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Secretary of State for Trade and Industry

12 December 1985

SECRET

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

Dear Nigel,

BL PRIVATISATION: GM/LAND ROVER- LEYLAND

Following our meeting with the Prime Minister on 4 December, there was a round of discussions in London between the joint BL/HMG team and GM representatives, ending on 7 December.

The concluding positions showed a wide gap between the two sides as regards the financial structure of the combined Bedford/LRL operation and the price to be paid. GM stressed the importance of some level of BL or HMG equity participation. They could only put up £65m in cash and wanted £121m of the consideration to be in the form of a non-guaranteed debenture secured on the new company. On price GM talked in terms of £210m, net of redundancies, provided the UK side took one-third of the equity in the new business and accepted the debenture. The UK side said that what was proposed was unacceptable. Both sides noted the difficult points for the other, expressed the intention of reconsidering their position, and reaffirmed their overall desire to conclude a deal. It is expected that the discussions will resume in the US on 19 December with the UK team led by Sir Robert Clark.

A major difficulty is assessing GM's intentions. It may be that their inability to put up more than £65m cash is only a negotiating position: their cash and other resources are very substantial. Alternatively there may be real limits to the price they are prepared to pay up front especially given the risks in the business. It is worth remembering that important GM talks on trucks with MAN in Germany and Enasa in Spain have both foundered this year. I think it is important therefore to give the negotiating team some flexibility to try and conclude a deal. If the momentum is lost the risk of failure could be real. I see four main elements to the negotiating brief:

FINANCING

I do not think that we should rule out a major element of debt in the financing of the new company if our negotiating team believe this to be necessary to secure a deal. But it is essential that the element of consideration represented by the £121m debenture should be direct cash equivalent once it is in BL's hands and, if GM are not prepared to guarantee it, it must be so structured that BL can sell it immediately on completion. I can see no way in which BL or HMG could take a debt of this kind. GM appear to understand the importance of this and both they and the UK merchant bank advisers are working on it.

PRICE

We need to develop further our ideas on what price we are prepared to settle for, assuming that the structure and financing of the package are satisfactory. The proper comparison for assessing our bottom line is what could be obtained next year by separate privatisation of Land Rover, and this could be well below the figure of £220m we have used in negotiating with GM, which rests on a vulnerable rising profit trend. Our joint objective remains to reach broad agreement on a price bracket, with the exact price to be finalised in further negotiations. I suggest that the negotiating team's bottom line instruction should be a GM cash or cash equivalent figure of £186m net of redundancies - implying about £226m with redundancies. We should aim for £230m net of redundancies as the top end of the bracket. I emphasise that this would be a bottom line: obviously the negotiating team would aim for a higher bracket.

LAND ROVER

If the GM side are not prepared to move far on central issues and claim that they are cash constrained, to the point where the prospect of a deal is at risk, I believe the team should have discretion to float the idea of taking Land Rover out of the package. Although GM have emphasised its importance to them, Land Rover is not central to the industrial rationalisation which is in the truck and van parts of the package, which both we and GM have pressing reasons to secure. Its removal might help GM if their need to limit their cash input to the deal is over-riding.

RISK

I think that our position should continue to be that neither BL nor HMG can take equity in the new company. But GM obviously attach a lot of importance to some of the risk residing with the UK side and may reduce the price they are prepared to pay disproportionately if we are prepared to take none - or, indeed, may walk away from the negotiations. I suggest that the team should be authorised to explore a small element of deferred cash consideration, related to performance. Any such consideration should be payable in proportion to how far Land Rover production volumes exceeds an agreed production floor related to LRL's own forecasts. Any such consideration should, however, be in addition to the £186m bottom line. This bottom line should not be breached without referring back to Ministers in London or fully reserving Ministers' position until they have seen a detailed proposal.

TIMING

I hope these proposals are acceptable to you. If not we shall need to discuss the position not later than Monday 16 December, since Sir John Clark and the negotiating team will be leaving for the next round of negotiations in the US on 18 December.

I am copying this letter to the Prime Minister.

Yours,

Leon

LEON BRITTAN

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Leon Brittan QC MP
Secretary of State
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1E 6RB

16 December 1985

Dear Leon

BL PRIVATISATION: GM/LAND ROVER-LEYLAND

You wrote to Nigel Lawson on 12 December about the next stage of negotiations with GM.

As you say, it is difficult to assess GM's intentions, but we do know that Bedford is performing very badly, and it must be GM's wish to stop the losses by one means or another. If they are to remain in the truck and van business in Europe almost certainly this can be done only by a substantial increase in market share, and a quick improvement in their products. BL offer both. I fully recognise that on our side there are strong financial and industrial reasons for Salton, but the price must be one which can be justified, particularly in relation to Land Rover. Also, I am bound to be concerned at the size of the equity injection into BL, which will vary inversely with the price.

I agree that we should seek to maintain the momentum of the negotiations so that at the next meeting (which I understand GM have now set back until after Christmas) only a relatively small gap remains between the two sides. As you say, that requires GM to make the £121 million debenture immediately cashable. If that is not possible, I agree that the exclusion of Land Rover from the deal should be considered. Truck and vans are our main problem.

If GM can offer at least £186 million (net of redundancy costs) in cash or cash equivalent I am content that our negotiators' bottom line should be £230 million, on the understanding that they will start at a substantially higher figure, say £250 million, and make every effort to bring GM up from £186 million.

You suggest that if necessary our negotiators should explore an offer of a small deferred cash consideration, related to performance. I assume that this would not be cashable, and Nigel and I are strongly of the view that we should not share in the risk of the new company in any way. That is contrary to the whole idea of privatising BL. (I understand that your officials have quoted Brooke Marine and Vospers as examples where the government has been prepared to retain a performance related interest. But because the prosperity of this sort of shipyard depends on winning just a few orders it is extremely difficult to value the companies particularly in the absence, as in these cases, of competing bids. The truck and van business is totally different).

It is difficult to believe that GM would be seriously interested if the amount were only a small fraction of the price, and it is very doubtful whether this could be a make or break issue on the deal. What we could find is that the issue comes to dominate negotiations as GM seeks to increase the amount, and probably relate performance to truck and vans as well as Land Rover. You will gather that I would need a great deal of convincing that we should entertain a quasi equity stake in the new company.

I am copying this letter to the Prime Minister.

Yours ever,

JM

JOHN MacGREGOR

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cc Brian Griffiths

cc B. ~~Unwin~~

10 DOWNING STREET

From the Private Secretary

13 December 1985

BL PRIVATISATION: GM/LAND ROVER-LEYLAND

The Prime Minister has seen your Secretary of State's letter to the Chancellor of the Exchequer of 12 December.

The Prime Minister is content with the proposed negotiating position to be taken by the UK side in the next round of negotiations with GM. Indeed, if, during the negotiations, officials feel that the two sides are still too far apart, she would be prepared for your Secretary of State to authorise a bottom line at a somewhat lower level than the one described in your Secretary of State's letter.

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

DAVID NORGROVE

John Mogg, Esq.,
Department of Trade and Industry.

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