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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

18 October 1984

The Rt Hon Paul Channon MP
Minister for Trade

Handwritten signature of Paul Channon in cursive.

Norman Tebbit wrote to me on 1 October about Austin Bide's letter of 17 August on BL/Government relations, indicating how he proposed to respond.

Sir Austin raises a number of important issues crucial to Government policy on BL over the next few years. Generally I agree with Norman's proposals, but there are some aspects which I believe we should emphasise. In particular, while the formal duties of the BL Board include the legal obligations to which Sir Austin makes reference, he must recognise that the Government as the major shareholder cannot abrogate its responsibilities. Moreover, because of the Varley Marshall assurances, we continue to underpin BL's borrowing past and future and this places upon us an obligation to be satisfied that the Plan incorporates acceptable decisions on investment as well as on progress towards privatisation.

Specific issues may also arise where the Government's wider interests may conflict with BL's commercial judgement. The Jaguar Executive share options scheme provides a recent example. I hope therefore that Norman will tell Sir Austin firmly and unequivocally that we cannot accept that BL should have the final say on all decisions which they may regard as of a commercial nature, particularly in a privatisation context.

I recognise that the dividing line between decisions appropriate to management and those where Government approval is needed may be difficult to define. But I am sure that given goodwill on both sides, the system can be made to work.

On objectives, I strongly support Norman's view that the reference to profitability should be retained. While privatisation might be said to subsume a profitability objective,

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an explicit commitment to achieve a sustained and growing level of profitability on the way to privatisation helps to impose commercial discipline on the company and provides a yardstick against which progress can be assessed. Moreover, a rising level of profits is crucial if BL is to generate sufficient funds to finance its investment programmes in the future on the way to disposal.

However, profitability targets for BL Group as a whole tend to lose much of their meaning as the disposal programme proceeds. The Jaguar sale, for example, will reduce BL profits as well as interest payments. I think it would therefore make more sense in future to express annual profit and cashflow targets for each business as well as for the Group as a whole, together with medium term objectives for return on assets. Norman might like to suggest Sir Austin incorporates this proposal in the 1985 Corporate Plan.

In the meantime, the Varley Marshall assurances remain in place. At the minimum, we need to contain the growth of our liabilities along the lines Norman suggests. But I hope we can eventually remove the assurances themselves. As an interim step, it might perhaps be possible to draw a line between past borrowing and all future borrowing. I appreciate this has been examined in the past, when it was concluded that withdrawal did not seem feasible in advance of disposal. I think, however, it would be worth officials taking another look.

As for progress on privatisation, we still await the further studies which were commissioned during the course of our discussions on the 1984 Corporate Plan. I understand that John Moore will be discussing this with Norman Lamont shortly.

There are also a range of specific privatisation issues which, as Norman suggests, will need to be considered case by case. On most, I agree with his approach. But on the proposal that BL should retain a minority stake in subsidiaries, I start from the presumption that the benefits of privatisation will be most completely felt if there is no residual publicly owned stake. I would not therefore want the response to Sir Austin to prejudice future decisions on Unipart by referring to it as a clear example where retention by BL of a minority shareholding might be justified, even though at the end of the day we might wish to concede this.

May I take this opportunity to mention two points which are causing me concern and which I suggest should be taken up in the examination of this year's Corporate Plan.

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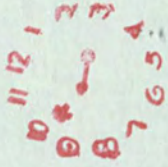
First, I think we should aim for a speedier consideration of the issues than was possible last year. Six months is far too long to be locked into an annual review exercise of this kind. My main concern, however, relates to the Austin Rover Group, where the privatisation prospects seem to be deteriorating. Trench warfare appears to be breaking out again at Cowley, boding ill for this year's pay settlement. The new ARG models have not achieved the reputation for reliability they will need if they are to secure adequate market share. And I understand that the collaboration with Honda on the XX programme has gone badly awry. We shall need to take stock of these developments, and be prepared to take a hard view of the implications for BL's future.

Copies of this letter go to the Prime Minister and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read 'Nigel Lawson'.

NIGEL LAWSON

22 OCT 1984



hd fol : The Future of BL A8 .

MR TURNBULL

5 October 1984

c Mr Redwood

BL - WHO SHOULD DRIVE?

The English for what Sir Austin Bide is saying is that Government should give the BL Board more licence than it has had of late. Norman Tebbit's draft reply is for the most part robust, but we think he could be firmer still. If the Prime Minister is minded to comment, she might draw upon the following.

