similar to Trudeau's; with the reaction in English Canada intense and emotional, Mulroney eventually ignored the advice of his Quebec lieutenant, Lucien Bouchard, and criticized the Bourassa government. However, the controversy provided a perfect excuse for the newly elected Conservative premier of Manitoba, Gary Filmon, not to proceed with ratification of the constitutional amendment. Filmon headed a minority government, with Liberal leader Sharon Carstairs – a devotee of Pierre Trudeau and Jean Chretien – holding the balance of power. Another Trudeau fundamentalist, Clyde Wells, had been elected premier of Newfoundland in the fall of 1989, and he withdrew the ratification resolution adopted by his Conservative predecessor.

With prospects for its success dimming, Mulroney re-engaged on Meech and told me that he was adding Paul Tellier and his chief of staff, Stanley Hartt, to the constitutional team. He also told me that he had been consulting with Paul Desmarais, and that Hartt was already meeting with two very close Chretien confidants, Eric Malloff and Eddie Goldenberg.

Murray and I were dispatched to help McKenna draft a "parallel accord" that would add elements to the Meech constitutional amendment without, we insisted to Quebec, modifying it – at least not too visibly. Eventually, Roger Tassé – Chretien's deputy minister in the 1980-82 constitutional discussions – was brought in from the outside to help out.⁶

After a parliamentary committee chaired by Jean Charest completed its hearings on the parallel accord and proposed changes to Meech Lake, Mulroney invited the premiers to a meeting at the Museum of Civilization in Hull on June 3. McKenna agreed almost immediately to the "improved" accord, and attention turned to

I had and Newfoundland. Miraculously, at this point near the end of the Liberal leadership campaign, Chrétien began to soften his opposition to Meech Lake. His people lobbied Carstairs, and New Democratic Party leader Ed Broadbent urged Gary Doer, who was then the leader of the third party and is now the Manitoba premier, to move simultaneously with the others to pass the accord in the legislature. However, after a full week of negotiations, Mulroney got only part way. Even after Peterson gave up six Senate seats, Clyde Wells would commit only to putting the amendments before his legislature, or to the people in a referendum, with no recommendation. Yet, in a move that puzzled me, Mulroney convened a formal signing ceremony late at night on Saturday, June 9, which ended in the early hours of Sunday morning.

On Monday, as a favour to *Globe and Mail* editor William Thorsell, Mulroney agreed to be interviewed by three of his reporters, including Susan Delacourt. Thorsell had deliberately assigned Delacourt – a fierce though professional Meech sceptic – to the file to counterbalance the *Globe's* generally supportive editorial line. I still recall the surprised faces in Paul Tellier's boardroom when press secretary Gilbert Lavoie popped in to inform the prime minister's closest advisers of the interview that had just taken place. We were even more shocked the next day when we read Mulroney's boast in the *Globe* about having timed the conference to maximize pressure on the premiers. Mulroney protested vehemently and demanded a retraction, which was quickly drafted. However, with talk of resignations in the air, *Globe* Ottawa bureau chief Chris Wadell persuaded Thorsell not to run it. The "rolling the dice" interview was the final nail in Meech Lake's coffin.

Once the mourning for Meech was over, Stanley Hartt was free to return to the private sector, but first he had to find a successor as Mulroney's chief of staff. Despite my repeated demurals, Hartt continued to inquire whether I'd accept the position if asked. In the late summer of 1990 Mulroney invited me for the first time to Harrington Lake, the prime minister's summer residence. As I drove past the cut-off to Meech Lake, it crossed my mind that the invitation might be his way of saying goodbye. Instead, he spent about half an hour outlining his determination to try again to reach a constitutional accord. His chief of staff would have to keep an eye on Joe Clark and the new team of officials who'd be responsible for the file. I felt some responsibility to manage the aftermath of the Meech failure; I suppose I was also flattered. Though I knew I would be jeopardizing my public service career by going to work in the PMO, I accepted his offer.

I was unhappy almost from the first day when Mulroney announced, Premier Grant Devine arrived to plead for federal monies to assist a dam project in Saskatchewan. Over the next months, it was very frustrating to watch Joe Clark make up what became the Charlotte town accord as he went along. The pressures were intense: Mulroney would telephone at all hours, and regularly after the lead item on the national news. Very soon, I brought Hugh Segal – who had also been on Mulroney's short list – into the office as deputy chief of staff. Paul Tellier asked incredulously if I knew what I was doing, and I assured him I did.

Before leaving, Stanley Hartt – a brilliant but disorganized man – had handed over forty-one "active" files. I farmed most of them out to the relevant departments, including one related to the Montreal Bronfman family. The second generation's wealth was sheltered by the so-called twenty-one-year rule governing family trusts. Its imminent expiration threatened their pocketbook and the third generation's inheritance; for several weeks I received increasingly frantic calls from a Bronfman senior executive. Eventually I told him I had handed the file to Finance and asked that he stop calling. Several months later, I pointed to the Bronfman file as an example of the mess I had found when I arrived in the PMO, and was determined to clean up. Mulroney replied that he'd never heard of the issue, and I wondered to myself whether Hartt may have been freelancing. Today I don't honestly know what to believe, just as I don't know what to think about so much of what I experienced working for Mulroney.

That's not to say I did not like him. According to Tellier, who had worked alongside him from the beginning, Mulroney had never once raised his voice in anger, no matter how stressful the situation. He's also a great family man: when one of the children came into the room, everything stopped, no matter how important the issue we were discussing. He's charming, particularly in small groups, and a great storyteller with a fantastic sense of timing. Beneath the cloying exterior Kaplan describes, he has a wicked sense of humour. Yet, in reading *A Secret Trial*, a powerful disquiet came over me. Closing my eyes, I could see and hear my former boss as he badgered Kaplan with one argument after the other not to publish the story of the cash payments. All his weaknesses, and some of his strengths, are on display in the narrative. After I got to know Mulroney better, I understood that he carried the insecurities of an outsider who had grown up as a working-class anglophone on Quebec's North Shore. More than once, for example, he warned me never to believe that Canadians were a generous and tolerant people.

Mua Mulroney, ensconced with her own staff in an office on the first floor of the Langevin Building, was a constant challenge. Believing it an honour to work for them, she constantly made it clear that the Mulroneys had done me the favour by hiring me. She had an expensive lifestyle, and Mulroney was not a rich man. Party funds were being drawn, and one of our staff was assigned to pore through personal expenses to determine if some might be reimbursed. Every month I cashed a cheque at a local bank and remitted the funds to Mila.

For the leader of an important G7 country, Mulroney spent what I thought was an inordinate amount of time doting on the wealthy. A trip to Paris coincided with the ceremony conferring the Légion d'Honneur on Paul Desmarais. The Varis, Helen and George – a Hungarian-born millionaire who ran Sefri Construction – popped up there and everywhere. During the Meech saga, Conrad Black received special attention when he turned negative after Premier Bourassa used the notwithstanding clause. Indeed, Black's long letter on Meech provoked a mini-crisis in our office. Though it would be several years before I met him, Mulroney asked me to draft what turned into a fourteen-page reply that he reworked, in his own hand, several times.

Other than dutifully signing correspondence, Mulroney, I soon learned, was a telephone addict – and that, perhaps, explained why he had not done his homework for the Meech Lake meeting. He loved to trade political gossip, and he regularly called wealthy and influential people. He never missed an opportunity to stroke caucus members celebrating a birthday or mourning a loved one. He was magnificent at this and, unlike the more popular Chrétien, never faced a caucus revolt.

I don't know for sure, but I guessed that the phone calls were one source of the notes about specific files that Mulroney referred to Paul Tellier at nearly every meeting. However, since Tellier had thrown Karlheinz Schreiber out of his office for alleging a public service conspiracy against him, Mulroney handed the Bearhead project file to me. He asked that I meet with senior federal officials and “ensure it was approved expeditiously.” I smelled trouble, so I invited Robert Fowler, the deputy minister of national defence, to my office. Fowler had prospered under Trudeau and had had a “good transition” under Mulroney, but he was not on the “helpful” list. I listened carefully as he explained that the Bearhead proposal to manufacture light armoured vehicles (LAVs) would threaten the viability of GM's existing operation in Ontario.

At the urging of Nova Scotia regional minister Elmer A. MacKay, I agreed to meet Schreiber in my office and listened politely as he wove his picture of an elaborate conspiracy. I knew I would need witnesses, and I gathered all the players around a table, including Minister of National Defence Bill McKnight and MacKay – who had introduced Schreiber to Mulroney. After listening to a rambling discussion, I asked the participants to prepare jointly a cost-benefit analysis. Someone, perhaps Schreiber or MacKay, had told Mulroney that the project would not cost a dime. However, the agreed-upon analysis indicated that \$100 million would have to be booked in the fiscal framework if it went ahead.

