PREM 19/2255

PART 13

MT

SECRET

CONFIDENTIAL FILING

THE FUTURE OF THE ROVER GROUP (BRITISH LEYLAND)

INDUSTRIAL POLICY

PART 1: SEPT 1979

PART 13: JAN 1987

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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PART 13 ends:-

DKN TO PM 30.9.87

PART 14 begins:-

INTERNAL DTI MINUTE 1.10.87

10 DOWNING STREET

Prime Minister

This proposal is potentially very sensitive.

Agree a meeting with Lord Young and the Chancellor.

DCW
30/9.

pa

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

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29 September 1987

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

Dear Nigel,

ROVER GROUP (RG)
ELIMINATION OF THE 0.2 PER CENT MINORITY SHAREHOLDERS

Graham Day has urged me to consider again the proposal RG advanced in February this year to take steps to eliminate the private shareholders in RG who now hold only 0.2 per cent of the equity. Based on the current share price the cost would be of the order of £14.6m-£17m to be met in this financial year. My officials have been discussing the arguments with yours.

RG point to the commercial disadvantages and costs of retaining the minority. In particular, any privatisation option would be complicated by the continued existence of the minority. There is also one other point we should consider. Informal soundings of Graham Day suggest he is strongly opposed to the separate sale of Land Rover and Austin Rover and would be very reluctant to entertain any talks with Ford, if they were again interested. While I do not wish to anticipate conflict, I would prefer not to leave the RG Board in a position where they can deliberate at length on whether privatisation options to which they are unsympathetic are in the interests of all the shareholders including the minority. Any disagreement with the RG Board would of course pose wider political problems than dealing fairly with the minority shareholders, and we shall need to do everything possible to settle on agreed solutions. But on balance I am inclined to set in train this ground-clearing step.

DW2CFH

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My officials have considered the problem which could arise in connection with disclosure of any discussions on disposal of RG assets while the necessary Scheme of Arrangement is in train : the planned completion date is mid-December. How significant a problem this might prove to be would depend on how quickly we move forward on RG privatisation. But I am satisfied that confidential approaches could be made to the Court, if necessary, to seek approval that sensitive commercial exchanges related to disposals need not be disclosed to the minority shareholders voting to sell their equity in RG. While this is a potential awkwardness I fear that it is likely to become more, not less, problematic as we draw up increasingly firm plans for privatising the remaining RG businesses. Consequently I favour taking action on the timescale Graham Day proposes. I would welcome your agreement to meeting the cost of this measure as a charge on this year's Reserve.

I am copying this letter to the Prime Minister.

Yours,

LORD YOUNG OF GRAFFHAM

DW2CFH

SECRET

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MR NORGROVE

29 September 1987

ROVER GROUP - MINORITY

We may receive tonight a copy of a letter to the Chancellor from Lord Young recommending that RG be allowed to eliminate the 0.2% minority shareholding. I have literally been given only minutes to think about this, but my instinct is to support the action providing it is done deftly. Barings advise that it can be achieved via a Scheme of Arrangement.

The arguments in favour are:

1. It is probably an essential step on the road to privatisation, whenever and in whatever form that might be.

2. Affairs are quiet at Rover now and the elimination of the minority will not have to take place as a politically high-profile part of some more complicated plan.

3. Directors will lose the 'minority shareholding' weapon when trying to frustrate some future action which Government wishes.

Apart from the fact that we will have to over-pay in order to take them out quietly, the principle negative argument is that we will be putting Rover Group into the spotlight at a time when its future strategy has not been clearly formulated and when there is a lot of other hay on the Government's fork.

Nevertheless, on balance I believe we should support the removal of the minority now. Total cost will be of the order of £17m.

GEORGE R J GUISE

SECRET

2/5/8

ROVER GROUP

The Rover Group plc
7-10 Hobart Place
London SW1W 0HH
Telephone: 01-235 4311
Telex: 926880

5 August 1987

Prime Minister (2)

These figures were released today. The press have picked up the reduction in losses.

MEA 5/8

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

Dear David

MS

ROVER GROUP INTERIM RESULTS

I enclose a copy of the Rover Group's half year results which the Prime Minister may be interested to see. The additional single page of extracts is being sent to all employees.

Yours ever
Graham

J GRAHAM DAY

Enc

Directors J Graham Day (Chairman and Chief Executive) Sir Robert Hunt CBE DL (Deputy Chairman) N J Carver OBE AFC (Group Executive Director) Sir Robert Clark DSC E W Dawnay A W Forster D R L Hankinson (Group Finance Director) Sir John Mayhew-Sanders B W Pomeroy **Registered Office** 7-10 Hobart Place London SW1W 0HH Registered in England 1213133

ROVER GROUP

THE ROVER GROUP PLC
Extracts from Half Year Results to 27 June 1987

	1987 £ million	1986 £ million
TURNOVER IN CONTINUING BUSINESSES		
Austin Rover Group	1,313	1,016
Land Rover Group	250	220
Other	17	12
	1,580	1,248
EXPORTS BY GROUP COMPANIES	529	355
PROFIT (LOSS) BEFORE INTEREST AND TAXATION		
Austin Rover Group	(19.8)	(65.1)
Land Rover Group	7.9	4.6
Share of associated companies' results*	3.4	–
Other (net)	1.2	(10.6)
TOTAL	(7.3)	(71.1)
LOSS AFTER TAXATION, INTEREST AND EXTRAORDINARY ITEMS	42.0	204.5
Vehicle Unit Production ('000s)	246.0	242.0
Vehicle Unit Sales ('000s)	259.0	233.0

*Associated companies comprise DAF BV, UGC Limited and JRA Holdings Limited

Rover Group Statement on the Half Year Results

Turnover in the continuing businesses for the first six months of 1987, as compared with the same period in 1986, increased by 27 per cent to £1,580m with unit sales up 11 per cent to 259,000. Exports accounted for over one third of unit sales and of turnover.

Improving operations resulted in a 90 per cent reduction in loss **before** interest and taxation to £7.3m and an 80 per cent reduction **after** interest, tax and extraordinary items to £42.0 million.

5th August 1987

ROVER GROUP

Interim Results
Half-year to 27 June 1987

This document is being circulated to the Ordinary Shareholders of the Company.

Copies are available to the public at the registered office of the Company, 7-10 Hobart Place, London SW1W 0HH

5 August 1987

THE ROVER GROUP PLC – HALF-YEAR RESULTS TO 27 JUNE 1987

The Board of The Rover Group plc has announced unaudited results for the six months ended 27 June 1987.

	1987 £ million	1986 £ million
TURNOVER		
Austin Rover Group	1,313	1,016
Land Rover Group	250	220
Other	17	12
Continuing businesses	1,580	1,248
Divested businesses[1]	39	548
Intra group sales	(91)	(168)
Total	1,528	1,628
Of which exports from the UK were	529	355
OPERATING PROFIT (LOSS)		
Austin Rover Group	(19.8)	(65.1)
Land Rover Group	7.9	4.6
Share of associated companies' results[2]	3.4	–
Other	(4.1)	0.4
Continuing businesses	(12.6)	(60.1)
Divested businesses[1]	2.9	(11.0)
TOTAL OPERATING LOSS	9.7	71.1
Exceptional profits	2.4	–
LOSS BEFORE INTEREST AND TAXATION	7.3	71.1
Interest payable less interest receivable	32.2	47.8
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION	39.5	118.9
Taxation on ordinary activities	2.1	1.8
LOSS ON ORDINARY ACTIVITIES AFTER TAXATION	41.6	120.7
Minority share of profits of subsidiaries	0.4	0.2
LOSS BEFORE EXTRAORDINARY ITEMS	42.0	120.9
Extraordinary Losses	–	83.6
LOSS AFTER EXTRAORDINARY ITEMS	42.0	204.5
Vehicle Unit Production '000	246	242
Vehicle Unit Sales '000	259	233
These figures relate to the continuing businesses only		
Loss per share	0.8p	2.8p

[1]Divested businesses for 1987 comprise Istel Ltd and Leyland-DAB A/S (Denmark).
[2]Associated companies comprise DAF BV, UGC Limited and JRA Holdings Limited.

Rover Group Statement on the Half Year Results

Turnover in the continuing businesses for the first six months of 1987, as compared with the same period in 1986, increased by 27 per cent to £1,580m with unit sales up 11 per cent to 259,000. Exports accounted for over one third of unit sales and of turnover.

Improving operations resulted in a 90 per cent reduction in loss **before** interest and taxation to £7.3m and an 80 per cent reduction **after** interest, tax and extraordinary items to £42.0 million.

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Lb

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

29 July 1987

ROVER GROUP

The Prime Minister was grateful for your Secretary of State's minute of 21 July which reported the latest position on Rover Group.

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

DAVID NORGROVE

Jeremy Godfrey, Esq.,
Department of Trade and Industry.

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Prime Minister 2

Lord Young would need very strong support to push through his preference against that of Graham Day, however I strong the undoubted merits of privatising Land Rover separately. DCR 21/7.

PRIME MINISTER

ROVER GROUP

I agree N.L.

At our meeting on 26 June it was agreed that I should take private soundings of Sir John Egan about the potential Jaguar interest in acquiring Land Rover. When I met Sir John he made clear that he had commissioned a broader strategic study of Jaguar's future, and would wish to have until September/ October to respond to us on Land Rover. I agreed that this was an acceptable timetable.

2 I also took the opportunity of a private dinner with Graham Day to explore in more detail how he proposes to take forward the privatisation of Rover Group. He has undertaken to provide a report on the possibilities in late September. There is little doubt that this will concentrate on his current preference for a flotation of the whole group but he accept that it should set out an overall timetable with decision points towards other options if the trading performance of the companies was not on track for flotation. Day made clear his view that it would be premature to decide this year to deal with Land Rover separately. However he recognised, that we have yet to be fully convinced on this. We will need to consider this issue further when we have both Day's further report and Sir John Egan's response in the Autumn.

3 I would like to see further work carried out in the summer on the question of RG's minority shareholders. When we met we recognised that there could be substantial advantages in an early buy-out. Day shares this view (and indeed is a firm advocate of it) but appreciates that the

JG5BET

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timing and presentation of such a move are crucial: one possibility might be to tie it in with the next Corporate Plan and, in any event, to offer the existing shareholder some form of priority in an eventual flotation. I propose that RG and my officials should draw up a proposal for us to consider after the Summer. I hope they will be able to find a solution to this long running problem which will command wide support.

4 I am copying this minute to Nigel Lawson.

D Y

21. July 1987

DEPARTMENT OF TRADE AND INDUSTRY

JG5BET

IND POL: Rouen Group PT13

SUBJECT
CC MASTER

SECRET AND PERSONAL

Ref ECL 30

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

26 June 1987

Dear Tim,

ROVER GROUP

The Prime Minister this afternoon held a meeting to discuss the prospects for privatisation of Rover Group. There were present your Secretary of State, the Chancellor of the Exchequer and Mr. George Guise (No.10 Policy Unit).

Your Secretary of State said that the golden share in Jaguar would expire in December 1990. It was very likely that Jaguar would then prove attractive to a bidder, which might be a company like BMW. It would almost certainly not be possible to block such a bid on grounds of public interest, particularly if the bidder were a company from within the European Community. If such a bid were to succeed the result would be damaging to the Government. One possibility might be to arrange a trade sale of Land Rover to Jaguar, with a fresh golden share whose life might extend for another five years beyond 1990.

In discussion it was noted that the purchase of Land Rover with a golden share which would extend to Jaguar as a whole would require the consent of shareholders. Very nearly half of Jaguar shares were held in ADRs. An extension of the golden share would reduce the share price and it was not clear why existing holders would agree to this unless Land Rover were sold at below its proper value. This would however be unacceptable to the Government itself and to Parliament and it would be necessary to allow others to bid. Matters other than the price offered by bidders would need to be taken into account, including for example the strength of the bidders in distribution. It was noted that one possibility would be to sell Land Rover with a golden share which did not extend into Jaguar as a whole; the difficulty of acquiring Jaguar without Land Rover could well prove to be a deterrent to potential bidders.

The meeting considered whether there would be merit in reviving discussions about a possible sale of Austin Rover Group (ARG) to Ford. Such a sale would almost certainly be financially advantageous and it might also now be politically a little less difficult: there would be less surprise and the sale would not be caught up in the hysteria which had surrounded the discussions over the possible sale of Land Rover to General Motors. It would nevertheless be an

extremely difficult decision. There would be concern amongst component suppliers in particular, and great opposition in Parliament: the House would have to be told as soon as discussions began. If discussions were to begin again they could not this time be allowed to fail. It was also very relevant that the Government in February 1986 had given an undertaking "that the right way to end the uncertainty is to make it clear that the possibility of the sale of Austin Rover to Ford will not be pursued".

The Prime Minister stressed the absolute importance of securing the support of Mr. Graham Day for whatever changes were proposed. Your Secretary of State stated his belief that Day would be prepared for Land Rover to be sold separately from ARG provided he could be given an assurance that he could continue with his recovery programme for ARG until late 1988 before he was expected to make recommendations on the future of the company, whether sale, flotation or retention by the Government. It was agreed on this basis that your Secretary of State should hold a strictly personal discussion with Sir John Egan on whether Jaguar would be interested in acquiring Land Rover.

The options for a golden share in Land Rover alone or in Land Rover and Jaguar together would need to be further considered.

The meeting discussed briefly whether it would be right now to seek to buy out the minority shareholders in Rover Group. This had been ruled out earlier on the grounds that it would give the appearance that the Government was trying to create greater secrecy about the Group. However there would also be substantial advantages to a buy out.

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

Yours,

David

DAVID NORGROVE

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

29

PRIME MINISTER

ROVER GROUP

Lord Young is likely to propose first that Range Rover/Land Rover should be sold to Jaguar and secondly that talks should be re-opened with Ford about Austin Rover.

The Policy Unit note below discusses the financial aspects of these proposals. There is no doubt that in these terms Lord Young's proposals would be beneficial. But the key questions are political.

You will want to consider whether this is an issue better tackled now or in a year or 18 months' time. The timing is a point which can be argued either way.

On more detailed matters, the considerations are somewhat different in relation to Land Rover and Austin Rover. But the common element is Graham Day. If he were to argue in public, or even in private, that he could have turned the joint company into a viable proposition or at least that given a few years more he could have made it possible for Rover Group to be kept wholly in British hands, the political difficulties would be immensely increased. Graham Day is seen as your own personal appointment, and any criticisms by him would be all the more damaging. But he is a very loyal person and he sees his task as being to satisfy his shareholders. It is possible that this consideration would override any other doubts he may have.

It is also worth bearing in mind Mr. Clarke's Birmingham connections, and his Midlands constituency.

Land Rover

Nothing said when the talks with GM broke down would preclude sale of Land Rover now. Indeed, the statements made by Mr. Channon at the time the talks broke down can have no

validity given that Freight Rover and Leyland Trucks have since then been merged with Daf.

A sale of Land Rover to Jaguar would also be helpful to national pride. There would, I think, be two problems to overcome:

(i) it would be difficult and perhaps undesirable to offer Land Rover only to Jaguar; flotation or trade sale to another company should also be considered;

(ii) Graham Day's strategy for the group as a whole is to try to build on the prestige of the Rover name and to move Austin Rover up-market. This strategy would be severely damaged by the sale of Land Rover.

But I doubt that either of these is an insuperable barrier, particularly if Graham Day is supportive.

Austin Rover

A sale of Austin Rover to Ford would be orders of magnitude more controversial. It would resurrect all the old arguments about the UK becoming the only country without a national mass car manufacturer; the effect on component suppliers would be pointed out; and there would be questions of potential monopoly powers.

It is also relevant that on 6 Februry last year Mr. Channon said:

> "We have decided that the right way to end the uncertainty is to make clear that the possibility of the sale of Austin Rover to Ford will not be pursued."

There may be statements elsewhere about later privatisation of Austin Rover, but I have been unable to lay hands on them this evening.

You will also wish to look at your exchange of correspondence after the election with the Chairman of Ford. DTI read the Chairman's letter as a clear indication of continuing interest in Austin Rover. This may be so and I confess that I missed it in the flurry of congratulatory letters. Your answer to Petersen is reasonably non-committal. But he may read it as an indication of interest. Clearly if there is a risk of this and you decide against pursuing discussions any further an early opportunity ought to be taken to make the position clear to Ford. This would avert the possibility of another damaging row if rumours were to leak from Ford.

Inner Cities

Lord Young may raise with you his concern that DTI does not have a clear role on inner cities. There is a note on this elsewhere in your box.

DAVID NORGROVE

25 June 1987

VC2AOY

28

Prime Minister

MR NORGROVE

25 June 1987

PRIME MINISTER'S MEETING WITH LORD YOUNG

Young is apparently very keen to bite the bullet on RG Group by disposing of the two remaining major companies, ARG and Land Rover as soon as possible. He has said that he would like to be rid of them both within 12 months.

Graham Day is likely to argue, as he did when we discussed the plan in January, that he needs several years to establish a track record, particularly at ARG, before the business is saleable. He will also argue that, even though Land Rover might be saleable now, it is only just beginning to perform and would be more valuable if kept for a few years to demonstrate strong earnings recovery. Day will further argue that he needs to keep the blossoming Land Rover business within the Rover Group to preserve financial flexibility during the strongly negative cash flow years which ARG faces up to and beyond 1991.

To illustrate all this I attach the Rover Group plan summary which I gave the Prime Minister in January and also the latest Rover Group financial figures for April. The latter shows better than budget performance so far this year for both ARG and Land Rover. However, May's market share dropped to 13.5% for ARG possibly as a result of Ford's successful launch of its new Sierra model.

The crucial issue is that Day and Young must work in harness and Young will have spoken to Day tomorrow morning and may therefore have some indication of his attitude for our meeting tomorrow. It is understandable that Day should want to demonstrate his capability of turning the business round. Howver, unless he materially betters the ARG plan that business will still be in bad shape in 1991. At end 1987 the plan indicates borrowings of £456m in ARG with negative

cash flow of £274m. By 1991 there is still negative cash flow of £61m and borrowings have risen to £538m.

My view is therefore that Young's determination to move quickly and get out of this business should be supported provided that we recognise the pitfalls. These are the questions that we need to focus on for tomorrow's meeting:

1. Should we push for separate solutions for Land Rover and ARG forthwith? I think we should.

2. Do we talk to Ford again on ARG? I understand that Peterson of Ford sent a congratulatory message to the Prime Minister with a strong hint that he would be interested in discussing this again.

3. Bearing in mind the great need for secrecy who should talk to Ford and at what level? I think it should be Day or Young at highest level in order to establish interest in principle.

4. Recognising that as soon as any detailed negotiations are entered, something is bound to leak, initially to Honda and publicly thereafter, how do we handle Honda? Are we willing to see them develop the Swindon site where they have announced the intention of building an engine plant? On the basis that the more private companies that built cars in Britain and the less companies that are Government owned the better, the answer should be yes.

5. On the question of how Land Rover is sold, there are more options because the business is more viable. Clearly, Jaguar is an obvious first possibility and Egan's position should be established. Assuming that he is interested, we must not close off other British possibilities such as JCB or even Lonhro. There is even

the possibility of structuring Land Rover in the form of a management buy-out because it is capable of generating positive cash flow after capital expenditure.

6. Young may raise the question of whether a new golden share for Land Rover would be a carrot for Jaguar since it would extend their protection from take-over. Considering that Jaguar's existing golden share does not expire until 1990, we should not support a perpetuation of this kind of protection from take-over. The best protection from take-over is to run one's business so successfully that it is too expensive. Given the additional Land Rover assets Egan should be able to do that.

It is unlikely that Jaguar shareholders would vote for an extension of what is already a negative factor from the Jaguar shareholders' viewpoint.

7. The cost to HMG of an early sale of the remains of the Rover Group can only tentatively be calculated but I suspect the figure is somewhere between £0.75 billion and £1 billion, broken down as follows:

	£m	
Total RG debt end 1987	630	
Add Restructuring Costs	300	guess
Subtract Proceeds from LR sale	200	guess
	730	- Say £750m

If, however, a management buy-out was considered there would probably be the need for some further injection into the ongoing business. Taking these two arguments together Government will probably need to find up to £1 billion of dowry if these businesses are to go. This

compares with Varley Marshall borrowings of £1.4 billion at end 1987 rising to £1.6 billion at end 1988.

8. Should the minority shareholding be taken out of RG prior to any of these plans? I believe this to be essential. Even assuming that we find willing buyers, the political road is not going to be easy. There is the danger of market share collapsing if negotiations are protracted and leaks take place. It can only compound our problems to have to have the whole proposals going to a public general meeting and all the publicity that will attract. Barings estimate that it will take approximately two months to complete the procedure for removing the minority and if we wish to support Young's proposals that first step should be taken forthwith.

Summary and Conclusion

Young's basic instinct is good and should be supported, but not at the expense of forcing Graham Day into actions he is deeply opposed to. It might even be better to get a different Chairman if Graham cannot be won over. There is considerable political and financial risk to pursuing Young's course. However, the plan doesn't indicate that these risks are going to be materially different if delayed for a few years. At such time one would, of course, be nearer to a new election.

GEORGE GUISE

ROVER GROUP - PLAN SUMMARY

SECRET

Years to December	1985	1986	1987	1988	1989	1990	1991	5 Year Total 87/91
Sales Vol (000) RG	542	502	496	495	456	455	448	-
of which ARG	466	433	434	434	434	432	425	-
% Market Share ARG	17.7	15.8	14.5	14.5	14.5	14.5	14.5	-
Manpower (000) RG	76	68	51	48	39	38	36	-
of which ARG	41	39	35	32	31	30	28	-
% Return on total assets	(3.2)	(16)	(2.0)	4.9	6.6	10.4	10.5	-
of which ARG	(1.6)	(18)	(4.9)	3.1	6.7	10.9	10.5	-
Cash Flow £m RG in (out)	(174)	(363)	(274)	(128)	97	(43)	(61)	(410)
of which ARG	(66)	(230)	(116)	(118)	(43)	(23)	(48)	(348)
Capital Exp. £m RG	185	142	162	225	196	182	206	971
of which ARG	145	97	122	166	156	161	191	796
Borrowings £m RG	637	1006	630	756	659	700	710	-
of which ARG	293	500	456	574	517	540	538	-
Varley Marshall £m RG	1700	2111	1428	1607	1486	1544	1551	
of which ARG	970	1200	1135	1303	1300	1346	1350	

Capital Expenditure at ARG in £m

AR8 5/3 door			20	50	69	39	6	186
K series Engine			37	34	31	34	-	136
K series - Metro			-	13	15	6	1	35
Gearbox - Metro			14	17	15	13	5	64
New Products			10	5	6	45	154	220
Relocate Montego			2	19	3	-	-	24
Balance			39	28	17	24	25	131
TOTAL ARG	145	97	122	166	156	161	191	796

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FINANCIAL REVIEW

ROVER GROUP

ANALYSIS OF GROUP RESULTS BY COMPANY

	April		Year-to-date		Full Year		
	Actual	Budget	Actual	Budget	F'Cast	Budget	1986
Sales Revenue £M							
Austin Rover Group	278.3	246.1	972.2	832.5	2427.7	2420.0	2268.2
Land Rover Group	43.0	46.8	168.3	162.4	513.4	499.3	446.5
LRLIH	5.5	4.7	16.2	16.4	34.9	34.9	47.6
Gaydon Technology	1.6	1.5	5.2	6.1	15.8	18.4	21.1
Istel	5.5	-	21.2	15.7	32.6	15.7	60.8
Disposed Companies	-	-	-	-	-	-	964.4
Consolidation	(16.1)	(12.6)	(66.1)	(58.7)	(150.1)	(141.3)	(396.6)
Rover Group	317.8	286.5	1117.0	974.4	2874.3	2847.0	3412.0
PBIT £M							
Austin Rover Group	1.5	2.5	(14.4)	(15.9)	(21.8)	(29.5)	(258.7)
Land Rover Group	2.0	1.8	5.1	2.0	14.8	12.9	(7.0)
LRLIH	1.2	0.6	1.7	1.2	5.8	5.8	4.9
Gaydon Technology	0.6	0.3	0.7	0.8	0.5	1.8	4.7
Istel	0.2	0.1	1.1	0.8	2.3	1.6	3.7
Associate Co's:							
Unipart	0.3	0.3	0.8	0.8	2.5	2.5	-
JRA Holdings	0.2	-	0.2	-	0.8	-	-
Disposed Companies	-	-	-	-	-	-	(83.4)
Consolidation/Head Office	(2.2)	(1.9)	(4.2)	(6.6)	(22.2)	(20.1)	(14.1)
Rover Group	3.8	3.7	(9.0)	(16.9)	(17.3)	(25.0)	(349.9)
Assets Employed £m							
Austin Rover Group			560.4	668.2	599.3	612.2	556.6
Land Rover Group			132.7	148.0	168.7	180.3	130.5
LRLIH			10.1	21.4	21.2	21.2	16.1
Gaydon Technology			17.3	17.6	18.7	18.3	19.2
Istel			12.4	4.4	5.1	4.8	16.1
Associate Co's:							
Unipart			15.2	15.1	16.5	16.4	14.5
JRA Holdings			1.9	1.7	2.2	1.7	1.7
Leyland Group Limited			(158.1)	(107.0)	(72.0)	(74.4)	(249.0)
Consolidation/Other			112.8	96.8	123.1	95.3	146.7
Rover Group			704.7	866.2	882.8	875.8	652.4
Cashflow £m							
Austin Rover Group	(88.3)	(34.9)	(43.5)	(155.2)	(142.3)	(169.9)	(285.9)
Land Rover Group	3.7	(2.7)	0.5	(18.7)	(31.3)	(46.3)	45.2
LRLIH	2.3	(2.3)	1.8	(9.6)	(11.9)	(11.9)	5.8
Gaydon Technology	(0.1)	0.4	2.5	2.2	1.2	2.5	4.5
Istel	(0.7)	-	4.9.	17.0	17.8	17.0	0.1
Leyland Group Limited		(33.1)	(90.9)	(144.2)	(176.8)	(176.8)	
Disposed Companies	(38.1)	-	-	-	-	-	(115.0)
Consolidation		0.6	35.9	44.9	11.1	40.8	
Rover Group	(121.2)	(73.2)	(88.8)	(263.6)	(332.2)	(344.6)	(345.3)

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COMMERCIAL IN CONFIDENCE

FILE
DSG

bc BG

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

8 May 1987

Dear Jeremy,

ROVER GROUP

The Prime Minister has seen your letter to me of 6 May and has noted that Mr. Day has decided to defer publication of Rover Group's preliminary results until 15 May.

