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

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 XVII

CHANGES IN THE BOARDS OF THE MAIN COMPANIES BETWEEN 2000 AND 2005
Chapter XVII

Changes in the boards of the main companies between 2000 and 2005

Techtronic¹

1. As noted in chapter V (Rover under new ownership)², by the time Techtronic’s acquisition of MGRG was completed on 9 May 2000, Techtronic’s board comprised the members of the Phoenix Consortium and Mr Parker³.

2. Subsequently:
   2.1. Mr Parker resigned with effect from 26 October 2000⁴;
   2.2. Mr Ames was formally appointed as a director of Techtronic on 26 November 2000⁵ and resigned on 16 December 2002; and
   2.3. Mr Bowes was appointed as a director of Techtronic on 23 January 2001⁶ and resigned on 20 November 2001.

MGRG⁷

3. As noted in chapter V (Rover under new ownership)⁸, in 2000 the MGRG board comprised the members of the Phoenix Consortium, Mr Howe, Mr Millett, Mr Beddow, Mr Bowen, Mr Oldaker, Mr Parkinson and Mr Shine. Each of those listed remained a director of MGRG until administration except for Mr Parkinson, who resigned his MGRG directorship on 26 April 2002.

4. In addition, the following joined MGRG’s board in later years:

   Mr Sanders

5. Mr Sanders worked at Renault UK Limited (“Renault”) in sales and marketing for a number of years until 1997.

6. In 1998 he joined MGRG, which was then owned by BMW, as UK marketing director. Mr Sanders remained with MGRG after its sale to Techtronic in 2000 in the role of group marketing director. In April 2002 he was promoted to sales and marketing director and became a member of the MGRG board on 26 April.

¹ A diagram showing the directors of Techtronic between 2000 and 2005 is at appendix 6.
² See V/16.
³ As noted in V/27, Mr Parker’s appointment as a director of Techtronic was never notified to Companies House.
⁴ See V/34 to 35.
⁵ As noted in V/19, Mr Ames appears to have become a director of Techtronic soon after its acquisition of MGRG was completed, though his date of appointment was given as 26 November 2000 in the form 288a which was filed at Companies House.
⁶ See V/18.
⁷ A diagram showing the directors of MGRG between 2000 and 2005 is at appendix 6.
⁸ See V/5 to 6.
Mr Sanders was made redundant from MGRG and resigned as a board director on 30 June 2003.

Mr Ramsay

Mr Ramsay joined MGRG in 1968, where he remained until 1998 when he left his position as head of dealer development to work as a marketing consultant.

Mr Ramsay provided consultancy services to the Group over a period of about six months in 2002 and 2003, and in March 2003 he was contracted by MGRG to establish a distribution network for imports from Tata9 in the role of franchise manager. In July Mr Ramsay was appointed as European commercial director for MGRG, administering the activities of the NSCs.

In November 2003 Mr Ramsay became director of sales operations, which extended his responsibilities in respect of the NSCs to include UK and international distributors. In November 2004 he became managing director of sales and marketing at MGRG; he remained in this role until MGRG went into administration on 8 April 2005.

Mr Ramsay was appointed as a member of MGRG’s board on 23 February 2005.

Mr Petrie

Since 2000 Mr Petrie had undertaken a variety of business consultancy and non-executive roles and had also been involved in corporate transaction work.

Mr Petrie had contact with the Group from mid-2004 when he was involved in a bid to acquire the Xpart business. Although the offer was not accepted, Mr Beale contacted Mr Petrie some time later to ask if he would be interested in becoming a non-executive director of the Group.

Mr Petrie was subsequently appointed as a non-executive director of both MGRG and PVH on 21 July 2004. In addition to the traditional role of a non-executive director, Mr Petrie was asked to assist in reviewing MGRG’s business and financial position.

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9 See XIX/49 to 59.
PVH

15. As noted in chapter V (Rover under new ownership), the members of the Phoenix Consortium and Mr Howe became directors of PVH in December 2000.

16. There were no changes to the PVH board until Mr Petrie was appointed as a non-executive director in July 2004.

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10 A diagram showing the directors of PVH between 2000 and 2005 is at appendix 6.
11 See V/24.
12 See paragraph 14 above.
CHAPTER XVIII
POWERTRAIN
Chapter XVIII
Powertrain

Introduction

1. On 28 April 2000, shortly before the sale of MGRG to Techtronic, what had been MGRG’s engine and gearbox manufacturing business was transferred to Powertrain, a shell company bought for the purpose, as this business was not intended to be included in the sale of MGRG.

2. However, as explained in chapter V (Rover under new ownership)\(^1\), Powertrain was subsequently acquired by Techtronic on 1 June 2001 in part settlement of the Completion Accounts dispute.

3. In this chapter, we consider: why Powertrain was purchased by Techtronic and not MGRG\(^2\); the composition of its board of directors\(^3\) and their relationship with PVH and MGRG\(^4\); its business strategy\(^5\); and its financial performance\(^6\).

Acquisition by Techtronic

4. At the time of its acquisition by Techtronic, Powertrain had ongoing contracts to manufacture and supply engines and gearboxes to Land Rover (by this time under Ford’s ownership). These contracts ran until 2003. Mr Millett told us that Powertrain was acquired by Techtronic, rather than by MGRG, partly because Ford was concerned to ensure that Powertrain would continue to supply its engines in the event that MGRG failed. He said:

   “... Ford ... wanted the Powertrain company specifically not to be an MG Rover subsidiary ... [so] that if things went wrong with the car company the Powertrain company could at least soldier on and make its engines for Freelander for a couple of years or so.”

5. Mr Howe told us:

   “Now, as I understand it, because 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 ...”

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\(^1\) See V/90 to 94.
\(^2\) See paragraphs 4 to 5 below.
\(^3\) See paragraphs 6 to 14 below.
\(^4\) See paragraphs 15 to 17 below.
\(^5\) See paragraphs 18 to 23 below.
\(^6\) See paragraphs 24 to 57 below.
Chapter XVIII
Powertrain

The composition of the board

6. On acquisition by Techtronic, Mr Beale and Mr Stephenson were appointed as directors. Mr Millett was appointed as a director on 22 October 2001.

7. On 4 February 2002 Mr Beale and Mr Stephenson resigned and Mr Howe and Mr Gordon Poynter were appointed as directors. Mr Welford Winton was appointed as a director on 8 April.

8. From 8 April 2002 until Powertrain went into administration on 8 April 2005, the directors were Mr Millett, Mr Howe, Mr Poynter and Mr Welford Winton.

Mr Millett

9. Mr Millett told us that he considered himself to be “definitely involved” in the running of Powertrain, as this was one of the three key elements of the Group’s business, along with the car and parts businesses. Mr Millett also told us:

“... my role still encompassed, for example, the management of the major trading companies that were set up such as Powertrain and Parts; I was a board director of those two companies anyway. But you could not disassociate those two companies from the MG Rover car company, for obvious reasons. So my role certainly covered all of those.”

Mr Howe

10. After a conversation with Mr Towers (and possibly Mr Beale, Mr Stephenson and Mr Edwards), Mr Howe was asked “to take control of Powertrain” and “to sit over the top of those core businesses”, referring to the powertrain, parts and car businesses. Mr Howe told us that his “initial task was to find a managing director for Powertrain to sit alongside [him]”.

11. When asked about Mr Howe’s involvement with Powertrain, Mr Poynter told us:

“He was one of the four directors, he always chaired our board meetings, and those were, in the first 12 months or so, every month, while [Mr Welford Winton] got his feet under the table, but I think their intention was [Mr Welford Winton] to become able to be running it at arm’s length ... He obviously gave us lots of input on group issues, board updates. We obviously were a supplier to his other company, to MG Rover Cars or MG Rover Group Limited, on engine – on gearboxes, so there was like always a supplier/customer relationship going on at the same time.”
Mr Poynter

12. Mr Poynter has a background in personnel management and joined Ford in 1969 before moving to British Leyland in 1974. In the early 1990s Mr Poynter moved into sales management and brand management, becoming brand director for the car business, a role that he retained when BMW purchased MGRG in 1994. In 1997 Mr Poynter became communications director for Rover and Land Rover products.

13. Mr Poynter joined Powertrain as commercial director in June 2001 after a conversation with Mr Howe. Mr Poynter told us that his role as commercial director was to:

“... look at the business, start to put together a business plan that would show a way forward that could result in Powertrain developing a more independent position ... such that [Powertrain] could diversify [its] customer base, grow more customers, because being reliant on one or two customers was too dangerous for the business going forward, and to exploit the assets of the business over time.”

Mr Welford Winton

14. Mr Welford Winton was an engineer who started his career at Northern Engineering Industries Limited. He took up a role at CompAir making compressors for submarines for the Ministry of Defence before joining Lucas Industries plc, where he “started doing turnarounds for businesses that were in trouble”. Mr Welford Winton told us he was then approached through a head-hunter about the role of managing director at Powertrain and was offered the position on 9 January 2002.

Powertrain’s directors’ relationship with PVH and MGRG

15. Mr Welford Winton and Mr Poynter were involved on a day to day basis working exclusively for Powertrain. In contrast, Mr Howe and Mr Millett were also directors of MGRG and Mr Howe was a director of PVH. Indeed, Mr Howe and Mr Millett had offices in a completely different area of the Longbridge site to where Powertrain was based.

16. When asked about the “PVH/MGR update” that appeared in a number of the Powertrain board minutes, Mr Welford Winton told us:

“[Mr Poynter] and I were not party to Phoenix Venture Holding board meetings or MG Rover board meetings. They were customers of the holding company so I would not expect to necessarily. But we did ask and have on every set of minutes and every agenda ... can Kevin and John update Powertrain board as to what is happening in the group, anything we need to know about, anything we might piggy-back ... what is the strategy of the group? Because we were always obviously presenting our strategy, it needed to be in line with the group strategy, and we spent quite a lot of time looking at our strategy for ways forward ... So it was always to keep us – it was their way of formally telling us – exactly where we are with the group, to what level
they felt they needed to, and what level we felt – we understand what we are trying to do, where you are going, how we fit in really.”

17. Mr Poynter stated that Mr Millett and Mr Howe always fed back to him and Mr Welford Winton formally about “what was going on with the rest of the Group companies, because [they were] on the board of MG Rover Group and seemed to be much more au fait with the broader picture”.

Business strategy

External customers

18. Powertrain provided engines and gearboxes for MGRG and Land Rover prior to and following its acquisition by Techtronic.

19. After its acquisition, it was intended that Powertrain would have customers other than MGRG and Land Rover that would generate profits for Powertrain and thus the Group. However, due to the age of the assets and product ranges, it was considered that western manufacturers would not be interested in entering supply contracts with Powertrain. Instead, it was considered that another market had to be found where the engines would be suitable, and Iran, where the engines and cars were much older, was the biggest market for cars in the Middle East7. The process of “identifying … who to talk to in Iran” started in 2002 and, as discussed in chapter XIX (Joint ventures), in 2003 Powertrain entered into discussions with Mega Motors Company (“Mega Motors”)8.

20. Powertrain remained profitable between 2002 and 2005 but Mr Welford Winton believed this became harder in the later years. He told us:

“Towards the end we were predicting break even, more those sort of positions for 2004 and 2005 because MG Rover volumes were falling, so had a significant impact on our business, but we could still see a way to profitability, and that was our task, to remain profitable however the volumes fell, and just really push for third-party business. So we entered into a number of negotiations ourselves as Powertrain for providing engines to others with a view that we were trying to run it as a separate business as far as our management team and board went and the structure.”

Transfer pricing

21. Prior to its acquisition by Techtronic, Powertrain agreed with MGRG that “the price to be charged for engines and gearboxes is cost plus 5%”. Costs were calculated as variable costs plus fixed costs, “Other Expenses”, depreciation and interest payable.

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7 See XIX/18 to 35 for further details of the Group’s negotiations with parties in Iran.
8 See XIX/33 to 35.
22. After Powertrain became part of the Group, it was agreed that it would transfer engines to MGRG at cost. In practice, Powertrain set the cost for transfers at the beginning of each year, and did not pass on any cost savings made in the year. As Mr Welford Winton explained:

“... I started the beginning of the year at cost and any improvements I made to productivity, cost down, material cost down, Powertrain kept as extra profit, if you like ... [Profit] was our performance, a measure of our performance, but at the end of the day we were working with the group to make a car at the end of the day.”

23. Mr Welford Winton told us that Powertrain would have achieved “significantly better profit if we had been charging MG Rover the same as we had been charging Ford Land Rover”.

Financial performance

24. The table below shows that over the period from 2001 to 2004 the turnover of Powertrain declined steadily. The 2000 figures are not directly comparable as they comprise the results for only nine and a half months, as the company was incorporated on 14 March 2000. With the exception of 2000, the company was profitable throughout the period and this profitability was reflected in the net current and net assets.

<table>
<thead>
<tr>
<th></th>
<th>2000 (restated)</th>
<th>2001 (restated)</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>£ million</td>
<td>£ million</td>
<td>£ million</td>
<td>£ million</td>
<td>£ million</td>
</tr>
<tr>
<td>Profit (loss) for the financial period</td>
<td>(26.8)</td>
<td>19.7</td>
<td>15.9</td>
<td>6.9</td>
<td>18.0</td>
</tr>
<tr>
<td>Net current assets (liabilities)</td>
<td>(124.5)</td>
<td>27.0</td>
<td>42.0</td>
<td>61.6</td>
<td>100.6</td>
</tr>
<tr>
<td>Net assets (liabilities)</td>
<td>(26.8)</td>
<td>94.9</td>
<td>110.9</td>
<td>117.8</td>
<td>135.8</td>
</tr>
</tbody>
</table>

25. In the following paragraphs we consider the major influences on each year’s trading.

2000

26. Powertrain was incorporated on 14 March 2000. On 28 April, Powertrain acquired the powertrain business from MGRG, then still owned by BMW, for consideration of £100 million.

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9 These figures are taken from Powertrain’s unaudited financial statements for the year ended 31 December 2004 and as draft figures they should be treated with caution.

10 It appears that BMW loaned Powertrain £100 million for this purpose.
27. Powertrain’s results for the period from 14 March 2000 to 31 December 2000, throughout which Powertrain was owned by BMW, were as follows:

<table>
<thead>
<tr>
<th></th>
<th>£ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>175.6</td>
</tr>
<tr>
<td>Operating loss</td>
<td>(22.1)</td>
</tr>
<tr>
<td>Loss for the financial period</td>
<td>(26.8)</td>
</tr>
<tr>
<td>Net current liabilities</td>
<td>(124.5)</td>
</tr>
<tr>
<td>Net liabilities</td>
<td>(26.8)</td>
</tr>
</tbody>
</table>

28. Included in the net liabilities figure were “Interest bearing loans from group undertakings” of £138.9 million, which presumably included £100 million that BMW had loaned to Powertrain and that Powertrain had paid to MGRG in April 2000 to acquire the powertrain business.

2001

29. On 27 April 2001 Powertrain agreed to sell the part of its business comprising the manufacture of R65 gearboxes to Midland Gears. The consideration payable by Midland Gears was £7 million.

30. On 18 May 2001 BMW agreed to transfer its shareholding in Powertrain to Techtronic as part of the Completion Accounts dispute settlement. In the course of the transfer, Powertrain’s debt to BMW was cleared. The sale and purchase agreement between BMW and Techtronic required that, immediately prior to completion, Powertrain would use its cash balance of £378,000 to reduce the “BMW Group Debt”, which at that time stood at £102.4 million. Immediately afterwards, BMW would subscribe for one share issued at par plus a premium equal to the remaining debt less £1. Powertrain’s 2001 financial statements show that on 1 June Powertrain issued to BMW one ordinary share of £1 at a premium of £102 million (being the value of the debt owed to BMW by Powertrain, thereby extinguishing such debt); BMW then transferred all of its shares to Techtronic.

---

11 As noted at paragraph 26 above, Powertrain was incorporated on 14 March 2000.
12 These are the restated results as shown in Powertrain’s 2001 financial statements. The 2000 figures were restated to correct three fundamental errors: Fixed assets were reduced by £4.1 million to correct the omission of an impairment provision in respect of assets identified for disposal in December 2000 that were disposed of in the first quarter of 2001; Accruals and deferred income was increased by £12.7 million and Negative Goodwill was reduced by £9.1 million with the balance being charged to the profit and loss account to correct errors in the postings arising from the hive out of the Company's assets from MGRG on 28 April 2000; and the warranty provision was reduced by £4.3 million to correct an overstatement resulting from the accrual of warranty costs on sales that did not attract this liability. The net effect of these adjustments was to increase the loss for the period and net liabilities by £3.4 million.
13 See footnote 10 above.
14 See chapter V footnote 106.
15 See V/90 to 94.
31. Powertrain’s financial statements show the following for the year ended 31 December 2001\textsuperscript{16}:

<table>
<thead>
<tr>
<th></th>
<th>£ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>269.4</td>
</tr>
<tr>
<td>Operating profit [i.e. before interest and tax]</td>
<td>19.9</td>
</tr>
<tr>
<td>Profit for the financial period</td>
<td>19.7</td>
</tr>
<tr>
<td>Net current assets</td>
<td>27.0</td>
</tr>
<tr>
<td>Net assets</td>
<td>94.9</td>
</tr>
</tbody>
</table>

32. The directors’ report states:

“The In 2001, new engine derivatives for the MG saloon and sports cars were developed and delivered on time. New product engineering programmes were identified to support MG Rover Group product requirements for 2002. For our Land Rover customer, a new KV6 engine derivative was developed and delivered on time.”

33. A schedule entitled “2001 Sales by Customer / Product” shows that over 95 per cent of revenue was received from MGRG and Ford (Land Rover):

<table>
<thead>
<tr>
<th></th>
<th>MG Rover</th>
<th>Ford</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue</td>
<td>£196.3 million</td>
<td>£61.8 million</td>
<td>£11.3 million</td>
<td>£269.4 million</td>
</tr>
<tr>
<td>% of total sales</td>
<td>72.9%</td>
<td>22.9%</td>
<td>4.2%</td>
<td>100%</td>
</tr>
</tbody>
</table>

34. Administration costs were £52.8 million for the year ended 31 December 2001, which was significantly higher than the £18.5 million reported for the nine and a half months to 31 December 2000, even taking into account the shorter period. Mr Welford Winton explained this as follows:

“We had consciously increased our overhead because, without an engineering capability in that business, we would have struggled to convince the outside world we could stand alone and give you an engineering solution that is not a part of an MGR solution. I was always looking to reduced admin costs, overheads costs. But, again, there was the jobs for life scenario around us. Natural wastage was there, but I did also want to bring an element of new blood in, because I think you need to into a business. In terms of when you look at it, it was a technology company. Making engines is not simple engineering, it is quite complicated and, therefore, it needs the right level of overhead and support to make it happen.”

35. Consequently, although gross profit had risen to £73.0 million, net profit was only £16.1 million.

\textsuperscript{16} These are the restated results as shown in Powertrain’s 2002 financial statements.
36. In 2002, a prior period adjustment relating to deferred tax increased both net profit and net assets by £3.7 million to £19.7 million and £94.9 million respectively for 2001.

37. Having cleared the debt to BMW by way of the share issue, total net assets at 31 December 2001 were £94.9 million, of which £69.6 million related to tangible fixed assets, predominantly “Land and buildings” and “Plant & Machinery”. Net current assets were £27 million, including cash balances of £22.2 million.

2002

38. Powertrain’s financial statements for the year ended 31 December 2002 show:

<table>
<thead>
<tr>
<th></th>
<th>£ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>245.1</td>
</tr>
<tr>
<td>Operating profit</td>
<td>18.9</td>
</tr>
<tr>
<td>Profit for the financial period</td>
<td>15.9</td>
</tr>
<tr>
<td>Net current assets</td>
<td>42.0</td>
</tr>
<tr>
<td>Net assets</td>
<td>110.9</td>
</tr>
</tbody>
</table>

39. Turnover fell by 9 per cent\(^{17}\) and production of engines fell by 7 per cent to 161,400 units. However, production of gearboxes fell even further, by 21 per cent, to 52,800 units. These production volumes were lower than the budget which was set at the start of the year, and lower even than forecasts prepared in November 2002. A presentation apparently intended for the Powertrain workforce and prepared in November 2002 stated:

“Our sales projection for the current year is 162,855 engines, compared to the budget of 192,938, a shortfall in total of 30k engines ... The sales forecast for our PGI gearbox at 53,784, which is 7,844 (13%) down on the budget of 61,628.”

40. The November presentation also noted, “During 2002 our trading position has deteriorated ... All too often we have had to reduce our forecast as a result of falling customer demand”.

41. A schedule entitled “Sales Revenue by Customer” shows the following:

<table>
<thead>
<tr>
<th></th>
<th>MGRG</th>
<th>Ford</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue</td>
<td>£175.0 million</td>
<td>£59.0 million</td>
<td>£11.1 million</td>
<td>£245.1 million</td>
</tr>
<tr>
<td>% of total sales</td>
<td>71.4%</td>
<td>24.1%</td>
<td>4.5%</td>
<td>100%</td>
</tr>
</tbody>
</table>

\(^{17}\) Turnover fell from £269.4 million in 2001 to £245.1 million in 2002.
2003

42. Powertrain’s financial statements for the year ended 31 December 2003 show:

<table>
<thead>
<tr>
<th></th>
<th>£ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>212.8</td>
</tr>
<tr>
<td>Operating profit / (loss)</td>
<td>6.3</td>
</tr>
<tr>
<td>Profit / (loss) for the financial period</td>
<td>6.9</td>
</tr>
<tr>
<td>Net current assets / (liabilities)</td>
<td>61.6</td>
</tr>
<tr>
<td>Net assets / (liabilities)</td>
<td>117.8</td>
</tr>
</tbody>
</table>

43. The “Sales Revenue by Customer” schedule shows the company increased its reliance on MGRG:

<table>
<thead>
<tr>
<th></th>
<th>MG Rover</th>
<th>Ford</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue</td>
<td>£161.6 million</td>
<td>£39.1 million</td>
<td>£12.1 million</td>
<td>£212.8 million</td>
</tr>
<tr>
<td>% of total sales</td>
<td>75.9%</td>
<td>18.4%</td>
<td>5.7%</td>
<td>100%</td>
</tr>
</tbody>
</table>

44. Total turnover decreased compared with the prior year by 13 per cent\(^{18}\), due to “significant volume reductions as a result of prevailing market conditions in Europe and the USA”.

