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REPORT ON THE AFFAIRS OF PHOENIX VENTURE HOLDINGS LIMITED, MG ROVER GROUP LIMITED AND 33 OTHER COMPANIES VOLUME I

Gervase MacGregor FCA
Guy Newey QC

(Inspectors appointed by the Secretary of State for Trade and Industry under section 432(2) of the Companies Act 1985)

Report on the affairs of Phoenix Venture Holdings Limited, MG Rover Group Limited and 33 other companies

by Gervase MacGregor FCA and Guy Newey QC

(Inspectors appointed by the Secretary of State for Trade and Industry
under section 432(2) of the Companies Act 1985)

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CHAPTER I

INTRODUCTION

Background

1. MG Rover Group Limited ("MGRG"), the manufacturer of Rover and MG cars, went into administration on 8 April 2005. A statement of affairs sworn by two directors of the company on 16 May 2005 estimated that it had a deficiency as regards creditors of £1,289 million when it entered administration. Various other companies in the group ("the Group") followed MGRG into administration or liquidation[1].

2. On 15 April 2005 the Secretary of State for Trade and Industry asked the Financial Reporting Council ("the FRC")[2] to arrange for a review of the financial statements of MGRG and related companies. A review was subsequently carried out by the Financial Reporting Review Panel ("the FRRP")[3], which submitted its report on 26 May 2005. The FRRP explained in its report that it had had limited access to information and that the report "*should be thought of as raising questions, rather than providing answers*". A copy of the report is attached as an **exhibit**[4].

Our appointment

3. On 31 May 2005 we were appointed by the Secretary of State for Trade and Industry as inspectors to investigate the affairs of Phoenix Venture Holdings Limited ("PVH", MGRG's ultimate parent company), MGRG, 32 other companies in the Group and MGR Capital Limited ("MGR Capital")[5]. The appointment was made pursuant to section 432(2) of the Companies Act 1985.

The scope of the inquiry

4. When we were appointed, we were told that we should address the period between the acquisition of MGRG by Techtronic (2000) Limited ("Techtronic") in 2000 and MGRG's entry into administration in 2005.

5. At the outset, we were asked to consider in particular:

    5.1. the events leading up to the appointment of administrators of MGRG in April 2005; and

    5.2. the matters raised in the FRRP report.

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1 See XX/164.
2 The FRC is the United Kingdom's independent regulator responsible for promoting confidence in corporate governance and reporting.
3 The FRRP was established in 1990 as part of the FRC. The FRRP seeks to ensure that the provision of financial information by public and large private companies complies with relevant accounting requirements.
4 We address the points raised in the FRRP report in chapter XXIII (Financial statements and audit).
5 As to which, see VII/22.

6. As the inquiry progressed, we kept the Companies Investigation Branch ("CIB") informed as to the issues which we were proposing to investigate. CIB was formerly part of the Department of Trade and Industry ("DTI") itself but is now included in the Insolvency Service, an executive agency of the Department for Business, Innovation & Skills (the department recently formed from the merger of the Department for Business, Enterprise and Regulatory Reform ("BERR"), the DTI's successor, and the Department for Innovation, Universities and Skills).

7. We do not refer in this report to every matter that we investigated. In the course of the inquiry (especially in its early stages), various concerns were raised with us by people whom we met for which, on investigation, we found no substantial evidence and of which there is therefore no mention in the report. Likewise, the documentary evidence available to us suggested some topics as meriting inquiry which, in the event, do not feature in the report because, in our view, there proved to be no substantial ground for mention.

8. From the beginning, we saw the inquiry as extending to the role of Government so far as relevant to the matters under investigation. We were informed that a "Chinese wall" had been put in place within the DTI/BERR to ensure that potential conflicts of interest within the department were satisfactorily managed.

Conduct of the inquiry

Support from BDO staff

9. We conducted our inquiry with the assistance of forensic accountants and other staff (including staff with forensic computing expertise) from BDO Stoy Hayward LLP ("BDO").

Documentary evidence

10. We obtained documentary and computer evidence from numerous sources.

11. Foremost among these, of course, was the Group. A team of BDO staff worked at the Group's Longbridge site for seven months reviewing, and where appropriate copying and logging[6], the voluminous records to be found there[7]. To a small extent, documents were also obtained from the Group's national sales companies ("NSCs") and the premises in Stratford-upon-Avon of Edwards Cars Limited ("Edwards Cars"), which had become part of the Group. In addition, the Group's servers were imaged[8], as were well over 100 computers used by officers and employees of the Group.

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[6] This involved identifying each page of each document with a unique reference number and recording details such as the date, author and contents of the document.

[7] The team began work at Longbridge on 7 June 2005.

[8] "Imaging" refers to the process by which the entire contents of a computer's hard disk are copied to a file. It creates a perfect replica of the contents and structure of the hard disk without altering it in any way. Once the image has been taken, certain procedures are carried out to verify the integrity of the image file.

12. The Group apart, the sources from which we obtained the greatest volumes of relevant material were Deloitte & Touche LLP ("Deloitte")[9] (who provided extensive computer records as well as documents), Eversheds LLP ("Eversheds")[10] and Government (including a range of departments and agencies). Other sources of large volumes of relevant material included Ernst & Young LLP ("Ernst & Young")[11], Garvin Trustees Limited ("Garvins")[12], HBOS plc ("HBOS")[13], KPMG LLP ("KPMG")[14], NM Rothschild and Sons Limited ("Rothschild")[15] and Slaughter and May[16]. However, we also obtained documentary evidence from scores of other sources.

Other evidence

13. We interviewed some 95 people formally and were provided with information orally by many others on an informal basis. For the most part, the formal interviews were conducted on oath and transcribed. In the case, however, of the individuals we interviewed from the Chinese automotive group ("SAIC") with which the Group was in negotiations in 2004 and 2005, the interviews were formal but not under oath since it was not appropriate for us to administer oaths in China, where the interviews took place. Informal interviews normally involved meetings, but a few were conducted by telephone. A written meeting note was generally agreed with, and signed by, the witness following a meeting.

14. Most interviews lasted a day or less. However, the interviews of a minority of witnesses extended over more than one day. A small number of witnesses gave evidence at much greater length. For example, Mr Peter Beale, one of the four members of the consortium ("the Phoenix Consortium") which acquired MGRG through Techtronic in 2000, gave evidence on eight days, in total for more than 41 hours (excluding lunch and other breaks). Mr John Edwards, Mr Nick Stephenson and Mr John Towers, the other members of the Phoenix Consortium, gave evidence for broadly comparable periods, and the interviews of Mr Maghsoud Einollahi of Deloitte also extended over eight days.

---

[9] Deloitte undertook extensive advisory work for individuals and companies associated with the Group, as well as acting as auditors to the Group, between 2000 and 2005.

[10] Eversheds acted extensively for individuals and companies associated with the Group between 2000 and 2005.

[11] Ernst & Young were instructed in August 2004 to carry out due diligence and asset valuations on behalf of SAIC, the Chinese automotive group with which the Group was in negotiations in 2004 and 2005. Ernst & Young were subsequently instructed to carry out further financial due diligence work in January 2005: see chapter XX (The events leading to administration).

[12] Garvins were the MGRG pension scheme's actuaries: see chapter XX (The events leading to administration).

[13] HBOS was involved with the acquisition by MGR Capital of most of BMW's Rover loan book in 2001: see chapter VII (Project Platinum).

[14] KPMG (a) assisted Alchemy Partners LLP with their proposed acquisition of MGRG in 2000 (see chapter III (The sale of Rover)), (b) represented BMW in connection with the completion accounts dispute referred to in chapter V (Rover under new ownership), (c) advised BMW in relation to the sale of its Rover loan book in 2001 (see chapter VII (Project Platinum)) and (d) were engaged by the DTI in 2005 to review cash flow forecasts prepared by MGRG, to identify assets which could be realised to reduce the cash requirement or made available as security, and to advise the DTI in relation to its negotiations with MGRG (see chapter XX (The events leading to administration)).

[15] Rothschild was retained by SAIC: see chapter XX (The events leading to administration).

[16] Slaughter and May were instructed by the DTI to advise in connection with the provision of rescue aid in 2005: see chapter XX (The events leading to administration).

15. In advance of most formal interviews, and also many informal ones, we would indicate to the witnesses concerned the topics that we expected to cover and provide bundles of documents which we considered could be relevant to the matters to be discussed.

16. We started interviewing informally on 7 July 2005, and informal interviews continued into 2009. We conducted our first formal interview in September 2005, and we began to interview intensively in early 2006, after we had been able to assemble and assess sufficient of the documentary and computer evidence and to compile and supply interview bundles from that evidence. The last formal interviews took place in October 2008, the significance of the two witnesses in question having emerged in one case from other evidence and in the other from a response to a provisional criticism[17].

17. In addition to oral evidence, we were provided with witness statements from more than 20 witnesses and also, to an extent, evidence by way of letter. We were supplied, too, with transcripts of interviews conducted by Mr John Randall QC and Mr Lance Ashworth QC, who had been instructed pursuant to a resolution of a committee of the board of St. Modwen Properties plc ("SMP") to prepare a report on matters referred to in chapter VI (Development agreement with St. Modwen) below.

18. The dramatis personae at **appendix 3** identifies those who provided us with evidence. It also shows whether the individual concerned gave evidence formally (whether orally or by way of witness statement) or informally, including details of legal representation.

Potential criticisms

19. Where it seemed to us from the evidence then available that there was potentially scope for criticism of witnesses, we aimed to put the points to them during their interviews. In addition, once we seemed to have obtained all the relevant evidence, we wrote to inform those affected of provisional criticisms and afforded those concerned an opportunity to respond. We began sending out provisional criticisms in June 2008, and the last response was received in May 2009. In preparing this report, we have considered each of these responses.

Support from CIB

20. As is normal with investigations by inspectors, we met representatives of CIB and lawyers from the DTI/BERR on a regular basis throughout the inquiry to review progress. We also sought advice from them from time to time on procedural matters.

[17] See paragraph 19 below with respect to provisional criticisms.

CHAPTER II

ROVER AT THE BEGINNING OF 2000

Ownership

1. At the beginning of 2000, Rover Group Limited (later to be renamed MG Rover Group Limited, "MGRG") was a wholly-owned subsidiary of BMW (UK) Holdings Limited ("BMW (UK)"), BMW having bought the company from BAE Systems plc ("British Aerospace") in 1994.

2. The structure of the relevant parts of the BMW group of companies ("BMW") at this time was as shown on the next page.

3. The chairman and chief executive officer of MGRG was Professor Werner Sämann, who was also a member of the board of BMW AG, the ultimate parent company. MGRG's board had one other member, Mr Christian John von Freyend.

Products

4. In early 2000, MGRG was producing the following vehicles: the Mini ("the Old Mini"), the Rover 25, the Rover 45, the Rover 75, the MGF and various Land Rover vehicles.

5. The Old Mini, of course, dated back many years. The intention was that its production should cease in the course of 2000.

6. The Rover 25, a small hatchback, was a facelifted version of the Rover 200 produced from 1995. The Rover 25 was launched in November 1999.

7. The Rover 45, which was presented as a small family car, was a facelifted version of the Rover 400. The Rover 400 (Mark 2) had been developed in collaboration with Honda Corporation ("Honda") and was based on the Honda Domani; it was first produced in 1995. The Rover 45, like the Rover 25, was launched in late 1999.

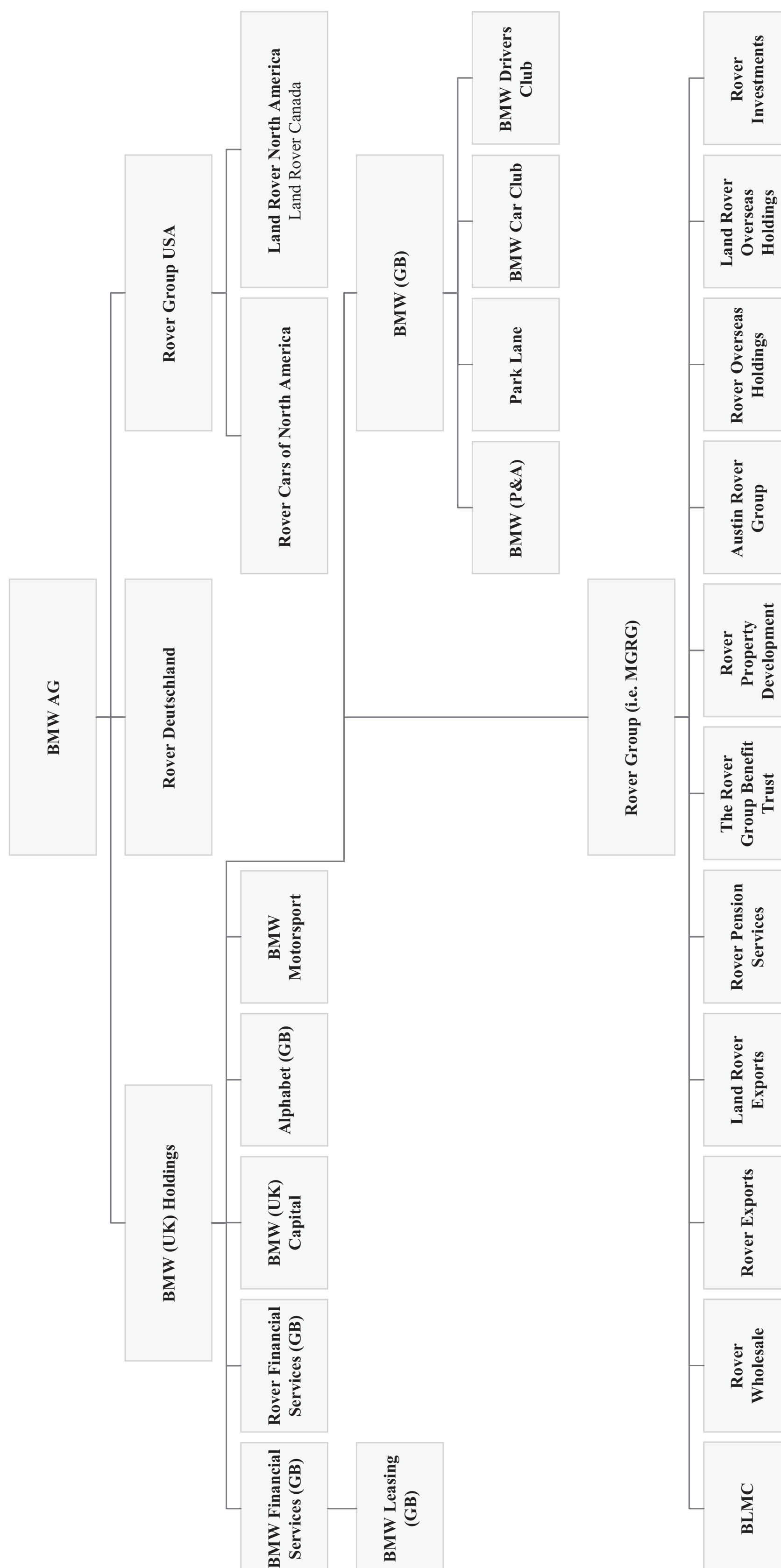
8. The Rover 75, an executive car, was developed during the period BMW owned Rover. It was unveiled at the 1998 Birmingham Motor Show and entered production in 1999.

9. The MGF, a small sports car, was launched in 1995.

10. Land Rover vehicles in production included the Defender, the Range Rover, the Discovery and the Freelander.

11. A new Mini ("the New Mini") was due to be launched during 2001.

BMW group structure chart[1]



[1] A number of MGRG's subsidiaries also had subsidiaries of their own. These have not been shown on the diagram above. The names of the companies used in this chart were those in use at the time. Changed names are dealt with in chapters III and VIII.

Plants

12. MGRG had plants in Longbridge, Cowley, Solihull, Swindon and Gaydon.

13. The Longbridge site contained the assembly lines for the Rover 25 and 45, the MGF and the Old Mini. It was also expected to be used for the production of the New Mini. In addition, it housed (principally in the Longbridge East Works at Cofton Hackett) the powertrain business, which manufactured engines and gearboxes.

14. The Rover 75 was being assembled at the Cowley plant.

15. The Solihull site was used for the production of Land Rover vehicles.

16. The Swindon plant accommodated a pressings business. It supplied body parts for all of the cars produced by the group other than the MGF and the Land Rover Defender.

17. The Gaydon site was used for product engineering and testing.

Other premises

18. Premises at Hams Hall were being developed to provide an engine production facility. The intention was that the facility should be amongst the most advanced in the world and that the engines should be used in certain BMW-badged vehicles as well as those branded Rover or Land Rover.

19. MGRG had an interest in various properties which were occupied by dealerships[2].

20. MGRG had leased office accommodation in Warwick and Bickenhill, near Solihull.

21. MGRG owned Studley Castle. This was used as a training, conference and marketing centre.

22. Other properties owned by MGRG included car storage facilities in Carrington and Avonmouth, land in Luton and Chadwell Heath and a number of other freehold and leasehold properties.

Subsidiaries[3]

23. MGRG had various subsidiaries. The companies of which it was the direct parent included, in particular, Rover Wholesale Limited (which was engaged in the UK wholesale of a range of Rover, MG, Mini and Land Rover cars), Rover Exports Limited (which was engaged in

[2] As to which, see IX/44.
[3] The names of the companies used in this paragraph were those in use at the time. Changed names are dealt with in chapters III and VIII.

the sale to overseas markets of the Rover and MG products of MGRG), Land Rover Exports Limited (which was engaged in the sale to overseas markets of the Land Rover products of MGRG) and Rover Overseas Holdings Limited (itself a holding company). Rover Overseas Holdings Limited was the parent of a number of "national sales companies" (or "NSCs"), which marketed Rover and Land Rover vehicles in their respective countries.

Financial performance

24. The financial statements of MGRG for the years ended 31 December 1994 to 1999 (i.e. during BMW's ownership) show the company to have made the following net profits and losses after interest and tax[4]:

	1994	1995	1996	1997	1998	1999
	£ million	£ million	£ million	£ million	£ million	£ million
Profit / (loss)	285.6	(45.0)	(93.1)	90.7	(512.2)	(2,066.7)

25. Since MGRG produced consolidated financial statements for the years ended 31 December 1996 to 1998 inclusive, it is not possible to ascertain the turnover and net operating profit for the individual company for 1996 and 1997. The turnover and operating profit for the other years are set out in the table below[5]:

	1994	1995	1996	1997	1998	1999
	£ million	£ million	£ million	£ million	£ million	£ million
Turnover	4,477.7	5,331.9	N/A	N/A	5,901.9	4,801.2
Operating profit / (loss)	(21.5)	74.2	N/A	N/A	(509.2)	(2,201.1)

26. The net assets of the company were as follows:

	1994	1995	1996	1997	1998	1999
	£ million	£ million	£ million	£ million	£ million	£ million
Net assets / (liabilities)	818.9	1,233.5	1,151.7	1,539.0	1,031.4	(464.2)

27. The financial performance of MGRG after 9 May 2000 is discussed in chapter XVI (Financial and trading performance of MGRG). It should be borne in mind when comparing the financial information set out above to that discussed in chapter XVI that MGRG whilst under BMW ownership included a number of different business divisions which were not comprised in the sale to Techtronic, for example the manufacture of vehicles under the Land Rover marque. This is discussed further in chapter V (Rover under new ownership).

[4] The profit figures for the years ended 31 December 1996 and 1997 are calculated as being equal to the change in the profit and loss reserve reported in the company balance sheets.
[5] The 1998 figures are shown as comparatives in the 1999 financial statements.

CHAPTER III

THE SALE OF ROVER

<u>The proposed sale to Alchemy</u>

<u>Origins</u>

1. Alchemy Partners ("Alchemy") are a venture capital house and, as such, manage various limited liability partnerships. The managing partner is Mr Jon Moulton. Alchemy's other partners at the time included Mr Eric Walters and Mr Paul Bridges.

2. Mr Moulton told us that Alchemy had attempted to acquire vehicle manufacturers prior to 2000 and that although they were not "*car industry people*" Alchemy did have "*industry knowledge*". Alchemy had previously organised a "*reserve bid*" to buy MGRG (had it not been purchased by BMW in 1994) and also attempted to acquire the Land Rover business ("Land Rover"), a bid which Mr Moulton told us was "*opposed by the Government at the time*". Mr Moulton also said that Alchemy had attempted to purchase "*Lotus twice and TVR in the past*".

3. Mr Moulton told us that he and Mr Walters had first considered the possibility of acquiring MGRG[1] from BMW in 1999. Alchemy approached BMW with the idea, and a meeting was subsequently held in, it appears, October 1999, with Dr Hagen Lüderitz, director of corporate strategy and coordination at BMW[2], and Dr Helmut Panke, BMW's finance director. That meeting appears to have resulted in "*something like a first understanding* [of] *what would be possible to do, but … no decision to do it*" (to use the words of Dr Jürgen Reul, the head of the international legal department at BMW, who, however, was not himself present at the meeting). Dr Herbert Grebenc, the director of mergers and acquisitions at BMW, said that BMW's thinking was, "*Let us firm up this proposal … and see where we get to*". In December, after further meetings had been held, Alchemy entered into a confidentiality agreement with Bayerische Motoren Werke AG ("BMW AG"). There were subsequently more meetings, following one of which, on 24 February 2000, Mr Bridges of Alchemy noted, "*BMW are considering options ranging from further investment to closure … We are the only people they are talking to about closing Longbridge for them, but they are also considering doing it themselves*". At some stage Dr Lüderitz and Dr Grebenc recommended to BMW's board that it was in the best interests of BMW to dispose of Rover and Land Rover.

4. Although Alchemy approached BMW with an offer to acquire MGRG, Dr Grebenc told us that BMW was "*already in the mode of reconsidering* [its] *Rover Group strategy*" and that during "*that revision or review of the strategy, we were approached by Alchemy*". Dr Grebenc told us that BMW had "*discussions with Ford to buy the entire group, Rover cars and Land Rover in one piece*" and that there were also "*discussions with other manufacturers*".

5. On, it appears, 6 March 2000, Mr Moulton flew to Munich at BMW's request. A meeting between Mr Moulton and two representatives of BMW, one of whom was Dr Lüderitz, was

[1] As noted at II/1, Rover Group Limited was later renamed MG Rover Group Limited, "MGRG".
[2] Dr Lüderitz headed a department termed "AU". He was referred to as "AU-1" and Dr Grebenc as "AU-2".

held at Munich airport. In the course of the meeting, a basis on which Alchemy would acquire Rover was agreed and a couple of pages of bullet points were agreed. Over the next days, the bullet points were developed into somewhat more extensive draft heads of terms.

The memorandum of understanding

6. A memorandum of understanding ("MOU") was negotiated between BMW and Alchemy during 15 and 16 March 2000 at the offices of Norton Rose LLP ("Norton Rose"), BMW's solicitors, in London. Mr Robin Brooks of Norton Rose told us that the negotiations were conducted on behalf of BMW principally by Dr Grebenc together with a team from Norton Rose led by Mr Brooks. Alchemy were represented by Mr Walters and Mr Bridges, with legal advice from Macfarlanes.

7. The MOU provided for "*funds*" (which were limited liability partnerships) managed by Alchemy to establish a company to acquire the issued capital of MGRG. Other key features of the MOU included the following:

   7.1. the purchaser was to pay £10 million for the shares in MGRG, but was itself to be paid £500 million by BMW;

   7.2. in advance of completion, there was to be a reorganisation so that certain assets and liabilities of MGRG were excluded. The assets so excluded (which were to be retained by BMW) were to include those relating to the Land Rover business, the pressings business (including the Swindon site), the R30 and R50[3] business, the production of Rover 75 vehicles, most of the engineering activities in Gaydon, the engine business in Hams Hall, the powertrain[4], gears, foundry and New Mini businesses in Birmingham, and the parts business for Rover cars (other than MG and the Old Mini). BMW was to keep, too, rights to the brand names Austin, Austin Healey, Land Rover, Mini, Morris, Riley, Triumph and Wolseley;

   7.3. following the reorganisation, MGRG was to own and be able to produce, among other things, the Rover 25, the Rover 45, the Old Mini and the MGF. It was also to have the right to be supplied with Rover 75 vehicles by BMW. As regards premises, MGRG would have the Longbridge site (other than those parts used for powertrain, gearbox, foundry and New Mini activities) and the use of accommodation at Bickenhill and, for a short period, Warwick;

   7.4. completion accounts comprising a balance sheet for MGRG were to be prepared as at the date of completion. In the event of dispute, matters were to be determined by an independent firm of accountants. If and to the extent that the completion accounts ultimately showed MGRG to have net assets of less than £811 million, BMW was to pay the difference to MGRG;

[3] R30 was the code name for a prototype of the Rover 55, a proposed mid-range vehicle that never went into production. R50 was the code name for the New Mini.
[4] As noted at II/13, the powertrain business manufactured engines and gearboxes.

7.5. execution (and to the extent possible completion) of the sale and purchase of the shares was intended to take place on Friday 28 April 2000;

7.6. while negotiations continued, BMW was to pay Alchemy £1 million per week; the amounts so paid were to be deducted from the £500 million mentioned in paragraph 7.1 above if the deal went ahead but would be retained by Alchemy if the deal did not proceed; and

7.7. most of the MOU (though not the provision mentioned in paragraph 7.6 above) was not to be legally binding[5].

8. Mr Moulton told us that Alchemy had been provided with relatively little information about Rover when the MOU was negotiated. As a result, the Alchemy team could not have known whether it would be possible to conclude any deal by 28 April. Further, the amount of the proposed payment from BMW (viz. £500 million) was, Mr Moulton explained, "*based on 'fag packets' from the* [6 March] *meeting at Munich airport*". Alchemy, however, saw themselves as having nothing to lose.

9. Alchemy's concept, essentially, was to concentrate on a specialised sports car model which would use the MG brand. They envisaged that it would take three or four years to establish the sports car business and to close down volume production.

<u>*The sale of Land Rover*</u>

10. Mr Moulton told us that Alchemy had suggested to BMW that it should sell the Land Rover business.

11. An MOU relating to Land Rover was negotiated in parallel with that concerning Rover during the night of 15 to 16 March 2000.

12. On 17 March 2000, BMW announced that it was proposing to sell Land Rover to Ford Motor Company ("Ford"). The press release also stated that BMW was "*conducting negotiations to sell its Rover car business to Alchemy Partners, a private investment group*"[6].

<u>*Subsequent events*</u>

13. In the weeks after the MOU was signed, Alchemy attempted to undertake extensive due diligence and explored the possibilities for the Rover business. Consideration was given to

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[5] In many respects the structure and content of the deal agreed with the Phoenix Consortium were the same as set out in the MOU agreed between BMW and Alchemy.

[6] A press release referring to the sale of MGRG to Alchemy had been issued the previous day. The news that BMW was "*conducting negotiations to sell its Rover car business to Alchemy Partners*" had earlier been foreshadowed by a story in a German newspaper, the Suddeutsche Zeitung, on Tuesday 14 March 2000 which referred to the possibility of Rover being broken up.

whether production should be limited to the MGF and, for so long as was feasible, the Old Mini, or whether MGRG should for a period continue to manufacture the Rover 25 and/or the Rover 45. The possibility of continuing to sell the Rover 75 was also addressed; the cars would have been produced at Cowley and then bought from BMW.

14. Alchemy had assistance regarding financial matters from KPMG[7], and they produced a number of reports for Alchemy. As Ms Ann Davies of KPMG remembered events, risks were seen to arise mainly in relation to dealer finance and employee redundancy liabilities. There were also lesser issues concerning lease obligations and the pension fund.

15. In terms of obtaining the necessary financial information, Mr Philip Davidson of KPMG told us that "*it was very apparent that it was going to be difficult to get information to form a view on the balance sheet, the profit and loss account and cash-flow*" and that "*As a result, the method KPMG employed was to create various scenarios and use the information provided to them to test such scenarios.*" Mr Moulton told us:

> "*... there was very little progress in terms of due diligence work during the first two weeks. Alchemy was not provided with any figures, could not speak to the right people, could not organise any overseas trips and could not deploy the team to get started ... Alchemy had abandoned any hope of a proper financial due diligence very early on ...*"

16. Legal due diligence was undertaken by Macfarlanes. Mr Moulton told us that Macfarlanes considered Rover's "*buy-back*" agreements[8] and estimated there to be a significantly larger liability in respect of them than had been anticipated.

17. Matters came to a head on Thursday 27 April 2000. A summary of issues prepared by Norton Rose and Macfarlanes during that day included items relating to employment (including redundancy costs and claims for non-consultation), residual values (where BMW had "*offered Alchemy the opportunity to buy out these* [MGRG] *exposures for £45 million*") and dealer finance. With regard to the last of these, Alchemy's position was stated to be "*No ongoing guarantee in respect of extended finance to dealers.*" The BMW position was summarised as follows:

> "*BMW proposal put on 24 April included a requirement that* [MGRG] *guaranteed all extended finance to dealers – current amount DM 3 billions ...*"

18. Dr Reul told us that dealer finance had been discussed before between Alchemy and BMW and had not previously been viewed as an issue. It became apparent at a meeting on 27 April 2000, however, that Alchemy did see dealer finance as an issue. Dr Reul told us that BMW was surprised that the topic was "*such a big issue*" as far as Alchemy were

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7 KPMG were also BMW's auditors, but BMW had given KPMG permission to act for Alchemy.

8 As to which, see VII/4.

concerned. Mr Brooks said that the feeling on the BMW side was, "*You can find a solution to it*".

19. Shortly after 5.00 pm that evening, there was a telephone conversation between, among others, Mr Moulton and Mr Walters of Alchemy, representatives of KPMG and Dr Lüderitz of BMW (who was in Munich). Some notes of the conversation record that Mr Moulton said that "*Liabilities must mean cash from BMW*" and proposed that BMW should make a (ring-fenced) loan of £1 billion. The idea appears to have been that the money should be lent for a two-year period, following which BMW should have returned to it most of whatever money had proved not to be needed. However, according to the notes Dr Lüderitz responded that the suggestion was a "*non-flier*", concluding at the end of the conversation, "*We don't have a deal*". Dr Grebenc's recollection was that, following this conversation, he discussed matters on the telephone with Dr Lüderitz and Dr Panke and then told Alchemy that BMW "*would either go ahead with the transaction in line with the terms outlined in the original memorandum of understanding or … step it down.*"

20. Dr Reul accepted that it was probably fair to say that by this stage there was no love lost between the parties. Mr Brooks was of the same view. Dr Grebenc told us:

> "*… it ended up in a situation that Alchemy insisted on much higher payments than what was outlined initially, and I regarded this position as outrageous and far away from being fairly considered in the best interests of BMW.*"

21. There was a perception on the BMW side that Alchemy were "*not car people*". Dr Reul, for example, referred to a feeling that Alchemy "*did not really know how a car manufacturer worked*". While, however, agreeing that Alchemy were not "*car people*", Mr Davidson and Ms Davies of KPMG said that the Alchemy team comprised experienced business people who recognised when to appoint experts to assist them in achieving their goals. Additionally, as noted in paragraph 2 above, Mr Moulton stated that although Alchemy were not "*car industry people*" he did feel that they had "*industry knowledge*".

22. There was some attempt to revive the negotiations. In a letter to BMW dated 30 April 2000, Alchemy put forward the following "*conceptual proposal*":

> "*1. Form of the deal to stay the same as much as possible.*
>
> *2. BMW decide which liabilities/arrangements they want to stay in Rover.*
>
> *3. BMW provide an adequate amount of money to run Rover down:*
>
> *a. Amount fixed by KPMG working for BMW; this can be input as needed,*
>
> *b. Should be sufficient to ensure solvency.*

4. *If after 2 years there is money left over, (say) 90% of the excess would be repaid to BMW.*

5. *BMW to have 'monitoring rights' to enable them to be comfortable that Rover is being sensibly managed to ensure solvency.*

6. *Until the end of year 2 BMW can buy Rover (not MG – we want some profit) back for a nominal consideration if they wish to do so to protect solvency etc.*"

This proposal seems to have been in keeping with what Mr Moulton had proposed to Dr Lüderitz in the telephone conversation mentioned in paragraph 19 above.

23. Replying, however, on 2 May 2000 BMW said:

> "*We have today started negotiations with the Phoenix Consortium and we progress them with the objective to get to signable agreements. As long as this objective is realistic we will not negotiate alternative proposals.*"

The Phoenix bid

Formation of the Phoenix Consortium

24. On Friday 17 March 2000, the day after BMW had announced the proposed sales to Alchemy and Ford, the then Secretary of State for Trade and Industry, Mr Stephen Byers, travelled to Birmingham to discuss the establishment of a task force to address the problems to which the sales would give rise. The meeting was attended by Mr Towers as chairman of the Birmingham and Solihull Learning and Skills Council. Mr Richard Burden, the Labour Member of Parliament for the Birmingham Northfield constituency, which encompassed much of Longbridge, was also present.

25. Mr Burden had known Mr Towers for some years, having first met him when MGRG was owned by British Aerospace[9]. Mr Burden told us that he and Mr Towers had been intending to meet to discuss BMW's future intentions for Rover for some time before the sales to Alchemy and Ford were announced. On 17 March 2000 Mr Burden introduced Mr Towers and Mr Byers to each other, and Mr Towers accompanied Mr Byers to the train station. In the course of the day, Mr Towers agreed to consider alternatives to the sale to Alchemy and to fax his ideas to Mr Burden, who would pass them on to Mr Byers.

26. Mr Burden explained to us that, while Ford was felt to be "*a reasonably good home*" for Land Rover, the perception was that Alchemy's plans to downsize Longbridge would send "*massive shockwaves through the West Midlands economy*".

[9] As noted at IV/3 to 4, MGRG was sold by British Aerospace to BMW in 1994.

27. On 21 March 2000 Mr Towers sent Mr Burden a paper headed "*Project Phoenix*". This began by identifying the primary objective as to "*Minimise job losses at Rover and at associated/dependant firms*" and the secondary objective as to "*Avoid further dilution of UK/Midlands manufacturing base.*" The paper proceeded to consider how it might be possible to achieve a "*Timely Sale of Rover to a Good Home*". "*The challenge*", Mr Towers noted in the paper, "*is considerable but the concept is simple*". This involved:

> "*1. Show how BMW's strategy for Rover has been inappropriate right from the outset.*
>
> *2. Show how better, more appropriate, strategies have worked and continue to work in real life.*
>
> *3. Rebuild as much of the lost PR for Rover as possible.*
>
> *4. Create a sensible background and establish BMW's support for a **<u>responsible</u>** onward sale either:*
>
> - *directly from BMW (favoured but unlikely)*
> - *indirectly through a **supportive** 'white knight' group (favoured).*
> - *indirectly through Alchemy (not favoured)*
>
> *5. As a contingency measure keep a high degree of intelligence and control over the Alchemy negotiations thus avoiding any contractual obstacles being created along the way.*"

Mr Towers observed in the paper:

> "*The initial task of* [a 'white knight'] *group would be to develop a credible business plan from which a much more substantial enterprise could emerge compared with the picture painted by Alchemy. Their next phase would be to steer the business through that process whilst at the same time developing partners for the ultimate sale – probably within 15 months of ownership.*"

28. Mr John Hemming, now a Member of Parliament but then the leader of the Liberal Democrat group on Birmingham City Council[10], was also seeking to provide an alternative to the proposed sale to Alchemy. On Sunday 19 March 2000, Mr Hemming told Mr Burden that he wanted to try to put together an alternative bid for Rover. By the following day, Mr Hemming had told the Birmingham Post that he was planning to construct a proposal. On 23 March he wrote to BMW stating that he represented a "*consortium of British Investors interested in tendering for all or part of the Rover Cars business based in the UK*" and requesting a meeting "*to identify what the next steps would be*". In a further letter to

[10] Mr Hemming still holds the position of leader of the Liberal Democrat group on Birmingham City Council.

BMW, dated 27 March, Mr Hemming suggested that it was in BMW's interests to make clear that it was looking at alternatives to the Alchemy transaction and said that the "*first step required to achieve this would be to provide* [him] *with access to information so that* [his] *team can analyse in detail the potential projected plans for Rover and work out* [their] *staffing, cash flow and other resource requirements*". Mr Hemming said:

> "*Our offer is to create a new company which operates the residual Rover business (i.e. not Landrover).*"

In, however, a letter to Mr Tony Woodley, then the national secretary for the vehicle building automotive group of the Transport and General Workers' Union ("TGWU") (and hence the chief union negotiator for the car and components industry), dated 28 March, Mr Manfred Schoch of BMW said that he had been informed that Mr Hemming's proposal "*does not constitute an offer*". An offer, Mr Schoch noted, had to include at least the following points:

> "*1. The purchaser has to demonstrate that he is competent to implement the transaction, i.e. he has to demonstrate experience in* [acquisitions], *preferably experience in automotive business and financial strength and resources.*
>
> *2. The offer has to include a definition of object of purchase, the price range, a concept for continuation of operation (financial and operational), a time schedule for transaction and must achieve the seller's objective to dispose of Rover.*
>
> *3. The contract will be subject to due diligence.*"

29. On 27 March 2000, Mr Hemming announced that an advisory board was being established "*to advise as to how to handle the bidding process.*" In addition to Mr Hemming, the members of the advisory board were stated to include Mr Mike Whitby, the deputy leader of the Conservative group on Birmingham City Council, Mr Andrew Sparrow, then a partner in Lee Crowder solicitors, Mr (now Professor) Carl Chinn, a historian, and Mr Brian Parker, a businessman who had apparently been introduced to Mr Hemming by Mr Sparrow.

30. Mr Hemming was also in contact with Mr Edwards, who owned[11] and managed a Rover dealership in Stratford-upon-Avon called Edwards of Stratford which traded through the corporate vehicle Edwards Cars Limited ("Edwards Cars")[12]. Mr Edwards, too, wished to find an alternative to the proposed sale to Alchemy. On 17 March 2000, Edwards of Stratford issued a press release arguing that "*the* [New] *Mini should and must remain with Rover cars*" and that the "*only other sensible alternative scenario is the sale of* [the New] *Mini through the current Rover* [dealer] *network*". By 21 March, Mr Edwards had contacted

[11] Mr Edwards owned 19,999 of the 20,000 issued shares and his wife, Ms Marianne Edwards owned the remaining 1 share.
[12] See also chapter XIV (Edwards Cars).

Mr Hemming. Mr Edwards attempted to assemble a "*credible consortium*" to put forward a rival bid and identified Mr Towers as an "*obvious candidate*" for such a consortium. Following a telephone conversation, Mr Towers and Mr Edwards met, together with Mr Beale, a board director and company secretary of Edwards Cars. The three agreed that it would be sensible to work together. They agreed, too, that Mr Towers should approach Mr Stephenson, an engineer who had been a board director of MGRG under BMW ownership, which he did.

31. Mr Stephenson had himself, independently, considered whether it would be possible to construct an alternative to the Alchemy sale. He told us that he had concluded that "*this would be a huge challenge*" and that he "*put together a few ideas of* [his] *own, none of which went anywhere*". He was, however, persuaded by Mr Towers to attend a meeting with Mr Edwards and Mr Beale and was subsequently "*sucked in*".

32. As Mr Hemming remembers events, he asked Albert E Sharp Limited ("Albert E Sharp"), a firm of stockbrokers based in Birmingham, to attend a meeting on Friday 31 March 2000. Those attending the meeting included Mr Dominic King and Mr Jonathan Bartlett from Albert E Sharp; Mr Hemming; Mr Towers, Mr Edwards and Mr Beale; Mr Parker; Mr Whitby; Mr Duncan Simpson from the Amalgamated Engineering and Electrical Union (the "AEEU"); Mr Chinn; Mr Sparrow and Mr Stephen Gilmore from Lee Crowder.

33. It was almost certainly for the purposes of this meeting that Mr Hemming prepared a document headed, "*John Hemming's Report 31st March 2000*". The first section of this, headed "*The Creation of the 'Hemming' bid*", listed objectives such as avoiding a perception that "*There is No Alternative*" and generating a nucleus of people interested in a future for Rover. The last part of the document, headed "*The future*", included:

> "*Bring everyone together into one team.*
>
> *Generate a solid business plan …*"

34. Mr Bartlett told us that it was clear to him that there was a personality clash between Mr Hemming and Mr Towers. Mr Hemming himself stated that he had a row with Mr Towers at the start of the meeting over who was to run it and that this led to him (Mr Hemming) pulling out of the detail of the discussions. Mr Hemming said that it was agreed at the meeting that an alternative bid should be pursued, but that he, Mr Parker, Mr Whitby and Mr Chinn agreed to leave the meeting while the finer details were discussed[13]. In somewhat similar vein, Mr Towers told us that he had indicated that a smaller group (including himself, Mr Beale and Mr Edwards) needed time together to get

[13] While Mr Parker and Mr Whitby left the meeting with Mr Hemming, in a letter to Mr Bartlett dated 3 April 2000, Mr Hemming said:

> "*I think it is important to invite Mike Whitby and Brian Parker to the planning meetings … Both are experienced entrepreneurs and would add to the process. We would not wish to see a situation develop that would be perceived as 'Alchemy II' and having them involved in the detail would assist in preventing this.*"

Whether or not as a result of this letter, Mr Parker was actively involved with the Phoenix Consortium (see e.g. paragraphs 46, 49 and 55 below).

into some of the detail. Mr Burden explained that he thought that it was agreed that Mr Towers and the business people there would concentrate on preparing a bid and trying to negotiate with BMW while the others would continue the public campaign to save Rover and the future of Longbridge.

The initial offer to BMW

35. On 14 April 2000 Mr Towers and Mr Edwards sent BMW a letter setting out an offer for MGRG. The offeror was named as Techtronic, a company:

> "*... formed for the purpose of the offer and representing the interests of:*
>
> - *John Towers*
> - *Edwards of Stratford (John Edwards, Peter Beale)*
> - *Nick Stephenson ...*"

Techtronic was "*also supported in its bid*" by "*The Mayflower Corporation Plc (Terry Whitmore*[14]*) and Lola Cars International Limited*", the trade unions representing the interests of the Rover employees, members of the Rover/MG/Old Mini dealer network, "*Senior automotive executives with experience in Marketing, Product Engineering, Manufacturing, Employee Relations, and Media Relations*" and local West Midlands business interests. The letter explained, among other things, as follows:

35.1. "*Techtronic expects that comprised within Rover at the point of acquisition will be the Longbridge assembly site, together with the manufacturing operation (and all associated rights and assets) for Rover 25, 45 and 75, Rover Cars, NSC's* [i.e. national sales companies]*, MG and current Mini*";

35.2. the offer required BMW to contribute £500 million in cash over a three-year period;

35.3. under the offer, production of the New Mini was to be transferred to Cowley[15] while production of the Rover 75 was to be moved in the reverse direction (from Cowley to Longbridge); and

35.4. "*BMW should be aware that a material part of Techtronic's business plan centres around the contribution made from vehicle financing and sale of parts and accessories. Techtronic would therefore expect ownership of those business processes and revenue streams to be vested with Rover.*"

Mr Towers and Mr Edwards noted:

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[14] Mr Whitmore was the joint managing director of The Mayflower Corporation plc in 2000.
[15] Mr Towers had sought to persuade BMW that it should not retain the New Mini, but without success.

"*Techtronic's proposals not only carry with them the goodwill of the public, and numerous other interested parties. They also carry the support of local government authorities, national government, trades unions and the Rover workforce.*"

36. In a covering letter to BMW, Mr Towers explained:

"*… it has always been and still is our preferred option to include New Mini and the Oxford site in this proposal. It remains the case that we consider the inclusion of New Mini and the Oxford site as the best solution for both parties. However, we have taken heed of BMW's views expressed on this matter and hence our letter of offer excludes Oxford and only includes rights for distribution of New Mini through UK dealers.*

We are equally aware that BMW may wish to dispose of the Swindon Body and Pressings business as well as Power Train. These are both matters which we would consider very relevant to our overall interests and would wish to register our interest in proceeding with those discussions at the earliest opportunity following completion of this offer."

37. Techtronic, the offeror, had been incorporated on 6 April 2000. The company's name was changed to Techtronic (2000) Limited on 13 April 2000, and Mr Towers, Mr Beale and Mr Edwards had been appointed as directors on the same day. The company's two issued shares were transferred to Mr Towers and Mr Edwards[16].

<u>*Support for the Phoenix Consortium bid from other stakeholders*</u>

38. As indicated in the offer letter (mentioned in paragraph 35 above), Messrs Towers, Edwards, Beale and Stephenson (the "Phoenix Consortium") enjoyed support from a variety of sources. The Mayflower Corporation plc ("Mayflower"), which was amongst those named in the letter, had a section which produced automotive bodies and components, including for the MGF. Following the announcement that BMW was to dispose of MGRG, Mr Whitmore, joint managing director of Mayflower, saw an opportunity for Mayflower to acquire MGRG's pressings plant at Swindon. In early April 2000, Mr Stephenson approached Mayflower about the possibility of combining Mayflower's interest in the Swindon plant with the Phoenix Consortium's bid for Rover. Mayflower considered this impractical, but it agreed to the Phoenix Consortium identifying Mayflower as a supporter. Mr Whitmore explained:

"*… at that time, I have to say, I wanted* [Mr Stephenson] *to succeed, because of what I saw of Moulton's* [of Alchemy] *plan, he was being paid to dispose of it. Having spent virtually a lifetime in the automotive industry, the ideas that he had were not feasible. And I wanted to see MGF continue because it was good business for us.*"

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16 Techtronic's share capital was subsequently increased, as to which see paragraph 64.

39. As with Mayflower, it was through Mr Stephenson that Lola Cars International Limited ("Lola") came to be identified as a supporter of the Phoenix Consortium's bid. Having left Rover in 1999, Mr Stephenson had begun to work for Lola, a company which produced racing cars, on a part-time basis[17]. When the Phoenix Consortium's bid for Rover was taking shape, Mr Stephenson discussed it with Mr Martin Birrane, who controlled the company, and Mr David Bowes, its managing director.

40. As indicated in the offer letter, the Phoenix Consortium also had trade union support. Trade unions which had members working for Rover were naturally concerned that a sale to Alchemy would result in very large job losses. Mr Woodley, in particular, was prominent in campaigning against Alchemy and in his support for the Phoenix Consortium; in fact, he telephoned Mr Towers within a week or so of the 16 March announcement to ask him to help. Mr Woodley explained:

> "*... my involvement was, without exaggerating, I would have thought 20 hours a day, every day. Every single day, from the time of the announcement to the eventual sale to Phoenix ... whether it was* [a] *trip to, say, Munich*[18]*, discussions in Britain with a multitude of Rover/BMW/Phoenix people, or whether it was the DTI particularly, there was daily contact. There would be almost daily discussions in one shape or form.*"

41. As also indicated in the offer letter, the dealer network lent support to the Phoenix Consortium. Mr Richard Ames, who owned a Rover dealership and was chairman of the Rover Franchise Board (i.e. the dealer council) in 1998 to 1999, was instrumental in marshalling the dealers. His particular role, he explained to us, was "*to get the backing of the dealer network*". Among other things, he obtained cheques of several thousand pounds each from a number of dealers to provide a fighting fund which Mr Ames thought totalled "*Probably between £40,000 and £60,000 from about 20 dealers*". Mr Ames passed the cheques on to Mr Beale, but they were ultimately returned uncashed. Further, the Rover Franchise Board also advanced through Simmons & Simmons LLP, solicitors, claims that dealers would have "*potentially substantial claims for compensation ... as a result of the break up of Rover Group*".

42. The Phoenix Consortium also enjoyed considerable support from the general public. This manifested itself in, for example, a "*March for Rover*" on 1 April 2000 and a campaign against the purchase of BMW cars. The chairman's statement included with Techtronic's financial statements for the period to 31 December 2000 referred to "*the wave of employee and public support in* [the Phoenix Consortium's] *favour*".

43. There was a perception that the Phoenix Consortium were acting for the public good. Indeed, as noted at paragraph 27 above, the "*Project Phoenix*" paper that Mr Towers sent to Mr Burden on 21 March 2000 referred to the sale of MGRG to a "*Good Home*". Mr Ames

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17 Mr Stephenson was recorded as being a director of Lola between 12 July 2000 and 20 November 2001.

18 We are aware from the documents we have seen that Mr Woodley attended meetings in Munich (where BMW was based) on 15 and 16 March, 23 March, 30 March and 13 April.

thought that everybody's original ambition was to "*save the company, save the jobs*". Mr Bartlett of Albert E Sharp told us that Mr Towers had said to him on more than one occasion that "*no-one in the Phoenix Consortium was in it for personal financial gain*". Mr Burden explained that the Phoenix Consortium "*never said that they would not make money out of buying Rover, but the understanding at the time of the Phoenix takeover was that it had been the result of the efforts of different stakeholders which would lead to employees themselves having some kind of stake in the new company in due course*". Mr Hemming said that the Phoenix Consortium's members "*agreed that their motivation for formulating a bid was to minimise damage to the local community*". In his evidence to us, Mr Towers agreed that people would have been justified in taking the view that the Phoenix Consortium were acting for the public good rather than for personal profit, Mr Beale said that such a perception "*was not wrong*", and Mr Edwards said, "*That was certainly my intention*".

Professional advice

44. The Phoenix Consortium secured professional advice from several sources. Albert E Sharp was involved from a very early stage, both through Mr King and through Mr Bartlett, who had known Mr Towers for several years[19]. In turn, Mr Bartlett recruited Eversheds to provide legal services; Ms Sue Lewis, a partner in the corporate practice group at Eversheds' Birmingham office, had met Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers by 7 April 2000. Mr Bartlett also introduced the Phoenix Consortium to Deloitte; a note made on 18 April by Mr Richard Edwards, a transaction services partner in the corporate finance services department within Deloitte's Birmingham office, identifies its subject as "*POSSIBLE NEW JOB – 'ROVER'*".

45. During April 2000, Mr Bartlett, doing the best he could in circumstances where the Phoenix Consortium had not yet secured access to detailed financial information on MGRG, prepared an outline business plan for Techtronic. The intention was that the plan should be used when seeking funding; it was noted in the plan that the BMW "*cash dowry*"[20] meant that "*no new equity subscription is required in the first instance to fund the deal*" and that an "*overdraft facility of up to £200m in year one should provide adequate financial resources for the new company*". The plan envisaged sales of 212,000 units in the first year, 220,000 units in the second year and 230,000 units in the third year. On this basis, the plan projected a net cash outflow before financing of £125 million in the first year and £31.5 million in the second year, but it was anticipated that the "*cash dowry*" from BMW would amply cover these. By the third year, there was to be a net cash inflow before financing of £40.5 million and an overall change in net cash (taking into account the BMW loan that year) of £140.5 million. It was intended that a Rover 75 estate should be brought to market in the second full year of

[19] Mr Bartlett told us that in 1997 he was a stock market analyst covering Concentric Group plc at Albert E Sharp and that he "*published a detailed research report on Concentric in December 1997, and spent time with* [Mr Towers] … *as a result.*" Mr Bartlett also said that during 1998 Mr Towers "*approached* [Mr Bartlett] *to ask if he could help to organise a process at* [Albert E Sharp] *that would lead to an MBO* [of Concentric Group plc]." Mr Bartlett said he "*stepped behind a 'Chinese wall' on this and in August 1998 the MBO was achieved*".

[20] Referring to the £427 million of loan notes eventually subscribed for by BMW, as to which see paragraphs 87 and 90 below.

the plan and that a replacement Rover 45 would be developed, "*probably as a collaborative venture with a major automotive partner*". The plan concluded:

> "*Given the readiness expressed by BMW to provide a recovery dowry of £450m over 3 years … and the forecast internal cash consumption of £116m over 3 years after £410m of investment spend and £25m redundancy expenses, we believe the proposal to be robust. The headroom facility we request of:*

	Yr 1	*Yr 2*	*Yr 3*
Headroom credit facility (£m)	*200*	*100*	*50*

> *we expect to be more than adequate to cover our requirements in the circumstances, given that we expect to be marginally cash positive (£40.5m) after £180m of capex in year 3 …*
>
> *For the mid term further development of new and improved motor cars is proposed through the medium of significant collaborative ventures of the kind Rover engaged in with Honda in previous years. The projected cash pile and partnership resources should be adequate to cover the funding of these projects.*"

46. As noted at paragraph 44 above, the Phoenix Consortium were introduced to Deloitte by Mr Bartlett. Deloitte had their first meeting with Mr Towers on 27 April 2000, the day the negotiations with Alchemy collapsed[21] (though Deloitte and Mr Towers were as yet unaware of the collapse). Deloitte were represented at the meeting by Mr Richard Edwards and Mr Einollahi, another partner in the firm, who specialised in corporate finance. Mr Bartlett and Mr Parker were also present. Mr Richard Edwards explained that the meeting was "*a preparatory meeting in case the transaction did proceed*" and provided an opportunity for himself and Mr Einollahi to meet Mr Towers.

<u>*Negotiations with the Phoenix Consortium*</u>

47. The collapse of the negotiations between BMW and Alchemy was announced the next morning. Alchemy issued a press release stating, "*Alchemy Partners and BMW have ceased negotiations as they were unable to agree upon certain contractual matters, some of which arose yesterday.*" In its press release, BMW said:

> "*BMW and Alchemy have terminated their negotiations. No agreement was reached on the sale of Rover Car Operations to Alchemy. The negotiating partners were finally unable to come to an understanding with respect to certain conditions of contract.*

[21] See paragraphs 17 to 19 above.

> *BMW Group will now pursue alternative routes to bring to an end its involvement in Rover Car Operations. Those routes include the sale of Rover Car Operations or its closure. A decision* [on] *which of those alternatives will be implemented will be taken during the course of next month.*"

48. On Saturday 29 April 2000 Norton Rose delivered first drafts of a number of agreements between BMW and Techtronic. The drafts were largely (though by no means entirely) based on the documentation that had been prepared for the proposed sale to Alchemy and, in essence, the overall structure of the deal was very similar.

49. The parties met at Norton Rose's offices in London on Tuesday 2 May 2000. Those present included Messrs Edwards, Stephenson, Towers and possibly Beale who may have attended the latter part of the meeting[22]; Mr Parker; Mr Bowes of Lola; Mr Bartlett of Albert E Sharp; Ms Lewis and Mr Mike Seabrook from Eversheds; Mr Richard Edwards from Deloitte; Dr Grebenc and Dr Reul from BMW; and Mr Brooks and Mr Simon Cox from Norton Rose. Mr Einollahi and Mr Ian Barton (also from Deloitte) apparently arrived at about lunchtime, having travelled to London from Manchester that morning. It emerged on 2 May that BMW expected a binding contract to be concluded as soon as 12 May.

50. More than one person told us of the important part Mr Einollahi played in the subsequent negotiations. Dr Reul told us that Mr Einollahi "*handled, managed the negotiation*" with regard to structure and financial details. Mr Bowes said that, following the 2 May meeting with BMW, Mr Einollahi "*took over*" and was very impressive. Mr Brooks said that "*the direction and the thrust of the negotiations on the Phoenix side was led by Deloitte & Touche*" and that Mr Einollahi was the "*person who came to the fore*".

<u>The BMW "dowry"</u>

51. The draft documentation delivered on 29 April by Norton Rose[23] provided for BMW to contribute £500 million by way of subscription for loan notes[24]. This level of funding had previously formed part of the MOU agreed between BMW and Alchemy[25].

52. In explaining why BMW was willing to advance such a sum Dr Grebenc told us that during 1999 BMW had recognised the need to revise its strategy with regard to MGRG and that any internal reorganisation was going to cost money; whether that be in restructuring the company or closing it down. Dr Grebenc also told us that in undertaking its own internal assessment of the cost of such restructuring, BMW had calculated that funds of "*very close to the* [£]*500 million*" agreed with Alchemy would be required.

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[22] Mr Beale told us that he could not remember attending this meeting and thought that he "*could have been* [there] *at the end of the meeting*". A table plan produced by Mr Richard Edwards indicates that Mr Beale was not present during at least part of the meeting.

[23] See paragraph 48 above.

[24] Loan notes are a form of vendor finance or deferred payment, in which the purchaser, in this case Techtronic, acts as a borrower, agreeing to make payments to the holder, in this case BMW, at a specified future date.

[25] See paragraph 7 above.

53. There was discussion at the 2 May 2000 meeting as to the basis on which BMW would provide MGRG with this funding. A note made by Ms Lewis following the 2 May meeting records as follows:

> "*BMW indicated that in real terms they want to be in a position to recover the £500m without damaging the business ... BMW's intention is to seek to clawback the £500m out of 'free cash' whatever that means. This seems to be akin to an anti-embarrassment type provision ... It was indicated that repayment in the event of the change of control may be okay although again this must not be triggered in the event that control changes by reason of the introduction of new funds by way of subscription into Phoenix.*"

In similar vein, Mr Towers was noted as telling representatives of the DTI on 5 May:

> "*Repayable, but this is a non-embarrassment situation ... We want that money to be a gift, not a loan.*"

Notes made of a meeting attended by Deloitte, Eversheds and the Phoenix Consortium on 7 May contain the observation:

> "*BMW looking to take 1st £500m of profit → need a mechanism to show to shareholders that they will get repayment → looking to link our* [profits] *into repayment of debt.*"

Later on the same day, the basis on which BMW would provide funding was discussed at a meeting attended by the Phoenix Consortium and representatives of Deloitte, Eversheds and BMW. Notes of the meeting refer to a "*Tight agreement*" to "*ensure money used for Rover*" and to the "*need to have the profits*" for redemption.

54. In the course of his evidence to us, Mr Edwards referred to BMW "*actually gifting the money*". While, however, it may very well be that BMW did not anticipate that it would in fact receive repayment, there is no reason to suppose that, as a matter of law, BMW paid moneys to Techtronic by way of gift rather than subscription for loan notes, nor that BMW intended a gift. Mr Edwards himself said that he left it to the advisors "*to work out the technicality behind what they were discussing.*" Mr Towers told us that he thought of the money as a gift in the sense that he did not think that BMW expected to get the money back, but not in the sense that there were no circumstances in which it was legally repayable[26].

55. Both Mr Parker and Deloitte approached Burdale Financial Limited ("Burdale"), then a majority owned subsidiary of the First Union International Banking Corporation, about providing funding. In a letter to Mr Parker dated 5 May 2000, Burdale made an indicative

[26] See also XV/14 regarding whether BMW expected that the money would be repaid.

offer, subject to due diligence, of a £200 million secured working capital facility[27]. By then, however, it was apparent that MGRG was unlikely to need such a facility.

56. At a meeting, apparently on 5 May 2000, BMW indicated that it required a letter confirming that the Phoenix Consortium would be in a position to complete the purchase and run the business. Accordingly, BMW was provided with a letter confirming that Techtronic "*has adequate financial resources to complete the acquisition of* [MGRG] *… and to run Rover as a viable business for the foreseeable future.*" The letter also stated that, in reaching this view, advice had been obtained from Albert E Sharp and Deloitte. In reality, it had by this stage been calculated that, having regard to the large amount of money BMW was to lend without any requirement for early repayment, there should be no need for any additional funding in the short term.

The parts business

57. One of the issues during the negotiations was whether BMW was to retain the Rover cars parts business[28]. The proposed sale to Alchemy had not been intended to extend to this, and provision was therefore made for the parts business to be transferred to BMW Parts Limited, a previously dormant subsidiary of BMW (UK), ultimately owned by BMW AG, pursuant to an agreement dated 28 April 2000. However, the Phoenix Consortium were keen that any sale should include the parts business, to which a value of £80 million was attributed in the sale agreement with BMW Parts Limited and in some notes dating from 5 and 6 May. The draft documentation delivered on 29 April envisaged that BMW would grant an option to purchase BMW Parts Limited. Later, however, it was agreed that BMW Parts Limited should be transferred to MGRG at once, with the value of the parts business being deducted from the third instalment of the loan which BMW was to make to Techtronic.

The proposed £75 million loan notes

58. While the BMW loan was to be reduced[29] to take account of the inclusion of the parts business in the deal, BMW agreed to pay an additional £75 million in substitution for warranties. Mr Einollahi told us that "*They* [i.e. the Phoenix Consortium] *concluded that they cannot really get the warranties that they want and their better answer would be to have additional cash and accept to give up meaningful warranties and indemnities.*" The question then arose as to how this payment should be treated.

59. A note made by Mr Toby Bushill, a director in Deloitte's tax department, is relevant in this context. The note, which is dated 8 May 2000, includes the following:

"*Opt*[ion] *of Hold*[ing] *co*[mpany] *with £75m of loan notes … – keep open.*"

[27] The business plan envisaged an "*overdraft facility of up to £200 million*": see paragraph 45 above.
[28] See further, as to the parts business, chapter XIII (Xpart).
[29] In the event by £60 million: see footnote 39.

Mr Bushill told us that this note arose out of a brief meeting which he and Mr David Hume, a partner in Deloitte's tax department, attended on 8 May. His recollection was that Mr Towers, Mr Beale, Mr Einollahi and Ms Lewis were also present. He explained as follows:

> "*It was explained to me … that a decision had been taken not to … try to seek to pursue indemnities for exposures from BMW, and, in return, BMW were prepared to provide an extra £75 million of cash to top up the assets of the company being acquired … It was explained to me that on the back of that decision, that … in the event of a future exit in five years' time, the Phoenix equity investors would seek to take the first slice of any sale proceeds up to an amount of 75 million … And there was a very brief discussion, I recall, at that meeting about how that might be structured. And it was concluded that there was not time in the time scale of the immediate transaction to consider how that would be structured … So from a tax perspective, we were asked at that time: would it be possible to put a new holding company on top after the transaction, subject to getting tax clearance? And we confirmed it was possible.*
>
> *… There was, I think, some discussion at that time as to whether … it might be structured as preference shares or as loan notes, and given the interest of the press in the whole transaction, a view was expressed that loan notes would not be immediately in the public domain, whereas a change in the articles would immediately be seized on by the press. There was a feeling that … by issuing loan notes to deal with this, that there would be two to three years further on, by which time at that time it was hoped that they would have found joint venture partners and the business was back on track.*"

Mr Bushill also said that the addition of a new holding company was thought to have two advantages:

> "*… first that it would facilitate the £75 million first slice of equity for the Phoenix Consortium. It was also a way of facilitating the share schemes for the dealers and employees.*"

60. Mr Hume gave evidence to similar effect. He said:

> "*… they had negotiated that BMW would inject an additional 75 million of share capital in return for the waiver of various warranties. And there was a desire from the team that in some manner they would extract that 75 million in the event of a transaction … on the evening of the 8th Toby* [Bushill] *and I went to a meeting where there was at least some of the four* [i.e. the Phoenix Consortium] *present, plus Eversheds, plus various people from Deloitte's. And that is when it was discussed … we were told that there was a desire to put some mechanism in place whereby the four members of the Phoenix Consortium would have the right to the 75 million in preference to any other shareholders. There was a brief discussion on the mechanisms by which that could be accomplished, but a conclusion drawn that (a)*

> *we did not have time to do it that evening and (b) it could be done later on. So the discussion was parked ... I can remember Sue Lewis being very reluctant to try and do anything about the drafting of it that evening ... There was a discussion about the fact that it could be done by a reorganisation of share capital of* [Techtronic] *or by putting another company on top.*"

Mr Hume told us that he understood that "*the idea being discussed would have simply provided the* [Phoenix Consortium] *with an interest akin to an equity interest in the sum of £75 million that would only have resulted in payments being made to the* [Phoenix Consortium] *in the event of the sale of MGRG.*" In particular, "*the idea was not to use loan notes as a means of allowing the* [Phoenix Consortium] *immediately to withdraw the £75 million from the group*".

61. Other evidence we were given in relation to the £75 million included the following:

61.1. Mr Towers told us:

> "*The only reference to £75 million that I recall is during the completion process when* [Mr Einollahi] *mentioned I think to all of us, or maybe to us, as individuals, that ... there was a greater possibility for flexible use of that money than there was for the rest of the 500 million.*"

He also said that when, later in the year, he heard of a notion that management should take out £75 million by way of loan notes, his reaction was one of horror at the quantum. He added that "*£75 million was never a sensible proposition per the four Phoenix consortium members*";

61.2. Mr Edwards said:

> "[Mr Einollahi]*, very proudly, told John Towers that he had negotiated a £75 million loan note with BMW and I thought John Towers was going to shoot him or something. He was absolutely beside himself with rage.*"

Mr Edwards said that Mr Einollahi had negotiated the arrangement without instructions;

61.3. Mr Beale told us that Mr Einollahi came up with the idea of loan notes:

> "*... pre-completion, when he was trying to explain to us ... what would happen if we formed this Topco, we would exchange our shares and exchange the shares in the Topco and the loan notes. It did not get very far because of John Towers' attitude towards the very idea that we should receive money as being – he did get quite animated and agitated with* [Mr Einollahi] ..."

Mr Beale said, too, that the Phoenix Consortium had been told by Mr Einollahi that BMW had approved their taking £75 million;

61.4. Mr Stephenson said that he did not remember "*at that particular point in time*" any idea that things should be structured in a way that would allow the members of the Phoenix Consortium to benefit from the £75 million. He also told us, "*we definitely did not have any specific discussion about how we would remunerate ourselves at that time*";

61.5. Mr Einollahi told us:

> "*... at some point, somebody suggested ... well, put* [the £75 million] *as a loan* [from] *BMW and sell the loan to ... the Phoenix Four individually. I do remember it, because my one comment was: well, if you are going to do that, you might as well put it into some sort of pension fund because if it ever gets repaid that is tax efficient, if that is what you are going to do ... I found John* [Towers] *in one of the meeting rooms and Mr Towers was unhesitating, he did not even let me finish the sentence, that that is wrong, cannot do that.*"

Mr Einollahi said that the idea was never fully developed (e.g. in relation to whether the £75 million loan would rank behind[30] the money which Techtronic was to borrow from BMW and to lend on to MGRG (i.e. the BMW "dowry" discussed in paragraphs 51 to 56 above)). As Mr Einollahi remembered events, Dr Grebenc had been comfortable with the proposal on the basis that the benefit of the £75 million would be a "*notional privilege – unless the business made some profit in the future*". He went on to say that BMW did not agree to any money being available to the Phoenix Consortium: "*nobody at any point either talked about having any money for the directors or agreed to it*";

61.6. Mr Barton told us that Mr Einollahi "*suggested that the £75 million might be injected by way of loan notes from BMW that would then be transferred to the* [Phoenix Consortium] *at nominal consideration*", but Mr Towers "*stated that he did not wish to adopt this approach to the injection of the £75 million*";

61.7. Dr Reul told us that there was no discussion of the Phoenix Consortium taking any kind of fee or commission for themselves; and

61.8. Dr Grebenc said that BMW had agreed to support a restructuring "*to achieve a broader share holding*[31] *and to be able also then, in the context of finding a partner, for the strategic reorientation to accommodate that partner*". However, "*there was not any form of agreement that we would allow a fee element to be incorporated*".

[30] Meaning whether, on MGRG going into administration, the £75 million would be repaid after the moneys owed to BMW.

[31] As Dr Grebenc explained, "*We want management, we want employees, we want dealers and suppliers to take a stake in the company. And at that time, they were not able to come up with a structure for it.*"

Asked whether he remembered any proposal for money to be paid to the Phoenix Consortium, he replied:

> "*No, and that would have been absolutely detrimental to the whole thing. There was nothing in that sense.*"

62. Reconciling the evidence as best we can, we think that what happened was probably as follows:

62.1. when BMW agreed to pay the extra £75 million, the suggestion was made that it should contribute the money by lending it to MGRG and transferring the benefit of the debt to the members of the Phoenix Consortium. That idea was, however, vetoed by Mr Towers;

62.2. it was subsequently proposed that the £75 million contribution by BMW should be reflected in the issue to the members of the Phoenix Consortium by a new holding company of £75 million of loan notes. That scheme was not rejected by Mr Towers or anyone else. Rather, it was parked because it was felt (in particular, by Ms Lewis) that there was insufficient time to implement it before completion;

62.3. it was not anticipated that the members of the Phoenix Consortium would receive the £75 million at once, or even in the short term. The focus was on providing a mechanism by which the members of the Phoenix Consortium could benefit in the event of MGRG being sold;

62.4. while BMW's representatives may not have opposed a scheme under which the benefit of a loan from BMW to MGRG would have been transferred to the members of the Phoenix Consortium, at the time the scheme was not yet fully developed and the idea was to give the members of the Phoenix Consortium something comparable to an equity interest in MGRG such that they could benefit from a sale of MGRG. BMW did not endorse any suggestion that the members of the Phoenix Consortium should receive £75 million (or, at this stage, any other sum) ahead of, or in competition with, creditors of MGRG; and

62.5. loan notes were preferred to preference shares because the former would not immediately become known to the public.

Appointment of Mr Stephenson and Mr Parker as directors

63. In advance of completion, Mr Stephenson and Mr Parker were both appointed as directors of Techtronic. In evidence to us, Mr Parker denied that he had ever become a director of Techtronic. While, however, Companies House was never informed of his appointment, he clearly was so appointed. Minutes of a board meeting on 8 May 2000 record a resolution that Mr Parker be appointed as an additional director with immediate effect. Further:

63.1. the loan note facility agreement entered into on 9 May 2000[32] contained a warranty on the part of Messrs Beale, Edwards, Stephenson and Towers that they and Mr Parker were the directors of Techtronic;

63.2. Ms Ann Bodkin of Eversheds referred in an internal email dated 5 July 2000 to Mr Parker's "*signed form 288a*";

63.3. Mr Seabrook of Eversheds stated in an internal email of the same date, "*the board meeting was held at which* [P]*arker was appointed and* [P]*arker knows that*"; and

63.4. in evidence to us, Mr Seabrook confirmed that he recalled Mr Parker being appointed as a director.

Capital injection by the Phoenix Consortium

64. Also on 8 May 2000, Techtronic's authorised share capital was increased from £1,000 to £240,000. The members of the Phoenix Consortium had indicated to Deloitte on the previous day that they were prepared to invest up to £120,000 per person in Techtronic. In the event, each member of the Phoenix Consortium contributed £60,000 and received 60,000 ordinary shares in Techtronic. Mr Beale's recollection was that in respect of his, Mr Edwards' and Mr Stephenson's shares, payment was effected by Edwards Cars transferring £180,000 to an Eversheds client account on their behalf on 8 May 2000, with Edwards Cars being reimbursed later.

Alternatives to the Phoenix bid

65. In case the negotiations with the Phoenix Consortium ultimately failed to come to fruition, BMW made contingency plans for MGRG to be put into members' voluntary liquidation[33]. KPMG were preparing for a members' voluntary liquidation during the weekend of 6 and 7 May 2000. Another possibility might have been a renewal of negotiations with Alchemy. Mr Brooks said:

> "*My own view, deep down, is that Alchemy were waiting in the wings desperate to come back and that we would have been probably back to renegotiate with Alchemy …*"

The limited scope of the due diligence work

66. The members of the Phoenix Consortium and their advisors were conscious of the fact that there had been only a limited period to carry out due diligence. Mr Richard Edwards told us,

[32] See paragraph 90 below.
[33] In a members' voluntary liquidation, unlike a creditors' voluntary liquidation, creditors receive full payment. Mr Brooks of Norton Rose stressed to us, "*There was never an option of an insolvent liquidation. It was always going to be solvent.*"

"*we realised in the time available it was not going to be practical to complete a due diligence exercise, there was not going to be enough time to do that*". He further commented:

> "*Effectively … the business was being acquired in a distressed situation, and often, from my experience, when one is buying businesses in that situation sometimes you do not get an opportunity to do full due diligence on them. So yes, it was unsatisfactory but not unique*".

67. A note prepared by Deloitte providing an overview of occasions when the "*issue of viability and future prospects for the Rover business were discussed*" records that on 7 May 2000 on "*a number of occasions, the point was raised that* [the Phoenix Consortium] *were keen to proceed to complete the transaction, irrespective that the financial advice under 'normal' circumstances would be to delay and perform further* [due diligence]."

68. By early on Tuesday 9 May 2000, the sale to Techtronic had been completed.

The contingent nature of the advisors' fees

69. Eversheds issued a formal engagement letter on 3 May 2000. This was addressed to Mr Towers "*C/o Techtronic (2000) Limited*" and included the following:

> "*I understand that you wish us to act on this matter entirely contingently with no fees being chargeable unless a deal is concluded with BMW. Bearing in mind the high level of risk for us both in terms of time and the money we are likely to have to expend in respect of such things as travel, hotels and searches, on a completion our fees will be the higher of £750,000 or twice the time expended plus disbursements and VAT. This will cover all our time to completion but will not include, for example, any due diligence work or documentation in respect of subsequent financing or work in respect of establishing employee share schemes or the like.*"

Mr Towers countersigned the letter on behalf of the Phoenix Consortium and Techtronic. A Techtronic board minute dated 3 May 2000 records that Mr Towers was authorised to sign the letter at a board meeting also attended by Mr Beale and Mr Edwards.

70. Mr Seabrook confirmed to us that Eversheds were to receive no payment at all unless a deal was concluded with BMW. He noted that if he had intended to charge disbursements in any event, he "*would have specifically excluded them from the contingency*". He also thought that the Phoenix Consortium's financial arrangements with Eversheds would have been discussed at an early meeting. For her part, Ms Lewis too told us that her understanding was that "*everything was contingent*". She also explained that disbursements would in any event have been quite limited:

"*... it would have been limited to costs of searches, hotels in London, and train fares. So maybe for a dozen people, two or three times, two or three nights, I guess I am making up a number, but it would not have been enormous ... It could have been, I do not know, £15,000, £20,000? ... it is not as though the transaction went on for a long time.*"

Mr Seabrook thought that the disbursements "*could have been* [£]*5,000 to* [£]*10,000*".

71. Deloitte's engagement letter is dated 4 May 2000. The letter was addressed to the directors of Techtronic and stated as follows:

"*Our fees for all stages of this assignment will be contingent on completion of the acquisition of shares in Rover. A fee of £6 million*[34] *will be payable on completion including all out of pocket expenses.*"

The letter was countersigned on behalf of Techtronic by Mr Towers.

72. Albert E Sharp was ultimately paid £750,000. Mr Bartlett said that Albert E Sharp's remuneration was a "*pure success fee*" with nothing further payable, commenting that he did not believe that the Phoenix Consortium members had the resources to pay Albert E Sharp's fees unless the deal went ahead. Mr Bartlett's recollection was that he had agreed that the fee should be contingent with Mr Towers, and that Mr Towers had also signed the letter of engagement.

73. We were told by the members of the Phoenix Consortium that they had concerns as to the extent of their personal exposure to advisors. Thus:

73.1. Mr Towers said that "*in the case of Eversheds and* [Albert E Sharp] *we felt that there would be a case for billing if the whole thing fell through and we could be liable jointly for something in excess of a million pounds*". He said that he could not recall an agreement with Albert E Sharp to the effect that they were working on a contingent basis and that, as regards Eversheds, he had thought that "*Disbursements would have to be paid no matter what happened*";

73.2. Mr Beale confirmed that the time costs of Deloitte, Eversheds and Albert E Sharp were all conditional, as were Deloitte's disbursements. On the other hand, they "*were all slightly worried about Eversheds and Albert E Sharp as to whether out of pocket expenses were or were not covered in the agreement*";

73.3. Mr Edwards, while noting that he "*left* [the fee issue] *to those who were better able to decide what was fair and what was not*", said that he "*just had this vision of a huge meter running somewhere with legal and commercial advisers clocking up*

[34] Mr Einollahi told us that he regarded the £6 million as representing approximately half a per cent of the transaction value.

money and that we were going to have to meet, one way or the other, and if it was a successful outcome, it would be a very big bill, and if it was an unsuccessful outcome, it was going to be a big bill"; and

73.4. Mr Stephenson said that he "*understood the principle of the fact, that we believed with the prime professional agencies vis legal and financial – set aside Albert E Sharp on one side, because I was less clear – that in theory we had conditional arrangements*". He said, however, that he was "*very cynical*" as to such arrangements and that his "*expectation was that we would have a fight, with both of these organisations* [i.e. Eversheds and Deloitte]*, if we were unsuccessful*".

74. Having regard, however, to evidence such as that mentioned in paragraphs 69 to 73 above, it seems to us that neither the members of the Phoenix Consortium nor even Techtronic (to which at least the Eversheds and Deloitte engagement letters were addressed) would have had any liability to Eversheds, Deloitte or Albert E Sharp if the sale had not been completed. Further, we do not think that the members of the Phoenix Consortium could justifiably have considered that they had any substantial, or indeed any, exposure in respect of professional fees.

75. In the event, the advisors were paid the following sums by Techtronic following completion:

Advisor	**Amount (excluding VAT)**
	£
Eversheds	[35]757,904
Deloitte	6,000,000
Albert E Sharp	750,000

<u>Other financial consequences</u>

76. Mr Towers, Mr Edwards and Mr Beale referred in their evidence to us to other costs and losses that they had incurred in relation to the acquisition of Rover.

77. Mr Towers mentioned travel and hotel bills. He said, however, that they were "*not much at all*".

78. Mr Edwards said that the "*true cost of everything that went on was quite phenomenal*". Asked to give details, he spoke of providing "*drivers on hand to move people around*", of the need for reception and security staff, and refreshments, for out-of-hours meetings (held at premises of a company owned by Mr Beale and Ms Jane Beale), of arranging for "*extra staff available to give the infrastructure support that was needed when we are typing up letters or doing faxes or taking notes from Sue Lewis* [of Eversheds] *or getting Sue Lewis*

[35] Comprising fees of £750,000 and disbursements of £7,904.

down there." He referred, too, to Mr Beale and he "*neglecting the* [dealership] *business*". At the suggestion of the solicitors representing Mr Edwards, it was agreed with us that Mr Edwards would prepare a schedule detailing such costs and losses. None, however, has ever been provided.

79. For his part, Mr Beale said that "*it was a very worrying time given that we were spending a lot of personal money, our businesses were suffering, and the chance of pulling off the deal was remote until the last minute.*" Asked about the expenditure, Mr Beale referred to train, accommodation and restaurant bills. He mentioned visits to Speke as well as London, and referred to "*trying to entertain people, take my bank manager out to lunch*", to "*buying people's meals*" when in London, and to hotel accommodation in London in the last few days. He spoke also of a "*PR person*" introduced quite late on by Deloitte or Albert E Sharp.

80. It seems to us, however, that Mr Beale and Mr Edwards will not have incurred very sizeable losses or costs. However intense their involvement with the bid may have been, it was over a relatively short period. Moreover, we are not aware of either of them using hotel accommodation other than for a few nights in the final stages of the negotiations and, while both clearly undertook some travel (in particular, to London), the total cost cannot have been that great. Nor do we think that the costs arising from out-of-hours meetings or "*infrastructure support*" can have been substantial. As regards disruption to the businesses in which Mr Edwards and Mr Beale were involved, we find it hard to believe that any losses can have been of any great size[36].

81. Solicitors acting for the Phoenix Consortium have quantified its members' exposure to incidental expenses at about £100,000: representations made to us on behalf of the members of the Phoenix Consortium suggested that, in addition to injecting a total of £240,000 in Techtronic, the members of the Phoenix Consortium were "*exposed to incidental expenses to a value of approximately £100,000.*" When we asked for details of how the £100,000 figure had been arrived at, reference was made to "*significant out of pocket expenses for, inter alia, travel costs, hotel bills, administrative staff, drivers and meals (for both* [the members of the Phoenix Consortium] *and for others) in the lead up to the acquisition of MGRG by Techtronic in May 2000*" and to the engagement of a public relations firm "*in the lead up to and following their acquisition of MGRG*". However, no figures were given, and we doubt whether the incidental expenses in fact came to as much as £100,000.

82. In any case it seems to us that:

82.1. the funding BMW was to provide was such that, if the deal was completed, there was no realistic possibility of MGRG failing before the Phoenix Consortium had had a chance to take at least as much from Techtronic and/or MGRG, by way of

[36] See further chapter XIV (Edwards Cars), especially at paragraph 10.2.

remuneration or otherwise, as their costs and losses in respect of the acquisition[37]; and

82.2. the fighting fund provided by dealers (see paragraph 41 above) could have been used to defray (or to help to defray) expenses.

83. It is noteworthy, too, that Mr Edwards and Mr Beale both stood to lose financially if MGRG were either sold to Alchemy or wound up. Both were directors of, and remunerated by, Edwards Cars, as was Mr Edwards' wife. Further, Mr Edwards was owed substantial sums by Edwards Cars. If, however, MGRG discontinued volume production (as would have happened had the sale to Alchemy proceeded), Edwards Cars was likely to suffer, especially as it dealt only in Rover cars and had already attempted to diversify without success[38]. Mr Beale told us that "*anything that involves reducing volumes would have been of great concern to us.*"

<u>VAT deferral</u>

84. It had been recognised early on in the negotiations that, due to the integrated nature of particularly the purchase ledger system, there would be problems for MGRG after any deal had completed in calculating its VAT liability. Mr Steve Holloway of Deloitte told us:

> "*... from day 1 there were going to be VAT issues with this, which had been highlighted by various people in connection with it, I think both from Customs and Excise's point of view but the people at the company itself, because I think it was realised that however any of these deals were structure*[d]*, VAT has to be accounted for from day 1 ...*
>
> *Rover was an integral part of the BMW VAT group at the time the deal was done, so there was going to have to be some splitting of that group and new accounting procedures put in place to divide up effectively I think it was the retained BMW business, the Landrover business, the Rover business, because they were all lumped together in one VAT group – one entity for VAT purposes, so they had to be split, and agreement with Customs as to how that would be done ...*"

85. By Friday 5 May 2000, Deloitte had approached HM Customs and Excise ("Customs") about the possibility of MGRG deferring VAT payments. Customs proving receptive to the initial approach, on Monday 8 May Mr Holloway wrote to Customs as follows:

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[37] In the event, Edwards Cars Limited invoiced Techtronic on 2 August 2000 for £108,000 in respect of "*Expenses and costs associated with the Acquisition of Rover Group up to and Including 31 May, 2000*". Mr Stephenson told us that it was "*extremely likely*" that this represented compensation for the period up to the acquisition.

[38] Mr Beale told us, "*we had for 12/18 months been having conversations* [about diversifying] *but nothing had actually come to fruition.*"

> "*If the Phoenix consortium bid is accepted tomorrow or later this week, application will be made either to remove the Rover cars and parts companies from the BMW (UK) Holdings Limited VAT group and form a new Rover cars VAT group registration ... or remove those companies not being acquired from the existing VAT group.*
>
> *In order to facilitate the current negotiations, we would however request that a facility is put in place immediately to defer payment of any liabilities due from the new Rover VAT Group/restructured VAT group to Customs ... This assumes acceptance of the proposals made by the Phoenix consortium by BMW and will allow the Phoenix consortium the short-term facility necessary to finalise the wider financial backing for a restructured Rover cars operation.*"

More specifically Mr Holloway requested the following, among other things, on behalf of the Phoenix Consortium:

> "*Deferral of all payments on account and any other amounts due from the new Rover VAT Group/restructured VAT group to Customs in respect of VAT until said liability reaches £100million with immediate effect.*"

Customs replied later on the same day acceding to what was proposed.

Completion

86. Techtronic's acquisition of MGRG was completed early on 9 May 2000 after negotiations had continued through the night.

87. Numerous documents were ultimately entered into in connection with the transaction. They included a sale and purchase agreement ("the SPA") and an agreement for a £427,369,500 subordinated loan note facility[39] ("the Facility Agreement").

88. Key features of the SPA included the following:

    88.1. BMW (UK) was to sell the issued shares in MGRG to Techtronic for the nominal sum of £10;

[39] The loan note facility was for £427,369,500 rather than the £500 million previously envisaged because the parts business and dealer properties were now included in the deal. A document entitled "*Explanation of Purchase consideration*" prepared by the Deloitte audit team explained that a value of £60 million was attributed to BMW Parts Limited and £13 million to dealer properties.

88.2. BMW (UK) was to lend MGRG £75 million and was also to subscribe for one ordinary share in MGRG at a premium of £74,999,999 less the amount of cash in MGRG and its subsidiaries at completion. The subscription was to be funded by capitalising the loan so far as necessary. The share was then to be sold to Techtronic for £1;

88.3. various agreements, including the Facility Agreement, were to be delivered, duly executed, on completion;

88.4. Techtronic was to supply BMW (UK) with documents confirming that the Rover Management Joint Consultation Group (which represented managers) would not pursue certain employment claims it had advanced (in particular, in respect of failure to consult) against BMW (UK);

88.5. Techtronic was to supply BMW (UK) with a letter from the Rover Franchise Board indicating its support for Techtronic and the transaction and confirming that neither it nor its members (i.e. dealers) would have any valid claims in connection with the transaction;

88.6. MGRG's subsidiaries were to include BMW Parts Limited, Rover Wholesale Limited, Rover Exports Limited, Rover Overseas Holdings Limited, a number of NSCs and companies with historic names (viz. The MG Car Company Limited, The Morris Garages Limited, The Rover Company Limited and Rover Cars Limited)[40];

88.7. MGRG was to lease parts of Longbridge to Powertrain Limited ("Powertrain"), a BMW subsidiary to which the powertrain business had been hived out;

88.8. if completion accounts showed the net assets of MGRG at completion to be less than £740 million, BMW (UK) would pay the difference, subject to an upper limit of £500 million, for a further share in MGRG and thereafter transfer it to Techtronic for £1;

88.9. Techtronic undertook to assist BMW (UK) with the removal of tooling and equipment associated with the New Mini from Longbridge;

88.10. BMW (UK) agreed to provide technical support and assistance to MGRG in relation to the launch of the "*R41*" (the code name for what became the Rover 75 Tourer, then a prototype car model);

[40] Under an agreement dated 9 May 2000 the share capital of Wolseley Motors Limited and The Austin Motor Company Limited (as well as that of BMW Parts Limited) was sold to MGRG by BMW and therefore these companies were also subsidiaries of MGRG from 9 May 2000 although not mentioned in the SPA.

88.11. BMW (UK) would assist MGRG to relocate the production of the Rover 75 car from Oxford to Longbridge and would contribute up to £40 million to the costs of the transfer;

88.12. title (in some cases freehold, in others leasehold) to more than 20 properties, of which all or most were occupied by dealers, was to be transferred to MGRG;

88.13. the accommodation at International House in Bickenhill ("Bickenhill") was to be divided between BMW, Land Rover and MGRG; and

88.14. schedule 2 to the SPA stated in terms that no warranties were given by BMW (UK) in connection with the agreement.

89. Under the SPA, MGRG was to have the Rover 25, 45 and 75, the MGF, the Old Mini for a short period, most of[41] the Longbridge site (subject to a lease in favour of Powertrain), properties occupied by dealers, and the parts business (through BMW Parts Limited). On the other hand, BMW (UK) retained the New Mini, the plant at Cowley, the engine and gearbox business (now operated by Powertrain) and the pressings business (now owned by Swindon Pressings Limited).

90. The Facility Agreement provided for BMW AG to lend Techtronic sums totalling £427,369,500 by subscribing for three interest free loan notes. The first loan note was to be issued immediately after the acquisition was completed and was to be for £200 million. A second loan note was to be issued a year later and was to be for £150 million. The third and final loan note was to be issued two years after completion and was to be for £77,369,500[42] (less the sum which would be due from MGRG if it exercised an option to purchase Studley Castle[43]). The Facility Agreement stated that, on a winding-up of Techtronic, BMW AG's claims should be postponed to those of other creditors of Techtronic (apart from its shareholders) and that, on a winding-up of MGRG, claims of Techtronic should be postponed to claims of other creditors of MGRG. Techtronic undertook with BMW AG that for so long as there was any amount outstanding in respect of any of the loan notes, among other things:

90.1. it would have no assets other than "*Agreed Assets*" (broadly, shares in MGRG and other subsidiaries and the balance standing to the credit of the account into which the proceeds of the issue of the loan notes were to be paid) and no liabilities other than "*Agreed Liabilities*"; and

[41] Part of the site was owned by Powertrain.
[42] In the event the amount received in respect of the third loan note from BMW was £51.4 million: see chapter XII footnote 3.
[43] On 9 May 2000 MGRG entered into an agreement with BMW Services Limited under which MGRG paid consideration of £1 to acquire an option to purchase Studley Castle for "*the open market value of the Property* [Studley Castle] *on the date the Option Notice was served*".

90.2. the proceeds of the issue of each loan note would be paid to MGRG to subscribe for "*Permitted Investments*" (i.e. shares in MGRG or loan instruments between MGRG and Techtronic providing for funds to be "*used for the general working capital requirements of the* [businesses of MGRG and its subsidiaries] *or to meet liabilities of* [MGRG] *arising from the Reorganisation*" and that such loans should accrue interest at a rate not exceeding market rates, be unsecured and subordinated).

The loan notes for which BMW AG was to subscribe were to provide for redemption as follows:

90.3. Techtronic was each year to redeem the loan notes to the extent of the lesser of (i) 25 per cent of the consolidated profit of Techtronic and its subsidiaries for the previous year and (ii) £25 million; and

90.4. unless previously redeemed, the loan notes were to be redeemed by Techtronic on 9 May 2049.

Further, on the occurrence of an "*Event of Default*" (defined to include (a) a breach by Techtronic or MGRG of an undertaking in the Facility Agreement, (b) an "*Insolvency Event*"[44] in relation to either Techtronic or MGRG and (c) a single person, or a group of persons acting in concert, acquiring the right to exercise or control the exercise of more than a specified percentage[45] of the total voting rights in respect of either Techtronic or MGRG) BMW AG was to be entitled to declare the amounts outstanding to be due and payable.

91. The tight timetable and consequential lack of due diligence discussed in paragraph 66 to 68 above are highlighted by an email sent by Mr Seabrook of Eversheds following completion in which he said:

> "*Congratulations and thanks to everyone for a great job in completing Phoenix within an impossible timetable – even if we don't know what we have bought or what any of the agreements say!!*"

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[44] This expression was defined to include:

> "*... any body corporate becoming unable to pay its debts (within the meaning of Section 123 of the Insolvency Act 1986) or any dissolution of a body corporate or the entry into by that body corporate of any liquidation, administration, administrative receivership, receivership, a voluntary arrangement, a scheme of arrangement with creditors ...*"

[45] Initially 30 per cent, but gradually rising to 70 per cent (from May 2004 onwards).

Summary

92. In summary:

92.1. the members of the Phoenix Consortium, via Techtronic, acquired MGRG (including the parts business) for a nominal sum[46];

92.2. BMW agreed to make an outright contribution of £75 million[47] and to lend £427 million more on an interest-free basis for up to 49 years[48]. It also undertook that MGRG should have net assets of at least £740 million[49]; and

92.3. the members of the Phoenix Consortium each invested £60,000 in Techtronic shortly before its acquisition of MGRG was completed[50]. Members of the Phoenix Consortium also incurred some costs and losses in connection with the acquisition, but the sums involved were relatively small[51].

The Phoenix Consortium's prospects

93. More than one witness told us that he thought that the Phoenix Consortium's plans for MGRG under its ownership were potentially viable. Dr Grebenc said:

> "*One thing I understood from the discussions with John Towers ... is that their intention would have been a different strategy* [from BMW's]*: exploit the technological basis of the Rover 75 and seek a partnership as they have done in the past, like Honda, to resolve the smaller car issue, and then come up in a situation where they think it is a viable position that they can exploit the value of the Rover mark with a 200,000-car shipment a year over the long run. I still regard that this is a strategy that could work, no doubt, provided you find that partner, but this would never have been an option which BMW would have done, because we wanted a different strategic positioning of that car business.*"

Mr Brooks told us:

> "*... for long time survival of the business it was clear they would need some sort of arrangement or some sort of partner, but that was a long-term consideration, not a short-term consideration. I think we believed that what they were trying to do was viable and stood a good chance of success.*"

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[46] See paragraphs 88.1 and 89 above.
[47] See paragraph 88.2 above.
[48] See paragraphs 90 and 90.4 above.
[49] See paragraph 88.8 above.
[50] See paragraph 64 above.
[51] See paragraphs 76 to 82.2 above.

94. As the passages quoted above suggest, MGRG's longer-term prospects were seen to depend on finding a joint venture partner. Mr Beale told us, "*We had said ... from day one that it was essential to the survival of our company that we had a joint venture partner*". Mr Stephenson said that "*It would probably be fair to say that throughout the period, as a long-term prospect, MG Rover's sales as a stand-alone company without a partner were not going to cut the ice*". Mr Towers explained: "*our preconception, that proved to be our correct view, was that the car company had to have a joint venture partner*". Mr Christopher Bowen, MGRG's operations director in 2000[52], agreed that it was recognised from 2000 onwards that MGRG could not survive long-term without a partner.

95. One reason MGRG needed a joint venture partner was to enable it to produce new models of car. Mr Tony Shine, who was MGRG's supply chain director in 2000[53], told us:

> "*... you have to replenish the products coming through ... And that is where the collaborative part of it came in. So there is an inevitability that unless you replenish the products, the products will age, they will become less attractive to customers, and your volume base will come down.*"

Mr Rob Oldaker, MGRG's product development director between 2000 and 2005[54], said that "*it was clear quite early that if we wanted a full range of vehicles* [i.e. variants of a new medium car ("New Medium Car")] *which really we did, then a collaborator was essential*".

96. It was also, however, thought to be important to proceed with product development in advance of a partner being found. Mr Towers told us:

> "*... new medium car was important not just in the sense of the product plan for the company but it was important as an enabling tool to get a joint venture ... if the company that you were talking to couldn't see a new model development programme within your portfolio then it would be tough to create the right environment for a JV.*"

97. Professor Garel Rhys of Cardiff Business School summarised the position to us as follows:

> "*... there was a chance that the Phoenix Consortium could 'hold the line' for five or six years, and if a joint venture was created it might be possible that the joint venture could have a close relationship with another car firm. However, it would not be possible for a car manufacturer of* [MG Rover's] *size to succeed on its own.*"

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52 See V/6.4.
53 See V/6.7.
54 See V/6.5.

98. In short, while the BMW “dowry” meant that there was no prospect of MGRG failing in the short term, the company’s longer-term survival depended on it successfully concluding a joint venture arrangement. Further, the members of the Phoenix Consortium recognised that MGRG’s survival was at risk in the longer term. Representations made to us on their behalf state that they “*knew that they were taking on a very real challenge and that there was a real risk that MGRG would ultimately fail*”.

CHAPTER IV

THE MEMBERS OF THE PHOENIX CONSORTIUM

1. The members of the Phoenix Consortium were as follows:

Mr Towers

2. Mr Towers started his career at Perkins Engines Limited ("Perkins Engines"), which sponsored him whilst he completed a mechanical engineering degree.

3. Mr Towers joined Land Rover in 1988 and became a member of the main board of MGRG the following year. He was subsequently promoted to group managing director in 1991. During this period MGRG was owned by British Aerospace.

4. Mr Towers was appointed chief executive of MGRG when it was sold by British Aerospace to BMW in 1994. He left MGRG in May 1996, and in October he joined the Concentric Group plc ("Concentric"), a group of engineering companies based in the West Midlands.

5. Mr Towers appeared to be the natural leader of the Phoenix Consortium given his public profile and prior involvement in the motor industry, and he became MGRG's chairman in May 2000.

6. Mr Towers was appointed as a director of Techtronic on 13 April 2000. On 14 June he was appointed as a director of MGRG[1] and on 15 December he was appointed as a director of PVH[2]. Mr Towers was also a director of a number of other Group companies between 2000 and 2005 (see **appendix 5**).

Mr Stephenson

7. Mr Stephenson is an engineer by profession and has worked in the automotive industry throughout his career. For a number of years he worked at Perkins Engines, during which time he met Mr Towers.

8. Mr Stephenson worked for many years at British Leyland Limited[3]. In 1996 Mr Stephenson became a member of the MGRG board with responsibility for design and engineering, a position he held until he left MGRG in 1999.

9. As noted in chapter III (The sale of Rover)[4], having left MGRG Mr Stephenson began working for Lola, a company which produced racing cars, on a part-time basis.

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1 The members of the Phoenix Consortium were formally appointed as directors of MGRG in June 2000, but they effectively took control on 9 May 2000.

2 PVH became the ultimate holding company of MGRG on 18 December 2000: see V/24.

3 British Leyland Limited became Rover Group Limited (later MGRG) in 1986.

4 See III/39.

Mr Stephenson was appointed as a non-executive director of Lola on 12 July 2000[5], a position he held until resigning on 20 November 2001.

10. Mr Stephenson was appointed as a director of Techtronic on 8 May 2000. He was appointed as a director of MGRG on 14 June[6] and as a director of PVH on 15 December. Mr Stephenson was also a director of a number of other Group companies between 2000 and 2005 (see appendix 5).

11. Following the administration of MGRG in April 2005, Mr Stephenson worked with Nanjing Automobile (Group) Corporation ("NAC"), advising it on purchasing the assets of MGRG out of administration.

Mr Edwards

12. From 1987 Mr Edwards owned and managed a Rover dealership in Stratford-upon-Avon named Edwards of Stratford, which traded through the corporate vehicle Edwards Cars.

13. Mr Edwards was also involved with Stratford Auto Body Centre Limited ("Stratford Auto Body Centre") and Advanced Management (2000) Limited ("Advanced Management"), of which Mr Beale was a director and shareholder as noted at paragraph 16 below.

14. Mr Edwards was appointed as a director of Techtronic on 13 April 2000. On 14 June he was appointed as a director of MGRG[7] and on 15 December he was appointed as a director of PVH. Mr Edwards was also a director of a number of other Group companies between 2000 and 2005 (see appendix 5).

Mr Beale

15. Mr Beale qualified as a chartered accountant and subsequently worked for Price Waterhouse[8]. In 1983 he joined Harrison Priddey and Co, a firm of chartered accountants based in Bromsgrove, where he became a partner. Harrison Priddey and Co were auditors of Edwards Cars. In 1989 Mr Beale left Harrison Priddey and Co and became the finance director of Edwards Cars. Mr Beale was appointed as a director on 1 July 1989 and as company secretary of Edwards Cars on 17 June 1994.

16. Mr Beale explained to us that he did not have a shareholding in Edwards Cars, but that, "*I had an understanding, I think, with John Edwards that we were more like partners than employer/employee, and that also was true of the two companies I owned*". These two companies were Stratford Auto Body Centre, a company engaged in the maintenance and

[5] Mr Stephenson was formally appointed as a director of Lola on 12 July 2000, but evidence provided by Mr Biranne suggests that Mr Stephenson joined Lola as a non-executive director in January 2000.

[6] See footnote 1 above.

[7] See footnote 1 above.

[8] Price Waterhouse later merged with Coopers & Lybrand to become PricewaterhouseCoopers ("PwC") and in January 2003 adopted Limited Liability Partnership ("LLP") status.

repair of motors, and Advanced Management, which appears to have carried on a car sale and leasing business, of which Mr Beale was a director[9] and shareholder[10].

17. Mr Beale was appointed as a director of Techtronic on 13 April 2000. On 14 June he was appointed as a director of MGRG[11] and on 15 December he was appointed as a director of PVH. Mr Beale was also a director of a number of other Group companies between 2000 and 2005 (see appendix 5).

[9] Mr Beale was appointed as a director of both Stratford Auto Body Centre and Advanced Management (at that time called Advanced Vehicle Contracts Limited) in March 1992. Mr Beale later resigned as a director of Stratford Auto Body Centre on 27 April 2004.

[10] The shares in Stratford Auto Body Centre and Advanced Management were held by Mr Beale and Ms Jane Beale.

[11] See footnote 1 above.

CHAPTER V

ROVER UNDER NEW OWNERSHIP: EVENTS BETWEEN MAY 2000 AND JUNE 2001

Establishing MGRG as an independent company

1. In the period following the completion of Techtronic's acquisition of MGRG, there were numerous tasks to attend to. There having been little opportunity for due diligence in the short period since the collapse of the negotiations with Alchemy[1], the members of the Phoenix Consortium and their advisors had to develop their understanding of what had been acquired. In addition, much had to be done to give effect to the SPA and associated agreements and to disentangle MGRG's business and assets from those retained by BMW or sold to Ford. After all, the business which MGRG was now to carry on had not hitherto been a free-standing one: it had been part of a business which had also encompassed, for instance, the powertrain business and the Swindon pressings plant (both of which BMW had kept)[2] and Land Rover (now to be owned by Ford)[3]. An independent business had to be created[4].

2. At the point of completion, it was not yet clear in many cases whether staff were to be allocated to MGRG, to Land Rover or to continuing BMW operations; that exercise had to be undertaken. Similar issues arose with dealers and the NSCs (i.e. national sales companies). In the case of the NSCs, it was necessary, too, to decide whether to withdraw from certain markets. MGRG and BMW had also (in accordance with the SPA) to undertake the transfer of the Rover 75 assembly line from Cowley to Longbridge and to move the New Mini equipment in the opposite direction[5]; in advance of the former, Rover 75 vehicles needed to be stockpiled to avoid an interruption in supply while its assembly line was being moved. In addition, a business plan for MGRG had to be developed, management had to be recruited, the structure of the group needed to be resolved and new pension arrangements were to be established. Further, MGRG had to arrange dealer finance to replace that previously provided by BMW. Consideration was given, too, to whether it would be desirable (and, if so, how) to acquire Powertrain (the company which now owned the powertrain business[6]), Studley Castle[7] or Swindon Pressings (which now owned the pressings plant).

3. Mr Stephenson outlined the position as follows:

> "*We took over an entity that was not a company ... strictly there was this legal entity, Rover Group, but it did not exist on the ground. It was operating out of about eight sites, Longbridge, Bickenhill, Warwick, Gaydon, Cowley, so on – and all the national sales companies in nearly every country in continental Europe. It did not have a secure supply base. Every single supplier that supplied the company turned up on*

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1 See III/47 to 50 and 66 to 68.
2 See III/89.
3 See III/10 to 12.
4 See III/7 and 35 for details of the reorganisation anticipated under Alchemy's and Techtronic's bids respectively, and III/88 for a summary of features of the SPA.
5 See III/88.9 and 88.11.
6 As noted in II/13, the powertrain business manufactured engines and gearboxes.
7 As noted in II/21, Studley Castle was used as a training, conference and marketing centre. Under the terms of the SPA MGRG was granted an option to acquire Studley Castle. In the event, Studley Castle was transferred to Studley Castle Limited, a subsidiary of PVH, in June 2001 as part settlement of the Completion Accounts dispute between Techtronic and BMW – see paragraph 92 below.

our doorstep wanting to know what the hell was going on, should they keep supplying, would their bills be paid, how had it happened? ... We had no management team in place ... there were loads of assets that were disputed between Ford, BMW and ourselves. We had to physically instantly start moving two entire production lines, one for the Mini ... and the other for the Rover 75 ... And the logistical planning of that was huge ... We actually moved a building ..., which was the painted body store for the Mini ... And we had to unearth an entire building."

4. More or less from the start, thought was being given to a change of name for MGRG (which was then still called Rover Group Limited). Minutes of an "*executive board meeting*" (i.e. a meeting of directors of MGRG other than the members of the Phoenix Consortium) on 2 June 2000 mention that the company name is "*under ongoing debate*". The company eventually changed its name to MG Rover Group Limited with effect from 30 October. It was felt that this would help it to exploit the MG brand.

Management of the main companies

MGRG

The composition of the board

5. The members of the Phoenix Consortium assumed control of MGRG when Techtronic's acquisition of the company was completed on 9 May 2000[8]. At first, it was envisaged that the four would not be executive directors of the company for long: a bulletin issued by the personnel department on 11 May therefore stated, "*Initially, John Towers, Nick Stephenson, Peter Beale and John Edwards will oversee the operation until a Managing Director is appointed and subsequently they will become members of the non-executive Board of Directors*". New directors having been recruited, minutes of an executive board meeting on 2 June record that the "*independence of the 'RGEB'* [i.e. Rover Group Executive Board] *was stressed, with the Techtronic board members being used to support the 'RGEB' when their contacts and expertise are of use*".

