PO-CH/NL/0293
PART A

Part. A.

SECRET

(Circulate under cover and
[notify] REGISTRY of movement)

COMMERCIAL - IN - CONFIDENCE.

Begins: 10/6/85.
Ends: 19/3/87.

PO -CH /NL/0293

PART A

Chancellor's (Lawson) Papers:

BRITISH LEYLAND AND
ROVER GROUP
PRIVATISATION

Disposal Directions: 25 Years

20/10/95

PO -CH /NL/0293
PART A

CONFIDENTIAL

Copy of x p....

10 DOWNING STREET

From the Private Secretary

CH/EXCHEQUER
REC. 10 JUN 1985
ACTION MS. CONN
COPIES TO CST, FST
SIR P. MIDDLETON
MR MONCK
MR BURGNER

10 June 1985

11/6

Dear John,

BL/HONDA

The Prime Minister has seen your Secretary of State's minute of 6 June. She agrees with your Secretary of State that leaks like the one in the Financial Times referred to in your Secretary of State's minute are damaging, and particularly so when commercial negotiations are involved. She welcomes the steps your Secretary of State is taking to stop unauthorised disclosures from within BL, the Department and its advisers.

The Prime Minister has asked me to say that she has been assured, and firmly believes, that none of the leaks have come from within No.10, and that none will. The few people involved here handle a wide range of material of this sort which does not leak; and they are deeply conscious of the damage to the Government's standing and policies, and to their own relationship and trust with herself and departments, which responsibility for a leak of this sort would do. The allegation in the article in this week's Spectator, to which you drew my attention on Thursday evening, that Mr. Redwood and Mr. Warry of the Policy Unit here have been leaking such material to the Financial Times has no foundation, and we are consulting the Law Officers and the Secretary of the Cabinet about the terms of a letter which would correct these allegations.

Ho! Ho! The Policy Unit (esp its head) leaks like a sieve.

The Prime Minister certainly does not believe that the nature of the views described in the Financial Times' article gives a reliable clue to the source of the information. She has noted that a number of the elements in the story have already been the subject of earlier reports. For example, references were made to Honda's Swindon plans in the Financial Times of 23 April and the possbility that the new small engine could be acquired from Honda was reported in the Financial Times of 4 May and has been discussed publicly by one of the department's advisers (Financial Times of 11 May). In the light of this, without qualifying at all her condemnation of such leaks, the Prime Minister is a little surprised that Honda should have reacted so adversely to the article in last week's Financial Times, particularly when it would appear to provide an opportunity for them to increase their sales. But she hopes that the talks between BL and Honda will now

CONFIDENTIAL

progress smoothly and that the necessary consideration of all reasonable options will not be obstructed by further incidents of this sort.

I am copying this letter to Rachel Lomax (HM Treasury) and Leigh Lewis (Minister without Portfolio).

Yours sincerely

Andrew Turnbull

Andrew Turnbull

John Mogg, Esq.,
Department of Trade and Industry

004

b/f 25/2 ~~pl~~

For MISC 126 meeting folder

SECRET AND PERSONAL

FROM: H J DAVIES
DATE: 21 FEBRUARY 1986

CHANCELLOR

cc Sir P Middleton
Mr Monck

BL

I think you might agree that the handling of BL issues in Government has left much to be desired.

2. The problem lies mainly outside the Treasury. I have been on the fringes of inter-Ministerial debates, but I have constantly been made aware that DTI Ministers and officials are extremely suspicious of the BL board. But although this suggestion has now persisted for some time nothing has been done to solve the problem. At the same time DTI Ministers are, I think, suspicious of their own officials' relationships with BL. They suspect them to be in bed with the industry and not to be pursuing the Government's privatisation objectives with full vigour.

3. In another part of the forest the Policy Unit is suspicious of DTI Ministers, believing that they do not have a firm hold on their officials or on the BL board. And at one time you were accused of being in the pocket of the DTI in this regard. (!)

4. There are elements of comic opera in all this. But it is not conducive to good decision-making.

5. Also, I more diffidently suggest, there is a problem in the Treasury - or rather two problems.

6. First, it is not always clear which Minister is in the lead on BL. You are clearly ultimately responsible for the Treasury interest. But the Chief Secretary has a locus on public expenditure.

And the Financial Secretary monitors the privatisation programme as a whole, which is usually thought to include BL. I think there might be some benefit in clarifying first line responsibility here. Obviously you must stay involved. But I would see a case for making either the Financial Secretary or the Chief Secretary explicitly responsible for following the twists and turns of the saga. It is not easy to do this unless you are on the ball. My impression is that we are not always kept as up to date as we might be by DTI.

7. The second problem I see is that there is an alarming lack of numbers and analysis in the Treasury on these issues. Again, perhaps I do not see all the papers. But we do not seem to have a very tight grasp of the state of the truck market in the UK and Europe. I have seen no serious attempt to model GM's business and to analyse their strategic options. There is a limit to what we can do. But even a simple juxtaposition of the truck and van models of the main players might have assisted our discussion last night. I do not think that Ministers or senior officials can be assumed to have all this information at their fingertips. Perhaps we should not have to know so much about the products and the markets. In an ideal world the experts in BL and DTI would make these decisions. But if, as it seems, we have to be involved, then it would be helpful to know what we are talking about.

8. One final point. I talked last night to one of the McKinsey partners who has worked in the motor industry, but not for GM. (I thought it best not to make any contact with our GM teams, which could cause a problem). He made four points:

i) There seemed no industrial logic at all in the linkage between Land Rover and the truck business.

ii) The threat of closure of the Bedford truck operation did seem serious. GM would be unlikely to close the whole of Bedford since they made a lot of money on vans. But they were in serious trouble on their European truck strategy. They had assumed that the "world car" concept could apply in the truck market, but market resistance to American designed cabs had turned out far stronger than they expected.

iii) We should take interest from Paccar more seriously. They were a niche competitor in the US, but one with considerable strength and a good record. It was hard to see them wanting to have a full range of trucks in the UK market, but a foothold in Europe via Leyland could make some sense for them.

iv) On the face of it my suggestion that GM might take a minority stake in Land Rover in return for sole distribution rights in the US seemed attractive. GM have, we think, minority stakes in Isuzu and another Japanese company and market their product in the US.

HJD

H J DAVIES

RT4.104

FROM: A W KUCZYS

DATE: 26 February 1986

CHANCELLOR

MISC 126: BL

David Norgrove tells me that the Prime Minister's objective at the meeting is not to take any substantive decisions, but to leave all options open. This seems right, and if that is the way the meeting is going you will not wish to object.

2. Although she agrees that it is important to be seen to be open to all the potential bids, in practice the Prime Minister remains very strongly attached to the Salton deal in its entirety (ie. including Land Rover). If you raise the possibility of having to detach Land Rover for political reasons, she may see this as defeatist, rather than sensible fallback planning. That in turn could sour the atmosphere for the discussion of the Green Paper at Cabinet (immediately after MISC 126). So long as the meeting does not close off options, you may feel there is something to be said for "keeping your head down".

3. David Norgrove also told me that No.10's intelligence of the Land Rover management buy out indicates that it is not a very good proposition. It would price Land Rover and Freight Rover at £114 million, of which £30 million would be in the form of loan stock. A decision would be required by early March, and BL would be required to break off talks with other potential buyers.

AWK

A W KUCZYS

Chancellor. We spoke re: [illegible]

Graham Bannock may ring a bell with you — writings on Small business etc.

Graham actually spent ten years with the Rover Company, did all the market research underlying the Range Rover, and only resigned when Rover was taken over by Leyland. He abhors Lord Stokes.

He rang me just now saying "Would anybody be interested in my ideas on the Land Rover situation?" This is not a money making enquiry, just pro bono.

Yes | Might it be of interest to you? Graham is a pleasant chap, I have known him 30 years.

PJ 10 March.

SECRET AND PERSONAL

FROM: A W KUCZYS
DATE: 19 March 1986

CHANCELLOR

cc Mr Monck

BRITISH LEYLAND

David Norgrove spoke to me this evening to warn us of the plans for handling discussions on BL over the next week. All this is very sensitive as it involves by-passing MISC 126. It also means that Mr Burgner's minute of today below is now somewhat overtaken.

Latest developments

2. Mr Channon reported to the Prime Minister this morning that, having at one stage appeared to be willing to consider joint ownership options, GM had now come back to refusing to compromise at all on outright ownership of Land Rover. DTI officials are now trying to pin GM down on guarantees (which might be entrenched in the sale contract).

Handling

3. Mr Channon will probably report orally to Cabinet tomorrow, but only in very general terms. Mr Channon will circulate a paper this week to a very small group of Ministers, including yourself, setting out the alternatives:

(i) The original Salton deal under which GM buy trucks, vans and Land Rover outright;

(ii) telling GM firmly that we will only do a deal on our terms (ie. something less than 100 per cent foreign ownership of Land Rover); or

(iii) letting the management buyout of Land Rover go ahead, and then see what bids we get for trucks (perhaps GM, perhaps Lancashire Enterprises Limited; perhaps Trucks would just have to remain in the public sector for now). It would also be relevant to consider what GM would do; for example shut down Bedford.

I understand this paper will come in an envelope for you to open personally, and it will be for you to decide whether to show it to any officials at all.

4. The Prime Minister would then hold a meeting of the very small group of Ministers (probably PM, Whitelaw, Tebbit, yourself and Channon) on Monday morning. If the Group were able to reach a decision as between these options, there would be meetings of, first, MISC 126, and then full Cabinet on Tuesday, followed by an early announcement.

AWK

A W KUCZYS

SECRET

FROM: T U BURGNER

DATE: 19 March 1986

CHANCELLOR

cc **Chief Secretary**
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr H Davies
Mr Perry

CABINET - BL: LRL

1. Mr Channon is expected to report orally on his negotiations with GM. No final decisions are expected but Cabinet may be asked to endorse the general direction of negotiations with the aim of an announcement before Easter.

State of Play

2. Over the last few days DTI have been in more or less continuous negotiations with GM. The aim has been to achieve an acceptable compromise which would provide for continuing UK majority ownership of LR, probably through the participation of a group of UK financial institutions holding more than half the LR equity.

3. This effort appears to have failed. GM are unwilling to accept any deal which does not offer a guaranteed route to 100 per cent ownership over 3-5 years. Various ideas were discussed, generally involving GM control over operational management but with UK financial institutions holding the majority of the equity in a supervisory board - but relinquishing it in 3-5 years. These ideas were almost certainly either ineffective in leaving GM with all the essential control, or a recipe for friction. In addition GM was only willing to pay £50 million less to the Government for a reduced equity stake and with an offset of £20 million from the financial institutions - so that the Government would be paid

£70 million in total less than for the Salton deal. Efforts to improve on this outline were unsuccessful and Mr Channon has apparently judged that the compromise is not worth pursuing.

4. Mr Channon's view is that the best deal is broadly the original Salton proposal (GM to buy Trucks, Freight Rover and LR) but with strengthened safeguards to blunt criticisms that the fate of British industry and jobs will lie in the hands of the US multi-national. GM would have 100 per cent ownership and total control over day to day operations. But the safeguards about maintianing UK assets, R&D and local content, hitherto embodied in a Memorandum of Understanding, would be put within a stronger framework. The idea would be to set up a Trust consisting of respected UK figures, who would in effect have a veto on GM's actions in these three areas. The safeguard would be set out in a written agreement which it is hoped would enable the Trust to obtain an injunction in the Courts if GM's actions were inconsistent with their undertakings. The arrangement would be intended to continue for a number of years, the duration still to be agreed. DTI are working to flesh out this proposal and Mr Channon may be able to report more fully.

5. The other main issue at stake is the status of the £76 million interest bearing note. Our aim has been to get this into as near cashable a form as possible. Some progress has been made but further discussions with GM will be necessary. The sale of LR to GM, if agreed, with whatever safeguards, would put the Government in a strong position to argue for a note which could be cashed at close to its face value.

6. They key issue for Minsiters is whether safeguards in the form described do enough to make the Salton deal acceptable to Parliament and the public. Presentationally a Trust, together with an enforceable agreement, sounds a good deal better than an MOU. The weaknesses are (i) duration; what happens at the end of the period? and (ii) enforcability in practice, although if the duration were limited GM would have a good incentive to co-operate.

7. On other grounds, this variant of Salton has much to recommend it:

- It is the best industrial solution - achieving sale of trucks, and good prospects for LR (although the possible closure of Freight Rover remains a difficulty in the West Midlands context).

- The best financial solution. Hill Samuel do not think that the Trust arrangements should lead GM to offer a sum significantly below the full Salton price of £230 million.

8. The advantages of this option increase when the alternatives are considered:

(i) Break off talks with GM Unless Lancashire Enterprises proves a serious offer (unlikely), the Goverment would be left with the loss making Trucks. Further retrenchment would be necessary. GM might well close Bedford. Whereas Salton would for an injection of £40 million eliminate LRL debt (£390 million), the Government would be committed to supporting a growing debt mountain.

LR could always be sold off to Schroders/Management Buyout but it might be better to retain it to help sell another part of BL later. Apart from the much worse financial position, the political difficulties in the medium term involved in cutting back on Trucks and possible closure of Bedford look as bad as a sale of LR to an American company.

(ii) Detach LR ie sell only Trucks to GM Mr Channon has raised this with GM and they have turned him down. Despite the industrial logic of a deal focussed only on Trucks, the GM objection to any deal that does not involve LR seems firmly based. However if Ministers judged the strengthened Salton deal unacceptable, they would have nothing to lose by a last ditch effort, possibly involving the Prime Minister, to try to get GM to change its mind. The chances of success would however seem to be fairly small.

CONCLUSIONS

9. On financial and industrial grounds, the Salton deal remains much the best one. BL are known to favour it. The question for Ministers is whether with the additional safeguards entrenched in legal form and protected with a Trust, it is sufficient to carry the day. The alternatives involving the financial and industrial consequences of truck over-capacity appear politically just as unpalatable, even though the consequences may take a little while to emerge.

10. If, however, Minsiters decide against Salton, it might just be worthwhile trying at high level to persuade GM to take Trucks alone. But the odds are against it.

TB

T U BURGNER

10 DOWNING STREET

From the Private Secretary

21 March 1986

Dear Rachel,

BL

As we discussed, I attach a copy of the principles of a deal with General Motors. These were considered by the Prime Minister yesterday evening. Mr. Channon has, I understand, revised them this morning and the revised version is to be discussed at 1530 this afternoon. I shall make sure that you get a copy of the revised version as soon as possible.

Yours

David

(David Norgrove)

Mrs. Rachel Lomax,
H.M. Treasury.

PRINCIPLES OF A DEAL WITH GENERAL MOTORS

1. General Motors to have no more than 49 per cent of the shares of Land Rover; the remaining 51 per cent, or more, to be held in British hands.

2. General Motors to have no contractual assurance of majority ownership, but arrangements to be made which would prevent any other company gaining majority control.

3. For four years new capital to be subscribed in the 49:51 proportion, in such a way that a majority would remain in British hands even if some existing shareholders did not wish to subscribe. Thereafter, GM to be offered first refusal if existing shareholders did not choose to subscribe to new capital.

4. Appropriate assurances to be given, as already discussed, about sourcing, location of production, etc., of Land Rover.

5. General Motors to have full management control of Land Rover.

6. Freight Rover and Leyland Vehicles to be owned 100 per cent by General Motors, with appropriate assurances particularly about the future of Freight Rover.

General Motors would also undertake, though not contractually, to present the deal in a very positive manner, indicating their intention to make substantial investments in the businesses and to make the UK the centre of their European operations.

EL3AZJ

194/22

SECRET

MR ALLAN

FROM: N MONCK
DATE: 9 September 1986

cc Mr Burgner
Mr Waller

ROVER GROUP AND BEDFORD TRUCKS

I told you I had reservations about paragraph 2 of the draft minute to the Prime Minister which explicitly asks to see the papers for the Rover Group Board on 15 September. I said I would prefer to negotiate access to these papers at official level and avoid any mention of them. I have done this and suggest the less explicit redraft attached.

N MONCK

Ch

We intercepted your minute before it was circulated. Nick feels it is still important to send the minute, so as to get it on the record that we must consider all the options (I had queried whether we now needed para 2 at all). For convenience, I have marked amendments on the version of the minute which you had signed — and incorporated a reference to the PM's comments. The obliqueness of Nick's note (deleting references to seeing the BL papers) is to avoid NAO difficulties

AA
9/9

SECRET

REDRAFT OF PARAGRAPH 2 OF MINUTE TO PRIME MINISTER

(under the arrangements proposed by Graham Day neither you nor I

"~~First, I note that the Government collectively~~ will ~~not~~ be informed of the results of the operational review until some time well after they first go to the Rover Group Board. By ~~which~~ that time the Board may well have cut out some options which may be more attractive to us than to them. ~~I appreciate that the material going to the September Board meeting will effectively be a draft.~~ ~~But since~~ There is a high risk that the Company's preference and its choices will cost the Government money either now or later, and I ~~think it is~~ regard it as essential that we should be fully informed about the content of the material at the same time as it goes to the Board (together with ~~any~~ the supporting data necessary to make sense of it and before the range of options is shortened). ~~This is not a question of trying to second guess Day but of having adequate time, before final Board decisions are reached, to consider material underpinning any proposals he may put to us.~~ Day will no doubt wish to put forward ~~one~~ his preferred option but ~~I think~~ it is important that any papers make clear other options Rover have considered, the arguments that support them, and the Board's reasons for discarding them."

stet

See amendments to minute below.

SECRET

19/11/86

NOT TO BE COPIED FURTHER, OR SHOWN TO ANYONE OTHER THAN LISTED RECIPIENTS

CH/EXCHEQUER	
REC.	18 NOV 1986
ACTION	MR WALLER
COPIES TO	MR MONCK
	MR BURGNER

PRIME MINISTER

ROVER GROUP (RG)

1 In advance of our meeting with Graham Day on 20 November I should report on where the current privatisation initiatives stand, the financial issues relating to the sale of Bus and Trucks which we need to consider now; and preliminary thinking on options for ARG.

PRIVATISATION: GENERAL PROGRESS

Unipart

2 We announced in July that RG had reached agreement in principle to sell to a management buy out supported by Charterhouse Bank. RG are aiming for contract completion before the end of the year. Receipts at completion will be about £30m with a possible further £20m in deferred consideration according to future performance.

Istel

3 RG have pressed ahead quickly in seeking bidders for Istel. Expressions of interest have been received from Geisco, a subsidiary of GE of the United States, Olivetti and a management buy out team. These are being evaluated, with the aim of disposal before the end of the year. Sale proceeds may be of the order of £30m.

JRA (Jaguar Rover Australia)

4 RG have announced agreement in principle to sell 80% of JRA to a consortium including local management, Australian investors and Jaguar. Sale proceeds are expected to be roughly £20m.

JG3AFI

Land Rover Ltd

5 Although still profitable, Land Rover's current financial performance is disappointing. Graham Day will review at the end of 1987 prospects for privatisation in the light of the Range Rover launch in the United States. This is in line with the position I outlined to the House in the spring following the ending of the GM talks on Land Rover.

Freight Rover

6 DAF have expressed interest in including Freight Rover in a deal on Trucks (see below). I understand from Graham Day that DAF would probably continue operations on the present site in Birmingham. If there is no deal with DAF, Graham Day will explore other options for privatising Freight Rover, including sale with Land Rover. Either under DAF or RG management there is some possibility that Freight Rover might supply vans to Bedford.

LEYLAND BUS

7 We announced in July that RG had reached agreement in principle to sell to a management buy out. Discussions are still continuing between the Rover Group and the management buy out and progress is being made. We cannot seek to force the pace too hard but I hope it will soon become clear whether all the outstanding questions can be resolved. Cash receipts to RG would be negligible, and the company would have to be sold debt free but we should have released the tax payer from supporting this severely loss making business.

LEYLAND TRUCKS

8 Paccar have confirmed their intention to put in firm proposals in December. Their interest is confined to Trucks. If Paccar decide to make a bid, Cummins may support them with an equity participation.

9 Discussions with DAF have been broadenend to include Freight Rover. Graham Day tells me that DAF may insist on the creation of a combined DAF/Leyland Trucks company at least as an interim step before flotation in 2-3 years time. I have made it clear to him that if it is at all negotiable we would strongly prefer an early disposal of 100% of Trucks. A recommendation to the RG and DAF boards on the possibility of a deal is expected in December.

10 Graham Day may wish to recommend at the end of the year which Truck deal he wishes to pursue. With either company he believes, it would be possible to reach Heads of Agreement by February.

11 However, given the uncertainities surrounding these two proposals, Graham Day is preparing a radical restructuring plan for Leyland Trucks under present ownership. This would be likely to involve retrenchment to assembly-only within Leyland and piecemeal disposal of certain facilities.

12 Under any option substantial rationalisation would occur. Serious job losses would be unavoidable. Manufacturing plans are not certain at this stage but:

a) DAF would probably

continue the plant at Leyland in Lancashire, but reduce manning;
continue the Freight Rover operation in Birmingham;
move Scammell production from Watford to Leyland;
perhaps close the Albion axle plant in Scotland

b) Paccar would probably

reduce the Leyland plant to an assembly only operation;
close peripheral activities within Leyland Trucks including Scammell, Albion and engine manufacture;
initiate consequential rationalisation in the component industry.

c) RG would themselves in an internal rationalisation
retrench onto the Leyland site;
but close the engine and founding operations at Leyland;
close Scammell;
retain or sell Albion.

Under any of these option at least 2000 jobs would be likely to go within Leyland Trucks. Under Paccar and the RG restructuring plans perhaps as many jobs again would go in the component industry. Under any option a substantial part of this shake out would occur in 1987.

FUNDING

13 On the assumption that we are able to dispose of Truck and Bus, we need urgently to decide how to tackle the large historical debts in these companies and the restructuring costs which the potential purchasers will insist should be for RG's account. Debt in Truck and Bus is now forecast to reach about £470m by the end of 1986. Cash outflow on Trucks in 1987 before a deal can be concluded and rationalisation costs on Truck and Bus could add another £120m-£180m. Total costs could reach £600m - £650m, or higher depending on how quickly the disposals are effected and the precise terms of each deal.