1. The Corporate Plan

This is the one solid point in Sir Austin's letter, given that Government took six months to review the last Corporate Plan. Mr Tebbit could commit to a quicker response in future. (Incidentally, how does it look that Sir Austin's letter of 17 August is still the subject of a draft reply on 1 October?)

2. Duties of the Board

The fiduciary duties of Boards stem from their obligations to shareholders. In this case, Government is the overwhelming shareholder and has a perfect right to have the company run as it sees fit. In the eyes of the taxpaying public, a PLC owned by Government is the same thing as a nationalised industry corporation. And in the case of the latter, the Secretary of State does have legal rights to issue directives. Mr Tebbit could remind Sir Austin more forcibly of his rights as shareholder, and of his obligations as Secretary of State to taxpayers.

3. Objectives

Privatisation of the parts or of the whole should indeed be BL's main objective. But it would be unwise for Mr Tebbit to say to BL that profitability must precede privatisation. That merely gives BL cause for delay. It is not strictly true anyway - privatisation can not only precede profitability, but is often a spur to it.

4. Ownership

We strongly agree with Norman Tebbit's open-mindedness on foreign ownership or part ownership. Given the international nature of vehicle manufacturing and sourcing, he could actually encourage BL to give it greater consideration, while reserving his right to take each case on its merits.

5. Varley Marshall Assurances

Again, we strongly support Norman Tebbit's line. In the case of a nationalised industry corporation, Ministers would not dream of setting no limit to the EFL. Containing BL's borrowings is exactly parallel.

6. Disposals

Privatisation is not just adaptation to commercial reality, but an important political objective, pledged in the Manifesto. Government does have the right to drive the disposals programme along. That apart, Government is equally entitled, as shareholder and guarantor, to determine financial priorities, and to require BL to act accordingly.

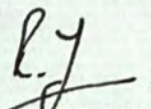
It is astonishing that Sir Austin Bide writes, 'The Board cannot simply do as it is told'. It must either do that, or go.

7. Minority Shareholders

There is certainly no case for buying them out. If the minority shareholders purport to be sober, long term investors, they need their heads examined: certainly Government should not pay to steer them away from a nasty accident. If they are gadfly investors who buy in and out on the hopes of preferential treatment with each privatisation then, again, we should not worry. Markets have their spills as well as their thrills and the punters above all should see the funny side of it.

There are wider issues at stake, too. It should strike Mr Tebbit as significant that Sir Austin feels entitled to write in the terms that he used. Before the final reply goes, Mr Tebbit could ponder:

- i. Do we need BL PLC? All Government's deliberations are now aimed at the individual businesses, not at the company as a whole.
- ii. If Government keeps BL PLC, is there a case for making changes to the Board? Look at its track record and ask what claims it can make to 'commercial judgement'.
- iii. Has the relationship between BL and DTI officials become too cosy? In our experience, DTI's sponsorship of the BL view to Government is far more assiduously done than the channelling of Government's requirements back to BL. Getting to grips with the old DoI's vast appetite for industrial intervention continues to be one of Mr Tebbit's main challenges.


ROBERT YOUNG



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

Secretary of State for Trade and Industry

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1 October 1984

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Dear Chancellor,

BL

I attach at Annex A a copy of a letter I have received from Sir Austin Bide about BL/Government relations. I apologise for the length of this letter, but Sir Austin's letter raises a number of important issues, and I should be grateful for your agreement to the way I propose to reply to it.

2 In my view the Memorandum of Understanding (MoU - copy at Annex B) between the Government and the Board has generally worked very well. I value its flexibility, which enables most issues between the company and the Government to be settled in a pragmatic fashion. But there have been occasions - like the recent debate over the introduction of senior executive share option schemes at Jaguar prior to flotation - where the Board has regarded as exclusively within its commercial remit a matter in which Government have a legitimate interest. I therefore welcome the opportunity to clarify with the Board our understanding of the roles assigned to Board and Government by the MoU.

CORPORATE PLAN

3 Sir Austin's appears to suggest that we should move away from the present system under which an annual Corporate Plan is submitted for our approval. I propose to reply that the Corporate Plan process is a well-established one for publicly-owned businesses and that I could see nothing in the circumstances of BL to justify making an exception in this case. Only last year, the PAC broadly endorsed the procedure and the way it is carried out.