45. Furthermore, the directors’ report warned that, “Due to reduced demand in 2004 from its major customers the level of activity will reduce in 2004”.

46. The company reported a small profit of £6.9 million and net assets increased overall on the prior year. However, closing cash balances decreased to £2.9 million. Despite this tight cash position, or possibly leading to this, Powertrain was owed £61.7 million by group undertakings at year end (up from £26.5 million at the start of the year).

47. Despite being owed money by MGRG, a “Going Concern” note in the 2003 financial statements, which were signed in October 2004, states that Powertrain was dependent on PVH’s support:

“The company is dependent on funding from its ultimate parent undertaking, Phoenix Venture Holdings Limited (‘PVH’). The directors have received confirmation from PVH, that insofar as it is able to do so, it will provide financial support as is necessary to enable the company to meet its liabilities as they fall due for a period of at least 12 months from 28 October 2004 the date of signing these accounts.”

\(^{18}\) Turnover fell from £245.1 million in 2002 to £212.8 million in 2003.
48. The note goes on to refer to note 1 in PVH’s financial statements, which explains the ongoing negotiations with SAIC. The note in Powertrain’s financial statements concludes: “Based on the letter of support and the explanations from the directors of PVH, the directors have assumed such support will be provided by PVH”19.

2004

49. Powertrain’s unaudited financial statements for the year ended 31 December 2004 show the following. As these are draft figures, taken from Deloitte’s audit files, they should be treated with caution.

<table>
<thead>
<tr>
<th></th>
<th>£ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>179.5</td>
</tr>
<tr>
<td>Operating profit / (loss) [i.e. before interest and tax]</td>
<td>20.6</td>
</tr>
<tr>
<td>Profit / (loss) for the financial period</td>
<td>18.0</td>
</tr>
<tr>
<td>Net current assets / (liabilities)</td>
<td>100.6</td>
</tr>
<tr>
<td>Net assets / (liabilities)</td>
<td>135.8</td>
</tr>
</tbody>
</table>

50. Despite the significant fall in turnover, the draft figures show that Powertrain increased its net profits to £18 million. Accordingly, total net assets increased by £18 million to £135.8 million.

51. Mr Welford Winton believed that he had enough control through his finance function to make sure Powertrain could meet its commitments at any point in time.

52. However, of net assets totalling £135.8 million at 31 December 2004, £112.3 million was due from “Rover trading debtors”, and cash balances had fallen to only £9,000. Mr Poynter explained in a questionnaire prepared for the administrators in May 2005:

“**Powertrain has an outstanding debt due from MGR of £120m. This is made up of the following:**

(a) **Profit on sales of engines to third party customers**

(b) **£17m realised by Powertrain on the sale of its K4 and KV6 engine IPR in September 2004**

(c) **£13m realised by Powertrain on the sale of its land and buildings to St Modwen plc on 12th November 2004 …**

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19 Similar disclosures were included in the 2003 financial statements of MGRG and other Group subsidiaries. We consider the disclosures in respect of going concern in chapter XXIII (Financial statements and audit).
Chapter XVIII
Powertrain

Since MGR was Powertrain’s major customer without whom Powertrain could not have survived the Board considered that it was in the best interests of its shareholders and its creditors to provide funds to MGR to allow MGR to complete its negotiations and discussions with its collaborative partner.”

53. As shown above, £13 million of the outstanding balance due from MGRG related to a loan made from the proceeds of a deal with SMP, which had netted Powertrain £14 million. On 18 November 2004, Mr Welford Winton told the board meeting that on 12 November Powertrain had entered into an agreement with SMP for the sale and lease back of its land and buildings. The minutes of the board meeting record:

“The Chairman [i.e. Mr Howe] advised the Board that the money that had been received by the Company for the sale of its land had been lent to MG Rover Group Limited for working capital purposes. He reported that this was necessary in order for MG Rover to have sufficient funds to trade lawfully until such time as the transaction with SAIC was completed and the joint venture was operative. The Chairman advised the Board that this was a suitable use of the proceeds of the sale of the land provided that the Board agreed that the loan was in the long term interests of the Company. The Board discussed this and concluded that it was in the interests of the Company to ensure that MG Rover was able to continue to trade until such time as the SAIC transaction was completed at which stage the future of the Company would also be secure.”

54. As we note in chapter XX (The events leading to administration), ultimately the negotiations with SAIC did not come to fruition and MGRG was placed into administration on 8 April 2005. Powertrain went into administration on the same day.

55. Mr Welford Winton informed the administrators:

“At the board meeting on 7 April the Board discussed the matter affecting MG Rover Group due to the DTI’s decision and resolved that given that MG Rover Group was the Company’s major customer (accounting for in excess of 80% of its sales) there was now no alternative to speaking to an insolvency practitioner with a view to requesting that he consider and if thought fit accept an administration appointment. The Board resolved that PriceWaterhouseCoopers should be contacted immediately following the meeting. On the afternoon of Friday 8 April 2005 Stephen Pearson, Anthony Lomas and Robert Hunt of PriceWaterhouseCoopers were appointed the joint administrators of the Company.”
56. Even though Powertrain was “80 per cent dependent on MG Rover” there were hopes that Powertrain could survive without MGRG. Mr Welford Winton told us:

“... when MG Rover went into administration, Powertrain went into administration at the same point in time. However, Powertrain still had third party customers and a contract with Ford Landrover. And therefore Powertrain had an opportunity there to do something different than maybe the MG Rover Group had and that is where we worked very closely with PWC to explore those avenues for a period of time and see how far we could take the Ford contract to move forward.”

“Ford Landrover came into the business, saw what we were doing, and decided they would take any volume we could still manufacture. We drafted a very quick business plan. I went with Pricewaterhouse and one of the administrators and myself addressed the supply base of Powertrain and they were all very keen to supply the business with a view that we could see a way forward with Ford.”

57. However, these hopes did not last and Powertrain was unable to survive. Mr Welford Winton told us: “there were two suppliers that did not play at the end of the day and it was down to those two suppliers at the end of the day that we could not continue manufacture”. Powertrain was subsequently put into liquidation.
Introduction

1. As noted in chapter III (The sale of Rover)\(^1\), 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.

2. In a letter to the Inland Revenue dated 14 November 2000, Mr Hume of Deloitte explained:

   “... the only way that Rover Group Limited will be able to survive as a volume car maker is to persuade another car producer to allow it to use a platform for a medium sized car. Rover does not have sufficient resources to develop its own car and it is therefore totally reliant upon such a partnership.”

3. The need to find a suitable partner, or partners, became more pressing as time passed. Mr Millett told us:

   “... it was always the declared intention to go out and seek a significant collaborative partner to both underpin the resources required and to gain other benefits ... I don't think we regarded it as absolutely vital in the first set of financial projections ... I don't think there was a precise time when it was determined that there must be a partner until much later in the time frame, 2000 to 2005.”

4. After Powertrain had become part of the Group in June 2001\(^2\), it, too, was independently seeking a partner for collaboration. Mr Poynter explained:

   “... Powertrain had to find its own way forward, and given the age of the assets, the age of the engine ranges, both of which dated back into the 1980s or indeed the 1970s in the case of the L-Series engines, and the gearboxes, it was pretty clear that no Western manufacturer would be interested in doing a deal or wanting to have supply from Powertrain Limited. The only obvious markets where we would find customers either directly for the engines or for local manufacturing deals and JVs [joint ventures] and so on would be in South America and the Middle East, Russia, China and India, so I spent a lot of time researching those markets, and so on.”\(^3\)

5. MGRG\(^4\) and Powertrain entered into discussions with a number of potential partners in Eastern Europe, the Middle East and Asia, and increasingly looked towards China in the search for a suitable collaboration. The more significant of these discussions are set out in the table below and in further detail in this chapter:

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\(^1\) See III/93 to 98.
\(^2\) For further details see V/90 to 94.
\(^3\) See also XVIII/18 to 20.
\(^4\) While some negotiations were conducted by MGRG, others, particularly later on in the period, were conducted by PVH. We have referred specifically to MGRG or PVH where this is clear from the evidence; where it is not clear which company was conducting negotiations we have referred to “the Group”.

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**Chapter XIX**  
**Joint ventures**

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Approximate dates of negotiations</th>
<th>Paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perusahaan Otomobil Nasional Berhad (“Proton”)</td>
<td>Malaysia</td>
<td>2000 to August 2004</td>
<td>6 to 13</td>
</tr>
<tr>
<td>Petroleam Nasional Berhad (“Petronas”)</td>
<td>Malaysia</td>
<td>August 2003 to 2004</td>
<td>14 to 17</td>
</tr>
<tr>
<td>Dastaan Industrial Development Company (“Dastaan”)</td>
<td>Iran</td>
<td>December 2000 to 2005</td>
<td>18 to 21 &amp; 28 to 32</td>
</tr>
<tr>
<td>Iran Khodro Industrial Group (“Iran Khodro”)</td>
<td>Iran</td>
<td>May 2001</td>
<td>22</td>
</tr>
<tr>
<td>Société Anonyme Iranienne de Production Automobile (“SAIPA”)</td>
<td>Iran</td>
<td>October 2003 to 2005</td>
<td>23 to 32</td>
</tr>
<tr>
<td>Mega Motors</td>
<td>Iran</td>
<td>2003 to 2005</td>
<td>33 to 35</td>
</tr>
<tr>
<td>Daewoo FSO Motor SA (“DFM”)</td>
<td>Poland</td>
<td>2001 to March 2005</td>
<td>36 to 48</td>
</tr>
<tr>
<td>Tata</td>
<td>India</td>
<td>January 2002 to 2005</td>
<td>49 to 59</td>
</tr>
<tr>
<td>ITL Sonalika Group (“Sonalika”)</td>
<td>India</td>
<td>March 2004 to 2005</td>
<td>60 to 62</td>
</tr>
<tr>
<td>China Brilliance</td>
<td>China</td>
<td>November 2001 to August 2002</td>
<td>67 to 90</td>
</tr>
<tr>
<td>Mr Yang and Star Apex Holdings Limited (“Star Apex”)</td>
<td>China</td>
<td>May 2003 to November 2003</td>
<td>91 to 100</td>
</tr>
<tr>
<td>C&amp;F Auto (“C&amp;F”)</td>
<td>China</td>
<td>2002 to 2003</td>
<td>101</td>
</tr>
<tr>
<td>Hainan Automobile Group Corporation Limited (“HAGC”)</td>
<td>China</td>
<td>June 2002 to June 2003</td>
<td>102 to 104</td>
</tr>
<tr>
<td>Geely Group Company Limited (“Geely”)</td>
<td>China</td>
<td>September 2002 to May 2004</td>
<td>105 to 111</td>
</tr>
<tr>
<td>Torch Automotive Group Company Limited (“Torch”)</td>
<td>China</td>
<td>December 2002 to April 2004</td>
<td>112 to 115</td>
</tr>
<tr>
<td>SAIC Chery Automobile Company Limited (“Chery”)</td>
<td>China</td>
<td>January 2003 to March 2003</td>
<td>116 to 119</td>
</tr>
<tr>
<td>China First Auto Works Group Corporation (“FAW”)</td>
<td>China</td>
<td>March 2003 to January 2004</td>
<td>120 to 123</td>
</tr>
<tr>
<td>Chongqing Changan Automobile Company Limited (“Changan”)</td>
<td>China</td>
<td>March/April 2003</td>
<td>124 to 127</td>
</tr>
<tr>
<td>LIFAN Automobile Company Limited (“LIFAN”)</td>
<td>China</td>
<td>August 2003 to September 2003</td>
<td>128 to 129</td>
</tr>
<tr>
<td>Beijing Automotive Investment Company (“BAIC”)</td>
<td>China</td>
<td>February 2004 to April 2004</td>
<td>130 to 131</td>
</tr>
<tr>
<td>NAC</td>
<td>China</td>
<td>March 2004 to 2005</td>
<td>132 to 142</td>
</tr>
<tr>
<td>Guangzhou Automobile Industry Group Company Limited (“Guangzhou”)</td>
<td>China</td>
<td>March 2004 to June 2004</td>
<td>143 to 146</td>
</tr>
</tbody>
</table>
Malaysia

Proton

6. Proton, a national car manufacturer in Malaysia, was identified by MGRG as a potential collaborator in a board paper dated 7 July 2000.

7. However, the likelihood of this collaboration’s success was questioned in a letter from Ms Sue Tilstone of Deloitte to the Inland Revenue dated 29 November 2000 which stated:

“… there are currently no discussions in progress which are likely to lead to the introduction of a joint venture partner. The parent company has signed a confidentiality agreement with … Proton, to explore the possibility of engineering collaboration in the future. This is at an early stage, no discussions on engineering matters have yet taken place and it is uncertain whether this process will lead anywhere … the number of potential joint venture partners is extremely limited …”

8. Talks between MGRG and Proton continued into 2001 and were known as “Project Jigsaw”. Mr Stephenson and Mr Howe met Proton representatives in August that year to discuss possible routes of collaboration, and a “Confidentiality Agreement” was signed between Proton and MGRG on 9 August. According to an MGRG board minute dated 18 August, Mr Howe reported that “Proton had expressed an interest in using the Rover 75 to re-badge as a Proton car” in Malaysia. In exchange Proton had offered MGRG use of the platforms used to manufacture the Proton GX41 model (for MGRG’s own New Medium Car\(^5\)) and the SCM24, a small car that was still being developed by Proton.

9. Proton representatives visited Longbridge for further discussions in September 2001, although the visit was cut short by Proton. The teams met again in Hethel (outside Norwich) in February 2002, by which time MGRG had also commenced discussions with China Brilliance\(^6\). In a letter to Mr Darus Kamarulzaman of Proton dated 26 March, Mr John Tweedy, saloon car platform director within MGRG, noted that MGRG was struggling to reduce its cost base for the new vehicle models to the level required by Proton. On 21 May Mr Kamarulzaman wrote to Mr Stephenson stating that the company had concluded “that the programme is not viable on our side”. Mr Howe later noted to the MGRG board that the negotiations had allegedly broken down as a result of press leaks concerning the discussions.

10. However, on 2 December 2003 Mr Hussin Jaafar of Proton wrote to Mr Stephenson further to a telephone conversation the previous day, requesting that “our discussion on Proton’s intention to adopt Rover 75 as Proton Large Car ... be regenerated”. MGRG and Proton representatives met the following month and a “Non-Disclosure Agreement” between Proton and PVH was signed on 15 January 2004. The negotiations were re-named “Project Monkey”. A “Letter of Intention” was signed between Proton and PVH on 18 February, and

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\(^5\) As to which, see III/95 to 96.

\(^6\) See paragraph 67 below.
a press release that day envisaged “PVH and its subsidiaries, including MG Rover Group, working with Proton to explore the feasibility of a number of potential collaborative projects”.

11. The discussions continued throughout the first half of 2004. However, on 23 June Mr Howe told the MGRG board that:

“… the Company had now formally [been] advised by Proton that they did not wish to proceed with the proposed collaboration since the PF-R\textsuperscript{7} could not, in their opinion, be made to work financially.”

12. On 5 August 2004 Datuk Kisai Bin Rahmat of Proton sent a fax to Mr Howe confirming:

“The results of the feasibilities studies … do not meet our business criteria and therefore we no longer wish to pursue opportunities with Phoenix Venture Holdings.”

13. In a letter of the same date, Ms Ruston responded: “We had also formed the opinion that the feasibility studies should not continue”.

**Petronas**

14. Petronas, the national oil and gas corporation of Malaysia, had a 26 per cent shareholding in Proton, with which MGRG conducted discussions as noted above\textsuperscript{8}. Petronas was also involved in motor sports and sought a partner to help manufacture a new engine range that it had been developing. Mr Welford Winton, who led negotiations with Petronas on behalf of Powertrain, said he was “very interested in that because it filled a particular product gap in our capability”. The discussions were known as Project Fajar.

15. A “Framework Agreement” dated 18 August 2003 was signed between Powertrain and Petronas, which allowed for a 90 day period for the parties to put a formal binding contract in place. Powertrain was required by Petronas to contribute €37 million to the project and sought funding from RHB Bank in Malaysia. However, Powertrain’s request was rejected in November. Efforts were made to resurrect the deal and another Malaysian bank, Commerce International Merchant Bank, was approached by Powertrain in January 2004.

16. In an email dated 20 February 2004 Dr Hamzah A Hamid, planning director of Petronas, stated that his company had “concluded that [Powertrain] is unable to raise the required funding to proceed with the project”. In response, Mr Welford Winton noted: “The second bank we had discussions with have not totally rejected the project yet but we have not pushed it to conclusion”.

\textsuperscript{7} PF-R was the code name for the proposed replacement for Proton’s Perdana model, which would be based on the Rover 75.

\textsuperscript{8} See paragraphs 6 to 13 above.
Chapter XIX
Joint ventures

17. The negotiations with Petronas appear to have been less of a priority for Powertrain than those with other potential partners. Mr Poynter told us “of the four or five things we looked at, [the deal with Petronas] was probably ranked fifth in the order of either importance or doability”.

A PVH “Project Status Report” dated 14 May 2004 noted that the project was “on hold” and there had been “No further contact between Powertrain & Petronas during the past few months”.

Iran

Dastaan

18. Dastaan, a distributor and manufacturer of cars based in Iran, first approached MGRG in December 2000 with a view to being appointed an exclusive distributor of MGRG vehicles. Talks between MGRG and Dastaan were known as “Project Iran”.

19. An MGRG “Status Report/Discussion Paper” dated 23 March 2001 set out MGRG’s potential involvement with Dastaan as follows:

- To supply Rover 25, Rover 45 and Rover 75 asap ...
- To enter into counter-trade of parts and components or tradable commodities.
- To offer Dastaan the opportunity to acquire the Rover 45 facility when production ceases in the UK in 2004.
- To offer Dastaan the opportunity to acquire the Rover 25 and Rover 75 facilities when production of these products ceases.”

20. However, it appears that the plans were hindered by the need for MGRG to obtain permission from Honda under their licence agreement to sell the Rover 45 model in Iran.

According to an MGRG board minute dated 12 September 2001, the progress of the project was discussed as follows:

“[Mr Millett] ... reported that there was still information that was required by the Company [MGRG] but which was missing. He reported that this related in particular to the local content regulations and the finance arrangements. The Board then discussed the fact that there had now been a formal rejection from Honda’s Chairman to the Company’s request to enter the Iranian market with the Rover 45. Mr Millett had given considerable thought to this obstacle and recommended to the Board that the Company entered Iran with the ZS rather than the Rover 45. The ZS was to be considered a Replacement Vehicle for the purposes of the Honda licence and as such was not subject to Honda’s consent. The Board approved this recommendation.”

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9 See also XX/146 and XXIII/153.2.
21. These proposals did not come to fruition; however discussions with Dastaan were subsequently renewed.\footnote{See paragraph 28 below.}

*Iran Khodro*

22. Discussions also took place between MGRG and Iran Khodro, a large car manufacturer in Iran, in May 2001 regarding supply of the K-series engine to Iran Khodro and a number of other potential vehicle projects involving, among other things, the Rover 75 and a joint small car programme. However it appears that the talks were not progressed as MGRG was already involved in negotiations with Dastaan at the time.

*SAIPA*

23. Deloitte were appointed to assist with negotiations with SAIPA, an Iranian auto manufacturer, as set out in an engagement letter dated 20 January 2004. The engagement letter was addressed to PVH and named PVH as the partner in a proposed joint venture with SAIPA. Discussions with SAIPA were known as “Project Oscar”.

24. A “General agreement For Joint venture” dated 15 October 2003 and signed by SAIPA and “MG Rover Powertrain Limited” envisaged that the two companies would create a joint venture company in Iran that would be owned 50:50 by MGRG and SAIPA.

25. However, a document prepared by Deloitte’s Corporate Finance team and entitled “Summary of transactions currently in progress” dated 28 November 2003 again identified PVH as SAIPA’s partner in a summary of the proposed deal:

   1. Establishment of a 50:50 joint venture company in Iran between PVH and SAIPA, to manufacture and assemble Rover 45 from KD [i.e. knock down] for the distribution to the Iranian and certain export markets …

   2. Potential purchase of the family of K series engines by SAIPA for deployment in cars currently manufactured by them.”

26. The second element of the transaction described above appears to relate to separate negotiations that were conducted by Powertrain with Mega Motors.\footnote{See paragraph 33 below.}

27. A PVH “Project Status Report” dated 14 May 2004 noted that representatives of SAIPA and MGRG were to meet at Longbridge on 7 June, “to finalise operations and contractual arrangements”. However, a later version of the “Project Status Report” dated 2 August noted:
“Progress on this project and the engine project [i.e. Mega Motors and Powertrain] ... has been frustrated in the past 6 weeks by political complexities in Iran and the effects of ministerial influence.

A letter has been sent (20 July) to Minister Jahangiri seeking his assistance in making progress, including a proposal for a meeting to resolve the issues. Until there is a response, the project remains live but on hold.”

28. In light of the difficulties in progressing the deal, it appears that negotiations were renewed with Dastaan as an alternative to the joint venture with SAIPA. In an engagement letter dated 13 January 2005 Deloitte stated:

“We will assist you following the resumption of your negotiations with SAIPA and/or Dastaan as a potential joint venture partner and in negotiations for the sale of built up units and engines to Iran.”