A few days later, seated beside Mulroney in the back of the armoured Cadillac limousine, he asked whether I had made any progress on Bearhead. We were en route to a speech in Quebec, but I had brought notes and informed him about the cost. He seemed surprised and declared immediately, “In that case, the project is dead.” But it wasn't – at least not completely.

In 1998, long after I had resigned as Mulroney's chief of staff, I learned that the Bearhead project had not been buried that day in the limousine. The first inkling came in an email from Lowell Murray, whom I had asked about a newspaper report, which I found very bizarre, that former Liberal minister Marc Lalonde had posted bond for Schreiber. In the course of our exchange, I learned that Hugh Segal had dealt with the Bearhead project after I left the PMO.

Kaplan raises a number of questions Crown lawyers should have asked Mulroney during the discovery phase of his defamation suit in 1997. I've long wondered why they did not ask why a project that he said had been killed on my recommendation never, in fact, died.

AFTER LIFE WITH BRIAN

In early December 1991 I submitted my letter of resignation to Brian Mulroney, and someone close to him leaked the news almost immediately. Eventually, the prime minister turned his attention to what to do with me. Tellier raised the idea of sending me to Paris as ambassador, but Mulroney opted for Tel Aviv.

Abroad, I had little contact with former colleagues. A few Cabinet ministers visited, but most wanted to discuss Mideast politics. From time to time I read about issues with which I was familiar. While abroad, for example, I learned that the government had tabled legislation just before the deadline to exempt family trusts from taxation until the last beneficiary had died. And later I read that two related

trust. I moved \$2 billion from Canada, without paying capital gains taxes, thanks to a secret advance ruling made late in 1991 by senior officials at Revenue Canada. I also made a mental note when Mulroney named Conrad Black and Charles Bronfman to the Queen's Privy Council, an appointment that will allow them to use the honorific "Honourable" for the rest of their lives.⁸ This seemed strange: I knew Mulroney had been inked by his lack of control over the Order of Canada. However, I didn't understand why non-ministers would be appointed to a body that provides the sole constitutional underpinnings of Cabinet government.

After the 1993 election I continued to serve Jean Chrétien's government as ambassador to Israel and the Palestinian Authority. During this very productive period, Canada and Israel began negotiations that eventually led to a free trade agreement. And I was able, twice, to bring Israeli prime minister Yitzhak Rabin to Canada. It was with mixed emotions, therefore, that I took a telephone call late one night in January 1995 and was advised by Tellier's replacement as Clerk of the Privy Council, Jocelyne Bourgon, that I'd be coming home at the end of the normal three-year term, to be replaced by David Berger, a Liberal MP and thorn in Chrétien's side. Following instructions, I informed the Israeli foreign ministry and obtained the necessary *agrément*. However, after word of the patronage appointment leaked, the government denied all and Berger was appointed as an adviser in the PMO — a delay that meant I was allowed to stay on in the Mideast for six more months.

To my pleasant surprise, Bourgon confided in her phone call that the prime minister wanted me to remain in the public service. A few months later she called again to report that Chrétien wanted me to run the Atlantic Canada Opportunities Agency (ACOA). She explained that a senior deputy minister was needed to keep an eye on David Dingwall, whose proclivity for pork-barrelling — though much appreciated by Cape Bretoners — had attracted negative press. I had first met Dingwall in Israel and had shown him around the country. His major ministerial portfolio was Public Works, where he put in place an advertising-management process that would later be extended to deliver sponsorships in Quebec.

Though ACOA's head office was in Moncton, I was in Ottawa one day a week. A month after taking up my new job, Sergeant Fraser Fiegenwald of the RCMP came calling to ask for the agency's files related to the Bearhead project — particularly the agreement in principle signed on the eve of the 1988 election.⁹ I mentioned in passing that I had served in Mulroney's PMO, which surprised him. He asked me about Airbus, and I told him the transaction had been concluded

ed before my time. However, I also informed him that I had been involved with the project that was the subject of his visit. Fiegenwald and his boss, Inspector Yves Bouchard, later returned to take a sworn written statement. Before leaving, they asked that I not tell anyone.

I agonized for a couple of weeks before advising Jocelyne Bourgon — the person to whom all deputy ministers report (aside from their minister). I sensed she was surprised, and more than a tad perturbed, that the RCMP had not informed her about the investigation. I left with the impression she'd be on the phone immediately to rake Commissioner Philip Murray over the coals.

Back at ACOA, I was having difficulty stopping the agency's embarrassing proclivity to lend cash to companies that didn't need it, deserve it, or have the ability to use it profitably. Liberal MPs complained to Dingwall that ACOA was slowing down the approval of project loan applications and financing requests. One MP summoned me to her office and explained that she, not I, should decide who received government money because she had to get re-elected every four years.

In 1996 Chrétien shuffled his Cabinet, and industry minister John Manley was given responsibility for ACOA. We now had a secretary of state too — Laurence MacAulay, the regional minister for PEI. Dingwall moved to Health but maintained an active and unhealthy interest in Cape Breton. When the government announced the closing of the Devco coalmine and the elimination of 600 to 1,200 jobs, he demanded that MacAulay set aside \$60 million to cushion the blow.

MacAulay would have preferred to use ACOA's budget to fund projects in PEI, but he understood that Dingwall was better connected to Chrétien, so he agreed. Although the Liberals could have flowed the dollars through ACOA's existing programs, Dingwall wanted to approve projects himself. Because most of the applications flooding in to his political staff contained no analysis and no rationale, he did not want normal program criteria to apply.

At first I tried to negotiate the least problematic proposals with him. However, Dingwall was insatiable, and the projects were of increasingly dubious merit. Eventually I suggested that he sign off on the projects. Not surprisingly, he was anxious that public servants take responsibility for "economic development" projects that included refurbishing the Sydney waterfront, a chair in tourism, a new student residence at the local college, and a variety of forestry projects that ACOA did not fund in any other province. I tried to protect my staff from political pressure, but Dingwall called on an ally in the PMO — Dominic LeBlanc, son of the former governor general

and late. Several MP from New Brunswick. Privy Council Office officials, who are supposed to preserve the integrity of the public service, looked the other way when they were not adding to the pressure on my staff. Though I complained to Bourgon, she just smiled. Eventually, I was summoned by Jean Pelletier, Chrétien's chief of staff, and warned about my growing reputation for having an "uncooperative" attitude.

In contrast to the charmed existence I had led under Mulroney, now I had no friends at court. For a time Eddie Goldenberg, whom I had known at McGill, tried to help. John Manley and his staff initially ran interference with the PMO, but they moved on after dividing that MacAulay and Dingwall had the full backing of the Boss. Faced with a choice of giving in to political pressure or resigning, I advised Bourgon that I would be leaving the public service. Though not in the way I had feared when I went to work for Mulroney, ultimately the change in government did, then, spell the end of my public service career.¹⁰

Seated beside Jocelyne Bourgon at the retirement dinner she hosted in my honour, I asked how RCMP commissioner Murray had reacted when she upbraided him for not mentioning the Bearhead investigation. Bourgon told me that he insisted he had no obligation to inform her, as Mulroney was no longer a minister. Later, when I publicly disclosed my first conversation with Bourgon, the RCMP denied she had ever contacted Murray about the issue.

While Bourgon never disputed the substance of that conversation, the Privy Council Office issued a written statement declaring that she had not concluded from our meeting that Mulroney was under criminal investigation. The deputy minister of justice, whom I had also informed, issued an almost identically phrased written statement. In political and bureaucratic circles these are known as non-denials, since no one can quarrel with the conclusions another person reaches.

In the best tradition of a lawyer arguing on behalf of a client, Bourgon's staff added that even if she had understood that Mulroney was under investigation, she would not have informed Chrétien. I would have, because it is always dangerous to withhold information from a prime minister. Had she informed Chrétien, there's no reason to believe he would have interfered politically. However, it would have been reasonable for him to issue a sharp admonition that officials and the police carry out the sensitive investigation with the utmost care.

After I resigned, the *Globe and Mail* editorialized: "Mulroney respected public servant Norman Spector in charge. . . . billed him as the man who would henceforth disburse grants based on economic merit, not political connections. Then he started living up to the advance billing. The Atlantic Canada caucus was shocked; the MPs think that ACOA's funds should continue to be doled out on a 'political' basis. Mr. Spector is no longer with ACOA. Ah, that a politician's reach should never exceed his grasp, else what is being in government for?"¹¹

REFLECTIONS

As I write these words and reflect on current events in the context of my career experience, I am reminded that the odour of corruption was not unique to Brian Mulroney's Ottawa.¹² This observation is not meant as an excuse; however, it does suggest that the problem is systemic, not personal, as any solution must be.

Kaplan reminds us of the offshore money that fuelled Mulroney's two leadership campaigns. These costly contests inevitably leave many people feeling they have 100s. Hangers-on in "consulting," advertising, investment banking, and legal firms expect rewards. Like Mulroney, many of those who accompanied him to Ottawa in 1984 had memories of having been shut out of the best patronage opportunities up to that point in their careers. Yet Mulroney came to office promising to clean up Liberal patronage and corruption.

