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PRIME MINISTER

5 June 1985

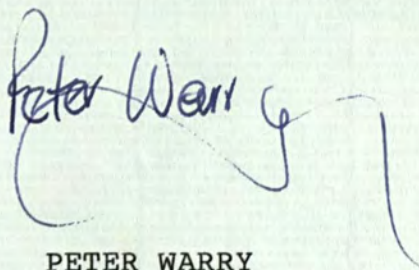
Agree to Tebbit's proposals?  
AT 5/6

UNIPART PRIVATISATION

Yes not

It is unusual for a car manufacturer to sell off its parts operation. The proposal that BL should retain a stake in Unipart for a limited period following privatisation is both sensible and necessary: it should not be seen as undercutting the objective of privatisation but rather as facilitating it.

One can quibble whether the stake should be as high as 25.1% and the period for which it should be retained, but in general we support Norman Tebbit's arguments. In view of other matters it might be helpful if a positive response were made to his note.



PETER WARRY

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CCP/W



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Secretary of State for Trade and Industry

4 June 1985

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

UNIPART PRIVATISATION

We need to decide urgently on the main outlines of the plan the BL Board have put forward for the privatisation of Unipart.

2 As you know, the Board are now fully committed to privatising Unipart this year and are working towards a date in November. In order to achieve this a new Board for Unipart will have to be in place in good time; and it will in particular be necessary to start approaching potential Chairmen as early as possible this month. This cannot be done until the main points of principle have been settled, and I am therefore writing to you about these now. (We shall need to leave to a later round of correspondence such matters as the treatment of the proceeds from the sale.)

3 In outline, the proposals as put to us by the Board are as follows:

- a. BL should retain a 25.1% stake in Unipart for a limited period after privatisation;
- b. BL should have the right, enshrined in Unipart's Articles, to be represented on the Unipart Board; and
- c. Unipart's Articles should contain a provision preventing any other party from acquiring more than 15 per cent of the shares.

The significance of a 25.1 per cent shareholding is of course that it would enable BL, for so long as the shareholding persisted, to block any changes to (b) or (c).

JH2ASR



4. I attach Samuel Montagu's advice on these proposals. They take the view that a retained shareholding by BL in Unipart, whether of 25.1 per cent or some other figure, would be seen by the City as a positive sign and would enhance Unipart's prospects. They also believe that there is a case for allowing Unipart a period of protection from takeover; and that in the early period after privatisation there would be a risk that BL's interests could be gravely damaged by a hostile take-over. They therefore endorse the proposal for a 15 per cent limitation on shareholdings (which would parallel the limitations in other privatisations, including Jaguar). They do however question whether this might be secured by a "golden share", which would permit a lower BL holding than 25 per cent, rather than by the mechanism proposed by BL. I have considered this suggestion, but reject it for three main reasons. First, although golden shares are increasingly common they are considerably less easy to defend (to the Stock Market, among others) for companies like Unipart than for some earlier cases, as the industries become less "strategic". Second, the intention behind the proposed Articles is primarily to protect BL's commercial interests, not wider Governmental or national interests, and it would therefore be sensible for the veto over changes to be in their, rather than in our hands. Third, Samuel Montagu believes that BL ought in any event to retain a shareholding. I therefore propose that we should accept the Board's proposals on these points.

5 You will note that Samuel Montagu are doubtful about the need for BL representation on the Unipart Board. Frankly, I believe that they over-rate the likely effectiveness of the consultative arrangements they propose. In a normal commercial relationship Board representation is of course not necessary to ensure that contractual relations run smoothly. But the interdependence between BL and Unipart, and the nature of their business, is such that the relationship will, though commercial, be highly unusual. Indeed the separation of a mass vehicle manufacturer and its parts operation will be unique in the European industry. In these circumstances I think that good relations between the companies would be facilitated if BL were represented on the Unipart Board. I also believe that, like the retained shareholding, such representation would be regarded by the City (and also by BL's dealers) as reassurance that the relationship would continue. I therefore propose that we should accept the Board's proposals here also.