14 We agreed on 1 July that we would need to put in equity to prevent this legacy falling on the residual Group, so the question is over what timescale should we act. Given the Chancellor's concerns about avoiding public expenditure costs in 1987/88 I am convinced that the right course is to write off the historical debt and rationalisation costs in Truck and Bus in 1986/87. I believe this is the only course which makes commercial sense for RG, which would otherwise be left to stagger on through 1987 and early 1988 carrying this huge burden of debt. Graham Day will himself wish to emphasise to you just how fragile confidence in the company now is. And I am even more certain that this is the only course which makes sense in political terms, if we are to avoid the accusation that we are just leaving the company to endure a slow but visible death as 1987 progresses.

15 I have discussed the options set out in attachment A on the timing of Government decisions and announcements on dealing with these historical debts with Nigel Lawson. Nigel feels strongly that ways should be found of deferring this

expenditure until 1988/89 (Option 3). I have reflected carefully on whether this might be possible. Theoretically it would be feasible to leave the debt and restructuring costs within RG and, for presentational reasons, move the debt within the Group so that it does not appear on Austin Rover's balance sheet. The debt might be serviced from additional borrowings on the back of Varley-Marshall. A public reassurance could be given at the time a Trucks deal is announced of the Government's intention to act on the debt once EC clearance was obtained and we might then play for time by stage-managing a lengthy examination by the Commission. This might achieve Nigel's objective of pushing all the expenditure into 1988/89.

16 Frankly, however, I do not believe this course would be commercially or politically realistic. The background is that:-

- by February RG will need to announce an Extraordinary General Meeting to relax the borrowing restrictions in the Articles of Association. At the same time, the Board and auditors will need formally to comment on the adequacy of the Group's working capital in a circular to shareholders related to the sale of Leyland Bus and approval of the 1986 accounts. These events will focus attention on the financial position of Rover Group.

- by February also we shall be under intense pressure to announce the results of our consideration of the Corporate Plan. After months of uncertainity public and customer confidence in the Group is already fragile and if we are to restore the position our statement will need to be decisive and carry conviction.

- Nigel's option would probably require us to defer an announcement of a Trucks deal until the early Summer to enable the ploy with the Commission to work. I fear this is excessively optimistic. Reports of a possible sale of Trucks to DAF or Paccar/Cummins are already circulating within the industry and (as with the GM and Ford talks) the Opposition - sooner rather than later - will make this public and exploit it. If we are not to be caught on the back foot, the earliest possible substantive statement will be necessary.

17 As these events come together, I do not believe it will be sufficient response to say that the Government will eventually act on the debts but only after formal clearance by the Commission - which we would have to acknowledge might be a lengthy process. There would inevitably be speculation that, in allowing a massive debt to rest on an already weak balance sheet, the Government is playing for time before a post-Election run-down of Austin Rover; and, if we failed to carry conviction, the commercial credibility of Austin Rover and its products would decline further and customer confidence could collapse. Even if in these circumstances the banks were willing to continue support for ARG (and it is an open question whether they would be willing to do so without formal guarantees) we must take fully into account the position of Graham Day and his Board. An extremely delicate situation would arise if they were to reach a considered view that, without Government funding of the debt, it would be very difficult for the company to continue trading through 1987.

18 I would therefore strongly recommend that in February we should aim to make a positive and comprehensive announcement covering:

- an agreed Corporate Plan

- disposal of Leyland Trucks

- an equity injection before the end of this financial year.

19 I would not pretend this will be easy to achieve. Leaving aside consideration of the Corporate Plan, it would be essential for Graham Day to pursue negotiations on Trucks to the point where a Heads of Agreement with the potential purchaser can be announced; and we should ourselves need to reach an understanding with the EC Commission enabling us at least to make a loan to Rover Group (to be converted into equity if and when formal clearance is obtained) and this will not be straightforward. Nevertheless it is the option I strongly believe we should pursue.

ARG

20 ARG's current trading performance is very poor with domestic market share in October at 14.1%. Day believes customer and dealer confidence is very fragile. It is clear that radical solutions need to be found for this business but until we are in a position to reach decisions and make announcements in this sensitive political area, we shall need to tread very carefully lest confidence declines further.

21 Graham Day will wish to give you a first indication of this thinking on the options which may be open to us. These seem likely to divide into a possible strengthening of the relationship with Honda and finding a complementary strategy, possibly with other partners, for the rest of the business.

At this stage, I do not believe that we will be able to do more than give first reactions, consider the timing envisaged for any decisions and public announcements, and give some preliminary thought to political handling. What I think Graham Day can legitimately expect from us is an indication of any areas we would not wish him to explore at the moment.

22 Any radical option of ARG, as on the commercial vehicle businesses, is likely to raise questions, sooner or later, about the need to improve the balance sheet if this proves necessary to secure commitment from potential purchasers for all or part of the business. From my discussions with Graham Day I believe it is yet too early to address this question. Ideas about ARG are stilll evolving. But it may be necessary to begin to look at these questions if we decide to encourage Graham Day to go into detailed discussions with potential partners in the next few months.

PUBLIC PRESENTATION OF GOVERNMENT POLICY ON RG

23 I suggest that we should also take the opportunity to discuss with Graham Day how best to handle public presentation of Government policy on RG. On Trucks I fear that concern in the component industry will translate into press speculation and well directed Opposition questions before too long. We must be prepared to meet this. My inclination is to favour a robust statement underlining that radical solutions are needed if the truck industry is to survive in the UK and Graham Day has our full support in exploring all options. The sticking point may be pressure to name the commercial parties to whom RG are talking. While Graham Day strongly supports the view that we must keep the initiative, he may find it difficult at this stage to persuade DAF and Paccar that they might be named if pressure

is intense. We cannot know how soon speculation may mount. If we reached agreement that RG should go forward into detailed price negotiations with one company we would then be better placed to make a firm statement. But there can be no certainty that we shall not be pressed earlier. We need to consider urgently with Graham Day just how full a statement we could seek to make if pressed.

24 On cars, equally, there is press speculation about plans to sell at least a minority holding in ARG to Honda. We shall need to decide how to handle this in the light of what Graham Day has to tell us. We may also need to consider what the Government might say to steady confidence in ARG's future. I know Graham Day believes a Government Statement of support would be helpful, though we should need to ensure that options for the future were not prejudiced.

CONCLUSION

25 There is a great deal of ground to cover with Graham Day. I suggest it may be helpful to focus on the key questions set out in attachment B.

26 I am copying this minute and attachments to Nigel Lawson.

P.C.

PAUL CHANNON
November 1986

JG3AFI

OPTION 1: FINANCIAL SUPPORT TO RG IN 1986/87

Summary
The payment of equity (or a loan for conversion into equity) during 1986/87. Amount sufficient to write off residual debt of Bus and Trucks. Possible announcement of acceptance of Corporate Plan.

Timing of decisions
Decision in principle November 1986
Decision to talk to DGIV November

Timing of public announcement
In Parliament during February 1987 before issue of Class 1 Circular and notice of EGM (for which latest possible date is 5 March).

Timing of action
Equity route:
EGM to amend Articles and reopen powers to take equity by 27 March 1987 at latest.
EC clearance for equity by end March 1987 at latest.
Equity injection by April 3 1987 at latest

Loan route:
EGM to amend Articles March 1987.
Loan under Industry Act by April 3 1987.
AGM to include power to take equity June 1987.
Conversion of loan to equity Summer 1987.

PROS

- Government acting in considered way on basis of Corporate Plan
- Bus sale should be completed and chance of reaching "Heads of Agreement" on Truck
- With proper groundwork, some degree of confidence in Commission decisions.

CONS

- Still a risk that Commission would decide to oppose
- Trucks deal might still founder in final stages
- Very limited scope for indicating future of ARG

SECRET

OPTION 2: GOVERNMENT FINANCIAL SUPPORT TO ROVER GROUP FOLLOWING EACH MAJOR DISPOSAL/RATIONALISATION

Summary
Payment of equity to write off Bus debts in 1986/87. Tackle Trucks debt in 1987/88 after Commission approval. February 1987 announcement refers to Bus specifically, makes general statement about the provision of equity for financial reconstruction, perhaps related to announcement of acceptance of Corporate Plan.

Timing of decisions
Decision in principle November 1986.
Decision on amount for Bus December 1986.
Decision on amount for Trucks March 1987 (?)
Decision to explain strategy to DGIV December 1986 (?)

Timing of public announcement
In Parliament during February 1987

Timing of action
EGM to amend Articles and reopen powers to take equity by March 1987.
EC clearance for first tranche of equity by end March 1987.
Equity injection for Bus by April 3 1987.
EC clearance for second tranche of equity Summer 1987.
Equity injection for Trucks Summer 1987.

PROS

- No risks taken on Commission approval of Trucks deal

- Shows that privatisation programme will not progressively leave behind a debt-ridden unmanageable rump.

CONS

- PES impact of Trucks in 1987/8

- Very limited scope for indicating future of Trucks and ARG in February statement.

- Weakens ability to produce "counterpart" to the Commission drawing on rationalisation across commercial vehicle and bus sectors.

- Commission consideration of Bus might still drag on into 1987/8

- Sequential treatment of Bus and Truck debt popularly perceived as "more and more money" for Rover Group.

SECRET

OPTION 3: GOVERNMENT FINANCIAL SUPPORT TO ROVER GROUP IN 1988/89

Summary
Announcement of intention to write off Bus debt, making general statement about the provision of equity for financial reconstruction. Indicate publicly that this is subject to EC Commission approval. Delay equity injection until 1988/89

Timing of decisions
Decision in principle November 1986
Decision on EC strategy January 1987 (?)
Decision on amout mid-1987 (?)

Timing of public announcements
In Parliament during February 1987

Timing of actions
EGM to amend Articles by March 1987
Confidential discussions with DGIV spring/summer 1987.
AGM to reopen powers to take equity June 1987 (?) or June 1988 (?)
EC approval 1988/89
Injection of equity 1988/89

PROS

- PES advantages

- Perhaps possible to combine handling of Bus/Trucks with re-structuring of ARG and possible Land Rover privatisation.

CONS

- Increasing Parliamentary pressure, focussed by EGM, on funding problem. Government judged to be marking time until post-Election run-down of Austin Rover

- Government delay publicly attributed to need for EC approval of UK plans

- Significant risk that saddling ARG with a mountain of debt/perceived Government indecision will lead to collapse of confidence in ARG

- Treasury palliatives (eg Government meeting interest costs) would lead to major difficulties with the Commission and would be unconvincing to the domestic audience

- Possible that RG Board would refuse to go forward on these terms

- Banks may demand re-assurance beyond Varley-Marshall eg formal guarantees.

QUESTIONS ON RG TO DISCUSS WITH GRAHAM DAY

Bus and Trucks

1 When does Graham Day believe these disposals will be concluded?

2 When can the full costs involved be accurately determined?

3 Subject to EC Commission clearance, when should the Government take action on the historic debt and rationalisation costs?

4 When can a full Government statement be made?

5 What should RG and the Government say if speculation mounts in the next few weeks?

ARG

6 Options and timing for privatisation (do we want to rule any out at this stage)

HONDA

7 - Day's impressions of their long term intention in Europe and towards ARG

a) - development of Honda's Swindon site?

b) - a substantial equity stake in ARG? With rights to increase it?

c) - or only on specific production facilities?

d) - what is the timing? of shareholding or next joint venture.

e) - implications for ARG's financial position eg would Honda insist on an improvement in ARG's balance sheet before investing?

f) - what funding decisions would be needed and when?

PUBLIC STATEMENTS

8 What could the Government say on ARG to steady confidence and discourage speculation? - but without giving the promise of more unlimited finance.

JG3AFK

RA7.55

FROM: A C S ALLAN
DATE: 19 November 1986

CHANCELLOR

HOWARD DAVIES ON AUSTIN ROVER

I rang up Howard to ask what the current state of play was from his point of view.

2. McKinseys had done a report earlier this year, when the strategy was to go for a full range of cars, mostly called Rovers but with an Austin at the bottom. McKinseys had not thought this was a viable strategy. Austin Rover seemed to want to be up-market and high-price, but they wouldn't give up the fleet market. McKinseys' view was that they needed to get a clear idea of where their market niche was. They couldn't just call cars Rovers and expect them to command a premium.

3. Another worrying problem was the dealerships. In McKinseys' view, Austin Rover had far too many; they were unprofitable; and the dealers didn't go out and sell cars.

4. The new commercial director had come to see Howard two weeks ago. Howard had reported these earlier views to him and he had expressed interest and said he would come back shortly. Howard still thinks that Day is concentrating too much on the future model range and the engineering, and not taking enough account of the equally important points about positioning in the market and about distribution.

5. McKinseys are also involved in advising GM about Vauxhall (having earlier been advising them also about negotiations with the Rover Group). Howard thought that the quality of work being put in by Vauxhall and GM management to try to solve a similar problem was much more impressive - though he did admit he was not closely involved with the latest Austin Rover thinking.

AA

A C S ALLAN

NO COPIES TO BE TAKEN.

CH/EXCHEQUER	
REC.	21 NOV 1986
ACTION	MR BURGNER
COPIES TO	SIR P MIDDLETON
	MR F E R BUTLER
	MR MONCK
	PS/CST

PWP

As we agreed, (a) it is essential that the bus/truck - certainly truck - deals are written off in 1986-87 - & it may be sensible to do this even if the sale talks are not concluded. (b) X does not of course apply if there are no PX consequences flowing 1987-88. N

SECRET AND PERSONAL

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

20 November 1986

cc Mr Tyrie 16/12

Dear Timothy

ROVER GROUP

The Prime Minister this afternoon met Mr. Graham Day, Chairman of Rover Group, with the Chancellor of the Exchequer, your Secretary of State and Mr. Giles Shaw (Minister of State, Home Office). Mr. George Guise, No. 10 Policy Unit, was also present.

Mr. Day said there was a great need to increase confidence in the company. Three disposals were on track and were likely to produce £80-90 million. Capital spending had been reduced by about £65 million. A good wage settlement had been achieved, for about three quarters of employees, which had introduced worthwhile incentives.

Continuing, Mr. Day said that the sale of Leyland Bus was in a fragile state. The position on Leyland Trucks was much as at the previous meeting with the Prime Minister. The sale, whether to DAF or PACCAR, was likely to come to a head around the turn of the year. The PACCAR deal would be the cleaner of the two. However, the deal with DAF would preserve more jobs and would retain for the UK a role in European truck building. The combined truck company would be in the first rank of truck builders. The proposal was that Freight Rover, Leyland Truck and DAF should be amalgamated into a new company in which RG might have a 25-30 per cent share of the equity. It would be late 1988 or early 1989 before such a joint company could be floated. DAF would not require RG to hold a continuing minority interest. They might agree to a placement of shares with institutions before flotation, but this was, on balance, unlikely. It would not be feasible for the new company to carry existing RG debt: debt which would be brought to the company by DAF would take gearing to the limits. A deal with DAF offered the advantage that RG would not have to fund model development for Freight Rover. DAF would retain the plant at Washbrook Heath. A link with DAF had already been forged through the provision next year by Freight Rover of 2,000 units for DAF. Plans were being prepared against the possibility that both deals might fail. Mr. Day noted that the award by MOD of contracts for DROPS and four-wheel drive four-ton trucks would make an immense difference to the successful company. It would tide Leyland Trucks through a very lean period. The Prime Minister said that the position on these contracts would need to be investigated. (I should be grateful if you could establish the position on these contracts with MOD before the meeting which is to be held next week - see below.)

On Land Rover Mr. Day said the Range Rover would be launched in the US in March. The traditional Land Rover business was falling away and a new vehicle below the level of the Range Rover was being developed. It would be possible in due course to consider a flotation, a trade sale or possibly a management buy out, but this was some way off: the earliest date would be 1988. If the deal with DAF on Leyland Trucks and Freight Rover combined were to fall through, Freight Rover might then be joined with Land Rover.

On Austin Rover, Mr. Day said employment had quietly been reduced by 8 per cent during the past five or six months. Capital expenditure and fixed costs had been reduced and further reductions were in prospect. The company faced at least 25 per per cent excess capacity. A number of possibilities for increasing throughput were in prospect. Mr. Day then outlined the projects described in his background note. He rated the probability of the projects coming to fruition in the order Honda, MG Roadster, Chrysler-Lotus and finally Chrysler.

SECRET AND PERSONAL

Mr. Day said his aim was to reduce the number of car platforms from seven to two. Production of the Mini would now continue until 1991. A replacement for the Metro had been postponed and the existing car would be re-engined with K series engines. If the Honda relationship was maintained the YY car would replace the Maestro and the Rover 200. The remaining cars in the range might be the MG Roadster and the Rover 800. The overall intention was to restrict the range of cars and to move up market. Austin Rover might eventually become like Volvo. The volume of car production might drop from the present 450,000 to around 300,000 with the difference being made up by production for other companies.

Mr. Day then described the possible shareholding to be taken by Honda. There was a three month window for discussions with Honda about this. Honda would probably at first take no more than a 19 per cent shareholding in Austin Rover since any higher level would involve consolidating Austin Rover into their balance sheet. The investment would be paid for by a contribution towards the capital costs for the joint project YY. There would need to be conditions and understandings to satisfy both sides. Honda were concerned that in the event of another company acquiring Austin Rover the Government should not then prevent them from developing their greenfield site at Swindon. This concern, however, appeared to stem from a misunderstanding about the relationship between Government and industry in this country. Both the Government and Honda would also probably wish to secure understandings about future increases in the Honda shareholding. If Austin Rover were making an operating profit in 1988 and Honda had by then taken a shareholding, it might be possible to sell further shares to employees, to existing shareholders and to institutions. Mr. Day noted finally that a decision on the capital injection of £550 million for Austin Rover mentioned in his note would be required by February because the company's borrowing limits would be reached then. The figure of £550 million did not take account of any group disposals.

Many of the points made by Mr. Day were in answer to questions and these need not be separately recorded. In dsicussion of the possible Honda shareholding, it was argued that this could tie the Government's hands: no other company would be interested in buying Austin Rover while it was so dependent on Honda. On the other hand, no other partnership was in prospect. The reaction to Honda taking a majority stake could not easily be predicted.

After further discussion, agreement was reached on the following points:

(i) it could well be necessary to make a statement during December about the sale of Leyland Bus and the possibility of deals with DAF or PACCAR. Mr. Day should prepare DAF and PACCAR for this possibility;

(ii) debt should be written off in 1986-7 rather than 1987-8 or 1988-9. However, any announcement of this would need to be made after publication of the 1987 Public Expenditure White paper: to announce changes in the public expenditure figures between the Autumn Statement and the PEWP would be damaging;

(iii) if the Leyland Bus sale were to be completed and an announcement made before publication of the PEWP it might be feasible for the debt to be retained by Rover Group, provided the banks could be re-assured that the debt position would be resolved before too long; a Treasury official might need to help re-assure the banks about this. It would not be possible to handle the much larger debt related to Leyland Trucks and Freight Rover in this way;

(iv) the European Commission were unlikely to cause difficulties over writing off the debt relating to Leyland Bus; discussions over debt relating to Leyland Trucks and Freight Rover were likely to be more protracted: these would need to begin soon if the write offs were to be made in 1986-7;

(v) a cash injection for Austin Rover would be needed, but the scale and options for this should be further studied and discussed in the context of the Corporate Plan.

Bringing the meeting to a close, the Prime Minister said that a meeting of the smaller group should be held next week. (This is likely to be arranged for Wednesday.) A meeting of MISC 126 could well be needed thereafter. DTI and Treasury officials should prepare a paper to be handed round at the meeting of the smaller group which would set out the position reached on Leyland Bus, the possible deals with DAF and PACCAR and the possibility of Honda taking an equity stake. The endorsement of the group would be sought for continuing the discussions with DAF and PACCAR with priority for DAF, and the group should be invited to consider the principle of Honda taking an equity stake. The paper should set out possible options for the size and form of a Honda stake, and indicate conditions which might be attached. But it should make clear that no decisions could be taken on these aspects until more was known of Honda's own preferences and intentions. The later meeting of MISC 126 would be invited to consider the DAF and PACCAR proposals, but not at this stage the possible Honda deal. Separately, DTI and Treasury officials should prepare a detailed note on the timetable and options for handling the statements which might be needed in the coming few months, the debt write offs and discussions with the European Commission. This would be discussed between the Prime Minister, the Chancellor of the Exchequer and Mr. Channon. Any statement by Mr. Channon would provide an opportunity to help restore confidence in the future of Austin Rover and there might be other opportunities. DTI should prepare a form of words which might be used to this end.

I am copying this letter to Alex Allan (H.M. Treasury).

Yours,

David.

DAVID NORGROVE

Timothy Walker, Esq.,
Department of Trade and Industry.

561/14/SC

SECRET

FROM: M A WALLER

DATE: 26 November 1986

1. MR MONCK

I agree. There is a summary on the last page
MM 26 Nov

2. CHANCELLOR

cc. Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Burgner

ROVER GROUP: PM's MEETING, 27 NOVEMBER 1986

This is a brief for tomorrow's meeting at No.10 to discuss the presentational and timetabling aspects of making a capital injection into Rover Group in 1986-87 to write off Truck and Bus debts. The meeting will be attended by the Lord President, the Chancellor of the Duchy of Lancaster, and the Minister of State (Industry) representing Mr Channon. It may be followed by a meeting of MISC 126.

2. Though we have not yet seen the papers in final form, the basis for discussion is expected to be 2 minutes from Mr Shaw to the PM, one dealing with Truck and Bus and presentational/handling issues, the other with ARG/Honda. Only you and the PM will have seen the minutes beforehand: Mr Shaw intends to hand out copies to other Ministers at the meeting. The minutes cover essentially the same ground as Mr Channon's minute to the PM which formed the background to last week's discussion with Mr Day.

TREASURY OBJECTIVES

3. We suggest the four main objectives for this meeting should be to ensure that:

(i) the timing and content of the proposed Statement in December enables the Government to keep the initiative, avoids compromising delicate negotiations on the future of Trucks and restores confidence in the Government's commitment to the future success of Austin Rover Group (ARG);

(ii) Ministerial agreement to RG pursuing the Trucks negotiations, subject to final agreement on terms;

(iii) the amount of capital injection for Truck and Bus debts is the minimum amount consistent with enabling the remainder of the Group to trade through 1987-88 without need for further injection in that year. (But no decision on the precise amount should be taken at this meeting).