29. A PVH “Project Status Report” dated 21 February 2005 set out the “Project Oscar” proposal as:

“Either

JV arrangement for the local manufacture of MGR products with Saipa inc engine deal with Mega Motors

Or

Supply of BU [i.e. built-up] product to Dastaan with possible extension to CKD [i.e. complete knock down] supply. Mutually exclusive so one or other.”

30. An updated version of the PVH “Project Status Report” dated 28 February 2005 noted:

“... several bureaucratic obstacles being encountered. Neither Dastaan nor the bureaucrats have experience of importing cars and many errors and delays result. MGR visit next week to ascertain true position and facilitate resolution of problems.”

31. On 14 March 2005 Mr Russ Thomas, business development manager at MGRG, provided an update on the situation in Iran in an email to Mr Ramsay:

“Some positive progress was made over the weekend. On Saturday vehicle certification was completed and yesterday and today some [registration] process ... was completed. In fact as I write this, the registration documentation is being collected from the Ministry. This means that, to the best of my knowledge, all of the bureaucratic requirements have been met. The only outstanding task is now the issue of the LC [i.e. letter of credit]. Dastaan are already heavily involved with two banks
with a view to getting an LC issued as soon as possible. Whilst it is still technically possible that we could see an LC this week, it is probable that the Iranian New Year will frustrate Dastaan’s efforts and that we should plan around March 29th as the date for receipt of the LC.”

32. An MGRG board minute dated 23 March 2005 recorded that Mr Ramsay “remained confident that the deal would proceed”. However, events appear to have been overtaken by the negotiations with SAIC at this time12 and it is unclear what further discussions, if any, took place with Dastaan.

*Mega Motors*

33. In 2003 Powertrain entered into discussions with Mega Motors, an engine manufacturer owned by SAIPA. The negotiations were known as “Project Falcon”. Mr Poynter summarised the deal as follows:

“... we would supply short engines, and they would manufacture components locally and assemble the engine locally to go into the Kia Pride, which is one of the joint venture deals that SAIPA had with Kia.”

“So clearly the opportunity for us to do a deal to up to 100,000 units a year of volume of initially fully built up engines, followed by then local assembly of certain components on what we call a short engine. So that sort of deal obviously would have been the sort of deal that would really make the difference in terms of Powertrain's being too [dependent] on Land Rover and Rover, MG Rover.”

34. A “Development and Supply Agreement” between Powertrain and Mega Motors was drafted in 2004. However, a PVH “Project Status Report” dated 2 August 2004 noted:

“Discussion and activity progress has been slow. The project reached a mature stage but progress has been halted recently (see above) [referring to problems encountered with the SAIPA deal described at paragraph 27 above].

PTL [i.e. Powertrain] are seeking to resume discussions and hope to make progress with the engine project when the current political issues have been resolved (say 2 months)”

35. Mr Poynter said that negotiations continued throughout 2004, “to a point where we had a final final version of the contract, signable, March 2005”. However, it appears that events were overtaken by the administration of MGRG on 8 April 2005. Mr Poynter told us:

12 See XX/107 to 111.
“... as far as I was concerned, the deal was always doable, and but for the administration I think we would have eventually got there but it may have taken us another 12 months.”

Poland

DFM

36. In late 2001, DFM’s parent company in Korea was in receivership. The DFM manufacturing plant at Žerañ in Warsaw had suffered substantial losses in 2000 and 2001 and the Polish Government had indicated that it would be prepared to support a rescue programme for the car factory. The Group saw this as:

“An opportunity ... to secure a local production facility and associated local production capability in the Polish market, where MG Rover currently does not have a presence.”

37. Following a visit to DFM in January 2002, Mr Stephenson wrote to Mr Maciej Leśny, the Deputy Minister at the Ministry of Economy in Warsaw, on 31 January, stating that PVH “would be prepared to collaborate with the proposed DFM rescue effort”. The discussions with DFM and the Polish Government were known as “Project Feniks”.

38. Deloitte were instructed to assist and lead Project Feniks. Deloitte’s engagement letter dated 23 October 2002, which was addressed to PVH, summarised the proposals as follows:

“A New Small Company (‘NSC’) is to be established in Poland. NSC will acquire from Daewoo-FSO Motor SA (‘DFM’) certain assets, namely the production facility at Zeran, Warsaw together with any related trading rights, commonly referred to as the ‘NSC Concept’.

Phoenix Venture Holdings (‘PVH’) has been considering various potential bases upon which it might participate in the NSC Concept. This includes a proposal to sell and licence certain assets to NSC, to become part of a consortium of investors in NSC, and to assist existing DFM management in controlling the day-to-day running of NSC.

NSC’s funding, in respect of that needed to acquire appropriate assets from DFM and MGR and its future working capital requirement, is to be procured by the Negotiation Group supported by the Government of Poland.”
39. On 22 November 2002 Mr Stephenson updated the MGRG board on negotiations with the Polish government:

“[Mr Stephenson] ... reported that MG Rover have requested that a period of exclusivity be granted which is currently being resisted by the banks. If that can be agreed Mr Stephenson stated that he felt the current chances of success were in the region of 60%.”

40. The progress of the discussions with DFM (and Tata\textsuperscript{13}) appears to have been used as justification for a contribution of £1.4 million to the Guernsey Trust in February 2003\textsuperscript{14}.

41. However, as Mr Stephenson reported to the MGRG board on 23 September 2003, progress “remained slow” and discussions continued into 2004. A “Business Plan Presentation” given to the State Treasury of Poland on 16 March 2004 set out the Group’s latest proposal:

- The initial strategy is for DFM to continue to produce Daewoo models Lanos and Matiz during a transition period ...
- Beginning of 2005, the Rover 75/MG ZT production line will be relocated from Birmingham to Żerań to produce Rover 75/MG ZT models at DFM on exclusive basis. Expected start of production date at DFM is May 2005. In 2006, new version of Rover 75/MG ZT (major facelift) will be introduced to the market
- In 2006, DFM will start production of a New Medium Car (NMC) on exclusive basis ...
- By the 1Q of 2005 most of MGR pressing (80%, possibly even 100%) will be relocated to DFM ...”

42. Following the presentation of the business plan, Mr Towers and Mr Edwards wrote on 18 March 2004 to Mr Zbigniew Kaniewski, Minister of the State Treasury, and Mr Jacek Piechota, chairman of the commission for restructuring DFM, setting out their investment offer for DFM, which was valid until 30 March:

“MG Rover offers 1 PLN [Polish Złoty – equivalent to approximately 14 pence\textsuperscript{15}] for 70% of the DFM shares held by the State Treasury of Poland ... which equals to 14.25% of the total share capital of the company and 61.38% of the total voting rights.

\textsuperscript{13} See paragraphs 49 to 59 below.
\textsuperscript{14} See XXI/14 to 16 and 38 to 42.4.
\textsuperscript{15} Using WM/Reuters closing spot rate on 18 March 2004, the date of the offer letter.
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... MG Rover plans to increase the share capital of DFM by USD 1,322 million [approximately £721 million¹⁶], subject to an independent valuation process, through in-kind contribution of:

<table>
<thead>
<tr>
<th>USD million</th>
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<tbody>
<tr>
<td><strong>Rover 75/MG ZT production assets</strong></td>
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<tr>
<td><strong>Press tools for Rover 25 and Rover 45</strong></td>
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<tr>
<td><em><em>NMC</em> development investment to-date</em>*</td>
</tr>
<tr>
<td><strong>Design rights, patents and IPR [Intellectual Property Rights]</strong></td>
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<tr>
<td><strong>Trademark portfolio and access to markets</strong></td>
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<tr>
<td><strong>Total value</strong></td>
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* New Medium Car (a new model to be introduced in 2006)
** MG Rover valuation

The above calculation includes the cost to transfer the assets.”

43. However, on 22 April 2004 Mr Beale wrote again to Mr Kaniewski and Mr Piechota, stating:

“We are now optimistic that a deal in China will be brought to a conclusion over the next few months ... The scale of this deal is much larger and has more short and long term benefits for our company than the Polish project and accordingly, as directors of our company, we believe that the right business decision would be to pursue this deal with all vigour. Unfortunately the most likely deal to be concluded will conflict with our current proposal for Poland. However, there still remains the possibility of allowing the manufacture of one of our other models such as the Rover 25 or Rover 45 in Poland. Also if the current deal in China is concluded then the new MG Rover/China joint venture company of which we will be a 50% shareholder may decide that further expansion of our joint manufacturing base in Poland would be a sensible route forward.”

44. Mr Beale did not name the prospective Chinese partner in his letter. It is unlikely that Mr Beale was referring to SAIC at this time, since the Group’s first meeting with SAIC took place on 19 April 2004¹⁷.

45. As noted below¹⁸, the decision to proceed exclusively with SAIC was taken by the MGRG board on 15 June 2004. Representatives from the Group and SAIC visited Warsaw in September, and on 12 October a letter from Mr Stephenson to Mr Piechota confirmed that “both SAIC and MG Rover would like to continue their efforts regarding investment into

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¹⁶ Using WM/Reuters closing spot rate on 18 March 2004, the date of the offer letter.
¹⁷ See XX/3.
¹⁸ See paragraphs 140 to 141 below.
FSO [i.e. DFM]”. This was followed up by a letter from Mr Stephenson and SAIC to Mr Piechota dated 20 October setting out SAIC’s and the Group’s investment offer in respect of DFM.

46. However, a PVH “Project Status Report” dated 21 February 2005 allocated Project Feniks a “Confidence Index” of just 10 per cent, noting: “All parties aware that project on hold pending completion of SAIC deal”.

47. On 18 March 2005 Mr Beale wrote to Mr Jacek Socha, Minister of the State Treasury in Warsaw, noting:

“... we would like to confirm that we are still interested in pursuing the deal in Poland but as you may be informed it is still subject to the completion of our deal with SAIC in China. We are in the very final phase of the deal in China which should be closed in the forthcoming weeks. Following completion of this deal we should be ready, along [with] our China partners, to come back to Poland and intensively pursue investment opportunities in Poland.”

48. It appears that no further correspondence took place before MGRG went into administration on 8 April 2005.

India

Tata

49. Tata was a leading Indian manufacturer and distributor of commercial vehicles, multi-utility vehicles and passenger cars. A delegation from Tata visited Longbridge in January 2002 to discuss the possibility of MGRG launching a new small car (“New Small Car”) based upon Tata’s “Indica” model. It was envisaged that the project would commence in mid 2003.

50. A suite of agreements was signed on 20 December 2002 between Tata, PVH, MGRG, Phoenix Distribution19 and Xpart. The master agreement set out two discrete elements to the collaboration:

50.1. Tata agreed to develop a version of the Indica that would be:

“... customised in a manner which distinguishes it as a Rover product and ... sold by companies in the MG Rover Group in Europe under Rover trademarks.”

50.2. Tata would appoint Phoenix Distribution as an exclusive distributor of the Tata Safari and a number of other Tata models in the UK and Ireland.

19 Previously named MG Rover Distribution Limited.
51. The New Small Car was code-named the “Rover X”. Under an engagement letter dated 28 January 2003, Deloitte were to assist in the raising of working capital finance in relation to the supply agreement between MGRG and Tata, under which MGRG would import the Rover X for sale in the UK and Europe.

52. With regard to the distribution element of the agreement referred to at paragraph 50.2 above, a PVH internal communication to employees dated 10 March 2003 announced:

- **Phoenix Venture Holdings (not MG Rover Group) has signed an agreement with Tata to distribute its utility vehicles in the UK and Ireland**

- **The franchise will be managed by Phoenix Distribution Ltd, a newly created, separate subsidiary of Phoenix Venture Holdings.**

- **The distribution agreement does not impact on the arrangements for sale and service of Rover’s new small car, which will be distributed through the MG Rover dealer network ...”**

53. As noted above20, the progress of the discussions with Tata (and DFM) up to February 2003 appears to have been used as justification for a contribution of £1.4 million into the Guernsey Trust21.

54. The Rover X was launched as the “CityRover” in autumn 2003, but received poor reviews and was beset by safety and quality issues. The distribution agreement22 also did not realise the benefits anticipated, as volumes were lower than expected. Mr Adam told us:

“... we found both of the ... two key projects, City Rover and Phoenix Distribution ... did not deliver business plan benefits for either side. City Rover, for example, when we launched it on to the UK market was initially reasonably well received until the first cars arrived in the dealers, at which point there were some quite critical articles written about the car, which made the launch of the car less than successful.

And predominantly, it was felt to be overpriced for what they were getting and the quality levels not quite up to European standards, which meant our initial sales were lower than expected and our revenues were lower than expected for both sides. We were making less on the cars and they were making less on the cars, obviously because the volume was down.

On the Phoenix Distribution side also the business plan had been constructed on some volume assumptions that we did not realise in the early stages. In this case, I think the price was not so much the issue, again it was – in this case we branded them Tata, not our brand, so it still had an Indian brand.

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20 See paragraph 40 above.
21 See XXI/14 to 16 and 38 to 42.4.
22 As to which, see paragraph 50.2 above.
And while there were a number of people who bought purely on price: I do not care what it is, I will buy the cheapest pick-up I can, the market was getting much more savvy ... 

I think both of the projects were not realising the benefits from either side.”

55. The CityRover quality issues were discussed at a meeting of the MGRG board on 26 February 2004, at which:

“... it was resolved that the Company [MGRG] would cease all further purchases of the CityRover from TATA until such time as the quality issues that surrounded the vehicle had been resolved to the Board’s satisfaction and they could be confident that the brand value would not be damaged.”

56. Mr Howe communicated this decision to Tata that evening. Discussions took place between representatives of MGRG and Tata during the rest of 2004 in attempts to resolve the quality issues. At an MGRG board meeting on 17 December Mr Adam noted that a variation agreement was being negotiated with Tata that “revised the main commercial agreements in place” and “incorporated the improvements in specification and price that had been put to the Board at the last meeting and would allow the Company to proceed to re-launch the car in the UK and to launch it in the European markets”. The variation agreement was signed on 20 December.

57. By this time the Project 528 negotiations23 were well underway and PVH and SAIC had just entered into a new “Letter of Intent”24. A PVH briefing paper dated 21 February 2005 provided an overview of the negotiations with SAIC and the implications for the collaboration with Tata:

“At the outset, PVH viewed the relationship with Tata as one that could develop into a broader range of collaborations than CityRover and the Utilities importer business. PVH would wish to re-open the discussions held on these topics. There remains considerable scope outside of the arrangements with SAIC. Indeed, there are aspects of the future proposals section that can initially form the discussions between the two organisations. These opportunities provide Tata with a route into both the sports car segment and the North American markets which would be dramatically more complex in isolation ...

For Tata, the potential for an on-going collaboration with PVH can present business benefits and intangible opportunities to further grow its brand in Europe and its manufacturing portfolio but with the comfort that it will in future be dealing with a much more financially robust organisation than it has in the past.”

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23 See chapter XX (The events leading to administration).
24 See XX/49.
58. It was proposed that the chairmen of SAIC and Tata should meet “to present and explore these ideas in much greater detail”.

59. The SAIC proposals envisaged that the CityRover business would not form part of the deal, but would remain with PVH and its subsidiaries. Mr Adam told us that the new contracts signed with Tata in December 2004 “established both sides’ enthusiasm to continue to work together with a new business plan”. Quality improvements were made to the vehicles, which were to be re-launched at a lower price with new marketing. However, the benefits of the new contracts were never realised as MGRG went into administration.

Sonalika

60. Powertrain considered a number of prospective partners in India before discussions were instigated with Sonalika, a tractor manufacturer in India. These discussions were separate to MGRG’s negotiations with Tata.

61. Mr Poynter summarised the deal as follows:

“The deal was basically that they would ... manufacture what we called a ‘short engine’, which is the core block of the engine. The block would be manufactured in India, much cheaper than we could manufacture it in Europe ... They would supply the block to us, and then we would continue the rest of the manufacture of the engine for MG Rover, our customer, or any other customer we could find out of our British premises, whilst they would complete the engine for their own new – a little 4x4 they were launching the following year.

So they became both a supplier to us of engine blocks, a customer for full engines, if you like, because we had to supply the rest of the intellectual property and other components to make the engine work, and eventually that would lead on to them opening up a factory to build more of the engine in the marketplace locally, so we would get the benefit of local sourcing of more of the engine. They had obviously lots of state aid grants from their local regional state aid body, tax free concessions, and other commercial agreements that made them very competitive.”

62. According to a “PVH Status Report” dated 23 April 2004, a contract was signed between Sonalika and Powertrain on 22 March. Mr Welford Winton told us that the engines would have gone into production, had events not been overtaken by the administration of MGRG.
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China

63. Increasingly, the Group looked towards China in its search for a potential partner. Mr Welford Winton told us:

“I think everyone was aware China was a potential solution because they had the cash, as well as having the demand to come. Whereas India had the demand to come but it was going to be harder to get any cash.”

64. However, some were less optimistic about the possibility of finding an appropriate partner in China. Mr Hugh Davies, who was an Asia adviser for Prudential plc but was working on a consultancy basis for MGRG, told us:

“... I do remember some of the extraordinary forward projections by these companies ... about how many vehicles they were going to put on the road within three years, meant that China would have been wall-to-wall automobiles, had they all done it. So there was a good deal of unreality about some of this.”

65. In an email to Mr Tweedy of MGRG on 30 October 2002, a representative from C&F warned:

“Our understanding is that if you don’t have several billions of US dollars as the investment, the government won’t be interested in your project. If you plan to [invest] in China and have done your preparations, the approval process will take several years.”

66. Discussions took place with a number of Chinese companies, the more significant of which are summarised below, before MGRG decided on SAIC as its preferred partner.

China Brilliance: Project Sunrise

67. China Brilliance was an automotive manufacturer in China. It was also involved in other sectors (for example, banking, insurance, pharmaceutical and real estate).

68. MGRG was introduced to China Brilliance by BMW, which already had (or was negotiating) a joint venture with China Brilliance for the production of cars in China. At this stage, the chairman and major shareholder of China Brilliance was Mr Yang. The negotiations between the Group and China Brilliance were known as “Project Sunrise”, and represented the first significant Chinese deal contemplated by the Group.

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25 See paragraph 101 below.
26 Brilliance China Automotive Holdings Limited was a company registered in Bermuda. The Brilliance Group included a number of listed companies, including Shenyang Brilliance Automotive Company Limited and Shanghai Brilliance Group Company Limited.
69. On 6 November 2001 a “Memorandum of Understanding” was signed between PVH and China Brilliance. Discussions continued into 2002 and a “Strategic Alliance and Cooperation Agreement” was signed between MGRG and China Brilliance on 15 March 2002, along with a suite of agreements that set out the plans for the parties’ cooperation. This included a shareholders agreement that established the management structure and organisation of a new joint venture company, Win Win. Win Win, a company incorporated in Bermuda, was owned 50:50 by MGRG and China Brilliance. The company was set up specifically for the purposes of implementing the “Project”, defined in the shareholders agreement as:

“... the development, planning, design, engineering and testing of the New Models, including the financing thereof and the ownership of the New Models Intellectual Property.”

70. The “New Models” were the New Medium Car and New Small Car.

71. While MGRG would undertake the design and development work involved in the project, funding would be provided by a £300 million loan from China Brilliance to Win Win. Under the “Loan and Security Agreement” between Win Win and China Brilliance the loan would be paid in varying quarterly tranches between 1 April 2002 and 1 April 2005. The shareholders agreement provided for the loan to be repaid via capital contributions to Win Win based on sales of vehicles. To avoid the risk of each party repaying a disproportionate amount of the loan, the maximum amounts repayable were capped at £190 million and £175 million for MGRG and China Brilliance respectively.

72. From the £300 million loan to Win Win, funding of up to £267 million was to be provided to MGRG by Win Win in tranches, which were linked to the project schedule included in the “New Medium Car Design and Development and Tooling Procurement Contract” between Win Win and MGRG. The remaining £33 million was included in a schedule of payments in the “New Small Car Design and Development and Tooling Procurement Contract” between Win Win and MGRG, for which the project schedule was “To be supplied”. If expenditure on the New Medium Car was less than £267 million, the remaining funds could be used for the New Small Car. However, MGRG would have to raise any additional funds required for the New Small Car in excess of the £300 million loaned by China Brilliance for the Project.

73. East West Holdings Limited (“East West”), a newly formed company also incorporated in Bermuda, was to construct a facility in Ningbo, China, for the manufacture of the Rover 25, Rover 45 and Rover 75 (to be sold as China Brilliance vehicles) and the New Small Car and New Medium Car, with technical support and assistance from MGRG. The intellectual

27 PVH was then still called MG Rover Holdings Limited.
28 Specifically, Brilliance China Automotive Holdings Limited.
29 Note that the agreements were with “China Brilliance Industrial Holdings Limited”, a company registered in Bermuda, rather than Brilliance China Automotive Holdings Limited, with which MGRG had signed the memorandum of understanding in November 2001. A document setting out the China Brilliance group structure describes “Brilliance Holdings Limited” as an “Affiliate of Brilliance China Automotive Holdings Limited (‘BCAH’) … Run by Mr Yang Rong (Chairman and President of BCAH) …”
property rights ("IPR") relating to the Rover 25, Rover 45 and Rover 75 would be assigned to East West by MGRG. MGRG would also supply the K4 and KV6 engines to East West in a "knocked down" form.

74. The first instalment of funding to be provided by Win Win, which was £23.4 million, was paid on 2 April 2002 into an MGRG bank account. This was recognised in the PVH 2002 consolidated financial statements, which described the £23.4 million payment as a "contribution to product development costs". However, the Group also incurred "Incremental product development costs" of £12.3 million "in accommodating the specific derivative requirements of our partner within our new medium car programme during the early stages of this relationship". The net benefit to the Group from the joint venture at this point was therefore £11.1 million. (In the event, this was the total benefit to the Group as the negotiations collapsed shortly afterwards – see below.)

75. The progress of the discussions with China Brilliance up to this point was used as justification for a contribution of £7.7 million to the Guernsey Trust30.