I am copying this letter to Alex Allen (HM Treasury) and Andrew Lansley (Chancellor of the Duchy of Lancaster's Office).

Yours,

David.

David Norgrove

Jeremy Godfrey, Esq.,
Department of Trade and Industry.

dg

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COMMERCIAL IN CONFIDENCE

& cc BG

DEPARTMENT OF TRADE AND INDUSTRY
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SWITCHBOARD 01-215 7877

PS/ *Secretary of State for Trade and Industry*

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6 May 1987

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 2AA

Prime Minister 2

To note that the plan now is to publish RG's preliminary results on 15 May.

DNS MS
7/5.

Dear David

ROVER GROUP

I had delayed responding to Andrew Lansley's letter to you of 29 April until officials here had been able to discuss further with Rover Group the presentational aspects of RG's announcement of their 1986 results. This had to await Graham Day's return to London from overseas business.

Mr Day has apparently now decided after consultation with the relevant Directors that publication of the preliminary results should be deferred by one week to allow for further work on treatment of the key issues - notably the 'extraordinary' and 'exceptional' losses. (The timetable for the Annual Report and AGM is unchanged). Although the date of 15 May is perhaps marginally less helpful for the preliminary announcement, my Secretary of State welcomes this signal that Mr Day is fully seized of the importance of presenting these figures in the best possible light. We will be keeping in close touch with RG as they put the finishing touches to their statement and briefing so that we and they can best rebut any misleading slants.

I am copying this letter to Alex Allen and Andrew Lansley.

Yours ever

Jeremy Godfrey

JEREMY GODFREY
Private Secretary

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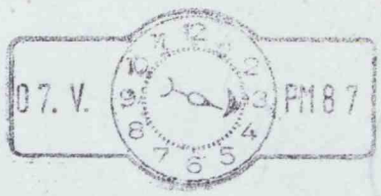

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bc BG.

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

29 April 1987

The Prime Minister has seen your letter to me of 23 April about the results of the Rover Group and has noted that RG will publish 1987 first quarter trading results alongside the preliminary 1986 figures.

I am copying this letter to Alex Allan (H.M. Treasury) and Andrew Lansley (Chancellor of the Duchy of Lancaster's Office).

(David Norgrove)

Michael Gilbertson, Esq.,
Department of Trade and Industry.

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JB

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CCBG

CABINET OFFICE,
WHITEHALL, LONDON SW1A 2AS

Chancellor of the Duchy of Lancaster

Tel No: 270 0020
270 0296

29 April 1987

David Norgrove Esq
Private Secretary to the
Prime Minister
No 10 Downing Street
LONDON
SW1

NRGM

Dear David,

ROVER GROUP

The Chancellor of the Duchy has seen a copy of Michael Gilbertson's letter to you of 23 April. He is grateful for the warning of this announcement.

Mr Tebbit agrees that it would be right to publish Rover Group's first quarter 1987 trading results alongside the prelminary 1986 figures. This would help to emphasise that the 1986 figures relate to a period before the reconstruction of the commercial vehicles business and that they subsume very large extraordinary items. This will not, however, still those who would wish to claim that these figures show that the Government is planning a run-down of ARG activity. The Chancellor wonders, therefore, whether Graham Day, and DTI Ministers, should be particularly ready to respond to any misleading claims in the period between the release of the audited figures on 22 May and 18 June, when, in the normal course of events, Graham Day would make his statement at the AGM.

It will be important, in any case, for Rover Group's current and prospective position to be put very much to the fore, rather than its historical figures; with the elimination of the commercial vehicle losses, agreement on the Corporate Plan as a basis for new investment, some sound sales figures and export prospects, e.g. the Sterling in the U.S., and developing collaboration with Honda, there should be an ample basis on which to emphasise that this Government has taken the necessary steps to put Rover on a more commercial footing, which is its necessary long-term future.

I am sending a copy of this letter to Alex Allan and Mike Gilbertson.

Yours sincerely,

ANDREW LANSLEY
Private Secretary

IND POL : Rover Group PT13

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CC PC

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PS/ *Secretary of State for Trade and Industry*

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23 April 1987

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 2AA

Prime Minister 2

I had no idea it would be quite so bad DCR 23/4.

Dear David,

ROVER GROUP

The Prime Minister may wish to be aware that Rover Group's preliminary accounts for 1986 are due to be published on 8 May. Although the size of the losses has effectively been trailed in the circulars for the Rover Group EGM that took place on 27 March, there is no doubt that the actual figures will give rise to some adverse publicity. This may be revived with the sending out of the full audited figures on 22 May and the holding of the Annual General Meeting on 18 June. Although this timetable does of course increase the risk of Rover Group being in the political spotlight in June, my Secretary of State believes that we must accept the RG Board's view that it is commercially vital to dispose of this historic bad news well before the key August selling period for cars.

The figures to be released of course relate to the period prior to the reconstruction of the commercial vehicles businesses. Prudent accounting practice requires that provision should be made for all the costs of that reconstruction, some of which will actually fall some time ahead. This is responsible for the bottom line loss of £899m now anticipated. Of course the trading level loss in 1986 (£350m) was also very poor and the need to turn this round quickly remains essential. Elimination of the commercial vehicle losses will contribute but the residual businesses will need to perform much better; we and Treasury officials will be monitoring this

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carefully. It is encouraging that RG's management accounts for the first two months of this year show the Group performing slightly ahead of budget though of course one must be wary of extrapolating from such a short period.

In order to counterbalance the historic 1986 figures with up to date evidence of the better trading performance this year, RG will publish 1987 first quarter trading results alongside the preliminary 1986 figures. Some may argue that this is a new departure to divert attention but my Secretary of State believes it should help to underline the new direction the Group can move in following the commercial vehicle disposals.

I am copying this letter to Alex Allan at the Treasury, and to Andrew Lansley (Chancellor of the Duchy's office).

Yours ever,

Michael

MICHAEL GILBERTSON
Private Secretary

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ABG

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

20 March 1987

ROVER GROUP: EC CLEARANCE

The Prime Minister has asked me to pass on her congratulations and thanks to your Secretary of State and all those who have helped to bring to a successful conclusion the negotiations with the Commission over the Rover Group debt.

I am sending a copy of this letter to Alex Allan (HM Treasury), Tony Galsworthy (Foreign and Commonwealth Office) and David Williamson (Cabinet Office).

(DAVID NORGROVE)

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

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CONFIDENTIAL

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

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

19 March 1987

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

CCBG

CONFIDENTIAL

PRIME MINISTER

Prime Minister 2 CCBG
Congratulations are
I think due to DTI, FCO
and others concerned in
this. DLR
18/3.

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

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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

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Secretary of State for Trade and Industry

PS/

18 March 1987

David Norgrove
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 2AA

Dear David

ROVER GROUP EC CLEARANCE

I told you that the Commission have today agreed to our paying £680 million to Rover Group in respect of retirement of debt and restructuring costs associated with the sale of the Bus and Trucks businesses. I attach a written PQ reporting this decision. It will be answered on 19 March.

I am copying this letter and attachment to the Private Secretaries of Members of E(A) and Sir Robert Armstrong.

Yours

TIMOTHY WALKER
Private Secretary

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CONFIDENTIAL

Q To ask the Secretary of State for Trade and Industry, pursuant to his statement about The Rover Group on 15 December 1986 (OR Col 348), what progress has been made in the discussions with the EC Commission.

Mr Channon

My hon. Friend the Minister of State for Industry informed the House on 13 January (OR Col 140) that the sale of Leyland Bus to a management-led consortium has been completed. I informed the House of 19 February (OR Cols 1059-60) that the Government had accepted Rover Group's recommendation that Leyland Trucks, DAF Trucks and Freight Rover should combine to form a new Anglo-Dutch joint venture; that the Government had notified the EC Commission of our intention to fund the write off of the accumulated debts from Leyland Bus and Leyland Trucks left in Rover Group and the restructuring costs resulting from their sale; and that normal procedures were in train. On 6 March I advised the House that the total costs were calculated at £680 million. I am now pleased to confirm to the House that these procedures have reached a satisfactory conclusion. It is intended that the Government will subscribe for £680 millions of new shares in Rover Group shortly.

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Secretary of State for Trade and Industry

CONFIDENTIAL

6 March 1987

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

Dear David,

VEHICLE INDUSTRY DEBATE : 11 MARCH 1987

For this debate, it has been agreed that we need two motions, one on the vehicle industry generally, and one specifically approving the Industry Act Order. It has been agreed through the usual channels that the two motions will be taken together.

On the vehicle industry we suggest:

> "This House welcomes the Government's approval of the Rover Group Corporate Plan, recognises the valuable contribution made by the vehicle industry, both UK and foreign-owned, to the UK economy, notes the important role of the UK component suppliers, welcomes the encouraging outlook for the future of the industry as a whole, and endorses the Government's policies to create the conditions for the long term success of the industry".

On the Order, we suggest:

> "That the draft Industry Act 1980 (Increase of Limit) Order 1987, which was laid before this House on 19 February, be approved".

I would be grateful for any comments by mid-afternoon on Monday.

I am copying this letter to Alex Allan (Treasury), Alison Smith (Lord Privy Seal's Office) and Murdo Maclean (Chief Whip's Office).

Yours ever,
Michael

MICHAEL GILBERTSON
Private Secretary

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SECRET

28

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

5 March 1987

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

cc R Williamson
Cabinet Office.

Prime Minister

DCW
5/3.

Dear Paul

ROVER GROUP

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

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 discuss 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, even if Commission clearance is delayed beyond the end of March. I understand that they believe they have identified an acceptable route.

Subject to final confirmation of those contingency plans, the only major point now for decision is the amount to be included in the Estimate. In the light of your letter, our proposed action would be based on a firm expectation of EC approval for £680 million, and I think that for reasons of Parliamentary propriety that is the figure we must include in the Estimate. I hope therefore you can agree to using that figure rather than £750 million in both the Estimate and the Budget documents. To meet the Parliamentary timetable, we have to finalise details of the Supplementary Estimate, including the amount, by close of play tonight.

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

Yours ever
NL

NIGEL LAWSON

IND POL: Rover Group PT3

CONFIDENTIAL

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

2 March 1987

ROVER GROUP

The Prime Minister has seen your Secretary of State's minute of 27 February which reported the results of his discussions with Commissioner Sutherland over the debt write-off for Rover Group.

The Prime Minister has noted that this now seems to be progressing satisfactorily and agrees with Mr. Channon's advice that at present there is no need for her to write to Delors. She will of course be very happy to do so later if problems emerge.

I am copying this letter to Alex Allan (HM Treasury) and Tony Galsworthy (Foreign and Commonwealth Office), and to David Williamson (Cabinet Office) together with a copy of your Secretary of State's minute.

(DAVID NORGROVE)

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

JB.

CC BTG

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PRIME MINISTER

ROVER GROUP

My meeting with Commissioner Sutherland earlier today allowed me to spell out once again, in very frank terms, the political sensitivities of this case: the political imperative of getting the Commission's authorisation and the need to have this before the Budget to allow us to pay RG in the current financial year. Sutherland showed that he fully understood these concerns but outlined the problems he faced - essentially that the level of aid proposed was far too great for the restructuring offered and that the flood gates could open for the other aid cases now being considered.

2 It quickly became apparent that Sutherland was looking for a significant reduction in the aid sought: the figure he proposed was £150 million. I rejected this out of hand as I did when he reduced this request to £100 million. (My officials later learnt that this amount was intended to be his final fall-back). After still further discussion in very restricted session, we agreed that Sutherland would recommend to the Commission authorisation of aid totalling £680 million for both Bus and Truck provided no substantial negative comment from other Member States or from an interested party is received by 12 March at the very latest. Sutherland said that no comment had yet been received although we ourselves have learned informally that Germany has submitted a short response. We do not believe that this would be sufficient to scupper the deal. However we will

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check this urgently early next week and will, of course, let you know if there are any problems.

3 The reduction of £70m is comfortably within the £100m we had originally built into our negotiating package. It is also above the figure that RG said they regarded as the minimum injection of funds needed. This afternoon my officials have confirmed with Graham Day that he is very happy with the outcome of my negotiations.

4 Officials now need to discuss with the Commision and RG how the authorisation for £680 million will be presented publicly. We shall wish to say when the time comes that the revised figure is the result of the greater precision that is possible now that the deal with DAF has been signed. My officials will also provide further information and help to the Commission in preparing Sutherland's report to his colleagues.

5 Sutherland said that he would now put his full authority behind getting the authorisation through the Commission. He believes that he cannot do this if he tries to rush it through and therefore, with the best will in the world, he could not put the case formally to the full Commission by 17 March. In particular he fears that consideration a week earlier would not allow proper preparation of the argument nor permit the necessary lobbying of his colleagues thereby risking his recommendation being rejected.

6 I questioned Sutherland in some detail and now conclude that his instincts are right. I asked Sutherland what degree of assurance he could offer that the full Commission would accept his recommentation on 18 March without amendment. He

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CONFIDENTIAL

gave me a confident and absolute assurance that his proposal would be accepted in the terms in which he made it. I believe that we should accept this assurance. It should allow Nigel Lawson to deal with the issue in very robust terms that can be worked out next week with Sutherland's people.

7 Sutherland's Cabinet have argued strongly against our seeking further reassurance from Delors and I think we should take their advice. At present, therefore, I suggest that you need not write to Delors unless problems emerge later.

8 We shall of course continue to lobby other Commissioners to ensure the maximum positive support for Sutherland's recommendation on 18 March. My officials will be in touch with Geoffrey Howe's to take this forward. Meanwhile I spoke to de Clercq and Matutes myself during my visit to Brussels to stress the importance of this case.

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

Timothy Walker

PP PAUL CHANNON
27 February 1987
(Approved by the Secretary of State and signed in his absence)

DEPARTMENT OF TRADE AND INDUSTRY

JF5BTC

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
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Secretary of State for Trade and Industry

27 February 1987

Charles M Pigott Esq
Chairman and Chief Executive Officer
Paccar Inc
Business Center Building
PO Box 1518
Bellevue
Washington 98009

Dear M. Pigott.

Many thanks for your letter and enclosures of 18 February. I have also seen your telex to the Prime Minister of the same date, to which I have been asked to reply, and your letter to Robin Mountfield.

First, I should confirm, as the Minister of State, Mr Shaw advised Mr Dunn, that the information set out in this correspondence was known to Rover Group and taken fully into account in their own and the Government's evaluation of the Paccar bid. Second, I should like to reassure you that the various options under consideration for Leyland Trucks were examined objectively and in an entirely even-handed way. The Government has no doubt about Paccar's commitment to the UK - your management of Foden has demonstrated this - and Foden's involvement in the DROPS venture is a further reflection of the Government's confidence in the company.

Nevertheless, in the event, the Rover Group came forward with a very clear recommendation that on financial and commercial grounds the proposals put forward by DAF were more favourable than the alternatives and, after careful consideration, the Government felt it right to support that judgement. I realise that the decision will have come as a great disappointment to you particularly as I know you believe that your own proposals would have been more beneficial to the UK in industrial and employment terms. You will I know equally appreciate the view of Rover Group that, despite the significant rationalisation (which would have been necessary under any option), the joint venture now proposed with DAF will offer long-term security of employment for many Leyland employees and,

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while the effect on individual companies may vary, the overall impact of the venture on supplying industries will also be positive.

I should like to record my thanks for the time and effort which Paccar devoted to pursuing this opportunity and to you and Mr Dunn personally for taking so much trouble to ensure that I and my colleagues were properly briefed on your proposals.

With best wishes.

Yours sincerely,

PAUL CHANNON

Paul Channon

DW3BTL

IND. POL: Rover group: Pt 13

Secretary of State for Trade and Industry

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27 February 1987

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

NBPM

Dear David,

PACCAR

Thank you for your letter and enclosure of 19 February.

I am now enclosing for the record a copy of the letter which my Secretary of State has sent to Mr Pigott in reply to his various communications of 18 February. In fact the Minister of State, Mr Shaw, met the Paccar President, Mr Joseph Dunn, on 19 February in advance of the Statement and explained the basis of the Government's decision. He also reassured Mr Dunn about the Government's high regard for Paccar's contribution to the UK through their ownership of Foden. Mr Dunn was naturally greatly disappointed but accepted the situation and our hope is that Paccar will now let the matter rest.

We see no need for a separate reply from the Prime Minister.

Yours ever,
Michael

MICHAEL GILBERTSON
Private Secretary

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IND. POL: Rover group: Pt 13

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FDI AUT

10 DOWNING STREET

LONDON SW1A 2AA

26 February, 1987.

From the Private Secretary

ROVER GROUP

The Prime Minister has seen Lyn Parker's letter to me of 25 February reporting the Foreign Secretary's discussions in Brussels about Rover Group. The Prime Minister would be grateful to know on Monday the results of Mr. Channon's discussions with Commissioner Sutherland and to have advice on whether the time has arrived for the Prime Minister to write to Delors. As you know, the Prime Minister believes it would be helpful for her to write before too long.

I am sending copies of this letter to Alex Allan (HM Treasury) and Trevor Woolley (Cabinet Office).

David Norgrove

DTI.

Michael Gilbertson, Esq.,
Department of Trade and Industry.

CONFIDENTIAL

CCBG

CIO

Foreign and Commonwealth Office

London SW1A 2AH

25 February 1987

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

(L Parker)
Private Secretary

David Norgrove Esq
10 Downing Street

PRIME MINISTER

ROVER GROUP

The Foreign Secretary reports below on his discussions in Brussels about a debt write-off for Rover Group.

He concludes that we shall need to take stock about further action after Mr. Channon has seen Commissioner Sutherland tomorrow or Friday. (He leaves for Brussels at lunchtime I believe.)

The Foreign Secretary does not propose that you should write to Delors, as you had wished. However this seems sensible given that Mr. Channon may discover more while he is in Brussels. I suggest you ask for a report on Monday of Mr. Channon's discussions, together with advice on whether you should then write to Delors.

by Pelstevens
DUTY CLERK
(DAVID NORGROVE)

25 February 1987
DCABTK

CONFIDENTIAL

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DTS.

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

19 February 1987

Dear Mr. Gilbertson,

PACCAR

I attach a telex the Prime Minister has received from Mr. Charles Pigott, Chairman of PACCAR.

As we discussed, it might well be useful if a DTI Minister, presumably Mr Shaw, could see Mr Joseph Dunn. Although in normal circumstance, the appropriate person to see him would be Graham Day, the need to dissuade PACCAR from the public campaign over this decision is clearly strong.

We also discussed Sir Anthony Jolliffe's telephone conversation with this office this morning. He is a Director of PACCAR and had asked to see the Prime Minister. You undertook to arrange for an appropriate person to speak to him.

Yours sincerely

D R Scala

pp D R NORGROVE

Michael Gilbertson, Esq.
Department of Trade and Industry

CONFIDENTIAL

Duty clerk

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PACCAR BVUE C
MSG GC183
02/18/87

TO: PRIME MINISTER MARGARET THATCHER

URGENT

DEAR PRIME MINISTER:
I KNOW THE CABINET DEBATES THE SALE OF LEYLAND TRUCKS TODAY, WHICH WE WOULD LIKE TO PURCHASE. IN CONVERSATIONS WITH SIR ANTHONY JOLLIFFE, A PACCAR OF UNITED KINGDOM DIRECTOR, I HAVE STRESSED THAT A PACCAR PURCHASE MEANS THAT FOUR TO FIVE THOUSAND JOBS WILL REMAIN IN THE U.K. AS (A) DAF MANUFACTURES ITS LARGE COMPETITIVE TRUCKS IN HOLLAND, WHICH DAF WILL EMPHASIZE, (B) DAF WILL MANUFACTURE ENGINES AND AXLES IN HOLLAND. ALL OF THE FOREGOING WE OR OUR SUPPLIERS WOULD MANUFACTURE IN THE U.K. WE SUCCESSFULLY HAVE TURNED AROUND FODEN TRUCKS WHICH WAS IN RECEIVORSHIP IN 1980, THUS PRESERVING COUNTLESS JOBS. THROUGH PACCAR'S DISTRIBUTION SYSTEM IN CANADA AND THE UNITED STATES WE ARE OPTIMISTIC THAT SMALLER LEYLAND TRUCKS CAN BE SOLD IN NORTH AMERICA, THUS CREATING ADDITIONAL JOBS FOR LEYLAND AND RELATED SUPPLIERS.

I HAVE DISPATCHED JOSEPH DUNN, PRESIDENT OF PACCAR TO LONDON WITH ADDITIONAL INFORMATION AND CLARIFICATION FOR YOUR DESIGNEE THE AFTERNOON OF FEBRUARY 19.

I HOPE THE FOREGOING EMPLOYMENT SITUATION PLUS OTHER MONETARY CONSIDERATIONS WILL PROVE PERSUASIVE.

RESPECTFULLY,

CHARLES M. PIGOTT
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
PACCAR INC

PACCAR BVUE C

27582 CABOFF G....REPLY TO) UB 3794037

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10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

18 February 1987

Dear Mr. Walker,

EUROPEAN COMMISSION ASPECTS OF THE DISPOSAL OF LEYLAND BUS AND TRUCK

The Prime Minister this morning discussed with your Secretary of State, the Foreign Secretary and the Chancellor of the Exchequer the task of getting Commission agreement to the aid necessary for Rover Group to carry through the disposal of Bus and Truck Division. Mr. Brian Unwin (Cabinet Office) and Mr. George Guise (No. 10 Policy Unit) were also present. The meeting had before it David Williamson's minute to your Secretary of State of 17 February.