(iv) the approach to the European Commission (EC) minimises the chances of Commission rejections or foot dragging on the assistance and thus the dangers of slippage of the capital injection into 1987-88. You may also want to secure colleagues agreement that, even if EC approval has not been obtained, the Government will ensure that any injection is made in 1986-87, if need be by a commercial terms loan from DTI Votes.

ISSUES

Timing and Content of Government Statements

4. As agreed at last Wednesday's discussion, Mr Shaw is proposing there should be two statements; one in December and one in February:

(i) in December, to forestall public/Parliamentary speculation over the discussions between Rover Group and DAF/Paccar, to report progress on the Bus negotiations and to reassert broad Government support for ARG.

Comment

(a) such a statement is essential to avoid news of the Trucks negotiations breaking in an uncontrolled way which would be politically damaging and might prejudice a successful outcome to the negotiations;

(b) given that the negotiations are known in industry circles the story could break at any time. It is therefore essential that a draft statement be prepared and cleared with Ministers very quickly. We have pressed DTI to prepare a draft statement covering Truck and Bus and ARG for tomorrow's meeting. We will, if at all possible, put a draft to you in advance of the meeting.

(c) subject to seeing the draft, the proposed coverage of the statement seems acceptable. The words of comfort in respect of ARG will require very careful drafting, but something will need to be said because a statement on Truck and Bus alone might well precipitate questions about the future of the remainder of the Group. There should however, be only a very guarded reference to the treatment of Truck and Bus debts since a reference to write off would prejudice Mr Day's negotiating stance with the companies and would excite questions on amounts, timing etc. (DTI officials agree with this approach). The reference might therefore be to the Government considering ways of preventing the accumulated debts of the company adversely affecting the performance of the rest of RG.

(d) on timing, other things being equal, there might be advantage in holding the statement over until 10 December just before Industry 1st Order Questions to avoid the Government being subjected to detailed questioning on RG twice in close succession. Contingency plans should, however, be prepared for an earlier statement should that prove necessary.

(ii) in February, covering the final agreement on the disposal of Trucks, the injection of capital in 1986-87 to retire Bus and Truck debts and the Government's response to the 1987 RG Corporate Plan. Subject to progress of talks with Honda and their views, the statement might also announce Honda's intention to take a minority stake in ARG.

Comment

(a) On Trucks Mr Shaw's minute proposes that Mr Day should be given a clear steer in favour of the DAF proposal. This will involve fewer job losses but will mean that, on present plans, RG would retain a minority stake in a joint DAF/RG Trucks operation until 1988 or 1989 when it would be floated off. In the meantime, there could be a continuing cash drain on RG, though this is not yet clear. We agree that the DAF deal looks the better option but suggest that Mr Day should be asked, if at all possible, to avoid any continuing financial commitment and to press DAF to convert some of the debt they intend to bring into the new company into equity.

X

(b) On content, it is not clear that the Government will be in a position to make a definitive response to the 1987 Corporate Plan by February. Ministers may wish to consider whether the difficult decisions which may be required on ARG restructuring should be delayed on account of wider political considerations but no decision is required at this meeting.

(c) Timing of the statement is largely dictated by likely progress with both the Trucks negotiations and consideration of the 1987 Corporate Plan which both point to no earlier than February.

Capital Injection

5. DTI's current estimate of the make up of the costs which the capital injection would write off is as follows:

	£m
Truck	
Debt (at 31.12.86)	370
Restructuring Costs	70
Contingency	80
SUB-TOTAL	520
Bus	
Debts (at 31.12.86)	100
Restructuring costs	30
TOTAL	650

6. The figures are subject to a considerable degree of uncertainty and need thorough checking - a good reason for not setting a precise figure for the injection now. The inclusion of the contingency of £80m is, for example, open to challenge. On the other hand, to the extent that the Trucks disposal is delayed, the write off could be correspondingly larger (Trucks are forecast to lose over £100m in 1987). And disposals of some of Land Rover International Holdings Overseas Subsidiaries (LRIH) (e.g. Santana) could involve debt write off of a further £30/40m.

7. On general public expenditure control grounds we would wish to restrict any injetion to the absolute minimum. This might involve:

- restricting the 1986-87 injection to just the amount needed to retire Bus, Truck, and perhaps, LRIH debt. This would reduce the capital injection to some £500m at the cost of further RG commercial borrowing to meet restructuring costs.

- using the Jaguar central proceeds, currently £120m. But this would correspondingly reduce RG's ability to trade through 1987-88 without need for a capital injection or increased borrowing. Given the greater difficulties with the EC which any Government injection for ARG would involve, the Jaguar proceeds are a useful cushion.

8. Unless Mr Day can shift some of the restructing costs on to DAF or Paccar (which in unlikely), the injection will probably need to cover both debt retirement and restructuring costs but should exclude the use of Jaguar proceeds. The amount will need detailed checking in the run up to the February Statement and should therefore be kept open at this stage.

Clearance with the EC

9. Mr Shaw is proposing to submit a draft notification to the Commission next Monday of the Government's intention to inject equity into Rover Group in 1986-87. The notification will be imprecise as to the amount and will canvass both DAF

and Paccar as possible buyers of Trucks.

10. The clearance procedure is critical for public expenditure plans because it vitally affects the timing of the injection. Payment of notifiable state aids is illegal under UK law unless cleared with the Commission. Commission procedure can take up to six months but DTI are hoping to obtain final clearance in under four. If necessary they envisage political pressure to achieve speedy clearance. But any slippage could put 1987-88 expenditure plans at risk. In view of this we suggest you should seek clarification on the following points:

(i) the choice of notifying the intention to inject equity this year. DTI envisage that, if delay beyond end 1986-87 seems likely, they would tell the Commission that we would make a commercial loan from Votes to Rover Group (a less overt form of assistance and therefore perhaps presentationally more acceptable to the Commission), pending completion of clearance procedures for equity. The alternative would be to notify the intention to make a loan immediately, something arguably which would not be a notifiable state aid. As a result the EC clearance procedure might be left to take its more normal, leisurely course. The choice in our view is evenly balanced but you may wish to press Mr Shaw to see if he has thought through the alternatives. (Since this issue is not addressed in the note you may wish to raise it with Mr Shaw in the margins of the meeting).

(ii) the way in which the notification is to be couched i.e. how robust should the UK be in pressing the case from the outset. Should we tell the Commission firmly what we intend to do rather than ask their permission?

(iii) the extent and timing of political pressure on the Commission likely to be required to secure eventual Commission clearance. The Foreign Secretary should be consulted on this. You will wish to emphasise the unacceptable public expenditure consequences of slippage of the injection caused by Commission delays, or refusal. (Presumably Ministers collectively would not be prepared to contemplate delay until 1988-89 if clearance procedures prevented a 1986-87 payment).

??

ARG

11. Mr Shaw is seeking colleagues agreement to Mr Day pursuing negotiations with Honda on their taking an equity stake in ARG. This is a sensible strategy but there are two points related to this:

(i) the need for an additional injection for ARG.

In our discussions with DTI officials they have made it clear that they are not persuaded that ARG will need an equity injection on either the scale or timing currently being suggested by Mr Day (i.e. £550m in 1987). Nor are they anxious to press the issue given the inevitable major difficulties with the EC. In addition to the use of the Jaguar proceeds, they have pointed out that other sources of internally generated funds could be used to cover ARG's financing requirements e.g. other disposals (Unipart, Istel), a flotation of their N.American marketing company (ARCONA) and equity/project participation from Honda or perhaps Chrysler. Some of these proposals are speculative but they underline the case for not taking precipitate decisions on ARG finance.

(ii) The terms of Honda participation

A key element for Honda appears to be an undertaking that, if other partners were to come into ARG, and Honda so desired the Government would support publicly the development of production assembly at Honda's site at Swindon. Honda attach great importance to the Government's attitude and it could therefore prove a useful bargaining counter in RG's negotiations with Honda over equity participation. The point was, I gather, discussed briefly at last Wednesday's meeting but Mr Shaw may seek agreement to restrain Mr Day from giving any undertaking on the Government's behalf before a deal satisfactory to the Government has been negotiated. This seems a sensible approach, although it is not one which is likely to be welcome to Mr Day. The proposal is hard to judge until we know what cash or new and reliable commitments Honda offers in return for equity.

SUMMARY OF POINTS TO MAKE

12. We suggest you should register the following points at the meeting:

(i) a December Statement is essential to enable the Government to keep the initiative and restore public confidence in RG;

(ii) the DAF deal is to be preferred, subject to Mr Day minimising the continuing RG involvement with Trucks and maximising the DAF financial contribution;

(iii) some capital injection will be necessary to relieve RG of Bus andTrucks debts but the precise amount will be for decision between yourself, the PM and the Secretary of State for Industry when the shape of the deals is clearer; but agreement on timing – ensuring that the injection is achieved in 1986-87 – is essential.

(iv) EC clearance procedures are critical to ensuring that the capital injection can take place in 1986-87: slippage into 1987-88 would be unacceptable on public expenditure policy grounds. It is, therefore, essential that the proposed tactics maximise the chances of securing Commission clearance for an injection this year. But on any scenario political pressure is likely to be required to secure at least EC acquiescence and Ministers must be prepared to face a political row with the Commission.

MAW

M A WALLER

006/1283

SECRET

pwp

CHIEF SECRETARY TO THE TREASURY

FROM: JILL RUTTER

DATE: 28 November 1986

PS/CHANCELLOR

cc:
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mr Burgner
Mr M A Waller

ROVER GROUP: PRIME MINISTER'S MEETING, 27 NOVEMBER.

The Chief Secretary has seen Mr Waller's brief of 26 November for this meeting. The Chief Secretary commented that this is extremely depressing. It is essential to avoid any announcement of a £500 million equity injection into Rover at any critical moment in the teachers' dispute. (The Chief Secretary may have already made this point orally to the Chancellor.)

Jill Rutter

JILL RUTTER
Private Secretary

C10/6

SECRET

FROM: M A WALLER
DATE: 28 NOVEMBER 1986

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Burgner

ROVER GROUP (RG): MISC126 PAPER AND PARLIAMENTARY STATEMENT

As agreed at yesterday's meeting at No.10, I attach for your comment and clearance drafts of the paper for MISC126 and the Parliamentary Statement. The drafts have been prepared by DTI in consultation with us. DTI are submitting to their Ministers in parallel over the weekend. Copies are also being sent to No.10.

2. DTI Ministers do not currently intend to show the statement to MISC126 unless pressed at the meeting to do so.

MISC126 Paper

3. This is essentially a truncated version of Mr Shaw's paper on trucks. It excludes any discussion of debt write-off or Eureopean Commission (EC) clearance procedures: the former because it will be likely to generate questions about the whole future financing regime of RG which cannot be settled now; the latter because of the complicated considerations involved (on which, however, the Foreign Secretary will need to be consulted on political tactics at some stage with the Commission - see paragraph 7-8 below).

Parliamentary Statement

4. The Statement is intended to set the trucks deal in the context of the Government's strategy for returning RG businesses to the private sector. Hence, it mentions other planned disposals. The words of comfort on Austin Rover Group sit fairly comfortably

not attached (nor ever seen ?) — what on: PM present M

into this context and reflect the terms of a recent letter on Rover from the PM to the Labour Opposition Spokesman on industry (Mr John Smith).

Now amended to take account of DAF/RG talks.

5. The section on DAF currently mentions the vans business but we understand that, at negotiations between RG and DAF this afternoon, it was agreed to drop the reference. Reflecting your concern that the Government should be as open as possible, we have agreed with DTI that they tell Rover to reach agreement to reinstate the reference. The wording is to be cleared at a DAF Board meeting tomorrow morning so Rover will need to move quickly. Paccar are content.

6. As in the MISC126 paper, there is no reference to debt write-off/capital injection. DTI are preparing a supplementary on this for both the MISC126 meeting and Parliament which we will clear with you on Monday.

EC negotiations

7. We have pressed DTI officials on the tactics of the equity route versus the commercial terms loans approach we discussed with you yesterday. Their advice is:

i. their view that the equity notification route is the most likely to secure a smooth and timely EC clearance is shared by the Cabinet Office, Foreign Office and UKREP;

ii. the balance of legal and EC policy advice is that the Commission would regard a loan as a notifiable state aid so that we might be in for two fights with them if we followed this up with equity;

iii. loan or equity would become illegal under UK law the moment the Commission took us to the European Court.

8. We are obtaining copies of the legal advice but in the face of the above we would need to have a very strong argument to overturn DTI Ministers' chosen course. Time on this is, in any

case, short because DTI officials will hold informal talks with the EC on Monday morning to tell them of the UK's intention to inject equity into RG on account of the bus and trucks rationalisation. It will be very difficult to change course thereafter. If, therefore, you were unhappy about the tactics DTI propose to adopt with the Commission, you would have to speak to Mr Channon over the weekend (he returns to the UK early tomorrow morning and his private office has been in contact with yours to exchange telephone numbers).

M A WALLER

Ch

Mr Channon is on 01-351-0293 after 8.00pm Saturday or after 3.00pm Sunday

MA

DRAFT PAPER FOR MISC 126

ROVER GROUP: FUTURE OF THE COMMERCIAL VEHICLE OPERATIONS

The collapse of the talks with General Motors (GM) over Land Rover-Leyland earlier this year removed our hopes of achieving orderly rationalisation of the UK commercial vehicle sector. As we then envisaged and with GM's subsequent decision to close the Bedford business, Rover Group (RG) have been reviewing alternative ways of securing a viable future for Leyland Trucks.

2. Leyland Trucks remians heavily loss-making. Following a 1985 loss after interest of £26.5m the estimated out-turn for 1986 on the same basis is £62.6m. Forecasts for 1987 show that the company will continue to make losses on this scale and thus represent a large cash drain for RG. Even allowing that Leyland will pick up a reasonable share of Bedford sales, on any reasonable assumptions there is no early prospect of a return to profitability or of the company generating enough income to fund new models before the end of the decade.

3. It is against this background that RG Chairman, Mr Graham Day has been exploring the possibilities for collaboration, merger or sale of the business. The two main options which have emerged are as follows:-

i) <u>DAF</u> (Annex A)

DAF have expressed interest in Leyland Trucks and Freight Rover with whom they already have collaborative marketing agreements. The proposal under discussion would involve the formation of a combined DAF/Leyland Trucks/Freight Rover company as an interim step before flotation in 2-3 years time. Until flotation RG would retain a 25-30% share of the equity in the joint company unless it should prove feasible to place this holding with institutions, a possibility which I am asking Mr Day to examine.

ii) <u>Paccar</u> (Annex B)

Paccar, a US truck manufacturer and owners of the UK company, Foden, are interested in acquisition of Leyland Trucks only. If Paccar do bid, Cummins (a US engine manufacturer but with substantial UK operations) may support them with an equity participation. In addition to Foden, the UK independent truck company, ERF, might also be involved.

4. Both sets of talks are at an early stage. Mr Day hopes to be in a position to recommend which option to pursue before the end of the year but a conclusion to any negotiation could not be expected before the first quarter of 1987. Against the possibility that neither of these deals should materialise, Mr Day is also preparing a fall-back restructuring plan for Leyland Trucks under present ownership. If Freight Rover were not included in any sale, that company would be retained by RG and prepared for later privatisation, perhaps alongside Land Rover.

5. Under any of the options substantial rationalisation would be needed and serious job losses would be unavoidable. The scope, location and timing of these are not certain at this stage but:

a) DAF would retain the Leyland assembly plant (though with reduced manning) and the Freight Rover operation in Birmingham where it would also fund new model development. The future of the Scammell plant at Watford and the Albion axle plant in Glasgow would be reviewed but these facilities would not necessarily be closed.

b) <u>Paccar</u> would probably reduce the Leyland operation to the assembly-only of vehicles from bought-in components. Peripheral activities including Scammell, Albion, and engine/foundry production at Leyland would almost certainly be closed. If ERF were involved, either the ERF or Foden plants at Sandbach would also be closed. There would be further consequential job losses in component supplier companies arising from UK rationalisation and some overseas sourcing.

c) Under the RG fall-back option, restructuring within Leyland Trucks would be likely to follow closely the Paccar pattern.

Under the DAF proposals, at least 2000 jobs would probably go within Leyland Trucks. Under Paccar and the RG 'retention' options perhaps as many jobs again would be at risk as retrenchment within Leyland would be more severe and the impact on the components sector could also be significant. These redundancies would either be implemented or become apparent in 1987.

6. Whilst for the moment Mr Day must clearly pursue both options, a merger with DAF would be politically and industrially the better choice. DAF would offer a secure future for Freight Rover as well as Leyland Trucks; it would offer a European solution; its product range is for the most part complementary to rather than competitive with that of Leyland (and it has no van range of its own); it would bring with it a good distribution network in Continental Europe where Leyland/Freight Rover is weak; and it would involve significantly less job losses within the UK. For these reasons I recommend that Mr Day should be asked to give priority to DAF even though this would require Rover Group temporarily to retain a minority holding in the proposed joint company.

PUBLIC PRESENTATION

7. Public presentation of these issues requires care. We must show we have a clear plan, and we must retain the initative. On Trucks, speculation about DAF/Paccar already running in the component industry may very soon translate into press speculation and well directed questions in the House. We must be prepared to meet this. I therefore recommend that I make a pre-emptive statement on the future of Trucks today:-

- underlining that radical solutions are needed if the truck industry is to survive in the UK;

- making clear that Graham Day has our full support in exploring all options;

- acknowledging that he is currently exploring possibilities with DAF and with Paccar;

- promising that a full statement will be made to the House when conclusions are reached.

8. As the same time, to avoid renewed and damaging speculation about ARG's future, I will also include a broad supportive statement on the Government's commitment to ARG.

RECOMMENDATIONS

9. A number of issues need to be decided now. I recommend:-

a) that Graham Day be asked to pursue both disposal options for Leyland Trucks, but giving priority to DAF and with the objective of concluding a deal in this first quarter of 1987.

b) that I make a pre-emptive announcement to-day.

c) that I should consult colleagues again when the details of any deal are known.

SM4 AAV SECRET 17.30 28.11.86

NAMED DISTRIBUTION ONLY

ROVER GROUP STATEMENT

With permission Mr Speaker I should like to make a statement about progress on the Government's strategy for returning the Rover Group businesses to the private sector.

The disposals being pursued on Leyland Bus and Unipart are already well known to the House and I can report that in both cases the negotiations are proceeding constructively and I hope to make a further statement shortly. The Rover Group is also taking forward the disposal of majority interests in Jaguar-Rover-Australia and Istel. It has invited bids for Llanelli Radiators.

In respect of commercial vehicles, the Chairman's review of the options for Leyland Trucks has taken place against a backdrop of depressed demand and severe over-capacity in Europe. The General Motors decision in respect of Bedford has[, sadly,] underlined the pressures on this sector. [~~All the options must therefore recognise the need for significant rationalisation including collaboration,~~ merger, sale, as well as continuation on a ~~stand-alone basis.~~] [These talks do not of course affect Land Rover on which the position remains as I stated last April.]

omit

This sentence belongs later on.

confusing

These should

What talks

There will be a need for significant rationalisation at Leyland Trucks whatever route is followed, whether that is a collaboration, merger or sale to another company or a continuation of the business ...

Talks are progressing with two companies.

The first is DAF. Hon Members will be aware that in October a limited but important collaboration on the marketing of Roadrunner and Sherpa vans was announced. DAF and Rover Group are now in talks about the benefits that could arise from a [~~much more fundamental~~] merger of their commercial vehicle businesses. ~~[DAF version (subject to DAF Board approval); DAF and Rover Group are now in talks about the benefits that could arise from a much more fundamental collaboration in their commercial vehicle businesses].~~

Now concluded: now reflects wording agreed this afternoon by DAF and RG MW

The second is Paccar, the parent company of Foden, who are considering whether they wish to make a full bid for Leyland Trucks.

Both sets of talks are at an early stage and, taking account of the severe problems in this sector, Mr Day has my full support in pursuing them; I shall of course make a further statement to the House as soon as there is something further to report, hopefully in the first quarter of 1987.

As I am sure the House will understand, and accept, it would be prejudicial to these discussions, and ultimately to the propects for job security of those employed in Leyland and suppliers' operations, for me to make any further comment at this stage.

OTIOSE [Indeed it would be wrong for me to do so.]

Mr Day's review of the plans for all RG operating companies including Austin Rover will form the basis of the 1987 Corporate Plan which I expect to receive shortly. I shall announce the Government's response as soon as possible in the New Year. In respect of Austin Rover, I should however like to take this opportunity to emphasise that I expect Mr Day's plan to set out a positive course for the continuation of the company as a major producer and leading exporter of cars made in Britain. I stress that be fully consistent with the Government's aim is to of secure ing the best possible future for Austin Rover, its suppliers and the motor industry generally in this country. That is what we shall continue to work to achieve and I am confident that is what Graham Day will deliver.

Ch

I wouldn't press this very strongly, but DTI's version is potentially something of a hostage to fortune.

AA

CONFIDENTIAL

pwp

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

6 December 1986

Dear Alex,

I should record that the Prime Minister did not in the event have an opportunity to raise our plans to rationalise the bus and truck divisions of the Rover Group with M. Delors in the margins of the European Council. The Chancellor will wish to be aware of this before his own visit to Brussels on Monday.

I am copying this letter to Tim Walker (Department of Trade and Industry).

CH/EXCHEQUER	
REC.	08 DEC 1986 – 8/12
~~ACTION~~	CST SIR P MIDDLETON
COPIES TO	MR MONCK MR BURGNER MR WALKER

Yours sincerely,

Charles Powell

(CHARLES POWELL)

Alex Allan Esq.,
HM Treasury.

copy no. 2 of 2

12/12/86.