6. The following also joined MGRG's board in 2000:

6.1. *Mr Kevin Howe*

Mr Kevin Howe became chief executive.

Mr Howe had spent some 17 years working for MGRG and its predecessors. Mr Howe joined Austin Rover in his mid-20's and rose to be managing director of the small and medium cars business. He left in December 1999 to be managing director of the fan systems division for Rolls Royce Plc ("Rolls Royce"), but he was

[8] As we note in chapter IV (The members of the Phoenix Consortium), the members of the Phoenix Consortium were formally appointed as directors of MGRG in June 2000, but they effectively took control on 9 May 2000.

persuaded to return to MGRG as chief executive at the end of May or beginning of June 2000[9] and he was still chief executive when the company went into administration on 8 April 2005[10].

6.2. *Mr John Millett*

Mr John Millett became finance and strategy director.

Mr Millett was not a qualified accountant but had a background in finance and by May 2000 had worked for MGRG and its predecessors for just under 30 years. At this time Mr Millett held the position of joint finance director of the sales and marketing division of BMW Group UK. After Techtronic's acquisition of MGRG, Mr Millett became finance and strategy director of MGRG[11], and he retained that position until MGRG went into administration.

6.3. *Mr Robert Beddow*

Mr Robert ("Bob") Beddow became human resources director.

Mr Beddow, too, had many years' experience with Rover and its predecessors. On completion of an apprenticeship with the British Motor Corporation ("BMC"), Mr Beddow was offered a post in the personnel department where he remained taking on various different roles in a variety of the company's locations. In 1996/1997 Mr Beddow became the "personnel director" of the Longbridge plant, the position he held until February/March 2000 when he left to join another employer. Asked, however, by Mr Towers to rejoin MGRG, Mr Beddow did so on 1 June 2000[12]. Mr Beddow remained human resources director through to MGRG's administration in April 2005.

6.4. *Mr Christopher Bowen*

Mr Christopher ("Chris") Bowen became operations director.

Mr Bowen became an apprentice at "*Jaguar Rover Triumph*" in 1979. He worked in a variety of roles at Land Rover (latterly as a production manager) before moving to Rover in or around 1995. During his time at Rover, Mr Bowen worked as a production manager with responsibility for launching the MGF sports car and then for the assembly hall at Longbridge, and later ran the paint operations plants.

9 MGRG's 2000 financial statements and Companies House records state that Mr Howe was formally appointed as a board director on 20 July 2000.
10 On 18 December 2000, Mr Howe became chief executive of Phoenix Venture Holdings Limited as well.
11 MGRG's 2000 financial statements and Companies House records state that Mr Millett was formally appointed as a board director on 20 July 2000.
12 MGRG's 2000 financial statements and Companies House records state that Mr Beddow was formally appointed as a board director on 20 July 2000.

Mr Bowen subsequently became "technology director" for body manufacturing and manufacturing engineering, overseeing the continuing production of existing models and the installation of the New Mini facilities at Longbridge. Mr Bowen was appointed operations director after the acquisition of MGRG by Techtronic in May 2000[13] [14] with responsibility for manufacturing, manufacturing engineering and quality.

In about August-September 2004 Mr Bowen's job title changed to managing director (manufacturing), reflecting the work Mr Bowen was doing in respect of the proposed joint venture with the Chinese automotive group ("SAIC") which included Shanghai Automotive Industry Corporation (Group) ("SAIC Group") and Shanghai Automotive Company Limited ("SAC").

6.5. *Mr Alan Robert Oldaker*

Mr Alan Robert ("Rob") Oldaker became product development director.

A graduate in mechanical engineering, Mr Oldaker worked for MGRG and its predecessors from 1969 to 1993, by which point he was the chief engineer of chassis engineering for the Ford engineering group. Mr Oldaker moved to Vickers plc, as engineering director for, and subsequently director of engineering and managing director of, Cosworth Engineering Limited (a racing car business), and then as product development director for "*Rolls Royce and Bentley Motor Cars*", before taking responsibility for the bespoke engineering operation for Volkswagen. Soon after Techtronic's acquisition of MGRG, Mr Oldaker rejoined MGRG as product development director[15]. In this position, Mr Oldaker was responsible for the complete engineering operation of MGRG, engaged in the design, development and validation of all products. Mr Oldaker remained product development director up to administration.

6.6. *Mr John Parkinson*

Mr John Parkinson became sales and marketing director.

Mr Parkinson joined BMC in 1965. Having completed an apprenticeship, he worked in a variety of sales and marketing positions with predecessors of MGRG both in the UK and in Europe. By May 2000 Mr Parkinson held the position of brand director with responsibility for Rover sales and marketing, reporting to the sales and

[13] A bulletin issued by MGRG's personnel department on 11 May 2000 referred to the "*appointment of Chris Bowen to the position of Manufacturing Director*".
[14] MGRG's 2000 financial statements and Companies House records state that Mr Bowen was formally appointed as a board director on 20 July 2000.
[15] MGRG's 2000 financial statements record that Mr Oldaker was appointed a director on 14 June 2000; Companies House records state that he was appointed on 1 October 2000.

marketing director. In around May 2000 Mr Parkinson was offered and accepted the position of sales and marketing director of MGRG.

In May 2001 Mr Parkinson became a director of Xpart Limited[16] ("Xpart"). In April 2002 he resigned his MGRG directorship and became the managing director of Xpart[17]. When the parts business operated by Xpart was sold to Caterpillar Logistics Services (UK) Limited ("CAT") in 2004, Mr Parkinson stayed with the parts business and he now works for CAT.

6.7. *Mr Anthony Shine*

Mr Anthony ("Tony") Shine became supply chain director.

An engineering graduate, Mr Shine joined Austin Rover in 1983. He worked in operational roles, logistics and manufacturing, becoming the logistics director at Longbridge in the BMW years. Mr Shine told us that his appointment as supply chain director took effect on 1 June 2000[18]. In that role, he was responsible for all aspects of logistics and purchasing.

Mr Shine's job title changed to global purchasing director towards the end of 2004, by which time he was focusing on joint purchasing activity with SAIC.

7. Minutes of a board meeting of MGRG on 20 July 2000 record that, with the exception of Mr Oldaker, all of those mentioned in the last paragraph were appointed as directors of the company on that date. However, those concerned clearly understood themselves to have become directors somewhat earlier than this.

8. Mr Parkinson had been a company director before joining the board of MGRG, as had Mr Millett, having been appointed as a director of BMW (UK) Supplementary Trustees Limited in 1999. In contrast, Mr Howe, Mr Beddow, Mr Bowen, Mr Oldaker and Mr Shine had not previously been company directors before joining the board of MGRG[19].

Ms Jane Ruston

9. Ms Ruston initially joined Coopers & Lybrand (which later merged with Price Waterhouse to become PwC) as a trainee accountant, but left after three years to follow a career in law.

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[16] As to which, see chapter XIII (Xpart).

[17] Xpart's 2001 to 2004 financial statements show Mr Parkinson as having been a director of Xpart from 21 May 2001 to 26 August 2004. Documents filed at Companies House show that Mr Parkinson resigned his Xpart directorship during this period, on 25 July 2002, and was reappointed as a director of Xpart on 16 August 2002. Companies House records show that Mr Parkinson resigned his Xpart directorship for the second time on 26 August 2004.

[18] MGRG board minutes and Companies House records show that Mr Shine was formally appointed as a board director on 20 July 2000.

[19] Although Mr Howe, Mr Beddow, Mr Bowen, Mr Oldaker and Mr Shine had previously held the title of "director", they had not been a company director, with the legal responsibilities that such an appointment confers, before joining the board of MGRG.

Ms Ruston subsequently joined Wragge & Co LLP ("Wragge & Co"), and after qualification she remained at the firm about 18 months within the corporate department.

10. In August 1994 Ms Ruston joined MGRG as a junior lawyer. She was promoted to the position of senior legal advisor in 1997. Another promotion to senior commercial counsel followed in 1998, and Ms Ruston was now the head of the internal legal affairs department.

11. Ms Ruston remained in this position with MGRG when it was acquired by Techtronic in May 2000. On 20 July she was appointed company secretary of MGRG, reporting directly to Mr Millett. Between 2000 and 2005 Ms Ruston was appointed company secretary and a director of a number of companies within the Group.

12. Following the establishment of PVH[20], Ms Ruston became the head of legal affairs for the Group on 1 January 2001. She retained this role until the administration of MGRG in April 2005.

Meetings

13. Between 2 June and 15 September 2000, there would be "*executive board*" meetings every (or nearly every) Friday and also on certain other days. These would be attended by directors of MGRG other than the four members of the Phoenix Consortium. The members of the Phoenix Consortium would, however, be provided with minutes of the meetings.

14. Between May and about September 2000, "*team*" meetings would also be held on a regular basis, normally on Tuesday afternoons. These would be attended by the members of the Phoenix Consortium and representatives of Deloitte and Eversheds. Mr Bartlett of Albert E Sharp would also sometimes be present at first. Mr Howe and Mr Millett would be invited too, though possibly only to parts of the meetings.

15. From September 2000, there would be meetings of the whole of MGRG's board (including the members of the Phoenix Consortium) on one Friday a month (typically the third Friday of the month). There continued to be "*executive board*" meetings (for which the members of the Phoenix Consortium were not normally present) on the other Fridays. From 24 November, these meetings were referred to as "*Executive Board Management Meetings*" or "*Board Management Meetings*".

<u>Techtronic</u>

The composition of the board

16. By the time Techtronic's acquisition of MGRG was completed, Techtronic's board comprised the members of the Phoenix Consortium and Mr Parker[21]. Following completion,

[20] As to which, see paragraphs 41 to 68 below.
[21] With regard to Mr Parker's appointment as a director, see III/63.

Mr Ames, Mr Bowes, Mr Whitmore and Mr Woodley were all invited to become directors of Techtronic, too.

17. In the event, Mr Whitmore and Mr Woodley never became directors of Techtronic. When he was approached by Mr Towers, Mr Woodley said that he did not think it would be appropriate for him to join Techtronic's board[22]. As regards Mr Whitmore, he told Mr Towers that he would like to become a non-executive director but would need clearance from Mayflower. When Mr Whitmore discussed the possibility with Mr John Simpson, the chief executive of Mayflower, he was not persuaded that Mr Whitmore should become a director. Nonetheless, with Mr Simpson's approval, Mr Whitmore attended two Techtronic board meetings, on 2 June and 11 August 2000. After the second of these meetings, Mr Whitmore told Mr Towers that he would not join the board.

18. Mr Bowes did become a director of Techtronic, but not, it seems, immediately. While Mr Birrane, the effective owner of Lola, was happy for Mr Bowes to attend Techtronic board meetings, he was not at first willing to allow Mr Bowes to become a director. Mr Birrane was maintaining (as he still does) that he (or Lola) was entitled to a shareholding in Techtronic, but the Phoenix Consortium would not agree to this. That being the case, Mr Birrane told Mr Stephenson in a letter dated 6 July 2000 that "*it would be inappropriate for David Bowes to become a non-executive director of either Techtronic 2000 or any of its subsidiaries*". However, on 23 January 2001 Mr Bowes informed Mr Beale that Mr Birrane had agreed to his joining Techtronic's board, and he is recorded as having done so that same day[23].

19. In contrast, Mr Ames appears to have become a director of Techtronic soon after its acquisition of MGRG was completed. His date of appointment was given as 26 November 2000 in the form 288a which was filed at Companies House, but he was considered to be a director substantially earlier than this. Even before 26 November, he had attended several Techtronic board meetings (on 2 June, 11 August and 27 October) and was referred to as a non-executive director[24]. Mr Beale said that he would have treated Mr Ames (as well, in fact, as Mr Bowes and Mr Whitmore) as a non-executive director from the 2 June meeting. Mr Ames told us that he thought "*there was a delay of these forms being filed*".

Roles and remuneration

20. When asked what roles Messrs Ames, Bowes, Parker and Whitmore played, Mr Beale explained:

[22] Mr Towers and Mr Beale confirmed to us that Mr Woodley had been invited to become a director. Mr Woodley does not himself remember the invitation, but told us that he "*would never have considered it*".

[23] It is Mr Birrane's own position that he had not agreed to Mr Bowes becoming a director of Techtronic and when later he found out he told Mr Bowes to resign immediately.

[24] Though so too were Mr Whitmore and Mr Bowes.

> "*The role that we were looking for was just somebody to help us with the strategy and obviously their different backgrounds helped that. Richard Ames, the dealers, Terry* [Whitmore] *with the manufacturing, David Bowes with his background generally and his financial experience, and Brian Parker with some of his … background, which was some help at times.*
>
> *… So it was an information-gathering process and … just a different point of view about the future of the company and so on. I thought it worked quite well to start with.*"

21. In practice, Techtronic's board was relatively unimportant. There were no more than five board meetings between 9 May 2000 and the end of the year which anyone other than the members of the Phoenix Consortium attended (or, it seems, to which anyone else was invited[25]). To judge from the minutes, no very significant decisions were taken at any of these meetings. The minutes record that Mr Towers (and, to an extent, others) reported on various matters at the meetings, but little seems to have been determined. Mr Whitmore observed that the first meeting was "*very superficial*" and the second was "*awful*". He also said that financial information was not available and that he felt that "*the way* [Techtronic] *was setting up was too far from what was actually happening at Longbridge*": he thought that "*if we could make a contribution, it would be at that level rather than at the other level*". Mr Howe said that he did "*not think* [Techtronic] *was ever anything other than redundant apart from to acquire the business*" and that he was told to think of Techtronic "*as a shelf company*" with "*no real purpose*".

22. That is not to say that the intended non-executive directors contributed nothing to the Group post-completion. Mr Ames, for example, was particularly involved with car rental matters. Mr Parker played a part in relation to the property owned by MGRG[26] and also expressed views on the disposal of scrap metal[27].

23. The basis on which non-executive directors should be remunerated was addressed at the 2 June meeting. In this respect, the minutes record:

> "*PB* [i.e. Mr Beale] *said the non-execs would be remunerated at 20K pa for 1 day per month. It was also agreed that if non execs would prefer a car instead of part of their remuneration then this would be done on an individual basis. Also remuneration for additional work above 1 day per month would be agreed on an individual basis.*"

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[25] See chapter VI (Development agreement with St. Modwen).

[26] See VI/6.

[27] Thus, the minutes of the 11 August 2000 meeting state in relation to "*scrap disposal*", "*BP outlined current situation & that we would in future stockpile & segregate scrap and then sell by tender to best bidder*". Mr Whitmore's recollection was that Mr Parker "*was saying that people who were taking the scrap away were ripping them off*". Mr Howe remembered Mr Parker coming to see him "*to tell me he did not think we were getting the right return on the scrap that we were getting rid of from Westworks …*"

Each of the intended non-executive directors was subsequently paid on this basis (though Mr Whitmore later returned the money he had received, and Mr Bowes returned the payments made to him in 2000). By August, however, Mr Parker was asking for additional remuneration. On 23 August, Mr Beale responded by referring to the 2 June minutes and continued:

> "*I do recall that at a meeting with Nick Stephenson and myself you did mention that you were spending 2-3 days a week sorting out various matters for the company. I feel I was very clear at the time when I stated that, whilst we were very grateful for your assistance, you were only being paid for one day per month and that we had no agreement for remunerating you for this amount of work. It is a shame that you did not mention you were looking for remuneration so we could have dealt with this matter at a much earlier stage.*
>
> *If you now consider you should be paid for past work performed we will obviously need to discuss this … It would be helpful in the interim if you would let me know how much time you have devoted to the company's business for which you are looking for some form of remuneration.*"

PVH

24. As explained below, on 18 December 2000 MG Rover Holdings Limited (later called Phoenix Venture Holdings Limited (i.e. PVH)) became the new holding company of the Group. In the course of 2000, it was contemplated that the board of the new holding company would comprise all the directors of Techtronic plus Mr Howe. As late as 7 December, Mr Beale told Mr Ames and Mr Bowes that they would be "*invited to join the new holding company as non-execs*". In the event, however, only the four members of the Phoenix Consortium and Mr Howe became directors of PVH[28]. Minutes of a Techtronic board meeting on 7 March 2001 record that Mr Towers "*asked* [Mr Ames] *&* [Mr Bowes] *to remain as non-execs of Techtronic rather than become non-execs of MG Rover Holdings which was agreed*".

25. On 18 December 2000 Mr Howe became chief executive of PVH as well as MGRG.

Reports in the press and Mr Parker's departure

26. Unlike Mr Ames, Mr Bowes and Mr Whitmore, Mr Parker had little if any experience in the automotive industry. His past experience was in scrap metal, demolition and property. In 2000 he was a director and majority shareholder of Landcrest Developments Limited ("Landcrest Developments"), which was engaged in property acquisition and development. He was also a director and majority shareholder of Landcrest Properties Limited, the business of which had also related to property. He had been involved too in, for example,

[28] Mr Towers, Mr Beale, Mr Edwards and Mr Stephenson were appointed as directors on 15 December 2000 and Mr Howe joined the board on 18 December. Ms Ruston became the company secretary on 20 July 2000.

companies whose businesses related to dismantling/demolition (A C & D Dismantlers Limited and A C & D Demolitions Limited), another company which reclaimed strip welders and a company which dealt in redundant machinery. The form sent to Companies House to record his appointment on 15 October 1998 as a director of Belgrave Projects Limited, which Mr Parker signed, named him as "Lord" Brian Parker. Although Mr Parker told us that this was a "*mistake*", we find it difficult to believe that he did not notice this error at the time.

27. Mr Parker was appointed as a director of Techtronic on 8 May 2000[29] and Companies House should therefore have been notified of his appointment to the board by 22 May[30]. Mr Parker evidently signed a form 288a for this purpose, and the minutes of the Techtronic board meeting at which Mr Parker was appointed state that the secretary (namely, Mr Beale) was instructed to file it. However, a deliberate decision was made not to file the form[31]. On 5 July, Ms Bodkin of Eversheds noted:

> "*I spoke with Peter Beale following completion and he stated that he was no longer sure that Brian Parker was to be a non-executive director and he instructed me to hold his signed form 288a pending a further decision in this regard ...*"

In similar vein, Ms Bodkin wrote in a letter to Ms Ruston dated 6 February 2001:

> "*As you know, we were specifically instructed by Peter* [Beale] *not to file the 288a in relation to Brian Parker with Companies House as Peter expected him to resign immediately. We explained to Peter that the meeting has nevertheless been held (with Brian present) and as such Brian's appointment should be reflected in the Company's records ...*"

Nonetheless, as we note in chapter XXII (Aspects of corporate governance)[32], Mr Parker's appointment as a director of Techtronic was never notified to Companies House.

28. In fact, the members of the Phoenix Consortium became increasingly doubtful about whether they wanted Mr Parker to be a director of Techtronic. In August 2000, Deloitte's forensic services department was instructed to investigate Mr Parker. The forensic services department was told:

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29 See III/63.
30 I.e. within the 14-day period prescribed by section 288(2) of the Companies Act 1985.
31 Mr Beale told us that he asked Eversheds "*to hold off on filing* [the form 288a] *until we got the facts established*".
32 See XXII/43.1.

> "*In a nutshell, we would want to know what may come out about him if someone did some serious digging, that could lead to embarrassment to Rover if he was directly connected to the company via Techtronic.*"[33]

29. Matters were aggravated by articles written by a journalist, Mr David Parsley[34], which appeared in the Sunday Times during October 2000. On 15 October the Sunday Times featured an article by Mr Parsley headed, "*Towers may be ousted in Rover boardroom revolt*". Mr Parsley wrote:

> "*THE struggling carmaker MG Rover faces a boardroom revolt this month with the group's non-executive directors threatening to vote John Towers out of his chairman's office.*
>
> *The supervisory board of Techtronic (2000), the private holding company of MG Rover, will hold an emergency meeting on October 27 to discuss the future direction of the company …*
>
> *The non-executives*[35] *will make three demands of Towers. First, that he scales down the group's annual production target of 200,000 cars. Second, that he immediately hands 35% of the group's equity to Longbridge workers. Third, that he comes clean on his plan to prepare the company for sale, which could net millions for Towers and the three other executive board members …*"

A week later, there was an article in the Sunday Times headed, "*Rover board rebels plot to take over MG*". This included the following:

> "*THE non-executive directors' uprising at MG Rover will explode this week when three board members unveil a plan to break up the group and attempt to take the famous MG marque away from John Towers, the group's chairman.*
>
> *Three non-executive directors*[36] *have established what is being called 'Consortium II' in an attempt to wrestle the prestigious MG sporting badge away from Towers, leaving the group's embattled boss with just the damaged Rover brand …*

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[33] Deloitte did not submit their findings in a formal report. Mr Barton noted in an internal email: "... [the forensic services department] *would be effectively doing … work for us and reporting to us (as Corporate Finance) rather than a client of the firm … We would relate key findings orally and would not require a 'signed off' report but would need an internal briefing paper.*" A briefing note was duly emailed to Mr Barton on 11 October 2000, which included background information on Mr Parker obtained from a number of sources including press reports, Companies House records and industry contacts.

[34] Mr Parsley had been a commentator on MGRG for some time, and wrote over 70 articles on the topic between April 2000 and April 2005.

[35] Identified in the article as Mr Ames, Mr Bowes, Mr Parker and Mr Whitmore.

[36] Identified in the article as Mr Bowes, Mr Parker and Mr Whitmore.

> *The plan includes buying a large chunk of land at the Longbridge plant, plus the Powertrain transmissions and Body & Pressings businesses from BMW …*
>
> *The three non-executives are expected to use their plans as a bargaining tool at this Friday's crisis board meeting. If Towers does not give in, then they will press ahead with their threat of a no-confidence motion against him.*"

30. In reality, there was no such boardroom "*revolt*" or "*uprising*", no threat to vote Mr Towers out of office, no plan to break up the group, no "*Consortium II*" and no "*crisis*" board meeting. Mr Ames described the 15 October article as "*complete hogwash*" and that of 22 October as "*rubbish*". Mr Parker said of the earlier article, "*none of it was true, because I certainly never discussed anything of this with Richard Ames, David Bowes or even Terry Whitmore*"; when we asked him how much of the later article was true, he said, "*None whatsoever*". With regard to the first article, Mr Whitmore explained:

> "*I know nothing of that at all. If that discussion ever took place, I was not party to it. I had already said to Towers after the August meeting that I would not become a non-executive director, so I had no more discussions with any of them.*"

Asked about the second article, he suggested:

> "*… this is a journalist adding 2 and 2 together and making 22.*"

31. We asked Mr Parsley about the basis for these articles. He declined to reveal his sources, but asserted that he had a proper basis for the articles. However, we find it hard to believe that there was any solid basis for the articles.

32. Be that as it may, the press coverage fuelled the concerns about Mr Parker. Mr Beale explained that "*Rightly or wrongly, Brian Parker got blamed for talking to the press in what I tended to generally believe was a naïve way rather than a malicious way*". Mr Stephenson told us that Mr Parker "*had started to kind of make very foolish statements to the press who were then turning them against him and us*"; he added that "*every time we were getting negative press, this was undermining the position of MG Rover and all our efforts to try and build the company up*". Ms Ruston told us that she was troubled by "*the bad press and the bad publicity that was happening round about that time and in particular the investigation that was going on into where the leaks might have come from*" and said that "*there was a climate of suspicion amongst people who they thought might have leaked information to the press.*"

33. By 25 October 2000, preparations were being made for Mr Parker to resign or be removed from Techtronic's board. On 25 October Ms Ruston supplied Mr Beale with drafts of documents to be used in connection with either Mr Parker's resignation or his removal. Mr Beale himself wrote some notes in anticipation, evidently, of a meeting between Mr Parker and Mr Towers. These included the following:

"• *Set out background:*

- *Much press speculation – causing serious damage to MG Rover*
- *Several press sources now mention your name as cause of the above ...*
- *A company search reveals no PLC's as you have often stated but instead 2 company liquidations*
- *We have no knowledge of your background*
- *Very worrying reference to you as a 'Lord'*[37]

• There are only 2 options:

- *Firstly you resign ...*
- *Or we would be forced to dismiss you ...*"

On the following day, The Maitland Consultancy Limited, a public relations agency engaged by MGRG, provided drafts of press statements and a briefing for use in connection with Mr Parker's departure (whether by resignation or otherwise). Mr Towers also rang Mr Ames to explain his intentions. Mr Ames told us:

> "*I had a personal phone call from John Towers telling me that there was an issue with Brian Parker ... and they ... had all sorts of people trying to find out who was leaking this information. And he was going to give Brian Parker the option to either resign or he was going to fire him.*"

34. A meeting between Mr Towers and Mr Parker took place on 26 October 2000. Although Mr Parker was not aware of the fact, the meeting was tape-recorded[38] [39]. Referring to the Techtronic board meeting to be held the next day, Mr Towers said:

> "*We're not going to get to the board meeting tomorrow Brian ... The only choice there is to be made is whether you take a recommendation for us, from us, to resign or whether we announce something different.*"

Mr Parker emphasised the contribution that he had made to the business and the conversation turned to the possibility of him receiving payment in recognition of his input. It

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[37] As to which, see paragraph 26 above.

[38] In evidence to us, Mr Parker questioned whether the tape accurately reflected his conversation with Mr Towers. He suggested that "*It was impossible to be taped at Longbridge*" and said that he would not use the "*sort of dialogue*" apparently recorded. However, we have no doubt that Mr Parker's conversation with Mr Towers was recorded on the tape.

[39] Mr Towers told us that he did not habitually tape-record meetings (this being one of only two such occasions); however, given the "*seriousness of the matter* [he] *thought it was a prudent thing to do*".

was subsequently agreed that Mr Parker would resign and, in return, he would raise an invoice via Landcrest Developments[40] for £50,000, to be described in terms of "*renegotiations of our scrap disposal arrangements*".

35. Minutes signed by Mr Towers record that a Techtronic board meeting was held on 26 October 2000. According to the minutes, the meeting was attended by the four members of the Phoenix Consortium, who resolved that resignations as non-executive directors of the company from Mr Parker and Mr Whitmore[41] should be accepted with effect from the close of the meeting. While, however, Mr Ames appears to us to have been a director of Techtronic by this date, he does not seem to have been invited to any board meeting on 26 October[42].

36. Following the meeting between Mr Parker and Mr Towers, Landcrest Developments rendered an invoice dated 27 October 2000 to MGRG for £50,000 plus VAT "*For work carried Out re scrap metal contracts. All as agreed with Mr J Towers letter enclosed*". On 23 November Mr Millett cleared the invoice for payment, and payment was in fact effected by an MGRG cheque issued on 28 November. Mr Millett explained:

> "*... the owner of the business had brought a cheque to me saying this man had carried out work in the early months and we are required to pay him. I did not say, 'Well, what hourly rate did he get, John?', or, 'How many hours has he been here?' ..., no, I did not, I did not challenge it.*
>
> *I am also aware at that particular time, Brian Parker was leaving ... I had every reason to believe that he had carried out work in those opening months on scrap contracts and that is what the invoice was for.*"

Mr Beale summarised his thinking as follows:

> "*There was all this publicity, and if you look at the articles it is all about MG Rover Group, it is damaging the brands of MG Rover. So as far as I was concerned, as a director of MG Rover, paying him £50,000, which I could justify to myself as, well, he was not a bad chap, he did do some savings, and it gets rid of all this attendant bad publicity, it is bloody good value for money.*"

For his part, Mr Edwards told us that he had breathed a "*very big sigh of relief*" when he had heard that Mr Towers had reached a resolution with Mr Parker. Mr Stephenson said that the payment was felt to be "*a damned good investment.*"

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[40] As noted at paragraph 26 above, Mr Parker was a director and shareholder of Landcrest Developments, which was concerned in property acquisition and development.

[41] As noted at paragraph 17 above, Mr Whitmore had not in fact become a director of Techtronic.

[42] In contrast, Mr Ames was invited to, and attended, a Techtronic board meeting on 27 October 2000, for which we have draft minutes.

37. At around this time, Ms Ruston told Mr Harry Dunlevy, who was the personnel director for MGRG until the company was sold to Techtronic, that Mr Parker had been paid about £50,000 to "*keep him quiet*"[43]. The reality, as it seems to us, is that Mr Parker, through Landcrest Developments, was paid £50,000 (plus VAT) to secure an agreed departure from the Group. In our view, the payment of such a sum could reasonably have been thought to have been in the interests of both Techtronic and MGRG. However, we think that it was inappropriate for the payment to have been described as "*For work carried Out re scrap metal contracts*", given that:

    37.1. it is not apparent to us that Landcrest Developments had in fact carried out such work, or work to the value invoiced (viz. £50,000), for MGRG; and

    37.2. in any event, the £50,000 was in fact being paid in return for Mr Parker's resignation from the Group rather than for services relating to scrap metal.

38. In interview, Mr Parker told us that he left the Group because of "*the media pressure*": "*it was,*" he said, "*putting pressure on my family and on myself and on my business*". He therefore "*tried to get a meeting with Towers*", wanting "*a face-to-face meeting with him to tell him that I was not going to work with them.*" When he eventually met Mr Towers, he:

> "*... just said to John Towers I – it was at Longbridge, and I said that I was – basically I was fed up with all the media pressure and all the insinuations and innuendo that was going into the press and also the things from Parsley. I just, you know, I could not continue any more.*"

In reality, however, far from telling Mr Towers that he could not continue, Mr Parker was told by Mr Towers that if he did not resign as a director he would be removed as such.

39. Mr Parker also told us in interview that:

    39.1. at the beginning of 2000 he was not involved in any companies other than Rover companies and Landcrest Developments, although he was in fact then involved in AC & D Demolitions Limited, Baycrest (Midlands) Limited, Landcrest Properties Limited, Power Transformers (Birmingham) Limited, Sullpark Aviation Limited and Thorpes Limited;

    39.2. he had never been a director of Techtronic, although, as we note at paragraph 27 above, Mr Parker signed a form 288a for the purpose of notifying Companies House of his appointment; and

    39.3. he had not taken part in the conversation with Mr Towers on 26 October 2000, of which there is a tape-recording as noted at paragraph 34 above.

[43] Mr Dunlevy also told us that Ms Ruston had expressed concerns to him at around this time with regard to levels of remuneration received by the members of the Phoenix Consortium and certain MGRG directors.

40. In our view, Mr Parker was untruthful in some aspects of his evidence to us. In particular, we do not think that Mr Parker can have believed that he was giving us an accurate account of how and why he left the Group. It is, for example, hard to see how Mr Parker can have thought that he had sought "*a face-to-face meeting with* [Mr Towers] *to tell him that* [he] *was not going to work with them*", that he had told Mr Towers that he could not continue because he was "*fed up with all the media pressure and all the insinuations and innuendo that was going into the press*" or that he had not taken part in the conversation with Mr Towers of which there is a tape-recording[44]. Again, we doubt whether Mr Parker can genuinely have believed that he had not been involved in any companies other than Rover companies and Landcrest Developments at the beginning of 2000[45].

The establishment of PVH

Events leading to the establishment of PVH

41. When the Phoenix Consortium were negotiating to "*buy*" MGRG, it was envisaged that, if the acquisition were successfully concluded, employees and dealers would receive shares[46].

42. Plans for the distribution of shares to employees and dealers were taken forward following completion. A bulletin issued by MGRG's personnel department on 11 May 2000 explained that the "*shareholding of the Company will be split between the Directors, Dealers and the Employees*" and that this "*will give everyone the opportunity to be part of the company*". Notes of a meeting between Mr Beale and Eversheds on the following Monday record that 25 per cent of Techtronic's shares were set aside for employees, 25 per cent for the dealer network, 10 per cent for senior executive management and the remaining 40 per cent for the members of the Phoenix Consortium. Consideration was subsequently given to whether employees and dealers should have their stakes in MGRG rather than Techtronic. On 24 May Mr Beale indicated to Ms Lewis that:

> "*Bearing in mind the fact that Techtronic plans to acquire Powertrain and Swindon Pressings they* [i.e. the Phoenix Consortium] *would like to consider a structure whereby the Rover employees and Rover dealers have their stake in Rover Group (as distinct from Techtronic). That would be so as to ensure that the Rover dealers and Rover employees participate in any growth in value of that entity; they would not, however, be entitled to participate in any growth in value of either Powertrain, Swindon Pressings or anything else which Techtronic might acquire.*"

A memorandum prepared by Eversheds on 30 May 2000 noted, however, that the issue of shares in MGRG to employees and dealers could give rise to problems (in particular, from a tax point of view) and suggested as an alternative creating "*a new class of shares in Techtronic (2000) which could only share in the profits and assets of the current trading group*".

[44] See paragraphs 38 and 39.3 above and also footnote 38 above.
[45] See paragraph 39.1 above.
[46] See III/43, 59 and 61.8.

43. By 30 May 2000, the possibility of the members of the Phoenix Consortium being given loan notes[47] had been revived[48]. On 30 May there was a "*team*" meeting at which, according to Mr Seabrook's note of the meeting, those present included "*All of the four executive Techtronic directors*" and eight people from Deloitte (including Mr Einollahi). Mr Seabrook said in his note:

> "*It would appear that* [Mr Einollahi] *has come up with a new scheme in order to give the four executive directors a cut of the £75 million subscribed for shares in Rover*. [Mr Hume] *said that this would either be by way of a Newco being put on top of Techtronic which would offer shares and a loan note to the value of £74,760,000 split between the four shareholders. Alternatively, the share rights in Techtronic could be altered so that the four shareholders effectively share in the first £75 million of any disposal proceeds.* [Mr Seabrook] *pointed out that any insertion of a new holding company over Techtronic would require the consent of BMW and also that there will be some fairly big political overtones as far as the employees (and dealers) are concerned with either route.*"

Notes made by Mr Richard Edwards of Deloitte at the same meeting include "*'Kicker' – 4 X £18.75m – loan note*" and (next to a diagram depicting Techtronic as a subsidiary of "Newco") "*shares + loan note of £75m*".

44. Mr Seabrook speaks in his note of a "*new*" scheme to give the members of the Phoenix Consortium a "*cut of the £75 million subscribed for shares in Rover*". While, however, this possibility was evidently new to Mr Seabrook, it had in fact been raised shortly before completion[49]. Mr Beale said, "*It certainly was not a new scheme to us on 30th May. It may have been a new scheme to him.*" For his part, Mr Bushill told us, "*In my mind it was a scheme that went back to the time of the acquisition.*"

45. Proposals as to the structure of the Group were further discussed and developed over the next couple of months. On 2 June 2000, Mr Seabrook told Ms Lewis of Eversheds of a conversation he had had that morning with Mr Hume in which:

> "[Mr Hume] ... *reported that he thinks that Techtronic ... may wish to implement the loan note proposal (for £75m) mentioned in my note of the team meeting at Bickenhill last Tuesday. He is talking to Peter Beale further to check that they appreciate the potential political repercussions of this with the unions and possibly also the executive team at Rover.*"

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[47] As we note in chapter III footnote 24, loan notes are a form of vendor finance or deferred payment, in which the purchaser, in this case Techtronic, acts as a borrower, agreeing to make payments to the holder, in this case BMW, at a specified future date.

[48] As we note in III/58 to 62, the possibility of the Phoenix Consortium being given loan notes was first raised earlier in May 2000.

[49] See III/58 to 62.

On 6 June the share structure was addressed at a further "*team*" meeting. Mr Richard Edwards' notes of the meeting record that Mr Hume introduced the "*new holding company*" and that it was envisaged that the members of the Phoenix Consortium would exchange their shares in Techtronic for shares in the holding company plus £75 million of loan stock. This, the notes state, was "*to allow management to take out first £75m on exit*", though it also seems to have been contemplated that the members of the Phoenix Consortium could be paid in advance of an "*exit*"*:* the notes speak of "*£15m p.a.* ***or*** *on exit (i.e. sale)*" (emphasis added). Employees, dealers and executives were, either directly or indirectly (for example, through an employee benefit trust), also to have shares in the holding company, but their rights were to be limited to the "*economic value of Rover (i.e. not for example Powertrain)*" and their voting rights needed to be "*dressed up*" so that their shares did not give them control of the company. Over the next week, Eversheds prepared two versions of a paper dealing with the proposed restructuring[50]. The later of the two, dated 13 June, included the following:

> "*... A new 'off the shelf' company would be acquired by the four members of the consortium (each member holding one share) (to be named Phoenix(?)).*
>
> *... Phoenix would acquire the entire issued share capital of Techtronic from the consortium in exchange for the issue of shares (on a 1 for 1 basis) in Phoenix and the issue by Phoenix of £75 million in unsecured loan stock ('ULS').*
>
> *... The £75m ULS 'match' the £75m injected into Rover by BMW (as the 'pay off' for no warranties) ...*
>
> *Phoenix would be incorporated with a number of classes of share ... The individual members of the consortium would each hold ... [A] shares which would have, inter-alia, ... 40% of the economic value of* [MGRG] *together with all the economic value ... of any other business held in the Phoenix group ... The Executive Team would via a trust hold the beneficial interest in [B] shares which would have ... 10% of the economic value of* [MGRG] ... [and] [n]*o voting rights ... The employees and dealers would, via their respective trusts, hold the beneficial interest in [C] and [D] shares respectively...,* [the rights attaching to which] *are likely to be similar to those for the Executive Team ...*"

That same day, there was a further "*team*" meeting, Mr Richard Edwards' notes of which show that "*share structure*" was mentioned. An internal Eversheds memorandum sent on 15 June attached a copy of the Eversheds' paper relating to the proposed restructuring and noted that a "*concern which has been raised by John Towers is the extent to which BMW will be prepared to give their consent, should this be needed, to such a scheme*". On 29 June, Ms Lewis reported to Mr Beale in an email as follows:

[50] The first version was emailed to Mr Beale, among others, on 8 June 2000.

> "*You will remember that I circulated a paper relating to the proposed share structure and restructuring. One of the aspects of the restructuring was the insertion of a 'newco' over the top of Phoenix so as to enable the four members of the consortium to extract (say) £75 million as a priority item on a sale. One of the issues addressed in that note was the question of whether Techtronic would need BMW's consent for the re-organisation which would be required to achieve the proposed new structure ...*
>
> *Any proposal to transfer the shares or assets of* [MGRG] *to a parent of Techtronic would breach the agreed asset position. Any breach of the loan note instrument would entitle BMW to call for repayment of any outstanding monies and cancel the availability of any funds yet to be loaned. This is tantamount to saying that we require ... BMW's consent for the purposes of the reorganisation.*"

On the following day, Ms Lewis confirmed to Mr Beale that he would "*inevitably need BMW's consent*"; she continued:

> "*The reason for that is that the loan note instrument (and other agreements) contain change of control provisions which will inevitably be triggered if a 'newco' is put over the top of Techtronic. Whilst it is, of course, the case that the change of control is of a 'technical' nature it nonetheless counts for the purposes of the loan note instrument. In conventional circumstances one would not normally have any hesitation about seeking consent; in the current circumstances (and particularly given the object of the exercise) my understanding is that you do not wish to approach BMW. If that is right then it seems to me that the scheme cannot go ahead. The corollary of that is that the shares for employees and dealers would be made available through Techtronic (on the same basis) as distinct from through newco.*"

A week afterwards, Ms Lewis wrote to BMW's solicitors, Norton Rose, to ask for BMW's consent to the introduction of a "*Newco*"[51] and, on the following day, she told another solicitor from Eversheds that "*it now looks as though we will be proceeding down the 'Newco' route outlined in the structuring note*". A note of a "*team*" meeting on 11 July includes, "*Equity restructuring on hold re employee issues to be settled in the next week or so*". A note of the next meeting, on 18 July, states, "*Share structure decisions made by PB* [i.e. Mr Beale]. *Eversheds to redraft and produce executive summary to present to Phoenix and agree on points*". A note of the following meeting, on 25 July, refers to Eversheds circulating restructuring documentation to Mr Beale "*in preparation for a meeting of the* [Phoenix] *Consortium on Thursday afternoon*".

[51] The issue of loan notes was not mentioned at this stage to Norton Rose.

46. Ms Lewis' understanding of the basis for the introduction of a new holding company is apparent from an email she sent to Mr Rupert Hague-Holmes, also of Eversheds, on 28 September 2000. She told Mr Hague-Holmes:

> "*The key point to remember is that real purpose for the introduction of Newco is not really to facilitate the proposed new share structure although it is helpful in that regard. The real purpose is to ensure that on the acquisition of Techtronic by Newco, Newco will issue to the four members of the consortium not only shares in itself (in exchange for shares held in Techtronic*[)] *but in addition it will pay (by way of a Loan Note presumably) a further £75,000,000 to the four individuals …*
>
> *I think it important to check … that the individuals cannot be caught for 'misrepresentation' or anything like that in that in seeking consent to the change of control we have said that it is to facilitate the new share structure. We have not, of course, mentioned the £75,000,000 issue.*"

47. The proposed loan notes were discussed with Norton Rose in October 2000. In a letter to Mr Brooks of Norton Rose dated 25 October, Ms Lewis wrote:

> "*… Newco in acquiring Techtronic will, of course, issue shares to the original 4 consortium members. The shares to be issued to the employee trust, the senior management and the dealer trust will be so issued later – may be a day or so later. It is contemplated, however, that Newco, when it makes its acquisition of Techtronic, would also issue to the 4 consortium members as consideration for their shares in Techtronic a Loan Note for an aggregate amount of £10,000,000*[52]*. As far as the Loan Notes are concerned it is contemplated that they would be interest bearing (at a commercial rate), non-qualifying corporate bonds and contain provisions whereby the capital amount in respect of them would be repaid on an exit or, if earlier, after (say) five years from May 2000. The interest in respect of the Loan Notes would not, however, roll up but would be paid quarterly and would be funded from* [MGRG] *(via an interest payment made to Techtronic and a dividend to Newco).*"

Earlier in her letter, Ms Lewis had noted that there was "*one additional point to raise regarding the issue of loan notes by Newco to the members of the Phoenix consortium*", explaining:

> "*I understand that the principle behind this point was agreed between Maghsoud Einollahi of Deloitte & Touche and representatives of BMW in relation to the acquisition of a proposed £75 million loan note at the time of the original negotiations. Please note that the proposal below involves the issue of Loan Notes by Newco for £10 million.*"

52 As discussed later in this chapter, the proposed value of the loan notes changed from £75 million to £10 million.

The basis for this comment is to be found in an Eversheds note of a conversation with Mr Einollahi on 24 October. This includes the following:

> "*£75 million → warranty claims → 4 individuals & then by way of Loan Note → acquired BMW Loan Note by Consortium for £1. Cannot name individual who had the discussion with but if objective is the same, this was discussed. Why £10 million now? Do not know the answer. Happy for me to mention details in fax.*"

Mr Einollahi evidently had in mind the discussions he had had about BMW lending £75 million to MGRG and the benefit of the loan being transferred to the members of the Phoenix Consortium[53]. Mr Einollahi commented that the meaning of these discussions "*got exaggerated as time went on*", explaining that "*the chance to own a financial instrument in the company … is entirely different from having a share of 75 million*".

48. By this stage, the proposal was that the holding company should issue loan notes to the value of only £10 million. The figure had, however, been reduced from £75 million only recently. Ms Lewis clearly thought that loan notes to the tune of £75 million were to be issued when she emailed Mr Hague-Holmes on 28 September 2000[54]. Further, when writing to Mr Hume and Mr Bushill on 20 October about points raised at a "*recent*" meeting[55], Ms Lewis noted in relation to the issue of a loan note:

> "*This is something where the discussions have moved forward and we are, of course, now to seek BMW's consent to the issue of £10,000,000 in loan notes as part of that transaction.*"

49. Eversheds prepared draft articles of association for the new holding company and, on 21 November 2000, obtained advice on them from Mr Robin Potts QC. The articles, as adopted on 18 December, included provisions to the following effect:

    49.1. the company, then called MG Rover Holdings Limited, had four classes of shares;

    49.2. the rights of holders of "A", "B" and "C" shares (unlike those of "D" shareholders[56]) were limited to assets "*which derive from or are fairly attributable to the MG Rover Group*", to "*MG Rover Profits*" and to the "*MG Rover Total Capitalisation*". The "*MG Rover Group*" was defined to mean:

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53 See III/58 to 62.
54 See paragraph 46 above.
55 Seemingly, on 10 October 2000.
56 By this time, the Phoenix Consortium's shares were to be "D" shares, not "A" shares as had been envisaged in June: see paragraphs 55.3 to 55.4 for the eventual holders of the different share classes.

> "*MG Rover* [i.e. MGRG], *its holding companies and its and their subsidiary companies (including MG Rover Parts Limited) and each of their businesses as at the date of the adoption of these Articles but excluding (i) any business or company which is part of the MG Rover Group on the date of adoption of these Articles but which is not part of the Enlarged MG Rover Group* [i.e. MGRG, its holding companies and its and their subsidiaries] *at any date on which the MG Rover Profits or the MG Rover Total Capitalisation fall to be determined and (ii) any business or company which is acquired by any member of the Enlarged MG Rover Group after the date of the adoption of these Articles*".

The "*MG Rover Profits*" meant:

> "*The profits of the Company that are (from time to time) available for distribution in accordance with the provisions of Part VIII of the* [Companies] *Act and which derive from or are fairly attributable to the MG Rover Group*".

The "*MG Rover Total Capitalisation*" referred to:

> "*That part of the Total Capitalisation* [broadly, the amount realised on a sale of the company or from a solvent liquidation] *which derives from or is fairly attributable to the MG Rover Group*";

49.3. "A", "B" and "C" shares carried no entitlement to vote at general meetings. These were conferred only on "D" shares;

49.4. holders of "A" and "B" shares were not entitled to receive notice of or attend general meetings unless they were the trustees of the MG Rover Employee Trust Company Limited or the MG Rover Dealer Trust (through which the interests of employees and dealers were to be held); and

49.5. article 19 of the articles allowed directors to vote on, and be counted in the quorum in relation to, matters in which they had interests.

There had been discussion at the consultation with Mr Potts QC as to whether what became the definition of "*MG Rover Profits*" should make specific reference to interest on loans, but after discussion it had been "*accepted that interest received by Techtronic from* [MGRG] *would be derived from or fairly attributable to* [MGRG] *and that, therefore, the reference to interest on loans … could and should be deleted*"[57].

[57] It was apparently also intended that "*MG Rover Profits*" should encompass profits derived from the parts business and dealer properties (as to which, see chapters XIII (Xpart) and IX (Property and share transfers)): Eversheds' note of a meeting with Mr Beale on 3 November 2000 records that "*monies generated or profits generated by either*

50. During November 2000 Deloitte sought Inland Revenue clearance for the formation of the new holding company. In a letter to the Inland Revenue's Capital Gains Tax Clearance Section dated 1 November 2000, Deloitte asked for confirmation that the Inland Revenue would accept that the proposed arrangements would be effected for bona fide commercial purposes. Deloitte stated in the letter that "... *Given* [MGRG's] *commercial situation and the recent arms length transaction with BMW it is anticipated that the share rights to be awarded to employees and dealers are currently of negligible value*". They also explained as follows:

> "*The Board of Techtronic also wish to retain the flexibility to make further acquisitions in the future and possibly enter into joint venture arrangements with other car manufacturers to facilitate the development of new models in the medium term. Techtronic is currently subject to various restrictions under the BMW Loan Notes facility. It is considered that the formation of a new holding company will enable the Techtronic shareholders to ring-fence their obligations to BMW and facilitate future investments in other businesses in due course.*"[58]

In a letter dated 29 November to the Inland Revenue's Shares Valuation Division about the "A" and "C" shares which were to be issued to employees and executives, Deloitte said:

> "*In our view the A and C shares are worthless. The recent arms' length acquisition of the business from BMW for consideration of £10 is the best possible guide to its current market value. Since that time a further £261,150 has been injected by way of share capital and a minimum shortfall of £300m in the value of the assets held by the business at completion has been discovered. There is no prospect of a return on the shares of any kind for the foreseeable future.*
>
> *All this suggests that the entirety of the business is, to all intents and purposes, worthless and that no value at all attaches to the employee shares.*"[59]

In a letter to the Inland Revenue's Section 703 Compliance Unit dated 1 December, Deloitte commented on why the members of the Phoenix Consortium were to be given loan notes rather than preference shares[60]. They explained:

Parts, Leasing, MG Sport or the dealer property company would count as Rover profits for the purposes of the 25% figure".

[58] The Inland Revenue stated in a letter dated 10 November 2000 that it was satisfied that the provisions of section 137(1) of the Taxation of Chargeable Gains Act 1992 should not have effect in respect of the transactions.

[59] The Inland Revenue replied on 6 December 2000, stating that it was prepared "*to accept that the 'A' and 'C' shares to be issued in the near future are 'to all intents and purposes, worthless'*".

[60] Mr Hume told us that he had heard from Mr Beale that Mr Towers did not want to issue preference shares because these would require earlier public disclosure. He also told us that he had emphasised to Mr Beale that he must feel comfortable with the fact that the letter stated that part of the rationale for using the loan notes mechanism was to avoid immediate public disclosure. Further, Mr Beale reviewed in draft the letter sent to the Inland Revenue on 1 November 2000, which stated that part of the rationale for using the loan notes mechanism was "*commercial issues relating to disclosure*".

> "*Naturally, the existence of the £10 million carve out to the founder shareholders is extremely sensitive and would attract close attention from the Press. The use of preference shares, whether redeemable or non-redeemable, was ruled out because they would be enshrined in the Articles and be in the public domain. By contrast, it is hoped that the loan notes will only become public when the first accounts of Newco are filed in around 2 years time.*
>
> *The use of preference shares would involve some uncertainty as to whether the shares are issued at a discount for Company Law purposes. This issue is avoided by the use of loan notes.*
>
> *Loan notes also have certain advantages in terms of presentation. To a casual reader of the accounts, it appears that the founder shareholders have put £10 million of loan capital into the business. In addition, it enables income to be paid to the founder shareholders by way of interest on the loan notes. This would be easier to present to the A, B and C shareholders than a preference dividend which may provoke questions as to why a dividend is not being paid on the ordinary shares.*
>
> *The availability of distributable reserves within* [Techtronic]*, and hence the ability to pay dividends to Newco, is likely to be uncertain.* [MGRG] *had a deficit on its profit and loss account of approximately £3 billion at 31 December 1999 and is unable to pay dividends. Although* [Techtronic] *is expected to receive interest at a commercial rate on its inter-company loan to* [MGRG]*, its reserves may be jeopardised by provisions against the inter-company debtor. A further advantage of the use of loan notes is that the principal amount could be paid without the requirement for distributable reserves.*"[61]

51. By 23 November 2000 BMW had agreed in principle to the new holding company issuing a £10 million loan note to the members of the Phoenix Consortium. Mr Brooks of Norton Rose told us, "*The reason that the request was agreed was it was thought to be a reasonable sum of money in the context of the transaction.*"

<u>Decision to pay interest</u>

52. There was also reference in November 2000 to MGRG paying interest on the money which was lent to Techtronic by BMW and lent on to MGRG.

53. On 28 November 2000 Ms Ruston reported that she had met Mr Beale and Mr Howe that morning and that they were "*content to charge interest on the loan from Techtronic to* [MGRG]"; "*Techtronic*", Ms Ruston also reported, "*will then pay dividends to Newco*"[62]. A

[61] In the event, the Inland Revenue gave only partial clearance under section 707 of the Income and Corporation Taxes Act 1988, stating that it was not satisfied that a tax advantage would not arise or that obtaining a tax advantage was not one of the main objects of the issue of loan notes as part of the consideration for the transfer of the shares in Techtronic.

[62] As we note in paragraph 59 below, a dividend of £9.8 million was subsequently paid from Techtronic to PVH.

manuscript note made the following day stated that Eversheds were "*to double check* [with Ms] *Ruston re backdating* [interest]", the point being that MGRG had not hitherto been paying, or been charged, interest on the money it had been lent by Techtronic[63]. In evidence to us, Mr Bushill's recollection was that Mr Beale had taken the decision that interest would be charged on the loan from Techtronic to MGRG.

54. As we note at paragraph 57 below, minutes of an MGRG board meeting on 18 December 2000 record that the board agreed to the payment of interest on loans from Techtronic.

Implementation

55. The introduction of the holding company was carried into effect on 18 December 2000. The arrangements involved, among other things, the following:

55.1. PVH executed a deed poll[64] constituting £10 million of loan notes. The loan notes were to be redeemed by 9 May 2005 and in the meantime were to bear interest. The holders of the loan notes could, after six months from the date of issue, also call for redemption if, among other things, any company in the Group entered into an insolvency regime or was deemed unable to pay its debts within the meaning of section 123 (but excluding for this purpose section 123(1)(a)) of the Insolvency Act 1986;

55.2. the four members of the Phoenix Consortium entered into an agreement with PVH (then called MG Rover Holdings Limited[65]) for the sale of their shares in Techtronic to PVH in consideration of "D" shares in PVH and the issue by PVH to each of them of loan notes to the value of £2.5 million;

55.3. the "A" shares were allotted to MG Rover Employee Trust Company Limited ("MG Rover Employee Trust Company") (which was to hold them on trusts for the benefit of employees), the "B" shares to MG Rover Dealer Trust Company Limited ("MG Rover Dealer Trust Company") (which was to perform a similar function in relation to dealers) and the "C" shares to MG Rover Executive Trust Company Limited ("MG Rover Executive Trust Company") (which was to perform a similar function in relation to executive directors of MGRG);

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[63] As noted at III/90.2, the Facility Agreement had allowed for money lent to MGRG by Techtronic to "*accrue interest*", but it had not authorised Techtronic to hold any such interest. The supplemental deed mentioned in paragraph 55.6 below varied the Facility Agreement in such a way as, "*for the avoidance of doubt*", to entitle Techtronic to hold interest on loans to MGRG.

[64] A deed poll is a form of legal document where one party, or several parties acting jointly, legally commit themselves to a particular course of action as detailed within the document.

[65] PVH was incorporated on 5 October 2000 as 115CR (022) Limited, but changed its name to MG Rover Holdings Limited on 15 December 2000. The name was changed again, to Phoenix Venture Holdings Limited, on 30 January 2002.

55.4. the "D" shares[66], which were the only shares with voting rights, were split equally between the four members of the Phoenix Consortium;

55.5. MG Rover Employee Trust Company, MG Rover Dealer Trust Company, The MG Rover Executive Trust Company and the members of the Phoenix Consortium entered into a shareholders' agreement under which, among other things, the parties were "*always to act in the utmost good faith and in such a way as ensures fairness to all Parties both in the interpretation of this Agreement and the Articles and also in achieving the Parties' mutual aim of ensuring success for the MG Rover Group and a realisation of each Party's interest in the economic value thereof*"; and

55.6. Techtronic, BMW AG, MGRG, the members of the Phoenix Consortium and PVH entered into a deed supplemental to the Facility Agreement[67] under which, among other things:

(a) BMW AG consented to the transfer of the issued capital of Rover Parts Limited[68] (later called Xpart Limited) to PVH and to the incorporation of "*Dealer Propertyco*" (later called MG Rover Property Holdings Limited, "Property Holdings"), "*Engine Developmentco*" (later called MG Rover Heritage Limited, "Heritage"), "*Leaseco*" (later called MGR Leasing Limited, "MGR Leasing") and "*MG Sport*" (later called MG X80 Limited, "MG X80") as subsidiaries of PVH;

(b) PVH undertook that all "*Permitted Agreements*" would be "*at a proper, commercial rate, commensurate with the services which they provide and having regard to the economic position of the Rover Group and its prospects*". "*Permitted Agreements*" extended to the £10 million of loan notes, and also to:

> "*... service agreements and management services agreements and arrangements between* [PVH] *and* [Techtronic] *and/or* [MGRG] *(or any of their subsidiaries) in relation to the provision of services (including management, directorship, secretarial or other consultancy services) and, without limitation service agreements between* [PVH] *and each of John Towers, Nick Stephenson, Peter Beale and John Edwards and between* [PVH], [Techtronic] *and/or* [MGRG] *and executive or senior employees ...*"; and

(c) Messrs Towers, Stephenson, Beale and Edwards each undertook to procure that PVH complied with its obligations under the deed.

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66 Including the subscriber shares, which were subdivided and reclassified as "D" shares.
67 As to which, see III/90.
68 As noted in VIII/15.12, BMW Parts Limited changed its name to Rover Parts Limited on 21 June 2000 and then to MG Rover Parts Limited on 23 May 2001. It became Xpart Limited on 7 August 2002.

56. Minutes record that these arrangements were approved:

56.1. at board meetings of PVH held on 18 December 2000 and attended, it seems, by Mr Towers, Mr Beale, Mr Edwards and Mr Stephenson, and by a written resolution of the company of the same date;

56.2. at two Techtronic board meetings, likewise held on 18 December 2000 and attended by Mr Towers, Mr Beale, Mr Edwards and Mr Stephenson; and

56.3. at a board meeting of MGRG, also held on 18 December 2000.

57. According to its minutes, the MGRG board meeting of 18 December 2000 both approved the deed supplemental to the Facility Agreement and agreed to the payment of interest on loans from Techtronic. In this respect, the minutes state:

> "*The Chairman reported to the meeting that the provisions of the Supplemental Deed … now clarified Techtronic's position vis à vis its ability to hold cash received by it in respect of interest payable to it from the Company on inter-company loan account. Whereas under the* [Facility Agreement] *it had been permissible for interest to accrue at a rate not exceeding market rates on monies lent by Techtronic to the Company that Facility had not specified that Techtronic would not be in default under such Facility if sums paid in respect of such interest were held by Techtronic without being immediately lent back to the Company. The Supplemental Deed, however, now specified that such sums may be held as an asset by Techtronic.*
>
> *On that basis and after careful consideration in the light of all circumstances IT WAS RESOLVED THAT since it was always the intention of both the Company and Techtronic that the Company would pay interest on any loans by Techtronic to the Company … and in anticipation of the advance of further monies by Techtronic, the Company should accede to the written request received from Techtronic to make payment to Techtronic of interest which had accrued and would in the future accrue on sums lent to the Company by Techtronic at a rate not exceeding market rates.*"

58. Also on 18 December 2000 Mr Howe sent each employee of MGRG a letter enclosing an application to join the employee share scheme. He stated in the letter:

> "*As you are aware one of the early statements by John Towers declared the desire of the Phoenix Consortium to have everyone, who works at MG Rover Group, own a part of the business.*
>
> *This is a very generous gesture and is a unique scheme, with sixty percent of the shares being given to employees and the dealers …*
>
> *… We all now have the opportunity to become stakeholders in our company.*"

59. Draft minutes for a further Techtronic board meeting, on 21 December 2000, deal with the payment of a dividend by Techtronic. We are aware of two versions of the draft minutes, but they do not differ materially. Each lists those present as Mr Towers, Mr Beale, Mr Edwards and Mr Stephenson. Each also contains wording to the following effect:

> "*... Mr Beale informed the Board that the purpose of the meeting was to consider whether or not to make a dividend payment from the Company to its shareholder,* [PVH]. *He reminded the Board that in order for such a payment to be made by the Company the Directors must be satisfied that the Company had sufficient distributable reserves to do so. Accordingly, Mr Beale presented to the meeting a draft profit and loss statement for the Company for the nine months to 31st December 2000. Mr Beale explained that this statement showed that the Company had incurred no expenses in the period and that the only income that the Company had received was the sum of £9,946,229.00 being interest from the loan of £192,000,000 made by the Company to* [MGRG] *('the Loan').*
>
> *... The Board considered whether it was necessary to make a bad debt provision in its accounts in respect of the repayment by* [MGRG] *of the Loan and after careful consideration IT WAS RESOLVED THAT this was not necessary.*
>
> *... Having carefully considered the draft profit and loss statement and the Company's ability to make a payment to its shareholder IT WAS RESOLVED THAT a dividend be declared in the amount of £9,800,000.*"

60. However, some directors of MGRG and Techtronic do not appear to have been given notice of the board meetings of those companies purportedly held on 18 and (in Techtronic's case) 21 December[69]. There is a general rule of law that all the directors of a company must be given notice of a board meeting[70]. Nonetheless, Mr Ames[71] told us that he was not invited to Techtronic board meetings on either 18 or 21 December. He said that, had he been, he would have attended. He also said that he had no involvement in the restructuring or in the decision that Techtronic should charge MGRG interest. He explained that he had at some stage become aware that the members of the Phoenix Consortium "*were planning to have a figure of circa £10 million which had been accrued from interest charges that was to be shared out among the directors of Techtronic*", but that that had been "*later on*".

61. With regard to MGRG, its directors were told that PVH was being established and became aware of the payment of interest. On the other hand, it seems clear that some directors were not given notice of any board meeting which took place on 18 December. Mr Beddow told us that, although he was a "*pretty regular attendee*" at board meetings, he did not recall being present at, and had no direct knowledge of, the MGRG board meeting purportedly

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[69] These were by no means the only occasions on which directors of Group companies were not included in board meetings. We comment further on this in chapter XXII (Aspects of corporate governance).

[70] See, for example, *In re Portuguese Consolidated Copper Mines Limited* (1889) 42 Ch D 160 and *Young v Ladies' Imperial Club* [1920] 2 KB 523.

[71] Mr Ames had probably been a director of Techtronic since soon after it had acquired MGRG and in any event since 26 November 2000; see paragraph 19 above.

held on 18 December and that he had no involvement in discussions as to whether MGRG should pay interest to Techtronic. Mr Bowen also said that, while he generally attended board meetings to which he was invited, he did not remember being present at the 18 December meeting and was not involved with the restructuring. Mr Howe said that "*it was going to be impossible to run a group without some monies flowing up*", but that he did not recall the 18 December meeting. Mr Millett said that he did not recall being present at the 18 December meeting and thought he would have been had he been invited. Mr Oldaker, too, said that he did not remember being present at the 18 December meeting, notwithstanding that he was "*very good*" at attending board meetings. Mr Parkinson stated that he had neither attended nor been invited to the 18 December meeting. Mr Shine told us that that he was not involved in the reorganisation, was not present at, or invited to, the 18 December meeting and did not recall being involved in a discussion as to whether interest should be paid.

62. When we asked Ms Ruston about these meetings, she expressed the view that "*Eversheds were dealing with all the formalities of these board meetings and they are the people to ask about how they convened them*". However, it seems to us that Ms Lewis will have been correct when she told us that it was not Eversheds' job to give directors notice of the meetings. Ms Lewis explained:

> "*If we were dealing with somebody like Jane Ruston on the basis that a board meeting had had to be convened, that would be something that we would leave to them to deal with internally, to convene a board meeting.*"

She pointed out that Eversheds would not normally be in a position themselves to give such notice to directors. She also commented:

> "*I would say that it is pretty self-evident that if you are having a board meeting then you need to give notice to all the directors. Otherwise it is not a board meeting.*"

<u>*The effect of the restructuring*</u>

63. In the upshot:

63.1. while Techtronic did not have to pay interest on sums it was lent by BMW AG, it charged interest on the sums it lent on to MGRG. In this way, Techtronic generated distributable profits, enabling it to pay dividends to PVH, regardless of the fact that MGRG, of which Techtronic was the sole beneficial owner, was making large losses[72];

[72] See chapter XVI (Financial and trading performance of MGRG) for further details.

63.2. the members of the Phoenix Consortium held the only shares in PVH with voting rights and also controlled the company's board. The only other director was Mr Howe[73];

63.3. the "A", "B" and "C" shares, in which employees, dealers and executives were interested, had no voting rights and, moreover, were not intended to benefit from subsequent acquisitions (e.g. of Powertrain[74]); and

63.4. although loan notes may originally have been conceived as a mechanism for benefiting the members of the Phoenix Consortium on an exit (in particular, on the achievement of a sale), the members of the Phoenix Consortium stood to benefit from the loan notes issued by PVH in other circumstances, too. They were to be redeemed by 9 May 2005 (earlier if a company in the Group became insolvent) and bore interest in the meantime[75]. There appears to have been reference at the "*team*" meeting of 6 June 2000 to the loan notes being discharged either "*on exit*" or at a rate of "*£15m p.a.*"[76]. Further, the fact that the loan notes were interest-bearing meant that early redemption could be (and in fact subsequently was[77]) justified as being in PVH's interests (since it would relieve the company of its liability to pay interest).

The Phoenix Consortium's knowledge of and responsibility for the restructuring plans

64. The members of the Phoenix Consortium gave evidence to the following effect in relation to the restructuring:

64.1. Mr Towers said that he "*was hardly at all involved in the debate that resulted in MG Rover Holdings and so on*" and that "*it would be inconceivable ... to have a discussion of that nature* [i.e. about the £75 million of loan notes] *without a very strong interjection ... from any one of us about that level*". He told us that he remembered a conversation with Mr Beale about loan notes in late 2000. "*The fundamental discussion about £75 million was raised by* [Mr Beale]", Mr Towers said. "*He said his view was it was ridiculous, which was everyone's view. It was not considered ridiculous that economic benefits should be taken by the founding directors by that time but £75 million was never a sensible proposition per the four Phoenix consortium members*". "*It is quite intriguing,*" Mr Towers commented, "*to find how actively our advisors were working on our behalf despite the fact that we did not wish them to be that active*";

64.2. Mr Beale told us, "*At one time we told Maghsoud* [Einollahi] *to forget about this loan note idea. At other times we seemed to be going along with it.*" The loan note proposal was, Mr Beale said, "*certainly a topic for ... a lot of conversations and*

73 See paragraphs 24 to 25 above.
74 See paragraphs 45 to 49 above.
75 See paragraph 55.1 above.
76 See paragraph 45 above.
77 See XXI/56.

meetings". The loan note was seen as giving "*a tax-efficient means of taking money from the company within a period of years*". In the end, however, the members of the Phoenix Consortium "*discussed it at some length and felt that the 10 million figure was a figure that we could feel comfortable with*" (although Mr Einollahi, said Mr Beale, was not in favour of coming down to £10 million). Mr Beale said that the establishment of PVH "*fulfilled all the various criteria that we needed to meet, which was the issuing of the shares to the employees, the issuing of shares and loan notes to ourselves, the legal view that it was actually distancing the holding company a little bit from some of the covenants in the BMW loan notes*[78]*, and the sort of management style of Maghsoud* [Einollahi] *that we split our companies into sort of identifiable businesses that could be easily contained and dealt with*";

64.3. Mr Edwards said that he "*left Peter* [Beale] *and Maghsoud* [Einollahi] and *Sue Lewis and lots of other people to deal with it.*" He was "*convinced that Deloittes and Maghsoud* [Einollahi]*, particularly, were the architect of* this [i.e. the establishment of the holding company]". He had no recollection of loan notes to the tune of £75 million being proposed and was "*not really clear*" about how loan notes to the value of £10 million came to be issued: "*Peter* [Beale] *dealt with the whole of that and Deloittes were doing the reconstruction*". Nor did he remember a question arising as to whether MGRG should pay interest to Techtronic; and

64.4. Mr Stephenson thought there had been an "*active debate*" about the £75 million (or, as Mr Stephenson remembered it, £80 million) BMW had subscribed and as to "*how it would be deployed as part of the restructure*". He "*thought the £75 million could be set aside as a provision that could be used both for ourselves or to deal with warranties and indemnities et cetera as we saw fit.*" He accepted that it was "*Entirely possible*" that a £75 million scheme was still alive in September 2000. Ultimately, however, the members of the Phoenix Consortium took the view that "*such a sum was obscene as a sum to* [pay] *the shareholders who did not want such a sum*", and the figure of £10 million arose. It was "*probably not*" his view that £10 million between the four members of the Phoenix Consortium adequately compensated them or reflected the risks they were undertaking.

65. It seems to us that all four members of the Phoenix Consortium must have contemplated the issue of loan notes to the tune of £75 million. Mr Beale and Mr Stephenson did not really suggest otherwise in their evidence to us. In any case:

[78] Mr Beale went on to explain:

> "*I think there was an idea, a sort of vague idea about that we could actually hive out business of MG Rover somehow, and sort of completely sideline the loan notes completely, which was an idea that cropped up several times over the period of years.*"

65.1. as already mentioned[79], we take the view that the possibility of a holding company issuing £75 million of loan notes had been raised, and had been kept open, when the acquisition was being completed;

65.2. the restructuring and, specifically, the £75 million of loan notes, featured in a number of "*team*" meetings[80]. Even if, as some evidence suggests, a person would not necessarily attend the whole of such a meeting, it is implausible to suggest that any member of the Phoenix Consortium would have been absent for all the discussions on such an important, and potentially sensitive, matter;

65.3. the documentary evidence indicates that Mr Beale confirmed to Mr Hume that the members of the Phoenix Consortium wished to proceed with the £75 million scheme[81]. Mr Beale is most unlikely to have given such confirmation without consulting the other members of the Consortium, and perhaps especially Mr Towers, the Consortium's leader;

65.4. Mr Beale was plainly supplied with a discussion document in respect of the scheme prepared by Eversheds[82]. The other members of the Phoenix Consortium are also likely to have had access to such a document;

65.5. on 15 June 2000 Eversheds referred to Mr Towers having raised a concern about obtaining BMW consent[83], which tends to confirm that Mr Towers was aware of what was proposed;

65.6. while Mr Edwards' knowledge and appreciation of what was envisaged may not have been as great as that of other members of the Phoenix Consortium, he is recorded as having taken part in a conference call with Eversheds about the proposed £10 million of loan notes on 21 November 2000; and

65.7. the members of the Phoenix Consortium shared an office at Longbridge, making it the less likely that any one of the four could have been unaware of the proposal.

66. The £75 million figure was evidently reduced to £10 million in about October 2000[84]. It seems likely that one factor at least in the decision was an appreciation that BMW's consent needed to be obtained and a perception that BMW would or might not accede to the higher figure, especially since the decision to limit the loan notes to £10 million appears to have been taken shortly before BMW was told of the intention to issue loan notes.

[79] See III/62.
[80] See paragraphs 43 and 45 above.
[81] See paragraph 45 above.
[82] See paragraph 45 above.
[83] See paragraph 45 above.
[84] See paragraph 48 above.

67. It seems to us that responsibility for the £75 million proposal, as for the restructuring that was ultimately effected, must rest with the members of the Phoenix Consortium rather than with their advisors. In the first place, while advisors may have suggested possibilities, it was for their clients to decide whether to pursue them. Secondly, advisors in fact expressed concerns about the £75 million proposal. Mr Seabrook mentioned in his note of the 30 May "*team*" meeting that he had referred to "*some fairly big political overtones*"; on 2 June Mr Seabrook recorded that Mr Hume was checking that the Phoenix Consortium "*appreciate the potential political repercussions*"; notes Mr Bushill made at the 6 June "*team*" meeting include, "*politically too much?*"; Ms Lewis told us that her recollection was that "*that was a theme throughout, that they needed to reflect on the appropriateness or otherwise of the 75 million*"; and Ms Ruston said that she had understood from Ms Lewis that she (Ms Lewis) had advised against the £75 million figure. In fact, even when the figure had been reduced to £10 million, Ms Lewis advised Mr Beale (in a fax dated 20 October) that he needed "*to be comfortable that this* [was] *something* [he could] *'sell' to BMW and to the world at large when it* [became] *public knowledge*". Thirdly, we do not think that Mr Einollahi was closely involved in the restructuring proposals.

68. We comment further in chapter XXI on the financial rewards which the Phoenix Consortium obtained for themselves.

Project Slag

Background

69. In the summer of 2000, Techtronic, Deloitte (on behalf of Techtronic) and Barclays Bank plc ("Barclays Bank", a company in the Barclays group of companies, "Barclays") sought Inland Revenue pre-approval of a stock lending agreement[85] designed to realise large sums for the Group, as well as for Barclays, from tax losses arising in MGRG. This scheme was codenamed "Project Slag".

70. Project Slag appears to have been instigated by Barclays[86]. A Barclays Capital ("Barclays Capital") presentation document addressed to "*Phoenix*" on the proposed transaction dated May 2000 lists the contacts as Mr Iain Abrahams, managing director, and Mr Steven Poulter, a manager, both within the structured capital markets department.

71. It seems that Project Slag was already under consideration by the time of Techtronic's acquisition of MGRG on 9 May 2000. In a note of a meeting with the Inland Revenue on

[85] As noted in a Deloitte corporate finance paper, "*An SLA* [i.e. stock lending agreement] *is a specialised form of transaction, normally entered into between dealers in securities, whereby securities are 'lent' (effectively ownership is transferred) to another party. The borrower is free to dispose of the securities provided that on the loan repayment date the securities are replaced with securities of the same kind.*"

[86] Mr Einollahi told us that the Deloitte tax team was approached by Barclays in respect of the proposed transaction, which he understood "*was on the basis that it was well known in the market that the* [Group] *had incurred significant tax losses*." Mr Bushill said, "*the tax product had been developed by Barclays Capital, so it was very much their technology … I understood it to be at the time a structure that had been implemented between different banks*."

17 July 2000[87], comments attributed to Mr Einollahi state, "*We were aware of opportunity before completed transaction with BMW. – Discussed with Barclays*" and "*Stock lending proposal put to us by* [Iain] *Abrahams when ME* [i.e. Mr Einollahi] *at Norton Rose*."[88]

<u>*Transaction overview*</u>

72. An overview of the transaction is provided in a Deloitte corporate finance document dated October 2000:

> "*Under the final proposals, Rover Overseas Holdings Ltd* [later renamed MG Rover Overseas Holdings Limited ("MGROH")][89] ... *was to subscribe for £330 million of securities (medium term notes or MTN's*[90]*) using £30 million of its own funds and £300 million loaned from Barclays. After a short period, the MTN's were to be 'lent' to Barclays under a stock lending agreement. Barclays was to deposit £330 million on an interest-free* [basis] *as collateral, which would be used to repay* [MGROH's] *borrowing.*
>
> *At the time, there was a specific provision in the tax legislation (Section 736B TA 1988) which would have generated a tax deduction for Barclays in the period equivalent to the interest income on the MTN's (£400 million). Corresponding taxable income of £400 million would have arisen in* [MGROH] *which could be sheltered by tax losses surrendered by* [MGRG].
>
> *... In the early discussions, PVH was to obtain 66% of the value from the transaction provided the* [Inland Revenue] *gave a favourable ruling in advance*[91]*. Once it became apparent that pre-transaction clearance would not be forthcoming, the revised deal was for the tax benefits to be shared 50:50 (Barclays:PVH) with the payment from Barclays to be contingent on the tax relief claim ultimately being allowed.*"

73. The benefits of the transaction would be £60 million to the Group (calculated as £400 million x 30 per cent x 50 per cent) and £42 million to Barclays (being its £60 million share less tax at 30 per cent)[92].

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[87] As to which, see paragraph 75 below.

[88] The second comment is likely to be a reference to a meeting that took place at Norton Rose's offices prior to the acquisition of MGRG by Techtronic. Undated manuscript notes on Norton Rose headed paper that appear to have been taken by Mr Einollahi are filed with other corporate finance documents dating from the time of the sale of MGRG and include Mr Abrahams' contact details.

[89] As noted in VIII/17.6, Rover Overseas Holdings Limited was a wholly-owned subsidiary of MGRG in 2000 and was renamed MGROH on 23 May 2001.

[90] A medium term note, or "MTN", is a debt note that is typically paid back in five to ten years, although the term may span between one and 50 years.

[91] As to which, see paragraph 74 below.

[92] The transaction as initially envisaged proposed that Barclays would transfer profits of £600 million to the Group and that the benefits would be split 66:34 in favour of the Group, which would have resulted in a benefit of £118.8 million to the Group and £42.8 million to Barclays (£61.2 million before tax).

Discussions with the Inland Revenue

74. It was intended that formal pre-clearance for the transaction would be sought from the Inland Revenue[93]. On 29 June 2000 Mr David Cruickshank, a partner at Deloitte and head of the tax division at that time, wrote to Mr Dave Hartnett, director general of the Inland Revenue, attaching a second letter setting out the details of the proposed transaction. Both of the letters stated that the proposal "*is considered a key element of the funding package currently being put together for Rover.*" The second letter also stated that the proposal would provide "*positive cashflow in the critical turnaround period*" and that the cash flow generated by the transaction "*would significantly improve the likelihood of additional funding being obtained.*" [94]

75. Two meetings to discuss the transaction were subsequently held on 17 and 26 July attended by, among others, Mr Towers and Mr Beale, Mr Einollahi and other representatives of Deloitte and Mr Hartnett. Comments attributed to Mr Towers in a note of the 17 July meeting reflected the sentiments expressed in Mr Cruickshank's letter in respect of the importance of the funding to the Group, including that a "*Substantial gap needs to be bridged to secure future of Rover*", that the arrangement was "*an essential part of funding*" without which the picture was "*not good*", that the proposal "*Opens doors for other financing options to Rover*" and that "*The business would benefit from losses over time in a normal economic cycle, Rover does not have this time.*"[95] In addition, Mr Towers is recorded as having said, "*Barclays would commit to never doing this again*" and "*We are asking you not to challenge, and then you can change the law.*" However, the Inland Revenue was unwilling to provide the clearance required for the transaction in its proposed form.

76. Nevertheless, the decision was taken to proceed with the transaction and a suite of agreements was signed on 29 September 2000 on behalf of Barclays Bank and MGROH. On the same day, Mr Einollahi sent a congratulatory email within Deloitte as follows:

> "*You will be pleased to learn that we have now completed the tax transaction for our Birmingham Office's major client.*

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[93] A letter from Deloitte to the Inland Revenue dated 29 June 2000 noted that both Barclays and Techtronic had informed Deloitte that they would not wish to proceed with the transaction without confirmation from the Inland Revenue of the tax implications of the proposal.

[94] In representations to us, Deloitte noted that:

> "*... the factual information in the letters regarding the background to the transaction and the importance of the funding to the group originated from discussions with the* [Phoenix Consortium] *during and after the original acquisition ... the statements in the letter regarding these matters were confirmed by the* [Phoenix Consortium] *(and, most likely,* [Mr] *Towers) prior to the sending of the letter*."

[95] In evidence to us, Mr Towers said:

> "*I think it was appropriate to represent to the Revenue that we here had a scheme that could significantly impact the time that we had to move the company into a long-term position ... I was positioning the Revenue that here was a tax-neutral scheme ... I mean, I was sort of resting upon the expertise of Deloitte and the bank* [i.e. Barclays] *in terms of the actual mechanics of it, but my overall understanding was that it was actually Revenue-neutral but it could be really quite a major benefit in terms of the cash resource for the company.*
> *My objective was to represent very powerfully to the Revenue that, since it was no skin off their nose, would they really want to deprive the company* [i.e. MGRG] *of this opportunity to have an extended period of sorting itself out for the long term*?"

> *Our total fees which remain conditional and therefore cannot be regarded as value may be in the region of £10 million ...* [96]
>
> *Please remember there are still 60 days in which this can go horribly wrong.*"

The final sentence of this email was prescient.

Failure of the transaction

77. In the meantime, the Group's discussions appear to have prompted the Inland Revenue to check whether similar arrangements were being effected elsewhere, and it had emerged that there were a number of schemes similar to Project Slag in the market place. An Inland Revenue press release entitled "*Stock lending: action to prevent avoidance*" was issued on 2 October 2000 and stated:

> "*... the Paymaster General ... today announced that the Government intends to introduce legislation on stock lending in the 2001 Finance Bill to put beyond doubt that tax avoidance schemes which seek to exploit the existing rules cannot succeed. The new provisions will take effect from today.*
>
> *The legislation will block attempted abuse of the very specialised rules that apply when stock lending arrangements do not require the borrower to pay to the lender amounts representing any interest or dividends arising on the borrowed stock*[97]*. It will not affect arrangements that provide for representative payments to be made.*"

The Project Slag transaction had to be terminated immediately following the announcement. A Deloitte corporate finance paper noted that, despite "*subsequent representations*", the anti-avoidance provisions were enacted in the 2001 Finance Act.

78. In 2002 and 2003, however, the Group entered into other schemes, again proposed by Barclays, to exploit tax losses. These schemes are discussed in chapter XI (Aircraft).

The completion accounts dispute

SPA provisions

79. As mentioned in chapter III (The sale of Rover), the SPA contained provisions under which completion accounts ("the Completion Accounts") were to be prepared and for BMW (UK)

[96] In addition to fees paid to Deloitte by the Group, Barclays was to pay Deloitte £1.75 million for arranging the transaction, though this was conditional upon the execution of the documents relating to the stock lending arrangements and payable in full on the date of the second interest payment on the bond.

[97] This clearly precluded the proposed Project Slag transaction: a draft Deloitte corporate finance paper dated 25 September 2000 noted that "*The unusual feature of this* [stock lending agreement] *is that Barclays will not be required to make any payments to* [MGROH] *in respect of the interest received on the MTNs.*"

to pay the difference to MGRG[98] if those accounts showed MGRG's net assets to amount to less than £740 million.

80. The Completion Accounts were to comprise a consolidated balance sheet of the business of MGRG at 30 April 2000, but excluding:

    80.1. the net assets of, and MGRG's investment in, BMW Parts Limited[99];

    80.2. amounts in respect of dealer properties[100];

    80.3. the £75 million which BMW had agreed to pay in substitution for warranties[101]; and

    80.4. pensions prepayments and liabilities.

81. The following adjustments were to be made to the net assets derived in the Completion Accounts:

    81.1. removal of cash, bank and other deposits and bank and other financial liabilities, other than funding for cars in the "Own Use Vehicle" ("OUV") and "Lease Plan" funding schemes[102];

    81.2. elimination of all balances in respect of amounts due to or from companies in the BMW group; and

    81.3. deduction of £2 million for each business day (or part thereof) in the period from 1 May 2000 to the date of completion.

82. Specific policies for the preparation of the Completion Accounts included not being allowed to include any provisions as a result of the announcement of the deal and the reversal of all fixed asset impairment provisions. These clearly prevented the Completion Accounts from representing a true and fair view.

Draft Completion Accounts

83. Draft Completion Accounts were delivered to Techtronic on 28 June 2000, showing net assets of £818.2 million. These were increased by £46.1 million to £864.3 million on

98 Subject to a maximum aggregate liability cap of £500 million.
99 As to which, see III/57 and 89 and chapter XIII (Xpart).
100 As to which, see III/88.12 and chapter IX (Property and share transfers).
101 As to which, see III/58 to 62.
102 As to which, see chapter X (Project Lisa).

25 July. A comparison of the draft Completion Accounts to a balance sheet prepared as at 31 March, apparently by KPMG (on behalf of BMW)[103], is as follows:

Balance sheet category	31 March 2000 balance sheet	30 April 2000 Draft Completion Accounts pre final adjustments	30 April 2000 Draft Completion Accounts post final adjustments
	£ million	**£ million**	**£ million**
Fixed assets	357.9	353.9	362.0
Stocks	526.3	461.9	463.9
External debtors	644.8	550.0	550.0
Provisions	-	(45.7)	(45.7)
External creditors	(632.9)	(501.9) (i)	(465.9) (i)
	896.1	**818.2**	**864.3**

(i) Includes deduction of £2 million for each business day in the period from 1 May 2000 to completion, i.e. £12 million.

84. Therefore, as far as BMW was concerned, the requirement under the terms of the SPA to provide Techtronic with a company with net assets of at least £740 million was satisfied.

Objections

85. On 26 July 2000, Techtronic provided to BMW (UK) a list of 112 objections, the acceptance of which would have resulted in the following Completion Accounts:

Balance sheet category	Draft Completion Accounts post final adjustments[104]	Total objections	Buyer's Completion Accounts
	£ million	**£ million**	**£ million**
Fixed assets	362.0	(77.2)	284.8
Stocks	463.9	(53.7)	410.2
Debtors	550.0	(68.1)	481.9
Provisions	(45.7)	(494.4)	(540.1)
Creditors	(465.9)	(248.8)	(714.7)
	864.3	**(942.2)**	**(77.9)**

[103] Supposedly on the same apportionment as the Completion Accounts.
[104] See table at paragraph 83 above.

86. On 6 December 2000, in conjunction with an offer to purchase Powertrain for £40 million which MGRG had made on 8 November 2000, Mr Millett wrote on behalf of "*MG Rover*" to BMW AG with a "*Without Prejudice*" offer for settlement of the Completion Accounts dispute without the need to appoint an expert, as follows:

86.1. a cash payment to MGRG of £190 million (to be reduced appropriately if MGRG were subsequently to purchase any other business from BMW AG);

86.2. BMW to take on responsibility for gains/losses on forward exchange contracts taken out in MGRG's name to purchase Euros in 2001 and 2002;

86.3. BMW to give MGRG indemnities against potential tax liabilities in respect of the German and French NSCs[105];

86.4. BMW to resolve with Ford/Land Rover to take responsibility for certain liabilities assigned to MGRG under the hive-down process; and

86.5. BMW to provide financial assistance to MGRG in Germany to dispose of returned BMW employee lease cars.

87. Mr Nigel Macdonald of Ernst & Young LLP ("Ernst & Young") was subsequently appointed as an expert to determine the disputed matters. Following discussions and meetings between the parties, there was acceptance of certain objections by BMW, and withdrawal of certain objections by Techtronic. The "*agreed*" Completion Accounts as at 26 February 2001 were as follows:

Balance sheet category	**"Agreed" Completion Accounts**	**Objections remaining to be determined by expert**	**Completion Accounts if remaining objections accepted**
	£ million	**£ million**	**£ million**
Fixed assets	351.6	(61.7)	289.9
Stocks	460.9	(44.8)	416.1
Debtors	545.1	(47.8)	497.3
Provisions	(45.7)	(324.6)	(370.3)
Creditors	(477.4)	(165.3)	(642.7)
	834.5	**(644.2)**	**190.3**

[105] I.e. MG Rover Deutschland GmbH and MG Rover France SA.

<u>*Letter of intent*</u>

88. On 9 February 2001, a letter of intent ("LOI") was signed between BMW AG, BMW (UK) and Techtronic. This recorded that the parties were interested in settling their dispute "*on the basis of a cash payment and the transfer of the entire issued share capital of Powertrain (following the hive-out of the R65 gearbox business) by way of a share purchase agreement*"; Techtronic was stated to have "*no interest to acquire Powertrain's R65 gearbox business at Cofton Hackett*". The LOI proceeded to provide for a cash payment of £60 million by BMW (UK) to MGRG on implementation of a settlement agreement and for BMW (UK) to pay £5 million as additional consideration for MGRG agreeing to surrender the maximum amount of trading losses capable of being surrendered in respect of the period from 1 January to 9 May 2000. This payment was to be in addition to ongoing discussions under which BMW (UK) was potentially to pay a final instalment of around £36.2 million for the surrender of tax losses.

89. The LOI further provided for the sale to MGRG of the entire issued share capital of Powertrain for a nominal sum once the R65 gearbox business had been hived out.

<u>*Settlement and acquisition of Powertrain*</u>

90. The expert determination process was suspended on 18 May 2001, and a settlement agreement was concluded, dated 1 June. The parties agreed to compromise their dispute on the terms set out in the settlement agreement, which essentially allowed for MGRG to issue and BMW (UK) to subscribe for one ordinary share in MGRG for the sum of £65 million, and for BMW (UK) to sell that for the sum of £1 to Techtronic. In addition, BMW (UK) was to have entered into an agreement to sell Powertrain[106] to Techtronic for £20.

91. As a result of the sale of Land Rover to Ford, the transfer of Powertrain, which produced engines for Land Rover as well as MGRG, to Techtronic required the consent of Ford. Ford's consent was given on the basis that BMW AG and Techtronic each paid money (£25 million in BMW's case and £14.1 million in Techtronic's) into an "*escrow*" account to be held on trust to fund costs and liabilities associated with the production of engines for Land Rover vehicles. Insofar as the funds contributed by Techtronic proved not to be required for that purpose, Techtronic was to be entitled to them.

92. Further, Studley Castle was transferred to Studley Castle Limited, a subsidiary of PVH, at a price of £2.8 million.

93. The expert determination process was formally terminated on 4 June 2001.

[106] Powertrain's R65 gearbox business had, however, been transferred to Midland Gears Limited ("Midland Gears"), which was owned by BMW, pursuant to a hive-out agreement dated 27 April 2001.

94. A note to PVH's 2001 financial statements states that 100 per cent of the issued share capital of Powertrain was acquired on 1 May 2001 for a consideration of £85,806,000, with no goodwill arising as a result of the acquisition. However, the same note attributes a figure of £109 million to "*Settlement of dispute arising from acquisition of MG Rover Group Limited on 9 May 2000*" and to "*Fair value of assets received on the Powertrain Limited acquisition*". The difference between the fair value of the Powertrain assets and the "*consideration*" of £85.8 million of £23.2 million is described as "*negative cash consideration*".

<u>*Use of BMW's £25 million contribution to the escrow account*</u>

95. On 1 June 2001 Mr Bushill made a note of discussions which had taken place on the previous day. The note included the following:

> "*… **Possibility of passing the £25m to the individuals***
>
> *We proposed ensuring that BMW made a payment to the D shareholders which offered the prospect of a capital receipt subject to taper relief.*
>
> *Sue Lewis of Eversheds was concerned with the Company Law aspects of this proposal. A suggestion was made that the £25m could be made in lieu of a bonus payment. We advised that this would be taxable under Sched E.*
>
> *In the end, Peter Beale/Nick* [Stephenson] *took a commercial decision that they would not pursue this any further …*"

96. The discussions which Mr Bushill was documenting arose out of BMW's agreement to pay £25 million into an "*escrow*" account[107]. During 31 May 2001, it was suggested that this payment should accrue to the benefit of the members of the Phoenix Consortium. Mr Bushill told us that he had a general recollection that the proposal that the £25 million could at some stage be paid to the members of the Phoenix Consortium directly had arisen during a general discussion late at night dealing with technical issues of transaction structuring. Ms Ruston similarly remembered that the point had been raised "*very late on 31st May, like 10.00 or 11 o'clock at night*", in circumstances where the hope was to complete on 1 June.

97. As Mr Bushill's note indicates, Ms Lewis expressed concerns about the proposal. In evidence to us, Ms Lewis said, "*I just remember thinking that it was somewhere that they should not go, really*". Ms Ruston told us:

> "*Sue* [Lewis] *quite rightly raised the issue about the directors' duties and whether this was appropriate in the circumstances. So she took advice from a colleague back in her Birmingham office as to the appropriateness of this payment. From my recollection the advice was that it would be appropriate provided it was a genuine*

[107] As to which, see paragraph 91 above.

> *arm's length commercial arrangement and a payment in return for an agreed bonus or an agreed remuneration.*
>
> *So, Sue and I then went to see Peter Beale and Nick Stephenson and provided them with … Sue's advice as to the propriety of this arrangement and to try and understand really what the consideration was that had been given for the £25 million …*
>
> *Peter said, 'Thank you for your advice, we will consider it.' … My understanding is that he considered it with Maghsoud* [Einollahi]*, he also discussed it with his fellow directors and ultimately we were advised that they didn't want to proceed with the arrangement.*
>
> … [Mr Beale] *certainly told me he had discussed it with his other directors and he told me that John Edwards had not been happy with the proposal.*"

98. Mr Beale, too, remembered Ms Lewis expressing concerns about the proposal that the Phoenix Consortium should benefit from BMW's contribution to the escrow account, but did not think that her concerns had been determinative in the decision not to pursue the proposal. He thought that he and Mr Stephenson had taken the decision because they regarded Powertrain as "*an absolutely critical, critical deal to conclude*" and they were "*aware that if this £25 million went back to the company, we would have the ability to pay ourselves … bonuses and rewards in the future, that somehow such a direct relationship would compensate for having given up this personal benefit*".

99. As mentioned in chapter VII (Project Platinum)[108], later in the year Ms Lewis was "*roundly ticked off*" by Mr Beale. Ms Lewis explained to us that "*as part of this conversation, Peter* [Beale] *… did actually say to me that had it not been for - had it not been for probably me, actually, rather than Eversheds in general, that the 75 million might have happened, and possibly also the 25 million …*" (referring to the proposal that the Phoenix Consortium should benefit from BMW's £25 million contribution to the escrow account). When we asked Mr Beale about this, he said:

> "*Certainly over this £25 million, I may have referred to that as being an example of … something which … I got a terribly different view from her than I did from Maghsoud* [Einollahi] *and may have speculated as to whether it was necessarily the best and clear-cut advice we could have got, but I think our commercial considerations overrode that anyway.*"

100. We were given conflicting evidence as to how far Mr Einollahi had devised or endorsed the idea that the members of the Phoenix Consortium should benefit from the £25 million. It was Ms Ruston's recollection that it was Mr Einollahi who had raised it with herself and Ms Lewis, and Mr Beale said that Mr Einollahi had felt that it was appropriate that a

[108] See VII/103.

significant sum of money should come to the Phoenix Consortium. In contrast, Mr Einollahi told us that, "*At no stage during the negotiation of the transaction was* [he] *aware of any proposal to pay the additional £25 million from BMW to the* [Phoenix Consortium] *personally, whether at the time of the transaction itself or upon the release of these monies from escrow*". The issue appears to us, however, to be of little significance. Whatever an advisor might suggest, it was the responsibility of the members of the Phoenix Consortium themselves to decide how much money they should extract for themselves from the Group.

101. In the event, as explained in chapter XXI (Financial rewards)[109], substantial payments made to and for the benefit of the members of the Phoenix Consortium in 2003 were in large part funded from dividends from Techtronic which were themselves financed for the most part from money released from the escrow account.

[109] See XXI/61 to 67.

CHAPTER VI

DEVELOPMENT AGREEMENT WITH ST. MODWEN

The Development Agreement[1]

1. St. Modwen Properties plc ("SMP") is a property company specialising in town centre regeneration, partnering industry in its restructuring, brownfield land renewal and heritage restoration. It has been listed on the Stock Exchange since 1986, but in 2000 it was a smaller company than it is now, operating from a head office based in the West Midlands.

2. In 2000 and 2001 the executive directors of SMP were Sir Stanley Clarke, who was the chairman, Mr Anthony Glossop, who was the deputy chairman and chief executive, Mr Richard Froggatt, who was land acquisitions director, and Mr Bill Oliver, who was the finance director[2]; Mr Oliver told us that in practice Mr Glossop "*was basically running the company*". It was SMP's practice to hold weekly meetings of the executive directors (or at any rate the executive directors other than Sir Stanley) on Monday mornings.

3. Even before the sale to Techtronic had been completed, SMP was alive to the development opportunities which the sale of MGRG might present. On 22 March 2000 Mr Glossop wrote to Alchemy "*to introduce St. Modwen as a potential partner to help you to generate value out of the Longbridge site*". Minutes of a board meeting of SMP on 14 April record that the "*pursuit of development opportunities arising as a consequence of the Longbridge closure was discussed,*" and the possibility of a joint venture between Land Securities plc ("Land Securities")[3] and SMP was suggested.

4. By early May 2000 Mr Parker[4] was in touch with SMP. Quite how this came about is not clear. Mr Froggatt's recollection is that he was first introduced to Mr Towers; he (Mr Froggatt) told us that Mr Tim Webb, a partner in Eversheds, had supplied him with Mr Towers' mobile telephone number and that he and Mr Towers had then had a long conversation on a Friday morning during which Mr Towers had referred him to Mr Parker as the person dealing with property matters. In contrast, Mr Towers said that he did not remember the conversation with Mr Froggatt of which Mr Froggatt spoke. Mr Towers' recollection was that Mr Parker had introduced him to "*one of Richard Froggatt's people*" and that he (Mr Towers) had "*subsequently met Richard Froggatt and the St Modwen board at one of their board meetings*". Reference to Mr Webb, however, caused Mr Towers a "*certain memory uncertainty*". Mr Parker's evidence was that he had contacted Sir Stanley after being told by Mr Towers that he (Mr Towers) had received a call from St Modwen.

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1 See chapter IX (Property and share transfers) for further information on the land at Longbridge.

2 Mr Glossop has since become SMP's chairman (in April 2004) and Mr Oliver its chief executive (again in April 2004). Sir Stanley died in September 2004. Mr Froggatt left SMP in 2006 to become managing director of London and Wharfedale. Tim Haywood has been SMP's finance director since 2003.

3 Land Securities, now called Land Securities Group plc, describes itself on its website as the UK's largest quoted property company providing commercial accommodation and property services to a wide range of occupiers.

4 As explained at III/63 and V/16 and 26 to 39, Mr Parker was a director of Techtronic from 8 May 2000 until 26 October 2000.

5. However contact between the two was first established, Mr Froggatt had dealings with Mr Parker in relation to the Longbridge site until October 2000, when Mr Parker ceased to be a director of Techtronic. On 15 May 2000 Mr Froggatt reported to SMP's board that he "*was still pursuing the Longbridge opportunity via Eversheds, and was in discussion with Brian Parker who is to become Deputy Chairman of Rover*". At about the same time Eversheds sent Mr Parker at Mr Towers' request a summary of the property provisions of the SPA and a detailed plan of the Longbridge site. Mr Seabrook's note of a "*team*" meeting[5] on 30 May records that Mr Parker was "*dealing with sorting out the Longbridge site*". On 12 June Mr Froggatt told the SMP board that "*a number of further meetings had been held with Brian Parker and Land Securities regarding property opportunities at Longbridge*". Minutes of a Techtronic board meeting on 11 August state that Mr Parker "*outlined various prospects for sale & leaseback of land*". Mr Towers said that he had encountered Mr Parker when he (Mr Parker) had been "*taking St Modwen people round and giving them a clear appraisal of the site*". All told, Mr Froggatt had upwards of a dozen meetings with Mr Parker[6], as well as telephone conversations, between May and October of 2000. Discussions, which also involved Land Securities, centred around SMP and Land Securities purchasing land and leasing back those parts needed for car production. At one stage, Mr Parker hosted a visit to Longbridge by Mr Roland Nevitt of Land Securities as well as Mr Froggatt. On another occasion, Mr Ian Henderson, the chief executive of Land Securities, met Mr Towers at Longbridge without Mr Parker being present.

6. In evidence to us, Mr Froggatt said that he "*was never sure what he* [Mr Parker] *was doing in there*". He went on to explain, however, that he was told by Mr Towers that Mr Parker was "*the property man*". He (Mr Froggatt) also spoke of Mr Parker, who seemed to him to be a director of the top company but not of MGRG, "*telling* [him, Mr Froggatt] *that his role was to find the right outfit*" (with the result that Mr Froggatt "*was spending more of* [his] *time doing the St Modwen sale rather than anything else*"). Mr Glossop told us, "*we knew that Brian Parker was the Phoenix front man for that transaction for that early period*"; he also said that the impression Mr Froggatt had given was that Mr Towers had "*passed* [Mr Froggatt] *to Brian Parker to deal with, and Brian Parker was portraying himself as being, 'I'm the man who you deal with'*". Mr Oliver explained that Mr Parker "*was obviously handling a property transaction which* [MG Rover] *wanted to achieve*" and that while "*presumably it would be the entire Phoenix consortium that would decide in the end ... Parker seemed to be fronting it*". In evidence to Mr Randall QC and Mr Ashworth QC[7], Mr Oliver said that, as far as he was concerned, Mr Parker "*was the gentleman representing MG Rover or the landowner, whoever it ends up being, who was negotiating the property transaction*".

7. Mr Towers told us that the "*fact of the matter is that Brian* [Parker] *did introduce the MG Rover possibilities to St Modwen*". He said that Mr Parker "*was quite quick to see the opportunities possible* [at Longbridge] *and got* [St. Modwen] *involved*". He also said:

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5 With regard to "team" meetings, see V/14.

6 Mr Froggatt's diary entries indicate that he met Mr Parker on at least 19 May, 8 June, 22 June, 2 July, 10 July, 12 July, 17 July, 8 August, 15 August, 22 August, 31 August, 3 October and 24 October 2000.

7 Mr Randall QC and Mr Ashworth QC were instructed in 2008 pursuant to a resolution of a committee of SMP's board to report on matters relating to the payment to Landcrest Developments. This is referred to below.

> "*... it is ... my clear recollection that Brian* [Parker] *was the one who was instrumental in bringing the two businesses together right from the outset.*"

8. As has already been explained[8], Mr Parker's involvement with the Group came to an end on 26 October 2000. Entries in Mr Froggatt's diary suggest that he was in contact with Mr Parker after this in December 2000 and January 2001. However, Mr Froggatt thought that these contacts related to other projects in which Mr Parker was seeking (in the end unsuccessfully) to interest SMP.

9. On 14 March 2001 Mr Froggatt sent Mr Towers an email setting out, on a subject to contract basis, a proposal for the sale and leaseback of land at Longbridge. The suggestion was that the property would be acquired for £42.5 million (or £51 million if land occupied by Powertrain were included). Within a short period, however, that particular proposal had been abandoned for, it seems, two reasons: first, Land Securities decided against involvement; secondly, Mr Froggatt understood that MGRG no longer considered that it could proceed on the basis of a sale and leaseback arrangement because the land in question was by now thought to be surplus to requirements. However, at a meeting on 21 March attended by, at least, Mr Froggatt and Mr Howe, there was discussion as to the possibility of MGRG entering into a development agreement under which land that was surplus to requirements could be disposed. Following this meeting, Mr Froggatt sent Mr Howe a letter dated 26 March in which he explained that he had "*re-worked the proposal to provide for a development partnership on the land identified as being surplus to operational requirements*". By 5 April Mr Froggatt was envisaging that an agreement could be finalised the next day.

10. In the event, an agreement was not concluded until 9 July 2001. On that date, MGRG entered into a written agreement with St. Modwen Developments Limited ("SMD", a wholly owned subsidiary of SMP) and SMP (as guarantor) for the development of parts of the Longbridge site. The agreement ("the Development Agreement") included the following provisions:

    10.1. SMD was to develop a plan, and obtain planning permission, for the comprehensive redevelopment of the relevant land. It was then either to develop the land itself in phases or to sell in advance of development;

    10.2. as and when SMD required land, it was to be entitled to serve a "*Draw Down Notice*", following which MGRG would be required to transfer the land comprised in the notice at the "*Land Price*". The "*Land Price*" was defined to mean £275,000 per acre less 115 per cent of the "*Estate Costs*" attributable to that phase of the development, subject to a minimum of £200,000 per acre;

    10.3. MGRG also stood to receive "*Overage*". This was to be calculated by deducting from the proceeds of a phase 115 per cent of the aggregate of the "*Estate Costs*" and "*Development Phase Costs*" attributable to that phase and the "*Land Price*" for the

[8] See V/26 to 39.

relevant land. The resulting amount was to be shared between MGRG and SMD in the ratio 3:1;

10.4. the expression "*Estate Costs*" referred to:

> "*... the aggregate of all costs fees and expenses reasonably and properly expended or incurred by* [SMD] *(whether before or after the date of this Agreement) in relation to the provision and preparation of the Site in readiness for Development and any other matter or obligation arising from this Agreement ...*"

"*Estate Costs*" included "*all sums payable to any building contractor or sub-contractor and to architects, surveyors, engineers, quantity surveyors or others engaged in connection with the Development or any part of it*", together with a 3 per cent project management fee on those sums[9]. SMD was required to obtain MGRG's permission to incur most types of costs, the main exceptions being VAT, finance cost, water rates and tenant costs;

10.5. SMD was to cause full accounts to be kept of, among other things, the "*Estate Costs*", with MGRG and its advisors being permitted access to all relevant records; and

10.6. "*works of construction*" were to be competitively tendered, and MGRG was to be consulted as to which contractors should be invited to tender and which tenders accepted.