In 1993 Chrétien too came to power promising new ethical standards and an independent commissioner reporting to Parliament to enforce them. Yet it sometimes seemed that the biggest change under Chrétien was in the political coloration of the lobbyists, law firms, investment brokers, and advertising firms that did business with the government.¹³ It was only after he left office that Canadians saw the full dimension of the rot. With a historically weak parliamentary opposition, one has to wonder where the media were during these years.¹⁴

The seeds of the sponsorship scandal that exploded after Paul Martin entered the Prime Minister's Office were planted in a strategy document concocted at the Pearson Building towards the end of the 1995 referendum campaign. Chrétien's advisers, in near panic, were open to ideas from any quarter, including the department responsible for Canada's foreign relations. More remarkably, a public servant (George Anderson, a close friend of Eddie Goldenberg)

expo on the need to defeat Bloc Québécois MPs - which, in the political landscape that existed after the 1993 election, amounted to electing Liberals.

Five years before he nearly lost the country in that referendum, Chrétien had predicted that the death of Meech Lake would be no big deal. It was like getting stuck in the snow: you could always try again to move forward. Yet he made no attempt to amend the Constitution during his years in office. And, rather than trying to win the hearts and minds of Quebecers through democratic dialogue, he chose to conduct a propagandistic campaign. Like most of his boot-dogglers, the sponsorship program grew out of Chrétien's desire to escape the rules of prudent public administration. Resorting to tactics he had honed as the minister responsible for the Canadian Unity Information Office during the 1980 referendum, his government discovered a supreme national interest in funding car races and comedy festivals.

David Dingwall had ACOA for purposes of pork-barrelling. Backbenchers looked on enviously and, eventually, they too got a turn at the trough through the Transitional Jobs Fund of the Human Resources Development department, but that eventually led to another scandal and came to an end. Ultimately, unhappy backbenchers fuelled Paul Martin's internal party coup against Jean Chrétien. For the first time in Canadian history an elected prime minister was forced from office. Fundamentally, Martin's decade-long campaign was about who should govern, not about good government. Is it any wonder the public has grown increasingly cynical?

If a deputy minister in Ottawa is fortunate, he'll never have to manage dollars dear to a prime minister. Alternatively, she'll be working for a minister motivated solely by the public interest (yes, they do exist). My luck ran out when I went to work for Dingwall. Ran Quail, the deputy minister of public works, found that his luck ran out when Chrétien turned to his department to deliver sponsorships in Quebec. Just a few years previously, Dingwall had landed on his doorstep as his minister, with responsibility for government advertising. Quail and I used to commiserate over drinks about the boss we shared. A veteran of the Coast Guard, Quail is straight as an arrow and mild-mannered, and was therefore no match for Dingwall's heavy-handed tactics.

The rulebook says that a deputy minister should inform the clerk of the Privy Council when a minister applies pressure to break the rules. Quail later testified that he had not done so when problems first popped up with sponsorships, because Chrétien had signed the

Treasury Board submission and he assumed that the minister and the clerk wanted the program to be run that way. No doubt, he also knew from our conversations that the Privy Council Office would back Dingwall and would even help enforce the wishes of Jean Pelletier, Chrétien's chief of staff. In the end, Quail went along when Dingwall chose Chuck Guité to run advertising programs. He promoted Guité at the request of a subsequent minister, Alfonso Gagliano, and allowed the two to deal directly on sponsorships. Later, when it was time for Guité to go, Quail accepted the parachuting of Gagliano's chief of staff into the civil-service position.

When I left Ottawa for the Mideast in 1992, he and other deputy ministers were working on a public service revitalization project called Public Service 2000. One group was assigned by Paul Tellier to write a paper on values and ethics. When I returned in 1995, deputy ministers were hard at work on a similar exercise launched by Jocelyne Bourgon. While I was dodging Dingwall's efforts to pork-barrel with ACOA funds - and Bourgon was doing nothing to help me resist political pressure - another working group was writing another paper, at her behest, on public service values and ethics. Completed a few months after I resigned from the public service, this otherwise excellent paper is flawed by a fundamental contradiction. By assigning the highest ethical value to carrying out the wishes of the government, deputy ministers were proposing, in the most charitable interpretation, an amoral definition of the public service.¹⁵

The deputies' talk about ethics was just that, notwithstanding their recommendation to adopt a formal code and a mechanism to resolve disputes when an ethical public servant balks at something that is going on - one modelled on the system used in the United Kingdom. For, in the very next breath, the deputy ministers rejected their British counterparts' legal and political accountability to Parliament for the financial administration of their departments, arguing that it would undermine ministerial responsibility. As I watched the Public Accounts Committee hearings on the sponsorship program, I found it hard to see how the situation could get any worse. The instinct of ministers was to blame others when found out; and the instinct of officials was to find ways to be out of the loop when "just following orders" would be an inadequate defence. You could call it the banality of corruption.

Some politicians seek public office to change the world; others try to hang on to office by buying support with public funds. They can always find a Chuck Guité to deliver the goods, and they're quick to blame anyone but themselves if things go wrong. Aside from high

living... expense accounts and the unfair stereotype that they are lazy layabouts, complicity in government boondoggles is the major cause of the deteriorating image of federal public servants.

The sponsorship program was not an aberration, nor was it the result of relaxed management controls, as the current clerk of the Privy Council suggests. The scandal was the inevitable outgrowth of longstanding malignancies in the system. I know one very courageous woman who refused to knuckle under to PMO and PCO pressure to approve dubious projects. Today, she is raising dogs and walking the beach in Nova Scotia. However, most bureaucrats have mortgages and kids, and, sometimes, the only option for the ethical ones is to hunker down and take notes. But where, pray tell, were two successful clerks of the Privy Council during the sponsorship years?

Properly structured, direct accountability of deputies to Parliament would enhance ministerial responsibility. On most decisions, a minister and his deputy are as one. When they are not, the minister should take the decision and be accountable to Parliament. Twenty-five years ago the Lambert Commission on Financial Management recommended something along these lines. Had the Lambert recommendation been adopted (a simple amendment to the *Financial Administration Act* would suffice), the deputy minister of public works would not have been able to look the other way and give Guinée free reign to run the sponsorship program. Before setting it up to operate outside normal channels, Liberal ministers would have had to gauge whether they could persuade Canadians that funding comedy festivals was about the national interest, not their partisan interests. And ministers and prime ministers would have to think twice before giving instructions to have "regional development" projects or defence-related procurements approved "as soon as possible."

For most of his decade of one-party rule, Chrétien trumpeted that Canada was the best country in the world in which to live, according to the UN's Human Development Index. He never once mentioned that, at the same time, our position was deteriorating markedly in Transparency International's "Corruption Perception Index." In 1995 we ranked fifth; by 2003 we had fallen to eleventh. According to the Berlin-based watchdog, construction companies vying for public works projects in developing nations are most likely to bribe government officials to win contracts. Businesses operating in the energy and defence industries - which would include Eurocopter, Thyssen, and Airbus Industrie - are also apt to engage in shady deal-

ings. Who knows where we would have ranked had transparency International examined Canada between 1984 and 1993.

While reading Kaplan's *A Secret Trial*, I thought back to Mulroney's first chief of staff, Fred Doucet, who, with Elmer MacKay, had introduced Schreiber to Mulroney. After leaving the PMO, Doucet went to work as a lobbyist and he still occasionally brought people to Mulroney's Parliament Hill office after Question Period. Perhaps he was on charity missions or working for private clients pro bono. I cannot say for sure, since we prepared no briefing material and were not present for the discussions. The appointments were not booked through our office and did not appear on our weekly schedule.

Kaplan concludes that there was a clear "factual basis" for the RCMP investigation of Airbus, MBB, and Bearhead. Yet he also raises questions about the force's competence and political independence. In 1995 Commissioner Philip Murray was personally interested in the investigation continuing. In 2003 the RCMP shut down the investigation without taking up Schreiber's two offers to tell all. As Kaplan notes, "Unsolved murder investigations are not ended. No unsolved criminal investigations are. They become cold files, not dead files. Except this one."

However, questions can and must also be asked about the RCMP's investigation into Jean Chrétien's role in securing a Business Development Bank loan for an insolvent hotel in his riding, adjacent to a golf course in which he still, technically, owned shares. Chrétien's lobbying to secure the loan likely contributed to Canada's slide in international rankings of corruption. For, in professing that he was not in a conflict of interest, Chrétien set a dangerous standard for ministers and backbenchers. Had not the prime minister - Shawinigan's number one constituent - repeatedly stressed that ministers are first of all MPs, and that it's the duty of MPs to represent constituents?