SECRET

ADVICE BY CLOSE 15.12.86

passed to Mr Waller AA

CH/EXCHEQUER
REC. 12 DEC 1986 12/12
ACTION MR WALLER
COPIES TO CST FST
SIR P MIDDLETON
MR F E R BUTLER
MR MONCK
MR BURGNER
MR TYRIE AA 16/12

PRIME MINISTER

ROVER GROUP

We are meeting next Tuesday to review progress and to discuss some points outstanding from our recent discussions with Graham Day and with colleagues.

Leyland Bus

2 RG report that all major issues on Bus have now been settled with the Management Buy-Out. The prospects for concluding a deal soon look promising.

Commercial Vehicles

3 My Statement on 2 December was well received and there is growing recognition of the severe difficulties facing Leyland Trucks. We must keep the initiative and move forward as rapidly as possible.

(i) DAF

RG are continuing their intensive discussions with DAF on the agreed timetable with a view to reaching Heads of Agreement by end-January.

You will recall that Nigel Lawson expressed concern about the structure of any deal and in particular the prospects for an early placement of the proposed Leyland minority interest. A note by officials is attached at Annex ~~A~~. C

DW5BBY

999-49

The key point is that Graham Day fully shares the Government's objective of making as clean a break as possible from the tucks business and I am confident that he will drive a hard bargain within the constraints of his overall negotiating hand. I have no doubt at all that he will work hard to keep the minority stake small and to avoid any obligation by Rover Group to contribute to any future cash calls by the new joint company. I strongly believe we should leave Graham Day to strike the best deal he can with DAF. We shall be free to take our own view when we have his recommendation.

(ii) <u>Paccar</u>

A team from Paccar is currently in the UK and will be staying a week or two until they have completed a thorough appraisal of the Leyland Trucks business and facilities. This is encouraging because it should enable Graham Day in early January to have a good appreciation of Paccar's attitude.

<u>TIMETABLE</u>

4 My objective remains to be in a position to make a Parliamentary Statement on the disposal of Bus and Trucks in mid-February and achieve the write-off of debt and restructuring costs within this financial year. A note on the main risks to this timetable - and proposals for dealing with these - is at Annex ~~B~~. A

DW5BBY

5 Assuming the commercial negotiations keep to schedule, the major uncertainty is in securing EC approval for the aid. We have moved quickly here and I am encouraged by my own contacts with Commissioner Sutherland that the sensitivity of the issues is well understood in Brussels and that he will do his utmost to smooth our path. As expected the Commission will almost certainly open a procedure on Trucks - I hope within the next week or so - but will accelerate their procedures so that a decision is reached in March.

PREMATURE DISCLOSURE

6 We are taking every precaution to avoid leaks of the substance of our proposals - both here and in Brussels - but we must recognise there is a high risk of this happening before we are ready to announce our decisions in mid-February. The fact of our notification to the Commission - and the implied admission that we are already to contemplate some debt write-off - are the most likely details to become public and, as guidance from Brussels suggests these might leak over this weekend, I have proposed, subject to your and Nigel Lawson's agreement, to announce this through an arranged Question on 15 December. Timing of the formal notification to the Commission of the more politically sensitive data - the level of equity injection proposed and the redundancy/rationalisation consequences of any deal - requires careful thought. It may be possible to take matters forward informally with the Commission and delay official notification until late January and this would reduce the risks appreciably. However, there is also the possibility that details will leak from industry circles and I have asked officials to consider with Treasury and the

Policy Unit how best we might deal with this. Our plans will need to take account of the speculation that is bound to be generated by the Public Expenditure White Paper in mid-January which will have to make some reference to the possibility of aid to the Rover Group.

ARG/HONDA

7 We have agreed that Graham Day should have authority to explore with Honda the possibility of their taking a stake of up to 20 per cent in Austin Rover. It is too soon to judge whether - or how soon - this can be accomplished, and therefore whether this could form part of my February Statement. In the meantime there is one issue we need to resolve.

8 You will recall that Honda have asked for an assurance from the Government that in the event of ARG being taken over by a third party Honda would be welcome to develop their own assembly operation at Swindon. Honda would like this assurance before they commit to a Design and Development Agreement with ARG on the replacement Maestro/Rover 200 (AR8). Annex ~~C~~ B sets out the pros and cons of our giving that assurance now rather than when Honda are ready to agree to a shareholding in ARG or at least are committed to a manufacturing agreement. This question involves a tactical judgement on when such an assurance would have maximum leverage. Graham Day is emphatic that the advantage lies in

giving the assurance now and, bearing in mind the importance we attach to the fundamental objective of strengthening the relationship with Honda, I think we should not overrule his judgement.

9 I am copying this minute to Nigel Lawson.

pp PAUL CHANNON

12 December 1986

Approved by the Secretary of State and signed in his absence

DEPARTMENT OF TRADE & INDUSTRY

ANNEX A

SECRET
COMMERCIAL IN CONFIDENCE

PROVISION OF CAPITAL INJECTION TO ROVER GROUP RELATING TO LEYLAND BUS AND LEYLAND TRUCKS

CONTINGENCY PLANS

Note by Officials

Following the meeting on 20 November between the Prime Minister, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, and the Chairman of The Rover Group, officials were asked to prepare a note on the steps required to make the capital injection. This note, prepared by DTI officials in consultation with HM Treasury officials and the No 10 Policy Unit, considers contingency plans in case the disposal of Bus or Trucks is not completed as expected, or European Commission approval for the equity injection is delayed.

Commercial Negotiations on Bus

2 We now understand that all major points of principle have been agreed with the Management Buy Out (MBO). However if, contrary to RG's expectations, the current negotiations with the MBO were to collapse, Rover Group would either seek an alternative buyer (most probably Lairds) or, failing that, close the business. The choice of an alternative buyer could delay Heads of Agreement by about two months, so that a deal might be agreed just after Trucks. A closure decision could be announced more quickly.

3 Sale to Lairds or closure would cause no greater difficulty over the European aspects than the existing proposals, since the degree of rationalisation would be increased.

Commercial Negotiations on Trucks

4 RG aim to reach Heads of Agreement on Trucks by end-January. Progress on the Trucks negotiations is important because of the need to supply detailed information about the consequences of the chosen option, in confidence, to the

JF6AKC

Competition Directorate of the Commission during late January and early February.

5 Mr Day has said that he would wish to implement a radical restructuring plan for Trucks if talks with both DAF and PACCAR broke down. The level of rationalisation under this plan is likely to be at least as great as under either sale option and the negotiating position with the Commission should not be weakened.

European Aspects

6 The major risk to the timetable is failure by the European Commission to give formal approval for the equity injection by 1 April 1987. The likelihood of this risk will be easier to gauge in mid-January.

7 A brief formal notification was tabled on 8 December. However, to enable accelerated consideration of this notification, by mid-January the Competition Directorate, DGIV, will need to be given formally, in strict confidence, the proposed level of aid and, in as firm detail as possible, the proposed counterpart on Trucks (as well as Bus). In order to be able to provide this information to the Commission, negotiations will need to have reached, or be close to, Heads of Agreement by end-January. Alternatively, if neither deal is possible, a commitment to implement Rover Group's internal rationalisation option may need to be given to the Commission.

8 Payment of an aid not authorised by the Commission would be contrary to the Treaty of Rome and could result in legal action before the European Court of Justice with the Commission seeking repayment of the aid. The Court has shown a tendency to side with the Commission in such arguments.

9 Provision by the Government of a commercial rate loan to Rover Group in advance of Commission approval for an equity injection would be an aid. However if by February authorisation of the equity injection within this financial year appeared unlikely, the use of a commercial loan (under Section 3(2)b of the 1980 Industry Act) might, with the Commission's connivance, enable us to meet our deadline without the Commission losing face. If we were forced to resort to the use of such a device we should need to make quite clear to the Commission that the loan would

X

subsequently be converted into equity and that this conversion would take place immediately their formal approval of the notification had been given.

10 A decision on whether the debt write off is made by an equity injection or through a commercial loan for conversion into equity must be made in early February because of the need to be explicit in the estimates.

DEPARTMENT OF TRADE AND INDUSTRY
12 December 1986

JF6AKC

ANNEX B

SECRET
COMMERCIAL IN CONFIDENCE

HONDA - SWINDON

The meeting of Ministers on 27 November to discuss Rover Group matters requested that Treasury and DTI should set out the facts and tactical implications involved in Honda's request to be given an assurance now, that HMG would not oppose the development of their Swindon site into a full manufacturing facility in the event of Austin Rover (ARG) being taken over by a third party. The following note has been prepared by DTI officials in consultation with Treasury.

2 Honda have no car manufacturing facilities in Europe but have purchased a very large site at Swindon, at present used for pre-delivery inspection of cars produced for them by Austin Rover, and also for some parts assembly/pressing. It is planned that part of the site will be used for a plant for assembly and machining of the medium size engine Honda propose to supply for the next ARG/Honda collaborative car (AR8). There would still be ample space to accommodate a full car manufacturing plant for Honda's European production.

3 The AR8 car is due to be launched in 1989 to replace the Maestro and Rover 200. The estimated capital cost to ARG is £185m spread over 1987 - 1991. (Honda would bear the corresponding capital costs of producing AR8 in Japan). Mr Day sees AR8 as an essential plank in Austin Rover's future model strategy and an important element in consolidating the Honda relationship, which Ministers have agreed is the way forward for ARG. It is commercially vital because the Austin Maestro is not selling well in its sector whilst the joint production agreement on, and Honda component supply for, Rover 200 is currently scheduled to end in 1989. With AR8 likely to account for upwards of 150,000 vehicles from that year (in excess of 30 per cent of anticipated total output) it will give vital loading to ARG facilities with a competitive vehicle. Any delay would leave ARG increasingly exposed to newer more up to date models from their competitors especially in export markets. RG assure us that the timetable is tight; any delay beyond a few weeks in the signature of the Design and Development agreement now scheduled for 18 December would be unacceptable.

JF6AKD

4 There are no formal central Government powers to oppose development at Swindon. Any further planning permission required would be likely to be a formality for the local authority. However a Japanese company will not embark on a major overseas investment project unless privately certain that it was not acting against the wishes of the host government. Despite the absence of formal powers to oppose the development it is clear therefore that the question of the Swindon assurance is a negotiating card whose timing merits consideration.

5 It is questionable whether in domestic political terms it would ever be defensible to take a stance that prevented creation of employment and exports, even if there were strong pressure from the existing UK vehicle manufacturers and other EC Member States to exclude Honda from the UK. That being so Rover Group believe that the assurance Honda seek should be given now as a quid pro quo for the certainty of early signature of the AR8 D and D agreement and to avoid any risk of reopening in Honda's mind fundamental doubt about whether the Government has a positive attitude to their presence in the UK. RG believe that Honda were seriously unsettled by the opening of the talks with Ford earlier this year and wish to establish as soon as possible that they could still look to a future in the UK as their route into Europe if those talks were to be revived at some point in the future.

6 There are three options open to Ministers:

(i) to accept RG's argument and give an assurance now, albeit one which would set out that any Honda operation at Swindon would have to conform to established UK policy on local content;

(ii) to hold back the assurance until the negotiation of the AR8 manufacturing agreement (six months away);

(iii) to hold back the assurance so that it was considered as part of a wider package of any conditions Honda seek in the context of negotiations about a minority shareholding (in the first quarter of 1987).

7 Option (i) carries the least risk of unsettling the Honda relationship at a critical time and is what Mr Day believes was agreed at Ministerial meeting on 20 November.

On the other hand the Design and Development Agreement already contains an escape clause for either company in the event of a substantial third party shareholding in ARG or Honda being taken, and it is arguable whether any further assurance should be given in this context.

8 Option (ii) could involve considerable delay to the AR8 programme with serious commercial consequences for Austin Rover, but might strengthen the negotiating position on the fine detail of local content and balance of investment in AR8. However it could be argued that it would still be premature to give the assurance Honda seek since AR8 is only a 4 year model life programme. The objective should be to withhold such an assurance until Honda could be locked into a very long term commitment to ARG as their route into Europe.

9 Option (iii) would carry a similar risk of delay to AR8 as option (ii) but the negotiating card would be reserved for use only in the context, perhaps most appropriately, of strategic negotiations on a very long term relationship. If Honda do not in the event prove willing to take an early decision in principle on a shareholding, the negotiating card might still be played to help achieve a fallback in which Honda entered into a long term framework of strategic collaboration with ARG, albeit without a shareholding to cement it.

10 Ministers will need to consider whether they wish to overrule the firm view of Mr Day and his colleagues that option (i) is the right option to follow if he is to move quickly to consolidate the Honda relationship in a constructive climate.

DEPARTMENT OF TRADE AND INDUSTRY
12 December 1986

JF6AKD

ANNEX C

SECRET
COMMERCIAL IN CONFIDENCE

FINANCIAL STRUCTURE OF A ROVER GROUP/DAF JOINT TRUCKS COMPANY

Note by Officials

Following the Prime Minister's meeting on 27 November about the Rover Group (RG), officials were asked to prepare a note on the initial debt of any joint RG/DAF trucks company; and on the possibility of placing Rover Group's shareholding in such a joint company with institutions, in advance of the main flotation.

Comparative Trading Performance of Leyland Trucks and DAF

2 DAF Trucks itself trades profitably and is able to service its debt while undertaking substantial capital expenditure. In 1985, a year in which DAF undertook some £30m capital expenditure, Profit before Interest and Tax was around £25m and Profit Before Tax was £4.4m. This compares to Leyland Trucks Loss Before Interest and Tax of £26m and Loss Before Tax of £60m in the same year, with capital expenditure of £21m. While DAF Trucks' trading performance is very much better than that of Leyland Trucks, DAF remains highly geared. It makes only modest trading profits of which 80 per cent are absorbed in interest costs and it is not therefore financially strong. As a result a combined company would not be financially robust.

Must Leyland Trucks be sold Debt Free?

3 No detailed discussions have yet taken place on the financial structure of any combined DAF/Leyland Trucks company and it is therefore too early to take a final view. However, given the marked contrast in the trading performance of the two companies, Mr Day does not believe it would be possible to take any of the Leyland Trucks debt into the joint company. Even when restructured the Leyland Trucks part of the joint company would still be cash negative for the first two to three years of operation. Mr Day believes that the complete write-off of Leyland Trucks debt underpins all the negotiations with DAF. He believes that this point was made clear in his meeting with the Prime Minister on 20 November.

JF6AKD

4 Barings advise that, if the combined company is to be financially independent, it is not unreasonable for DAF to be very reluctant to take Leyland Trucks except on a debt-free basis.

Structure of the Proposed Joint Company

5 RG fully share the Government's concern to obtain as clean a break as possible from the Trucks business. In particular they wish to retain as small an equity stake as possible for as short a time as possible in any joint company. Ministers may wish to emphasise to Mr Day the importance the Government attaches to these broad objectives in pursuing detailed negotiations with DAF on the balance struck between the RG and DAF equity stakes in any joint company and the amount of debt DAF is allowed to bring into the joint company. In particular Ministers may wish to ask Mr Day to explore with DAF the possibility of DAF (and its shareholders) converting some part of the DAF debts to equity prior to any merger. This would reduce further the gearing of the combined company and thereby improve its financial prospects.

Y

6 With these broad objectives in view, Ministers may also wish to emphasise to Mr Day that the new company must be expected to stand on its own feet financially and that, unless it is unavoidable for the conclusion of an agreement, there can be no commitment to the provision of further capital from either RG or HMG to the joint company.

Prospects for Early Placement of RG's Minority Holding In a Joint Trucks Company

7 At his meeting with the Prime Minister on 20 November Mr Day mentioned the possibility that DAF might agree to placement with institutions of RG's minority shareholding in any joint company, in advance of the main flotation planned for late 1988 or 1989. Rover Group's view is that it is likely to prove difficult to obtain DAF's agreement to unilateral early placement of the RG shareholding. In any case, investors may be reluctant to invest in a company facing very substantial initial uncertainties in a difficult industrial sector. Nevertheless, RG recognise that early placement of their minority holding would be desirable, and are examining further with their merchant bank advisers, Lazards, and with DAF the possibilities of an early placement.

JF6AKD

8 Barings view is that until the new venture is seen to be on a reasonably firm footing it would be difficult to place RG's minority shareholding. Depending on the progress of the business, they believe that the earliest date for sale or placement of the minority shareholding would be early 1988.

Freight Rover

9 Freight Rover (FR) will be considered as a separate issue in the discussions between Rover Group and DAF. The debt in FR was £2.9 million at end-September, and is unlikely to be a major issue, in negotiations. (More significant may prove to be the need to fund investment in new products for FR.)

DEPARTMENT OF TRADE AND INDUSTRY
12 December 1986

JF6AKD

CONFIDENTIAL
COMMERCIAL-IN-CONFIDENCE

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5186
GTN 215) ....
(Switchboard) 01-215 7877

From the Minister of State for Industry

Private Secretary to
GILES SHAW MP

The statement on DAF so v. cryptic. What do we know of state of play? ?

David Norgrove Esq
No 10 Downing Street
London
SW1

CH/EXCHEQUER
REC. 07 JAN 1987
ACTION MR WALKER
COPIES TO CST FST, SIR P MIDDLETON, MR F E R BUTLER, MR MONCK, MR BURGNER

7/1

7 January 1987

Dear David

ROVER GROUP

I am writing to inform you of the latest position regarding discussions on the sale of the Bus and Truck divisions of Rover Group and the discussions with the European Commission over the planned write-off of their accumulated debts.

The conclusion of a deal to sell Leyland Bus to a management buy-out is imminent. RG hope to make an announcement this week. On Leyland Trucks, RG are taking forward detailed talks with DAFF. Paccar are also evaluating Leyland Truck facilities although their proposals are less well developed. RG have also developed a plan for internal rationalisation to be deployed if sale does not prove possible. RG hope to take a view on these options around the end of the month.

Following the last meeting of MISC 126 our formal notification under Article 93 of the Treaty of Rome was made to the Commission on 8 December. Parliament was informed of this by a written answer on 15 December. In the subsequent discussion officials have emphasised to the Commission the need for strict confidentiality and the paramount importance of securing formal authorisation of the proposed write-off before 30 March 1987. Commissioner Sutherland has responded positively and has succeeded in opening within two weeks - a record for the Commission - a formal procedure for both Bus and Truck under Article 93. By so doing the Commission are now able to carry out their detailed examination and begin their discussions with us. By acting so quickly the Commission have also given themselves the best

THUBMX

possible chance of meeting the very fierce deadline we have set although we must expect some tough bargaining with them - especially on Truck - in order to satisfy the Community's (stringent) state aid rules. The Commission has now responded formally to our request for authorisation and, as is normal practice, will shortly send a copy of this letter to other Member States for them to comment if they wish. A brief announcement will also appear in the Official Journal although this may not take place until mid-January.

Although my Secretary of State has told the House of our application we cannot rule out the possibility that there will be some critical comments on the terms of the Commission's letter if it becomes public knowledge. In such an eventuality we shall play down the significance of the exchange pointing out that the Commission's response is part of normal state aids procedures and that Parliament was told in mid-December of the Government's action in notifying the Commission of their intention to deal with the historic debt in Truck and Bus when decisions had been taken. We shall also confirm that discussions with the Commission will take place over the next few weeks and that further reports to Parliament will be given as and when there are significant developments.

Copies of this minute go to the Private Secretaries of the members of MISC 126, to Sir Geoffrey Howe and to Sir Robert Armstrong.

Yours ever

Malcolm McHardy

MALCOLM MCHARDY

THUBMQ

999-49

SECRET CMO

This is a very curious note of the mtg. The key is X: there was a clear and explicit understanding that we would review the whole matter after the election, minimising [illegible] & that this is simply a holding operation —

10 DOWNING STREET

LONDON SW1A 2AA

CH/EXCHEQUER

REC.	23 JAN 1987
ACTION	
COPIES TO	

From the Private Secretary

23 January 1987

PMP

Dear Timothy,

ROVER GROUP - THE 1987 CORPORATE PLAN

The Prime Minister this morning held a meeting to discuss the 1987 Rover Group Corporate Plan on the basis of your Secretary of State's minute of 19 January. There were present your Secretary of State, the Chancellor of the Exchequer, Mr Giles Shaw, Minister of State for the Department of Trade and Industry and Mr George Guise, No 10 Policy Unit. Mr Graham Day, Chairman of the Rover Group, joined the meeting after half an hour.

(!) Ministers discussed in the first part of the meeting questions to be put to Mr Day.

When Mr Day joined the meeting, the Prime Minister expressed to him her gratitude for his achievements in the short time he had been Chairman of the Group. However, there were considerable grounds for concern in the Plan which had been proposed. It suggested continuing very substantial capital expenditure and it had the hallmark of the successive Plans which had been proposed to the Government since 1979. It might be worthwhile, for example, to approach Honda directly to ask whether they would be willing to supply engines as an alternative to building the K Series, though the Prime Minister noted that Honda appeared to be now less positive about closer links with Rover.

In response to these and other comments, Mr Day agreed that Honda had become rather cooler. They said, reasonably enough, that they could not afford in publicity terms to have a close relationship with a shaky company. The strength of the Yen was having an effect on their earnings and profitability, and Honda were giving priority to their investments in the United States and Canada which were their largest and most profitable markets. Europe was tending to take a lower priority. It was not now possible to "make a credible medium to longer term assumption about a merger with Honda".

As for the Corporate Plan itself, Mr Day said the programme had already been reduced by some £300 million through dropping the AR6, the S Series engine and other changes. After the third year, the allocation of capital expenditure was entirely notional. The spending represented the minimum to keep the business alive. Even though it was the intention to develop niche products in the medium term, the company could not withdraw from the small end of the market, which provided 40% of its revenue, in less than 5 or 6 years. It was unlikely that Honda would provide engines in place of the K series. Indeed it was even doubtful whether they would provide 1.6 litre engines for AR8: they might now choose not to open an engine plant at Swindon. Moreover, ARG would need to enter into a 3-5 year contractual commitment to buy engines or gear boxes from other suppliers. Given all the uncertainties, such commitments would be better avoided. Indeed, the uncertainties were so great that it was not sensible to plan firmly for more than a year ahead.