The collapse of Project Sunrise

76. Mr Howe updated the MGRG board on developments during a meeting on 28 June 2002:

"Mr Howe reported to the Board that he had recently returned from a Board meeting of Win Win Co Limited in Bermuda [on 24 June 2002] at which Board meeting Brian Sun and Charles Huang attended on behalf of the Company’s joint venture partner, China Brilliance. Mr Howe reported that the first and most pressing item on the agenda for Win Win Co was to understand the current structural changes and their impact on the collaboration. Mr Howe advised the Board that Mr Huang (the China Brilliance’s Finance Director) reported that there had been a material reorganisation within the Brilliance Group of Companies, resulting in Chairman Yang being replaced as Chairman in the case of certain of the group companies. Mr Huang explained that Shanghai Brilliance (the Company listed on the Shanghai stock exchange) remained under the Chairmanship of Chairman Yang. Mr Howe advised that Shanghai Brilliance intended to continue to honour the suite of contracts that had been entered into between the Company and China Brilliance Industrial Holdings Limited and with MG Rover Group Limited and in particular it was committed to the development of the new medium car and the new small car in accordance with the design and development agreements that were in place.

Mr Howe advised the Board however that Mr Huang had reported that the next instalment payment which was due to be made by China Brilliance Industrial Holdings Limited to the Company on the 1st July 2002 in the amount of £23.4 million would be delayed. Mr Huang further reported that whilst the funds were available they may not be payable until such time as the Board Director of Shanghai Brilliance

30 See XXI/30 to 37 for further details.
had been reconstituted. To this end a shareholders meeting was due to take place at Shanghai Brilliance on the 19th July 2002 at which four directors would be removed and Chairman Yang confirmed as Chairman of that Company. Following that Mr Huang had reported that it would be possible to release the funds to Win Win Co Limited for them to make the second instalment payment to MG Rover Group pursuant to the Design and Development agreement. Therefore, it had been requested by China Brilliance that the payment due on the 1st July 2002 be delayed until the 1st August 2002. Mr Howe reported that reluctantly he and Mr Millett who had represented the Company at the Joint Venture Board meeting had agreed to this cause of action and it remained to be seen that whether or not the payment would therefore be made. However, he confirmed that China Brilliance had been advised that if the payment was not forthcoming on the 1st August 2002 then he reserved his rights to seek to take whatever remedies were appropriate under the Agreements to recover the money from China Brilliance Industrial Holdings Limited.

It had also been agreed that the arrangement fee due to be paid by MG Rover Group Limited to China Brilliance Industrial Holdings in the amount of £2.5 million would be delayed until receipt of the second instalment payment.”

77. When we asked whether there was concern as to whether the deal would proceed following this meeting, Mr Millett answered: “One couldn't argue that there was doubt that it would resolve itself. There must have been some level of doubt”.

78. Mr Howe updated the MGRG board again on 2 August 2002:

“Mr Howe reported that during the course of the Board meeting he had taken a telephone conversation from Charles Haswell of the British Embassy in Beijing. He confirmed that he had requested the British Embassy to make enquiries on the Company’s behalf as to the identity and whereabouts of Yang Rong, Brian Sun and Charles Huang and the position in respect of the Brilliance Group of companies. Mr Haswell reported back that Mr Yang appeared to have fled to the United States of America where he was expected to stay. He further reported that Brilliance as a group of companies had never had any intention of building motor vehicles with the Company, although Yang Rong clearly had identified a relationship with the Company as being something to which he was committed but that which he was going to do outside his capacity as Chairman and major shareholder of Brilliance. It appears that he intended to set-up a car manufacturing plant with a third party who had a licence to manufacture cars in Ningbo.

... the Company recognised that China Brilliance Industrial Holdings were now in breach of the collaboration agreement in that the second instalment of the money due to be paid under the Loan and Security Agreement had not been advanced (it had been authorised to be delayed until the 1st August 2002) and as such the Company

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31 Under the terms of the “Loan and Security Agreement” between Win Win and China Brilliance Industrial Holdings Limited dated 15 March 2002. This was never paid.
felt it had no alternative but to write formally to advise China Brilliance Industrial Holdings of this fact. Miss Ruston was asked to send a formal notice to those authorised to receive it under the agreements of the breach.”

79. Ms Ruston subsequently wrote to China Brilliance and Win Win on 9 August 2002 advising the companies that they were in default under the Shareholders Agreement and New Medium Car Design and Development and Tooling Procurement Contract respectively.

80. PVH’s 2002 financial statements reported that the joint venture with China Brilliance had been “terminated as a result of the non-receipt of payments due to MG Rover from the Chinese Partner”.

81. Several additional reasons for the failure of the Project Sunrise negotiations have been suggested.

82. More than one witness suggested that the Group had not recognised the importance of obtaining political support in China and the need to involve the appropriate Chinese authorities in the negotiations. Mr Millett, for example, told us:

“Apart from any other wrongdoings by Yang, I think not going through the proper [Chinese Government] channels was seen to be a shortcoming in what our process had been ...”

Mr Davies said:

“... when I came on board I was trying to, as it were, steer them in the direction of dealing with Brilliance in a much more structured and China-oriented way, ... – in a politically sensitive way, I should say, because they did not seem to understand the need in a country such as China to have the authorities on board.”

Furthermore, Mr Adam said:

“I think the only learning that came out of that for us was we wanted to find a company who had very good and political support. So when I visited all the other companies, we made sure we met the local government officials, and the mayor and so on, just to assess the Government support ...”

83. It has also been suggested that the proposals were resisted by the local Liaoning Government, which wanted the project to be based in the province’s capital city, Shenyang, rather than in Ningbo in Zhejiang as envisaged. Mr Stephenson said:

“... whether he [Mr Yang] ever did anything illegal or not truthfully by Western standards we will never know, in my view. But sure as hell what he did wrong was he got on the wrong side of an incredibly influential political individual, who was called Mr Bo Jia Lai. Mr Bo Jia Lai amongst other things was head of the Liaoning
province and that is of relevance to Brilliance because their factories were in the Liaoning province.

_We think the reason he got on the wrong side of Mr Bo Jia Lai was the project he was doing with us was not in the Liaoning province, it was in the Ningbo, which was a different province. We don't know this was the reason but we think this probably incurred Mr Bo Jia Lai's wrath …_

84. In any case, the failure of Project Sunrise was linked with allegations being made against Mr Yang. Mr Davies told us:

“... China Brilliance was ... a false trail from the beginning, in my view, and I was very suspicious about it when I first started digging into it ... Certainly the people I talked to did not know where Yang Rong had made his money. So the fact that MG Rover were pinning their hopes on this gentleman had always struck me as being mistaken.”

85. There were various references to Mr Yang in the British press during the spring of 2002. A Financial Times article dated 11 April reported:

“... over the last year, investors have started to worry that the enigmatic Mr Yang ... has performed a few tricks too many, with his group’s complex structure, controversial share dealings and multiple tie-ups with foreign companies.”

In May and June of 2002, a number of press articles reported that several senior executives at China Brilliance, including Mr Yang, were under investigation over suspected asset stripping and that Mr Yang had been ousted as chairman of China Brilliance. For example, an article from the Daily Telegraph dated 29 May stated that the Chinese provincial government had signalled its determination to oust the chairman of its local partner, Brilliance China Automotive. Another press article from the Financial Times dated 31 May stated:

“Several senior executives at Brilliance China Automotive Holdings Ltd. ... are under investigation over suspected asset stripping among the group’s sprawling network of subsidiaries ... One of those under investigation is Yang Rong, the chairman and a former central bank official ... One subject of investigation is why Mr Yang, who is one of China’s most respected businessmen, failed to carry out in full an internal 1999 finance ministry decree that ordered the transfer of a 55 per cent stake in Brilliance held by the Chinese Financial Education Development Foundation, a non-profit body controlled by the People’s Bank of China, the central bank.”

An article printed by Reuters on 20 June 2002 confirmed that China Brilliance had announced that Mr Yang had been replaced as chairman by Mr Wu Xiaoan.
86. Despite this press coverage, Mr Millett told us that at the time:

“... assurances were being given from the China end that this was conflict within the board of Brilliance, and that the Brilliance company that we were doing business with ... was based in Shanghai, and the people who were objecting to this were from a different province, and it was certainly said for a period of time in June by officers of China Brilliance that Chairman Yang would see off the recalcitrant members of the board and everything was fine ...”

He also said:

“By September [2002] it still wasn't absolutely clear that the deal had gone completely wrong ... I think at that stage, no firm conclusions had been formed as to whether Yang Rong had (a), done anything wrong, and (b), was going to be able to complete the deal. Later on, we have the accusations of him taking money from this Chinese foundation trust which, I mean, we will never know what the truth is about that, I guess. It is something that organisations in China will know about, and there is so much political element to that as well as factual element, I am sure.”

87. Mr Beale said:

“... I think at the point when we understood there was a problem with Yang Rong, I don't think we saw it as being a particularly – we probably would have seen it as slightly disappointing because he was a man we had a huge amount of respect for but at the end of the day, we had, you know, a legal agreement with a respected Chinese company who I think at this point had paid us quite a lot of money. So I don't think we would have assumed anything other than it was business as usual and, you know, chairmen do get ousted from time to time.”

88. However, Mr Beale’s optimism was apparently not shared by all of the other PVH directors. Mr Stephenson and Mr Edwards, in particular, seem to have been less optimistic about the prospects of concluding a deal following the reports of Mr Yang’s departure. Mr Stephenson told us:

“Possibly we were all of different opinions about these incredibly mixed messages we were receiving, and it is probably fair to say that I got myself into a position where I was more negative about Mr Yang and the possibilities of him ever recovering his position than some of my colleagues.”

“... I think Peter [Beale] and the Deloitte camp, Maghsoud et cetera, remained in the optimistic camp, longer, definitely longer than myself. I think JT [John Towers] moved quickly into a neutral camp, you know, keep an open mind ... and I moved into a more negative camp. This wasn't a – didn't create sort of massive internal friction. We were so busy at the time. This was a really sort of frenzied period, not
particularly this date, of opening the door and possible JV partners. And this is a long process, just with a single partner. So we were dividing up responsibilities and activities in a comfortable way.

Q. ... did John Edwards have a view?

A. Yes. And I can't recall. I think he was probably pretty sceptical about Yang camp fairly early on.”

89. Following the collapse of Project Sunrise, in December 2002 Mr Howe, Mr Millett, Mr Brett Riley and Mr Davies met officials at the British Embassy in Beijing and Chinese Government organisations to discuss the way forward for MGRG. Mr Millett told us:

“We got the hearing which said that they did like the business model that we had presented with Brilliance very much, because it brought technology transfer to the Chinese market, as opposed to other deals licensed by other big [Original Equipment Manufacturers] which only gave the Chinese company the non-current model ... this brought a full range of products, so they liked that, and it was a joint venture which enabled us to make new cars and they liked it very very much. So we were given some encouragement that a deal could be resurrected.

At the same time, they were very clear in their views on Chairman Yang Rong, that they believed that he was someone we should distance ourselves from ... we were told that we should distance ourselves from Yang Rong for the future.”

Further discussions with China Brilliance

90. During the meetings with the Chinese authorities in December 2002, the Group was advised to meet the new management team at China Brilliance to see if the deal could be saved. In the following month, Mr Howe, Mr Millett, Mr Adam and Mr Davies met representatives of China Brilliance in Beijing. A note of a meeting records that China Brilliance expressed an interest in co-operating with MGRG, but would not proceed under the current terms of the agreement and wanted to “modify or wind down agreements”. In addition, there would be no further investment and China Brilliance wanted the £23.4 million paid to MGRG to be reimbursed “either at full cost or reduced cost”. This was not acceptable to MGRG, and the agreements with China Brilliance were formally terminated via Mr Millett’s letter to the chairman and director of China Brilliance Industrial Holdings Limited on 10 June 2003.

Project Battens

91. In the meantime, the Group had continued discussions with Mr Yang. Mr Davies’ note of a meeting with Mr Howe and Mr Millett at Longbridge on 30 September 2002 recorded that: “Yang Rong is still keen & willing if nec to arrange deal for MGR with another co”. The transaction with Mr Yang was code-named “Project Battens”.

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92. A letter from Mr Millett to Mr Yang dated 19 September 2002 set out proposed terms for a collaboration between MGRG and Mr Yang’s new company, further to a visit to Longbridge by Mr Yang the previous week. Mr Yang’s company was to provide funding of £180 million in six equal quarterly instalments. The proposals were based upon the original agreements between MGRG and China Brilliance described at paragraph 69 above, with the same corporate structure and with MGRG continuing to develop the New Medium Car under the original specification. The timetable set out in the original agreement would be put back by a minimum of six months.

93. Heads of agreement dated 9 May 2003 were signed between PVH and Star Apex, a British Virgin Islands company controlled by Mr Yang. A PVH document entitled “Project Battens – summary of the deal”, circulated to the MGRG directors and others by Ms Ruston on 4 July, summarised the latest version of the deal as follows (a diagrammatic summary is to be found on the next page):

93.1. Star Apex would pay $222.72 million (approximately £133.6 million) for a 49 per cent shareholding in PVH, to be paid in 15 monthly instalments following completion. It appears that it was intended that additional shares in PVH would be issued to Star Apex in return for this consideration (rather than Star Apex acquiring shares already in existence, and therefore the proposed transaction would result in new money coming into PVH);

93.2. PVH and Sun East LLC (“Sun East”), a company registered in California and also controlled by Mr Yang, would each take a 50 per cent shareholding in a newly formed company, MG Rover Pacific. In exchange for its shareholding, PVH would contribute the Rover 25 and Rover 45 tangible assets and the IPR for manufacture and sale of these models in China. Sun East would receive its 50 per cent shareholding in MG Rover Pacific “in return for the value it brings to the transaction.”;

93.3. The Rover 25 and Rover 45 IPR would be sold by MG Rover Pacific to “JJV”, a new joint venture company set up to manufacture vehicles in Jiangyin, China, in exchange for a 50 per cent shareholding in JJV;

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32 Using WM/Reuters closing spot rate on 4 July 2003, the date on which Ms Ruston circulated the latest version of the Project Battens deal.
**Chapter XIX: Joint ventures**

**Existing “D” shareholders**
- Star Apex: 49%
- Sun East: 51%

**PVH**
- R25/R45 tangible assets to Star Apex for $222.72m
- Licence of R75 IPR, MGTF “K” series engines and NMC (for sub-licence to JJV)

**MG Rover Pacific**
- 50%
- Licence of MG and Rover trade marks

**Chinese Parties**
- 50%

**MGRG**
- R25/R45 tangible assets to JJV for $222.72m

**JJV**
- R25/R45 IPR
- Licence of MGFTF “K” series engines and NMC (for sub-licence to JJV)
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93.4. The other 50 per cent shareholding in J JV would be owned by “a small number of Chinese companies and financial institutions” that were connected with the local government of Jiangyin. The Chinese parties would receive their 50 per cent shareholding in J JV in exchange for an investment of $365 million (approximately £218.9 million). A “Contract For The Equity Joint Venture” was signed on 12 June 2003 between MG Rover Pacific and the Chinese parties;

93.5. MG Rover Pacific would sell the Rover 25 and Rover 45 tangible assets to Star Apex for $1. Star Apex would then sell on the Rover 25 and Rover 45 tangible assets to J JV for $222.72 million (approximately £133.6 million), which it would use to fund its 49 per cent shareholding in PVH described at paragraph 93.1 above. According to a Deloitte meeting note dated 11 July 2003, Mr Beale understood that Mr Yang was underwriting the deal and that the $222.72 million “will be repaid [to the Chinese parties] in due course when Mr Yang Rong has access to funds”; and

93.6. MGRG would license the Rover 75 IPR, MGTF K-series engines and the New Medium Car (when available) to MG Rover Pacific under terms that would allow MG Rover Pacific to sub-license the IPR to J JV. MGRG would also licence the MG and Rover trade marks to J JV. Both these transactions were to be arm’s length agreements, for which MGRG would receive a royalty income. MGRG would also enter into agreements to supply J JV with models in “knocked down” form and provide technical support.

94. The proposed deal differed from Project Sunrise in three key ways:

94.1. as noted at paragraph 93 above, Mr Yang would acquire a shareholding in PVH (through Star Apex), as well as in the joint venture companies to be established (MG Rover Pacific and J JV);

94.2. the value attributed to the assets to be transferred to the joint venture company, i.e. the Rover 25 and Rover 45 tangible assets and associated IPR, appears to have increased from £7 million under Project Sunrise to £352.5 million under Project Battens; and

94.3. the plans to develop a New Small Car were dropped.

33 Using WM/Reuters closing spot rate on 4 July 2003, the date on which Ms Ruston circulated the latest version of the Project Battens deal.
34 The “Machine and Die Transfer Agreement”, part of the suite of agreements signed on 15 March 2002 described at paragraph 69 above, stated that the parties agreed that £1 million for the Rover 25 assets and £1 million for the Rover 45 assets “shall represent fair market value for such Assets”. The “Assignment of Intellectual Property Rights relating to Rover 25” and “Assignment of Intellectual Property Rights relating to Rover 45”, also signed on 15 March 2002, referred to considerations of £3 million and £2 million respectively.
35 As noted at paragraphs 93.3 and 93.5 above, J JV was to pay $222.72 million (approximately £133.6 million) to Star Apex for the Rover 45/Rover 25 tangible assets. MG Rover Pacific was to transfer the Rover 45/Rover 25 IPR to J JV in exchange for a 50 per cent shareholding, which appears to equate to the $365 million (approximately £218.9 million) investment from the Chinese Parties in return for the remaining 50 per cent shareholding.
95. The summary of the deal circulated by Ms Ruston on 4 July 2003 noted that:

“All contracts relating to both transactions are in agreed form. Completion is expected to take place in Longbridge in the week commencing July 14th.”

96. However, Deloitte’s note of a meeting with Mr Beale and Mr Howe a week later, on 11 July 2003, stated:

“Peter Beale highlighted that completion may not take place on 15 July due to the amount of legal work to be concluded. Kevin Howe observed the back stop date for completion of 31 Aug (later highlighted to be 30 Sep by the Company’s Financial Advisor)”

97. The Deloitte audit team’s “Going Concern review” in respect of the PVH 2002 audit noted that the first $15 million tranche of the funds to be paid by Star Apex was due on 15 July 2003. An update to the review on 15 July recorded that there had been a delay in the signing of the deal, although it also stated, “There is no indication at this stage that the Project Battens deal will not go ahead”.

98. It appears that the Group had anticipated that the transaction would only require approval from the local government of the province in which JJV would be based. However, it emerged that authorisation was required from the Central Government in Beijing before the necessary legal agreements could be concluded, which would be much more time-consuming. In a letter sent by email to Mr Costello of Capital Bank on 17 October 2003, Mr Millett stated:

“As I told you, to date Phoenix Venture Holdings has not received any funds from the Chinese partner.

The arrangements envisaged by Peter Beale indicated that approval for the investment in MG Rover Group would be granted quickly, authorised only by local (i.e. provincial) Government in Jiangsu Province. Subsequently, we have been told that the venture requires the concurrence of Central Government in Beijing. This has necessitated further visits to China by Peter Beale and a senior partner of Deloitte & Touche [Mr Einollahi] to establish the necessary subsidiary business set-up followed by the obtaining of a business licence. The bureaucratic processes in China are very thorough and slow. Having achieved these steps Peter is planning to visit China later this month when we expect a clearer picture of when funds may become available to us.

In respect of our major programmes, i.e. New Medium Car, our plan is still in place for an introduction date in Quarter 4, 2005.”
99. A Deloitte summary of corporate finance transactions in progress, dated 28 November 2003, stated in respect of Project Battens:

“A 100% subsidiary of PVH has been set up in Jiangyin, China and it received a Business license (w/c 17 Nov 03). We are currently in the process of opening bank accounts for this company and drafting the necessary legal documentation (based on the agreements drafted earlier in the process in June 2003) and finalising the transaction structure.

... It is hoped that the transaction will be completed by February 2004 (3 months from receipt of the business licence when the initial tranche of capital into the Chinese subsidiary is due) but it may be possible to conclude the deal before then.

... A mechanism for repatriating the cash to the UK has yet to be fully investigated.”

It appears that this final point of getting funds back to the Group was never resolved.

100. When we asked what ultimately happened to the Project Battens deal, Ms Lewis of Eversheds said:

“They just never came up with the money ... It just died, I think. Not – as far as we are aware, we had all the documents there, and there just never was any money.”

C&F

101. Discussions also took place between the Group and C&F, a vehicle importer and distributor in China, during 2002. However, the talks appear to have been put on hold by the Group in October of that year, to allow the Group to consult with the Chinese Government following the collapse of Project Sunrise\(^{36}\). Discussions were revived briefly in March 2003, when the Group considered entering into a temporary “non-exclusive Distributor Agreement” to enable C&F to purchase and sell on ten Rover 75 vehicles that were left in Hong Kong following the failure of the Project Sunrise negotiations. C&F was also requesting that the temporary agreement allow it to sell “the 10 cars plus more”. It is unclear whether this agreement was ever finalised.

HAGC

102. Discussions between MGRG and HAGC began in June 2002. A draft “Framework Agreement” was drawn up between the two companies in 2003. The agreement was not legally binding and does not appear to have been finalised. The agreement, which was closely modelled on the Project Sunrise deal, stated that MGRG and HAGC would create a joint venture company, with each company owning a 50 per cent share:

\(^{36}\) See paragraphs 76 to 89 above.
“... to coordinate and finance the development of current models, future models and current and future engine ranges. The manufacture, marketing and sale of the motor vehicles and engines will be carried out by HAGC and MGR in their respective territories under their own brands.”