It was agreed that it was vital for the debt to be written off in this financial year. The clear objective should be to achieve Commission agreement from the Commission by Budget day on 17 March. The timetable set out in paragraph 6 of the attachment to David Williamson's minute to Mr. Channon of 17 February was too slow for this purpose. It should be made clear in writing to the Commission that 17 March was our objective. Your Secretary of State agreed to make this point to Commissioner Sutherland at their meeting tomorrow. The Foreign Secretary would lobby Commissioners at his weekend meeting. The Prime Minister would probably wish to write to Delors early next week.

I am copying this letter to the Private Secretaries to all those present and to Mr. Brian Unwin (Cabinet Office).

Yours sincerely,
Lillian Ontrel-Rhodes
p.p. DAVID NORGROVE

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

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file X626

cc GG Guise

10 DOWNING STREET

LONDON SW1A 2AA

18 February 1987

From the Private Secretary

Dear N. Walker,

ROVER GROUP

The Prime Minister this morning held a meeting to discuss the Rover Group on the basis of the two papers circulated with your letter to me of 17 February. There were present your Secretary of State, the Lord President, Chancellor of the Exchequer, Foreign and Commonwealth Secretary, Secretary of State for the Environment, Chancellor of the Duchy of Lancaster, Mr. Giles Shaw (Minister of State, Department of Trade and Industry), Mr. Brian Unwin (Cabinet Office) and Mr. George Guise (No. 10 Policy Unit).

Your Secretary of State said the Rover Group Board was certain to recommend that the DAF bid for Leyland Trucks and Freight Rover should be accepted in preference to the bid from PACCAR for Leyland Trucks alone. The DAF bid was preferable financially in part because under the PACCAR bid the Rover Group would be liable without limit for re-structuring and redundancies for at least nine months. The industrial and employment consequences of the two bids were complicated. There was not much difference between them in terms of the effect on employment at Leyland Trucks itself. But DAF would be better for component suppliers for light trucks whereas PACCAR would be better for component suppliers for heavy trucks. The Cummins plant at Shotts in Lanarkshire would be more vulnerable under the DAF bid than under the PACCAR bid, but the prospects for Albion Axles, also in Scotland, would be better. The DAF bid would be good news for Freight Rover. Mr. Channon concluded that the long-term future of the businesses would be more secure with DAF than with PACCAR and his clear recommendation was in favour of accepting the DAF approach.

After a brief discussion, the Group agreed that this recommendation should go forward to E(A).

In discussion of the Corporate Plan the difficulty of second-guessing the company was recognised. There were clearly substantial risks in the Plan. But it seemed at present to offer the best route towards a more secure position for the company.

The meeting recognised that the decision not to go ahead at this stage with AR 6 would be seen by some as an indication that RG was planning to pull out of the small car market. The Government would need to point out that small cars would remain a substantial proportion of the company's output into the 1990s. AR 6 had been postponed, not cancelled. The Metro was to have a new engine and a new body to extend its life and increase its sales. Whether and when it would be replaced by a new model would depend on the performance and prospects of the Metro and of the Company more generally.

The Prime Minister invited your Secretary of State to circulate papers to E(A) today about the Corporate Plan and Leyland Trucks. The paper on the Corporate Plan should discuss the small car sector (so far as any discussion was necessary) in the way described above.

The meeting then considered the draft Parliamentary statement, attached to your paper, on the Corporate Plan. The statement, as re-drafted, should be circulated to E(A). (Amendments were as set out in the note attached.) It was further agreed that the statement should be made at 1530 in order to allow Leyland workers to be told of the plans before they left work. For this purpose, Business Questions would be converted into a Business Statement.

In this part of the meeting, Mr. Channon noted finally that it might be necessary to suspend RG's shares to avoid speculative movements in the share price in the run-up to the statement. The Prime Minister said this should be for his discretion.

I am recording separately a discussion of European Commission aspects of aid for Rover Group.

After others had left, the Prime Minister discussed with your Secretary of State, the Chancellor of the Exchequer and the Foreign and Commonwealth Secretary the scheme of arrangement proposed by the Rover Group Board. Whilst those present saw the advantages of this proposal and agreed that it might well be worth pursuing at some stage, it was felt that this would be difficult to pursue now both because it would seem as though the Government was attempting to be able more easily to conceal information about the affairs of the Group and because the scheme might well not succeed.

I am copying this letter to the Private Secretaries to all those present, and Mr. Unwin (Cabinet Office).

Yours sincerely
Lillian Cotter-Rhodes (Mrs.)
P.P. DAVID NORGROVE

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

AMENDMENTS TO DRAFT PARLIAMENTARY STATEMENT

The first sentence of paragraph 3 should be amended in the way proposed by the Treasury in Alex Allan's letter to you of 17 February.

Paragraph 4 to begin: "The Corporate Plan provides that the new K series engine ....."

Paragraph 5, sentence in square brackets to be omitted.

The second and third sentences of paragraph 8 to be taken in the reverse order.

The first sentence of paragraph 9 to be re-drafted along the lines: "The Government sees no alternative to these decisions and very much regrets the need for these job losses". Second sentence amended to read: "..... the new venture is to have a good chance of success."

Final sentence of paragraph 10 to be amended to read along the lines: "I am today laying an Order under the Industry Act 1980 to make this possible".

In paragraph 11, third sentence: quote the market share from the beginning of the year rather than for the first 10 days of February.

Rover Group Market Share

1985 Average - 17.72 %
1986 Average - 15.58 %

1984 Average 17.66%
(all these % are excl Range Rover)

1986 in months: -

Jan	18.41%
Feb	15.79%
Mar	16.49%
Apr	16.34%
May	15.85%
June	14.74%
July	15.77%
Aug	15.73 %
Sept	14.58%
Oct	14.08%
Nov	12.76%
Dec	14.40%

average 13.96%

DTI say drop towards end of 1986 because (a) end of Lucas strike meant availability of some models was limited; and (b) AR were doing little on dealer support and special marketing - towards end of year marketing push on Rover 2000, followed by push on Mini over Christmas, and now on the Montego.

Market Share in January 1987 - 16.85%
first 10 days of February 1987 - 19.85%

Source: Peter Bunn, DTI, 212 0198

Brian

Here you are.

Dens 18/2

SECRET

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PRIME MINISTER

E(A)(87)2nd Meeting
Rover Group

DECISIONS

The Secretary of State for Trade & Industry will circulate a note this evening covering his recommendations on the future of Leyland Trucks and Freight Rover, and the new Rover Group Corporate Plan, together with a draft statement to be made in the House at 3.30 pm tomorrow covering both these issues. You will want the Sub Committee:-

(i) to decide whether to accept the Rover Group Board's recommendation for a merger of Leyland Trucks and Freight Rover with DAF;

(ii) to decide whether to approve the new Rover Group Corporate Plan (subject to the usual Board and HMG authorisations on major investment projects);

(iii) to authorise the proposed statement in the House tomorrow afternoon announcing both the above decisions.

BACKGROUND AND MAIN ISSUES

2. You are familiar with the background and I will not rehearse it in detail in this note. Some key points worth bearing in mind, however, are:-

(i) Leyland Trucks: the preference for DAF over PACCAR is the Rover Group Board's own choice. The two deals are broadly the same financially (though DAF may have a slight edge) and also, in respect of Leyland Trucks alone, job neutral. Both involve some 3,300 redundancies, including closure of Scammell at Watford (700 jobs) and (by end 1988) Leyland Foundry (260 jobs). But PACCAR claim that, taking components into consideration, the DAF deal will cost 5,000 more jobs. This is in part due to the closure of Cummins (800 jobs at Shotts in Lanarkshire, and 200 jobs at Darlington) and Perkins at Shrewsbury (400 jobs). Thus the DAF deal could be bad for Glasgow (especially on top of Govan, if it goes, and Caterpillar). But on the other hand:-

- 500 jobs or more should be preserved at Albion in Glasgow under DAF;

- the PACCAR deal is still pretty uncertain and could involve lengthy delay;

- Freight Rover is assured under DAF;

- the DAF deal will be more acceptable to the Commission.

If PACCAR themselves go on to the offensive, the Government could be pressed very hard on the job implications. But the arguments above in favour of DAF form a powerful case.

(ii) Corporate Plan: On any reckoning the outlook is extremely fragile. The Company is expected to record overall losses throughout 1987-91, and is cash negative in every year except 1989. Although the Group will continue to rely heavily on the Varley Marshall assurances, they are not actually asking for additional cash for the cars operation. But this depends crucially on achieving the assumed market share of 14.5 per cent (compared with under 14 per cent for the last 4 months of 1986, although there has been improvement since). However, the plan is essentially a holding

holding

??

operation, which effectively postpones the really tough decisions (eg such as whether finally to pull out of the small car range) until later. The only realistic alternative is closure. If, therefore, the business is to be kept going, there seems no alternative to accepting at least for now the personal strategy of the man the Government have put in, Mr Graham Day. The DTI are certainly not in a position to second guess, and the sooner their endorsement of Mr Day's proposals is given, the better;

(iii) Parliamentary Statement: the statement incorporates the drafting suggestions made by you and other colleagues in earlier discussion. It seeks to strike a delicate balance between coming clean on the bad news (the unavoidable redundancies) and displaying the Government's support for the new Corporate Plan. The Secretary of State may well be questioned on the absence of any specific indication of future policy on small cars. If pressed, he will need to emphasise the decision to give the Metro a new engine and new body, which should see it through the period of the plan, while making it clear that no final decisions have been taken on the Group's future at the small car end.

European Commission Clearance

3. Although colleagues will need to be aware of the problems here, you will not want to be drawn into any discussion of the details or tactics. You have made it clear that the trucks deal must go ahead whether or not the Commission approve; and the matter must if at all possible be settled in time for the Budget. The next step will be for Sir Geoffrey Howe to raise the matter with M Delors and other Commissioners in Brussels on Sunday and Monday. It will then be possible, in the light of his report, to decide whether Mr Channon should go ahead with his proposed further discussions with Mr Sutherland in Brussels next Thursday; or whether you should intervene directly then yourself. But this will be a matter for consideration between you, Mr Channon, and the other Ministers most directly concerned early next week. In

the meantime, the statement will simply make it clear that normal consultation with the Commission about the proposed £750 million write-off is taking place.

NEXT STEPS

4. You will want to invite Mr Channon to report the outcome of the discussion to Cabinet under Parliamentary Affairs. You may also want to stress the importance of complete confidentiality, not least for market reasons, until Mr Channon has made his statement.

Handling

5. You will wish to invite the Secretary of State for Trade and Industry to introduce his paper and the Chancellor of the Exchequer, on the financial aspects, and other Ministers more generally to comment. The Secretary of State for Social Services has been invited specially to the meeting, and you will wish to know whether he has any comments.

J B UNWIN

Cabinet Office
18 February 1987

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PRIME MINISTER

Cabinet: Rover Group and Leyland Trucks

You will wish to invite the Secretary of State for Trade and Industry to report to Cabinet the outcome of the E(A) discussion earlier this morning. You will want Cabinet to endorse the proposals for:

i. the new Rover Group Corporate Plan;

ii. the merger of Leyland Trucks and Freight Rover with DAF;

and iii. a statement to the House at 3.30 pm tomorrow announcing the two decisions above.

You will have the briefing in Mr Unwin's separate minute for E(A) of today's date.

RCA

ROBERT ARMSTRONG

18 February 1987

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Prime Minister 23
CC RUP

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COMMERCIAL IN CONFIDENCE

cc George
Guise &
return.

Qz.05646

SECRETARY OF STATE FOR TRADE AND INDUSTRY

Rover Group

In accordance with your minute of 10 February to the Prime Minister, a small group of officials under my chairmanship has looked at ways of getting Commission agreement to the aid necessary for Rover Group to carry through the disposal of Bus and Truck Division. The report is attached.

We took as fixed points for our consideration:

(i) that the aid is to be paid by 31 March 1987; and

(ii) that we have to get Commission agreement by that date.

We identified two ways of achieving this, the current strategy and, as instructed, a fall back option. These are:

(i) the current strategy is to push the Commission over and to have available for this purpose the negotiating margin in the present figures. This margin (the unallocated reserve) is now assessed at about £80 million. This margin should only be used - in whole or in part - if it will clinch a positive recommendation from Mr Sutherland. We take the view that, if Mr Sutherland were to make a positive recommendation to the Commission within his responsibility for state aids and competition, it should be possible to generate significant support from non-British (Vice-President Andriessen and, possibly, Commissioner de Clercq) as well as, of course, from British Commissioners and to neutralise much of the potential opposition. Your Department is continuing to provide to Commission officials the information necessary

for this strategy while keeping right off the question of Government guarantees (Varley/Marshall/Joseph);

(ii) the preferred fall-back option is to give some of the aid - in my view the smallest negotiable part - in the form of a Government loan at commercial interest rates which could be converted into equity. If all or part of the conversion into equity was linked to the completion of the restructuring already in the plan, this would not change the basic commercial deal but it would ensure that the limited restructuring was carried through and could have considerable attractions for the Commission.

The play-off between courses (i) and (ii) is important. As course (ii) would be slightly less favourable to Rover Group (interest on the loan until converted into equity) it would be advantageous not to have disclosed our margin for manoeuvre under (i) if we think that we may need to go on to (ii).

We looked at other options and rejected them but have referred to them in the paper.

I consider that we simply have to get Commission agreement by end March and that this is achievable, although hard. If we did not, there would be a very difficult situation not only because of the legal objections to paying a state aid without authorisation but, equally importantly, because of the commercial effect on Rover Group: first, because the Directors might not in these circumstances go forward with the acceptance of the aid and the allotment of shares and, secondly, because if the scheme went forward and the Commission demanded that money should be repaid there would be a crisis of confidence in the slimmed down Rover Group. We must not allow this to happen. Nor will it happen if we play our cards right with the Commission in the next few weeks.

SECRET
COMMERCIAL IN CONFIDENCE

I am sending copies to the Prime Minister, the Foreign and Commonwealth Secretary and the Chancellor of the Exchequer.

D F Williamson

D F WILLIAMSON

17 February 1987

SECRET
COMMERCIAL IN CONFIDENCE

ROVER GROUP: CLEARANCE OF STATE AID WITH THE EUROPEAN COMMISSION

Note by Officials

This paper:

- sets out the objectives of and the position reached in our efforts to secure the Commission's authorisation of aid to the Rover Group (RG)

- outlines our present strategy and assesses the difficulties and ways of minimising them

- identifies a recommended fall-back option, for use if necessary, and explains why other courses of action have been rejected.

Policy Objectives

2. Our broad policy objectives in relation to RG of relevance to Community issues are:

i. to ensure the lowest possible equity injection consistent with the disposal of RG's Bus and Truck Division and with RG being able to trade through next year without further recourse to the Government;

ii. to minimise the size and timescale of RG's continuing financial involvement in the manufacture of Trucks;

iii. to ensure that the injection of Government funds (in whatever form) is made by 31 March 1987 come what may; and

iv. to secure Commission authorisation by 31 March and to pay by that date the aid that the Government wishes to pay.

Commission views so far

3. On 12 February the Secretary of State for Trade and Industry had a short meeting with Commissioner Sutherland. It is clear from this that the Commission is likely to authorise aid in relation to Bus, but that there will be difficulty over Truck. The Commissioner recognised the political sensitivities of the prospective Trucks deal; the practical difficulties of providing the Commission with full information; the need for urgency in giving the Commission's authorisation; and expressed his own favourable disposition to a European rationalisation plan. Commissioner Sutherland had not yet, himself, considered fully the detail of our notification. He said that he would hold an early meeting with his officials and would advise us if there were potentially serious difficulties.

4. Despite our detailed formal notification (8 December), a confidential side letter to DG IV (23 January) and detailed oral briefing by officials, Commission officials have pressed for further information. A good proportion of this will be given in the next few days and most of the rest will be provided when the Truck deal is signed and its rationalisation plans and costs assessed. Commission officials consider the amount sought for Truck far too large in relation to the degree of restructuring proposed. Given the extent of European Truck overcapacity they have tended to disregard our considerable past restructuring effort. They are pressing for RG and/or the new merged company to bear at least some (unquantified) debt, thereby reducing the level of aid necessary; and to this end are seeking further information on, inter alia, the extent of Government guarantees to the Rover Group. (In responding to this request it will be essential that we avoid the Commission calling into question the Varley-Marshall-Joseph assurances that the Government will ensure that the obligations of RG will be met.) The Commission would, of course, also accept further capacity reduction or firm, preferably written, undertakings to carry out such restructuring within a specified timescale.

5. Annex A sets out an analysis of the position on the amount of aid needed in respect of both Bus and Truck. The "unallocated reserve" - currently assessed at about £80 million - is the negotiating cushion we have deliberately built into our notification.

Timing

6. The probable timing of key events is:

Table 1

19 February	Parliamentary Statement
End February (unless extended)	Deadline for comments from other member states and interested parties
27/28 February [provisional]	Further meeting between Secretary of State for Trade and Industry and Commissioner Sutherland
First two weeks in March	Recommendation from Commissioner Sutherland to full Commission
First 10 days of March	We should maximise support from United Kingdom and other members of the Commission (eg Dutch and Belgian members).
	An intervention by the Prime Minister with M Delors may be recommended.
Mid-March	Formal consideration by full Commission (two meetings may be needed)

Our Present Strategy

7. Our present strategy is to push the Commission into agreeing the aid package without any further conditions, subject to possible reduction of the package by the negotiating margin ("the unallocated reserve") if this would get agreement. To meet the key objectives a substantive exchange at Ministerial level with Commissioner Sutherland in late February will probably be necessary. Despite Commissioner Sutherland's own initial scepticism (which we believe to be based on official advice) such a meeting will help us to get across the key points before he firms up his recommendation to the full Commission. At this meeting the Secretary of State for Trade and Industry would deploy the powerful arguments on political sensitivities; emphasise our timing constraints; highlight the fact that a significant proportion of the aid covers past and future restructuring; and underline our past restructuring efforts. The Secretary of State for Trade and Industry would also be more precise about the consequential restructuring. The key aim will be to ensure that Commissioner Sutherland argues forcefully at the meetings of the full Commission for an outcome which is satisfactory to us. In order to achieve this it may be necessary to offer at that stage to reduce the amount of aid by all or part of the amount contained in the unallocated reserve (ie by the amount of the negotiating cushion we have built into our notification).

8. After the Parliamentary statement (19 February) the Cabinets of the British Commissioners will be briefed and contact made with the Netherlands authorities to enlist their help, and through them, that of vice President Andriessen. To maximise our chances of winning Commission support it will also be important to win over at least one other senior Commissioner such as M de Clercq, and to ensure that others (such as M Delors and M Cheysson) are at least neutral. We shall consider

Ministerial and senior official approaches to key Commission figures during March. (It may also be necessary to consider whether pressure can be brought on the Commission by action in other areas of Community policy.)

The Preferred Fall-Back Option

9. As instructed, we have examined possible fall-back options, should the Commission seek changes in the proposed aid as a condition for its authorisation. We have identified a preferred option for use if, and only if, our present direct strategy seemed likely to be unsuccessful. It has been drawn up on these assumptions:

i. that the aid sought should not be reduced below the total needed to write-off the outstanding debt and meet the anticipated restructuring costs associated with the Bus and Truck deals;

ii. that the Government will not force RG to rationalise more than they would wish to do in accordance with normal commercial considerations;

iii. that the aid must be paid before 31 March 1987;

iv. that, for the reasons considered in paragraphs 14-16 below, payment of the aid should be made after Commission authorisation.

10. The preferred fall-back consists essentially of two elements:

a. maximise the amount of equity which the Commission will authorise before 31 March;

b. for the balance, seek the Commission's authorisation for a Government loan to RG at commercial rates. Conditions, cosmetic or real, would be attached to this.

11. Both elements require Commission authorisation. (A Government loan in these circumstances even at commercial interest rates would be an aid, since a commercial lender would not be willing to lend at those rates.) A loan at commercial interest would help make the package more saleable in Brussels. It would be less attractive to RG than a straight equity injection of the full amount, since in our view the interest would have to be paid by RG until the loan was liquidated. Conditions which one might offer to attach to the loan include:

i. conversion to equity linked to the total true restructuring costs on the Trucks deal (likely to be about £130 million, though we have given the Commission a higher figure). The loan would be converted into equity as specific restructuring costs up to £130 million were incurred. Since this restructuring is clearly provided for in the plan (Annex A) this would not be a new burden, but would help to ensure that the plan was actually carried out and would respond more specifically to the Commission's emphasis on restructuring;

ii. the loan could be linked to RG's expected proceeds (about £90 million) from the flotation of the new company in 1989, ie these proceeds would be used to pay off part of the loan. This has obvious attractions but we consider that by depriving the slimmed down RG of these proceeds, even greater problems in the future finances of RG might be created.

Other variants of a presentational kind could also be examined.

12. Further consideration is being given to this possible fall-back position. It is clear that the balance between loan and equity will be critical. RG itself would, of course, prefer the full equity injection with Commission authorisation, but they may be prepared to recognise the difficulties and not to rule out some element of loan (convertible into equity) if this were absolutely necessary. RG may prefer this fall-back to be an alternative and not an addition to accepting any reduction in the total aid sought.

13. We also examined and rejected a number of other options as undesirable or impractical:

Option 1: Leave some debt with the new company, thereby reducing the aid required

This was rejected because the contractual terms have already been virtually agreed between RG and DAF. In any case DAF would never have accepted such a requirement.

Option 2: Leave some of the debt with RG again cutting the level of aid needed

This is a variant of element (b) of the preferred fall-back but is less satisfactory. Its principal disadvantage is that it leaves, without term, a servicing cost to be borne on a declining revenue base. It would also make more difficult any future discussions with the Commission on the future of ARG.

Option 3: Give (perhaps oral) undertakings to the Commission about additional future restructuring

Although it would be possible to be more specific about the proposed restructuring once a deal is concluded, it would be highly risky to offer some covert undertaking about additional restructuring in the new private sector

truck company. It would fly in the face of public statements by DAF and by the Government about future job prospects. Any notion of offering oral undertakings about future restructuring in RG is also not recommended. Such an offer would absorb the (limited) negotiating capital we have for future discussions with the Commission on the rump of RG.

14. The Commission are likely to seek changes in the planned aid rather than to reject the notification altogether. The fall-back outlined in paragraph 10 is designed to be used if necessary to secure authorisation by 31 March. We have, however, also considered the worst case scenario, Commission rejection or failure to authorise the aid before 31 March. We considered the consequences of paying the aid without authorisation. These would be serious both legally and commercially. The legal position is clear (Annex B). Aid paid before completion of the Article 93.2 procedure or after an unfavourable final decision from the Commission would be unlawful. The Commission could be expected to order repayment of the aid or some part of it. If we were to ignore this order (likely, under Article 93.2, to come within weeks) the Commission would take us to the European Court of Justice. The Court could take at least a year to reach its judgement, but would be unlikely during that period to suspend the Commission's order to repay. The expectation is that the Court's judgement would require us to recover at least some of the aid. With this in prospect the Accounting Officer would be likely to require Ministerial instructions on the payment of unauthorised aid and would be guided by legal advice on whether such instructions should be followed.

15. The effect on RG of aid subject to legal challenge must also be considered. RG's Directors would be bound to take

legal advice on this point, but it seems clear that an allotment by them of shares in return for aid unlawfully given would itself be unlawful, and would amount to a breach of their fiduciary duties to the company and constitute a void transaction. Advised in this sense the Directors would no doubt decline to accept the payment and would hence not make the allotment.