Mr Day referred to companies with which ARG might possibly enter into partnerships. He believed that after an Election and after the company's market share could be seen to have been sustained or improved, Honda might be more attracted to ARG. Another possibility was PSA, with whom there was some synergy of models and engines. General Motors was another possible partner, who might well be preferable to Ford. Mr Day said he had held preliminary discussions with the head of GM in Australia: GM in Australia needed a new engine and there was a possibility of jointly building a car. (It was however noted that GM at present had their own difficulties.) Fiat was yet another possibility. And finally, Chrysler might be interested in buying a reskinned Metro with the K Series engine for sale in the United States. But even with partnerships of this kind, it would only be possible to move AR fully into the private sector with the benefit of a dowry.

Concluding this part of the meeting, the Prime Minister said that, if colleagues approved the Plan, your Secretary of State might aim to convey to Parliament the Government's approval in the middle of next month. He would be able to point to a number of positive developments at the Rover Group and say that he was satisfied with progress. The Plan would of course be approved subject to the usual Annual Review.

The meeting noted the position on discussions with DAF and Paccar for the purchase of Leyland Trucks. The preference for DAF was confirmed. Mr Day said he would probably wish to discuss the Paccar approach with Department of Trade and Industry Ministers next week and to review progress on DAF with them in about a fortnight's time.

After Mr Day had left the meeting, it was agreed that a meeting of MISC 126 should be held, probably on 18 February, to discuss Leyland Trucks and the Corporate Plan, and a meeting of E(A) on Thursday 19 February to discuss the same subjects. Cabinet would wish to be informed of the position on Leyland Trucks and your Secretary of State would then be in a position to make a statement that same afternoon.

I am copying this letter to Tony Kuczys (H.M. Treasury).

Yours,

David.

D R NORGROVE

Timothy Walker, Esq.
Department of Trade and Industry

copy no 1 of 3.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215)
(Switchboard) 01-215 7877

PS/ Secretary of State for Trade and Industry

SECRET
COMMERCIAL IN CONFIDENCE

11 February 1987

Alex Allan Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1P 3AG

CH/EXCHEQUER
REC. 11FEB1987 11/2
ACTION MR WALLER
COPIES TO PS/CST PS/FST SIR P MIDDLETON MR F E R BUTLER MR MONCK MR BURGNER MR BENT MR SLADE

Ch No briefing on this yet - I will chase in the morning. AA

Dear Alex,

ROVER GROUP

Officials here have been in discussion with both their Treasury counterparts and Rover Group about the mechanics of taking forward the policy decisions in the next few weeks. My Secretary of State now wishes to confirm that the Chancellor is content with what is proposed on two particular issues.

The first is the laying of an Order under the Industry Act 1980 increasing the limit placed on payments for shares by the Government in, and external borrowings of, Rolls Royce and Rover Group. My Secretary of State strongly believes that the risks in assuming an increase in the limit could be avoided are unacceptable. He would therefore wish to lay an Order at the time of the Rover Group statement. It could be presented as a technical measure to accommodate the RG restructuring and the Rolls Royce injection prior to privatisation. He takes the view that the Order should increase the limit by the full £850m allowed by the primary legislation as this would be normal practice; to suggest any other figure would simply fuel speculation on the reasoning behind it.

The second issue is the formulation to be used with regard to the amount of new equity in the resolutions to be put in the Circular for the Rover Group EGM. My Secretary of State believes that the RG Directors should take powers to issue new capital of up to £750m (or whatever is the maximum figure than current in negotiations

JG2AUZ

999-1

with the EC Commission). Similarly the authorised share capital of RG should be increased by the same figure. Since both motions will be of an enabling nature, they will be without prejudice to the exact amount to be injected which will be discussed separately with colleagues in due course.

I should be grateful for your confirmation that the Chancellor is content with what is proposed. I am copying this letter to David Norgrove at No 10.

Yours ever,

Michael

MICHAEL GILBERTSON
Private Secretary

JG2AUZ

999-49

561/3/SC

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

pm

FROM: M A WALLER

DATE: 11 February 1987

CHANCELLOR

cc. Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Burgner
Mr Bent
Mr Slade

ROVER GROUP: MEETING AT NO.10, THURSDAY 12 FEBRUARY

This is a brief for tomorrow's meeting with the Prime Minister and Secretary of State for Trade and Industry.

2. There are currently two items on the agenda:

(i) a decision on the choice between DAF and Paccar as preferred bidder for Leyland Trucks (and Freight Rover). This is discussed in Mr Channon's minute to the Prime Minister dated yesterday.

(ii) a position report, conveyed under a separate minute from Mr Channon, on negotiations with the European Commission (EC) on the size of equity injection. No decisions are called for at this stage.

LEYLAND TRUCKS/FREIGHT ROVER

3. The main financial features of the bids now on the table are as follows:

(i) DAF

- establishment of a joint DAF/RG company (Daylight) into which DAF would put its entire Trucks and Bus business (both assets and all debts) and RG would contribute the assets of Leyland Trucks, African Operations (AO) and

Freight Rover (FR). RG would retain the Trucks debt (£370m at end 1986) and also meet the restructuring/redundancy costs (£160m, including 1987 Q1 loss).

- in return RG would receive a 40% stake in the joint company the shares in which would be floated in 1989.

- the terms of the agreement would rule out any further cash call on RG but RG may be required to offer an indemnity of around £10m against industrial action in Leyland Trucks immediately following the deal.

- because RG would be a minority shareholder Varley Marshall assurances in respect of Trucks, FR and AO would cease to have effect.

(ii) <u>Paccar</u>

- Straight sale to Paccar of Trucks only, thus extinguishing Varley Marshall assurances in respect of the Trucks business.

- RG to receive a cash contribution of up to £105m, subject to further detailed negotiation/investigation by Paccar.

- Trucks debts to remain with RG, together with net trade creditors (total £430m). RG would also be required to pick up the losses of the Trucks Business for 1987 (or for the 12 months from date of sale if, as is likely, this is later than 1 April 1987) and redundancies/restructuring which Paccar choose to incur in 1987 (currently estimated at £120m but uncapped).

4. A summary of the coverage of the deals, compared with RG retaining and retrenching Trucks, is at Annex B to Mr Channon's minute.

Financial Assessment

5. RG have now largely completed a financial assessment of the

sale options, compared with retention (coupled with an equity injection/debt retirement). (The results are summarised at Annex A to Mr Channon's minute). The assessment represents RG's best guess of the financial outcome of the three options, without taking into account downside risks (particularly in respect of the Paccar and retention options). We, together with DTI officials and their advisers (Barings), have discussed the figures with RG and their advisers. Barings have assessed the downside risks on the cashflow forecast, taking account of information provided by RG. They have also assessed the possible risks associated with retention. In a sense, therefore, the Barings figures provide a worst case scenario. In summary the RG and Baring figures are as follows (closure costs have been included for completeness):

RG ESTIMATES

	(1)	(2)	(3)	£m (4)	BARINGS (5)
	1986-91 P+L	1986-91 CASHFLOW	CUMULATIVE CASHFLOW NPV(15%)	TRUCK* DEBTS	NPV CASHFLOW
DAYLIGHT (ie DAF)	(251)	(70)	(79)	531	(163)
PACCAR	(182)	(104)	(104)	488	(146)
RETENTION	(45)	(30)	(68)	496	(258)
CLOSURE	(355)	(274)	(276)	658	N/A

* i.e. amount to be met by equity injection

6. The key figures are in columns 3, 4 and 5. The main uncertainties are as follows:

(i) Daylight

- the proceeds from the flotation in 1989 (this is a firm date) of RG's 40% share in Daylight which RG estimate at £90m based on fairly conservative PE ratio and profit forecasts. To take account of forecasting risk Barings have discounted at 50% to give an NPV of £40m.

- the scale of any profit indemnity. Baring have allowed £50m for this (i.e the original DAF bid). As noted above, RG now say this figure will be no higher than

£10m and that it will be capped. (This would reduce the Baring NPV figure for Daylight to £(123)m.)

(ii) Paccar

- the uncapped RG liability for losses and restructuring costs of Trucks for up to 12 months under Paccar ownership for which Barings have allowed a margin of £50m.

(iii) Retention

- very substantial risks of higher than forecast losses over the period 1987-91 which Barings estimate to be around £190m.

7. There is very considerable uncertainty about which of the two bids would, in event, be more financially advantageous to RG. On the basis of the above estimates the NPV cashflow for Daylight could fall in the range £(79)-(163)m and Paccar in the range £(104)-(146)m. The retention option looks superficially attractive but given the persistent failure of Trucks to perform to target under RG management the figures are open to great risk, as the Barings adjustment for a worst case scenario shows. (This is an important consideration in relation to possible PAC interest in the Government's choice of options.) It would therefore be dangerous to place any great weight on the precise figures.

Employment/Industrial Considerations

8. RG estimate that both the DAF and Paccar deals would involve the loss of some 3300 jobs in Trucks by the end of 1989. In addition the DAF bid might also result in the loss of a further 1500/2000 jobs in the UK components sector. As Mr Rifkind's letter of today to Mr Channon illustrates, hardest hit would be the other UK engine manufacturers (Perkins and Cummins) who currently supply engines for Leyland Trucks and whose products would be displaced by DAF - sourced engines.

9. In addition, as Mr Channon's minute makes clear (paragraph 10 and Annexes C and D), the DAF option will involve the progressive shift of sourcing of components for medium and heavy trucks from Leyland to DAF. Thus, while these new products destined for the UK will be assembled at Leyland, most of the work and value added will accrue to the Dutch/Belgium end of the operation. Over the period 1987-91 the Daylight plans show Leyland sales increasing by 12% compared with 30% for DAF. And there are no job losses at the DAF end of the operation. These differences to a large extent reflect the different commercial performance of DAF and Leyland: the former is making a modest profit; the latter huge losses (a reflection of overcapacity and poor productivity).

ASSESSMENT

10. Treasury objectives in relation to Trucks have been to:

(i) to ensure that RG have no requirement for Exchequer support in 1987-88.

(ii) to ensure the lowest possible 1986-87 equity injection consistent with enabling RG to trade through next year without further recourse to the Government; and

(iii) to minimise the size of RG's continuing financial involvement with the truck and van businesses.

11. Of the options now on the table:

<u>DAF</u>

(a) is founded on a better understanding of the Trucks business and appears to be conservatively based.

(b) avoids residual risks associated with retaining FR and AO in RG.

(c) requires a substantial minority equity stake but involves RG in no further cash calls aside from a limited warranty against industrial action.

Paccar

(a) provides £105m up front, though subject to considerable downside risk as negotiations progress;

(b) offers a clean break from Trucks (not FR or AO) but provides an open-ended commitment for RG to meet the costs any redundancies/restructuring which the Paccar management introduce within 12 months of sale. Creative management or accounting would also significantly alter the size of the losses which RG would be called upon to meet.

Retention

(a) involves very substantial downside risks arising from failure to meet trading targets;

(b) provides no withdrawal from Trucks, FR or AO operations.

12. The financial forecasts are not conslusive. And both deals result in the withdrawl of Varley Marshall assurances. But we believe that the DAF bid is better founded than Paccar's and, as such, provides much greater certainty of outcome. While there will be a continuing substantial minority stake in Daylight, RG's financial liabilities are limited. DAF/RG will be in a position to sign a deal towards the end of next week. Negotiations with Paccar are likely to drag on for months with the risk that DAF would lose interest and seek collaboration elsewhere. As we have seen in the Bus deal, lengthy negotiations from a position of weakness tend to result in deteriorating sale terms.

13. Against this must be set the very real presentational difficulties associated with the employment/industrial aspects of the DAF deal, as exemplified by Mr Rifkind's letter. Paccar have already made public play of the implications of their strategy for UK employment and are known to be lobbying MPs in whose constituencies the Perkins and Cummins plants are situated. A decision in favour of DAF will therefore need very careful public presentation, calling, perhaps for some form of positive commitment by DAF to the future of Daylight's UK operations. On balance,

however, we would recommend you endorse Mr Channon's judgment that the Government should accept RG's recommendation that DAF should be the preferred bidder. We understand that the No.10 Policy Unit will be putting a similar recommendation to the Prime Minister.

14. In endorsing the RG judgement we will, of course, need to ensure that the Government's liability for RG is subject to tight limits. A borrowing limit is a crucial element in this. It is no use ridding ourselves of one set of Varley-Marshall liabilities if this merely allows RG to make unlimited use of further commercial borrowing. We understand Mr Channon will address this issue in a separate paper on the handling of the Corporate Plan.

EC CONSIDERATIONS

15. As Mr Channon's note says, while the prospects for Commission approval for the bus injection remain good, the Commission are likely to press for a reduction in the injection for the Trucks deal. Mr Channon will be able to report the Commission's latest thinking following his meeting tomorrow with Mr Sutherland.

16. While Mr Channon proposes to take a tough line with the Commission the tone of his minute is not encouraging. Moreover, he also says he will be prepared to offer a redution of up to £100m in the size of the injection towards the end of the month. There are two points here:

(i) the headroom between the £750m negotiating figure put to the Commission and the actual costs of debt write off/restructuring may not be large enough to accomodate such a reduction. The more we are forced to concede, the greater the pressure on RG's trading position and the more likely the requirement for further Government aid in 1987-88 (which would similarly require EC approval); and

(ii) it is not clear that it would be tactically wise to give ground at the end of February, particularly if the negotiating margin is tight. Indeed, Mr Channon acknowledges (paragraph 6) that there is no certainty that such a concession would secure EC approval. It may therefore be preferable to defer any final decision on this until the Williamson Group have prepared a report for Ministers on fallback options.

17. The fallback options currently being canvassed take as fixed the need to pay the money over to RG this year. Cabinet Office have queried whether some movement on timing might be possible. We have told them that this is an immovable requirement. But you may wish to re-emphasise to Mr Channon the paramount need for a 1986-87 payment and that failure to pay this year would mean that RG would have to wait for their money until 1988-89.

SUMMARY OF POINTS TO MAKE

18. I recommend that you:

(i) agree to DAF being the preferred bidder for Trucks and FR;

(ii) emphasise to Mr Channon the need to bring forward proposals for imposing limits on the Government's liabilities to RG by placing a cap on their borrowing;

(iii) press for reconsideration of the tactics in relation to theEC in the light of the paper on fallback options being prepared in the Williamson Group;

(iv) stress the need for a tough line with the Commission to ensure that the payment to RG is made in this financial year;

(v) emphasise to Mr Channon that payment must be in 1986-87: failure to pay this year will result in RG not receiving an equity injection until 1988-89 at the earliest.

Whatever EC says, payment must happen in 1986-87 - if by commercial loan

M A WALLER

SECRET

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

12 February 1987

CH/EXCHEQUER
REC. 13 FEB 1987
ACTION Mr Waller
COPIES TO PS/CST PS/FST Sir P Middleton Mr FER Butler Mr Monck Mr Burgner Mr Bent Mr Slade

PBM w.s. (ii) & top X' r.

13/2

LEYLAND TRUCKS AND ROVER GROUP

The Prime Minister this afternoon held a meeting to discuss Leyland Trucks and the handling of the Rover Group Corporate Plan on the basis of your Secretary of State's two minutes of 10 February. There were present your Secretary of State, the Chancellor of the Exchequer, Mr. Giles Shaw (Minister of State, Department of Trade and Industry), Mr. Brian Unwin (Cabinet Office) and Mr. George Guise (No.10 Policy Unit).

The meeting reached the following conclusions:

(i) The choice between DAF and PACCAR was more finely balanced than had earlier been expected, but DAF remained the preferable option. It would be important to guard against DAF exploiting their position by transferring production outside the UK. The Government would need to prepare carefully its arguments to rebut accusations that the PACCAR approach would have been preferable in terms of its effect on UK employment. DTI should set this in hand. DTI Ministers should discuss with Mr. Rifkind before meetings next week the effect on jobs in Scotland of choosing the DAF option.

(ii) Commissioner Sutherland would probably try to be helpful over the debt write-off. But there could still be difficulties in securing Commission agreement on the write-off for Leyland Trucks. The write-off would need to be made in this financial year come what may. The paper in preparation under Cabinet Office chairmanship on options for dealing with this should be brought forward as soon as possible and discussed between the Prime Minister, the Chancellor and DTI Ministers. It was noted that a Commission decision one way or the other would probably be quick.

X

(iii) The DTI's negotiating margin of £100 million should only be given away in the discussions with the Commission at the very last moment, in order to secure a settlement.

SECRET

(iv) DTI should bring forward proposals for discussion next week on a cap on RG borrowings of the kind which had been imposed in 1985. It would need to be discussed first with Mr. Graham Day.

(v) RG's proposal for delisting would need to be considered further. But it seemed at first sight unattractive. It would be difficult to present, giving the impression that the company was being nationalised. Some shareholders might refuse to sell, leading to further difficulties. Delisting would probably be right at some stage, but not yet.

(vi) A meeting of the "small" group should be held next Wednesday to discuss both Leyland Trucks and the Corporate Plan. An expanded E(A) should be held on Thursday morning before Cabinet. A paper should be prepared for this, to which should be attached a draft of Mr. Channon's statement to the House of Commons. A decision on when to circulate it would be taken at the Wednesday meeting.

I am copying this letter to Tony Kuczys (HM Treasury) and to Brian Unwin (Cabinet Office).

(DAVID NORGROVE)

Timothy Walker,
Department of Trade and Industry.

563/4/SC

SECRET
COMMERCIAL IN CONFIDENCE

FROM: M A WALLER

DATE: 12 February 1987

CHANCELLOR

OK

cc. Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Burgner
Mr Bent
Mr Slade

Chex plas

OK for me to write?

AA

ROVER GROUP: INDUSTRY ACT LIMITS AND LIMIT ON NEW EQUITY

The letter of 11 February to Mr Allan from the Private Secretary to the Secretary of State for Trade and Industry seeks your agreement to laying an order to increase the limits under the Industry Act 1980 by £850m (i.e. the full amount allowed by the primary legislation) and that RG directors should take powers to issue new capital of up to £750m (or whatever is the maximum figure then current in negotiations with the EC Commission).

INDUSTRY ACT LIMIT

2. This limit bites on payments by the Government for equity in, and the external borrowings of, Rolls Royce and Rover Group. The current limit is £4.4 billion and there is scope under the primary legislation to increase this by Order by up to £850m, subject to Treasury approval.

3. As the letter indicates, we have discussed this issue with DTI officials. The need to increase the limit arises from a transitory peak in RG borrowing between when new equity is injected in March and when Truck and Bus debts are repaid; a peak in Rolls Royce utilization arising from the Government's subscription for new equity and the possible delay in the Government ceasing to hold a controlling interest in the company arising from the use of the instalment method; and a peak in RG's utilisation of borrowings towards the end of 1987 when

their cash outflow arising from investments will once again increase the level of commercial borrowings. Precise financial projections are not available on these items. On reasonable assumptions the headroom under the existing limit could be little more than £100m. But all are subject to a considerable margin of error. We therefore share DTI's view that it would be prudent to take the opportunity offered by the Parliamentary Statement on the Corporate Plan and the Truck/Bus sales to lay the order before the House now. The alternative would be to rely on being able to raise the existing limit at relatively short and necessarily unpredictable notice.

4. As far as the size of the increase is concerned, Mr Channon believes any figure below the maximum provided under the primary legislation would be likely to invite unwelcome questioning on the justification for the precise figure chosen. We think this is right; raising it to the maximum can be defended on grounds of logic without implying that RG's liabilities will be allowed to reach that maximum.

5. The important point from the Treasury's point of view is that the increase in the limit does not imply any loss of control over RG's borrowings. As discussed in my brief yesterday, the appropriate way to pursue this issue is the imposition of a borrowing cap, as was done in the context of the 1985 Corporate Plan. Mr Channon has been briefed to agree to the principle of a cap. Nonetheless it would do no harm to register the point in the reply to Mr Channon's office.

EGM: LIMIT ON ISSUE OF NEW CAPITAL

6. RG's powers to take new equity have lapsed and the authorised but unissued share capital is not adequate to cover the size of the proposed equity injection. An Ordinary Resolution will therefore need to be put to the EGM to reopen powers to take new equity. RG's and DTI's adviser say that the Resolution must contain a figure for the maximum amount of new shares to be issued. The exact amount of the injection required to meet Truck and Bus debts and restructuring costs will not be known when the EGM circular issues (late next week).

Mr Channon therefore proposes to use the figure currently in negotiation with the EC - £750 million.

7. The proposal is sensible and unexceptionable. We can gain nothing in terms of further improvements to the DAF/Paccar offers by quoting a lower figure: and to do so would only weaken our negotiating hand with the Commission. I therefore recommend you agree to Mr Channon's proposal.

8. A draft Private Secretary letter is attached.

M A WALLER

SECRET
COMMERCIAL IN CONFIDENCE

~~DRAFT~~ LETTER FROM

Plead type

PRINCIPAL PRIVATE SECRETARY

TO

Michael Gilbertson

PS/SECRETARY OF STATE FOR TRADE AND INDUSTRY

Department of Trade and Industry
1 Victoria Street

ROVER GROUP

Thank you for your letter of 11 January seeking the Chancellor's agreement to raise the 1980 Industry Act limit by £850m and to the EGM Resolutions quoting an equity figure of £750m.

2. The Chancellor is content with Mr Channon's proposals. He has, however, asked me to say his agreement to raising the Industry Act limit does not imply his acceptance of any relaxation of control over RG's borrowings. ~~The appropriate way to pursue this issue is the imposition of a borrowing~~ He feels there should continue to be a cap on RG's external borrowings, as was done for ~~in the context of~~ the 1985 Corporate Plan.

3. I am copying this letter to David Norgrove.

A C S ALLAN
Principal Private Secretary

Ch
The RG shareholders are a nuisance, but presentational difficulties in buying them out. (Awaiting advice but may like to see now)
AA

Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215)
(Switchboard) 01-215 7877

16 February 1987

SECRET
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1

CH/EXCHEQUER
REC. 16 FEB 1987 16/2
ACTION MR WALLER
COPIES TO CST FST SIR P MIDDLETON MR FERB BUTLER MR MONCK MR BURGNER

Dear Chancellor

ROVER GROUP (RG) : SCHEME OF ARRANGEMENT

As you are well aware, the position of the minority shareholders, and the RG Board's obligations to them, have been complicating factors in our consideration of privatisation and other RG issues over the past couple of years. Although we have looked at it from time to time, we have not been able to find the opportunity or the device for removing the minority. RG have now proposed that, as part of the planned financial reconstruction of the Group, the Government (at the cost of some £12m) should make an offer for the shares under a Scheme of Arrangement which, if successful, would achieve this objective.