The Auberge Grand-Mère story took a serious turn when a document, ostensibly the BDC's, arrived at the *National Post*. This time editors had no interest in burying a potential scandal (though they eventually took Andrew McIntosh off the case).¹⁶ However, they were unsure about the document, which showed that the Auberge owed \$23,940 to Chrétien's holding company. If it was authentic, he would have been an indirect beneficiary of the loan for which he was lobbying - potentially, a criminal matter.

The PMO claimed the document was a forgery, and the BDC

obtain court order permitting a search of the home and office of its fired president, François Beaudoin. For months the RCMP made no progress and, in December 2001, it announced that "the investigation was being wrapped up." As McIntosh reported, investigators were "unable to confirm" the document was a forgery, but also "unable to conclude" that it was not.¹⁷ Subsequently, the RCMP raided Beaudoin's home and cottage looking for evidence; then, when the police went to court demanding that the *National Post* turn over its copy, it provided what it said was the original from BDC files. It turned out that someone had forged the hotel owner's signature on the *Post's* copy.

For me, a non-lawyer, the most troubling aspect of Kaplan's two Airbus books is his description of the criminal justice system. In *Presumed Guilty*, he exposes Keystone Kops who bungle investigations, mid-ranking officials who don't consult with superiors on politically sensitive matters, and an RCMP commissioner who's proud not to know what his officers are up to. In *A Secret Trial*, Kaplan describes the tactics used by high-priced and highly skilled lawyers to get their clients off. Simply put, the police and the courts have not been, and perhaps cannot be, an effective instrument for rooting out political corruption.¹⁸

Convictions such as Senator Michel Cogger's on charges of influence peddling are rare. Even that prosecution had to go through multiple appeals, strung out over more than a decade. And it had to survive political pressure on the RCMP when, in 1990, the government asked René Marin, a retired judge, to look into Cogger's declaration in the Senate "that the RCMP was trying to destroy me, no more and no less." Cogger would call me periodically to ask about the timing of Marin's report. Sixteen months after being appointed, he rejected Cogger's allegation of entrapment. However, he found that the RCMP had been manipulated by an undercover agent who was hired despite a prohibition on his services, and he recommended better training and updated manuals for the force. Eventually, Cogger seized on his one glimmer of hope and argued on appeal that first-term MPs and senators too needed to be educated in the law. In the end, however, he was convicted and he eventually resigned from the Senate in September 2000. In May 2001, Cogger was given an absolute discharge by the Quebec Court of Appeal that, while not reversing his 1998 guilty verdict, had the effect of erasing his conviction. The court reasoned that he had already suffered enough and that, while ignorance of the law is no defence, Cogger had acted in good faith without knowing that his actions were prohibited by the *Criminal Code*.

The court also found that there was no evidence of corruption and that his fees were not excessive.

As Kaplan explains, investigations of prime ministers inevitably raise doubts about police independence. In future, when any politician is suspected of wrongdoing, Ottawa should follow British Columbia's practice of appointing a special outside prosecutor to decide whether charges should be laid.¹⁹ Parliament should also have a veto over the appointment of the commissioner of the RCMP. In order to maintain both the perception and the reality of the police force's independence, the next commissioner should not have deputy minister status and should not be treated as part of the deputy ministers' community in Ottawa.

"Independent" is not a term anyone would ever have thought of applying to ethics counsellor Howard Wilson, who was responsible for ruling on conflicts of interest and compliance with the code on post-employment-activities during the Chrétien decade. Repeatedly, he determined that the two-year "cooling-off" period for public office holders applied only to lobbying Ottawa or taking jobs from firms with which a former minister had "direct and significant" official dealings in his final year in office.

As prime minister, Jean Chrétien hosted a state visit in June 2003 for Kazakhstan dictator Nursultan Nazarbayev, who lobbied for the invitation after his country's "poor [and worsening] human-rights record" was noted by the U.S. State Department. After leaving office, Chrétien signed on with three major law firms; his first announced client was PetroKazakhstan, a Calgary-based oil company.

As prime minister, Chrétien was very busy on the China front, visiting six times, leading two Team Canada trade and investment missions, and meeting frequently with top leaders. He purposely chose to meet Prime Minister Wen Jiabao on his last day in office. Less than two months later, the former prime minister travelled unannounced to China with son-in-law André Desmarais and a team of Power Corporation executives. The company has interests in property development in Shanghai's Pudong district and in manufacturing railway cars in Qingdao. Like the PetroKazakhstan relationship, the trip to China raised eyebrows in the Canadian business community. The *Globe and Mail* learned about the visit, but Chrétien's law office and the Canadian Embassy in Beijing refused to give out any details. A *Globe and Mail* reporter eventually discovered that the visit was organized by Citic, China's biggest and most powerful conglomerate.

ate, with a vast range of interests on four continents in financial services, military exports, energy, real estate, and hotels.

A month later, Chrétien travelled to Niger to meet with President Mamadou Tandja on behalf of the World Energy Corp., a small Calgary oil company. Chrétien became well known in Africa because of his involvement with the Commonwealth and la Francophonie, and is well respected among African leaders because of his promotion of Africa's economic needs, particularly at the 2002 Group of Eight summit in Kananaskis.

What's been novel in the odour of corruption permeating Ottawa during the past two decades is its bipartisanship – a rare spirit in this very political capital city. Take, for example, the “consultants” who live well off their access, or perceived access, to the powerful, and whose shared interests sometimes outweigh their partisan differences.

At Cabinet one day, Mulroney looked up from writing notes, his main activity during ministerial discussions, and asked me to check which company being discussed around the table was represented by his former press secretary, Bill Fox, who was working as a lobbyist. After the Conservatives lost power in 1993, Fox eventually sold his interest in the firm with which he was associated, Earncliffe.²⁰ It transmogrified into a well-connected adjunct of Finance Minister Paul Martin, becoming his PMO-in-waiting and the core group that deposed Chrétien. When Earncliffe's name came up during the sponsorship controversy, the government pointed to its contracts in the Conservative period as a certificate of probity.

What was also new was the public role played by lobbyists. The Tories' pollster, Alan Gregg, after selling Decima Research, reappeared a few years later in partnership with Chrétien's ex-director of communications Peter Donolo. After Auditor General Sheila Fraser released the first report on the sponsorship program in May 2002, Gregg – who was a regular on *The National's* “At Issues” panel – explained frankly to the CBC's Peter Mansbridge how the “system” works: “At the root you have a situation how political parties run their election advertising as they pull together a consortium of essential volunteers. They're either unpaid or if they're paid, they're paid significantly below market value. And at the end of a winning campaign ... there's kind of a nudge, nudge, wink, wink, you know, we owe you one.”²¹

After Fraser's second audit in 2003, Gregg accused the auditor general of “behaving more like the leader of the Official Opposition

than the accountant she is” and belittled the sums involved in his *Globe and Mail* opinion piece identified him as chair of the Strategic Counsel, a polling and research firm.” It did not mention the name of his partner or that the firm does business with the federal government.

Throughout his decade in power, Chrétien dodged the Red Book commitment to appoint an independent ethics commissioner reporting to Parliament. To his credit, Paul Martin – the author of the Red Book – moved on the promise immediately after taking office. However, the post-employment code needs strengthening: it should apply to office holders who have had any dealings with a prospective employer for four, not two, years after leaving government, and the regulations should cover lobbyists and government contractors who move in and out of the system.

Kaplan was surprised and disappointed that the *National Post* proved to be a lapdog for the powerful, and not a watchdog. However, anyone who knows about Brian Mulroney's relationship with Conrad Black would not have been. Still, to the *Post's* credit, another of its reporters, Andrew McIntosh, uncovered Jean Chrétien's dubious dealings to secure the Business Development Bank loan.²² For the longest time, it seemed to me that the CBC's chief political correspondent, Jason Moscovitz, minimized the significance of the story. Eventually, he crossed the street to a senior job at the Business Development Bank of Canada.

There's something Orwellian, even at the best of times, in the government's owning a major source of news and information; Ottawa's power to appoint the president and the board could easily bring on the worst of times.²⁴ In my experience, the public broadcaster is always conscious that the PMO has the final say on its budget and the appointment of its president. In the one-party Chrétien decade, the government cleverly provided one-time funding increases that were not added to the budgetary base. Peter Mansbridge did not follow up on Allan Gregg's surprising confession about how the advertising and polling game works.²⁵ Nearly two years would pass before the CBC's flagship news program, *The National*, took an in-depth look at the sponsorship program.

The CBC did, however, run a brief item on Schreiber's cash payment after the *Globe and Mail* published Kaplan's series. No *Sun* newspaper published details of the payment: that chain is owned by a company chaired by Mulroney. Nor did any of the seven Gesca

newspaper owned by Paul Desmarais find the revelations newsworthy. As prime minister, Mulroney could always count on the publisher of its foremost newspaper, *La Presse*, to find the right words at the right time on the Constitution or free trade. This was not a partisan act: a few years later *La Presse* removed columnist Chantal Hébert — a thorn in Chrétien's side.