103. On 18 March 2003 Mr Adam sent a memorandum to Ms Min Dan of HAGC, stating:

“With the full knowledge of HAG, we have been looking for a Chinese partner who could replace Brilliance and enter into a very similar business model with MG Rover Group. Either through a lack of understanding, or for some other reason, we have found it difficult to find a common view of a potential framework. The current view of HAGC does not reflect the nature of the business model that we have presented to you on several occasions ... We still regard HAGC a serious potential partner, but we do need to understand very clearly the nature of this cooperation as viewed by HAGC, as it is different to that proposed by MGRG.”

104. Discussions continued over the next three months and revisions were made to the “Framework Agreement”, but it appears that the parties were unable to agree upon terms.

Geely

105. Geely was a large multi-sector group, whose “core business” was the manufacture and distribution of motor vehicles and motorcycles, decorative materials and machinery.

106. Representatives from Geely visited Longbridge in September 2002 and a “Confidentiality Agreement” was signed between MGRG and Geely on 9 September. Following visits to Longbridge and Shanghai in 2003, “Heads of Agreement” between MGRG and Geely were signed on 12 December. This was a non-exclusive agreement, within which the parties proposed:

“... to enter into a collaborative arrangement by setting up a Joint Venture in China for the manufacture of passenger vehicles in China and the development by MG Rover of a new medium Rover car ...”

107. The joint venture company would be owned 75 per cent / 25 per cent by Geely and MGRG respectively, with Geely paying RMB600 million (approximately £41.5 million37) in cash for its shares. MGRG would acquire its shareholding in exchange for contributing to the joint venture company the IPR relating to the manufacture and sale of the Rover 75 and the Rover 75 Long Wheel base in China. MGRG had the option to increase its shareholding to 50 per cent after one year in exchange for the assignment of IPR relating to the manufacture and sale of the Rover 25 and Rover 45 models in China to the joint venture company.

37 Using WM/Reuters closing spot rate on 12 December 2003, the date of the Heads of Agreement.
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108. A contract and “Letter of Intent” were subsequently drafted for the joint venture in February 2004. It was anticipated that the contract would be signed in May, and that the joint venture would achieve approval from the State Council in June.

109. In a note to Foreign & Commonwealth Office officials dated 9 February 2004, Mr Davies noted that there was a “split in the Board” between those led by Mr Beale, who favoured the “Jiangyin ... project”, being the Project Battens deal with Mr Yang, and those led by Mr Howe, who favoured the deal with Geely. In a later email to Mr Ian Cranshaw, a commercial officer in the British Embassy in Beijing, on 21 April, Mr Davies noted that the Group was continuing discussions with a number of parties, including NAC, SAIC and Guangzhou, but that Geely had “slipped out of the picture”.

110. On 17 May 2004 Dr Qu Li, who was employed by the Group as a consultant in 2004 to 2005, sent a letter to Mr Nan Yang of Geely setting out a proposal further to a recent meeting, noting:

“PVH is in negotiations with a number of potential partners in China and is willing to consider Geely as one of the potential partners and to have further discussions providing that MGRG receives an acceptable financial proposal and an implementation plan from Geely before the end of May.”

111. The negotiations do not appear to have progressed after this point. Mr Riley told us:

“... the issue or the bottleneck was the funding for the new medium car. Geely could not actually commit to that and could not support it at the time when they were wishing to do a joint venture but also open a new factory up in Shanghai, and just financially they could not manage both, which left us a big gap in the plan, and that was the only reason.”

Torch

112. Torch first visited Longbridge in December 2002. An “Outline Proposal From Torch” was sent to the Group by Dr Li (who at this stage appears to have been working for Torch as a consultant) on 7 May 2003. However, on 25 June Mr Riley advised Dr Li:

“... the MG Rover Senior management Team are not in a position to receive, host, or to have discussions with Torch Executives during July and August.

38 See paragraph 91 above.
39 See paragraph 132 below.
40 See chapter XX (The events leading to administration).
41 See paragraph 143 below.
42 See further XX/176.
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The reason for this is that we have entered into detailed discussions with other Business Groups that involves an Exclusivity period [with JJV, the joint venture company to be established under Project Battens\textsuperscript{43}] which precludes any MG Rover personnel having parallel co-operation meetings at this time.”

113. The following year Mr Chang of Torch contacted the Group expressing an interest in establishing MG Rover dealers in China, and representatives from Torch and the Group met in Shanghai on 19 February 2004.

114. A "Framework Agreement" between PVH and Torch was signed on 14 March 2004, whereby the parties would “explore the opportunity to form an equity joint venture in China as a new vehicle development and manufacture base of MG Rover cars”. Under this agreement, all of MGRG’s and Powertrain’s “vehicle design and development activities and vehicle production” were to be transferred to the joint venture company in China and Torch was to “inject cash, and provide land-use rights and buildings as investment” to the joint venture company. There was to be a “share swap”, whereby Torch would take a 49 per cent shareholding in MGRG, and the new joint venture would be owned 49 per cent / 51 per cent by MGRG/Powertrain and Torch respectively.

115. A PVH “Project Status Report” dated 23 April 2004 noted that Torch was to review the manufacturing proposal as the current arrangements were complex and would be problematic for the Chinese Government to approve. A later version of the “Project Status Report” dated 2 August stated that Torch had “formally withdrawn from the total strategy circa end of April ’04”, and that no other communication had taken place.

Chery

116. Chery was a manufacturer of motor vehicles, engines and gearboxes. Also known as “SAIC Chery”, Chery was not a subsidiary of SAIC, the group that was ultimately chosen by MGRG as its preferred partner\textsuperscript{44}, although SAIC had trading arrangements with Chery and owned a 20 per cent stake in the company.

117. Mr Howe, Mr Millett and Mr Adam held discussions with Chery in Beijing in January 2003. Mr Adam visited Chery again in January, concluding that the company was “keen to collaborate, but ... want to proceed ‘step-by-step’”.

118. According to notes of a Chery visit to Longbridge on 28 March 2003, a number of potential opportunities for collaboration were discussed. Mr Millett’s handwritten notes of the meeting record that Mr Howe pointed out that Chery’s proposal was very different from the business model previously discussed in Beijing in January, and emphasising that joint new model development was a priority for MGRG. The Group subsequently sent a “Business Co-operation Proposals” document to Chery dated 28 March, which was then updated to include Chery’s response. Discussions do not appear to have progressed further.

\textsuperscript{43} See paragraph 93.3 above.

\textsuperscript{44} See chapter XX (The events leading to administration).
119. When we asked what had happened to the possibility of forming a joint venture with Chery, Mr Riley said:

“The possibility ... there was a straightforward technology transfer joint venture and not sort of broad enough or sort of big enough for MG Rover ... to get any benefit from that. It was transferring IPR and technology and having vehicles produced in China and sold in China and both companies receive profits on those vehicles...

Q. Was one of your concerns that you needed to have something that would give you a new medium car?

A. Correct.

Q. And this just would not?

A. It would not, no. The main concern was that we wanted some avenue of investment as part of the package that we could develop a new medium car, yes.

Q. Do you remember how quickly that seemed to fade away as a possibility?

A. From what I recollect on this one, it was lingering over several months. It never died off because there [were] more iterations that they wanted to do, we could do with them – and I think it took several months before that sort of ended in that way.”

FAW

120. Discussions between MGRG and FAW, one of the biggest automobile companies in China, began in March 2003. The purpose of the negotiations was to “Establish co-operation with a joint design & development project on NMC [New Medium Car]”. Mr Adam and Mr David Mason, a member of the finance and strategy team at MGRG, met FAW representatives in Changchun City in April, and FAW visited Longbridge in September. A “Confidentiality Agreement” dated 30 October was subsequently signed between MGRG and FAW, and further meetings took place in November.

121. However, Mr Mike Booth, head of programmes in product development at MGRG, who had visited FAW in November 2003, set out concerns about the negotiations in an email to Mr Riley on 19 January 2004, asking:

“Are FAW really serious (previous experience has been uncertain), and how much are we prepared to share? I understand that they have signed confidentiality agreements, but given general lack of appreciation of IPR ownership in China we should tread carefully.”
On the other hand, clearly they would not want to contract with us without understanding more tangibles ...

I am not clear how this stands against other China initiatives, perhaps you can advise.”

122. Plans had been made for FAW representatives to visit Longbridge in February 2004. However, in a letter to Mr Wu Shaoming of FAW dated 23 January 2004, Mr Booth and Mr Riley wrote:

“... it is with regret that we inform you that we are currently unable to receive you in early February as originally planned, due to conflicting new model launch commitments, which require key people in our organisation as well as ourselves.

We would like to understand your availability sometime in March when we will be better placed to receive you. Please give this your consideration and advise when you might be available.”

123. Although Mr Booth followed this up with another letter dated 27 January 2004 explaining in more detail the reasons for delaying FAW’s visit, this appears to have marked the end of the discussions. A PVH “Project Status Report” dated 14 May stated:

“Visits & meetings have taken place

Further FAW visit to MGR planned in April [2004] to finally establish project parameters, payment conditions etc.

This scheduled meeting was cancelled by PVH team on the basis that this proposal was now competing with many more advanced projects, and it may complicate other business arrangements.

FAW have formally withdrawn from New Project Joint Development project. The main reason for this change is not being able to establish a clear plan with FAW and MGR terminating their planned visits ...

FAW seek only to work jointly on new product Development in order to gain experience.

Joint vehicle manufacturing is not on their objective list”

Changan

124. During 2003 discussions also took place with Changan, which at the time had the fourth largest passenger car business in China. Mr Adam and Mr Mason visited Changan in
March 2003, after which Mr Adam prepared an “Evaluation Report” dated 7 March that concluded:

“Very keen to proceed. They would like to sign an agreement for the first stage of the project in April [2003]. They would like a long term cooperation, leading to a manufacturing JV.”

125. A “Confidentiality Agreement” dated 7 April 2003 was subsequently signed between MGRG and Changan.

126. It is unclear how the discussions progressed and why they were ultimately not successful, although it is likely that events were overtaken by negotiations with other Chinese companies.

127. It is unclear whether there was any further correspondence between the parties.

LIFAN

128. MGRG was contacted by Mr James Zhao of Chery on behalf of LIFAN, a motorcycle manufacturer looking to expand into the manufacture of vehicles, on 14 August 2003. Mr Adam responded on 21 August:

“MG Rover Group is still working very hard to secure a good relationship with a Chinese partner. However, we are currently actively investigating one specific opportunity [i.e. Project Battens45]. This means that we cannot enter into discussions for a short period. I would ask that you contact me again in four weeks time and I will give you further information relating to the status of our discussions.”

129. Mr James Zhao contacted the Group again in September 2003, proposing a visit to Longbridge. However, as Mr Riley told us, the negotiations “never really got off the ground”.

BAIC

130. Manuscript notes dated 18 February 2004 stated that BAIC was interested in a technology transfer with a view to manufacturing vehicles in China, rather than in a joint venture. A paper discussed at an MGRG board meeting on 26 February stated that a “positive” initial meeting had taken place, that discussions were continuing and a memorandum of understanding had been signed. However, a PVH “Project Status Report” dated 14 May noted:

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45 See paragraph 91 above.
“BAIC visited MGR’s plant on the 22nd April [2004], to view production facilities and discuss technology transfer proposals. It was agreed that this type of arrangement is insufficient to generate sizeable financial benefit for MGR, BAIC were asked to review their strategy”

131. A later PVH “Project Status Report” dated 2 August 2004 stated:

“Discussion suspended after their visit to Longbridge (End of April) Reason being BAIC could not take part in the overall strategy only licence manufacturing of specific vehicles”.

NAC

132. NAC, one of the earliest vehicle manufacturers in China, was introduced to the Group by Dr Li in early 2004.

133. On 17 March 2004 a “Principal Agreement” was signed between PVH and NAC. This stated that the two parties would establish a joint venture company in Nanjing through joint investment, which would “develop, manufacture, sell and do service work of the complete vehicle products of MGR Series and the powertrain products of [Powertrain]”. Under the terms of this agreement PVH would transfer to the joint venture company intangible assets (“intellectual property and know-how”) and “assets in kind” (machinery, equipment, tooling, parts, etc.) relating to the Rover 25/ZR, Rover 45/ZS and Rover 75/ZT model ranges, K-Series and L-Series engines, and all transmissions. The agreement stated that the total value of these assets was £240 million.

134. In addition, £120 million was to be paid by NAC to PVH through the JVC, comprising one £60 million payment within one month of the approval of the project and a further £60 million in royalties to be paid within 18 months. PVH’s net contribution to the JVC would thus be £120 million.

135. However, as noted in chapterXX (The events leading to administration)46, the Group’s funding requirement was £192 million. A meeting was held on 13 May 2004 between NAC representatives, Mr Cowburn, Mr Riley and Dr Li to “discuss methods of reducing the funding gap”.

136. A “Pre-FS [Feasibility Study] Report” was submitted to the Chinese Government in May 2004. In an email to Dr Li, Mr Beale, Mr Riley and Mr Stephenson on 2 June, Mr He Xiao Qing noted that NAC was preparing the formal feasibility study.

137. On 11 June 2004, Mr Stephenson and Dr Li met with representatives of NAC in China to discuss “issues such as way of cooperation and cash payment”. NAC revised its proposal, which is summarised in an MGRG board minute dated 15 June:

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46 See XX/5.
“... [NAC’s] proposal ... includes a cash payment of £192m, to be paid at £120m in November 2004 and two further stage payments of £47m and £25m to be paid at a later date, the period of time being beyond 18 months. The shareholding ... is proposed at 50% in the joint venture. The strategy is primarily China orientated, seeing only Rover 25 remaining at Longbridge.”

138. As noted in chapter XX (The events leading to administration)\(^47\), by this time the Group had also entered into discussions with SAIC, and was still exploring the possibility of collaboration with Guangzhou\(^48\).

139. Three days after the 11 June 2004 meeting with NAC, on 14 June Mr Stephenson, Dr Li and Mr Cowburn met with representatives of SAIC in Shanghai. A minute of the meeting stated that: “PVH will decide between the two proposals provided by SA [i.e. SAIC] and NJC [i.e. NAC] in 24-48 hours, decide the partner, grant exclusivity to the partner”.

140. A minute of an extraordinary meeting of the MGRG board on 15 June 2004 recorded:

> “Following discussion that had taken place in China, a decision is required as to the choice of appropriate potential partner for the proposed venture in China.

> *Three parties [Guangzhou, NAC and SAIC] are demonstrating significant interest and are at the point where exclusivity is required in order to progress one of the routes to conclusion.*”

141. The MGRG board resolved to proceed with SAIC, and on 15 June 2004 Mr Stephenson wrote to Mr Huang Xiaoping, chairman of NAC, confirming the board’s decision.

142. However, as noted in chapter XX (The events leading to administration)\(^49\), NAC was subsequently involved in the “Project 528” negotiations between the Group and SAIC.

*Guangzhou*

143. Guangzhou, an automobile manufacturer, was introduced to Mr Einollahi in March 2004, and Guangzhou “expressed strong interest in taking over the Jiangyin proposal [i.e. Project Battens\(^50\)]”. In an email dated 26 March Mr Beale noted that Mr Einollahi and Mr Stephenson had had “an initial meeting” with Guangzhou and that representatives from the company would be visiting Longbridge on 9 April.

144. Negotiations with Guangzhou appear to have progressed further than those with many other prospective Chinese partners. Mr Einollahi told us:

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\(^{47}\) See XX/3 to 5.

\(^{48}\) See paragraph 143 below.

\(^{49}\) See XX/29 to 30.

\(^{50}\) See paragraph 91 above.
“... I conclude on two organisations as being people that further discussions would be appropriate with. And they are Guangzhou and SAIC.”

145. As noted above\(^5\)\(^1\), Guangzhou was mentioned in the minutes of an extraordinary meeting of the MGRG board on 15 June 2004. The minutes stated that:

“... [Guangzhou] are proposing a cash payment of £192m in December 2004 and a shareholding in a joint venture of 50%. The strategy and implications for Longbridge are not totally clear at this stage.”

146. However, at the meeting it was concluded that MGRG should proceed with negotiations with SAIC as the preferred partner.

\(^{51}\) See paragraph 140 above.
CHAPTER XX

THE EVENTS LEADING TO ADMINISTRATION
Project 528

Background to the negotiations

1. “Project 528” was the title given to the proposed deal between the Group and the Chinese automotive group (“SAIC”) which included Shanghai Automotive Industry Corporation (Group) (“SAIC Group”) and Shanghai Automotive Company Limited (“SAC”). It appears to have taken its name from the date during 2004 (May 28) on which work on the transaction was considered to have begun.

2. During 2004 the Group continued its search for a Chinese partner. As noted in chapter XIX (Joint ventures), various Chinese vehicle manufacturers were considered. Views differed as to which company offered the best prospect.1

3. The first meeting with SAIC appears to have taken place on 19 April 2004. There was a further meeting, attended by Mr Stephenson and Dr Li (who was employed by the Group as a consultant), on 26 April and a confidentiality agreement between PVH and SAC was signed on the same day. By 13 May the parties had entered into a memorandum of understanding, but this did not mean that PVH had decided to proceed with SAIC rather than another Chinese company. In fact, as noted in chapter XIX (Joint ventures), (non-binding) agreements were concluded with several Chinese concerns.

4. By mid-June 2004 the field had been narrowed to Guangzhou, NAC, and SAIC. SAIC already had joint ventures with both General Motors Corporation (“General Motors”) and Volkswagen. However, it seems that SAIC expected that China would in the future permit foreign companies to invest in the country otherwise than through joint ventures and anticipated that, when that happened, General Motors and Volkswagen may no longer want the joint ventures. SAIC therefore saw the acquisition of its own technology, design and engineering as a business imperative. SAIC was ultimately controlled by Chinese Government interests.

5. The Group approached SAIC, NAC and Guangzhou, as well as other Chinese companies, on the basis that the Group required £192 million. Mr Beale told us that he could not recall how the “rather precise figure” of £192 million was arrived at, but that it was “one of those figures that remained constant” and “had a certain logic to it as regards the cash ... needed to transform [the] business”. Mr Beale stated that the £192 million represented:

“... a sum of money we thought we required which we thought was a fair price for the counterparties to pay for what we were offering, although that obviously changed

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1 See, for example, XIX/144.
2 See further paragraphs 174 to 201 below.
3 See XIX/143 to 146.
4 See XIX/132 to 142.
The events leading to administration

on a daily basis; but also the sum of cash we needed to ensure that what then subsequently became known as the PVH residuals remained solvent.”

6. The SAIC proposals involved a joint venture company. SAC (a subsidiary of SAIC Group) was to have a 60 per cent interest, to the Group’s 40 per cent. SAIC was to pay some £40 million in July 2004, for intellectual property rights relating to the Rover 75 and of Powertrain, and £152 million more, via the joint venture company, on completion. In total, therefore, SAIC was to pay £192 million. The Rover 25 and 45 were to move to China, but MG sports cars were to be built at Longbridge and the Rover 75 and the New Medium Car might also be assembled there.

Letter of intent of 16 June 2004

7. On 15 June 2004 the Group decided to proceed with SAIC. On the next day SAIC Group, SAC and PVH signed a letter of intent. This provided, among other things, for the following (a diagrammatic summary is shown below):

7.1. SAC was to be granted exclusivity for the term of the agreement;

7.2. a Chinese joint venture company would be established, whose objectives were to include the manufacture and sale of the Rover 25, 45 and 75, the comparable MG models, and engines;

7.3. PVH and/or its affiliates were to grant the joint venture company a licence for the manufacture and sale of MGTF vehicles, but the joint venture company was itself to grant PVH a licence to use the MG trademark on two-seater sports cars;

7.4. SAC and PVH were respectively to own 60 per cent and 40 per cent of the joint venture’s registered capital;

7.5. the Group was to contribute assets to the joint venture company that were stated to have a total value of US$619.2 million (equivalent to £344 million). Of this amount, US$345.6 million (equivalent to £192 million) was to be considered as PVH’s capital contribution to the joint venture company. The balance was to be paid to PVH by the joint venture company in cash and to be used for purposes related to the establishment of the joint venture company;

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5 I.e. the successor business to the Group once the transaction with SAIC had been completed.
6 The NAC and Guangzhou proposals are discussed in XIX/133 to 136 and XIX/145.
7 See paragraph 7 including the diagrammatic summary for further details of the proposals.
8 The letter of intent stated:

“The Parties agree that they shall review the grant of exclusivity … in the event of the following: a. If the consideration due by SA under the Intellectual Property Assignment Agreement has not been paid by SA by July 31, 2004; b. If the Parties determine that they have no objective to establish the JVC in accordance with the Letter of Intent.”
7.6. SAIC was to acquire intellectual property rights in respect of the Rover 75 and a variety of engines for about £40 million and to contribute US$446,400,000 (equivalent to £288 million in total) in cash; and

7.7. the Chinese joint venture company was to have a UK subsidiary with the right to manufacture and sell vehicles in territories agreed by the parties.

For the most part, however, the letter of intent was not to be legally binding.

8. Mr Zhao Fenggao, who was the general manager of SAC at the time, told us that when the letter of intent was signed SAIC thought that it was “100% possible” that the deal would be concluded. SAIC saw MG Rover as having a strong technical background and a very strong brand. Madam Li Dan, SAIC’s chief financial officer, said:

“We were very confident at this stage. Both sides matched well. They lacked capital and market and we lacked technology and brands.”

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9 The letter of intent stated that it was not legally binding except in respect of clauses relating to confidentiality, publicity and exclusivity.

10 Mr Cox of Rothschild told us, “Contracts do not have the same meaning [in China] as they do here and … the heads of terms is really only the start of something as far as they are concerned.”
9. Shortly before the letter of intent was signed on 16 June 2004, Mr Millett sent Mr Beale a memorandum expressing concern about MGRG’s financial position, with a copy to Mr Howe. Mr Millett explained that the latest Group cash forecast for June and July showed a cash deficit peaking at £49 million in the last week of June and £63 million at the end of July. Mr Millett referred to the possible deferral of creditor payments and concluded:

“I believe unless we have a high level of confidence that a significant further cash inflow (e.g. Fox)\(^\dagger\) 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.”

