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cc: Peter Warr

10 DOWNING STREET

From the Principal Private Secretary

4 April 1985

Dear John,

AUSTIN ROVER AND HONDA

The Prime Minister has read overnight your Secretary of State's manuscript minute of 3 April covering a proposed statement by British Leyland and Honda and the statement of understanding between the two companies.

The Prime Minister doubts the need and the wisdom for a joint statement at this stage. She feels that a statement would only build up a presumption in Parliament and elsewhere that collaboration arrangements on the lines proposed will go ahead before the Government has seen or had an opportunity to consider the financial implications of the arrangements. She cannot see why Honda should not make a statement about the attitude of their Board while British Leyland say that they will have to discuss details with the Government before they could reach a view.

As regards the memorandum of understanding itself, the Prime Minister regrets the phrasing of Clause 17 (a) in which Austin Rover take up the position that Austin Rover would not accept engines from a new Honda UK facility for incorporation into Austin Rover cars other than the R200 series.

The Prime Minister recognises, however, that discussions between Austin Rover and Honda may have reached such a point that the company cannot retreat from a joint statement without severely damaging the relations between the two companies. If that is so, she would not wish to prevent such a statement, provided that it is cleared with the Treasury. But she would wish to see two amendments made:-

(i) she would not wish the statement to contain a commitment to an objective that each company should use its own engines in a jointly designed and developed vehicle; and with this in mind the second sub-paragraph of indent one might best be omitted.

(ii) She dislikes the reference to a "new Corporate Plan" in the last sentence, which might be taken to imply both new money and more delay. She would prefer the last

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sentence to read:- "in the case of British Leyland, however, the pursuit of these things must form part of the British Leyland Corporate Plan requiring the approval of HMG who have asked for further study of the financial and commercial details".

I am copying this letter to Rachel Lomax (H M Treasury).

Yours sincerely,

Robin Butler

John Mogg Esq
Department of Trade and Industry



From the Secretary of State

3/4/85

Prime Minister,

Mr. Kume of Honda is expected here on 10th April. He expects to break the ground for a Honda pre-delivery inspection plant at Swindon. He is personally committed to a collaborative programme with B.L. and will ask his Board to approve the M.o.U. on 5th April (Friday).

We have no way of stopping him from saying that his company backs the proposals in the M.o.U. The B.L. Board are bound to say that they want to follow the path outlined in the M.o.U.

I enclose a draft of a statement which B.L. might make.

I also enclose a copy of the draft M.o.U. It is for your eyes only at this stage. You will see B.L. is not committed to any expenditure at all, let alone that they will bear the costs of capital investment for the production facility at Longbridge.

I hope under these circumstances you will agree that I may authorise the draft statement. In the meantime I have initiated steps towards a rigorous examination of all B.L.'s proposals.

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PROPOSED PRESS STATEMENT BY BL + HONDA.

As a result of a collaboration which has been successfully developed between ARG and the Honda Motor Company over the past six years, represented by the Acclaim, the Rover 200 series and the very impressive progress to date on the jointly designed and developed XX car project, ARG and Honda have been discussing plans which would further strengthen the links between the two companies.

Several areas of mutual interest have been discussed. Specifically:

1. As a further development of the encouraging progress of the XX project, the establishing of another joint design and development programme on a new car, bringing to it the best appropriate technology of both companies.

The objective is not only jointly to design and develop a vehicle with each company using its own engines, but also the manufacture by each company of the other's version of the car.

2. Other points which have been discussed cover the establishment by Honda of an engine manufacturing facility at Swindon to provide UK source engines for the Rover 213 and subsequent Honda versions of vehicle built by ARG for Honda.

The above points are satisfactory in principle to the Boards of both BL and Honda. In the case of BL, however, the pursuit of these things must form part of a new BL Corporate Plan requiring the approval of HMG who have asked for ^{so} further study of financial and commercial details that they may be considered within the new Corporate Plan.