FORMAL DUTIES OF THE BOARD

4 On the points raised by Sir Austin about the formal duties of the Board, his statement of the law is of course impeccable;

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but as a basis for defining the relationship between us I believe it is inadequate. The Government not only own 99.7 per cent of the shares in BL, but also effectively guarantee through the Varley-Marshall assurances the continuation of the business; and I do not imagine that a commercial holding company in a similar position would give the Board absolute freedom to take decisions without reference up, nor would the Board expect it. There are bound to be decisions of an essentially commercial nature in which we legitimately have an interest. Indeed, the MoU recognises this by providing that the Corporate Plan itself and individual investment projects require my approval. The Government must be involved in major decisions about the allocation of publicly owned resources, and in particular in shaping the company's privatisation strategy. So I would propose to tell Sir Austin that, while it is in no way the Government's intention to "second-guess" the Board's commercial judgement, there are matters, some of them commercial in nature, in which Government properly has an interest and on which the Government's views and those of the Board may not necessarily coincide. In that event, I could not accept that the MoU should be so interpreted as to give automatic precedence to the views of the Board. Rather, I hoped that we would continue, as in the past, to discuss the issues involved frankly and reasonably and to agree in the light of the circumstances of individual cases, the best way forward.

OBJECTIVES

5 On the proposed revised objective (the existing objectives are at Annex C) I welcome the increased emphasis on privatisation as the Board's overriding objective. You will see that in the process the reference in the existing objectives to pursuing a targeted programme of profitability improvement has been dropped, but I think this is acceptable as an improvement in profitability is an essential precursor of privatisation.

OWNERSHIP OF PRIVATISED BL BUSINESSES

6 On the question of foreign ownership or control of privatised BL businesses, I would propose to tell Sir Austin that the Government would naturally wish privatised businesses to remain at least initially in British hands, other things being equal. But the arguments will not always be as clear-cut as they were in the case of Jaguar. It is not obvious that a continuation of British ownership will necessarily be the best way of ensuring the future of all the businesses within BL, and it could be that a determination to retain British ownership would hamper attempts to privatise some of the businesses. Except, therefore, where there are special circumstances (as in the case of Jaguar) we would not wish our general preference for British ownership to be regarded as an overwhelming consideration, especially if insisting on it would stand in the way of privatisation.



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7 On whether BL should be allowed to retain a minority stake in privatised businesses, I would propose to tell Sir Austin that the Government recognised that in some cases, of which Unipart is perhaps the clearest example, the links (whether trading, marketing or technical) with companies remaining within BL were so substantial as to justify a residual BL minority holding, which would be in keeping with the emerging pattern in the world vehicle industry in which such links are often underpinned by cross-shareholdings. In such cases we would of course be prepared to agree to the retention of such a shareholding. Other cases, where the justification was less clear cut, would be considered on their merits: but we would generally start from a presumption that the benefits of privatisation to the privatised company will be most completely felt if there is no residual publicly owned stake.

VARLEY-MARSHALL

8 On the Varley-Marshall assurances, I would propose to tell Sir Austin that no Government could contemplate with equanimity a position in which large contingent liabilities were allowed to build up without limits on either extent or time. The Government's liabilities will of course cease once all the businesses are privatised. Until then, it is only natural that the Government should wish to limit both its overall exposure under the assurances and the risk that the assurances will be called. We recognise that there is no prospect of withdrawing or substantially modifying the assurances in the immediate future, but as the company's performance improves we will continue to aim at this, even before complete privatisation is achieved, if it can be done without damaging the company or jeopardising the privatisation programme.

In the meantime, BL's borrowings should be kept within agreed limits so as to maintain control on at least one component of the Government's contingent liability; and discussions about this are in train at official level.

DISPOSALS

9 Sir Austin also raises the question of sales of lines of BL being accompanied by a "dowry". Naturally this is not something we should wish to encourage. But it is certainly conceivable that the benefits to BL of being rid of a troublesome business which could do better elsewhere would outweigh the once-off financial loss, and make sense (just as BL have already sold some of their loss-making peripheral businesses at a substantial discount on book value).

10 Similar considerations apply to the idea of selling businesses at what Sir Austin terms "less than: a commercially justifiable value" - by which I take him to mean selling at a particular time even when he believes that a sale at a later date would yield a higher price. There will be cases when



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uncertainties about the future make an earlier sale preferable, even at the cost of giving up the prospect of higher proceeds at a later date. All we can tell Sir Austin, I think, is that each case will be judged on its merits.