11. Following the conclusion of the Development Agreement, a joint design team was established for the project. This team (which included representatives of both MG Rover and St. Modwen) first met on 9 August 2001. The minutes of the meeting show that it was then envisaged that the transaction should be the subject of an announcement on 17 or 20 August. In the event, a press release about the Development Agreement was issued by SMP on 22 August. On the previous Friday, Mr Howe had told the MGRG board that the "*announcement of the property development transaction that the Company had completed with St Modwen would be made on the following Monday*" and that a "*limited and low key press release was planned*".

12. Entries in Mr Froggatt's diary suggest that he met Mr Parker on 21 August 2001. When it was put to him that such a meeting must have been to discuss the question of a fee, Mr Froggatt said that he could not think of another reason.

[9] The project management fee was to be payable if SMD chose to carry out project management functions itself. If it instead chose to appoint a project manager, the "Estate Costs" were to include that project manager's fees.

<u>The payment to Landcrest Developments</u>

13. Landcrest Developments is a company owned by Mr Parker and Ms Angela Parker[10].

14. On 20 September 2001 Mr Froggatt wrote to "*Mr B Parker Landcrest Developments Limited*" in the following terms:

> "*<u>Land at Longbridge</u>*
>
> *With apologies for the delay, I confirm our agreement to pay an introductory commission for your part in bringing together St Modwen and MG Rover.*
>
> *The agreed fee is £100,000, half to be paid immediately and the balance 12 months from the date of this letter, and is conditional upon signing the attached Confidentiality Agreement.*
>
> *I also confirm that you will be given the opportunity to tender for groundworks and demolition as and when we implement such work. The tendering and placing of all contracts will be handled by our Construction Director, Steve Burke who is based here in Birmingham.*
>
> *If you would let me have one of the signed Confidentiality Agreements together with your invoice for the initial payment I will immediately authorise it for payment.*"

15. While we have not seen a signed version of the confidentiality agreement, we have been provided with a draft confidentiality agreement between SMP, Landcrest Developments and Mr Parker which computer records show to have been "*modified*" on 20 September 2001. This recited that Landcrest Developments and Mr Parker had "*effected an introduction between SMP and MG Rover which has led to the formation of* [a] *development partnership*". Ms Susan Johnson-Brett, who drafted the confidentiality agreement as SMP's assistant company secretary, told Mr Randall QC and Mr Ashworth QC that the recital would "*most likely*" have been based on information from Mr Froggatt.

16. Landcrest Developments raised an invoice to SMP dated 20 September 2001 for £50,000 plus VAT in respect of "*Introduction fee as agreed with Mr Froggatt for MG Rover 50%*". The invoice is stamped as having been received by St. Modwen on Monday 24 September. On the same date, the invoice was approved by Mr Froggatt and authorised for payment by Mr Glossop.

17. Landcrest Developments raised an invoice for the balance of the £100,000 in September 2002. This invoice was stated to be in respect of "*Introduction fee as agreed with R Froggatt for MG Rover As per agreement dated 20/9/2001 to be paid 20/9/2002*". The

[10] Mr Parker holds 99 per cent of the shares in Landcrest Developments and Ms Parker 1 per cent.

invoice was dated 18 September, and it was approved by Mr Froggatt, and authorised for payment by Mr Oliver, on that same day.

18. The £100,000 which SMP paid to Landcrest Developments was referred to in materials which were provided to representatives of MGRG. On 19 September 2001 Mr Tim Hurdiss, who was then working for SMP as a senior development surveyor, sent Mr Graham Jones, MGRG's general manager, manufacturing engineering, an email in which he noted that the "*main change*" in an attached fee budget was the "*£50k payment to Landcrest (Brian Parker)*". The fee budget itself included "*Landcrest Developments Introduction 50K (£50K in future)*"[11]. The payment to Landcrest Developments was also alluded to in slides used for a meeting of the "*executive steering group*" for the project on 18 February 2002: a slide listing costs included "*St Modwen Costs*" of £80,000 in respect of December 2001 and a footnote explained "*An additional £50,000 is required to be paid in the future*". Similarly, slides headed "*MG Rover-St Modwen Industrial Partnership – March '02 Status*" referred to "*St Modwen Costs*" of £50,000 and noted that "*An additional £50,000 is required to be paid in the future*". Mr Jones may possibly have been provided with other documentation referring to the sums paid to Landcrest Developments, as well.

19. On 7 April 2003 SMD and SMP entered into a further development agreement in similar terms, but with Advantage West Midlands ("AWM") rather than MGRG. This agreement contemplated that the Group would transfer the land which was the subject of the Development Agreement to AWM[12]. In the event, the bulk of the land was bought by AWM, and the balance was acquired by a subsidiary of SMP (together with other parts of the Longbridge site)[13].

20. By invoices dated 24 October 2003 and 30 January 2004, SMD invoiced AWM for such proportion of "*Estate Costs*" to date, including the £100,000 (plus VAT) which had been paid to Landcrest Developments and a 3 per cent project management fee, as corresponded to the extent of the Development Agreement land that AWM had acquired. AWM settled the invoices on 19 December 2003 and 2 April 2004. Mr Tim Haywood, who succeeded Mr Oliver as SMP's finance director, explained that, when AWM became involved, it was asked to reimburse St. Modwen for costs incurred to date.

21. On 23 June 2005 the secretary to the inquiry wrote to SMP asking for details of its involvement with the Group and of documents received or generated in relation to such involvement. Mr Haywood replied on behalf of SMP on 7 July. His letter included the following:

> "*In September 2001 we agreed to pay an introductory commission to Brian Parker of £100,000 for his part in bringing together St. Modwen and MG Rover which was paid to Land Crest Developments Limited ...*"

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[11] The fee budget also included items in respect of "Planning Consultant", "Planning Application", "Architects", "Engineers" and "Solicitors (Title)".
[12] As in fact happened - see chapter IX (Property and share transfers).
[13] See IX/28.

Mr Haywood told Mr Randall QC and Mr Ashworth QC that he had circulated this letter in draft to Mr Glossop and Mr Froggatt and that the former had made a number of amendments.

Explanations of the payment to Landcrest Developments

22. We were given conflicting accounts of how the payment to Landcrest Developments came to be made.

Mr Parker's evidence

23. Mr Parker told us:

> "*What happened was the – I think he was the land acquisitions director said ... they were going to pay me a fee. And there was £100,000, I recollect, mentioned, and ... they were talking about a top-up dependent on planning, and it was then that I said I really did not want to be involved with anything other and above an introduction and it was for them to sort out with whoever the parties were.*"

He said that he would have presumed (though he could not "*honestly remember*") that this discussion would have been between May and October of 2000 (from which point he had had no contact whatsoever with the Group) and that he did not think he had told the Techtronic board about the arrangement (though he could not be "*truthfully honest*" about that). He said that it was "*nothing to do with MG Rover*", it was "*between* [himself] *and St Modwen*". The £100,000 that Landcrest Developments received was an "*introductory fee*".

St. Modwen evidence

24. Mr Froggatt[14] referred in his evidence to us to a "*meeting with John Towers ... when John said he owed Brian Parker an introductory commission*". Mr Froggatt said that the meeting had taken place between the date that the Development Agreement was concluded (9 July 2001) and 20 September 2001 (i.e. almost a year after Mr Parker left the Techtronic board). He explained:

> "*There was a meeting ... where John Towers mentioned to me that Brian* [Parker] *had been acting as a consultant on the property side, and he should be paid a fee, and I remember saying: yes, you are right. And John said something like – at least it gives the sort of spirit of the conversation – I was thinking about 25 or 50,000. I said: he is not going to be happy with that, that is a major deal, and you would expect to pay more than that to an agent. John also said that: it would help me if, whilst he is our consultant, you would pay his fee. And I said: I am not just paying*

[14] As explained in footnote 2, Mr Froggatt left SMP in 2006.

> *his fee but if it can be included as a development cost in the agreement then I would agree to it.*"

Mr Froggatt expanded by saying:

> "*... I seem to recall the conversation that Brian is looking for 200,000 or something, I honestly cannot remember the detail, and John was thinking 25,000 or something. I said: no, that is not sort of the market, that is not where it would be.*"

Mr Froggatt said that he was "*almost certain that* [Mr Towers] *is the one who ... went away to discuss it with Brian Parker*". Mr Froggatt said that, since the Development Agreement entitled it to recover 115 per cent of "*Estate Costs*", St. Modwen would make a profit on the payment to Landcrest Developments, which is "*why*", said Mr Froggatt, "*I was not going to make a mountain out of it with John Towers*". He said that the arrangement would have been mentioned at one of SMP's weekly executive meetings.

25. Mr Froggatt told us that there could have been conversations between himself and Mr Parker. He said that he suspected, though he could not remember, that Mr Parker had raised the question of tendering for groundworks and demolition before the conversation with Mr Towers. He said that he thought that Mr Parker "*may well have said something like, 'I am in for a commission', or something like that, 'and I would like the opportunity of tendering'*". He thought it "*logical*" and "*quite likely*" that this would have been in 2000, before Mr Parker's involvement with MG Rover came to an end.

26. Mr Glossop's evidence to us is essentially encapsulated in the following passage:

> "*... somewhere between 9th July* [2001 and 20 September 2001 at] *one of the Monday morning meetings, Richard* [Froggatt] *said something along the lines of, 'problem over Brian Parker, or payment to Brian Parker. John Towers wants us to settle a payment to Brian, he doesn't want to make it'. The impression that Richard gave us was that this was an embarrassment over internal politics ... And I think we asked the very simple question, can you dodge it? To which he said: 'Well, I don't want to, because, with the start of the new relationship, there's a lot more to go for than what we've got at the moment. We need MG Rover to feel comfortable with us, so I'd like to support it, if we can.' Second question: 'How much is it?' And he said that Brian Parker was wanting £200,000, which either I or Stan – probably I, actually, said was quite ridiculous ... so he was sent away ... with the brief that whatever he agreed had to be agreed with John Towers, and it also had to be acknowledged as a development cost, I think it's actually called an estate cost under the agreement, so that in the end, providing the scheme was profitable, that cost would actually have fallen back through the mechanism of the agreement on to MG Rover, because we saw ourselves as actually picking up an MG Rover's cost ... He came back either to a Monday morning meeting or to one of my reviews or possibly just coming into my office, it could have been any of the three and said, 'Job done, it's not £200,000, it's £100k, and I've managed to get £50,000 deferred. However, Brian Parker is not very happy so he's asked to be put on a tender list for*

> *demolition', and I said, 'That's okay it doesn't cost us or MG Rover anything just to put him on the tender list so I'll go with that.' He also said 'John Towers is happy, and they've agreed that it can be considered development cost'. So on that basis, Richard was authorised to agree it, which he did ...*"

27. In his evidence to us, Mr Oliver explained that he had not been involved in any negotiations about the Longbridge land, but that he had become aware of the payment to Landcrest Developments. His recollection was that he was "*a signatory on the first invoice, approving it for payment,*" and that he had learned of the payment "*very close to the time it was paid*". He explained:

> "*It would have been Richard* [Froggatt] *who would have said – Richard and/or Anthony* [Glossop] *would have said, 'We are making a payment to Parker.' My recollection is exactly that he was saying we are paying this on behalf of MG Rover or Phoenix, whichever, but it would have been very much just that was it, and Anthony knew all about it ...*
>
> *The way it was explained was that it was a cost that we are being asked to pay, and that it would be recovered as a development cost.*"

Mr Oliver had no recollection of the payment being spoken of at a Monday morning meeting, of a £200,000 figure or of the payment being negotiated down.

28. Mr Oliver gave similar evidence to Mr Randall QC and Mr Ashworth QC. Whereas, however, Landcrest Developments' invoice for the first instalment was not available when we interviewed Mr Oliver, it had been found by the time Mr Oliver was interviewed by Mr Randall and Mr Ashworth. Having seen that invoice, Mr Oliver realised that, contrary to his earlier recollection, he had not signed it. He said:

> "*The only other thing I could have signed was the cheque. It's likely that I would sign the cheque but it would be likely I would have signed the invoice as well because these would come along with a cheque attached for payment then, and you'd normally sign the invoice and sign the cheque. It is possible that this came in with the invoice signed and I signed the cheque. That's the only thing I can think of, off the top of my head, to reconcile the fact that I believe I saw this first invoice.*"

29. When giving evidence to Mr Randall QC and Mr Ashworth QC, Mr Froggatt elaborated on the evidence he had given to us. In the course of his evidence to Mr Randall and Mr Ashworth:

    29.1. Mr Froggatt portrayed Mr Parker as being of little importance within the Group. He said that he "*never perceived* [Mr Parker] *in any way in an executive role and ... never perceived him ... being in any way in an influential or decision-making role*" and "*didn't believe he was advising them*". Further, he "*never had any commercial discussions with Brian Parker*". His discussions with Mr Parker were "*PR based*",

feeding the message that "*If there is something to be done at some point, we are well placed to carry that out*". He did not understand Mr Parker to be "*part of Techtronic, MG Rover any of those companies*";

29.2. Mr Froggatt suggested that Mr Towers had favoured secrecy. He said that during the conversation in which he had raised the question of a payment being made to Mr Parker, Mr Towers had "*clearly wanted to keep the lid on Brian Parker*". In response, Mr Froggatt had suggested a confidentiality agreement and deferring part of the payment (though Mr Froggatt subsequently said that it might have been Mr Towers who had suggested the confidentiality agreement);

29.3. Mr Froggatt said that he might have spoken to Mr Towers in 2000 about a possible payment to Mr Parker. He said:

> "*... I have a general recollection or thought that at some point in late 00 – and I am desperately sorry to be so vague – Parker may have called and said, 'I will be needing to look to St Modwen for my fee.'*[15]
>
> *It's something that's in the back of my mind, and again I believe that I rang John Towers and said, 'Brian wants us to pay his fees; is that right?' or whatever. He said, 'Yes.'*"

He added, however, that he had "*no stronger a recollection of a call from Parker than I do ... of a call to Towers*";

29.4. Mr Froggatt referred to a conversation with Ms Ruston. He said:

> "*I also remembered part of a conversation with Jane Ruston, which I can't date specifically, but the conversation was about development costs and what it included, and the conversation was something like 'and including Brian Parker's fees?', and she said, 'Oh, yes, and Brian Parker's fees', with a bit of a shake of the head*"; and

29.5. Mr Froggatt said that he could "*remember the conversation with Anthony* [Glossop] *about the business of tender list, because clearly* [he] *would have reported that to him*". He made no reference to speaking to Mr Glossop about a £200,000 figure, to being asked to negotiate that down or to doing so; he commented, "*There is a disconnect somewhere, I accept that*".

[15] At another point in his evidence to Mr Randall QC and Mr Ashworth QC, Mr Froggatt said that he "*had in* [his] *mind that there was a request from Parker in late – at some point in the second half of 2000 for a fee*".

MG Rover evidence

30. Mr Towers told us that Mr Froggatt had telephoned him and said something like, "*I have had Parker on the phone*[16] *taking a position that frankly I agree with, which is that he introduced you to us, and … I feel I am under an obligation to pay him an introduction fee*". Mr Towers said that he was "*massively disinterested in it, frankly*". According to Mr Towers, Mr Froggatt "*honestly felt that St Modwen owed Brian Parker an introductory fee on the basis of a very normal process of working within their industry*" and he himself "*did not have a view*". Mr Towers said that he:

> "*… basically said to Richard* [Froggatt] *there wasn't an MG Rover position on it. We had finished with Brian. His relationship with Brian was up to him.*"

Mr Towers said that he had to "*assume that the conversation with Richard* [Froggatt] *was just before he sent* [the 20 September 2001] *letter*" (which, however, he had not seen at the time).

31. When we told him of Mr Froggatt's evidence:

31.1. Mr Towers said that he was "*quite clear*" that the payment to Landcrest Developments was not his idea, reiterating that he was "*totally disinterested in the matter*";

31.2. Mr Towers referred to the lack of any documentary evidence. "*There is,*" he said, "*certainly nothing wrong in, you know, passing over a note of a so-called conversation*";

31.3. Mr Towers suggested that, had Mr Froggatt's account been correct, he (Mr Froggatt) would have "*at least alluded to some sort of conversation with MG Rover on the matter*" in the 20 September 2001 letter to Mr Parker;

31.4. Mr Towers pointed out that the 20 September 2001 letter had not even been copied to him; and

31.5. Mr Towers commented:

> "*There is no way I am going to agree to pay Parker another £100,000 out of our funds and then on top of that pay another £15,000 for St Modwen profit.*"

32. Mr Edwards gave us evidence which was consistent with Mr Towers'. He referred to Mr Towers:

[16] In later evidence, Mr Towers told us that Mr Froggatt had said that Mr Parker had "*contacted*" him; he did not know, he explained, whether Mr Parker had telephoned Mr Froggatt or met him.

> "*... coming in to the office one morning and saying that he had received a call*[,] *I think it was from Richard Froggatt, it was certainly somebody from St Modwen's, to the effect that they were minded to pay an introductory commission to Brian Parker and did we have any objections. And he just said I could not see that there were grounds for us to object to that, it was a matter for them, and that was as much as we understood.*"

Mr Edwards said that, as far as he was aware at the time, there were no financial implications for PVH or MGRG.

33. Ms Ruston also remembered hearing of a payment being made by St. Modwen. She said that she remembered Mr Towers mentioning the payment at a time when she and Mr Howe were in Mr Howe's office[17]. She thought that this would have been "*shortly after Richard Froggatt had agreed heads of terms with Kevin Howe*". She could not remember any more detail.

34. Mr Jones' evidence to us suggested that he probably would not have queried the £100,000 paid to Landcrest Developments. He said that his "*skill base was not really in this particular realm, architects, planning consultants, et cetera*" and that he could "*only assume that* [the agent fee] *was something that was previously agreed upon*". He explained:

> "*... the way it was put to me was that it was a partnership, that it was a shared incentive in terms of the output and that we should work on that basis. So we shouldn't be defensive about protecting land or whatever, we should be working towards the same end, and it certainly wasn't our intention to double up resources to sort of oversee what St Modwen were doing, and similarly they ... weren't overseeing particularly what we were doing. Because for the same reasons I was saying, I do not have expertise in geo-environmental, similarly St Modwen Properties, for all the things they can do, they weren't best placed to understand some of the manufacturing equipment that we would have to lift and shift around the site, so it was kind of focusing on our own areas of expertise within that partnership framework.*"

With regard, in particular, to the fee budget attached to the email to him of 19 September 2001[18], Mr Jones said:

> "*I didn't question the planning consultant costs, I didn't question the architect's costs and I guess in the same way, I didn't question the Landcrest Development introduction as it's referred to in that particular schedule.*"

[17] When giving evidence to us, Mr Howe did not himself remember knowing of the St. Modwen payment. Mr Beale, Mr Millett and Mr Stephenson also had no recollection of the payment.
[18] See paragraph 18 above.

Conclusions

35. It is improper for an agent to ask for, agree to accept, or in fact receive a payment from a third party with whom his principal is dealing without the principal's informed consent[19]. It is also, in general terms[20], improper for a third party to offer, agree to give or in fact make such a payment.[21] As Mr Justice Millett explained in *Logicrose Ltd v Southend United Football Club Ltd*[22]:

> "*A principal is entitled to the disinterested advice of his agent free from the potentially corrupting influence of an interest of his own. Any such private interest, whether actual or contemplated, which is not known and consented to by his principal, disqualifies him ...*"

36. During 2000 Mr Parker was an agent of the Group, as a director of Techtronic[23] and because he was dealing with property matters for the Group[24]. Moreover, SMP was aware of Mr Parker's role: it understood Mr Parker to be "*handling a property transaction which* [MG Rover] *wanted to achieve*" (to quote from Mr Oliver)[25]. Nonetheless, SMP made, and Mr Parker (via Landcrest Developments) accepted, the payment of an "*introductory*

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[19] See e.g. *Imageview Management Ltd v Jack* [2009] EWCA Civ 63. "*Informed consent*" has been said to involve "*full knowledge of all the material circumstances and of the nature and the extent of* [the agent's] *interest*" (see *Hurstanger Ltd v Wilson* [2007] 1 WLR 2351).

[20] The third party's legal liability may depend on whether he actually knew that, or was wilfully blind as to the question whether, the agent had concealed the payment from his principal (see *Logicrose Ltd v Southend United Football Club Ltd* [1988] 1 WLR 1256 and *Ross River Ltd v Cambridge City Football Club Ltd* [2008] 1 All ER 1004), but it appears that "*where one party to a transaction takes ... 'the hazardous course' of making a payment for the personal benefit of the other's agent, and does not disclose it to the principal, he cannot afterwards defend the transaction by claiming that he believed the agent to be an honest man who would disclose it himself*" (see the Logicrose case).

[21] See e.g. Hurstanger Ltd v Wilson, where Tuckey LJ said:

> "*An agent who receives commission without the informed consent of his principal will be in breach of fiduciary duty. A third party paying commission knowing of the agency will be an accessory to such a breach.*"

The "*payment or receipt of a secret commission is considered to be a form of bribe*" (per Tuckey LJ in the Hurstanger case); as was explained in Industries & General Mortgage Co Ltd v Lewis [1949] 2 All ER 573:

> "*For the purposes of the civil law a bribe means the payment of a secret commission, which only means (i) that the person making the payment makes it to the agent of the other person with whom he is dealing; (ii) that he makes it to that person knowing that that person is acting as the agent of the other person with whom he is dealing; and (iii) that he fails to disclose to the other person with whom he is dealing that he has made that payment to the person whom he knows to be the other person's agent.*"

If a payment is made "*corruptly*", it can potentially occasion criminal as well as civil liability: see the Prevention of Corruption Act 1906.

As, however, Hurstanger illustrates, there can be cases where "*there has been sufficient disclosure to negate secrecy, but nevertheless the principal's informed consent has not been obtained*". In such a situation, the remedies available to the principal may be more limited than would be the case had the commission been kept secret (see Hurstanger).

[22] [1988] 1 WLR 1256

[23] See III/63.

[24] See paragraphs 4 to 7 above and paragraph 37.7 below.

[25] See paragraphs 4 to 7 above and paragraph 37.7 below. We agree with the following observation by Mr Randall QC and Mr Ashworth QC:

> "*It was clearly understood by the relevant SMP personnel that while Mr. Parker was on the scene he was, in some manner, representing the interests of the Rover side of the deal. Therefore, whether he owed his duties as a director of Techtronic or as an agent of 'Rover' in the broader sense, they would still have been such that he could not properly have agreed to accept or have accepted monies from SMP while acting in that capacity (without his principal's informed consent).*"

commission" when SMP concluded a contract with the Group (for Mr Parker's "*part in bringing together St Modwen and MG Rover*")[26].

37. The thrust of Mr Froggatt's evidence is to the effect that the Group (through Mr Towers) not merely knew of SMP's payments, but asked that they be made on its behalf. Were that right, the payments would be unobjectionable. However, we have not been persuaded by Mr Froggatt's account. More specifically, we do not consider that SMP paid the £100,000 to Landcrest Developments at Mr Towers' request or that Mr Towers agreed that the payment should be treated as part of the "*Estate Costs*". Our reasons include these:

37.1. we found Mr Towers convincing when he said that there was "*no way* [he was] *going to agree to pay Parker another £100,000 out of* [MGRG's] *funds and then on top of that pay another £15,000 for St Modwen profit*". Mr Parker having already been paid £50,000 to secure his departure[27] in addition to previous remuneration as a director of Techtronic[28], we cannot see why Mr Towers should have wished him to receive an additional £100,000 at MGRG's expense;

37.2. nor can we see why Mr Towers, even supposing that he had intended Mr Parker to receive an additional £100,000 at MGRG's expense, should have asked St. Modwen to make the payment. In September 2001, MGRG was relatively cash rich and would have had no difficulty in funding the £100,000 payment[29]. It was suggested to us that Mr Towers might have wished to keep the payment secret, but Mr Edwards and Ms Ruston, at least, were told that Mr Parker was being paid. Mr Towers would not, therefore, appear to have been concerned to hide the fact that Mr Parker was being paid;

37.3. it is telling[30] that no contemporaneous document refers to Mr Towers (or the Group generally) asking St. Modwen to pay the £100,000 on MGRG's behalf. Had Mr Froggatt agreed to make the payment at Mr Towers' request and on the footing that it would be comprised within "*Estate Costs*", it would surely have been no more than prudent to confirm the arrangement with Mr Towers in writing. That, however, was not done. Nor did Mr Froggatt even send Mr Towers a copy of his 20 September 2001 letter to Mr Parker or refer in that letter to the fact that the money was to be paid on MGRG's behalf. Instead, Mr Froggatt simply confirmed "*our*" (meaning, seemingly, St. Modwen's) agreement to pay an introductory commission;

37.4. the likelihood is that the question of paying a commission first arose between May and October of 2000, when Mr Parker was still involved with the Group, but (a) there was no reference to the possibility of Mr Parker receiving any commission during his

[26] See paragraph 14 above.
[27] See V/34 to 37.
[28] See V/23.
[29] The minutes of an MGRG board meeting on 18 August 2001 show that "*the cash position at the end of period 7 was £275m.*"
[30] Even allowing for the fact that, as Mr Oliver told us, Mr Froggatt is "*not a detail person*".

(quite lengthy) tape-recorded conversation with Mr Towers on 26 October 2000[31], which tends to suggest that Mr Towers was not yet aware of the proposal and, hence, that Mr Froggatt could not have become involved with discussions about commission at Mr Towers' request, and (b) Mr Froggatt's evidence to us was essentially to the effect that Mr Towers had raised the question of SMP paying Mr Parker between July and September of 2001[32];

37.5. in some other respects, Mr Froggatt's account is difficult to reconcile with those of both Mr Parker and Mr Glossop, as well as with Mr Towers' evidence. Mr Froggatt maintained that the £100,000 was paid at Mr Towers' behest. However, Mr Parker told us that it was "*nothing to do with MG Rover*" and "*the only way that I think John Towers could have known is if the people at St Modwen had told John Towers*". Mr Glossop spoke of Mr Froggatt being told that a proposed £200,000 payment was "*quite ridiculous*" and of that figure being negotiated down, whereas Mr Froggatt made no reference to telling Mr Glossop of a £200,000 figure or to negotiating that down; to the contrary, Mr Froggatt said that he had told Mr Towers that the sums the latter had in mind were too small;

37.6. we find the elaborations on Mr Froggatt's evidence mentioned in paragraph 29 above unpersuasive. It is noteworthy that there had been no previous reference to a conversation with Mr Towers in 2000 about a possible payment to Mr Parker or to Mr Froggatt speaking to Ms Ruston about Mr Parker's fees. It is, moreover, implausible that all Mr Froggatt's meetings and telephone conversations with Mr Parker between May and October 2000 were "*PR based*";

37.7. it was suggested to us that Mr Parker had not in fact introduced St. Modwen and MG Rover to each other and that St. Modwen would therefore have had no reason to pay an introduction fee. However, Mr Parker does in fact appear to have been seen as having brought the parties together: for example, Mr Froggatt's 20 September 2001 letter referred to an introductory commission being paid "*for your part in bringing together St Modwen and MG Rover*", and the draft confidentiality agreement, which was probably based on information from Mr Froggatt, spoke of Landcrest Developments and Mr Parker having "*effected an introduction*" which had led to the Development Agreement. Moreover, it seems to us that, despite Mr Froggatt's portrayal of Mr Parker as of little importance within the Group in his evidence to Mr Randall QC and Mr Ashworth QC, Mr Parker was seen by Mr Froggatt in 2000 as someone who could influence the Group's choice of the "*outfit*" with which to

[31] See V/34.

[32] Mr Froggatt told us:

> "*... up until the point that I had a meeting with John Towers I understood that Brian* [Parker] *was being paid by MG Rover. So it was only when John Towers said to me that: it would help enormously if you could deal with the fee. And my pragmatic response was: yes, but it has got to be a development cost.*"

Mr Froggatt referred to this conversation having taken place between the conclusion of the Development Agreement (on 9 July 2001) and 20 September 2001 (when he wrote to Mr Parker about the commission). Further, since the possibility of a development agreement did not emerge until March 2001 (see paragraph 9 above), it is hard to see how Mr Froggatt could have been concerned in 2000 that any commission should be treated as a "development cost".

enter into a transaction relating to Longbridge: Mr Froggatt himself spoke of Mr Parker representing himself as responsible for finding the "*right outfit*" and of Mr Froggatt therefore trying to sell St. Modwen to Mr Parker[33]. Further, were it the case that Mr Parker had not been considered to have been instrumental in bringing St. Modwen and MG Rover together, that would have borne on the likelihood of MG Rover thinking an introductory commission appropriate as well as on the likelihood of St. Modwen doing so;

37.8. it was suggested to us that Mr Parker's use of "*for MG Rover*" in the Landcrest Developments invoices reflected his understanding that the fee was being paid *on behalf of* MG Rover. However, Mr Parker himself told us that the payment was "*nothing to do with MG Rover*" and "*between* [himself] *and St. Modwen*". In any case, as a matter of language the invoices' use of "*MG Rover*" are consistent with Mr Parker intending to refer to the MG Rover transaction rather than signifying *on behalf of* MG Rover;

37.9. while Mr Oliver (whose integrity and truthfulness we do not question) thought that Mr Froggatt had said that the £100,000 was being paid on behalf of MG Rover, he may be misremembering (after all, he proved to be mistaken in his recollection that he had signed Landcrest Developments' first invoice) or may have been given incorrect information;

37.10. it was suggested to us that it was significant that the £100,000 was referred to in materials provided to representatives of MGRG and that Mr Jones did not challenge the payment. However, the payment to Landcrest Developments was not on any view a secret: on Mr Towers' version of events, as on Mr Froggatt's, Mr Towers was aware that Landcrest Developments was being paid. Further, it seems to us that no significance can be attached to Mr Jones' failure to challenge the item; it was apparent from his evidence to us that he did not understand it to be part of his role to challenge such entries; and

37.11. it was suggested to us that the fact that Mr Glossop and Mr Froggatt had allowed SMP's letter of 7 July 2005[34] to refer to the £100,000 confirmed that they saw nothing amiss in that respect. It seems to us, however, that no inference can be drawn. After all, on any view Mr Towers knew that a payment was going to be made for the benefit of Mr Parker and the £100,000 featured in documents which had been provided to MG Rover.

38. Further, while SMP did not pay any commission until September 2001, the likelihood is that it was agreed between May and October of 2000 that it would do so. If we are right in thinking that Mr Towers did not ask SMP to make any payment, common sense suggests that it would not have done so unless the subject had been broached between Mr Parker and Mr Froggatt at a time when the former was still involved with the Group and its property

[33] See paragraph 6 above.
[34] See paragraph 21 above.

affairs (i.e. by 26 October 2000). Moreover, Mr Parker told us that he would have presumed that it had been between May and October 2000 that Mr Froggatt had said that SMP would pay him a fee[35]. For his part, Mr Froggatt accepted that it was "*logical*" and "*quite likely*" that Mr Parker had raised the question of a commission before his involvement with the Group had come to an end[36], elsewhere saying that he "*had in* [his] *mind*" that Mr Parker had requested a fee "*at some point in the second half of 2000*".

39. It is right to reiterate that Mr Towers knew that there was a prospect of SMP paying a commission before it in fact did so. The payments made to Landcrest Developments were not, therefore, kept secret. However, we do not think that either Mr Towers or anyone else in the Group was informed of any proposed commission in 2000, when, as it seems to us, Mr Froggatt will have agreed to pay a commission (probably at Mr Parker's instigation). Further, while Mr Towers was told in the summer of 2001 that SMP was intending to pay commission, he was not informed that the question of paying a commission had arisen in the previous year, that is, crucially, before Mr Parker left the Group.

40. We should also reiterate that we do not question Mr Oliver's integrity or that he gave his evidence to the best of his recollection. We have found it much more difficult to arrive at conclusions in relation to Mr Glossop. However, Mr Glossop's evidence differs in important respects from Mr Froggatt's account as well as Mr Towers', and also from our own view as to what in fact took place. Mr Glossop's version of events involves Mr Froggatt reporting on two separate occasions on two separate conversations with Mr Towers: according to Mr Glossop, Mr Froggatt said at "*one of the Monday morning meetings*" that Mr Towers wanted St. Modwen "*to settle a payment to Brian* [Parker]" and that Mr Parker "*was wanting 200,000*", Mr Froggatt was "*sent away*" with a brief, and Mr Froggatt returned to report on, among other things, a further conversation with Mr Towers. However, as noted in paragraph 29.5 above, Mr Froggatt himself made no reference to speaking to Mr Glossop about a £200,000 figure, to being asked to negotiate that down or to doing so. Likewise, as mentioned in paragraph 27 above, Mr Oliver, who would attend the Monday morning meetings, had no recollection of the payment being spoken of at such a meeting, of a £200,000 figure or of that being negotiated down. Further, we do not believe that the conversations between Mr Froggatt and Mr Towers that Mr Glossop says Mr Froggatt told him of in fact took place. Our impression, moreover, is that Mr Froggatt would have been unlikely to offer or agree to pay a commission without the express or implied concurrence of Mr Glossop, who "*was basically running the company*". With some hesitation, therefore, we have concluded that Mr Glossop endorsed Mr Froggatt's actions.

41. Finally, having regard to the matters mentioned above, we consider that Mr Parker asked for, agreed to accept and in fact received (through Landcrest Developments) a commission from SMP in breach of his fiduciary duties as a director/agent. We note that although we warned Mr Parker that we were provisionally minded to conclude that he had, through Landcrest Developments, "*received a bribe in breach of fiduciary duty*", he did not dispute the suggestion or, indeed, make any substantive response.

[35] See paragraph 23 above.
[36] See paragraph 25 above.

CHAPTER VII

PROJECT PLATINUM

1. This chapter is concerned with a transaction by which a company owned by the Phoenix Partnership (comprising the four members of the Phoenix Consortium and Mr Howe) and HBOS plc ("HBOS") came to acquire most of BMW's Rover loan book (i.e. amounts due under finance contracts). The members of the Phoenix Partnership have all derived substantial financial benefits from the acquisition[1].

Basic facts

Financial arrangements between MGRG and Rover Financial Services (GB) Limited

2. When BMW (UK) sold MGRG to Techtronic, a company called Rover Financial Services (GB) Limited ("RFS"), a subsidiary of BMW (UK)[2], was the exclusive provider of vehicle finance for new and used vehicles to customers of the Rover and Land Rover dealership network. RFS's assets therefore predominantly comprised books of debt, or portfolios, in respect of financed Rover and Land Rover vehicles and its contract with Rover to provide such services.

3. RFS started writing business in May 1998[3] and offered a range of finance products to customers acquiring Rover and Land Rover vehicles. Among the products were "*personal contract plan*" (or "PCP") arrangements. A PCP contract was a species of hire purchase under which, in effect, the customer would be guaranteed that the vehicle in question would be worth a specified minimum sum (a "*Guaranteed Minimum Future Value*", or "GMFV") at the expiry of the contract[4]. GMFVs could be a valuable marketing tool, but they exposed those offering them to the risk that the value of the cars when the contracts came to an end (their "*residual values*") would be less than the GMFVs.

4. MGRG agreed to indemnify RFS against any losses it incurred as a result of offering GMFVs on certain contracts. In particular, on 1 May 1998, MGRG and RFS entered into an agreement in the following terms:

> "*It has been agreed by the parties that RFS will offer Guaranteed Minimum Future Values … on the following plans:*
>
> - *Rover Select*
> - *MG Lifestyles*
> - *Mini Expressions*

[1] See paragraphs 217 to 226 below.
[2] See II/2 for a structure chart.
[3] Prior to this, vehicle finance was provided to Rover customers through a joint venture between MGRG and Lombard which traded as Rover Finance.
[4] Under a type of PCP offered by RFS called "*Rover Select*", for instance, a customer could return the relevant car at the end of the agreement without further liability and could also potentially, if the particular contract so provided, be entitled to be paid a "*Guaranteed Equity*".

- *Land Rover Freedom*
- *ECOPS/EUCP*[5]

These will be offered on the basis that RG [Rover Group[6]] *guarantee to make good any shortfall/loss RFS suffer in relation to vehicles returned by the customer at the end of the agreement …*

In the event that a vehicle is returned under the terms of the customer's agreement the following process will be adopted:

1. *If applicable, RFS will pay the customer any 'Guaranteed Equity' that is detailed on the agreement. This payment will be made within 90 days of the vehicle being returned at the end of the agreement.*

2. *The vehicle will be collected from the Dealer by RFS, or its agent, and disposed of at auction. The choice of auction will be at the sole discretion of RFS.*

3. *Upon disposal of the vehicle, RFS will invoice RG for the difference between the sales price of the vehicle after administrative costs and the 'GMFV' specified in the original customer agreement.*

4. *RFS will advise RG monthly of cars bought back under the scheme.*

5. *In the event that RG want to hold the vehicle back from auction, as is currently the case with Land Rover products, the vehicle will be passed to RG who will simultaneously pay RFS the full GMFV as defined by the customer's agreement with RFS. The vehicle will remain the property of RFS until cleared funds have been received by RFS.*"

"*Rover Select*", "*MG Lifestyles*", "*Mini Expressions*" and "*Land Rover Freedom*" were all types of PCP products offered by RFS to retail customers. ECOPS/EUCP were employee car schemes (as were "*MVO*" (Management Vehicle Ownership) and "*ACOP*" (Associate Car Ownership Plan) schemes).

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5 EUCP and ECOPS were Rover employee car schemes.
6 I.e. MGRG.

Implications of the sale of MGRG by BMW

5. MGRG's sale on 9 May 2000 did not relieve it of its liabilities in respect of GMFVs. As before, MGRG was liable to compensate RFS (which continued to be a BMW company) where certain vehicles failed to sell for their GMFVs[7]. The SPA, however, provided for an adjustment to the Completion Accounts to take account of MGRG's obligations in this respect[8]. It stated as follows:

> "*There shall be a provision in the Completion Accounts to reflect the residual value guarantee risk on cars subject to Personal Contract Plan ('PCP') schemes, for example Rover Select or similar arrangements with a similar buyback commitment. This provision shall be set at an amount of £20 million.*"

6. While MGRG had agreed to indemnify RFS against many of the residual value risks to which it was exposed, RFS had no such indemnity in respect of certain such risks. Some new car and the majority of used car residual values were the responsibility of RFS alone (the residual values of used cars sold to employees were the responsibility of MGRG).

7. In the period immediately before the sale of MGRG, exceptionally large numbers of vehicles were sold on PCP contracts incorporating GMFVs. Mr Ames explained as follows:

> "*... there were a number of cars that were sold in what I would only describe as a fire sale, where I think we sold something like six months' worth of cars in a month. Wonderful for the dealers, everyone thought it was fantastic. It was all funded on a PCP type programme ...*"

The "*fire sale*" led to some 9,000 Rover vehicles being sold on PCP contracts starting in April/May 2000[9] (compared with a norm of between 200 to 1,000 per month). This could be expected to produce a corresponding "*spike*" in PCP contracts expiring in April/May 2002 (two year PCP contracts) and April/May 2003 (three year PCP contracts). There was a danger that, as these contracts came to an end, unusually large numbers of second hand

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[7] Mr Guy Pigounakis (UK commercial director in the sales and marketing division of MGRG) explained the position as follows in a communication circulated to dealers in August 2001:

> "*You may be unaware that MG Rover are still heavily connected with Select vehicles financed by Rover Financial Services over the last three years. Rover Select, Mini Expressions and MG Lifestyles were all PCP products introduced to the market with the full support of the then Rover Group. As such the GMFV's associated with these products for original new car sales and original new and used employee sales, continue to be guaranteed by MG Rover. We (MG Rover) are therefore accountable to Rover Financial Services (BMWFS) for the shortfall in resale value of these vehicles at auction compared with their GMFV, compensated by any excess mileage and damage chargeable to the customer.*"

[8] Alchemy had also identified the liabilities in respect of vehicles not achieving their GMFVs as an issue during its negotiations to acquire MGRG, as to which see III/16 and 17.

[9] Following the acquisition of MGRG there was a dispute between BMW and MGRG as to whether MGRG would be responsible for any residual value losses suffered on these 'fire sale' vehicles. Mr Griffiths explained in his interview, "*I think what was clarified in the end ... was (1) that BMW was responsible for the residual values in the fire sale; but (2) that had been taken account in the ... purchase and sale of the Rover car group and that 20 million had been passed across already.*" Mr Griffiths' understanding will have been derived from the provision in the SPA quoted in paragraph 5 above.

vehicles could be released into the market, thereby reducing the residual values of second hand Rovers (with the consequence that MGRG's exposure in respect of GMFVs could be increased) and eventually also impairing the sales prices of new Rover cars.

8. The SPA provided for BMW[10] to continue to provide finance to Rover dealers for a time after the sale, but only to allow a reasonable opportunity for alternative sources of funding to be found. By 28 February 2001, RFS was no longer entering into Rover financing agreements. Finance was instead provided by First National Bank plc ("First National"), a company ultimately owned by Abbey National plc ("Abbey").

<u>*BMW's decision to dispose of RFS and the early stages of the auction process*</u>

9. By January 2001, BMW had decided that it wished to dispose of both the Rover and Land Rover loan books. Minutes of a BMW meeting held on 22 January note that PRIMUS Automotive Financial Services ("Primus") had been told that the Land Rover portfolio was for sale and that First National had been informed that the Rover portfolio was available. On 26 January Mr Ian Whyte, employed by BMW Leasing (GB) Limited[11] as a "*Risk Controller*", wrote to Mr Edwards (as "*Deputy Chairman MG Rover Group Limited*") enclosing information about the Rover portfolio and asking for "*a firm indication of your interest and your thoughts as to pricing as soon as possible*".

10. BMW called the project to dispose of the Rover and Land Rover loan books "Project Globe". The overall scheme encompassed "Project Gold" (which related to the sale of the Land Rover loan portfolio) and "Project Platinum" (which was concerned with the Rover portfolio). The team leading Project Globe on behalf of BMW was made up of the following people: Mr Bob Griffiths, the chief executive officer of the BMW Financial Services group (including BMW Financial Services (GB) Limited ("BMW FS") and RFS)[12]; Mr Frank Munk, the chief financial officer[13] of the BMW Financial Services group[14]; and Mr Whyte, referred to above. The BMW team had legal support from Norton Rose and corporate finance advice from KPMG.

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[10] RFS was the only BMW company that provided dealer and customer finance.

[11] BMW Leasing (GB) Limited was a subsidiary of BMW Financial Services (GB) Limited, in turn a subsidiary of BMW (UK) – see II/2.

[12] Mr Griffiths was employed as the chief executive officer of the BMW Financial Services group of companies in 2001. His specific employer was BMW Leasing (GB) Limited. Mr Griffiths resigned as a director of BMW (UK) and BMW FS on 31 December 2001, following the disposal of the Land Rover and Rover loan books.

[13] Mr Munk was employed as the chief financial officer of the BMW Financial Services group of companies in 2001. His specific employer was BMW AG, but he was seconded to BMW Leasing (GB) Limited.

[14] Mr Munk became a director of BMW FS and RFS on 7 June 2000.

11. KPMG prepared an information pack for distribution to those interested in acquiring the Rover loan book. This stated that, as at 28 February 2001[15], the portfolio comprised some 83,639 vehicles with a gross receivable value[16] of £585.5 million. The portfolio could be analysed as follows:

Type of finance	**Gross receivables**	**Units**
	£ million	
Hire purchase, lease purchase and personal loan	235.4	47,405
PCP	330.3	34,714
Leasing book (mainly contract hire)[17]	19.8	1,520
Total Rover retail book	**585.5**	**83,639**

Potential bidders were told:

> "*For the purpose of your indicative offer you should assume that commercial arrangements will be in place whereby residual value losses arising on cars subject to PCP contracts will be mitigated.*"

12. Numerous financial institutions were approached by either BMW or KPMG on its behalf[18]. A number of these entered into confidentiality agreements, but only two submitted indicative offers. Capital Bank plc ("Capital Bank") (then a subsidiary of Bank of Scotland ("BoS")) put forward an indicative bid of 85.64 per cent of gross receivables while GE Capital Bank Limited ("GE Capital") suggested a figure of 84 per cent of gross receivables. Each bid assumed that, as was envisaged in the information memorandum, residual value risks would be covered by guarantees. Further, Mr Paul Brice[19] of KPMG noted at a Project Globe steering committee meeting on 26 April 2001:

> "*… at this stage bidders are probably expecting these arrangements are BMW rather than third party agreements. Purchaser appetite and perception of value may alter once purchasers have a full understanding.*"

[15] The portfolio was decreasing with time.
[16] Receivables are defined as "*all receipts, rents, periodical payments and other payments receivable by* [BMW FS] *under the terms of the Contracts as at* [30 September 2001] *(whether or not such amounts are then due and payable)*" in the agreement for the sale and purchase of part of the business and related assets of RFS entered into between RFS and BMW FS on 8 November 2001.
[17] It was noted that the leasing book gross receivables included £9.9 million in respect of residual values on contract hire vehicles.
[18] Associate Capital Corporation, Nikko Principal Investments Japan Limited, HFC Bank Plc, Halifax Group plc, Capital Bank, First National, GE Capital, Primus, Nationwide Building Society, and Alliance & Leicester plc.
[19] Mr Brice was the engagement partner.

Mr Brice evidently had in mind the fact that a bidder would not consider a guarantee from MGRG to be equivalent to one from BMW[20]. However, BMW decided that it was not itself prepared to guarantee the residual values.

13. First National did not submit even an indicative bid. On 27 March 2001 KPMG noted:

> "*During a conversation with Ian Whyte he confirmed that First National had not returned a confidentiality agreement. Ian did not want to chase them as he suspected they had lost interest.*"

Mr Chris Maynard, who was then the director responsible for national accounts with First National, agreed that First National probably had not returned a confidentiality agreement. Mr Maynard also told us that if he was offered the opportunity to bid for the Rover loan book, he would probably himself have taken the decision not to pursue it, in the belief that First National's motor board and Abbey would not be interested.

<u>*Interest in a bid by MGRG and withdrawal of other bidders*</u>

14. By the end of April 2001, there was as yet no bid from anyone associated with the Group, either. On 18 April Mr Ian Barton of Deloitte wrote "*on behalf of John Edwards, Deputy Chairman of MG Rover*" to Mr Keith Eldridge[21] of KPMG, stating:

> "*We anticipate that your client will acknowledge MG Rover's unique competitive position for purchasing the Portfolio. We also understand that you are currently expecting circa twenty first round bids. After careful consideration, and on the basis of our assessment of BMW's position, we have concluded that we don't wish to participate in an auction process involving some twenty bidders. We remain interested in acquiring the Portfolio and we believe that our compelling competitive position will enable us to offer the best terms for your client.*
>
> *We therefore propose to enter the process when you have reached data room stage and have reduced your bidders from the current high numbers to a preferred short list of three, including MG Rover. We would equally be prepared to move to data room stage now, in order to assist you in meeting your proposed timetable for completion, which is clearly ambitious.*"

15. By the end of May 2001, Capital Bank and GE Capital had both confirmed that they were no longer interested in the Rover loan book. Minutes of a BMW Project Globe steering committee meeting on 10 May record that GE Capital was "*reconsidering price with the knowledge that MG Rover are the RV guarantors*", and by 24 May GE Capital had indicated that only the Land Rover portfolio was of interest. By 25 May Capital Bank was reported to

[20] Mr Brice explained that:

> "*... GE's interest melted away dramatically when they discovered that the bid was not going to be underpinned by a BMW guarantee ...*"

[21] Mr Eldridge was at the time an associate director.

be "*reconsidering the prices offered with the knowledge that the RV guarantees are from MG Rover and Ford*". By 29 May Capital Bank was understood to be interested only in the Land Rover portfolio. On 22 June Mr Tom Costello of Capital Bank confirmed to Mr Eldridge that it "[would] *only have* [an] *interest in Platinum at a deeply discounted price*". Mr Griffiths described the residual value guarantees as the "*crux of the disposal of the portfolio to any company*".

<u>*Formulation of the Phoenix Partnership's bid*</u>

16. In the meantime, Deloitte had been exploring ways in which a bid for the Rover loan book could be financed. In particular, the possibility of securitisation was explored. Barclays Bank and the Royal Bank of Scotland plc ("RBS") were both approached "*as potential providers of bridging finance prior to a securitisation*". By 25 June 2001, however, the proposal was that the portfolio should be acquired by a joint venture with a financial partner. On 25 June Mr Einollahi met Mr Stuart Middleton, senior director, product and market development, at BoS. Mr Middleton's meeting note records as follows:

> "*We are aware that BMW are considering a sale of the asset finance books … held over from their ownership of Land Rover and Rover …*
>
> *BoS (via Motor* [i.e. Capital Bank]*) submitted an indicative offer for the books but have been advised that an alternative bidder is to be granted an exclusive. We had determined that we were only interested in the Land Rover paper and did not wish to carry MG Rover risk (in respect of residuals).*
>
> *We have been asked to determine our appetite to form a JV with the Phoenix Partnership to acquire the MG Rover financial assets …*
>
> *To ensure we are comfortable that we will not carry any MG Rover risk, the Phoenix Partnership working with MG Rover in a transparent manner, would be willing to underwrite (and cash collateralise if necessary) what we consider is necessary in respect of any residual value risk. In exchange for taking the losses on RVs, they would wish the benefit of any surpluses.*"

Following internal discussions, Mr Middleton confirmed to Deloitte that BoS was interested in progressing discussions. In interview, Mr Middleton confirmed that "*a proposal under which there was protection against residual values was a fundamentally different and more attractive one than a transaction under which the purchaser would carry the residual value risk*". Mr Middleton also told us:

> "*The overriding concern for* [BoS] *was the decline of the residual values of Rover cars and the effect that Rover collapsing would have on this market.* [BoS] *required protection from this risk to be part of any transaction otherwise it would not even consider entering into the transaction.*"

17. Also on 25 June 2001, Mr Einollahi wrote on behalf of Mr Edwards to Mr Griffiths. Mr Einollahi said in the letter:

> "*Our current conclusion is that this portfolio should be fully ring-fenced from MG Rover Holdings Limited and we intend to achieve this through a common ownership structure i.e. the company set up for the acquisition will be owned primarily by the Phoenix team and their financial partners.*"

Enclosed with the letter was a "*valuation discussion document*" in which Deloitte set out a range of valuations for the Rover portfolio. Substantial sums were deducted in respect of residual values. These items were explained as follows:

> "*Under the Rover Select scheme, MG Rover has guaranteed any shortfall in residual values on PCP contracts for new cars together with shortfalls on used car PCP contracts with Rover employees. Such guarantees applied to sales approved by Rover up to and including 31 March 2000.*
>
> *MG Rover is in possession of correspondence which clearly sets out that residual values on April 2000 registrations are BMW's responsibility. However, we understand that RFS believes that MG Rover provided guarantees until 9 May 2000. Given that 7,697 PCP contracts relate to April 2000 registrations (associated residual value £57 million), it is important to resolve this issue.*
>
> *We believe that the Portfolio is exposed to residual value shortfalls in the following circumstances:*
>
> - *where there is no guarantee. We assume that this applies to:*
>   - *all contract hire vehicles*
>   - *all used PCP vehicles other than those with Rover employees approved by 31 March 2000*
> - *where there is a guarantee, but the guarantor may be unable to honour it. It is BMW's expectation that MG Rover will not survive after 9 May 2002. On that basis we have assumed that residual value shortfalls from May 2002 where MG Rover has given a guarantee are 100% at risk*
>
> *… in the event of MG Rover failure, we would expect the level of early terminations to rise substantially and for this to depress residual values further than normal. In this case additional losses over and above the 20% experienced in recent times are likely to occur.*"

Negotiations on price

18. Negotiations ensued. Eventually, on 8 August 2001, Mr Einollahi wrote to Mr Munk in the following terms:

> "*... I can confirm that my client's* ***final*** *offer for the entire RFS portfolio, excluding the contract hire vehicles, is 94.25% of net investment at the date of completion. The price assumes that BMW will have no further residual value risk associated with the portfolio following completion. This offer has been approved in principle by both the Phoenix Consortium and their financiers.*"

("*Net investment*" was calculated by discounting the gross receivables by reference to an interest rate.)

19. In late September 2001 (non-binding) heads of agreement were signed on behalf of both BMW (UK) and the "*purchaser*". The heads of agreement explained that it was anticipated that "*the issued share capital of RFS will be acquired by MG Rover Holdings Limited or another member of the Techtronic 2000 Limited group of companies*". The heads of agreement also stated that it was anticipated that RFS would, at completion, include:

    19.1. "*... a portfolio of active hire purchase, personal contract purchase, finance lease, personal loan, lease and variable rate agreements, certain securitised agreements to be re-acquired by* [RFS] *pre-completion and approximately 75 non-vehicle contracts ...*";

    19.2. "*... insurance receivables pursuant to certain of the aforementioned agreements* [i.e. the agreements referred to in the previous sub-paragraph]*...*";

    19.3. "MVO" and "ACOP" contracts (under which employees would be lent money to buy Rover vehicles)[22]; and

    19.4. certain sundry net assets.

The portfolio would exclude, among other things, contract hire agreements. Further, RFS no longer held the Land Rover loan book, this having been transferred to Meritpoint Limited, another subsidiary of BMW (UK), on 6 June 2001[23]. The sale of RFS was to have an effective date of 30 September.

20. As at 30 September 2001, the portfolio held by RFS consisted of the following (excluding contract hire agreements):

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[22] See paragraph 4 above.

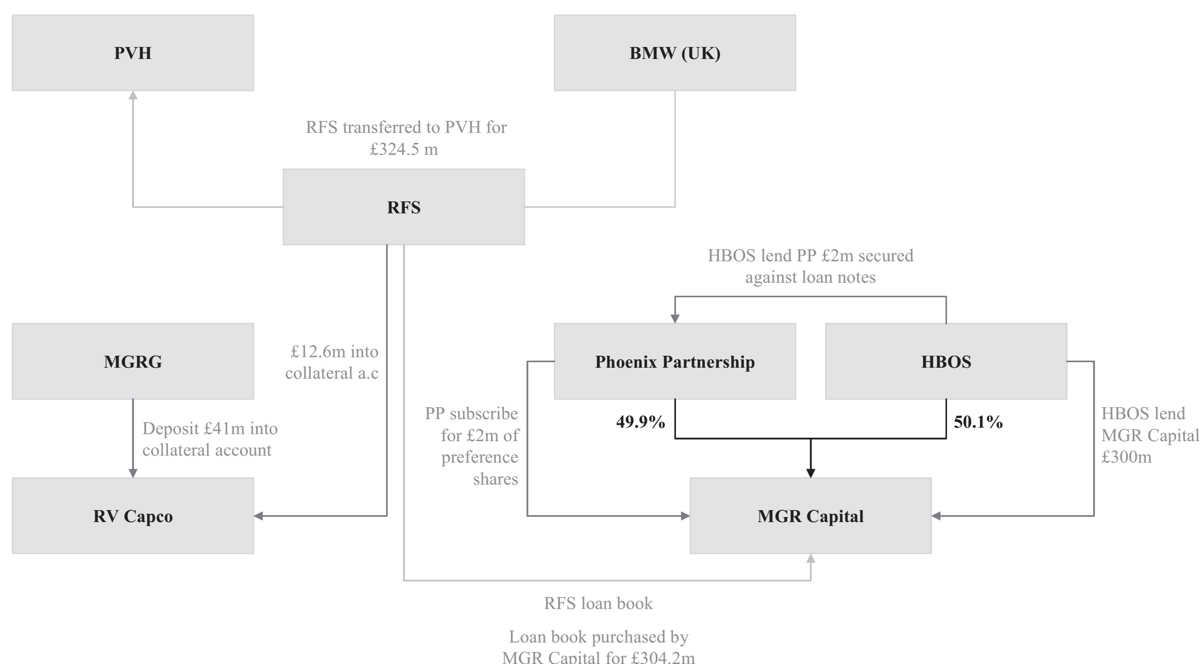
[23] The Land Rover loan book was subsequently sold to FCE Bank plc on 10 October 2001. FCE Bank plc is Primus' parent company, and its ultimate parent undertaking and controlling party is the Ford Motor Company (US).

	Number of contracts as at 30.09.2001	Gross receivables[24] as at 30.09.2001	Net investment[25] as at 30.09.2001
	£	£	£
Customer contracts (main book)	59,422	382,893,516	335,617,360
MVO/ACOP contracts	311	2,800,233	2,800,233
Insurance book	9,746	3,209,220	1,469,735
Total	**69,479**	**388,902,969**	**339,887,328**

Completion of the transaction

21. The deal was finally concluded on 8 to 9 November 2001.

22. In summary, PVH bought RFS from BMW (UK) and most of its loan book was then sold on to MGR Capital, a company jointly owned by HBOS (which was the corporate entity through which the merger of BoS and Halifax Group plc was completed on 10 September 2001) and the Phoenix Partnership (a partnership in which Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers each had a 22 per cent share and Mr Howe had a 12 per cent share). MGR Capital was protected from residual value risks by the establishment of RV Capco Limited ("RV Capco"), a newly formed company owned by PVH, which was to use sums deposited by RFS and (mainly) MGRG to defray losses arising out of GMFVs. A diagrammatical summary of the deal is shown below.



[24] See footnote 16.
[25] "*Net investment*" was calculated by discounting the gross receivables by reference to an interest rate.

23. By the time the transaction was completed, MGR Capital had an issued share capital of £2,001,000, consisting of 50,001 ordinary "A" 1p shares, 49,999 ordinary "B" 1p shares and 2,000,000 preferred ordinary £1 shares. The "A" and "B" shares had equal voting rights and ranked *pari passu* as regards distributions. The preferred shares had no voting rights, but entitled the holders to a preferred dividend of about 20 per cent of the shares' nominal value[26]. The "A" shares were held by Uberior Investments plc ("Uberior"), an HBOS subsidiary. The "B" shares were held by Mr Beale and Mr Edwards on behalf of the Phoenix Partnership. In addition, Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers held the preferred shares.

24. The highly complex arrangements entered into on completion included the following elements:

    24.1. in anticipation of its own sale, RFS sold its contract hire business to Alphabet (GB) Limited, another subsidiary of BMW (UK), on 6 November 2001 and certain other assets to BMW FS on 8 November;

    24.2. on 8 November BMW (UK) sold the issued share capital of RFS to PVH on terms such that BMW (UK) received a total of £324.5 million (plus interest of £2 million in respect of the period since 30 September), almost entirely by way of repayment of inter-company debt[27]. The £324.5 million represented 94.25 per cent of the net investment value of RFS's loan book, plus £4.2 million in respect of sundry assets;

    24.3. on 9 November RFS sold the main loan book for 98 per cent of its net investment value, and the insurance book[28] for 94.25 per cent of net investment value, to MGR Capital. RFS (now a wholly owned subsidiary of PVH) retained the MVO/ACOP agreements[29] (subsequently, it seems, transferring them to MGRG);

    24.4. the difference between the repaid inter-company debt and the consideration payable by MGR Capital was some £12.6 million, as shown below:

Consideration payable for the acquisition of RFS from BMW:			
	£		**£**
Net investment of main book at 30.09.01	335,617,360	@ 94.25%	316,319,362
Net investment of insurance book at 30.09.01	1,469,735	@ 94.25%	1,385,225
			317,704,587

[26] The dividend varies between 19.5 per cent and 20.05 per cent, depending on the company's net profit in the relevant accounting period.

[27] Debt due by RFS to BMW was repaid as a result of payments to BMW by MGR Capital, RFS and PVH of respectively £297.561 million, £26.317 million and £2.639 million.

[28] Referring to insurance company debts which are defined as "*all amounts due from any insurance company in respect of any Motor Vehicle*" in the agreement for the sale and purchase of part of the business and related assets of RFS entered into between RFS and BMW FS on 8 November 2001.

[29] As to which, see e.g. paragraph 19.3 above.

Consideration payable for the acquisition of the loan books by MGR Capital from RFS:			
	£		**£**
Net investment of main book at 30.09.01	335,617,360	@ 98%	328,905,013
Net investment of insurance book at 30.09.01	1,469,735	@ 94.25%	1,385,225
Total[30]			330,290,238
Difference			**12,585,651**

24.5. RFS agreed that, when the contracts sold to MGR Capital (other than finance lease contracts) came to an end or the customers defaulted, it would purchase the vehicles in question from MGR Capital. The purchase price was generally to be the GMFV in respect of the relevant vehicle. The result was that RFS retained its exposure to residual value risks;

24.6. MGRG agreed to deposit £41 million[31] in an account with RV Capco "*on account of and in advance of any liability* [MGRG] *may have to pay RFS pursuant to the MGR Residual Value Guarantees* [i.e. the residual value guarantees MGRG had given RFS]". In consideration of that payment, RFS agreed to release MGRG from any liability it might otherwise have under its residual value guarantees insofar as such liability exceeded the £41 million plus interest. MGRG thus capped its exposure at the expense of tying up £41 million;

24.7. a novation deed served to transfer to RV Capco RFS's obligation to buy vehicles from MGR Capital and, hence, its residual value risks. In return, RV Capco was given the benefit of the £12.6 million difference mentioned above[32]. £6,630,651 of this money (i.e. £12,585,651 less £5,955,000 in respect of GMFVs in contracts which had expired or terminated since 30 September 2001) was deposited in the same RV Capco account as MGRG's £41 million;

24.8. the sums in the RV Capco account were to be used to bear losses arising from GMFVs. To the extent, however, that the money proved to exceed what was required for that purpose, it was to be returned to MGRG;

24.9. MGR Capital's acquisition of the loan books, and in turn PVH's purchase of RFS, was principally funded by HBOS. HBOS lent £300 million to MGR Capital by way of term loan and made available an overdraft facility of £30 million of which about £2.2 million was drawn down. In addition, Uberior paid £500.01 for the "A" shares in MGR Capital;

[30] In practice, MGR Capital paid £304.2 million for the loan book. The bulk of this difference arises from £26 million collected by RFS from customers over the period 1 September 2001 (effective date of contract) to 8/9 November 2001 (date of completion) which was due to MGR Capital.

[31] The original intention was for MGRG to deposit £43 million into the RV Capco account; this was subsequently reduced to £41 million after concerns raised by Mr Millett at an MGRG board meeting on 12 October 2001, as to which see paragraphs 180 and 210 below.

[32] See paragraph 24.4 above.

24.10. Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers paid £2 million for the preferred shares in MGR Capital. In addition, the Phoenix Partnership paid £499.99 for the "B" shares in the company; and

24.11. £2,639,220 was transferred from MGRG to RFS to finance the MVO/ACOP contracts[33]. MGRG and PVH treated this transfer as a payment made on behalf of PVH and therefore increased PVH's inter-company indebtedness to MGRG[34]. PVH also paid £50 for RFS's issued shares to BMW FS.

25. Messrs Beale, Edwards, Stephenson and Towers used the loan notes PVH had issued in their favour at the end of the previous year[35] to fund their acquisition of the preferred shares in MGR Capital. The arrangements were as follows:

25.1. Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers each borrowed £500,000 from HBOS on the security of their loan notes;

25.2. to obtain the £500,000 loans from HBOS, the loan notes needed to be secured by way of a bank guarantee. Co-operative Bank plc ("Co-op Bank") agreed to provide such a guarantee subject to PVH depositing £10 million in a blocked deposit account with the bank and granting security over the account in favour of the bank;

25.3. to enable the £10 million to be deposited, Techtronic transferred that sum to PVH on 21 September 2001. PVH deposited the £10 million (plus an arrangement fee) in a "Blocked Guarantee Account" with Co-op Bank on 10 October 2001;

25.4. Techtronic's payment to PVH was initially treated as a loan, but a £10 million dividend was declared in favour of PVH in December[36]; and

25.5. Techtronic was able to declare a dividend of £10 million in accordance with the Companies Act 1985[37] principally on the basis of interest paid or payable on its loans to MGRG[38]. As a practical matter, the money transferred to PVH to enable it to make the £10 million deposit appears to have been derived in part from the second tranche

[33] A payment of £43.639 million was made from MGRG's HSBC Holdings plc ("HSBC") Treasury Account (no. 41825836) on 2 November 2001 (being £41 million for cash collateral plus £2.639 million for MVO/ACOP loans).

[34] As at 31 December 2001, PVH owed MGRG £3.62 million. By 31 December 2002 this had reduced to £1.87 million, and by 31 December 2003 MGRG owed PVH £22.94 million.

[35] See V/55.1 to 55.2.

[36] See XXI/61.2 and 62.

[37] Section 263 of the Companies Act 1985 barred companies from making distributions (including dividend payments) otherwise than out of "*profits available for the purpose*" (as defined in the Act).

[38] As explained in XXI/61.2, Techtronic minutes dated December 2001 record a resolution to pay the £10 million dividend and that Mr Beale explained that the company "*had received income in the sum of £13,446,878, being interest from the loan made by the Company to* [MGRG] ... *together with interest on cash deposits and tax refunds*".

of the BMW "dowry"[39] and in part from money which Techtronic received on Powertrain's behalf at the time of Powertrain's acquisition[40] [41].

Individuals involved with the Phoenix Partnership's bid

The composition of the Phoenix Partnership

26. As mentioned in paragraph 22 above, the Phoenix Partnership comprised not only Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers (the four members of the Phoenix Consortium), but also Mr Howe.

27. Mr Howe told us that he thought he had been approached "*probably around the early part of the second half of 2001*" about participating in the acquisition. His recollection was that he had originally been told that he would need to put personal equity into the transaction, but that he had later been informed:

> "*... we understand and we are aware that you do not have much capital around you, but we are prepared to basically invite you in on a non-personal equity basis and the share will be reflective of that, but nevertheless, we still want you to consider being involved.*"

Mr Howe explained that he regarded the offer as "*excellent recognition*".

28. We asked Mr Beale how Mr Howe came to be invited to join the Phoenix Partnership. He stated:

> "*... I think it was part of making sure Kevin felt involved with ourselves and also as part of his – we had promised to make sure that he had some sort of bonus structure going forward. It seemed an ideal opportunity to give him something to show that we were serious about that.*"

When asked the same question, Mr Edwards replied:

> "*I think John* [Towers] *and Peter* [Beale] *felt that it would obviously be very important if Platinum succeeded in terms of the acquisition that MG Rover was in a position to exercise its control properly of the acquired portfolio, therefore it was very important to have Kevin involved at all levels: the acquisition level, participation level and the operational level, in terms of making sure that the benefits*

[39] As to which, see III/90. While BMW subscribed in May 2001 for loan notes to the tune of £150 million, Techtronic lent on to MGRG only £145 million (see chapter XII footnote 3).

[40] As to which, see V/90 to 94. £8,651,000 was transferred to Techtronic in June 2001 from an Eversheds client account and charged to Tectronic's inter-company account with Powertrain.

[41] See paragraphs 217 to 226 below for details of sums subsequently paid to or for the benefit of the members of the Phoenix Partnership as a result of or by reference to Project Platinum.

> *that we obtained for MG Rover in acquiring the Platinum book were properly realised.*"

29. In practice, Mr Howe had little if any involvement in the Project Platinum negotiations.

<u>*The Deloitte team*</u>

30. The Deloitte team working on the Project Platinum transaction was led by Mr Einollahi. Others involved from Deloitte's corporate finance team were Mr Barton, who was then an assistant director and who moved to London from Manchester early in 2001, Ms Caroline Butterfield, then formally an assistant director but treated and remunerated as a director and who reported to Mr Einollahi in Manchester although she was based in Edinburgh, Mr Nigel Birkett, then a manager based in Manchester, and Mr Matt Widdall, also then a manager based in Manchester.

31. Ms Butterfield explained the composition of the Deloitte team as follows:

> "*... it was Maghsoud's project as lead engagement partner and then below him he had Ian Barton, and myself as directors, assisted by Matt Widdall and Nigel Birkett and latterly John Cowburn, from the corporate finance team, and then, from the tax side, the partners David Hume – Toby Bushill was his manager and Steve Holloway dealt with the VAT aspects.*
>
> *... Maghsoud was the lead engagement partner, so he had prime responsibility for all the corporate finance aspects, and the rest of us were there to do the tasks that he asked us to do. So Nigel Birkett was there as number 2* [to Mr Einollahi] *in, I think, all the areas. So he was doing a lot of the day-to-day tasks.*
>
> *Ian Barton was – my understanding was Ian had a number of roles. He was there to deal with the operational areas, which meant that he was liaison man with Rover. So when it got into areas of nuts and bolts – how is this transaction going to work, what are the demands it is going to make on the information flows – he was the person to go and speak to Rover personnel and try and translate that – and translate that into – help Eversheds translate that into the legal documentation.*
>
> *I am actually struggling to recall what Matt Widdall's precise areas of responsibility were ...*
>
> *John Cowburn had a fairly limited role, in that he was brought in towards the end of the transaction, when there were concerns as to the cash flows into BMW collection accounts. So he visited them and communicated the process, the systems that they were put in place, to segregate the monies and make sure that the receipts on the various contracts ended up in the right collection account.*

Towards the end of the transaction we divided up responsibility amongst the team for – divided up prime responsibility amongst the team for the legal agreements. So, whereas Maghsoud had prime responsibility for the sale and purchase agreement, Ian Barton and myself had responsibility for the sales agreements, the residual value remittance agreement and the … marketing agreement …

… What I have not explained is my role on the transaction. I was brought in [in June 2001] *at the outset because it was envisaged that the transaction would involve securitisation. I was brought in because of my experience in public document work and Maghsoud had asked me, because it involved the preparation of a placing document – to take responsibility for the financial information within that.*

So that was my initial role but, of course, the deal moved on and we were never required to produce such a document and therefore, quite swiftly, my role changed into responsibility for preparation of an additional valuation discussion document and from there into taking responsibility for liaising with the client to set the scope of the due diligence requirement, communicating that to PwC, for oversight of the results coming out of the due diligence – for oversight from our part – of making sure that those results were fed back into the HBOS funding model, and then, towards the end of the transaction, where it was clear that the PwC due diligence scope had not covered all the areas that were originally included in the scope – there was a small area of sundry assets where the decision was made that the Deloitte team would do the due diligence on those areas, so I handled that and produced a report on that, and then I was responsible for those legal documents that I have described earlier."

Mr Ian Whyte

32. As mentioned above[42], in 2001 Mr Whyte was employed by BMW Leasing (GB) Limited as a "*Risk Controller*". When BMW decided to sell the Rover and Land Rover loan books, Mr Whyte was charged with finding buyers for them. As Mr Whyte explained to us, for practical purposes the key people concerned with the disposals were himself and Mr Munk. Mr Griffiths said that Mr Whyte and Mr Munk were respectively project manager and project sponsor in relation to Project Platinum. Mr Whyte told us:

"*… KPMG gave some advice and I basically ran it from the business side. Any internal resources from BMW, any view-taking in terms of the position that BMW was going to take – I would negotiate with either Petra* [i.e. Ms Petra Kerp, Mr Griffiths' predecessor as chief executive officer of the BMW Financial Services

[42] See paragraph 9 above.

> group[43]] *or Frank Munk … and we agreed between us what we were going to do and I then presented it.*"

33. At an early stage, the possibility was raised as between Mr Whyte, Mr Edwards and Deloitte of Mr Whyte also taking part in a "management buy-out" ("MBO") or "management buy-in" ("MBI"). In interview, Mr Barton told us that that there were a "*number of conversations quite early in the process with Ian* [Whyte] *that we attended …, to say: do you want to do a management buy-out?*" and Mr Whyte was "*supportive of that idea*".

34. On 31 January 2001 Mr Barton sent an email to others at Deloitte describing the potential new assignment as:

> "*… Rover Financial Services – a subsidiary of BMW, … advising a joint venture including MG Rover and an MBI candidate (to be confirmed).*"

The likelihood is that the "*MBI candidate*" was Mr Whyte. Mr Einollahi told us that Mr Whyte was "*introduced to* [him] *by* [Mr Edwards] *as a potential manager of the lease book following the acquisition*". Mr Edwards accepted that the possibility of Mr Whyte being involved "*could well have cropped up out of a conversation with* [him]" (meaning a conversation between Mr Whyte and him).

35. Notes made by Mr Birkett, the most junior member of the relevant Deloitte team, on 19 February record that "*team administering RFS now could move across to Rover to continue business*" and that "*operations manager had been D&T contact to date*". When we asked Mr Birkett who the "*operations manager*" was, he said that the "*contact who we had at the time was Ian Whyte … so it may well refer to him*".

36. On 13 March Mr Whyte attended a meeting at Bickenhill with Mr Edwards, Mr Einollahi, Mr Barton and Mr Birkett. It is evident from notes which Mr Birkett made at the meeting that Mr Einollahi told Mr Whyte that a management team could be involved with the "*MG Rover bid*" and that there would be a more powerful position to take to financiers if "*MG Rover,* [management] *team, D&T worked together*". Those listed as potential members of the management team were Mr Whyte (who identified himself as the entrepreneur in the management team), Mr Mike Dennett, Mr Mark Worthington, Mr Richard Bishop, Mr Richard Hill and Mr Simon Burney. Mr Whyte said that he was "*interested in joining the party*" and indicated that to date he had had "*superficial conversation with some of the key managers*". Mr Einollahi suggested an "*equity figure of 15% for management*" and there was reference to a "*pot*" (which would not be a "*huge amount*") being set aside "*to cover management commitments i.e. mortgage etc*".

37. Messrs Dennett, Worthington, Bishop, Hill and Burney all gave evidence to us. Mr Worthington and Mr Bishop, each of whom worked for the BMW group in early 2001,

[43] Mr Whyte's reference to Ms Kerp must be a mistake because Mr Griffiths appears to have taken over from Ms Kerp as chief executive officer of the BMW Financial Services group by April 2000. Ms Kerp resigned as a director of BMW FS and RFS on 7 June 2000.

told us that no one had ever raised with them the possibility of any kind of MBO or MBI. In contrast, Mr Dennett, who at the time worked for BMW Financial Services as group financial accountant, remembered Mr Whyte coming into his office and asking whether he had ever thought of an MBO. Mr Dennett, who was unable to date this conversation with any precision, told us that he had indicated to Mr Whyte that he would not be interested. As for Mr Hill and Mr Burney, the former had left BMW Financial Services to work for another company at the end of 2000 and Mr Burney was to move to MGRG at the beginning of April – he had known since about the end of January that he would become redundant and he was approached by Mr Edwards in early March or so about joining MGRG. Both had a recollection of a meeting at a public house on about 20 March at which Mr Whyte referred to the possibility of an MBO. Mr Hill said that he took the matter no further. Mr Burney explained that Mr Whyte had sounded him out about whether he would be interested in being involved in an MBO-type arrangement in casual conversations since, perhaps, late February. He also said that he had had several further conversations with Mr Whyte after the meeting at the public house. He thought that he had called Mr Whyte in April and maybe also in May. On a couple of occasions, the content of the call was probably:

> "*... along the lines that ... negotiations are still going on, sort of thing, you know, 'Just hold back, I will let you know if anything happens' ...*"

The message from a final call (which would have predated Mr Burney's learning in August of the proposed arrangements with BoS) had been:

> "*... 'Nothing is happening on this,' and it was dead, it was closed ...*"

38. On 6 June Mr Birkett made notes in respect of a discussion with Mr Einollahi. His notes include the following:

> "*Ian Whyte to do business plan.*
>
> *... what do we need in ongoing support → need Ian Whyte to tell us what we need.*
>
> *... mgmt team → Ian Whyte – told him to think of D&T (MG) as VC*[44] *...*
>
> – *need Ian to produce paper showing strategy – 3 months top for BMW running book for MG*
>
> – *could do outsource of book*
>
> – *Caroline* [Butterfield] *to ensure Ian Whyte gets info sorted*
>
> *– SPEAK TO IAN WHYTE TO PREPARE FOR CAROLINE*"

---

[44] "*VC*" stands for venture capitalist.

39. Notes made by Ms Butterfield on the same occasion include the following:

> "*Ian Whyte responding well to carrot*
>
> *to regard us as VC (good* [package] *for bringing team) …*
>
> [Ms Butterfield] *to bully for info*
>
> *2 months ago: commitment to MBO: 10% equity …*"

Ms Butterfield (who only became involved in Project Platinum on 6 June 2001) told us that Mr Einollahi had informed her that Mr Whyte "*had already committed to an MBO on terms that he and his management team would be offered 10% equity*". She said, however, that it was not suggested to her that the "*carrot*" of an MBO was being held out to Mr Whyte "*as a means of extracting information from him that Deloitte would otherwise be unable to obtain*".

40. On Monday 11 June Mr Birkett sent Mr Whyte a fax[45] which began:

> "*Matters have moved on since Maghsoud met with you some two months ago to explore the possibility of a management buy-out.*"

The fax concluded:

> "*As discussed with Ian Barton, please could you give him a ring to discuss the contents of this fax*"

The fax appears to have been drafted by Ms Butterfield.

41. At 11.13 pm on the same day Mr Barton sent Mr Whyte an email in which he said:

> "*Thanks for your voicemail regarding Tuesday's meeting. Further to my message re Thursday the message below supersedes that.*
>
> *We have been meeting with John Edwards this afternoon in respect to RFS and discussed next steps.*
>
> *From that conversation we would like to set up a meeting whereby we can explore the key business plan issues in respect of the acquisition of RFS between ourselves and you and your team.*

[45] The fax will have gone straight to Mr Whyte's own computer.

… D&T would be attending as financial advisers to Newco.

We would like to include as many of your MBO team that you would envisage being part of the operational team post acquisition, and to this end we would also include Simon Burney from MG Rover.

We would hope that from that meeting we could have discussed the operational plans going forward, challenged them and resolved how to document these as Newco's business plan and projections.

It would also be an opportunity for you and your team to raise any issues / concerns you may have about the process and plans for Newco.

Clearly this would be a meeting where we are all on the same side as MBO team. MGR and advisers and I would hope it would be productive.

In order to ensure that we would not be constrained by time, I would expect that the discussions may last all day, and would be held offsite (perhaps Studley Castle).

Given the timescales of the deal, we need to arrange this meeting for asap, and I would be grateful if you could discuss with your team a date when they could free their diaries for. To this end a weekend day may be required.

Perhaps you could give me a call when you have discussed with your team and got some date options so that I can check with diaries on our side."

42. On Thursday 14 June 2001 Mr Whyte met Mr Edwards, Mr Einollahi and Mr Birkett at Studley Castle. Once again, Mr Birkett made notes. These include the following passages:

- "*Proposal to Ian Whyte …*

  IBO with MGR as VC [Venture Capitalist]

  Management deal

  ME [i.e. Mr Einollahi] *went thru MBO* [Management Buy Out] *structure …*"

- "*Timing*

  – Ian Whyte agreement

  take sample from legal agreement …

  – draft summary points for Ian Whyte"

- "*IW*

  when IW announce he is MBO, ME to request unencumbered access to mgmt team and info."

43. For his part, Mr Whyte said that it "*would have been inappropriate for* [him] *to have been involved in the conduct of the sale if* [he] *had been coincidentally involved as a prospective purchaser*". Mr Whyte, however, explained matters as follows. He had not, by 31 January 2001, discussed with Mr Edwards or Deloitte the possibility of being involved in any form of vehicle to purchase the Rover loan book. Nor had there been any discussions as to an MBO by 7 February. The prospect of involvement in an MBO was raised with him at a meeting with Mr Edwards and Mr Einollahi at Studley Castle in March (and the matter "*may have been raised shortly prior to the actual meeting on 13 March 2001*"). Following that meeting, Mr Whyte "*discussed the idea of involvement in an MBO with, firstly, Simon Burney and Richard Hill (who were relatively enthusiastic about the prospect) and then with Mike Dennett*", who "*was very negative and gave … his opinion that it would not work*". The strength of Mr Dennett's concerns "*caused* [Mr Whyte] *to dismiss the idea of being involved in a management buy out team from this point*". At this stage, which "*must have been no later than late March/early April*", Mr Whyte "*went to see Frank Munk to tell him about the approach and that he needed to know that I did not propose to engage in it and did not therefore expect to be removed from the team*" and he thereafter "*conducted* [himself] *as if the MBO had never been raised*". He did not receive, or at least did not see, the 11 June fax mentioned above[46]. Moreover, he "*emphatically*" denied that there was any positive discussion or proposal made to him in June of involvement in an MBO. He "*certainly did not know that the* [14 June] *meeting was intended other than to discuss the service agreement*" and he does "*not believe that there was discussion as to any MBO in which* [he] *was to be involved*" during that meeting. In short, he "*discussed the possibility of an MBO in advance of a meeting of 13 March 2001 but … the prospect itself was only 'live' for a short period of a couple of weeks by which time* [he] *had dismissed the idea*" and "[a]*fter the meeting on 13 March, the subject was never positively raised with* [him] *by representatives of Phoenix or Deloitte*".

44. We cannot accept this version of events. Mr Munk having died, we were unable to ask him about Mr Whyte's evidence. However, Mr Whyte's account is inconsistent both with the documentary evidence and with evidence given to us by other witnesses. Mr Birkett's notes of the 14 June meeting are of particular importance. These confirm that, contrary to Mr Whyte's explanations, the subject of Mr Whyte's involvement in a purchase of the Rover loan book was raised with him in June 2001. They indicate, too, that Mr Whyte did not reject the proposal. Mr Whyte told us that his recollection was that the meeting "*was not largely taken up in matters relating to the management*" and that he did "*not believe that there was any discussion as to any MBO in which* [he] *was to be involved*". He pointed out that "*it appears* [from the attendance note] *that the first part of the meeting was conducted without* [him]". While, though, the first page of Mr Birkett's notes seem to deal with matters in respect of which Mr Einollahi and Mr Edwards at least were not present (headed "*Pre*

[46] See paragraph 40 above.

ME/JE"), the passages quoted above[47] follow the heading "*Meeting with JE, IW, ME*" and clearly relate to events for which Mr Whyte was present. Further, Mr Einollahi told us that at this meeting Mr Whyte portrayed himself as receptive to involvement in an MBO and as trying to give the impression that he was helping. Mr Edwards confirmed that the section of the notes dealing with "*Proposal to Ian Whyte*" accorded with his recollection, albeit that he added that he "*did not pay an awful lot of attention to this because* [he] *did not think there was any way this would go anywhere*".

45. In our view, the possibility of Mr Whyte being involved in an acquisition of the Rover loan book was a live one for far longer than Mr Whyte accepts. The likelihood is that it had been raised with or by him before the end of January 2001 and that it remained open until at least early July. Subsequently, for whatever reason, the idea faded. Mr Barton told us, "*we regarded him as being a BMW man from midway at least, through the process*". Ms Butterfield said that by 17 July Mr Whyte "*was clearly not going to do a management buyout*". Mr Edwards suggested that RFS had made Mr Whyte "*an offer that gave him some continuity and some existence afterwards*", following which he had become "*quite an adversarial negotiator on behalf of RFS*". Mr Barton told us that, when discussions with Barclays Bank about securitisation of the loan book were discontinued, Deloitte's attention "*turned towards a joint venture structure with a partner able to provide both finance and management support*".

46. For so long, however, as there was a possibility of Mr Whyte being involved in an acquisition of the Rover loan book, he will have had a conflict of interest. He will have had a personal interest in the bid with which he was connected succeeding at the lowest possible price, yet it will have been incumbent on him as someone handling the disposal of the loan book for BMW to seek to maximise the sale proceeds. Had BMW known of Mr Whyte's potential involvement in a bid for the loan book, his role in handling the sale negotiations for BMW would inevitably have been brought to an end. Mr Griffiths said that had he learned of Mr Whyte's position:

> "*… I would expect that we would have not discouraged the MBO, but we would not have put Ian – we would have taken him off the project management position because of conflict of interest. I think you will expect that and so would he.*"

In similar vein, Mr Brice of KPMG told us:

> "*… you could not have a competitive sale process being run by someone who had an interest in one of the bidders winning, it would not have been tenable …*
>
> *… the principle of someone from BMW looking at some sort of MBO or synthetic MBO is not per se a problem; what is a problem is the same person then running a competitive M&A process.*"

[47] See paragraph 42 above.

During Mr Whyte's interview, he gave evidence as follows:

> "*Q.* *If you had gone into* [Mr Munk's] *office and said: there has been this approach and I am still thinking about it; he would have said: well, you are off the deal for the moment, mate, would he not?*
>
> *A.* *I suspect so.*"

47. In fact, however, Mr Whyte retained responsibilities in relation to the disposal of the loan book throughout the period an MBO was under consideration and, during this time, supplied Deloitte/Mr Edwards with a variety of information relevant to the deal. The following events can be seen from the documentary evidence to have occurred between February and August 2001 (during most of which period the possibility of Mr Whyte being involved in an MBO was probably live):

47.1. at a meeting attended by Mr Whyte, Mr Edwards and Deloitte on 7 February, Mr Whyte provided the following information:

- BMW's valuation of the portfolio was "*not clear*". The residual value risk had been provided for, so this value was known. The BMW "*irritation factor*" was important;

- the level of bad debts in the portfolio was low compared with the rest of the market;

- BMW was concerned about dealer hostility towards BMW and the impact that would have on RFS trying to sell returned vehicles to Rover dealers. This was identified as giving rise to a "*major HASSLE FACTOR/exposure*"; and

- BMW believed the value of the loan book to be more than £500 million, but the market would value it at "*a lot less*" as a result of the residual value risk.

Mr Whyte told us that in this conversation he "*was ... 'talking up' the value of the bad debt provision*";

47.2. on 22 February, Mr Whyte told Mr Barton:

- "*Rover*" would be the preferred purchaser;

- there were five bidders, one of whom was a waste of time and only two of whom were expected to make it to the data room;

- First National had a poor relationship with dealers; and

- the RFS systems could not manage a growing book, so a service provider would be needed.

Mr Brice of KPMG said of a note of the conversation:

> "*... I could read that note in one of two ways. I could either read that note as an encouragement to step up to the plate and get stuck in ..., or I could read that as being a somewhat candid account of where things were.*"

Mr Whyte told us that the "*primary reason why nothing could have been lost by telling Phoenix that it was the preferred bidder was that it must have known that was the case*";

47.3. at a meeting attended by Mr Whyte, Mr Edwards and Deloitte on 13 March, Mr Whyte supplied the following information:

- no decision had been made as to the value of the Rover loan book;

- a figure of £47 million was attributed to the MGRG guarantee;

- Mr Whyte felt that the discount by other bidders will be approximately 60 per cent; and

- the names of the other bidders in the process (Capital Bank, GE Capital, First National). As to these, in the United States GE Capital had "*got out of vehicle leasing due to residual value issues*". First National was "*not making acquisitions due to Lloyds TSB takeover*".

When we asked Mr Brice about Mr Whyte indicating that other bidders would be applying a discount of approximately 60 per cent, he said:

> "*That is astonishing. It is one thing to say to someone: come into the process, there are a number of other bidders in the frame, get your skates on and join in, which could be an invitation to someone to get stuck in and keep their pencil sharp. To tell them what the other parties are going to be bidding I think is astonishing*";

47.4. on 18 April Mr Whyte told Mr Barton:

- Mr Whyte had spoken to KPMG about Deloitte's letter of 18 April[48] (in which Deloitte had informed KPMG that they would not yet be submitting a bid);

- he agreed with the contents of Deloitte's letter;

- KPMG were negative about Deloitte's letter, viewing it as an inability to make an offer rather than tactics or a lack of information; and

- he was due to meet KPMG and BMW later that week (on Thursday) and would support Deloitte's position;

47.5. at a meeting attended by Mr Whyte, Mr Edwards and Deloitte on 14 June, Mr Whyte supplied the following information:

- there were no serious offers against BMW's aspirations;

- in particular, GMAC UK plc ("GMAC") and First National were not in; and

- 91.5 per cent (of net investment) had been suggested as the value at which BMW would keep the Rover retail book.

Mr Whyte said that "*we had to encourage them to buy it*" and that the true figure "*was a lot lower than* [91.5 per cent]". However, Mr Griffiths confirmed to us that he would have had a problem with Mr Whyte speaking in such terms to the Rover side; he commented that Mr Whyte was "*certainly compromised by that*". Mr Brice commented that for Mr Whyte to refer to 91.5 per cent as "*lowest keep value*" would be "*absolutely astonishing*" and observed, "*if Ian Whyte made that comment, it makes me understand why the discussions of the next few weeks were so bloody difficult*";

47.6. on about 26 June, Mr Whyte told Mr Birkett the following:

- the other bidders put in "*very low*" offers, around the "*same range that we* [Deloitte] *are at.* [T]*old other bidders to piss off, if all even MG Rover would get it anyway*";

- BMW was seriously considering keeping the loan book;

[48] See paragraph 14 above.

- the letter enclosing the "*valuation discussion document*"[49] had arrived the previous night and had "*put KPMG on back foot*"; and

- KPMG were "*gobsmacked*".

Mr Griffiths confirmed to us that he would not have expected Mr Whyte to say such things even if they were true. Mr Eldridge of KPMG said, "*It is, without doubt, surprising that Ian Whyte should be informing one of the bidders in the process about BMW's confidential internal deliberations and the bids that have been received from other parties in the process*";

47.7. on 29 June Deloitte attended a meeting with representatives of BMW FS (including Mr Whyte) and KPMG. KPMG's notes of the meeting include the following:

- "*BG* [i.e. Mr Griffiths] *explained that on price, BMW was not anticipating a significant discount to book value. Price should be very close to 100% – say 99% ...*

- *FM* [i.e. Mr Munk] *re-iterated that BMW's walkaway price is in the region of 99% ...*

- *FM noted again that BMW's walkaway price is around 99% ...*

- *FM reminded ME* [i.e. Mr Einollahi] *that BMW's walkaway price is 99%.*"

Mr Birkett's notes of the same meeting likewise refer to Mr Munk putting the "*keep value*" at 99 per cent. They record, too, that Mr Griffiths said that "*<u>not</u> all bidders have been turned down*";

47.8. in a letter to Mr Einollahi dated 2 July Mr Griffiths stated once again that "*the walk away price for BMW is in the region of 100% of the net book value of the portfolio*";

47.9. in a letter to Mr Griffiths dated 4 July, Mr Edwards wrote:

> "*We are prepared to acquire the portfolio for a consideration in the region of 95% of the net investment value ... as at completion ... Clearly, the issue of residual values is still outstanding. In this context, we propose a deduction for the full amount of RV shortfalls which are currently the obligation of BMW Group. We estimate the current shortfall to be in the region of £20 million. We consider this proposal to be equitable as you have proposed no adjustment for RV risks which are currently the obligation of MG Rover.*"

[49] See paragraph 17 above.

On 5 July Mr Philip Kerry, Controller of Finance at BMW FS, calculated that, having regard to the £20 million deduction, the offer was of 90.6 per cent of net investment;

47.10. on 5 July, Mr Whyte told Mr Barton as follows:

- BMW FS was happy with most of Mr Edwards' 4 July letter other than the price;
- they understood where the £20 million calculation came from, and would discuss it with Munich;
- Munich had a copy of the letter for their comments and approval;
- he believed that Mr Gunther Lorenz (BMW's head of "*FF*" – i.e. Financial Services) would do a deal at 95 per cent, though probably not much lower than this; and
- BMW were looking through their documents for information on why MGRG was so robust on April 2000 residual values ("RVs"), and calculating what BMW's overall exposure to RVs was.

Mr Griffiths told us, "*I would not expect* [Mr Whyte] *to say it* [i.e. that Mr Lorenz would do a deal at 95 per cent] *without our knowledge or approval*", but that he could not be "*confident that we did not give that knowledge and approval*";

47.11. Mr Griffiths replied on 9 July (in a letter addressed to Mr Einollahi), stating:

> "*Our understanding is that the indicative offer from MG Rover is a price in the region of 95% of NI before making any adjustment for RV shortfalls which are currently the obligation of BMW Group. If this interpretation of the indicative offer is correct, you will be aware that it falls materially short of our minimum requirements*";

47.12. at a meeting with Mr Edwards and Deloitte on 17 July, an offer of 93 per cent of net investment was put forward to BMW;

47.13. by 31 July, BMW had rejected this offer; and

47.14. during the first half of August, BMW agreed to accept a revised offer, of 94.25 per cent of net investment, subject to board approval.

48. Mr Whyte told us that "*any information which was provided to Phoenix about BMW's attitude or position was agreed and approved in advance by Mr Munk (and sometimes*

Mr Griffiths …)". It seems plain, however, that that cannot always have been the case. Take, for example, Mr Whyte's statements on 14 and about 26 June 2001 that 91.5 per cent had been suggested as the lowest keep value, that there were "*no serious offers against BMW aspirations*" and that other bidders had been told "*to piss off*". Had Mr Munk or Mr Griffiths known of what Mr Whyte had said, they would not have maintained at the 29 June meeting or in Mr Griffiths' letter of 2 July that "*not all bidders have been turned down*" or that BMW's walkaway price was 99 per cent or more (or, at least, would not have done so without explaining their change of position).

49. In any case, we consider that the fact that Mr Munk or Mr Griffiths had agreed that any particular information could be supplied does not necessarily absolve Mr Whyte from criticism. When advising or discussing with Mr Munk or Mr Griffiths whether that information should be made available, Mr Whyte's duty to promote BMW's interests is liable to have been compromised, knowingly or not, by the conflict of interest he had while the MBO was in prospect.

50. It is doubtless the case that Mr Whyte never made a final decision to take part in an MBO. It appears, too, that relatively little happened in relation to the proposed MBO during April and May of 2001. Nonetheless, we consider that Mr Whyte should not have continued to be involved with the sale of the Rover loan book without informing BMW that there was a possibility of his taking part in an MBO.

51. We asked Mr Einollahi, Mr Barton, Ms Butterfield and Mr Edwards about how they viewed Mr Whyte's position. Mr Einollahi told us that it "*was not a matter for* [him] *to be concerned*". He explained that he had believed Mr Whyte to be a "*BMW stooge*"; Mr Whyte appeared to him to be "*a BMW man in collaboration with BMW seeking to provide us, guide us, influence us, extract information from us*". In the course of one of Mr Einollahi's interviews, there was the following exchange:

> "*Q.* *… if you find Ian Whyte continuing to be concerned in the sale process, when he is potentially concerned in the bid, would it be the case that there are really two possibilities? One, that the employer does not know what is going on, or the other, is that he is a stooge?*
>
> *A.* *Yes. I think that would be a fair one.*
>
> *Q.* *In your mind, it was the latter: he was a stooge?*
>
> *A.* *Definite.*"

Later in the interview, Mr Einollahi agreed that it was absolutely crucial to his thinking that he believed Mr Whyte to be a stooge. Had it occurred to him that Mr Whyte was acting otherwise than with BMW's blessing, Mr Einollahi would have told them, he said.

52. Mr Einollahi put matters slightly differently in subsequent written evidence. In particular, he referred to being suspicious of Mr Whyte rather than to believing him to be a stooge. Mr Einollahi said in one witness statement:

> "*From the start of discussions with* [Mr Whyte]*, I was suspicious that* [he] *was assisting BMW in extracting information regarding the MG Rover bid for the lease book. Nevertheless, I kept an open mind about* [Mr Whyte's] *motives …*
>
> *In any event, I did not at any stage consider that there was an issue concerning the propriety of* [Mr Whyte] *providing us with information regarding the sale process. At all times I acted on the assumption that he had whatever consents he needed from BMW to provide us with this information. I did not, moreover, consider that it was Deloitte's role to verify whether such consents had been obtained …*"

In another witness statement, Mr Einollahi said that he assumed that Mr Whyte had been authorised by BMW to provide financial information for three principal reasons: first, because "*it seemed to* [him] *that, by appointing* [Mr Whyte] *as its information conduit, BMW were in effect giving potential purchasers – or, at least the* [Phoenix Partnership] *– unfettered access to information regarding the target asset*"; secondly, because of his "*suspicions … that* [Mr Whyte] *was providing information regarding the lease book as a BMW 'stooge'*"; thirdly, because Mr Whyte "*was introduced to* [him] *by* [Mr Edwards] *as a Chartered Accountant*"[50]. If, however, Mr Einollahi merely had "*suspicions*" that Mr Whyte was a "*stooge*", he must also have been alive to the possibility that he was not a "*stooge*".

53. In oral evidence, Mr Barton accepted that he must have known that Mr Whyte had a conflict of interest. He said, however, that it was for Mr Whyte to make his own decision on how to resolve the conflict. In a later witness statement, Mr Barton said:

> "*My understanding at the time was that* [Mr Whyte] *was acting appropriately and, to the extent necessary, had authority from BMW.*
>
> *However, I did not consider it my or Deloitte's responsibility to verify whether* [Mr Whyte] *had obtained such consent.*"

54. Ms Butterfield explained:

> "*My view at the time would have been, as soon as Ian* [Whyte] *had committed himself to the concept of leading the management buyout, he would have had to have sought permission from BMW to do so and that BMW would have had to find a substitute for him in the disposal process because I would not have expected him to be able to manage the two roles.*"

[50] It should be noted, however, that we have seen no evidence to suggest that Mr Whyte is or ever was a chartered accountant.

She also said that she always assumed that Mr Whyte had not told BMW that he was an MBO candidate. She told us that she had not addressed her mind to whether there was a problem in Mr Whyte being concerned in the disposal of the loan book for BMW when there was the possibility of his being involved in a management buy out. This, she said, "*was not part of* [her] *role on the transaction*", it was "*an area that* [she] *expected Maghsoud to deal with*".

55. Mr Edwards said that Mr Whyte:

> "*... could not continue to act for BMW and act for himself so there would come a point when he would need to get into real information and real detail and if he was doing that on an MBO, he would not be doing it for BMW.*"

He also said that he had "*never had any confidence that this was not just a ploy from BMW to get inside MG Rover, so* [he] *kept his distance from it as much as possible*".

56. It seems to us that Mr Einollahi, Mr Barton, Ms Butterfield and Mr Edwards must all have known that there was at least a strong risk that BMW was not aware of the possibility of Mr Whyte being involved in an MBO. In fact, we think that only wilful blindness could have prevented Mr Einollahi, Mr Barton, Ms Butterfield and Mr Edwards from appreciating that BMW did not know that an MBO had been proposed. As already mentioned, Ms Butterfield frankly accepted that her assumption was that Mr Whyte had not told BMW that he was an MBO candidate. That assumption was the obvious inference from the facts: it could hardly be supposed that, if it had known of the possibility of an MBO, BMW would have allowed Mr Whyte to continue to handle the sale of the loan book unless he was a "*stooge*". While, however, Mr Einollahi told us in interview that he had believed Mr Whyte to be a "*stooge*":

56.1. if the position is rather, as suggested by his written evidence, that Mr Einollahi was merely suspicious of Mr Whyte, he will have been aware that Mr Whyte might not be a "*stooge*";

56.2. we cannot see why Deloitte should have sought information from Mr Whyte as they did[51] had Mr Einollahi (or anyone else concerned) been confident that Mr Whyte was a "*stooge*";

56.3. representations made to us on behalf of the members of the Phoenix Consortium stressed that "*all of the discussions which occurred with Mr Whyte regarding his potential involvement were genuine discussions regarding an option which was on the table (with a view to having experienced management involved after the bid)*". Such discussions would hardly have been conducted had Mr Whyte been regarded as a "*stooge*";

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[51] See in particular paragraph 58 below.

56.4. passages in the meeting notes indicate that the understanding was that Mr Whyte had not yet told BMW of the MBO. Thus, Mr Birkett's notes of the 13 March meeting[52] with Mr Whyte include the passage, "*Until MG Rover have clear run at RFS, would prefer IW mgmt not to 'come out of the woodwork'*". Similarly, Mr Birkett's notes of the 14 June meeting[53] with Mr Whyte include the words, "*when IW announce he is MBO, ME to request unencumbered access to mgmt team and info*"; and

56.5. so far as we are aware, neither Mr Einollahi nor anyone else concerned had any reason at all to suppose that BMW was the sort of organisation that would use Mr Whyte as a "*stooge*".

If, as his evidence indicates, Mr Einollahi nevertheless thought that there was a chance that Mr Whyte was a "*stooge*", we cannot believe that he thought the possibility a likely one.

57. It may be that, as Mr Barton's evidence particularly suggests, there was a feeling that it was for Mr Whyte to resolve his own conflict of interest. We do not, however, think that the conflict should have been of concern only to Mr Whyte. We take the view that Deloitte and Mr Edwards should not have placed themselves in a position where they were receiving information from Mr Whyte in circumstances where there was every reason to think that BMW did not know him to be an MBO candidate and where, in our view, those concerned must all have known that there was at least a strong risk that BMW was not aware of the possibility of Mr Whyte being involved in an MBO[54].

58. In fact, Deloitte did not just receive information from Mr Whyte, they sought it from him. In the 11 June fax from Mr Birkett mentioned above[55], Deloitte, having stated that they "*assumed that* [Mr Whyte] *remain*[ed] *wholly committed to* [an MBO]", went on:

> "*We now have 2 weeks to submit our initial bid for the existing portfolio. For us to achieve that (which we must for it to succeed), we need the following from you:*

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52 See paragraph 36 above.
53 See paragraph 42 above.
54 As mentioned in chapter VI (Development agreement with St. Modwen) (at VI/35), Millett J noted in *Logicrose Ltd v Southend United Football Club Ltd* that:
> "*A principal is entitled to the disinterested advice of his agent free from the potentially corrupting influence of an interest of his own. Any such private interest, whether actual or contemplated, which is not known and consented to by his principal, disqualifies him ...*"

The same case indicates that a third party making a payment to another's agent may incur civil legal liability if he knows that, or is wilfully blind as to the question whether, the agent has concealed the payment from his principal, and also that "*where one party to a transaction takes ... 'the hazardous course' of making a payment for the personal benefit of the other's agent, and does not disclose it to the principal, he cannot afterwards defend the transaction by claiming that he believed the agent to be an honest man who would disclose it himself*". It may be possible to draw an analogy with the position as regards Mr Whyte.
55 See paragraph 40 above.

1. *Future monthly cash flows from the current portfolio …*

2. *Your estimates of the administration and collection costs to manage the portfolio over its life. This should be on two bases:*

   – *as a stand-alone portfolio*

   – *on the assumption that the portfolio is run together with the new Rover leasing business*

   As a cross-check, please also provide the current monthly average administration and collection costs for the portfolio.

3. *Your estimates of the effect on contracted cash flows of:*

   – *bad debts*

   – *early terminations*

   – *shortfall in residual values where not guaranteed*

   – *any other variables based on your experience*

4. *The current level of residual values guaranteed by MG Rover and the level which will be guaranteed at 9 May 2002 (assuming normal pattern of early terminations).*

5. *From the above, your valuation of the portfolio.*

6. *Details of any material assumptions or uncertainties in the above.*

7. *Your business plan for Newco on the basis that Newco raises the funding to enable it to write new business for MG Rover dealers. This will need to be developed in detail, but for the initial bid we need an outline strategy which deals with:*

   – *the proposed management team*

   – *systems*

   – *the transitional arrangements for the existing portfolio*

   – *new business criteria and broad terms*

   – *the level of new business to be written and the overall portfolio size at maturity*"

On 7 June Ms Butterfield had said in an internal email:

> "*I am very conscious of the info requirements and the need to get I Whyte motivated to supply as much help as possible asap.*"

It was about the same time that there was reference to Mr Whyte "*responding well to carrot*"[56].