RG envisage :

- that I announce the Scheme, including the £1 offer price, in my 19 February Statement. This would contain no reference to de-listing.

- that the Scheme is the subject of a circular to shareholders in early March and voted on at an EGM at the end of March.

- that, if successful, de-listing would be automatic. If the Scheme failed to obtain the necessary support (50 per cent by number and 75 per cent by value of the shares voted) shareholders would have 3 months in which to sell at the offer price.

DW1CRE

999-1

- that, after the 3 months, RG would review with HMG the question of de-listing.

When RG first raised this issue with me I had misgivings about it. First, they intended to announce an intention to de-list regardless of the shareholders' response to the Scheme (raising questions about possible "oppression" of the minority) and secondly they risked infringing Stock Exchange rules on disclosure. RG's revised proposals remove the complications on both points. The circular to shareholders would simply say that RG would consider the appropriateness of maintaining a listing in the light of the response to the Scheme; and the Stock Exchange have confirmed that they would be quite relaxed on the timing of Class 1 circulars on the Bus and Unipart disposals. Indeed, the Stock Exchange volunteered that they regard the proposal for a Scheme as a sensible approach to the highly unusual situation whereby the listing had relevance only to a tiny (0.3%) percentage of the shareholders whose holding will be further diluted by the fresh injection of substantial Government equity.

Public justification for the Scheme would I believe need to rest on the arguments:-

- that, with the proposed new Government equity, the shareholding structure of RG will become increasingly anachronistic (the Stock Exchange point);

- that, at a time of disposal of major chunks of the business and a significant financial reconstruction, it is fair to give the minority shareholders the opportunity to exit on reasonable terms;

- that while the Scheme might temporarily bring the company wholly into public ownership, this move will in fact simplify and facilitate the RG Board's and the Government's consideration of privatisation options for the residual businesses (the RG proposal to offer the minority some form of preferential rights in any future flotation of Land Rover/Austin Rover might help here).

X There is of course no certainty that the Scheme will receive the required support - in which case we shall have lost nothing of substance - but if it does succeed we shall have significantly improved our room for manoeuvre in handling future privatisation and other RG isues that will arise.

Of course this could be criticised on the grounds that - so far from privatising Rover - we were actually extending public

DW1CRE

999-49

ownership. Moreover, I would be unable to find the £12m necessary to finance the Scheme of Arrangement from within my budget; and I know how difficult the pressures are on the Reserve for 1987/8. But there is no doubt that this must be done sometime and would greatly facilitate the handling of affairs.

I am inclined in terms of the policy to agree with Graham Day, although clearly the cost presents difficulties. I would welcome your views, and those of the Prime Minister, to whom I am copying this letter, before finally coming to a decision.

Yours sincerely

Timothy Walker

PAUL CHANNON

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

DW1CRE

999-49

PLEASE RETURN TO CHANCELLOR'S OFFICE BY CLOSE OF PLAY 17.2.87

Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215) ....
(Switchboard) 01-215 7877

PS/

SECRET
COMMERCIAL IN CONFIDENCE

16 February 1987

David Norgrove Esq
Private Secretary to the
 Prime Minister
10 Downing Street
LONDON
SW1

CH/EXCHEQUER
REC. 16 FEB 1987 ✓16/2
ACTION MR WALLER
COPIES TO CST FST
SIR P. MIDDLETON
MR F.E.R. BUTLER
MR MONCK
MR BURGNER

Note
Show to Mr Waller.
AA

Dear David

ROVER GROUP

As agreed at the meeting on 12 February, I attach a first draft of the proposed Parliamentary Statement. Clearly this will need to appeal to a variety of audiences, not least the Government backbenchers most directly concerned.

I am copying this letter and attachment to Alex Allan (HM Treasury).

Yours

Timothy

TIMOTHY WALKER
Private Secretary

Ch
Some of the early parts look a bit grandiose
AA

I agree. Some quite unwelcome [illegible] looking over-egging. I have suggested a [illegible] of [illegible] [illegible]

DW1CRF

9/164

DRAFT PARLIAMENTARY STATEMENT

1 With permission, Mr Speaker, I should like to make a statement concerning the Rover Group.

2 I am pleased to be able to announce today the Government's approval of the Rover Group's 1987 Corporate Plan. The Plan is reviewed annually to cover a rolling period of 5 years ahead; the strategy in this Plan, which relates to the period 1987-91, will evolve in that period to meet market developments. In accordance with usual practice I am today placing in the Library of the House a summary of the Plan excluding commercially sensitive details.

3 It is envisaged that throughout the five year plan period Austin Rover will continue as ~~a major~~ an important car producer with a ~~full,~~ competitive and up-to-date range of models. The programme of model collaboration with Honda will be taken forward with a new medium sized car - AR8 - for which a manufacturing agreement should shortly be concluded. The future relationship between the companies will of course continue to develop in the light of experience but it is the intention of both companies that the relationship should be a long term one and should endure beyond the life of existing design and production contracts. The Government very much welcome this joint intention to continue to strengthen links in the future.

Do we want to stress this (audience?)

4 The new K series engine will be taken forward to full production and used in Austin Rover's smaller engined cars. This engine will equip the company for the next decade with a new high economy engine designed to meet new emissions

of the market.

controls and will also make a major contribution to Austin Rover's [strong] presence in the small car sector [~~which,~~ with the planned further development of the model range, is a vital element in the company's marketing plan.]

Again, a hostage to fortune?

5 Turning to Land Rover, the Plan takes account of the launch of Range Rover in the United States this year which will be a major step in diversifying Land Rover's market base. ~~[The company will also be taking steps to extend its product range.]~~

6 On the commercial vehicle businesses my hon Friend, the Minister of State for Industry, told the House on 14 January that the sale of Leyland Bus to a management buy out had been competed. I told the House on 2 December that Rover Group were also holding commercial discussions with DAF in relation to Leyland Trucks and Freight Rover, and separately with Paccar in relation to the Trucks company. The Rover Group Board have now recommended and the Government has accepted the proposals made by DAF, to bring together Leyland Trucks, DAF Trucks and Freight Rover into a new Anglo-Dutch joint venture with the capability to achieve a major presence in the European commercial vehicle market. The deal will also include the associated parts operations and certain overseas operations. These proposals build upon important existing distribution links between the companies. RG will take a 40% shareholding in the new company based on the value of the assets they bring to the merged operations and will have Board representation. Market conditions permitting it is the firm intention of RG and DAF to float the company within two to three years.

JG1ARL

7 Within the joint venture Freight Rover are planning to invest in a major model replacement programme and will continue to manufacture vans at its Common Lane site in Birmingham, and Leyland will continue as the focal point for truck manufacture in the UK.

8 I made plain, however, in my statement in December, that all the commercial options open to Rover Group in relation to the Trucks business would involve significant rationalisation and restructuring. The engine and foundry plant at Leyland will not be part of the new venture and will be closed by the end of 1988. The Scammell plant at Watford will also be closed and its production transferred to Leyland. Some [1800] jobs will be lost through these closures and a further [600] through slimming of the Leyland and Albion operations; no job losses are forecast at Freight Rover.

9 The Government regrets that these ~~hard commercial~~ decisions have had to be taken. But with severe over-capacity in Europe ~~I am convinced that~~ rationalisation cannot be avoided if the new venture is to have a competitive manufacturing base. I believe that this deal offers the best prospect of building a secure long term future for Leyland Trucks and Freight Rover and I can assure the House that the plan developed by the two companies envisages significant expansion of truck production at Leyland including for export and an important expansion of the export of Freight Rover vans.

10 As part of this restructuring the Government intends to deal with the historic debts from Leyland Bus and Leyland Trucks left in Rover Group, and with the restructuring costs resulting from their sale. The Government have notified the EC Commission of this intention and the normal procedures are

JG1ARL

in train. Meanwhile Rover Group will be convening a General Meeting in March to enable the Government to provide yp to £750m for this purpose. In parallel, I am today laying an Order under the Industry Act 1980 to increase the limit in that section which applies to sums paid for shares in, and external borrowings of the ex NEB companies, Rover Group and Rolls Royce.

11 The Government's clear intention is that Rover Group should be given every opportunity to take forward the development of Austin Rover and Land Rover. The Government believes that the proposals on commercial vehicles together with the additional financial support I have announced today will give Rover Group this opportunity. Success now depends on achievements in the market place. Mr Day has focused sharply on this important aspect of the business in recent months and I am encouraged by news that Austin Rover's market share in the first ten days of February was approaching 20% its highest for X months. With new marketing initiatives increasing sales, recent successes in the fleet market, such as the orders by major car rental companies, and the launch of the Sterling and Range Rover in the United States this year, I believe that Rover have ~~in their own hands~~ the resources and skills to succeed.

PS8/57A

SECRET
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

cc Chief Secretary
Financial Secretar
Sir P Middleton
Mr F E R Butler
Mr Monck
Mrs Lomax
Mr Burgner
Mr Waller
Mr Ilett
Mr Bent

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

pup

17 February 1987

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
1-19 Victoria Street
LONDON SW1

v dirty photocopies!

Dear Secretary of State,

ROVER GROUP (RG): SCHEME OF ARRANGEMENT

Thank you for your letter of 16 February seeking my views on RG's proposals for a scheme of arrangement to buy out the minority shareholders with the object of delisting RG's shares.

We have discussed this proposal at earlier meetings. While I fully understand the advantages of removing this potentially troublesome minority, I see several major disadvantages. As you make clear in your letter, the main reason for wanting to buy out the minority shareholders is to avoid the disclosure requirements imposed by Stock Exchange listing and to avoid the need to have an EGM to get shareholders' approval for disposals. Against this, however, must be set the very real presentational difficulties for the Government of the course you propose. It would quickly become apparent that the main motive for offering the scheme of arrangement was to relieve RG of the obligations on disclosure and on securing approval for disposals. The more difficult minority shareholders will undoubtedly make much of this point, as would the Press and the Opposition. It would be very difficult to defend the proposal against the background of our general policy of encouraging transparency in company affairs. We, and the company, would quickly be open to charges we could not be bothered - or actively want to conceal - what RG are up to.

It would also involve expenditure of up to £12 million next year. I could not accept a claim on the Reserve for this purpose unless the case was very strong.

Against this background, I could only agree to the proposal if we had a cast iron assurance that the scheme would be accepted with the minimum of public fuss. It seems to me that this condition cannot be met. It is by no means clear that a sufficient number of the minority shareholders would vote in favour of the scheme. Even if they did, we would still have to seek the approval of the Courts for the scheme and that would give a further opportunity for minority shareholders to make a public fuss about the arrangements. There is a real likelihood that, one way or another, we would end up with egg on our faces, having achieved nothing except to give ammunition to our opponents. All things considered, I believe that Rover Group should be told that the Government is not prepared to agree to their proposal at this time.

I am copying this letter to the Prime Minister.

Yours sincerely

Alex Allan

pp **NIGEL LAWSON**

(approved by the Chancellor and signed in his absence).

SECRET
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

Appendix 3

ROVER GROUP: ANALYSIS OF MINORITY SHAREHOLDINGS

Range	NON-GOVERNMENT TRACEABLE				NON-GOVERNMENT UNTRACEABLES	
	Holders		Shares		Holders	Shares
	Number	(%)	000s	(%)	(number)	(000s)
1-500	47184	(94)	3887.7	(32)	10269	607.6
501-2000	2494	(5)	2669.2	(22)	133	127.2
2001-5000	409	(1)	1407.9	(12)	15	43.3
5001-10,000	122	(")	977.5	(8)	-	-
10,000-49,991	68	(")	1324.1	(11)	-	-
50,000+	12	(")	1741.6	(15)	-	-
TOTAL	50289		12008		10417	778.1

Thanks –

Sparrow to PSM:

c/ Rover Group.

Mike Waller is investigating the vehicles option. In the meantime they have found a precedant involving DTI and Phoenix II. Money was paid by the Paymaster General into a non interest bearing account because EC approval for the scheme ran out at the end of 1985 and British Steel did not want the money until financial year 1985-86.

He will let you have a more detailed note today or tomorrow.

CR 18/2

CHANCELLOR OF THE EXCHEQUER

Ch

The Williamson report is the only new document. It* reveals the unpalatable fact that it looks impossible to pay in 1986-87 unless we do get Commission authorisation. It is quite bullish about the chances of getting authorisation, but cannot of course guarantee it. So there remains risk — which it seems we can do nothing to eliminate completely — that payment may slip into 1987-88. V important for PM to lobby Delors etc to stop this.

(* but not brief!)

AA

CHANCELLOR OF THE EXCHEQUER

Ch

ROVER GROUP

PS/Mr Channon rang.
DTI are, broadly, accepting all our comments on the draft statement *except* the following (highlighted below):-

a. The deletions at the end of para. 4

b. The deletion in para. 6

c. The reference in para. 10 to the Commission — DTI do not want to be provocative at this stage

AK
15/2

563/35

SECRET
COMMERCIAL IN CONFIDENCE

cc Chief Secretary
Financial Secretar
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Burgner
Mr Waller
Mr Bent

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

17 February 1987

Timothy Walker Esq.
PS/Secretary of State for Trade and Industry
1-19 Victoria Street
LONDON SW1

Dear Timothy,

ROVER GROUP: DRAFT PARLIAMENTARY STATEMENT

The Chancellor has seen the copy of the first draft of the proposed Parliamentary Statement attached to your letter to David Norgrove of 16 February. He has asked me to pass on the following amendments which are primarily designed to tone down the draft in some places and to emphasise that implementation very much depends on commercial success.

2. Taking the points in turn:

- Paragraph 3, first sentence: The Chancellor would prefer to stick to the formulation used by Mr Channon in his statement on 2 December. He therefore proposes that the first sentence should be replaced by the following:

  "As I expected, the plan sets out a positive course for the continuation of Austin Rover as a major producer and leading exporter of cars made in Britain.

- Paragraph 4, first sentence: Amend to read "The plan is for the new K Series engine to be taken forward to full production...."

- Paragraph 4, second sentence: Delete "strong" and end with "small car sector of the market." (deleting the last two lines).

- Paragraph 5: Delete last sentence.

- **Paragraph 6, last sentence: Delete "...of RG and DAF". The Chancellor does not wish to rule out altogether the possibility of a placing of RG's Daylight shares prior to flotation.**

- **Paragraph 10: The Chancellor considers that it would be helpful here to state briefly the position we have taken with the Commission. He proposes that the first and second sentences be amended to read:**

  "The Government intends to deal with the historic debts from Leyland Bus and Leyland Trucks and with the restructuring costs resulting from their sale. It would be quite wrong to burden the new Bus and Trucks operations or the companies remaining in Rover Group with the substantial legacy of past losses and over capacity. The Government have therefore notified the European Commission of the intention to make a capital injection this financial year and are discussing the proposal with them.

- Paragraph 11: Redraft the first four sentences to read as follows:

  "As a result of the actions I have announced today, the Rover Group will have every opportunity to take forward the development of Austin Rover and Land Rover. Rover Group's ability to grasp these opportunities, as well as ultimate success, now depend on achievements in the market place. These will have to match the performance which the company have forecast in their plan. Mr Day has focussed sharply on the need for commercial success in recent months and I am encouraged....."

- Paragraph 11: last sentence: Delete "in their own hands."

3. I am sending a copy of this letter to David Norgrove at No.10.

Yours
Alex

A C S ALLAN

563/35/SC

SECRET
COMMERCIAL IN CONFIDENCE

FROM: M A WALLER

DATE: 17 February 1987

CHANCELLOR

cc. Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Burgner
Mr Bent

ROVER GROUP: DRAFT PARLIAMENTARY STATEMENT

The letter of 16 February from Mr Channon's Private Office to No.10 provides a first draft of Thursday's proposed Parliamentary Statement. Since the statement may be discussed in the margin of tomorrow's meeting at No.10 it would be helpful if the Prime Minister and Mr Channon had your comments on the draft in advance of the meeting. I therefore attach, for your approval, a draft Private Secretary letter suggesting a number of amendments to the statement which are essentially designed to tone down the rather categorical commitment to the plan (e.g. paragraphs 3 and 4 of the statement) and to forge a rather stronger link between commercial success and implementation of the plan (paragraph 11). Given that the Prime Minister's meeting on RG is to take place tomorrow morning, the letter should issue as quickly as possible today.

Ch
OK to write as attached?
– preferably tonight
AA
+ 2nd letter below

M A WALLER

OK as drafts!

DRAFT LETTER FROM PRINCIPAL PRIVATE SECRETARY

TO:

Timothy Walker Esq.
PS/Secretary of State for Trade and Industry
1-19 Victoria Street
LONDON SW1

ROVER GROUP: DRAFT PARLIAMENTARY STATEMENT

The Chancellor has seen the copy of the first draft of the proposed Parliamentary Statement attached to your letter to David Norgrove of 16 February. He has asked me to pass on the following amendments which are primarily designed to tone down the draft in some places ~~the degree of commitment to the detail of the plan~~ and to emphasise that implementation very much depends on commercial success.

2. Taking the points in turn:

- Paragraph 3, first sentence: The Chancellor would prefer to stick to the formulation used by Mr Channon in his statement on 2 December. He therefore proposes that the first sentence should be replaced by the following:

  "As I expected, the plan sets out a positive course for the continuation of Austin Rover as a major producer and leading exporter of cars made in Britain.

- Paragraph 4, first sentence: Amend to read "The plan is for the new K Series engine to be taken forward to full production...."

- Paragraph 4, second sentence: Delete "strong" and end with "small car sector of the market." (deleting the last two lines).

- Paragraph 5: Delete last sentence.

- Paragraph 6, last sentence: Delete "...of RG and DAF". ~~The point here is that~~ the Chancellor does not wish to rule out altogether the possibility of a ~~placement~~ placing of RG's Daylight shares prior to flotation.

- Paragraph 10: The Chancellor considers that it would be helpful here to state briefly the position we have taken with the Commission. He proposes that the first and second sentences be amended to read:

  "The Government intends to deal with the historic debts from Leyland Bus and Leyland Trucks and with the restructuring costs resulting from their sale. It would be quite wrong to burden the new Bus and Trucks operations or the companies remaining in Rover Group with the substantial legacy of past losses and over capacity. The Government have therefore notified the ~~EC~~ European Commission of the intention to make a capital injection this financial year and ~~we are~~ are discussing ~~this~~ the proposal with them.

- Paragraph 11: Redraft the first four sentences to read as follows:

  "As a result of the actions I have announced today, the Rover Group will have every opportunity to take forward the development of Austin Rover and Land Rover. Rover Group's ability to grasp these opportunities, as well as ultimate success, now depend on achievements in the market place. These will have to match the performance which the company have forecast in their plan. Mr Day has focussed sharply on the need for commercial success in recent months and I am encouraged....."

- Paragraph 11: last sentence: Delete "in their own hands."

3. I am sending a copy of this letter to David Norgrove at No.10.

A C S ALLAN

565/11/SC

SECRET
COMMERCIAL IN CONFIDENCE
MANAGEMENT SENSITIVE

FROM: M A WALLER

DATE: 17 February 1987

CHANCELLOR

Ch
Again, some advantage & costs
tonight

AA

cc. Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mrs Lomax
Mr Burgner
Ms Ilett Who she?
Mr Bent

ROVER GROUP (RG): SCHEME OF ARRANGEMENT

We share your concerns (Mr Allan's minute of today) about the proposals in Mr Channon's letter of 16 February for a scheme of arrangement designed to take out the minority shareholders in RG. In particular we believe Mr Channon's letter overstates the advantages and underplays the difficulties with the RG proposal, even though the proposal represents an improvement on RG's original plan to delist regardless of the shareholders' response.

2. The main and, indeed, only reason why RG want to eliminate the minority is to avoid the disclosure and procedual requirements arising from Stock Exchange listing. These involve the need to issue circulars to all shareholders when disposals of assets take place and, in the case of disposals of assets constituting a significant proportion of RG's assets, to seek advance agreement from the shareholders by means of an EGM. The former requirement can be troublesome because of the need for statements as to the adequacy of working capital. The latter requirement is essentially a procedural nuisance rather than a constraint on action because HMG can vote its shares in favour of disposals.

3. Against this must be set the presentational difficulties to which you have drawn attention:

(i) it is by no means certain that the scheme would be accepted by the minority. DTI officials accept that there is a strong risk that an insufficient number of the minority will sell, even at a relatively attractive price, to make the scheme automatic and thus achieve delisting. And even if the required minimum number of votes were received it would still be open to "aggrieved" shareholders to challenge the scheme when the scheme is submitted to the Courts for approval. (Court approval, which is by no means automatic, would take place some time after the EGM at end March so the minority wishing to cause a public fuss would have two bites at the cherry).

(ii) Whatever the outcome the proposal sits very uneasily with the Government's general stance on the need for transparency in company dealings. The impression would be conveyed that RG (and HMG) either cannot be bothered or actively want to conceal what they are up to.

(iii) As Mr Channon acknowledged, buying out private shareholders would also sit rather oddly with the Government's longer term aim to return RG to full private ownership.

4. The scheme would also cost up to £12m in 1987-88, a very difficult year for public expenditure, with little or no prospect of an offset on DTI votes. (We could not dock the money from RG's capital injection because of problems with the EC.)

5. There is one point to which Mr Channon does not refer but which we know is in the minds of DTI officials i.e. the extent to which the existence of the minority involves an additional constraint on RG Directors in exercising their fiduciary duties towards the company. The short point is that there may on occasion be a conflict between the wider interests of the Government and the narrow commercial interests of the company. Removal of the minority would not strictly, however, relieve the Directors from acting in the commercial interests of the company, even if 100% owned by HMG although the absence of private shareholders may make the conflict less explicit.