16. A Commission order for repayment, which could be made within weeks, and the subsequent initiation of an ECJ case if we did not repay, would provoke a crisis of confidence amongst RG's bankers and their customers. The future of RG itself would be in question. The opening of hostilities with the Commission could also bring the Varley-Marshall-Joseph assurances into focus and induce the Commission to challenge them formally under the state aids regime. These assurances are the prop on which the banks have in the past and will in the future rely to justify lending to RG. Their removal too would call the future of RG into question.

Cabinet Office
17 February 1987

ANNEX A

ROVER GROUP: THE STATE AID APPLICATION - "TRUE" FIGURES

BUS	£m	£m
Restructuring costs from actions carried out before 1987	21.8	
Estimated cost of Eastern Coach Works closure	5.0	
Estimated cost of other redundancy and restructuring costs	15.0	
Balance sheet adjustments	15.0	
Historic debt not arising from restructuring	76.3	
	133.1	
Unallocated reserve	11.9	
TOTAL Bus		145.0
TRUCKS AND PARTS		
Restructuring costs from actions carried out before 1987	68.1	
Estimated cost of Engines, Foundry and Scammell closure	8.0	
Costs of retaining plants until closure	23.0	
Costs of retaining staff until they are made redundant	8.0	
Estimated redundancy costs	64.0	
Historic debt at 31.12.86 not arising from restructuring	302.9	
Operating loss of Trucks Q1 1987	25.0	
Cost to RG of integrating DAF and Leyland Trucks	32.0	
	531.0	
Unallocated reserve*	69.0	
TOTAL Trucks and Parts		600.0
GRAND TOTAL		745.0

* Charges to this reserve include any debt write off for the international operations and any indemnity given by Rover Group to DAF.

ANNEX B

Payment of aid without authorisation: legal implications

1. A cash payment of aid before EC approval under Article 93.3 of the EEC Treaty (part of the state aids regime), or in defiance of a final decision not to approve the aid, would be unlawful both under EC and UK law. The Commission would in all probability take action to order HMG to recover the aid, or a part of it, within weeks of the unlawful payment. If HMG refused to take steps to comply with this order, the Commission would be likely to refer the matter to the European Court of Justice. The Court could take at least a year to give its final judgement, but in the exceptional circumstances of this case there would be pressure to complete the process more quickly. The Court would be unlikely to suspend the operation of the Commission's order pending its judgement.

2. The consequences of an unlawful payment are governed by UK law. The unauthorised payment plus the allotment of shares in return add up to a contract illegal at its inception, which in UK law makes it void, viz a complete nullity. Furthermore the shares allotted would not be validly issued and the Secretary of State would have no good title to the resulting "capital", which would not form part of the actual authorised issued share capital of RG. In these circumstances the Secretary of State would be under a legal obligation to take steps to recover this aid.

3. By the time an EC order was issued, the money given by way of aid would have disappeared into the commercial banks, in repayment of existing borrowings. The question then arises of whether the money is traceable through RG to the banks. As a matter of general principle, the banks would be entitled to assume that all EC requirements had been met in relation to the payment to RG out of which the borrowings had been discharged. But in practice, as a result of the debt negotiations and public

statements the banks would be likely to be on notice of non-compliance with EC requirements, so that they would not be able to rely on the presumption that the original payment was lawful.

4. If the banks were required to repay, they would look to RG to discharge the outstanding debt and the likely consequence of this would be the liquidation of RG. But this is academic because (even if the banks successfully claimed they could keep the money) RG would not have the funds to repay, and liquidation would then also be likely to follow.

5. An allotment by the Directors in these circumstances - in which they knew that the consideration paid for the shares was an unlawful aid - would be misfeasance by them, a breach of their fiduciary duties (challengeable by the minority shareholders) and an unlawful exercise by them of a lawful authority (obtained by Resolution in EGM) to allot shares, giving rise (as stated above) to a void transaction. (In circumstances where HMG did not know what was going on it could certainly be grounds for an inquiry under Section 432 of the Companies Act 1985.)

6. The Directors would be bound to take their own legal advice on the position if they made an allotment in these circumstances. On this advice, it is very unlikely that they would be prepared to make the allotment (eg personal liability of Directors could be engaged) and the question of payment by the Secretary of State would then not arise.

7. In that case, exposure still exists under the Varley-Marshall-Joseph assurances. The Commission knows of these assurances, but bringing them into focus in this way might induce the Commission to challenge them formally under the State aids regime, particularly if the contingent liability represented by them turned into a payment of money in order to avoid a liquidation.

22

PRIME MINISTER

ROVER GROUP

This is a meeting of the "small" group to prepare for E(A) on Thursday, which would be followed by Cabinet and then Mr. Channon's statement. The papers, which are less formidable than they may seem at first sight, are as follows:

(A) Paper on the corporate plan to which is attached a revised draft statement.

(B) Paper on Leyland Trucks and Freight Rover.

(C) Paper by David Williamson on European Community considerations.

(D) Letter from Mr. Channon about the Rover Group proposal to buy out the minority shareholding and possibly de-list the company.

(E) Letter from the Chancellor about the draft statement.

(F) Letter from the Chancellor about the proposed de-listing.

I suggest you arrange the meeting like Haydn's Farewell Symphony. David Williamson's paper has gone only to the Chancellor of the Exchequer and the Foreign Secretary. You might invite the Foreign Secretary to stay on for a discussion of this at the end of the main discussion. He can then leave and you could discuss the proposal to buy out the minority shareholders with just the Chancellor and Mr. Channon.

Decisions needed in the various parts of the meeting are as follows:

(i) whether the proposed corporate plan is acceptable;

(ii) how much should be said in the paper for E(A) and in

particular how far the possibility of a withdrawal from the small car sector in the mid-90s should be displayed;

(iii) whether the draft Parliamentary statement is acceptable;

(iv) whether the proposed deal with DAF on Leyland Trucks and Freight Rover is acceptable;

(v) whether the two papers for E(A) (on the corporate plan and Leyland Trucks) should be circulated tomorrow or handed round at the meeting on Thursday morning;

and then when the majority of Ministers have left:

(vi) whether David Williamson's proposals for handling the European Commission are acceptable;

(vii) whether the RG proposal for buying out the minority shareholders should be accepted.

Corporate plan

This is very familiar territory following your meeting with Graham Day, and I doubt that people at your meeting tomorrow will disagree with the conclusions.

It may however be a different matter with one or two of the people who will be at E(A) on Thursday. There is also a risk that commercially sensitive information will leak from E(A), however highly classified the paper.

I would offer two suggestions:

(i) the paper ought to make it quite clear just how dire the position at Rover Group has been and still is, giving figures for losses over a run of years, of

broken promises in successive corporate plans and of the declining market share; the paper circulated to the small group and the draft statement give an upbeat flavour with some optimism, and Mr. Walker and Mr. Fowler might question on this basis why the Metro replacement is being dropped;

(ii) does the paper have to mention the possibility of withdrawal from the small car sector in the mid-90s; this could cause alarm and it would be extremely damaging to the company and to sales if it leaked?

To circulate the paper at the meeting itself could increase the difficulties with Mr. Walker and perhaps Mr. Fowler, who might feel they were being bounced on an important and complicated issue.

Leyland Trucks

This too is familiar territory. The only new factor is Mr. Channon's report that the Rover Group Board's recommendation will be strongly in favour of the proposed deal with DAF.

You might want to ask how Mr. Channon has got on with Mr. Rifkind: the paper says it would be premature to conclude that the closure of the Cummins plant in Lanarkshire is inevitable.

European Commission

The paper by David Williamson is in some ways disturbing. The consequences of not reaching agreement with the Commission look awful (paragraphs 14 and 15 of the paper by the Cabinet Office): first, the accounting officer would be likely to require Ministerial instructions on the payment of unauthorised aid and there is a hint that he might refuse to follow the instructions; secondly, the directors of Rover Group would refuse to take the actions necessary to write off

the debt because to do so would be unlawful and a breach of their fiduciary duties. (David Williamson's covering note is more tentative in this respect than the paper.)

David believes that Commission agreement by the end of March is achievable, although hard. The Cabinet Office have developed a fall back option under which some of the aid would be given in the form of a Government loan at commercial interest rates which could be converted into equity.

I have discussed with David Williamson a further fall back option (dismissed in the paper) under which some part of the Leyland Trucks debt would remain with Rover Group. David agrees that this might in the final resort be a possibility, though it would of course complicate the future of Rover Group itself.

Purchase of private shares

Mr. Channon is now inclined to agreed with Graham Day that the Government should seek if possible to buy out the remaining private shareholders. Whether the company would be de-listed would depend on the response to RG's offer.

Mr. Channon's Private Secretary tells me he fully expects this to be turned down both on grounds of the cost (£12 million) and because of the political difficulties. The Chancellor has now written opposing the proposal.

Amanda Ross
Duty Clerk
pp DAVID NORGROVE
17 February 1987

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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.

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- 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

copy no. 1 of 4

cc CO/LP

cc PG

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PRIME MINISTER

ROVER GROUP : EC CONSIDERATIONS

David Williamson has now reported to me the conclusions of the inter-Departmental Group he chaired at my request.

2 I agree with these conclusions. They point clearly to the need for us to maintain the strongest pressure on Commissioner Sutherland to ensure that the Commission authorizes the aid we need by 31 March. How we play our negotiating hand will, of course, depend on the way my discussions with Sutherland develop but further work needs to be carried out by officials to explore in detail the best way of presenting our preferred options.

3 I shall keep you and colleagues in touch with developments.

4 Copies of this minute go to Nigel Lawson and to Geoffrey Howe.

P.C.

PAUL CHANNON
17 February 1987

DEPARTMENT OF TRADE AND INDUSTRY

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

17 February 1987

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

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

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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

Alec Allan

pp NIGEL LAWSON

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

A copy no 1 of 9 18

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PS/ *Secretary of State for Trade and Industry*

SECRET

17 February 1987

David Norgrove
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 2AA

Dear David

ROVER GROUP

I attach two papers by my Secretary of State, dealing with the Rover Group Corporate Plan, and Leyland Trucks and Freight Rover, for discussion at the Prime Minister's meeting at 11.30 tomorrow morning.

I am copying this letter and attachment to Joan MacNaughton (Lord President's Office), Alex Allan (Treasury), Lyn Parker (FCO), Andrew Lansley (Chancellor of the Duchy's Office), Brian Leonard (DOE), Murdo Maclean (Chief Whip's Office), and Brian Unwin (Cabinet Office).

Yours

TIMOTHY WALKER
Private Secretary

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ROVER GROUP: 1987 CORPORATE PLAN

Introduction

1 The Rover Group 1987 Corporate Plan sets out the group's business strategy and projects financial performance over the next five years (1987-91). The Plan builds on the operational review commissioned by Mr Graham Day, the Chairman and Chief Executive of Rover Group, during 1986 and carried out by independent professional advisers. This review also met the Government's own wish for a fundamental re-examination of the Group's strategy in the light of the disappointing commercial performance in 1986. I believe it is very much in our (and the company's) interests to make an early announcement of our response to the Corporate Plan at the same time as the announcement on the future of Leyland Trucks. In doing I will of course need to highlight the positive elements and head off Opposition attacks that this is a holding operation prior to a post-Election re-examination.

2 The Plan will be reviewed annually to cover a rolling period of 5 years ahead. In addition any investment programme over £25m will require specific Government approval in the usual way. The Plan very much keeps open options for product development in the latter years. But already it represents a significant change of direction for Austin Rover:-

a) a more realistic market share forecast of 14.5% throughout the Plan period - comfortably exceeded in the admittedly short period so far this year;

b) a holding strategy in small cars which should sustain short term volumes but keep open the possibility of a withdrawal from the sector in the mid-nineties;

c) development of the relationship with Honda in the medium and executive sectors with new derivatives of the Rover 800 and a new jointly designed Maestro/Rover 200 replacement codenamed AR8;

d) dropping of two in-house engine development programmes (the gaps likely to be filled by Honda) leaving the K series (small) engine as the only new engine programme.

3 I believe Day's plan offers the best chance to meet the political need for a credible strategy for Austin Rover which retains key investment programmes, and the commercial need to stabilise market share on the back of a much sharper commercial approach to the business.

4 Sales of Leyland Bus, and majority shares in Unipart and Jaguar-Rover-Australia have been completed this year. A majority stake in the information technology subsidiary, Istel, is also in process of disposal. If Leyland Trucks and Freight Rover are sold, Rover Group will then consist principally of Austin Rover and Land Rover. This note reviews the prospects for the Group as a whole and these businesses in particular. (Because of uncertainties at the time of the Plan's preparation Freight Rover was included in the Group's financial forecasts, but if the DAF deal proceeds the figures will need to be adjusted accordingly.)

Overall Financial Position

5 The Rover Group is projected to achieve a modest trading profit from 1988, but the heavy burden of interest payments on accumulated debt means the company will record overall losses throughout 1987-91. The group is cash negative in all years of the plan period except 1989 when the proceeds of the sale of Land Rover are estimated to be realised. Return on assets employed rises only to 10.5% at the end of the Plan period.

6 Colleagues will recall that this Government, like its predecessors, has given assurances that the obligations of Rover Group companies will be met (principally to the banks and trade creditors.) Our exposure under these liabilities currently totals about £2.2bn but, following the proposed equity injection to deal with the debts and restructuring costs of the Truck and Bus deals, this figure should drop to about £1.5bn and remain at around that level throughout the rest of the Plan period.

Austin Rover

7 Rover Group's objective for Austin Rover was to develop a company that can be marginally profitable in the short term and cash neutral in the medium term. The strategy seeks to move up-market towards an emphasis on medium-sized and executive cars. This is to be combined with a holding strategy on small cars, traditionally Austin Rover's greatest strength but expected to be an increasingly difficult market. This holding strategy revolves around reshaping the Metro to accommodate the new K series engine (para 9) and postponing investment in an all-new small car. The

latter (well trailed in the Press as the AR6 programme) will undoubtedly be a major source of political attack.

8 The principal element of Austin Rover's product plan is the new medium-sized car (AR8) to be launched in 1989. Austin Rover will build their version of the car and, under contract, the Honda version, at Longbridge. The AR8 follows the Rover 800, launched in 1986, in the successful history of collaboration between the two companies.

9 Austin Rover are developing a new engine, the K series, to power the reshaped Metro and the lower range AR8 models. It is to be built in 1.1 and 1.4 litre versions. I know colleagues have some reservations about this programme, but Day believes it is commercially vital. I believe it is also essential to the political presentation of the Plan.

10 The company's minimum objective is to produce (including vehicles for export) 450,000 cars per year (1986 output: 410,000) and to achieve a UK market share of 14.5%. These targets are much more modest than in previous Plans. Manufacturing capacity is to be brought into line with these more realistic forecasts. This will inevitably mean job losses, but the exact scale of these will depend on future market performance. On the conservative target of a 14.5% market share, Austin Rover's confidential projections show a reduction in UK manpower of about one quarter from the end of 1986 to the end of 1991.

11 The proposed strategy, if achieved, will generate a trading profit from 1988, rising to £75m by 1990 on sales revenue of £2990m. The heavy debt burden, however (borrowings expected to reach £600m in 1988), causes losses at the retained earnings level and continued cash outflows throughout the period of the Plan. The outflow is reduced to £(48)m in 1991, partly through reducing the capital expenditure programme of previous Plans by £300m.

12 I cannot pretend these results reflect a business which would be regarded as viable on ordinary commercial terms. Austin Rover will continue to rely heavily on the Government's assurances in order to secure adequate loan facilities to sustain the business, and is thus some way from a position where it would be floated or sold on a commercial basis. Nevertheless Day sees the the Plan as seeking to provide for a process of consolidation and improvement which, if successfully managed, could lead ultimately to a return to the private sector.

13 Rover Group have not asked for additional cash for the cars operation believing it can be funded from disposal receipts and borrowings backed by Varley Marshall. Nevertheless this rests crucially on the company meeting its market share targets. There are other substantial risks involved in this Austin Rover Plan. In particular, the company will be critically dependent on collaboration with Honda at a time when Honda will have freedom to manoeuvre, being unprepared at this stage to commit themselves beyond expressions of intent on a long term relationship. The upmarket strategy relies heavily on the AR8 programme as the only

all-new car in the Plan period, and on an increase in the real and perceived quality of Austin Rover cars. No credible Plan for the company, however, can avoid such risks; from my discussions with Mr Day I understand that the independent operational review did not identify a viable alternative.

Land Rover

14 I announced last April that Land Rover was to be retained within Rover Group and prepared for return to the private sector at a later date. The Corporate Plan assumes that Land Rover is sold or floated with effect 1 January 1989, although we can examine the prospects for an earlier disposal in the light of a review of performance at the end of 1987.

15 In the meantime Land Rover have considered how best to boost sales in the face of falling demand for traditional Land Rover products. Range Rover is shortly being launched in the USA. The major additional element of this Plan, however, is a new model (Jay) due for launch in 1989. This is intended to take Land Rover into the growing cheaper 4-wheel drive sector. This should lead to a recovery from the recent poor profits and cash outflows. PBIT is projected to rise to £41.6m by 1991, representing a return on assets exployed of 17.4%. Manpower is projected to remain at around 7,600 throughout the period of the Plan, and manufacturing will continue on the now consolidated Solihull site.

Borrowing Objective

16 Rover Group will continue to be a major potential liability to the Government, with its obligations covered by Government assurances. I believe we should therefore reimpose a confidential end-year borrowing objective on Rover Group. This should act as a control mechanism within the strategy of the Plan; the first year figure should be set at the end-1987 Plan projection of borrowings (as updated for developments since the figures were drawn up). A similar figure for end-1988 would be established now, subject to review in one year's time.

Presentation

17 I believe it is important that our broad approval of the Corporate Plan is set out at the same time as the announcement I hope to make on Trucks and Freight Rover. The attached statement emphasises RG's plans for the manufacture of AR8, the development of the K series engine and the launch of the Rover 800 (and its hatchback derivative - Rover 600) and Range Rover in the USA, which are all major opportunities for Rover Group and indeed for the British motor industry as a whole.

Recommendation

18 This Plan is Mr Day's personal strategy worked up from an independent operational review. There is still intense political speculation and commercial confidence in the company is fragile. Under these circumstances I believe it would be extremely damaging to delay in order to explore further options. I therefore

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recommend that I put a paper to EA on Thursday inviting colleagues to:-

(a) approve (subject to the usual Board and HMG authorisations on major investment projects) the Austin Rover and Land Rover plans;

(b) authorise a statement in the House that afternoon announcing approval of the Corporate Plan and the Trucks deal.

PC

PAUL CHANNON

17 February 1987

Department of Trade and Industry

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 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.

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

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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. ~~[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.

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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

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SECRET UNTIL 20 FEBRUARY 1987

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. 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 proposals which I have announced today will strengthen Rover Group and the vehicle industry in this country. 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, Rover have the opportunities and skills to succeed.

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ROVER GROUP : LEYLAND TRUCKS AND FREIGHT ROVER

Colleagues will recall that, following discussions in Misc(126) and Cabinet, I announced to the House on 2 December 1986 that Rover Group were in discussion with DAF and with Paccar about a possible disposal of Leyland Trucks and, additionally, of Freight Rover. It was also agreed that there should be an equity injection from the Government, during the current financial year, to write off residual debt and restructuring costs in RG following the disposal of Leyland Bus and any disposal of Leyland Trucks which was eventually agreed. I told the House on 15 December that I had notified the EC Commission of our intention to take that action.

2 The disposal of Leyland Bus was completed on 13 January 1987. I have now learned that RG's recommendation on Leyland Trucks and Freight Rover will be strongly in favour of the proposed deal with DAF. This note considers how we should respond to that recommendation and how any decision should be taken forward.

THE DAF PROPOSAL

3 DAF and RG have been working for some months on a detailed study of how Leyland Trucks might be merged with DAF. With the exception of certain Leyland Trucks facilities which are discussed below, DAF are willing to take the majority stake in a merged business (comprising DAF Trucks, Leyland Trucks including Leyland Parts and some African operations, and Freight Rover) with the RG

holding set at 40% corresponding to the relative value of the assets they contribute. There would be no cash consideration - Graham Day does not believe this is negotiable with DAF even as a trade-off for a lower shareholding - but RG tell me that on flotation in 2 or 3 years' time the RG stake might realise some £90m.

4. Trucks and related RG debt and restructuring costs would be borne by RG and could total about £530m. But Graham Day has given me an absolute assurance that RG could not be required to contribute to any further cash calls by the new company. This will be made explicit in an exchange of letters between RG and DAF. In spite of the continuing shareholding therefore, the Government would be effectively extricated from this severely loss-making business. Government's exposure under Varley-Marshall would obviously also be terminated.

5. The company, incorporated in the Netherlands, would have a two-tier structure with RG representation on both Boards. Flotation is planned for 1989 or 1990 on the Amsterdam and London stock exchanges, and possibly also in Brussels.

THE PACCAR PROPOSAL

6. Paccar presented their proposals to RG on 26 January. They are interested only in Trucks having looked at but declined to bid for Freight Rover. Paccar have made a cash "offer" of £105m for Trucks' assets though in their proposal Trucks' net trade creditors as well as debt would be for RG's account. Not only

would RG carry operating losses until the date of sale but Paccar also insist that RG should bear all losses on the Trucks business for at least 9 and possibly as long as 12 months after completion. To this would be added whatever restructuring and redundancies Paccar decided upon in the course of 1987. Hence RG's liability would be effectively uncapped in monetary terms and the amount of the necessary Government injection could be substantially higher than RG's present estimate of about £490m, perhaps up to £550m (Annex A). Paccar understand that their bid is less attractive to RG than the DAF proposal but have declined to improve their offer.

FINANCIAL EVALUATION

7. RG's financial analysis at Annex A indicates a small margin in favour of DAF but, given the substantial uncertainties in the calculations, I do not regard the financial analysis as conclusive in itself. Our advisers, Barings, whose figures are included at Annex A, advise against putting any great weight on the apparent financial advantage of one route over another. (Barings do however discount retention as a viable option because of the high risk of failure to achieve planned performance.) Graham Day argues that a significant distinction between the offers is that DAF has made an exhaustive examination of the businesses and the figures, jointly prepared, are therefore reasonably based. Under Paccar, important details would remain to be negotiated and RG fear that this would inevitably lead to a deterioration in the value of the offer. A deal - if available - could therefore be some months off which would increase running costs under RG ownership and further

extend the date when the open-ended commitments to Paccar would be terminated. We have seen on the Leyland Bus disposal the commercial and political difficulties of protracted negotiations following agreement in principle. I do not think we should underestimate the danger of a long negotiation with Paccar in which RG would have few negotiating cards.

INDUSTRIAL AND EMPLOYMENT CONSIDERATIONS

8. The RG Board have recommended strongly in favour of a deal with DAF based on their own financial appraisal of the alternatives, the certainty of a quick agreement on acceptable terms and, in the commercial context, a belief that Leyland's future would be more solidly based in a larger grouping with DAF than remaining as a relatively small player in the European league. My own judgement is that, while on financial grounds the arguments seem marginally in favour of DAF, industrial and related arguments for the DAF deal are compelling.

In particular:-

- Although Paccar say they will seek to develop markets in Europe and the USA, experience with Foden since 1980 does not suggest we should place too much weight on those intentions. With DAF on the other hand, Leyland would be merged into what is already a substantial European producer which should provide a solid base for continuing operations and employment in the UK;

- DAF offers a secure future for Freight Rover which, under the Paccar proposal, would remain with Rover Group who would need to fund the £100m new model investment programme;

- to opt for Paccar would probably require prolonged and expensive negotiation and continuing uncertainty for the businesses involved. There is a real risk in these circumstances that DAF would also lose interest. In a situation in which Paccar were the only bidder, I fear there is a significant risk of a very expensive or perhaps a totally unacceptable deal;

- Commission clearance (critical to complete any deal and already an uphill task) would be significantly more difficult in the case of Paccar than DAF.

9. Nonetheless, in considering these factors, colleagues will wish also to have regard to the implications for the UK vehicles and component industry as a whole. This is where press and political comment is likely to focus although we would clearly try to balance against such considerations the strong arguments for the DAF proposal.