59. Ms Butterfield told us that she "*would have assumed that Ian Whyte would have had to clear his lines to provide this information*". When it was suggested to her that Deloitte had been "*asking for information which includes information that you would not expect a vendor to provide but you would expect a management buyout candidate to provide*", she said:

> "*Well, it is a mixture of the two ... – the basic information underlying all of this, valuation or otherwise, is all information that you expect a vendor to provide, but the translation of that information into things like a valuation is something that you expect the management buyout candidate to provide.*"

60. When we asked Mr Eldridge about this letter, he commented:

> "*I would not expect to see a letter of this nature in circumstances whereby the project manager was planning a buy-out or buy-in without the knowledge of his employer, which I assume must have been the case otherwise we would have learnt about it.*"

61. In effect, Deloitte were, as it seems to us, seeking to use the prospect of involvement in an MBO to persuade Mr Whyte to supply potentially confidential information, or information BMW would or might have preferred Mr Whyte not to disclose, in order:

    61.1. to give their clients an advantage in their bid as compared with any other bidders; and

    61.2. to facilitate the acquisition of the Rover loan book at the lowest possible price.

    In the event, Mr Whyte did not supply all the information requested; there is, for example, no evidence that he ever provided a business plan. That fact does not, however, make either Mr Whyte's or Deloitte's conduct acceptable.

62. The person primarily responsible for Deloitte's conduct in relation to Mr Whyte must be Mr Einollahi, the partner concerned. It seems to us that Mr Barton, who was a director of Deloitte and closely involved with Project Platinum over an extended period, must also bear some responsibility. Ms Butterfield was in a significantly different position. She did not become involved in Project Platinum until 6 June 2001 and had no real involvement with the

[56] See paragraph 39 above.

transaction negotiations; rather, she was given specific and technical tasks (in particular, to oversee the preparation of a document to raise money through securitisation and to undertake a valuation of the loan book). It seems to us that she bears relatively little responsibility for what occurred.

63. We understand that, in the event, BMW was not unhappy with the price it obtained for the Rover loan book. There must, however, be at least a possibility that it would have achieved a better bargain if Mr Whyte had not supplied the information he did to Mr Edwards and Deloitte. Indeed an email sent by Mr Middleton on 8 August 2001 indicates that Deloitte were claiming that they would be able to achieve a lower purchase price for the Rover loan book due to their "*close relationship*" with BMW. Mr Middleton stated:

> "*D&T acknowledge the fee is high but justify it by claiming they have a close relationship with BMW and through that relationship will be able to deliver a deal that buys the book at a price significantly below what we would ordinarily pay for a motor book.*"

<u>The identity of the purchaser</u>

64. Members of the Phoenix Consortium were aware of the RV risks to which MGRG was exposed when negotiating to buy the company in the spring of 2000. Mr Beale explained as follows:

> "*During negotiations with BMW in May 2000, the liability of MGRG in respect of the residual value guarantees under contracts written by* [RFS] *was one of the key issues for the Phoenix Consortium. This was a material problem and involved a liability on the part of MGRG running into the tens of millions of pounds … This was an issue that I had been aware of from my time as a Rover dealer, well before the acquisition of MGRG, in that I was aware that MGRG was responsible for guaranteeing the residual values on Rover vehicles and knew that it must have had a significant liability in this respect.*"

65. Both Mr Beale and Mr Edwards thought that it was in early 2001 when they learned that BMW was trying to sell the Rover loan book. As noted above, Mr Whyte first wrote to Mr Edwards about the potential sale of the Rover portfolio on 26 January, addressing his letter to Mr Edwards as deputy chairman of MGRG. In interview, Mr Edwards was referred to this letter of 26 January and was asked whether he could think of anything that would have alerted the BMW side to the fact, if it were one, that he was not wearing a company director hat at this stage. He replied:

> "*… No. No, I cannot.*"

66. When Mr Edwards replied to Mr Whyte, in a letter dated 8 February 2001, he did so on PVH writing paper and expressed himself as signing "*For and on behalf of MG Rover Holdings Ltd*". At the end of the next month, KPMG sent their information pack to Mr Edwards as "*Deputy Chairman MG Rover Holdings Ltd*". Mr Edwards responded on PVH writing paper and in a letter to KPMG dated 18 April Mr Barton wrote:

> "*I am writing to you on behalf of John Edwards, Deputy Chairman of MG Rover. As you are aware, MG Rover have expressed an interest in acquiring RFS and we are acting as financial advisors to MG Rover Holdings Limited.*"

67. At the beginning of June 2001, a confidentiality agreement was concluded. The parties were RFS and MGRG (referred to as "*MG ROVER*"). It was recited that RFS had "*entered into discussions with MG ROVER regarding the Proposed Transaction*" and "*Proposed Transaction*" was defined to mean "*(i) the proposed sale by RFS and the purchase by MG ROVER of a portfolio of automotive receivables and related rights and obligations or (ii) the sale by the sole shareholder of RFS … of the entire issued share capital of RFS and the purchase thereof by MG ROVER*".

68. By later that month, however, it was being proposed that the loan book should be acquired by an entity in which certain directors (and not MGRG, PVH or any other company in the Group) would be interested. As noted above, when writing to Mr Griffiths on 25 June 2001 Mr Einollahi explained that the plan was to ring-fence the portfolio from PVH and that "*the company set up for the acquisition will be owned primarily by the Phoenix team and their financial partners*". Following a meeting with him on the same day, Mr Middleton noted that Mr Einollahi was "*acting for Towers and a number of fellow directors (through Phoenix Partnership distinct from MG Rover)*" and that BoS had been "*asked to determine our appetite to form a JV with the Phoenix Partnership to acquire the MG Rover financial assets*". On 4 July, Mr Edwards signed a letter to Mr Griffiths "*for the Phoenix Consortium*".

69. The shareholdings in the proposed joint venture vehicle were discussed at a meeting attended by Deloitte, Mr Edwards and Mr Beale on the same day, 4 July 2001. Mr Birkett's notes include a passage in the following terms:

> "*MGR do not want dealers part of s/h but do want Kevin Howe.*"

In another meeting that day, attended by representatives of Deloitte and BoS, one of the objectives was said to be, "*boys to make money*" (as recorded by Mr Birkett).

70. Later in the month, BoS raised the question of whether its joint venture partner should be one of the companies in the Group. In an email to Mr Birkett dated 27 July 2001, Mr Middleton wrote:

> "*In each of our meetings, I've stressed the need to ensure the transaction is highly transparent and would welcome your proposals in this regard. Clearly if the transaction does well and RVs hold up, our JV partners (but not the Bank) could do particularly well. The shareholders (I think this includes representation of the dealers and employees?) at least of MGR would have to be aware of the transaction and its possible ramifications for the directors – perhaps you would let me know D&T's thoughts. Would it be cleaner for MGR to be the partner or for the directors to agree a profit share with MGR to return a share of any RV upside?*"

When asked in interview what he had meant by "MGR", Mr Middleton replied:

> "*... At that time we would have regarded MGR as being MGR Holdings,* [i.e. PVH] *or MGR Group* [i.e. MGRG]. *We would not have differentiated between them.*"

At a meeting with Deloitte five days later, on 1 August, BoS again stated that it would prefer "*MGR*" to be the joint venture partner. In his notes of the meeting, Mr Birkett recorded the following as being Deloitte's response to this preference:

> "*Kevin Howe & John Millett want to concentrate on cars.*
>
> *Phoenix want to have shares as better profits for them.*"

Mr Birkett's notes record, however, that Mr Einollahi "*agreed with SM* [i.e. Mr Middleton] *idea that upside on RV should be paid back to MGR*" (referring, presumably, to the cash which was to be collateralised to cover the RV risks).

71. On 10 August 2001, Mr Middleton prepared a note for Mr Einollahi summarising the key commercial points in respect of the acquisition. Mr Middleton noted that the "*structure of the* [joint venture] *had yet to be determined*" and that the decision would be "*influenced by* [due] *diligence, tax and accounting*". He continued:

> "*The JV partner may be:*
>
> - *MGR, probably our preferred partner*
> - *A SPV* [i.e. Special Purpose Vehicle] *formed by a number of directors of MGR (there are a number of areas we would need to get comfortable with, including transparency and a profit share back to MGR in respect of Residual Values ('RV') in the event these are higher than our downside case).*
> - *A JV between the SPV and MGR*"

72. On 15 August, Mr Barton and Mr Einollahi spoke to Mr Alan Christie of BoS for an update following a BoS board meeting at which the proposed transaction had been discussed. Mr Christie again stated that BoS would prefer "*MGR*" to be the joint venture partner. Mr Barton's notes of the conversation include the following:

"• *MGR preference rather than Phoenix*

→ ME PC taking personal risks to drive process → ... going to be MGR will create value issue

- *No issue on transparency → wish MGR to get its value fairly, but looking to control ownership*"

During interview, Mr Barton said that he thought BoS was proposing a joint venture with PVH rather than MGRG. While, however, he explained that he did not remember Mr Christie referring to the car company (i.e. MGRG), he accepted that he did not remember any reference to PVH either. The likelihood, in our view, is that no distinction was drawn between the two companies. BoS was simply expressing the wish that its partner should be an "*MG Rover*" company.

73. Following the conversation with Mr Christie, on 16 August Mr Einollahi sent him a fax responding to BoS's preference for "*MGR*" to be the joint venture partner. Mr Einollahi wrote:

> "*Following our telephone conversation yesterday, I had a chance to speak to Phoenix Partnership ('PP') and respond to BoS's preference for MGR being the JV partner. As we have always indicated, there is absolutely no issue with regard to transparency and full disclosure. Indeed, this is a requirement of PP because of the high public profile that they enjoy. PP however, take the view that transparency is fundamentally different from one partner determining who the other partner may be.*
>
> *This transaction has gained its current status of being achievable almost entirely due to the efforts of PP and they firmly believe it is inequitable that they should now be deprived* [of] *the opportunity to be rewarded for their enterprise. Without PP's commitment to make a personal investment in the proposed transaction, there would be a funding gap. Should MGR be the JV partner, PP's potential return would be significantly reduced.*
>
> *In these circumstances, PP would be reluctantly prepared to go ahead with BoS's preference only on the basis of having a much reduced investment for a proportionately higher equity share. This would, however, introduce a funding gap. I would welcome an early response as to whether the choice of JV partner is a requirement of BoS or merely a preference as PP have now reluctantly come to the conclusion that I should be approaching another financier.*"

74. This fax had been sent to Mr Edwards in draft for approval earlier in the day. A handwritten note was made by Mr Birkett on a fax which accompanied the draft:

> "*JE confirmed to be sent to BoS 17/8*"

When this was shown to Mr Birkett during his interview, he stated:

> "*... I am assuming I got that wrong.*
>
> *Q. Which bit of it wrong?*
>
> *A. It seems to confirm after the date it was sent.*
>
> *Q. And do you think that is what happened?*
>
> *A. It would be unlikely ...*
>
> *MR NEWEY: To state the obvious, you think the likelihood is that it would not have been sent until there had been the confirmation?*
>
> *A. Yes ...*
>
> *A. I would have – the reasoning for putting a comment on saying John* [Edwards] *had approved was to ensure for our internal procedures we had not sent something out without being confirmed, so to put on a date post of when it was approved would seem like a strange thing to put on a file.*"

We accept this evidence. Mr Einollahi confirmed that he "*would not have allowed* [the fax to Mr Christie] *to go anywhere without client going back and saying it is okay*".

75. We asked Mr Middleton for his recollection as to how Deloitte responded to BoS's suggestion that "*MGR*" should be the joint venture partner. Mr Middleton stated:

> "*... there was more than one occasion whereby we raised transparency and potentially MG Rover as being the Joint Venture Partner. Ultimately, we were left in little doubt that if we wished to push that point, then the deal would be introduced to someone else.*"

When asked whether BoS had changed its position, Mr Middleton said:

> "*I do not think we were changing our position as such. I guess in August we were making stronger representations – or we started to really think about who the partner may be. Up until then, we had a germ of a potential deal and in the nature of these things, you look at the detail once you start getting towards a real transaction.*"

76. We asked each member of the Phoenix Partnership about the 16 August 2001 fax to Mr Christie. They gave a range of explanations.

77. Mr Edwards acknowledged that he had approved the sending of the fax (in Mr Einollahi's name), but said:

> "*It was not in accordance with my instructions. It was in accordance with* [Mr Einollahi's] *advice. The letter that I was going to send them was so rude that he said that they would not proceed with the transaction, so he found a way of constructing a letter with points that they would understand that told them no.*"

When Mr Edwards was asked to clarify what he had wanted to say in the fax, he replied:

> "*I basically wanted Maghsoud to tell Capital Bank that they were not going to be a partner alongside MG Rover and they would not be able to participate in new business going forward as part of this transaction. Maghsoud said: well, they are not going to like that very much, and I said: well, find a way of telling them no, and he crafted this letter which I approved to send them.*
>
> *… This Phoenix taking personal risk stuff is all Maghsoud. I was very incensed that they had used the Phoenix money to indemnify them to a position of confidence and then coming back wanting MGR to be the partner but my real concern was as I told you before.*"

Earlier in his evidence, Mr Edwards had said:

> "*Capital Bank, not content with just the opportunities in this acquisition – which I had pointed out to them very carefully revolved around a historic book that was an issue for MG Rover, that was my only concern, to gain control of that book and the disposals of the cars on it – saw a further opportunity, having got themselves risk-free, to grab MG Rover and get themselves into a position of grace for taking all sorts of dealer business which is quite profitable without ever having opened themselves up to the risk of funding dealers who need funding for new and used car facilities …*
>
> *… I believed that if Capital Bank, through HBOS, once got into an agreement with MG Rover, they would not have let it stop there …*"

Mr Edwards also said that Mr Einollahi had given him "*a long list of issues to deal with which just reinforced my opinion*". He told us that Mr Einollahi had said:

> "*If you let these guys get into MG Rover and they have any problems with the transaction, even if they have not got any problems with the transaction, they will want to take all sorts of security over balance sheet assets, all sorts of things, and what you will wind up with is an impaired balance sheet to go and buy a finance book when what you really want to be able to do is to keep your balance sheet as tidy as you can, to deal with your principal business.*"

78. In his evidence, Mr Beale said that Mr Einollahi's advice was "*firmly that we should stick to the structure that we all thought worked, the Phoenix Partnership and you know, quickly knocked out the idea of a MGRG entity entering into the deal*". Asked why he considered that "*MGR*" would not be a suitable vehicle to undertake the investment in MGR Capital, Mr Beale said:

> "*I think, based on advice from Maghsoud, there were several key issues. The first one was it would have put a significant liability on our balance sheet. Obviously there would be a matching asset, but it would still affect the rather simplistic view of some of the credit rating agencies.*
>
> *A bank could not help itself, if it had lent the money to an MG Rover entity, it would not have been able to help itself to go around looking to secure assets and impose covenants on us.*
>
> *It would almost certainly have involved a lot more due diligence …*
>
> *… and the fourth reason is obviously with all those covenants and so on, it would affect our ability to raise funding in the future. And all that advice sounded perfectly correct to me and my understanding of how things work*"

When asked whether the statement in the fax that the transaction had gained its current status of being achievable almost entirely due to the efforts of the Phoenix Partnership and they firmly believed it was inequitable that they should now be deprived of the opportunity to be rewarded for their enterprise was untrue, Mr Beale replied:

> "*I do not recollect seeing it. And yes, I certainly did not feel like that at the time*"

79. In his evidence, Mr Towers denied having been aware that BoS had expressed a preference for having "*MGR*" as its joint venture partner. He stated:

> "*The view from the Phoenix Consortium at that time would, I think, have been a fairly simple one which was: if MGRG can do it, let MGRG do it.*"

Mr Towers told us that his views were not as stated in the 16 August fax and that he had not seen that fax until we provided a copy of it.

80. Mr Stephenson, too, told us that he had not been aware that BoS had expressed a preference for having "*MGR*" as its joint venture partner. Asked whether it was his view that it was inequitable that the Phoenix Partnership should be deprived the opportunity to be rewarded for their enterprise, Mr Stephenson replied:

> "*Probably stronger than I would have put it, but I do not disagree with the sentiment expressed in the document. But it would not have been my choice of words*"

81. The fifth member of the Phoenix Partnership, Mr Howe, said in evidence to us that he had had no knowledge of BoS expressing a preference for having "*MGR*" as the joint venture partner. When asked whether it was his view that it was inequitable that the Phoenix Partnership should be deprived the opportunity to be rewarded for their enterprise, Mr Howe stated:

> "*... No, and it is not something – this member of the Phoenix Partnership could not have been being referred to, because I had not been spoken to about it.*"

82. For his part, Mr Einollahi acknowledged that he might have voiced a concern that, if a group company were a joint venture partner, BoS would seek security and covenants from MGRG. On the other hand, he told us that:

    82.1. Mr Edwards and Mr Beale were both opposed to having a Group company as the joint venture partner on the basis that they considered that the Phoenix Partnership should derive a personal benefit from the transaction;

    82.2. as far as he was aware, the reasons set out in the 16 August 2001 fax for the Phoenix Partnership undertaking the transaction were genuinely held by the Phoenix Partnership;

    82.3. he did not recall Mr Edwards stating that the contents of the 16 August fax were merely a cover for other reasons for him not wanting MGRG to be a joint venture partner;

    82.4. he did not recall Mr Edwards telling him that, in his view, BoS was suggesting that MGRG should be the joint venture partner as a means of getting closer to MGRG so that Capital Bank could attempt to write future finance business from MG Rover dealerships; and

    82.5. Mr Beale told him at the time that both he and Mr Towers had approved the 16 August fax in draft.

83. We consider that the likelihood is that all members of the Phoenix Partnership other than Mr Howe were aware of BoS's wish to have a Group company as its joint venture partner and rejected that option principally because they wanted to secure the anticipated profits for the Phoenix Partnership. This conclusion is supported by the following considerations:

    83.1. the 16 August fax stated that the Phoenix Partnership believed it to be "*... inequitable that they should ... be deprived the opportunity to be rewarded for their enterprise*";

    83.2. Mr Edwards accepts that he approved the fax;

83.3. Mr Einollahi recalls being told at the time that Mr Beale and Mr Towers had approved the fax[57]. In any event, Mr Edwards probably would not have taken it upon himself to approve the fax without knowing that Mr Beale, Mr Towers and Mr Stephenson all shared the views expressed in it, especially as the four were working closely together (in fact, in the same office);

83.4. Mr Edwards is unlikely to have been motivated by a concern that having a Group company as the joint venture partner would lead Capital Bank to write future business since (a) Mr Einollahi does not remember Mr Edwards expressing such a concern and (b) the extent (if any) to which Capital Bank was allowed to write future business would have remained in the hands of the Group even if Capital Bank had had a Group company as its joint venture partner;

83.5. had the concern been that BoS would demand security or covenants from MGRG, it is unlikely that BoS's proposal would have been rejected peremptorily, without investigation. After all, BoS had not to date suggested that any such security or covenants would be required, BoS was to have no comparable security if the Phoenix Partnership were the joint venture partner, and BoS might have been thought to be the less likely to insist on having security from MGRG when, in agreeing to have a Group company as the joint venture partner, the Phoenix Partnership would have been accommodating a BoS preference. Further, in September 2001, when it was thought that it might be advantageous from a tax perspective to have a Group company as the partner, that possibility appears to have been contemplated[58] without anyone worrying about whether that could result in security or covenants being demanded from MGRG. In any case, there would surely have been no reason to give a false explanation for the Phoenix Partnership's decision in the fax;

83.6. there are other references in the documentary evidence to Messrs Beale, Edwards, Stephenson and Towers wishing to benefit from the transaction. As mentioned above, notes from 4 July and 1 August respectively speak of "*boys to make money*" and "*Phoenix want to have shares as better profits for them*". Further, some notes made by Mr Birkett in about August 2001, perhaps by way of personal aide memoire, include, "*JE does want profit but does not* [want] *reputational risk at any cost*"; and

83.7. in early 2002, a matter of months after Project Platinum had been completed, it was proposed that one of the companies established for a scheme called Project Lisa (which is considered in chapter X) should be owned by the Phoenix Partnership rather than MGRG even though there was no bar to the company being owned by MGRG.

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[57] See paragraph 82.5 above.

[58] Thus, on 13 September 2001 Ms Butterfield confirmed to Mr Hume that he was "*to explore with BMW tax the possibility of creating a trading loss in RFS pre-acq*" on the basis of an "*assumption that* [PVH] *rather than* [the Phoenix Partnership] *acquires RFS*". Ms Butterfield told us that she had herself been asked by Mr Einollahi to do some work in connection with an acquisition by PVH.

84. With regard to the suggestions in the 16 August fax that the transaction had "*gained its current status of being achievable almost entirely due to the efforts of* [the Phoenix Partnership]" and that there would be a "*funding gap*" if "*MGR*" were the partner:

84.1. the Phoenix Partnership was to provide only limited funding (no more than £5 million in total ever seems to have been contemplated and by 14 August Mr Towers had suggested that £2 million should suffice). At this period, MGRG would have had no difficulty in funding such an investment from its own resources[59];

84.2. the protection against RV risks which MGRG was to provide (by depositing tens of millions of pounds in an RV Capco account) was crucial to the transaction[60]; and

84.3. it is in any case difficult to see why the transaction should be said to have been rendered achievable by efforts of the Phoenix Partnership *personally* (rather than as directors of Group companies). In any event, Mr Towers and Mr Stephenson by their own admission had very little to do with the completion of Project Platinum.

85. Mr Einollahi told us that it was his recollection at the time that Mr Millett and Mr Howe were both opposed to MGRG acquiring the loan book. That this was Mr Einollahi's understanding might be said to be consistent with a passage in the notes of a meeting with BoS on 1 August 2001 reading, "*Kevin Howe & John Millett want to concentrate on cars*". In fact, however, Mr Millett and Mr Howe did not object to MGRG being involved in the purchase of the loan book. To the contrary, it was Mr Millett's evidence (which we accept) that he had "*strong views*" that MGRG should be the joint venture partner and expressed those views more than once. Mr Beale confirmed that Mr Millett had had a "*real desire for MG Rover to be party to this transaction*" and had thought that any funding problems were "*solvable*".

<u>Advice from Mr Robin Potts QC in respect of the duties of the members of the Phoenix Partnership as directors of MGRG and PVH and possible unfair prejudice to other shareholders of PVH</u>

86. In an email to Mr Einollahi dated 20 August 2001, Ms Lewis of Eversheds expressed the view that the proposed transaction structure raised issues relating to "*the old chestnut of 'directors duties'*". She wrote:

> "*This time the issue we need to face is that like all fiduciaries, directors are not, as such, allowed to make a profit from their position. Where a director 'wrongly' profits personally from his position the courts will often give a remedy to the company on the basis that by reason of his fiduciary position as a director he is not allowed to derive any profit from it without complying with disclosure and/or approval requirements. This requirement is sometimes known as the 'secret profits' rule.*

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[59] Especially as the second tranche of the BMW "dowry" had recently been provided, see III/90, XVI/21 and chapter XII footnote 3.
[60] See further paragraph 216 below.

In this particular case the argument would run that the opportunity to participate in Project Platinum has arisen to the consortium members by reason of the fact of their involvement with MG Rover. In those circumstances and bearing in mind the fact that each of them is a director there is a duty imposed on each of them not to take on for themselves or to divert to another person or company with whom or with which he is associated a business opportunity.

There are a number of important points here:

1. *The basis of liability is that a director makes a profit himself without the knowledge and consent of shareholders. Liability arises from the mere fact of a profit having been made and in no way depends on fraud, absence of bona fides or upon such questions or considerations as whether the profit would or should otherwise have gone to the company or whether the company has in fact been damaged.*

2. *The directors*['] *profit need not be at the company's expense. If directors attract a contract to themselves by virtue of their position and profit thereby then they are liable even though other parties may have refused to contract with the company. There is also a line of cases which say that it does not matter that the company was financially or legally unable to acquire the benefit or take advantage of the opportunity in question. Similarly it would also seem not to matter that the company had refused to agree to the arrangement which generated the profit. To emphasise the point made in paragraph 1 above, the fact which triggers the liability is the mere fact of the directors having made a profit; the fact that the company did not wish to or could not have made the profit (perhaps in our case because the funders would not back the company or a joint venture in which the company was a partner) is irrelevant.*

3. *The obligation to account for the profit made is owed to the company itself. Except in certain limited circumstances only the company can bring an action against the directors to require the directors to account. In our particular circumstances, of course, the consortium has control and is therefore unlikely to vote for proceedings to be issued against themselves! However it will remain an issue for the future on a sale or other exit, potentially in the event of insolvency and, perhaps from a more practical point of view, may give rise to allegations of unfair prejudice in respect of the other shareholders.*

4. *I believe, however, that if shareholders were to approve the transaction then that would absolve the directors from any obligation to account for any profit which they make. Again the consortium are the only shareholders who vote and shareholders approval is, therefore, something which ought to be a deliverable. Perhaps the issue, however, is one of transparency. Notice of shareholders meetings has to be given to the holders of the C Shares (the executive team) and the two trust companies. I emphasise, however, that none*

of these can vote so control is firmly vested in the consortium. There are two sub-points here:-

(a) I have seen your fax to Capital Bank discussing the issue of transparency and PR; presumably, therefore, the notice requirements contained in the Articles should not pose a particular issue? If they do then it may be the case that shareholders approval could be obtained 'after the event' but this is something I would need to check.

(b) Confidentiality may, of course, be an issue before the transaction is concluded. That is, however, a practical issue with which we should be able to deal.

5. The final issue which we need to consider is that of unfair prejudice. In other words can the other shareholders allege that the proposed transaction undertaken by the consortium personally (as distinct from through the company) unfairly prejudices their position. My preliminary view at this stage is that they could not for the simple reason that the other shareholders only participate in the economic value of MG Rover. Whether Project Platinum is effected personally or through the Group will not, therefore, make any difference to the value of their shareholdings. It would, of course, be important to ensure that transactions between the target and the company are on an arms length and proper basis after completion but that would be the case no matter who the joint venture partner is.

Recognising that this is a sensitive and potentially difficult issue I plan to instruct Counsel for his views. I fully expect his view will be that if the joint venture partner is the consortium as a collection of individuals then in order to avoid any obligation in future to account for any profit they make it will be necessary to have the transaction approved by shareholders. This should be a mechanistic exercise bearing in mind the fact that the voting shareholders and the consortium members are one and the same. Nonetheless I think that leading Counsel's opinion would be helpful for PR purposes going forward."

87. Ms Liz Kitchin of Eversheds sent Deloitte a draft of the instructions to counsel on 21 August 2001 for their comments. Mr Barton responded the same day on the question of whether "*the JV partner has always been envisaged to be the Consortium rather than MGR*". He said:

"*This is the case, as the Consortium have arranged/are arranging the affairs of the Group such that the vehicle manufacturing business is managed by the executive managers, and all the other interests of the Group are separate companies under Holdings. To this end it was always envisaged that RFS would be managed as an entirely separate company, either with its own managers, separate from the Group, or as is now the case in a JV company with the Consortium as shareholders.*

Yourself and Sue [Lewis] *will be aware that the members of the Consortium are keen to ensure transparency, and you rightly note that debt funding relating to the Group has been a difficult area since the original acquisition – hence the concept of keeping RFS separate from the MGR core business.*"

88. We asked Mr Barton whether it was correct to state that "*the JV partner has always been envisaged to be the Consortium rather than MGR*". He explained that, while the acquisition of the loan book might not always have been seen as a Phoenix Consortium transaction (as opposed to an "*MGR*" one), for so long as the possibility of a joint venture had been under consideration the plan had been for the Phoenix Consortium to be the joint venture partner. He also pointed out that he responded quickly (within about an hour) to Ms Kitchin's email and that he did not draft his email with the care and attention to the exact language that he would employ in a formal piece of correspondence. He said, too, that his reference to the management of RFS "*separate from the Group*" was not intended as a reference to any separate ownership of RFS, outside the broader MG Rover group; what he was intending to say was that RFS would be *managed* separately from the rest of the Group.

89. Following receipt of Mr Barton's response, Ms Kitchin wrote the following to Ms Lewis:

"*I haven't got back to Ian as wasn't sure whether you'd already spoken to Maghsoud. Although Ian's comments explain why MG Rover* ***Group*** *Ltd was never intended to be the JV partner, to my mind they don't really explain why MG Rover* ***Holdings*** *Ltd wasn't intended to be JV partner.*

To have Holdings as the JV partner would surely be in line with the policy to arrange the affairs of the Group such that the vehicle manufacturing business is managed by the executive managers, and all the other interests of the Group are separate companies under Holdings."

90. On 29 August 2001, Ms Butterfield of Deloitte emailed Eversheds with comments on the draft instructions to counsel. In her email, Ms Butterfield set out various relevant facts which could usefully be added to the instructions to counsel. These were as follows:

90.1. "*... the 4 individuals comprising the Phoenix Consortium own all the voting shares in MG Rover Holdings and are entitled to all profits generated by it and its subsidiaries, except for a proportion of the profits of the car business as constituted at its acquisition in May 2000 – to which various Rover employees, senior executives and authorised distributors are entitled. Therefore financially it makes no difference to the 4 individuals whether RFS is acquired by a new company wholly owned by them or by MG Rover Holdings or any of its subsidiaries – they are still entitled to all of its profits*";

90.2. "*One of the key questions must be as to whether the opportunity for the Phoenix Consortium to acquire RFS has arisen to the Consortium as individuals (by virtue of who they are and indeed perhaps the ability they have already demonstrated to BMW*

of being able to complete major financial transactions when they bought Rover) or as directors of MG Rover Holdings or indeed any of its subsidiaries. This is not a question we can answer as we do not know how BMW has assessed them in concluding that they are acceptable purchasers"; and

90.3. "*... Maghsoud raised the possibility of acquiring RFS in discussions with the Consortium members before RFS was put on the market and the Consortium members expressed an interest at that stage. At no point has anyone from MG Rover Holdings, Techtronic or MG Rover Group other than the individual consortium members been in discussion with BMW in connection with acquiring RFS ...* [T]*he Consortium members have assumed that, because of Rover's poor credit rating, none of Holdings, Techtronic or Rover would be able to raise the necessary finance to conclude such a transaction and therefore the opportunity would not arise to them. The only point at which it has been raised in the process as to whether any of Holdings, Techtronic, or MG Rover Group should be party to the transaction was when it was raised by the bank which it is proposed should fund the acquisition in discussion as to who their joint venture partner would be*".

91. When we spoke to Ms Butterfield about points arising from this email, she replied:

> "*You really should pose these question*[s] *to Maghsoud because he was the one who drafted this response and he was the one who gave me the words to put into that response to Sue Lewis. So I was reliant on his – what he thought appropriate to put in. I have told you two separate things: I have told you what my understanding as a team member was and I have told you what I was instructed to put.*"

For his part, Mr Einollahi told us it was "*absolutely possible*" that the email was drafted principally on his dictation.

92. The email seems to us to be open to criticism in the following respects:

92.1. as can be seen above[61], between January and June of 2001 correspondence with BMW and KPMG was conducted by or on behalf of MGRG or PVH. Ring-fencing from PVH does not feature in the correspondence until 25 June. It was therefore misleading to say, "*At no point has anyone from MG Rover Holdings, Techtronic or MG Rover Group other than the individual Consortium members been in discussion with BMW in connection with acquiring RFS*"; and

92.2. although Ms Butterfield mentions that the bank funding the acquisition, i.e. BoS, had raised the question as to who its joint venture partner would be, she does not explain that BoS had actually expressed a preference for having "*MGR*" as its joint venture partner. Nor does she state that BoS's preference was rejected on the basis that it

[61] See paragraphs 9, 14, 17, 65 and 66 above.

would be "*inequitable*" that the Phoenix Partnership should be deprived the opportunity to be rewarded for their enterprise (as per the 16 August fax[62]).

93. With regard to the suggestion (for which we do not criticise Deloitte) that "*financially it makes no difference to the 4 individuals* [i.e. the members of the Phoenix Consortium] *whether RFS is acquired by a new company wholly owned by them or MG Rover Holdings or any of its subsidiaries*":

93.1. were either MGRG or a subsidiary of MGRG to be the joint venture partner, the Phoenix Consortium's ability to extract profits generated by the Platinum transaction was likely to be severely attenuated, especially as MGRG's financial circumstances precluded the payment of dividends[63];

93.2. as a practical matter, it was going to be much easier for the Phoenix Consortium to secure Platinum profits for themselves with the Phoenix Partnership as the joint venture partner than with even PVH as the joint venture partner[64]; and

93.3. it can be seen from the 16 August fax to Mr Christie that the perception was that the Phoenix Partnership's "*potential returns would be significantly reduced*" were "*MGR*" to be the joint venture partner[65].

94. The final version of the instructions to counsel was sent out on 31 August 2001. Understandably, the instructions reflected comments Deloitte had made on the draft instructions.

95. By way of background to the transaction, in the instructions sent to counsel Eversheds stated:

> "*There has been an awareness by the individual members of the Phoenix Consortium (and probably more generally) that BMW is looking to extract itself from all 'Rover' and 'Land Rover' related businesses, including RFS. An adviser to the Phoenix Consortium (who also advises the MG Rover Group in addition) raised the possibility of acquiring RFS in discussions with the Phoenix Consortium before RFS was put on the market and they expressed an interest in so doing at that early stage. That interest was communicated to BMW. Subsequently, BMW produced an Information Memorandum which has been distributed around a relatively large number of prospective purchasers. Offers were invited.*

62 See paragraph 73 above.

63 Section 263 of the Companies Act 1985 barred companies from making distributions (including dividend payments) otherwise than out of "*profits available for the purpose*" (as defined in the Act).

64 Paragraph 95.3 below alludes to some of the obstacles which could have been expected to arise had PVH been the joint venture partner.

65 See paragraph 73 above. A manuscript draft of the fax had referred to the Phoenix Partnership's potential return being "*reduced by half*".

> *Discussions were held with BMW and those discussions were held either with the Phoenix Consortium members, or their advisers. At no stage have discussions been held with Holdings, Techtronic or Group (save insofar as it might be said that the Phoenix Consortium members are representatives of all or any of those companies).*"

Counsel was informed that it "*was always the intention that RFS would be held separately*" from PVH for the following reasons:

95.1. "*... the strategy of the Phoenix Consortium generally is that the affairs of Holdings* [i.e. PVH] *and its subsidiaries are being arranged such that the vehicle manufacturing business is held by Group* [i.e. MGRG] *and is managed by Group's executive managers. All other business interests are held separately under Holdings*";

95.2. "*... debt funding for Group (and any entity within the same group of companies as it including Techtronic and Holdings) has been extremely troublesome from the outset. Following the original transaction in May 2000 it was extremely difficult to persuade a clearing bank to provide a clearing facility for the group as a whole, let alone make financial facilities available. The Phoenix Consortium concluded that trying to structure any transaction such that debt funding was made available to a member of the group as a whole was doomed to failure*"; and

95.3. "*... even if it were to be the case that Holdings were to be involved in the proposed acquisition of RFS (in place of the private individuals), the D Shareholders, as the Articles of Holdings are currently structured, would be entitled to all the economic benefit of RFS. The Phoenix Consortium feel, however, that if they were to extract that benefit from Holdings in accordance with their entitlement, it could be damaging from an industrial relations point of view on the basis that some shareholders are extracting value whereas others (particularly the workforce) get nothing. That is thought to be the case even though any such extraction of value would be in accordance with legal entitlements*".

96. There was no mention in the instructions of MGRG's financial position. We asked Ms Lewis whether she had considered this. Ms Lewis explained (and we accept) that, at the time, Eversheds had been given no indication as to MGRG's financial position and had no particular reason to be concerned about it.

97. The instructions to counsel were copied to Mr Beale under cover of an email in which Ms Lewis said:

> "*I know that you have been out of the office this week and so have not, therefore, had the opportunity to review them. If there are any specific comments you would like me to pass on to Counsel in advance of our meeting with him so that he can consider them please let me know.*"

98. Mr Robin Potts QC advised on the instructions in a telephone consultation on 10 September 2001. Ms Lewis, Mr Beale, Mr Einollahi and Mr Barton all attended the consultation by telephone. A note of the advice approved by Mr Potts includes the following:

> "*... on the face of it there is an argument that the* [Phoenix] *Consortium members have a disclosable interest under the principle of Regal Hastings*[66] *because of the possibility that the Consortium has gained the opportunity to acquire Rover Financial Service*[s] *(GB) Limited ('RFS') by virtue of them being directors of MG Rover Holdings Limited ('Holdings') ...*
>
> *Mr Potts concludes from reading Articles 19.1.1, 19.1.4 and 19.1.5* [of PVH's Articles of Association] *that provided the matter is disclosed to the board of Holdings and approved by the board of Holdings this is sufficient to whitewash the breach of duty and prevent the directors from having to account for any profits derived from the acquisition of RFS by a company in which they are interested ...*
>
> *There could be an argument that the opportunity to acquire RFS had arisen by virtue of the members of the Consortium being directors of MG Rover Group Limited ('Group'). It will be necessary to check the Articles of Association of Group to see if they contain an equivalent provision to that in Article 19 of Holdings Articles. Mr Potts further comments that the applicable board resolutions should be stated to ratify the breach in respect of the relevant individuals' capacity as directors. Mr Potts also confirms his agreement with instructing solicitors that 'for good measure,' obtaining the approval of the D shareholders to the transaction would be advisable but Mr Potts confirms that he sees no need to have a shareholders meeting of which notice is given, but that a written resolution procedure could be used.*
>
> *Mr Potts comments that he does not see how the proposed transaction could be seen to be unfairly prejudicial to the minority shareholders of Holdings. As he sees it, if the D Shares are the only shares with voting rights, if the D Shareholders exercise these voting rights then that should be the end of it. Mr Potts further comments that to succeed, an unfair prejudice action requires the complainant to show there is some prejudice. If therefore, for whatever reason, Holdings or Group do not have the opportunity to make the acquisition, then there can be no prejudice.*
>
> *Mr Potts also confirms that he agrees with Instructing Solicitors that as the A, B and C shareholders of Holdings are only entitled to participate in the economic benefit of the business of Group, as it existed at the date of adoption of the Articles of Association, then there clearly can be no prejudice by the proposed acquisition of RFS taking place outside the Group. Even if Holdings or Group were to acquire RFS, the other shareholders of Holdings would not be able to participate in any consequential economic benefit.*"

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[66] This must refer to the decision of the House of Lords in *Regal (Hastings) Limited v Gulliver* [1942] 1 All ER 378.

99. Among the points to emerge from this note are the following:

    99.1. Mr Potts suggested that there should be resolutions from the boards of both PVH and MGRG;

    99.2. Mr Potts advised that the board resolutions should be "*stated to ratify the breach of the relevant individuals' capacity as directors*"; and

    99.3. Mr Potts took the view that there could be no prejudice to PVH's "A", "B" and "C" shareholders on the basis that PVH and MGRG did "*not have the opportunity to make the acquisition*". (He had not, of course, been informed that BoS had expressed a preference for having "*MGR*" as its joint venture partner.)

100. It is apparent from the note that Mr Potts warned that there "*could be an argument that the opportunity to acquire RFS had arisen by virtue of the members of the Consortium being directors of* [MGRG]". In our view, there was an additional ground on which the members of the Phoenix Partnership were liable to become accountable to MGRG. There is a rule of law (the "*no profit*" rule) to the effect that a fiduciary (such as a company director) must account to his principal (which, in the case of a director, will be his company) for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it[67]. That rule might be said to be applicable in the context of Project Platinum not only because the "*opportunity to acquire RFS had arisen by virtue of the members of the Consortium being directors of* [MGRG]", but on the basis that the members of the Phoenix Partnership were to obtain profits by procuring MGRG (of which they were all directors) to deposit money in the RV Capco account[68]. As already mentioned, the protection against RV risks which this deposit afforded was crucial to the transaction[69].

101. Article 19.1 of PVH's articles of association, to which there is reference in the note of advice, provided as follows:

> "*Subject to the provisions of the Act, and provided that he has disclosed to the board of directors the nature and exten*[t] *of any interest of his, a director notwithstanding his office:*
>
> *19.1.1 may be a party to or otherwise interested in any transaction or arrangement with the Company or in which the Company is in any way interested; …*

[67] See e.g. *Chan v Zacharia* (1984) 154 CLR 178 and *Don King Productions Inc v Warren* [2000] 1 BCLC 607.
[68] See paragraph 24.6 above.
[69] See paragraphs 15, 16 and 84.2 above. See further paragraph 216 below.

19.1.4 shall not by reason of his office be accountable to the Company for any benefit which he derives ... from any such transaction or arrangement ... and no such transaction or arrangement shall be liable to be avoided on the ground of any such interest or benefit; and

19.1.5 shall be entitled to vote on any resolution and (whether or not he shall vote) be counted in the quorum on any matter referred to in any Articles 19.1.1 to 19.1.4 (inclusive) or on any resolution which in any way concerns or relates to a matter in which he has, directly or indirectly, any kind of interest whatsoever and if he shall vote on any resolution as aforesaid his vote shall be counted."

102. As recorded above[70], Mr Potts QC advised that MGRG's articles of association needed to be checked to see whether they contained "*an equivalent provision to that in Article 19 of* [PVH's] *Articles*". In fact, MGRG's articles of association gave much less scope for directors to vote on matters in which they had personal interests. Article 83 of MGRG's articles of association provided that, subject to specified exceptions, "*a director shall not vote at a meeting of directors ... on any resolution concerning a matter in which he has, directly or indirectly, an interest or duty which is material and which conflicts or may conflict with the interest of the Company…*".

103. Shortly after the telephone consultation with Mr Potts, Ms Lewis was "*summoned over to Longbridge to see Peter Beale, and then was roundly ticked off by Peter*". She explained:

"*... he was saying we had gone off and got this opinion, and the words I remember him using were we were not anybody's moral guardians and our job was just to implement the legals, and I explained to him that that was precisely what we were trying to do, was to make sure that what was being done was being done properly.*

I think after what was actually a very difficult conversation with Peter, I spoke to Jane Ruston about it because she knew that it was coming. She understood where we were coming from on that, and that actually, we were just trying to protect the interests of the directors.

… it is one of those conversations that you do not forget. I mean, that was the tenor of it really, that it was not for me to contribute in a sort of judgmental type of way – those are my words, not his – as to how they were trying to structure things and that was obviously a matter for them, and my role was limited to the legals which of course is right, but that was what we were doing ...

[70] See paragraph 98 above.

… in the context of what he was talking about on Platinum, I explained to him that we were doing precisely what we were supposed to be doing, which was making sure that whatever transaction ultimately took place was one which was proper in the legal sense of the word, both as far as the companies and the directors were involved.

Q. *The essential idea behind what he was saying was it was not for you to judge the morality of them taking benefits for themselves in one way or another?*

A. *Pretty much. Yes.*"

104. We consider in paragraphs 183 to 209 below the steps which were subsequently taken with a view to "*whitewashing*" the Phoenix Partnership's involvement in Project Platinum.

Anticipated returns

105. On 27 July 2001 Mr Middleton emailed to Deloitte a model which BoS had prepared for the proposed transaction. It is apparent from a document sent with the model that, for the purpose of preparing it, BoS had made the following assumptions:

105.1. the "*doomsday*" scenario[71] (involving the failure of MGRG) would occur as of May 2002;

105.2. Deloitte would receive both £7 million and a 5 per cent profit share[72]; and

105.3. BoS would have a 51 per cent profit share and its joint venture partner 44 per cent.

The model contained a "*Valuation summary*" which showed the following expected profits (excluding the £7 million payment to Deloitte):

	Percentage share	**£ million**
BoS	51	9.5
Joint venture partner	44	6.7
Deloitte	5	0.9
Total		**17.1**

106. By 8 August 2001, BoS had prepared a "*Preliminary Acquisition Paper*" in respect of the transaction. This explained as follows:

[71] The "*doomsday*" scenario envisaged a 20 per cent fall in residual values if MGRG failed to survive. As stated, BoS made the assumption that the "*doomsday*" scenario would occur as of May 2002. To protect against this exposure, BoS required MGRG to deposit money to cover this fall in value, and the money was referred to as "*doomsday*" money.

[72] As to which, see paragraph 120 below.

> "*A major risk in the transaction is the exposure to MGR vehicle residual values. During our discussions with* [Deloitte]*, we made it clear that we would take a cautious stance in this regard. It is proposed therefore that our JV partner would provide BoS with a security cash deposit of £39.5 million to underwrite any residual value ('RV') losses, thus removing any reasonable assessment of inherent MGR risk in the portfolio (theoretically a risk would remain in the highly unlikely event RVs went below our doomsday scenario).*"

It was calculated that, even if the cash collateral were exhausted, BoS should achieve a return of £5.3 million and its joint venture partner one of £1.4 million. Should "*the doomsday scenario*[73] *not materialise to the extent forecast*", BoS would "*benefit by a further amount up to £4.4 million*" (and, by implication, the joint venture partner would also stand to benefit).

107. On 14 August 2001, two days before Mr Einollahi's fax responding to BoS's preference for "*MGR*" to be its joint venture partner was sent[74], Mr Beale and Mr Towers discussed Project Platinum at a meeting with Deloitte. The notes of the meeting taken by Mr Birkett do not record any discussions about BoS's preference, but do refer to the profits the Phoenix Partnership could expect to make from entering into the joint venture. Mr Beale and Mr Towers were told by Deloitte that they could expect a yield of 10 per cent on their investment in MGR Capital, plus a further 10 per cent when the book was run down, as well as a profit share of circa £7 million before tax.

108. In October 2001 HBOS prepared a paper outlining the strategic case for the purchase of the Rover portfolio. The paper noted that a "*comprehensive financial due diligence exercise has been undertaken by PricewaterhouseCoopers* [i.e. PwC]" and that it had been possible to structure the transaction "*to mitigate, in full, against certain key risks*", including "*Residual value exposure, voluntary termination and repossession*". Included in this paper was a calculation of the potential benefits to each of the joint venture partners under three scenarios: base case, downside case and upside case. The base case reflected BoS's Motor Division's current experience with its existing book, while the downside case reflected the "*doomsday*" scenario. The expected profit under each scenario was:

[73] See paragraph 105.1 above.
[74] See paragraph 73 above.

	Base case		Downside case		Upside case	
	HBOS	Phoenix Partnership	HBOS	Phoenix Partnership	HBOS	Phoenix Partnership
	£ million	**£ million**	**£ million**	**£ million**	**£ million**	**£ million**
Pre-tax profits[75]	9.84	9.84	7.72	7.72	11.68	11.68
Funding	2.96	-	2.85	-	3.06	-
Cash distribution	-	0.92	-	0.77	-	0.92
Total profit	**12.80**	**10.76**	**10.57**	**8.49**	**14.74**	**12.60**

The paper concluded:

> "*This transaction affords BoS an opportunity to purchase at a significant discount a portfolio of motor receivables that will return excellent profitability over a five-year period. The negotiated position will ensure that all the major risks associated with the transaction have been mitigated, even in the severest of downside cases, thus protecting a high level of return.*"

It is clear that both HBOS and the Phoenix Partnership were expected to gain large returns from Project Platinum even in the "*doomsday*" scenario.

109. On 26 October 2001 HBOS sent Mr Birkett a copy of its current projections and Mr Birkett forwarded them to Mr Edwards and Mr Beale on the same day. Mr Birkett noted in his email to Mr Edwards and Mr Beale that there might be "*some changes to this following the discussion with BoS this morning*", but that "*any changes are likely to move projected profit upwards*". The projections showed the following profits:

	HBOS	Phoenix Partnership	Total
	50%	**50%**	**100%**
	£ million	**£ million**	**£ million**
Pre-tax profits	7.085	7.085	14.170
Funding	2.989	-	2.989
Cash distribution	-	0.900	0.900
Total profit	**10.074**	**7.985**	**18.059**
Cash to fund loan	-	(0.900)	(0.900)
Cash rolled up	-	7.085	7.085

110. On 1 November 2001 Mr Birkett sent Mr Beale both a document summarising key benefits and risks for the Phoenix Partnership and a further copy of HBOS's projections. Mr Birkett asked that Mr Beale "*distribute to the other members of the Phoenix team in advance of*

[75] MGR Capital's 2002 to 2008 financial statements report pre-tax profit before exceptional items as a total of £20.11 million (incorporating the re-stated 2005 figures).

your discussion with Maghsoud later today". The summary of key benefits and risks included the following:

> "*Key benefits*
>
> *1. PP will have a prior right to a 20% return on its £2 million investment. 10% will be paid annually (although it will be payable out of the PP's share of profits in JV Co). The further 10% will be rolled up and payable when the book has run down.*
>
> *2. PP will receive 50% of JV's profits.*
>
> *Key risks*
>
> *1. If sufficient profits are not made within JV Co, PP may lose all or some of their £2 million investment in JV Co.*"

111. Later on 1 November there was a conference call between Deloitte and the "*Phoenix Partnership*". Mr Birkett's notes of the meeting include the following:

> "*Peter Beale noted partnership have reviewed presentation/projections …*
>
> *ME – projections show transaction will make money <u>BUT</u>*
>
> - *can lose your £2m*
> - *if RVs too high, can lose it also*
>
> *– JT confirmed was the case*"

The notes do not include any specific reference to Mr Stephenson, but Mr Beale's recollection was that the four main members of the Phoenix Partnership (himself, Mr Edwards, Mr Stephenson and Mr Towers) were all present for the call. Mr Beale also said that, although he did not recall whether he had distributed to other members of the Phoenix Partnership the documents Mr Birkett had sent him, he presumed that he had done so. In interview, Mr Stephenson said at one point that he thought he had seen the HBOS projections, but he subsequently said that he was not sure that these particular projections were the ones that he had seen.

112. Mr Birkett sent HBOS's final projections to Mr Edwards on 12 November 2001. These projections showed an increase in the profits expected to accrue to the Phoenix Partnership, to £9.59 million:

	HBOS	Phoenix Partnership	Total
	50%	**50%**	**100%**
	£ million	**£ million**	**£ million**
Pre-tax profits	9.59	9.59	19.18
Funding	2.94	-	2.94
Cash distribution	-	0.90	0.90
Total profit	**12.53**	**10.49**	**23.02**
Cash to fund loan	-	(0.90)	(0.90)
Cash rolled up	-	9.59	9.59

113. In interview, Messrs Beale, Edwards, Stephenson and Towers were inclined to emphasise the risks that they had perceived in the transaction. For example, Mr Stephenson said that he had considered the transaction "*fairly risky*", and Mr Towers said that "*it was a very evenly balanced view between whether that money* [i.e. the £2 million investment] *was going to be lost or whether it was going to make any profit*". For his part, Mr Beale explained the position as follows:

> "*... I always had a high degree of expectation of getting my half a million pounds back. That was something I really hoped we would do, and certainly the 5 or 10 per cent returns on it, the profit opportunity was something that if one day it happened, then fine. But it was more a matter of whether I was ever going to get that half a million pounds back rather than a great expectation of profit.*
>
> *... I expected and hoped to get my half million pounds back. If a profit fell out of it, it would be a bonus, is how I would describe it.*"

Mr Edwards said that he had thought it was more likely than not that there would be no profit and that his view was that "*it was quite likely that Phoenix would lose all its equity in this particular stake*".

114. On the other hand, Mr Edwards also told us that, although Mr Einollahi expressed the view that MGRG would not be likely to recover more than £3 million to £5 million of the money deposited in the RV Capco account[76], he (Mr Edwards) expected MGRG to receive a considerably larger figure. He said for instance:

> "*... I told* [Mr Einollahi] *that I didn't want to be disrespectful to a very eminent financier but with our eyes shut we could beat £10 million and we should be able to deliver 20-plus in the process of returning cash to MG Rover.*"

[76] As to which, see paragraphs 24.6 and 24.8 above.

On that basis, there could be no question of MGR Capital being other than profitable[77].

115. We consider that Messrs Beale, Edwards, Stephenson and Towers must all have expected to make sizeable profits from the acquisition of the Rover loan book. While they will doubtless have been aware that there was a risk that they would lose their £2 million investment, they must, in our view, have realised that the danger was slight. Our reasons include the following:

115.1. Messrs Beale, Edwards, Stephenson and Towers are all likely to have seen HBOS projections forecasting Phoenix Partnership profits in excess of £7 million;

115.2. they were also told by Deloitte that they could expect a profit of that order[78] (albeit that Mr Einollahi also, properly, drew attention to the risks);

115.3. the RV risks were to be mitigated by the large sums which were to be deposited in the RV Capco account, as mentioned above[79]. HBOS regarded this as ensuring that "*all the major risks associated with the transaction* [had] *been mitigated, even in the severest of downside cases*"[80], and the evidence referred to in the previous paragraph confirms that Mr Edwards thought that the RV Capco money would be easily sufficient to meet residual value obligations;

115.4. as explained above[81], they rejected the suggestion that BoS's joint venture partner should be a Group company because they anticipated that the transaction would be profitable and wanted to secure profits for themselves; and

115.5. they would not have been likely to agree to Deloitte's large fee (viz. £7.5 million)[82] unless they had thought it likely that the transaction would generate substantial profits.

<u>Possibility for finance to be provided by First National/Abbey</u>

116. First National was approached by BMW early in 2001 about the Rover loan book. As mentioned above[83], First National did not in the event submit even an indicative bid.

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[77] As mentioned in paragraph 77 above, Mr Edwards also spoke of Capital Bank having "*got themselves risk-free*", suggesting that he did not expect MGR Capital to incur losses.
[78] Indeed, notes made by Mr Barton in about July 2001 indicate that Deloitte were expecting a 5 per cent equity interest in MGR Capital to yield a return of £900,000 (see paragraph 125 below).
[79] See paragraph 24.6 and 24.7 above.
[80] See paragraph 108 above.
[81] See paragraph 83 above.
[82] It should be noted that Deloitte were acting on a contingency basis.
[83] See paragraph 13 above.

117. The joint venture proposal developed later in the year offered protection to potential investors against RV risks. It was, as a result, likely to be far more attractive to financial institutions (including First National) than a straight purchase of the loan book[84].

118. From March 2001, First National was providing finance for Rover and MG vehicles. It might, therefore, have been thought to be an obvious entity to approach about a possible joint venture. In fact, Mr Edwards told us that it had been his view that "*Project Platinum should be concluded with* [First National] *as the funding partner if possible*" and that he had "*suggested to* [Mr Einollahi] *on numerous occasions that an approach be made to* [First National]". In his oral evidence, Mr Einollahi agreed that Mr Edwards might have said that he would like Project Platinum to be concluded with First National, if possible[85].

119. In the event, it was BoS that Mr Einollahi approached, first meeting Mr Middleton on 25 June 2001. Mr Einollahi told us that the reason he approached BoS was that he had trust in Mr Middleton and knew BoS to be both one of the largest investors and the lowest cost operator in the field.

120. At a further meeting with BoS on 4 July 2001, the possibility of Deloitte having a 5 per cent interest in the joint venture company (as a "*kicker*") was aired (although Mr Birkett's notes of the meeting add "*structure not finalised*"). Mr Birkett's notes also include the following:

> "*Abbey National → D&T not discussing deal with them because both MGR & Abbey are clients* [so] *potential minefield to advise MGR in JV with another D&T client*"

(Abbey was of course First National's parent company.)

121. When asked about this passage, Mr Barton said:

> "*My interpretation was that would have been a positioning statement. This is ... not quite a negotiation meeting because it is very early in the process. But it is making a statement to say: we believe this is worth you considering seriously and we would like you to consider it seriously and we would like to give you some comfort that there is a serious opportunity for you here to be the funding partner.*"

Mr Einollahi gave a rather different explanation. He said:

> "*I had the experience ... in other occasion, another entity altogether, where they had audit relationship, and they sought to use the audit relationship to improve the terms for them as a financier, bringing pressure to bear on me. I think I am sufficiently robust to be able to withstand it, but it would have been a nightmare dealing with*

[84] See e.g. paragraph 216 below.
[85] Deloitte have suggested that Mr Edwards did not express a preference for First National until August 2001, but we think it likely that he made his views known before BoS was approached in June 2001.

> *Abbey, who – sometimes people get the impression, because they have an audit relationship, they can encourage Deloitte to go across Chinese walls or prefer – however forcefully – however tactfully you try and manage that, it inevitably becomes a problem.*"

Mr Einollahi said that this point would have been "*one of the influences*" on his decision not to approach Abbey.

122. There was a further meeting between Deloitte and BoS on 1 August 2001. Mr Birkett's notes of the meeting include this:

> "*ME noted off the record that Abbey ... not seen it as clients* [therefore] *issue on fees.*"

123. When we referred Mr Barton to this note, he again interpreted it as a "*positioning statement*":

> "*... it would strike me more as a positioning statement, again along the same lines of trying to give Bank of Scotland comfort that they had got a clear run at this. In terms of trying to encourage them to be proactive, it is not unusual to say things that would give them the comfort that they have got a very serious possibility of getting this.*"

Mr Einollahi's explanation was as follows:

> "*Abbey had not seen it from us. And we would have had issue on the equity element of our fee. So the statement I make is true, that 5 per cent would have been a financial interest in a business which was audit client, but it was not most significant issue. If that was adequate to keep people happy, that was – in value terms it was circa £250,000, £300,000.*
>
> *... as you find later, we do forego that in any event, anyway. That was not(?)*[86] *a material element but it was an easy thing to explain certainly talking to BOS.*"

124. The proposed Deloitte 5 per cent interest in the joint venture featured in the documentation until September 2001. For example, BoS referred to Deloitte having "*5% equity*" in a list of assumptions they sent to Mr Birkett on 27 July and showed Deloitte as having a 5 per cent profit share in a "*Preliminary Acquisition Paper*" it produced in August. A "*Summary of Key Commercial Points*" written by Mr Middleton on 10 August included "*D&T 5%*" and a Deloitte "*Comparison of funding offers*" dated 6 September likewise provided for Deloitte to have a 5 per cent shareholding. As late as 20 September, Deloitte's draft engagement letter provided for Deloitte to receive by way of remuneration not only fees of £7.5 million, but a "*5% participation right in the income and capital of Newco*".

[86] This question mark is in the original transcript.

125. On the other hand, there were also recurring references to the possibility of the Deloitte interest being bought out. Notes made by Mr Barton of, it appears, a meeting between Deloitte and BoS on 4 July 2001 include, "*BoS to buy out D&T 5% equity fee*". Mr Barton's notes from this period also include, "*D&T equity to be bought out NPV = £900k*" (meaning, presumably, that Mr Barton reckoned that the proposed 5 per cent interest had a net present value of £900,000). Mr Middleton's "*Summary of Key Commercial Points*", after mentioning the "*D&T 5%*", said, "*D&T may convert their share into a fixed fee to be agreed basis to be discussed/agreed*". A "*structuring and deal paper*" prepared by Deloitte in September stated that BoS had "*indicated they may wish the D&T equity to be bought out at a mutually agreeable price*". In the end, although Deloitte's draft engagement letter had provided for the firm to have a "*5% participation right*", the final version of the letter omitted any such provision. When we asked Mr Einollahi about this change, he said:

> "*Two things: one, the 5 per cent became 2.5 per cent because John Edwards and Peter Beale took the position that the 5 per cent was 5 per cent of their shareholding and not 5 per cent of the 100 per cent. At 2.5 per cent it became – I think it would be wrong to say a negligible sum, but became a very small amount of circa £250,000 to £300,000.*
>
> *I was offered the opportunity that at the disposal or eventual dissolution of the JV agreement, I will be appointed adviser and I will receive that fee – a fee of that nature at that point to overcome this residual concern from HBOS, from ourselves generally about holding shares.*"

126. First National learned of the prospective joint venture during August 2001. Ms Ruston's note of a telephone conversation with Mr Einollahi on, or shortly before, 23 August records that she was told by Mr Einollahi that Abbey had "*picked up rumours in market*". In similar vein, Ms Lewis noted in an internal email of 5 September:

> "*Apparently Abbey National have picked up rumours of the proposed transaction in the market place and have indicated to MG Rover that they would like to join in.*"

127. It seems that First National was alerted to the existence of the joint venture proposal by Mr Millett. Mr Keith Horlock, a director of First National and managing director of First National Motor Finance (then a division of First National), told us that Mr Millett had told him of the joint venture in July or August of 2001; his impression, he explained, was that Mr Millett was concerned that First National was being kept out of the picture. When we spoke to Mr Millett, he said that it was quite likely that he would have mentioned to Mr Horlock that the deal was being undertaken. Mr Einollahi confirmed to us that he had not himself introduced First National to the transaction.

128. Mr Steve Almond, the Deloitte partner in charge of the Abbey audit and the key point of contact for professional relationships between Deloitte and Abbey, told us that Mr Einollahi had telephoned him about the business opportunity. His recollection was as follows:

> "*My memory is that Maghsoud contacted me … to say that he was involved in advising his client, who were looking … to refinance or to sell a portfolio of business loans which were related to Rover cars. He said that the Bank of Scotland were already in the frame and were, I think, ready to do a deal – or certainly were already in the frame. But he was keen, because he knew Abbey National was a prestigious and important client of the firm, to give them the opportunity to pitch for the business, and again that would be a perfectly normal thing for him to contact me … as the lead relationship point. I then passed it on to – I cannot remember – probably Tim Ingram.*"

It seems to us that this conversation is likely to have taken place in late August 2001, at a point after Mr Einollahi had learned that Abbey had "*picked up rumours of the proposed transaction*". Mr Tim Ingram (to whom Mr Almond referred) was the chairman of First National and a director of Abbey.

129. On 23 August 2001 Ms Ruston sent Abbey a draft confidentiality agreement. On 28 August Deloitte and Mr Edwards met a team from Abbey (comprising Mr Horlock, Mr Vim Maru and Mr Philip George) at Manchester Airport to discuss the acquisition. In the course of the meeting, Mr Edwards said that he "*would be willing to go with* [First National] *if timetable satisfactory and terms okay*". Mr Einollahi observed that the meeting was taking place only "*because of JE's appetite to deal with FN*" and gave 30 September as the completion date.

130. Mr George said at the meeting that Abbey had not previously known of the sale of the Rover loan book. We have no reason to doubt that that reflected his understanding and that of the other people from Abbey/First National who were concerned with the possible joint venture in August to September 2001; as noted above[87], Mr Maynard said that he probably would not have referred the opportunity to buy the loan book to others at Abbey/First National. Mr Einollahi told us, however, that Mr George's comment made him suspicious of Abbey because he was aware that Abbey had known of the loan book's sale. He said:

> "*… Philip George is the most senior person there. He starts with – they have not been bidding because of their relationship with MGR.*
>
> *That caused me to change – well, made my attitude worse. Because I know they were bidding. By then I did know they had been bidding on their own. And I knew that from BMW side. And a potential prospective partner starting with untruth does not – did not ingratiate himself to me at all.*"

[87] See paragraph 13 above.

131. The joint venture was considered at a meeting of Abbey's executive committee on 3 September 2001. It was agreed that First National would attempt to secure the transaction. It was, however, reported to the committee that while the "*relationship with MG Rover remained good ...*", "*the Deloitte & Touche Corporate Finance Team had not been helpful*". The minutes record that Mr Mark Pain, the group financial director, was to "*raise this with the External Audit partner*".

132. Following this meeting, Mr Pain spoke to Mr Almond to complain about Deloitte's conduct. Mr Almond in turn called Mr Einollahi and, in his absence, spoke to Mr Birkett, who wrote the following note to Mr Einollahi:

> "*Steve Almond called. He has received a call from Group FD at Abbey. Issues came out of Board meeting yesterday*
>
> - *Why Abbey not included originally when opportunity given to BoS*
> - *Abbey feel that 'door slammed shut' since they were brought in*
> - *Abbey feel D&T may not be acting independently. They know D&T looking for equity of 5% and that could not get this if JV with Abbey*"

Mr Almond asked that Mr Einollahi call him in the morning.

133. We asked Mr Almond whether Abbey had raised any points with him beyond those summarised in Mr Birkett's note. Mr Almond (of whom we have no criticism) replied:

> "*No, and they were in that order, I would say. Philip George, Tim Ingram, that division of the group, felt that they had not been given a fair crack of the whip. The reference to questioning our independence certainly was conveyed to me by Mark as a speculative afterthought, I would say; it was not the primary point that he was raising. He asked me – he referred it to me which would be the natural thing for him to do and I offered, or he asked me, but either way, to follow it up directly with my colleagues who were dealing with the transaction.*"

Mr Almond also confirmed that Mr Einollahi did call him back, stating:

> "*... my overriding memory is that he was completely indignant at the suggestion that he was not acting independently, and that was his main concern, frankly, and he was quite keen, as I recall, to discuss it directly with my client. In the event, I fed back the details of my conversation with Maghsoud to the client. As I say, that was the main thing he was focusing on. He did go through his views on why Abbey had not won the business.*"

We asked Mr Almond specifically about the proposed 5 per cent equity stake. He said:

> "[Mr Einollahi] *was indignant at the suggestion that that* [the proposed 5 per cent equity stake] *was influencing whatever he was doing, or indeed influencing anybody within the firm.*
>
> *... he said this was not an immoveable feature of the transaction. They were looking at ways in which Deloitte might be remunerated for Deloitte's work and that was one possibility but it was not seen as being an essential part of any terms. I think that is probably his explanation why – just as a matter of fact, this was not – that we were not being – our independence was not being impaired.*"

Mr Almond was asked for his recollection of Abbey's reaction when he reported back the outcome of his conversation with Mr Einollahi. He stated:

> "*Only that Mark would convey it internally and, you know, I imagine I would have said, 'Let me know if you want to discuss it further.' I think some little while afterwards, probably the next time I spoke to Mark, he said – he reported back and it was dead. You know, there was no need for any further action or discussion on my part.*
>
> *... This was the end of it. Certainly there was no continuing rumpus in my relationship with Abbey National. It was done and dusted.*"

134. We also spoke to Mr Einollahi about his conversation with Mr Almond. He said (among other things):

> "*... I did not like the allegation of the reason I am not treating them well is the 5 per cent equity which was merely* [£]*250-300,000. If I ever allowed my professional opinion to be influenced by that size of money, I will be disappointed with myself.*"

135. Abbey (or First National) submitted a funding proposal on 5 September 2001. Following receipt of the proposal, Deloitte prepared two schedules comparing Abbey's offer with that from BoS. The first schedule was based on actual figures; in the second, the assumptions underlying the Abbey figures had been adjusted in an attempt to prepare a like for like comparison. This comparison shows a larger potential return to PP (of £4.98 million) under Abbey's proposal (or £5.18 million adjusted to like for like), compared with £1.58 million under BoS's proposal[88]. The key differences in commercial terms between the two funding offers can be summarised as follows:

[88] The potential return is stated to be £2.18 million but £0.6 million has also been deducted due to the Phoenix Equity Service Cost (not roll-up).

	BoS	Abbey
Price at which RFS will be acquired from BMW (% of net investment)	94.25%	94.25%
Price at which JV Co will acquire Rover retail book from RFS (% of net investment)	98.00%	100.00%
Margin to be achieved by the bank on provision of debt to JV Co	1.00%	0.40%
Cost of migration from RFS's systems to bank's systems	£2.00m	£0.25m
Cost of running Rover retail book post-acquisition (£ per contract per month)	£2.00	£2.69
Cash collateral requirement	£54m	£28m

136. Deloitte spoke to Mr Edwards about the rival offers. The advantages and disadvantages of the two offers were listed as follows in Mr Birkett's notes of the conversation:

Abbey	BoS
"*Offer too good to be true*"	Financially worse
£5-10m better than BoS	More robust, therefore deliverable
At start of process therefore more risky	Could impact on Abbey's relationship with Deloitte or MGRG

137. When we asked Mr Barton why Abbey's offer was said to be "*extreme*", he drew attention to the price, the margin and, in particular, the cost of migration. Mr Einollahi, too, said that it was BoS's cost of migration that was credible.

138. On Monday 10 September the deal was again brought up at an Abbey executive committee meeting. The minutes of the meeting include the following:

> "*Relations with Deloitte & Touche had seemed to improve, but late on Friday, they had unexpectedly presented First National with a Tuesday 'deadline'. Phillip George did not feel confident that the residual value issues could be resolved in time to meet this deadline. He was not prepared to risk the potentially significant downside of getting the residual values wrong. He would ask for more time, but, failing that, First National would withdraw. Ian Harley felt that it should be made quite clear to MG Rover that Abbey National was unhappy with the way this matter had been handled.*"

Two days earlier, Mr George had sent Mr Ingram an email saying:

> "*Further to our conversation today I reiterate that I believe D and T have behaved appallingly. I intend to speak to Steve Almond again to advise him of the position. We were never told that Wed was a drop dead day when we first met D and T and my belief is that a) D and T did not want us involved and b) we were being used to see/prove they had negotiated a good deal with Capital. In short we have to make a binding decision by Tuesday night.*"

139. Abbey's funding offer was discussed at a meeting at the Post House hotel in Stoke attended by BoS, Deloitte, Mr Edwards and Ms Ruston on 10 September 2001. In his file note in respect of the meeting, Mr Middleton wrote:

> "*Abbey National are very keen to get into this transaction and had issued indicative terms considerably favourable to our own (for example, charging the JV debt at 40 bp, buying the book at 101% face value, far lower RV cash collateral requirements). Abbey had been putting pressure on the Phoenix directors and through D&T (who are their auditors).*
>
> *We discussed the Abbey position. I expressed the view that I was surprised they had not taken up the opportunity when the book was originally marketed by KPMG and their terms seemed to be uneconomic, I therefore expressed doubt that the terms would be delivered as our returns were not particularly high.*"

Mr Middleton's note also refers to the grant of exclusivity to BoS. He recorded:

> "*We … agreed the Bank would be granted exclusivity until 30th, September. In the event our JV partners walk away, we would be paid all our costs plus £250,000. We have to be sensitive to the Abbey position and have agreed that D&T may talk to them on the understanding they are letting Abbey down gently and Abbey will be informed of the exclusivity granted to BoS.*"

Subsequently, on 13 September, PVH and BoS entered into a written agreement giving the latter exclusivity until 30 September.

140. On balance, we think it likely that Mr Einollahi decided not to approach First National about the proposed joint venture because Abbey was a client of Deloitte and, more specifically, because of a concern that involving Abbey could prejudice Deloitte's fee arrangements. That is what Mr Birkett's contemporaneous notes suggest[89]. Moreover, BoS was told that the reason for not approaching Abbey was that Abbey was a client of Deloitte and that that fact would give rise to an "*issue on fees*". We find it hard to see why BoS should have been told this unless it was the truth. Deloitte could perfectly well have indicated to BoS that it should take the joint venture seriously without concocting a false concern about Abbey's position as a client. If, as suggested by Deloitte, they rated BoS highly, they could surely have told BoS so, and explained why.

141. If we are right in thinking that Mr Einollahi's decision not to approach First National stemmed from the fact that Abbey was a client, the likelihood is that his concern arose at least in part from the fact that Deloitte could not have an interest in a venture in which Abbey was also interested. Mr Almond explained that the primary restriction would have been American, "*because Abbey National is SEC-registered, and no joint ventures of any sort are allowed with SEC-registered audit clients*". As regards the British position, the

[89] See paragraphs 120 and 122 above.

relevant guidance at this time would have been the Guide to Professional Ethics as set out in the Institute of Chartered Accountants in England and Wales ("ICAEW") Members Handbook 2001. One of the fundamental principles stated there is that members should strive for objectivity in all professional and business judgments. Objectivity is defined as the state of mind which has regard to all considerations relevant to the task in hand but no other. One of the potential threats to objectivity described in the Guide to Professional Ethics is a self-interest threat, which would include holding an interest in a client. The situation where a firm takes a beneficial shareholding in a client company is not specifically addressed in the Guide to Professional Ethics, but a partner holding a beneficial shareholding is considered:

> "*Any beneficial interest* [viz. a beneficial shareholding or other direct investment in the company] *on the part of a principal* [i.e. a partner] *or anyone closely connected with a principal of the audit firm in a client company will constitute an insurmountable self-interest threat.*"

142. On the other hand, we can understand how BoS's offer could properly have been preferred to Abbey's in September 2001. By the time Abbey was finally introduced to the transaction in the August, BoS's offer was already well advanced. Further, there was reason to think that Abbey's funding proposal was "*too good to be true*"[90]: Mr Middleton said that he had thought Abbey's terms "*uneconomic*", and Mr Maru, who at the time was a corporate finance manager in Abbey's corporate development unit, told us that the proposal was not a firm one and that, when it was submitted, Abbey had not yet been able to do a proper RV calculation. It is noteworthy, too, that there was time pressure. For example, in a letter to Mr Einollahi dated 29 August Mr Munk referred to a "*clear desire on both sides to complete this transaction by the 30th September*" and asked for certain information (including "*written confirmation that sufficient funding is available to the Phoenix Consortium to complete the transaction*") to be provided by Friday 7 September at the latest.

<u>The 21 September 2001 PVH board meeting</u>

143. Matters relating to the acquisition of the Rover loan book were considered at a PVH board meeting on 21 September 2001. All five directors of PVH (Mr Howe as well as Messrs Beale, Edwards, Stephenson and Towers) are recorded as having been present.

144. The minutes of the meeting were prepared in advance of its actually being held. Ms Ruston explained to us that she had drafted the minutes on the basis of information provided by Mr Beale. She stated:

> "*I believe that I would have spent some time with Peter putting together a draft minute that would have been the basis of a script that he would then use to take the other directors through the meeting that was held on 21st September and he provided me with the rationale for the transaction happening in that way in those points, 1 to 3. I would not have created those myself without his input …*

[90] See paragraph 136 above.

Q. Did you see it as your job to think about whether they were right or not?

A. I certainly – if I had known that they were wrong, I would have raised it and discussed it with Peter Beale, yes."

On 19 September 2001 Ms Ruston emailed the minutes to Mr Einollahi in draft "*for* [his] *consideration*" and Mr Einollahi replied about 40 minutes later:

"*... it was a pleasure to read the minutes.* [No] *comment.*"

In their final form, the minutes were signed by Mr Towers as chairman of the meeting.

145. According to the minutes, Mr Beale informed the board that the purpose of the meeting was as follows:

"*(a) to consider and approve the acquisition of the portfolio of motor vehicle contracts relating to MG Rover products which are being administered currently by* [RFS] *(the 'Portfolio');*

(b) to approve a variation to the terms and conditions of the £10,000,000 variable rate unsecured loan notes 2005 as constituted by deed poll dated 18th December and made by the Company [i.e. PVH] *(the 'Loan Notes'); and*

(c) to approve a loan from Techtronic ... to the Company in the amount of £10,000,000."

146. Sub-paragraphs (b) and (c) relate to the arrangements by which, in due course, Messrs Beale, Edwards, Stephenson and Towers borrowed money on the security of the loan notes PVH had issued in their favour in the preceding December[91]. According to the minutes:

146.1. "*Mr Beale reported that each of the beneficiaries of the Loan Note may be required to borrow money against the loan notes to introduce equity into the joint venture company. In order for this to be done Mr Beale reported that it was necessary for the payments provided under the terms of the Loan Note to be secured by way of a bank guarantee*";

146.2. "*Mr Towers advised the Board in order for the Company to be in a position to provide the collateral required for the guarantee of the Loan Note ... it was necessary for it to raise funds*"; and

146.3. the board resolved to require Techtronic to lend PVH £10 million with immediate effect.

[91] See paragraph 25 above.

147. With regard to (a), the minutes record that Mr Beale advised the board that the acquisition was to be effected by a joint venture between a bank and the Phoenix Partnership for the following reasons:

> "*1.* *debt funding for the Company* [i.e. PVH] *(and any entity within the same group of companies as it including Techtronic (2000) Limited and MG Rover Group Limited) had been extremely troublesome to obtain from the outset. Following the original transaction in May 2000 it had proved difficult to persuade any UK bank to provide a clearing facility for the group as a whole. Mr Beale reminded the Board that this transaction would require significant levels of equity and debt funding from a bank and it would be unlikely that that funding would be provided to the Company;*
>
> *2.* *in the unlikely event that the level of funding required was provided directly to the Company to make the acquisition Mr Beale advised the Board that the financial covenants, undertakings, representations and warranties that would be required by the Bank to protect its investment could restrict severely the operation and effectiveness of the Company and its group companies;*
>
> *3.* *that the Company and the group had structured itself in order to be a manufacturer of Motor vehicles and all that that entails including the operation of a parts business, a sport and racing business and an engine and gearbox business. Mr Beale advised the Board that he believed that the disclosure in the statutory accounts of a current liability of the nature and extent of that which was required to fund the acquisition of the Portfolio for the Company or any company within its group would affect the Company's credit rating and pose a potential risk to its ability to obtain future financing.*"

The minutes go on to state that "*Mr Potts had advised that the proposed transaction was required to be approved by the Board of Directors of the Company and that a written resolution of the members of that Company should be obtained in order to ensure that there was no breach of duty by the Directors*" and that it was resolved that "*the acquisition of the Portfolio be approved in the manner proposed and that the Phoenix Partnership may make the acquisition*".

148. We asked PVH's then directors about the reasons given in the minutes for having a joint venture between HBOS and the Phoenix Partnership. Mr Edwards said that he did not recollect any discussion of the points, but that he "*relied on* [Mr Beale's] *advice as to whether this properly reflected what was going on at the time*". Mr Stephenson said that he "*did not particularly concern himself*" as "*our advisors recommended this*" and "*someone that* [he] *trusted in terms of his judgment, John Edwards, had … led the charge, and Peter* [Beale] *had cast his eye over it*". For his part, Mr Towers asserted that the reasons were "*pieces of advice that made absolute sense in the context of our experience with the business and really did not stand out to be questioned or examined in any great detail at all*". Mr Towers said in particular:

"*… the commercial deal would have been entirely different with the company compared to what it was with the individuals.*

Individuals personally at risk for half a million pounds bears a level of significance that is not equivocated by the company being at risk for £2 million. It would have been a different kettle of fish altogether."

Mr Beale made a similar point, commenting that a deal with PVH would have been a "*very different deal*" and that he had "*no idea what a deal with* [PVH] *would look like*". He told us, too, that he had been advised by Mr Einollahi that having PVH as the joint venture partner would have had a "*credit rating effect*" and that he thought that Deloitte had helped with the preparation of the minutes.

149. The fifth director, Mr Howe, told us that he remembered Mr Beale going through the reasons for having a joint venture between HBOS and the Phoenix Partnership during the meeting. He went on to explain:

"*I probably addressed my mind to one issue, really, other than we needed to buy the book, which was a concern over the prospective balance sheet …*

… I am not an accountant … but I believe I am right in saying that the taking on of the debt, even if it had been in a 50/50 joint venture, would have to have been consolidated onto the balance sheet of the parent company …

So, on that basis, that was an issue that I was concerned about from my day job, which was basically managing the business and moving forward …

Q. So that I can understand, in terms of who Halifax Bank of Scotland's joint venture partner should be, you did address your mind to the issue. Is that fair, or not?

A. Not in a questioning sense.

Q. … So you accepted that, as was being suggested, it should be the Phoenix Partnership?

A. … The deal was with the Phoenix Partnership. There was a board meeting here saying, there is a rationale as to the deal and various things, consultations have been made, et cetera, et cetera. It was not in a questioning sense, it was a statement of fact.

Q. And do you think you had in your mind at that point this balance sheet concern that you have been referring to?

A. ... it was something that was in my mind ..., but did not need to be brought out, because ... it was a matter of fact that the deal was being done in a particular way. So it was not something I needed to deal with ...

... my understanding was that this deal was only going to be done with the Phoenix Partnership ...

My belief of what that meant was that the information I had been given was that HBoS would have been unprepared to make a significant 'injection' in to a direct relationship with the company ...

Q. ... So your understanding was that Halifax Bank of Scotland would not have been prepared to lend lots of money to MGR Capital if MGR Capital was 50 per cent owned by a Rover company?

A. Yes, that is absolutely what my understanding was, yes.

Q. What is the basis for that understanding?

A. The basis for that understanding goes back to our previous discussion; that HBoS were prepared to do the deal through a vehicle that was not directly with the company. The term that had been used by other banks and what have you at the time, was 'reputational risk' ...

Q. You did not know there was an alternative?

A. No ... I am still not clear that there was an alternative, even having read the notes, I am still not clear.

Q. But at any rate, your understanding at the time was, that there was no alternative?

A. This was the way the deal was going to be done."

150. We also asked Mr Middleton about the reasons given for the joint venture being between HBOS and the Phoenix Consortium[92]. In respect of the first reason, Mr Middleton stated:

"*I think without doubt, there was a history of having difficulty in securing banking facilities by MG Rover itself and that would have been banking facilities without debt. There was a clear impression in the marketplace that MG Rover would struggle to survive in the long-term, so the difficulty MG Rover may have had in securing*

[92] See paragraph 147 above.

bank lines on its own account, would be in the directors' minds, I would have thought ...

Q. Do you think any of this would have been an obstacle to an MG Rover company being your Joint Venture partner in MGR Capital?

A. No. I am comfortable that something could have been structured in a way that would protect a lender.

Q. ... The fact that MG Rover might have had trouble borrowing on its own account has nothing to do with it?

A. Has nothing to do with it. MG Rover itself was not something that the bank as a group would wish to lend money directly to. If Beale is saying that MG Rover Group would be looking to borrow, then I think it may have had difficulties within MG Rover Group. If they ring-fenced it into a separate subsidiary, for example, then I am persuaded that that is a banking deal that could be done."[93]

In respect of the second reason, Mr Middleton said:

"*... It would depend on the entity from the company's point of view itself, it would depend on the terms of the banking facilities. It is not unusual for banks to impose strict covenants and capability with regard to making acquisitions, operating within covenants, and so on.*

Q. But ... if an MG Rover company had simply taken the place of the Phoenix Partnership in the MGR Capital Joint Venture, none of this would have been a problem?

A. From whose point of view?

Q. You would not have been insisting on financial covenant undertakings, representations and warranties that would severely restrict the operation and effectiveness of the company and its group companies?

A. I can envisage a situation whereby we would not need to, but that was not being offered. It would really depend on the terms of the banking finances that were being provided and the security by way of supporting residual value

[93] Elsewhere, Mr Middleton explained that, since BoS "*considered there was real risk that* [MGRG and PVH] *would fail, it was unwilling for either entity to be the joint venture partner*", but that BoS was "*prepared to consider a joint venture with a ring-fenced MG Rover entity*". The reason this possibility was not fully explored was that, "*When BOS had decided that it had a serious intention to proceed with the Project Platinum transaction, it was presented to BOS as a transaction that could only be done by way of a joint venture with the Phoenix 4.*"

losses that was being offered, as to how the rest of MG Rover Group would be tied into that arrangement.

Q. *... if you had had essentially the same structure as the MGR Capital structure but with an MG Rover company as your Joint Venture partner, as you had wanted, you would not have needed to insist on financial covenants, undertakings, representations and warranties from MG Rover company, that would restrict severely the operation and effectiveness of the group.*

A. *That is right.*"

151. Mr Einollahi had the following to say about the reasons given for the joint venture being between HBOS and the Phoenix Partnership:

151.1. while the first reason might have had substance earlier in 2001, by 21 September a "*more balanced version of it ... would have stated a further fact that at some point HBoS got themselves comfortable and expressed a preference*";

151.2. while he did not know the basis on which the second reason had been given, there was substance in it since "*there would have been ... realistic possibility, ... of other member companies being drawn into covenants or undertakings*". The position, however, was never put to the test; and

151.3. with regard to the third reason, he could not see why there should have been a real danger that having a corporate joint venture partner would cause a liability to arise in the accounts that could embarrass the Group.

Mr Einollahi also told us that he had declined to comment on the minutes. He explained that he did not regard it as his role to review such material and that the email from him mentioned above ("*it was a pleasure to read the minutes.* [No] *comment*") "*was* [him] *declining to be drawn into it*".

152. It seems to us that the minutes do not accurately state the reasons the acquisition was being effected by a joint venture between a bank and the Phoenix Partnership:

152.1. as stated above[94], in our view the option of having a joint venture between HBOS and a Group company was rejected principally for the reasons given in the 16 August fax (i.e. because the members of the Phoenix Partnership, other than Mr Howe, believed it to be "*inequitable that they should ... be deprived the opportunity to be rewarded for their enterprise*"). No such reason was, however, mentioned in the minutes;

[94] See paragraph 83 above.

152.2. under the joint venture proposal, HBOS was to provide substantial funding to MGR Capital[95]. There was no reason to think that PVH itself would require any funding at all from HBOS in the event of a joint venture between the two;

152.3. the way in which the Group had structured itself can have been of no relevance. As Ms Kitchin had pointed out in an email to Ms Lewis[96], to have PVH as the joint venture partner would have been in line with a policy of arranging the affairs of the Group such that the vehicle manufacturing business was managed by the executive managers, and all the other interests of the Group were separate companies under PVH; and

152.4. there was, in our view, no good reason to conclude that a joint venture between HBOS and PVH would "*affect* [PVH's] *credit rating and pose a potential risk to its ability to obtain future financing*". As already stated, HBOS's lending would have been to MGR Capital rather than PVH. In any case, there was no prospect of PVH obtaining "*future financing*".

153. Of course, four of the five directors present at the 21 September board meeting were already aware of the rejection of a joint venture with a Group company and of the reasons for that. However, the fifth director, Mr Howe, had no knowledge of these matters[97]. He was proceeding on the (incorrect) basis that there was no alternative to a joint venture involving the Phoenix Partnership.

154. Further, we do not accept Mr Beale's suggestion that Deloitte had helped with the preparation of the minutes[98]. We found no evidence of any Deloitte involvement beyond Mr Einollahi's email saying, "*it was a pleasure to read the minutes.* [No] *comment*". Moreover, we accept that, in sending this email, Mr Einollahi was not intending to indicate approval of the minutes' contents.

<u>The 10 October 2001 PVH board meeting</u>

155. The arrangements by which Messrs Beale, Edwards, Stephenson and Towers were to borrow money on the security of their loan notes[99] were considered further at a PVH board meeting on 10 October 2001. It was resolved to approve arrangements under which PVH would deposit £10 million in a blocked deposit account so that Co-op Bank would guarantee the loan notes. The directors recorded in the minutes as having been present are Mr Edwards (as chairman), Mr Beale and Mr Stephenson[100].

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[95] See paragraph 22 above.
[96] See paragraph 89 above.
[97] See paragraph 149 above.
[98] See paragraph 148 above.
[99] As to which, see paragraph 25 above.
[100] Mr Towers confirmed to us that he knew of the meeting.

156. Section 6 of the minutes deals with "*corporate benefit*". Paragraph 6.1 records as follows:

> "*The Chairman reported that in order for the Documents to be entered into by the Company* [i.e. PVH] *the Board must have formed the bona fide opinion that it is of commercial benefit to the Company to enter into the Documents and that the entering into of the Documents is for the purpose of carrying on the Company's business. The directors considered that the execution, delivery and performance of the Documents was in the best economic, strategic and financial interests of the Company in that (inter alia) the* Beneficiary [i.e. Messrs Beale, Edwards, Stephenson and Towers] *had confirmed that if the Bank Guarantee were provided to them, it would not be their present intention to take cash out of the Company by way of bonus or dividend. Additionally, to compensate the Company for the cost to it of providing the Guarantee the Beneficiary had confirmed that it would enter into a deed of variation with the Company which would provide that the terms of the Loan Notes be varied by reducing the interest rate payable on the Loan Notes by 0.25% …*"

Paragraph 6.2 of the minutes recorded that the board was unanimously of the opinion that:

> "*… there would be significant benefit to the Company for the reasons specified in paragraph 6.1 above, in its entering into each of the Documents to which it is to be a party and granting the security and confirmations therein contained and it would for such reasons be in the best interests of the Company to enter into each of the Documents to which it is to be a party …*"

157. In other words, while the arrangements would mean that PVH tied up £10 million[101], that disadvantage was offset by the fact that Messrs Beale, Edwards, Stephenson and Towers had "*confirmed that if the Bank Guarantee were provided to them, it would not be their present intention to take cash out of the Company by way of bonus or dividend*". (The fact that the interest payable on the loan notes was to be reduced by 0.25 per cent could not represent a positive benefit of entering into the arrangements since it merely compensated PVH for the cost of providing the guarantee.)

158. Mr Edwards and Mr Towers both told us that, at the date of the board meeting, it was not their intention to take money out of PVH by way of bonus or dividend. Mr Beale said that he did not recall that being the case, but that *he* "*was apparently at the meeting and it must have been our intention on the day*". Mr Stephenson said that he could not remember what his intention was at the time.

159. In the event, within no more than a month it was being proposed that payments should be made to the MG Rover Holdings Limited Family Benefit Trust (the "Guernsey Trust") which was established on 3 January 2002[102]. During a telephone conversation with

[101] Being the total value of the loan notes which the Phoenix Consortium were borrowing against, as to which see V/55.1 to 55.2.
[102] See further as to the Guernsey Trust XXI/14 to 15.

Mr Bushill on 7 November 2001, Mr Beale said that he had been discussing the Guernsey Trust proposal with the other PVH directors (including Mr Howe) and:

> "*They would like to implement quickly so that the* FBT [i.e. Family Benefit Trust] *can receive certain proposed bonuses (including a potential success fee for John Edwards re Project Platinum).*"

By 20 November, Mr Bushill was aware that the desire was to set up the Guernsey Trust as soon as possible, "*preferably Thursday this week*"; he was "*told at the time that it was to do with the possibility of paying some bonuses, effectively paying some bonuses in relation to the Platinum transaction*". On the following day, Mr Bushill reported in an internal email that PVH intended to make contributions to the Guernsey Trust, once set up, of £600,000 each in favour of Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers[103] (as well as £250,000 in favour of Mr Howe)[104]. In the course of the next year, PVH made contributions in favour of Messrs Beale, Edwards, Stephenson and Towers totalling £10,143,455 (including £3,192,560 in February 2002 alone)[105].

<u>The 12 October 2001 MGRG board meeting</u>

160. Project Platinum was the first item on the agenda at the MGRG board meeting on 12 October 2001. Every one of MGRG's directors was present at the meeting, as was Ms Ruston (company secretary).

161. The meeting began with a presentation on the acquisition of RFS. Mr Edwards had emailed Mr Barton about this on 8 October 2001. He said:

> "*I would like to do a full board proposal on the morning of 12th October (Friday).*
>
> *A lot of them won't have a clue about it so we need to cover history (9/5/00), risks and opportunities, as well as current deal structure and requirements …*
>
> *I can start some of the history etc and talk to you to compare notes. I will work in Powerpoint. Do you want to use OHP or PC projector?*"

162. On the following day, there was a conversation between Mr Edwards, Mr Barton and Mr Birkett about the presentation. Mr Birkett's notes of the conversation (which are consistent with Mr Barton's) include:

> "*– explanation why not Abbey*

[103] The proposed bonuses were thus to be larger than the sums which Messrs Beale, Edwards, Stephenson and Towers had invested in MGR Capital.
[104] In the event, PVH resolved on 26 February 2002 to make contributions to the Guernsey Trust of approximately these amounts (see paragraph 223 below), thus more than recouping the sums invested in MGR Capital.
[105] See paragraph 223 below and also XXI/49 to 51.

– why PP, not MGR → conflict of interest with Abbey National"

163. Mr Birkett sent a first draft of the slides to be used for the presentation to Mr Barton for review on 10 October 2001. The final draft slide had the text "*Deloitte & Touche*" in large letters. Other draft slides featured MG Rover logos/pictures.

164. Mr Barton sent an email to Mr Edwards on 11 October 2001 attaching a revised version of the presentation. The presentation bore the title "*MG Rover Group – Rover Financial Services Board Paper*", and was much more detailed than the version emailed by Mr Birkett the previous day. The slides quoted below[106] were all introduced into the presentation at this stage and in their final form, but the concluding paragraphs in this draft[107] differed from those included in the final version[108]. The branding throughout the document is Rover, with the reference to Deloitte having been removed from the last slide.

165. Some further changes were made to this version to arrive at the final version of the presentation used in the 12 October board meeting.

166. The first slide in the presentation read as follows:

"*MG Rover Group*

Rover Financial Services

Board Paper

12 October 2001"

167. One slide was headed "*Background to the transaction*". This read as follows:

"*Recognising the risks associated with a change in ownership of RFS, the Phoenix Partnership ('PP') opened discussions with BMW about acquiring RFS. PP together with HBoS, the debt financiers offered to form a joint venture ('JV') to acquire the customer finance contracts in RFS ('Portfolio').*

This offer has achieved exclusivity ahead of all offers from financial institutions, and has been approved by BMW's Vorstand.

HBoS have also approved the transaction at main board level, and legals are now in progress."

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[106] See paragraphs 166 to 169 below.
[107] In the draft, the last paragraphs read as follows: "*The management of RV's is an issue that impacts upon the whole Board, dependent upon the decisions taken as to how to manage this risk. This transaction gives MG Rover the opportunity to take pro-active management of this issue in-house*."
[108] See paragraph 169 below.

168. The next slide, headed "*Why PP, and why HBoS?*", read as follows:

> "*Given the existing commercial relationship between* [First National] *and MG Rover it was not possible to enact a deal whereby MG Rover entered into a JV with a funder other than FNF to buy the Portfolio.*
>
> *It was decided therefore that to separate this, such that the existing FNF/MGR relationship was not affected PP would act as JV partner.*
>
> *So why not FNF?*
>
> *FNF were approached very early in the consideration of making an offer for RFS, but the response was not positive, and at the time Abbey National were in defence mode against the Lloyds/TSB bid. In addition it became clear that FNF were bidding for the Portfolio on their own and so could not join our bid as a funder.*
>
> *We approached HBoS as a funder, who had been excluded from the bid process by BMW earlier, and worked on the offer. Once we had secured exclusivity with BMW, we approached Abbey given the existing MG Rover relationship, but they were unable to meet the required timetable imposed by BMW on our offer confirmation.*"

169. The presentation concluded:

> "*Opportunity to take control of the disposal in the market of returned vehicles thereby managing the RV's and shortfalls claimed.*
>
> *Cap the obligations for MG Rover re GMFV guarantees, with upside of managing these to maximise returns.*
>
> *Develop a 'captive' finance provider for the future and utilise database for new vehicle sales.*"

170. The minutes of the board meeting begin as follows:

> "*Mr Barton from Deloitte and Touche was in attendance at the meeting and made a presentation to the Board on the proposed acquisition of* [RFS] *from BMW.*"

The minutes proceed to state that Mr Barton "*reminded*", "*explained*", "*reported*" and "*advised*" on various matters relating to Project Platinum.

171. Ms Ruston (who prepared the minutes) confirmed to us that her recollection was that it was Mr Barton who gave the presentation. Others gave evidence to similar effect. Mr Edwards said that it was Mr Barton who presented the material, though he might have helped where areas needed amplification. Mr Howe thought that Mr Edwards would have done no more

than "*chip in*", and Mr Millett, too, told us that Mr Edwards would merely have "*chipped in with points of clarity*". Mr Bowen said that he remembered Mr Barton "*presenting through to us, or talking through to us, how it would work*" and Mr Oldaker said that Mr Barton who was the "*main person who was presenting along the way*", although "*there were interventions as we went along as well*".

172. There was also a perception that Mr Barton was speaking on behalf of Deloitte as advisors to the Group, including MGRG itself. Ms Ruston explained:

> "*I believed* [Ian Barton] *was informing the MG Rover Group board of the transaction to date.*
>
> *Q. As an advocate for the Phoenix Partnership, or in some other capacity?*
>
> *A. No. As an adviser to the Group, to the MG Rover Group.*
>
> *Q. Was it your understanding that Mr Barton was speaking for Deloittes, or merely acting as a mouthpiece for Mr Edwards?*
>
> *A. I certainly did not think he was acting as a mouthpiece for Mr Edwards. I believe he was there to provide full detail of the transaction to the MG Rover Group board in order that they could make a decision about going ahead with it.*
>
> *Q. Speaking in the first instance for yourself alone, when you saw what was said in the presentation and heard what Ian Barton said at the meeting, did you take the words as having the blessing of Deloittes or as relaying what Deloittes might have been told by somebody else or whatever?*
>
> *A. No, I believe that they were effectively there at that meeting as our advisers and that they were providing that information as our advisers. So, yes, I believe that it was – blessing of Deloittes.*"

Mr Howe told us that he had not thought for a second that Mr Barton was speaking on behalf of the Phoenix Partnership, Mr Towers said that his expectation was that Mr Barton would "*give us a proper appraisal of where circumstances stood on this project*", Mr Beddow said that he understood Mr Barton to be speaking "*on the basis that Deloittes had been involved and considered this to be the most appropriate way forward*" for MGRG, Mr Oldaker said that he "*would take this presentation as addressing the needs of both the Phoenix guys as well as the MG Rover Group*" and Mr Millett said that he understood Deloitte to be "*there to negotiate and arrange this deal on our behalf*" so he "*thought it was for the common good of the business, the business as a generality*".

173. Further, Mr Edwards told us that the contents of the presentation essentially emanated from Deloitte. His evidence included the following:

"*... there are clearly things here where he* [Mr Barton] *had asked me to provide logos and things from our marketing team which I did make available to him but the whole point about asking him to do it is that the files that they had were the only files that existed about the transaction. I did not employ Deloittes to keep files on all this stuff myself. So, the reference sources and all the rest of it, so far as I am aware, were from Deloittes' own references or from knowledge they had of being involved in transactions.*

Q. *Did you check the document before it was used at the board meeting?*

A. *I think Ian would have sent it to me to look at, but I think 'check' is probably too strong a word. I do not think I had time to check it but I certainly viewed it to see if it contained any key points ...*

Q. *Just compendiously as to what we have so far, I think Ian Barton might say that all of this stuff has come from you, he is merely setting down what he has been told by you; do you think that is right?*

A. *I do not follow how, having engaged Deloittes to put a package together, to deal with the detail of that package, advise on it, report back to me occasionally or frequently, however you view it, on how progress is going and the main points of that transaction, when I asked them to collate the details of what they had been doing and present it to MG Rover board, they could turn around and say they got the details from me. The short answer is no.*"

174. Mr Barton's evidence was to rather different effect. He told us:

"*It is John's* [i.e. Mr Edwards'] *presentation. Most of the information is from John, other than to the extent that there was detail needed around it where John said: we need to talk about this point and we need to show this and I said: right, okay, these are the actual numbers or these are the actual points or this is the detail around it. In terms of how the presentation was broadly sketched out, that was what John wanted it to say. In terms of assisting him in completing the detail of that presentation, that was really the role that I was supporting him in.*"

He said too:

"*I probably presented large parts of it. But it was a two hander, really, with John. Essentially, it was John's presentation in which, as his adviser, I was assisting him, in making sure that it was the right information was delivered to the board.*

... It was not a Deloittes presentation. It was a Phoenix Partnership presentation at, which their advisers were assisting. Their advisers presented large chunks of that presentation ...

But the purpose of the presentation was to be absolutely clear with them what the transaction was involving, what the implications were for this particular company, so that they could make a decision as to whether they agreed with that, wanted to modify that or however they wanted to react to that.

[Q.] *Can you think of anything that would have alerted a member of the board to the fact that this was a John Edwards presentation, not a Deloittes presentation?*

[A.] *The fact that John introduced the presentation and said: this is what the purpose of the presentation is, this is what we are going to spend the next – however long it was, half an hour an hour – discussing and getting information across to you, Ian is here to go through some of the detail with you. And then we got into the two hander part of it. Like I say, I probably – I certainly presented more of it than John presented but around some of the points that were particular to the group; relationship with Phoenix Partnership or the group relationship with other companies, RV Capco and the like, those were the areas where John would step in because he was sales and marketing, his role was liaising with BMW over a number of months.*"

175. Mr Einollahi, too, was clear that the presentation did not involve Deloitte advising MGRG. He said:

"*Ian* [Barton] *knew that this was merely us helping our client with capturing some facts and data, not a presentation to the board. They weren't our client. We weren't acting for them. And it would have gone through a partner review process had we been ...*

I would have expected the chairman, if he got the slightest bit of impression that anybody was looking at it as [if] *it has got Deloitte's blessing, I would place it on the chairman to correct that wrongful impression.*"

(Mr Einollahi was not himself present at the board meeting.)

176. We think it likely that the presentation was principally delivered by Mr Barton, albeit that Mr Edwards may have "*chipped in*". We think, too, that it was reasonable for those present (or at any rate those present other than Messrs Beale, Edwards, Stephenson and Towers) to take Mr Barton to be speaking (a) on behalf of Deloitte rather than merely as a mouthpiece for either Mr Edwards or the Phoenix Partnership as a whole and (b) as an advisor to the Group and, in particular, MGRG. There is no suggestion that the board was told otherwise. Moreover:

176.1. the first slide stated merely "*MG Rover Group*" and "*Rover Financial Services Board Paper*". There was no indication that the paper was being presented on behalf of any other person;

176.2. Mr Edwards was a director of MGRG as well as a member of the Phoenix Partnership and will have been attending the board meeting in the former capacity; and

176.3. by October 2001 Deloitte were MGRG's auditors and had acted, or were acting, for MGRG on a number of matters[109].

177. In our view, the slides[110] (and correspondingly the presentation to the board[111]) were inaccurate and misleading in the following respects:

177.1. the slides stated that the Phoenix Partnership had opened discussions with BMW about acquiring RFS, but BMW's letter of 26 January 2001 was addressed to Mr Edwards as "*Deputy Chairman MG Rover Group Limited*"[112] and subsequent correspondence was conducted by or on behalf of PVH or MGRG[113]. It was not until 25 June that BMW was told that there was a plan to ring-fence the portfolio from PVH[114];

177.2. the slides attributed the decision that the Phoenix Partnership should be the joint venture partner to the fact that the "*existing commercial relationship between* [First National] *and MG Rover*" made it impossible for "*MG Rover*" to enter into a joint venture with another funder to buy the loan book, but (a) we found no evidence of any such impossibility and (b) in any case the real reason for the Phoenix Partnership being the joint venture partner was the desire of its members (other than Mr Howe) that profits from it should accrue to them. There was no mention in the presentation of HBOS's preference that its partner should be a Group company;

177.3. the slides did not explain that the protection against RV losses which was to be provided (in particular, by MGRG depositing money in an RV Capco account) meant

[109] Invoices rendered to MGRG by Deloitte show that by October 2001 the firm had acted for MGRG in respect of pensions advice, tax advice, the acquisition of the assets of Station Garages (Leyland) Limited, and due diligence in relation to the acquisition of Powertrain. It has been pointed out to us by Deloitte that the firm's "*corporate finance advisory team had not carried out any engagements on behalf of MGRG prior to Project Platinum*", but (a) corporate finance personnel assisted with the Powertrain acquisition aspect of the Completion Accounts dispute, albeit pursuant to an engagement letter agreed between MGRG and Deloitte forensic and (b) more fundamentally, we do not see why, in the absence of any further explanation, members of MGRG's board should have been expected to be alive to, let alone to attach importance to, the internal organisation of Deloitte.
It is, moreover, to be noted that there had been a lack of clarity as to the identity of Deloitte's client(s) in relation to Project Platinum. Thus, a conflicts search submitted to Deloitte's compliance department in February 2001 named Deloitte's client as "*MG Rover*", whose ultimate holding company was "*Techtronic*". On 18 April 2001 Deloitte told KPMG in a letter that they were "*acting as financial advisors to MG Rover Holdings Limited*". On 25 June 2001 Deloitte stated in a letter to Mr Griffiths that they were "*corporate finance advisor to the Phoenix Consortium*". When Deloitte finally entered into an engagement letter, on 20 September 2001, it was addressed to the Phoenix Partnership and the directors of "*Newco*" (MGR Capital).
[110] See paragraphs 166 to 169 above.
[111] See paragraphs 161 and 165 to 171 above.
[112] See paragraph 9 above.
[113] See paragraphs 14 and 66 above.
[114] See paragraph 17 above.

that the joint venture proposal was radically different from, and far more attractive to financiers than, the loan book BMW had marketed earlier in the year; and

177.4. the slides stated that Abbey could not join the bid as funder because First National was bidding for the portfolio on its own, but (a) First National had never in fact submitted even an indicative bid for the portfolio, (b) Mr Whyte had told Deloitte and Mr Edwards on 14 June 2001 (i.e. before BoS was first approached) that First National was "*not in*", (c) Mr Whyte had told Deloitte on about 26 June that there were "*no other bidders*" and (d) BoS was approached despite the fact that it had submitted an indicative bid for the portfolio.