11 Finally, there is no question that the remaining minority shareholders in BL have considerable nuisance value. If we were at any stage to carry a motion solely by virtue of our overwhelming majority of the shares, and against the demonstrated wishes of the minority, there would at the least be scope for considerable embarrassment. And at some stage we are going to have to turn our minds to what is to happen to the minority when the last subsidiary is privatised and BL itself is wound up. However, I do not propose that we should now attempt to buy out the minority shareholders. The only secure means of achieving the objective would be new legislation. This would be very unpopular with our own backbenchers and would sit very uneasily with our overall privatisation objectives. I do not believe that it is a politically acceptable option except in the most extreme of circumstances. I therefore propose to tell Sir Austin that the option of buying out the minority is highly unattractive, and that we could consider it only if it was manifestly and incontrovertibly clear that the existence of the minority was impeding either privatisation or the company's return to viability or both - and even then without any commitment to accept it.

12 I am sending copies of this letter to the Prime Minister ' and to Sir Robert Armstrong.

Yours sincerely

N. Tebbit

NP

NORMAN TEBBIT

*seen and approved by the
Secretary of State*

JH3BAE



| | |
|--------------------|----------------|
| TO MR HEADWAY (v) | COPIES TO |
| FOR ADVICE (AND | P/S NL |
| DRAFT REPLY IF | P/S JB |
| APPROPRIATE) | P/S SIR BH |
| PLEASE BY: 28/8/84 | MR MOUNTFIELD |
| IF DEADLINE | MR LINGARD (v) |
| CANNOT BE MET | |
| PLEASE PHONE | |
| 215 5422 | |

BL Public Limited Company
106 Oxford Road, Uxbridge
Middlesex UB8 1EH
Telephone: 0895 51177
Telex: 263654
Cables: Leymotors Uxbridge Telex

SECRETARY OF STATE
FOR
TRADE & INDUSTRY

The Rt Hon Norman Tebbit, MP
Secretary of State
Department of Trade & Industry
1 Victoria Street
LONDON SW1

1000 20 11:47
17 August 1984

Dear Secretary of State,

BL/GOVERNMENT RELATIONS

The purpose of this letter is to put down my views of the essential issues affecting the relationship between BL and Government. The Memorandum of Understanding adopted when the Department of Industry took over from the NEB Government's shareholding in BL, has served us tolerably well as a practical, albeit imprecise guide, to the conduct of our relationship. It does not, however, address the fundamental issue of the formal duties of the Board on the one hand and the Government on the other. I suggest that this letter, together with the correspondence deriving from it, be treated as an addendum to the present Memorandum of Understanding covering this aspect.

I approach the matter at this time when we are between Corporate Plans with a view to improving our understanding of each other's role and duties in what is inevitably an often complex and sometimes difficult relationship. We have already agreed that your officials and my Corporate Staff will address, as a matter of urgency, the modus operandi for hastening the process of Corporate Plan development and acceptance - always on the assumption that we both continue to believe that the submission to you of a formal Corporate Plan to be laid before Parliament is the best way in today's circumstances of HMG's reviewing the business.

I believe the first and fundamental step in the process of improvement is for us to reach an understanding on a clear and practical objective for BL.

The Rt Hon Norman Tebbit, MP

17 August 1984

In order to advance in this direction, the BL Board considered at its last meeting the following Objective which we believe is appropriate in today's circumstances:

"To return BL and its constituent businesses, either together or separately, to the private sector as soon as practical, while satisfying the Board's fiduciary duties. In any case where this objective cannot be achieved, the Board will review the future of that business."

The next fundamental step is to ensure that there is a clear understanding all round about what are the operational procedures and boundaries of responsibility and authority between Government and the Board.

My views on that are as follows:-

- a In Law it is the Board's fiduciary duty to determine in all respects what is in the best interests of the Company.

However, since the Government is Parliament's guardian of the public interest in BL and, the owner of an overwhelming majority of the Company's shares and the effective guarantor of the business by virtue of the Varley Marshall assurances, then:-

- b The Board must, so far as proper observance of its fiduciary duty permits, take account of matters that a Government sees as important.

There are a number of such matters where the tasks ahead of us require that we take account of Government's views but where our knowledge of those views is at best imprecise.