STATEMENT OF UNDERSTANDING BETWEEN
HONDA MOTOR CO., LTD. AND
AUSTIN ROVER GROUP LIMITED

1. INTRODUCTION

- 1.1 In recent months the two companies have been discussing the way in which their relationship might develop in the future.
- 1.2 This Statement sets out the objectives and strategic considerations upon which any further collaboration should be based and recognises the need for the longer term collaborative strategy to take full account of each company's individual policy aims. While the provisions of this Statement will not constitute legally binding obligations on either party, each party recognises the need for good faith, and adherence to the general principles set out in this Statement, in future discussions as to the detailed implementation of the projects referred to herein.
- 1.3 It is further recognised that even in the context of a Statement of Understanding it is not possible for either party to commit itself unreservedly to any of the listed projects and developments in isolation, since it is acknowledged that the feasibility and/or success of particular projects is likely to be directly related to progress on other projects and developments described in this Statement.
- 1.4 The following projects or developments are regarded as central to the longer term collaborative strategy of the two companies:-
- (a) the joint design and development of a specific new vehicle on the basis of a programme similar in concept to that adopted for XX, i.e. involving shared design and development and subcontract manufacture by each company for the other;
 - (b) the establishment by Honda in the UK of an engine plant;
 - (c) subcontract manufacture by ARG of the Honda Ballade and joint investigation of the feasibility of subsequent subcontract manufacture of the 5-door Honda Integra by ARG for Honda; and
 - (d) the vehicle build of further Honda products, other than the jointly designed and developed vehicles, within the UK.

1.5 In setting out their respective intentions as to the way in which the above projects should inter-relate and be implemented, each company has recognised certain basic policy decisions made by the other.

1.6 Thus, ARG recognises:-

- (a) that Honda has no intention of jointly developing engines with another manufacturer at the present time;
- (b) that Honda's willingness to pursue the possibility of a longer term joint design and development programme will be influenced by progress made in discussing the detailed terms on which ARG could manufacture the Honda Ballade on a subcontract basis incorporating locally produced Honda engines.

1.7 Honda in turn recognises:

- (a) that while ARG would accept engines from a new Honda UK engine facility for use in Honda subcontract vehicles built by ARG, ARG would not in principle accept engines from such a facility for incorporation into ARG badged vehicles other than the Rover 200 Series;
- (b) that ARG's willingness to undertake subcontract manufacture of the Honda Ballade will depend, not only upon the commercial feasibility of such a project, but also upon the progress which is made in the detailed discussion of the longer term joint vehicle design and development programme; and
- (c) that in view of ARG's willingness to manufacture any jointly developed vehicle on a subcontract basis for Honda, ARG will take a close interest in the compatibility of models produced at any Honda vehicle build facility in the United Kingdom or Europe.

1.8 Subject to the principles outlined above, the parties' intentions with regard to the various projects and developments listed above are set out in the remainder of this Statement.

2. JOINT DESIGN AND DEVELOPMENT OF A NEW VEHICLE

2.1 The following general principles are agreed by the parties to be fundamental to further joint product developments:

- (a) every project should provide a balance of input.
- (b) both parties will seek to attain balanced benefits and individual elements which are to the primary benefit of one party can only be agreed in the context of an overall, balanced strategy.

- (c) jointly developed products should only be built in Japan by Honda and in Europe by ARG.
- (d) neither party shall have undue influence over the other's technology or ability to make commercial decisions.

2.2 The details of the Understanding reached on a specific new project, which reflect these general principles, are set out below.

Vehicle Concept

- 2.3 The next collaborative vehicle will be a medium sector car with engines in the range of approximately 1.3 to 1.6 litres. It will be suitable in overall size, specification and design cost as a replacement for the Rover 200. It is anticipated that this will make the core vehicle a four door notchback or five door hatchback saloon. However, the strategy in relation to additional derivatives will be considered and, if appropriate, the sharing of resources will be discussed. Either party will in any event have freedom to develop such derivatives on its own behalf.
- 2.4 The vehicle will be designed to have sporty and prestigious appeal. Its design will not be constrained by an insistence upon commonality of technology with any other existing or planned vehicle in either party's range, unless it is agreed that such a constraint would not be prejudicial to either party.
- 2.5 The vehicle shall be designed to accommodate power units to both Honda's and ARG's design.

Technology

- 2.6 As a general principle, the technology used in the joint project shall be the latest appropriate technology developed by each party. This shall exclude technology at the research stage at the time of commencement of the development programme. The general principle is to exclude technology superseded (or planned to be superseded) in either party's range at the time the joint development programme is started, although the parties may agree that such technology is appropriate for inclusion in particular cases.
- 2.7 The overall design of the vehicle shall be jointly owned. Subject to industrial property rights of third parties the ownership of elements of the vehicle will also be joint, with the exception of engines and any other areas where it is agreed in advance that technology developed by one party independently of the joint project be used. No royalty shall be payable on the vehicle. Any plant and equipment supplied by one company to the other shall be entirely at the discretion of the purchasing party and under commercially competitive supply terms.