10 Within Leyland Trucks (Annex B) <u>both</u> options involve the closure of Scammell at Watford as well as the Leyland Foundry at end-1988. Both closures would become public at the time of any announcement. In the same timescale, DAF would close the Leyland

Engine plant, a facility which Paccar claim they would keep open through a deal with Cummins Engines - though employment would still be reduced by 5-600. The Albion axle plant outside Glasgow would be purchased under both options: under Paccar, for rationalisation and later sale or possibly closure; under DAF for initial rationalisation but with reasonably good prospects for the foreseeable future. Overall, job losses within Trucks (3300) would be broadly the same under DAF and Paccar. The phasing of redundancies under the DAF proposal, peaking in 1989, is known; while Paccar's intentions are still unclear, it is pretty certain that the pace of rationalisation would be at least as quick if not more so than that proposed by DAF.

11. There may be attempts to represent the Paccar deal as much more favourable for employment in UK component companies. The position is very complex (see Annex C):

PACCAR would - maintain and develop existing Leyland product range in UK

- continue export of light trucks to Europe through DAF

- introduce new products at heavier end of range (Paccar's area of expertise)

- maintain high level of UK components (around 90%)

- source engines in UK (principally from Cummins though Perkins would also be competing for Paccar's business)

- bring cab manufacture in-house leading to probable closure of Motor Panels' plants at Coventry (550 jobs) and Wigan (130 jobs)

DAF would

- continue manufacture in UK of light trucks using British engines and components

- continue present range of medium trucks with customer choice of engines, until the early 1990s

- expect to increase the numbers of engines bought from Cummins (light and medium engines only)

- continue and possibly increase sourcing of cabs from Motor Panels

- replace heavy trucks (probably in 1988 or 1989) by DAF-designed vehicles using significant amounts of imported components, particularly engines. For right-hand drive markets, these trucks would be assembled in UK.

See Annex D (the truck range) and Annex E (component sourcing)

12. Paccar have already publicly claimed that the DAF proposals would cost 5,000 more UK jobs than would be involved in Paccar's own bid. We believe this figure would be difficult to substantiate, but our opponents are likely to seek to exploit it on the basis that we would be turning Leyland into a "screwdriver" assembly operation. DAF have gone some way towards recognising this difficulty in so far as it can be reconciled with their strategic objective of achieving economies of scale. I now believe I should be able to be fairly positive in any announcement, pointing to the greater security for Leyland itself and also for certain component suppliers such as Motor Panels. Nevertheless, if we approve the DAF deal, we must I think recognise that, while the overall growth which DAF expect for the Leyland operation will benefit a certain range of component suppliers, others will undoubtedly suffer. The two most vulnerable suppliers are Cummins Engines and Perkins Engines. Cummins would need to review the future of their plant at Shotts, Lanarkshire (800 jobs) but it would be premature to conclude that its closure is inevitable. Cummins might have to declare 200 redundancies at their Darlington plant, though DAF's latest indications on engine sourcing might reduce the level of job losses. Perkins Engines would probably need to declare 400 redundancies at Shrewsbury.

EC CONSIDERATIONS

13 Discussions with the Commission are continuing on the basis of a figure of up to £750m of equity to be paid by 31 March this year in respect of Leyland Bus (up to £145/150m) and Leyland Trucks (up to £600m). The Commission have made clear that they remain to be convinced on the Trucks case where they view the amount of aid as disproportionate to the amount of restructuring. I have taken a firm line on both timing and amount and propose to continue to do so though I have retained a small negotiating margin in the figures I have put forward.

PRESENTATION

14 Rover Group advocate an early announcement of the proposed merger with DAF which would also include detailed information on closure and redundancy plans. Their objective is to include in a single announcement the "good news" of the merger and all the "bad news" about rationalisation plans. They believe that this approach would remove uncertainty within RG and allow Leyland Trucks and Freight Rover to move forward positively. My draft statement (attached to my paper on the Corporate Plan) is intended, from the Government's point of view, to fulfil that same objective, making positive statements about the Corporate Plan and making clear our strong support for the proposed deal with DAF. My statement would also make clear that the Government is prepared to back the deal to the extent of funding the write-off of debt and restructuring costs of up to £750m, the figure we have already given to the EC Commission.

RECOMMENDATIONS

15 If colleagues agree, I will recommend in a paper to E(A) tomorrow that:

- we should accept the Rover Group Board's recommendation for a merger of Leyland Trucks and Freight Rover with DAF;

- we should announce our decision to the House immediately in a single statement bringing together the benefits of the deal with the unavoidable rationalisation costs;

- we should include in the statement our intention to write-off up to £750m of residual debt and restructuring costs by means of an early equity injection for which normal EC procedures are in train.

PAUL CHANNON

17 February 1987

Department of Trade and Industry

FINANCIAL ASSESSMENT

A. CASH COSTS/BENEFITS TO ROVER GROUP (RG's Assessment)

	DAF	PACCAR	RETENTION WITHIN RG
Trading Cashflow and costs in 1987	(160)	(259)	(130)
Cash consideration in 1987	-	105	-
Possible cash receipts in 1989/90 from flotation	90	-	-
Assumed cash values of operations retained within RG (Freight Rover)	n/a	50	100
TOTAL CASH FLOW	(70)	(104)	(30)
Net present value (discounted at 15%)	(79)	(104)	(68)
Baring's assessment of NPV figures, making adjustments particularly for lower proceeds from flotation (DAF), higher risks of losses (PACCAR and, especially Retention)	(110)	(146)	(267)

B GOVERNMENT FINANCIAL INJECTION (RG's Assessment)

	DAF	PACCAR	RETENTION WITHIN RG
Residual debt + restructuring costs	531	593	495
Less cash consideration 1987	-	105	-
FINANCIAL INJECTION FOR TRUCKS	531	488	495*
Possible adjustments to Paccar totals (suggested by Barings and officials):			
- Additional margin for risk of losses in 1987/88		50	
- Additional restructuring costs which Paccar might identify in 1987		10	
	531	544	

*The figures for the retention option are particularly open to question on trading performance where Trucks is assumed to be cash positive from 1988. An injection of this amount in 1986/87 would not provide for future losses.

LEYLAND TRUCKS PRODUCTION FACILITIES: PROSPECTS UNDER DAF, PACCAR OR RETENTION

Production Facilities	Employment at 31.12.86	OPTION 1 DAF PROPOSAL	OPTION 2 PACCAR PROPOSAL	OPTION 3 RATIONALISATION WITHIN RG
Leyland Assembly Plant Leyland, Lancs	} } }1631	Acquired	Acquired	Continues
Leyland K D (Comet) Leyland, Lancs	}	Acquired	Acquired	Continues
Leyland Engines, Farington Leyland, Lancs	842	Not acquired. RG to close by end 1988	Acquired, but possible on sale to Cummins. Longer term survival in doubt	Close in 1988
Leyland Foundry, Farington Leyland, Lancs	263	Not acquired. RG to close by end 1988	Acquired, to close by end 1987	Close in 1987
Scammell, Watford	698	Not acquired RG to close by end 1988	Not acquired [RG to close by end 1988]	Close in 1988 or earlier
Albion, Glasgow	1015	Acquired, with possibility of rationalisation in 1990s	Acquired, for possible on-sale to Eaton	Retain or sell to Eaton
Leyland Parts Chorley, Lancs St Helens, Lancs	}1268 } }	Acquired	Acquired	Retain, but integrate with other parts operations
Butec Birmingham	181	Acquired	Acquired	Continues
Freight Rover, Birmingham	c.1900	Acquired	Possible later disposal perhaps with Land Rover	Possible later disposal perhaps with Land Rover

DL2AAH

ANNEX B

DISPOSAL OF LEYLAND TRUCKS: IMPLICATIONS FOR THE MAJOR COMPONENTS SUPPLIERS

SUPPLIER	PLANT	PRODUCTS FOR TRUCKS	APPROX TOTAL NO. EMPLOYED	CURRENT OVERALL UTILISATION OF PLANT (ie ENGINES FOR ALL PURPOSES TRUCKS, AGRICULTURAL AND INDUSTRIAL)	OPTION 1 (DAF)	OPTION 2 (PACCAR)	OPTION 3 (Retention with Restructuring)
PERKINS	PETERBOROUGH	PHASER engine for medium size truck	4000	approx 40%	Continue to offer engines till 1990s	Rationa-lization	Rationa-lization
PERKINS (formerly Rolls Royce Diesels)	SHREWSBURY	EAGLE engine for heavy trucks plus engines for Armoured Fighting Vehicles	1200	approx 30%	400 job losses	Not known In comp-etition with Cummins	Risk to some jobs in the longer term
PERKINS (L Gardner & Sons)	MANCHESTER	engines for buses	600	approx 25%	No change	No change	No change
CUMMINS	SHOTTS (Lanarkshire)	L10 and 14 litre engine for heavy trucks	800	approx 50% (of which 20% is for Leyland Trucks)	Possible closure in 1988	Continue Production	Continue Production at former level

PN1AAB

SUPPLIER	PLANT	PRODUCTS FOR TRUCKS	APPROX TOTAL NO. EMPLOYED	CURRENT OVERALL UTILISATION OF PLANT (ie ENGINES FOR ALL PURPOSES TRUCKS, AGRICULTURAL AND INDUSTRIAL)	OPTION 1 (DAF)	OPTION 2 (PACCAR)	OPTION 3 (Retention with Restructuring)
CUMMINS	DARLINGTON	'B' Series engine for medium size trucks	900	approx 30%	Increased production of B series but 200 jobs linked to Shotts	Continue Production	Continue Production
MOTOR PANELS (COVENTRY) LTD	COVENTRY	CABS	550	generally high	Lose heavy truck cabs in 1988 but overall volumes should increase	Probable Closure	Possible Closure
MOTOR PANELS (WIGAN) LTD	WIGAN	Some CABS (also CABS for agricultural and industrial applications)	130	not known	Continues	Uncertain	Uncertain

PN1AAB

LEYLAND TRUCKS RANGE: EFFECT OF MERGER WITH DAF

Current Model	1986 Sales (Units)	1991 Sales under DAF
Light Vehicles		
UK Roadrunner (6-10)	2783	3500
DAF Roadrunner (6-10)	-	1160
L/W Freighter (10-16)	1067	800 + 1000 (to DAF)
Medium/Vehicles *		
Freighter (16)	1906	2500
Constructor 6 (24)	889	1100
Cruiser (16-35)	418	500
Heavy Vehicles **		
Constructor 8 (30)	482	620
Roadtrain (32-65)	1068	2100
Scammell Special (65-300)	139	-
Overseas Models		
Comet (9-24)	38	1500
Landtrain (19-65) **	47	-

* To continue at least until 1991 with UK engine options and components.

** Vehicles to be replaced with DAF products in 1988/9 with assembly only in the UK of right-hand drive models. Engines, cabs and certain other components imported.

ANNEX E

LEYLAND TRUCKS : COMPONENT SOURCING UNDER DAF OPTION

LIGHT VEHICLES	DAF REPLACEMENT	CAB	ENGINE	TRANS.	AXLES	SUSP.
UK Roadrunner	No change	UK	UK	UK	UK	UK
DAF Roadrunner	No change	UK	UK	UK	UK	UK
L/W Freighter	1989	UK	UK/DAF	Euro	UK	UK
MEDIUM VEHICLES*						
Freighter	1991	DAF	DAF	Euro	UK/DAF	UK
Constructor 6	1991	DAF	DAF	Euro	UK	UK
Cruiser	1991	DAF	DAF	Euro	Euro	N/K
HEAVY VEHICLES						
Constructor 8	1988	DAF	DAF	UK/Euro	UK/DAF	UK/DAF
Roadtrain	1988	DAF	DAF	UK/Euro	Euro	Euro
Scammell Specials	1988	DAF	DAF	UK/Euro	Euro	Euro
OVERSEAS MODELS						
Comet	continues with DAF components	UK	UK/DAF	UK	UK	UK
Landtrain	1988	DAF	DAF	UK/Euro	Euro	Euro

* Until 1991. continues with UK engine options and components.

1 of 4 17

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Secretary of State for Trade and Industry

PS/

cc George Guise & return.

16 February 1987

cc Brian Unwin
sgd pa

SECRET
COMMERCIAL IN CONFIDENCE

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

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 WALKER
Private Secretary

DW1CRF

SECRET UNTIL 20 FEBRUARY 1987

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 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.

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

JG1ARL

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. [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 completed. 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

999-49

SECRET UNTIL 20 FEBRUARY 1987

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.

This money has been lent. Nowhere written off.

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.

JG1ARL

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Secretary of State for Trade and Industry

16 February 1987

cc George Cruise & return.

SECRET
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

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

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

- 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).

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

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

Nicholas Walker

PAUL CHANNON

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

DW1CRE

Thr ● Norgrove pa.

Leyland

I took a call early this morning from Sir Anthony Tuke, who had asked to speak to the PM. He apparently knows Le well.

Sir Anthony is a director of Paccar. Apparently the Chairman of Paccar has yet to ring a CEO from Seattle telling out details of the firm's offer, which she ought to see. The main points are that Paccar were ready to put a lot of money into Leyland Trucks. Once they had turned the company round, they would be ready to float it on the UK market. They would not take assets or business away from the UK. Sir Anthony

Said that he had explained all this in detail to Lord Young last night.

I said that I had asked this dossier. He ought to try to speak to DTI. I offered to call the Chancellor's office to contact him. His number is 925-0171

CD

ps8/47A

SECRET
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15

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

16 February 1987

Michael Gilbertson Esq
PS/Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
LONDON SW1

Dear Mike

ROVER GROUP

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

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. He feels there should continue to be a cap on RG'S external borrowings, as was done for the 1985 Corporate Plan.

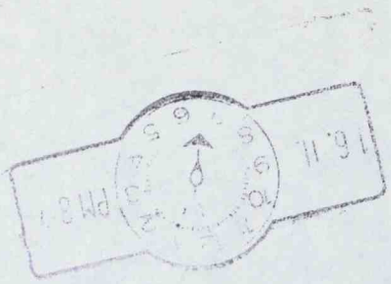
I am copying this letter to David Norgrove.

Yours

Alex

A C S ALLAN
Principal Private Secretary

IND Pol: Rowen Cmnp PT 13



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Secretary of State for Trade and Industry

CONFIDENTIAL

16 February 1987

Rt Hon Malcolm Rifkind MP
Secretary of State for Scotland
Scottish Office
Whitehall
London SW1A 2AU

Dear Malcolm,

LEYLAND TRUCKS : CUMMINS

Thank you for your letter of 11 February.

I do of course understand your concern about the Cummins' factory at Shotts as well as the Albion axle plant and the impact on Leyland's component suppliers is an issue I shall look at very carefully in evaluating the relative merits of any deal.

I expect to have the Rover Group Board's recommendations very shortly and will bring forward my proposals to colleagues as soon as possible thereafter.

I am copying this letter to members of E(A) and to Sir Robert Armstrong.

Yours

PAUL CHANNON

Paul

JG1AQX

INDUS POL : BL : PE13

SECRET

SUBJECT
cc MASTER

File

JA1BFR
cc G. Guise, Policy Unit
14

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

12 February 1987

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.

(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.

(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.

13

SECRET
COMMERCIAL IN CONFIDENCE

P 02499

From: J B UNWIN
11 February 1987

MR NORGROVE

ROVER GROUP

with DRN.

Mr Channon's two minutes of 10 February broadly confirm the picture in my minute to you of 4 February. But I think there are still some important gaps in the DTI analysis which the Prime Minister may wish to probe further tomorrow:-

(i) DAF or PACCAR: Mr Channon recommends acceptance of the RG Board's likely preference for DAF. This is on the basis that although PACCAR might well have the edge on jobs (as many as 5,000 in the UK overall according to PACCAR), there are other reasons (listed in paragraph 11) for opting for DAF. This may well be right, but the DTI paper is remarkably thin on the question of jobs. There is little detailed analysis in the covering letter, and Annex B contains no numbers. Before any final decision is taken I should have thought that the Prime Minister would want to see a fuller analysis of the estimated direct and indirect job effects of the two bids, showing the localities and the likely timing. Other colleagues will, of course, have a very keen interest in this, and it is clearly an area on which the Government will be pressed;

(ii) EC considerations: Mr Channon's report confirms my view that DTI have under-estimated the problems here. There is little analysis of alternative options and none of the consequences of failing to carry the Commission; and time is now getting short. Among the points that should still be considered are:-

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(a) the consequences of going ahead <u>without</u> Commission agreement. Would the Commission go to the European Court? How long would this take? What action could the Court take if we were found in breach of the Treaty? How would this affect, either before or after, the DAF or PACCAR deals?

(b) How detailed must RG be in the Notice summoning the Extraordinary General Meeting, which will in part at least determine the contents of the Parliamentary Statement? Would it commit the Government on <u>structural matters</u> - and thereby rule out fall-back options - which are to be discussed with the Commission during February and March?

(c) How detailed will the agreement with DAF or PACCAR have to be by 19 February? Would it leave any flexibility for subsequent negotiation or compromise with the Commission?

B

DTI have in effect passed the buck to the Cabinet Office to look into this (Mr Williamson will be chairing a small group) but the Prime Minister may wish to stress that the problem needs fuller analysis before informed decisions can be taken.

J B UNWIN

Cabinet Office

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E (B

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
LONDON
SW1H 0ET

11 February 1987

Dear Paul,

LEYLAND TRUCKS: CUMMINS

Thank you for your letter of 13 January about the Leyland Trucks Albion axle plant in which you undertook to keep me informed of developments in Rover Group's discussions with DAF and Paccar.

I met recently, at his request, Mr Henry Schacht of Cummins Engines Inc. He explained that the future of Leyland Trucks was the key to the future of the Cummins engine plant at Shotts, Lanarkshire. If the DAF bid were successful, Mr Schacht thought that DAF would move engine, and perhaps heavy vehicle, production to Holland, thus reducing dramatically the demand for engines from Shotts. This would put at risk 800 jobs at Shotts and a further 200-500 (depending on whether heavy vehicle production were to go to Holland) downstream. On the other hand a successful bid by Paccar would be regarded favourably by Leyland dealers and could result in increased output at Shotts.

I am very concerned not only about the prospects for the Cummins plant at Shotts, but also about the future of the Albion axle plant and its 900 employees in Glasgow. I hope you will agree that in considering the Rover Group's proposals for the truck operation, we will need to take full account of the implications for manufacturing activity and employment both in Scotland and in the North of England.

Scotland has, as you know, suffered a succession of serious redundancies and closures in recent months. We have just had confirmation that Caterpillar's US management will not reconsider their proposal to close the Uddingston factory with the loss of over 1200 jobs. This followed hard on the heels of the announcement of the closure of the Golden Wonder crisp factory at Broxburn (340 jobs) and the Unisys plant at

HMP04113

Cumbernauld (775 jobs) and of the rundown of employment at Babcock's Renfrew factory (several hundred redundancies).

I am copying this letter to members of E(A) and to Sir Robert Armstrong.

Yours ever,

MALCOLM RIFKIND

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PRIME MINISTER

11 February 1987

ROVER GROUP

Relevant are papers from Mr Channon of 10 February.

The Paccar proposal shows all the signs of having been hastily thrown in at the last moment in order to delay completion of the DAF purchase. It is not an offer capable of acceptance and the apparent immediate cash advantage is eroded by the continuing liabilities which Rover would carry for trading losses after completion. I therefore do not agree with Mr Channon that we shall be 'foregoing the opportunity of a clean Government exit from Trucks'. Both Paccar and DAF involve continuing Government involvement. The difference is that with DAF the retained 40% shareholding may have some positive value in the future. What is important is that it will not have a negative value through RG being required to contribute to any further cash calls. I was very pleased to see that Graham Day intends to make this explicit in the agreement, which also releases the Truck business from any continuing Varley Marshall exposure.

In Annex A You have been given a somewhat confusing and over complicated financial analysis of the two options compared with that of retaining Trucks within RG. There is so much uncertainty in the alternative Paccar and retention cases that I do not believe any great weight should be put on the financial advantages of one route over another. The principal financial message is that Government equity injection for the Trucks deal will remain of the order of £530m (the separate Bus deal involves Government equity injection of £120m making the total of £650m which we have discussed).

Paccar are trying to argue that the employment consequences of their proposals will be less severe than with DAF because Paccar will continue to use UK component companies. However, this is a very easy statement to make as an expression of intent at the outset of negotiations. After

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the detailed examination, which Paccar still have to make, there is every possibility that these undertakings would diminish. The Paccar claim, that their proposal would cost 5,000 less UK jobs may be politically embarrassing but the figure appears to be totally unsubstantiated. The worst calculation I have been able to make of the differential job losses is as follows:

Cummins Engines, Lanarkshire	1,100
Perkins, Shrewsbury	600
Perkins, Manchester	600
	2,300

This is less than half Paccar's claim.

The EC considerations are referred to in Channon's shorter paper, which should be clearer at Thursday's meeting after he has seen Sutherland. It may even be necessary for your intervention with Delors as was discussed at our meeting before Christmas. I do not see how the Rover Group can sustain any of the debt left in its consolidated balance sheet after the exit of Trucks because the company would become legally insolvent. Refinancing with new commercial debt will amount to the same thing.

Conclusion and Recommendation

To attempt to freeze the DAF negotiations now, when there is a draft agreement almost ready to sign, would be a very high risk action. In order to justify the delay necessary for a detailed Paccar evaluation we should need indication of a far better bird in the bush. Furthermore, however tiresome the EC refinancing negotiations prove for a DAF deal, they will be far more so and take far longer for a non-European solution such as Paccar. The Rover recommendation, to proceed to completion with DAF, should be supported.

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GEORGE GUISE

PRIME MINISTER

cc Mr Guise

ROVER GROUP

The Chancellor, Mr Channon, Mr Shaw and Brian Unwin will be present. There are two main areas for discussion:

(i) the choice between DAF and PACCAR;

(ii) the programme for discussions with colleagues and announcement.

The papers are:-

A Policy Unit note

B Note by Mr Channon on Trucks

C Note on EC considerations

D Earlier note on EC considerations

E Letter from Mr Rifkind

F Note about increasing the limits on finance for Rolls Royce and Rover Group.

DAF v PACCAR

The choice between DAF and PACCAR is more finely balanced than Mr Channon had earlier expected, but still comes out in favour of DAF.

- the proceeds are more certain and a little larger;

- DAF will take Freight Rover;

- the Commission are likely to agree more easily to a debt write-off;

- Leyland is likely to have a more secure future;

- the RG Board are likely to recommend DAF.

The DAF deal has some disadvantages:-

- there is no clean Government exit from trucks;

- PACCAR might have the edge on jobs;

- DAF could be presented as turning Leyland into more of an assembly operation;

- in particular, the Cummins engine plant at Shotts in Lanarkshire, with 1,000 jobs, may be at risk. (Mr Rifkind has written about this.)

The disadvantages do not outweigh the advantages as presented in the papers, but it is difficult to follow the comparison of the job effects, their timing and where they will happen. You might want to ask for a more detailed discussion of these.

Discussions with colleagues

DTI still hope to make a statement next Thursday covering Bus, Trucks and the Corporate Plan. One possibility would be:-

- MISC 126 on Wednesday afternoon

- E(A) on Thursday morning before Cabinet

- Cabinet

- Statement

I suggest Mr Rifkind should be invited to MISC 126 if this timetable is followed.

The main alternative would be to hold E(A) on Wednesday afternoon in place of MISC 126.

I assume a meeting of your informal "small" group is not needed.

You will also want to note the position on the discussions with the EC. I suggest you also say that, whilst you are prepared to be very tough with Delors and the Commission, a row would be much better avoided: we are likely to have other arguments with the Commission in the coming months, over agriculture, and they would be a better place to use rowing capital. DTI should not underestimate the problems. Possible questions include:-

(a) The consequences of going ahead without Commission agreement. Would the Commission go to the European Court? How long would this take? What action could the Court take if we were found in breach of the Treaty? How would this affect, either before or after, the DAF or PACCAR deals?