6 The outstanding question concerns the timing of the eventual disposal of the residual BL shareholding. Just as the Government is constrained, when disposing of part of a business, to reserve its position on the timing of residual sales, the Board will feel constrained not to commit itself publicly, or even privately, to a date. However, I would propose with your agreement to seek to establish with the Board as clear an understanding as can be negotiated about the timing of the sale of the BL shareholding.

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The object will be to ensure that BL do not retain the shareholding beyond the point where Unipart is fully established and both companies could cope if necessary with a termination of the BL/Unipart contracts.

7. I am sending copies of this letter to the Prime Minister, to Lord Young and to Sir Robert Armstrong. Because of the urgency I should be grateful for a reply this week if at all possible.

*Norman*  
NORMAN TEBBIT

JH2ASR

→ CO PW

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IMcI/SAC/VS

31 May 1985

*W Long  
cc for RM...*  
*RM  
36.*  
Mr R J Meadway  
Department of Trade and Industry  
Ashdown House  
123 Victoria Street  
London  
SW1E 6RB

Dear Mr Meadway

You have asked us to provide advice to you in relation to the first set of proposals submitted by BL in relation to the privatisation of Unipart in November 1985. These proposals are described in detail in a letter from Mr N J Carver to yourself dated 3 May 1985 together with three supporting attachments.

This letter summarises our views and recommendations on the aforementioned proposals and in particular addresses two principal points. These points are firstly, that BL should retain (for a limited duration) a minority interest in Unipart of 25.1 per cent, and secondly that an upper limit should be imposed on third party shareholdings of 15 per cent.

## THE ARG/UNIPART CONTRACT

Paramount to the privatisation of Unipart is the need to provide for its independence and ability to stand alone in the private sector. This in turn involves the establishment of an arms-length relationship between BL and Unipart to provide Unipart with the freedom to develop its own new products and markets, whilst at the same time recognising the commercial interests of both parties and the need for co-operation. One of the most important tools to achieve this series of objectives has been identified as the ARG/Unipart contract. Obviously we have not yet had an opportunity to review the ARG/Unipart contract and so our comments are necessarily tentative.

## THE RATIONALE FOR A RETAINED INTEREST

The two principal arguments put forward by BL in justifying the need for a retained interest are:-

- (a) to help to ensure the smooth operation of the ARG/Unipart contract; and
- (b) to provide an effective means to prevent a takeover of Unipart by a hostile bidder.

To Mr R J Meadway

In relation to the first of these points, we believe that the smooth operation of the contract could be safeguarded by effective and comprehensive drafting of the contract itself at the outset. This might involve, for example, clear provision for regular "co-operation" meetings between members of the management teams of the two companies in order to ensure undistorted flows of communication in both directions. Indeed it is debatable whether board participation to which BL would be entitled through its retained interest would achieve this objective on its own. As an independent company, the Board of Unipart should be fully committed to the protection of the interests of its own shareholders whilst satisfying the terms of its contractual obligations.

The rationale for setting the level of the retained interest at 25.1 per cent in relation to the second argument above stems from company law and is related in turn to the proposal to limit third party shareholdings to a maximum 15 per cent through a clause in the company's articles. With this article in place, a change of control could not be achieved without the consent of BL because a special resolution would be required to change the articles and the passing of such a resolution would need a 75 per cent majority vote. The restriction of holdings to 15 per cent is considered below.

#### THE 15 PER CENT RESTRICTION

The retention of a 25.1 per cent interest by BL would not in itself provide protection against a hostile bidder - in practice by offering a sufficiently attractive price a bidder would be able to achieve 50 per cent control which would be all important in terms of ultimate control over management. For this reason, it is necessary to impose a restriction over the level of third party shareholdings in Unipart and under the BL proposals the retention of a 25.1 per cent stake would be used to preserve this restriction.