Manufacturing

- 2.8 Each party agrees to subcontract manufacture the jointly developed product on behalf of the other. In addition, either party may request that derivatives of the core product be manufactured on a subcontract basis by the other, and every effort will be made to meet this request, subject to normal commercial acceptability.

Component Sourcing

- 2.9 Each party shall have freedom to choose its source for components for the models built by it which will carry its badge. In order to ensure this, each party accepts the responsibility for ensuring that either its suppliers will co-operate with the other party on terms for component supply or on the release of design technology, or that the other party will be advised at the earliest possible opportunity, before the final decision on the allocation of design responsibility, that these conditions cannot be met. Where design responsibility for a component is subcontracted to a supplier, other than where the design requirement is met totally by a proprietary item, this should be on terms which allow the parties equal access to and free use of the design. If this requirement cannot be met, the other party will be advised prior to the final decision on the design source being made. These obligations apply equally in respect of all suppliers, whether wholly or partly owned or independent.
- 2.10 Later in 1985, the parties will be conducting at senior management level a thorough and overall review of the XX programme. In the new joint development programme it is intended that the best procedures identified by that review should be adopted for access to, and relationships with, component suppliers.

Timing

- 2.11 The companies will aim to achieve the following timetable:

. Discussion of joint vehicle (j.v.) pre-concept (2)	May	1985
. XX Review	May	1985
. Complete feasibility study on Ballade manufacture	May	1985
. Establish provisional j.v. pre-concept (1-a) (2)	Sept	1985
. Agreement on subcontract manufacture of Ballade (1-b)	Sept	1985
. Honda's internal review	Oct	1985
. Finalise j.v. pre-concept	Nov	1985
. Finalise 3 hard points/basic structure	Feb	1986
. Proposal for j.v. Design and Development Agreement (provisional design responsibilities)	April	1986
. Finalise j.v. Design and Development Agreement(3-a)	June	1986
. Commence commercial production of Ballade (3-b)	June	1986
. Finalise j.v. Manufacturing Agreement	Autumn	1986
. Production launch of j.v.	Autumn	1988

Notes:

- (1) Linked events: (1-a) must occur before (1-b).
- (2) Pre-concept includes preliminary identification of the following:
 - . Broad definitions of sector.
 - . Principal body type.
 - . Other body types to be considered.
 - . Wheelbase, track, approximate overall length, height, width, and front overhang, key interior package dimensions.
 - . Engine/gearbox families to be accommodated.
 - . Key mechanical constraints or commonalities.
 - . Legislative requirements.
 - . Key timetable points.
 - . Provisional volume targets.
 - . Commonality between Honda and ARG versions.
 - . Main areas of design leadership.
- (3) Linked events: (3-a) must occur before (3-b).

Split of Design Responsibilities

- 2.12 The parties agree to consider the most effective use of design resources, given experience gained through the XX programme. Specifically, the companies will aim to work more closely on those areas of the vehicle whose design has an effect on other aspects of the vehicle. Development should only be carried out by one party in isolation, where:
- there is no risk that other design areas will be affected and one company has particular expertise; or
 - that aspect of the design was agreed not to be owned jointly (e.g. engines).

3. ESTABLISHMENT BY HONDA OF A UNITED KINGDOM ENGINE FACTORY

Honda will keep ARG informed as to the timing and progress of establishment of any such facility. Honda currently intends that such a facility would be operational by [Spring 1986] in order to facilitate achievement of the local content timetable. ARG intends to purchase engines from that facility for installation in the Rover 213. The companies will discuss the terms applicable to such purchase with a view to achieving an equitable balance of any commercial benefits which may derive from local sourcing of engines, but in any event the terms shall be no less favourable to ARG than those on which such engines are currently purchased from Japan. ARG will consider supplying certain components to that facility.

4. SUBCONTRACT MANUFACTURE BY ARG OF THE HONDA BALLADE

- 4.1 In parallel with the discussions on the joint development of a new vehicle, the two companies will give detailed consideration to the commercial terms on which subcontract manufacture by ARG of the Honda Ballade will take place prior to jointly developing the new vehicle and the parties intend to finalise the contract for such subcontract manufacture by September 1985.
- 4.2 It is currently contemplated by the two parties that such subcontract manufacture will start in mid-1986 and the engines for such Ballade vehicles will be supplied from Honda's engine plant in the United Kingdom.