10. In response, Mr Beale sought legal advice. By 15 June 2004, Mr Einollahi had put him in touch with Mr Andrew Buchanan, the national head of corporate recovery based at the Manchester office of Halliwells LLP (“Halliwells”)\(^\ddagger\). On 21 June Mr Beale sent Mr Millett a memorandum based on a draft prepared by Mr Buchanan. The memorandum included the following:

“Clearly in looking at this issue the interests of the creditors of MGRG are paramount.

You are aware of the proposed disposal of XPart to Caterpillar and the current intention of the Board of Directors of PVH in the short term to fund the MGRG losses out of available funds until the China joint venture solution can be implemented. You are also aware we now have a better indication from the advisers as to the time scale of the XPart transaction which helps to clarify the position.

You are also aware that the negotiations for the China joint venture are extremely positive and not only do we have the recently announced deal with SAIC at a very advanced stage we also have a further two Chinese companies keen to do business with us on a similar scale.

Given the above I fail to understand the point of the final paragraph of your memo apart from a desire to state the obvious.

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\(^\dagger\) I.e. the code name for the disposal of Xpart in 2004 – see XIII/33.

\(^\ddagger\) Halliwells were initially instructed on behalf of the PVH directors. In January 2005 it was decided that Halliwells’ terms of engagement should be extended to include the board of directors of MGRG. However, as noted at paragraph 79 below, with effect from early February it was agreed that Halliwells’ role should be limited to giving advice to MGRG.
I believe that the MGRG directors must take every step to minimise any potential loss to creditors. This includes avoiding the taking of steps to cease trading where there is a credible and funded restructuring strategy which of course we are actively pursuing.”

11. In a letter to Mr Beale dated 22 June 2004, Mr Buchanan expressed the preliminary view that it was most probably appropriate for MGRG to continue to trade in the short term, despite its monthly losses, subject to some specified assumptions (e.g. that there were realistic expectations as to the realisation of value from the Xpart business within an acceptable time frame). Mr Buchanan discussed the issues in greater detail at a meeting with Mr Beale at Longbridge on 30 June. On 13 July Mr Buchanan sent Mr Beale a draft letter of advice. The draft stated, in particular, that MGRG was probably insolvent on a balance sheet basis but that:

“If MGRG ... fails the balance sheet test but the board considers that it has a reasonable prospect of avoiding insolvent liquidation and can expect to pay creditors as they arise from its cashflow or from new capital, it may continue to trade, but the prospect of avoiding liquidation must be kept under constant review.

On the basis therefore that MGRG continues to enjoy the unqualified support of PVH then the directors of MGRG should be protected by continuing to trade cautiously as there would appear to be a ‘reasonable prospect’ of MGRG avoiding insolvent liquidation. However in the medium term it seems that this will only be achieved by radically restructuring the current manufacturing operation. You must form the view that there are reasonable prospects of MGRG closing down on a solvent basis as part of the restructuring which leads to implementation of the SAIC joint venture and this should be carefully considered.”

Memorandum of understanding and letter of intent of 2 July 2004

12. On 2 July 2004 SAC and PVH entered into a further memorandum of understanding. This acknowledged that NAC and General Motors had expressed interest in investing in the Chinese joint venture and stated that SAIC would discuss with NAC and/or General Motors the proposed investment structures shown in an attachment (which envisaged that SAIC could invest in the joint venture company through an entity in which NAC was also interested and/or that General Motors could acquire an interest in the joint venture company, with PVH’s own interest potentially falling to 24 per cent). The memorandum of understanding also contained a provision to the effect that PVH and its affiliates would not assign to the joint venture company intellectual property rights relating only to sports cars. This and other points were reflected in a revised letter of intent of the same date. Neither the new letter of intent nor the memorandum of understanding was, in general, to be legally binding.¹³

¹³ The memorandum of understanding stated that it was not legally binding. The letter of intent stated that it was not legally binding except in respect of clauses relating to confidentiality, publicity and exclusivity.
The Group’s negotiating team

13. The negotiations with SAIC were led on behalf of the Group by Mr Stephenson, in conjunction with Dr Li. The core team also included Mr Cowburn, Mr Riley (overseas projects and programmes manager, PVH) and Mr Widdall (whom the Group had “borrowed” from Deloitte to support Mr Cowburn). At Longbridge, Mr Beale was responsible for financial aspects of the deal. Mr Towers told us that he started to get personally involved in the detail in late November or early December 2004. Mr Edwards played little part in the transaction.

14. Whereas Mr Einollahi had had a leading role in previous deals undertaken by the Group, in this instance he played a much more limited part. Mr Cowburn told us that Mr Einollahi “perceived himself as being put in a role where he was being given specific tasks to do rather than being involved in the overall deal and he didn’t like that position at all.” Mr Stephenson explained:

   “... Chinese culture is a very different one to our own. And in the main, the cultural norms of business dealings are carried out in a very balanced, polite – and even huge disagreements are done in a polite and friendly fashion and are not personalised.

   I absolutely do not want to overstate this as an issue but I had some issues with Maghsoud’s just style, not professionalism but style that was definitely getting in the way of moving the business forward. In any case Deloitte did not need to sit on the front line ...

   And I had individuals who carried all of the necessary finance skills to sit with me, such as John Cowburn.”

Ms Lewis of Eversheds, who commented that Mr Einollahi was “very direct and could be quite aggressive, and a bit combustible”, said that Mr Stephenson “thought that Maghsoud’s sort of way of going about things wouldn’t necessarily work as far as the Chinese were concerned”14. Mr Stephenson told us that, instead, they “looked for somebody who could provide that insight into what was really going on at the China end.”

15. In contrast, Mr Petrie (who became a non-executive director of PVH and MGRG on 21 July 2004) told us:

   “... in terms of their abilities as professional negotiators, I think it needed [Deloitte’s] involvement probably to a greater extent than it had, but that may be a reflection of a lower level of competence on Nick Stephenson’s part.”

14 Compare, however, Mr Edwards’ references in his evidence to Mr Einollahi “knitting spaghetti” and Mr Dillon’s description of Mr Einollahi as “a sort of world champion of constructing corporate finance deals”.

16. On 23 August 2004, Mr Einollahi sent a note (the “23 August Note”) to members of the PVH board. The note referred to a recent meeting attended by Mr Widdall, Mr Riley, Mr Cowburn and Ms Ruston, “the purpose of which was to agree a strategy for structuring, progressing and managing the deal with SAIC.” An attached paper included, under the heading “Process Management”, the following:

- The person in overall control of the project is Nick Stephenson.

- A deal team, led by Maghsoud and John Cowburn, will conduct negotiations, document and implement the transaction.”

The 23 August Note concluded with the words, “The deal team considers that no changes should be made to this paper other than to expand on the points that are made.”

17. Mr Cowburn told us that the first draft of the 23 August Note would have been prepared by him and Mr Widdall, that they had asked for the meeting to which the note refers, that, having checked that all those at the meeting were happy with what was proposed, they had “put [the paper] to the board via Maghsoud” and that he, Mr Widdall, and Ms Ruston would all have preferred Mr Einollahi to be involved in the SAIC negotiations. When we asked Ms Ruston about these events, she did not dissent from Mr Cowburn’s account of how the paper had come to be prepared, although she explained that she had little recollection of the meeting mentioned in the paper and wondered whether the paper had been prepared by Deloitte. For his part, Mr Einollahi told us that the 23 August Note was born of “Complete frustration in [a] number of people who were engaged in the transaction” and that there was a “lack of precision in negotiation”. In the event, however, Mr Stephenson continued to lead the negotiations with Dr Li.

18. Neither Mr Stephenson nor Dr Li had any significant financial or legal training or much experience of corporate finance. Mr Stephenson’s expertise and background lay principally in engineering. Mr Millett told us, “the last thing in the world I would describe Nick Stephenson as is a finance-[orientated] guy”. During a conversation with Mr David Duggins of Ernst & Young on 17 March 2005, Mr Beale commented that Mr Stephenson did not really understand a due diligence report. Following a conversation with Mr Stephenson on the same day about sensitivities identified in an Ernst & Young report, Mr Duggins observed that Mr Stephenson’s reaction to the sensitivities “reflects a totally different non-accountant approach to sensitivity and a basic misunderstanding of some key issues”. In evidence to us, Mr Duggins said that Mr Stephenson “struggled with some of [the issues] because he was an engineer by background and simply did not have the experience or expertise to really deal with some of the more complex issues like redundancy, pension issues and so on”. Mr Millett said, “He is a non-accountant or a non-finance man and therefore whether he understood the detailed elements of sensitivities and fine-tuning of plans would be questionable, I guess”. When we spoke to Mr Petrie, he said:

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15 Dr Li’s qualifications and experience are summarised in paragraph 174 below.
16 As noted at paragraph 34 below, Ernst & Young carried out due diligence and asset valuations in September 2004 on behalf of SAIC. Ernst & Young were subsequently instructed to carry out further financial due diligence work in January 2005; see paragraph 60 below.
“I would question whether Nick Stephenson really had the fundamental skills to actually lead a project of this kind or the person to be in overall control ... his strong suit is not in a role of this kind; it may well be in car design and things of that kind. This was a very significant transaction in terms of size and complexity and I think Maghsoud and John Cowburn could see particularly what needed to be done, but it was very difficult – or they found it very difficult – to influence Nick Stephenson in the way that he needed to be influenced to keep the thing on the rails.”

19. There were problems with defining, communicating and documenting the negotiations as they proceeded. Mr Petrie told us:

“... one of the key things with anything of this kind is that as you move through the various pieces that need to be agreed that they are properly documented so that you can kind of park those, regard them as complete and move on to the next stage. One of the weaknesses here is that I don’t really believe the team were very good at doing that.”

Mr Beale told us that Mr Cowburn would on occasion tell him that he “wasn’t being properly kept informed by [Mr Stephenson] and Qu Li and that better lines of communication should take place”. Mr Cowburn himself did not remember being concerned about the reliability of what was reported back from meetings with SAIC, but said that “there was a concern sometimes about feedback from meetings with government officials because it never seemed to go the way the government officials had told them it would do.” For her part, Ms Lewis explained:

“... one of the things that happened whilst we were in China was none of the lawyers, even including Jane Ruston when she was out there, were permitted ... to attend any of the negotiation sessions between principals, and so all we got fed back to us after the end of those discussions was the outcome, and as a consequence, there were a lot of misunderstandings and points not dealt with ... 

... there were language issues, and also issues of detail. So they would come out of meetings where there will be a list of points that had been discussed and things had been agreed, and they would be in Chinese and English, but the English version of the Chinese wasn’t actually quite the same. So, for example, you would have – I think this was one issue we did have. The English version would say, ‘SAIC will do X’; whatever it happened to be. But the Chinese version would say, ‘SAIC may’. Things like that.

And also then when you – as commonly happens, you will have headline principles that may be agreed but then when you get down into dealing with the detail in the documents there are whole loads of questions that arise out of that, and someone will say, ‘We have agreed this’. ‘Well, what do you mean, what are the consequences?’ Because the lawyers weren’t there, we were never able to interrogate that to sort of move things along.”
Ms Lewis said that it was “just a very slow and [tortuous] process”. For her part, Ms Ruston said that she “found [Mr Stephenson] quite challenging to work with” and explained:

“I don’t think he was used to working with a legal team, a transaction team, and I did find it quite difficult not to be involved in some of the commercial meetings where things were discussed and agreed.

The way that Nick dealt with the negotiations is that he would have the negotiations with the counterparty and he would come back and give us instructions with how to write up the agreements and the documents.

That was very unusual for me as an experience of doing a transaction. I wouldn’t normally get involved in meetings. I wouldn’t necessarily get involved in the commercial transactions, but I would certainly be at the meetings where I would hear the discussions happening first-hand.

It was sometimes quite difficult to be able to reflect the understanding that had been agreed by the principals into the documents that we were being asked to produce in a very short period of time under circumstances which were ... not ideal.”

20. Points agreed in meetings would be recorded, in both English and Chinese, on a whiteboard. At the end of a meeting, each side would keep a print-out of the whiteboard notes. These, however, could be both brief and hard to interpret. For example, some notes of a meeting held on 25 February 2005 recorded (in their English version) as follows:

“When JVUK’s accumulated profit is above zero and working capital permitted, JVUK will first buy the remained assets with its profits. Price will be £81 M deducted by paid rent.

JVUK will continue to lease if PVH preffered.

During the process, with the approperate and sufficient reason, JVUK working capital permitted

JVUK may purchase part of the remained assets first.”

It is easy to see why the legal advisors found it hard to translate such notes into their drafting, especially as they will not themselves have been present at the meetings to hear the points discussed.

21. On 27 February 2005 Mr Zhao and Mr Stephenson discussed the extent to which SAIC should have control over how sums it was paying for assets were used. They agreed on the following whiteboard notes:
“Establish a mutually agreed cash flow forecast to ensure PVH/MGR normal operation.

PVH/MGR needs to submit report on implementation of cash flow plan to [Donghua] weekly.

[Donghua] has the right to audit the implementation of PVH/MGR’s cash flow plan (might contract 3rd party financial adviser.)

If there is a fairly big discrepancy between the actual and the forecast, [Donghua] might contract 3rd party financial adviser to jointly supervise.”

Baker & McKenzie LLP ("Baker & McKenzie"), SAIC’s legal advisors, sought to expand on the concept, but Ms Lewis explained in an email of 24 March 2005:

“That has been rejected by MGR who insist (and apparently Zhao agrees) that all we need to incorporate are the white board notes!”

Yet the whiteboard notes clearly lacked precision.

22. Mr Petrie told us that he had not regarded, and did not regard, whiteboard notes as adequate because “most of it was written completely informally and didn’t necessarily record what was agreed.” Ms Ruston said that she understood why everyone was comfortable using whiteboard notes, but:

“... obviously necessarily ..., a headline point that has been agreed doesn’t often deal with the underlying issues that need to come out of that and that is what we then found we had to do by going and speaking to the counterparty and sorting out those issues.

... it did lead to confusion when we then actually sat down and tried to negotiate some of the underlying points in the documents and that ultimately meant that it took longer to finalise the documents than ... if all these points had been agreed at the outset, but it is possible that the counterparty just couldn’t have operated in that way.”

23. We were told that the use of whiteboard notes is common in China. Thus, Dr Li said that whiteboard notes are “widely used in China and other Asian countries particularly in business discussions involving multiple parties and languages”, and representations made to us on behalf of the members of the Phoenix Consortium stated that whiteboard notes were “understood to be an accepted norm as part of the Chinese business process.” On the other hand, that whiteboard notes are not always used, even in China, for legal matters is apparent from Dr Li’s evidence that, in the context of Project 528, the “Whiteboard process” was not

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17 I.e. the vehicle through which SAIC and NAC were to invest: see paragraph 99.1 below.
initially adopted for “the consideration and evaluation of legal issues” (as opposed to “technical and other matters”, where it had already been used extensively). According to Dr Li, it was not until meetings between lawyers (which, according to Dr Li, would comprise 20 to 30 people) had made “no progress whatsoever” that the whiteboard process was instigated for legal issues. Whatever problems had, however, been encountered with lawyers’ meetings, we should not have thought that the solution lay in meetings attended by no lawyers and recorded only in whiteboard notes.

24. Mr Petrie commented that Mr Stephenson “tended to have this sort of blind view that it was all going to work out fine and perhaps not contemplating properly the amount of work that was necessary to make that happen.”

25. As for Dr Li, her background is summarised below. Mr Cowburn said that, when the 23 August Note was prepared, Dr Li was probably seen as somebody who would have a “more significant contribution in terms of operational issues like logistics” and that he probably would not have been concerned if Dr Li had withdrawn from the scene. Ms Ruston also told us that Mr Cowburn found Dr Li quite difficult to work with at times, that she “got on Brett’s [i.e. Mr Riley] nerves a bit” and that she could understand some of the reservations that Mr Einollahi expressed about Dr Li, albeit that she felt that he was sometimes a little harsh in his views. Mr Petrie, too, referred to concerns about Dr Li’s role. He told us that Dr Li’s involvement caused “even greater tensions within the team”, between Mr Stephenson and Dr Li on the one hand and people such as Mr Cowburn, Mr Riley, Ms Ruston, Mr Widdall and Mr Einollahi on the other. Mr Einollahi said that Dr Li came to lose credibility as what she said did not always prove reliable (for example, where she implied “knowledge of government thinking which subsequent events proved ... not to be right”).

26. There were others who took a quite different view of Dr Li’s contribution to the negotiations with SAIC. Mr Stephenson described Dr Li as “an absolutely key component of the joint delivery team” and stressed the importance of having someone who “was familiar with auto industry policy and process and could help ... with the government interface.” Mr Beale said that if they “hadn’t had Qu Li alongside [them], these deals would never have been done” and commented that Dr Li “had ability to get meetings with the Chinese central government which ... even our own government at times struggled to achieve”, that she was “incredibly well respected wherever [they] went by all chairmen and chief executives of the whole of the company” and that she had the “ability ... to speak Chinese and understand the Chinese culture.” Mr Zhao said that he formed a favourable view of Dr Li. Mr Towers said that he remembered what he considered to be a personality clash between Dr Li and Mr Einollahi but did not remember anyone within the MG Rover organisation criticising her work; he added that he had made it clear to Mr Einollahi that “simply because [Mr Einollahi] wasn’t numero uno, primo leader, he had to start acting responsibly on the part of his client rather than going into corners and sulking all the time.”

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18 See paragraph 174 below.
19 See paragraph 16 above.
27. Our own view is that Mr Stephenson’s skills and experience were not such as to equip him well to lead the negotiations with SAIC, at least without more assistance from appropriate corporate finance advisors. If it was felt that Mr Einollahi’s style was inappropriate in a Chinese setting, the Group should have found someone else with comparable corporate finance expertise and seniority. Dr Li was not an adequate substitute, having little or no corporate finance experience.

Progress of the negotiations

28. At first, it was hoped that a contract could be concluded quite quickly. Minutes of the meeting with SAC on 26 April 2004 referred to a contract being entered into after six months. An attachment to the memorandum of understanding with SAC of 13 May contemplated that the deal would be finalised by the end of August. A timetable bearing the names of both PVH and SAC provided for the letter of intent to be signed in June and an agreement to be signed in August. Joint documents dated 16 August and 1 September envisaged that a feasibility study would be submitted to the Chinese Government on 31 October and that the Government would give its approval, and the joint venture contract would be signed, on 15 December. Later in September, it was being anticipated that the contract would be signed on 15 December but that Government approval would follow by 15 January 2005, with funds being transferred by the end of January. On 28 October 2004 Mr Beale expressed confidence that the deal would be signed in January 2005.

29. In evidence to us, Mr Stephenson confirmed that timing slipped “on a regular basis”; he said, “we ended up slipping timing, SAIC and ourselves, and that became a very critical issue later on in the day”. Mr Einollahi told us that he learned in the autumn of 2004 that the transaction was “changing almost every other day”. Mr Cowburn thought that there had been 28 versions of the China cash flow model and about 27 of the UK cash flow model. Mr Zhao identified a number of reasons for delay. He told us that the transfer of the Rover 75 intellectual property rights took almost one month. He pointed out that 26 versions of the feasibility study were produced. He said that there was a change in SAIC’s management in January 2005 (when Mr Hu Mao Yuan was promoted to chairman of SAIC Group and Mr Chen Hong became president of the company) and that the new management needed time to understand the project. Finally, the negotiations between SAIC and NAC took time.

30. The possible role of NAC, which had been alluded to in the memorandum of understanding of 2 July 2004,20, recurred as an issue through 2004 and into 2005. Documents dating from the latter part of 2004 envisaged that shares in the Chinese joint venture would be held by a company jointly owned by SAIC and NAC. By the end of the year, however, the extent (if any) of NAC’s involvement remained the subject of debate; on 24 December Dr Li attributed “Continuous delays on the project” to, among other things, “SAIC’s inability to reach agreement with NAC”. On 2 February 2005 Mr Widdall reported that NAC was the “biggest issue” and that SAIC was to meet NAC the next Sunday. While that particular meeting apparently went badly (as a result of which Rothschild was asked to consider

20 See paragraph 12 above.
transaction structures which did not involve NAC), by mid-February SAIC had reached agreement with NAC.

31. While there were frustrations in the second half of 2004, there was also progress. As had been contemplated in the letter of intent of 16 June, the Group entered into an agreement for the sale of intellectual property rights relating to the Rover 75, Powertrain products and “L” series engines to SAIC Group. The total consideration was to be £37 million, £20 million of which was to be paid to MGRG and the balance to Powertrain. The assignment was duly completed on 15 September.

32. On 26 August 2004 Mr Beale provided MGRG’s directors with a letter of comfort. The letter, which was written on behalf of PVH, referred to the fact that MGRG would have difficulty in paying creditors when due from the end of August in the absence of further funding, but noted that the disposal of the Xpart business should result in a net realisation by PVH of in excess of £100 million and that SAIC was timetabled to pay £37 million in September and £152 million in December. Mr Beale proceeded to confirm that it was PVH’s current intention to continue to support MGRG and to fund its cashflow to the extent that it was unable to do so from its own resources until the end of October up to a maximum amount of £55 million. PVH would also provide MGRG with a £15 million loan until the latter company received its share of the expected £37 million payment. In the event, £82.4 million of the proceeds of the sale of Xpart’s business to CAT was paid to PVH\textsuperscript{21}, and sums totalling £75.8 million were subsequently made available to MGRG\textsuperscript{22}.

33. In August 2004 SAIC and PVH set up a joint working group to prepare a feasibility study and to address matters such as organisational structure, market and product development, purchasing and planning, and finance evaluation. As time passed, perhaps 50 Group staff went to China to work on different elements of the project and SAIC provided the negotiating team with the use of office accommodation.