As publisher of the *Jerusalem Post*, I learned that many readers are like Chrétien: they prefer not to read discordant views at the breakfast table and gravitate to niche media that confirm their prejudices. Yet, any Canadian who has the time to read more than one daily newspaper or watch more than one TV news broadcast will often find differing reports of the same event.²⁶ Competition and diversity are our only safeguard against media bias.²⁷

A Senate committee chaired by Joan Fraser, who was removed as editor-in-chief of the *Montreal Gazette* by Conrad Black, is examining issues of media competition and diversity, particularly in the private sector. Public broadcasting should not be left out of the equation, given the CBC's huge presence and power in radio, television, the Internet, and cable news and information programming. The corporation and large newspapers should appoint truly independent ombudsmen, as have the *New York Times* and the *Washington Post*; smaller newspapers should consider the industry-wide model of the Canadian Broadcast Standards Council established by private broadcasters.

As he prepared to leave office, Jean Chrétien pointed to national unity as one of his two main achievements — and journalists, for the most part, nodded in agreement. Anyone examining public opinion polls in Quebec in the wake of the sponsorship scandal and the results of the 2004 election, however, would have come to a less sanguine conclusion.

After taking office, Paul Martin maintained he had not known what was going on in the sponsorship program. However, nothing costing a quarter of a billion dollars moves in Ottawa without the Finance Department and other central agencies knowing; only Chrétien's pet project could have escaped scrutiny. Many Canadians suspected Martin had heard rumours in his home province and knew a lot more than he was letting on — he could have found out the rest and put a stop to it by asking a few questions, they reasoned, but he chose not to because a different war against Chrétien had higher priority. Preparing for an imminent election call, Martin and his minis-

ters insisted they wanted to reform the way Ottawa did business.

Almost daily, Stephen Owen, the man who had Dingwall's job at Public Works, would rise in the House of Commons to assure Canadians that he would get to the bottom of the scandal. Yet his government never embraced the non-partisan process he devised in British Columbia when serious allegations are made about politicians. In Ottawa the Cabinet appointed the special counsel assigned to recover sponsorship monies. Cabinet named the RCMP commissioner responsible for most of the criminal investigation. (Quebec government prosecutors were also involved but their ultimate boss, Premier Jean Charest, has deep links to some of the firms being investigated.)²⁸ Liberals were in the majority on the public accounts committee looking into the sponsorship program. And the government appointed the head of the judicial inquiry set up to look into the scandal. Mr Justice John Gomery was named to the bench by the Trudeau government and, later, to head the Copyright Board by the Chrétien government.²⁹ His wife too owes her judicial appointment, and later her promotion to the appellate court, to the Chrétien regime. The two will benefit from special survivor pension provisions Chrétien legislated for a very few judicial couples.

In announcing Mr Justice Gomery's appointment, Paul Martin told the House of Commons: "I would suspect that this particular inquiry will be up and running faster than almost any others we have seen." Not before the election, it turned out. Before beginning his inquiry, Justice Gomery left on summer vacation after appointing two co-counsel. One, Bernard Roy, Mulroney's first principal secretary, recruited Tory candidates for the 1984 election alongside Marc Lévesque, who was fired by Via Rail after Auditor General Sheila Fraser's report. The other, Neil Finkelstein, served as senior policy adviser to Ian Scott, the attorney general of Ontario in the Liberal government of David Peterson, and worked closely with Chrétien's constitutional team against the Meech Lake accord in the late 1980s. In Ottawa, the Martinites spun the appointments as proof of a bipartisan process. Out where I live on the west coast, the commission would not pass the smell test.

In his conclusion, William Kaplan wonders why Karlheinz Schreiber paid Brian Mulroney \$300,000, or, as he puts it, what Mulroney did to earn the money. He also notes that this amount does not "come even close to adding up to the millions in commissions identified in Schreiber's own records for distribution in Canada." Even after writing two major books on the Airbus affair, then, Kaplan does not have the foggiest idea of what happened to more

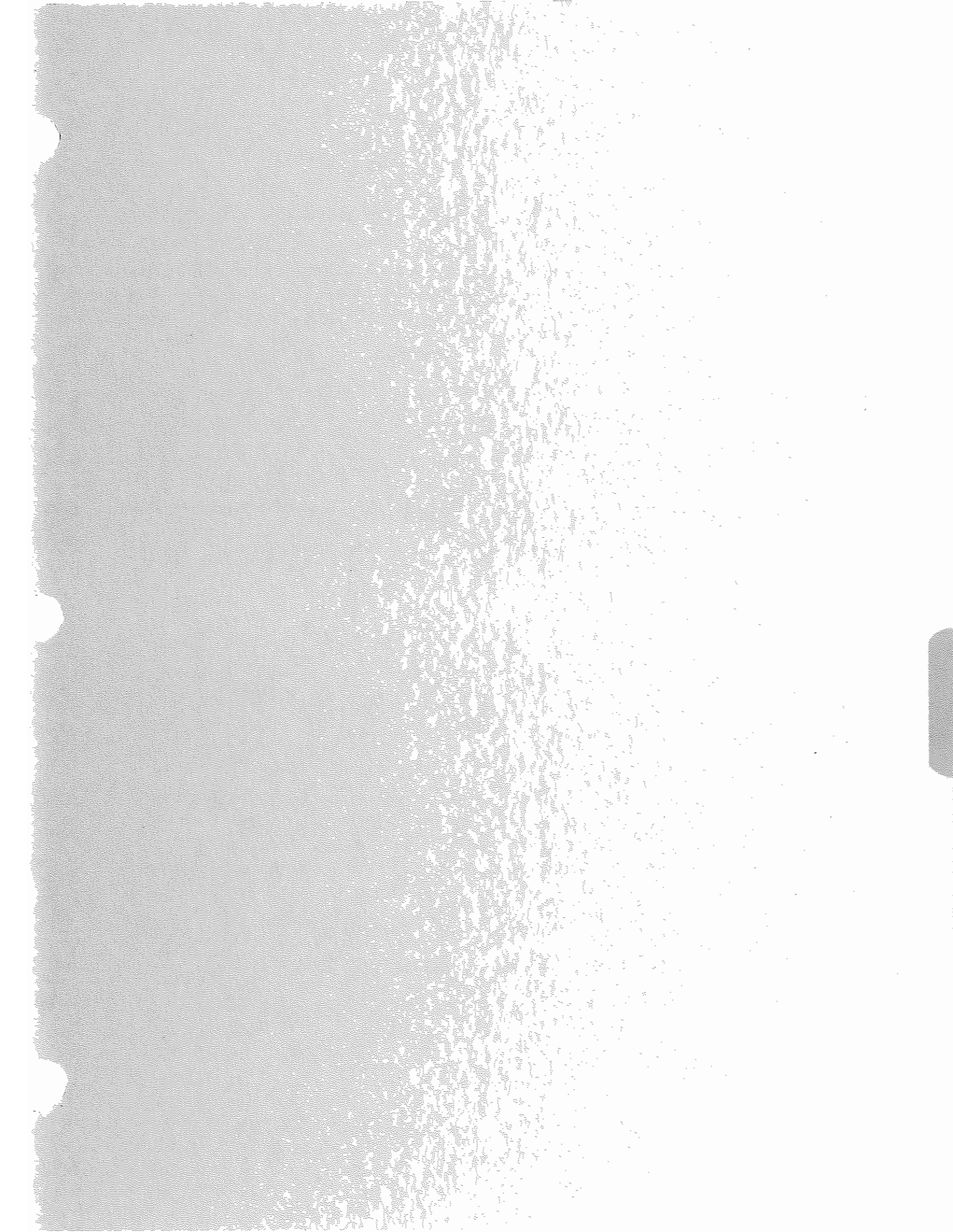
than \$2 million that was paid to Schreiber in commissions by Airbus between September 1988 and October 1993. Pelossi's documents also show that there were secret commission schemes in the MBB and Bearhead projects. As Kaplan writes, "The evidence is incontrovertible that millions and millions of dollars were deployed through middleman Schreiber and that some of that money ended up in Canada."

It's in the public interest that these questions be answered — not just to reduce public cynicism, though that too is important. We must learn the truth in order to assess whether we have adequate safeguards in place to prevent unethical behaviour. If the millions in sponsorship commissions merit a judicial inquiry, so do the Airbus commissions — and the mysteries surrounding the loan to the Auberge Grand-Mère, for that matter — ideally under a new chair and with new co-counsel.

Canadians watch, and wait, as governments repeatedly break election promises and, safely in power, blame each other for deteriorating services — including their number one priority, health. While provinces starve most programs to keep waiting lists from growing longer, Ottawa, awash with cash, is eager to step into additional provincial areas while neglecting its own. Restoration of a competitive political system at the federal level outside Quebec, as a result of the partial reunification of the conservative family, should help revive ministerial accountability. It should also prevent further erosion of Parliament's first duty — to control public spending. But there's no substitute for integrity in high office.