178. It seems to us that Mr Barton (who largely drafted the slides and by whom the presentation was principally delivered), Mr Edwards (at whose instigation the presentation was given, who had the opportunity to comment on the slides in draft and who at least "*chipped in*" at the meeting) and Messrs Beale, Stephenson and Towers (who were all present at the meeting, in Mr Towers' case in the chair) should all have appreciated that the slides and presentation were deficient and misleading. Even if they were not all aware of every matter in respect of which the slides were inaccurate or incomplete, they will each have known, for example, that HBOS had expressed a preference that its partner should be a Group company and that that option had been rejected principally because the Phoenix Partnership's members (other than Mr Howe) wanted to secure the anticipated profits for themselves. They should also, in our view, each have realised that there was no mention of either fact in the slides.

179. We cannot say with certainty what course the meeting would have taken had the board been given an accurate and fuller account of the reasons for the acquisition being undertaken by a joint venture between HBOS and the Phoenix Partnership. However, Mr Beddow told us that, if he had been aware of the 16 August fax to Mr Christie, it would have "*caused* [him] *to ask some questions*". Mr Millett said that if he had known of the 16 August fax:

> "*It would have again strengthened my resolve to take it to the board members that MG Rover should be the partner, sharing in potential future profit streams rather than the Phoenix Partnership. Again, how far I could have progressed in that recommendation is a matter for speculation, is it not?*"

Mr Parkinson said:

> "*If HBOS had said, 'We prefer to deal with MG Rover,' I think we would all have had another conversation. It may not have changed the ultimate outcome but HBOS dealing directly with MG Rover when* [First National] *had an exclusive arrangement with us was something we believed was not possible to achieve.*"

Mr Shine told us that if Deloitte had not advised on who the joint venture partner should be, he would have taken the view that it should be "*MG Rover*" because it "*... very directly related to MG Rover's core business of managing those cars back in to MG Rover, to managing the residual values, and there was a very extensive database of customers and existing contracts and existing cars that MG Rover sales and marketing teams could have used to sell on.*"

180. What in fact happened was that, following the presentation to the board, Mr Millett expressed concerns about the money MGRG was to deposit in the RV Capco account. The minutes record as follows:

> "*There was then a discussion amongst the Board at some length on the commercial issues raised by Mr Barton in his presentation. Mr Millett expressed his concern as to the amount of cash which was required to be collateralised in order to satisfy the Company's liabilities for the GMFV. His view was that £43 million was over cautious as a provision for the Company's current exposure. In addition, Mr Millett raised a concern that by entering into this transaction, the Company was acquiring additional risk in respect of the GMFV's that it had previously had no liability for. These being the obligations currently assumed by Rover Financial Services and estimated to be in the order of £11 million*[115]*. There was further discussion amongst the Board of Directors on the numbers in question and it was resolved that Mr Millett and Mr Edwards carry out further work as to the level of cash to be collateralised in RV CAPCO and to further understand what proportion of the money the Company would receive or have remitted back from RV CAPCO.*
>
> *Mr Millett also expressed concern about the amount of money that was due to be collateralised in the RV CAPCO bank account. He explained that over time the risk would diminish and as such he would expect to see a gradual release of funds from that account. Mr Beale suggested that it would be appropriate to implement a review mechanism on an annual basis whereby the joint venture company could consider to what extent the money collateralised in the account was sufficient. To the extent that it was more than sufficient, then an amount could be remitted back to the Company before the portfolio expired. The Board resolved that this requirement be introduced into the negotiations with HBoS.*"

181. The minutes conclude:

> "*Mr Barton then explained that the next steps were to progress the commercial negotiations with HBoS and BMW and that all the issues raised by Mr Millett and the rest of the Board would be taken into consideration as part of those negotiations.*"

[115] See paragraph 6 above.

182. It was argued in representations made to us on behalf of the members of the Phoenix Consortium that "*the MGRG board ... provided its approval to the Platinum transaction proceeding at the 12 October 2001 board meeting subject to certain amendments to the transaction being made (and which amendments were in fact made)*". We are not persuaded that this is correct. It is not apparent from either the minutes of the 12 October meeting or the evidence we have been given about it that the board arrived at any final decision about Project Platinum at that stage. In any case, having regard to the deficiencies in the presentation mentioned in paragraph 177 above, the board will not have been in a position to make any decision on a fully-informed basis[116].

Completion

183. The Project Platinum transaction was completed overnight, on 8 to 9 November 2001, at the offices in London of Herbert Smith LLP ("Herbert Smith").

184. The resolutions which would be required for completion were considered by Herbert Smith, who were acting for HBOS, in an internal memorandum dated 7 November 2001. The author observed that there were "*essentially three things that cause problems in relation to the Phoenix Consortium being directors of* [PVH]": first, the duty under section 317 of the Companies Act 1985 to make a declaration to the board that they are "*interested*" in the transaction, second, the similar duty under article 19[117] of the company's articles of association and, third, "*a potential breach of various forms of the fiduciary duty that a director must not put himself in a position in which his duty and interest conflict, such as a duty not to make a secret profit, duty not to act in competition with the company, duty not to use information that he receives by virtue of his office*". The author went on to say:

> "*With a view to the issues identified above with regard to s 310 and 317 CA* [i.e. the Companies Act 1985]*, and the potential risk that disclosure to the board alone, for some wider reason, would not be sufficient to prevent the transaction being voidable at the instance of* [PVH]*, it would seem sensible to request that there is suitable disclosure by the directors at a board meeting, and that there is a resolution of the members. For the resolution of members, we should request a written resolution in accordance with s 381A CA, and that it should be a special resolution to take advantage of Regulation 70 Table A. It would also seem sensible that it should be worded such that the members instruct the directors that* [PVH] *should enter into the SPA, rather than attempting to ratify a breach that might happen in the future.*"

As regards MGRG, the author noted that the problems were "*slightly more complex than for* [PVH]", MGRG's articles of association being "*somewhat more restrictive*" than PVH's. The note explained as follows:

[116] It is to be noted in this context that representations made to us on behalf of the members of the Phoenix Consortium stated, "*A resolution passed at a board meeting would not be effective, qua board resolution, if information supplied to the relevant board at the meeting was materially incomplete, inaccurate or misleading.*"
[117] Article 19.1 of PVH's articles of association is quoted in paragraph 101 above.

> "*Article 83(a)-(e)*[118] *... sets out those transactions that directors may be interested in, and may vote and count to quorum when the board is voting on a resolution concerning a matter he is interested in. The list covers things like directors guarantees and employment contracts, but would not cover something as clearly in conflict with the interests of MGRG such as the transaction envisaged.*
>
> *Therefore it would seem sensible that we should also see a similar written resolution of* [PVH] *being the shareholder of MGRG*[119]*, directing the directors that the company should enter into the transaction*"

185. On 8 November 2001, Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers, as the "D" shareholders in PVH, passed several written resolutions, including:

    185.1. a resolution approving the purchase of RFS; and

    185.2. a resolution approving the appointment of Ms Ruston:

    > "*... to sign on behalf of the Company (as the sole shareholder of Techtronic ...) a Written Special Resolution of Techtronic to approve and direct the directors of Techtronic to appoint an authorised representative of Techtronic to sign on behalf of Techtronic (as sole shareholder of* [MGRG] *...) a Written Special Resolution of MGRG approving the Residual Value Remittance Agreement to be entered into between RFS (1) and MGRG (2) and the Remarketing Agreement to be entered into between RV Capco Limited (1) and MGRG (2) ... and directing the directors of MGRG to execute and complete the same.*"

    The "*Residual Value Remittance Agreement*" was to provide for MGRG to deposit £41 million in an RV Capco account on the basis mentioned above[120]. The "*Remarketing Agreement*" was to deal with the appointment of MGRG by RV Capco as its agent to remarket the vehicles returned to MGR Capital on either the expiry or default of a finance contract.

186. On the same day Ms Ruston signed on behalf of PVH a written resolution of Techtronic to approve her appointment:

    > "*... to sign on behalf of* [Techtronic] *(as sole shareholder of* [MGRG]*...) a Written Special Resolution of MGRG approving the Residual Value Remittance Agreement ... and the Remarketing Agreement ... and directing the directors of MGRG to execute and complete the same.*"

[118] Article 83 of MGRG's articles of association is quoted in paragraph 102 above.
[119] PVH did not in fact hold any shares in MGRG itself, but a subsidiary of PVH (namely, Techtronic) did. See further paragraphs 191 to 193 below.
[120] See paragraph 24.6 above.

Minutes[121] in respect of a Techtronic board meeting attended by Mr Beale and Mr Edwards state that, this written resolution having been signed by PVH, it was resolved that Ms Ruston be appointed to sign on behalf of Techtronic a written special resolution of MGRG approving, and directing MGRG's directors to execute, the "*Residual Value Remittance Agreement*" and the "*Remarketing Agreement*".

187. At 11.20 pm on 8 November, there was held (or purportedly held) a board meeting of MGRG. The minutes record that the meeting was held at Herbert Smith's offices and that the directors present were Mr Edwards, Mr Beale and Mr Howe; Mr Beale and Mr Howe attended by telephone. The minutes explain that the purpose of the meeting was:

> "*... to consider and, if thought appropriate, approve the circulation to the sole shareholder of* [MGRG] *entitled to vote at a general meeting of the* [MGRG]*, a written resolution of* [MGRG]*, to be signed by such shareholder as a special resolution ('the Written Resolution'), approving (for all purposes including, without limitation, for the purposes of Section 320 of the Companies Act 1985) the Residual Value Remittance Agreement, the Remarketing Agreement, the Database Access Licence, the Trademark Licence and the Trademark Sub-Licence as defined in Minute 3 and (in accordance with Article 65 of the Company's Articles of Association) directing that the directors of the Company execute and complete the same.*"

The minutes go on to state that it was resolved that the documents referred to be accepted and executed on behalf of MGRG.

188. On the same day, Ms Ruston signed on behalf of Techtronic, as "*the sole member of the Company* [i.e. MGRG]", a written special resolution of MGRG that the documents mentioned in the previous minutes be approved and that "*the directors of the Company be directed to take the requisite action*" in relation to their completion.

189. Ms Ruston also signed that evening, again on behalf of Techtronic as "*the sole member of* [MGRG]", a written special resolution of MGRG providing for MGRG's articles of association to be amended by the substitution of a new article 83[122]. The replacement article 83 was to be in similar terms to article 19[123] of PVH's articles of association and so to allow directors of MGRG to vote on matters where they had personal interests (subject to disclosure of those interests). Minutes record that MGRG's board had resolved to recommend the amendment to the company's articles at a 9 pm meeting attended by Mr Edwards, Mr Beale and Mr Howe.

190. Various points arise in connection with the resolutions of 8 November 2001.

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[121] The minutes are not dated, but were faxed in draft by Eversheds at 7.31 pm on 8 November 2001.
[122] The old form of article 83 is quoted in paragraph 102 above.
[123] Quoted in paragraph 101 above.

191. In the *first* place, while the written resolutions of MGRG[124] were passed on the basis that Techtronic was the sole member of MGRG, MGRG's share register showed BMW (UK) as holding one share in the company. The background to this was as follows:

191.1. the SPA provided for BMW (UK) to subscribe for one ordinary share ("*the Acquisition Share*") in MGRG for £1 plus a premium of £74,999,999 less the cash amount determined under clause 6.4 and to lend MGRG £75 million. It was intended that the Acquisition Share would be transferred to Techtronic for a nominal sum;

191.2. on 21 June 2000 BMW sent Eversheds a signed stock transfer form for the transfer of one share in MGRG to Techtronic. BMW stated:

> "*We ... enclose an undated Stock Transfer Form transferring said share to* [Techtronic] *for the consideration of £1 and hereby authorise you to date the same upon receipt of the above-mentioned subscription monies*";

191.3. on 27 July 2000 MGRG's board resolved to allot an ordinary share to BMW (UK);

191.4. on 12 August 2000 Companies House received a form 88(2) (return of allotment of shares) recording the allotment of a share to BMW (UK) for "*£1 plus a premium of £74,999,999 less the amount of cash, bank or other deposits in the Company and/or its subsidiaries at 9 May, 2000*";

191.5. in an email to Mr Howe dated 21 September, Ms Ruston wrote:

> "*... BMW (in addition to Techtronic) are a shareholder in Rover (they have one share) ...*
>
> *As a shareholder BMW will have to be written up in the register of members and will have the right to attend AGMs of the Company and get copies of the annual report and accounts. They will also be required to approve the special resolution of the members of the company for the change of name to MG Rover Group Limited*";

191.6. on 12 June 2001 Ms Ruston signed an annual return for MGRG in which Techtronic was named as MGRG's only shareholder. The information relating to Techtronic was written in manuscript;

191.7. MGRG's financial statements for the year ended 31 December 2000, which were approved on 29 October 2001, reported that one ordinary share had been issued to BMW (UK) on 27 July 2000;

[124] See paragraphs 188 and 189 above.

191.8. on 15 January 2002 Ms Ruston enclosed with a letter a certified copy of MGRG's register of members, which showed that as at 4 December 2001 BMW (UK) was the registered holder of one share;

191.9. once BMW (UK) had been entered in the register, it was a member of MGRG;

191.10. nonetheless, on 31 May 2002 Ms Ruston signed an annual return for MGRG in which Techtronic was again given as MGRG's only shareholder. On this occasion, the form will already have shown Techtronic as MGRG's shareholder when it was sent out to MGRG by Companies House. The signed version lodged with Companies House includes manuscript ticks against the information relating to Techtronic;

191.11. no steps were ever taken to complete the transfer of the Acquisition Share to Techtronic, to have it stamped or to make the appropriate entries in the register of members;

191.12. the point surfaced in 2004 during the Project 528 negotiations with SAIC[125]. In an email to Ms Ruston dated 6 September, Ms Lewis said that she understood that MGRG's register of members showed that BMW held one share and asked "*whether that is thought to be right and how that comes about*"[126]. On 20 December, Ms Ruston explained in an email to Ms Lewis:

> "*I haven't actually taken BMW's share off them I didn't like to approach them to suggest that. What I did was transfer one of Techtronic's shares to me to give the Company three shareholders. This means that we can sign a consent to short notice with just me and Techtronic rather than needing to involve BMW each time. Clearly we can't sign* [any] *written resolution but with the short notice provisions then this doesn't really matter*"[127]; and

191.13. when we asked Ms Ruston whether Techtronic was the sole member of MGRG on 8 November 2000, she said that she did not think it was, because "*BMW had a share in* [MGRG]."

192. In the circumstances, there is no doubt that BMW (UK) was a member of MGRG from 4 December 2001 onwards (since it had clearly been entered in the register of members by

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125 As to which, see chapter XX (Events leading to administration).

126 We can well understand why in November 2001 (and, indeed, at all later times until September 2004) Eversheds should have assumed that Techtronic was the only member of MGRG. That, after all, was what the position should have been. Ms Lewis told us that "*it came as a complete surprise*" when Eversheds were told in 2004 that one share in MGRG was held by BMW and that she "*did not understand how that could be*".

127 Norton Rose told us that Ms Ruston did ultimately request the share's transfer and that they had "*then advised BMW that the share should simply be transferred for a nominal price as this was Techtronic's entitlement*". This, Norton Rose explained, "*was a piece of housekeeping which was under discussion with Jane Ruston at the time of the proposed joint venture with Shanghai Automotive and was never implemented because of the intervening administration of MG Rover.*"

that date)[128]. The question arises whether it had already been entered in MGRG's register of members, and therefore become a member, by 8 November (when Project Platinum was completed). The fact that BMW (UK) was not shown as a shareholder in the annual return submitted to Companies House in June 2001 provides some evidence that it had not yet been entered in the register of members, but the significance of the point is reduced by the fact that BMW (UK) was not recorded as a shareholder in the next annual return either, even though it was plainly in the register by then. On balance, we think that the likelihood is that BMW (UK) had been recorded as a member by 8 November (the relevant entry having perhaps been made soon after Ms Ruston sent her email of 21 September 2000 and, in any event, before the 2000 financial statements were approved in October 2001).

193. It has been argued in representations to us that BMW (UK) was bare nominee for Techtronic of the share registered in its name and that, accordingly, Techtronic was the only person entitled to attend and vote in general meetings of MGRG. Even, however, if BMW (UK) held its share as nominee for Techtronic (as may very well be the case), we doubt whether a resolution signed by Techtronic alone can have complied with the requirements of the written resolution procedure for which sections 381A to 381C of the Companies Act 1985 provided. We should have thought that BMW (UK) would also have been a member "*entitled to attend and vote at* [a general] *meeting*" (within the meaning of section 381A), albeit that Techtronic might have been entitled to require it to vote as Techtronic directed.

194. A *second* point is that directors of MGRG who were not also members of the Phoenix Partnership were not given notice of the MGRG board meetings[129]. On 8 November 2001, MGRG's board comprised, in addition to members of the Phoenix Partnership, Mr Beddow, Mr Bowen, Mr Millett, Mr Oldaker, Mr Parkinson and Mr Shine. We asked each of these whether he was informed of a meeting on 8 November. Mr Beddow and Mr Shine both told us that they were not invited to such a meeting, and Mr Bowen, Mr Oldaker and Mr Parkinson all said that they could not recall being invited. When asked whether he was notified of the meeting mentioned in paragraph 187 above, Mr Millett answered:

> "*No. I do not believe so, but I was aware that the deal was getting close to completion around the first week of November, but I was not notified of that meeting.*"

[128] This is accepted by the members of the Phoenix Consortium. Representations made to us on behalf of the Phoenix Consortium stated, "*by 4 December 2001 and at all times thereafter BMW was a member of MGRG since its name was entered in the register of members as holder of at least one share.*"

[129] See paragraphs 187 and 189 above.

Ms Ruston, too, told us that she did not think the non-Phoenix directors were given notice of an MGRG board meeting on 8 November[130]. There is, however, a general rule of law that all the directors of a company must be given notice of a board meeting[131].

195. A *third* point is that, notwithstanding the advice of Mr Potts QC that there should be board resolutions "*stated to ratify the breach of the relevant individuals' capacity as directors*"[132], we have found no trace of any such resolution. MGRG's board, in particular, never seems to have been asked to consider such a resolution, let alone to have passed one[133]. Further, we cannot see that a resolution approving the particular documents mentioned in the MGRG minutes (for instance, the Residual Value Remittance Agreement), even if validly passed, can have performed the same function.

196. Representations made to us on behalf of the members of the Phoenix Consortium argued that the "*no conflict*" and "*no profit*" rules[134] were not in fact engaged, from which it would follow that no resolutions "*to ratify the breach of the relevant individuals' capacity as directors*" were needed. In this connection, it was contended that the business opportunity presented by the Platinum transaction did not come to the Phoenix Partners as directors, or at any rate not as directors of MGRG, and that the opportunity "*was not within the scope of MGRG's business*". In our view, however, there is a strong case for saying that the Platinum opportunity presented itself to the Phoenix Partners as directors, whether of MGRG or PVH[135]. In any case, as already mentioned[136], the "*no profit*" rule might be said to be applicable in the context of Project Platinum on the basis that the members of the Phoenix

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[130] Ms Ruston said "*Certainly* [Eversheds] *were responsible for dealing with the formalities of* [the board meetings]". In contrast, Ms Lewis told us that, as far as she was concerned, it was not part of Eversheds' job to give notice to directors of a meeting; she said:

> "*If we were dealing with somebody like Jane Ruston on the basis that a board meeting had had to be convened, that would be something that we would leave to them to deal with internally, to convene a board meeting.*"

It seems to us that it will not have been incumbent on Eversheds to notify MGRG's directors of the 8 November 2001 meeting.

[131] See, for example, *In re Portuguese Consolidated Copper Mines Limited* (1889) 42 Ch D 160 and *Young v Ladies' Imperial Club* [1920] 2 KB 523. This was by no means the only occasion on which directors of Group companies were not included in board meetings. We comment further on this in chapter XXII (Aspects of corporate governance).

[132] See paragraph 98 above.

[133] Ms Ruston told us that she "*entirely asked Eversheds to deal with all the documentation that was needed to deal with the Potts opinion, or any other matter that came out of the transaction*". For her part, Ms Lewis thought that Herbert Smith (who, as already noted, were acting for HBOS) had drawn "*certain conclusions as to how they thought it was appropriate to deal with the issue*" and said that she was assuming that "*as a consequence of conversations between Herbert Smith and* [Eversheds], *the documents that are in the bundles are those which were ultimately agreed upon*".

[134] The "*no conflict*" and "*no profit*" rules mean that "*a person who is under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain* [the "no conflict" rule] *or (ii) which was obtained or received by use or by reason of his fiduciary position or of opportunity or knowledge resulting from it* [the "no profit" rule]" (see *Chan v Zacharia* (1984) 154 CLR 178, quoted in *Don King Productions Inc v Warren* [2000] 1 BCLC 607). See also paragraphs 86 and 100 above.

[135] See e.g. paragraphs 9 and 64 to 67 above.

[136] See paragraph 100 above.

partnership were to obtain profits by procuring MGRG to deposit money in the RV Capco account[137].

197. A *fourth* point is that at least two of Techtronic's directors were not given notice of the Techtronic board meeting which is recorded as having been held[138]. Mr Ames and Mr Bowes were both directors of Techtronic on 8 November 2001, but neither was notified of any Techtronic board meeting on that date[139].

198. *Fifthly*, Ms Ruston was not authorised by Techtronic's board to sign on that company's behalf the written special resolution providing for the amendment of MGRG's articles of association[140]. The minutes of the Techtronic board meeting purportedly held on 8 November 2001[141] make no reference to any change to MGRG's articles of association.

199. *Lastly*, were it to be the case, having regard to the points mentioned in paragraphs 191 to 193 and 198 above, that MGRG's articles of association had not been validly amended and that article 83 thus remained in its old form, the directors present at the MGRG board meeting mentioned in paragraph 187 above (namely, Messrs Edwards, Beale and Howe) would each appear to have been disqualified from voting on matters relating to Project Platinum. As unamended, article 83 provided that "*a director shall not vote at a meeting of directors … on any resolution concerning a matter in which he has, directly or indirectly, an interest or duty which is material and which conflicts or may conflict with the interest of the Company unless his interest arises only because the case falls within one or more* [specified exceptions]". None of the exceptions would appear to have applied, but, as members of the Phoenix Partnership, Mr Edwards, Mr Beale and Mr Howe would all seem to have had personal interests which conflicted (or potentially conflicted) with those of MGRG.

200. The overarching response on behalf of the members of the Phoenix Consortium is that Project Platinum was approved by PVH, or at any rate by the voting shareholders of PVH (viz. the four members of the Phoenix Consortium as PVH's "D" shareholders), and that any technical irregularities are therefore irrelevant. It is argued, for example, that "*given that the ultimate voting shareholders approved the transaction no issue can arise out of any deficiencies regarding approvals which occurred at board level.*" Reference is made to the principle in *Re Duomatic Ltd*[142], which was summarised as follows in representations to us:

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137 As to the significance of the RV Capco arrangements, see further paragraph 216 below.
138 See paragraph 186 above.
139 See further XXII/18 and 19.
140 See paragraph 189 above.
141 As to which, see paragraph 186 above.
142 [1969] 2 Ch 365

> "*Where there is any defect in or failure to comply with the formal shareholder resolution procedure, the principle stated in* <u>Re Duomatic Ltd</u> *provides that there will still be valid shareholder approval in respect of the course of action in question provided that every member who would have the right to vote on such a resolution is aware of and approves of such course of action (or, after becoming aware of it, conducted themselves in such a way as to make it inequitable for them to deny that they had given such approval) …*"[143]

201. These arguments themselves give rise to a number of issues. In particular:

201.1. it is not clear from the decided cases that the *Duomatic* principle operates where a matter has merely been approved by the shareholders of a company (here, PVH) which holds the shares in another company (here, Techtronic) which is itself the beneficial owner of the shares in a third company (here, MGRG). There is relatively little authority dealing with such indirect interests. Further, there are conflicting indications in the cases as to whether the *Duomatic* principle can apply where the beneficial owner of a share approves a course of action but the share's registered owner does not do so[144]. The point could be of significance if, as we think likely[145], BMW (UK) was registered by 8 November 2001 as the holder of one share in MGRG;

201.2. it is an open question whether the *Duomatic* principle can apply where the shareholders entitled to vote at a shareholders' meeting (as regards PVH, the "D" shareholders) have assented unanimously to a matter but a shareholder to whom notice of such a meeting is to be given even though he has no right to vote at it (here, the "A", "B" and "C" shareholders[146]) has not been notified; and

201.3. it is arguable that MGRG's financial circumstances[147] were such as to preclude the operation of the *Duomatic* principle.[148]

202. With regard to the last of these points, the interests of a company are normally identified with those of its members. When, however, a company has financial difficulties, the interests of creditors can become relevant. In *West Mercia Safetywear Ltd v Dodd*[149] (a

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[143] It is, moreover, contended as follows:

> "*It is sufficient for the shareholders in question to be shareholders in the company indirectly – that is, for the decision to be taken by the sole voting shareholder(s) of the sole voting shareholder(s) of the company: compare* <u>NBH Ltd v Hoare</u> *[2006] 2 BCLC 649…*"

[144] Compare *Domoney v Godinho* [2004] 2 BCLC 15 with *Shahar v Tsitsekkos* [2004] EWHC 2659 (Ch).

[145] See paragraphs 191 to 192 above.

[146] See V/49.

[147] MGRG's financial circumstances are considered further in chapter XVI (Financial and trading performance of MGRG).

[148] See paragraphs 202 to 207 below.

[149] [1988] BCLC 250; the *West Mercia* case was discussed recently in *Sandhu v Sidhu* [2009] EWHC 983 (Ch).

decision of the Court of Appeal), Lord Justice Dillon approved the following statement of a New Zealand Judge in *Kinsela v Russell Kinsela Pty Ltd*[150]:

> "*In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration.*"

203. It has been said that the interests of creditors can "*intrude*" even when a company may not strictly be insolvent. In *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd*[151], Mr Leslie Kosmin QC (sitting as a Deputy High Court Judge) put the position as follows[152]:

> "*Where a company is insolvent or* ***of doubtful solvency or on the verge of insolvency*** *and it is the creditors' money which is at risk the directors, when carrying out their duty to the company, must consider the interests of the creditors as paramount and take those into account when exercising their discretion*" (emphasis added).

In similar vein, Mr Justice Park said in *Re MDA Investment Management Ltd* that:

> "*... when a company,* ***whether technically insolvent or not****, is in financial difficulties to the extent that its creditors are at risk, the duties which the directors owe to the company are extended so as to encompass the interests of the company's creditors as a whole, as well as those of the shareholders*" (emphasis added).

204. It could be argued that this principle already applied to MGRG by the autumn of 2001. At that stage (and for some considerable period afterwards), MGRG was able to pay its debts on time and was not perceived by its directors as insolvent[153]. However, MGRG's financial statements for the year to 31 December 2000 gave its net assets at that date as just £12 million and the company was known to be incurring sizeable losses during 2001. (In the event, the company's 2001 financial statements showed it to have incurred a loss during the year of £227.3 million, producing net liabilities as at 31 December 2001 – less than two months after Project Platinum's completion – of £150.4 million.) It could accordingly be

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[150] (1986) 4 NSWLR 722
[151] [2003] BCC 885
[152] Cooke J said in *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 that "*creditors are entitled to consideration ... if the company is insolvent, or near-insolvent, or of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency*".
[153] MGRG's financial circumstances are considered further in chapter XVI (Financial and trading performance of MGRG).

contended that MGRG was insolvent on a balance sheet basis by November 2001 (when Project Platinum was concluded) and, hence, that the interests of creditors so "*intruded*" as to preclude the authorisation or ratification of any breach of duty[154].

205. It has been suggested in representations which have been made to us that MGRG should not be considered to have been insolvent, even on a balance sheet basis, in November 2001 (or indeed afterwards). The argument is on the following lines:

205.1. MGRG's audited financial statements show that in each of the years ended 31 December 2000 to 2003 the value of the company's assets exceeded its liabilities to creditors other than Techtronic. For example, MGRG's 2001 financial statements (as restated) disclose that the company would have had net assets of £162 million but for its indebtedness to Techtronic (which totalled £337 million at 31 December 2001);

205.2. the agreement dated 9 May 2000 pursuant to which BMW agreed to make a subordinated loan to Techtronic[155] provided for Techtronic to lend on to MGRG on a subordinated basis. Techtronic's remedy against MGRG in relation to such lending was to be the institution of winding-up proceedings, yet Techtronic's claims were to be subordinated to those of other creditors in the event of a liquidation; and

205.3. MGRG's liability to Techtronic was a contingent one. If at any time before 8 April 2005, any value should have been placed on the liability, it would have been a relatively small sum and much less than the surplus of MGRG's total assets over liabilities, excluding the loan from Techtronic. Further, even when the liquidation or administration of MGRG was firmly in prospect, the value to be placed on its debt to Techtronic could never exceed the amount, if any, that Techtronic would recover as a subordinated creditor of MGRG.

On this basis, it is contended that MGRG's debt to Techtronic was irrelevant to an assessment of whether MGRG was solvent on a balance sheet basis.

206. There are counter-arguments. While it is true that in November 2001 MGRG would have had net assets but for its debt to Techtronic:

206.1. MGRG's indebtedness to Techtronic would not appear to have been properly regarded as contingent. While BMW's loan to Techtronic did not fall due for repayment before 2049 unless (a) Techtronic and its subsidiaries, taken together, achieved profits or (b) an "*Event of Default*" (within the meaning of the Facility

[154] The *Kinsela* case to which Dillon LJ referred in *West Mercia* was itself one where ratification was in issue. In a subsequent Australian case, *Re New World Alliance Pty Ltd* (1994) 122 ALR 531, Gummow J went so far as to say that "*the duty to take into account the interests of creditors is merely a restriction on the right of shareholders to ratify breaches of the duty owed to the company*" (a comment discussed in *The Bell Group Ltd v Westpac Banking Corporation (No 9)* [2008] WASC 239, at section 20.3.3.3).

[155] See III/90.

Agreement) occurred[156], there seems to have been no similar restriction on repayment of Techtronic's lending to MGRG. To the contrary, the loans to MGRG from Techtronic were apparently repayable on demand. In any case, even BMW's loan to Techtronic would become due for repayment in time (on 9 May 2049, if not before); and

206.2. while BMW's loans to Techtronic were made on an interest-free basis, MGRG was obliged to pay interest to Techtronic. In 2001 itself, that interest amounted to £9.81 million. In our view, it would be strange if indebtedness on which a company was incurring interest at a commercial rate were to be disregarded, or even discounted substantially, when determining the company's solvency.

It is to be noted, too, that in the context of Project Platinum negotiations with BMW and HBOS were conducted on the basis that there was a risk of MGRG failing[157] and that the RV Capco arrangements were established to address this very danger. Further, MGRG's longer-term survival had depended since its acquisition by Techtronic on the successful conclusion of a joint venture arrangement[158], and none had come to fruition when Project Platinum was undertaken.

207. On the other hand, arguments to the following effect have also been advanced to us:

207.1. the principle seen in the *West Mercia* case does not apply unless (a) the company in question is faced with inevitable insolvent liquidation, (b) such a liquidation is firmly in prospect unless the Court intervenes or a rescue is achieved, or (c) a particular transaction brings about the circumstances in (a) or (b);

207.2. neither before nor after the completion of Project Platinum was liquidation either inevitable or firmly in prospect in MGRG's case;

207.3. in any case, directors are discharged from their duty to the company to take account of the interests of a particular creditor if that creditor knows of, and approves or acquiesces in, the relevant transaction; and

207.4. Techtronic must be taken to have assented to the Project Platinum transactions[159].

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[156] See III/90.

[157] For example, the "*valuation discussion document*" which Mr Einollahi sent Mr Griffiths on 25 June 2001 (see paragraph 17 above) included "*provision ... for MG Rover's failure to meet its guarantee obligations*", and on 18 July 2001 Mr Einollahi told Mr Middleton that the "*risk of the business going pop before May 2002* [i.e. within 10 months] *is remote*". Going forward, BoS "*assumed that the 'doomsday' scenario would occur as of May 2002*". Mr Middleton told us that it was made clear to Deloitte at the outset, "*we would need to ensure that Bank of Scotland did not carry risk of MG Rover failing*".

[158] See III/93 to 98.

[159] There could, however, be a question as to whether the principle seen in the *West Mercia* case precluded Techtronic from so assenting.

208. The arguments outlined in paragraphs 200 to 207 above raise complex legal issues on which we do not think we should express conclusions in this report. The points should rather, it seems to us, be aired, if and so far as necessary, in Court proceedings with full legal argument.

209. Understandably, members of the Phoenix Partnership left the legalities to lawyers. Mr Edwards, for example, told us, "*I relied on the lawyers to make sure that all of* [the issues] *were being complied with*". For her part, Ms Ruston maintained, "*I entirely asked Eversheds to deal with all the documentation that was needed to deal with the Potts opinion, or any other matter that came out of the transaction*"[160].

The 16 November 2001 MGRG board meeting

210. Project Platinum was one of the items on the agenda at MGRG's board meeting on 16 November 2001. The minutes of the meeting record as follows:

> "*Miss Ruston explained that the project, code named Platinum, … had been completed on the 15th November 2001. At a previous Board meeting Mr Millett raised a number of concerns. These had been taken into consideration in the commercial negotiations. In particular, the money that was to be put into the collateralised bank account with RV CAPCO by the Company* [i.e. MGRG] *had been reduced from £43 million to £41 million. This had followed negotiations with Halifax Bank of Scotland on the residual value risk associated with cars in the portfolio. In addition to this and in respect of the new residual value risk being assumed an amount of £12.7 million had been identified to be used in respect of these risks … This had increased from £11 million to £12.7 million. Initially, the proposal was that this money would be remitted back to MG Rover Group and to the new joint venture company in certain proportions. The negotiations leading up to the completion of the transaction had resulted in all this money being available to be remitted back to the Company. The final point that had been a matter of concern to Mr Millett was the extent to which the money was being tied up within the collateralised bank account. Miss Ruston explained that following intensive negotiations on this matter it had been agreed with the new joint venture company that an objective criteria would be assessed to consider a release from the bank account of the money.*"

211. No resolutions relating to Project Platinum were proposed or passed at this meeting.

Implications for MGRG

212. It has been said in evidence to us that it was in MGRG's best interests for the loan book to be "*in the hands of a friendly owner*". For example, Mr Edwards told us in a witness statement that during the period after Techtronic's acquisition of MGRG, MGRG had to pay

[160] Note, however, footnote 133 above.

"*unacceptably high amounts*" to RFS pursuant to its obligation to reimburse RFS for losses suffered on the resale of vehicles financed by PCP contracts and that:

> "*The main problem for MGRG going forwards was that its exposure under the RV Guarantees was unlimited and there was no definitive way of ascertaining what its ultimate liability might be.*"

213. Mr Edwards told us that when it became clear that BMW was intending to sell the Rover loan book there were concerns over who would acquire it; he said:

> "*Whilst there were currently problems with the sale process which was being performed by RFS, there was a concern that the process might become even more uncontrolled if the RFS Book fell into the hands of a third party and that the problems which MGRG was facing … would be exacerbated even further …*
>
> *We concluded that the pragmatic approach was to try to acquire the RFS Book from BMW Financial Services and, having attained control of it, implement Project Revolve*[161] *…*"

214. Project Platinum also enabled MGRG to cap its exposure to residual value (or "RV") losses. As mentioned above[162], in consideration for depositing £41 million into RV Capco's bank account, RFS agreed to release MGRG from its obligation to continue to fund RV losses.

215. On the other hand, MGRG lost the ability to use the £41 million transferred to RV Capco in its day to day business. Further, the cap on MGRG's exposure to RV losses was of little real value since its liabilities were in any event most unlikely to reach the £41 million figure[163]. As mentioned above[164], Mr Edwards told us, for instance, that he thought that MGRG would be able to recover £10 million "*with our eyes shut*" and that it should be possible "*to deliver 20-plus*". Moreover, HBOS had assumed in its calculations that the "*doomsday*" scenario would occur as of May 2002[165], but there was no realistic prospect of MGRG failing by then: while MGRG's prospects remained uncertain in the longer term, the BMW "*dowry*" meant that there was no appreciable risk of a collapse as early as May 2002[166].

216. In addition, and importantly, the returns which were anticipated from the Project Platinum transaction[167] can fairly, we think, be regarded as attributable to a substantial extent to MGRG's £41 million deposit in the RV Capco account. The residual value guarantees represented (in Mr Griffiths' words) "*the crux of the disposal of the portfolio to any*

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[161] Mr Edwards described Project Revolve in the following terms: "*Members of John Millett's team developed processes and systems to try and improve the returns on vehicles which were sold by RFS at the end of the RFS Contracts*".
[162] See paragraph 24.6 above.
[163] This is discussed further in chapter XXIII (Financial statements and audit).
[164] See paragraph 114 above.
[165] See paragraph 105.1 above.
[166] MGRG's financial circumstances are considered further in chapter XVI.
[167] As to which, see paragraphs 105 to 115 above.

company"[168]. When BMW was marketing the Rover loan book, prospective purchasers were clearly put off by the fact that the residual value guarantees were from MGRG[169]. The RV Capco arrangements made the loan book far more attractive; as Mr Middleton said, "*a proposal under which there was a protection against residual values was a fundamentally different and more attractive one.*"[170] The collateralisation which MGRG was to provide was key to HBOS' willingness to finance the Platinum transaction. It is also, we consider, likely to account for the size of the returns which MGR Capital was projected to achieve. Since (a) the RV Capco arrangements meant that MGR Capital enjoyed protection against "*all the major risks associated with the transaction…, even in the severest of downside cases*" (to adopt words of HBOS)[171] but (b) comparable protection was not available to any other potential purchaser, it is not surprising that the transaction was expected to prove a profitable one. Yet MGRG, whose deposit facilitated the transaction, did not share in the returns from it.

The Phoenix Partnership's benefits from Project Platinum

217. As explained above, Mr Beale and Mr Edwards hold the "B" shares in MGR Capital on behalf of themselves and the other members of the Phoenix Partnership. Messrs Beale, Edwards, Stephenson and Towers also held the preferred shares in the company[172].

218. MGR Capital has not to date paid any dividends on its "A" or "B" shares, but it declared dividends, at the rate of 20 per cent (or £400,000) a year, on its preferred shares. In all, the company declared dividends totalling £2.756 million on its preferred shares. Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers were each entitled to one quarter of the preference share dividends. They thus each derived dividends of about £689,000 from their preferred shares. Further, they received the capital value of the shares (viz. £2 million) when they were redeemed in October 2008.

219. MGR Capital's last filed financial statements, for the year ended 31 December 2008, reveal net assets of £23,232,000[173]. The instalment credit debtors are now negligible. The company's assets consist substantially of "*Amounts owed from HBOS plc group undertakings*".

220. The Phoenix Partnership stand to receive roughly half of the amount of MGR Capital's net assets in due course. In the event of the partnership obtaining £11.6 million (viz.

[168] See paragraph 15 above.
[169] See paragraphs 12 and 15 above.
[170] See paragraph 16 above.
[171] See paragraph 108 above.
[172] The preferred shares have now been redeemed – see paragraph 218 below.
[173] It is to be noted that MGR Capital's profits were boosted in 2005 by exceptional income of £16.2 million in respect of a VAT rebate from Customs (i.e. HM Customs and Excise). This arose from litigation (unconnected with MGR Capital itself) in which it was established that, where a hire purchase car is returned voluntarily or is repossessed, with the consequence that the price required to be paid by the customer under the contract is reduced, there is a consequent decrease in the consideration for the supply by the finance company for VAT purposes. The £16.2 million rebate will have increased the company's profits after tax, and hence its net assets, by a rather smaller amount, since it had to pay corporation tax on its profits at the rate of 30 per cent.

approximately half of the £23,232,000), Mr Howe would receive about £1.4 million while each of the other members of the partnership would receive some £2.55 million[174].

221. Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers each invested only £500,000 in MGR Capital[175]. The fifth member of the Phoenix Partnership, Mr Howe, invested nothing at all in the company. On the figures given above[176], the members of the partnership would obtain the following returns (in addition, in the case of Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers, to the return of the original £2 million investment) from their shares in MGR Capital:

	Each of Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers	**Mr Howe**	**Total to Phoenix Partnership**
	£ million	**£ million**	**£ million**
Preference dividends from incorporation to 2008	0.689	-	2.756
50% profit share from "B" shares	2.550	1.400	11.600
Total	**3.239**	**1.400**	**14.356**

222. Large sums have also been paid into the Guernsey Trust in connection with Project Platinum.

223. Minutes record that at a PVH board meeting held on 26 February 2002, a contribution to the Guernsey Trust of £2.675 million was approved for the benefit of the following employees:

	£ million
Mr Beale	0.606
Mr Edwards	0.606
Mr Stephenson	0.606
Mr Towers	0.606
Mr Howe	0.252

The minutes give the following justification for the £2.675 million payment:

> "*The proposed level of contribution was reviewed in the context of the services provided by the directors in securing the continued viability of the Company's investment in MG Rover Group Limited. It was noted that as a result of the acquisition of Rover Financial Services Limited that the group now has much greater control over the second hand value of MG Rover vehicles. This had always been a*

[174] Mr Towers, Edwards, Beale and Stephenson would receive 22% each while Mr Howe would receive 12% of profits.
[175] Not including the funds used to acquire the ordinary B shares of £499.99.
[176] See paragraph 218 to 220 above.

long-term strategic aim of the company given the volume of vehicles which would be released into the market in 2003."

224. Minutes record that at a PVH board meeting held on 13 October 2003, a contribution to the Guernsey Trust of £3.63 million was approved for the benefit of the following employees:

	£ million
Mr Beale	0.74
Mr Edwards	0.74
Mr Stephenson	0.74
Mr Towers	0.74
Mr Howe	0.62
Ms Ruston	0.05

The minutes give the following justification for the £3.63 million payment:

"*The proposed level of contribution was reviewed in the context of the achievement of the Directors in managing the release of a significant number of second hand vehicles into the market place during 2003 via RV Capco Ltd and in controlling the second hand values achieved, such that £16.5 million of the initial loss provision on these cars will be released back to MG Rover group.*"[177]

225. Minutes record that at a PVH board meeting held on 3 September 2004, a further contribution to the Guernsey Trust of £0.21 million was approved for the benefit of Mr Howe. It was noted that:

"*The proposed level of contribution was reviewed in the context of:*

the achievement of the Group Chief Executive in continuing to manage the release of a significant number of second hand vehicles into the market place during 2004 via RV Capco Ltd and in controlling the second hand values achieved, such that £16.5 million of the initial loss provision on these cars will be released back to MG Rover group."

226. Including bonuses, the members of the Phoenix Partnership thus stand to derive the following benefits from Project Platinum:

[177] In our view (as in Mr Edwards' – see paragraph 114 above), the provision for residual value losses was generous from the outset, and it was therefore foreseeable that moneys would be repaid to MGRG – see XXIII/247 to 259.

	Each of Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers	Mr Howe	Total to PP
	£ million	**£ million**	**£ million**
Total from MGR Capital[178]	3.239	1.400	14.356
Guernsey Trust payment – 26 February 2002	0.606	0.252	2.675
Guernsey Trust payment – 13 October 2003	0.740	0.620	3.580
Guernsey Trust payment – 3 September 2004	-	0.210	0.210
Total	**4.585**	**2.482**	**20.821**

Explanations to MPs

227. On 6 November 2003 Mr Burden MP wrote to Mr Towers about stories in the Daily Telegraph arising out of the publication of PVH's 2002 financial statements. Mr Burden noted that one of the claims made was that "*the effect of restructuring the leasing business as MGR Capital outside the main Group has meant that this profitable part of the business does not contribute to the survival of the core manufacturing operation but that it is declaring dividends payable to the individual and corporate owners of MGR Capital*". Mr Burden sought, among other things, "*a note setting out the rationale behind keeping MGR Capital outside the Group and what is happening to the proceeds from MGR Capital*".

228. Mr Beale replied to Mr Burden's letter on 11 November 2003. As regards MGR Capital, he said:

> "*MGR Capital is not the finance arm of MG Rover and all profits on retail business written previously with First National Bank and in the future with HBOS is shared between the dealers and these Finance Companies. MGR Capital took over the residual book debt from BMW Finance to protect the residual values of Rover vehicles. All residual value benefit on these vehicles is passed to MG Rover. One of the most important factors for keeping MGR Capital outside of MG Rover and PVH was to avoid showing the debt in the Balance Sheets of these companies as that would have seriously impaired MG Rover's ability to raise further borrowings. Unfortunately the only other way to achieve this was for The Phoenix Consortium members to yet again put their hands in their pockets and put personal monies at risk.*

[178] See paragraph 221 above.

Any profits in MGR Capital will therefore be shared between Phoenix consortium members and HBOS who put up the balance of the funding."

229. Mr Beale advanced similar explanations of MGR Capital when he and Mr Towers gave evidence to the Trade and Industry Select Committee on 30 March 2004. When asked by the chairman of the Committee about MGR Capital, he said:

"*What MGR Capital is is the business that BMW had written when they were selling Rover Cars under their ownership. It was a static debt of book of some £327 million that was owed to BMW Financial Services by various customers that had bought cars. That was not for sale because BMW did not want to sell it but it was fundamentally important that MG Rover actually acquired that book of debt for two very good reasons. Firstly, it is a huge database of people who have bought Rover products so it enabled us to market those customers as their financial agreements came to an end as opposed to BMW being able to market them and try to convince them to buy a new Mini or a 3-Series. Secondly, BMW had entered into an inter-group contract that basically said if any of those vehicles when they came up at the end of their financial lives lost money compared to the expected value then Rover Group had to pay BMW Financial Services for it. Those losses in the first 12 months were running into many thousands of pounds per vehicle. BMW had no need or desire to sell our cars in the second-hand market in an efficient manner because we were underwriting it, so it is absolutely crucial for MG Rover Group to either get control of that book of debt by themselves or have somebody who would favour MG Rover owning it. Unfortunately our financial advisers could not find a way of MG Rover or PVH buying that book of debt because of the impact on our balance sheet showing that huge liability so the only option that was left to us was for us to enter into the arrangement personally which involved us putting up a fairly serious personal stake in conjunction with a major bank to get control of that book of debt. So we did take some personal risk. We hope we will* [one] *day get some personal reward out of that but the benefit to MG Rover was £20 million /£30 million/ £40 million saving in residual value losses plus the ability to market those customers so it was absolutely crucial that we did that for the company.*"

Mr Beale also told the Committee:

"*Just to be totally fair, I would say that our personal guarantees and so on in MGR Capital get less as time goes on because as the book of debt goes down the possibilities of losses are much lower today than they were 12 months ago when it was very scary levels.*"

230. In reality, however:

230.1. the Phoenix Partnership was involved in the joint venture because its members (other than Mr Howe) wanted the profits to accrue to them, not because that was the "*only option that was left*" or for reasons relating to the balance sheets of companies in the Group. Further, it was not the case that the only way to acquire the loan book was

"*for The Phoenix Consortium members to yet again*[179] *put their hands in their pockets and put personal monies at risk*". In fact, HBOS had expressed a preference for having a Group company as its joint venture partner; and

230.2. the members of the Phoenix Partnership had undertaken very little risk and expected large returns[180].

Concerns of Ms Ruston and Mr Millett

231. Project Platinum was one of the matters in relation to which Ms Ruston and Mr Millett privately consulted Ashurst Morris Crisp ("Ashurst"), the firm of solicitors, in 2002[181].

232. Mr Millett explained the background as follows:

> "*The events leading up to seeking advice was or were a general feeling that there were issues in the business which gave rise to – a horrible word – concerns, in my mind, as to whether everything that was being done was, if you like, absolutely legal. So, I would have discussed various business transactions and business matters with Jane Ruston ... in the normal course of business. And I think it came to pass that we both recognised that we shared misgivings, concerns, or we wanted to take some advice to make sure that we were carrying out duties as officers of the company properly and legitimately.*
>
> *So it was a question of: did not really know whether some of the things that were being done were absolutely right, and we needed to get that advice.*"

233. However, since one or both of Ms Ruston and Mr Millett declined to waive privilege in relation to the advice from Ashurst (as they were fully entitled to do), we are not in a position to comment on either the advice Ashurst gave or the instructions they were given.

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[179] The only previous occasion on which the members of the Phoenix Consortium had "*put their hands in their pockets*" will have been when Techtronic acquired MGRG in May 2000, but the members of the Phoenix Consortium in fact invested relatively little and undertook only limited risks in connection with that acquisition: see III/64, 69 to 83 and 92.

[180] See paragraphs 105 to 115 above.

[181] Ms Ruston referred to the advice being given in August 2002.

CHAPTER VIII

GROUP STRUCTURE AFTER 2000

Plans for the Group

1. From an early stage, there was reference to the possibility of the parts business and, if they were acquired, Powertrain and Swindon Pressings being outside MGRG's ownership. By 24 May 2000, Ms Lewis of Eversheds was aware that there were plans for Powertrain and Swindon Pressings to be acquired by Techtronic (and not MGRG). Around the end of May, Mr Barton of Deloitte drew a diagram depicting MGRG, "*Power*", "*Swindon Press*" and also "*Parts*" as separate subsidiaries of Techtronic.

2. By June 2000, it was being suggested that "*Parts*" (and possibly other companies) should be in the direct ownership of the new holding company which was being proposed (in the event, PVH), and not Techtronic. When on 20 October Mr Beale made a presentation to the board of MGRG on the proposed corporate structure, he put forward a proposal where PVH would be "*the parent company for a number of subsidiaries*", one of which would be MGRG and the others "*a dealer properties company, a powertrain business, a parts company and an MG motor sport company*". Shortly after this, Ms Lewis explained to Mr Brooks of Norton Rose that it was "*proposed … that following Newco's acquisition of Techtronic, Rover Parts and the corporate entity holding the dealer properties will be transferred from* [MGRG] *so as to become direct subsidiaries of Newco*" and that it was also "*likely that a leasing company will be established, together with another new company to be named MG Sport Limited, both to be direct subsidiaries of Newco*". As noted in chapter V (Rover under new ownership)[1], when a deed supplemental to the Facility Agreement (relating to the BMW loan notes[2]) was entered into in December 2000 on PVH becoming Techtronic's parent, it allowed for the transfer of the issued share capital of Xpart (formerly BMW Parts Limited)[3] to PVH and for the incorporation of four further companies, referred to as "*Dealer Propertyco*"[4], "*Engine Developmentco*"[5], "*Leaseco*"[6] and "*MG Sport*"[7], as subsidiaries of PVH.

3. By 2001 the planned restructuring had been extended to include the transfer to PVH subsidiaries of land at Longbridge and of companies with historic names. Further, although Powertrain was acquired in June 2001 as a subsidiary of Techtronic[8], thought was given to shifting the company (or its business) so as to be directly owned by PVH. Thus, a document headed, "*MG Rover Holdings – Points for discussion*", which appears to date from June and to have been written by Mr Beale, includes the following:

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1 See V/55.6.
2 See III/90.
3 See paragraph 15.12 below.
4 115CR (030) Limited, company number 4084430, later called MG Rover Properties Limited, and then MG Rover Property Holdings Limited.
5 115CR (031) Limited, company number 4084602, later to become MG Rover Engine Development Limited, and then MG Rover Heritage Limited.
6 115CR (032) Limited, company number 4084227, later called MGR Leasing Limited.
7 115CR (033) Limited, company number 4084371, later called MG Sport and Racing Limited.
8 See V/90.

"*... 2. Techtronic:*

- *Hive up of assets.*
- *Sidelining of liabilities ...*

5. Hive up of Longbridge Property.

6. Hive up of Heritage companies & assets ..."

The points in the list were expanded on in a further document, headed "*MG Rover – Group Reorganisation*". This included the following:

"*... 2. Techtronic (2000) Limited ...:*

- *Investment in PTL* [i.e. Powertrain] *to be hived up, or paid as a dividend in specie to* [PVH] *... Hive up to be performed now such that no value change for PTL following recent acquisition. PTL therefore becomes direct subsidiary of* [PVH].
- *Legal consideration to be given to moving Techtronic so that* [MGRG] *becomes direct subsidiary of* [PVH]. *Deloittes to consider if the loan note right to receive monies from* [MGRG] *could be hived up to* [PVH] *but leaving the obligation to repay BMW with Techtronic ...*

5. Longbridge property and land assets to be hived up from [MGRG] *to a Newco subsidiary of MG Rover Property Holdings Limited ... Transfer at market value and market rent to be charged across to those companies using the site (PTL/MGR etc).*

6. Identify heritage assets in the Group (cars, brand names, memorabilia, spares etc) and these to be hived up/transferred into a Newco subsidiary of [PVH] *and Newco to be renamed MG Rover Heritage Limited. Other non-trading companies (e.g. Morris Garages Ltd) to be transferred to this Newco. The Visitor Centre or other marketing initiative developments to be included here to assist with heritage funding.*"

4. At much the same time, a "*management brief*" was distributed outlining the group structure which was to be implemented. It was explained that each company in the Group would "*have its own board of directors who will be responsible for the running of that company, and who will report directly to the* [PVH] *board*". The brief stated that the proposed structure would "*ensure each management team is fully focused on maximising the operational performance of each company and it will enhance our ability to make swift management decisions to take advantage of individual business opportunities*".

5. It was recognised that the proposed restructuring would have some manpower and cost implications. The document headed "*MG Rover – Group Reorganisation*" which is mentioned in paragraph 3 above referred to the employment of an accountant by PVH whose duties would include maintenance of books and records, preparation of management and statutory accounts and cash management for the subsidiaries. In October 2001, Mr John Jarvie, then a director in the accounting, treasury and taxation department at MGRG, sent Mr Beale and Mr Millett a memorandum drawing attention to certain issues to which the restructuring gave rise as regards accounting, treasury and tax. Mr Jarvie noted in the memorandum that the "*creation of the new companies will increase overheads, in the way of manpower and audit fees, for example*".

<u>Changes in the structure of the Group</u>

6. The structure of the Group in January 2001, after PVH had become Techtronic's parent, was as shown on the next page[9].

7. The structure of the Group three years later, in 2004, was as depicted in the diagram following that for the 2001 structure.

8. The more significant changes in the Group structure between 2001 and 2004 included the following:

    8.1. Powertrain was acquired in June 2001 as a subsidiary of Techtronic[10];

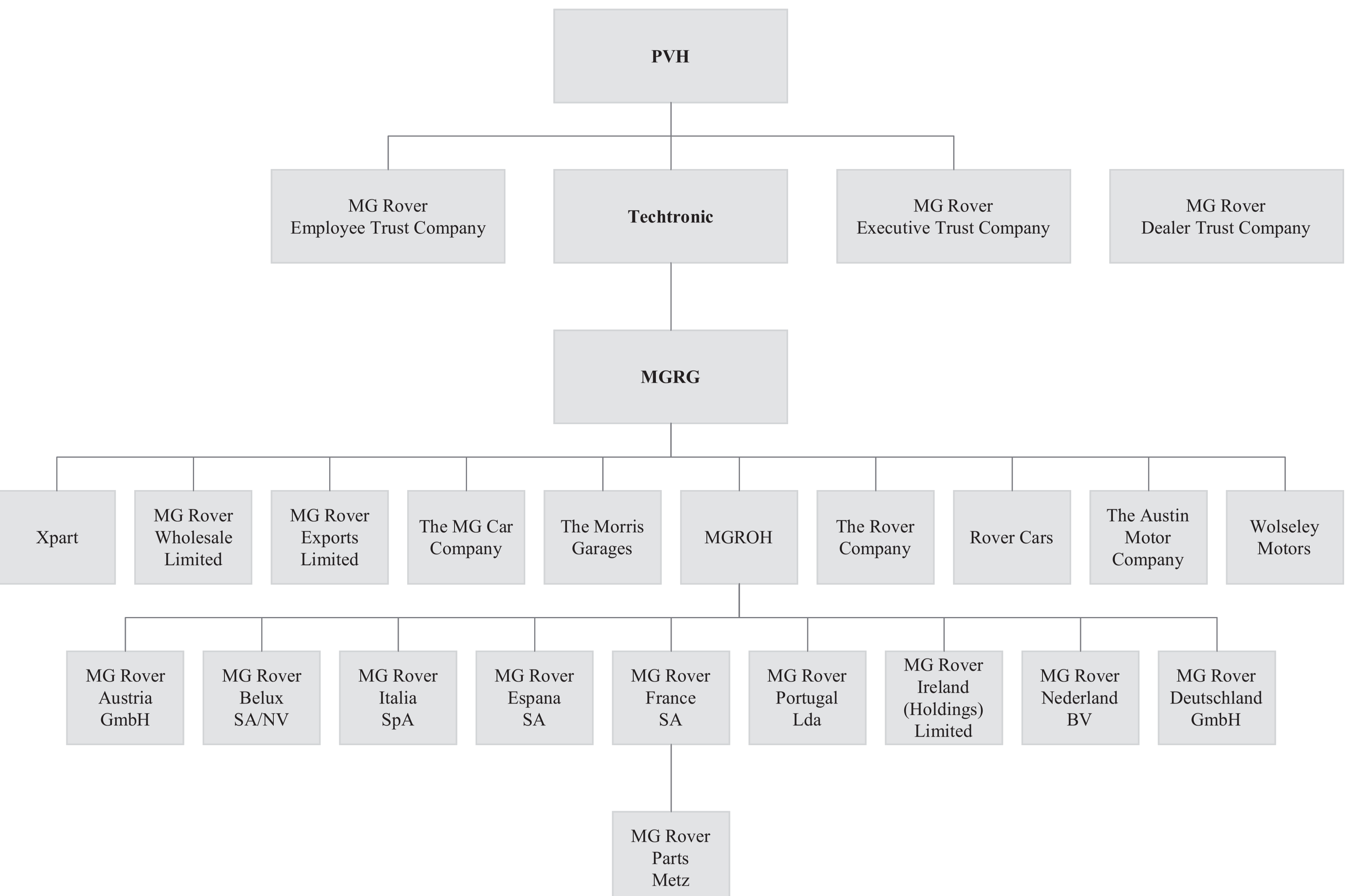
    8.2. Studley Castle was acquired in June 2001 by Studley Castle Limited[11], which was owned by Property Holdings[12], a subsidiary of PVH;

    8.3. other properties owned by the Group, with the exception of the land occupied by Powertrain, were transferred to Property Holdings or that company's other subsidiary, MG Rover Dealer Properties Limited ("MGRDP"). These transactions are considered in chapter IX (Property and share transfers);

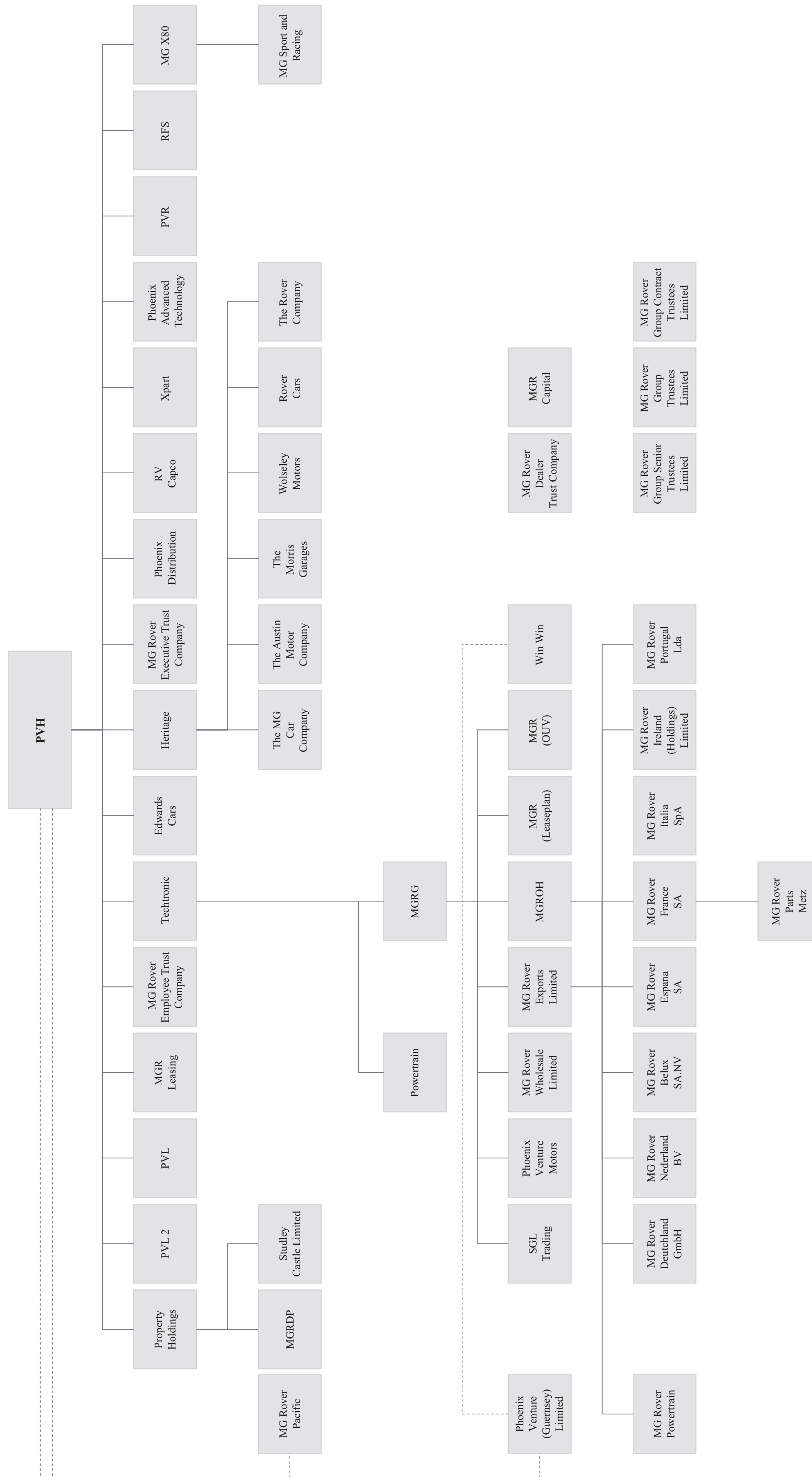
    8.4. RFS and RV Capco were acquired in connection with Project Platinum[13];

[9] MGR Leasing, Heritage (then called MG Rover Engine Development Limited), MG X80 (then called MG Sport and Racing Limited) and Property Holdings (then called MG Rover Properties Limited) have all been omitted from this diagram as the shares in these companies were not transferred to PVH until February 2001.
[10] See V/90.
[11] See V/92.
[12] Formerly MG Rover Properties Limited.
[13] See VII/22.

Group structure in January 2001



Group structure in 2004



8.5. various companies bearing historic names (viz. The MG Car Company, The Austin Motor Company, The Morris Garages, Wolseley Motors, The Rover Company and Rover Cars) were transferred from MGRG to Heritage[14], a subsidiary of PVH. These transfers are also considered in chapter IX (Property and share transfers);

8.6. Phoenix Venture Leasing Limited ("PVL") and Phoenix Venture Leasing 2 Limited ("PVL2") were acquired as subsidiaries of PVH in connection with tax loss schemes. These schemes are considered in chapter XI (Aircraft);

8.7. Xpart (formerly BMW Parts Limited[15]), to which the parts business had been hived out, was transferred from MGRG to PVH. This transfer is considered in chapter XIII (Xpart); and

8.8. Mr and Ms Edwards transferred Edwards Cars, the company which owned the Stratford dealership, to PVH. This transfer is considered in chapter XIV (Edwards Cars).

9. Neither Powertrain nor its business was in the event transferred away from Techtronic[16].

<u>Stated justification</u>

10. As the "*management brief*" mentioned in paragraph 4 above suggests, the main justification advanced for the restructuring of the Group related to management focus. The group chief executive's statement included with PVH's 2001 financial statements stated of the restructuring, "*Each business area has its own management board and this structure promotes increased focus on their differing business requirements*". The members of the Phoenix Consortium explained the restructuring of the Group in much the same way when giving evidence to us. Mr Towers told us:

> "*... focus and transparency and understanding where real cash was flowing and where real profits and losses were being created was a really fundamental philosophy of that business ... I can think of none of the restructuring proposals that did not exactly fit with that type of philosophy: focus and concentration and absolute clarity and transparency of what was going on, whether you were making cars, whether you were building diesel engines or making components ... Not confused by whether or not you have got a playing field that was going to make £10 million in the near future.*"

Mr Beale said:

[14] Formerly 115CR (031) Limited and MG Rover Engine Development Limited; referred to as "*Engine Developmentco*" in the deed supplemental to the Facility Agreement.
[15] See paragraph 15.12 below.
[16] As had been contemplated: see paragraph 3 above.

> "*... the concept between the separating out of the activities* [was] *just clearly to create more management focus on those individual businesses.*"

Mr Beale went on to say that he was not interested in "*just management focus as far as management performance and how the managers were performing*", but in:

> "*... our management process as well, so that we could look at sets of accounts and look at the figures and understand them better, because they were self-contained and not just an amorphous mass.*"

Mr Stephenson told us:

> "*... it is page one of the management handbook: you must have complete focus. And what our organisation absolutely desperately needed was that ... We did not want to be sidelined, worried about longer-term strategy, what it was doing with all sorts of slightly irrelevant elements of the organisation. It needed to be focused on the mainstream business of making cars.*"

11. It was a theme of the evidence we were given that Mr Einollahi of Deloitte had favoured the approach that was adopted. Mr Beale told us:

> "[Mr Einollahi] *had a very, very clear vision of how a group or company should be run, and to some extent we never achieved his vision. His vision was always we should separate out, for example, sales and marketing from manufacturing and have those in a separate company. We never, for various reasons of time and IT systems and so on, ever managed to divide the group up as much as he felt it should be.*
>
> *But his view was, you know, fairly simplistic in the way it was described, although we had sort of long theoretical debates about it. Small businesses are easier to manage and control than large businesses. Individuals are easier to motivate that are running those businesses than larger businesses. He ... used to call them cells, divide things into cells with a smaller number of people, it is far easier ... to manage them.*"

Mr Edwards said:

> "*... I remember* [Mr Einollahi] *talking about the need for clarity, for focus and for transparency. His general principle was that the various operations of the company should be clearly identified and accountable within their own right, so it would be easy to see where issues needed attending to. The other thing that he explained was that Rover had a previous history under BMW and others of lots of little companies within one, each having its own team of accountants, its own team of lawyers, and, before you knew where you were, you would wind up with 7,500 staff if you were not careful.*

> *So where it was possible to centralise functions, they wanted to centralise functions. So we would have one legal department offering a legal service to all the other entities within the group. So, what that managed to do was to contain us in terms of not having a need to recruit huge numbers of additional staff to cope with things.*"

12. Mr Einollahi himself told us that his "*view or knowledge of what appeared to be good sensible practice was a parent company with direct subsidiaries, all direct subsidiaries*". He explained:

> "*… I became concerned that* [MGRG] *was a large entity with large company bad attitudes. To expand on that one, it was compartmentalised and accountability performance from all of the functions was far from transparent. I had suggested to Towers, to Peter Beale that they ought to consider better ways of creating accountability, smaller operating units where you can measure performance, arm's-length transaction between all of these units because it was not clear which model was making profit, where the losses were being made and unless the board got themselves comfortable and understood where the issue was, they were highly unlikely to be able to address it, so I was a proponent of the view* [that] *said, 'You, as the board, should really consider very carefully why should Powertrain supply at a particular price which is anything other than market price, if you want to measure the performance. How are the parts supplied through the part business? How do you measure performance in various units'. In that context, say try and break it up into measurable operating units. I went as far as suggesting in relation to* [the] *car business why do you not put* [the] *sales function differently from manufacturing function where manufacturing produces to a cost, so they manage the cost of it, the same function has a marketing budget. These are ideas and, gentlemen, you know, go and get advice from people who have done cost reduction programmes, see whether that sort of an idea will have merit and value.*"

Mr Einollahi said that "*performance measurement does not always need to have legal entities attached to it*" and that "*You could cause your parts department to be measured and reporting its revenues, provided you have a strong enough management team and they are authorised to negotiate their commercial deals with their colleagues at arm's-length,*" but "*Putting in a new company gives it just added benefit of there's a structure that people understand*". In any case, Mr Einollahi thought it would have made sense to have Powertrain, parts, property and Studley Castle in identifiable divisions or separate legal entities.

13. On the other hand, Mr Einollahi does not appear to have been closely involved in the restructuring of the Group which was in fact effected. He told us:

> "*I have not provided specific advice as to what the group structure should be. I have given the generic view in conversations …*"

Similarly, he said:

> "*As was the case with the 2000 reorganisation, I was not engaged in respect of the 2001 reorganisation or the various intra-group property transfers that were necessary to bring that reorganisation into effect. The only advice I gave to the* [Phoenix Consortium] *regarding the structure of the group concerned how large corporate groups generally structure their businesses.*"

14. We consider further in chapter XV the reasoning behind the changes in the Group's structure.

PVH's subsidiaries

15. Brief details are given below in relation to each of PVH's subsidiaries shown in the Group structure diagram above[17], other than Techtronic:

15.1. ***PVL***

PVL was acquired by PVH on 24 May 2002. At this time the company was called MCC Leasing (No. 18) Limited and its ultimate parent company was Barclays plc. Following acquisition by PVH, on 2 June the company's name was changed to Phoenix Venture Leasing Limited.

PVL was a leasing company and was at the centre of the "Project Aircraft" transaction, which is discussed in chapter XI.

On 28 February 2003 PVL transferred its business and assets to MGR Leasing, another PVH subsidiary, and ceased trading.

15.2. ***PVL2***

PVL2, another leasing company in the Barclays group, was acquired by PVH on 1 April 2003. At the time the company was called Mercantile Leasing Company (No.162) Limited; it was renamed Phoenix Venture Leasing 2 Limited on 13 April.

PVL2 was involved in "Project Trinity", a scheme similar to Project Aircraft - see chapter XI.

15.3. ***MGR Leasing***

The company was incorporated on 5 October 2000 as 115CR (032) Limited, and was renamed MGR Leasing Limited on 31 January 2001.

[17] See paragraph 7 above.

MGR Leasing leased equipment to group companies and, from 2004 onwards, to third parties. As noted above, on 28 February 2003 PVL transferred its business and assets to MGR Leasing.

After MGRG went into administration on 8 April 2005 MGR Leasing commenced an orderly wind down of operations and effectively ceased to trade[18].

15.4. ***Property Holdings***

The company was incorporated as 115CR (030) Limited on 5 October 2000, changing its name to MG Rover Properties Limited on 31 January 2001, and then to MG Rover Property Holdings Limited on 15 January 2002.

Property Holdings was dormant until it acquired land and buildings at the Longbridge site in December 2001[19]. The 2002 financial statements state that the company was to "*continue maintaining the main Longbridge site used by* [MGRG] *and seek to redevelop any surplus land*".

In 2003 the company entered into a sale and leaseback agreement with SMP. When MGRG entered administration on 8 April 2005, MGRG, on behalf of Property Holdings, continued to make rental payments to SMP. On 22 February 2006 the company signed a deed of release with Redman Heenan Properties Limited ("Redman Heenan"), a subsidiary of SMP, which removed its obligation to make further lease payments.

For further detail on these transactions see chapter IX (Property and share transfers).

15.5. ***MGRDP***

The company was incorporated on 14 February 1986, changing its name to Rover Property Development Limited on 1 July 1997 and later to MG Rover Dealer Properties Limited on 15 January 2002[20]. As at 31 December 1999 MGRDP was a wholly owned subsidiary of MGRG and did not trade. During the year ended 31 December 2000 MGRDP became a wholly owned subsidiary of PVH, and the following year it became a wholly owned subsidiary of Property Holdings (see above)[21].

[18] Though we note that MGR Leasing continued leasing equipment to third parties after this date.

[19] Note that the financial statements state that Property Holdings acquired the land and buildings relating to the Longbridge site on 31 December 2001, whereas the contract between MGRG and MG Rover Properties Limited in relation to the transfer of the Longbridge site is dated 28 December 2001.

[20] The company was incorporated as Ingleby (143) Limited, changed its name to ARF Properties Limited on 2 January 1987, then to Rover Finance Properties Limited on 21 October 1989.

[21] The entire share capital of MGRDP was transferred to BMW (UK) on 28 April 2000, to PVH on 16 May 2001, and to Property Holdings on 28 December 2001.

MGRDP acquired a portfolio of dealer properties from MGRG in December 2001. For further details of this transaction see chapter IX (Property and share transfers). From 1 January 2002 the company was responsible for the dealer property portfolio, charging rent on the properties and incurring expenses to maintain them.

15.6. ***Studley Castle Limited***

The company was incorporated on 7 February 2001 as 115CR (077) Limited. Its name was changed to Studley Castle Limited on 24 May.

As noted in chapter V (Rover under new ownership)[22], Studley Castle was transferred to Studley Castle Limited at a price of £2.8 million on 1 June 2001 as part of the completion account dispute settlement between Techtronic and BMW.

Studley Castle was run by Sovereign Catering Services Limited as a training, conference and marketing centre.

Studley Castle was sold on 22 August 2005 for £4.5 million to Firoka (Studley Castle) Limited (a party unrelated to the Group). Studley Castle Limited ceased trading after the sale.

15.7. ***Edwards Cars***

As noted in chapter IV (The members of the Phoenix Consortium), by 2000 Edwards Cars had already been carrying on business as a car dealership for some years[23]. The company traded from leased premises in Stratford-upon-Avon under the name "Edwards of Stratford".

The company was owned by Mr Edwards and his wife, 19,999 of the 20,000 shares being held by Mr Edwards and the remaining share by Ms Edwards. Mr Edwards and Mr Beale were both directors of the company[24], and Ms Edwards was also shown as a director in Edwards Cars' financial statements for 1999 and 2000. The company sold motor vehicles and provided related motor vehicle services.

According to the financial statements, the company was sold to PVH on 29 December 2002[25].

The company went into administration on 21 April 2005.

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22 See V/92.

23 Edwards Cars was incorporated as Rapid 2136 Limited on 5 December 1986, changing its name to Edwards Cars Limited on 23 December 1986.

24 See XIV/2.

25 The acquisition of Edwards Cars by PVH is discussed further at XIV/15 to 28.

Edwards Cars is considered further in chapter XIV.

15.8. ***MG Rover Employee Trust Company***

The company was incorporated on 9 June 2000 as 115CR (016) Limited and was renamed MG Rover Employee Trust Company Limited on 15 December.

The company did not trade but acted as trustee of the MG Rover Employee Trust, which held the “A” class shares in PVH on behalf of the employees of subsidiaries of PVH and their relatives[26].

15.9. ***MG Rover Dealer Trust Company***

The company was incorporated on 9 June 2000 as 115CR (018) Limited and was renamed MG Rover Dealer Trust Company Limited on 15 December.

As indicated by the Group structure diagrams on pages 6 and 7, MG Rover Dealer Trust Company was not part of the Group, but is included here with the other two trust companies for context.

The company did not trade but acted as trustee of the MG Rover Dealer Trust which held the “B” class shares in PVH[27].

15.10. ***MG Rover Executive Trust Company***

The company was incorporated on 5 October 2000 as 115CR (024) Limited and was renamed MG Rover Executive Trust Company Limited on 15 December.

The company did not trade but acted as trustee of the MG Rover Executive Trust which held the “C” class shares in PVH on behalf of executive directors of subsidiaries of PVH[28].

15.11. ***Heritage***

The company was incorporated on 5 October 2000 as 115CR (031) Limited, changing its name to MG Rover Engine Development Limited on 31 January 2001 and to MG Rover Heritage Limited on 2 August.

As noted in chapter IX (Property and shares transfers) the share capital of the following companies was transferred to Heritage from MGRG in December 2001:

[26] See V/55.3.
[27] See V/55.3.
[28] See V/55.3.

- The Austin Motor Company
- The Morris Garages
- Wolseley Motors
- The MG Car Company
- The Rover Company
- Rover Cars

None of these subsidiaries traded but each was held by Heritage to protect the historic company names.

15.12. ***Xpart***

In 2000 Xpart was called BMW Parts Limited. Its name was changed to Rover Parts Limited on 21 June 2000, to MG Rover Parts Limited on 23 May 2001 and then to Xpart Limited on 7 August 2002. Xpart's name was later changed to MGR PAW Limited on 20 September 2004.

As explained earlier in this report, the planned sale of MGRG to Alchemy was not intended to extend to the Rover parts business[29]. However, it was subsequently agreed that Xpart would be transferred to MGRG, with the value of the parts business being deducted from the third instalment of the loan which BMW was to make to Techtronic[30]. Xpart was later transferred to PVH in 2002[31].

We consider the transfer, management and eventual sale of the parts business outside the Group in chapter XIII (Xpart).

15.13. ***Phoenix Distribution Limited ("Phoenix Distribution")***

The company was incorporated on 7 February 2001 as 115CR (087) Limited. The name of the company changed several times during 2001 and 2002[32] before it became Phoenix Distribution Limited on 12 March 2003.

As noted in chapter XIX (Joint ventures)[33], a suite of agreements was signed on 20 December 2002 between Tata Engineering and Locomotive Company Limited ("Tata"), PVH, MGRG, Phoenix Distribution and Xpart. As part of the agreements,

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[29] See III/7.2.
[30] See III/57.
[31] See XIII/20.
[32] The company name was changed to SGL Trading Limited on 17 September 2001, to MG Rover Limited on 11 October 2001, to Xpart Limited on 27 February 2002, to MG Rover Parts Limited on 7 August 2002 and to MG Rover Distribution Limited on 10 October 2002.
[33] See XIX/49 to 59.

Phoenix Distribution was given the exclusive right to distribute a number of Tata motor vehicles in the United Kingdom and Republic of Ireland.

In evidence to us, Mr Stuart Adam, who was a director of Phoenix Distribution, said:

> "*The whole reason for Phoenix Distribution was to support the broader relationship with Tata. We would not have entered into that contract in isolation because it was not, in the medium term, particularly profitable.*
>
> *Clearly, as we established the franchise, recruited the dealers, bought some stock, clearly, there was an outflow of cash at that point. And as we started to sell vehicles and, clearly, it would generate a revenue, but it would take some time for us to recover our initial costs.*
>
> *We were doing this to support MG Rover and MG Rover would generate a profit stream from* [the CityRover] *programme that would allow them to offset the costs* [incurred]. *Tata would not have entered into the* [CityRover] *arrangements unless we did the Phoenix Distribution contract. So we accepted the financial position of Phoenix Distribution as an entry requirement for the* [CityRover] *programme. To that extent, therefore, MG Rover provided the necessary funding for Phoenix Distribution to trade.*
>
> *… It is fair to say that if you looked at the books of Phoenix Distribution, its major creditor was MG Rover Group and we owed money to MG Rover Group for stock purchased on our behalf by MG Rover Group.*"

Phoenix Distribution's financial statements for the year ended 31 December 2003, the first year of trading, show that the company made a loss of £1.2 million. Of a total creditors balance of £5.4 million at the 2003 year end, £5.0 million was shown as "*Amounts owed to group undertakings*". No further financial statements were filed.

Mr Adam told us that, after MGRG went into administration on 8 April 2005, he held discussions with the UK representative of Tata to see if it would be interested in purchasing the Phoenix Distribution business. However, it soon became apparent that Tata was not interested in the proposal and Phoenix Distribution went into administration on 26 April.

15.14. ***Phoenix Advanced Technology Limited ("Phoenix Advanced Technology")***

The company was incorporated on 24 December 2002 as EVER 1993 Limited and changed its name to Phoenix Advanced Technology Limited on 4 March 2004.

The company has never traded.

15.15. ***RFS***

As noted in chapter VII (Project Platinum), when BMW (UK) sold MGRG to Techtronic, RFS, a subsidiary of BMW (UK), was the exclusive provider of vehicle finance for new and used vehicles to customers of the Rover and Land Rover dealership network. RFS's assets therefore comprised books of debt, or portfolios, in respect of financed Rover and Land Rover vehicles and its contract with Rover to provide such services.

In November 2001 PVH bought RFS from BMW (UK) and most of its loan book was then sold on to MGR Capital[34]. This transaction was known as "Project Platinum" and is discussed in chapter VII.

During 2001 RFS hived out all of its activities to other financial service companies and became dormant.

15.16. ***RV Capco***

The company was incorporated as 115CR (107) Limited on 27 July 2001 and was renamed RV Capco Limited on 6 November.

RV Capco was also involved in the "Project Platinum" transaction and is discussed in chapter VII.

15.17. ***Phoenix Venture Resourcing Limited ("PVR")***

The company was incorporated on 3 June 2003 as EVER 2095 Limited and was renamed Phoenix Venture Resourcing Limited on 11 June.

The PVR 2003 financial statements state that the principal activity of the company was to provide personnel services for various activities operated by MGRG. According to Deloitte's 2003 PVH audit summary memorandum the rationale behind the company was to employ displaced or surplus staff who were not covered by the minimum wage set by the trade unions, such as call centre workers. The employees' contracts were with PVR, but since the company did not have its own administrative capability and bank account the costs were initially borne by MGRG, which recharged these costs to PVR. PVR then recharged the employee costs to MGRG at a mark up, thereby generating a small profit.

The company was dissolved on 20 October 2006.

[34] See paragraph 18 below.

15.18. ***MG X80***

The company was incorporated on 5 October 2000 as 115CR (033) Limited and was renamed MG Sport and Racing Limited on 31 January 2001.

In the period to July 2003 MG X80 participated in motor sport activities using the MG brand.

On 14 July 2003 the company sold its trade and assets to MG Sport and Racing Limited[35] ("MG Sport and Racing") – see below – and became dormant. The company was renamed MG X80 Limited on 19 July 2003.

The results of the company during this period as shown in the financial statements can be summarised as follows:

	Period to 31 December 2001	**Year ended 31 December 2002**	**Year ended 31 December 2003**
	£ million	**£ million**	**£ million**
Turnover	0.3	2.6	2.2
Cost of sales	(0.1)	(0.3)	(0.1)
Gross profit	[36]**0.1**	**2.3**	**2.1**
Administrative expenses	(17.4)	(12.4)	(3.2)
Operating loss	**(17.3)**	**(10.1)**	**(1.1)**
Net liabilities	**(17.3)**	**(27.5)**	**(28.6)**

As shown above, MG X80 was loss making throughout its period of trading. This was mainly due to costs incurred in respect of research and development, which comprised the majority of "*administrative expenses*" shown in the financial statements[37].

15.19. ***MG Sport and Racing***

The company was incorporated on 7 February 2001 as 115CR (088) Limited.

On 22 June 2001 MG Sport and Racing purchased certain assets of Qvale Automotive Group Srl ("Qvale"), an Italian based sports car manufacturer, with a view to manufacturing a high performance MG sports car based on the Qvale

[35] At that time called MG X80 Limited.
[36] There is a difference due to rounding.
[37] Research and development costs were £14.9 million in the period to 31 December 2001, £6.0 million in the year ended 31 December 2002, and £2.2 million in the year ended 31 December 2003.

Mangusta model. The MG Xpower SV went on sale in late 2003. Sales figures for 2004 show that four cars were sold during that year.

On 27 June 2001 the company was renamed MG X80 Limited.

As noted above, on 14 July 2003 MG Sport and Racing acquired the trade and assets of MG X80, and changed its name to MG Sport and Racing Limited on 19 July (while MG X80, then called MG Sport and Racing Limited, changed its name to MG X80 Limited). Its activities were then widened to include participation in motor sport.

The results of the company during this period as shown in the financial statements can be summarised as follows:

	Period to 31 December 2001	**Year ended 31 December 2002**	**Year ended 31 December 2003**
	£ million	**£ million**	**£ million**
Turnover	-	-	2.0
Cost of sales	-	-	(0.2)
Gross profit	**-**	**-**	[38]**1.9**
Administrative expenses	(9.7)	(5.8)	(11.4)
Operating loss	**(9.7)**	**(5.8)**	**(9.5)**
Net liabilities	**(9.5)**	**(15.6)**	**(25.8)**

MG Sport and Racing was loss making throughout this period, mainly due to costs incurred in respect of research and development, as well as expenses arising following the acquisition of the trade and assets of Qvale in 2001 and of MG X80 in 2003 as referred to above[39].

No further financial statements were filed. The company went into administration on 12 April 2005 and was liquidated on 11 April 2006.

15.20. ***MG Rover Pacific Limited ("MG Rover Pacific")***

PVH was to have a 50 per cent shareholding in MG Rover Pacific, a company specifically set up for the purposes of "*Project Battens*", which was the name given

[38] There is a difference due to rounding.
[39] Research and development costs were £1.7 million in the period to 31 December 2001, £4.0 million in 2002 and £3.4 million in 2003. Other significant expenses included depreciation and goodwill amortisation, and impairment of fixed assets and goodwill.

to joint venture negotiations between the Group and Mr Yang Rong. In the event, the proposed transaction did not complete[40].

Techtronic's subsidiaries

16. ***Powertrain***

The company was incorporated on 14 March 2000 as Treasurerealm Limited and was renamed Powertrain Limited on 13 April. At the time of the acquisition of MGRG by Techtronic in May, Powertrain remained a wholly owned subsidiary of BMW.

The principal activity of the company was the manufacture of engines and gearboxes for the automotive industry.

Powertrain was acquired by Techtronic from BMW on 1 June 2001 as part settlement of the completion account dispute between BMW and Techtronic - see chapter V (Rover under new ownership) for further details.

The company went into administration, along with MGRG, on 8 April 2005.

Powertrain is considered further in chapter XVIII.

MGRG's subsidiaries

17. Brief details are given below in relation to MGRG's subsidiaries shown in the Group structure diagram above[41]:

17.1. ***SGL Trading Limited ("SGL Trading")***

On 3 May 2002 MGRG acquired the entire share capital of the company, which was then called Premier Motors (Havering) Limited, from Mr GC Rolls, a director of the company[42].

The company changed its name to Phoenix Venture Motors Limited on 24 December 2002, and then to SGL Trading Limited on 21 February 2003.

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40 We consider Project Battens in further detail in XIX/91 to 100.
41 See paragraph 7 above.
42 The company was incorporated on 8 January 2001 as Derrybrook Limited. On 21 February 2001 the company changed its name to Premier Motors (Havering) Limited, then changed its name back to Derrybrook Limited on 2 June 2002.

The company's financial statements for the period ended 31 January 2002 state that the company purchased a freehold property used by an MG Rover dealership and subsequently sold it to MGRG. Other than these transactions, the company did not trade.

17.2. ***Phoenix Venture Motors Limited ("Phoenix Venture Motors")***

The company was incorporated on 9 June 2000 as 115CR (006) Limited. The company changed its name a number of times before it became SGL Trading Limited on 11 October 2001[43].

The company did not trade until 1 January 2002, when it purchased the assets and liabilities of Station Garage (Leyland) Limited, a car dealership, from MGRG. Going forward the company acquired further dealerships and operated a number of motor vehicle dealerships under the MG Rover franchise. On 21 February 2003 the company changed its name to Phoenix Venture Motors Limited.

The company went into administration on 18 April 2005 and went into liquidation on 11 April 2006.

17.3. ***MG Rover Wholesale Limited***

In 2000 the company was called Rover Wholesale Limited and was a wholly owned subsidiary of MGRG.

Following the sale of MGRG on 9 May 2000 the company remained a wholly owned subsidiary of MGRG and became MG Rover Wholesale Limited on 23 May 2001.

The principal activity of the company was the UK wholesale of a range of cars sold under the Rover and MG marques.

The company ceased trading on 30 June 2001 and all the trading, assets and liabilities were transferred to MGRG.

17.4. ***MG Rover Exports Limited***

In 2000 the company was called Rover Exports Limited and was a wholly owned subsidiary of MGRG[44]. The principal activity of the company was to sell MGRG's car products to overseas markets, primarily in Europe.

[43] On 15 August 2000 the company changed its name to MGR Motor Company Limited, and then to MG Rover Limited on 7 September 2000. On 11 October 2001 the company changed its name to SGL Trading Limited.

[44] The company was incorporated on 7 March 1960 as Auto Body Dies Limited. The company changed its name to Rover Exports Limited on 4 September 1989.

Following the sale of MGRG on 9 May 2000 the company remained a wholly owned subsidiary of MGRG and became MG Rover Exports Limited on 23 May 2001.

The company went into administration on 21 April 2005 and went into voluntary liquidation on 21 April 2006.

17.5. ***MG Rover Powertrain Limited ("MG Rover Powertrain")***

The company was incorporated on 24 September 2003 as EVER 2193 Limited and changed its name to MG Rover Powertrain Limited on 23 October. MG Rover Powertrain was a wholly owned subsidiary of MG Rover Exports Limited (see above).

MG Rover Powertrain was established with a view to forming a joint venture with an Iranian partner. As noted in chapter XIX (Joint ventures)[45], the Group held discussions with a number of Iranian companies but the negotiations did not result in a joint venture being agreed. Consequently the company has not traded since incorporation.

17.6. ***MGROH***

In 2000 the company was called Rover Overseas Holdings Limited and was a wholly owned subsidiary of MGRG.

Following the sale of MGRG on 9 May 2000 the company remained a wholly owned subsidiary of MGRG and was renamed MG Rover Overseas Holdings Limited on 23 May 2001.

MGROH did not trade but was the holding company for all of the NSCs. These were located in Spain, Belgium, Italy, Portugal, France, Germany, the Netherlands and Ireland. The French NSC, MG Rover France SA, owned MG Rover Parts Metz, which supplied spare parts for Rover vehicles to the other NSCs.

MGROH received income from its subsidiaries as follows:

[45] See XIX/18 to 35.

Year ended 31 December	Amount
	£ million
2000	-
2001	6.751
2002	-
2003	8.035

The company was liquidated on 10 May 2006.

17.7. ***MG Rover (Leaseplan) Limited ("MGR (Leaseplan)")***

The company was incorporated on 23 January 2002 as 115CR (133) Limited and was renamed MGR (Leaseplan) Limited on 15 October.

The company's principal activity was the leasing of MG and Rover vehicles through daily rental companies such as Europcar UK Limited ("Europcar"). MGR (Leaseplan) was involved in the "Project Lisa" transaction, which is considered in chapter X.

The company went into administration on 4 May 2005.

17.8. ***MG Rover (OUV) Limited ("MGR (OUV)")***

The company was incorporated on 23 January 2002 as 115CR (134) Limited and was renamed MGR (OUV) Limited on 15 October.

The principal activity of the company was to lease MG and Rover vehicles that might be made available as demonstrators, for use by staff or for promotional purposes.

Like MGR (Lease Plan), MGR (OUV) was involved in the "Project Lisa" transaction, which is considered in chapter X.

The company entered into administration on 4 May 2005.

17.9. ***Win Win Co Limited ("Win Win")***

MGRG had a 50 per cent shareholding in Win Win, a company set up specifically for the purposes of implementing "Project Sunrise", which was the name given to joint

venture negotiations between the MGRG and Brilliance Group ("China Brilliance"). In the event, the proposed transaction did not complete[46].

MGR Capital

18. The company was incorporated on 20 July 2001 as 115CR (106) Limited. On 30 October the company name was changed to MGR Capital Limited.

As noted above and in chapter VII (Project Platinum), in November 2001 PVH purchased RFS from BMW (UK) and most of its loan book was sold on to MGR Capital[47]. For further details of this transaction, known as "Project Platinum", see chapter VII.

MGR Capital was jointly owned by HBOS and the Phoenix Partnership[48] and was not a part of the PVH group.

The principal activity of the company was the provision of finance and associated services.

MG Rover Group Trustees Limited

19. The company was incorporated on 30 April 2001.

The company did not trade but held the pension deeds and acted as trustee for the main MGRG pension scheme.

The company was dissolved on 6 December 2005.

MG Rover Group Senior Trustees Limited

20. The company was incorporated on 25 April 2001.

The company did not trade but held the pension deeds and acted as trustee for the MGRG pension scheme for senior employees.

The company was dissolved on 6 December 2005.

MG Rover Group Contract Trustees Limited

21. The company was incorporated on 24 April 2001.

[46] We consider Project Sunrise in further detail in XIX/67 to 89.
[47] See VII/21 to 22.
[48] See VII/22.

The company did not trade but held the pension deeds and acted as trustee for the MGRG contract pension scheme, which was a scheme for a small number of MGRG senior managers[49].

The company was dissolved on 17 October 2006.

[49] Members of the Contract Related Scheme ("CRS") had their full pension guaranteed on retirement by MGRG. These guarantees were provided by St Paul Travelers and meant that, if MGRG went into administration and there were insufficient funds in the pension scheme, the members of the CRS would have their benefits "*topped up*".

CHAPTER IX

PROPERTY AND SHARE TRANSFERS AT THE END OF 2001

Introduction

1. In December 2001 steps were taken to transfer certain properties and companies from MGRG to other companies owned by PVH in which MGRG had no interest. The transfers were of:

   1.1. title to MGRG's Longbridge site from MGRG to Property Holdings;

   1.2. title to dealer properties[1] from MGRG to MGRDP; and

   1.3. companies bearing historic names[2] from MGRG to Heritage.

2. A common feature of these transfers was that they were carried out at the net book value of the assets (nominal value of the share capital in the case of the companies with historic names). It is not uncommon for assets to be transferred within groups at net book value, and such transfers are likely to be unobjectionable if (a) they are not entered into for the purpose of putting assets beyond the reach of creditors[3] and (b) the companies making the transfers are financially secure[4]. However, the administration of MGRG (but not PVH or the transferee companies) has resulted in the creditors of MGRG potentially being deprived of the excess in the value of these assets over their net book value.

3. In this chapter, consideration is given to each of these transactions and, in particular, evidence relating to the value of the assets, the authority for the sales, the reasons for the sales[5] and how the proceeds of any subsequent disposals were used.

The Longbridge land and buildings

4. An aerial view map[6] of the Longbridge site is on the next page.

The sale

5. Board minutes for MGRG and Property Holdings state that the two boards approved the sale *of* "*various parcels of land*" at Longbridge to Property Holdings on 28 December 2001. The MGRG minutes record as follows:

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[1] As we note in II/19, in 2000 MGRG had an interest in various properties which were occupied by dealerships. Further explanation of the history and role of dealer properties is provided in paragraphs 44 and 45 below.

[2] As we note in III/88.6, under agreements dated 9 May 2000 a number of companies with historic names were sold by BMW to MGRG (viz. The MG Car Company, The Morris Garages, The Rover Company, Rover Cars, Wolseley Motors and The Austin Motor Company).

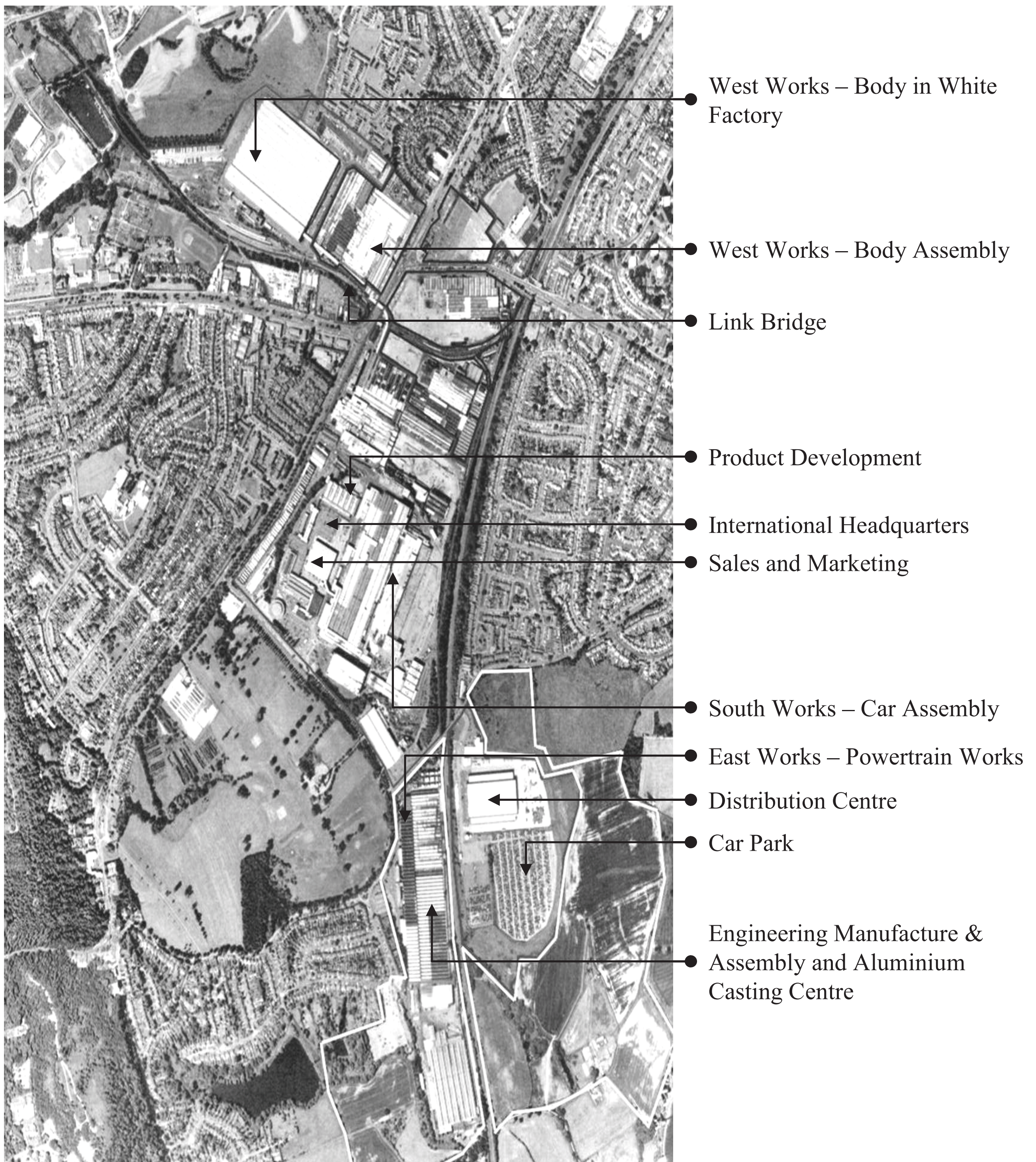
[3] See section 423 of the Insolvency Act 1986.

[4] Note in this connection the discussion at VII/202 to 207 of the principle seen in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.

[5] Though we consider the reasons for the sales further in chapter XV (Reasons for Group structure).

[6] The aerial photograph was obtained from SMP. The delineations were added for illustrative purposes by SMP, and are not relevant to our investigation.

Aerial view of the Longbridge site



> "*The Chairman reported that it was proposed that the Company* [i.e. MGRG] *would enter into an agreement to sell MG Rover Properties Limited* [i.e. Property Holdings] *various parcels of land on or within the Longbridge site. It was noted that the Company currently owned the legal and/or beneficial title to such parcels of land. It was further noted that completion of the sale would take place on the earlier of (i) 20 years from the date of the agreement and (ii) 14 days from the service by either party of a notice on the other requiring them to complete. It was noted that the price payable for the parcels of land upon completion would be the open market value or £1 (if greater), or such other amount as the parties might agree. It was pointed out that upon execution of the agreement, beneficial interest in relation to all such properties would be vested in MG Rover Properties Limited* [i.e. Property Holdings].
>
> *There was produced to the meeting a form of contract ('the Agreement') for the sale and purchase of the parcels of land, all of which parcels were detailed in the Schedule to the Agreement.*"

The Property Holdings minutes are in equivalent terms.

6. The sale was carried into effect by a contract also dated 28 December 2001. In accordance with the board minutes, the contract provided for the land to be sold for "*the Open Market Value of each of the Properties on today's date or £1.00 if greater or such other fair and proper amount as the parties may agree*". "*Open Market Value*" was defined as:

> "*... the best price at which the sale would be completed assuming:*
>
> *(a) a willing seller;*
>
> *(b) that, prior to the date of valuation, there had been a reasonable period (having regard to the nature of the property and state of the market) for the proper marketing of the interest, for the agreement of the price and terms and for the completion of the sale;*
>
> *(c) that the state of the market, level of values and other circumstances were, on any earlier assumed date of exchange of contracts, the same as on the date of valuation;*
>
> *(d) that no account is taken for any additional bid by a prospective purchaser with a special interest;*
>
> *(e) that both parties to the transaction had acted knowledgeably, prudently, and without compulsion.*"

7. In the event, the sale was effected at net book value. The tangible fixed assets note to the Property Holdings financial statements for the year ended 31 December 2001 shows that the Longbridge land was transferred from a fellow group undertaking at its net book value,

given as £37.626 million. This amount was recorded as a creditor in Property Holdings' accounting records and as a debtor in MGRG's.

8. The Property Holdings audit file for the year ended 31 December 2002 notes an opening balance adjustment of £946,000 to the cost of land and buildings due to a previous error in the classification of certain assets. It is explained on the Deloitte audit file that "*£946k of Plant and Machinery (at cost) was incorrectly transferred over to MG Rover Property Holdings Ltd*", resulting in "*a correction to the cost of the opening balance at the beginning of 2002 to put the assets back into Plant and Machinery*". The net effect of the correcting accounting entries was to reduce the net book value of the Longbridge land by £946,000. This resulted in an adjusted net book value of the Longbridge land of £36.68 million as illustrated in the table below:

	MGRG	**Property Holdings**
	£ million	**£ million**
Net book value of land and buildings transferred on 28 December 2001	(37.626)	37.626
2002 adjustment:		
Plant and machinery previously classified as land and buildings	0.946	(0.946)
Net adjustment to fixed assets	**(36.680)**	**36.680**

9. Property Holdings' inter-company account with MGRG was amended by reducing the creditor in the accounting records of Property Holdings by £946,000 and reducing the debtor in MGRG by the same amount.

10. The financial statements of Property Holdings for the year ended 31 December 2003 disclose that further land and buildings were transferred to the company from MGRG with a net book value of £3.8 million (being £100.7 million cost less £96.9 million accumulated depreciation). This transfer is explained in the audit working papers of MGRG for the year ended 31 December 2003 as follows:

> "*This exercise was performed because in order to place the plant and machinery which was physically held within the building structure such as air conditioning all in the one company for it to be disposed of in one large disposal as part of the sale and leaseback agreement. Thus effectively the assets have been disposed of as part of an intercompany transfer.*"

This adjustment reflects a transfer of the ownership of the fittings physically attached to the buildings at Longbridge to Property Holdings, apparently in order that they could be sold on to SMP with the land and buildings[7].

[7] See paragraph 28.3 below.

11. The inter-company account between Property Holdings and MGRG was amended by increasing the creditor in the accounting records of Property Holdings by £3.8 million and increasing the debtor in MGRG by the same amount.