(b) How detailed must RG be in the Notice summoning the Extraordinary General Meeting, which will in part at least determine the contents of the Parliamentary Statement? Would it commit the Government on structural matters - and thereby rule out fall-back options - which are to be dicussed with the Commission during February and March?

(c) How detailed will the agreement with DAF or PACCAR have to be by 19 February? Would it leave any flexibility for subsequent negotiation or compromise with the Commission.

Answers on these points are needed before next week's meetings.

DRN

David Norgrove
11 February 1987

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Copy no. 293

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

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

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

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Brian Unwin
a George Guise
return.

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COMMERCIAL IN CONFIDENCE

PRIME MINISTER

ROVER GROUP: EC CONSIDERATIONS

I shall be seeing Commissioner Sutherland briefly this coming Thursday and will report back later. The meeting will give me the opportunity to give him an outline of my proposed Parliamentary Statement where it relates to matters of concern to the Commission. It will also allow me to judge, at first hand, the prospects of the Commission authorising aid for Bus and Truck by the end of March.

2 The Parliamentary Statement itself should not present too many problems. Sutherland's position will be safeguarded by the inclusion of some reference to the need for Commission authorisation for the equity injection of "up to £750m".

3 As for the prospects for the authorisation itself, Sutherland will almost certainly be unable to give either his own or the Commission's definitive position. The best we can expect is a general political steer with some indication of the major problems to be resolved. These will, without doubt, relate to the volume of aid we have sought and to the level of restructuring offered. Sutherland will probably suggest that at least part of the debt should remain either with Rover Group or with the new company. He will no doubt explain to me that he is himself severely limited in what he

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can offer us given a number of existing and imminent aid proposals from other Member States and the high degree of overcapacity that exists in the Truck sector.

4 I intend to take a robust line with Sutherland. I shall point out the excellent record we have in carrying out painful restructuring in this sector, for example at Bathgate and Bedford. It will be emphasised that we have no room for manoeuvre either in relation the amount of aid or the degree of restructuring proposed. Neither Rover Group nor the new merged company can bear any of the debt. In short, it is not politically feasible to avoid making the aid payment to Rover Group by 31 March.

5 There will probably be no meeting of minds on Thursday. At least Sutherland will have heard for himself our wilingness to comply with the state aid rules provided the Commission authorises the required aid by 31 March. I envisage a further discussion later this month (probably around 26/27 February) when I will be able to be more precise about the planned restructuring and, as planned, offer to reduce the level of aid sought by up to £100m.

6 Even after these exchanges the prospects for agreement remain very much as described in my private secretary's minute of 22 January. On Bus the prospects for Commission authorisation remain good. On Truck they appear far less promising. My officials have, therefore been giving thought to other options we might pursue if the present strategy looks in doubt. I understand that David Williamson has agreed to chair a small interdepartmental group to report to me on these options - together with any others identified - in time for my late February meeting with Sutherland.

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COMMERCIAL IN CONFIDENCE

7 I have copied this minute to Nigel Lawson and to Geoffrey Howe.

PC

PAUL CHANNON

10 February 1987

Department of Trade & Industry

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Brian Hilton
Ce Georgebourne
& return.

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SECRET

COMMERCIAL IN CONFIDENCE

PRIME MINISTER

ROVER GROUP - LEYLAND TRUCKS : FREIGHT ROVER

Rover Group (RG) will shortly complete their commercial evaluation of the proposals they have received from DAF and Paccar. You and the Chancellor may however wish to reflect on the options before we meet for a preliminary discussion of them on Thursday 12 February. I am writing separately about the Community considerations.

DAF

2 The DAF proposal remains broadly as Graham Day reported to us on 23 January. DAF are willing to take the majority stake in a merged business (to include DAF Trucks, Leyland Trucks and Freight Rover) with the RG holding set at 40 per cent corresponding to the relative value of the assets they contribute. There will be no cash consideration - Graham Day does not believe this is negotiable with DAF even as a trade-off for a lower shareholding - but RG tell me that on flotation in 1989 their stake might realise some £90m.

3 Trucks and related RG debt (£370m at end-1986) would be retained by RG who would also be liable for Leyland Trucks' first quarter 1987 losses (£25m) and all restructurng costs (£135m). Still unresolved is DAF's request for indemnity against certain risks inherent in the newly integrated

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business but Graham Day has given me an absolute assurance that RG would not be required to contribute to any further cash calls by the new company. This will be explicit in the terms of the agreement. The Government's exposure under Varley-Marshall would obviously also be terminated.

4 The new company, incorporated in the Netherlands, would have a two-tier structure. Graham Day and the RG Finance Director, David Hankinson, would have seats on the Supervisory Board while Mr George Simpson (who would remain MD of Leyland Trucks and Freight Rover) would have a place on the Management Board. Flotation in 1989 would be on the Brussels, Amsterdam and London stock exchanges.

PACCAR

5 Paccar presented their proposals to RG on 26 January. They are interested only in Trucks having looked at but declined to bid for Freight Rover. Paccar have made a cash "offer" of £105m for Trucks' assets though in their proposal Trucks' net trade creditors (£60m) as well as debt (£370m) would be for RG's account. Paccar also insist that RG should bear all losses on the Trucks business for 9 months after completion (if contracts are signed before 1 April) or for 12 months if contract completion is delayed beyond this date. Whatever restructuring and redundancies identified by Paccar in the course of 1987 as necessary would also be funded by RG (presently estimated at £120m but effectively uncapped). RG told Paccar clearly on 29 January that preliminary evaluation indicated that their bid was less attractive than the DAF propsal. Paccar were pressed but declined to improve their offer.

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FINANCIAL EVALUATION

6 RG's financial analysis at Annex A indicates a small margin in favour of DAF. The analysis of both options includes a number of uncertainties. In each case, estimates have had to be made of future sale proceeds for substantial businesses - the flotation proceeds for DAF, and the value of Freight Rover for Paccar - and each case includes substantial estimates of contingencies, much larger and more uncertain for Paccar. Given these uncertainties I do not regard the financial analysis as conclusive in itself nor do our advisers, Barings. Graham Day argues that a significant distinction between the offers is that DAF has made an exhaustive examination of the businesses and the figures, jointly prepared, are therefore reasonably based. Paccar by contrast have come in late and examined the Trucks business only superficially. Important detail would therefore remain to be negotiated and RG fear that this would inevitably lead to a deterioration in the numbers. A deal - if available - could therefore be some months off which would increase running costs under RG ownership and further extend the date when the open-ended commitments to Paccar would be terminated. We have seen on the Leyland Bus disposal the commercial and political difficulties of protracted negotiations following agreement in principle.

INDUSTRIAL AND EMPLOYMENT CONSIDERATIONS

7 While RG have naturally concentrated on the commercial implications for them of any deal, we need to look rather more widely at the implications for the UK vehicle and component industry as a whole. This is where press and political comment is likely to focus.

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8 Within Leyland Trucks (Annex B) both options involve the closure of Scammell at Watford as well as the Leyland Foundry at end-1988. Both would become public at the time of any announcement. In the same timescale, DAF would close the Leyland Engine plant, a facility which Paccar claim they would keep open through a deal with Cummins Engines - though employment would still be reduced by 5-600. Overall, however, job losses within Trucks (3,300) would be broadly the same under DAF and Paccar. The phasing of redundancies under the DAF proposal, peaking in 1989, is known; while Paccar's intentions are still unclear, it is pretty certain that the pace of rationalisation would be at least as quick if not more rapid than that propsed by DAF.

9 There is however a potentially troublesome difference in the relative attractions of the proposal for UK component companies. The working assumption is that Paccar would aim to maintain and develop the existing Leyland product range in the UK, continue the links with DAF on the export cf light trucks and gradually introduce new products at the heavier end of the range where Paccar have their expertise. Paccar also maintain that, as with Foden, they would continue to operate the business with very high levels of UK components, including engines.

10 DAF would also continue with the manufacture of light trucks in the UK using British engines and components. However, in the heavy (1988) and medium truck sectors (1991) Leyland products would progressively be replaced by DAF-designed vehicles (Annex C) and while these would continue to be assembled at Leyland for right-hand drive

markets they would incorporate significant amounts of imported components, particularly engines (Annex D). Paccar have already publicly claimed that the DAF proposals would cost 5,000 more UK jobs than would be involved in Paccar's own bid. While this figure is difficult to substantiate, our opponents would seek to exploit it on the basis that we would be turning Leyland into a "screwdriver" assembly operation. Further talks are being held with DAF to explore possible way of defusing the problem on engines though I am not confident that these will produce much of substance. If we approve the DAF deal, we must therefore, I think, recognise that while the overall growth which DAF expect for the Leyland operation will benefit, a certain range of component suppliers, others will undoubtedly suffer. The two most vulnerable suppliers are Cummins Engines who would need to review the future of their Shotts, Lanarkshire plant (1,000 jobs) and Perkins Engines who would probably need to declare 400 redundancies at Shrewsbury.

11 The RG Board are almost certain to recommend strongly in favour of a deal with DAF based on their own financial appraisal of the alternatives, the certainty of a quick agreement on acceptable terms and, in the commercial context, a belief that Leyland's future would be more solidly based in a larger grouping with DAF than remaining as a relatively small player in the European league. My own judgement is that on financial as well as industrial grounds the arguments are more finely balanced and, in endorsing a DAF deal, we shall also be foregoing the opportunity of a clean Government exit from Trucks. I do not however believe that the arguments are sufficiently strong for us to overturn a commercially-based recommendation from the RG Board and there are a couple of considerations which tip the balance in favour of DAF notably:

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- Although Paccar say they will seek to develop markets in Europe and the USA, experience with Foden since 1980 does not suggest we should place too much weight on those intentions. With DAF on the other hand, Leyland would be merged into what is already a substantial European producer which should provide a solid base for continuing operations and employment in the UK.

- DAF represents a profitable and well-established European partner for Leyland while Paccar's experience in Europe is limited to Foden (on whom they have made little impact);

- DAF offers a secure future for Freight Rover which, under the Paccar proposal would remain with Rover Group who would need to fund the (100m new model investment programme;

- to opt for Paccar would require possibly prolonged negotiation and continuing uncertainty for the businesses involved. There is some risk in these circumstances that DAF would also lose interest and we would fall between the two stools;

- Commission clearance (critical to complete any deal and already an uphill task) would be significantly more difficult in the case of Paccar than DAF.

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COMMERCIAL IN CONFIDENCE

12 I recommend that we accept the RG Board decision, if as expected it favours DAF and announce this Parliamentary Statement on 19 February together with our conclusions on the Corporate Plan. We shall have to consider very carefully how to handle this both with colleagues and subsequently.

13 I am copying this minute to the Chancellor of the Exchequer.

PC

PAUL CHANNON

10 February 1987

DEPARTMENT OF TRADE AND INDUSTRY

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ROVER GROUP'S FINANCIAL EVALUATION OF DAF AND PACCAR OPTIONS

A CASH COSTS/BENEFITS TO ROVER GROUP

		DAF		PACCAR		Retention	
Trading cashflow:	-Trucks Q1 '87	(25)		(25)		-	
	-Trucks Q2-4 '87	-		(21)*		-	
	-Trucks 87-91	-		-		(22)*	
	-FreightRover 87-91	-		(27)		(27)	
	-African Operations 87-91	-		(10)		(10)	
	TOTAL		(25)		(83)		(59)
Balance Sheet Liquidation Costs			n/a		(57)	-	
Restructuring:							
redundancies	-Trucks	(57)		(56)*		(55)	
	-Parts	(7)		(9)*		-	
closure costs		(8)		(8)*		(12)	
costs of retaining plants until closure		(23)		(12)*		-	
costs of retaining staff until they are made redundant		(8)		(18)*		-	
costs of integrating DAF and Leyland Trucks		(32)*		n/a			
	TOTAL		(135)*		(103)*		(67)
Costs to RG of guaranteed commission to Leyland Bus			n/a		(16)		(4)
Cash consideration in 1987			n/a		105		n/a
Possible cash consideration in 1989			90*		n/a		n/a
Assumed cash values of operations retained within RG:							
	-FreightRover		n/a		50*		50*
	-Trucks Group		n/a		n/a		50*
TOTAL CASH FLOW			(70)		(104)		(30)
NPV (discounted at 15%)			(79)		(104)		(68)

B GOVERNMENT EQUITY INJECTION

	DAF	Paccar	Retention
Forecast debt at 31.12.86	371	371	371
Trucks Group Losses: Q1 '87	25	25	-
Q2-4 '87	-	21*	-
1987-1991	-	-	53*
Balance Sheet Liquidation (net creditors)	-	57	-
Guaranteed Commission to Leyland Bus	-	16	4
Cash Costs of Restructuring	135	103*	67
	531	593	495
Less: cash consideration 1987	-	(105)	-
EQUITY INJECTION 1987	531	488	495

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* Figures most likely to be subject to wide margins of error

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UK PRODUCTION FACILITIES

TENTATIVE COMPARISON OF DAF & PACCAR OFFERS FOR LEYLAND TRUCKS WITH RG STAND-ALONE OPTION

	OPTION 1	OPTION 2	OPTION 3
Production Facilities	DAF PROPOSAL	PACCAR PROPOSAL	RATIONALISATION WITHIN RG
Leyland Assembly Plant	Acquired	Acquired	Continues
Leyland K D (Comet)	Acquired	Acquired	Continues
Leyland Engines, Farington	Not acquired. RG to close by end 1988	Acquired, but possible on-sale to Cummins. Longer term survival in doubt.	Close in 1988
Leyland Foundry, Farington	Not acquired. RG to close by end 1988	Acquired; to close by end 1987	Close in 1987
Scammell	Not acquired. RG to close by end 1988	Not acquired [RG to close by end 1988]	Close in 1988 or earlier
Albion	Acquired, with possibility of rationalisation in 1990s	Acquired, for possible on-sale to Eaton	Retain or sell to Eaton
Leyland Parts	Acquired	Acquired	Retain, but integrate with other parts operations
Butec	Acquired	Acquired	Continues
Freight Rover	Acquired	Possible later disposal by RG with Land Rover	Continues, possible later disposal by RG with Land Rover

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ANNEX B

Annex C

RG's endorsed for the DAF option.

LEYLAND TRUCKS RANGE

VEHICLE (TONNES)	1986 SALES (Units)	1991 "DAYLIGHT"
Light Vehicles		
UK Roadrunner (6-10)	2500	3500
DAF Roadrunner (6-10)	-	1160
L/W Freighter (10-16)	1000	800 +1000 (to DAF)
Medium Vehicles		
*Freighter (16)	2000	2500
*Constructor 6 (24)	900	1100
*Cruiser (16-35)	450	500
Heavy Vehicles		
*Construction 8 (30)	480	620
*Roadtrain (32-65)	1050	2100
*Scammell Specials (65-300)	140	-
Overseas Models		
Comet (9-24)	32	1500
*Landtrain (19-65)	50	-

*Vehicles to be replaced with DAF products with assembly-only in the UK of right-hand drive models.

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ANNEX D

"D[illegible]IGHT" : COMPONENT SOURCING

LIGHT VEHICLES	DAF REPLACEMENT	CAB	ENGINE	TRANS.	AXLES	SUSP.
UK Roadrunner	No change	UK	UK	UK	UK	UK
DAF Roadrunner	No change	UK	UK	UK	UK	UK
L/W Freighter	1989	UK	UK/DAF	Euro	UK	UK
MEDIUM VEHICLES						
Freighter	1991	DAF	DAF*	Euro	UK/DAF	UK
Constructor 6	1991	DAF	DAF*	Euro	UK	UK
Cruiser	1991	DAF	DAF*	Euro	Euro	N/K
HEAVY VEHICLES						
Constructor 8	1988	DAF	DAF	UK/Euro	UK/DAF	UK/DAF
Roadtrain	1988	DAF	DAF	UK/Euro	Euro	Euro
Scammell Specials	1988	DAF	DAF	UK/Euro	Euro	Euro
OVERSEAS MODELS						
Comet	continues with DAF components	UK	UK/DAF	UK	UK	UK
Landtrain	1988	DAF	DAF	UK/Euro	Euro	Euro

* From 1988

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p 02479

From: J B UNWIN
4 February 1987

NRPT.

MR NORGROVE

THE ROVER GROUP

As I mentioned to you, I have been taking stock with DTI of developments on Leyland Truck and Bus and Austin Rover. Mr Channon plans to minute to the Prime Minister some time next week, but you may find it helpful to have this preview of what might emerge.

Leyland Truck and Bus

2. The bus deal (management buy out) is progressing satisfactorily, and there should be no further problems. The position is, however, more complicated on trucks. At MISC 126 before Christmas Mr Channon reported that the DAF option seemed more promising, and Ministers welcomed this and asked him to make clear the Government's preference for it to Graham Day. Among the considerations was the likelihood that this deal would be more acceptable to the European Commission.

3. The position now, however, is that Paccar, in making their formal bid, have revised and improved their original proposals. Although they would still not take Freight Rover, and the Albion axle plant in Glasgow would probably have to close, they would plan to keep the full range of vehicles (ie both the heavy and the light end) going and they offer the prospect of substantial exports from 1990 to the US market. Their cash offer is worth £100 million, on condition that the Rover Group meet losses for the first 12 months.

4. DTI are currently comparing this with the DAF offer. This would include Freight Rover, but, as a result of withdrawal from the heavy end, probably involve the eventual closure of Cummins in Darlington (1,000 jobs), and leave the Rover Group with a 30-40 per cent share until a new joint company could be floated. Their preliminary assessment is that the two bids are probably cash neutral, but that Paccar is likely to have the edge on jobs.

5. We shall have to wait for the full DTI evaluation before reaching any conclusions, but if the Paccar offer is demonstrably more attractive on jobs, this could present problems - particularly if Paccar campaign agressively (there have already been signs of this). The impression that the Government favoured DAF was deliberately created in December; and choice of Paccar could add to the difficulties with the Commission.

European Commission

6. The position on the application to the Commission is still unclear. DTI claim that Mr Sutherland is being understanding and cooperative and that the application should be cleared by the end of March. But we have no hard evidence of this and I am a little concerned that the DTI are too readily assuming that, if necessary, the Prime Minister will be able to apply pressure at the highest level to resolve the problem. They do not seem to have prepared any fall back position, and an announcement on 19 February (though apparently unavoidable for logistical reasons, if the write-off is to be able to score against this year's PSBR) could presumably make final clearance with the Commission even more difficult. The Prime Minister will certainly need to pursue this further with Mr Channon when he reports next week.

Rover Group Corporate Plan

7. DTI are still digesting this. In one sense it may not present major problems, since there will be no request for new Government money. On various assumptions about the proceeds of sales and disposals, use of the existing Varley-Marshall facility,

and cash already likely to be available, the company reckon they will need to attract about a further £300 million in new equity over the next 5 years. On the other hand, the plan, as I understand it, will be essentially a short term holding operation. Major issues such as whether to stay in the light end and replace the Metro (which the plan assumes will simply be "reskinned"), and on the Montego replacement, will be ducked; and the viability of the plan will in any case rest crucially on stopping the decline in market share. The underlying assumption is a market share of 14.5 per cent, which compares with the decline to an annual rate of 12 per cent at the end of last year (though I am told it has improved a bit since then).

8. The essential decision for Ministers will, therefore, be whether to give Mr Day further breathing space on this temporary basis (with a risk that things could go badly wrong before very long), or whether to insist that at least some of the longer term strategic issues should be tackled now. I image that they will want to give him more time.

Collective Consideration

9. The Prime Minister will want to consider further how to handle this in the light of Mr Channon's report. If the course ahead were reasonably clear and settled by the end of next week, it might be possible to make do with one meeting only (of either MISC 126, or E(A), augmented as necessary) on Wednesday, 18 February or early on Thursday, 19 February, prior to Cabinet and a statement later that day.

J B UNWIN

Cabinet Office

SECRET CMO

SUBJECT
cc MASTER

hle

7.

DAS

bc Mr Guise

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

23 January 1987

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

6 CC, B/UP

PRIME MINISTER

ROVER GROUP: 1987 CORPORATE PLAN

Mr. Channon, the Chancellor and Giles Shaw will be present for your meeting. Mr. Day will join the meeting after 3/4 hour.

George Guise has commented on the corporate plan, below. The folder also includes a letter which sets out the latest position on Leyland Trucks and Bus.

Overall plan for the company

It is not easy for the Government to second-guess Graham Day on model and engine plans, though George Guise raises some pertinent questions.

The starting point for your discussion might be the aggregate figures set out conveniently at the end of George Guise's note.

These figures show:

- falling output and employment in 1987 and 1988 for the group as a whole, but fairly stable thereafter;
- falling output and employment for ARG throughout the period;
- a rising return on total assets for the whole group and for ARG;
- sharply reduced cash outflows by 1989 but continuing negative;
- capital expenditure at about 1985 levels or a little higher;
- borrowings and Varley Marshall assurances reduced in 1987 from the very high levels of 1986 but then flat or gently rising.

It would be interesting to know how the plan was arrived at. The suspicious mind might suggest that they assumed the Government would find around £1500 million of Varley Marshall assurances a tolerable level, and then worked out what could be done within that limit. And perhaps that would not be too bad a way of doing it. This company cannot be run on normal commercial criteria: if it were, it would be closed.

The Policy Unit argue that more options should be displayed. These would necessarily be for a smaller company. It would only be worthwhile to ask Graham Day for them if you felt that it would be realistic to look for a more rapid and larger reduction in employment.

Honda

Mr. Channon's minute does not report the position on discussions with Honda about an equity stake. Where does this stand?

Next steps

Unless you send Mr. Day back to the drawing board, would you wish the corporate plan to be discussed at MISC 126 or at E(A)?

Leyland Trucks and Bus

Would an announcement in mid February of continued substantial support for Rover Group complicate the discussions with the Commission about the debt of Leyland Trucks and Bus?

Gaynor Kelly Duty Clerk

PP DAVID NORGROVE

22 January 1987

SLHAFE

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S cc B/UP

PRIME MINISTER 22 January 1987

ROVER GROUP 1987 CORPORATE PLAN

The immediate plans include the Rover EGM in March and the Secretary of State's minute points to a Government statement in mid-February covering the disposal arrrangements for Truck and Bus and the already agreed equity injection of £650m. Efforts are also being made to dispose of the remainder of the business, in particular, Land Rover, which is assumed to be sold for a total of £180m including debt retirement during 1989.

The argument is advanced that at the same time as these necessary statements, Government should also endorse the five year corporate plan. It is logical to attempt to do both together and Rover naturally want be seen to have Government support. However, this must not be turned into pressure for blind acceptance of the Rover plan on the basis that there is 'no alternative'. This note will concentrate on the proposals for ARG which increasingly dominate the financial performance of the Group.

Financial consequences of the plan: - see summary on back page

The plan as presented is extremely cash hungry, proposing capital expenditure of nearly £1bn over the next five years, of which £800m would be in ARG. Total cash drain over five years exceeds £400m of which ARG accounts for £350m. Borrowings only reduce because of the proposed equity injection and the Land Rover disposal. These are rising again towards the end of the plan period. Varley Marshall exposure, the ultimate measure of Government liability, is still over £1½bn at the end of 1991. The key financial parameters of the plan are set out on the back page, and show the extent to which ARG, the surviving business, becomes dominant.

SECRET

What is wrong with the plan?

ARG are seeking to reposition themselves in the car market. That is good. They are seeking to acquire a reputation for reliability, to build on the Rover name which is prestigious, and to simplify their product range. This would become comparable with, for example, Volvo. There would be a small car, a medium sized car and a top executive model, all probably called Rover. Such ambitions are good and, in part, not dissimilar to the way Jaguar attacked its appalling public image some years ago. The difference is that Rover believes that in order to get there it must commit capital beyond its capacity to finance it.