*Initial due diligence and valuations*

34. In September 2004, teams from SAIC and Ernst & Young visited Longbridge to conduct due diligence and asset valuations. The exercise was a relatively limited one. So far as Ernst & Young were concerned, they were instructed to carry out specific financial and tax due diligence (for example, outlining the group structure, commenting on the utilisation of cash, reviewing financial statements and trading and carrying out a brief review of the Group’s historical tax affairs) and to value on an “existing use” basis the intangible assets being transferred to the joint venture. Ernst & Young reported their conclusions in reports dated 30 September 2004. The intellectual property rights associated with the Rover 25, Rover 45, Rover 75 and Powertrain were valued at £401 million by reference to cost of replacement, £108 million to £137 million applying a relief from royalty method and £2 million on a

\textsuperscript{21} See chapter XIII footnote 45.

\textsuperscript{22} As noted at chapter XIII footnote 53, PVH transferred £70 million to MGRG on 27 August 2004 and £5.8 million on 29 October 2004.
commercial basis. Ernst & Young stressed that their valuations were “highly theoretical”. They explained as follows:

“In considering the IPR we believe that it has value to MG Rover on an existing use basis, but only in the following context – if MG Rover did not own the IPR it would make even larger losses. The valuations ... are highly theoretical because the basis of valuation – namely ‘existing use’ in a business that is unlikely to be a going concern, is difficult to contextualise.

... Whilst we have not tested the market we believe it is unlikely that a Western European or North American automotive group would be interested in the above assets. From a UK perspective the competition would benefit from MG Rover ceasing to trade as it would remove surplus capacity. From both a technology and brand perspective the competition already owns better, or at least equivalent IPR. Any acquisition therefore would merely duplicate.

Whilst our theoretical valuations provide a range of positive values for the Rover and MG brands and the IPR underlying the existing product range, the key assumption on which our analyses are based, namely that the business [is] viable on a long-term basis in its current state, is potentially fundamentally flawed.”

35. Ernst & Young were also asked to justify a valuation in excess of £16 million for MGRG’s dealership network. They reported that the cost of replicating that network would be higher than £16 million, but that “On a stand alone basis [they] would ascribe no value to the distribution network”. They commented:

“... the overall combination of brand, technology and distribution has no value at all in the context of MG Rover as a stand alone business because it is massively loss making. The replacement cost methodology is arguably irrelevant as no rational investor would attempt to build equivalent brand, technology or distribution as it would be an entirely wasted investment incapable of ever generating a return.”

36. A further report was prepared by the New York office of Ernst & Young. This valued manufacturing and associated assets held by MGRG and Powertrain, but by reference to replacement cost rather than market value or income-producing capability.

*Further insolvency advice from Halliwells*

37. Mr Buchanan was consulted on several further occasions in the latter part of 2004. On 28 September he met Mr Beale at Longbridge and said that there was no need to change his initial advice. On 6 October, Mr Buchanan sent Mr Beale a letter providing some supplemental advice. On 15 December, Mr Buchanan attended a meeting with Mr Beale and Mr Petrie, among others. Following this meeting, Mr Buchanan prepared a detailed agenda and discussion points for use at the MGRG board meeting on 17 December. A section headed “Overview from Halliwells” included the following advice:
“Ultimately, it is a question of the commercial judgment for the directors having made full enquiry as to whether or not the SAIC project is sufficiently likely to conclude on satisfactory terms that there is a reasonable prospect of the Company avoiding insolvent liquidation.”

Impact of disclosures in the Group’s 2003 financial statements

38. The Group’s financial statements for 2003 were filed with Companies House in late October 2004. The notes to the financial statements brought out the importance to the Group of the deal with SAIC coming to fruition. The notes to the MGRG financial statements, for example, stated that the company was dependent on funding from PVH and that, while PVH had confirmed its intention to provide financial support, this was on the basis of the successful completion of the SAIC transaction. It was explained in the notes to PVH’s financial statements (and repeated in MGRG’s financial statements) that “the directors have a very high level of confidence that the overall transaction will be completed successfully” and that the directors continued to believe the going concern basis to be appropriate because they “assumed the necessary additional funding will be received in the profit and cash flow forecasts they have approved”.

39. As noted in chapter XXIII (Financial statements and audit), Deloitte and the Group had conflicting views as to the information to be included in the 2003 financial statements. Mr Stephenson told us that around this time he “kind of notionally parted company with Deloittes and felt they had been hugely irresponsible.” His view was that Deloitte “could have quite properly carried out their duties as auditors ... without undermining the very deal that was going to save the company.” It was, said Mr Stephenson, “completely idiotic that they should undermine the very negotiations that were taking place that were going to secure the future of the company.” Similarly, Dr Li asserted that “Deloitte and Touche almost totally destroyed the deal by including inaccurate statements in the PVH accounts”, as a result of which she “had to immediately return to China to rescue the transaction.” It seems to us, however, that Mr Stephenson’s and Dr Li’s criticisms fail to take account of the proper role and responsibilities of Deloitte as auditors. We do not think that Deloitte can be criticised for insisting that the disclosures refer to the importance of the negotiations with SAIC.

40. The financial statements, and the adverse press coverage they triggered, caused concern to SAIC and led it to seek changes to its proposed deal with the Group. Following discussions with Mr Stephenson, revised arrangements were embodied in a document dated 11 November 2004. This envisaged that PVH would have a 40 per cent interest in a UK joint venture which would undertake sales and product development, but that its share in the Chinese joint venture company would be reduced to 30 per cent. SAIC was now to buy intellectual property rights relating to the Rover 25 for £22 million by 5 January 2005, brands and network for £55 million by 15 March and equipment relating to the Rover 25

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23 See XXIII/117 to 120.
24 See XXIII/121 to 122.
25 In a chronology she prepared on 24 December 2004, Dr Li noted, “7 Nov. 04 SAIC dismantled LOI unilaterally ...”
and 45 for £78 million by June (although payment was to be spread over the next year). The contract in respect of the Chinese joint venture was to be signed by the end of February.

41. A feasibility analysis dated 9 December 2004 contemplated slightly different payments to PVH. It referred to payments of £30 million in January 2005, £64 million in March and £61 million between July 2005 and June 2006. The £30 million was to be paid in respect of Rover 25 intellectual property rights, the £64 million for brands and network and the £61 million for parts, equipment and tooling relating to the Rover 25, Rover 75 and Powertrain. The Rover 25 intellectual property rights were to be bought by SAIC and the other assets by the Chinese joint venture company (with money contributed by SAIC).

42. The terms of the deal were by no means settled. When they met Ms Patricia Hewitt, the Secretary of State for Trade and Industry, on 10 November 2004, Mr Towers and Mr Howe “emphasised that details of the deal were still being negotiated and were changing substantially week by week – and indeed that the final outcome could well be different from the deal as agreed.”

Contact with Government in late 2004

43. There were various contacts with Government in the latter part of 2004. As noted above, on 10 November there was a meeting between representatives from the Group and Ms Hewitt. Later in the month a meeting was held with DTI officials. On 1 December, there was a meeting with Mr Geoffrey Norris\(^{26}\), senior policy advisor to the Prime Minister on business, industry and energy issues.

44. British diplomatic posts in China had some contact with the Group, too. By early December 2004 the British Consulate-General in Shanghai had managed to speak to Mr Stephenson. Mr Barry Nicholson, a trade and investment officer with the British Consulate-General, met Mr Stephenson and Dr Li in China on 8 December and subsequently, at their request, arranged a meeting with a Vice Mayor of Shanghai on 17 December which was also attended by Mr Hu (then the president of SAIC Group but soon to become its chairman\(^{27}\)), Mr Stephenson, Dr Li, Mr Nicholson and Ms Sue Bishop (the Consul General). In the course of the meeting, the Vice Mayor indicated that the Shanghai Government (the major shareholder in SAIC) firmly supported the proposed deal between the Group and SAIC. Ms Bishop again wrote to President Hu on 2 December and stated that “HM Government is following these discussions closely and is supportive of the proposed alliance between [SAIC] … and [the Group]”. In his reply dated 13 December, President Hu said that he shared the view that the “alliance will provide true win-win benefits to both parties”. In addition, shortly before Christmas Mr Stephenson and Mr Beale met a diplomat from the Beijing Embassy when he was visiting the United Kingdom.

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\(^{26}\) Mr Richard Price of HM Treasury (“the Treasury”) explained to us that Mr Norris’ role in relation to the SAIC negotiations was to represent “the political interests of the Prime Minister” and “the broader political interests of the government”. Mr Mark Russell, the director of the DTI’s Industrial Development Unit, told us that Mr Norris and Ms Shriti (now Baroness) Vadera “were our kind of conduits at a political level into Number 10 and into the Treasury”.

\(^{27}\) See paragraph 29 above.
45. Further, the Group approached Customs with a view to deferring payment of VAT liabilities, as summarised below:

45.1. in an email to Customs dated 26 November 2004, Mr Holloway of Deloitte, on behalf of the Group, proposed that £4.6 million of VAT liabilities due from the MGRG VAT group and £3.9 million of VAT liabilities due from the Powertrain VAT group, which were due at the end of that month, should be deferred pending the outcome of the negotiations with SAIC;

45.2. on 6 December, Mr Beale wrote to request a VAT deferral facility of £50 million through to 31 December 2005; the suggestion was essentially that MGRG and Powertrain should make no VAT payments during 2005, but that VAT payments should be brought up to date in 2006, starting on 31 January;

45.3. following a meeting with Customs on 20 December 2004, Mr Beale put forward a revised proposal, under which MGRG/Powertrain would pay £50,000 a month towards their outstanding VAT liabilities, but make no monthly payments on account up to and including 31 March 2005, nor pay any VAT due to be paid by 31 March 2005, with the result that an additional debt of approximately £12 million would arise;

45.4. on 22 December Customs informed MGRG that those proposals were unacceptable. However, MGRG immediately offered to increase its monthly payments from the end of January 2005 to £1 million, following which, in a letter dated 23 December, Customs agreed a one-off arrangement under which the payment on account instalments due on 31 December would be reduced to nil;

45.5. on 12 January 2005 Customs wrote to confirm that they would accept payment of the debt outstanding from November (of about £4.7 million) by instalments of £1 million each at the end of January, February, March and April, with the outstanding balance being paid at the end of May; payments totalling about £2.9 million were thus to be made by 31 January (being the £1 million instalment due under the Time To Pay arrangement and about £1.9 million of payments on account);

45.6. at a meeting on 28 January and in a letter dated 31 January, however, the Group explained to Customs that it was not in a position to pay the sums due at the end of January or the anticipated £10 million VAT liability due on 28 February; and

45.7. on 2 February Customs agreed revised arrangements under which the VAT payable at the end of February (of about £10 million) would not be paid when due, but MGRG/Powertrain would pay monthly instalments of £1 million on the 19th of each month, commencing on 19 February, and make payments on account of no less than £800,000. Customs referred in the same letter to having been in contact with Inland Revenue colleagues about “expected future arrears for PAYE & NIC”; what was envisaged was that between February and May MGRG and Powertrain would pay
reduced amounts in respect of PAYE and NIC, so that VAT would be paid in full and the company would be allowed to pay PAYE/NIC in arrears and by instalments\(^{28}\). Recommending these arrangements for approval in a memorandum dated 4 February, a Customs official wrote:

“MG Rover are in a desperate financial situation but it is not in the Department’s or taxpayers’ interests to bring the company down when there is the prospect, in the not too distant future, of the company coming under new ownership. Our approval of the proposed arrangement can be fully justified on the grounds that it appears to be the only viable way of us having a prospect of recovering tax due.”

The agreed instalment payments were reflected in a letter Customs sent to Mr Beale on 16 February\(^{29}\).

**Appointment of Rothschild as SAIC’s financial advisor**

46. By November 2004 SAIC was considering whether to appoint Rothschild as a financial advisor. On 24 November, Mr Andrew Rickards and Ms Jennifer Yu of Rothschild met Mr Rong Liu of SAIC to discuss the possibility. On 14 December Rothschild was retained by SAIC as a financial advisor, but on 29 December SAIC said that it only wanted Rothschild:

46.1. to advise on the value of Project 528;

46.2. to identify and evaluate potential risks associated with the transaction (in particular, in respect of UK employee-related aspects and the feasibility of the transition plan) and to advise SAIC on how to mitigate those risks; and

46.3. to participate in a forthcoming due diligence and feasibility study of the UK joint venture.

SAIC explained to Rothschild that the project was already well advanced and that it had not originally intended to instruct a financial advisor at all. Mr Zhao told us that SAIC had concluded that it might not be sufficient to look at the problems only from a Chinese perspective and so wanted a company “with British experience” to be involved.

47. In the following month, Rothschild commenced work as SAIC’s financial advisor. The scope of Rothschild’s work was set out in a mandate letter which provided for Rothschild to

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\(^{28}\) A contemporaneous document explained, “some £16 M intended for PAYE will be reallocated with some £10 M being paid to the IR and some £5.6 M paid to Customs as well as default surcharge.”

\(^{29}\) As at 8 April 2005, when MGRG went into administration, the MG Rover Group owed VAT of £4.0 million with a “Projected liability to cessation” of £5.1 million, resulting in a total estimated VAT liability of £9.1 million. Without repayments due of £4.3 million in respect of MG Rover Exports Limited and £0.6 million in respect of PVL2, the liability would extend to £14.2 million.
undertake the work mentioned in the previous paragraph, but also to assist SAIC in managing the UK political and public relations issues related to the project and to design and implement a strategy for communicating with the UK Government.

48. On about 22 December 2004 Rothschild provided SAIC with a draft report summarising its assessment of the strategic issues associated with Project 528. The report was positive in tone. Rothschild said, for example, that “MG Rover is a strong strategic fit for SAIC”, that “Overall, Project 528 should have a positive improvement on SAIC’s business”, that “Project 528 (if structured properly) can effectively equip SAIC to become a truly integrated automotive manufacturer that is able to take its products from conceptualisation, through the complete development cycle to production – all in-house with full control” and that “it is likely that the deal is being struck on sensible commercial terms”. Rothschild warned, however, that timing was critical. It said:

“We ... believe that this is a sensible commercial deal but one which may disappear in March if MG Rover/PVH is placed into administration. We believe that the transaction as contemplated before administration [is] much better for SAIC than might be achieved in a deal with the administrator ...”

Rothschild took the view that the “critical path item in closing a deal is PRC [i.e. People’s Republic of China] government approval”. Other areas of possible risk they identified included “pension fund shortfall”, “MG Rover financial position worse than disclosed”, “Inheriting employees under TUPE [i.e. the Transfer of Undertakings (Protection of Employment) Regulations]”, “Restructuring cost” and “‘Political approval’ not achieved”. With regard to the last of these, Rothschild said:

“Establishing a direct dialogue with the UK authorities is an advisable course of action for SAIC, rather than leaving the government relations purely in the hands of PVH, the management of which have lost respect in official circles.”

Letter of intent of 17 December 2004 and other developments

49. Shortly before this, on 17 December 2004 SAIC and PVH entered into a new letter of intent. This letter of intent differed from its predecessor of 2 July in the following, among other, respects (a diagrammatic summary is shown below):

49.1. it stated that SAIC was intending to form a new investment company with NAC (“SA Investment”) and that it would be that investment company which would be PVH’s partner in the joint venture companies;

49.2. it referred to the intended establishment of a British joint venture company (“UK Affiliate”) as well as a Chinese one (“JVC”);
49.3. it stated that the parties were in the process of arranging the assignment of intellectual property rights relating to the Rover 25, Rover Commerce and Streetwise for £30 million;

49.4. it explained that SAIC was to have a 70 per cent interest in JVC (with PVH holding the remaining 30 per cent) and a 51 per cent interest in the UK Affiliate (with PVH holding the remaining 49 per cent);

49.5. it provided for SAIC’s interest in JVC to fall to 60 per cent (with PVH’s interest increasing to 40 per cent) and SAIC’s interest in the UK Affiliate to increase to 60 per cent (with PVH’s interest falling to 40 per cent) if and when JVC obtained the remaining manufacturing assets from PVH;

49.6. it stipulated that SAIC was to make a capital contribution to JVC of £259 million, £87 million of which was to be used (in “phase 1”) to purchase from PVH rights in respect of the MG and Rover brand names and trademarks and control of PVH’s dealer network and £38 million of which was to be used (in “phase 2”) to purchase equipment and tooling relating to the Rover 25;

49.7. it stated that SAIC was to invest $10 million (approximately £5.2 million\(^{30}\)) in the UK Affiliate and that the UK Affiliate would conduct part of JVC’s design and development activities; and

49.8. it provided for a feasibility study to be submitted to the Chinese Government by 30 December 2004, for the assignment of the Rover 25 intellectual property rights to be completed by 10 January 2005, for negotiation of the joint venture contract to be completed by 30 January, for the approval of the Chinese Government to be obtained by 28 February and for the establishment of JVC to be completed by 28 March.

\(^{30}\) Using WM/Reuters closing spot rate on 17 December 2004, the date of the letter of intent.
A few days later, the Group entered into an agreement for the sale of intellectual property rights relating to the Rover 25 (including the Rover Commerce and Streetwise derivatives) for the net sum of £30 million. Following completion of the sale MGRG received payment on 13 January 2005.

The proposed arrangements in respect of the UK joint venture were summarised in a document dated 15 January 2005 which was signed on behalf of both PVH and SAIC. This envisaged that Powertrain employees would be transferred to MGRG, that MGRG employees would then be transferred to PVH, and that PVH would subsequently provide the UK joint venture with the services of the employees it needed. The UK joint venture was to lease plant and equipment from PVH and intellectual property from JVC. PVH was to be responsible for redundancy payments and for any liability relating to any shortfall in any of the pension schemes operated by the Group.

With regard to finance for the UK joint venture, it was noted at a Deloitte meeting on 27 January 2005 that SAIC was willing to provide a guarantee in respect of funding for the joint venture in proportion to its equity in the venture (i.e. for 51 per cent of the funding).

**DTI contingency planning**

On 20 December 2004 the DTI decided to create a planning group to undertake contingency planning in relation to MG Rover. The group met for the first time on 5 January 2005. The group was chaired by Mr John Alty, the head of Business Relations in the DTI, and those who attended included Mr Ben Rimmington, who was to take over as the director of the DTI’s Automotive Unit (part of Business Relations) on 17 January, and representatives of
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the Shareholder Executive (formerly attached to the Cabinet Office but by now part of the DTI), of HM Treasury (“the Treasury”), of the Foreign Office, of Number 10, of the Government Office for the West Midlands, of the Department for Work and Pensions and of AWM. The group considered both how to facilitate the deal and what could be done in the event of the deal collapsing.

54. It was suggested to us by Mr Stephenson that the Government’s contingency planning might have been responsible for some of MGRG’s problems. We found no evidence to support this theory. Mr Rimmington told us that the exercise did not involve contacts with any suppliers or dealers. Mr Alty confirmed this and said, “we were very concerned and ministers were concerned ... that this was kept extremely tight, because obviously if it became known that the government was making these plans it would, indeed, have that effect [i.e. causing creditor pressure]”. In evidence to us, Mr Howe said that he “absolutely categorically ... could not directly link” the DTI’s contingency planning and the pressure MGRG came under from suppliers.

MGRG’s pension liabilities

55. MGRG’s pension liabilities became of increasing concern. In a letter to Mr Millett of 12 November 2004, Mr Mark Frost of Garvin Trustees Limited (“Garvins”), the MGRG pension scheme’s actuaries, explained that:

55.1. on the basis that MGRG continued to support the scheme it had a deficit of about £100 million;

55.2. using the method and assumptions required by FRS 17, “Retirement benefits” (“FRS 17”), for the company’s financial statements the current deficit was about £70 million to £75 million;

55.3. if the company wished to wind up the scheme voluntarily the cost of securing members’ benefits would give rise to a debt of over £400 million; and

55.4. new regulations would be coming into force soon under which the debt on insolvency would be calculated in the same way as on a voluntary wind up (producing a debt of over £400 million).

In a further letter to Mr Millett dated 21 December, Mr Frost estimated that the current debt in the event of a winding up of the MGRG pension scheme (the “buyout” debt) would be around £400 million to £450 million. On 9 February 2005 Garvins provided an actuarial valuation of the MGRG pension scheme as at 31 December 2004, reporting that the scheme “had sufficient assets to secure 47% of accrued benefits with an insurance company, representing a possible ‘buy-out’ debt of about £410 million.”
SAIC visit to Longbridge

During January 2005 a large delegation from SAIC visited Longbridge. The main purposes of the visit were to explore the feasibility of the UK joint venture, to discuss matters relating to the transfer of Powertrain operations and production of the Rover 25 and 75 to China, and to confirm the Rover 75 development plan. Rothschild representatives were also involved.

Further advice from Rothschild

On 12 January 2005 Rothschild gave SAIC a presentation on the feasibility of the proposed UK joint venture. Rothschild concluded that:

“... the UK JV should be feasible from a financial and legal perspective and be capable of being put in place in a manner and timeframe consistent with the remainder of the arrangements contemplated between MG Rover and SAIC, albeit that the UK JV business plan may result in medium-term losses.”

Rothschild identified the key risks as:

- “Employee issues” (including “the risk of unintended transfer of other staff e.g. through application of TUPE; thus transferring redundancy and pension liabilities into UK JV”);
- “Dealership network” (where a migration/novation plan was needed);
- “Financing of UK JV” (where there were “Limited near-term options given lack of assets and forecast short-term negative cash flow of the UK JV”); and
- “Insolvency of MG Rover or PVH” (as to which, Rothschild said, “Cross-cutting risk that affects all aspects of the transaction, both UK JV and China JV – in reality risk cannot be mitigated fully, only the transaction structure made as resilient as possible to administration/insolvency post-completion”).

Rothschild reiterated that it considered it essential for SAIC to establish its own dialogue with the UK Government.