12. The accounting entries therefore imply that, following the adjustments in 2002 and 2003, the Longbridge land including fixtures and fittings, was transferred from MGRG at its net book value of £40.49 million as follows:

Year ended	**Cost**	**Accumulated depreciation**	**Net book value**
	£ million	**£ million**	**£ million**
31 December 2001	180.09	(142.46)	37.63
31 December 2002	(0.95)	-	(0.95)
31 December 2003	100.71	(96.90)	3.81
	279.85	**(239.36)**	**40.49**

The value of the Longbridge land

13. In September 2001 Mr Richard Baker, the group property controller, asked GL Hearn Limited ("GL Hearn"), a firm of property consultants, to provide fee quotes for a number of property valuations, including of the Longbridge land. By early November, however, it had been decided that Mr Baker should himself undertake the valuation work. In an internal memorandum dated 5 November, Mr John Cowburn (who was a member of the Deloitte corporate finance team, but at that time was on secondment to Studley Castle Limited, working in financial management) stated:

> "*... Richard Baker has obtained outline quote for Property valuation exercise from GL Hearn, which has come in at around £50,000. This was considered excessive and Richard is undertaking valuation work in house.*"

14. On 23 November 2001, Mr Baker circulated his "*deliberations as to property values*". He took as his starting point a valuation GL Hearn had prepared of MGRG's property portfolio in 1999. Mr Baker noted that GL Hearn had valued Longbridge at about £198 million as at 31 December 1999, using a combination of:

- open market value for existing use ("OMVEU"); and
- depreciated replacement cost ("DRC").

Making adjustments for partial demolition of North Works and for the allocation of certain land to Powertrain, and excluding the areas comprised in the Development Agreement with St. Modwen[8], Mr Baker reduced the GL Hearn figure to £164.78 million. On the other hand,

[8] See VI/10.

he attributed a value of £14.5 million to the 72 acres within the Development Agreement[9]. Mr Baker's calculations thus suggested an overall valuation for the Longbridge land of £179.28 million (£164.78 million plus £14.5 million); this is shown in the table below:

	£ million
GL Hearn valuation of Longbridge site land and buildings	198.44
Adjustments:	
Value of partially demolished North Works	(0.23)
Land and buildings retained by Powertrain	(24.95)
Areas of land covered by Development Agreement with St. Modwen	(8.48)
Valuation of land identified for disposal through St. Modwen	14.50
Mr Baker's valuation	**179.28**

15. Mr Cowburn referred to Mr Baker's valuation of the Longbridge land in an internal email of 18 December 2001. He said:

> "*Further to our meeting yesterday I have thought about the valuation issue relating to the proposed property transfer. The valuation which Richard* [Baker] *has provided is based upon* [its] *value to another car manufacturer as an operational site. As I understand it a transfer at this valuation would require a significant write up of the asset in MG Rover's books and create a significant loan due to MGR from the property company. I have discussed the Longbridge site with Richard who advises that the* ***forced sale value*** *of the site is probably less than the impaired carrying value within the books, Richard is providing some numbers to support this view.*
>
> *Unless there is a specific reason to support a land transfer at a significant premium to book value, from an overall Group perspective, I believe that the transfers should be done at NBV* [i.e. net book value] *as long as that value exceeds forced sale* [value]" (emphasis added).

Mr Cowburn explained the rationale for transferring at net book value as follows:

> "*Reasoning for this is the transfers are part of an internal reorganisation which should not generate value increases and the parties who could be disadvantaged by this are the creditors of MG Rover if that* [company] *failed following the transfer. The value of the 'lost asset' to those creditors must be* [its] *value in a liquidation scenario it's forced sale value, consequently as long as NBV is in excess of forced sale it must be reasonable to transfer at NBV.*"

9 Mr Baker used a figure of £200,000 per acre, presumably on the basis of the minimum price of £200,000 per acre prescribed by the Development Agreement (for which, see VI/10.2).

We understand from this that Mr Cowburn was of the view that MGRG's creditors would be sufficiently protected if the transfer occurred at no lower than the forced sale value.

16. Mr Baker provided his "*thoughts on realisable value*" in an internal fax to Mr Cowburn dated 18 December 2001. He stated as follows as regards the land at Longbridge owned by MGRG:

> "*Here we have 286 acres which if sold on the open market as a single, or several large lots would be bought by a property organisation for redevelopment. Bearing in mind the sheer size, and the purchaser, and the Planning regime would want it tackled as a single site, the contamination issues, large concrete structures and foundation which are difficult to clear etc., the price would be heavily discounted.*"

Mr Baker continued:

> "*Redevelopment would encompass a variety of uses (as St. Modwen), but even at £200,000 / acre x 286 acres = £57.2* [million] *for the site, no PLC would touch it. Buying the site is the easy part, developing it out would cost billions. Hence, the purchaser would be an* [entrepreneurial] *developer who would package part sites for disposal – cleared, and with planning.*
>
> *In my view, on this basis we are probably looking at nearer £150,000 / acre say £43m on the whole site.*"

17. A further document, headed "*Summary of Values for Property Transfers*", provides values for the Longbridge land, East Works (which Powertrain owned) and dealer properties as follows:

	Existing use	**Net book value**	**Forced sale**
	£ million	**£ million**	**£ million**
Longbridge	173	45	43
East Works	25	21	12
Dealer Development	12	12	12
	210	**78**	**67**

This tends to confirm, as the email from Mr Cowburn quoted in paragraph 15 above in any event suggests, that Mr Baker's £43 million figure for the Longbridge land represented its forced sale value.

18. On 19 December 2001 Mr Cowburn informed Ms Liz Scott, a solicitor in the Group's legal department, in an email:

> "*Peter* [Beale] *is happy if transfers can be done at or near to NBV as it is not envisaged that this process should generate any increase in asset value.*"

Subsequently, as already mentioned, the Longbridge land was in fact transferred at net book value (viz. £37.626 million or, after the adjustments described at paragraphs 8 to 12 above, £36.68 million before the fixtures and fittings adjustment and £40.49 million after the fixtures and fittings adjustment). The property was thus transferred for less than either Mr Baker's £179 million valuation[10] or his £43 million valuation (even though the latter evidently represented forced sale value)[11]. The price attributed to the property was also less than the £59.96 million for which, as mentioned at paragraph 31 below, it was sold in 2003[12].

19. Mr Cowburn, however, told us that it was his understanding at the time that the net book value of the Longbridge land was in excess of the £43 million given as "*forced sale*" value. It seems to us that it was reasonable for Mr Cowburn to arrive at this conclusion since, as he pointed out to us, the net book value of the land was taken to be £45 million[13] as at 31 December 2000. It was not until the 2001 financial statements were being prepared that it was discovered that the land's book value had been substantially overstated (because impairment relating to work in progress had been allocated against plant and machinery rather than land and buildings).

20. Even, however, had the land's net book value exceeded its forced sale value (as Mr Cowburn believed to be the case), we would not have thought that that justified a transfer at net book value. Since MGRG did not need to undertake a forced sale of the land in December 2001, it could not have been in its interests to sell the land on that basis; the fact that the land might have had to be sold in that way in a different set of circumstances (viz. if MGRG had been in liquidation) seems to us to be entirely immaterial. In any event, the sale contract entitled MGRG to "*Open Market Value*", as defined in the contract, and thus to a price determined assuming a "*reasonable period … for the proper marketing of the interest*" and that both parties had acted "*without compulsion*". MGRG was accordingly entitled to be paid full market value.

21. We conclude that the Longbridge land was transferred for less than its market value. We also conclude that MGRG was entitled to insist on receiving open market value for the Longbridge land that was transferred under the terms of the sale contract.

22. However, no Group director other than Mr Beale is likely to have been closely involved with the price at which the Longbridge land was transferred. In particular, Mr Beale apart, even the directors listed as having attended the board meetings at which the sale of the

[10] Being GL Hearn's £198 million valuation in 1999, as adjusted by Mr Baker (see paragraph 14 above).
[11] See paragraphs 16 and 17 above.
[12] The 2003 sales will, however, have encompassed the fittings transferred to Property Holdings for £3.8 million in 2003 (see paragraph 10 above).
[13] This was the figure given for net book value in the "*Summary of Values for Property Transfers*" (see paragraph 17 above).

transfer of the land was approved[14] may well not have known of the £43 million "*forced sale*" figure, let alone that that figure represented forced sale value.

<u>The board meetings approving the sale</u>

23. Minutes record that the sale of the Longbridge land was approved by MGRG's board at a meeting on 28 December 2001 attended by Mr Towers (as chairman), Mr Beale, Mr Edwards, Mr Stephenson and Mr Howe. Several points, however, arise in relation to this meeting.

24. In the *first* place, it seems unlikely that Mr Howe was present at such a meeting. He told us that he did "*not recall a specific meeting to discuss this one agenda item*", and the likelihood of the minutes being inaccurate is increased by the fact that they were not signed, or even drafted, before March 2004. When we asked Ms Scott, the solicitor in the Group's legal department who prepared the minutes, whether she had been guessing when she listed those present, she said:

> "*I guess ... I suppose so. I can't – I think John Edwards signed the property contracts. For some reason I have put – I've just put the Phoenix people there though, which is not the full board.*"

25. A *second* point stems from the general requirement, mentioned elsewhere in this report, that all the directors of a company should be given notice of a board meeting[15]. It seems clear that some of MGRG's directors were not given notice of any meeting held to approve the sale of the Longbridge land. Mr Beddow said that he was not invited to, or aware of, the meeting; he also told us that he had not been consulted on whether the Longbridge land should be transferred, though he had learned of the transfer after the event. Similarly, Mr Bowen said that there was a "*probability*" that he had not been invited to the meeting and that he knew of the transfer of the land after it had taken place. Mr Millett thought it unlikely that he had been invited to the meeting, and Mr Oldaker, too, said that he did not recall being invited to the meeting. Mr Parkinson told us that he did not think he had been invited to the meeting, and Mr Shine said that he had not been invited.

26. A *third* point relates to article 83 of MGRG's articles of association. As mentioned in chapter VII (Project Platinum)[16], steps were taken on 8 November 2001 to replace article 83 of MGRG's articles of association. On the strength of the substituted article 83, the minutes of the MGRG meeting relating to the sale of the Longbridge land state, "*It was noted that, pursuant to the articles of association of the Company, a director may vote or form part of the quorum in relation to any matter in which he or she is interested*". However, for the reasons given in chapter VII, it is open to question whether MGRG's articles of association had been validly amended on 8 November[17]. Were they not to have been, article 83 of the

[14] See paragraphs 23 to 27 below.
[15] See, for example, *In re Portuguese Consolidated Copper Mines Limited* (1889) 42 Ch D 160 and *Young v Ladies' Imperial Club* (1920) 2 KB 523.
[16] See VII/189.
[17] See VII/190 to 199.

articles would have remained in its old form and so would still have provided that "*a director shall not vote at a meeting of directors … on any resolution concerning a matter in which he has, directly or indirectly, an interest or duty which is material and which conflicts or may conflict with the interest of the Company unless his interest arises only because the case falls within one or more* [specified exceptions]". The only exception of possible relevance to the 28 December 2001 meeting would have been that in relation to a director whose "*interest arises by virtue of his employment by or by virtue of his being a director of any company which for the time being holds not less than 50 per cent in nominated value of such of the issued share capital for time being of the Company as carries the right of attending and voting at general meetings of the Company or any subsidiary of such company other than a subsidiary of the Company*". Since, however, the members of the Phoenix Consortium had potentially conflicting interests not merely as directors but as shareholders in Property Holdings' parent company (viz. PVH), it seems to us that the exception would not have applied in relation to the sale of the Longbridge land to Property Holdings and that article 83 (as unamended) would have precluded the members of the Phoenix Consortium from voting on any resolution to approve the sale. In that event, the transfer could not have been duly approved because no director entitled to vote on the sale of the Longbridge land to Property Holdings would have been present when the sale was purportedly approved.

27. As regards Property Holdings, according to that company's minutes, its board approved the purchase of the Longbridge land at a meeting on 28 December 2001 attended by Mr Edwards (as chairman) and Mr Millett. However, Mr Millett said that he could not recall the minuted meeting, while Mr Parkinson, the other director of Property Holdings, thought that this was "*probably something that was just concluded between John Millett and John Edwards*". The likelihood is that one or more directors were not given notice of any meeting held to approve the acquisition of the Longbridge land[18].

Disposal of the Longbridge land by Property Holdings

28. Property Holdings sold the Longbridge land in 2003 as follows:

28.1. Phase I – by an agreement dated 7 April 2003, 41.6 acres comprised in the Development Agreement[19], being South Works, North Works and part of the North Car Park, were sold to AWM;

28.2. Phase II – by an agreement dated 12 December 2003, the Old West Works and its immediate environs were sold to AWM; and

28.3. Phase III – by agreements dated 23 December 2003, the remainder of the land owned by Property Holdings, a total of 227 acres, was sold to Redman Heenan, a subsidiary of SMP.

[18] These were by no means the only occasions on which directors of Group companies were not included in board meetings. We comment further on this in chapter XXII (Aspects of corporate governance).

[19] See VI/10 and 19.

29. Most of the land that was sold was leased back to Property Holdings. The Phase I land appears to have been leased back from AWM until 2006. As regards Phase II, buildings of 651,206 square feet were leased back from AWM for a "*peppercorn*" rent for a term of three years expiring on 11 December 2006. The property sold to Redman Heenan in Phase III was leased back to Property Holdings under an agreement dated 30 December 2003 for a term of 35 years at a rent of £3.62 million per annum.

30. Each of the sale agreements referred to above set out the consideration to be paid in respect of the land and property covered by that agreement. The table below summarises the consideration set out in the sale invoices issued by Property Holdings to AWM and the completion statement for the sale to Redman Heenan:

	Proceeds per sale invoices/completion statement		
	Net of VAT	**VAT**	**Gross**
	£	**£**	**£**
Phase I	11,304,074	1,978,213	13,282,287
Phase II	5,317,194	930,509	6,247,703
Phase III	42,550,000	7,446,250	49,996,250
Total	**59,171,268**	**10,354,972**	**69,526,240**

A working paper on the Property Holdings audit file indicates that the net proceeds receivable in respect of Phase I were actually £12,091,571 rather than the net amount due per the sale invoice of £11,304,074. The difference, being £787,497, is explained as "*the rent in advance from the period April 2003 to March 2006*".

31. The property was thus sold for net proceeds of £59.96 million[20] as compared with an adjusted net book value at which it was transferred of £40.49 million as referred to in paragraph 12 above.

<u>*Use of the proceeds of sale*</u>

32. Property Holdings' board minutes indicate that it was intended that the net proceeds of the sales to AWM and Redman Heenan were to be passed to MGRG in discharge of Property Holdings' indebtedness to MGRG and otherwise by way of loan. Minutes dated 23 December 2003 record that the directors acknowledged that the proceeds of sale of Phases I and II:

> "*... would be used to discharge in part the inter group loan that had been outstanding between the Company and MG Rover Group Limited ...*"

[20] Being £59.17 million as disclosed in the table in paragraph 30 above, plus the £787,497 also referred to in paragraph 30.

Minutes for a further meeting on 23 December refer to the Phase III sale proceeds being used:

> "*... in the first instance to discharge the inter group loan that was outstanding between the Company and MG Rover Group Limited following the sale by MG Rover Group Limited to MG Rover Property Holdings Limited of the land in 2001 and secondly to lend MG Rover Group Limited money for the purpose of its business operations including the development of new product.*"

33. In accordance with the minutes, all the net proceeds of sale were passed to MGRG. The money discharged indebtedness of Property Holdings to MGRG to the extent of £41.58 million, £40.49 million of which arose from the original transfer of the land in 2001[21]. The balance of the money was paid to MGRG by way of loan, giving rise to indebtedness to Property Holdings, after adjustments had been made for costs relating to the sale including stamp duty, of £16.482 million. This is shown in the table below:

	£ million
Amounts due to MGRG by Property Holdings as at 31 December 2002	37.59
Transfer of assets and additions financed through the inter-company account[22]	3.99
Moneys due to MGRG by Property Holdings prior to sale	41.58
Net proceeds from sale	(59.58)
Stamp duty and other taxes[23]	(8.63)
Prepaid rent and administrative expenses	1.92
VAT	8.23
Amount due to Property Holdings by MGRG	**16.48**

Thus MGRG's liabilities were increased as a result of Property Holdings, and not MGRG, profiting on the sale to SMP. The sum of £16.48 million remained outstanding when MGRG went into administration.

34. While MGRG obtained the benefit of the sales to AWM and Redman Heenan in cash terms, the transfer of the Longbridge land to Property Holdings will nonetheless have disadvantaged MGRG and its creditors. Had it remained the owner of the land at the time of the sales to AWM and Redman Heenan, MGRG would have been entitled to the full proceeds from the sales as of right. Instead, MGRG incurred indebtedness to Property Holdings, and MGRG's liabilities were increased, to the tune of more than £16 million.

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[21] See paragraph 12 above.

[22] Comprising the £3.807 million net book value of fixed assets transferred and £0.181 million of additions financed through the intercompany account.

[23] Comprising stamp duty of £0.25 million and VAT relating to Phases II and III of the disposal and totalling £8.377 million.

Management

35. Property Holdings' board comprised Mr Edwards, Mr Millett and Mr Parkinson until 13 January 2003, when Mr Parkinson left the board. Mr Parkinson was replaced as a director by Mr John Sanders, but he himself resigned on 30 June. In the period between that date and MGRG entering into administration in April 2005, the directors of Property Holdings were Mr Edwards and Mr Millett.

36. Each of the individuals mentioned in the preceding paragraph was also a director of MGRG[24] (although Mr Parkinson remained a director of Property Holdings for some eight months after he had left MGRG's board in April 2002[25]).

37. In practice, the directors of Property Holdings were not closely involved in decisions relating to the Longbridge land (Property Holdings' only significant asset until it was sold, other than its shares in MGRDP and Studley Castle Limited) or otherwise in the management of the company. The minutes for the company do not reveal regular board meetings or any debate amongst the directors, but rather provide a formal record of decisions. Thus, the minutes in respect of the period from the appointment of Mr Edwards, Mr Millett and Mr Parkinson as directors (on 13 February 2001) to the end of 2004 relate exclusively to the approval of the acquisition of MGRDP as a subsidiary, the company's change of name, the acquisition and disposal of the Longbridge land[26], changes in the board and the auditors, annual accounts and a cross guarantee and security agreement.

38. The individuals most involved in decision-making as regards the Longbridge land appear, both before and after its transfer from MGRG to Property Holdings, to have been Mr Towers and, perhaps, Mr Howe, with assistance from Mr Baker and Ms Ruston. When, for example, we asked Mr Towers which people were involved in the transactions involving the Longbridge land, he said:

> "*I would say it was mainly myself and Kevin* [Howe]. *Richard Baker and Jane Ruston played a role as well.*"

None of these was even a director of Property Holdings and, while Ms Ruston was the company secretary, she also had that role in relation to other companies in the Group, including MGRG[27]. Mr Baker's responsibilities were Group-wide, too.

39. Further, Property Holdings did not have its own bank account: income and payments were received and made via MGRG's bank account, and transactions were subsequently processed through the inter company account. This suggests that Property Holdings was not being independently managed.

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[24] See IV/14, V/6.2 and 6.6 and XVII/6 to 7.

[25] Mr Parkinson resigned from Property Holdings' board on 13 January 2003. As explained at V/6.6, he had resigned his MGRG directorship to become managing director of Xpart.

[26] The minutes record the sale and leaseback to AWM being approved only retrospectively, on 23 December 2003.

[27] See V/11.

40. Moreover, Property Holdings' interests were not looked at in isolation from MGRG's. The Property Holdings board minutes for 23 December 2003 state that, in arriving at their conclusions, the directors considered the fact that the sale of the land enabled MGRG "*to apply these funds for its future business requirements*" and the "*fact that* [MGRG] *was to put the funds generated by the sale of the land to its business requirements*". It would in any event be obvious that Property Holdings' directors would have been unlikely to lend, in effect, all its net assets to MGRG at the end of 2003[28] had they been considering exclusively the interests of Property Holdings.

41. In addition, it seems to us that the transfer of the Longbridge land to Property Holdings will not of itself significantly have improved financial transparency. To the extent that financial information about the Longbridge land was required, the existing property and/or finance departments could have produced whatever was required without any transfer of ownership.

42. In all the circumstances, we cannot see that the transfer of the Longbridge land to Property Holdings contributed to "*management focus*" or "*management process*"[29] [30].

Dealer properties

43. The transfer of dealer properties to MGRDP has a similar history.

Background

44. A working paper prepared by the Deloitte audit team in 2001 in connection with the MGRG audit for the year ended 31 December 2000 provides a convenient explanation of the history and role of dealer properties:

> "*The Dealer property scheme was set up between 1987-1988 in a response to the market conditions of the property industry.*
>
> *During the mid-late eighties property valuation soared, especially around the M25 as development companies looked for property for expansion purposes. A number of these companies began approaching Rover dealers and offering significant sums of money in exchange for property rights. Unsurprisingly the majority of dealers were accepting the offers and Rover were losing their market power in and around London.*
>
> *In response a decision was made by Rover to purchase these properties and rent them to dealers at a subsidised rate. As this was met with success it gradually spread to become a nationwide policy, concentrating on areas in which dealers either had problems paying rent or* [were] *being offered large sums of money to sell up.*

[28] We comment in chapter XVI on MGRG's financial position at this date.
[29] See VIII/10.
[30] We consider the reasons for the Group structure further in chapter XV.

> *As at Dec 2000 the dealer property scheme stretched from Scotland, through Manchester and London, down to the South.*"

45. Mr Towers explained that a dealer property was designed to ensure a "*presence in an area where sales would claim that it was otherwise difficult to have a presence*". Mr Beale confirmed that it was important to MGRG that the outlets continued to be there and that the dealers would sometimes be subsidised or given subsidised rent to that end. Mr Stephenson said that the properties had been purchased for the benefit of the car company. Mr Edwards told us that his own company, Edwards Cars, had been one of the first to be set up under the dealer property scheme. He also said:

> "*... it was much better to guard your position as a manufacturer by owning the property in a particular area where it was difficult to form a profitable business plan.*"

<u>The sale</u>

46. Board minutes for MGRG and MGRDP[31] state that the two boards approved the sale of dealer properties to MGRDP on 28 December 2001. The MGRG minutes record as follows

> "*The Chairman reported that it was proposed that the Company* [i.e. MGRG] *would enter into an agreement to sell to Rover Property Development Limited* [i.e. MGRDP] *various properties known as 'dealer development' properties. It was noted that the Company currently owned the legal and/or beneficial title to such properties. It was further noted that completion of the sale would take place on the earlier of (i) 20 years from the date of the agreement and (ii) 14 days from the service by either party of a notice on the other requiring them to complete. It was noted that the price payable for the parcels of land upon completion would be the open market value or £1 (if greater), or such other amount as the parties might agree. It was pointed out that upon execution of the agreement, beneficial interest in relation to all such properties would be vested in Rover Property Development Limited.*
>
> *There was produced to the meeting a form of contract ('the Agreement') for the sale and purchase of the properties, all of which were detailed in the Schedule to the Agreement.*"

The MGRDP minutes are in equivalent terms.

47. The sale was carried into effect by a contract also dated 28 December 2001. The properties comprised in the contract are listed in a schedule to it as follows:

[31] MGRDP was formerly called Rover Property Development Limited, but resolved to change its name to MG Rover Dealer Properties Limited on 28 December 2001.

	Description	Title number
1	Unit J Park Avenue Estate, Sundon Park, Luton	BD124297
2	Units 2/3 Avenue Farm, Stratford-on-Avon	WK305987
3	R/O Bishopton Filling Station, Stratford-on-Avon	WK303347
4	78 Capitol Park, Colindale, London NW9	NGL597081
5	278 High Road, Chadwell Heath, Romford	EGL145334
6	Advertising Hoarding Site, Chadwell Heath	EGL123805
7	250/260 High Road, Chadwell Heath, Romford	EGL216791
8	250/260 High Road, Chadwell Heath, Romford	EGL214711
9	Land to the south of High Road, Chadwell Heath, Romford	EGL236701
10	489/499 London Road, Hemel Hempstead	HD373711
11	Unit 1D Greenhill Crescent, Watford	HD63652
12	Premises at Eltham High Street, Greenwich, London SE9	372754
13	Land, Eltham High Street, Greenwich, London SE9	Unregistered
14	320 London Road, High Wycombe	BM149379
15	Land on south side of London Road, High Wycombe	BM19405
16	Plot 19B Blenheim Road, Epsom	SY601088
17	Plot 19C Blenheim Road, Epsom	SY598291
18	Plot 20 Blenheim Road, Epsom	SY590428
19	Unit 1 Britannia Buildings, Leagrave Road, Luton	BD105283
20	Unit 2 Britannia Buildings, Leagrave Road, Luton	BD100069
21	Unit 3 Britannia Buildings, Leagrave Road, Luton	BD124296
22	Land at Britannia Buildings, Leagrave Road, Luton	BD126662
23	Land at Britannia Buildings, Leagrave Road, Luton	BD137298
24	Unit 1 Riversway Motor Park, Nelson Way, Preston	LA821792
25	Premises at Bengal Street, Chorley	LA893450
26	204 Colney Hatch Lane, Muswell Hill, London NE10	AGL89705
27	Premises at Sealand Road/Stadium Way, Chester	CH265625
28	306 London Road, Romford	EGL404517

48. In accordance with the board minutes[32], and like the contract relating to the sale of the Longbridge land[33], the contract provided for the dealer properties to be sold for "*the Open Market Value of each of the Properties on today's date or £1.00 if greater or such other fair and proper amount as the parties may agree*". "*Open Market Value*" was defined in the same way as in the contract relating to the Longbridge land[34].

[32] See paragraph 46 above.
[33] See paragraph 6 above.
[34] See paragraph 6 above.

49. In the event, the dealer properties, like the Longbridge land, were transferred at net book value. MGRDP's financial statements for the year ended 31 December 2001 recorded it as having acquired during the year tangible fixed assets valued at £13,926,742. That figure is explained in the tangible fixed assets note, from which it is apparent that it relates to land and buildings acquired from elsewhere in the Group and is calculated by deducting £3,377,880 in respect of accumulated depreciation and amortisation from a modified historical cost of £17,304,622. The derivation of the £13,926,742 is clarified further by an audit working paper prepared by the Deloitte audit team in 2002. This lists the dealer properties at the beginning of the year as follows[35]:

Property	**Cost**	**Depreciation**	**Net book value**
	£ million	**£ million**	**£ million**
Chadwell Heath	0.431	0.211	0.220
Colindale	1.720	0.490	1.230
Eltham	1.891	0.427	1.464
Epsom	1.922	0.800	1.122
Hemel Hempstead	1.617	0.467	1.150
High Wycombe	1.335	0.073	1.262
Stratford	0.704	0.205	0.500
Watford	1.021	0.660	0.361
Muswell Hill	2.597	(0.057)	2.654
Chorley	0.832	0.021	0.811
Romford	1.987	0.050	1.937
Preston	1.248	0.031	1.217
Sundry	-	-	-
Total	**17.305**	**3.378**	**13.927**[36]

50. Deloitte's audit working papers disclose that the cost and depreciation figures were adjusted in certain respects in 2002, principally on the basis that VAT of £284,375 payable on the acquisition in 2001 of the Romford property should not have been capitalised[37]. The adjusted net book values are given as follows:

[35] The Luton and Chester properties listed in the contract (numbers 1, 19 to 23 and 27) do not appear to be referred to in the Deloitte schedule and never seem to have been regarded as of value.

[36] The totals do not cast due to differences in rounding.

[37] Deloitte's audit working papers note that cost and depreciation were adjusted downwards by £3.132 million and £2.847 million respectively. The majority of these adjustments relates to a previous accounting error following the 1999 revaluation of certain properties that resulted in both cost and depreciation being overstated by £2.847 million. The net difference of £284,375 between the adjustments to cost and depreciation relates to VAT as described above.

Property	Unadjusted net book value[38]	Adjusted net book value[39]
	£ million	£ million
Chadwell Heath	0.220	0.241
Colindale	1.230	1.238
Eltham	1.464	1.466
Epsom	1.122	1.242
Hemel Hempstead	1.150	1.172
High Wycombe	1.262	1.218
Stratford	0.500	0.488
Watford	0.361	0.370
Muswell Hill	2.654	2.532
Chorley	0.811	0.812
Romford	1.937	1.659
Preston	1.217	1.217
Sundry	-	(0.012)
Subtotal	**13.927**	**13.643**[40]

<u>*The value of the dealer properties*</u>

51. As mentioned in paragraph 13 above, in September 2001 Mr Baker asked GL Hearn to provide fee quotes for a number of property valuations. These included valuations in respect of such of the dealer properties as had not been acquired during 2001. By 5 November, however, it had been decided not to instruct GL Hearn, the cost of doing so being considered excessive[41].

52. Mr Baker and Mr Cowburn had somewhat different recollections as to how it came to be decided that the dealer properties should be transferred at their net book value. Mr Baker thought that "*apart from sort of recording a change of name in our register*", he had not had any real involvement. In contrast, Mr Cowburn's recollection was that the "*Summary of Values for Property Transfers*" mentioned in paragraph 17 above, in which a total figure of £12 million was given for the dealer properties on existing use basis, at net book value and on a forced sale basis, had been supplied by Mr Baker, or at any rate by the property department.

53. The net book values of the properties which the Group had held since before 2001 can be traced back to the valuations which GL Hearn had provided of MGRG's property portfolio

[38] Calculated from Deloitte's working paper as "*cost – original opening balance*" less "*depreciation – original opening balance*".
[39] Calculated from Deloitte's working paper as "*cost – adjusted opening balance*" less "*depreciation – adjusted opening balance*".
[40] The totals do not cast due to differences in rounding.
[41] See paragraph 13 above.

in 1999[42]. The table below shows the values attributed to the relevant properties by GL Hearn as at December 1999 and their adjusted net book values (having regard to both depreciation and additions) as at 31 December 2001[43]:

Property	**Valuation as at 31.12.99**	**Adjusted net book value as at 31.12.01**[44]
	£ million	**£ million**
Chadwell Heath	0.250	0.241
Colindale	1.300	1.238
Eltham	1.535	1.466
Epsom	1.300	1.242
Hemel Hempstead	1.228	1.172
High Wycombe	1.275	1.218
Stratford	0.516	0.488
Watford	0.390	0.370
Total	**7.794**	**7.435**

54. GL Hearn's 1999 valuation also encompassed a number of properties which had been included in the sale of MGRG in 2000 but which had been disposed of to third parties by the end of 2001. The table below shows the values attributed to the properties in question by GL Hearn as at December 1999 and the sums that were apparently realised on disposal:

Property	**Valuation as at 31.12.99**[45]	**Sale value**[46]	**Difference**	**Date of disposal**
	£ million	**£ million**	**£ million**	
Bury New Road, Manchester	0.617	0.625[47]	0.008	29.12.00
Gillingham	1.254	1.300	0.046	30.03.01
Upper Brook St., Manchester	0.450	1.000[48]	0.550	01.08.00
Salisbury	1.200	1.300	0.100	30.03.01
Barrow-in-Furness	0.165	0.180	0.015	21.12.00
Total	**3.686**	**4.405**	**0.719**	

42 See paragraph 14 above.
43 The GL Hearn valuation reports do not include title numbers for properties. In addition, the figures for "adjusted net book value" are derived from working papers on Deloitte's audit files, which do not give details of individual properties. Where necessary, therefore, assumptions have been made as to the properties to which valuations relate, based on the property description and boundary illustration.
44 See the table at paragraph 50 above.
45 As noted above, the GL Hearn valuation reports do not include title numbers for properties. Where necessary, therefore, assumptions have been made as to the properties to which valuations relate, based on the property description and boundary illustration.
46 Excluding VAT.
47 Note that the sales proceeds shown above relate to four Land Registry title numbers.
48 Being £0.775 million plus £0.225 million described as "'*top-up*' *sum received upon Planning Consent*".

As regards premises in Redditch, which GL Hearn valued at £1.15 million as at 31 December 1999, Mr Baker noted in an internal fax dated 31 August 2001 that a sale was in progress for £1.1 million.

55. Each of the properties which had been disposed of had thus realised more (even if not that much more) than its 1999 valuation. That comes as no surprise given that property prices generally were rising between 1999 and 2001. The value of the other dealer properties valued by GL Hearn could likewise be expected to have increased somewhat in the two-year period between their valuation (as at December 1999) and the transfer to MGRDP (in December 2001). Mr Baker acknowledged this in his evidence to us. He said:

> "*Common sense would say that they ought to be a bit more because it is a bit later.*"

56. That conclusion is consistent with valuations carried out in 2002. In October 2002 Strutt & Parker LLP ("Strutt & Parker"), a firm of property consultants, provided First National Motor Finance with a valuation for secured lending purposes of properties owned by MGRDP. Two months later, GL Hearn carried out a similar exercise, again for secured lending purposes, for HBOS. The table below compares the adjusted net book value of properties which had been valued in 1999 with the values given for the same properties by Strutt & Parker and GL Hearn in 2002:

Property[49]	**Adjusted net book value**	**Strutt & Parker valuation**	**GL Hearn valuation**
	December 2001[50]	**September 2002**	**December 2002**
	£ million	**£ million**	**£ million**
Epsom	1.242	1.850	1.550
Hemel Hempstead	1.172	1.670	1.475
High Wycombe	1.218	2.000	1.640
Stratford	0.488	[51]0.800	0.660
Total	**4.120**	**6.320**	**5.325**

57. The properties referred to in the previous paragraph have all since been disposed of to third parties, as have the premises in Watford. The table below compares the adjusted net book values of the properties with the sums realised for them on disposal.

[49] As noted above, the valuation reports do not include title numbers for properties. In addition, the figures for "adjusted net book value" are derived from working papers on Deloitte's audit files, which do not give details of individual properties. Where necessary, therefore, assumptions have been made as to the properties to which valuations relate, based on the property description and boundary illustration.

[50] See the table at paragraph 50 above.

[51] Comprising two Stratford properties valued at £0.55 million and £0.25 million.

Property	**Adjusted NBV at 31.12.01**[52]	**Additions 2002-2007**	**NBV plus additions**	**Gross sale proceeds**	**Difference**	**Date of disposal**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**	
Epsom	1.242	-	1.242	1.705	0.463	18.07.06
Hemel Hempstead	1.172	-	1.172	1.350	0.178	10.02.06
High Wycombe	1.218	-	1.218	3.400	2.182	13.10.06
Stratford	0.488	0.239	0.727	[53]1.200	0.473	18.04.06 / 18.12.06
Watford	0.370	0.279	0.649	0.650	0.001	10.03.06
Total	**4.490**	**0.518**	**5.008**	**8.305**	**3.297**	

58. The other properties MGRDP acquired from MGRG have also been disposed of, as follows:

Property	**Adjusted NBV at 31.12.01**[54]	**Additions 2002-2007**	**NBV plus additions**	**Gross sale proceeds**[55]	**Difference**	**Date of disposal**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**	
Chadwell Heath	0.241	-	0.241	0.200	(0.041)	14.07.06
Colindale	1.238	-	1.238	1.625	0.387	12.04.02
Eltham	1.466	-	1.466	1.379	(0.087)	15.11.02
Muswell Hill	2.532	-	2.532	5.000	2.468	10.10.05
Chorley	0.812	-	0.812	1.025	0.213	05.04.06
Romford	1.659	-	1.659	1.300	(0.359)	21.12.05
Preston	1.217	0.162	1.379	2.975	1.596	23.08.05
Sundry	(0.012)	-	(0.012)	-	0.012	
Total	**9.153**	**0.162**	**9.315**	**13.504**	**4.189**	

59. Overall, the properties which were transferred to MGRDP from MGRG realised £7.486 million[56] more than the value at which they were transferred[57].

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[52] See the table at paragraph 50 above.
[53] Comprising sale proceeds of £0.725 million and £0.475 million for two Stratford properties. With regard to the £0.475 million, we are aware (a) of an offer in this sum dated 28 September 2005, (b) that the offeror was registered as the land's proprietor on 16 May 2005 and (c) that the Land Registry records that the "*value as at 18 April 2006 was stated to be between £500,000 and £1,000,000*". We have assumed that the sale was completed at the offer price of £0.475 million.
[54] See table at paragraph 50 above.
[55] Excluding VAT.
[56] Calculated as the difference between transfer value, i.e. net book value (£5.008 million and £9.315 million) and the gross sale proceeds for the properties (£8.305 million and £13.504 million) listed in paragraphs 57 and 58 above.

60. It seems to us that the transfer of dealer properties to MGRDP was effected for somewhat less than the properties' market value and, therefore, also less than MGRG was entitled to receive under the terms of the sale contract[58]. However, we do not think the evidence establishes that the transfer was carried out with the intention that the transfer price should be less than market value. It is to be noted in this context that the "*Summary of Values for Property Transfers*" referred to in paragraph 17 above drew no distinction as regards the dealer properties (unlike the Longbridge land) between "*existing use*" and "*forced sale*" values.

The MGRG board meeting approving the sale

61. Minutes record that the sale of the dealer properties was approved by MGRG's board at a meeting on 28 December 2001 attended by Mr Towers (as chairman), Mr Beale, Mr Edwards, Mr Stephenson and Mr Howe. The same points arise in relation to this meeting as in relation to the corresponding meeting in respect of the Longbridge land.

62. Once again, Mr Howe does not appear to have been present at such a meeting[59], and the other directors recorded as having been present would have been precluded by article 83 of MGRG's articles of association from voting on the sale to MGRDP were the amendments purportedly made to the articles on 8 November 2001 to have been invalid[60]. Once again, too, some of MGRG's directors were evidently not given notice of any meeting. Mr Beddow told us that he was not invited to, or aware of, the meeting; he also said that he had not been consulted on whether the dealer properties should be transferred and that he had not subsequently learned of the transfer "*in detail*". Mr Millett thought it unlikely that he had been invited to the meeting. Mr Oldaker said that he did not recall being invited to the meeting and that he did not remember having any involvement with the transfer of the dealer properties. Mr Parkinson told us that he did not believe that he had been invited to the meeting. Mr Shine said that he had not been invited and had not known at the time that the dealer properties were being transferred.

MGRDP's indebtedness to MGRG

63. As a result of the transfer of the dealer properties, MGRDP became indebted to MGRG in the sum of £13.927 million. This debt is reflected in MGRDP's financial statements for the year ended 31 December 2001, which record an inter-company liability of £13.927 million.

64. MGRDP's financial statements for the following year show that the creditor balance due from MGRDP to MGRG had reduced to £5.2 million by 31 December 2002. The financial statements also record a "*term loan*" of £10.65 million, taken out it seems during December, that was secured on the company's properties. Ms Ruston confirmed to us that this loan was used to repay some of MGRDP's debt to MGRG for the transfer of the dealer properties.

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[57] It is to be noted, however, that the £7.486 million figure does not take account of disposal costs.
[58] See paragraph 48 above.
[59] These minutes, like those relating to the Longbridge land, were neither signed nor drafted before March 2004.
[60] See paragraph 26 above.

65. MGRDP's financial statements show little further change in the company's indebtedness to MGRG in the period up to MGRG's going into administration in April 2005. The financial statements record a creditor balance due from MGRDP to MGRG of £5.0 million as at 31 December 2003, £4.8 million as at 31 December 2004 and £4.8 million as at 31 December 2005.

Management

66. MGRDP's board comprised Mr Beale and Mr Edwards. Both were also directors of MGRG[61].

67. MGRDP's board met only infrequently. Like those of Property Holdings, MGRDP's minutes provide a formal record of decisions rather than revealing regular board meetings or any debate amongst the directors. Thus, the minutes in respect of the period from the appointment of Mr Beale and Mr Edwards as directors (on 29 March 2001) to the end of 2004 relate exclusively to the approval of the transfer of its shares from PVH to Property Holdings, the company's change of name, the acquisition of the dealer properties from MGRG, changes in the auditors, annual accounts and a cross guarantee and security agreement.

68. While Mr Edwards had an involvement with, and was looked to for guidance in relation to, dealer properties, Mr Beale told us that he was not involved in the management of MGRDP. Mr Beale also said that he was not sure who the management team was and "*was not aware of how many management meetings they did hold*".

69. In practice, the transfer of the dealer properties does not appear to have affected who managed them. MGRDP never had any employees of its own and Mr Millett told us that it did not have a specific management team. Mr Edwards said that he thought the individuals dealing with the properties "*were the same throughout the process*". Mr Howe referred to the "*property people*" working for Mr Millett (a director of MGRG and not MGRDP[62]) and the "*franchising people*" working for MGRG's sales and marketing director (successively Mr Parkinson, Mr Sanders, Mr Edwards and Mr Rod Ramsay, none of whom, excepting Mr Edwards, was ever a director of MGRDP). Mr Edwards' recollection was that, after the properties had been transferred to MGRDP, the individuals dealing with them had effectively been answerable to Mr Howe, but while chief executive of MGRG (and PVH) he was not even a director of MGRDP.

70. Like Property Holdings, MGRDP did not have its own bank account: income and payments were received and made via MGRG's bank account, and transactions were subsequently processed through the intercompany account. This suggests that MGRDP was not being independently managed.

[61] See IV/14 and 17.
[62] See V/6.2.

71. Further, MGRDP's interests were not looked at in isolation from MGRG's. Mr Beale thought that the dealer properties continued to be approached on the basis that they provided an important outlet for MGRG and that rents to dealers might be subsidised. Mr Howe said that the "*only thing that really mattered was that we actually had dealer representation in that particular area*", because that was important for "*selling cars ... and engines and parts*". Mr Millett told us:

> "*... those managing* [MGRDP] *would have been just as much managers of MG Rover Group as they were of* [MGRDP] *or – there was not really a management team in* [MGRDP] ... [MGRDP] *was a company which owned properties, and ... if an area manager in the sales and marketing division of MG Rover said, 'We have an open point in Hemel Hempstead and there is a dealer property come up, we would like to acquire that', then* [MGRDP] *would be the company that would acquire it for the benefit of MG Rover and the group.*"

Mr Baker spoke of MGRDP occupying sites in shopping centres and elsewhere "*just to get cars in front of the public*", in the interests of MGRG.

72. As with the transfer of the Longbridge land and buildings[63], it seems to us that the transfer of the dealer properties to MGRDP will not of itself significantly have improved financial transparency, nor should we have thought that the transfer of the dealer properties to MGRDP will have assisted with "*management focus*" or "*management process*".

Events since administration

73. MGRDP's financial statements for the periods ended 31 December 2005 and 27 June 2007 reveal that the company has now sold all its properties and that the net proceeds are being held in a restricted cash account. A note to MGRDP's financial statements for the year ended 31 December 2005, filed at Companies House on 4 May 2007, explained as follows:

> "*The restricted cash account is subject to a deed of cross guarantee signed on 12 December 2003 in favour of HBOS plc and its subsidiaries. This arose as a condition of the extension of further funding facilities by HBOS plc and its subsidiaries, when it was agreed that the facilities would be cross-collateralised by way of a cross guarantee to be entered into by each member of the Phoenix Venture Holdings Group who was party to such facilities.*
>
> *Bank of Scotland Corporate Banking on behalf of HBOS plc advised in August 2006 that it projects that its vehicle disposal programme (being managed and financed by HBOS plc under a separate arrangement) will cause a shortfall of some £25 million in recovery of HBOS plc's lending and that HBOS plc intends to make a claim under the cross guarantee. This amount is in excess of the total amounts realised from the disposal of dealer properties. The Directors have challenged this and have requested*

[63] See paragraphs 41 to 42 above.

certain information from HBOS plc to allow them to properly understand the claim and assess its validity and reasonableness. To date, HBOS plc has not provided the information requested and discussions to resolve this position continue."

74. MGRDP's most recent filed financial statements, for the period to 26 June 2008, disclose net current assets of £12,152,496, but provisions of the same amount[64]. A note explains as follows:

"*An amount of £12,146,752 (2007: £11,330,456) has been provided relating to the balance held in a restricted cash account at HBOS plc. It represents the proceeds from the dealer property sales programme after adjusting for the costs of achieving the sales, the amount of the term loan due to HBOS plc and what would otherwise be due back to* [MGRG] *in Liquidation had its insolvency not caused HBOS plc to claim under its Deed of Cross Guarantee against the Company. The remaining balance is an onerous lease provision relating to vacant leased properties following the* [MGRG] *insolvency. Some £1,567 (2007: £104,113) of this provision remains at the year end and will be used in the next 12 months.*"

75. As we understand it, therefore, as at 26 June 2008 an amount of £12.1 million arising from the sale of properties by MGRDP was held in a ring-fenced bank account that was subject to a deed of cross guarantee[65] in favour of HBOS. It is unclear what, if anything, has happened to this sum since this date as no further financial statements have been published for MGRDP.

Heritage companies

76. The December 2001 transfers extended not only to land at Longbridge and dealer properties, but to companies owned by MGRG which bore historic names. The companies in question ("the Heritage Companies") were The Austin Motor Company, The MG Car Company, The Morris Garages, Rover Cars, The Rover Company and Wolseley Motors.

Background

77. As mentioned in chapter VIII (Group structure)[66], a document which Mr Beale created on 19 June 2001 refers to "*non-trading companies (e.g. Morris Garages Ltd)*", together with "*heritage assets*" such as cars, brand names and memorabilia, being transferred to a "*Newco subsidiary of* [PVH]" which was "*to be renamed MG Rover Heritage Limited*". Soon afterwards, a "*management brief*" stated, "*MG Heritage will hold title to heritage brands not in current use and other assets of historical interest*". In September, Ms Scott circulated a memorandum which explained that the proposed group restructuring would involve

[64] Excepting £1.
[65] A deed of cross guarantee presides over the relationship between a number of companies that agree to form an alliance for the purpose of raising capital or taking out a loan, for which the companies are jointly and severally liable. In this particular case, the guarantors are listed as MGRG, Phoenix Distribution, MGRDP, MGR (Leaseplan), MGR (OUV), Phoenix Venture Motors and Edwards Cars.
[66] See VIII/3.

"*Transfer of the shares in the dormant companies (The MG Car Company Limited, The Morris Garages Limited, The Rover Company Limited, Rover Cars Limited, The Austin Motor Company Limited, Wolseley Motors Limited and MG Rover Limited) from* [MGRG] *to MG Rover Heritage Limited*". An update on the restructuring dating from 5 November stated:

> "*Arrangements are to be progressed to transfer the companies owned for name protection to the ownership of MG Heritage. Trademark ownership will remain with MG Rover group.*"

78. Ms Ruston confirmed to us that the Heritage Companies were "*name protection companies*" and that they were not thought to have any trademark rights or other assets. Ms Ruston told us:

> "*There was … a view generally held by John Edwards that if we did not have those companies or the MG Car Company or the Morris Garages, it might be possible for somebody to incorporate a company and use that name and in that way pass off on some goodwill that we might want to establish or re-establish in respect of the company's* [heritage]."

Mr Beale confirmed that it was his understanding at the time that the companies were of no value.

<u>The sales</u>

79. Board minutes for MGRG and Heritage[67] (a direct subsidiary of PVH) state that the two boards approved the sale of the Heritage Companies on 4 December 2001.

80. In the case of, for example, The Morris Garages Limited, MGRG board minutes record as follows:

> "*The Chairman reported that it was intended to sell the entire issued share capital of The Morris Garages Limited to MG Rover Heritage Limited for a consideration of £1000. It was noted that the consideration payable by MG Rover Heritage Limited was to be left on inter company loan account, repayable on demand and interest free.*
>
> ***IT WAS RESOLVED*** *that the sale of the entire issued share capital of The Morris Garages Limited for £1000 be approved and the consideration payable by MG Rover Heritage Limited be left outstanding on inter company loan account.*"

[67] Heritage was incorporated as 115CR (031) Limited, but changed its name to MG Rover Engine Development Limited on 31 January 2001. It changed its name again, to MG Rover Heritage Limited, on 2 August 2001.

Comparable MGRG minutes exist in respect of each of the other Heritage Companies, recording resolutions to approve the sale of those companies for, variously, £2 (The Austin Motor Company), £100 (Rover Cars and Wolseley Motors), £1,000 (The Rover Company) and £19,000 (The MG Car Company). The sale prices corresponded to the issued share capitals of the different Heritage Companies and, hence, to the values attributed to the companies in MGRG's books.

81. Minutes for Heritage in equivalent terms record that six meetings of the board of that company were held to approve the acquisition of the Heritage Companies. Those in respect of The Morris Garages, for instance, state as follows:

> "*The Chairman reported that it was intended to purchase the entire issued share capital of The Morris Garages Limited from* [MGRG] *for a consideration of £1000. It was noted that the consideration payable to* [MGRG] *was to be left on inter company loan account.*
>
> ***IT WAS RESOLVED*** *that the purchase of the entire issued capital of The Morris Garages Limited for £1000 be approved and the consideration payable to* [MGRG] *be left outstanding on inter company loan account repayable on demand and interest free.*"

82. The various share transfers appear to have been registered on 28 December 2001.

83. The sums due to MGRG from Heritage in respect of its purchase of the Heritage Companies (with the possible exception of the £2 payable for The Austin Motor Company) were left outstanding, on an interest-free basis, on inter-company loan account.

<u>The involvement of advisors</u>

84. Some of those who gave evidence to us referred to the role of advisors in relation to the transfer of the Heritage Companies[68]. It seems to us that Eversheds did not in fact give any advice on, or play any part in, the transfers. As for Deloitte, Mr Einollahi told us that the proposed restructuring, including in relation to the Heritage Companies, had been discussed with him in the middle of 2001, but that his firm had not been involved in the implementation of the scheme.

[68] For example, when asked who within the Group had dealt with the transfer of the Heritage Companies, Mr Stephenson said:

> "*... the restructuring of the company and the clearing of the decks, getting the management focus I have spoken of many times, was something where we were clear in the principles and objectives but we then took advice from* [Deloitte]*, Eversheds, et cetera, as to precisely what the appropriate mechanisms were to achieve those objectives*."

Attendance at the board meetings

85. According to the MGRG minutes, the meetings at which the sales of the Heritage Companies were approved were attended by Mr Towers (as chairman), Mr Beale, Mr Edwards, Mr Stephenson and Mr Howe.

86. Similar issues arise here as in relation to the MGRG meetings in respect of the transfer of the Longbridge land and dealer properties[69]. Mr Howe does not in fact appear to have been present at the minuted meeting, the other directors recorded as having attended would have been precluded from voting by article 83 of MGRG's articles of association were the amendments to the articles purportedly made on 8 November 2001 to have been invalid, and some of MGRG's directors were not given notice of any meeting held on 4 December 2001. Mr Beddow said that he was not invited to the meetings and knew "*very little*" about the transfers of the Heritage Companies. Mr Bowen said that he did not remember the meetings and had no recollection of the share transfers. Mr Millett said that he could not recall being invited to the meetings. Mr Oldaker told us that he did not recall being invited to the meetings and could "*only surmise that* [he] *was not invited to those meetings*". Mr Parkinson told us that he did not believe he had been invited to the meetings (though he remembered "*discussions around tidying up some of the large numbers of companies that were of no real worth*"*)*. Mr Shine said that he had not been invited or had any involvement with the transfers. Mr Millett commented that it was "*unlikely that all six of them* [i.e. the other directors of MGRG] *would have been on holiday on 4th December*".

87. According to Heritage's minutes, the meetings at which the purchases of the Heritage Companies were approved were attended by Mr Howe (as chairman), Mr Bowen[70] and Mr Oldaker[71]. However, Mr Bowen said that he could not remember the meetings, and Mr Oldaker told us that he did not have a recollection of being involved in the meetings (though he added that he "*may well have*"); he also said that he did not remember having any involvement in the decision to transfer the Heritage Companies, nor any discussion about the transfers. For his part, Mr Howe accepted that he had signed the various minutes, but said that he too had had no recollection of the meetings or of being involved in deciding on the share transfers. Again, the likelihood is that one or more directors were not given notice of any meetings held on 4 December 2001[72]. We doubt, in fact, whether any meetings took place at all.

Management

88. Between 13 February 2001 and 10 June 2002, Heritage's board comprised Mr Bowen, Mr Howe, Mr Oldaker and Mr Stephenson. From 10 June 2002 onwards, the board consisted of Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers.

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69 See paragraphs 23 to 26, 61 and 62 above.

70 It is to be noted that Mr Bowen is not recorded as having attended the corresponding MGRG board meetings which are stated to have taken place on the same day.

71 Mr Oldaker, too, is not recorded as having attended the corresponding MGRG board meetings.

72 These were by no means the only occasions on which directors of Group companies were not included in board meetings. We comment further on this in chapter XXII (Aspects of corporate governance).

89. The minutes in respect of the period between 4 December 2001 (when the acquisition of the Heritage Companies was approved) and the end of 2004 relate exclusively to changes in the board and the auditors, to the approval of annual accounts and to the approval of the sale of MG Rover Distribution Limited to PVH for £2. There is no record of any debate amongst the directors.

90. The reality is that the Heritage Companies did not require any active management either before or after their transfer from MGRG to Heritage. Mr Millett described the companies as dormant and said that there was "*nothing to manage*" and that the transfer of the companies did not involve any change. Mr Towers commented that "*the necessity for significant management of those companies was simply not there*". Mr Beale said that he did not think that the transfers from MGRG to Heritage would have made any practical difference to the companies or that the companies "*would have needed much management, apart from making sure that they did not get crossed off at Companies House*". Mr Stephenson agreed that, as the companies were not trading, they did not require management meetings. Ms Ruston told us that her department dealt with the filing of annual returns and that Mr Millett's finance team had generated the statutory accounts.

91. In the circumstances, it is difficult to see that the transfer of the Heritage Companies contributed to "*management focus*". Mr Millett told us in terms that the transfers "*would not have involved any more management focus*".

92. On the other hand, it is not surprising that the transfer was not seen as important. In that regard, Mr Beale referred to the transfer as a "*bit of a non-event*" and "*a trivial matter*" and Mr Edwards said that it was "*a very small, ... almost insignificant, part of the restructuring process and the tidying-up*". Mr Towers said that he was "*energetically disinterested in this at the time*".

<u>The "Duomatic" principle</u>

93. It has been argued in representations made to us on behalf of the members of the Phoenix Consortium that the transfers of the Longbridge land and dealer properties were approved by Messrs Beale, Edwards, Stephenson and Towers "*as the ultimate controlling shareholders pursuant to the <u>Duomatic</u> principle*" (i.e. the principle in *Re Duomatic Ltd*[73] under which conduct can be approved by shareholders informally) and that the transfers will thus have been valid and effective regardless of whether they were carried out at less than market value. On the other hand:

93.1. it could be contended that, having regard to MGRG's financial circumstances, the principle seen in *West Mercia Safetywear Ltd v Dodd*[74] was applicable and prevented the *Duomatic* principle from operating[75];

[73] [1969] 2 Ch 365
[74] [1988] BCLC 250
[75] See VII/202 to 207.

93.2. as mentioned in chapter VII (Project Platinum)[76], it is not clear that the *Duomatic* principle operates where a transaction has merely been approved by the shareholders of a company which holds the shares in another company which is itself the beneficial owner of the shares in the company effecting the transaction;

93.3. as also mentioned in chapter VII[77], it is an open question whether the *Duomatic* principle can apply where the shareholders entitled to vote at a shareholders' meeting (as regards PVH, the "D" shareholders) have assented unanimously to a matter but a shareholder to whom notice of such a meeting is to be given even though he has no right to vote at it (here, the "A", "B" and "C" shareholders[78]) has not been notified; and

93.4. the *Duomatic* principle could not be an answer to a claim pursuant to section 423 of the Insolvency Act 1986.

94. It seems to us that the issues should be resolved, if at all, in legal proceedings.

[76] See VII/201.1.
[77] See VII/201.2.
[78] See V/49.

CHAPTER X
PROJECT LISA

1. Both before and after its sale to Techtronic in May 2000, MGRG had stocks of "own use vehicles" ("OUVs") and vehicles used for self drive hire purposes ("leaseplan" vehicles). OUVs might be made available as demonstration vehicles ("demonstrators"), for use by staff or for promotional purposes. "Leaseplan" vehicles would generally be leased out through daily rental companies such as Europcar.

2. "Project Lisa" was the name given to a scheme to raise money on OUV and leaseplan vehicles. The background and purpose of "Project Lisa" were summarised as follows in a briefing note prepared by Eversheds on 26 March 2002[1]:

> "[MGRG] *has a need to provide from time to time new vehicles as 'demonstrators' promotional vehicles and other like purposes. Such vehicles are known within* [MGRG] *as '*[own] *use vehicles' ('OUV'). Generally, such vehicles are used for such purposes on a short term (less than six months) basis and are then sold.*
>
> [MGRG] *has a 'lease plan' arrangement with* [Europcar] *whereby* [Europcar] *leases new cars from* [MGRG] *(on a six month basis) for the use in* [Europcar's] *car hire business. At the end of the six month period such vehicles are then sold by* [MGRG] *(in this note these vehicles are referred to as 'Lease Plan Vehicles').*
>
> *Up until now,* [MGRG] *has been unable to 'finance' the arrangements relating to OUV and Lease Plan Vehicles to the effect that there has been deferment in the time it takes to turn the new vehicles into cash. The result is that at any one time an additional £50/60m is tied up in working capital ...*
>
> *A package has now been agreed with HBOS to finance these arrangements so as to release the relevant amounts out of working capital.*"

3. At an early stage, it was proposed that MGRG should enter into arrangements with Lombard (a finance arm of the Royal Bank of Scotland Group) so as to raise money on the OUV and leaseplan vehicles. Mr Millett outlined a scheme along these lines in a letter he sent to Mr Einollahi on 17 January 2002[2]. Mr Einollahi, however, suggested that Deloitte might be able to achieve a more financially advantageous deal[3]. To this end, Deloitte approached HBOS, with which, of course, Project Platinum had recently been concluded[4].

4. As it developed, Project Lisa involved the transfer of the OUV and leaseplan vehicles to two newly established companies. One of the companies, in the event MGR (Leaseplan), (formerly 115CR (133) Limited), was to acquire the leaseplan vehicles and the other, in the

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1 Mr Beale, Mr Millett and Ms Ruston all confirmed to us that this account of the background to Project Lisa was substantially accurate.

2 Mr Edwards' recollection was that Mr Millett had been "*trying to arrange stocking loans through various entities*".

3 Mr Einollahi said that either Mr Beale or Mr Millett had mentioned that "*they had come to an arrangement with another bank to borrow money at a particular rate of interest*" and that he (Mr Einollahi) had "*offered to raise the finance on better terms*".

4 See chapter VII (Project Platinum).

event MGR (OUV) (formerly 115CR (134) Limited), the OUVs. The vehicles were then to be sold to HBOS and leased back on operating leases.

5. Mr Beale attributed the use of the new companies to an idea of Mr Einollahi. He told us:

> "*It was certainly one of Maghsoud's fairly bright ideas that one of the problems with funding cars was going to be the attendant uncertainty around* [MGRG]*, and his idea was to set up separate companies so that the finance companies could be completely satisfied that there was no inherent – such as environmental – liabilities or whatever surrounding that company, so a nice, clean company and they could fund the cars and know that they had good title to them without risks of unknown liabilities. So the concept was to set up two clean companies and enter into deals with financial institutions.*"[5]

There were, moreover, tax reasons for using one company exclusively for leaseplan vehicles[6].

6. By no later than February 2002, it was envisaged that the OUV company should be a subsidiary of MGRG but that the leaseplan company should rather be owned by the Phoenix Partnership, consisting of the four members of the Phoenix Consortium and Mr Howe[7]. Mr Birkett of Deloitte explained the proposed structure as follows in an email he sent to HBOS on 26 February:

> "*Leaseplan*
>
> *The Leaseplan vehicles and future operations would be run through a Newco owned by the Phoenix Partnership ('PP'), comprising the four directors who acquired MG Rover from BMW, and Kevin Howe, the Chief Executive of* [MGRG].
>
> *It is proposed to do this transaction through PP as this allows the future business to be financed through a separate ring-fenced entity which can be managed as a core activity with dedicated management team and staff. In addition, HBOS are familiar with PP as it is its joint venture partner in MGR Capital.*
>
> *Own use vehicles ('OUV')*
>
> *OUV's would be funded via a Newco owned by* [MGRG]*, the car manufacturing subsidiary of MG Rover Holdings (and if there is any VAT issue through* [MGRG]*) which is the ultimate parent company in the group.*"

5 Mr Einollahi himself said that this account "*might well be true*".
6 Notes of a meeting with HBOS refer to the desirability of being able to tell the Inland Revenue that leaseplan transactions were being undertaken by a company whose business was carrying on a daily hire business.
7 See VII/1.

7. It remained the plan until 27 March 2002 that the leaseplan company should be owned by the Phoenix Partnership. Writing to HBOS on 11 March, Mr Birkett noted, "*Leaseplan will sit in a Newco as a subsidiary of Phoenix Partnership*". On 22 March HBOS told Mr Birkett that facilities had been approved for "*Newco A (Phoenix Partnership Subsidiary)*" *and* "*Newco B (MG Rover Group Ltd Subsidiary)*". On 25 March Mr Birkett prepared internal client acceptance forms, which were countersigned by Mr Einollahi as engagement partner on 26 March, in which one of the new companies was described as a subsidiary of the Phoenix Partnership and the other as a subsidiary of PVH. The briefing note Eversheds prepared on 26 March[8] recorded, "*Newco A will be a wholly owned subsidiary of the Phoenix Partnership and Newco B will be a wholly owned subsidiary of* [MGRG]".

8. It was intended that the company which was to be owned by the Phoenix Partnership (i.e. the leaseplan company) should be profitable. Mr Beale told us that the company was "*hopefully*" expected to make a profit. In an email to HBOS of 11 March 2002, Mr Birkett stated, "*Phoenix Leaseplan will exist to generate a profit*". Notes made by Mr Birkett of a telephone conference between Deloitte, Mr David Stevenson of Eversheds and Ms Ruston on 27 March refer to Newco A taking "*margin on pass through of funds from HBOS*"[9], reflecting the evident intention that the leaseplan company should receive a profit from the sale and leaseback arrangements in respect of leaseplan vehicles. Mr Birkett's notes continue:

> "*Options for MG Rover passing across margin to PP* [i.e. the Phoenix Partnership].
>
> *1. Operating lease from HBOS → allows sub lease of cars to MG Rover – identical other than additional 2% rental.*
>
> *→ cars go from HBOS → Newco A → MGR.*
>
> *2. Newco A → appoint MG Rover as agent.*
>
> *MG Rover take all profits of Newco A except 2% of capital value of assets.*
>
> *3. Can put Newco A under MG Rover.*"

Under the first of these options, the leaseplan company would have achieved a margin by leasing cars to MGRG at a higher rental than it had to pay HBOS. The second option would have left the leaseplan company with two per cent of the value of the cars.

8 See paragraph 2 above.
9 The notes also state, "*PP* [i.e. the Phoenix Partnership] *not taking additional margin on OUV vehicles*".

9. When Eversheds began work in March 2002, they recognised that the Phoenix Partnership's ownership of the leaseplan company gave rise to potential conflicts of interest, both as regards legal advisors and for the members of the Phoenix Partnership. The Eversheds briefing note of 26 March included the following in a list of issues:

> "*Whilst it is contemplated that E* [i.e. Eversheds] *will act for both NewcoA and NewcoB in the context of its arrangements with HBOS, in respect of any arrangements to be entered into direct between* [MGRG] *and NewcoA … to what extent will either or both of the Newco and* [MGRG] *need to be independently advised.*
>
> *Directors Duties – need to consider 'Platinum' type (hygiene) issues and (in all likelihood) implement the solution employed in that case.*"[10]

10. The plan for the leaseplan company (in the event, MGR (Leaseplan)) to be owned by the Phoenix Partnership was abandoned following an email of 27 March 2002 from Ms Maryanna Sharrock, a director in Deloitte's tax department. The email included the following:

> "*There are two restrictions for expensive cars.*
>
> *The one that concerns HBOS restricts available capital allowances for cars where the capital expenditure incurred by HBOS exceeds £12,000. Thus an £18,000 car discounted to £11,999 is not a problem for HBOS.*
>
> *The other restriction restricts the deductibility of rentals paid by the lessee. This applies where the retail price when new exceeds £12,000. This will affect the Phoenix lessee and the Rover lessee; i.e. there would be a double restriction …*
>
> *For the Rover lessee, the restriction is bad news because it will need to draw on its 'reserves' of current year losses (in the form of capital allowances). It cannot use carried forward losses. Unfortunately the reserve of current year losses are the ones that it could have sold elsewhere. If Rover has to commit more of its reserve losses to this transaction, it is effectively getting a low price for these losses compared to other potential transactions.*
>
> *For the Phoenix lessee, the restriction is pretty disastrous because it could not offset any Rover losses against its income so as to replace the missing deduction. Depending on the proportion of 'expensive cars' this will give it a very high tax rate.*

[10] The author evidently saw the proposed arrangements as giving rise to issues similar to those which had arisen as regards Project Platinum – see e.g. VII/184.

> *We need instructions on (a) whether to drop the Phoenix lease out of the chain and (b) whether Rover will do the transaction and, if so, whether this will be for a smaller amount just relating to cars with an original retail value of £12,000 or less.*"

11. In evidence to us, Mr Hume of Deloitte commented as follows on the final two paragraphs of the email:

> "*... the Phoenix lessee as described would not be part of the MG Rover Group and therefore would have no access to losses. So ... some of its expenses would be non-deductible whilst its income was fully taxable, resulting in a very high tax rate for that company. That is what the first of the two sentences mean. And the second one is effectively because of that, we need to decide whether to drop a company out of the chain to limit the amount of disallowance.*"

Mr Hume said that there was a concern that "*a doubling up of the disallowance* [of lease payments for tax purposes]" was being created.

12. As a result of the problem identified in Ms Sharrock's email, the leaseplan company (MGR (Leaseplan)), like the OUV company (MGR (OUV)), became a subsidiary of MGRG. Mr Barton confirmed that the change was attributable to the "*expensive cars point*" explained in Ms Sharrock's email. Likewise, Mr Hume said that his recollection was that "*the transaction was restructured, because of this issue*".

13. Completion was effected on 28 March 2002. At that stage, MGRG sold all vehicles on hire (principally to Europcar) to MGR (Leaseplan) for 60.8 per cent of their original list price plus VAT, the 60.8 per cent having been calculated by reference to the average estimated disposal price of the vehicles. MGR (Leaseplan) sold the vehicles on at the same price to a subsidiary of HBOS, which in turn leased the vehicles back to MGR (Leaseplan) on operating leases. In the case of OUVs, the pattern was similar, vehicles being sold by MGRG to MGR (OUV) and then on to the HBOS subsidiary[11], which leased the vehicles back to MGR (OUV). In consequence, HBOS paid £45.517 million to MGRG, including VAT.

14. Also on 28 March 2002, Mr Edwards countersigned on behalf of MGR (Leaseplan) and MGR (OUV) engagement letters which Deloitte had issued on 26 March[12]. These provided for MGR (Leaseplan) to pay fees totalling £770,000[13] plus VAT and MGR (OUV) to pay a total of £480,000 plus VAT, contingent on the successful agreement of HBOS facilities. The fee arrangements were subsequently amended so that Deloitte would be entitled to fees equal to the finance savings during the first year of the facilities' utilisation, subject to

[11] Where VAT was recoverable, the cars were sold to MGR (OUV) at a 39.2 per cent discount (i.e. 60.8 per cent of list price) and sold on to the HBOS subsidiary at the same price, plus VAT. Where VAT was not recoverable, the cars were sold at a 28.6 per cent discount.
[12] Mr Edwards was appointed as a director of MGR (Leaseplan) and MGR (OUV) on 27 March 2002.
[13] £1,080,000 was reduced to £770,000 by a manuscript amendment.

minimum fees of £750,000; £600,000 was payable on completion with the balance based on savings[14]. Ultimately, Deloitte received fees totalling £1,167,000 plus VAT.

15. Eversheds charged time costs of £69,568, based on hourly rates, plus disbursements and VAT, for their services. For providing MGR (Leaseplan) and MGR (OUV) with leasing facilities totalling £65 million, HBOS received arrangement fees of £162,500.

16. We asked each member of the Phoenix Partnership why the leaseplan company was to have been owned by the Phoenix Partnership rather than MGRG. Mr Towers, Mr Edwards and Mr Howe each denied being aware of the plan. Mr Towers maintained that this:

> "*... would have been a very controversial proposal and not only would I have questioned it but the other directors would have questioned it as well.*"

Mr Stephenson said that he had no recollection of any plan for either of the new companies to be owned by the Phoenix Partnership.

17. We can understand how Mr Howe could have been unaware of the proposal for the leaseplan company to be owned by the Phoenix Partnership. However, we find it hard to accept that any of the four members of the Phoenix Consortium would have been unaware of the proposal, especially when the four shared an office at Longbridge. Mr Beale's recollection in relation to Project Lisa was as follows:

> "*John Edwards, John Millett, Maghsoud* [Einollahi] *would all make sure myself and John Towers were fully briefed. It tended to work on a deal like that, that they would make sure that I was aware of quite a lot of the detail, and I would make sure that John Towers and Nick were involved in any of the key issues or decisions.*"

While Mr Beale may have misremembered the extent of Mr Millett's (and even Mr Edwards') involvement in Project Lisa[15], we think that Mr Beale would have ensured that, if they did not already know, the other members of the Phoenix Consortium were aware that the Phoenix Partnership were to own the leaseplan company. Given that completion was already imminent by the time the decision was made that the leaseplan company should not, after all, be owned by the Phoenix Partnership, there was all the more reason for Mr Beale to

[14] Deloitte's updated letter of engagement states:

> "*... the savings achieved will be calculated based on the difference between the effective interest margin paid (with reference to LIBOR) on the lease contracts and an interest margin of 2% above LIBOR. LIBOR will be as specified in the lease contracts. This marginal rate will be multiplied by the amount of finance provided under each of the lease contracts. This calculation is limited to lease contracts that commence during the first year of the facility.*"

[15] Mr Einollahi said that he dealt with Mr Millett initially, but later Mr Edwards. Mr Edwards told us that he did not become closely involved in Project Lisa until the plan had changed to have the Newcos held as subsidiaries of MGRG, which was shortly before completion.

have made sure that all members of the Phoenix Consortium knew what was in prospect by this stage, if not earlier[16].

18. No one provided any cogent explanation of why it would not have been possible for the leaseplan company to be a subsidiary of MGRG instead of the Phoenix Partnership. To the contrary, Mr Millett told us that he could not think of any good reason for having a distinction between OUV and leaseplan vehicles. Similarly, Mr Howe said that he could "*not understand what the logic would be*". When we asked Mr Barton whether there was any reason to suppose that HBOS would not have been happy for the leaseplan company to be a subsidiary of an MG Rover company, he said:

> "*Not that I am aware, and obviously ultimately it was.*"

19. As Mr Barton's evidence implies, actual events confirm that there was no obstacle preventing the leaseplan company from being a subsidiary of MGRG. Once Ms Sharrock had identified the tax problem which would arise if the leaseplan company were owned by the Phoenix Partnership, the company was at once made a subsidiary of MGRG. According to MGR (Leaseplan)'s minutes, the transfer of its shares to MGRG was approved on the very day Ms Sharrock sent her email (27 March). Completion followed only one day later. We are aware of no evidence that anyone saw any difficulty in MGR (Leaseplan) being owned by MGRG instead of the Phoenix Partnership.

20. For his part, Mr Beale did not deny having known of the plan that the leaseplan company should be owned by the Phoenix Partnership. His position was that Mr Einollahi had suggested in early May 2000, in advance of Techtronic's acquisition of MGRG being completed, that the Phoenix Consortium should establish a leasing company outside the Group. He said:

> "*The idea was that we ought to be thinking a bit bigger than just acquiring MG Rover Group, that the four of us could, for instance, take on a leasing company and it is more or less as it is here, but with Newco A and Newco B, that it would work very well ... – he was confident the banks would be willing to fund us, especially if we were then successful with the acquisition of Rover, because we would have had a history of completing transactions ...*"

What, Mr Beale said, he could not remember was "*why we decided at this point* [Newco] *B would not be part of the Phoenix partnership*" (as opposed to why Newco A *was* to be owned by the Phoenix Partnership).

21. We have not found any reference in the contemporary documents to Mr Einollahi suggesting in early May 2000 that the Phoenix Consortium could "*take on a leasing company*". Even, however, if such a suggestion was made, we should not have thought that Mr Einollahi would have had in mind sale and leaseback arrangements such as Project Lisa involved. In

[16] On 25 March 2002 Mr Birkett noted that "*we are looking to complete the deal on Thursday*" (i.e. on 28 March, as in fact happened).

fact, in evidence to us, Mr Einollahi confirmed, and we accept, that he had not advised that the company set up to conduct the leaseplan financing should be owned by the Phoenix Partnership. In any case, the simple fact, in our view, is that there was no good reason for the leaseplan company not to be owned by MGRG.

22. It would, as it seems to us, have been especially inappropriate to interpose a company owned by the Phoenix Partnership (and not MGRG) given MGRG's central role in the arrangements. Project Lisa was in essence a scheme to improve MGRG's cashflow. Furthermore, MGRG owned the vehicles prior to their sale and was responsible for the disposal of the vehicles on termination of the leases. When the leaseplan company was to be owned by the Phoenix Partnership, it was envisaged that an agency arrangement would be set up between the leaseplan company and MGRG and that a put option agreement would be put in place between the two companies to cover disposal at the lease end date.

Conclusion

23. We conclude that the reason the leaseplan company was to be owned by the Phoenix Partnership (and not MGRG) was that the four members of the Phoenix Consortium saw an opportunity to make money for themselves. When we suggested as much to Mr Beale, he said:

> "*I see nothing wrong with us forming a company and putting our money in and making a profit, no, so if that proposition was put to me I would have thought it was a smashing idea.*"

24. In the event, of course, the leaseplan company became a subsidiary of MGRG (because of the tax problem identified in Ms Sharrock's email). The plan for the company to be owned by the Phoenix Partnership still seems to us to be of significance, as indicating the Phoenix Consortium's desire to find opportunities to extract benefits for themselves at the expense of MGRG[17]. It also, as noted in chapter VII (Project Platinum)[18], casts light on why the members of the Phoenix Consortium rejected BoS's suggestion that its joint venture partner in the context of Project Platinum should be a Group company rather than the Phoenix Partnership.

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[17] In the event, MGR (Leaseplan) reported total profits before tax of £1.252 million in 2002 and 2003, and MGR (OUV) reported total profits before tax of £3.282 million in 2002 and 2003.

[18] See VII/83.7.

CHAPTER XI

AIRCRAFT:
EXPLOITING TAX LOSSES

Tax losses

1. As explained in chapter XVI (Financial and trading performance of MGRG), MGRG incurred trading losses in each of the years ended 31 December from 2000 until 2004. Under corporation tax legislation, trading losses in one company can be set against profits arising in the same accounting period in another UK group company[1]. Broadly speaking, a group exists for corporation tax purposes where one company owns 75 per cent or more of the other or a third company owns 75 per cent or more of each of them[2].

2. During 2002 and 2003 the Group entered into schemes to generate returns from its tax losses[3]. To a considerable extent, the profits from these transactions provided the basis for payments for the benefit of PVH's directors[4].

Project Aircraft

Basic facts

3. In early 2002, Mr Hume, a tax partner at Deloitte, was approached by Mr Abrahams[5] of Barclays Capital[6] inquiring as to whether the Group would consider a transaction that would turn its tax losses to account. Mr Hume and Mr Einollahi subsequently met Mr Abrahams.

4. At the centre of the scheme, which was called "Project Aircraft", was MCC Leasing (No.18) Limited ("PVL"[7]), a finance leasing company whose ultimate parent was Barclays plc. By 2002 PVL was the lessor of two Boeing 767 aircraft. These were leased to companies called ALE-ONE, Limited and ALE-TWO, Limited[8] and then sub-leased on operating leases[9] to Britannia Airways Limited ("Britannia Airways"), which was part of the Thomson Travel Group ("Thomson"). PVL was reckoned to have large future tax liabilities[10]. Barclays suggested that the Group should acquire the share capital of PVL so that the losses in the Group could be used to eliminate PVL's tax liabilities. The benefits derived from this elimination were to be shared between the Group, Thomson and Barclays itself[11].

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1 Income and Corporation Taxes Act 1988, sections 402(1), 402(2) and 403(1).
2 Income and Corporation Taxes Act 1988, section 413(3)(a).
3 Attempts had previously been made in the summer of 2000 to convert MGRG's tax losses into cash benefits, but these were unsuccessful - see V/69 to 78 in relation to Project Slag.
4 See also chapter XXI (Financial rewards).
5 Mr Abrahams had previously had contact with the Group through the proposed Project Slag transaction: see V/70.
6 Barclays Capital is the investment banking division of Barclays Bank plc.
7 As mentioned at paragraph 12 below, MCC Leasing (No.18) Limited changed its name to Phoenix Venture Leasing Limited after it had become a subsidiary of PVH.
8 ALE–ONE, Limited and ALE–TWO, Limited were Irish subsidiaries of Japanese companies.
9 The leases had been executed in 1995 and the aircraft delivered in 1996. One lease was due to terminate on 1 July 2002, while the other appears to have been terminable on 30 June 2006.
10 PVL's audited financial statements for the period ended 20 May 2002 reported deferred taxation of £37.16 million. £36.86 million of this liability arose as a result of capital allowances being claimed in advance of finance lease income being recognised.
11 See paragraph 10 below for a split of the benefits between the parties.

5. Mr Cowburn summarised the position in evidence to us as follows:

> "*PVH provided the tax losses and Barclays provided the funding ... and* [Thomson] *accelerated all the leases up. So it was, if you like, split between those three. They each shared the value of the tax saving.*"

6. Barclays explained what was proposed in a presentation to Deloitte dated March 2002. This stated:

> "*The MG Rover Group has previously agreed to a premium on all of* [PVL's] *shares equal to 65% of the present value of the future tax liability of* [PVL]. *In calculating such future tax liability it is assumed that a termination of* [PVL's] *lease to Ale-One occurs per July 1, 2002 and a termination of* [PVL's] *lease to Ale Two occurs per July 1, 2006 ...*"

The idea was therefore that the Group should retain an amount equal to 35 per cent of the tax liabilities from which PVL would be relieved (i.e. 35 per cent of the expected tax saving). The benefit to the Group was estimated in the presentation as "*approximately £9.43 m on a present value basis*".

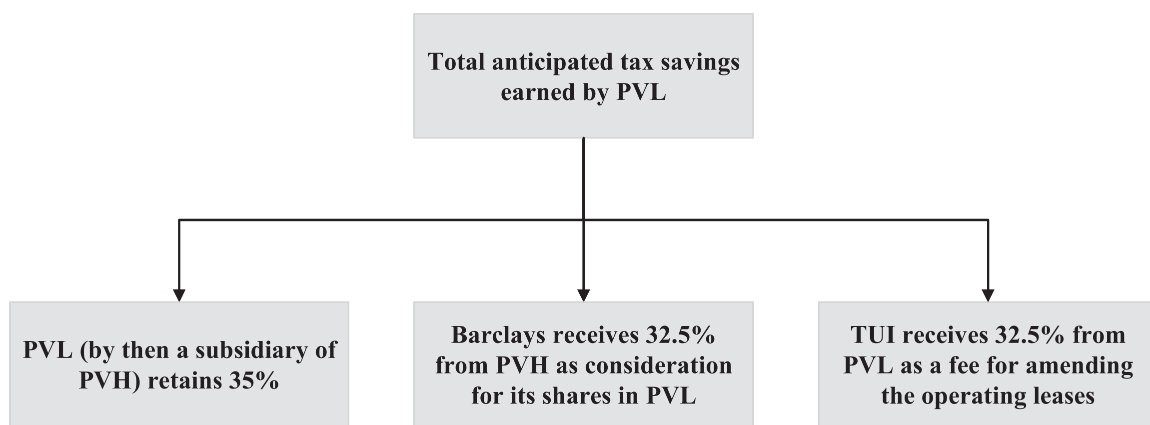
7. By 5 April 2002 a term sheet had been agreed. This recorded that it was proposed that PVL should be purchased by PVH. PVH was to "*take over the existing debt associated with the Aircraft and, in addition, pay a premium of 65% of the present value of the expected future corporation tax ... liability of* [PVL]". The premium was to be paid to a company in the Barclays group, which was in turn *to* "*pay or procure the payment of a fee to Thomson ... equal to 50% of what the premium would have been if* [PVL] *had not carried on any business other than entering into the two UK finance leases* [relating to the two Boeing aircraft]". PVH's purchase of PVL was to be funded by a facility from Barclays.

8. Although the term sheet identified the purchaser of PVL as PVH, thought was evidently given to alternatives. In an email of 12 April 2002, Ms Lewis of Eversheds mentioned that Mr Einollahi had said that he "*anticipated the acquisition would be made through a newly incorporated company formed specially for the purpose*". A week later, Ms Lewis noted that the purchaser was "*most unlikely to be* [PVH]" and that "*work is still being undertaken to identify where the purchaser should sit within the MG Rover Group*".

9. In the event, it was PVH which effected the purchase of PVL. Mr Hume told us that the decision that MGRG should not be the counterparty to the transaction was taken after tax counsel had advised that using MGRG could potentially affect the availability of group relief and that, additionally, Barclays had indicated that it might not be willing to lend to MGRG because of concerns as to its credit position. The recollection of Mr Barton of Deloitte was that Barclays had insisted on the leasing company being a subsidiary of PVH rather than MGRG in order, principally, to ensure that it was ring-fenced as much as possible from an MGRG insolvency. Mr Einollahi's understanding was that Barclays had

"*expressed a preference not to have MGRG act as the purchaser of the leasing companies*"[12] because it "*was reluctant to loan the necessary money to MGRG to enable it to acquire the leasing companies*".

10. While the term sheet had envisaged that PVH would pay a premium of 65 per cent of the anticipated tax saving to a company in the Barclays group, which would in turn pay or procure the payment of a fee to Thomson, by mid-May 2002 the plan was for PVH to pay only half of the 65 per cent to Barclays. "*The other half*" as Ms Lewis mentioned in an email, was to "*be paid directly by* [PVL] *to Thomson as a fee*". The Group was still to keep the remaining 35 per cent of the tax saving for itself. These arrangements are illustrated in the following chart:



11. PVH's acquisition of PVL was completed on 24 May 2002. At that stage:

11.1. Mr Beale signed on behalf of PVH a letter to PVL in which it was stated:

> "*We consider there will be tax losses of at least £125 million available for surrender as group relief to* [PVL] *in the period from 23 May 2002 to 20 May 2003, being the next accounting period end ... We will procure that losses of up to £125 million will be surrendered as group relief to* [PVL] *for no consideration in the current accounting period ended 20 May 2003*"[13];

[12] I.e. PVL and also PVL2, referred to in paragraphs 53 to 59 below.
[13] Tax losses of £100,002,128 were ultimately surrendered to PVL by MGRG.

11.2. PVL, Barclays Mercantile Business Finance Limited ("Barclays Mercantile", PVL's immediate parent company) and TUI Northern Europe Limited ("TUI", a Thomson company) entered into an agreement for PVL to pay TUI a fee of £11,665,197 (plus VAT of £2,041,409) for agreeing to amendments to the operating leases in respect of the Boeing aircraft. The fee represented Thomson's share of the anticipated tax saving[14];

11.3. Barclays Mercantile sold the issued share capital of PVL to PVH for £11,357,742. The price appears to represent Barclays' share of the anticipated tax saving less an adjustment in relation to PVL's net assets at the date of transfer;

11.4. on the other hand, Barclays Mercantile agreed to pay PVH £137,500 in settlement of all claims PVH might have against it "*with regard to the liability of £300,577 recognised within deferred tax in the Completion Accounts in respect of short term timing differences in respect of the rentals paid in advance for the year beginning 1 July 2001*". The net sum payable to Barclays Mercantile was thus £11,220,242 (£11,357,742 less £137,500); and

11.5. PVH borrowed £121,250,019 from Barclays Bank. £11,220,242 of the loan was used to discharge PVH's indebtedness to Barclays Mercantile. £99,518,640 of the balance was lent on to PVL and used by that company to discharge pre-existing indebtedness of £85,812,034 to Barclays Mercantile and to pay £11,665,197 plus VAT of £2,041,409 to TUI in respect of its fee. The loan balance of £10,511,137 plus the £2,041,409 VAT recoverable from PVL totalled £12,552,546 and represented 35 per cent of the anticipated tax saving.

12. Following its acquisition by PVH, PVL changed its name to Phoenix Venture Leasing Limited[15] on 2 June 2002.

13. On 1 July 2002 PVL was credited with £123,100,179, being the amounts outstanding on the two aircraft leases, which allowed PVL's indebtedness to PVH (which, with interest, totalled £99,965,344) to be discharged and funded a dividend to PVH of £19,880,463[16]. PVH was in turn able to repay in full its loan from Barclays Bank, plus interest of £544,130. A further dividend, of £2,026,409, was paid on 8 October after PVL had recovered the VAT it had paid on TUI's fee[17].

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[14] It appears to us that the transactions were based on total anticipated tax savings of approximately £35.8 million. PVL's financial statements for the period ended 15 December 2002 note that the taxation charge on losses surrendered to PVL for no consideration (i.e. the tax saving) was actually £36.69 million. It also appears that the tax saving resulted from the surrender of tax losses to PVL totalling £100,002,128 from MGRG and £9,415,886 from PVH.

[15] As mentioned at footnote 7 above, PVL was previously called MCC Leasing (No.18) Limited.

[16] Although the 2002 PVL financial statements show a dividend of £21,829,000.

[17] PVL retained £15,000 of the VAT repayment against deferred tax liabilities.

14. The overall benefit to PVH from the transaction can be calculated as follows:

	PVL	PVH
	£	£
Barclays loan to PVH	-	121,250,019
Consideration paid to Barclays Mercantile for PVL	-	(11,220,242)
PVH loan to PVL	99,518,640	(99,518,640)
Discharge of debt to Barclays Mercantile	(85,812,034)	-
Payment of TUI's fee	(11,665,197)	-
Payment of VAT on TUI's fee	(2,041,409)	-
Receipt of lease termination payment	123,100,179	-
Payment of interest variation creditor	(728,002)	-
Payment of interest payable	(578,027)	-
Payment of interest on inter-company loan	(446,604)	446,604
Payment of interest of Barclays loan	-	(544,130)
Repayment of inter-company loan	(99,518,640)	99,518,640
Repayment of Barclays loan	-	(121,250,019)
First dividend to PVH	(19,880,463)	19,880,463
Recovery of VAT on TUI's fee	2,041,409	-
Second dividend paid to PVH	(2,026,409)	2,026,409
Total benefit	**1,963,443**	[18]**10,589,104**

15. Deloitte's fees in respect of Project Aircraft totalled £1,925,000 plus VAT[19]. Eversheds were paid £153,599 plus VAT for their work on the project.

<u>*Application of the returns*</u>

16. A number of the directors gave evidence to the effect that they believed the profits from Project Aircraft would be used for the benefit of the Group, including MGRG. Mr Edwards said that "*from* [his] *standpoint, the whole point of using MG Rover tax losses was to generate funds for the continued operation of MG Rover*". Mr Stephenson said that his understanding was that the profits would be used for the benefit of the Group generally; he also expressed the view that, if the parent company made a gain from tax losses, "*the companies in the group would benefit from that, and therefore that was fine*". Mr Towers said, "*frankly, for us, what mattered was there was a possibility here of creating cash, additional cash for the group; and most particularly, for the cash-consuming part of the group, which was the car company*"[20]. Mr Beale's evidence was to the effect that MGRG benefited from the transaction because "*it gave the group additional cash reserves which it could lend to MG Rover as and when required*".

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[18] After deduction of Deloitte's and Eversheds' fees, the benefit to PVH was £8,510,505.

[19] See paragraph 17 below.

[20] Mr Towers also told us that "*to a man, they* [i.e. the directors of MGRG] *knew that what we were doing with our money was funding enormous amounts of cash consumption in the car company.*"

17. In practice, much of the money which the Group generated from Project Aircraft was used to fund a payment to the Guernsey Trust[21]. Immediately before Barclays Bank made its £121 million loan, PVH had credit balances on its bank accounts totalling £2,184,083[22]. The loan increased the credit balances to £14,736,629, enabling the company on 26 June 2002, without having received any money from any outside source in the interim, to pay £7,705,125 to the Guernsey Trust[23] (as well as paying £2,261,875 to Deloitte[24] in respect of fees for Project Aircraft). No payment was made by PVH to MGRG at this stage, or in fact at any time before November 2003.

18. In evidence to us, the members of the Phoenix Consortium were reluctant to accept that there was linkage between Project Aircraft and the £7.7 million payment to the Guernsey Trust. When we asked Mr Beale whether money from Project Aircraft had been used to fund the payment, he said:

> "*We certainly didn't have, and I am not sure many corporate entities have, a habit of sort of earmarking funds in such a way. Yes, there would have been a balance on the bank account; yes, I would have been aware that that was substantially due to that payment, but I don't quite see that the sort of earmarking, if that was your term, was used, no.*"

In similar vein, Mr Stephenson said that he had not understood the £7.7 million to be derived from the proceeds of Project Aircraft and disputed that that was in fact the case; he told us, "*Monies are not tagged in a large corporation, they don't go into bank accounts with somebody's name written upon them*". Mr Towers said that he did not think it had been envisaged that the proceeds of the aircraft transactions would be used to finance benefits for the directors of PVH and that he did not remember them being used in that way. Mr Edwards told us that he "*did not have time to think about how* [the bonuses] *were funded*".

19. For his part, Mr Howe said that he was not aware that the deal was used to fund a large payment to the Guernsey Trust. He explained that he would have been given assurances that PVH had the requisite funds to enable it to make the £7.7 million payment and, that being so, he "*didn't sit there: is this from the aircraft deal or is this from residual funds that are sitting in the* [PVH] *account or not?*"

20. On the other hand, Ms Ruston said that she was told by Mr Beale when Project Aircraft was being undertaken that some or all of the proceeds would be "*used to fund the bonuses to be paid on achievement of the Brilliance deal*"[25]. Similarly, Ms Natalie Atkins, the solicitor in the Group's legal department who handled the transaction on a day-to-day basis, told us that

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[21] As to which, see VII/159 and XXI/14 to 51.
[22] £12,552,546 of the £121 million loan was paid directly to PVH. The remaining funds were paid directly by Barclays Bank plc to Barclays Mercantile and TUI in the sums noted in paragraph 11.5 above.
[23] The £7,705,125 contribution to the Guernsey Trust is considered further at XXI/30 to 37.
[24] See paragraph 15 above.
[25] I.e. the proposed joint venture with China Brilliance: see XIX/67 to 90.

she "*became aware very late in the stages of the transaction that some of the money would be used to pay bonuses*".

21. Our own view is that the £7.7 million payment can fairly be attributed, at least in large part, to the money received from Project Aircraft. Without Project Aircraft, PVH simply would not have been in a position to make a payment of that size, and the evidence quoted in the previous paragraph confirms that Mr Beale at least intended that money from Project Aircraft should be used to pay bonuses. Moreover, it seems to us that every member of the Phoenix Consortium should have known how the payment was being funded. PVH itself was not a "*large corporation*" for practical purposes. Its receipts were derived from only a small number of sources and were few in number; in fact, bank interest apart, PVH received no further payments after 24 May 2002 (when the Barclays Bank loan was made) other than in respect of Project Aircraft before the end of that year[26].

MGTF tooling

22. During May 2002, it came to be thought that Project Aircraft's prospects of success would be improved and, in particular, that the chances of a challenge by the Inland Revenue to the use of tax losses to relieve leasing profits would be reduced, if PVL entered into further leasing arrangements after its sale to PVH had been completed. At a consultation on 15 May, tax counsel "*welcomed the suggestion that* [PVL] *would, post-Completion, write intra-group leases with a substantial value*". In a letter to PVH and PVL dated 22 May, Deloitte recommended that PVL "*should write additional lease once it has joined the PVH group*"[27]. Deloitte suggested that leases should be intra-group, for less than 12 months, written over plant and machinery such as production line equipment, amount to an investment of at least £1.2 million and take effect before 1 July 2002. The minutes of a PVL board meeting at 2.45 am on 24 May record that the director (Mr Beale) reported that "*it was intended that, on or before 1 July 2002,* [PVL] *would enter into one or more finance leases … with third party lessees of a value no less than £1.2 million in aggregate*".

23. To achieve this, sale and leaseback arrangements were concluded between PVL and MGRG. On 28 June 2002, the MGTF tooling was transferred from MGRG to PVL and then leased back to MGRG. The equipment lease provided for MGRG to pay rentals totalling £2,282,339 over a three year period. The lease was signed on behalf of both parties (PVL and MGRG) by Mr Beale as a director and Ms Ruston as company secretary.

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26 We consider PVH's sources of funding further at XXI/59 to 68.3.

27 Deloitte explained that the extent to which losses could be surrendered to PVL would be restricted if the company were not a member of the Group for the whole of the accounting period in which it received the rental payments in respect of the Boeing aircraft. It was, Deloitte noted:

> "… *important that* [PVL's] *trade should not cease too soon as this will bring the accounting period to an early end and further restrict loss surrenders under the 'overlap' rules*" and "*critical that* [PVL's] *trade should not have ceased before the change of ownership as this could on one reading of the legislation be a 'disposal event' which would give rise to a balancing charge equal to the market value of the aircraft in the Barclays period of ownership*".

24. The sale and leaseback were purportedly approved at meetings of the boards of MGRG and PVL on 28 June 2002. The MGRG minutes record that a board meeting was held at 2.00 pm, that the directors present were Mr Beale and Mr Howe and that Ms Ruston was in attendance. According to these minutes:

    24.1. "*The Chairman* [i.e. Mr Beale] *explained that it was proposed that the Company sell certain tooling ('the MGtF Tooling') relating to the production of the MGtF vehicle to* [PVL]. *It was proposed that the assets on the list produced to the meeting be sold at net book value, which was £1,948,343 … It was also proposed that following the acquisition of the MGtF Tooling, it should be leased to the Company on the terms of the agreement produced to the meeting ('the Lease Agreement')*"; and

    24.2. it was resolved "*that the acquisition of the MGtF Tooling be approved and that the Lease Agreement be approved and that Mr Beale and Ms Ruston, as secretary, be authorised to execute the Lease Agreement*".

    The PVL minutes, which include equivalent passages, record that a meeting of the board of that company was held at 2.15 pm on 28 June.

25. A number of directors of MGRG told us, however, that they were not invited to the MGRG board meeting at which the sale of the MGTF tooling is recorded as having been approved. Some also said that they were unaware of the sale and leaseback of the tooling. Mr Beddow said that he had not been invited to, or even aware of, the meeting and that he had discovered that the tooling was no longer owned by MGRG only during the negotiations with SAIC during 2004 and 2005. Mr Oldaker said that he had not known of the sale of the MGTF tooling until after MGRG had gone into administration and that he assumed that he had not been invited to the meeting[28]. Mr Shine said that he, too, was not invited to the meeting and that he had learned of the sale of the MGTF tooling only when reviewing the documents with which he had been provided for the purpose of his interview with us. For his part, Mr Howe said that he did not think that he had been at the meeting or aware of the sale of the MGTF tooling[29]. When we asked Mr Millett whether he had been consulted on whether there should be a sale and leaseback of MGTF tooling, he said:

    > "*I think 'advised' would be better than 'consulted', insofar as I was probably aware that … a sale and lease back had to be entered into for* [PVL] *to comply with its terms of this particular transaction, and that it would be … undoubtedly doing it with the piece of plant and equipment that was part of the group's assets. When you say 'consulted', that would imply asking me … did I think that was the right thing to do.*

[28] Mr Oldaker explained how, post-administration, he had learned that MGRG did not own the MGTF tooling and had spoken to the others on site about this. He said, "*we shared our views on that subject and I do not think anybody I spoke to had been aware of this transaction.*"

[29] Mr Howe said that he had no recollection of either the meeting or the sale and leaseback of the MGTF although they were the sorts of things he would have remembered. He added:

> "*... I can actually go further to say that I don't recall ever being at an MG Rover Group board meeting where there would only have been two people, because … I was mistakenly of the belief that we needed four directors for an MG Rover Group board meeting.*"

> *That was not the case, no. Because it was not really an option if we were going ahead with this deal.*"

Mr Millett also thought that he had not been aware until "*much later in the period of the company's history*" that it was the MGTF tooling that had been used for the sale and leaseback and that he had not been aware of the meeting.

26. Mr Edwards, too, said that he had been unaware of the sale and leaseback. He explained that he had learned of the arrangement only after MGRG had gone into administration: "*it certainly,*" he said, "*was a surprise to me, it seemed to be a surprise to most other people's recollection, that Phoenix owned tooling, for* [the MGTF]".

27. When we spoke to Ms Ruston, she thought that she had discussed the issue of the MGTF tooling with Mr Howe. Further, Ms Atkins said that she found it difficult to believe that Mr Howe had not been aware of the meeting or, more especially, the transfer of the tooling. She also commented that members of Mr Millett's team had been closely involved in identifying the assets that were to be the subject of the sale and leaseback and that she found it "*difficult to believe that they would not have been discussing that issue with* [Mr Millett]".

28. Regardless, however, of whether Mr Howe and Mr Millett could have been mistaken in their recollections, we think it overwhelmingly likely that some of MGRG's directors were neither invited to the meeting nor made aware of the sale and leaseback. As mentioned elsewhere in this report, however, there is a general rule of law that all the directors of a company must be given notice of a board meeting[30]. In addition, as we note in chapter XXII (Aspects of corporate governance)[31], there was a somewhat informal attitude towards the holding of board meetings, and the lack of proper corporate governance in respect of the approval of this transaction is symptomatic of that attitude.

The surrender of tax losses for no consideration

29. As will already be apparent, the Group's share of the returns from Project Aircraft accrued to PVH and a subsidiary (viz. PVL) in which MGRG had no interest (and thereafter, to an extent, to the Guernsey Trust) and not to MGRG[32]. That this was so was the result not so much of the fact that PVL was a subsidiary of PVH (as opposed to MGRG) as of the fact that MGRG was not paid for the losses that it surrendered. The fact that PVL was a subsidiary of PVH rather than MGRG did not of itself prevent the benefits of the deal from accruing to MGRG. As Mr Einollahi explained:

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[30] See, for example, *In re Portuguese Consolidated Copper Mines Limited* (1889) 42 Ch D 160 and *Young v Ladies' Imperial Club* [1920] 2 KB 523. This was by no means the only occasion on which directors of Group companies were not included in board meetings. We comment further on this in chapter XXII (Aspects of corporate governance).

[31] See XXII/44 to 46.

[32] See paragraph 17 above.

> "*... there is absolutely no reason why* [PVL] *could not pay consideration for the tax losses it used. It is not the structure which causes that to be in a form that it is. It is the agreement of the two parties whether they pay consideration or they don't.*"

30. When MGRG was in BMW ownership, it was fully compensated for tax losses it surrendered. Mr Andy Coggins, who was employed by MGRG as its tax manager, told us that BMW policy was such that, generally speaking, MGRG would be paid at the full tax rate. If, therefore, MGRG had surrendered tax losses of (say) £100 million, at a tax rate of 30 per cent MGRG would have received £30 million.

31. After MGRG was sold to Techtronic, the practice changed. Mr Coggins gave evidence to the effect that a decision had been made that losses were not to be paid for[33]. He explained that Mr Beale had been involved in the decision and that he saw it as the directors' decision. Mr Beale himself said:

> "*... the subject came up in the early stages of 2000 as to whether when we were preparing the accounts Rover should take any credit for group relief and surrender of losses to other group companies, and we decided then that was not to be done.*"

32. In the context of Project Aircraft, Mr Millett felt that that MGRG should receive a benefit for the tax losses that it was to surrender. Mr Millett told us, "*It was Rover Group that incurred the historic losses so therefore I would argue that MG Rover Group should have some benefit in those*". He also said that he had conversations at the time, in particular with Mr Beale, Mr Howe and Ms Ruston, "*making the point that the tax losses were MG Rover's and therefore* [he] *would expect MG Rover to have some benefit from those tax losses that were being used*". This evidence is consistent with that of Mr Beale, who said:

> "*The only point that I think it was probably John Millett raised to me was – it could have been Kevin Howe but I think it was probably more likely to have been John Millett – was whether MG Rover was going to get any benefit out of the transaction for their profit and loss account*",

to which, Mr Beale said, his answer had been, "*No*".

33. Mr Beale's response was not based on any advice from Deloitte. Mr Bushill of Deloitte said that he had not advised as to whether any consideration should be paid for tax losses, viewing this as a matter for the relevant boards to decide upon. Mr Einollahi said that he had had no involvement with discussions over whether MGRG should be paid by the leasing company for the transfer of its losses. Mr Hume told us that he, too, had not advised as to

[33] According to the transcript of Mr Coggins' evidence, he said that "*the conclusion was that losses were going to be paid for*". Omission of the word "not" from this passage appears, however, to represent a slip either on Mr Coggins' part or in the transcribing. Indeed, Mr Coggins' solicitors told us, albeit in making representations on behalf of the Phoenix Consortium, "*Mr Coggins ... told the Inspectors that ... it was decided that all intra group transfers would be done on a gratuitous basis.*" The upshot of Mr Coggins' evidence seems to us to have been to the effect that tax losses were not to be paid for in the future.

whether any consideration should be paid to MGRG for the tax losses surrendered. To the contrary, Mr Hume recalled telling Mr Coggins that this was a decision for the directors of the companies concerned. Mr Hume explained:

> "*At one of the meetings, one of the tax review meetings ... that we had with Andy Coggins, particularly - I think it was with reference to the first of the aircraft transactions, he raised the subject and I commented that it was a matter for agreement between the board of MG Rover and the board of Phoenix to agree on and that it was not a tax issue per se.*"

Mr Beale agreed that Mr Hume had not advised on whether MGRG should be paid for its tax losses. "*I do not think David Hume would care one way or the other*", he said.

34. Mr Barton said that he recalled a meeting at which Mr Millett had raised the question of how much MGRG should be paid for the surrender of tax losses, in response to which he had made it clear to Mr Millett that this was not an issue for Deloitte to consider but should be discussed amongst the directors. Mr Barton said that he did not know whether this meeting had taken place in the context of Project Aircraft or in the context of Project Trinity[34], but it seems likely that the relevant conversation was on 18 June 2002. On that date Mr Widdall of Deloitte attended a meeting with various representatives of MGRG. Mr Widdall's notes of the meeting include the following:

> "*If payment to be made by MCCL* [i.e. PVL] *for tax losses to MGR, will lower dividend – to be decided by 1 July 2002 and board minuted.*"

35. In the event, MGRG tax losses of £100,002,128 were surrendered to PVL for no consideration.

<u>*Approving the surrender of tax losses*</u>

36. On 2 May 2002 Ms Karen Ashton, an associate at Eversheds, sent Ms Atkins a note addressing "*some of the directors duties and related issues arising from the structure of Project Aircraft*". Amongst the topics covered by the note were:

    36.1. directors' duties in relation to the surrender of tax losses by MGRG;

    36.2. duties of directors who were directors of both holding and subsidiary companies; and

    36.3. directors' duties in relation to diversion of corporate opportunity.

Under the heading "*Directors duties in relation to surrender of tax losses*", Ms Ashton wrote:

[34] As to which, see paragraphs 53 to 59 below.

"*In this scenario we are looking at the duties of the directors of* [MGRG] *at the time when they would be deciding to surrender tax losses for the benefit of* [PVL]/*Group.*

The general duties of a director are to act bona fide in the best interests of the company and this is the company of which they are taking the current decision … The directors will therefore need to resolve that such a surrender is in the best interests of the company itself, having considered (and minuted what those interests are) and deal carefully with the benefits they are getting for the transfer. The potential benefits are group benefits and the directors must be comfortable that they will get some benefit from that advantage to the group. If this is the case then there is no breach of duty; the directors need to act reasonably, but it is a subjective rather than objective test that would be imposed upon them and therefore there is less risk of looking back with hindsight.