It is probably a good thing to plan for a new model, the AR8, if possible in collaboration with the Japanese. It is not logical to commit vast capital investment to the K series engine for this model, and also for a new Metro, before there is any evidence that the sales turn-around is likely to be achieved.

Indeed, the plan contains inconsistent statements. For example, it is suggested that the Metro sector of the market is "unlikely to sustain adequate margins during the '90s because of competition from Spain, Eastern Europe and Korea". It then goes on to detail how much capital expenditure will be spent on modifying the Metro in order to accommodate the K engine, namely £35m. Furthermore, a £64m capital programme on a new Metro gearbox is planned in order to utilise this engine!

Over the next three years, £24m will be spent relocating the Montego production facilities at Longbridge, undoubtedly for some plausible long term reason. However, Montego market share falls consistently throughout the plan period from a high of 4% in 1985 down to 2.3% by 1991.

10-15

The protagonists of the plan will point out that it emphasises quality and reliability and market position while cutting capital expenditure by approximately £400m from previous proposals. However, it is still a plan to spend one's way out of problems even if the range of proposed engines have been cut back to a single K series. It spends at a level which leaves the company, and therefore the Government, with severe financial exposure should the market share predictions for the new AR8 model not eventuate. Indeed the plan points out that an overall movement either way of one percentage point in market share would affect cash flow by £27m!

Alternative Plans

The directors of such an enterprise should put survival first, and that means the elimination of cash drain as fast as possible. It is unacceptable to put forward a long term strategy 'to develop a company that on conservative marketing objectives can be marginally profitable in the short term and cash neutral in the medium term'.

(i) A 'survival plan' would cut all expenditure which does not go directly into selling cars during the next few years. Undoubtedly this would mean greater redundancies than the 11,000 projected at ARG over the five years (some 30,000 in the Rover Group as a whole). A plan which built upon the £650m of new equity for debt retirement in order to achieve cash neutrality in the remaining business as fast as possible, would identify the political consequences. These might be unacceptable. We might ask for less draconian actions but the tension in the leash would then be in the right direction, with management arguing for the best things for the business. The present plan appears

to have pre-judged all that, and put forward what ARG believe is politically acceptable!

(ii) It should also be possible to devise a plan which allowed for the development of the AR8 but with engines bought-in from Honda or elsewhere. Coupled with a running down of Mini and Metro, this would mean exit from the increasingly competitive small car market in the nineties. This would generate cash over the next few years (Mini and Metro are reputed to be cash positive now) because new investment would be cut. It might later be possible to devise a capital programme on the back of enhanced overall financial strength.

(iii) Another plan would be to tranche the capital programme such that the ultimate ambitions of the present plan are not destroyed but made dependent upon the achievement of market recovery as a pre-condition for releasing capital expenditure.

I suspect that ARG's initial reaction will be that capital has been cut or delayed as much as possible already and that this is the best and only workable plan. The evidence as presented neither confirms nor refutes that assertion. The plan does not show profitability by product line. It does not detail any of the costing data by model or even by cost factors such as labour, materials etc. The whole scheme has a basic 'take it or leave it' flavour which shows all the signs of being promoted by the engineering enthusiasts within ARG. Indeed, the original draft text spoke of the ARG plan as having been produced by ARG 'in conjunction with the Group'. Alternative plans must be possible, particularly when a company is as shaky as this.

Honda

The plan states that there is no perceived alternative to collaboration with Honda whereas my most recent information is that Honda are neither willing to take an equity stake nor to put assets into a joint venture, whereas it was the original intention for Honda to contribute to the AR8 manufacturing facilities.

What they may do is licence ARG to produce Honda vehicles. These might include the four door version of the AR8, the coupé version of the 800, or the Honda small car, 'the City'. The first of these two would be consistent with the proposed Rover strategy but the last would have Rover producing a product in direct competition to their own Mini and Metro! It would also give local content problems. So it seems as though the great marriage with Honda, which I have heard described as the whole kernel of the plan, is very thin on practical financial schemes. General statements of long term support are much cheaper!

Conclusions

Despite Graham Day's signal achievements in disposing of peripheral activities and a basically sound plan to fatten Land Rover for market prior to sale during 1989, there is every evidence that the engineers are still in charge at ARG. The investment which has already taken place in computer-aided design and manufacture is staggering and visitors from companies like Mercedes and BMW go around the facilities in awe and amazement. This was pointed out to me proudly by technical management when I was at Longbridge! As ever, the technocrats' solution to a marketing or financial problem is to spend one's way out of it through capital investment and this plan certainly proposes to do that.

It is significant that nowhere in the entire planning document is the directors' requirement for the minimum overall return on capital employed stated. Furthermore, it is nowhere stated what is the minimum DCF return requirement before committing fresh investment. Graham Day may argue that it is naive to talk of return on capital when a business is in as bad a state as this. However, my experience is that, once directors lose sight of why they are in business, commercial and financial health is unlikely to return.

There are therefore many questions to ask before even reluctant acceptance of this plan, which would almost certainly leave the Government exposed to crisis demands for another half billion pounds before long:

1. May we see a survival plan which cuts capital expenditure to the bone and achieves a positive overall cash flow within ARG as soon as possible. What are the employment consequences of such a plan?

2. If it be assumed that Honda offers no more than permitting Rover to build models under licence, what effect does that have on the current projections?

3. What would be the characteristics of a plan which concentrates on improved reliability and market perceptions and the development of the AR8, but with bought-in engines and therefore lower capital spend?

4. When would the present plan achieve an acceptable return on capital of, say, over 15 per cent? Note that the present proposals, despite Group capital expenditure of £1bn, only achieves a return on capital employed of 10.5% by 1991.

Recommendations

Rover Group must not be allowed to get away with the argument that this is the only possible plan and that the Government must therefore accept it lock, stock and barrel. Day must firmly be told that, whatever plan he adopts, there is absolutely no more Government funding after the £650m equity injection.

This note has tried to indicate at least the possibility of more prudent financial strategies and the different kinds of plans that might result from them. However, it is impossible and quite inappropriate that the burden of setting out how to run the business should be transferred from Rover management to Government. Government is the dominant shareholder, the ultimate financial guarantor and in the front line of political vulnerability. It has every right to reject this plan because it does not put first things first, the fastest achievement of cash neutrality.

Neither is it acceptable for the directors to blame Government for the company's predicament because political considerations prevented certain proposed sales last year. The directors should stop feeling sorry for themselves and get on with the task of producing and selling cars which people want to buy, and to do so well within the framework of presently agreed financial resources.

GEORGE GUISE

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ROVER GROUP - PLAN SUMMARY

Years to December	1985	1986	1987	1988	1989	1990	1991	5 Year Total 87/91
Sales Vol (000) RG	542	502	496	495	456	455	448	-
of which ARG	466	433	434	434	434	432	425	-
% Market Share ARG	17.7	15.8	14.5	14.5	14.5	14.5	14.5	-
Manpower (000) RG	76	68	51	48	39	38	36	-
of which ARG	41	39	35	32	31	30	28	-
% Return on total assets	(3.2)	(16)	(2.0)	4.9	6.6	10.4	10.5	-
of which ARG	(1.6)	(18)	(4.9)	3.1	6.7	10.9	10.5	-
Cash Flow £m RG in (out)	(174)	(363)	(274)	(128)	97	(43)	(61)	(410)
of which ARG	(66)	(230)	(116)	(118)	(43)	(23)	(48)	(348)
Capital Exp. £m RG	185	142	162	225	196	182	206	971
of which ARG	145	97	122	166	156	161	191	796
Borrowings £m RG	637	1006	630	756	659	700	710	-
of which ARG	293	500	456	574	517	540	538	-
Varley Marshall £m RG	1700	2111	1428	1607	1486	1544	1551	
of which ARG	970	1200	1135	1303	1300	1346	1350	

Capital Expenditure at ARG in £m

AR8 5/3 door			20	50	69	39	6	186
K series Engine			37	34	31	34	-	136
K series - Metro			-	13	15	6	1	35
Gearbox - Metro			14	17	15	13	5	64
New Products			10	5	6	45	154	220
Relocate Montego a[redacted]			2	19	3	-	-	24
Balance			39	28	17	24	25	131
TOTAL ARG	145	97	122	166	156	161	191	796

ROVER GROUP

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22 January 1987

Mrs C E D Bell
Department of Trade and Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

PR saw 23/1

JGD

Dear Catherine,

AUSTIN ROVER PROSPECTS WITH NO 'K' SERIES ENGINE

I regret the delay in answering your question about the effects on ARG of not proceeding with the development of the 'K' Series engine. However, we believe that the consequences of such a step to be so serious that it was essential that we took time to confirm that the judgments we had taken on the many difficult issues involved were sound.

In the first case, that Metro carries on with the the 'A' Series engine until 1990, no small car replacement has been assumed, because we know of no way by which such a car could be made available to Austin Rover on a viable basis. We do not, however, believe it a reasonable planning assumption that we could buy the 1400cc Honda engine for use in Metro thereafter, so we have not assessed your second case.

Our main reason for taking this view on the supply of a 1400cc engine for Metro is that Honda so far have firmly refused to supply engines for use in non-Honda related vehicles. Recent discussions with them (although they have not been asked directly about supply of 1400cc engines) have tended to confirm this. Further, Honda have not taken the decision to build even the 1600 cc engine at Swindon. Although it seems likely that they will do this, it is a fact that the recent strengthening of the yen has reduced the cash available for investment and they are, as always, giving priority to the USA. We believe they could well have re-assessed their European strategy and will put less resources into Europe than they had intended, say a year ago. To expect them to increase their envisaged engine investment at Swindon even for AR8 is, therefore, optimistic.

Directors J Graham Day (Chairman and Chief Executive) Sir Robert Hunt CBE DL (Deputy Chairman) N J Carver OBE AFC (Group Executive Director) Sir Robert Clark DSC E W Dawnay A W Forster D R L Hankinson (Group Finance Director) Sir John Mayhew-Sanders B W Pomeroy **Registered Office** 7-10 Hobart Place London SW1W 0HH Registered in England 1213133

We have, however, assumed in our financial calculations that they would supply a 1400cc engine for AR8, although not for Metro.

Reverting to the case of Metro (and Mini) running out in 1990, at present, Metro still comprises some 38% of ARG car volumes and even in 1991 is forecast to account for 24%. Dealer defections would become inevitable as soon as it became clear that ARG did not intend to replace it (this would start when news of the 'K' cancellation became public). This would have a substantial impact on volumes, particularly in Europe where there is a disproportionate dependence on Metro. The loss of an 'entry level' product would also reduce medium sector sales, and would damage ARG's ability to sell into UK fleets. As a consequence, ARG's volume in the 1990's would almost certainly fall to below 300,000 a year.

In practice, Longbridge would have to be closed and operations concentrated at Cowley. This would involve the loss of some 15,000 jobs; mainly in the West Midlands with closure costs of about £225 million. It is, however, unrealistic to believe that this would give ARG any chance of ever achieving commercial viability and the run-down of the company seems an inevitable consequence. Thus the financial figures are, in a real sense, irrelevant.

In our Plan submission, we said that ARG was moving to two major platforms, with variants, and that we had postponed a decision on the small car until 'there is a clearer view of the forward market and the effectiveness of the strategy for Austin Rover in apparently more promising sectors is known'. We also made it clear that the product strategy was not complete. We still need this time to make our assessment of the position.

If 'K' Series were cancelled, we would, of course, try to find ways of alleviating the position - for instance, we would look for a substitute engine and probably for a small car programme of some sort with another manufacturer. The chances of success in either of these is, we believe, very low and they cannot be taken as serious possibilities to use in an assessment of ARG's future. In any case, delays would occur to at least part of the AR8 programme and serious damage would result from the time the

'K' Series cancellation became known. We strongly believe, therefore, that by far the most likely outcome of a decision to stop the 'K' Series engine programme is the run-down and eventual demise of Austin Rover.

Yours ever

Peter Thompson

P C M Thompson
Group Director
Policy and Government Relations

cc Mr M Waller
Mr G Guise

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Secretary of State for Trade and Industry

PS/

CONFIDENTIAL

22 January 1987

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

Dear David,

ROVER GROUP

You will have seen Mr Day's letter of 19 January to my Secretary of State, which was copied to the Prime Minister. I attach for your information my Secretary of State's reply.

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

Yours ever,
Michael

MICHAEL GILBERTSON
Private Secretary

Encl

JF4AMW

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Secretary of State for Trade and Industry

22 January 1987

J G Day Esq
Chairman & Chief Executive
The Rover Group plc
7-10 Hobart Place
London SW1W 0HH

Dear Graham,

Thank you for your letter of 19 January.

These additional views which you and the Rover Group Board have put forward on the 1987 Plan are most helpful and my colleagues and I will take them fully into account in considering the Government's response.

Yours,

PAUL CHANNON

JG2ARH

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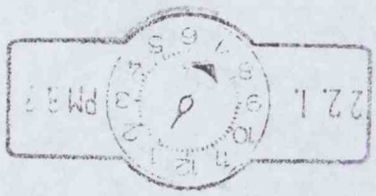

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Secretary of State for Trade and Industry

PS/

SECRET

22 January 1987

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

Seen by PP
DCW
22/1

Dear David

LEYLAND TRUCKS AND BUS

My Secretary of State has asked that the Prime Minister be given a progress report before the meeting with Graham Day on 23 January. This letter therefore summarises the commercial discussions on Leyland Trucks and exchanges with the EC Commission on writing off the debt and restructuring costs associated with the sale of Leyland Bus and Leyland Trucks.

Progress in Commercial Negotiations

The Rover Group say that the talks with DAF are progressing well. The Rover Group Board and the DAF Board have now both approved a joint study which sets out plans for product development, marketing, and the rationalisation of production facilities. The financial prospects of a Leyland/DAF venture have also been agreed in broad terms. The next round of discussions with DAF will address questions of price and of the structure of the joint company, including in particular the size of a retained RG share. On present proposals, Freight Rover would be part of the joint company from formation. The facilities in Leyland Trucks which would be closed under this option would not be taken into the joint company but remain with RG. These are principally the engine plant and foundry at Leyland and Scammell at Watford. The Rover Group are to having further talks with DAF on Monday, 26 January.

On Paccar, much less detail is available. Paccar have not moved at the pace with RG sought, though they are now beginning to show greater interest. Paccar took a first look at the Leyland Trucks facilities in December, and senior management are now in the UK

JF4AMU

looking at both Trucks and Freight Rover. Rover Group do not believe Paccar have a serious interest in freight Rover, however. On Trucks, Paccar might decline to take on the axle plant at Albion in Scotland as well as the Leyland engine plant and foundry, and Scammell. RG are insisting that Paccar develop their views very quickly so that progress towards a decision is not impeded. A meeting between RG and Paccar is also scheduled for Monday, 26 January.

The Prime Minister is aware that Rover Group have also developed a plan for retrenchment of Leyland Trucks within Rover Group. Under this option the Leyland plant and foundry, and Scammell, would close. The axle plant would continue for the present if no purchaser could be found.

My Secretary of State has emphasized to Mr Day that his objective is to make a Parliamentary Statement on Rover Group in mid-February. RG are therefore working towards taking a view on the options in early February.

Although it may not be possible for Mr Day to give definitive views at this stage, my Secretary of State believes it would be helpful to explore how far Rover Group will be able to limit future commitments and liabilities under the DAF option. It would be useful to have Mr Day's views on the level of the proposed RG retained stake, and its valuation. Mr Day understands that HMG want the stake to be as small as can be negotiated but there is a suggestion that DAF may press Rover Group to hold 30-39 per cent of a new joint company. It may also be helpful to explore the timing of a possible flotation of the joint company, and the option for an earlier disposal of the RG stake; and to explore further the prospects of agreement with DAF that there would not be further cash calls on Rover Group after a joint company was formed. These would all be important points for consideration when we receive RG's formal recommendation on Trucks.

Exchanges with the EC Commission

Last week officials had confidential discussions with DG IV on both Bus and Truck. Following this meeting we are writing in strict confidence (to DG IV only) to provide them with additional and more sensitive information. This letter will supplement our formal notification and thereby allow DG IV to continue their detailed consideration.

We expect that Commissioner Sutherland will receive advice on which to base his recommendations to the full Commission later this month or early next. For this reason we expect a brief pause in our

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contacts whilst DG IV officials pull together their recommendations. Our present plans are that Mr Shaw should meet Commissioner Sutherland a few days before our anticipated Parliamentary Statement in mid-February to outline plans on Leyland Trucks and seek to iron out any problems with the Commission. A little later that month my Secretary of state would himself call on Sutherland to resolve any major sticking points before the full Commission considers the case (which we hope will be in the early days of March).

The prospects for authorisation by the Commission are, at this early stage, still difficult to assess with any confidence. They seem relatively good in respect of Bus but far less so in relation to Truck. Here the Commission's problems stem from two difficulties. First, they are most concerned about the size of the proposed equity injection (this has, however, been inflated by some £100 million to give us some scope for a future negotiating concession). Secondly, the Commission have pressed us to be more precise about the restructuring on Trucks. Officials suspect that the Commission will argue that, instead of writing-off the full debt for both Bus and Truck, the Rover Group balance sheet should continue to carry part of those debts. The implications for Rover Group if the Commission choose to follow this route are now being examined by officials.

Sutherland, and indeed Delors, are well aware of the political sensitivities of the RG issue. However, it might be useful if, during Delors visit to London on 5 February, the Foreign Secretary could repeat the message. My Secretary of State also hopes that later intervention by the Prime Minister can be avoided. However, if his own discussions with Commissioner Sutherland do not make sufficient progress he envisages that it may be necessary for the Prime Minister herself to intervene with Delors later in February before formal proposals are brought to the Commission.

I am copying this letter to Alex Allan (Treasury) and Tony Galsworthy (FCO).

Yours

TIMOTHY WALKER
Private Secretary

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3

PRIME MINISTER

1

ROVER GROUP

You are meeting Mr. Channon and the Chancellor on Friday to discuss this.

DTI would be content for Mr. Day to be present.

I am not sure whether this would be right. You may well want to discuss it with him later. But the Policy Unit have doubts about the proposals, and in any case you should perhaps discuss them in the first instance unconstrained by the presence of the author.

Agree not to invite Mr. Day to this first meeting?

We will have a bilateral first after that with Mr. Day

DAVID NORGROVE

20 January 1987

SLHAFC

DRN 2

cc Sir Wise

cc B/UP

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PRIME MINISTER

ROVER GROUP : 1987 CORPORATE PLAN

We have agreed that any injection of equity into Rover Group must be made this financial year and not in 1987/88. To achieve this, the Rover Group need to hold an Extraordinary General Meeting in March in order to renew the powers to issue equity and probably vary their the borrowing limits. This will require a Government statement in mid-February and there will be intense political pressure on us at that time to announce the Government's response to the 1987 RG Corporate Plan. This is consistent with our earlier desire to respond to the Corporate Plan in February. I shall therefore need to make early recommendations to colleagues and you and Nigel Lawson may welcome a preliminary discussion of the main issues with Graham Day, which we can then follow up ourselves.

2 Completion of privatisation of Unipart and Bus has already been announced; Trucks, Freight Rover, Istel and JRA are now under negotiation. I shall be reporting separately on these shortly. This minute concentrates on the overall Group finances, the Plan's proposals for Land Rover and, especially, Austin Rover (ARG).

OVERALL FINANCIAL PARAMETERS

3 Assuming the sale of Trucks and Freight Rover, and a Government equity injection of £650m the Plan projects that

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RG will achieve profitability at the trading level in 1988 and at the pre-tax level in 1990. Apart from 1989, when notional receipts from the Land Rover disposal are taken, the Group remains cash negative throughout the Plan period but the massive haemorrhage of 1986-7 is much reduced. Government liabilities under Varley Marshall continue in the range £1.4 to £1.6 bn throughout the Plan period once the equity injection has been made.

LAND ROVER

4 Land Rover is scheduled for sale or flotation in 1989 with forecast receipts of £100m and investors taking on the company's debt of £80m. This plan rests in part on the successful launch of the Range Rover in the US. To offset the declining volume of traditional Land Rover vehicles, the Plan proposes the launch of a new vehicle aimed at the four wheel drive personal transport sector a market where hitherto the Janapense have had their own way. The cost of this new vehicle is held to a modest £30m by a substantial carry-over of components from the Range Rover.

ARG

General

5 The Plan represents a significant change of direction for ARG compared with that pursued by previous management. Notably:

(i) having made a forecast of a 14.5 per cent share of the UK market through the Plan period, the company would no longer be committed to a position as a "full-line" manufacturer of cars. Termination of

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Mini production and postponement of all work on a Metro replacement provides the possible basis for a complete ARG withdrawal from the small car sector in the 1990s, though the long term strategy on small cars is effectively kept open for the present, so long as they sustain satisfactory volume.

(ii) in the medium/executive car sectors, planned new products will flow from collaboration with Honda, key models being derivatives of the Rover 800 (including the Rover 600 hatchback) and a new jointly designed replacement for the Maestro/Rover 200 (the AR8). The question of a Montego replacement is left open although design work would allow this to be a "stretched" version of the AR8.

(iii) the only new engine to be developed by ARG is the small K series. Plans for a 4 valve version of the 1.6 (S series) engine and for an in-house V6 have been abandoned, the gaps likely to be filled by Honda.

6 By the end of the Plan period total sales volumes at 425,000 are slightly down on current levels but the model mix changes significantly. Sales of Mini/Metro reduce by 80,000 to 110,000 units while sales of the AR8 are forecast to reach 160,000 in 1991, around 30,000 more than the current combined sales of Maestro/Rover 200.

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Capacity and Employment

7 Manufacturing capacity is to be brought into line with more realistic sales forecasts. AR8 and the development of the K series engine would be based at Longbridge. Cowley South Works will be closed around 1989. Peripheral businesses will be closed or sold notably Llanelli Radiators and the Longbridge Foundry (both 1987) and the Beans Foundry and Longbridge Forge (1988).

8 As a result of closures, disposals and general streamlining total employment in Austin Rover by the end of the Plan will be reduced by one quarter (around 11,000 people). Some 1,600 UK redundancies will be announced at the end of January 1987. (I will report to you further about these shortly).

Financial Performance

9 ARG is forecast to become modestly profitable at the trading level in 1988 and to achieve a profit after interest in 1990. Cash flow remains negative throughout the Plan period but reduces from a forecast (£230m) in 1986 to around (£50m) in 1991. Year-end borrowings reach a peak of £575m in 1988 (from £500m in 1986) falling to around £540m by the end of the Plan.

10 Total capital expenditure over five years is forecast at £681m (down £300m on the previous Plan). Major items include some £185m for the AR8 and £200m for the new K series engine and the related gearbox. There is also a substantial notional provision of around £190m in the later years of the Plan which would be allocated when present uncertainties

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about future model plans (notably a replacement Montego) are resolved.

11 The Plan assumes that ARG will receive the proceeds from the planned disposals, the balance of the Jaguar proceeds from central deposits and any contribution which might at some stage be made by Honda. On this basis the Plan seeks no fresh equity from Government although it remarks that to set borrowings at "a more acceptable level of 50% of shareholders funds" a further £300m of equity would be required in 1987.

Risks

12 In addition to the obvious risks of political controversy over the handling of the Plan, there are major commercial risks associated with these proposals. These revolve around:

- in the short-term, the ability to sustain customer confidence in the company's products;

- in the longer term, the ability successfully to manage the transition from "full-line" manufacturer to "niche" producer assuming an intention ultimately to withdraw from the small car sector. This requires ARG to sustain a sufficient volume of sales of small cars whilst establishing a track record (and arguably ambitious sales targets) in the medium/executive sectors;

- a deepening dependence on Honda at a time when Honda are still not committed to equity participation;

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Graham Day himself would not wish us to under-estimate these risks.