The instinct of ministers at both levels of government is to take credit for anything that goes right and to point fingers at the other or their officials when anything goes wrong. If the guilty are not punished by the courts, if no one can be held accountable for screw-ups or punished at the ballot box, citizens will ultimately question why they bother to vote. Unchecked, this growing public cynicism will provide fertile ground for simplistic solutions that do nothing to address the problem of corruption.

The root of the problem is that money always looks for power; regrettably, the powerful sometimes violate their public trust in the hope of becoming wealthy. The time for concrete action against political corruption, Ottawa's bipartisan problem, is now.



Commission of Inquiry into Certain Allegations
Respecting Business and Financial Dealings
Between Karlheinz Schreiber and
the Right Honourable Brian Mulroney



Commission d'enquête concernant les allégations
au sujet des transactions financières et
commerciales entre Karlheinz Schreiber et
le très honorable Brian Mulroney

Public Hearing

Audience publique

Commissioner

L'Honorable juge /
The Honourable Justice
Jeffrey James Oliphant

Commissaire

Held at:

Bytown Pavillion
Victoria Hall
111 Sussex Drive
Ottawa, Ontario

Tuesday, April 14, 2009

Tenue à :

pavillion Bytown
salle Victoria
111, promenade Sussex
Ottawa (Ontario)

le mardi 14 avril 2009

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1 . 2380 That's all true?

2 2381 MR. SCHREIBER: That's correct, sir.

3 2382 MR. WOLSON: As a matter of fact,

4 when I look at the correspondence -- because you often

5 wrote letters to the Prime Minister, didn't you?

6 2383 MR. SCHREIBER: Yes.

7 2384 MR. WOLSON: You wrote a letter on

8 August 28th, '89, which can be found in Book 4, at Tab

9 2, in which you said to the Prime Minister:

10 "I very much enjoyed meeting

11 with you last week, an

12 unexpected pleasure."

13 2385 MR. SCHREIBER: Yes.

14 2386 MR. WOLSON: So you had obviously met

15 with him then.

16 2387 MR. SCHREIBER: Yes.

17 2388 MR. WOLSON: Mr. Mulroney

18 acknowledged that meeting in a letter dated September

19 the 18th, '89, acknowledging the meeting that you and

20 he had.

21 2389 MR. SCHREIBER: Yes.

22 2390 MR. WOLSON: On July the 6th, 1990 --

23 Book 4, Tab 4 -- you write to Mr. Mulroney:

24 "It was a pleasure to see you

25 Tuesday, in the morning. I

1 appreciated your taking the time
2 to talk with me."
3 2391 MR. SCHREIBER: Yes.
4 2392 MR. WOLSON: So you obviously met
5 with him then.
6 2393 MR. SCHREIBER: Yes.
7 2394 MR. WOLSON: October 10th of 1990,
8 Book 4, Tab 6:
9 "Many thanks for the enjoyable
10 meeting we had last month."
11 2395 You obviously met with him then.
12 2396 MR. SCHREIBER: Yes.
13 2397 MR. WOLSON: Book 4, Tab 7, April
14 19th, '91. You write:
15 "As a follow-up to our meeting
16 last week..."
17 2398 You obviously met with him then.
18 2399 MR. SCHREIBER: Yes, sir.
19 2400 MR. WOLSON: Book 4, Tab 9, May 6,
20 '92:
21 "Thank you for finding the time
22 to meet with me yesterday."
23 2401 You obviously met with him then.
24 2402 MR. SCHREIBER: Yes, sir.
25 2403 MR. WOLSON: Book 4, Tab 12, December

1 3, '92:

2 "I want to thank you for

3 honouring me with the great

4 honour again of being a guest at

5 your home for the most

6 delightful breakfast."

7 2404 You had a breakfast meeting at his

8 home.

9 2405 MR. SCHREIBER: Sussex.

10 2406 MR. WOLSON: That was his home.

11 2407 MR. SCHREIBER: Well, it was from the

12 government.

13 2408 I look at this a little bit

14 different, but this is where he lived.

15 2409 MR. WOLSON: That's where he was

16 living.

17 2410 MR. SCHREIBER: Yes.

18 2411 MR. WOLSON: Yes.

19 2412 Add to that Harrington Lake. You

20 remember the meeting at Harrington Lake?

21 2413 MR. SCHREIBER: Absolutely.

22 2414 MR. WOLSON: Something you would

23 likely never forget; right?

24 2415 MR. SCHREIBER: Yeah. Mr. Mulroney

25 said that he made two big mistakes in his life

1 regarding me; I can say that I made only one, when I
2 started the first time to believe him.

3 2416 MR. WOLSON: That's not my question.
4 I asked you a question about Harrington Lake.

5 2417 Do you remember Harrington Lake?

6 2418 MR. SCHREIBER: Yes.

7 2419 MR. WOLSON: You remember it well?

8 2420 MR. SCHREIBER: Yes.

9 2421 MR. WOLSON: What was the date?

10 2422 MR. SCHREIBER: It was in June.

11 2423 I think it was the 23rd.

12 2424 MR. WOLSON: June 23rd?

13 2425 MR. SCHREIBER: I think so.

14 2426 MR. WOLSON: That's a date you will
15 remember for a long time.

16 2427 MR. SCHREIBER: Yeah, it's a sad day
17 for me.

18 2428 MR. WOLSON: That's a date where you
19 write about -- or you have a note in your affidavit, in
20 Book 3, Tab 21 --

21 2429 I am going to read it to you.

22 2430 Paragraph 15:

23 "On June 23, 1993 Mr. Doucet, at
24 the request of Mr. Mulrone, y
25 arranged a meeting between me

1 and Mr. Mulroney which took
2 place on June 23, 1993, at
3 Harrington Lake, the official
4 summer residence of the Prime
5 Minister (the 'Harrington Lake
6 Meeting'). It was at this
7 meeting that Mr. Mulroney and I
8 entered into the Agreement. On
9 June 23, 1993 Mr. Mulroney was
10 still in office as Prime
11 Minister of Canada and
12 consequently resided at 24
13 Sussex."

14 2431 MR. SCHREIBER: Yes, sir.

15 2432 MR. WOLSON: You go into, at
16 paragraph 16, one of the terms of the agreement, where
17 Mr. Mulroney would perform certain services on your
18 behalf.

19 "Mulroney undertook my efforts
20 in obtaining the approval of the
21 establishment of a production
22 facility for light-armoured
23 vehicles by Bear Head Limited."

24 (As read)

25 2433 MR. SCHREIBER: Sir, that's correct,

1 but here there is quite a misunderstanding. When I
2 said that we entered into an agreement, the agreement
3 was that we would work together, with him, when he has
4 left office.

5 2434 MR. WOLSON: Yes.

6 2435 MR. SCHREIBER: And that we would
7 meet again.

8 2436 So it was not agreed at Harrington
9 Lake in details what he would do, or what he would get
10 paid. That happened in August in Mirabel.

11 2437 The point was that Mr. Mulroney
12 offered me help to continue the Bear Head Project,
13 which had now moved to Montreal, where he believed he
14 could be of much greater help. First of all, there
15 were more votes in Quebec, more influence in Quebec,
16 and, of course, he very much hoped that Mrs. Campbell
17 would form the next Conservative government with a
18 majority.

19 2438 MR. WOLSON: So you made an agreement
20 in principle at Harrington Lake --

21 2439 MR. SCHREIBER: Yes.

22 2440 MR. WOLSON: -- but the actual deal,
23 when you gave him money, that happened later.

24 2441 MR. SCHREIBER: After the meeting in
25 Harrington Lake, I ordered the transfer of funds from

1 the bank in Switzerland, and that's the money which I
2 brought, then, to Canada in August.

3 2442 MR. WOLSON: So the fact that you
4 agreed to work together is something that was important
5 to you.

6 2443 MR. SCHREIBER: Absolutely.

7 2444 MR. WOLSON: Yes.

8 2445 MR. SCHREIBER: And I may remind you
9 that there was another meeting on the 3rd -- I think it
10 was the 3rd of June --

11 2446 MR. WOLSON: I will get to that.

12 2447 MR. SCHREIBER: Okay.

13 2448 MR. WOLSON: So you met with him at
14 Harrington Lake, his summer home.

15 2449 MR. SCHREIBER: Yes.

16 2450 MR. WOLSON: You met with him at his
17 Sussex home.

18 2451 MR. SCHREIBER: Yes, sir.

19 2452 MR. WOLSON: 24 Sussex.

20 2453 MR. SCHREIBER: Yes.

21 2454 MR. WOLSON: Why did you tell the
22 fifth estate, "I've never been to his home"?

23 2455 MR. SCHREIBER: Because, as I
24 mentioned earlier, I looked at his home in a way that
25 it's a home which belongs to him. For me, this is a

1 residence that he received from a government. That was
2 not his home, in my understanding.