The directors can seek shareholders sanction in respect of what is proposed in case their exercise of duty is ever challenged. This will protect them from liability as far as the Company and its shareholders are concerned but is ineffective as regards creditors; but as summarised below, if our assumptions are correct this should not be an issue.

The second situation is the possibility of there being a reversal of the transaction transferring the tax losses. There are three Insolvency Act provisions which are potentially relevant and these are:-

- *creating a preference*
- *carrying out a transaction at an undervalue; and*
- *carrying out a transaction to defraud creditors.*

Both the creation of a preference and transactions at an undervalue offences require the company creating the preference or entering into the transaction at an undervalue to be insolvent at the time or insolvent as a result of the transaction. We do not believe that either of these would be relevant but this is something we need to check with you.

The provisions in relation to defrauding creditors are slightly different; here there is no requirement for there to be insolvency at the time or as a result of the transaction, although there is a requirement for there to be a transaction at an undervalue. Transfer of tax losses without sufficient benefit would potentially fall within this category. It is important therefore to ensure that the transfer is properly considered and minuted to ensure that there is no intention to defraud creditors and to reduce the risk of a claim by a victim (i.e. a creditor who believes assets have been put beyond their reach) that assets have been put beyond reach of creditors …"

Turning to "*Duties of directors who are directors of both subsidiary and holding company*", Ms Ashton stated as follows:

> "*... The overriding duty is to act bona fide in the best interests of the company. The courts generally do not interfere in the commercial judgements of the directors but directors should bear the following in mind:-*
>
> *1. they must consider what the interests are (and minute these deliberations)*
>
> *2. having considered the interests they must honestly believe the action to be in the best interests of the company*
>
> *3. they must act independently of any appointor (this includes nominee directors). They must consider what is in the best interests of the company or, if appropriate, the creditors as a whole ...*
>
> *4. The directors must not fetter their discretion, for example by agreeing to exercise their discretion in a particular way ...*
>
> *Again this is something which can be dealt with in the Board Minutes.*"

On "*Diversion of corporate opportunity*", Ms Ashton advised:

> "*Directors of individual companies should consider opportunities which they become aware of and should not divert them to another company or individual. The potential diversion in our situation is the position that a Newco rather than* [MGRG] *will be making the acquisition and receiving the potential benefit; again provided there are good commercial reasons for this and the directors (of each) company act in good faith this can be correctly minuted and indeed ratified by shareholders.*"

37. Several members of the Phoenix Consortium told us that they did not see Ms Ashton's note or the email with which she sent it. Mr Edwards said that he had neither seen nor been aware of the advice. Mr Stephenson said that he was sure he had not seen the note or the email. Mr Towers, too, said that he did not remember learning of Ms Ashton's advice. However, Ms Ruston told us that Ms Atkins had discussed the advice with her and that she had spoken to Mr Beale and explained why there needed to be an MGRG board meeting; she said, moreover, that she would probably have explained to Mr Beale that Eversheds had advised that there needed to be such a meeting. For his part, Mr Beale said that he did not recall seeing the note, but "*given it was a note prepared for the directors of* [MGRG]*, I assume we all saw it*".

38. On 20 May 2002 Ms Ashton emailed some draft documents to Ms Atkins. She explained in the email:

"*Attached are the minutes for* [MGRG] *together with a shareholders resolution. These deal with approving the deal from its point of view and resolving that its directors, having considered the best interests of that particular company, believe it to be in the best interests of* [MGRG]. *This goes back to the conversation we had at your offices with Jane* [i.e. Ms Ruston] *and Sue* [i.e. Ms Lewis][35] *about duties of directors and the fact that it is going to be this company which will need to surrender its losses.*

The key paragraph is minute 4 and the directors should consider this carefully and add in any other reasons. I have included some suggestions but please feel free to amend these if they are not genuine beliefs of the directors ..."

"*Minute 4*" (i.e. paragraph 4 of the draft board minutes) read as follows:

"*After careful consideration **IT WAS RESOLVED** that the Transaction* [i.e. PVH's acquisition of PVL] *and more particularly the possible requirement to surrender current year tax losses to* [PVL] *in the future would be in the best commercial interests of the Company. In* [reaching] *this conclusion the directors considered:*

4.1 the value of the accrued and anticipated current year losses;

4.2 the value of historic tax losses;

4.3 the plans for the Company and the time when profits were predicted to be generated within the Company and the time therefore when the Company would itself have need to shelter profits;

4.4 the fact that PVH would gain cash benefit from the Transaction which was not available to the Company [(the Company having been advised that the Seller of [PVL] *(ultimately Barclays Bank plc) had required the PVH direct covenant in relation to the Transaction)] and that if PVH did not obtain the cash benefit from the Transaction the Company would be required, as part of the Group, to provide other funding to PVH;*

4.5 the fact that the Transaction involved the acquisition of a Company involved in finance leasing which was outside the directors' and the Company's employees' sphere of expertise and that as such there would be issues of risk and use of management time if the Company acquired [PVL] *direct which the directors did not believe were in the best interests of the Company;*

4.6 [OTHERS]

[35] This conversation will have taken place on 3 or 10 May 2002.

> 4.7 *that the shareholder of the Company (Techtronic Limited) had been approached in relation to the Transaction and was supportive of the Transaction being completed by PVH and the consequences for the Company of such a transaction. In this regard a resolution of Techtronic Limited was produced to the meeting.*"

39. Ms Atkins replied:

> "*Karen, I thought that the conclusion that we reached when we met here was that a board meeting of MGR was not necessary and that all we needed was a board meeting of PVH and a shareholders* [resolution] *of Techtronic (as shareholder of MGR). This is certainly what we have advised our chief executive and is the preferred route.*"[36]

Later on the same day, Ms Ashton sent Ms Atkins a further email in which she said:

> "*I have talked through this with Sue* [i.e. Ms Lewis] *and although it is not essential that there is a board minute now (as there is nothing which actually needs positive action) we believe that it would be helpful for the directors to have acknowledged the transaction and their future part in it. To get shareholder approval/ratification is really only possible if the shareholder refers to the actions (or inactions) of the directors and it would seem a little odd if there was no board* [resolution] *to ratify.*"

40. When we asked Ms Lewis to comment on Ms Ashton's email, she said:

> "*... the way in which the transaction was structured,* [MGRG] *was not actually signing anything but it clearly would be signing a surrender of tax losses at some point. And therefore, the reference there ..., there is nothing actually needing positive action now but it must be the right thing for the directors to acknowledge the transaction.*"

Ms Lewis also told us:

> "*... what we advised was that* [MGRG] *needed to get benefit for the surrender of its tax losses.*"

41. The subject of minutes approving the surrender of tax losses came up again in the summer of 2003. On 31 July, Mr Cowburn, by now a financial accountant at PVH, sent Ms Ruston an email in which he asked for copies of "*the minutes of the MGR meeting which approved the transfer of tax losses which were used in the first tax loss deal i.e. PVL 1*"; he explained

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[36] When we asked Mr Howe about this email, he said, "*if Natalie has put in an email that she has briefed me on it, then I can't see why she should say in an email if she hadn't, but it is not something that I recall at all.*" Mr Howe also said that he had no recollection as to whether Ms Atkins' comment could relate to a more general discussion about the use of shareholders' resolutions rather than to the particular transaction.

that he needed these "*for inclusion in the file* [he was] *putting together in respect of bonus payments made*". Ms Ruston passed a copy of the email to Ms Atkins having written on it:

> "*Can you deal with this. Did we do any?*"

Ms Atkins in turn wrote a note for Mr Cowburn:

> "*John, I attach minutes of PVH which at 4.1.2 state that PVH will procure the release of the tax losses. This was not approved at MGRG board due to a conversation I had at the time with (I think) Andy Coggins. If you would like me to do a minute to ratify for MGR then we can.*"[37]

Mr Cowburn said that, as he was "*just pulling the documents together*", he did not suppose he would have pursued the point; he might have "*just said to Peter* [Beale], *'This is the situation'*".

42. In the event, the surrender of the tax losses was never approved by MGRG's board. Mr Millett told us:

> "*I think the board was advised that this transaction was taking place, or maybe just after it had taken place, and many of the MG Rover only board directors would have found out about it later than I would have done, simply ... because of the finance department having to get involved in it.*"

Despite the advice Eversheds had given, neither Project Aircraft nor the surrender of tax losses it entailed was ever even addressed at an MGRG board meeting. There was, accordingly, no occasion for the directors to consider whether the proposed arrangements were in the best interests of MGRG, let alone for those interests to be minuted (as Eversheds had suggested).

43. It was argued in representations made to us on behalf of the members of the Phoenix Consortium that "*the approval of the MGRG board was not necessary for MGRG to surrender its tax losses for the purpose of the aircraft transactions*". Reference was made to the following passage in an authority manual which MGRG used:

[37] When we asked Ms Atkins about this note, she said:

> "*... I should remember a conversation I had with Andy Coggins if it says, but I don't recall. I think I didn't recall then whether it was definitely Andy Coggins. So I certainly can't remember now.*"

"*TAXATION*

All Company taxation matters must be referred via the Director Accounting, Treasury and Taxation to the Finance and Strategy Director. Major issues are to be reported to the MGRGEB [i.e. MGRG's "*executive board*"[38]]."

Further, it was said that tax matters were determined for MGRG by a "*Tax Review Board*" which had "*decided that all intra group transfers* [of tax losses] *would be done on a gratuitous basis*".

44. We have not been persuaded that these matters obviated the need for MGRG's board to approve the surrender of the tax losses used for Project Aircraft. It is by no means clear that the decision whether to surrender losses for Project Aircraft (and, if so, on what terms) was properly to be regarded as merely a "*taxation matter*", but, if it was, we should have thought that it gave rise to "*Major issues*"; nevertheless, the matter was not referred even to MGRG's "*executive board*". Further, while "*tax review*" meetings took place on a regular basis, typically attended by Mr Beale, Mr Coggins and representatives of Deloitte, the evidence does not appear to establish that those attending such meetings were termed (or seen as) "*the Tax Review Board*", nor that any such entity as such decided the basis on which tax losses would be surrendered[39], nor that any delegation of authority by MGRG's board to any such body extended to decisions as to the terms on which MGRG would facilitate schemes to exploit tax losses (such as Project Aircraft). In the context of Project Aircraft, what was proposed was that MGRG should surrender tax losses for nil consideration to facilitate a scheme generating a very large profit for a company indirectly controlled by some of MGRG's directors and enabling, moreover, substantial payments to be made for the benefit of certain of MGRG's directors. The question of whether (and, if so, on what basis) tax losses should be surrendered was thus one on which there were plain conflicts of interest. In the circumstances, it was surely appropriate for the requisite surrender of tax losses to be considered at a board meeting.

45. We cannot say with certainty what stance MGRG's directors would have taken had they been called on to consider Project Aircraft and, more specifically, the surrender of MGRG tax losses for no consideration[40]. It does not seem to us, however, that the points listed in paragraph 4 of the draft board minutes prepared by Ms Ashton[41] (which Ms Ashton herself said were only "*suggestions*") demonstrated the arrangements to be in MGRG's interests. While paragraphs 4.1 to 4.3 might have meant that MGRG was unlikely to need the tax losses to shelter profits of its own, these paragraphs could not of themselves have made the surrender of the tax losses positively beneficial to MGRG.

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38 As to which, see V/13 to 15.

39 Compare paragraph 31 above.

40 As explained in chapter VII (Project Platinum), a new article 83 was purportedly inserted into MGRG's articles of association on 8 November 2001, but it is not clear that the amendment was effective. Were the previous version of article 83 to have continued to apply, the members of the Phoenix Consortium should not, it seems, have been involved in decision-making by the MGRG board (because the old form of article 83 generally precluded a director from voting on any resolution concerning a matter in which he had, directly or indirectly, a conflicting interest).

41 See paragraph 38 above.

46. With regard to paragraph 4.5 and the claim in paragraph 4.4 that "*PVH would gain cash benefit ... which was not available to* [MGRG]", the points made, if correct[42], might have served to explain PVL's position as a subsidiary of PVH rather than MGRG, but they would not appear to have justified the surrender of tax losses for no consideration. As for the claim that "*if PVH did not obtain the cash benefit from the Transaction* [MGRG] *would be required ... to provide other funding to PVH*", MGRG had already been required to pay interest to Techtronic[43] and it is difficult to see how PVH could honestly have been said to require additional funding from MGRG to meet PVH's ordinary running expenses (as opposed to making payments into the Guernsey Trust).

47. So far as paragraph 4.7 is concerned, no resolution of Techtronic was in fact passed[44].

48. In our view, it was not in MGRG's interests to surrender its tax losses for no consideration. Even assuming that PVL could not have been a subsidiary of MGRG and, hence, that MGRG could not have pursued Project Aircraft without PVH's assistance, neither was PVH in a position to implement Project Aircraft without MGRG's cooperation. PVH needed MGRG to contribute its tax losses, as well as to enter into the sale and leaseback of the MGTF tooling. Just as Barclays and Thomson were willing to share the proceeds of Project Aircraft with the Group because they could not carry out the scheme without the Group (in particular, MGRG's tax losses), so should the profits generated by the Group have been shared with MGRG given that the Group could not have generated those profits without MGRG's tax losses. The tax losses were central to the scheme and were overwhelmingly being contributed by MGRG.

49. Further, as mentioned above, while Eversheds contemplated that "*shareholder sanction*" would be provided, Techtronic did not in fact pass any resolution endorsing Project Aircraft[45]. Nor is it entirely certain that Techtronic's board would have approved the arrangements had it been asked to do so. It is noteworthy in this context that in May 2002 Techtronic's board still included Mr Ames as well as the members of the Phoenix Consortium[46].

<u>*Cessation of trading*</u>

50. On 28 February 2003 PVL transferred its business and assets (including the MGTF tooling) to MGR Leasing, another subsidiary of PVH. PVL ceased trading on the same day.

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[42] In fact, paragraph 4.5 seems to us to have no real substance. PVL required very little management in the short period before it ceased to trade (see paragraph 50 below), and the individuals involved would have been the same regardless of whether PVL was a subsidiary of PVH or MGRG.

[43] See V/52 to 54, 57 and 63.1 and XXI/61 to 62.

[44] See paragraph 49 below.

[45] There is the further point that Techtronic was not MGRG's only registered shareholder, BMW (UK) being recorded as holding one share (see VII/191 to 193).

[46] Mr Ames ceased to be a director of Techtronic on 16 December 2002.

Advice from Ashurst Morris Crisp

51. Project Aircraft was amongst the matters in relation to which Mr Millett and Ms Ruston sought advice from Ashurst Morris Crisp (now Ashurst), a firm of solicitors, in August 2002[47]. Mr Millett told us:

> "*I wanted to make sure that the structuring of the company for things like aircraft leasing which was using MG Rover tax allowances, whether that was a group resource was not clear and so on – that all these things were proper and in the interests of the company.*"

52. Since Ms Ruston and Mr Millett declined (as they were fully entitled to) to waive privilege in relation to the advice from Ashurst Morris Crisp, we are not in a position to comment on either the advice Ashurst Morris Crisp gave or the instructions they were given.

Project Trinity

53. "Project Trinity" was the name given to a scheme similar to Project Aircraft which was undertaken in 2003. Like Project Aircraft, it was designed to generate profits from MGRG's tax losses.

54. Project Trinity involved the following:

    54.1. Mercantile Leasing Company (No.162) Limited ("PVL2"[48]), another finance leasing company in the Barclays group, was the lessor of a further Boeing 767 aircraft. The aircraft was leased to ALE–FOUR, Limited[49] and sub-leased on an operating lease to Britannia Airways[50];

    54.2. on 1 April 2003 Barclays Bank sold PVL2 to PVH for £5,551,467. The £5,551,467 represented, as to £4.951 million, Barclays' share of the anticipated tax benefit and, as to £0.6 million, compensation for the net assets Barclays left in PVL2 on disposal;

    54.3. Barclays Bank provided funding for the transaction via a facility of up to £59,048,786 to PVH. The facility was to be used as follows:

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[47] See VII/231 to 233. Mr Millett explained the background to this as follows:
"*I wanted to make sure that all the structuring that was going on was – I wanted to know more about it. I also was concerned about certain aspects of the levels of remuneration being paid to the Phoenix directors. I understood it was a private company and therefore my belief was that they are the shareholders. They can conduct themselves in this manner as they own the company. But ... I did not know anybody in the company I could talk to about this matter, so I wanted to just check and I had a conversation with Jane Ruston and she believed it would be a good idea to go jointly and seek some advice.*"

[48] As mentioned at paragraph 54.5 below, Mercantile Leasing Company (No.162) Limited changed its name to Phoenix Venture Leasing 2 Limited after it had become a subsidiary of PVH.

[49] Like ALE–ONE, Limited and ALE–TWO, Limited, ALE–FOUR, Limited was an Irish subsidiary of a Japanese company.

[50] The aircraft had been sub-leased to Britannia Airways since 27 June 1997.

£	Purpose
5,551,467	Acquisition by PVH of PVL2's shares
34,950,627	Repayment of PVL2's existing debt to Barclays
3,465,041	Payment to Thomson for acceleration (in escrow)
4,282,100	Payment to PVL2 (in escrow)

In the event, the draw downs appear to have totalled £48,249,235. Money was initially placed on escrow so that it was available to meet tax liabilities should the scheme fail;

54.4. in a letter to PVL2 dated 1 April 2003, PVH agreed to procure that losses of up to £48 million would be surrendered to PVL2 for no consideration;

54.5. PVL2 changed its name from Mercantile Leasing (No.162) Limited to Phoenix Venture Leasing 2 Limited on 13 April 2003;

54.6. £41,271,689 of MGRG tax losses were subsequently surrendered to PVL2; and

54.7. by October 2003 PVL2 had been credited with the amounts outstanding on the aircraft lease. The sums allowed PVL2 to discharge its indebtedness to PVH and to fund a dividend to PVH of £9.943 million. PVH was in turn able to repay in full its loan from Barclays Bank.

55. The overall benefit to PVH from Project Trinity can be calculated as follows:

	£ million
Barclays loan receipt[51]	48.249
Loan to PVL2	(42.697)
Purchase price of PVL2	(5.551)
Fees incurred[52]	(1.259)
Receipts from PVL2 including interest but excluding dividends[53]	43.623
Repay Barclays including interest[54]	(49.025)
Dividends	9.943
Net benefit	**3.283**

[51] See paragraph 54.3 above.

[52] Deloitte charged fees to PVH totalling £1,099,078 plus VAT in respect of Project Trinity (representing 25% of the total of the cash receipts from PVL2 and receipts from a sundry lease). These fees included tax services charged of £180,000 plus VAT. Eversheds charged fees of £159,548 in respect of work undertaken on Project Trinity.

[53] This figure comprises the £42.697 million loaned from PVH to PVL2 and £0.926 million interest.

[54] This figure was taken from Deloitte working papers and comprises the £48.249 million loaned from Barclays Bank to PVH and £0.776 million of interest.

56. A note written by Mr Beale in 2003[55] included the following under the heading "*Aircraft Leasing -2*":

"*Agreed that PC would take 75% of any surplus as bonus.*"

These words evidently refer to the members of the Phoenix Consortium taking 75 per cent of the net return from Project Trinity as a bonus for themselves. When we asked Mr Edwards about the note, he said, "*I have absolutely no recollection of that at all, and if it was agreed, I would love to know who it was agreed between*". Mr Stephenson told us that the words did not accord with his recollection. For his part, Mr Towers told us that he could not recall "*aircraft leasing being an objective against which a bonus was paid*"[56]. However, Mr Einollahi confirmed in evidence to us that he was aware at this stage that Project Trinity would be used to generate a bonus payment. Ms Ruston likewise told us that she was told by Mr Beale that the proceeds of the deal would fund bonus payments. This is, moreover, consistent with an email Mr Cowburn sent to Mr Beale on 15 May 2003 which included the following:

"*Provide for future bonus payments as follows:*

... Tax PVL2 £3 million ..."

57. In the event, PVH made a payment of £3,632,500 to the Guernsey Trust at about the time PVL2 paid the £9.943 million dividend. The £3,632,500 was paid on 13 October 2003, and £4,363,819 was credited to PVH's bank account in respect of the dividend on 16 October. While the money paid to the Guernsey Trust will not as a matter of fact have been derived from the dividend (which had not yet been received), the likelihood is that the payment was made because receipt of the dividend was known to be imminent.

58. By way of note, Barclays evidently had concerns about MGRG's future prospects. On 18 February 2003 it sought "*comfort that MG Rover will be in existence to make the relevant surrenders when needed*"; Mr Brad Hurrell of Barclays explained in an email to Deloitte on 19 February:

"*On the first deal, we took a more relaxed view that there would not be a problem within 19 months when standing in May 2002. This time however we are looking forward 21 months from March 2003 and given the negative news flow in the industry together with some Rover specific news flow, I think we will need to do a bit more convincing.*"

Mr Barton noted in an internal email of 18 February that a copy of PVH's 2001 financial statements "*will be as much as I am prepared to deliver*", indicating that Deloitte were not prepared to provide Barclays with any additional comfort.

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[55] We comment further on this note in XXI/82 to 86.
[56] Mr Howe, too, told us that he had not known of a plan to take 75% of any surplus as bonus.

59. As with Project Aircraft, neither Project Trinity nor, more specifically, the surrender of tax losses which it was to exploit were approved by, or even considered at, an MGRG board meeting.

Concluding comments

60. Representations made to us on behalf of the members of the Phoenix Consortium made the point that "*it is not unusual for tax losses to be surrendered and utilised within a group without any direct payment or any direct corresponding payment being made by or on behalf of the recipient of the tax benefits to the entity which surrendered the losses in question*". During our inquiry, more than one person confirmed to us that it is common for tax losses to be surrendered to other group companies for no consideration. Mr Hume, for example, said that it is common for many group companies to surrender tax losses for nil consideration. Mr Mark Mullins, the Deloitte partner with responsibility for the Group audit from 2002 onwards, similarly said that "*it wasn't unusual and isn't unusual for tax losses to be surrendered around a group for nil value*".

61. There may well be no harm in tax losses being surrendered at nil consideration where the companies making the surrenders are of undoubted solvency. If, however, there is a perception that it is legitimate for even a company in financial difficulties, or which is in fact insolvent by one or more measures, to surrender tax losses for no consideration without regard to whether doing so will in fact be of benefit to the company, it seems to us that that perception needs to be dispelled.

62. Projects Aircraft and Trinity illustrate the point. The schemes depended for their success on MGRG surrendering tax losses. MGRG also facilitated Project Aircraft by entering into the sale and leaseback arrangements in respect of the MGTF tooling. Nonetheless, there was no provision for MGRG to receive any benefit from the schemes, and it did not do so. Much of the money that the schemes generated for the Group rather provided the basis of payments to the Guernsey Trust (totalling £11,337,625)[57] for the benefit of individuals who were directors of MGRG as well as of PVH. Assets of MGRG were thus used to produce benefits for certain of its directors.

63. These arrangements were not in the best interests of MGRG itself or of its creditors. They might also be thought to have engaged the "no conflict" rule and the "no profit" rule referred to in chapter VII (Project Platinum)[58].

64. In the case of a company of unquestionable solvency, the arrangements could be appropriately authorised or ratified by shareholders. Even, however, by the dates Projects Aircraft and Trinity were completed, MGRG was on the face of it insolvent on a balance sheet basis. MGRG's 2001 financial statements reported net liabilities of £150.4 million (as

[57] This being £7,705,125 transferred on 26 June 2002 (shortly after Project Aircraft), and £3,632,500 transferred in October 2003 (shortly after Project Trinity).
[58] See VII/196.

well as losses in the year of £227.3 million[59]). The company's 2002 financial statements recorded net liabilities of £243.3 million (as well as losses in the year (before taxation) of £69.8 million). The company's 2003 financial statements recorded net liabilities of £335.9 million (as well as losses in the year of £92.6 million).

65. That Barclays considered MGRG's prospects to be doubtful, at least in the longer term, is evident from the fact that it expressed concerns during Project Aircraft to Deloitte about MGRG's credit position and the risk of "*an MGRG insolvency*"[60]. In the context of Project Trinity, Barclays sought comfort as to whether MGRG would be "*in existence to make the relevant surrenders*"[61] [62].

66. It has been argued on behalf of the members of the Phoenix Consortium that it was nonetheless open to MGRG's parent companies to sanction MGRG's involvement with Projects Aircraft and Trinity and that they in fact did so. It has been contended, for example, that "*given that the surrender of the tax losses for no consideration and the transfer of the MGTF tooling were approved by the sole shareholder of MGRG (Techtronic)*[63] *and of Techtronic (PVH) respectively there can be no question of there being any breach of duty by Messrs Beale, Edwards, Stephenson or Towers*". In this context, as in others[64], it is maintained on behalf of the members of the Phoenix Consortium that the principle seen in cases such as *West Mercia Safetywear Ltd v Dodd*[65] (to the effect that the interests of creditors can displace those of shareholders where a company is insolvent, of doubtful solvency or on the verge of insolvency) was inapplicable and, more particularly, that MGRG's debt to Techtronic was irrelevant to an assessment of the former company's solvency on a balance sheet basis[66].

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59 Note that MGRG's 2001 loss was restated in the 2002 financial statements as £179.4 million, to take account of a change in accounting policy in respect of provisions against investments and group debtors.
60 See paragraph 9 above.
61 See paragraph 58 above.
62 Further evidence as to MGRG's financial circumstances when Projects Aircraft and Trinity were being undertaken is to be found in chapter XVI (Financial and trading performance of MGRG) and at XXI/19 to 20, 29, 42 and 47.
63 Techtronic's board did not in fact pass any resolution approving either Project Aircraft (see paragraph 49 above) or Project Trinity. Further, while Techtronic may have been the sole beneficial owner of MGRG's shares, it was not the only registered shareholder (see VII/191 to 193).
64 See e.g. VII/202.
65 [1988] BCLC 250.
66 At the end of each of the years ended 31 December 2001 to 2003, the value of MGRG's assets exceeded its liabilities to creditors other than Techtronic: see XVI/22 to 23, 33 and 40.

67. As mentioned earlier in this report, there is considerable room for argument as to the scope of the principle seen in the *West Mercia* case and whether it is appropriate to disregard MGRG's indebtedness to Techtronic when considering the former company's solvency[67]. In any case, none of the MGRG tax losses required for Projects Aircraft and Trinity was in fact surrendered before late 2004[68]. As noted above[69], tax losses of more than £100 million were surrendered for the purpose of Project Aircraft. These were surrendered on 10 December 2004, by which time MGRG's future was obviously in the balance. The £41 million of tax losses needed for Project Trinity were surrendered only on 8 April 2005, the very day that MGRG went into administration[70].

[67] See VII/202 to 207.
[68] Since Projects Aircraft and Trinity were not, Eversheds' advice notwithstanding, approved by MGRG's board at completion, it is hard to see why MGRG's solvency should be considered only on the dates of completion rather than those on which the tax losses were in fact surrendered. Further, the tax losses having been surrendered within two years before MGRG entered administration, there could be scope for challenging the surrenders as transactions at an undervalue pursuant to section 238 of the Insolvency Act 1986.
[69] See paragraph 35 above.
[70] It is, though, to be noted that there is reference to the surrender of tax losses for no consideration in notes to MGRG's 2002 and 2003 financial statements, which are stated to have been approved by the company's board on respectively 6 October 2003 and 28 October 2004.

CHAPTER XII
PROJECT PATTO

Introduction

1. Hard on the heels of Project Aircraft came Project Patto, another scheme from which the members of the Phoenix Consortium could potentially have derived very substantial benefits.

2. This chapter of the report represents the views of only one of us, Guy Newey. As mentioned below, BDO Stoy Hayward LLP ("BDO"), Gervase MacGregor's firm, had an involvement in the relevant events. For this reason, Gervase MacGregor has not contributed to the chapter.

Basic facts

3. When Techtronic acquired MGRG on 9 May 2000, BMW AG undertook to lend it about £427 million in three tranches by subscribing for loan notes[1]. By the summer of 2002, BMW had advanced the full £427 million[2]. Techtronic, in turn, had lent most of this amount to MGRG[3] .

4. BMW AG lent the £427 million on an interest-free basis. Moreover, Techtronic did not have to make any repayment until 2049 unless (a) it and its subsidiaries made an annual profit or (b) an "*Event of Default*" (including a person or group of persons acquiring control of more than a specified percentage of the total voting rights in respect of either Techtronic or MGRG) occurred[4]. Arguably, therefore, the net present value of the loan notes held by BMW AG was less than their face value. Nonetheless, in proper accordance with accounting standards, the indebtedness to BMW AG fell to be recorded in Techtronic's financial statements at face value. For example, the balance sheet included in Techtronic's financial statements for the year ended 31 December 2001 showed "*amounts falling due after more than one year*" of £351 million, of which £350 million was attributed to the BMW loan notes.

5. MGRG's indebtedness to Techtronic was similarly taken into account in MGRG's financial statements. Thus, MGRG's 2001 financial statements reported "*amounts falling due after*

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[1] See III/90.
[2] BMW advanced £401 million in cash and the balance by way of settlement of certain MGRG debts.
[3] Of the first loan note of £200 million, £192 million was paid to MGRG by Techtronic. The difference of £8 million related to costs associated with the acquisition of MGRG by Techtronic. Of the second loan note of £150 million, £145 million was paid to MGRG. The difference of £5 million is in part accounted for by costs of £3.3 million incurred by Techtronic during the acquisition of Powertrain (including VAT), while the remainder contributed to the £10 million payment made to PVH in September 2001 (as to which, see VII/25.5 and XXI/61.2 and 62). With regard to the third and final loan note of £77 million, Techtronic had already advanced £20 million to MGRG; a further £51.4 million was paid in line with the original agreement, bringing the total paid to MGRG to £71.4 million. It appears that BMW may have set the remaining £6 million off against a debt relating to warranty costs due by MGRG.
[4] See III/90.

more than one year" of £337 million[5] in respect of "*interest bearing loans from group undertakings*".

6. By June 2002, after BMW had subscribed for the final £77 million of loan notes, consideration was being given to the possibility of the four members of the Phoenix Consortium, as the "D" shareholders in PVH, covenanting not to sell their shares in PVH without BMW's consent. It was hoped that such a covenant would reduce the chances of an "*Event of Default*" occurring in relation to the BMW loan notes and, hence, make it possible to show the indebtedness to BMW AG (and perhaps also MGRG's liability to Techtronic) at less than face value on the basis that the loan would probably not be repayable until some time in the future. It was also being proposed that the members of the Phoenix Consortium should be paid for entering into the covenant.

7. Advice on the scheme was sought from tax counsel. The instructions, which were dated 14 June 2002 and prepared by Deloitte, stated:

> "*It is now proposed that PVH, or one of the other companies in the group, will pay a substantial sum (in the region of £13-£15 million to each of the Phoenix Consortium members). The payments would be in consideration for each individual shareholder entering into a covenant not to sell more than a specified percentage of their shares in PVH without the prior consent of BMW.*"

The instructions explained:

> "*The commercial benefits for PVH and its subsidiaries would include greater security of long term funding. It would also be a necessary but not sufficient factor in enabling the group to recognise a P&L credit and disclose a reduced creditor in its accounts in relation to the BMW Loan Notes. By removing certain contingencies attaching to the loan notes, it may be possible to value the liability for accounts purposes based on the net present value of expected payments rather than show the full face value of the loan notes as a creditor. Commercially, it is considered that this would assist the group by increasing its capital and reserves.*"

8. The scheme was discussed in a conference call on 28 June 2002 in which Mr Einollahi, Ms Ruston, Ms Lewis and Ms Ashton (also of Eversheds) participated. An attendance note prepared by Eversheds records that Mr Einollahi said that the objectives were twofold:

> "*1. Aim to present the liability for the BMW loan note in the balance sheet not at £427m which is the current value but at its fair value.*
>
> *2. Minimise tax liability for shareholders on taking money out.*"

5 The third tranche of BMW money had yet to be paid at the end of 2001. Payment was effected in May 2002.

The attendance note reflects discussion as to what value was to be ascribed to the covenant which it was envisaged that the members of the Phoenix Consortium would give. Mr Einollahi is recorded as having said, "*it is a unique asset therefore does not have a market value so needs to be agreed between parties but the parties must be independent*". The attendance note also contains the following:

> "*To counter the argument that the shareholders would not sell it to a purchaser who would then take on the company with £427m to pay. ME* [i.e. Mr Einollahi] *would say that because of over capacity any large manufacturer might buy the shares for say £10m so Longbridge closes and if shareholder/investor sells they have no ongoing interest.*"

9. The idea that another car manufacturer might buy PVH in order to shut down Longbridge features in other documents, too. Ms Lewis referred to the theory as follows in draft instructions to counsel which she prepared in July 2002[6]:

> "*Whilst it might on the face of it seem unlikely that the shareholders would find a purchaser who would buy their shares for any real value knowing that they would risk putting their newly acquired group into insolvency (or with a need to refinance the Loan* [i.e. Techtronic's indebtedness to BMW AG]*) this is not necessarily self evident; it may be possible to argue that, for example, due to the current perceived over capacity in the automotive market a competitor might be prepared to acquire MGRG and then allow it to default on its repayment to BMW thereby taking the capacity out of the market.*"

When, in October 2002, Mr Peter Gallimore, a senior manager in the assurance & advisory department at Deloitte, prepared a draft of a document addressing the accounting implications of Project Patto, he included (albeit in square brackets) the following:

> "*... The Group is not expected to make any significant profits in the foreseeable future.*
>
> *However, we are informed that the right to sell the Group has significant value to the consortia shareholders since they currently have the opportunity to sell the brand to a competitor for significant value who may wish to remove MG Rover as a competitor.*"

10. In evidence to the inquiry, Mr Einollahi suggested that this justification for payment to the "D" shareholders had emanated from Mr Beale. In contrast, Ms Ruston's evidence was that it "*was an idea that* [Mr Einollahi] *came up with*".

6 In the event, counsel was not in fact instructed.

11. BMW was asked to help. In a letter of 24 July 2002, Mr Towers told Dr Grebenc that "*the financial value of the Loan Notes*" was regarded as "*about £3m (based on a discount rate of 11%)*", but that current accounting standards did not permit the loan notes to be shown at their financial value because of the provisions for early repayment in the event of a change of control or of "*MG Rover Group*" making profits. Mr Towers continued:

> "*Therefore, I am requesting your assistance to resolve this accounting problem which poses a significant threat to the ongoing funding of the business. The minimum changes that may allow recognition of the Loan Notes at their financial value are;*
>
> *(i) Removal of the repayment condition due to change of control and its replacement by an undertaking from the four D shareholders who control the ultimate company that they will not dispose of their share nor would they permit disposal of MG Rover Group shares without the prior consent of BMW.*
>
> *(ii) Removal of the repayment condition due to MG Rover Group profitability and its replacement by a requirement placed on the same D shareholders such that in the event of MG Rover Group making a dividend payment (which results in the ultimate parent company also making a dividend payment) then the D shareholders will have to make a payment to BMW. In consideration for such payments BMW would then transfer to the D shareholders title to an equivalent amount of the outstanding loan notes.*"

12. BMW's position was discussed at a meeting on 17 September 2002 attended by, among others, Dr Grebenc, Mr Brooks of Norton Rose, Mr Einollahi and Mr Birkett (also from Deloitte). Dr Grebenc indicated that BMW might be willing to help with the loan notes if the Group would itself provide assistance to BMW in relation to Midland Gears, the gearbox manufacturer which had been hived out of Powertrain and retained by BMW[7] but which continued to supply MGRG and Powertrain. BMW had kept Midland Gears because it manufactured the gearbox for the New Mini. By the autumn of 2002, however, BMW was intending to source the New Mini's gearbox from Getrag Corporate Group ("Getrag") instead of Midland Gears. It was thus faced with the prospect of having to close Midland Gears down. When, therefore, it was approached in connection with the loan notes it held, BMW's stance was essentially that it would be willing to cooperate provided that the Group took over Midland Gears. As was noted at a meeting between Deloitte and directors of PVH on 10 October, BMW was "*doing loan note deal for a price*".

13. Far, however, from wanting to acquire Midland Gears, MGRG and Powertrain had themselves been planning to cease using the company as a supplier. MGRG and Powertrain wished to replace the R65 gearbox provided by Midland Gears and, like BMW, they had

[7] See chapter V footnote 105.

decided that it would be preferable to source gearboxes from Getrag. Mr Oldaker[8] explained the position as follows:

> "*We were being supplied with that gearbox* [i.e. the R65] *for our small cars and were unhappy about ... the transfer pricing of that gearbox to us, and Tony Shine particularly as the purchasing director had spent a significant time with some of my people as well* [as] *some of the Powertrain people looking for an alternative gearbox to the R65 which they found in the Getrag IB5 gearbox which could be procured at a much lower cost than the R65 gearbox.*"

Mr Fraser Welford Winton[9] said that the IB5 gearbox was "*a better gearbox, more modern*".

14. Project Patto was nonetheless pursued. Over time, the structure of the proposed transaction altered. Thus:

    14.1. on 1 August 2002 Mr Einollahi told Mr Hume that the transaction he had in mind was as follows:

    > "[Phoenix] *consortium purchases the loan notes from bmw for a* [consideration] *of say £15m AND an undertaking not to sell their shares to unapproved parties ... bmw loan notes are then repaid by way of a new loan note say for £75m (secured on* [intangible] *assets of pvh ?) PLUS cash of say £10m PLUS transfer of certain surplus property and other assets such as studley castle (at market value)*";

    14.2. by 20 November it was being proposed that a "*Put Option Deed*" should be entered into. The scheme was summarised as follows in a note of a conversation between Deloitte and KPMG (whom BMW had instructed to advise it):

    > "*Under the draft Put Option Deed the ultimate repayment obligation by May 2049 remains with Techtronic. However, during the period to 2049, BMW AG are granted an option to 'put' the repayment obligation to the 'D' Shareholders ... if there is a Deemed Profit Distribution (being lower of 25% of Group Net Profit and £25million ...) ... The effect of the Put Option is to leave Techtronic liable for repayment of the Loan Notes in 2049 but to transfer the early repayment obligation if the Group records a Net Profit ... to the 'D' Shareholders*"; and

    14.3. at a meeting with Eversheds on 25 November, Mr Hume of Deloitte explained what he then had in mind as follows:

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[8] Mr Oldaker was MGRG's product development director (see V/6.5).
[9] Mr Welford Winton was managing director of Powertrain (see XVIII/14).

> "*The structure which DH* [i.e. Mr Hume] *has discussed with Maghsoud envisages that the current facility is ripped up and the existing Loan from BMW to Techtronic is 'waived' … A new loan facility is then entered into by a company other than Techtronic (e.g. PVH or MGRG) without the two offending provisions (i.e. the change of control event of default and the repayment on obligations linked to the making of profits).*"

15. The manner in which the members of the Phoenix Consortium were to benefit from the proposed transaction also varied over time. While in June 2002 it was being suggested that the four members of the Consortium should each be paid £13 million to £15 million (representing a total of between £52 million and £60 million), by October the proposal was that a loan note to the tune of £77 million[10] would be issued in favour of the Consortium's members. Thus, a file note Eversheds prepared following a meeting with Deloitte on 10 October records:

> "*The Company (although we will need to decide which company) will pay the D shareholders for entering into the covenant to enable the applicable accounting treatment to be obtained. It is currently thought that the company will pay the D shareholders £77,000,000 although this 'payment' will be on deferred terms by the issue* [of] *a loan note to them.*"[11]

Shortly afterwards, it was being envisaged that there would be a deed of covenant in favour of the members of the Phoenix Consortium. Notes of internal discussions within Deloitte on 15 October refer to the possibility of PVH entering into a deed of covenant to pay £77 million over five years. On 19 November Ms Ruston told Eversheds that there would probably be a covenant to pay rather than loan notes. On 26 November Eversheds drafted instructions to counsel[12] which explained:

> "*PVH would pay the Shareholders a sum of money in consideration for the beneficial effect of them taking on this personal liability has on the balance sheet of its Group Companies. This payment from PVH to the Shareholders would take the form of a covenant to pay a specified sum over a period of time. It is proposed that the value to PVH and its Group of the Shareholders Covenant and hence the amount of consideration PVH will covenant to pay to the Shareholders is valued by an independent firm of accountants and arrangements have been put in place with such a firm for this to take place.*"

In an email of 2 December, Ms Lewis said that it was her understanding that "*the payments will be made by MG Rover Group*". However, when DLA Piper Rudnick Gray Cary UK ("DLA"), a firm of solicitors which had been instructed to represent the "D" shareholders as

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[10] It may not be coincidental that the third tranche of the BMW loan was also about £77 million (see III/90).

[11] Deloitte notes of the same meeting are to similar effect. They include, "*Company will have £77m loan note issued to shareholders in consideration for covenant to company … terms to be discussed but likely to be over 5 years*". In notes dated 9 October 2002, Deloitte calculated their fees by reference to a "*gross consideration*" of "*£77m*" and assumed that the "*loan note to s/h*" would have a fair value of (say) £70 million.

[12] The instructions were not in the event sent.

individuals, circulated a first draft of a deed of covenant on 12 December, it provided for payment by PVH.

16. Notes made by Mr Birkett at a meeting on 10 October 2002, which was also attended by three members of the Phoenix Consortium (Mr Towers, Mr Beale and Mr Stephenson), as well as Mr Einollahi and, for at any rate some of the time, Mr Howe, include the following:

> "*JT – would like D&T to come up with scheme that makes it look as if D shareholders have put their own money into the business.*
>
> *JT suggestion – check with ME → support business with capital contribution*
>
> *→ no cash moves …*
>
> *JT – … D&T scheme to make it look like directors invested.*"

On the face of it, these notes indicate that Mr Towers was asking Deloitte to devise a scheme which would make it appear that the members of the Phoenix Consortium had injected money of their own into the business. Mr Towers said that he would not have used the words found in the note, but there is no good reason to doubt that he used words to the effect recorded.

17. For a long time, BMW was not told that there was to be provision for the benefit of the members of the Phoenix Consortium. On 19 November 2002 Ms Ruston told Eversheds that the deed of covenant in favour of the members of the Phoenix Consortium was "*Not to be seen by BMW*". On 12 December Ms Ruston wrote to Mr Wolfgang Guellich, who had succeeded Dr Grebenc as vice-president, corporate co-ordination, economics in October, "*to set out for you the current Loan Note structure and the proposal that we would like you to consider*". Under the heading "*Our Proposed Structure*", Ms Ruston explained:

> "*(i)* *BMW will consent to the novation of the Original Loan Notes from Techtronic to* [MGRG]*;*
>
> *(ii)* *MG Rover accepts being substituted as the issuer of the Original Loan Notes in return for Techtronic cancelling all or part of the inter-company loan of £427m owed by MG Rover as a result of the onward loan of the original proceeds from the notes;*
>
> *(iii)* *Once MG Rover has been substituted as the issuer of the Original Loan Notes, BMW would cancel the Original Loan Notes and MG Rover will issue a new loan note ('New Loan Note');*
>
> (iv) *the Phoenix consortium would personally enter into a covenant with BMW not to sell their shares to a single person or group of persons prior to 9 May 2049. The penalty for breach of the covenant would be that BMW*

could exercise a put option to require the Phoenix consortium to purchase the New Loan Notes for £427m [; and]

(v) *the Phoenix consortium would personally grant a put option to BMW which would enable BMW to require them to purchase units of the New Loan Notes equivalent to the lower of £25 million or 25% of the Group's net profit for the preceding year.*"

There was no reference in the letter to any provision for any payment to be made to the members of the Phoenix Consortium.

18. Ms Ruston explained in her evidence that it had not been her decision to withhold from BMW the fact that there was to be provision for the members of the Phoenix Consortium. Her recollection was that it was Mr Einollahi who instructed her not to mention such provision in her 12 December 2002 letter. For his part, Mr Einollahi said that he was not familiar with the idea of keeping something back from BMW and that he "[did] *not recall requesting* [Ms Ruston] *to remove any reference to the payments to the D shareholders from her letter*", but it seems to me that Ms Ruston's recollection is more likely to be accurate, especially since Ms Ruston would probably have wanted instructions from someone in relation to the letter, and Mr Einollahi did not state in categoric terms that he had not said that there should be no mention in the letter of provision for the members of the Phoenix Consortium.

19. There was recognised to be a conflict of interest between, on the one hand, the members of the Phoenix Consortium as "D" shareholders in PVH and, on the other hand, the companies in the Group. On 10 October 2002 Mr Einollahi said that Deloitte would be "*advising D shareholders if any conflict*". By 15 October it appears to have been decided that the members of the Phoenix Consortium should be separately advised, by Mr Jim Lavery of DLA[13]. All four members of the Phoenix Consortium attended a meeting with him on 25 November.

20. By 19 November 2002 it had also been decided that Mr Andrew Caldwell of BDO should be instructed to provide a valuation. On 16 December BDO emailed to Deloitte a draft valuation certificate. This explained the proposals as BDO understood them as follows:

"*As part of a re-organisation of debt within the Phoenix Venture Holdings Group ('Phoenix') you have informed us that it is intended that :-*

(v) *Techtronic will cancel the Loan Notes* [i.e. the loan notes issued to BMW AG].

(vi) *Techtronic will waive the right to £277,369,500 of the loans made to MGRG.*

[13] The members of the Phoenix Consortium, as they were perfectly entitled to do, chose not to waive legal privilege over DLA's papers in this respect.

(vii) Techtronic will not charge any interest on the loan balance of £150,000,000.

(viii) The loan of £150,000,000 is repayable on demand.

(ix) [MGRG/Techtronic][14] *will issue Loan Notes ('New Loan Notes') in the sum of £427,369,500 to BMW upon broadly similar terms to those currently issued by Techtronic, save for the conditions re partial and total redemption referred to in ii) above* [i.e. the conditions providing for repayment in the event of a change of control or of a profit being made].

(x) The holders of D ordinary shares in Phoenix will enter into a covenant not to sell their shares. In the event that the covenant is breached, BMW will be granted a Put Option agreement whereupon, the D shareholders will be personally responsible for the purchase of all New Loan Notes at par value from BMW.

(xi) If a defined profit is made, BMW will have a Put Option to compel the D Shareholders to buy at par, loan notes equivalent to 25% of the defined profit, subject to a maximum of £25m in any one year, from BMW.

You have informed us that these changes, and the benefits accruing to [MGRG/Techtronic][15] *therefrom, have arisen [substantially/solely]*[16] *from the assumption of the amended partial and total redemption provisions referred to in ii) above.*"

The draft certificate continued as follows:

"*In the light of the above, and on the assumption that Phoenix, Techtronic and MGRG continue as going concerns for the foreseeable future, we are of the opinion that :-*

the fair value of the New Loan Notes is £1,000,000

the fair value of the removal of the requirement for Techtronic to redeem certain of the Loan Notes in the event of a defined profit being made is £1,000,000

the fair value of the removal of the obligation to redeem the Loan Notes in the event of a defined change in control is in the order of £40,000,000 to £60,000,000."

21. However, Mr Caldwell's draft valuation was based on the assumption that MGRG would become profitable and that the D shareholders would be able to sell their shares in five

[14] The square brackets and their contents are contained in the original quotation.
[15] The square brackets and their contents are contained in the original quotation.
[16] The square brackets and their contents are contained in the original quotation.

years. Mr Caldwell explained the assumptions that underpinned his draft valuation in an email to Mr Birkett of 8 December 2002:

> "*Logically, a change of control is only likely to take place if there is a gain accruing to the shareholders which will offset the redemption of the Loan notes in their entirety. This appears to mean a sale for more than £427m. At present, there is little evidence that supports this possibility.*
>
> *Let us assume that press speculation is correct in that the intention is to return MG Rover to profit in the next few years and then sell on to another manufacturer, or even float!*".

Mr Caldwell also explained in his email to Mr Birkett that the assumptions would need to be substantiated:

> "*I would suggest that the figure is likely to fall within the £30m - £100m range*[17]*, on the assumption that evidence of forecast performance, and the shareholders intention re realisation is provided, and supports a realisation by 2007.*"

Mr Caldwell said in representations that his recollection was that:

> "*... the financial information requested was to become available in January* [2003] *when management accounts and the budgeting process had been completed.*"

22. Mr Gallimore made a number of observations on the draft certificate in a memorandum which he circulated to others within Deloitte during 17 December 2002. Mr Gallimore's comments included these:

    22.1. the draft certificate did not state whether "*fair value*" referred to "*the fair value of the cost to the consortia shareholders of taking on the liabilities or the fair value of the benefit to the Group of removing these liabilities*";

    22.2. the passage in the draft certificate which referred to the benefits accruing to MGRG/Techtronic appeared "*to suggest that the valuation is calculated on a benefits basis to MGRG/Techtronic*";

    22.3. the benefit to MGRG from the waiving of part or the entire loan due to Techtronic "*does **NOT** in any way depend on the assumption of the provisions*";

    22.4. the payment to BMW "*as a minimum should be deducted from the valuation if this is a benefits driven value*";

[17] Mr Caldwell told me that the "*£30m - £100m range*" referred to in his email was narrowed to £40 million to £60 million in the draft valuation letter.

22.5. with regard to the change of control clause, "*it is clearly of significance that from 9 May 2003, the consortia directors can effectively pass control of the Group to a third party without the covenant being breached*"[18];

22.6. with regard to the assumption that PVH, Techtronic and MGRG continue as going concerns for the foreseeable future, "*We would be unable to draw such a conclusion at this stage*"; and

22.7. BDO were proceeding on the basis that the Group would only be liable for repayment of the loan notes in 2049, but insolvency and default-related acceleration provisions would remain[19].

In the event, the financial information requested was never provided to Mr Caldwell and the valuation certificate was never finalised.

23. Project Patto was considered at a meeting of MGRG's board on 13 December 2002. In advance of the meeting, a paper on the topic was circulated. This stated as follows as regards the consideration which the members of the Phoenix Consortium were to receive:

> "*In consideration for the Phoenix consortium covenanting not to sell their shares and for granting the put option MG Rover will covenant to pay the Phoenix consortium an amount which will not exceed the minimum amount as determined by an independent valuer. The Phoenix consortium will undertake by way of a side letter to the Company that any payments made pursuant to this covenant will come out of new funds generated through tax loss deals, the Powertrain escrow account or the Polish venture.*"[20]

The minutes of the board meeting record that Mr Towers explained as follows as the meeting's chairman:

> "*The Chairman commenced this discussion by confirming that it was not the intention of the individual 'D' shareholders to receive significant payments in respect of them adopting obligations which were otherwise obligations of the Company but that the transferring to them as individuals would result in the loan note being re-classified and treated differently for accounting purposes under FRS4. Mr Towers advised the Board that if, however, there were opportunities whereby the 'D' shareholders would otherwise receive bonuses due to them either in the normal course of business or as a result of extraordinary actions taken by them then it could be appropriate to process the payments through the mechanism set-up under the loan note arrangement given its tax efficient nature.*"

[18] See paragraph 32 below.
[19] See paragraph 4 above.
[20] In relation to these sources of "*new funds*", see V/90 to 101, chapter XI (Aircraft) and chapter XXI (Financial rewards).

Some directors, however, expressed concerns about the proposed arrangements as regards Midland Gears. The minutes state as follows:

> "*Mr Shine*[21] *identified for the Board that there was an arrangement in place with Getrag for the supply of gearboxes to the Company to replace the R65 gearbox from the second quarter of 2003. The price at which this gearbox could be acquired was significantly cheaper than the R65 gearbox and the Board noted that it was a better quality and more modern gearbox. The Board recognised that in abandoning the future supply of gearboxes from Getrag and entering into the loan note arrangement the Company would be obligated to continue with the long-term supply contract with Midland Gears under which it would purchase the R65 gearbox and in due course be required to acquire the Midlands Gear business. Mr Shine then presented an analysis of what he thought the costs would be of not proceeding with Getrag. He estimated that it would be in the order of £22 million by 2004 …*
>
> *The Board then considered in some considerable detail whether or not this was an amount that they were prepared to sacrifice in order to have the benefit of the reclassification of the loan and the effect that that would have on the Company's balance sheet. Mr Millett was of the view that it was too high a number and that the value that he placed on the change to the accounting treatment was more in the order of £10 million. Mr Sanders*[22] *was in broad agreement with Mr Millett. Further discussions ensued and it was resolved that in order to make final decision* [it] *was necessary to have more clarity on the numbers that Mr Shine had proposed and Mr Shine was requested to travel to see Getrag early the following week in order to discuss and confirm the veracity of those numbers. The Board would then reconvene on Wednesday of the following week in order to make a final decision.*"

24. The board meeting was not attended by Mr Beale or Mr Stephenson, both of whom appear to have been in Poland at the time. Mr Beale said in evidence that, had he been present, he might not have agreed with the comments Mr Towers is recorded as having made.

25. Work on Project Patto continued, and on Tuesday 17 December representatives of BMW, Norton Rose, Eversheds and Deloitte met at Norton Rose to finalise the transaction. At 7.23 pm, DLA sent Ms Ruston, Deloitte and Eversheds "*a revised draft of the deed of covenant to pay by Phoenix Venture Holdings Limited*" under which PVH was to covenant to "*pay or discharge on demand an aggregate sum of up to £15 million*", subject to the money out of which payment was to be made being "*deemed to be exceptional items*" by either PVH's board or its auditors. A few minutes later, Ms Ruston told Mr Lavery in an email that the "*revised position on the structure*" meant that "*the covenant to pay will now be between each of the shareholders and* [MGRG]".

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[21] Mr Shine was MGRG's supply chain director (see V/6.7).
[22] Mr Sanders had succeeded Mr Parkinson as MGRG's sales and marketing director in April 2002 (see XVII/5 to 7).

26. By this stage, however, BMW had learned that there was to be provision for payment to the members of the Phoenix Consortium. BMW's reaction, in the early evening of 17 December 2002, is reflected in notes made by Eversheds:

> "- *the two £50k*[23] *loan notes to shareholders is not acceptable.*
>
> - *as far as BMW are concerned any payment is a no:no* [and] *if this is happening the deal is off the table – want warranty in loan note* [document] *that* [shareholders] *have not been paid anything for doing this.*"

Mr Einollahi said, "*BMW's position on it was pretty strong, that you are not getting paid*".

27. Shortly before midnight, Eversheds informed Norton Rose, "*We will agree that* [shareholders] *are not paid for entering into the Put Option Deed*". The following morning, however, Project Patto was aborted. Mr Towers said that he was sure that the board had reconvened[24]. Ms Lewis said:

> "*... when the project was abandoned, we were in London and Jane Ruston and I were told on a telephone call by, I think, John Towers that the board had decided that the Getrag gearbox deal was the right way to go.*"

It seems that Mr Beale and Mr Stephenson might have taken a different view had they been present. Mr Einollahi said, "*Nick Stephenson and Peter Beale ... did utter words of whatever happened on the day John* [Towers] *concluded not to proceed – had they been in the board meeting there would have been a different outcome*". Similarly, Mr Beale said, "*we spoke to John Towers the day before or the morning, Nick Stephenson and myself, by phone, and I think our view was slightly different to this*".

<u>The basis of the proposed provision for the "D" shareholders</u>

28. Until BMW objected, it had always been intended that there should be provision for the members of the Phoenix Consortium, as the "D" shareholders in PVH, to receive substantial benefits in return for their participation in Project Patto. As already mentioned, at one stage or another it was proposed that the Consortium's members should be given "*in the region of £13-£15 million*" each[25], loan notes totalling £77 million[26], the benefit of a covenant to pay them the same sum[27], and up to £15 million[28].

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[23] It is not clear if and when it came to be proposed that "*two £50k loan notes*" should be issued.

[24] No minutes of such a meeting appear to have been produced, but that may have been because Ms Ruston was in London and so not present at the meeting.

[25] See paragraph 7 above.

[26] See paragraph 15 above.

[27] See paragraph 15 above.

[28] See paragraph 25 above.

29. Ms Lewis and Ms Ruston both had concerns about the size of the proposed benefits. Ms Lewis commented that the "*amount of money that* [Mr Einollahi] *was talking about in terms of value placing on this restrictive covenant was enormous*" and that both she and Ms Ruston "*struggled to see how you could get to a stage where that kind of number would be justifiable*". Ms Ruston said that both she and Ms Lewis "*thought that £77 million was a lot of money*".

30. In fact, neither the detriment which the members of the Phoenix Consortium were to incur nor the benefits which they were likely to confer on the Group would seem to have warranted very substantial recompense for them. It was certainly hoped that Project Patto would allow Techtronic's, and possibly MGRG's, financial statements to be presented in a more favourable way. That in turn might have improved one or both companies' standing with credit rating agencies and financial institutions. Mr Millett said that "*having to show negative equity on the bottom of the balance sheet was obviously a disadvantage*" and that "*we all probably believed … it would have helped us secure better terms to go out and talk to financial institutions about potential borrowings or facilities if we did not have that appearing in the report and accounting sheet.*"

31. On the other hand, Project Patto would not have relieved Techtronic (or MGRG) of liability to repay eventually. Nor would the obligations which the members of the Phoenix Consortium were to undertake have prevented liability to repay being triggered by either an insolvency event or a breach of an undertaking[29].

32. Project Patto was intended to relieve Techtronic of its liability to make repayments in the event of a change in control or of a profit being achieved. However, there was no likelihood of a repayment obligation arising in this way in the near future, if ever. It is to be noted that, under the terms of the loan note facility[30], from May 2003 onwards there could be a transfer of a majority of the shares, and thus of control, without any obligation to repay being triggered even if BMW's consent was not obtained. Up to 8 May 2003, BMW AG could demand payment if a person or group of persons acquired control of 50 per cent or more of the voting rights in respect of Techtronic or MGRG. However, the relevant proportion of the voting rights rose to 60 per cent from 9 May 2003 and 70 per cent a year later[31].

33. As mentioned above, it was suggested that another car manufacturer might buy PVH with a view to shutting Longbridge down and, hence, reducing overcapacity[32]. However, such a scenario was not, as it seems to me, a realistic one. In his evidence, Mr Einollahi said that this was the "*strongest available rationale*" for the "D" shareholders receiving benefits, but accepted that the scenario was "*pretty far-fetched*" and that it was "*not an obvious possibility that is going to happen*". Mr Millett said that he "*would not have thought that that was a likely event*" and explained, "*If you were to ask a competitor to acquire a business so that he could put it out of business and then take a share of whatever market share it was that MG Rover Group had, they could never be certain that they would take a*

[29] See paragraph 4 above.
[30] See III/90.
[31] See III/90.
[32] See paragraphs 8 and 9 above.

significant share of that in the first place". Others were equally sceptical. Mr Towers said, "*What it seems to be suggesting here is a link to overcapacity in the industry, and someone deciding it would be worth a couple of hundred million pounds to take capacity out, which is a pretty extreme view, is it not*". He accepted that it could not really be supposed that the "D" shareholders would sell their shares successfully in circumstances where that would trigger repayment of the BMW loan note. Mr Stephenson said that he was "*pretty doubtful*" whether it would have been a real possibility. Mr Beale and Mr Howe gave evidence to similar effect.

34. Further, whatever advantages Project Patto might have brought to the Group in terms of its perceived credit worthiness, they would have been offset by the disadvantages of taking on Midland Gears. Mr Howe said, "*we were not too enamoured with the prospect of taking on Midland Gears, primarily from a core point of view, a vehicle point of view, in as much as we had already made great progress in negotiating with Getrag*".

35. Representations made to the inquiry on behalf of Deloitte and the members of the Phoenix Consortium have stressed that the "*fair value of the removal of the obligation to redeem the Loan Notes in the event of a defined change of control*" was put at "*in the order of £40 million to £60 million*" in the draft BDO valuation certificate. However, the draft certificate was just that: a draft. It depended on assumptions in respect of which Mr Caldwell was awaiting evidence[33] and, in the event, was never finalised.

<u>Knowledge and approval of the proposed benefits</u>

36. Mr Towers said that he reacted "*negatively*" to the proposal that the "D" shareholders should receive value and that "*the concept itself was very quickly kicked into touch*". He also said that he was "*entirely clear that everyone was clear that there was not going to be a fundamental payment, additional payment, to ... the D shareholders as a result of this transaction*". He explained that he had been "*aware of a proposal that would have involved extra money and said 'no' to it, as did the other three*" and that the four had also rejected a proposal under which they would have been paid millions of pounds for giving a covenant.

37. When he gave evidence, Mr Edwards thought that he had become aware only recently that there had been proposals under which the members of the Phoenix Consortium would be paid money or given loan notes in exchange for entering into arrangements in connection with their shares. He also said that he would have objected to a proposal under which the members of the Phoenix Consortium gained £77 million of loan notes, or other personal benefit, as a pre-condition to changing some character in the loan notes.

38. When Mr Stephenson was asked whether he remembered any proposal that the members of the Phoenix Consortium should be paid or given anything in return for doing something that would allow the BMW indebtedness to be presented at a lower figure, he said, "*I don't particularly, ... but it absolutely doesn't mean to say that it was not presented to me at some time*". Likewise, Mr Stephenson said that he had "*no recall*" of a proposal that loan notes to

[33] See paragraph 21 above.

the tune of £77 million should be issued or of Mr Lavery being instructed to act on behalf of the members of the Phoenix Consortium.

39. Whatever, however, they may remember now, the likelihood must be that all four members of the Phoenix Consortium knew at the time of, and endorsed, proposals for them to receive substantial benefits. The reasons for arriving at this conclusion include the following:

39.1. as Ms Ruston pointed out, "*they all sat together in the same room … at Longbridge and they would discuss these things with each other*". It would be particularly surprising if the four members of the Phoenix Consortium had not talked between themselves about proposals under which they could have become entitled to such large sums[34];

39.2. Ms Ruston said that both Mr Beale and Mr Towers had been involved in giving her instructions and discussing the transaction with her. She also remembered Mr Stephenson being involved in the transaction;

39.3. Mr Beale said in evidence that he thought that Mr Towers "*was very much involved with all this*";

39.4. Mr Stephenson's evidence was that he had "*no recall*", or no particular recollection, of the proposed benefits. He did not go so far as to deny knowledge and approval of them;

39.5. Mr Towers, Mr Beale and Mr Stephenson all attended the meeting on 10 October 2002 with Deloitte referred to above[35]; and

39.6. all the members of the Consortium (including, notably, Mr Edwards) attended a meeting with Mr Lavery on 25 November 2002 to discuss what was proposed[36].

Concluding comments

40. Project Patto provides another example of the members of the Phoenix Consortium seeking to derive financial benefits for themselves from the Group. It appears, moreover, that the members of the Phoenix Consortium endorsed proposals under which they would have stood to receive extremely large sums out of all proportion to either the detriment which they would be incurring or the advantages which the Group would be securing. In the latter stages of the project, the scale of the proposed benefits was reduced, but the members of the Phoenix Consortium only agreed to forgo all such benefits because BMW had learned that they were intended to benefit and objected to them doing so.

[34] Mr Edwards did not move offices to the sales and marketing building until February 2003.
[35] See paragraphs 12 and 16 above.
[36] See paragraph 19 above.

CHAPTER XIII

XPART: THE TRANSFER, MANAGEMENT AND SALE OF THE PARTS BUSINESS

Introduction

1. The Rover parts business was to have been excluded from BMW's proposed sale of MGRG to Alchemy. As the parts business belonged to MGRG, to facilitate the sale a hive-out agreement was entered into, on 28 April 2000, to transfer the business into a separate company that became Xpart. However, the agreement that was eventually completed on 9 May 2000 with Techtronic included the parts business and therefore Xpart[1].

2. In practice, the establishment of Xpart did not really change the operation of the parts business. The purchase and supply of parts was contracted out to third parties, initially Unipart Group Limited ("Unipart") and then from March 2002, CAT[2]. Whereas prior to the termination of the Unipart contract all the profit of the business had accrued to MGRG, following the appointment of CAT, the profits were shared between MGRG and Xpart. The proportions in which these profits were shared were subject to the transfer pricing arrangement between MGRG and Xpart which was set by the directors of the two companies.

3. While Xpart was a subsidiary of MGRG, the sharing of profits between MGRG and Xpart was of little consequence. However, the proposal to sell and the eventual sale of Xpart to PVH gave rise to a number of questions relating to the propriety of transferring value from MGRG, especially in the light of its deteriorating solvency, to PVH. These concerns were raised again as a consequence of the sale of Xpart's business to CAT in August 2004 which generated a £32 million profit in Xpart.

4. This chapter considers: the background in greater detail[3]; the transfer of Xpart from MGRG to PVH in December 2002[4]; the management of Xpart[5]; and the sale of Xpart's business to CAT in August 2004[6].

Background

5. As explained earlier in this report:

    5.1. the planned sale of MGRG to Alchemy was not intended to extend to the Rover parts business[7]. Provision was therefore made for that business to be transferred to Xpart[8]

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[1] The share capital of Xpart was acquired by MGRG on 9 May 2000. Xpart was therefore a subsidiary of MGRG when it was acquired by Techtronic, also on 9 May.
[2] I.e. Caterpillar Logistics Services (UK) Limited.
[3] See paragraphs 5 to 12 below.
[4] See paragraphs 13 to 28 below.
[5] See paragraphs 29 to 32 below.
[6] See paragraphs 33 to 70 below.
[7] See III/57.
[8] Xpart's name was changed from BMW Parts Limited to Rover Parts Limited on 21 June 2000 and then to MG Rover Parts Limited on 23 May 2001. It became Xpart Limited on 7 August 2002 (see VIII/15.12).

(then BMW Parts Limited, a previously dormant subsidiary of BMW (UK)), pursuant to an agreement dated 28 April 2000 at a price of £80 million[9];

5.2. in the event, of course, MGRG was acquired by Techtronic rather than Alchemy[10]. Unlike Alchemy, the Phoenix Consortium were keen that the transaction should include the Rover parts business[11]. It was therefore agreed that Xpart should be transferred to MGRG, with the value of the parts business being deducted from the third instalment of the loan which BMW was to make to Techtronic[12]. A value of £60 million was attributed to Xpart in this context[13]; and

5.3. shortly after Techtronic's acquisition of MGRG had been concluded in May 2000, it was being suggested that Xpart should be transferred from MGRG to Techtronic's new holding company (in the event, PVH)[14].

6. At the time Techtronic acquired MGRG, the parts business was operated under a long term contract by Unipart; under these arrangements, Unipart would pay MGRG the gross margin achieved on sales of parts, and MGRG would pay Unipart fees. In early 2001, however, it was agreed that CAT should take over operation of the parts service when the Unipart agreement expired at the end of February 2002[15].

7. In August 2001 Mr Jarvie[16] sent Mr Beale and Mr Millett a memorandum in which he considered how the parts business should be conducted in the future. He outlined the background as follows:

> "*It had been assumed that parts would be traded through* [MGRG]. *This has the advantage that profits from the parts business, estimated at c.£40m p.a., can be sheltered by* [MGRG's] *carried forward tax losses.*
>
> *Separate management accounts would be prepared for the parts business ... from information generated by CAT. This would then be consolidated as part of the* [MGRG] *accounts.*
>
> *Peter* [i.e. Mr Beale] *has indicated that he would prefer parts to be traded through* [Xpart]. *This presents the challenge of how to do this in a way that allows continued use of* [MGRG's] *historic tax losses, once* [MGRG] *moves into profit.*"

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[9] See III/57. The Rover parts business was also referred to as having a value of £80 million in some notes dating from 5 and 6 May 2000 (see III/57).
[10] See chapter III (The sale of Rover).
[11] See III/35.4 and 57.
[12] See III/57.
[13] See chapter III footnotes 29 and 39.
[14] See VIII/1 to 2.
[15] CAT already managed European warehouses on behalf of the Group.
[16] Mr Jarvie was head of finance in MGRG's sales and marketing division.

Mr Jarvie proceeded to consider a number of possible approaches. The one which it was decided should be adopted was as follows:

> "*Insert* [MGRG] *into the trading process.* [MGRG] *would buy in the parts and sell them on to* [Xpart] *at a premium ...*
>
> *The statutory accounts of* [Xpart] *would reflect the higher purchase price, including the price premium, but management accounts would add the premium back into the* [Xpart] *gross margin.*"

8. A written contract between CAT and Xpart was concluded on 23 November 2001. This recited that Xpart's business was "*the distribution of components, replacement parts and accessories for MG Rover branded and other cars, used in the maintenance, servicing, damage repair and enhancement of such cars together with branded merchandise intended for sale to owners of such cars*" and that Xpart had decided to appoint CAT to provide a supply chain management and distribution service in relation to parts. CAT was to be remunerated by the payment of fees in accordance with the contract.

9. CAT took over responsibility for the parts service from March 2002. The change was referred to in the following terms in the group chief executive's statement included with PVH's 2001 financial statements (which were approved on 10 July 2002):

> "*March 2002 saw the transfer of overall responsibility for our worldwide parts distribution operation to Caterpillar Logistics. This business has an overall turnover in excess of £200m. Parts operations are a significant profit generator for all vehicle manufacturers and it was a key strategic aim to gain full control of our parts business. This new arrangement with Caterpillar enables us to realise a greater share of these profits.*"

10. Notwithstanding the transfer of the parts business to Xpart in 2000, MGRG (as opposed to Xpart, its subsidiary) continued to treat payments by Unipart as its income. Once, however, CAT had replaced Unipart, Xpart was regarded as carrying on the parts business. A March 2004 "*information memorandum*" prepared by Deloitte accordingly stated:

> "*Opening stock of £30,646,000 was transferred into the business on 1 March 2002 at which date trading through XPart Ltd commenced.*"[17]

The operation of the parts business was summarised as follows in the same memorandum:

> "*The purchasing, warehousing, sales administration and distribution functions of the business are outsourced to CAT under a long term agreement. CAT personnel place purchase orders directly with suppliers, however the parts and accessories are*

[17] In contrast, Xpart's 2000 financial statements were framed on the basis that the company had purchased the parts stock from MGRG during that year.

actually sold to and paid for by MGRG. These parts and accessories are then sold to XPart under an intercompany trading arrangement. The parts are delivered directly to and stored at the CAT warehouse."

11. As mentioned in this passage, Xpart would buy parts from MGRG. Although MGRG would apply a mark-up (26 per cent until March 2003, then rising to 30 per cent), Xpart's financial statements show it to have made a profit in both 2002 and 2003. The 2002 financial statements record a profit for the year ended 31 December 2002 of £2,444,000 and net assets of the same amount. The 2003 financial statements disclose a profit for the year of £2,112,000 and net assets of £4,556,000.

12. The intention was to develop the parts business. Mr Parkinson, who became Xpart's managing director on 25 April 2002[18], told us that his "*emphasis was all on building up Xpart into a big parts opportunity*". Likewise, the group chief executive's statement included with PVH's 2002 financial statements refers to Xpart having "*a clear remit to develop a broader portfolio of third party customers*" and "*developing a third party business capability*".

The transfer of Xpart to PVH

Events leading to the transfer

13. By 2002 Mr Beale was pressing for the long-contemplated transfer of Xpart to PVH to be carried out[19]. He had had the sense, he told us, of "*wading through treacle*" and that he was "*being given excuses for it not happening rather than good commercial reasons*". Mr Millett thought that Mr Howe came "*under pressure to effect this reorganisation*".

14. The transfer was delayed in part by a debate about the price at which it should take place. On 19 March 2002 Ms Scott (of the PVH legal department) sought advice from Eversheds on whether it was appropriate to effect the transfer at a nominal figure. Ms Lewis referred the question to Ms Louise Pheasant, a partner at Eversheds specialising in insolvency and corporate recovery work, explaining in an email:

> "*The Parts business was originally held within* [MGRG] *itself and before the original Phoenix transaction was hived out of* [MGRG] *into a separate corporate entity. At that time BMW placed a value of £60 million*[20] *on* [the] *Parts business. Internally within MG Rover at the moment views are varied as to Parts' value ranging from quite a high number to a nominal figure.*
>
> *The plan is that once Parts has been transferred into the ownership of* [PVH] *it will buy parts from suppliers and will sell them on to* [MGRG] *at cost.* [MGRG] *will sell those parts to dealership etc. at a margin so that all profit is made in* [MGRG]. *One*

[18] See V/6.6.
[19] See further chapter XV (Reasons for Group structure).
[20] See in this connection III/57 and 58.

of the reasons for that is that [MGRG] *still has substantial tax losses which it will be able to use to shelter any taxable profits; those losses would not be able to shelter any taxable profits in Parts.*

The arrangement between Parts and [MGRG] *is not to be committed to paper. The argument runs that whilst* [MGRG] *exists Parts has no value as it has a sole customer to whom it sells at cost (and therefore makes no profit).*

The concern is what would the position be (both in the context of the proposed reorganisation and for the directors) if [MGRG] *were subsequently to become insolvent. Once the relationship with* [MGRG] *had been severed Parts would have customers (in the form of the MG Rover dealerships) and could therefore sell parts to them direct and at a profit.*"

It is notable that, in her explanation, Ms Lewis anticipates a reversal in the relationship between MGRG and Xpart. She has Xpart, "*Parts*", buying from suppliers and selling to MGRG, the reverse of the relationship described in paragraph 11 above. This variation is, however, less significant than the fact that, irrespective of which company buys from the supplier, setting the transfer price determines the respective levels of profit made from the parts business by Xpart and MGRG. Ms Lewis proceeded to ask that Ms Pheasant or one of her team consider the issue.

15. Ms Pheasant evidently referred the question on to Mr Brian Rawlings, a senior associate in Eversheds' insolvency and corporate recovery department. On 20 March 2000 Mr Rawlings spoke to Mr Cowburn, following which Mr Cowburn reported as follows in an email to Ms Scott:

"*In summary, Brian believes it would be better to transfer the shares of Parts as a dormant co, although my understanding is that we have already put trade through the co. Ideally we should do a Board Minute explaining the future trading relationship between MGR and MG Parts including the key issue that all profit continues to accrue into MGR which forms the cornerstone of the MGR Directors view that the share transfer value is nominal. It is really a question of how comfortable tax would be in formally documenting the trading arrangement. In essence the Directors of MGR could take the view that the nominal valuation is reasonable on the basis that at the time of transfer it is the intention that future profit will effectively remain in MGR after share transfer.*"

16. By July 2002, however, it was being anticipated that Xpart would be allowed to retain some of the profit from the parts business after its proposed transfer to PVH. On 22 July, therefore, Ms Scott sent an email to Mr Rawlings in the following terms:

"*The debate has been over what the value of* [Xpart] *is. When you last advised it was that the nominal value of the shares was the appropriate transfer value because it was not intended that the company would make a profit (this being managed by*

> *virtue of the transfer price at which parts would be sold by the company to* [MGRG] *for onward sale).*
>
> *This is no longer the case. It is now anticipated that* [Xpart] *will indeed make a profit.*
>
> *Therefore is it still appropriate to transfer the company at the nominal value?*"

Mr Rawlings' response was that the fact that Xpart would make a profit did change the position. He told Ms Scott in an email of 24 July:

> "*The simple answer is yes it does make a difference because* [Xpart] *might reasonably be assumed now to have a value and no value is being paid. On that basis the transaction could be set aside if the transferring party goes into liquidation within 2 years*[21]*. Would it matter if it was set aside in these circumstances?*
>
> *The other point is that the directors of the transferring party should not authorise the transfer unless there is some genuine commercial reason justifying it from the transferor*[']*s point of view.*"

17. Ms Scott forwarded Mr Rawlings' email to Mr Cowburn, who replied as follows:

> "*My view is that the commercial reasons are two fold:*
>
> *Firstly the independent management of the Parts business should be of benefit to the Car company in terms of efficiency and service, should it not.*
>
> *Secondly the Car company's ultimate parent company who provides continuing financial support to the car company requires this reorganisation to take place as a condition for continuing support.*"

Ms Scott, however, was not persuaded by Mr Cowburn's reasoning. She said in an email to him dated 30 July:

> "*On your first point, possibly we would be able to argue that the independent management of the parts business should benefit the car business but it already is independent where it sits now …*

[21] Mr Rawlings was presumably referring to section 238 of the Insolvency Act 1986 regarding transfers at an undervalue. Where a company has, within two years of the onset of insolvency, entered into a transaction with any person at an undervalue, the office-holder may apply to the court for an order that restores the position to what it would have been if the company had not entered into that transaction.

> *On your second point, I don't think that it is necessarily true to say that the parent company requires the transfer as a condition of receiving continuing support. Under the BMW loan note, Techtronic is required to pass down the money which it receives from BMW to* [MGRG] *to use for its trading businesses, including parts. This is not conditional in any way. Is there any other funding which is made available to* [Xpart] *other than the loan note money?*
>
> *And also, even if it were a condition for continuing support, the condition could only be that the transfer was made, not that it be made at nominal value?*
>
> *I am struggling to see how we can justify the nominal value. Why can't we do it at full value and then leave outstanding on loan account, as we did with the properties.*"[22]

18. Mr Cowburn replied on the same day as follows:

> "*Properties were moved at their value in* [MGRG's] *books and I think that we should do the same with* [Xpart] *which is in* [MGRG's] *books at nominal value.*"

Ms Scott, though, decided that she should refer the point to Mr Howe. On 19 August 2002 she sent a memorandum to Mr Howe in which she outlined the background in the following terms:

> "*As you know,* [Xpart] *... has yet to be transferred from* [MGRG] *to* [PVH]. *The reason for the delay is that I have been trying to get an answer as to what the transfer value should be for quite some time, but the issue is not straightforward.*
>
> *The preferred option for* [PVH] *is that the company is transferred at its nominal value such that there will not be any indebtedness outstanding and owing by* [PVH] *to* [MGRG]. *At first this seemed to be possible as it was envisaged that* [Xpart] *would not realise any profits, due to the transfer pricing issue. It would therefore have been reasonable to attribute a nominal value to the shares in* [Xpart]. *However, I understand that the X Part business plan now indicates that profits will arise in the company. This makes a transfer at nominal value more problematic.*"

Ms Scott then explained that there were "*issues for* [MGRG] *and for the directors of* [MGRG]*, particularly those who are also directors of* [PVH]", and also for the directors of PVH[23]. After describing these issues, she concluded:

> "*In the event that it is considered inappropriate to transfer the shares in X Part at nominal value, it will be necessary to have the shares valued independently, and*

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[22] For further details of the property transfers referred to here, see chapter IX (Property and share transfers).

[23] Briefly, the issues identified were that the transaction could potentially be set aside as a transaction at an undervalue and also that, in transferring an asset at undervalue, the directors could be in breach of their fiduciary duties.

transfer at that value. The transfer consideration will then be left outstanding on loan account between [PVH] *and* [MGRG].

Please could you consider these issues and let me know if you have any questions."

19. Mr Howe's answer came in a memorandum dated 13 November 2002[24]. He said:

"*It's some time since we discussed the transfer out of XPART at its nominal value.*

Originally, as was well articulated in your memo, there were concerns over the company valuation versus the company's profitability …

I am now assured by Peter Beale that any such concerns have been overcome and that you are able to carry out the transfer.

Please undertake the necessary, or contact me if you require any further clarification."

<u>The transfer</u>

20. In accordance with this memorandum, Xpart was subsequently transferred to PVH for £2. Minutes signed by Mr Towers record that the transfer was approved by the boards of MGRG and PVH on 20 December 2002. According to the minutes, each meeting was attended by every member of the relevant board. However, certain of MGRG's directors do not in fact appear to have been present at, or invited to, the MGRG board meeting[25]. Mr Beddow told us that he "*certainly* [did not] *recall*" the meeting and that he could not remember being consulted on whether the transfer should be for £2. Mr Bowen gave evidence to similar effect. Mr Sanders had no recollection of either the meeting or its subject matter. Mr Shine said that he did not recall being at the meeting, that he had no recollection of approving the £2 consideration and that he thought he would have remembered had he done so.

<u>The value of Xpart</u>

21. We can well understand that, when it was transferred to PVH, Xpart was worth considerably less than the values of £80 million and £60 million attributed to the parts business in 2000. In the first place, the plan was for Xpart to continue to purchase parts through MGRG at a large mark-up[26]. Secondly, Xpart had a very substantial liability to MGRG as a result of buying stock from the latter company[27]. Thirdly, MGRG retained tooling, trade mark and

[24] The memorandum was copied to Mr Millett, Mr Parkinson and Ms Ruston.
[25] This was by no means the only occasion on which directors of Group companies were not included in board meetings. We comment further on this in chapter XXII (Aspects of corporate governance).
[26] See paragraph 36 below.
[27] Xpart's filed financial statements show it to have owed about £57 million to group undertakings on 31 December 2002.

other intellectual property rights which were important to the carrying on of the parts business[28].

22. On the other hand, we also think it plain that Xpart was worth far more than the £2 for which it was transferred. We do not see how Xpart could have had the nominal value which was ascribed to it unless (a) it had had no net assets and (b) MGRG had been able to insist on receiving all the profits from the parts sales for ever. In reality, however:

22.1. Xpart's 2002 financial statements show it to have had net assets of more than £2.4 million as at 31 December 2002 (i.e. the end of the month in which the transfer was effected). It is fair to say that the financial statements were not filed until October 2003 and are unlikely to have been available even in draft until well into 2003. However, it should have been possible to ascertain in December 2002 that Xpart had been trading profitably and so would have net assets worth substantially more than £2;

22.2. Xpart could be expected to continue to earn profits, even if on a relatively small scale, despite the arrangement for it to buy parts from MGRG at a mark-up. Mr Millett, for example, told us at one point that he "*would expect Xpart to make a very small profit*", explaining that £2 million[29] "*was at the high end of* [his] *expectations*". In similar vein, he said that "*the absolute bulk of the profit streams would remain in MG Rover Group*", implying that some profit would accrue to Xpart. Likewise, Mr Stephenson said that "*the intention was that* [Xpart] *would make very little profit*", and minutes of an Xpart board meeting on 14 April 2005[30] refer to Xpart having been transferred to PVH on the basis that it would remit the "*bulk*" of its profits back to MGRG;

22.3. it was suggested to us that Xpart was as likely to make losses as profits. For example, it was argued in representations made to us on behalf of the members of the Phoenix Consortium that the £2 million profit made by Xpart in 2002 "*could just as easily have been a loss*". In our view, however, there was no likelihood of Xpart making a loss. It seems to us that, had Xpart been thought to be in danger of incurring losses, the mark-up at which it bought parts from MGRG would have been reduced;

22.4. there was no guarantee that the arrangement under which Xpart bought parts from MGRG would continue. Xpart did not enter into any written contract with MGRG, and we doubt whether Xpart was under any obligation to continue to buy parts from MGRG. At all events, we do not think that there is any question of Xpart having been bound to purchase parts exclusively from MGRG in perpetuity, let alone to do so at a mark-up which would leave it with no profit. Any valuation of Xpart should thus have taken into account the possibility of the company obtaining the benefit or,

[28] Note in this connection paragraphs 38.3, 41, 46 and 47 below.
[29] Xpart's 2002 and 2003 financial statements show a profit of £2.4 million and £2.1 million respectively.
[30] Xpart did not go into administration.

at least, some of the benefit of the profit stream, estimated to be worth upwards of £30 million a year, attributable to the parts business; and

22.5. the point made in the previous sub-paragraph is borne out by representations made to us on behalf of the members of the Phoenix Consortium. Those representations state as follows:

> "*Had the pricing arrangements been embodied in a contract or otherwise documented, these arrangements would still have been brought to an end in August 2004 to facilitate the sale to Caterpillar. There is simply no basis to suggest ... that XPart would have been unable to terminate these arrangements on notice.*"

If even a written contract would not have precluded Xpart from terminating its purchasing arrangement with MGRG, the company must plainly have been entitled to do so in the absence of such a contract. It is, moreover, to be noted that consideration was being given to the possibility of disposing of Xpart (in which event, on the argument advanced in the representations on behalf of the members of the Phoenix Consortium, the purchasing arrangements would come to an end) within a short time after its transfer to PVH. Deloitte had been formally engaged by PVH to advise on the potential sale or refinancing of Xpart by May 2003, at which stage (as the engagement letter recorded) the directors of PVH had "*reviewed a number of options for the Xpart business but* [had] *yet to reach a decision on whether or not to dispose of the Company*".

23. While, however, we consider that Xpart was transferred for less than its true value, we do not think that the majority of MGRG's directors will have been aware of this. For example, we can understand how functional directors such as Messrs Beddow, Bowen, Oldaker and Shine, who were not closely involved in the decision-making in relation to Xpart, can have failed to appreciate that Xpart was worth more than £2. We accept, too, that Mr Howe will not have been conscious of the fact that the £2 did not represent Xpart's true value; as he explained to us, he was not involved in the detail "*with everything else that was going on*". Nor do we think that Mr Millett was conscious of the fact that Xpart's value was in excess of £2.

24. Further, we do not think that the evidence establishes that Mr Towers, Mr Edwards or Mr Stephenson was aware that Xpart had a higher value. Mr Edwards told us that he was focusing his attention on the fact that the profits that arose out of parts sales would be available to MGRG.

25. In contrast, we find it hard to accept that Mr Beale, who was the director primarily responsible for the transfer of Xpart and the terms of that transfer, thought that the company was worth only £2. Mr Beale had qualified as a chartered accountant[31] and our impression, having interviewed Mr Beale over a number of days, is that he had a good grasp of the

[31] See IV/15.

Group's financial affairs and of financial matters generally. Further, Mr Einollahi told us that Mr Beale was "*a competent finance man*" and that "*there was nothing about his ability* [he (i.e. Mr Einollahi)] *ever doubted*". In the circumstances, we should have thought that Mr Beale would have been alive to matters such as those summarised in paragraph 22 above and, hence, to the fact that the company that MGRG was losing and PVH was gaining was of significant value. It is telling that, within a matter of months after the transfer of Xpart to PVH, Mr Beale was proceeding on the basis that the company was of considerable value. As explained in chapter XIX (Joint ventures)[32], during 2002 and 2003 joint venture negotiations took place with Mr Yang Rong ("Mr Yang"), a Chinese businessman. By 9 May 2003 it was being proposed that Star Apex Holdings Limited ("Star Apex", a company controlled by Mr Yang) and PVH would establish a joint venture company and that, to that end, PVH should set up a company called MGR Holdings Limited which would acquire MGRG, Powertrain and MG Sport and Racing and in which Star Apex would invest. Under this scheme, Star Apex would have had no interest in Xpart. Later in the month, however, the PVH side suggested that the deal with Star Apex should be enlarged to encompass also Xpart. Following a meeting with Mr Einollahi on 14 May, Mr Peter Dillon, a director in the corporate finance department at Deloitte, noted:

> "*Xpart to be added to deal with* [Mr Yang] *– needs further negotiation to increase his offer from $222.72m to cover value of 49% stake in enlarged group.*"

When explaining the revised proposal to Mr Yang a fortnight later, Mr Beale said that Xpart had an equity value of $80 million to $260 million (account having been taken of $100 million of inter-company debt).

<u>*Reliance on professional advice*</u>

26. The members of the Phoenix Consortium, Mr Howe and Mr Millett all told us that they understood that Eversheds had advised that a transfer at nominal value was appropriate. The basis for this is to be found in the advice given by Mr Rawlings, who told Mr Cowburn on 20 March 2002 that it could be proper for MGRG's directors to take the view that nominal consideration was reasonable[33]. Mr Rawlings evidently gave this advice on the assumption that all future profit would be accruing to MGRG, and he suggested that Xpart should still be dormant when it was transferred. He pointed out, moreover, in his email to Ms Scott of 24 July that the position would be different if Xpart were going to make a profit and that MGRG's directors should not authorise the transfer unless there was a genuine commercial reason for doing so from MGRG's point of view. In the event, by the time Xpart was transferred, the company had been trading for nine months or so and had generated significant profits and net assets[34]. Moreover, the expectation was that Xpart would continue to earn some, albeit relatively modest, profits[35], and there was no guarantee that the arrangements for Xpart to buy parts from MGRG at a mark-up would continue[36].

[32] See XIX/91 to 100.
[33] See paragraph 15 above.
[34] As at 31 December 2002, Xpart had generated profits of £2.444 million, and had net assets of the same amount.
[35] See paragraph 22.2 above.
[36] See paragraphs 22.4 to 22.5 above.

Nonetheless, it is understandable that Mr Rawlings' advice should have been taken as approving the transfer of Xpart for £2 in circumstances where the intention was that at any rate most profit should continue to accrue to MGRG.

The reasons for the transfer

27. Xpart's transfer, like other aspects of the restructuring of the Group, was attributed to a desire to achieve management focus. Mr Towers, for example, told us that the he did not consider Xpart to be independent when it was "*sitting within the financial umbrella of the car company*" and this was "*fundamental and core to the management theory and organisational restructuring*". The MGRG board minutes of 20 December 2002 record that the transfer was part of the larger Group reorganisation as follows:

> "*It was noted that the sale* [of Xpart's share capital] *was being effected as part of a reorganisation of the Phoenix Venture Holdings Group of Companies, the purpose of which was to create separate and identifiable businesses within the Group, one of which was the warehousing and distribution of spare parts.*"

28. In the course of his evidence, however, Mr Stephenson more or less accepted that one reason for the transfer was to ring-fence Xpart from MGRG. Mr Stephenson said that his "*personal view*" was that the transfer was primarily motivated by a desire to achieve management focus, but that ring-fencing from MGRG was a "*subsidiary benefit*". Mr Stephenson said that this was "*entirely proper*"[37].

Management

29. With effect from 21 May 2001, Xpart's board comprised Mr Howe, Mr Millett and Mr Parkinson. On 26 April 2002 Mr Parkinson resigned from the board of MGRG, to remain as managing director of Xpart. Mr Millett resigned as a director of Xpart on 16 August, leaving Mr Howe and Mr Parkinson[38] as the company's directors. However, on 17 February 2003 Mr Millett rejoined Xpart's board, and Mr Charles Binns[39] also became a board director. The composition of the board then remained unchanged until the company's business was sold to CAT in 2004, as mentioned below.

30. From 2003 onwards, Xpart's board performed a very real function. Its minutes suggest that the company's affairs were considered at length at board meetings, and two members of the board (including Mr Parkinson, the managing director) were not also directors of MGRG or PVH.

[37] We consider further in chapter XV the reasons for the Group's structure.

[38] Mr Sanders (MGRG's sales director from 2002 to 2003 (see XVII/6 to 7)) appears to have replaced Mr Parkinson on Xpart's board for a few weeks in the summer of 2002, but Mr Parkinson had returned to Xpart's board by 16 August 2002. See V/6.6, and footnote 17, for further details.

[39] Mr Binns had previously worked at Unipart and joined Xpart in the role of "parts director" in November 2002.

31. Nonetheless, it is difficult to see how Xpart's transfer to PVH can have been needed to improve management focus. By the time the transfer took place in December 2002, the parts business was already being managed by a separate company (viz. Xpart) with its own board; as Ms Scott pointed out in her 30 July 2002 email to Mr Cowburn[40], the management of the parts business "*already* [was] *independent*" where it was sitting then (i.e. as a subsidiary of MGRG).

32. Further, the transfer of Xpart to PVH would seem to have contributed nothing to financial transparency. Xpart's financial statements provided no real guide to the financial performance of the parts business. Profits from the business continued also to accrue to MGRG and, to a lesser extent, to the NSCs. To obtain any understanding of the financial performance of the parts business, it was thus necessary to aggregate figures from Xpart, MGRG and even the NSCs[41].

The sale of the parts business to CAT

Events leading to the sale

33. The possibility of selling Xpart was under consideration during 2003. The project was given the code names "Project Fox" and "Project Werewolf".

34. In March 2004 Deloitte produced an information memorandum for use in connection with the disposal of Xpart. This summarised the rationale for the sale of Xpart as follows:

> "*The directors of PVH have concluded that the sale of XPart is in the best interests of the Group. MGRG requires cash for investment in its new model program and to assist with various joint venture opportunities. The sale of XPart is seen as one source of funding for these purposes.*"

35. In the same month a briefing paper in respect of the project was prepared by Deloitte for use within the firm. This noted that "*Much of the profit of the Parts business is not reflected in the Xpart statutory accounts as goods are currently purchased by* [MGRG] *and sold on to Xpart with a mark-up*", but that "*Following disposal, Xpart will make the purchases from suppliers directly*".

36. Ms Lewis once again consulted Ms Pheasant. In an email dated 26 March 2004, she explained:

> "*The issue for you, please, to consider is the effect on the commercial terms (or more properly what happens to the proceeds of sale) by reference to the basis on which PVH acquired Xpart.*

[40] See paragraph 17 above.
[41] In this respect, it is notable that the notes to Xpart's 2002 financial statements regarding director and employee costs state, "*The emoluments of the directors are paid by another group company. It is not practicable to determine the proportions of such emoluments that are attributable to the directors' services to the company.*"

> *Xpart was previously (although called something different) a direct and wholly owned subsidiary of* [MGRG]. *Some time ago (but less than 2 years ago)* [MGRG] *sold the entire issued share capital of the corporate entity now called Xpart to PVH for £1*[42]*. The board at the time took the view that Xpart had no value on the basis that commercial agreements were in place which meant that Xpart made no profit; all profits on the sale of parts arose in* [MGRG]. *This was because* [MGRG] *acquired all the parts 'on behalf of' Xpart and then sold them onto Xpart at a margin of 30% leaving Xpart to sell them on to its own customers but make no profit on them.*
>
> *Jane Ruston is now conscious of the fact that if the transaction proceeds as proposed there will be a material profit arising in PVH.* [MGRG] *will be expected to enter into a long term supply agreement with the Purchaser and, of course, the arrangements whereby* [MGRG] *acquires those parts on behalf of Xpart and sells them to them at a mark-up will be dismantled. She is concerned that were there to be an insolvency of* [MGRG] *the transaction may be scrutinised. Her proposal is that the sale proceeds be remitted (on a basis which we have not yet worked out) to* [MGRG]. *Whilst the cash proceeds of sale will be made available to* [MGRG] *in any event (to fund its continuing business and to fund the development of new models) what this all boils down to is whether the corporate entity which is the Seller (Xpart Limited) makes those funds available to* [MGRG] *by way of 'capital contribution' or by way of loan which would, of course, if circumstances were to change, be capable of repayment.*"

37. Ms Pheasant referred the question to Mr Rawlings, who told us that he remembered "*running up to Sue Lewis and saying ... that it was odd that* [the business] *had been said to be worth nothing and was now worth quite a lot*". Having spoken to both Ms Pheasant and Mr Rawlings, Ms Lewis emailed Ms Ruston in the following terms on 27 May 2004:

> "*At the outset of Project Werewolf/Fox you mentioned to me that you wanted to ensure that the proceeds of sale of the Xpart business were dealt with properly bearing in mind the fact that, given the nominal value attributed to Xpart when PVH acquired it from* [MGRG] *the proceeds of sale may well need to find their way back to* [MGRG] *(which is, as I understand it, the commercial requirement in any event).*
>
> *We spoke previously about how this might be achieved and thought that this might be, perhaps by a capital contribution or a loan. Having thought about this and bearing in mind the fact that the whole justification for the transfer of Xpart at nominal value was the existence of the arrangements whereby the mark up charged by* [MGRG] *on supplies to Xpart effectively eliminated profit, it would ... probably be appropriate for Xpart to pay the requisite sum to* [MGRG] *to 'buy out' the profit mark up arrangement. The fact that there may be no formal documentation in place recording that profit mark up arrangement would not, it seems to me, matter on the basis that it is established by a course of dealing. This route has the advantage of:-*

[42] Xpart was in fact sold for £2 rather than £1 (see above).

1.1. *supporting the logic behind the original transfer of Xpart from* [MGRG] *to PVH at a nominal value; and*

1.2. *arguably protecting Xpart from any subsequent questions as to why Xpart thought it appropriate to make an investment in or a loan to* [MGRG].”

38. On 6 June 2004 PVH and CAT entered into a written memorandum of understanding. The main features of the proposed deal included the following:

38.1. CAT would purchase the parts business (including stock) for £105 million, of which £100 million would be paid on completion and the £5 million balance would be paid two years later;

38.2. the £105 million figure assumed that there would be stock to a value of £44.5 million. If the stock proved to be worth either more or less than £44.5 million, the price would be adjusted on a pound for pound basis;

38.3. among the assets transferred to CAT would be (a) a non-exclusive licence to use the trademarks Austin, Austin Healey and Austin Healey Sprite for the purpose of carrying on the business, (b) an exclusive licence to use certain other trademarks (including “MG”, “Rover” and “MG Rover”) for the same purpose and (c) a variety of rights in respect of tooling;

38.4. CAT would grant MGRG a “*Future Profit Interest*” (or royalty), payment of which would be conditional on annual sales of new vehicles continuing at or above 50 per cent of such sales in 2003; and

38.5. PVH would have the option to repurchase the business from CAT between the fourth and fifth years after completion.

39. A few days later, on 9 June 2004, Ms Lewis told Ms Ruston in an email that she had had a long conversation with Ms Pheasant and that the latter would be preparing a note. The note, Ms Lewis said, was to deal with the following points:

“*1. The transfer of Xpart from MGRG to PVH for £1 in December 2002. When we have talked about this in the past this was on the basis that the majority of the purchase price for Xpart would be ‘repatriated’ to MGRG (so that in effect the £1 transfer was arguably a non issue). From the discussions we had with Maghsoud* [i.e. Mr Einollahi] *over the weekend it seems that will not necessarily be the case.*

2. The granting by MGRG of paid up perpetual licences in respect of its trademarks. I know that we plan to attribute the 5% ‘earn out’ type of payment to the trademarks by way of royalty but the MGRG board need to satisfy themselves that this is sufficient.

3. *MGRG will transfer ownership of non-current tooling to the Purchaser on completion; tooling which becomes non-current in the periods following completion will also be transferred. Again we need to think about whether this is appropriate for MGRG.*

4. *After the deal is done Maghsoud has suggested that the proceeds of sale should be passed from Xpart up into the hands of its shareholder (PVH). PVH might then, for example, acquire MGF*[43] *from MGRG for (say) £30 million. We need to look at this transaction; this is, of course, linked into paragraph 1 above.*"

Ms Ruston told us, "*certainly Maghsoud had quite strong opinions about dealing with the proceeds of sale and the profit*".

40. On 14 June 2004 Ms Lewis sent Ms Ruston a further email to which she attached "*a note to* [her] *from Louise Pheasant considering various issues*". In the note:

40.1. Ms Pheasant recommended that some of the proceeds of the sale to CAT should be paid to MGRG otherwise than by way of loan. She explained her thinking as follows:

> "*I understand that before and after the sale* [of Xpart to PVH] *MGRG supplied aftermarket parts to Xpart at a 30% mark-up on cost, providing an attractive commercial return to MGRG. I suggest you ask to review the minutes of MGRG relating to the sale of Xpart shares at £1. There may, for example, be reference to the 'onerous' contract for the supply of aftermarket parts not being capable of immediate termination (expressly or impliedly). Although this contractual arrangement has seen a significant financial return to MGRG since December 2002, if the assets of Xpart are now sold for £105m the existence of this favourable commercial arrangement to MGRG would not, without more, in my view, eliminate the risk of an attack by the Administrator/Liquidator for the original sale of Xpart shares at an undervalue or a transaction to defraud MGRG creditors.*
>
> *In order to avoid an allegation that the shares of Xpart were sold at an undervalue or amounted to a transaction to defraud creditors of MGRG, it would seem sensible to ensure that part of the consideration payable by CAT is paid from Xpart/PVH to* [MGRG] *as 'compensation' for the loss of the commercial contractual arrangement for the supply of aftermarket parts and/or as additional consideration for the sale of the shares in Xpart …*

[43] The MGF was a small sports car.

It follows that if the proceeds of sale of Xpart are passed from Xpart to PVH and used by PVH to acquire, for example, MGF from MGRG then no compensation/consideration would pass to MGRG in respect of the original share transaction which would remain susceptible to challenge ...";

40.2. Ms Pheasant went on to consider whether MGRG could "*safely give paid-up exclusive/non-exclusive and perpetual licences to CAT to use the trademarks 'MG', 'Austin', 'Austin Healey' 'Austin Healey Sprite' etc for no guaranteed royalty payments*". She concluded:

> "*A perpetual licence to use the trademarks with no licence fee payable could amount to a transaction at an undervalue or a transaction to defraud the creditors of MGRG. For this reason, it would be sensible to apportion a licence fee or certain royalty payments from CAT to MGRG in consideration for the perpetual use of the trademarks*"; and

40.3. as regards tooling, Ms Pheasant said:

> "*Whilst arguably obsolete tooling is of no obvious value, given the imperative to avoid an Administrator/Liquidator of MGRG arguing that a transaction at an undervalue or transaction to defraud creditors has taken place, again, Xpart/MGRG may wish to consider requiring an appropriate apportionment of the purchase price be paid to MGRG in consideration for the obsolete tooling which may be valuable in the hands of CAT, a special purchaser.*
>
> *CAT is to receive a paid-up perpetual licence to tooling for production of aftermarket parts ie, ownership of aftermarket parts will stay with MGRG, but MGRG will grant a licence to tooling for production of aftermarket parts to CAT. Again, Xpart/MGRG may wish to consider apportioning part of the purchase price to* [MGRG] *in respect of an appropriate licence payment for the right to tooling of aftermarket parts which may be of significant value to CAT.*"

Ms Pheasant told us that the note was her considered advice on the points which had been raised, and Ms Lewis said that she did not think that Eversheds' advice had changed subsequently. Ms Ruston thought that she would have discussed elements of the advice with certain directors ("*probably with Peter Beale, with Kevin Howe and with John Millett*").

41. Contracts were exchanged, essentially in accordance with the memorandum of understanding mentioned above[44], on 8 July 2004[45]. The parties to the asset purchase agreement were Xpart, MGRG, PVH, CAT and Caterpillar Logistics Services Inc. (CAT's

[44] See paragraph 38 above.
[45] After various adjusting items, the consideration received by Xpart on completion was £92.781 million, consisting of £82,430,498 cash received by PVH and £10,350,314 paid to BMW. See further paragraph 52 below.

parent company). The contract provided for the "*Vendors*" (defined as Xpart and MGRG) to "*sell and ... procure that any other member of the PVH Group (that has title or any interest in any of the Business Assets* [i.e. the assets which were to be sold]) *will sell*" the parts business and a variety of rights and assets used, exercised and employed in it. Those assets were to include goodwill, stock, "*Non-Current Tooling*" (i.e. all tooling for parts other than tooling in use in the production of vehicles and tooling for the Rover 800 and Rover 400) and rights in the trade marks "XPart" and "Xcheck". The contract provided, moreover, for MGRG to execute a number of documents on completion, including documents which would give CAT rights in relation to a range of trade marks and also certain other intellectual property rights. The contract further stipulated that completion should be conditional on (a) the transaction being approved by the European Commission and (b) BMW granting certain rights as regards trade marks which it had licensed MGRG to use.