CONCLUSION

6. We think Mr Channon understates the presentational difficulties involved with the RG proposal in the current climate of concern about the need for transparency in company dealings. Success cannot be guaranteed and, even if the scheme is accepted, it will provide considerable opportunity for the minority to make public mischief. This seems an unacceptable and unnecessary risk to run, particularly when it will involve a call on the Reserve next year up to £12m. A draft letter to Mr Channon outlining these points is attached. As with the Parliamentary Statement, this issue may be discussed in the margins of tomorrow's meeting at No.10. So it would be helpful if the letter could be issued today.

7. This note has been agreed with FIM.

M A WALLER

565/12/SC

SECRET
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

DRAFT LETTER

From: Chancellor

To: Secretary of State for Trade and Industry.

thus removing potentially troublesome troublesome minority minority shareholders, I see

ROVER GROUP (RG): SCHEME OF ARRANGEMENT

Thank you for your letter of 16 February seeking my views on RG's proposals for a scheme of arrangement to ~~take~~ buy out the minority shareholders ~~and thus achieve~~ with the object of delisting ~~delisting of~~ RG's shares.

We have discussed this proposal at earlier meetings. While

2. I fully understand the advantages of ~~As you know, we had some useful discussions on this proposal at No.10 recently. I continue to see few attractions and a number of real~~ several major disadvantages. As ~~your~~ you make clear in your letter ~~makes clear~~, the ~~prime motivation~~ main reason for wanting to buy out ~~removing~~ the minority shareholders is to avoid the disclosure requirements imposed by Stock Exchange Listing and to avoid the need ~~in certain circumstances,~~ to ~~seek~~ have an EGM to get shareholders' approval for disposals. ~~by means of an EGM.~~ Against this, however, must be set the very real presentational difficulties for the Government of the course you propose.

- It would quickly become apparent that the main motiv~~ation~~e for offering the scheme of arrangment was to relieve RG of its obligations on disclosure and on securing approval ~~obligations~~ for disposals. The more troublesome minority shareholders will undoubtedly ~~play on~~ make much of this point, as would the Press and the Opposition. ~~This~~ It would be very difficult to defend the proposal against the background of our general policy of encouraging transparency in company affairs. We, and the company, would quickly be open to charges we could not be bothered, or actively wanted to conceal what RG are up to.

- As you recognise in your letter, removing the minority (i.e. private) shareholders would sit very oddly with our avowed longer term aim of returning RG to full private ownership.

SECRET
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

3. It would also involve expenditure of up to £12m next year. ~~Against the current expenditure prospects for 1987-88~~ I ~~would be extremely reluctant to contemplate~~ could not accept a claim on the Reserve ~~of up to £12m~~ this size for this purpose unless ~~unless there was a very strong case for taking out the minority.~~ the case was very strong.

4. Against this background, I ~~would~~ could only ~~be prepared to~~ agree to the proposal if we had a cast iron assurance that the scheme would be accepted with the minimum of public fuss. It seems to me that this condition cannot be met. It is by no means clear that a sufficient number of the minority shareholders would vote in favour of the scheme. Even if they ~~do~~ did, we would ~~have~~ still have ~~the need~~ to seek the approval of the Courts for the scheme ~~after the vote has taken place will~~ and that would give a further opportunity for ~~aggrieved~~ minority shareholders to make ~~a~~ public ~~fuss about~~ objections to the arrangements. ~~If the scheme is not successful, then we will not have achieved the objective of automatic delisting at the cost of additional public expenditure and exposing ourselves to charges of double standards in relation to transparency and accountability in company affairs.~~ ~~Subject to the views of the Prime Minister, therefore,~~ I ~~consider that~~ Rover Group should be told that the Government is not prepared to agree to their proposal at this time.

5. I am copying this letter to the Prime Minister.

There is a real likelihood that, one way or another, we would end up with egg on our faces, having achieved nothing except to give ammunition to our opponents. All things considered, I believe that

NIGEL LAWSON

565/14/SC

SECRET

FROM: M A WALLER

DATE: 17 February 1987

CHANCELLOR

Ch
I gather plot is
(1) meeting of Inner Group to discuss draft E(A) papers
(2) All except PM, Channon, you & SoS leave withdraw. You then discuss Williamson paper
(3) SoS leave goes and you discuss (i) & (ii) below
AA

cc. Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Burgner
Mr Bent

ROVER GROUP: MEETING OF INNER GROUP AT NO.10

You are to attend a meeting at 11.30 am tomorrow at No.10 with the Inner Group of Ministers on Rover Group issues (i.e. in addition to the Prime Minister, Mr Channon and yourself, Lord Whitelaw, Mr Tebbit, Mr Ridley, Mr Wakeham and Mr Shaw). I understand that main items on the Agenda will be two draft EA papers, one on the Truck and Bus deals, the other on the Corporate Plan. As I am dictating this, these papers are still being drafted in Mr Channon's office. The papers are primarily directed at the political and presentational aspects of these two subjects with which you are very familiar. However, if on receiving copies of the papers there is anything in them which we need to specifically draw to your attention I will put up a note early tomorrow morning.

~~MW letter~~
MW removed.

2. It is possible that three other items may be discussed in the margins of tomorrow's meeting:

? why Timothy (PPS/Channon!)

(i) The draft Parliamentary Statement circulated under cover of Mr Walker's letter of 16 February, on which see my note and draft PS letter of today;

(ii) RG's proposals, described in Mr Channon's letter of 16 February, for a scheme of arrangement to remove the minority shareholders, on which see my separate note and draft letter of today;

(iii) A paper on EC negotiating tactics and fallback options prepared by a working group under chairmanship of David Williamson in the Cabinet Office. Mr Williamson intends to submit this paper to Mr Channon, with copies to you and the Prime Minister, by close of play tonight. The main points to note on this paper are that the need to make the payment in this financial year is taken as an immovable requirement but that an equity injection without Commission approval would be fraught with difficulties (not least because the RG Directors would be legally obliged to refuse to accept the money). The strategy therefore remains to secure Commission approval for the full amount of the equity injection required by end March. The preferred fallback option involves a mixture of equity and government loan on commercial terms, the latter perhaps related to the size of planned restructuring costs and which would be converted to equity as the costs are incurred. (Pending circulation of the final version of the paper, you may find it helpful to have the attached copy of the latest draft of the paper (top copy only). The fallback option is described in paragraphs 10-12. The legal difficulties with making the payment in advance of Commission approval are discussed in paragraphs 14-16 and Annex B.)

below

[illegible]

Not now attached – final version below

3. Finally, I attach a one page summary on the mechanics/timetable for securing Parliamentary approval for Estimates provision for the injection. Currently, there are no problems here but you may find it a useful reference in case the issue is raised during tomorrow's meeting.

M A WALLER

VOTE MECHANICS

We propose to introduce a new DTI Vote by Late Spring Supplementary Estimate.

2. There would need to be the following preliminary events:

- an announcement to the House on 19 February on the broad terms of the deal;

- the tabling, and subsequent debate, of an Affirmative Resolution to increase the financial limit in the Industry Act 1980;

- an EGM called by Rover Group to approve resolutions, including, inter alia, power to issue new shares for subscription;

- a decision by the EC Commission to approve an equity injection, or a policy decision by HMG to adopt some other method of injection such as a commercial loan (assuming HMG is prepared to declare its intention to convert the loan into equity at a later date);

- a policy decision on the amount of the injection, within the total approved by the EC Commission.

3. Completion of all these preliminaries by the first week of March will enable the Late Spring Supplementary to be tabled for voting with all other Spring Supplementaries in the planned Consolidated Fund Act around, say, 18-20 March, with payment effected by 31 March at the latest. The Rover Group new shares will be open for subscription during this period.

4. Exceptionally, a further week's delay (ie until 16 March at the very latest) could be accommodated by laying a special Supplementary. This would require Parliamentary approval of a separate Consolidated Fund Bill, which would allow a payment to be made just before the end of the financial year.

5. It seems unlikely that any Contingencies Fund advance will be required to make payment to a timetable earlier in 1986-87 than that set out under either option above. If, however, something unforeseen arises which would require early payment, there would need to be a prior announcement of the intention to draw on the Fund and the Late Spring Supplementary would also need to make clear the intention to use the Fund in anticipation of Parliamentary approval of it.

make clear 60%/40% Dutch/UK (Shell)

(1) make more of it Euro-venture.

DRAFT PARLIAMENTARY STATEMENT

1 With permission, Mr Speaker, I should like to make a statement concerning the Rover Group.

2 I am pleased to be able to announce today the Government's approval of the Rover Group's 1987 Corporate Plan. The Plan is reviewed annually to cover a rolling period of 5 years ahead; the strategy in this Plan, which relates to the period 1987-91, will evolve in that period to meet market developments. In accordance with usual practice I am today placing in the Library of the House a summary of the Plan excluding commercially sensitive details.

3 As I expected, the plan sets out a positive course for the continuation of Austin Rover as a major producer and leading exporter of cars made in Britain. The programme of model collaboration with Honda will be taken forward with a new medium sized car - AR8 - for which a manufacturing agreement should shortly be concluded. The future relationship between the companies will of course continue to develop in the light of experience but it is the intention of both companies that the relationship should be a long term one and should endure beyond the life of existing design and production contracts. The Government very much welcome this joint intention to continue to strengthen links in the future.

4 The Corporate Plan provides for the new K series engine to be taken forward to full production and used in Austin Rover's smaller engined cars. This engine will equip the company for the next decade with a new high economy engine

designed to meet new emissions controls and will also make a major contribution to Austin Rover's strong presence in the small car sector which, with the planned further development of the model range, is a vital element in the company's marketing plan.

5 Turning to Land Rover, the Plan takes account of the launch of Range Rover in the United States this year which will be a major step in diversifying Land Rover's market base.

6 On the commercial vehicle businesses my hon Friend, the Minister of State for Industry, told the House on 13 January that the sale of Leyland Bus to a management buy out had been competed. I told the House on 2 December that Rover Group were also holding commercial discussions with DAF in relation to Leyland Trucks and Freight Rover, and separately with Paccar in relation to the Trucks company. The Rover Group Board have now recommended and the Government has accepted the proposals made by DAF, to bring together Leyland Trucks, DAF Trucks and Freight Rover into a new Anglo-Dutch joint venture with the capability to achieve a major presence in the European commercial vehicle market. The deal will also include the associated parts operations and certain overseas operations. These proposals build upon important existing distribution links between the companies. RG will take a 40% shareholding in the new company based on the value of the assets they bring to the merged operations and will have Board representation. Market conditions permitting it is the firm intention of RG and DAF to float the company within two to three years.

X

SECRET UNTIL 20 FEBRUARY 1987

7 Within the joint venture Freight Rover, who are planning to invest in a major model replacement programme, will continue to manufacture vans at its Common Lane site in Birmingham, and Leyland will continue as the focal point for truck manufacture in the UK.

8 These decisions take place in the context of severe over-capacity in Europe. As I made plain in my statement in December, all the commercial options open to Rover Group in relation to the Trucks business would involve significant rationalisation and restructuring. This cannot be avoided if the new venture is to have a good chance for the future. The Scammell plant at Watford will be closed and its production transferred to Leyland. The engine and foundry plant at Leyland will not be part of the new venture and activities will be gradually run down for closure by the end of 1988. Some [1,800] jobs will be lost through these closures and a further [600] through slimming of the Leyland and Albion operations; no job losses are forecast at Freight Rover.

9 ~~The Government sees no alternative to these decisions and very much regrets the need for these job losses.~~ I believe that this ~~deal~~ offers the best prospect of building a secure long term future for Leyland Trucks and Freight Rover and I can assure the House that the plan developed by the two companies envisages significant expansion of truck production at Leyland including for export and an important expansion of the export of Freight Rover vans.

£750m

10 As part of this restructuring the Government intends to deal with the historic debts from Leyland Bus and Leyland Trucks left in Rover Group, and with the restructuring costs resulting from their sale. The Government have notified the EC Commission of this intention and the normal procedures are

JG1ARL

999-49

in train. Meanwhile Rover Group will be convening a General Meeting in March to enable the Government to provide up to £750m for this purpose. I am today laying an Order under the Industry Act 1980 to make this possible.

11 The proposals which I have announced today will strengthen both Rover Group and the vehicle industry in this country. Success now depends on achievements in the market place. Mr Day has focused sharply on the need for commercial success in recent months and I am encouraged by news that Austin Rover's market share so far this year is sharply up on that of recent months. With new marketing initiatives increasing sales, recent successes in the fleet market, such as the orders by major car rental companies, and the launch of the Sterling and Range Rover in the United States this year, Rover have the opportunities and skills to succeed.

JG1ARL

CH/EXCHEQUER
REC. 25FEB1987 25/2
ACTION Mr Waller
COPIES TO CST FST
Sir P Middleton
Mr FER Butler
Mr Monck
Mr Burgner

Foreign and Commonwealth Office

London SW1A 2AH

25 February 1987

FSRB

I take it our contingency plan are all ready?

Dear David,

Rover Group

As agreed by Ministers last week, the Foreign Secretary spoke to M. Delors in Brussels on 22-23 February about Rover Group.

The Foreign Secretary first spoke to M. Delors on Sunday night stressing that, by agreeing to the merger between Leyland Truck and DAF, we had opted for a European solution. This would help maintain a viable European truck industry. The deal was dependent upon the Government writing off the debt involved and the restructuring costs. The restructuring, including job losses and factory closures, was commensurate with the aid. The Foreign Secretary stressed the political and economic importance of the agreement with DAF and its significance for the future of the UK motor industry.

The Foreign Secretary raised the issue again the following day. M. Delors said that he had looked at the matter overnight. He well remembered the discussion he had had with the Prime Minister. He fully understood the importance of the issue and appreciated that the deal was a European reconstruction. His concern was to be sure that the reconstruction was sufficiently fundamental to be effective. The Commission had before it a comparable application from Italy. They would need to go into the detail of our application.

Sir Geoffrey Howe said there was no doubt about the fundamental character of the reconstruction and its deliberately European nature. He drew attention to the closures involved and stressed that the objective was to produce a strong European entity. The Foreign Secretary said that the Chancellor needed to have the position clear by the time he introduced his budget on 17 March: M. Delors would know from his experience as a Finance Minister of the importance of timing such matters properly. M. Delors said that he realised that a substantial sum of money was involved - a large burden for the Exchequer, which had to be managed properly. He would be discussing this with his colleagues.

The Foreign Secretary also raised the issue with Lord Cockfield, with the Dutch Foreign Minister and, in Paris on Monday, with the French Foreign Minister. The Dutch can be expected to be helpful; their officials are talking to officials from the DTI about how they can assist in securing Commission approval. The point has been made clearly to the French that we did not intervene in the recent Renault state aid case and would expect them, similarly, not to intervene in our case.

All members of the Commission have had briefing on the Leyland/DAF deal. The Foreign Secretary believes that the main task now must be to ensure that Commissioner Sutherland makes a favourable recommendation to his colleagues in the timescale we need. Mr Channon will be seeing him at the end of the week and we shall need to take stock thereafter on what further action is required.

I am copying this letter to the Private Secretaries to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry and to Sir Robert Armstrong.

Yours ever

Alison (Colin)

PP (L Parker)
Private Secretary

David Norgrove Esq
10 Downing Street

568/15/SC

CONFIDENTIAL

FROM: M A WALLER

DATE: 26 February 1987

Thanks:

CHANCELLOR

cc. Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Burgner

Ch
This looks OK. Officials (under Robin) are working at contingency plans; difficulties inevitably emerge but they are fully seized of over-riding imperative.
AA

ROVER GROUP: EC CLEARANCE

The Foreign Secretary's letter of 25 February to the Prime Minister reports the outcome of his contacts with M. Delors, Lord Cockfield and the Dutch and French Foreign Ministers. The tone of his exchanges appears to be helpful, particularly in respect of the point registered with M. Delors on the need for reasons of orderly financial management to have Commission clearance by Budget day. As such it does not call for a Treasury comment or response.

CURRENT POSITION

2. In the penultimate paragraph of his letter Sir Geoffrey Howe underlines the importance of ensuring that Commissioner Sutherland makes a recommendation to his colleagues in favour of the injection. Official contacts on Tuesday between DTI and DGIV officials confirmed this and indicated that, while the Commission might be persuaded on the degree of restructuring, Commission officials felt that the cost was exhorbitant. (Sutherland's Cabinet hinted that some reduction in the injection, perhaps of the order of £100m, would greatly increase the chances of a favourable recommendation from Sutherland).

3. The next step is for Mr Channon to talk to Commissioner Sutherland in Brussels at 9.00 am tomorrow morning. The favourable outcome of this meeting is crucial to the Treasury objective of getting clearance by 17 March. If Mr Channon can reach agreement with Sutherland on a figure it greatly improves the chances of pushing proposal through a full Commission meeting scheduled for 11 March.

4. In preparing briefing for this meeting DTI have asked Rover for a reassessment of the negotiating cushion of some £80m built into the £750m total figure which we have notifed to the Commission. RG figures, supplied by phone this morning, suggest that they could, if necessary, live with an injection of £670-£700m, depending on the treatment of the costs of closing Truck's overseas subsidiaries in South Africa and France resulting from the Daylight deal. Following discussions with the Cabinet Office, RG and Treasury, DTI officials will be briefing Mr Channon to offer to bring down the injection to £670-700m only if it will secure Commissioner Sutherland's agreement to making a favourable recommendation to the Commission. Given the crucial nature of this meeting and the very tight timetable, we think this is sensible. Any figure above £650m would be cosistent with the White Paper figures and your budget judgement.

NEXT STEPS

5. Mr Channon will report back on his talks with Sutherland to the Prime Minister, the Foreign Secretary and you over the weekend. If the outcome is favourable he will recommend letting Commission procedures run their course to 11 March. If not then he will recommend the Prime Minister to intervene with Delors.

M A WALLER

SECRET

Ch
This is rather an odd note: Paras 2-3 make it sound as if it all hopeless, but then Paras 4-9 put forward a simpler & seemingly effective scheme
AA

FROM: M A WALLER

DATE: 27 February 1987

1. MR F E R BUTLER
2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Monck
Mr Burgner
Mr Judd
Mr Turnbull
Mr Hyett (T.Sol)

ROVER GROUP: COMMISSION CLEARANCE ETC

As agreed at your meeting on 18 February, we have carried forward contingency planning for ensuring that, even in the absence of Commission clearance, we would still achieve our public expenditure plans for 1986-87.

2. We have considered various possibilities. These include the trustee arrangements discussed on 18 February. On closer examination, however, it became apparent that the only feasible scheme of this sort would be to put the money on deposit with the PGO and make Rover Group (RG) drawings on the account subject to approval by independent "stake holders". These stake holders would only be empowered to release the money when EC Commission clearance for the equity injection was forthcoming.

3. An arrangement on these lines would be very complicated and highly artificial and, as such, would have serious drawbacks:

- it would be so unusual as to require notification in advance to the Trade and Industry Select Committee and the Public Accounts Committee. Given the artificiality, the committees might well challenge the proposed arrangements with the result that the Government would be faced with the unattractive options of backing down or forcing the RG estimate through by using its majority. This would largely frustrate the original objective of the exercise since the presentational advantages of getting the expenditure into this year would be largely dissipated.

- Depositing the money with the PGO would also jeopardise funding policy. Though scoring against the 1986-87 PSBR, it would also be available to finance the PSBR because it would be lodged with the PGO. This would reduce the funding requirement this year by up to £750 million thus making it very difficult to avoid an over-fund.

hy i lots of next year's gilts?

4. We have therefore concluded that it would be preferable to pursue a simpler route if Commission approval is not forthcoming. This would involve holding back payment to Rover Group until the end of March when, failing Commission approval, the money would be paid over the company on the following conditions expressed in an exchange of letters between DTI + RG:

(a) RG would hold the money on deposit and would not apply it to debt retirement/restructuring costs (or for any other business purposes) until EC Commission approval was received;

(b) On receipt of Commission approval, RG would allot shares to HMG and would reimburse the Government for the interest costs HMG had incurred by paying the money to the company in advance of RG applying the funds to debt write off/restructuring.

(c) RG would undertake to repay to HMG any amount not approved by the Commission, together with accrued interest.

5. Though not quite so proof against legal challenge as the PGO route, Treasury Solicitors believe that this simpler alternative would be defensible in strictly legal terms against a State aid challenge from the Commission because RG would derive no material benefit from the payment until the Commission approved the injection. For similar reasons, Treasury Solicitors believe it would not conflict with the RG Director's fiduciary duties. But we would of course need to confirm this with DTI lawyers and the legal advisers to Rover Group.

6. We also consider it would not be necessary to clear this arrangement in advance with the Trade and Industry Select Committee and the PAC since it would be a payment off votes direct to the Company without the presence of an artificial trustee/stakeholder intermediary. We consider that it would be necessary, however, to make clear in the Estimate what we are proposing. A draft of the Estimate is attached.

7. If we were to go ahead with this arrangement, it would be preferable to lay the RG supplementary estimate within the timetable prescribed for Spring Supplementaries in Parliamentary Standing Orders. On current plans the late Spring Supplementaries are due to be laid before Parliament on 4/5 March which may be rather too soon to enable us to clear the proposed arrangement with DTI and RG and settle on the appropriate form of words for the Supplementary Estimate. We would therefore propose to delay laying the estimate until 10 March which is the last day we could do so without breaching the Standing Orders. By then we should also have a much clearer idea of how much money the Commission are likely to approve.

8. In order to meet this estimate's timetable we will need to consult DTI and RG early next week.

9. If we were forced to implement these arrangements, the payment would remain open to ex post challenge by the C&AG on grounds of payment in advance of need and avoidance of the annuality doctrine, and the arrangements may be quoted against the Treasury by Departments as a precedent for bringing expenditure forward. We think that we have a reasonable defence on both points but it would undoubtedly be preferable to obtain EC consent and make the payment unconditionally.

CONCLUSION

10. Subject to your approving the arrangements outlined above, we propose to seek DTI and RG views on the proposal early next

SECRET

week with a view to agreeing the detailed terms of the estimate and the exchange of letters (including arrangements for RG reimbursing HMG for interest costs).

M A WALLER

Class V, Vote 11

Vehicle manufacture

Introduction

1. This Vote is treated as a cash limit.

2. It is a new Vote, introduced to provide for £XXX million in respect of the restructuring of the Rover Group announced by the Secretary of State for Trade and Industry on 19 February 1987. The provision is for an additional Government capital injection for the Rover Group plc to meet restructuring costs and the write off of accumulated debts from the disposal of Leyland Bus and Leyland Trucks. The most recent Estimate to which the provision now sought relates was 1983-84 Class IV, Vote 8.