- i The position as to foreign ownership and control (whether de facto or de jure) of privatised BL businesses;
- ii The retention of partial interests by BL in those businesses it privatises (this could be of major importance in the Unipart case);
- iii The limitations you may wish to place on your obligations under the Varley Marshall assurances and the circumstances, if any, in which you would curtail or withdraw these assurances.

The Rt Hon Norman Tebbit, MP

17 August 1984

- iv Ideas about "dowry" and similar plans that may involve sales at less than a commercially justifiable value.
- v The desirability or otherwise of eliminating the cadre of minority shareholders.

I believe it is essential that Government's views on such matters be ascertained and made known to the Board at the earliest possible date. If the Board is in the dark until the last minute or beyond about such things then its ability to take them into account is inevitably and substantially curtailed and the inherent risks of the actions we propose to take are greatly magnified.

It has over the years been a matter of grave concern to members of the Board that the absolute nature of its fiduciary duty might not have been fully understood and accepted in Government circles. It follows from the views expressed above that the Board cannot simply do as it is told; and the Board's willingness to consider and, if consistent with its fiduciary duties, to take heed of Government's aims and problems in no way alters this basic fact. There have been many occasions when apprehensions have been voiced by the Board and generally referred to as second-guessing the Board's commercial judgement. Inevitably, privatisation in particular has raised the issue from time to time. It would assist greatly if you felt able to offer us assurances on this subject within the context of the views I have expressed in (a) and (b) above.

If you or your colleagues find my view on our relationship in any way controversial, I know you will not hesitate to say so and I would welcome discussion between us of any such points. I trust that in any event you will receive these views in the spirit intended; as an attempt to contribute constructively to making progress more swiftly and with less likelihood of a major mishap.

*Sincerely,
Austin Bide*

Sir Austin Bide
Chairman

I

RELATIONSHIP BETWEEN BL AND SECRETARY OF STATE FOR INDUSTRY

MEMORANDUM OF UNDERSTANDING

- 1 In his relations with the company, the Secretary of State has two primary roles - that of holder of over 99% of the ordinary shares of BL, and that of overall sponsorship of the vehicle industry.
2. In relation to his sponsorship role, the Secretary of State will deal with BL on the same basis as with any other vehicle manufacturer.
- 3 As shareholder, the Secretary of State expects the Board of BL to operate as far as possible as an independent company; it is not the intention of the Secretary of State to concern himself with the day-to-day management of the company or to diminish in any way the responsibility of the Board for the conduct of the company's affairs. The Secretary of State requires the company to act commercially, and to seek a commercial return, to be defined from time to time after consultation with the company, on the capital employed in its operations.
4. The Secretary of State expects the company to

consult him about future plans and the way in which it proposes that they should be financed. Such consultations will be primarily based on the provision each year of a medium/long term Corporate Plan dealing with the strategic options available to the company and a short-term operating plan and annual budget. Once agreement has been reached, the Board will be responsible for implementing the plans. The Company will ensure that the Secretary of State is kept up to date on progress in this by regular provision of its management accounts and will advise the Secretary of State of any significant changes in relation to the agreed plans and also of any decisions which clearly have major economic or political implications. The company will prepare a summary of each year's Corporate Plan for presentation by the Secretary of State to Parliament.

5 The Secretary of State expects the Board to seek his approval before extending the company's activities into new areas of business, or disposing of significant existing interests, and before embarking on any new major programmes or major capital investment projects.

6 Proposals affecting the composition of the Board of BL will be the subject of prior consultation with the Secretary of State as majority shareholder

who will be given adequate time to consider any such proposals . The appointment of the Chairman will require the Secretary of State's approval, and he may also make nominations for the post.

7 The Chairman will have access to the Secretary of State to discuss any matters he or the Board wish to raise.

The Board's objectives are:-

1. To return all the constituent businesses, either together or separately, to the private sector as soon as practical. If the return of a constituent business carries the risk of reduced viability of the remainder, the issue should be put to the Secretary of State with options.
2. Consistent with 1, to dispose of peripheral activities so as to concentrate on vehicle manufacture and sales.
3. To pursue in the Corporate Plan a specifically targeted programme of profitability improvement, within stated limits of public funding, so as to achieve a rate of return that would attract external funds on normal commercial terms without Government support.

- 3 OCT 1984