Issues for Colleagues

13 Unless an acceptable purchaser should unexpectedly emerge, we have to accept that there is no realistic prospect of ARG privatisation in the Plan period. Honda, whilst willing to sign up on individual new projects, still appear reluctant to commit themselves to more fundamental links with ARG. Until they do, Honda retain their own freedom of manoeuvre while, under the Plan, ARG's dependence on Honda becomes critical.

14 Nor does the Plan itself provide a lasting solution for ARG. By the end of the Plan period the company's performance is much improved and it is marginally profitable at the PBT level. But it is still not generating sufficient earnings to make its operations self-sustaining and the Plan accepts that the company will still be cash negative with no return on assets, even after five years. Rather than a cure, the Plan should therefore rather be viewed as providing for a process of consolidation and improvement which, if successfully managed, would put ARG in a position where it could be prepared for later sale or flotation. But politically, at the present time, to move faster would be very risky.

15 As I see it, therefore, the immediate issues for colleagues include:

(i) whether the proposed strategy for Austin Rover, preparing for concentration on a limited number

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of models, is acceptable and likely to move the company towards viability;

(ii) whether, if we agree with that basic strategy, the Plan makes the necessary changes fast enough;

(iii) whether the deepening collaboration proposed with Honda narrows our freedom of manoeuvre should the company's subsequent performance lead us to look at alternative strategies.

(iv) whether in accepting the Plan we should seek to limit the Government's contingent liabilities under Varley-Marshall or reduce them below the levels proposed. The latter essentially would mean further pruning of the investment programme.

16 In deciding what we do, the fundamental question is one of public confidence in ARG. There are real risks that if over the next few months we are seen to be equivocal in our support for the company confidence may indeed collapse and we should be confronted with an unpalatable rescue operation at an exceptionally awkward time. Our interestes lie therefore in a speedy and public statement of support for an "agreed" Corporate Plan. This does not however mean that we need to commit ourselves to all its ingredients. In practice we need to decide only those elements of the Plan sufficient to carry the company forward in the short term. The Plan itself leaves open major questions, notably ARG's involvement in the small car sector and in relation to a Montego replacement. From the Government's point of view we should aim to retain the option of reviewing the strategy.

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17 Against this background we need now to decide only:

(i) to approve the collaboration with Honda for the manufacture of the AR8 (Maestro/Rover 200 replacement). The terms on which this is carried forward include issues e.g the balance between Japanese and UK content which will need to be negotiated but the model itself is a fundamental element in Graham Day's strategy for the company.

(ii) to confirm our previous backing for the K series engine. Graham Day firmly believes that this investment is central to his hopes of managing the transition of ARG away from dependence on the small car sector. I believe we have to support his judgement. As plans for investment in both a new medium sized and a V6 engine have been abandoned, commitment to the K series will also be helpful in deflecting arguments that ARG's research and engineering capability is being sacrificed;

(iii) to recognize that while, if the more realistic forecasts for the business are achieved, no new direct Government support will be required (at least until there is a privatisation prospect); the Plan is necessarily high-risk and will require the closest monitoring.

18 On Land Rover the long term prospects depend significantly upon the new Jay model. To be successful this will need to take market share from the Japanese who have secured a commanding position in the growing personal

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transport sector. Graham Day is however convinced that this is a challenge the company must confront to maintain its position in the four wheel drive market and that prospects for a successful privatisation are linked to this.

19 I am copying this minute to Nigel Lawson.

MRC

pp PAUL CHANNON
19 January 1987

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

DEPARTMENT OF TRADE AND INDUSTRY

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CC BG
CC GMWSO

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ROVER GROUP

The Rover Group plc
7-10 Hobart Place
London SW1W 0HH
Telephone: 01-235 4311
Telex: 926880

19 January 1987

Prime Minister 2
You have a first meeting on the Rover Group corporate plan on Friday.
DCR
19/1

Rt Hon Paul Channon MP
Secretary of State for Trade & Industry
Department of Trade & Industry
1 Victoria Street
LONDON
SW1

CONFIDENTIAL

Dear Secretary of State

Following our meeting last week, I wish to put on record some of the concerns which I and the Rover Group Board have about the strategy which we discussed.

Many of the questions which you and your officials have posed have been directed towards the robustness of the strategy. While I believe that the strategy and the financial forecasts which we have included in the Corporate Plan can be delivered, it should be remembered that if it were not for the Government's support and in particular the Varley Marshall Joseph assurances, the Rover Group would be technically bankrupt. In this context, it should be noted that the banks are hesitant about renewing and extending lending to the Group and are looking for repeated or strengthened assurances.

Following the disposal of Unipart, ISTEL, the commercial vehicle and bus activities, the Group will comprise the passenger car and 4 x 4 businesses. The Group's results will be critically sensitive to the volume of sales of these businesses and in particular the domestic market penetration of ARG. While we will focus on profitable sales rather than chase volume in its own right, the sensitivity to volume is such that 1% of the UK market in passenger cars is worth about £27 million in profitability and cash flow. Austin Rover is highly vulnerable in the domestic market and a continuation of the

continued

Directors J Graham Day (Chairman and Chief Executive) Sir Robert Hunt CBE DL (Deputy Chairman) N J Carver OBE AFC (Group Executive Director) Sir Robert Clark DSC E W Dawnay A W Forster D R L Hankinson (Group Finance Director) Sir John Mayhew-Sanders B W Pomeroy **Registered Office** 7-10 Hobart Place London SW1W 0HH Registered in England 1213133

19 January 1987

Rt Hon Paul Channon MP

decline in this market could lead to progressive collapse during 1987. Confidence in ARG could be jeopardised by a public perception of a worsening position of Austin Rover, particularly when the record 1986 losses of at least £320 million, before restructuring costs, are published later this year.

On the basis of the current plan, the Austin Rover business will not generate sufficient cash to finance the levels of investment required and there is no prospect of privatising Austin Rover other than by way of a distress trade sale. However, if the market share could be restored to 1985 levels (ie 17.7%, compared with the 14.5% in the Plan), the Group would enjoy additional profit and cashflow of £400 million over the planned period thereby transforming privatisation prospects. An adverse movement of similar magnitude would almost certainly lead to the need to terminate the business. One of the important measures which will help to avoid such a collapse of market share would be a quick endorsement of the strategy by the Government to minimise public debate about the future of the business.

Yours sincerely

J GRAHAM DAY

cc Prime Minister
Chancellor of the Exchequer
Minister of State

CG 89

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Secretary of State for Trade and Industry

PS/

CONFIDENTIAL

13 January 1987

Prime Minister 2

This is a bland letter because of its circulation. DTI will be meeting the Commission tomorrow and will then provide to you and the Chancellor a more complete report.

JCS 14/1

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

Dear David

ROVER GROUP

My Secretary of State and Mr Shaw have seen your letter of 9 January.

Officials propose to have preliminary talks with the Commission. In these the aim will be to explain the difficulties of giving them precise details (particularly about the possible restructuring of the Truck Division) at a time when talks between RG and the bidders have still to reach a more definitive phase. Officials will, however, give a robust explanation of the substantial restructuring that has already taken plce in the UK Truck industry. They will also continue to take great care to keep the Commission fully in touch with developments and to be as open as they can in explaining to them the latest position. This approach will undoubtedly help in demonstrating to the Commission our wish to be co-operative as possible whilst, at the same time, repeating the over-riding need for the Commission to authorize the proposed aid before the end of March this year. My Secretary of State will let you and colleagues know if any major difficulties emerge.

I am copying this letter to the Private Secretaries, to Members of MISC 126, Colin Budd (FCO) and Trevor Woolley (Cabinet Office).

Yours

Timothy

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TIMOTHY WALKER
Private Secretary

999-1

IND POL BL PT13

10 DOWNING STREET

LONDON SW1A 2AA

9 January 1987

From the Private Secretary

Dear Malcolm,

ROVER GROUP

The Prime Minister has seen your letter to me of 7 January about the opening of the Commission procedure for the plan to write-off the accumulated debts of the Bus and Truck Divisions of Rover Group.

The Prime Minister agrees that there could be critical comments about the Commission's letter if it becomes public knowledge. It asserts that the proposals "threaten to distort competition" and are "not compatible with the Common Market", though this is qualified by saying "on the basis of the information provided so far". You told me that this is standard Euro-speak and that the rejection is needed in order to get the procedure under way. It may also be that if in the end approval is given the letter should help the presentation by strengthening the impression that the Government is fighting for Britain in the Community.

Nevertheless, the Prime Minister believes nothing must be left to chance in this. She will be glad to see the line of argument that the DTI will take in seeking to persuade the Commission that the proposals are legitimate on restructuring and rationalisation grounds. She also wishes to see an assessment of whether there is any possible fallback plan short of a major political confrontation if Commission consent continues to be refused. Finally, the Prime Minister would wish to have maximum warning of any request for an intervention by her.

I am copying this letter to the Private Secretaries to members of MISC 126, Colin Budd (Foreign and Commonwealth Office) and Trevor Woolley (Cabinet Office).

Yours,

David.

DAVID NORGROVE

Malcolm McHardy, Esq.,
Department of Trade and Industry.

SECRET

P 02430

From: J B UNWIN
8 January 1987

MR NORGROVE - NO 10

ROVER GROUP

A few brief comments on Mr McHardy's (curiously unclassified) letter to you of 7 January reporting progress on the request to the Commission for clearance of the write-off proposals for the sale of the bus and truck businesses.

2. Although a prima facie finding against the UK seems unavoidable in order to initiate the consultation procedures quickly, the Commission's (imminently expected) letter, which I imagine will almost certainly become public, will appear to many as a severe rebuff to the UK. It asserts that our proposals "threaten to distort competition" and are "not compatible with the common market". Except for a cautious hint in the first sentence of the last paragraph, the DTI letter does not prepare colleagues for this. Nor does it give any assessment of the prospects for securing Commission approval on the second round.

3. DTI officials seem fairly confident that Commission approval will be obtained. But at the same time they are talking in terms of asking the Prime Minister to intervene at the highest political level if necessary, and of pressing on regardless if the Commission persist in their opposition.

4. Given the very large sums involved (the negotiation of which could be further complicated if clearance is needed for further substantial aid in relation to the new RG Corporate Plan), it will not obviously be easy to secure Commission approval and the Government may simply need to press on and face as it comes any recourse to the European Court. But this would not be the most propitious background for the bus and truck disposals, and you

will no doubt want to ensure that DTI give you the maximum possible warning of any proposal for intervention by the Prime Minister. In my view it would also be prudent to invite the DTI now:

(i) to set out more fully the line of argument they propose to take in seeking to persuade the Commission that the proposals are legitimate on restructuring and rationalisation grounds (this need not entail circulation of sensitive information on jobs and capacity cutbacks which could be very embarrassing if leaked);

(ii) to consider further whether there is any possible fall-back plan short of a major political confrontation if Commission consent were still refused. Advice within DTI so far is that there is no device (such as establishing new companies, replacing bank borrowing with interest-bearing Government loans etc) which would avoid offending the provisions of the Treaty, but it would be sensible to be satisfied that DTI have exercised their ingenuity far enough. It would obviously be much preferable to find some such route than to have a major political row.

5. You may care to consider drawing on the above points in responding to DTI.

J B UNWIN

Cabinet Office

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PRIME MINISTER

ROVER GROUP

The semi-literate letter from DTI below explains that the European Commission have now written to set in motion the procedure for examining the debt write-offs for Leyland Bus and Truck.

The letter will be mentioned in the Official Journal of the European Community and the letter itself could leak. If so it would look to some like a severe rebuff. It asserts that our proposals "threaten to distort competition" and are "not compatible with the common market", though this is qualified by saying "on the basis of the information provided so far".

DTI assure me that this is standard Euro speak and that the rejection is needed in order to get the procedure under way. In any case assuming that in the end approval is given the letter should help the presentation by strengthening the impression that the Government is fighting for Britain in the Community.

It may nevertheless be prudent for you now to ask the DTI:

(i) to set out more fully the line of argument the DTI will take in seeking to persuade the Commission that the proposals are legitimate on restructuring and rationalisation grounds (without circulating sensitive information on the likely outcome in terms of jobs and capacity);

(ii) to consider further whether there is any possible fall back plan short of a major political confrontation if Commission consent continues to be refused;

(iii) to ask for maximum warning of any proposal for intervention by you.

Agree?

David Norgrove
8 January 1987

JA1BDW

Confidential
Commercial in confidence

CCPG

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From the Minister of State for Industry

Private Secretary to
GILES SHAW MP

David Norgrove Esq
No 10 Downing Street
London
SW1

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 DAF. 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. | letter attached

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

FLAGC

COMMISSION
OF THE
EUROPEAN COMMUNITIES

Brussels
SG(86) D/

Subject: Aid plan by the UK Government to provide new equity capital to an undertaking in order to facilitate the restructuring of two commercial vehicle subsidiaries.

Sir,

By letter dated 8 December 1986 your Government notified in accordance with Article 93 $ 3 EEC its proposal to provide new equity capital to a car and commercial vehicle producer in order to facilitate the restructuring of its bus and truck subsidiaries.

In the notification your Government explained that the capital injection to the undertaking will be used to write off the historic debts of the two commercial vehicle subsidiaries reflecting, in part major rationalisation which has been undertaken in these businesses over the last three to four years, and costs which arise from the further restructuring of these companies associated with their sale.

Your Government indicated that its policy is to return the whole undertaking to the private sector. The bus and truck subsidiaries are facing considerable losses and debts. Therefore your Government proposed to restructure and privatise these businesses. This will require significant levels of state aid to write off accumulated debt and restructuring costs.

Given the poor financial record of these businesses, your authorities indicated that it was impossible to attract bids for either the bus or truck subsidiary without eliminating the heavy accumulated debt in those businesses. The privatisation of the commercial vehicle divisions is

The Right Hon. Sir Geoffrey HOWE, Q.C., M.P.
Secretary of State for
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designed to create the conditions for viable enterprises which are expected to sustain themselves in the market without further specific government financial support.

Negotiations are in progress on the sale of the bus subsidiary to a management led consortium. As a result of the overcapacity in the manufacture of conventional single and double-deck buses both in Europe and in the UK, discussions with the management team have focussed on the need to rationalise production facilities. It is a condition of the proposed sale that the parrent company meet the costs of an agreed programme of reductions in capacity and redundancies.

Since 1983 the bus subsidiary has been adversely affected by the reduced demand from many traditional export markets and by the changes in the domestic bus operating industry through the deregulation policy adopted by your Authorities. In spite of capacity reductions the bus subsidiary made trading losses in 1984 and 1985 and is forecast to make a further loss in 1986.

The parent company is also in discussion with two prospective buyers for the sale of the trucks business including truck parts. Although some 97 % of European demand is satisfied by European truck production, it is widely accepted that there is still some 40 % excess capacity in Europe.

Your authorities explained that there will be further rationalisation of UK truck manufacture but detailed proposals are still to be developed.

The accumulated debts of trucks and truck parts subsidiaries including estimated restructuring costs (which are still to be finalised), are forecast to be very significant. Debt of the three businesses together (trucks and buses and their parts) at the end of 1985 was some £320 million. To this must be added the debt arising from accelerating losses until disposal and the anticipated costs of restructuring.

The equity injection will be made using the powers under Section 3(2)a of the Industry Act 1980. The injection will relate to the residual debt in both businesses plus restructuring costs consequent upon the privatisation of both.

Your Authorities maintained that the proposed aid is consistent with the objective of creating a more rational structure for the commercial vehicle industry in the Community. It is directly linked to the restructuring of the parent company and returning its operations to the disciplines of the market.

The Commission considers that the provision of new equity capital to the parent company which corresponds to the debts of the bus and trucks businesses of the group and the restructuring costs of these businesses allows the undertaking which is at the moment in financial difficulties to remain in competition and to sell two loss-making and heavy indebted divisions without bearing the corresponding charges. Therefore, the capital injection cannot be considered as the provision of risk capital according to the standard company practice in a market economy. At the same time the new owners will keep the bus and truck units in competition and receive an opportunity to obtain a restructured business. As there is intra-Community trade in trucks and buses and as the company participates in that trade, albeit at a relatively modest level, the proposed measures constitute an aid and threaten to distort competition in the sense of Article 92 § 1 of the EEC Treaty.

at this stage the Commission has no reason to believe that the aid can benefit from one of the derogations provided for by Article 92 § 2 and § 3 of the EEC Treaty. Your authorities believe that the aid facilitates the development of the bus and truck activity where the aid does not adversely affect trading conditions to an extent contrary to the common interest. Both the bus and truck industries are facing problems of large overcapacity. The aid can only be approved if the restructuring effort contributes to the development of these activities at Community level and is in balance with the amount of aid proposed.

However, the restructured truck and bus businesses freed from their debts and sold at a low price to private investors could intensify competition in the common market. Consequently, on the basis of the information provided so far the Commission has concluded that the aid plan notified by your Government is not compatible with the common market having regard to Article 92 of the EEC Treaty.

The Commission has therefore decided to initiate the procedure provided for by Article 93 § 2, first sentence EEC with respect to the provision of equity capital to the undertaking under consideration. Within the same procedure, the Commission gives hereby your Government notice to submit its comments within one month from the date of this letter, and to provide all the information necessary for its appraisal.

In particular your Government is requested to provide the following information :

- exact amount of new equity capital ;
- detailed restructuring plan for the two subsidiaries and eventually the investments proposed ;
- the breakdown of the debt of the parent company over the different subsidiaries which should be verified by an independent accountant bureau ;
- the exact terms of the debt to be repaid : the interest rates, government guarantee and its legal ground, banks involved, etc. ;
- separate accounts for the two subsidiaries for 1983-85 as well as provisions for 1986 ;
- the unit sales, production and production capacity by model or type of product for both divisions (past and future) ;
- the age of the models produced by both subsidiaries ;
- the number of trucks and buses exported to the other Member States in the past and forecasted in the future ;
- details on the existing marketing agreement with the continental competitor ;
- the viability forecast of the two businesses after privatisation ;
- when the deals have concluded, the financial terms of both agreements.

The Commission is also giving notice to the other Member States by sending them a copy of the present letter, and to the other parties concerned by means of a publication in the Official Journal of the EC, to submit their comments.

The Commission reminds your Government that according to the provisions of Article 93 § 3 EEC no aid measure can be put into effect before the 93 § 2 EEC procedure has resulted in a Commission's final decision.

The Commission draws the attention of your Government to its letter of 3 November 1983 sent to all Member States regarding their obligations as they arise from the provisions of Article 93 $ 3 EEC and to the communication published in the Official Journal of the EC No C 318/3 of 24 November 1983, on the basis of which any aid provided illicitly, that is without waiting for the Commission's final decision resulting from the 93 $ 2 EEC procedure, could be subject to a recovery order.

Yours faithfully,
For the Commission

LND POL: BL Pt 13

COMMERCIAL IN CONFIDENCE

P 02426

From: J B UNWIN
5 January 1987

MR WILLIAMSON

cc Mr Wiggins
Mr Jay
Mr Norgrove (for info)

COPY FOR

ROVER GROUP

Thank you for sending me a copy of the UKREP letter of 23 December to John Mogg covering an advance copy of the Commission letter.

2. On the substance, John Mogg claims success in persuading the Commission to initiate the Article 93.2 procedure so quickly. This means that we are on track to get a substantive decision by the end of March, as required. He admits, however, that it will be far from easy to get a favourable final decision. The level of aid proposed is extremely high and will not easily be justified on restructuring grounds. He appears to believe, however, that at the end of the day the Commission may be prepared to bow to the politics of the proposal. It has apparently already been at least hinted to them that the political imperatives are such that we shall be prepared to go ahead with the scheme even if the Commission's approval cannot be secured.

3. I said that I thought it most important that the Prime Minister should be told what is afoot. The substance of the Commission's letter would presumably very soon find its way into the press, and its significance might well be misrepresented. This would hardly help the proposed disposals. I also thought that other members of MISC 126 should be informed. The question of clearance with the Commission was discussed at their meeting on 2 December, when they were told that Commission approval would be "readily forthcoming" in respect of the losses of Leyland Bus.

COMMERCIAL IN CONFIDENCE

4. Mr Mogg assured me that No 10 had been kept informed although they had not yet seen the text of the Commission letter. He undertook to consider further the possibility of a short note round to members of MISC 126. This might, however, have to await his Secretary of State's return in a few days from the Caribbean.

5. I hope DTI will now move as I suggested. I have asked Mr Mogg to copy any further papers to me. They may have done well in getting the procedures initiated so quickly; but this will not be of much avail if the final decision is adverse, and I must confess that I am not as sanguine about the prospects as DTI appear to be. The Government could find itself in a very embarrassing position. We can, of course, press on regardless; but proceedings in the European Court would hardly form the most auspicious background for the proposed two privatisations.

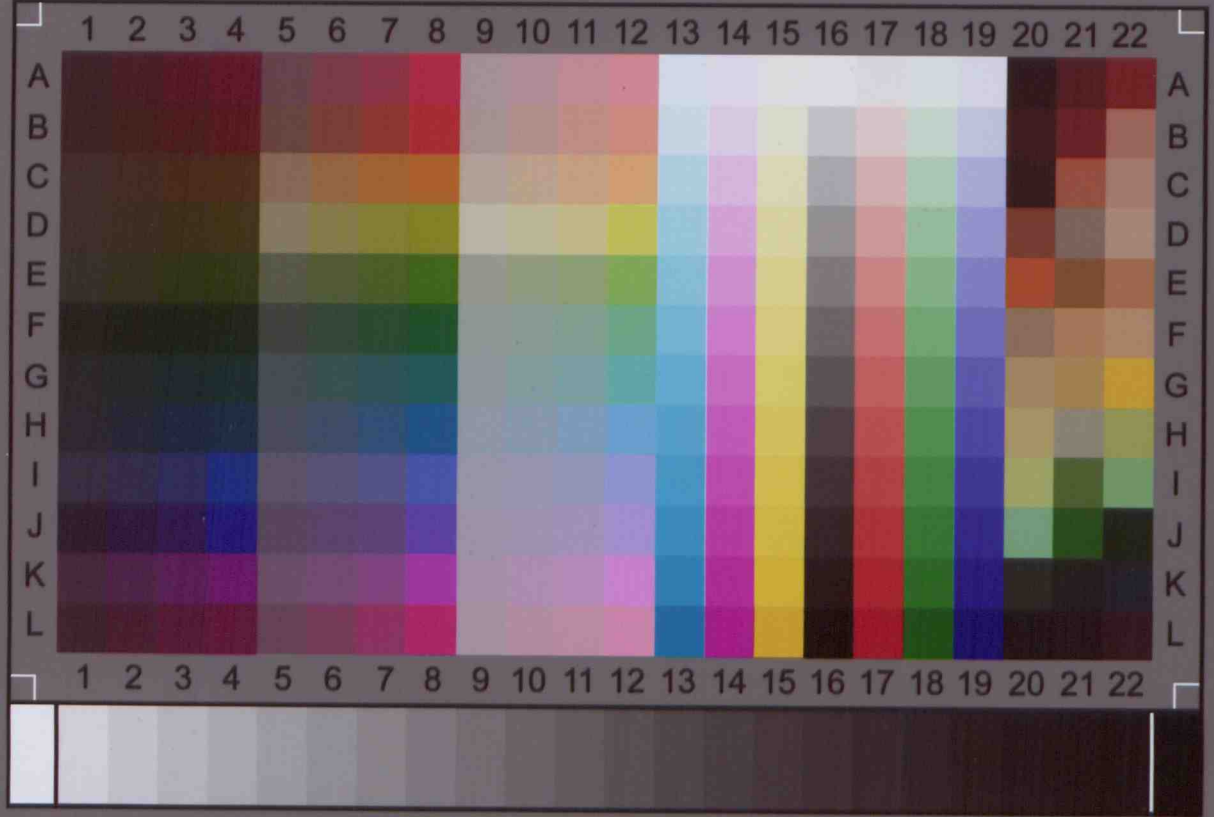
J B UNWIN

PART 12 ends:-

DRN TO DTI 16.12.86

PART 13 begins:-

B. UNWIN TO D. WILLIAMSON 5.1.87



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