42. European Commission approval was not expected to be problematic and it did not prove to be so. With regard to the rights which were required from BMW, BMW raised concerns as to how the proceeds of the sale to CAT would be used[46]. It also wished to be paid certain sums which it maintained were outstanding but which were in part disputed by the Group. After negotiation, BMW agreed to provide what was required on the basis of a deed of settlement dated 27 August 2004. This recited that BMW was:

> "*... prepared to grant the consents and licences requested provided that (i) certain debts owed by members of the PVH Group ... to members of the BMW Group ... are first discharged; and (ii) certain disputes as between members of the PVH Group ... and members of the BMW Group ... are resolved ...*"

The deed proceeded to provide for the payment by MGRG and Xpart of sums totalling £10,350,314 to BMW. The deed also contained undertakings in respect of the application of the proceeds of the CAT sale. PVH undertook that:

> "*... the sum of £96.5million (being the amount to be received or deemed received by XPart,* [MGRG] *and others pursuant to the Sale Agreement* [with CAT] *will be used for the purposes of the business requirements of members of the PVH Group ...*"; and

> "*... no distribution, fee or payment will be paid out of or by reference to the* [£96.5 million] *directly or indirectly to any person who is a shareholder of PVH at the date of this Agreement.*"

Dr Reul of BMW explained BMW's thinking to us as follows:

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[46] It was such concerns which led Ms Ruston to tell Dr Reul of BMW in an email dated 9 July 2004:

> "*Quite understandably you are worried about BMW's reputation and what effect this sale may have on you ... As I said when we talked the sale proceeds of XPart will be re-invested into the group and used exclusively by it for its business requirements. None of this money will be paid to any of the D shareholders (the Phoenix Consortium) ...*"

> "*We have always had of course that concern that money would leave the business, that the management would use some money for other purposes than for maintaining the Rover business, and of course selling the parts business and then keeping the money is a way to do exactly that.*"

43. At the request of Mr Beale and Mr Towers, Ms Ruston wrote to BMW on 26 October 2004 to express concern about how BMW had handled the trademark issue. In that letter, Ms Ruston referred to "*being put in a position where we felt we had no alternative but to accept unreasonable demands of money from BMW*". She explained in the letter:

> "*During the course of the discussions that we had with BMW it was made clear to us that we had no opportunity to negotiate or verify the alleged claims. This is despite the fact that in some cases we had genuine or valid reasons for disputing the payments or we had no knowledge at all of the sums claimed. In view of our financial situation at that time BMW was made well aware of what the implications were to us of not being able to complete the XPart sale. Accordingly, we found ourselves forced to give in to BMW's unreasonable demands. To make matters worse BMW also imposed conditions on us as to how we were entitled to spend the money we received from the sale of our parts business.*"

In reply, BMW said that it considered that it had "*acted in a fair and reasonable manner*". It observed:

> "*Most of those receivables had been under discussion with MG Rover for years without any progress having been made. The impression was that MG Rover were taking advantage of the fact that suing MG Rover is a futile exercise, commercially. Therefore, we felt it was perfectly fair to link the consent you requested from us to a satisfaction of our claims. BMW did not ask a penny for the consent as such. Each claim on our list was long known before and in our honest belief justified and due.*"

In our view, BMW was not being unreasonable.

44. The sale to CAT is recorded as having been approved by the boards of Xpart, PVH and MGRG at meetings on 8 August 2004. It is evident, however, that board meetings were not in fact held on 8 August, which was a Sunday. It has been argued in representations to us that there was a typographical error and that the minutes should have been dated 8 July 2004 (the day on which contracts were exchanged). However, we are not confident that the meeting took place on 8 July either.

45. By 23 August 2004 Mr Einollahi had suggested that there should be "*an internal 'surrender' of XPart's implied licence to use the Rover trademarks*". Ms Lewis outlined what was proposed in an internal Eversheds email:

"*The concept is this:-*

(i) *XPart in carrying on its business uses* [MGRG's] *trademarks;*

(ii) *Whilst no formal licence agreement has been entered into between* [MGRG] *and XPart clearly one is implied;*

(iii) *Maghsoud* [Einollahi] *wants XPart to surrender all rights it has under that implied licence back to* [MGRG] *in return for value. The value that he places on that surrender is equivalent to the amount of the inter-group loan which is outstanding and due from XPart to* [MGRG]*; although this needs to be checked Jane* [Ruston] [indicated] *to me that this is in the region of £40 million.*"

By 24 August Eversheds had prepared a draft document to give effect to Mr Einollahi's concept, but the matter was not then pursued. Ms Lewis told us that she was "*actually quite perturbed by* [the proposal]" and that she and Ms Ruston "*both thought that this was just a non-starter, on those numbers*". Mr Einollahi told us that he was seeking to protect the interests of his client, namely PVH. It was in fact a more general theme of Mr Einollahi's evidence to us in the inquiry, and of the representations made to us by Deloitte, that Mr Einollahi was acting for clients other than MGRG (typically, PVH and/or the members of the Phoenix Consortium) and so that it was incumbent on him to further their interests even when those interests conflicted with the interests of MGRG[47].

46. In advance of completion, MGRG agreed to sell to Xpart the "*Non-Current Tooling*"[48] which was to be transferred to CAT. The agreement, made between MGRG and Xpart on 26 August 2004 and signed on behalf of both parties by Ms Ruston, recited as follows:

"*In order to facilitate the transaction recorded in the Sale Agreement* [i.e. the asset purchase agreement dated 8 July 2004] [MGRG] *and XPart have agreed that* [MGRG] *will sell to Xpart at full market value the Non-Current Tooling …*"

There followed provision for the relevant tooling to be sold to Xpart for £1 or such other sum as might be determined as a result of a valuation which, according to the agreement, Deloitte were to carry out. In this respect, the agreement stated as follows:

"*The parties acknowledge and agree that Deloitte of 1 Woodborough Road, Nottingham … (the 'Independent Valuer') has been instructed to determine whether, in their view, the Initial Price* [viz. £1] *reasonably represents the fair market value of the Non-Current Tooling. If the Independent Valuer is unable to conclude that the Initial Price reasonably represents a fair market value then the Initial Price shall be adjusted to the extent necessary for the Independent Valuer so to conclude …*

47 See VII/68 and 174 to 175.
48 See paragraph 39 above.

> *If no opinion has been delivered by the Independent Valuer within 4 weeks of Completion the Initial Price shall not be adjusted and accordingly shall as between the parties be for all purposes, the fair market value of the Non-Current Tooling.*"

In the event, Deloitte do not appear to have carried out, or to have been instructed to carry out, any valuation of the "*Non-Current Tooling*" and the price thus remained at £1. Ms Ruston's recollection was that Eversheds had sent a copy of the agreement to Mr David Jones, then a director of Deloitte and the head of the corporate finance department in its Nottingham office. For whatever reason, however, Mr Jones does not in fact seem to have been provided with the agreement. Mr Jones told us that he was never instructed to value tooling and that he did not do so. He explained:

> "*... I cannot recall having any discussions regarding such a valuation engagement at the time of the transaction, and, in consequence, the reference to Deloitte Nottingham carrying out a tooling valuation was inserted into the* [agreement] *without my approval ... Moreover, if Deloitte had received such instructions we would have required an engagement letter confirming the nature of our role and responsibilities. To my knowledge, none was either prepared or signed. Indeed, if I had been requested to assist, I would have explained that neither I nor Deloitte's Nottingham office generally had the appropriate skills to undertake the valuation.*"

Likewise, Mr Einollahi told us that neither he nor, to his knowledge, anyone else within Deloitte had been asked to provide a valuation of any tooling.

<u>Completion</u>

47. The sale to CAT was completed on 27 August 2004. Numerous documents were executed at this stage. They included the following documents by which MGRG granted rights or undertook obligations (in addition to the deed of settlement mentioned above[49]):

[49] See paragraph 42 above.

Document	Parties	Details of rights granted and obligations undertaken by MGRG (or MGRG and CAT)	Consideration
Trade mark licence and assignment	MGRG & CAT	Grant by MGRG to CAT of rights to use Rover and Austin trade marks	CAT to pay royalties to MGRG
Registered trade mark assignment	MGRG & CAT	Assignment by MGRG to CAT of rights in respect of Xpart and Xcheck trade marks	No provision for consideration
Licence of technology	MGRG & CAT	Grant by MGRG to CAT of rights to use intellectual property	No provision for consideration
Assignment of goodwill	Xpart, MGRG & CAT	Assignment by Xpart and MGRG to CAT of goodwill	Such of the consideration payable by CAT under the asset purchase agreement otherwise than in respect of stock as should be determined by the parties; none of the consideration was apportioned to MGRG (see below)
Transitional services agreement	MGRG & CAT	MGRG to provide administrative services to CAT through a transitional period	CAT to pay £75,000 per month plus VAT to MGRG

Application of the proceeds of sale

48. The application of the proceeds of sale was not simple. As part of the sale CAT purchased stock which had been accounted for in Xpart and in three of the NSCs. Additionally, while no profit was attributed to MGRG, some profit was attributed to nine of the NSCs. To complicate matters further, Xpart had no bank account and the proceeds were received on its behalf by PVH. Finally, Xpart's financial statements for the year ended 31 December 2004 record the payment of a dividend, but no dividend was in fact paid.

Profit on the transaction

49. Note 8 to the Xpart financial statements for the year ended 31 December 2004 provides details of the profit arising on the transaction which may be summarised as follows:

	£'000
Gross purchase consideration	101,900
Provision against deferred consideration	(5,000)
Book value of Xpart stock disposed	(34,700)
Book value of NSCs' stock disposed	(5,700)
"*Goodwill*"	**56,500**
Professional fees	(4,069)
Total profit arising on the sale	**52,431**
Apportioned between companies as follows:	
Xpart	31,685
NSCs	20,746
	52,431

50. As noted above, £20,746,000 of the profit was apportioned to the NSCs[50]. Xpart's 2004 financial statements explain matters as follows:

> "*The purchase consideration included a payment of £56.5 million in respect of goodwill ...*
>
> *On completion of the transaction, amounts were credited to the inter company accounts of other group companies for their share of the goodwill associated with the parts business. Those amounts were determined by the management of PVH.*"

Taking account of sums allocated to the NSCs, Xpart was treated as realising a profit of £31,685,000 from the sale to CAT.

[50] The NSCs had been involved with the supply of parts, by way of "*sales to their local dealer networks at a gross margin of 15% and some locally incurred marketing costs*" (to use words from a Deloitte report of July 2004).

Amount received and paid by PVH

51. CAT paid £92,780,000 on completion to Eversheds. This amount was derived from the purchase consideration as follows:

	£'000
Gross purchase consideration	101,900
Deferred consideration due 27 August 2004	(5,000)
Trade payables deposit	(5,892)
VAT on stock transfer	1,772
Amount paid on completion	**92,780**

52. This money was applied by PVH as follows:

	£'000
Gross purchase consideration	92,780
Payment to discharge BMW liabilities of MGRG[51]	(10,350)
Amount paid to Deloitte[52]	(3,605)
Amount paid to MGRG[53]	(75,800)
Balance	**3,025**

[51] The £10,350,000 was paid to BMW by Eversheds out of the completion moneys on 27 August 2004 pursuant to the deed of settlement mentioned in paragraph 42 above.
[52] The payment appears to have been made on Xpart's behalf.
[53] £70 million was transferred to MGRG on 27 August 2004 and £5.8 million on 29 October 2004.

Amount received and paid by MGRG

53. In addition to the £75.8 million paid by PVH to MGRG, the following further payments can also be identified as relating to the sale of the parts business[54]:

Date	Details from correspondence	MGRG receipts	Payments to CAT
		£	**£**
18.01.05	Trade payables due to CAT	-	555,000
18.01.05	Balance of interim settlement	690,000	-
04.03.05	Offer to settle all outstanding matters from completion	672,741	-
16.03.05	Interest due on amounts withheld by CAT	39,295	-
21.03.05	Final settlement	926,350	-
		2,328,386	**555,000**

An additional net sum of £1.77 million (i.e. £2,328,386 less £555,000) was thus paid by CAT as consideration for the parts business in the period between completion and MGRG entering into administration[55].

54. The moneys paid to MGRG were in part used to pay £22.67 million to the NSCs and to pay professional fees in respect of the transaction of £464,000 (principally to Eversheds) on Xpart's behalf. Further, the payments to MGRG served to discharge pre-existing inter-company indebtedness; Xpart was indebted to MGRG for stock when the parts business was sold to CAT, and that debt was discharged.

55. The balance (which was in excess of £30 million) of the sums paid to MGRG was treated as a loan to the company by PVH.

56. While some of the money paid for goodwill was apportioned to NSCs, none of it was allocated to MGRG. Thus, minutes of an Xpart board meeting on 18 April 2005 refer to the consideration received for the parts business having been:

[54] CAT was also to have paid deferred consideration of £5 million and ongoing royalties. While, however, the information available to us in this respect is limited, it seems that the failure of MGRG will have made further payments unlikely. The agreement entitling PVH to repurchase the parts business after five years (as to which, see paragraph 38.5 above) would also appear to have terminated.

[55] CAT also paid £1.6 million to MGRG in February 2005 by way of royalty pursuant to the trade mark licence and assignment mentioned in paragraph 47 above.

> "*… lent to MGRG via PVH on an interest free, unsecured, subordinated*[56] *to every other creditor basis in circumstances where there was no visibility of PVH having the loan repaid and no prospect of an arm's length financier providing such funds.*"

Similarly, when completing questionnaires at the request of MGRG's administrators in May, the directors stated:

> "*The net proceeds of sale received by XPart were used for the following purposes:*
>
> *(a)* *as to £9m being paid to BMW … in settlement of amounts claimed by BMW against* [MGRG]*, MG Rover Deutschland and Techtronic … in consideration of which BMW agreed an amendment to the Rover trademark licence;*
>
> *(b)* *the balance of the consideration received on completion was provided to* [MGRG] ***as an interest free unsecured loan*** *to be used by it for working capital purposes*" (emphasis added)[57].

57. Ms Ruston told us that the allocation of the consideration was considered by Mr Beale and Mr Millett.

<u>The dividend</u>

58. Xpart's 2004 financial statements, which were approved by Mr Beale as the company's only director at the date of their signing[58], state that the payment to PVH of the net proceeds of sale was "*accounted for as a dividend of £33,982,000 paid by* [Xpart] *to PVH and an inter company loan*". Further, PVH's 2004 financial statements, which were approved by a board including the four members of the Phoenix Consortium, refer to the receipt during the year of dividends of £33,982,000. However, it is clear that no dividend was in fact paid or declared. Mr Howe and Mr Millett, who were the only directors of Xpart on 27 August 2004[59], both told us that they were unaware of any dividend having been declared on or around that date, that there was no contemporaneous board resolution approving a dividend and that they did not believe that any dividend was paid. Moreover, it was accepted in representations made to us on behalf of the members of the Phoenix Consortium that no dividend had been paid or declared in August 2004. We were told, however, that "*Mr Beale's understanding was that the proceeds of the sale of the parts business had been transferred to PVH from XPart by way of dividend in August 2004*" and that when "*it became apparent that the payment made by XPart to PVH had not been formally documented in 2004 … steps were … taken to prepare documentation providing for the*

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[56] We are not aware of any other evidence that the loan was made on a subordinated basis. Further, the representations made to us on behalf of the members of the Phoenix Consortium do not refer to the loan being subordinated.

[57] Several witnesses confirmed in their evidence to us that sums paid to MGRG had been treated as loans. Further, representations made to us on behalf of the members of the Phoenix Consortium state, "*the balance of the monies raised as a consequence of the sale of the XPart business were … lent to MGRG on an unsecured basis …*"

[58] Mr Beale was appointed as a director of Xpart on 8 August 2005.

[59] Mr Parkinson and Mr Binns had resigned as directors on 26 August 2004.

ratification of the dividend". As for Messrs Edwards, Stephenson and Towers, we were informed that they did "*not recall the circumstances surrounding the payment of the dividend from XPart to PVH in August 2004 or any discussion in this regard when the accounts were signed off in 2006*", but that they had "*believed that the financial statements were accurate*".

The benefits to MGRG

59. The sale of the parts business to CAT improved MGRG's cashflow position in the short term. By the time of the sale, MGRG acutely needed an injection of cash; Mr Towers, for instance, spoke of MGRG having been "*in urgent need of cash to get it through to a joint venture with Dong Hua*"[60]. The sale, and the transfer to MGRG of the bulk of the net proceeds, alleviated MGRG's immediate problems.

60. The funding came, though, at a price. When the parts business was sold, MGRG lost the very valuable income stream which the business had previously provided. Further, since proceeds from the sale were only made available to MGRG by way of loan, they did not improve the company's balance sheet position at all. The injection of cash was offset by a corresponding increase in liabilities.

61. In our view, some or all of the proceeds from the sale (beyond merely royalties for use of Rover and Austin trade marks, as mentioned in paragraph 47 above) should have been treated as due to MGRG as of right rather than by way of loan. In the first place, Xpart had been transferred for just £2 less than two years earlier on the footing that parts would still be bought from MGRG and that profit would thus continue to accrue to MGRG[61]. The sale to CAT depended on MGRG losing that profit stream: despite the assumption underlying Xpart's transfer to PVH, the sale to CAT meant that parts would no longer be bought from MGRG and that the profit would cease to accrue to MGRG. It seems to us that, as a result, there was a strong case for regarding MGRG as entitled to all or most of the profit arising from the sale of the business to CAT. To have approached matters in that manner would, we think, have been both obviously fair and in keeping with Eversheds' advice.

62. The treatment actually adopted meant that PVH had it both ways in as much as the argument for transferring Xpart at nominal value to PVH was that MGRG would enjoy the future profits generated by Xpart, but then when Xpart was sold PVH received all the proceeds.

63. It has been argued in representations to us on behalf of the members of the Phoenix Consortium that "*Eversheds provided advice to the effect that, provided the transfer value in 2002 was appropriate, no further amount was due to MGRG*" and that "*the directors of MGRG had decided, and been advised by Eversheds, that the appropriate transfer value for XPart was £2 in light of the pricing arrangements in place between XPart and MGRG*"; there was "*therefore no need for any further amount to be paid to MGRG*". We find this

[60] Donghua Automobile Investment Holding Corporation ("Donghua") was the company formed by SAIC and NAC for the purpose of the proposed joint venture with the Group (see XX/99.1).
[61] See paragraph 26 above.

argument entirely unconvincing. The thrust of Eversheds' advice was clearly to the effect that money should be paid to MGRG. For example, Ms Pheasant said in her note[62] that "*it would seem sensible to ensure that part of the consideration payable by CAT is paid ... to* [MGRG] *as 'compensation'*".

64. It may well be that none of the directors ever read Ms Pheasant's note. Ms Ruston, however, told us that she "*would have discussed elements of this advice with them*", adding, when asked with whom she would have had the discussions, "*probably with Peter Beale, with Kevin Howe and with John Millett*". We have no doubt that Ms Ruston will have ensured that Mr Beale at least was aware of the substance of Ms Pheasant's advice, especially since Ms Ruston plainly herself had concerns about the implications of Xpart's transfer to PVH in 2002. Ms Lewis told us that she remembered Ms Ruston saying to her that:

> "*... she* [Ms Ruston] *was concerned about the 2002 transfer, and we needed to think about what needed to happen to deal with that.*"

65. There was, in any event, another reason for MGRG to be entitled to some of the profit from the sale to CAT: the role it played in that sale. MGRG facilitated the sale in several ways. It granted a variety of trade mark and other intellectual property rights, in two cases without provision for consideration[63]. It transferred "*Non-Current Tooling*" to Xpart so that it could in turn provide it to CAT[64]. It paid sums to BMW which it would not otherwise have paid then, or possibly ever[65].

66. It is noteworthy in this context that CAT's audited financial statements for 2004 refer to the assets it acquired from Xpart including "*plant and machinery*" to a value of £4.477 million. The assets in question must to a great extent at least have been contributed by MGRG. Neither Xpart's 2003 financial statements nor its 2004 financial statements refer to the company having, or having had, any fixed assets at all. Moreover, a Deloitte report dating from July 2004 states as follows:

> "[Xpart] *has no fixed assets. Roll cages and stillages were acquired in December 2001 for £1.25 million from Unipart for continued operations. This was entirely expensed in 2001 ... Replacement assets and all tooling are expensed as incurred.*
>
> *Office and I.T. equipment for the XPart operations at Longbridge have also been expensed. Consideration will need to be given to the continued access to this equipment and the PVH Group systems, and computer servers, post transaction.*"

67. At all events, it seems to us that the profit generated by the sale of the parts business was to a substantial extent sensibly to be attributed to MGRG's contributions to the transaction and

[62] See paragraph 40 above.
[63] See paragraph 47 above.
[64] See paragraphs 41 and 46 above.
[65] See paragraphs 42 and 43 above.

that a proportion of the profit should have been allocated to MGRG for this reason even if there had been no question mark over the price at which Xpart had previously been transferred to PVH.

68. One idea which has featured in both original documentation and evidence given to us is that MGRG's receipt of most of the profits from the parts business between 2002 and 2004 meant that no more needed to be paid to it when the business was sold to CAT. For example, minutes of an Xpart board meeting on 14 April 2005 contain the following passage:

> "*It was noted for the record that the shares in XPart limited were transferred from MGRG to PVH for £1 in November 2002 on the basis that XPart Limited would remit the bulk of its profits back to MGRG. In the time since that sale, some £60 million of profits have been distributed in that way. It was concluded by the board that* [Xpart] *may rely on this interpretation of the transaction at this time to regard the deferred consideration asset as its own.*"

In the course of his evidence, Mr Millett told us:

> "*If … you constructed a deal that said, 'We are going to sell* [Xpart] *at market value', what would have been constructed at that market value, then probably a figure not dissimilar to the £60 million that BMW put on it would be the same figure. And the argument was put that* [MGRG] *had enjoyed that level of profits …*"

Mr Cowburn said that "*for the next two years or slightly less than two years* [MGRG] *received £54 million of profits after the transfer of shares at nominal value*", as a result of which MGRG had "*already had their profit out*".

69. This thinking seems to us to be misconceived. Had it retained Xpart until the parts business was sold to CAT, MGRG would automatically have been entitled to all the profits it derived from the parts business between 2002 and 2004 <u>and</u> to all the profit from the sale to CAT[66]. In substance, what happened in 2004 was that MGRG was lent sums to which it would anyway have been entitled but for Xpart's transfer to PVH. The fact that MGRG received large profits from the parts business between 2002 and 2004 highlights the value of the business which MGRG lost; it can provide no justification for Xpart or PVH (which had acquired Xpart for a mere £2) keeping the profit from the sale.

70. The person primarily responsible for the manner in which the profit from the sale to CAT was treated will have been Mr Beale. It is by no means clear, in fact, how far any other director played a part in the relevant decision-making. Certainly, there is no reason to suppose that the treatment of the money was ever discussed at an MGRG board meeting. Mr Edwards said that the "*only important thing from* [his] *perspective* [was] *that* [they] *found ways in which to get* [MGRG] *to continue to trade*" and that he "*was not aware of the*

[66] Had MGRG still been the owner of Xpart, it would also have had the benefit of the profits which that company earned before the sale to CAT.

details of how the proceeds of sale would be made available to MGRG". Mr Howe explained his thinking as follows:

> "*... for me and I think for others, the sale of Xpart was triggered by the requirement for the cashflow – for* [MGRG] *... If the advice had come in saying: the money should go straight to* [MGRG]*, or the advice comes in saying: it should go to PVH and then find its way to* [MGRG]*, to me, providing the money finds its way through to* [MGRG]*, you just follow the advice.*"

Concluding comments

71. The overall effect of the transfer of Xpart to PVH and the subsequent sale of its business to CAT was to deprive MGRG of a very valuable asset. It is true that the parts business was sold with a view to keeping MGRG afloat and that most of the profit from the sale was lent to MGRG. Had, however, it still been the owner of Xpart, the profit (which amounted to more than £30 million[67]) would have come to MGRG as of right and not by way of loan. Further, while those concerned may have understood Eversheds to have endorsed the basis on which Xpart was transferred to PVH, the way in which the proceeds of the sale to CAT were treated did not accord with advice which Eversheds had given.

[67] The total profit recognised on the sale of the parts business was in excess of £52 million, of which approximately £21 million was allocated to the NSCs.

CHAPTER XIV

EDWARDS CARS LIMITED: FINANCIAL SUPPORT AND ACQUISITION

Background

1. By 2000, Edwards Cars had already been carrying on business as a car dealership for many years[1]. The company traded from leased premises in Stratford-upon-Avon and was also known as "Edwards of Stratford".

2. The company was owned by Mr Edwards and his wife, 19,999 of the 20,000 shares being held by Mr Edwards and the remaining share by Ms Marianne Edwards[2]. Mr Edwards and Mr Beale were both directors of the company[3], and Ms Edwards was also shown as a director in Edwards Cars' financial statements for 1999 and 2000[4].

Financial support from the Group

3. Between 9 May and 30 November 2000 Edwards Cars invoiced for, and Techtronic paid, sums totalling £308,000 (excluding VAT)[5] as follows:

Date of invoice	Description on invoice	Net amount of payment	Turnover year
		£	
02.08.00	Expenses and costs associated with the acquisition of Rover Group up to and including 31 May 2000[6]	108,000	2000
21.08.00	Payment on account of management charges and expenses in respect of the period 1 June 2000 to 31 December 2000	200,000	2000
Total		**308,000**	

4. Between December 2000 and the end of 2002 Edwards Cars invoiced PVH for sums totalling £3,877,958 (excluding VAT) as follows:

[1] Edwards Cars was incorporated as "Rapid 2136 Limited" on 5 December 1986, changing its name to "Edwards Cars Limited" on 23 December 1986.
[2] Note, however, IV/16.
[3] Mr Edwards became a director of Edwards Cars on 12 December 1986, Mr Beale joined the board on 1 July 1989.
[4] Although Mrs Edwards is shown as a director in the financial statements, Companies House does not record that she was ever a director of Edwards Cars, and she is not listed as a director on the Edwards Cars 2000 annual return.
[5] Techtronic also made loans totalling £1,210,837.50 to Edwards Cars between May and November 2000, but the loans were repaid in full in December 2000.
[6] As noted in chapter III footnote 37, the £108,000 is likely to have been paid, at least in part, to compensate Edwards Cars for costs associated with Techtronic's acquisition of MGRG.

Date of invoice	Description on invoice	Net amount of payment	Turnover year
		£	
18.12.00	Payment on account of management charges and expenses as agreed for the period ended 31 December 2000	235,500	2000
08.01.01	Payment on account of management charges and expenses as agreed	100,000	2001
31.01.01	Payment on account of management charges and expenses as agreed	185,000	2001
05.07.01	Payment on account of management charges and expenses as agreed for the period ended 31 March 2001	108,787	2001
08.08.01	Payment on account of management charges and expenses as agreed for the period ended 30 September 2001	120,000	2001
05.10.01	Payment on account of management charges and expenses as agreed for the period ended 30 September 2001	148,500	2001
31.10.01	Fees and recharges as agreed for the period ended 31 December 2000[7]	300,000	2000
06.12.01	Payment on account of management charges and expenses as agreed for the period ended 31 December 2001	76,000	2001
09.01.02	Payment on account of management charges and expenses as agreed for the period ended 31 December 2001[8]	86,000	2001
27.02.02	Payment on account of management charges and expenses as agreed for the period ended 31 March 2002[9]	146,000	2001
28.03.02	Payment on account of management charges and expenses as agreed for the period ended 31 December 2001[10]	210,464	2001
30.04.02	Payment on account of management charges and expenses as agreed	83,000	2002
31.05.02	Payment on account of management charges and expenses as agreed	92,000	2002
19.07.02	Payment on account of management charges and expenses as agreed	86,000	2002

[7] Despite being raised in 2001, this invoice was included in Edwards Cars 2000 turnover figure.
[8] Despite being raised in 2002, this invoice was included in Edwards Cars 2001 turnover figure.
[9] Despite being raised in 2002, this invoice was included in Edwards Cars 2001 turnover figure.
[10] Despite being raised in 2002, this invoice was included in Edwards Cars 2001 turnover figure.

Date of invoice	Description on invoice	Net amount of payment	Turnover year
		£	
31.07.02	Payment on account of management charges and expenses as agreed	103,000	2002
30.08.02	Payment on account of management charges and expenses as agreed	86,000	2002
27.09.02	Payment on account of management charges and expenses as agreed	93,000	2002
22.10.02	Additional vehicle bonuses as agreed for period ended 31 December 2001[11]	850,000	2001
22.10.02	Costs and expenses incurred on behalf of Phoenix Venture Holdings and MG Rover Group for the period May 2000 to 31 December 2001 as agreed[12]	681,207	[13]2001
30.10.02	For management services 01.10.02 – 31.10.02	87,500	2002
Total		**3,877,958**	

5. Neither the invoices nor any other records of which we are aware apportion the sums invoiced between management charges on the one hand and expenses on the other. Further, no further details are provided on the invoices or in other records of the expenses referred to, of any management services provided or of how the management charges were calculated.

6. As explained below, Edwards Cars was acquired by PVH with effect from 30 December 2002. PVH continued to make payments to Edwards Cars following the acquisition. Between January 2003 and April 2005 (when Edwards Cars, like MGRG, entered administration), PVH paid £1,718,953 to Edwards Cars as follows:

[11] Despite being raised in 2002, this invoice was included in Edwards Cars 2001 turnover figure.

[12] This charge was used to discharge a loan of the same amount which PVH had made to Edwards Cars. Edwards Cars had apparently needed £681,207.33 to cover a VAT liability.

[13] Despite being raised in 2002, this invoice was included within "*other income*" in Edwards Cars 2001 financial statements.

6.1. *2003*

Date of payment	Comment	Amount of payment
		£
07.02.03	Bank transfer: – no invoice	250,000
26.02.03	Bank transfer :– no invoice, however the payment was intended to cover various trade payments due from Edwards Cars to MGRG	178,953
03.04.03	Bank transfer: – no invoice; to a relatively small extent, the payment appears to have been designed to enable Edwards Cars to discharge debts to J B Public Relations (£5,875) and Woolrich-Burt Aviation Limited (£12,924.75)	170,000
08.05.03	Bank transfer: – no invoice; the payment appears to have been designed to enable Edwards Cars to discharge debts to J B Public Relations (£24,675.00) and Woolrich-Burt Aviation Limited (£33,542.95) and pay "*Pensions/Health etc*" costs in favour of Mr Edwards and Mr Beale (£13,991.16)	120,000
01.07.03	Bank transfer: – no invoice, however it appears that the payment was designed to enable Edwards Cars to pay various trade creditors	150,000
29.07.03	Bank transfer – no invoice	100,000
02.09.03	Bank transfer – no invoice	50,000
20.11.03	Bank transfer – no invoice, however the payment appears to have been designed to enable Edwards Cars to pay salaries and for the acquisition of seven demo vehicles	100,000
18.12.03	Bank transfer – no invoice, however, the payment appears to have been designed to enable Edwards Cars to pay trade creditors in December 2003	100,000
Total[14]		**1,218,953**

6.2. *2004*

Date of payment	Comment	Amount of payment
		£
06.10.04	Bank transfer – no invoice	300,000
Total		**300,000**

[14] These payments appear to have been treated, for the most part, as loans by PVH, and therefore were not included within Edwards Cars 2003 turnover figure.

6.3. *2005*

Date of invoice	Comment	Amount of payment
		£
26.01.05	Bank transfer – no invoice	200,000
Total		**200,000**

7. In total, the sums referred to in paragraphs 3 to 6 above amount to £5,904,911[15]. Of this amount £4,185,958 was passed through the profit and loss account up to 31 December 2002 as follows:

Year/ Profit and loss category	2000	2001	2002	Total
	£	**£**	**£**	**£**
Turnover	843,500	2,030,751	630,500	**3,504,751**
Other operating income		[16]681,207		**681,207**
Total	**843,500**	**2,711,958**	**630,500**	**4,185,958**

8. Several justifications for the payment of management charges were advanced in correspondence between Deloitte and the Inland Revenue. In a letter[17] dated 10 November 2004, for example, Deloitte explained as follows:

> "*... the main reasons for the* [management] *charges were as follows:*
>
> - *to provide fair compensation to Edwards Cars Limited for the Directors having to devote so much time to the affairs of PVH;*
> - *to compensate Edwards Cars Limited for offering special discounts and promotions with a view to maintaining sales volumes for the benefit of MG Rover Group Limited; and*
> - *to avoid a high profile insolvency within the MG Rover dealer network which would have adversely affected the goodwill of MG Rover Group.*"

Another letter of the same date dealt with, among other things, the £850,000 invoice to PVH of 22 October 2002. Deloitte said:

[15] This figure does not include £7,856 invoiced by Edwards Cars to PVH in respect of specific work and costs (for example, an invoice dated 21 June 2004 for £176 (inclusive of VAT) for removing and fitting a phone kit).

[16] Deloitte working papers show that management charges of £681,207 were included within "*other income*" in Edwards Cars' 2001 financial statements and were "*shown net against balance adjustments*".

[17] For the avoidance of any doubt, we should say that we do not criticise Deloitte for writing the letters quoted in this paragraph.

"*We understand the vehicle bonus of £850,000 was agreed as compensation for Edwards Cars Limited maintaining sales volume for MG Rover models by offering discounts and promotions to customers. It was also recognised that, in the absence of this charge, Edwards Cars Limited would have been technically insolvent as at 31 December 2001 due to the exceptional trading losses in this period.*"[18]

9. Similar reasons were given for the payments in evidence to us. Mr Beale, for example, identified the following reasons for the payment of management charges:

   9.1. reimbursement of actual expenses incurred[19];

   9.2. compensating Edwards Cars for the lack of management whilst Mr Edwards and Mr Beale were involved in the Group business[20];

   9.3. compensating Edwards Cars for achieving sales targets by selling vehicles at a loss[21]; and

   9.4. to avoid such a high profile dealership being put into administration, "*both from a Phoenix Consortium point of view and ... from an MG Rover Group point of view*".

10. Taking the first three of these points in turn:

   10.1. *Reimbursement of actual expenses incurred*

   Mr Beale explained to us that the amounts charged to PVH and Techtronic in respect of reimbursement for actual expenses incurred, such as car repairs, were "*probably a very small element*" of the total amount invoiced.

   10.2. *Compensation for lack of management*

   Mr Beale did not think that this factor accounted for a very large proportion of the management charges either. Common sense tends to confirm that view:

   (a) first, others could have been recruited to undertake work previously carried out by Mr Beale and Mr Edwards for a tiny fraction of the sums paid to Edwards Cars;

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[18] It is to be noted that the Edwards Cars 2001 financial statements were approved on 28 October 2002 and received by Companies House on 31 October 2002.
[19] See further paragraph 10.1 below.
[20] See further paragraph 10.2 below.
[21] See further paragraph 10.3 below.

(b) secondly, any financial disadvantage to Edwards Cars arising from the loss of Mr Beale's and Mr Edwards' services will have been mitigated to an extent by a reduction in the sums paid to them by Edwards Cars by way of directors' remuneration: whereas directors' emoluments in Edwards Cars amounted to £110,061 in 1999, they fell to £80,035 in 2000, to £37,427 in 2001, to £38,297 in 2002 and to zero in 2003; and

(c) thirdly, while it is true that Edwards Cars' turnover declined after Mr Beale and Mr Edwards became involved in the affairs of the Group in 2000, it was already falling before that. If the amounts invoiced to Techtronic and PVH as mentioned in paragraphs 3, 4 and 6 above are disregarded, Edwards Cars' turnover can be seen to have decreased by at least 6 per cent in each year from 1998 to 2003 (the last year for which financial statements are available):

Year	**Turnover per financial statements**	**Adjustments to turnover to exclude management charges etc**	**Adjusted turnover** ***adjusted to exclude management charges etc***	**Increase/ (decrease) from previous year**
	£	**£**	**£**	
1997	15,019,714		15,019,714	16%
1998	13,331,057		13,331,057	(11%)
1999	12,463,138		12,463,138	(7%)
2000	11,749,162	(843,500)	10,905,662	(12%)
2001	10,999,698	(2,030,751)	8,968,947	(18%)
2002	8,964,065	(630,500)	8,333,565	(7%)
2003	7,843,660		[22]7,843,660	(6%)

10.3. *Compensation for selling vehicles at a loss*

When asked about compensation paid to Edwards Cars for achieving sales targets by selling at a loss, Mr Beale replied:

> "*As I understand it, the issue there … is that if the … MG Rover Group wished to sell, to use the word, rather than register, sell additional cars at a month end or a quarter end to make the overall figures slightly better, the company would enter into special arrangements with various dealers around the country, and Edwards was rather used in this way, but sort of rather out of proportion to the turnover of the business.*"

It seems to us, however, that the support given to Edwards Cars by the Group will have represented compensation for selling cars at a loss to no more than a small extent. It is to be noted that:

[22] See footnote 14 above.

(a) only one of the invoices listed in paragraphs 3, 4 and 6 above refers to "*vehicle bonuses*"[23];

(b) we are not aware of any contemporary document recording additional purchases by Edwards Cars or containing any calculation of how far Edwards Cars should be compensated for such purchases; and

(c) other dealers, despite (as Mr Beale indicated) also receiving additional stock (even if on a smaller scale than Edwards Cars), did not receive comparable support[24].

11. It seems clear that the principal reason for the sums being paid to Edwards Cars was so that the company could continue to trade. Mr Beale accepted as much in his evidence to us. He said, for instance, that a "*major element of it*" was wishing to avoid putting a high profile dealership such as Edwards Cars into administration. He also said:

> "*It was not a terribly scientific process. It was more: what does Edwards Cars Limited need to keep surviving, rather than: this is the amount it deserves.*"

Mr Towers said:

> "*... I think the predominating feature of Edwards Cars is that – and this ... was not unique in that other dealers had had to be supported in this way*[25]*, but the predominating feature of Edwards Cars is that it was a dealership that had a valuable geographic position, a valuable turnover for the business, and it was in financial difficulties that required support.*"

As was accepted in representations to us on behalf of the members of the Phoenix Consortium, Edwards Cars "*was propped up by the PVH Group*".

12. It is plain that, but for the money it received from Techtronic and, particularly, PVH, Edwards Cars would have incurred very large losses and been most unlikely to have been able to continue trading. This is indicated by the tables below, which adjust the figures reported in Edwards Cars' financial statements by excluding the sums mentioned in paragraphs 3, 4 and 6 above:

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[23] I.e. the £850,000 invoice dated 22 October 2002.

[24] When we asked Mr Millett about the £850,000 invoice from Edwards Cars for "*Additional vehicle bonuses*", he said, "*I have never seen anything like that before in any dealings from MG Rover to any dealer.*"

[25] As noted in paragraph 10.3(c) above, it appears that other dealers in the network did not receive comparable support. When we asked Mr Beale whether Edwards Cars was being treated in the same way as other dealerships he replied, "*Absolutely not*". Similarly, Mr Millett told us that other dealerships in areas where the Group wanted representation would not have been paid management charges on the same scale, if at all. See also footnote 24 above.

	2000	2001	2002	2003
	£	£	£	£
Profit/(loss) before tax *per financial statements*	48,269	86,365	(507,086)	(968,471)
Profit/(loss) before tax *adjusted to exclude management charges etc*	(795,231)	(2,625,593)	(1,137,586)	(968,471)

	2000	2001	2002	2003
	£	£	£	£
Net assets/(liabilities) *per financial statements*	511,219	531,911	90,499	(877,972)
Net assets/(liabilities) *adjusted to exclude management charges etc*[26]	(332,281)	(3,023,547)	(4,095,459)	(5,063,930)

13. Mr Beale explained as follows:

> "*... everybody was aware that John Edwards was a member of the Phoenix Consortium. I think if therefore his dealership could not survive, why should any other dealership survive? Other dealers may well have thought about exactly that, we as a manufacturer were going round trying to get new dealers on, et cetera, et cetera.*"

14. We can see force in arguments such as this one and, hence, that there may well have been a commercial justification for providing Edwards Cars with some financial support. Even so, we do not think that support on the very large scale in fact provided can have been commercially justified[27]. Since, though, the money was provided by PVH (and, to a small extent, Techtronic), MGRG and its creditors will not have been disadvantaged, except to the extent that PVH consequently had less funds to reinvest in MGRG or alternatively extracted additional money from MGRG to fund its own expenditure. The more immediate losers will have been PVH and its shareholders (who included, but were not limited to, the members of the Phoenix Consortium).

<u>The acquisition of Edwards Cars by PVH</u>

15. By December 2002, it was being proposed that Edwards Cars should be acquired by a company in the Group. Mr Beale explained the decision to us as follows:

[26] The tax effect of the adjustments made to exclude the management charges etc from the financial statements is considered immaterial and has been disregarded in our calculations.
[27] Note in this connection footnote 24 above.

"*There was a strange issue with Edwards of Stratford in as much as some of the dealers were unhappy that Edwards of Stratford was getting rather preferential treatment from MG Rover because John Edwards owned it. And yet on the other hand, we were aware that it was actually suffering quite badly.*

It was also very clear that it was going to continue – I mean, I am talking about now – we are thinking through 2000 and 2001, a long time before the actual transfer took place, that it would actually require a huge amount of support to keep going, the way it was going.

So, the two obvious choices would be, one, to put it into administration or, two, keep it going but to avoid any question of impropriety to make it part of PVH, given it was PVH that was actually doing all the funding."

16. On 16 December 2002 Mr Bushill of Deloitte sent Mr Cowburn an email in which he said that he understood that "*for commercial reasons relating to the dealership network John* [Edwards] *and Peter* [Beale][28] *are proposing to transfer their shares in Edwards* [Cars] *to PVH … for nil consideration*". Mr Bushill went on to advise that the transaction should be structured as a "*paper for paper exchange*", for example by Mr Edwards gifting shares in Edwards Cars to the other three members of the Phoenix Consortium and the four of them then exchanging their shares in Edwards Cars for extra "D" shares in PVH.

17. On 2 January 2003 Mr Cowburn replied:

"*Peter seems to want to progress the above early next week, with the intention that Edwards is made a subsidiary of MG Rover dealer properties, I am seeing Peter and Jane Ruston on Tuesday 7 Jan … and will ring you … on Monday 6 Jan so we can agree what needs to be done.*"

It appears that at this stage no transfer had yet been effected and that the proposal was for Edwards Cars to be made a subsidiary of MGRDP.

18. Four days later, on 6 January 2003, Ms Ruston sent Mr Beale and Mr Edwards a memorandum about the "***Proposed** Acquisition of Edwards Cars Limited*" (emphasis added). In that memorandum, Ms Ruston wrote:

[28] As noted in paragraph 2 above, the shares in Edwards Cars were held by Mr and Mrs Edwards and not, as suggested by Mr Bushill's email of 16 December 2002 above, Mr Beale. Note, however, IV/16.

"*I have made the purchase MG Rover Property Holdings Limited rather than MG Rover Dealer Properties Limited because the only directors of that company are yourselves. The articles of association of that company do not allow you to vote on matters in which you are interested. I could change the articles but I think that it looks cleaner this way. Once we have made the initial acquisition we can then move the company to be a subsidiary of whichever one within the group we like.*"

Enclosed with the memorandum was a set of draft Property Holdings board minutes approving the acquisition of Edwards Cars and undated stock transfer forms for the transfer of shares from Mr and Mrs Edwards to Property Holdings. It can be seen from their metadata[29] that the draft minutes were created between 8.18 am and 10.28 am on 6 January 2003. The heading, however, refers to the meeting being held "*On December **2002***" (emphasis added). We were told in representations made on Ms Ruston's behalf that she believed that the reason for the 2002 date "*would have been that she was working from a set precedent/template minutes and did not change the date contained in this precedent/template when preparing these minutes.*"[30]

19. During the afternoon of 6 January 2003, Mr Cowburn forwarded Mr Bushill's email of 16 December 2002 to Ms Ruston and Mr Beale. Mr Cowburn's own email included the following:

"*In practical terms we need to have held a Board meeting of Phoenix agreeing to acquire Edwards for nil consideration subject to tax clearance, presumably Peter there needs to be a mirror of this meeting in the books of Edwards.*"[31]

20. On the next day, 7 January 2003, Ms Ruston sent Mr Beale and Mr Edwards a further memorandum[32], in which she wrote:

"*I have now been copied with an email from Toby* [Bushill] *... in which a different structure has been outlined for this acquisition ...*

Toby's scenario envisages issuing 1 new 'D' share in PVH in return for the shares held by each of the consortium in Edwards Cars Limited. In view of the fact that all of the authorised D shares have been issued already and to increase the share capital PVH will require a special resolution (with all that that entails) then I have agreed with Toby [Bushill] *that the same tax treatment can be obtained if we issue loan notes for a nominal amount. I have put this change into the Board Minutes. The*

[29] Metadata is "data about data", that is, data that provides information about other data. References to the term metadata in this report should be taken as referring to the properties of a document which are automatically maintained by Microsoft Office applications and recorded on the electronic version of the document, such as the original author's name, the file size and the dates files were created and last modified.

[30] The representations also explained, "*At this stage, ... Jane Ruston ... was simply seeking instructions as to how the transfer was to be completed which was a matter for the PVH Directors.*"

[31] Mr Cowburn explained to us that he was not contemplating a backdated board meeting, but was rather assuming that there had not yet been a board meeting and that one needed to be held.

[32] The memorandum was also copied to Mr Cowburn.

> *documents that I gave you yesterday are now redundant and you can dispose of them.*"

By this point, the draft minutes were for a meeting of the board of PVH (instead of Property Holdings) and provided for PVH to acquire Edwards Cars from the members of the Phoenix Consortium in exchange for the issue of £10 of loan notes to each of them. The heading still referred to the meeting being held "*On December **2002***" (emphasis added). Once again, representations made on Ms Ruston's behalf attributed the date to use of a precedent/template.

21. This scheme was itself abandoned. Mr Cowburn noted in manuscript on a copy of Ms Ruston's memorandum:

> "*SUPERCEDED PER PETER BEALE 7.1.03*
> *DRAFT MINUTES DONE ON SIMPLE* [TRANSFER] *BASIS*"

22. In accordance with Mr Cowburn's note, draft minutes were prepared recording the approval by PVH's board of the company's acquisition of Edwards Cars from Mr and Ms Edwards for £1. The metadata for the draft minutes show that they were created between 9.43 am and 4.11 pm on 7 January 2003. The heading, however, again referred to the meeting being held "*on December **2002***" (emphasis added). In contrast, the share sale agreement which Ms Ruston prepared in connection with the acquisition began "*DATED **2003***" (emphasis added). It was explained to us that Ms Ruston inserted the "2003" date because she thought that the transaction was being effected in that year, while the draft minutes referred to "2002" because they were prepared from a precedent/template.

23. The transaction was carried into effect on the basis of these drafts. Minutes in the form of those mentioned in the previous paragraph but now dated "*30th December 2002 at 2.30pm*"[33] and signed by Mr Towers purport to record a meeting of PVH's board, attended by Messrs Beale, Edwards, Stephenson and Towers, at which the acquisition of Edwards Cars for £1 was approved. Further, the share sale agreement referred to in the previous paragraph had been dated "*30/12 2002*" (the typed 2003 having been amended in manuscript to read "*2002*"*)* and signed by Ms Ruston[34] on behalf of PVH and by Mr Edwards as a vendor. Mr Edwards also signed a stock transfer form which was dated "*30.12.02*" in manuscript.

24. These various documents have plainly been backdated. As at the date they bear, 30 December 2002, it had not yet been decided which company should acquire Edwards Cars or for how much. A week later, the parties were still debating the best way in which to structure the acquisition of Edwards Cars and were yet to decide which company was to be

[33] We were told in representations made on Ms Ruston's behalf that she did not see the minutes in their final form and that the date was inserted by others without her knowledge.
[34] Representations made to us on Ms Ruston's behalf stated that, when Ms Ruston signed the agreement, the date in the document was not completed and bore the typed date "2003", and also that Ms Ruston did not see the agreement after she signed it and had no reason to believe that it had been backdated.

purchaser. The final method of purchase, i.e. share transfer to PVH for a consideration of £1, was not decided until 7 January 2003. Moreover, the share sale agreement which, according to the signed minutes, was tabled and approved at a PVH board meeting on 30 December 2002 was not in fact drafted until January 2003. If a board meeting such as that recorded in the signed minutes took place at all (which we doubt), it did not do so on the date specified in the minutes.

25. The documentation will have been backdated to 30 December 2002 so that the acquisition would appear to have been effected in that year rather than in 2003[35]. We are not sure why this was thought desirable. Representations made to us on behalf of the members of the Phoenix Consortium refer to the transfer having been made in December 2002 "*seemingly, for tax reasons*", but we are not clear what tax advantages might have been considered to arise from a change in ownership in 2002 as opposed to 2003. Another possible explanation is to be found in Financial Reporting Standard 8, "*Related party disclosures*" ("FRS 8"). This exempts a company from having to disclose in its financial statements as related party transactions, transactions with another company in the same group as itself where consolidated financial statements are prepared and publicly available[36]. Edwards Cars' 2002 financial statements invoked this exemption. Note 19 (related party transactions) to the financial statements states:

> "*The company has taken advantage under Financial Reporting Standard Number 8 not to disclose related party transactions with companies within the same group as itself.*"

26. Had the acquisition of Edwards Cars been treated as taking place in 2003 (as it in fact did), Edwards Cars would have remained outside the Group for the year ended 31 December 2002. However, it still would have been classed as a related party to PVH[37], as a result of which full disclosure of transactions between Edwards Cars and PVH would have been required within the notes to the financial statements for both companies[38]. As a result of PVH's acquisition of Edwards Cars being treated as having been effected before the end of 2002, the inter-company dealings had only to be separately disclosed in PVH's financial statements.

27. A further point is that Mr Howe, despite being a director of PVH, does not appear to have been given notice of any meeting of PVH's board which may have been held in connection with its acquisition of Edwards Cars, nor even to have been aware of the acquisition until after it had happened. Mr Howe told us that he was "*pretty confident*" that he "*actually didn't realise Edwards Cars had been brought into the group until after it had been brought into the group*". When specifically asked whether he knew anything about the minuted meeting on 30 December 2002, he responded:

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35 Mr Beale said in interview that he could "*only assume we were trying to get this through for the year end*".
36 FRS 8 paragraph 3(c).
37 FRS 8 paragraph 2.5(a).
38 FRS 8 paragraph 6.

> "*… it was in my tenure as being involved with Phoenix, but whether I was invited to it and couldn't make it, I don't know. You know, the actual correct answer is no. No, I don't recall it. But it is not – just to be careful, it is not me saying that I wasn't invited. But I don't know about it. By definition I would have known it had been brought into the group if I had been there.*"

However, PVH's articles of association specifically provided for every director of the company to be given notice of board meetings[39].

28. It was suggested to us in representations on behalf of the members of the Phoenix Consortium that in December 2002 "*a decision had been made by the directors of PVH that* [Edwards Cars] *should become a subsidiary of PVH and be brought into the PVH group of companies*" and that it was "*Messrs Beale, Edwards, Stephenson and Towers' understanding that the documentation was simply formalising the oral agreement in December 2002 and therefore the appropriate date for the transaction was before 1 January 2003*". While, however, some or all of Messrs Beale, Edwards, Stephenson and Towers may have concluded in the December that Edwards Cars should be brought into the Group:

    28.1. PVH's board cannot be said to have made any decision in December 2002 since Mr Howe, a member of that board, had not been involved;

    28.2. it was not in fact until January 2003 that it was decided that Edwards Cars should be acquired by PVH itself and for £1; and

    28.3. even if every member of PVH's board had decided in December 2002 that PVH should acquire Edwards Cars for £1, that could not justify the production and signature[40] of minutes for a board meeting which had not taken place, or at any rate had not taken place by the date given in the minutes.

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[39] Article 19.7 provided as follows:

> "… *Regulation 88 of Table A shall be amended by substituting for the sentence:*
> *'It shall not be necessary to give notice of a meeting to a director who is absent from the United Kingdom'*
> *the following sentence:*
> *'Notice of every meeting of the directors shall be given to each director and his alternate director, including directors and alternate directors who may for the time being be absent from the United Kingdom and have given the Company an address within the United Kingdom for service.'* "

As noted elsewhere in this report, there is any event a general rule of law to the effect that all directors must be given notice of board meetings: see, for example, *In re Portuguese Consolidated Copper Mines Limited* (1889) 42 Ch D 160 and *Young v Ladies' Imperial Club* [1920] 2 KB 523. See also chapter XXII (Aspects of corporate governance).

[40] Representations made to us on Ms Ruston's behalf pointed out, "*Ultimately, it was for others who attended the meeting, and who dealt with its formalities, to check that the correct date was inserted in the minutes and that the correct attendees are listed.*"

Insolvency

29. Edwards Cars went into administration on 21 April 2005 and into creditors' voluntary liquidation on 24 January 2006. A statement of affairs sworn by Mr Beale on 8 June 2005 estimated that it had a deficiency as regards creditors of £4.1 million when it entered administration.

CHAPTER XV

THE REASONS FOR THE GROUP STRUCTURE

Background

1. As explained in chapter VIII (Group structure)[1], the restructuring of the Group, notably the transfer of land at Longbridge[2], dealer properties[3], Heritage Companies[4] and Xpart[5] from the MGRG sub-group to other companies owned by PVH, was said, both at the time and in evidence given to us, to have been for reasons of management focus and financial transparency. The Group structure that was adopted was calculated, it was argued, "*to create more management focus on those individual businesses*" and to produce figures which were "*self-contained and not just an amorphous mass*" (to quote in each case from Mr Beale). It was suggested, too, that there were thought to be advantages in having "*a parent company with direct subsidiaries*" (to use words of Mr Einollahi).

2. However, as explained below[6], the evidence indicates that the restructuring of the Group was not always conducive to management focus and financial transparency and that it sometimes resulted in subsidiaries of subsidiaries. There is also evidence which indicates another motivation for the restructuring, namely a desire to ring-fence assets from MGRG's and Techtronic's liabilities[7].

Unlikelihood of achieving management focus and financial transparency

3. A first point is that the transfers from MGRG (of land at Longbridge[8], dealer properties[9], Heritage Companies[10] and Xpart[11]) did not in fact achieve, and were not likely to achieve, better management focus and financial transparency. Thus:

   3.1. the same individuals, none of whom was a director of Property Holdings, were the most involved in decision-making as regards the Longbridge land both before and after it was transferred to Property Holdings; in fact, Property Holdings' directors were not closely involved either in decisions relating to the land or in the management of the company. Further, Property Holdings' interests were not looked at in isolation from MGRG's, Property Holdings never had any employees or bank account of its own, and the existing property and/or finance departments could have produced financial information about the land without any transfer of ownership[12];

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1 See VIII/10.
2 See IX/4 to 27.
3 See IX/44 to 62.
4 See IX/76 to 87.
5 See XIII/5 to 32.
6 See paragraphs 3 to 5 below.
7 See paragraphs 6 to 17 below.
8 See IX/4 to 27.
9 See IX/44 to 62.
10 See IX/76 to 87.
11 See XIII/13 to 28.
12 See IX/35 to 42.

3.2. similarly, the transfer of dealer properties to MGRDP did not change who managed them in practice, and MGRDP's interests were not looked at in isolation from MGRG's. Like Property Holdings, MGRDP never had any employees or bank account of its own. In addition, the existing property and/or finance departments prepared, or could have prepared, financial information relating to property transactions without any change in the properties' ownership[13];

3.3. the Heritage Companies did not require any active management either before or after their transfer from MGRG to MG Rover Heritage[14]; and

3.4. by the time Xpart was transferred to PVH in December 2002, the parts business was already being managed by a separate company (viz. Xpart) with its own board. Moreover, the transfer certainly did not achieve financial transparency: to obtain any understanding of the financial performance of the parts business as a whole, it was necessary to aggregate figures from Xpart, MGRG and even the NSCs[15].

4. Mr Millett explained to us that he was never persuaded that the restructuring was necessary. He said for example:

> "*The establishment of* [PVH] *and the rationale for so doing, about this improved management focus on the specialist companies, I was never a subscriber to that school of thought*"; and

> "*As a general principle, I was not persuaded that this structure needed to be put in place to make companies more efficient.*"

<u>Use of indirect subsidiaries</u>

5. Further, despite the professed preference for "*a parent company with direct subsidiaries*", companies were sometimes made subsidiaries of subsidiaries under the restructuring. MGRDP became a subsidiary of Property Holdings, itself a subsidiary of PVH. Studley Castle Limited was also transferred to Property Holdings. Ownership of the Heritage Companies was likewise transferred to a subsidiary of PVH (namely, Heritage) rather than to PVH itself. MG Sport and Racing was made a subsidiary of MG X80.

<u>Ring-fencing</u>

6. On the other hand, there are indications in the contemporary documents and evidence given to us of a desire that assets and business activities should be ring-fenced from both MGRG's liabilities and Techtronic's indebtedness to BMW.

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[13] See IX/66 to 72.
[14] See IX/88 to 92.
[15] See XIII/31 to 32.

7. There was reference to ring-fencing when Powertrain was being acquired from BMW in 2001[16]. On 7 May Mr Bushill of Deloitte sent Mr Barton of the firm an email in which he listed "*Points arising from a tax viewpoint*", including:

> "*Identity of purchasing company – given the necessity of ring-fencing* [Powertrain] *from* [MGRG], [PVH] *would seem to make more sense than Techtronic 2000. This also avoids any limitations created by the BMW Loan Note.*"

Later on the same day, Mr Barton wrote as follows in an email to Mr Einollahi:

> "*Agreement over purchaser –* [PVH] *is more removed than Techtronic and above the group in which* [MGRG] *is held giving a greater ability to ring fence.*"

The idea was evidently that a major reason for making Powertrain a subsidiary of PVH was that this would insulate it both from MGRG and from the loan notes for which BMW subscribed.

8. Ms Lewis of Eversheds confirmed to us that "*the client's preference was to have Powertrain as a subsidiary of PVH*". The lawyers, however, advised otherwise; Ms Lewis told us:

> "*We thought that because the acquisition of Powertrain was linked to the resolution of the completion accounts dispute that arose out of the* [SPA] *... that it was probably more appropriate that it go underneath Techtronic, rather than underneath PVH.*"

Asked about why there was preference for Powertrain to be a subsidiary of PVH rather than Techtronic, Ms Lewis said that she thought "*there was a concept of keeping things separate, or keeping businesses separate from the vehicle manufacturing business*".

9. Mr Beale said that the idea of sidelining the loans BMW had made to Techtronic "*cropped up several times over the period of years*". At one stage, he said, there was "*an idea, a sort of vague idea about that we could actually hive out business of* [MGRG] *somehow, and sort of completely sideline the loan notes*".

10. Powertrain was ultimately acquired in Techtronic's name, but within a short period thought was being given to the possibility of the company being transferred to PVH. A document[17] which appears to have been prepared by Mr Beale in June 2001 includes the following among a number of "*Points for discussion*":

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[16] See V/90 to 94.
[17] See further VIII/3.

"*Techtronic:*

- *Hive up of assets.*
- *Sidelining of liabilities.*"

The point was developed as follows in a further document[18]:

"*... Techtronic (2000) Limited ... :*

- *Investment in PTL* [i.e. Powertrain] *to be hived up, or paid as a dividend in specie to* [PVH] *... Hive up to be performed now such that no value change for PTL following recent acquisition. PTL therefore becomes direct subsidiary of* [PVH].
- *Legal consideration to be given to moving Techtronic so that* [MGRG] *becomes direct subsidiary of* [PVH]. *Deloittes to consider if the loan note right to receive monies from* [MGRG] *could be hived up to* [PVH] *but leaving the obligation to repay BMW with Techtronic ...*"

11. The points referred to in the documents mentioned in the previous paragraph were discussed at a meeting attended by, among others, Mr Einollahi and Mr Barton on 11 June 2001. Asked about the reference to "*the loan note right to receive monies from* [MGRG]" being "*hived up to* [PVH] *but leaving the obligation to repay BMW with Techtronic*", Mr Einollahi told us:

"*... this was putting Techtronic, which had nothing else, no other creditor, if it was possible to put Techtronic in that position, that BMW could only go to Techtronics and Techtronics did not have funds to pay, that was very seriously contemplated.*"

This, Mr Einollahi said, was "*a defensive move against BMW potential demand for repayment*".

12. In early 2002 Herbert Smith were instructed by PVH to review documentation relating to Techtronic's acquisition of MGRG, the hive outs effected in advance of that transaction, and the establishment of PVH. On 28 February representatives from Herbert Smith had a telephone conference with Ms Ruston and Ms Atkins from the Group's legal department and Mr Barton. An attendance note in respect of the telephone conference includes the following:

"*RML* [a solicitor from Herbert Smith] *explained that* [Mr Einollahi] *had wondered whether the new* [PVH] *subsidiaries ... might be used in order to filter profit out of* [MGRG] *and its subsidiaries, and therefore not trigger the repayment obligations under the Loan Notes. However, the review conducted by Herbert Smith to date had*

[18] Mr Beale was probably also the author of this document.

ascertained that this did not appear to be possible and he would caution generally in any event against trying to artificially reduce the net profit for the purposes of the repayment clauses of the Loan Notes. The evident danger was that any strategy that went awry in this respect could trigger an event of default and therefore allow BMW to claim the whole amount due under the Loan Notes."

13. Mr Einollahi told us that the "*vocabulary of filtering profit*" was "*rather aggressive*", but that the purpose was "*denying BMW the opportunity to come and have repayment*". He referred to an "*objective that there was nothing in the business which owed the money*" and to the possibility that "*you could defensively let that company go bust*".

14. Later in his evidence, Mr Einollahi said that it would be inconceivable for him to suggest any arrangement whereby a "*legitimate creditor will lose out or there is a risk of them losing out*", but that he did not regard BMW as a legitimate creditor; while he was "*not challenging* [BMW's] *legal position as a creditor*", so far as Mr Einollahi was concerned there could have been "*no expectation to repay*" when BMW had agreed in May 2000 to provide money to Techtronic. However, the attendance note of the telephone conference on 28 February 2002 records[19]:

> "[Ms Ruston] *and* [Mr Barton] *noted that there was no extraneous hard evidence that the Loan Notes were not intended to be repayable.* [A solicitor from Herbert Smith] *noted that this was certainly the case on a review of the documents and it would be a logical objective conclusion that BMW had not anticipated a return of the Loan Note principal but had wished to take a slice of any future profits of* [MGRG] *in the event that the business did (contrary to BMW's fears) prove to be a success.* [Ms Ruston] *agreed: from her perspective the repayment provisions in the Loan Notes were to avoid the potential embarrassment of BMW contributing large amounts of cash to (as it saw it) rid itself of the MG Rover group and then seeing those companies either becoming highly profitable or being bought by a competitor to BMW; under the repayment provisions of the Loan Notes, in such circumstances BMW would be repaid.*
>
> *... Returning to the question of whether the Loan Notes were a sham,* [Ms Ruston] *noted that all the evidence pointed to BMW taking the Loan Notes extremely seriously. They had been very careful in the drafting of the amendments incorporated in the Deed Supplemental*[20] *in order to fully protect their interests in the Notes and ... BMW had always insisted that the MG Rover group should comply fully with the Loan Notes obligations ...*"

[19] See also III/54, where we express the view that, while it may very well be that BMW did not anticipate that it would in fact receive repayment, there is no reason to suppose that, as a matter of law, BMW paid moneys to Techtronic by way of gift rather than subscription for loan notes, nor that BMW intended a gift.

[20] See V/55.6 and 57.

15. Some of the other evidence that was given to us also indicated that the Group structure was motivated in part by a desire to ring-fence assets and business activities from liabilities of MGRG and Techtronic. Thus:

    15.1. Mr Stephenson more or less accepted that ring-fencing was a reason for the restructuring. When asked whether the Group had been restructured "*to get assets out of the car company, not least so that if the car company failed, the rest would survive*", Mr Stephenson said that that "*was not a reason for the reorganisation*" but went on to observe that "*it might not have been a bad reason*" and to comment:

    > "*You would argue that directors have a responsibility to protect the individual elements of a corporate entity and, therefore, it might be absolutely the right thing to do.*"

    Mr Stephenson also said that while ring-fencing from MGRG "*wasn't the prime reason for our reorganisation, it may have been a subsequent additional element of that*". With regard specifically to the transfer of Xpart to PVH, Mr Stephenson said that ring-fencing from MGRG "*was a subsidiary benefit*". He also said that "*one reason*" to "*put our property portfolio into one holding company*" was to ring-fence it from the trading operation (though he maintained that the "*main reason we had in mind was it provided better management focus*");

    15.2. when giving evidence about Project Platinum[21], Mr Beale said in relation to the Rover loan book that "*it would have made no sense to put this type of asset beneath* [MGRG]*, particularly given MGRG's trading losses*". Expanding on this, Mr Beale said that one of the things he had in mind was that holding assets through subsidiaries of MGRG would be of advantage to that company's creditors (though also, he noted, "*a disadvantage to* [PVH's] *creditors*");

    15.3. Mr Howe said that one factor in the restructuring was that:

    > "*… if an element – and obviously you are concentrating on* [MGRG] *because it is the obvious one – but if an element had failed, then there was sustainability for the rest of the group and the rest of the employees that were working in there*";

    15.4. Mr Barton said that the directors thought it desirable to protect other parts of the Group from MGRG. He stated that his "*general understanding*" was that there was an idea that "*if the car company … did go bust because its recovery plan did not succeed, then at least there were other assets within the group that could be protected in that way* [i.e. by ring-fencing]". He explained that, while he could not recall a director making a specific comment along those lines, his understanding was "*built up over the course of a long period of time, and many discussions*"; and

[21] See chapter VII (Project Platinum).

15.5. Mr Ames referred to being told that the Group needed to be structured as it was "*to safeguard monies and so on*", and to the idea being to protect different parts from the failure of MGRG.

16. When asked whether it was ever suggested that one advantage of the structure being adopted would be that if MGRG failed the rest would survive, Mr Bushill of Deloitte said that he could "*not remember it being spelt out as baldly as that*", but that "*it would have been a fairly obvious assumption, looking at the structure, given that everyone appreciated how risky the car company was*". In response to a similar question, Ms Lewis said that she thought she "*had heard it from Deloitte's but after the event ... probably in very general terms, in the context of ringfencing*".

17. Two other occasions on which members of the Phoenix Consortium did not want shareholdings to be held by MGRG are relevant. First, in early 2002 (i.e. soon after the transfers of the Longbridge land, dealer properties and Heritage Companies, and in the same year as Xpart was transferred), the members of the Phoenix Consortium wanted the company which was to be used to raise money on leaseplan vehicles (in the event, MGR (Leaseplan)) to be owned by the Phoenix Partnership; the motivation was nothing to do with management focus or transparency but rather a desire to benefit the members of the Phoenix Partnership[22]. Secondly, during the negotiations with SAIC there was an attempt to insist on PVH rather than MGRG holding shares in the joint ventures which were envisaged; as we explain in chapter XX (The events leading to administration)[23], we consider that the main reason Mr Beale, Mr Towers and (even if to a lesser extent) Mr Stephenson wanted PVH to be the shareholder was probably to ensure that the value of the shares would accrue to that company (and, hence, themselves as its directors and "D" shareholders[24]) regardless of what became of MGRG. With both the leaseplan company and the proposed joint ventures, therefore, members of the Phoenix Consortium preferred shares to be held otherwise than by MGRG for reasons unconnected with management focus or financial transparency.

Involvement with the restructuring of the Group

18. Mr Beale was undoubtedly the member of the Phoenix Consortium most involved with the restructuring. Mr Edwards said that the restructuring "*was a Peter Beale issue with the senior members of the MG Rover board really*"; he (Mr Edwards) said that his "*own take on it was that it was something of a paperwork exercise, and that it was all to do with corporate tidying ...*". Ms Ruston said that she always understood the structure to be "*very much Peter Beale's idea or his goal for the company*". Mr Howe said that "*Corporate structure, corporate finance ... that was* [Mr Beale's] *domain*" and that "*The discussion about making sure we had a corporate structure that was solid and had some sustainability would have been more driven by* [Mr Beale]".

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22 See X/6 to 10 and 16 to 24.

23 See XX/84.

24 As noted at V/49.1, 49.2 and 49.3, PVH had four classes of shares. The rights of holders of "A", "B" and "C" shares (unlike those of "D" shareholders) were limited to assets "*which derive from or are fairly attributable to the MG Rover Group*" , to "*MG Rover Profits*" and to the "*MG Rover Total Capitalisation*". "A", "B" and "C" shares carried no entitlement to vote at general meetings; these were conferred only on "D" shares.

19. Asked how far the four members of the Phoenix Consortium discussed the Group structure between themselves, Mr Beale said:

> "*To some extent, it is something that we quickly identified with and agreed was a good policy, so it just became our strategy.*"

Mr Towers told us that, while he was "*hardly involved in the debate that resulted in MG Rover Holdings and so on*", he was involved in the debate surrounding management structure and accountability. Mr Stephenson was certain that "*there were many and varied discussions.*" For his part, Mr Edwards told us that he had "*very little*" knowledge of matters relating to the restructuring.

20. We should add that, in our view, the functional directors of MGRG were not motivated by any desire to ring-fence assets from creditors. The restructuring was effected on the initiative of members of the Phoenix Consortium (in particular, Mr Beale) and, as the functional directors understood it, for reasons of management focus and transparency.

<u>Concluding comments</u>

21. It has been strenuously argued in representations to us on behalf of the members of the Phoenix Consortium that there is no evidential basis for supposing that the Group structure was intended to circumvent the loan notes BMW held or to insulate assets from any failure of MGRG. We do not agree. In our view, the matters mentioned earlier in this chapter afford ample and persuasive evidence of such an intention.

22. There were good reasons for certain companies in the Group not being subsidiaries of MGRG. For instance, more than one witness told us that Ford would not have agreed to Powertrain (which manufactured engines for Land Rover as well as MGRG until it went into administration on 8 April 2005) being owned by MGRG[25]. Similarly, it seems that Barclays would have been unwilling that PVL or PVL2 should be a subsidiary of MGRG[26].

[25] Mr Brooks of Norton Rose (BMW's solicitors) told us, for example, "*there was no way Ford would ever agree that Powertrain be a subsidiary of MG Rover.*" Mr Millett recalled that Ford "*wanted the Powertrain company specifically not to be an MG Rover subsidiary, so it could not be acquired in that way*". Mr Howe said: "*I do not think I have actually seen it in writing but I think I am pretty clear, that Ford had a degree of control over what we could and could not do with Powertrain through BMW, and I think one of those areas of control was it was not to become part of the car company, it had to sit aside from the car company*".

[26] See XI/9.

23. On the other hand, we consider that a major reason (if not the main reason) for the December 2001 transfers of the Longbridge land, dealer properties and Heritage Companies, and the transfer a year later of Xpart, was to insulate assets and business activities from MGRG's existing and potential future liabilities and Techtronic's indebtedness to BMW. If the transfers were also motivated by a concern as to management focus and transparency, that, in our view, was probably a subsidiary consideration and the transfers effected were not likely to achieve this. The director principally responsible was Mr Beale, but Mr Towers and Mr Stephenson are likely to have shared his aims. Mr Edwards, in contrast, may well (as he said in evidence) have had very little knowledge of matters relating to the restructuring.

CHAPTER XVI

FINANCIAL AND TRADING PERFORMANCE OF MGRG BETWEEN 1999 AND 2004

Introduction

1. This chapter outlines the main aspects of MGRG's financial and trading performance between 1999 and 2004.

2. It can be seen from the table below that the turnover of MGRG, having fallen dramatically in the year it was sold by BMW, rose until 2002 and then declined again in the period leading to administration. The losses followed a similar trend, reducing until 2002 but then rising again. The losses were broadly echoed in the movements in MGRG's net liabilities, save that the sale of discontinued operations in 2000 gave rise to exceptional profits[1]. These profits resulted in a net asset position of £12 million at the end of 2000, but by 2004 net liabilities had returned to their 1999 level.

	1999	2000	2001 *(restated)*	2002	2003	2004
	£ million					
Turnover from continuing operations	2,303	1,260	1,321	1,493	1,307	1,080
Operating loss from continuing operations	(917)	(503)	(183)	(70)	(88)	(118)
Net assets (liabilities)	(464)	12	(175)	(243)	(336)	(463)
Paragraphs	5 to 7	8 to 15	16 to 23	24 to 34	35 to 44	45 to 58

3. The following chart shows the volumes of car sales made by MGRG from May 2000 until December 2004[2]. The sales volumes peak earlier than turnover, in 2001, but otherwise follow the trend indicated in the table.

Volume of sales

1 See paragraph 6 below.
2 The 2004 figures are draft.

4. The main features of MGRG's financial and trading performance for each of the years between 1999 and 2004[3] are detailed in the paragraphs indicated in the table above.

<u>1999</u>

5. MGRG's financial results for the year ended 31 December 1999[4] (the last full year of BMW ownership) were as follows[5]:

	£ million
Turnover from continuing operations	2,303
Turnover from discontinued operations	2,499
Operating loss from continuing operations	(917)
Operating loss from discontinued operations	(1,199)
Loss on ordinary activities before taxation	(2,139)
Loss for the financial year	(2,067)
Net current liabilities	(1,137)
Net liabilities	(464)

6. The "*discontinued operations*", which were identified retrospectively in the financial statements for the year ended 31 December 2000, were those of Land Rover, the powertrain business, the Swindon pressings plant and the manufacturing facility at Cowley[6]. As we note in chapter III (The sale of Rover)[7], the Land Rover business was sold to Ford, while BMW retained the powertrain business, the Swindon pressings plant and the manufacturing facility at Cowley.

[3] For details of MGRG's financial and trading performance in 2005, see chapter XX (The events leading to administration).
[4] As shown in the 2000 financial statements of MGRG.
[5] Also see II/24 to 26.
[6] As we note in II/13, 14 and 16 and III/88.7, the powertrain business was the business of manufacturing engines and gear boxes (which Powertrain acquired from MGRG in April 2000), the MGRG plant at Swindon housed a pressings business that supplied body parts for all of the cars produced by the group other than the MGF and the Land Rover Defender, and the Rover 75 was assembled at Cowley.
[7] See III/10 to 12 and 89. See also V/90 to 94.

7. The losses included exceptional items totalling £1,253 million of which £1,228 million was in respect of the write down of certain tangible fixed assets, relating to both the continued and discontinued operations, to their estimated recoverable value[8]. Without the exceptional items, MGRG's total operating loss would have been £863 million[9].

2000

8. MGRG's financial statements for the year ended 31 December 2000 show:

	£ million
Turnover from continuing operations	1,260
Turnover from discontinued operations	1,051
Operating loss from continuing operations	(503)
Operating loss from discontinued operations	(103)
Profit on ordinary activities before taxation	543
Profit for the financial year	542
Net current assets	251
Net assets	12

9. The reported results for the company include the results of trading prior to 9 May 2000, when MGRG was sold to Techtronic, as well as exceptional profits recognised as a result of the reorganisation[10]. As the directors' report points out:

> "*As a consequence of the restructuring of the Company, the financial results for 2000 are atypical. The hive out created exceptional profits on disposal amounting to £1,154.8 million adjusting the operating loss of the business into an overall profit for the financial year.*"

It was primarily this exceptional profit which changed the operating losses on continued and discontinued operations into a profit of £542 million for the year and resulted in net assets at 31 December 2000 of £12 million.

[8] Impairment reviews are required under Financial Reporting Standard 11 (Impairment of fixed assets and goodwill). In general, fixed assets and goodwill need be reviewed for impairment only if there is some indication that impairment has occurred. Impairment is measured by comparing the carrying value of the asset with its recoverable amount. The recoverable amount is the higher of the amount that can be obtained from selling the asset and its value in use. The categories of assets that were written down to their recoverable amounts were land and buildings (£273 million), plant and machinery (£576 million) and special tools, dies and jigs (£379 million).

[9] Total operating loss in restated 1999 financial statements less exceptional items (i.e. £2,116 million less £1,253 million).

[10] Profit on disposal totalled £1,154.8 million and represented: profit on disposal of discontinued operations of £1,107.3 million; profit on sale of intellectual property rights from discontinued operations of £50 million; and loss on disposal of subsidiary undertakings from discontinued operations of £2.5 million.

10. In relation to operations continuing after 9 May 2000, MGRG reported turnover for the year of £1,260 million, cost of sales of £1,283 million and a gross loss of £23 million. There was a net loss from continuing operations of £503 million after administrative expenses and other costs.

11. During the eight months to 31 December 2000 (approximating to the part of the year which followed the sale of MGRG to Techtronic), MGRG sold 111,800 cars. 54,500 of these were sold in the United Kingdom and 51,700 in Europe. The remaining 5,600 were sold elsewhere in the world.

12. Mr Howe wrote in the chief executive's statement, entitled "*Review of the MG Rover Group business*" and enclosed with Techtronic's 2000 financial statements:

> "*The retail sales of 111,800* [units] *in the period May to December 2000 were ahead of the Business Plan*[11] *... In addition, within the overall volumes, the proportion of sales in the most profitable markets and customer channels was better than planned ...*
>
> *Furthermore the decision of MG Rover Group to undertake certain activities in a fundamentally more cost effective manner generated savings of £100M in Product Development and Sales and Marketing costs.*"

13. MGRG's reported net assets as at 31 December 2000 were £12 million. However, in the MGRG 2002 financial statements adjustments were made to the 2001 comparative results, which affected the 2001 brought forward position (i.e. the 2000 closing position). This restatement reduced the original figure for net assets of £12 million by £72.4 million[12], resulting in a net liability position of £60.4 million[13].

14. The figure for net assets (£12 million) took into account "*interest bearing loans from group undertakings*" of £192 million. This referred to money lent to Techtronic by BMW as part of the dowry and lent on to MGRG[14]. Excluding this liability, MGRG's net assets would have totalled £204 million[15].

15. Cash inflows for the year included:

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[11] Retail sales were 1% above the forecast figure of 110,844 units in the MGRG business plan (2001 to 2005) prepared in November 2000.

[12] The MGRG 2002 financial statements show a restated balance of (£60.4 million). The 2001 financial statements have a balance of £12 million. The adjustment required to correct these is (£72.4 million).

[13] A prior year adjustment was made "*to account for the impact of subsidiaries in line with the Parent company accounting policy*". Adjustments were "*made to provide against irrecoverable intercompany debt rather than to provide for the net liabilities in subsidiary companies*".

[14] See III/90.

[15] The impact of MGRG's indebtedness to Techtronic on its solvency is considered further in VII/202 to 207.

- £75 million from BMW in exchange for warranties on the acquisition of MGRG by Techtronic[16]; and

- £192 million loan from BMW[17] (via Techtronic).

Nonetheless, MGRG's cash balances at 31 December 2000 were £214 million[18]. Without the above inflows MGRG would have had a negative cash position.

2001

16. MGRG's financial results for the year ended 31 December 2001 were as follows:

	As originally stated	As restated[19]
	£ million	£ million
Turnover	1,321	1,321
Operating loss	(230)	(183)
Loss on ordinary activities before taxation	(227)	(179)
Loss for the financial year	(227)	(179)
Net current assets	284	213
Net liabilities	(150)	(175)

17. MGRG's turnover increased by 5 per cent compared with the prior year, to £1,321 million in 2001. This was driven by an increase in sales of the Rover 75 and MGF models and the introduction of new vehicle models. In the course of the year, MGRG launched a number of MG-badged saloon cars derived from the Rover 25, Rover 45 and Rover 75 models. It also introduced, in both Rover and MG forms, the Tourer, an estate car derived from the Rover 75. A hatchback version of the Rover 25, the MG ZR, was also introduced.

18. Nonetheless, during 2001 MGRG sold 170,200 cars, 8 per cent below the projected sales volume of 185,000 units. 97,300 of these were sold in the United Kingdom and 63,600 in Europe. The remaining 9,300 were sold elsewhere in the world. The group chief executive's statement included with PVH's 2001 financial statements noted that "*This level of retail sales was lower than our business plan target of over 180,000 units.*"

[16] See III/58.
[17] See chapter XII footnote 3.
[18] Cash balances include cash at bank and in hand and short term investments (which encompass cash deposits with terms in excess of seven days).
[19] The results for 2001 were restated in the 2002 financial statements due to a change in accounting policy. To account for the impact of subsidiaries in line with the parent company accounting policy, a prior year adjustment was made to provide against irrecoverable intercompany debt rather than to provide for the net liabilities in subsidiary companies. This change of policy resulted in an increase in investments of £29.9 million, a reduction in amounts owed by group undertakings of £70.9 million and a reduction in the provision for losses in subsidiaries of £16.5 million. There was also a reduction in administrative expenses in 2001 of £47.9 million.

19. Cost of sales fell 11 per cent to £1,140 million and administrative expenses by 24 per cent to £349 million in 2001 following a "*continued rigorous control of fixed costs in all functions*". Even so, MGRG reported a £179 million net loss for 2001.

20. Mr Howe wrote in the PVH 2001 chief executive's statement in respect of the 2001 net loss:

> "*Although this* [performance] *was a significant achievement, it fell short of our objectives as targeted in our 5-year business plan. The two major factors which have caused this adverse variance were the continued strength of Sterling against the Euro …, and the prices charged for components sourced from companies which were formerly part of Rover Group under BMW ownership. The latter factor has been mitigated to an extent by our acquisition of Powertrain during 2001 …*
>
> *Our European market volume was affected by two major factors: firstly, the need to partially unwind the MG Rover dealer network from the formerly integrated Rover/BMW/Land Rover set-up, and secondly, our decision not to sell vehicles at a loss, due to the unfavourable exchange rate.*"

21. Cash inflows for the year included:

- £145 million loan from BMW (via Techtronic)[20]; and
- £62 million received from BMW as part of the Completion Accounts settlement[21].

Despite these additional receipts from BMW, cash balances[22] at 31 December 2001 were £116 million, down £98 million from 2000.

22. As at 31 December 2001 MGRG had net current assets of £213 million. However, after taking account of fixed assets, provisions for liabilities and charges and creditors falling due after more than one year, MGRG reported net liabilities of £174.9 million.

23. Long-term creditors included "*interest bearing loans from group undertakings*" of £337 million. As noted above[23], this referred to the dowry lent to Techtronic by BMW and lent on to MGRG. Excluding this liability, MGRG would have had net assets of £162.1 million.

[20] See chapter XII footnote 3 and VII/25.5.
[21] See V/90.
[22] Cash balances include cash at bank and in hand and short term investments (which encompass cash deposits with terms in excess of seven days).
[23] See paragraph 14 above.

2002

24. MGRG's financial statements for the year ended 31 December 2002 show:

	£ million
Turnover	1,493
Operating loss	(70)
Loss on ordinary activities before taxation	(70)
Loss for the financial year	(68)
Net current assets	129
Net liabilities	(243)

25. Turnover rose 13 per cent to £1,493 million in 2002.

26. However, whilst sales volumes for the year were forecast to be 209,675 units, MGRG only achieved retail sales of 148,500 cars. 99,100 of these were sold in the United Kingdom and 42,100 in Europe. The remaining 7,300 were sold elsewhere in the world. The group chief executive's statement included with PVH's 2002 financial statements explained:

> "*... the retail sales level at 148.5K units was c.13% down on 2001 sales. However, within this shortfall our UK sales increased by 2% (this despite the impact of a fire at our seat foam supplier, Fehrer, which left MG Rover short of R25/45/ZR/ZS stock for the critical August, September and October months, costing several thousand vehicle sales).*
>
> *Overseas sales reduced by 32% and this reduction, particularly in Europe, was influenced by two major factors. Firstly, the weak European economies influenced total industry volumes (down by c.4% year on year in mainland Europe). Secondly, and more significantly, was the decision to remove from sale of a number of unprofitable derivatives in markets influenced by the strong Euro ...*"

27. In the course of the year, MGRG launched the MGTF roadster to replace the MGF, which had been in production since 1995. The MGTF, which had a more powerful engine than the MGF and was different in both appearance and mechanics, continued to sell well until MGRG went into administration in April 2005.

28. Cost of sales increased in proportion to turnover but administrative expenses continued to decrease, falling 23 per cent in 2002 to £268 million, and MGRG recorded its lowest net loss under the ownership of the Phoenix Consortium of £68 million. However, this was worse than the company's projections set out in their five year business plan which, when first prepared in 2000, had forecast that the company would break even for the first time in

2002. Further, the loss would have been £79 million[24] [25] but for profits recognised in relation to Project Sunrise[26].

29. Mr Howe wrote in PVH's 2002 group chief executive's statement:

> "... [the] *performance* [of MGRG], *albeit in line with expectations, has been hampered by a number of key factors.*
>
> *The company's performance in 2002 was not helped by the reduction in automotive market volumes in Europe and the relative weakness of the Euro against Sterling. Furthermore MG Rover was affected by problems with the China Brilliance Joint Venture which has since been terminated ...*[27]
>
> *In addition, the fact that TWR - our main engineering contractor on the new medium car development programme was placed into administration brought further delays to this key programme. Together with the China Brilliance problem this caused us to take 'time-out' on the new medium car to assess the status of that programme, establish a new and improved development methodology and confirm the funding capability ...*
>
> *MG Rover's losses constitute a drain on the group's substantial cash resources and whilst this can be sustained in the short term, MG Rover must start to contribute positive trading results to the group.*"

30. Cash inflows for the year included:

- £51 million loan from BMW (via Techtronic)[28]; and
- £23 million received from China Brilliance in relation to Project Sunrise.

31. However, as at 31 December 2002 MGRG had net current assets of £129 million (down £84 million from the prior year), including cash balances of £154 million[29].

32. Minutes[30] of a PVH board meeting held by telephone conference on 29 November 2002 state that:

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24 See XIX/74.
25 Net benefit £11.1 million plus £68 million equals £79 million.
26 See XIX/67 to 89 for details of Project Sunrise.
27 See XIX/76 to 89.
28 See chapter XII footnote 3.
29 Cash balances include cash at bank and in hand and short term investments (which encompass cash deposits with terms in excess of seven days).
30 The minutes are unsigned.

> "*The Chairman advised the Directors that the reason he was calling an Extraordinary meeting of the Board of Directors of the Company was because of the discomfort that was being felt amongst the Directors of the true cash position of the Company and its trading subsidiary MG Rover Group Limited. This discomfort was largely borne out of the fact that the Directors had been presented with financial data and in particular cashflow projections which on occasions proved not always to be accurate …*
>
> *The Chairman reminded the Board of each of the Directors' personal obligations to the company but also confirmed that it was not the obligation of the parent company to fund its subsidiary companies … The Chairman reminded the Board that it and its subsidiaries must operate within its resources. It must not in preparing its forecasts and business plans allow them to be a 'wish list' of all the things that the Directors may like to see or do. Further the Chairman directed that the Directors and the subsidiary company directors must take actions to address the Company's financial situation, which should include;*
>
> *(a) Headcount reductions;*
>
> *(b) Freezing capital expenditure;*
>
> *(c) Examining ways of freeing up collateralised cash;*
>
> *(d) Examining means of raising additional funding*
>
> *The subsidiary company's board would be requested to immediately take all such actions as are appropriate to address the current financial situation.*
>
> *… In the light of the failure of the China Brilliance co-operation the Board also discussed the reality of proceeding with the new medium car. The Chairman reminded the Board that at a meeting with Mr Howe and others on 25 November 2002 the Company had put a temporary halt on further spending on the new medium car and after some debate the Board resolved that it would be appropriate to now suspend this project and forthwith cease all further spending. The Chairman noted that the MG Rover Board was already examining other options including a facelift for Rover 45. The Board was conscious of the adverse publicity that could ensue from this decision and noted that matters must be handled carefully and on a balanced basis.*"

33. The figure for net liabilities (£243.3 million) took into account "*interest bearing loans from group undertakings*" of £391.5 million. As previously noted, this referred to the dowry lent to Techtronic by BMW and lent on to MGRG. Excluding this liability, MGRG would have had net assets of £148.2 million.

34. At the end of 2002, MGRG was continuing to incur losses and had received the final tranche of the BMW loan. It was therefore now essential that MGRG establish new sources of income. However, the joint venture with China Brilliance was not proceeding and development of the New Medium Car[31] was not advancing. Professor Rhys told us, "*After the collapse of the China Brilliance deal MGR's odds of survival were longer, but there was still a chance that the company could continue*".

2003

35. MGRG's financial statements for the year ended 31 December 2003 show:

	£ million
Turnover	1,307
Operating loss (after exceptional item)	(88)
Loss on ordinary activities before taxation	(93)
Loss for the financial year	(93)
Net current assets	55
Net liabilities	(336)

36. During 2003 MGRG sold 144,900 cars, a decrease of 2 per cent. 96,500 of these were sold in the United Kingdom and 39,800 in Europe. The remaining 8,600 were sold elsewhere in the world.

37. Despite a fall in sales volume of only 2 per cent, turnover decreased by 12 per cent[32]. The group chief executive's statement noted:

> "*... turnover* [fell] *... largely as a result of the reduction in the volume of vehicle sales of 2.4% and the gross profit percentage reducing ... due to increased incentives being offered in a hugely competitive market ...*" and

> "*The gain in sales of large platform models and the TF sports car were more than offset by the decline in demand for the medium car platform models (Rover 45/ MG ZS).*"

38. As explained in more detail in chapter XIX (Joint ventures)[33], in late 2003 MGRG launched its new small car, the "*City Rover*", with a starting sales price of £6,500. It was produced through collaboration with Tata of India and was based on the Tata "*Indica*" model[34].

[31] As to which, see III/95 to 96.
[32] Turnover in 2003 was £1,307.1 million compared with £1,493.3 million in 2002.
[33] See XIX/49 to 59
[34] See XIX/49.

However, beset by safety and quality issues, it received poor reviews and sales volumes were lower than expected[35].

39. Administrative expenses continued to fall, from £268 million in 2002 to £218 million in 2003, after exceptional items, helped by "*strict cost controls*". These included a reduction in research and development costs from £77.9 million in 2002 to £14.7 million in 2003. Nonetheless MGRG recorded a £93 million loss for the year ended 31 December 2003. Mr Howe wrote in the group chief executive's statement that "*Our target is to get to a position of break even during 2005*".

40. The figure for net liabilities (£335.9 million) took into account "*interest bearing loans from group undertakings*" of £411.5 million. As noted above, this referred to the dowry lent to Techtronic by BMW and lent on to MGRG. Excluding this liability, MGRG would have had net assets of £75.6 million.

41. Cash inflows for the year included £48 million received from Property Holdings in relation to the sale of land at Longbridge to SMP[36]. MGRG nevertheless ended the year with cash balances of £166 million[37], up only £12 million from 31 December 2002.

42. Furthermore, net current assets fell to £54.5 million at 31 December 2003. MGRG's net current assets were therefore lower than its annual losses.

43. There had been increasing concerns over cash flow since the start of 2003. Minutes of an MGRG management meeting held on 31 January indicate that there was concern over cash and a need to stop non-essential expenditure, noting that:

> "*K Howe outlined the cash situation and highlighted the cost issues. Major points included: unacceptable P&L proposed budget; 2002 cash supported by £225 m one-off funding/cash actions; 2003 cash 'burn' influenced by increased Capex £(170)m; P&L impact with much lower levels of one-off funding actions available.*
>
> *J Towers instructed that spend must be stopped on anything not linked to 'keeping the tracks running tomorrow'.*"

44. Correspondence with suppliers during 2003 and 2004 indicates that suppliers were putting pressure on MGRG to reduce the amounts that MGRG owed to them and for MGRG to pay more promptly in the future. These actions were a result of the suppliers' credit insurers withdrawing cover for amounts owed to them by MGRG. However, the suppliers were apparently reacting to concerns over MGRG's ability to pay in future, rather than problems with actual payments to date. For example:

35 See XIX/54.
36 See chapter IX.
37 Cash balances include cash at bank and in hand and short term investments (which encompass cash deposits with terms in excess of seven days).

44.1. on 5 March 2003 one of MGRG's largest suppliers, Autoliv Limited, wrote to MGRG and stated:

> "... [we] *have been instructed* [by our management] *to immediately find solutions that would enable Autoliv to reduce* [its] *exposure towards MG Rover, but at the same time allow continued supplies of our products to you.*
>
> *To accommodate for this we hereby propose to amend and reconfirm our commercial relation ...*";

44.2. on 20 March Autoliv Limited wrote a further letter to MGRG stating:

> "*We appreciate the time MGR has invested in explaining* [its] *current financial position and plans for the future, however we have had to conclude that you continue to represent an unacceptable financial risk to Autoliv ... It should also be noted that we have approached a number of financial institutions to underwrite the MGR debt, all have declined reinforcing our own views*";

44.3. on 15 April Schefenacker Vision Systems UK Limited wrote to MGRG noting:

> "*We have been advised by credit insurers that they will no longer provide cover on MG Rover. The 2001 accounts for MG Rover report a substantial loss and market information shows further declines in sales in 2001 and in the first quarter 2002.*
>
> *As a consequence we are very concerned at the ongoing trading position of MG Rover and the unsecured financial risk we are exposed to*"; and

44.4. on 11 June ThyssenKrupp Automotive Tallent Chassis Limited wrote:

> "*As a substantial component supplier to the MG Rover Group, I am writing to you with concerns we have regarding the amount of debt that you owe ourselves ...*
>
> *During the course of the past two to three months, there has been a number of concerns within our group regarding our inability to credit insure the debt owed by you to ourselves ...*
>
> *We are under specific instruction to ... minimise* [our] *potential exposure. To this end I would like to ... discuss the feasibility of reducing the period we have to wait in order to receive outstanding debts.*"

2004

45. MGRG's financial statements for the year ended 31 December 2004 were never filed. However, draft figures, which should only be used as a guide[38], show:

	£ million
Turnover	1,080
Operating loss	(118)
Loss on ordinary activities before taxation	(127)
Loss for the financial year	(127)
Net current liabilities	(50)
Net liabilities	(463)

46. With no sign of the New Medium Car, many of MGRG's existing models were updated during 2004. The design of the Rover 45 was updated by changing the car's headlamps, adding new rear and front bumpers and a different engine, the Rover 25 was remodelled, introducing new headlamps, tailgate, facia, badges and revised suspension and electrics, and the design of the Rover 75 was updated, receiving new bumpers, lights, wheels, interior trim and colours. As with the redesign of the Rover 25 and Rover 45, the changes made to the Rover 75 were of a cosmetic nature.

47. In addition, MGRG began selling the MG Rover SV ("MG SV"), which was based on the Qvale Mangusta sports car, the rights to which were acquired in July 2001[39]. The MG SV had a starting price of about £65,000. However, in 2004 (its first year of production) only four were sold, and its manufacture was very labour intensive, which contributed to a high cost base. Also in 2004, a new version of the MG ZT was introduced based on the updated Rover 75 model. Further, MGRG decided to reduce the price of the CityRover and added more equipment to the car in an attempt to increase sales. The improvements were due to be introduced into production in three phases starting on 18 February 2005, and the sales price was to be reduced (by between £500 and £900 depending on the exact model).

48. Despite these efforts, turnover fell 17 per cent to £1,080 million in 2004, being its lowest level since Techtronic's acquisition of MGRG.

49. The draft figures show that cost of sales fell at a greater rate than turnover, but administrative expenses rose by £71 million to £289 million. This resulted in an increase in the net loss for the year to £127 million.

[38] The figures shown in the following table are the 2004 unaudited figures taken from Deloitte's draft working papers. The 2004 audit was not completed as MGRG went into administration in April 2005.
[39] See VIII/15.19.

50. Cash inflows for the year included:

- £20 million received from SAIC in relation to the Project 528 negotiations[40]; and

- £53 million (net) received from PVH following the sale of Xpart to CAT[41 42].

However, MGRG ended the year with cash balances of only £29 million[43] and net current liabilities of £50 million.

51. MGRG's total net liabilities as at 31 December 2004 were £463 million. Even excluding the Techtronic loan of £427 million[44], MGRG had total net liabilities of £36 million as at 31 December 2004.

52. MGRG continued to receive correspondence from suppliers throughout 2004, with many suppliers demanding immediate payment of outstanding debts by MGRG and/or reductions to, or removal of, extended payment terms. In addition, there is evidence of concerns amongst MGRG's management over the worsening financial position of MGRG and the increasing need for the SAIC deal to come to fruition. For example:

52.1. on 20 February Armstrong Fastenings Limited, a supplier to both MGRG and Powertrain, wrote to Powertrain and stated:

> "*... our credit insurer, TI Euler,* [is] *cutting by 50% the credit limit for both Powertrain and MG Rover. It is this action, which has forced on us the need to closely monitor the level of monthly despatches in order to ensure we do not exceed the revised credit limit.*"

In a note to the letter, Laura Coates of Powertrain wrote: "*Kash has spoken with the insurers directly with no positive feedback. Their angle is that we are too reliant upon MGR*";

52.2. on 23 February another of MGRG's largest suppliers, Unipart Eberspacher Exhaust Systems Ltd ("UEES"), wrote to MGRG following a meeting UEES had held with their credit insurer, Atradius Limited. The author wrote:

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40 See XX/31.
41 See XIII/47 to 54.
42 This represents amounts received from PVH totalling £75.8 million, less amounts paid by MGRG to the NSCs of £22.67 million and professional fees of £464,000.
43 Cash balances include cash at bank and in hand and short term investments (which encompass cash deposits with terms in excess of seven days).
44 See III/90.

> "*... I would say I am seriously worried after the Meeting that* [Atradius Limited] *are about to further reduce* [our] *cover ...*
>
> *All I can ask is that you please impress on your Directors the importance of trying to keep the Credit Insurers on-board ...*
>
> *My personal feeling is that unless you act quickly to get these people on-side, events will quickly overtake us all. Certainly UEES will need to react, should such a reduction occur*";

52.3. on 2 March, Mr Millett wrote a memorandum to Mr Beddow, Mr Bowen, Mr Edwards, Mr Oldaker and Mr Shine. He wrote:

> "*In recent months there has been an increasing number of cases where suppliers have been granted payment terms less than the standard '30 day terms' which applies in MG Rover.*
>
> *I recognise in exceptional circumstances we, as a company, have had to accede to such requests but it is imperative that we keep these occurrences to a minimum. We are all aware of the adverse cash flow implications which would result if such practices are allowed to expand*";

52.4. on 4 March Armstrong Fastenings Limited wrote to MGRG and stated:

> "*It has ... been indicated to us* [by TI Euler] *that further action is likely to be taken shortly which will result in a total withdrawal of cover for MG Rover ...*
>
> *We would appreciate an understanding of any action being taken by MG Rover to address the issue directly with TI Euler, or advice as to any other Credit Insurer that is willing to offer cover for your business. The last company name which MG Rover suggested, Credance, is not willing to provide any cover! Additionally our broker has not been able to establish cover elsewhere*";

52.5. on 18 March Wagon Industrial Limited wrote to MGRG stating:

> "*... we have carried out an extensive and exhaustive search for a company to provide* [credit insurance] *cover. The fact that the entire market has not been willing to provide cover has further raised the sensitivities of our Board to this issue and therefore we need to find another solution ...*

After reviewing a number of alternatives, we are willing to consider ... a review of payment terms such as to reduce our debtor exposure ...";

52.6. on 5 April Calsonic Kansei Limited wrote to MGRG stating:

"*... in late 2003, we were advised by our insurers that the credit insurance cover for our MG Rover business had been significantly reduced. This caused considerable concern within our company ...*

the situation has recently worsened significantly, with a further substantial reduction in our MG Rover credit limit"; and

52.7. on 6 April Automotive Applied Technologies Ltd ("AAT") wrote to MGRG and stated:

"*We have regretfully been forced to stop deliveries to MG Rover Group in view of the recent negative press-reports about your company and actions taken by other suppliers of components.*

In the short term, components will be despatched by AAT to MG Rover once the following conditions are met: [including …] *All outstanding monies due to AAT by MG Rover Group as of today are paid in AAT's bank account ...*

Going forward, AAT will require MG Rover Group to provide adequate security of funds in order to cover the value of materials in AAT's supply chain for MG Rover components."

53. On 11 June 2004 Mr Millett wrote a memorandum to Mr Beale and Mr Howe regarding the short-term cash forecast stating:

"*I have now updated the June/July 2004 Group cash forecast ...*

The outcome ... shows a cash deficit peaking at £(49)m in the last week of June and £(63)m at the end of July ...

Clearly the only other action open to us are deferrals of creditor payments since we cannot run a negative cash balance ...

The June/July period however presents serious problems:

(i) At the end of June we would have to defer £13m of Dealer VMS/Warranty and £17m of other creditors from 28th June, with no visibility of paying it all before the mid-month July creditor/payroll runs.

(ii) At the mid-July creditor run we show a deficit peaking at £(33)m with only £25m of payments (including £8m payroll) which can be stopped.

(iii) At the end of July our best projection shows a deficit of £(55)m. To eliminate this we would have to defer well over 50% of our creditor payments due in the last week.

... I believe unless we have a high level of confidence that a significant further cash inflow (e.g. Fox) [i.e. the sale of Xpart, as to which see chapter XIII] *will occur before mid-July, these levels of creditor deferrals are unsustainable beyond the end of June actions. Given all of these facts, I would recommend that we consider this probability as soon as possible and if necessary reassess whether we should be seeking external professional advice.*"

54. Mr Beale presented a finance update to the board of directors of MGRG on 23 June 2004. The minutes record that:

"*... Mr Beale reminded the Board that the cash position for the Company going forward was extremely tight ...* [Mr Beale] *reminded the Board that what was in the best interests of the creditors was not necessarily to cease trading. Whilst there was a reasonable expectation of the XPart money being received and the SAIC transaction being implemented then it was the case that it may be in the best interests of the creditors to continue to trade ...*"

55. On 26 August 2004 Unipart Manufacturing Group Limited ("UMG") wrote to MGRG stating:

"*To be quite frank with you we can see no reason why MG Rover should not be able to convince Atradius of its financial viability (particularly as you have realized £100 million from the sale of your parts business) and therefore enable us to benefit from the insurance cover which as I previously explained, we have already paid for.*"

56. Mr Millett commented on the UMG letter in a memorandum to Mr Shine dated 3 September 2004. He said:

"*MG Rover has of late been in dialogue with Atradius and given updates of the progress on both the Xpart sale and the Chinese collaborative deal.*

Because the SAIC deal is so fundamental to our business plans, Atradius has indicated that it would prefer to wait for some substantive evidence of a deal being in place."

57. Monthly sales forecasts for 2004-05 issued on 21 September 2004, 20 October 2004, 17 December 2004 and 26 January 2005 are shown below:

	Sep-04	Oct-04	Nov-04	Dec-04	Jan-05	Feb-05	Mar-05
Total retail sales forecast at 21 September 2004 (units)	19,176	9,661	10,447	9,559	N/A	N/A	N/A
Total retail sales forecast at 20 October 2004 (units)	14,459	9,822	10,378	9,549	N/A	N/A	N/A
Total retail sales forecast at 17 December 2004 (units)	14,459	7,938	7,410	7,784	8,320	5,634	18,680
Total retail sales forecast at 26 January 2005 (units)	14,459	7,938	7,410	7,424	7,955	5,443	17,754

58. Monthly cash flow forecasts for 2004-05 derived from three separate forecasts issued on 20 October 2004, 17 November 2004 and 26 January 2005 show a consistent net cash outflow from MGRG and are summarised in the table below:

	Oct-04	Nov-04	Dec-04	Jan-05	Feb-05	Mar-05
Date of forecast	**20.10.04**	**17.11.04**		**26.01.05**		
Forecast/actual opening UK free cash position (£ million)	33	4	(2)	7	2	(14)
Total forecast movements in period (£ million)	(17)	(6)	(16)	(5)	(16)	(11)
Forecast closing UK free cash position (£ million)	[45] 16	(2)	[46] (18)	2	(14)	(25)

[45] Between the 20 October 2004 forecast and the 17 November 2004 forecast the actual opening cash position of November 2004 was established as £4 million.

[46] Between the 17 November 2004 forecast and the 26 January 2005 forecast the actual opening cash position of January was established to be £7 million. The change from £(18) million appears to have been attributable principally to the deferral of payments of VAT and other debts. With regard to the deferral of VAT, see XX/45.

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