3. Payment will be made under Section 3 of the Industry Act 1980. It is subject to normal procedures for clearance by European Commission under Articles 92 and 93 of the Treaty of Rome. Pending that clearance it will be paid subject to an undertaking from the company to repay [with appropriate interest] any amounts not approved by the Commission.

Part I £XXX,000,000

Amount required in the year ending 31 March 1987 for expenditure by the Department of Trade and Industry on support for the vehicle manufacturing industry

The Department of Trade and Industry will account for this Vote.

Part II Subhead detail

1984-85 Outturn	1985-86 Total Provision		1986-87 Provision
£'000	£'000		£'000
-	-	A1 Support for vehicle manufacturing Subscription for new securities in Rover Group plc under the Industry Act 1980	XXX,000

Part III Extra receipts payable to the Consolidated Fund

No extra receipts are expected in 1986-87

RG

SECRET

I will discuss, with Robin. on Monday ...

FROM: F. E. R. BUTLER
27th February, 1987.

CHANCELLOR OF THE EXCHEQUER

Ch
X overleaf is the key.
Would you like urgent word with either Robin or Mr Channon himself?? AA

c.c. Chief Secretary
Financial Secretary
Sir P. Middleton
Mr. Monck
Mr. Burgner
Mr. Judd
Mr. Turnbull
Mr. Hyett (T.Sol.)

ROVER GROUP: COMMISSION CLEARANCE ETC

The attached submission from Mr. Waller describes the proposition which we have been preparing to ensure that payment is made to the Rover Group before the end of the financial year even if EC approval were not obtained. A number of alternatives have been considered and I am very grateful to Mr. Waller and Mr. Hyett for the work done on them. The submission seeks your approval for my putting the preferred proposition to Sir Brian Hayes, as Accounting Officer for the DTI Vote, with a view to his clearing it with the DTI legal advisers and the company.

2. Since the submission was prepared, we have heard that Mr. Channon has struck a deal with Commissioner Sutherland for a payment of £680 million, which Sutherland has promised that the Commission will approve, though not until 18th March.

see letter below (separate string)

3. This creates a dilemma. If we are to have this fallback, we need to take the preparatory steps to put it in place and publish the supplementary estimate in the next ten days. It will only be necessary if Commissioner Sutherland's undertaking is not fulfilled. On the other hand, if something were to go wrong at the Commission's end, 18th March would be too late to put the fallback into operation without special Parliamentary procedures which would put it under the spotlight.

4. Given the unequivocal nature of Commissioner Sutherland's undertaking, and the disadvantages that are inherent in our fallback procedure (possible Parliamentary criticism, the precedent which other departments could quote against us and - most important of all - the risk that the fallback would itself irritate the Commission and perhaps endanger the delivery of Sutherland's undertaking), I am inclined to think that we should rely on the undertaking and not pursue this fallback. That, I am sure, will be the view of the DTI and, following Mr. Channon's agreement, I would expect to have greater difficulty in selling the fallback arrangement to Sir Brian Hayes. There is, however, a slight risk in leaving ourselves without the fallback, and you will want to judge whether it is acceptable in the light of Mr. Channon's report to the Prime Minister on his talks with Commissioner Sutherland, which I understand that you will be seeing over the weekend.

F.E.R.B.

F. E. R. BUTLER

ROVER

SECRET

FROM: F. E. R. BUTLER
4th March, 1987.

CHANCELLOR OF THE EXCHEQUER

c.c. Chief Secretary
Sir P. Middleton
Mr. Anson
Mr. Monck
Mr. Cassell
Mr. Burgner
Mr. Judd
Mr. Turnbull
Mr. Pratt
Mrs. R. J. Butler
Mr. Hyett (T. Sol.)

Ch
OK?
AA
(could discuss with Mr Channon if necessary).

ROVER GROUP: COMMISSION CLEARANCE ETC.

I agree with the advice in Mr. Waller's note below, that we should submit a straightforward supplementary estimate for the payment to Rover without any reference to the fallback and if, contrary to our expectations, Commission approval is deferred, the Secretary of State should make a statement to Parliament on the lines that the payment will be made subject to the fallback arrangements. I also agree that we should press Mr. Channon to lay an estimate for £680 million rather than £750 million and that you should send the draft ~~minute~~ letter in the terms which Mr. Waller suggests.

2. I have one gloss on Mr. Waller's submission. Para 8 says that there could be Parliamentary criticism of our going ahead with the payment on this basis but that, if Sir Brian Hayes as accounting officer is content, we can go along with this. If Sir Brian Hayes is challenged on this point, I am sure that he would expect the Treasury to support him in defending the payment and that we should do so.

FERB

F. E. R. BUTLER

SECRET

FROM: M A WALLER

DATE: 4 March 1987

1. MR F E R BUTLER

2. CHANCELLOR

cc. Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Cassell
Mr Burgner
Mr Judd
Mr Turnbull
Mr Pratt
Mrs R J Butler
Mr Hyett (T.Sol)

ROVER GROUP: COMMISSION CLEARANCE ETC.

This minute reports the results of the work we have done on the options we discussed with you on 2 March. This is reflected in a draft minute for you to send to Mr Channon in response to his letter of 27 February to the Prime Minister reporting the outcome of his discussions with Commissioner Sutherland. This minute also deals with the amount to be included in the Estimate.

Options

2. There are three options now on the table, all of which involve laying a Supplementary Estimate within the timetable prescribed in Parliamentary Standing Orders, at least in the first instance. They differ in the way in which we would deal with the contingency of the Commission failing to reach agreement on the Rover Group equity injection at their meeting on 18 March. In the event of failure to agree all three options would involve the Government paying the money over to Rover Group this financial year on the condition that, pending Commission clearance, Rover Group would not apply the money to any purpose connected with its business and would undertake to repay the money to the Government, with suitable reimbursement of interest costs, if the Commission refused to agree to an equity injection.

3. The options are:

(i) to present now a Supplementary Estimate which mentioned the provision for repayment on the face of the Estimate and so effectively asked Parliament to approve it as a contingency plan (which would invite the question why we do not just wait until we do have EC clearance).

(ii) to present a Supplementary Estimate which assumes EC clearance, and then replace it if necessary with a revised Supplementary Estimate after 18 March which would refer to the repayment provisions. This would miss the normal supply timetable and so necessitate suspending Parliamentary standing orders which would be open to unlimited debate and would risk a procedural wrangle. But it would avoid mentioning the contingency until it had arisen and then deal with it as in (i).

(iii) to proceed with the Supplementary Estimate on our present assumption that the Commission's clearance will be delivered. Then if Commission clearance was still not forthcoming by the end of March to make a statement to Parliament that, in the circumstances, the payment would have attached to it a condition that the money must not be used without clearance and that repayment would be required in the event of EC clearance being refused.

As agreed, Mr Butler has discussed these options with Sir Brian Hayes in order to ensure that DTI and RG lawyers share the Treasury Solicitor's views on the legal aspects of the payment (i.e. in relation to state aids and RG Directors' fiduciary duties) and to take his mind, in his capacity as DTI's Accounting Officer, on the Estimates treatment.

4. On legal aspects Sir Brian has undertaken to come back to us by mid-day tomorrow. We understand, however, that DTI's lawyers have already looked into the state aid question and have come to the same conclusion that we have i.e. a payment to RG hedged with conditions as to use and repayment would not be classified as a state aid. As far as the estimates treatment is concerned Sir Brian Hayes appeared relaxed about any of the three options,

all of which do come clean with Parliament, as they touch upon his Accounting Officer responsibilities. But we understand from contacts with officials in DTI's Vehicles Division that they will be advising strongly against mentioning the provision for repayment unless absolutely necessary because of the possible repercussive effects on RG creditor confidence. They are therefore likely to recommend that Sir Brian Hayes should go for option (iii), although option (ii) also broadly meets the point.

Parliamentary timetable

5. The timetable for submission of Supplementary Estimates within the provisions of standing orders is now tighter than we reported to you on 2 March. Though Standing Orders would permit the submission of Supplementaries as late as 10 March with the introduction of the Consolidated Fund Bill on 18 March (after 10.00 pm), this would require a Whip operating against the normal conventions in Budget week. The Chief Whip has now advised very strongly against this and is therefore pressing for presentation of the Consolidated Fund Bill on 16 March. To meet this timetable it will be necessary to finalise details of the Supplementary Estimates, including the amount, by close of play tomorrow so the Supplementary Estimates Booklet can be printed and laid by 11.00 am on Friday. X

6. The only alternative to this arrangement would be to take the Rover Group Supplementary in a separate Consolidated Fund Bill outside Standing Orders and after the Budget. This would, however, draw attention to the Estimate and leave it open for debate. We have therefore agreed with DTI Officials that we should work towards finalising all the details of the estimate by close of play tomorrow.

Assessment of Options

7. Given the considerable degree of certainty which now attaches to Commission clearance on 18 March we believe that the natural Parliamentary treatment of the Estimate would be to present it with no reference to a provision for repayment (i.e options (ii) or (iii)) and that the action contemplated if the contingency happens is defensible. Of these two options, (iii) would allow the maximum available additional time for the Commission to reach a favourable decision if the decision slips beyond 18 March. And, if the

contingency arose, the payment with conditions would still be within the ambit of the Estimate and justifiable to Parliament on the basis that the Government was proceeding with its original intention, with safeguards to deal with the exceptional situation created by the delay in Commission consent. It also minimises the exposure in advance to criticism that we are prepared to flout normal annuality rules when it suits us; and minimises the danger of departments generally looking in this direction for a new form of "end year flexibility".

8. However, we would be vulnerable to the criticism that Parliament has voted the provision on the basis that the money would be paid to Rover on receipt of EC approval, whereas we would be paying it in advance of that approval. In that sense we would be paying in advance of need, and arguably, departing from the terms of the Supplementary. In the final analysis, however, this would be for Sir Brian Hayes, as Accounting Officer to defend. If he is content, we can go along with this.

9. By comparison:

- option (i) to the Commission, signals our intention to make the payment in any circumstances and might therefore prejudice a favourable Commission decision; to Parliament it signals in advance, probably unnecessarily, our readiness to circumvent annuality rules; and to RG's bankers it signals, perhaps unnecessarily and certainly earlier than required, the possibility that the arrangement might fall through. It could therefore have an adverse impact on the confidence of RG's bankers and other creditors which might undo the intended effect of Mr Channon's statement and thus increase the chances of Austin Rover running into financial difficulties next year.

- option (ii), although broadly meeting the point at paragraph 8 above, would be highly unusual (we can find no immediately obvious precedent) which would give scope for unlimited Parliamentary debate; it could well be characterised as a panic measure by the Government; and, by introducing the measure in response to the Commision failing to reach agreement, it could prejudice a favourable outcome within the financial year. (It is also possible that procedural difficulties might prevent our paying this year).

We would therefore recommend option (iii) i.e. presenting an Estimate which omits any mention of repayment, if Sir Brian Hayes agrees. If he prefers option (ii) we could also accept that, though it would be less desirable for the reasons set out above. Provided Sir Brian Hayes agrees both options are feasible, we do not need to make a final decision on the option immediately because the same form of Supplementary would be presented in either case.

<u>Amount to be shown in the Estimate</u>

10. Assuming DTI officials recommend in favour of option (iii) or (ii), the only major outstanding issue to be decided between Treasury and DTI will be the amount to be included in the Estimate. We have told them that we would strongly favour £680m, primarily because this is the figure now in play with the Commission and, even failing Commission approval, it is very unlikely that we would pay more than that amount. Any other figure indeed would make the case for option (iii) much more doubtful because the only figure we can honestly expect the Commission to approve is £680m.

11. DTI officials will be advising Mr Channon to accept £680m, who will be considering his position tomorrow afternoon, particularly the public presentation of the move from £750m (announced in Mr Channon's statement to Parliament on 19 February) to £680m. DTI Ministers will be exposed to lengthy questioning on the issue during the debate on the Industry Act Order which is now scheduled for 11 March.

12. Clearly, whatever is shown in the Estimate will have to be carried into the figures in the Financial Statement and Budget Report (FSBR). Given the absolute size of Rover Group payment and its significance in relation to the total 1986-87 outturn, we believe it is necessary specifically to mention this item in Chapters 5 and 6 of the FSBR (though not in your Budget Speech). DTI officials are seized of this point and we are in touch with them about the form of words to be included in the FSBR.

13. Given that the current best estimate of the payment to Rover Group is £680m we believe this is the only justifiable figure. But for the reasons set out in paragraph 11 above Mr Channon may wish to stick to £750m and may seek your agreement to this. We cannot advise that that figure is defensible on the basis of option (iii) and we strongly recommend that you press Mr Channon to accept the figure of £680m and have included a reference to this point in the draft minute to Mr Channon.

Summary

14. Subject to final confirmation from DTI on legal aspects and tidying up any loose ends of the exact wording of the Estimate, we would recommend that we lay a Supplementary Estimate for Rover Group which does not refer to the repayment arrangements (i.e. option (iii)). As to the amount of the Estimate, we believe £680m is the right figure and that this should appear in the Supplementary Estimate and be carried through into the FSBR. We will seek formal Ministerial approval for the Estimate in the course of tomorrow.

15. I attach a short draft letter to Mr Channon registering these points.

M A WALLER

563/1/SC

SECRET

DRAFT LETTER FROM THE CHANCELLOR OF THE EXCHEQUER

To: Secretary of State for Trade and Industry

cc. Prime Minister
Foreign Secretary

Please type for Ch's signature

ROVER GROUP

Thank you for sending me a copy of your minute to the Prime Minister reporting the outcome of your discussions with Commissioner Sutherland.

2. As the Prime Minister has noted, matters do now seem to be progressing satisfactorily. It is a pity that we will not have complete certainty of outcome on Budget day but I accept your judgement that further pressure to achieve that outcome might well prejudice final Commission agreement. Given, however, that we remain vulnerable to objections from other Member States, I have asked my officials to dicuss with yours contingency plans for ensuring that we can make the payment to Rover Group this year without violating the state aids provisions of the Treaty, ~~of Rome~~, even if Commission clearance is delayed beyond the end of March. ~~Present indications are~~ I understand that ~~that~~ they believe they have identified an acceptable route: ~~which is consistent with the legal constraints~~.

3. Subject to final confirmation ~~on the details of the~~ of those contingency plans, the only major point now for decision is the amount to be included in the Estimate. ~~Given,~~ In the light of your letter, our ~~our~~ proposed action ~~is~~ would be based on ~~our~~ a firm expectation of EC approval for £680m, and I think that for reasons of Parliamentary propriety ~~I think~~ we have to stick to this figure. I ~~therefore~~ hope you can agree to ~~the figure of £680m. This will, of course, need to be carried through into~~ using that figure in the Estimate and the Budget documents. (*) rather than £750m or both

That is the figure we must include in the Estimate.

4. I am copying this letter to the Prime Minister and to Geoffrey Howe.

(*) To meet the Parliamentary timetable, we have to finalise details of the Supplementary Estimate, including the amount, by close of play tonight. So I should be grateful if you could let me know immediately if

MR 9/83

CONFIDENTIAL

DRAFT LETTER FROM THE CHANCELLOR TO

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
1-19 Victoria Street
LONDON SW1

OK

ROVER GROUP: EC CLEARANCE

I have seen your minute of 18 March to the Prime Minister, with the very good news that the Commission have agreed to clear the £680 million payment to Rover Group. I am most grateful to you, and to your officials, for all your work in making sure that the Commission gave their clearance in time for the payment to be made this year.

I am copying this letter to the Prime Minister and to Geoffrey Howe.

NIGEL LAWSON

Ch
Circulate, final letter to Treasury officials with note saying thanks to them too? | yes
(Budget thank-you drafts to follow today) | good

AA

Ch
Very good news: Letter to Mr Channon thanking him?
CONFIDENTIAL
18/3/87.

AA

CH/EXCHEQUER
REC. 18 MAR 1987 13
Mr Waller
COPIES TO
CST FST.
Sir P Middleton
Mr FER Butler
Mr Monck
Mr Burgner
Mr Bent

PRIME MINISTER

ROVER GROUP: EC CLEARANCE

I am pleased to report that the Commission have today agreed with Commissioner Sutherland's recommendation that the £680 million payment to Rover Group in respect of retirement of debt and restructuring costs associated with the sale of the Bus and Truck businesses should be cleared. This decision, communicated to me this afternoon by Commissioner Sutherland, allows us to put equity into Rover Group before the end of the current financial year. (The Commission's formal letter is not expected for several days). Tomorrow I will be answering in low key terms a written PQ reporting the Commission's decision. This will be copied to colleagues this evening.

2 Sutherland has been extremely helpful and has fully lived up to the undertakings he gave me which I reported to you in my minute of 27 February. There was, however, a flurry of exchanges yesterday afternoon when we first saw a draft of the Commission's formal letter. This referred to the Commission reserving its position on "the special guarantee system for bank loans to Rover Group". At my insistence Sutherland agreed to change this unfortunate phrase. The Commission's letter will now refer only to

JG3ATP

their request to us to provide information on "any guarantee that exists in favour of the Rover Group". This wording was cleared with the Finance Director of RG.

3 I am sending copies of my minute to Nigel Lawson and Geoffrey Howe.

PAUL CHANNON
(Approved by the Secretary of State
and signed in his absence)

18 March 1987

DEPARTMENT OF TRADE AND INDUSTRY

JG3ATP

565/3/SC

CONFIDENTIAL

FROM: M A WALLER

DATE: 19 March 1987

CHANCELLOR

cc. Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Burgner
Mr Bent

ROVER GROUP: EC CLEARANCE

Mr Channon's minute of 18 March to the Prime Minister reports the Commission's approval to the Government injecting £680m of new equity into Rover Group. This is a satisfactory outcome from the public expenditure point of view, clearing the way for the payment this financial year. On the current plans the intention is to make the payment on 30 March.

2. Mr Channon's minute does not call for a Treasury response but there are a couple of niggling points associated with the Commission approval:

(a) As paragraph 2 of Mr Channon's minute indicates, the Competition Directorate sought to include in the formal letter of approval a reserve on the "special guarantee system" for RG bank loans (i.e. the Varley Marshall assurances). Our clear preference would have been to have had any reference to Varley Marshall excised from the letter but Commissioner Sutherland made it quite clear to Mr Channon that this would be impossible without jeopardising Commission clearance yesterday. The fairly anodyne form of words finally agreed represents a compromise which neither we nor Rover Group feel are likely to cause any problems with RG's commercial lenders. It is, however, important that the Commission are not allowed to open up this issue. DTI therefore intend to stand on the notification of the 1981 equity injection which referred to Varley Marshall (a point the Commission appear to have overlooked). If the Commission look like opening a procedure on Varley Marshall then Mr Channon will warn Commissioner Sutherland off.

(b) Mr Channon will today be answering an arranged written PQ designed to inform Parliament of the Commission's decision. The intention is that this should be low key, following naturally from the earlier announcement in the House that the figure now in play was £680m and not £750m previously notified. But as reported in today's "Financial Times" (copy attached), Commission officials have, unhelpfully, played up their part in reducing the figure by £70m. This somewhat contradicts the line that we have been taking publicly that the reduction is mainly on account of better estimates of the total costs of the Bus and Truck deals. Our original understanding was that the Commission announcement of approval would be very low key. The way the story is now being reported probably reflects annoyance in DGIV about the pressure they were subjected to in relation to the Varley Marshall point. This is rather irritating, particularly since the opposition parties may raise the issue during Monday's Budget debate on industry. But this should cause no serious problems. We understand DTI Ministers will play the whole Commission angle down and again emphasise that Parliament has already been informed of the £680m and that the final figure agreed primarily reflects refined estimates of the total cost of the deals.

M A WALLER

Financial Times
12-3-87

EEC restricts £750m write-off of Leyland losses

BY TIM DICKSON IN BRUSSELS

THE GOVERNMENT'S plan to write off £750m of accumulated losses and other costs at Leyland Trucks and Leyland Bus have been revised downwards by the European Commission.

In what represents an embarrassing setback for Mr Paul Channon, the Industry Secretary, a full meeting of commissioners yesterday gave the formal go-ahead only for a more modest package of £680m.

The sums involved—which have to be cleared by the Brussels executive under Article 92 of the Treaty of Rome—stem from the recent management buy-out of Rover Group's Leyland Bus division and the merger between Leyland Trucks and Daf of Holland agreed last month.

The Government originally announced that it would be bearing costs of "up to £750m" as a result of the two deals, and during negotiations with the competition directorate in Brussels initially requested the maximum amount.

"They asked for £750m at first but there were some points we were not happy with," a Commission official explained last night.

The lower figure was agreed after intense negotiations and subsequently announced in Parliament by Mr Channon—but without any mention of the Commission's role.

Officials at the competition directorate in Brussels were apparently happy with the proposals for the bus division but did not feel that Leyland Trucks' parent company—which is keeping a 40 per cent equity stake in the new combined group—should be absolved of all its debt.

In approving the somewhat smaller package the Commission has taken into account three factors.

First, the extent of Britain's contribution to rationalising the European truck manufacturing industry, which is still suffering severe overcapacity. Second, the fact that the Rover board opted for a European company, Daf, rather than selling to the other interested party, Paccar of the US, and finally, the large number of jobs being lost in the regions of the Community.

Kenneth Gooding writes: Rover revealed yesterday that the cost of further rationalisation and disposal of Leyland Trucks to the joint company controlled by Daf will be about £800m.

The latest restructuring will involved the loss of 2,200 jobs and the phased closure of the Scammell specialist heavy vehicles plant at Watford, Hertfordshire, and engine production at Leyland in Lancashire.

Disposal of Leyland Bus via a management buy-out will cost another £55m.

These costs, to be taken as extraordinary charges in the 1986 accounts, along with further substantial losses last year, will wipe out Rover's shareholders' funds.

However, the UK Government will inject a further £680m in exchange for new Rover equity before April 1 when the extraordinary charges relating to the truck operations will be incurred.