3 2456 MR. WOLSON: I see. Okay.

4 2457 I want to go on with the meetings,
5 because there were more. You talked about June 3rd of
6 '93, you met him then.

7 2458 MR. SCHREIBER: Yes.

8 2459 MR. WOLSON: With Mr. Doucet.

9 2460 MR. SCHREIBER: Yes, sir.

10 2461 MR. WOLSON: That was a Bear Head
11 meeting.

12 2462 MR. SCHREIBER: Yes, sir.

13 2463 MR. WOLSON: You and Elmer MacKay had
14 met with him.

15 2464 MR. SCHREIBER: Yes, sir.

16 2465 MR. WOLSON: Mr. Mulroney, that is.

17 2466 MR. SCHREIBER: Yes, sir.

18 2467 MR. WOLSON: In your affidavit that I
19 referred to, at Book 3, Tab 21, paragraph 13, you say:
20 "I met Mr. Mulroney in Bonn..."
21 2468 Bonn, Germany; right?
22 2469 MR. SCHREIBER: Yes.

23 2470 MR. WOLSON:
24 "...at a luncheon... in honour
25 of Canada's role...in the

1 reunification of Germany."

2 2471 MR. SCHREIBER: Yes, sir.

3 2472 MR. WOLSON: Then, there was also an

4 evening reception.

5 2473 MR. SCHREIBER: Yes, sir.

6 2474 MR. WOLSON: So that's, by my count,

7 10 or 11 meetings; right?

8 2475 MR. SCHREIBER: By your count on

9 letters and diaries --

10 2476 MR. WOLSON: Yes.

11 2477 MR. SCHREIBER: -- but that doesn't

12 mean that I haven't seen him more often.

13 2478 MR. WOLSON: Oh, I am sure you have

14 seen him more often, because in your affidavit -- the

15 November 7th affidavit -- you indicate that from '85

16 you started seeing him, and I have only been asking you

17 from '89. So you have seen him a lot of times.

18 2479 MR. SCHREIBER: Yes, in the lobby, in

19 the room behind the Parliament --

20 2480 MR. WOLSON: The lobby being the

21 lobby of Parliament?

22 2481 MR. SCHREIBER: Of Parliament, yeah.

23 2482 MR. WOLSON: And the room behind

24 being Parliament, as well?

25 2483 MR. SCHREIBER: Yes.



KARLHEINZ SCHREIBER
MACKAY LAKE ESTATES
7 BIFFERN COURT
ROCKCLIFFE PARK
OTTAWA, CANADA
K1L 8K9

August 28, 1989

The Right Honourable Brian Mulroney,
Prime Minister of Canada,
House of Commons,
Ottawa, Canada

Dear Brian,

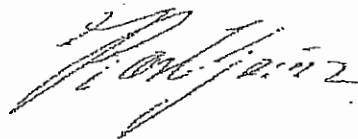
I very much enjoyed meeting with you last week; it was an unexpected pleasure and especially because only a few days ago, I was cleaning out some old boxes and came upon my 1982 Canadian citizenship papers, and a kind telegram from a friend. I enclose copies.

When I was in Alberta, I was struck by the support you enjoyed (compared, say, to Premier Getty).

I listened with great interest to your address to the P.C. Annual Meeting and was especially moved by your remarks concerning education and the challenge to the young. I was reminded of the days in post-war Germany when we knew that we had better find ways of keeping our brightest in the country; if we lost our engineers, our children would become slaves of the high-tech countries. I too am working to create quality jobs for our children in this great country of mine that is Canada.

I salute you and your accomplishments. Please receive my kindest regards.

Sincerely,



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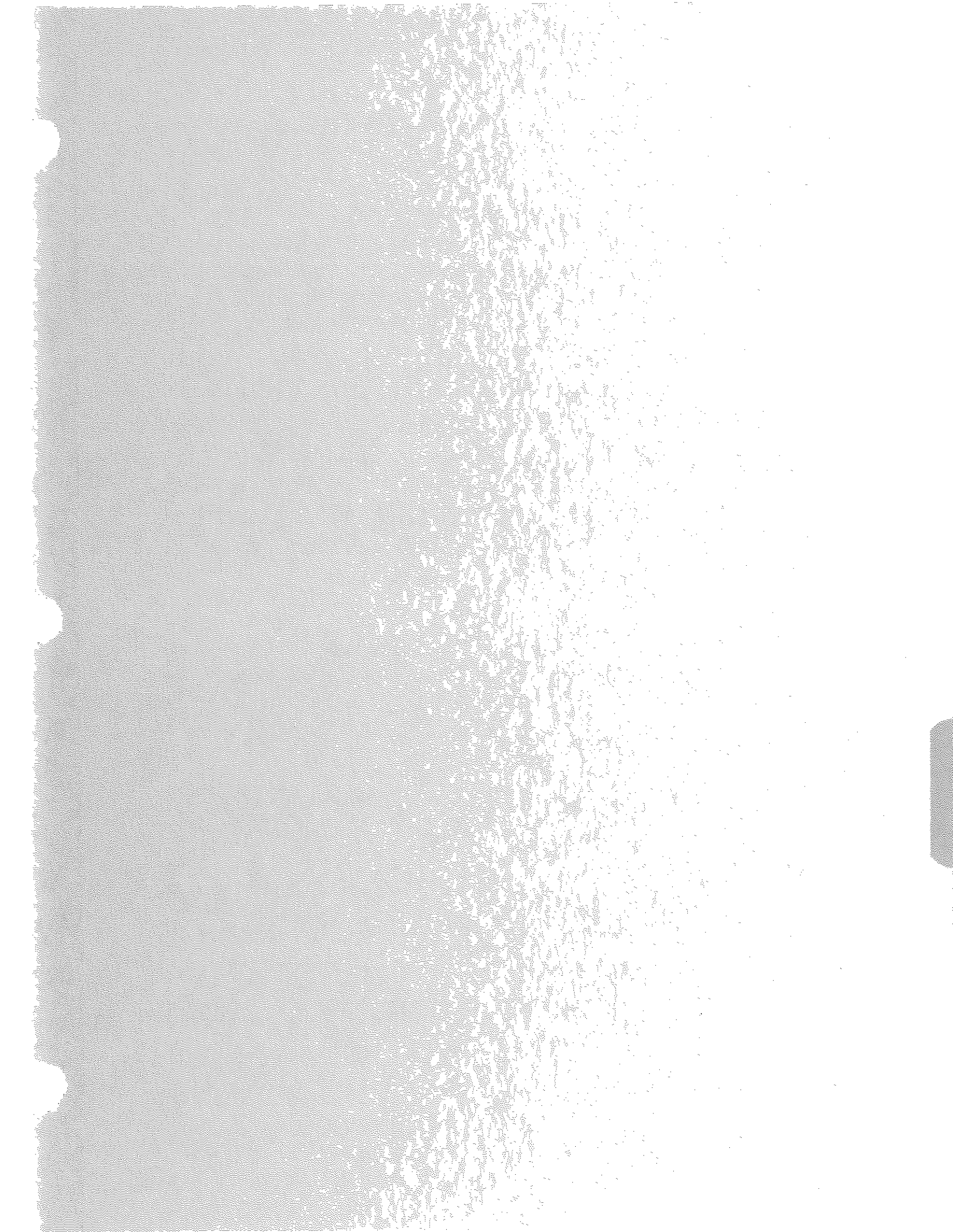
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MR KARLHEINZE SCHREIFER C/O RITZ CARLTON HOTEL ROOM:725
1228 SHERBROOKE OUEST MONTREAL QUE (LIVRAISON PAYEE P.M.)
BT

DEAR KARLHEINZE,
CONGRATULATIONS AND BEST WISHES ON THIS IMPORTANT
AND FIRST DAY OF YOUR NEW RELATIONSHIP WITH OUR COUNTRY.
IT IS A PLEASURE TO WELCOME YOU TO CANADA.
ERIAN MULRONEY

a+
RITZCARLTN MTL





PRIME MINISTER · PREMIER MINISTRE

September 18, 1989

Dear Karlheinz,

Thank you for your letter of August 28.

I too was pleased to have the opportunity to meet with you. The recent General Meeting provided a tremendous opportunity for the PC Party to reflect on its past success and to look ahead to a future that promises to offer Canadians countless opportunities both at home and abroad.

It was with interest that I read the telegram I sent you back in 1982 when you received your Canadian citizenship. That date now seems so long ago; a lot has happened in the space of a few short years. You can be proud of your contribution to helping to ensure the continued growth and future prosperity of your new home, Canada.

Once again, thank you for writing. It was a pleasure to hear from you.