5. HONDA VEHICLE MANUFACTURE

- 5.1 Honda wishes to see the manufacture of its vehicles established more closely to the European market place. No firm plans for this in terms of timing and scale of operation have yet been established. However, Honda have established two objectives:-

- (i) a preference for such a facility to be in the UK, and;
- (ii) a desire to maintain independence and flexibility in meeting changing market conditions.

Recognising the currently prevailing circumstances of manufacturing over-capacity in Europe, Honda has two possible options for the manufacture of vehicles other than those jointly developed with Austin Rover. They are as follows:-

- (a) To make use of existing Austin Rover manufacturing facilities in the UK. Austin Rover and Honda will discuss the conditions for such local manufacture to seek in good faith to provide Honda with a satisfactory degree of independence and flexibility. This recognises that Austin Rover is opposed to the establishment of additional vehicle assembly capacity within the UK and continental Europe.
- (b) To establish a new Honda vehicle facility in the UK.

Both parties will hold a joint review, at regular intervals to be established, to examine the prevailing circumstances in Europe. In recognition of these circumstances at this stage it is agreed by both parties that option (a) above is the preferred route and Honda agrees that it will only decide to follow option (b) if it considers in good faith that option (a) is not feasible, whether for technical, commercial or managerial reasons. Such a decision would only be made after an in depth investigation of option (a).

In carrying out this investigation both companies will approach the subject in the most constructive, expeditious and open fashion with the declared intention of seeking a speedy and successful conclusion to problems which may arise, and ensuring that such conclusions are to the mutual benefit of both companies.

If, following such investigation, option (b) is selected then, notwithstanding Austin Rover's opposition to the establishment of additional capacity, Austin Rover and Honda would intend that this situation would not adversely affect their commercial relationship on projects already in existence or contemplated by this Statement. Both companies recognise that the subsequent initiation of further projects may be affected.

5.2 In order to safeguard Austin Rover's allocation of capacity in subcontract manufacture, any other Honda vehicle build in the UK or continental Europe will not be of vehicles belonging to the same family as the jointly developed vehicle, as defined in the Appendix to this Statement. Moreover, Honda agrees positively to promote complementation and co-operation with Austin Rover, for the benefit of both parties, through such means as being supplied with certain vehicle components from Austin Rover and Austin Rover's established component suppliers.

6. CONFIDENTIALITY

Both the existence and the terms of this Statement shall be kept confidential by the parties and shall not be disclosed to any third party except by mutual agreement, save where either party is specifically required by applicable law or regulation to make such a disclosure.

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For and on behalf of
HONDA MOTOR CO., LTD.

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For and on behalf of
AUSTIN ROVER GROUP LTD

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APPENDIX

DEFINITION OF VEHICLE FAMILY RELATIONSHIP

(1) Purpose

To define on a basis agreed between ARG and Honda the characteristics which will qualify a vehicle comprised in one Party's model range as being of the same family as the proposed future joint vehicle, to be used in deciding the manufacturing location for the purposes of paragraph 5.2 of the Statement.

(2) Exclusion of certain Honda vehicles

Notwithstanding (1) above and (3) below, it is accepted by ARG as being of overriding importance to Honda that there should be no restriction on its manufacturing freedom in respect of vehicles in the Accord and Civic families.

Equally, it is accepted by Honda that ensuring the productive use to the maximum reasonable extent of ARG's investment in subcontract manufacture of the joint vehicle is of overriding importance to ARG. In order to ensure this it is recognised by both parties that the joint vehicle will not be a derivative of either the Civic or Accord families.

(3) Definition

Subject to (2) above, a derivative of any model range will be considered as being of the same family where the overwhelming majority of the following criteria apply:-

Component Commonality

- same engine family/families as joint vehicle;
- front suspension and steering systems of similar design and having substantial number of detailed components in common with joint vehicle.

Body Structure

- front floor pan, upper and lower dash, and front structure generally of same design as joint vehicle.

Suitability For Build on Common Facility

- ability of being constructed in same BIW facility, assembled on same production line and tested on largely the same equipment as the joint vehicle, with minimal additional investment.

If there is any doubt, the parties will seek to agree in good faith where a model should be built, taking into account:

- ARG's commercial interests.
- Honda's commercial freedom.
- The economics of alternative manufacturing sites.
- The ability of ARG to fulfil Honda's volume requirements.

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