It could be argued that if BL has the right to terminate the ARG/Unipart contract upon a change of control of Unipart then it holds the ultimate deterrent to a hostile bidder, in that the commercial success of Unipart is itself presently heavily dependent on the existence of the contract. However, the acquisition of Unipart could be seen by a competitor of BL as a 'one-off' cost of inflicting possibly irreversible damage to BL's business. Given the finite life of the proposed contract, BL, as a responsible commercial organisation, will inevitably need to take steps to protect itself against the eventuality of termination (or the contract not being renewed by Unipart at its first break point) and thus seek ways of alternative parts sourcing. BL's assertion that the deterrent of termination is unworkable in practice (because of the time it would take to re-establish a parts distribution service) is not therefore wholly tenable. In the short term however, whilst contingency plans are put in place, some sympathy may be held for this argument.

We believe that a stronger argument to justify a restriction over third party shareholdings is that Unipart should be allowed an interim period during which it can fully establish itself as an independent company by diversifying its own business.

To Mr R J Meadway

An alternative method of protecting Unipart against a hostile bidder would be the creation of a 'golden share'. The holder of this share would be the Secretary of State and not BL. Although the proposals submitted by BL suggest that a golden share would not be acceptable in the circumstances of Unipart, we believe that this matter could be investigated further. If this alternative were to be pursued, the actual level of BL's retained interest would become less critical and might for example be set at below 25 per cent.

In order to preserve the attractiveness of Unipart as a private sector investment, we believe it important that a time limit should be set for any restriction over third party shareholdings. The proposed restriction of 15 per cent and, if adopted, the existence of a golden share, should be for a limited duration only, such period being designed primarily to permit Unipart to develop into a fully independent company in the private sector. The extent of the period might be set for example, to coincide with the first break point of the ARG/Unipart contract, assuming that this arises after, say, three years. We do not believe that a restriction of this nature for a limited period would be viewed unfavourably in itself.

#### UNIPART FROM THE PRIVATE SECTOR VIEWPOINT

We believe that the private sector will associate the future prospects of Unipart with those of BL and thus the retention of an interest by BL would provide a useful demonstration by BL of a continuing financial commitment to Unipart's future success and would recognise their interdependence. The retention of an interest should also help to allay doubts that may exist over the concept of a vehicle manufacturer which relies on an independent company for its supply of parts. It should also provide comfort against the worries among ARG dealers identified in Mr Carver's letter of 3 May 1985.

With regard to the duration of a retained interest by BL, if the BL proposals are adopted we believe that the period should be designed to coincide with that discussed under the 15 per cent restriction above. If the golden share approach were pursued it would be appropriate to provide for a review of the position say at the time of the first break point of the contract.

#### CONCLUSION

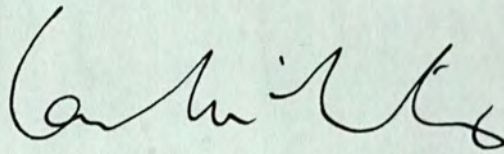
Whilst there are arguments which suggest that in the longer term the continuing commercial interests of BL might be capable of protection wholly by way of the ARG/Unipart contract, in the short term there is justification for some additional form of protection. The protection of Unipart against a takeover for a limited period will allow BL to provide contingency plans against possible termination of the contract and will also allow Unipart to develop further as an independent company. There are arguments in favour of BL retaining an interest in Unipart, in particular with regard to the optimum presentation of the company to the private sector.

31 May 1985

To Mr R J Meadway

Whilst the BL proposals represent one method of achieving the stated objectives, an alternative method would be through the use of a golden share. Under this alternative, the actual level of any retained interest becomes less critical (and could be set below 25 per cent if desired) and any decision over change of control would be made by an independent body (ie the Secretary of State) which might ultimately be in the interest of Unipart itself.

Yours sincerely





JUN 1985

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