With kindest personal regards,

Yours sincerely,

Mr. Karlheinz Schreiber,
MacKay Lake Estates,
7 Bittern Court,
Rockcliffe Park,
Ottawa, Ontario.
K1L 8K9



KARLHEINZ SCHREIBER
MACKAY LAKE ESTATES
7 BITTERN COURT
ROCKCLIFFE PARK
OTTAWA, CANADA
K1L 8K9

July 6, 1990

The Rt. Hon. Brian Mulroney, P.C., M.P.
Prime Minister of Canada
Room 309-S
Centre Block
House of Commons
Ottawa, Ontario
K1A 0A6

Dear Prime Minister:

Let me say what pleasure it was to see you again Tuesday morning and how much I appreciated your taking the time to meet with me.

Speaking as a Canadian citizen, let me tell you how much I admire the way you have conducted yourself on the entire issue of Canadian unity and I shudder to think what condition this country would be in if anyone but yourself were at the helm.

Speaking as a friend, let me assure you of my continued support in any way I can be helpful.

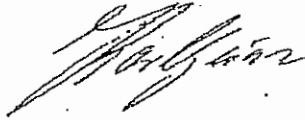
I am overjoyed to learn of your coming official visit to Germany. If there is any way I can be helpful regarding this visit, please call on me. I humbly suggest that I could be helpful.

From my days with Franz Josef, I know the burdens we impose on our political leaders. But even God rested on the seventh day!

.../2

For that reason, I look forward to seeing you and
your wife relax in Bavaria.

With friendship and admiration.

A handwritten signature in cursive script, appearing to read 'Karlheinz Schreiber', written in dark ink.

Karlheinz Schreiber



DOCUMENTS IN SUPPORT OF THE TESTIMONY OF

Norman SPECTOR

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2.	October 10, 1990 , Letter from Karlheinz Schreiber to the Right Honourable Brian Mulroney
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4.	October 1990 memo from R.N. Sturgeon to ADM (Mat)
5.	November 1990 Memorandum of Understanding
6.	November 2, 1990 letter from Peter Smith to Rob Gillespie and Cliff Mackay
7.	November 9, 1990 letter from Karlheinz Schreiber to Norman Spector
8.	November 30, 1990 note by Rob Gillespie to Deputy Minister
9.	November 30, 1990 note by Rob Gillespie
10.	December 5, 1990 memorandum to the Minister from Robert Fowler
11.	December 7, 1990 letter to Peter Lesaux from Robert Fowler, and attachments
12.	December 7, 1990 memorandum to the Minister from Frederick Gorbet
13.	December 10, 1990 memorandum to Norman Spector from Paul Tellier, and attachment
14.	December 10, 1990 memorandum to Norman Spector from Paul Tellier marked "Returned from PMO with no comments (91-02-18)", with attachment.
15.	December 10, 1990 memorandum to Minister Wilson, Finance, from Frederick Gorbet
16.	December 11, 1990 letter to the Right Honourable Brian Mulroney from the Honourable Elmer MacKay
17.	December 19, 1990 letter to Norman Spector from the Honourable Elmer MacKay
18.	January 3, 1991 fax from Peter Smith to Peter Lesaux forwarding December 19, 1990 letter from Elmer MacKay to Norman Spector
19.	January 9, 1991 notes on a teleconference with McDowell
20.	January 9, 1991 letter to William Rowat from Peter Smith
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22.	Post January 17, 1991 "Thyssen/Bear Head Industries Proposals Chronology and Current Status"
23.	January 28, 1991 letter to William Rowat from R.D. Gillespie
24.	March 26, 1991 memorandum to Norman Spector from Paul Tellier, and attachment
25.	April 17, 1991 memo from William Rowat to Paul Tellier and attachments
26.	April 19, 1991 letter from Karlheinz Schreiber to the Right Honourable Brian Mulroney
27.	May 7, 1991 letter from Karlheinz Schreiber to Paul Tellier
28.	May 7, 1991 letter from Karlheinz Schreiber to Paul Tellier with handwritten notes
29.	May 9, 1991 letter from Karlheinz Schreiber to the Right Honourable Brian Mulroney
30.	May 13, 1991 briefing note for the Minister on Thyssen Industries AG proposal for a directed contract to supply DND with 207-250 Light Armoured Vehicles
31.	May 17, 1991 letter from Paul Tellier to Karlheinz Schreiber
32.	June 27, 1991 unsigned memorandum to Wayne Wouters from Jim Stanton
33.	July 9, 1991 letter to W.A. Rowatt from J.C. Mackay, and attachment
34.	March 17, 1992 letter to R. Bilodeau from R.D. Gillespie, and attachment
35.	May 6, 1992 letter from Karlheinz Schreiber to the Right Honourable Brian Mulroney
36.	May 22, 1992 letter from Karlheinz Schreiber to the Right Honourable Brian Mulroney
37.	September 17, 1992 memorandum to Hugh Segal from Glen Shortliffe
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39.	"Afterword" by Norman Spector from Bill Kaplan's <i>A Secret Trial</i> (2004)
40.	Excerpt from Oliphant Commission Public Hearing transcript, April 14, 2009
41.	August 28, 1989 Letter from Karlheinz Schreiber to the Right Honourable Brian Mulroney
42.	September 18, 1989 Letter from the Right Honourable Brian Mulroney to Karlheinz Schreiber
43.	July 6, 1990 Letter from Karlheinz Schreiber to the Right Honourable Brian Mulroney
44.	December 12, 1990 memorandum for Paul Tellier from Ronald Bilodeau

*Rev [unclear]
Name included
you be assisted and
interest some control
A.F.
17/12/90*

SECRET

December 12, 1990

(104916)

MEMORANDUM FOR PAUL TELLIER

Thyssen/Bear Head Industries

On our December 10 memorandum on Thyssen's Bear Head Industries proposal, you asked why DND attached additional costs of \$765 million to the Thyssen proposal. Thyssen is asking the Government for a directed contract for 250 of its TPZ "Fox" vehicles, at a price of \$290 million, as part of DND's Multi-Role Combat Vehicle (MRCV) project.

The MRCV project comprises a purchase of seven to eight hundred MRCV's, in three primary variants to replace, augment and rationalize existing fleets over the next fifteen years. Beginning in the mid-1990's, DND is looking at purchasing under the MRCV project, in the following order of priority, Reconnaissance Combat Vehicles (RCV), Armoured Combat Vehicles (ACV), and Infantry Combat Vehicles (ICV).

The Thyssen Fox would be used for the ICV component of the project. Currently, DND has budgeted \$290 million for the purchase of 206 (not 250) ICV's, at a unit cost of \$568,000 per vehicle times a project factor cost of 2.5 (to allow for spares, training, other support and project management). The additional costs of \$765 million for the Thyssen vehicle break down is as follows:

- Capital Costs: plus \$435 million. The Thyssen vehicle costs \$1,160,000 each, excluding project costs. At the same project factor cost of 2.5, the 250 vehicles would cost \$725 million.
- Unforeseen O & M: \$130 million. Because these vehicles would be purchased about nine years ahead of schedule, with no corresponding retirement of other vehicles, DND argues that it would need \$14.5 million per year for additional O & M, before inflation.
- Inefficiencies and lack of fleet rationalization: plus \$200 million. Increased expenses due to lost economies of scale on the purchase of several hundred vehicles are estimated at 10 percent of the MRCV project cost of \$2.1 billion.

SECRET

(Thyssen has just advised ACOA that the cost for DND to trade up to the new generation TH 495, previously uncosted, would be 207 vehicles for \$290 million. This could reduce the additional O & M costs since fewer vehicles are involved but the other additional costs would appear to be unaffected.)

You also questioned the implications for DND of going ahead with this purchase before the Defence Policy Review is completed. As part of the Defence Policy Review, DND is looking at the associated equipment requirements. DND expects that there will be less equipment overall and a significant rationalization of types of equipment in order to yield savings on O & M costs. Since the precise nature of DND's army equipment requirements are unknown, DND has been planning on the basis of a lighter, more flexible army and a rationalization of combat vehicles. The MRCV project has been based on these considerations. Purchasing a Thyssen vehicle ahead of the completion of the Policy could limit DND's ability to meet its overall MRCV project objectives within the new Policy framework and could cause DND to reorder priorities and reduce acquisitions in other areas.

COMMENT

Purchasing more ICV's than needed at a significantly, higher unit cost than anticipated, and sooner than they are required, immediately adds \$435 to project costs. Although DND's calculations on additional costs attributable to inefficiencies appear somewhat inflated, we have no basis on which to challenge them rigorously. We should emphasize that it would be unfortunate to proceed with a project of this magnitude in advance of the completion of the Defence Policy Review.

RB.
Ronald Bilodeau

P.S. Appelles moi si tu veux en parler. Norman doit parler à M. Mackay avant de décider d'aller de l'avant ou de dire non à Thyssen. Si l'on va plus loin, il faudra en discuter au comité des Opérations, très prochainement car la compagnie souhaite que nous précisions nos intentions a.p.s.

Attachment
Billings/de