On 20 January 2005 Rothschild submitted a further report, on the risks of the UK joint venture and potential mitigating factors. Rothschild now described the key risks as follows:

“We see the key risks of entering into the transaction as

i. Uncertain ability to finance UK JV in a sustainable manner going forward

ii. The insolvency of PVH or MG Rover
iii. Employee issues (i.e. acquisition by UK JV of unwanted liabilities)

The relative rankings of these risks has changed over time (and between our status reports) as additional work and due diligence has allowed us (and, we believe, the SAIC working team) to become more comfortable with the risks and their potential mitigating factors. This prioritisation of key issues is a natural process, the result of which is that the financing of the UK JV is now the highest priority for additional work.”

As regards the first two risks, Rothschild proposed (among other things):

“Further financial due diligence on UK JV business plan to be conducted by Rothschild and, in particular, Ernst & Young to gain required level of confidence to sign binding transaction documentation ...”

and

“Financial due diligence to be conducted by Ernst & Young on PVH, MG Rover and associated companies’ current and projected financial position and cash flow forecasts to clarify extent of insolvency risk. Additional transaction structure needs to isolate UK JV (and SAIC and China JV) from insolvency risk as far as possible.”

Rothschild said that:

“In Rothschild’s view, the largest remaining area of work to be completed relates to financial due diligence, in which Ernst & Young’s role will be essential, completion of the transaction documentation, and obtaining the necessary approvals to complete the transaction.”

59. On 8 February 2005 Rothschild submitted a draft report assessing insolvency risks. Rothschild warned that “the consequences of insolvency of MG Rover and / or associated companies subsequent to establishment of UK JV could be significant”. Rothschild explained as follows:

“Fundamentally, the operational disruption and negative publicity that might ensue would be likely to undermine the commercial rationale for SAIC to enter into the transaction in the first place, as well as jeopardise the chances of turning around the business (i.e. achieving UK JV business plan) ...”

Therefore, SAIC needs to have a good level of confidence in the UK JV business plan and in the ability of a partnership between SAIC and PVH/MG Rover significantly improving the profitability of MG Rover’s business, taken as a whole (i.e. including both UK JV and the residual businesses), prior to entering into JV arrangements with SAIC ...”
Availability of financial information

60. Ernst & Young had been approached by 17 January 2005 about reporting on PVH’s forecasts and on “when the money runs out”. The partner selected to lead Ernst & Young’s work was Mr Duggins, who undertook corporate recovery and insolvency work from the firm’s Birmingham office. On 24 January Mr Duggins met Mr Beale and Mr Cowburn. Mr Duggins gained the impression that, as far as PVH was concerned, it was a “done deal” and everything had already been agreed. At all events, Mr Duggins was told that the forecasts for the UK joint venture comprised only profit and loss and cash flow forecasts (not balance sheets), that the commercial assumptions had been developed jointly between PVH and SAIC and PVH did “not expect them to be subject to review”, and that, while PVH accepted SAIC’s need to review the residual PVH position, the information had not yet been prepared.

61. Mr Nigel Young, MGRG director of accounting, treasury and taxation, referred to the limitations on what could be provided at a meeting on 26 January 2005 with others from the Group and Deloitte. It was noted at the meeting that SAIC wanted an outline of what “PVH remains” would look like by 1 February and that it would be a pre-condition of the deal that Rothschild should be happy with the solvency of “PVH remains”. Mr Young explained that the Group could provide a balance sheet based on underlying assumptions, but it was not able to do a fully integrated double entry model. At the same meeting, Mr Stephenson summarised the proposed deal and said it was “all fairly straightforward”.

62. The limitations of the Group’s accounting systems, and what they could be used to produce, led to a testy exchange of emails between Mr Einollahi and Mr Millett on 1 February 2005. Mr Einollahi wrote:

“The cashflow models at present do not incorporate Balance sheets and almost all the cells are hard coded. Therefore the consistency of the model relies on human mental processing of the data and as such is susceptible to internal inconsistencies. The assumptions have not been clearly documented in respect of each company and there is no evidence that the forecasts have been approved by individual chief executives or the person who is accountable for delivery of the forecast.”

Mr Einollahi proceeded to suggest that, by way of remedy, Deloitte should prepare “simple models” integrating profit and loss, cash flow and balance sheets. He added, as a postscript, “I do apologise if I am failing to be sufficiently sensitive or subtle”.

63. In reply, Mr Millett pointed out that the relevant documentation had been produced in about two days to meet a deadline specified by the negotiating team. He acknowledged the advantages that an integrated business plan model gives, but said, “Right now I do not see a way of improving on the quality of data included in the current pack.” He added:

31 Another Ernst & Young partner, Mr Steve Routledge, was jointly responsible for the work, but in practice he was much less involved than Mr Duggins.
“Since you mention it in your postscript, let me assure you that your usual sensitivity and subtlety is evident throughout your email. I think it would have been more helpful to recognise and value support from key members of the client’s staff rather than focus on shortcomings of the output provided.”

64. While Deloitte were not in the event instructed to prepare the “simple models” suggested by Mr Einollahi, they had been instructed to carry out additional work. Under the terms of their engagement letter of 14 February Deloitte were instructed to review the directors’ “Working Capital Statement”\(^{32}\) and supporting forecasts\(^{33}\) for the “Remainder Companies”, although Mr Widdall of Deloitte explained to Rothschild on 20 January that they had not yet received the business plan from PVH and that the process of reviewing it, once they had received it, was estimated to take up to four weeks. The work was primarily undertaken by Mr Jeremy Wisker, an assistant director at Deloitte within the transaction services department; the partner with responsibility for the work was Mr Richard Bell (also in transaction services). It was also proposed, again by Mr Einollahi, that Mr Bill Dawson, another partner in Deloitte within the reorganisation services department, should be appointed to carry out an independent review of the SAIC acquisition, the restructuring process and the likelihood of MGRG avoiding insolvent liquidation, but no such appointment was ever in fact made.

65. Rothschild and Ernst & Young continued to be dissatisfied with the financial information available to them. Sending Mr Duggins the “latest information received from PVH” on 2 February 2005, Mr Mohsin Rashid of Rothschild observed, “The attached spreadsheet was not supplied with any of the underlying assumptions or calculation sheets; and more importantly, no opening balance sheet information has been provided”. Mr Duggins replied that he had been given a set of forecasts for the same businesses covering the same period, “but the numbers were very different.” On 3 February Mr Rashid spoke to Mr Kouros Mehrabani of Deloitte with a view to understanding how far Deloitte had progressed with the PVH business plan, to be told that “for all practical purposes Deloitte have made no progress as [Mr Mehrabani] and his team are unable to gain access to the people within PVH whom they need to speak to and extract the required information from.” On 4 February Mr Nick Gowlland of Rothschild told Mr Cowburn that they were “extremely dissatisfied with the extent and quality of financial information that [they] had received to date.” On the same day Mr Duggins sent Mr Rashid an email outlining concerns about the proposed transaction. He said:

“I have looked at the financial information that you have received from PVH and SAIC and forwarded to us. It is all high level information with little or no supporting detail. It was particularly disappointing to hear from you today that the Deloitte team has made no progress with their work over the last two weeks. As you know, we would like the opportunity to spend time at the company and have someone explain to us how the forecasts have been prepared and assess the quality and reliability of

\(^{32}\) Defined as “the statement made by the directors of each of [PVH], [MGRG] and [Powertrain] … confirming that … the working capital available to each company is sufficient for each company’s present requirements, that is, for at least the next twelve months from the date of the board memorandum …”

\(^{33}\) Being “cash, profit and balance sheet forecasts on a monthly basis for the 2 years ending 31 December 2006 …”
the supporting information for the forecast and historical information. We would then be in a position to estimate what our detailed information requirements are, and form a view on the level of [resources] and timescale required to review and report on it. What is already clear to us is that the time remaining between now and the target completion date of 28 February is inadequate to perform the level of work required for a transaction of this size and complexity.”

When the Group provided Ernst & Young with the latest draft of the business plan on 21 February, a “Brief preliminary review” revealed “several serious cash flow and assumption related questions requiring clarification”.

66. KPMG were engaged by the DTI in March 2005 to review the short and medium term cash flow forecasts prepared by the Group, 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 the Group. They also noted weaknesses in financial information provided by the Group. In a report dated 24 March, they commented in relation to a cash forecast supplied by management:

“Forecast does not have an integrated profit & loss, balance sheet and cash flow. There is no significant modelling in the forecast, making flexing of the forecasts difficult ...”

On 6 April Mr Mike Pink of KPMG referred in an email to Mr Young to problems with a forecast which had been produced the previous day:

“We recognise that the reforecast was completed in a rush; that you do not have a fully integrated model and that you were faced with a lack of time to address all issues; however, as you acknowledge, there are a number of errors in presentation and addition, together with continued use of ‘bolt-ons’, which create a degree of opacity in the figures produced. Whilst we have, by use of analytical review and your assistance on the telephone, performed a high level logic test of the model, we could not confirm the integrity (and, therefore, reliability) of the model.”

67. Giving evidence to us, Mr Richard Heis, the KPMG partner most closely involved with the work on MG Rover, said:

“In the kind of cashflow forecast or P&L forecast that one would normally like to see, there would be an integrated model at the heart of it whereby if you made a change, for example, to sales, then that would feed through into cash and into a number of other drivers, so you could simply tweak one variable and the impact of doing so would flow through into the balance sheet and profit and loss account and cashflow, whereas they did not have an integrated one. So, effectively, if you wanted to make a change you would have to manually try to work out the impact ... I think to our surprise, given the size of the business, they did not have the ability to do ... what one would expect to see in most businesses.”
Mr Heis surmised that the reason MGRG did not have an integrated model was that “they had a big cash-credit balance, courtesy of BMW, and did not have lenders to chivvy them in terms of their financial information in the same way as one would get with ... a different company of equivalent size.” In similar vein, Mr Duggins commented, “considering the size of the business that we were reviewing, the complexity of the transaction, the sheer numbers involved, there was a surprising lack of detailed information.” He also said:

“I think a properly-run company would have had cashflows much more like the final ones much sooner than they did. Now, how much sooner, it is just impossible for me ... to say. But it should not have taken us as long as it did, I do not think, to get to that final cashflow – set of cashflow forecasts.”

68. Both Rothschild and Ernst & Young were concerned that the Group might be being deliberately obstructive. For example, on 15 February 2005 Rothschild told Mr Zhao that “Financial information that has been provided so far by PVH has been patchy, non-timely and highly incomplete” and expressed the belief that “PVH/MG Rover are resisting attempts to conduct detailed financial due diligence in the hope that SAIC will be forced to enter into a transaction without having conducted detailed financial due diligence, on the basis that if SAIC does not do so, MG Rover will go bankrupt (by end March 2005, we understand).” In a report dated 26 February, Rothschild wrote that PVH “in Rothschild’s opinion have, until very recently, strongly resisted attempts by SAIC and its advisers to conduct even limited financial due diligence”.

69. Concern about the information being provided by the Group led Mr Gowlland of Rothschild to say on 19 February 2005 that he thought it “essential” that when Ernst & Young visited Longbridge in the following week they kept a detailed daily log of “what they have asked for and what they are (or more likely, are not) getting.” Suspicions of non-cooperation were hardly allayed when Ernst & Young were at first told, on their arrival at Longbridge on Monday 21 February, that Mr Beale and other senior management were unavailable. It seems that Mr Cowburn had left a message to warn Rothschild that Mr Beale would not be available, but the message did not reach the team from Ernst & Young and Rothschild at Longbridge.

70. On 10 March 2005 Mr Gowlland referred to “More resistance from PVH on perfectly legitimate due diligence.” In a report of 14 March Rothschild expressed surprise that “PVH/MGRG has not produced weekly cash flow forecasts for the current group (i.e. pre-transaction) for April and May, despite repeated requests”.

71. In fact, Mr Stephenson does seem to have considered whether the best course would be to seek to obstruct Rothschild. Thus, on 2 February 2005 Mr Widdall reported that Mr Stephenson thought it was in the Group’s interests “to slow [Rothschild] down on their insolvency issues/reporting”, adding that he thought what Mr Stephenson had in mind was that SAIC should submit the feasibility report “before considering view on insolvency, which will probably be problematic for them”. Further, Dr Li thought that she possibly remembered Mr Stephenson expressing the view that Rothschild needed to be kept under control. It seems to us, however, that no such strategy was ever in fact implemented. The
problem was not that the Group was being deliberately obstructive, but that the relevant information was not readily available in the first place. In his evidence to us, Mr Howe said, “I don’t think it would be fair to say that there were attempts being resisted but maybe information was slow.” Mr Cowburn told us that “no instructions [were] sent back to the UK to delay the production of information or the release of it to [Rothschild]”. Mr Millett said, “I never received any indication to slow things down and I never imparted any indication nor was I ever aware of any desire to slow things down in the production of these business plans for these people [i.e. Ernst & Young and Rothschild]”. Mr Millett told us that his team was “incredibly stretched”. In similar vein, Mr Widdall said:

“... I was aware that the company was slow in producing the necessary information. I believe, however, that any such delay was due to the fact that PVH’s general level of post-transaction business planning was not very good, and that much of the information that SAIC had begun to request from January 2005 had to be prepared from scratch and that preparation of accurate information and forecasts was slow and difficult to produce, requiring input from the very stretched MGRG finance department.”

Mr Einollahi, too, attributed the delay and lack of quality information to the fact that “going into the transaction PVH had paid inadequate attention to PVH residual business planning”.

72. On the other hand, it was pointed out in representations made to us on behalf of the members of the Phoenix Consortium (and we accept) that residual business planning “had not, prior to January 2005, been asked for”. It is also fair to say that the same accounting systems had been in use before Techtronic acquired MGRG and that they had not prevented the issue of unqualified audit reports over a number of years.

Further contacts with Government

73. During January 2005 there were further contacts with the British Government. On 14 January Mr Francis Evans and Mr Simon Carter, from the DTI’s Automotive Unit, attended a meeting at Longbridge with representatives of both the Group and SAIC, including Mr Zhao. On 17 January Rothschild saw Mr Norris at Number 10 and also met officials from HM Treasury and the DTI at the Treasury. One of the key points which Rothschild derived from these meetings was a:

“General view that the transaction should be well received and seen as a means of saving jobs and the government appears realistic about the prospect of job losses on a relatively large scale over time.”

Mr Meyrick Cox of Rothschild also noted that the Government wanted “to co-operate on packaging and presenting [the transaction]” with Mr Norris to “co-ordinate their end”. On 18 January five officials from the DTI, including Mr Mark Russell, the director of the DTI’s
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Industrial Development Unit (a branch of the Shareholder Executive)\(^{34}\), visited Longbridge with a view to understanding the cash flows and business plan.

74. On 19 January 2005 the Minister for Science and Innovation, Lord Sainsbury, who was visiting China, met representatives of SAIC, including Mr Hu, by now the chairman of SAIC Group. A diplomat who attended the meeting provided the following summary:

“A very positive meeting about MG Rover ... SAIC fully committed, but timeframe longer than expected owing to processes involved for central government approval. HMG needs to consider how to assist MGR in the interim.”

With regard to the timeframe for the deal, the diplomat recorded as follows:

“... Mr. Hu said that it might take a little time, as central government approval had to be secured for the agreement. In reply to Lord Sainsbury’s question asking how long, Mr Hu said that he thought half a year (i.e. six months) should be sufficient.”

One of the SAIC representatives “noticed all the faces on the British side go pale when the 6 month timetable was mentioned.” Mr Hu apparently went on to explain that they had been working on the deal for some time, with the result that the six month period had already started. This point seems to have been missed on the British side, but a representative of SAIC clarified the position in the following week. The upshot, as Mr Evans of the Automotive Unit understood it, was that “SAIC are still aiming for end-March and have no reason to believe that this cannot be met.”

75. Later in the month, the Foreign Secretary, Mr Jack Straw, raised MG Rover with both Premier Wen Jiabao and Foreign Minister Li Zhaoxing when visiting Beijing.

Preparation of legal documentation

76. By January 2005 the numerous legal documents required for the deal remained embryonic. Ms Lewis of Eversheds described the position as follows on 20 January:

“Despite what has been in the press for some months MG Rover’s proposed joint venture with Shanghai Automotive is just about to commence in earnest. Although the terms of the transaction are not yet cast in stone they are such that the lawyers have been instructed to create the relevant documents with a timetable to achieve completion on 28 March.”

\(^{34}\) Before becoming the director of the Industrial Development Unit in 2004, Mr Russell had been a corporate finance partner in KPMG.
On 28 January Ms Lewis referred to a conversation with Ms Ruston in which the latter had told her that she:

“... had been talking to Nick [Stephenson] to express her concerns about the volume of work which had to be done, the number of issues which appear to remain outstanding and the fact that the Chinese do not really seem to have ‘got it together’ yet with their lawyers.”

On 10 February Mr Beale wrote to Mr Stephenson, “The legal process has in reality not started”. On 22 February Mr Beale reported to the MGRG sub-committee which had been established at the end of 2004\(^\text{35}\) that “the legal process itself has hardly started, all that Baker & McKenzie have done so far is list the issues in the documentation on which the parties don’t agree.” In fact, very substantial legal work remained outstanding up to the point administrators were appointed. On 7 April, the day before MGRG went into administration, Ms Lewis noted that “discussions have taken place in respect of only a limited number of the requisite documents and ... there is a material number of further documents which require to be drafted and then negotiated with advisers acting on behalf of SAIC.” Ms Lewis thought that the drafting could be completed by the end of May.

**The BMW loan notes**

77. The BMW loan notes\(^\text{36}\) also needed to be addressed if the proposed deal was to be concluded. BMW had been approached in this connection by 17 December 2004. On 24 or 25 January 2005 Ms Ruston reported that BMW had instructed Mr Brooks of Norton Rose to agree terms for buying the loan notes back for a nominal sum. By 7 February Norton Rose had prepared a draft agreement under which BMW was to sell the loan notes to PVH or associated entities or individuals. By 1 March, however, BMW was reluctant to proceed in this way; Mr Brooks told us that there was “a very great concern within BMW to avoid giving any opportunities for windfall profits in any form to the Phoenix Four [i.e. the members of the Phoenix Consortium] or anyone connected with the Phoenix Four.”

Mr Beale informed the MGRG sub-committee that “the crux of the matter is apparently that if BMW can get comfortable they may come back to the original deal” and that Mr Brooks had “told [him] that BMW have their concerns and they want to understand more, but BMW will commit to resolve any problems so that there is no need for an insolvency.” It was agreed at the sub-committee meeting that, to enable BMW to appreciate the importance of the loan note issue, Mr Buchanan should draft a letter dealing with the implications of the BMW loan notes for MGRG’s solvency. This he did, preparing a letter dated 7 March to the MGRG sub-committee in which he concluded:

“... my advice is that the MGRG directors will need to be satisfied that the loan from [Techtronic] (and therefore also the loan from BMW to [Techtronic]) is either waived or compromised or rendered capable of waiving or compromising, prior to proceedings with the SAIC transaction.”

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\(^{35}\) See paragraph 78 below.
\(^{36}\) As to which, see e.g. III/90 and XII/4.
BMW, however, required more information. Mr Brooks told Ms Lewis in an email of 17 March that BMW “still don’t understand the connection between the Loan Note issued by Techtronic and the position of the Board of MG Rover” and that it would be helpful to have a more detailed understanding of how the money the Group would receive from the SAIC deal would be disbursed. BMW’s thinking was explained further in a letter from Norton Rose to Mr Buchanan of 21 March:

“Based on the facts of the transaction currently known to us we do not understand why a sale of the Loan Note is necessary to enable the SAIC transaction to proceed. The directors’ primary concern should be with regards to wrongful trading and whether entering into the SAIC joint venture gives a reasonable prospect of avoiding insolvency. Provided that the directors act in what is considered to be the best interests of the creditors by achieving the best price possible this concern should be addressed.

In any event, since the Loan Note is issued by Techtronic ... any decision relating to a change in the status of the balance sheet of MG Rover should therefore be at the discretion of the directors of Techtronic ... and MG Rover.

As explained at the meeting which Peter Beale attended in Munich on 1 March, BMW will seek to find a solution which will enable MG Rover to give effect to the SAIC transaction but currently believes that the sale of the Loan Note is unnecessary.”

Ultimately, no agreement was ever concluded in relation to the loan notes. However, Mr Brooks told us:

“... at the end of the day I am confident that whatever would have been necessary to do the deal would have been achieved. We would have found a way of doing it.”

Dr Reul of BMW confirmed that, had SAIC and the Group otherwise arrived at an agreement, the loan notes would have been dealt with.

Establishment of the MGRG sub-committee

78. On 17 December 2004 MGRG’s board resolved to establish a sub-committee, comprising Mr Beale, Mr Howe and Mr Petrie, “to review the trading and cash flow of the Company and the status of main projects such as SAIC.” The sub-committee appears to have met for the first time a few days later, on 21 December. From mid-January 2005 the sub-committee met frequently. On 14 February the sub-committee was reconstituted to comprise four directors of MGRG of whom two were also directors of PVH (Mr Beale and Mr Petrie) and two were not (Mr Millett and Mr Bowen).
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Change in Halliwells’ role

79. Mr Buchanan continued to provide legal advice in 2005. With effect, however, from mid-February, it was agreed at Mr Buchanan’s suggestion that Halliwells’ role should be limited to giving advice to MGRG.

Identity of the shareholder in the joint ventures

80. An issue which finally receded only at the end of March 2005 was whether it should be PVH or MGRG which became a shareholder in the joint ventures. The point was discussed between Mr Buchanan and Ms Lewis on 2 February; according to an attendance note, Ms Lewis said that she “could not get her head round ... why PVH was receiving equity in return for the transfer of intangible assets and IPR by MGR” and Mr Buchanan agreed. The issue occupied much of a meeting on 9 February which was attended by, among others, Mr Einollahi, Ms Ruston, Mr Cowburn, Mr Buchanan and (for part of the meeting) Messrs Towers and Beale. Before the arrival of Mr Towers and Mr Beale, Mr Einollahi argued that PVH should be the shareholder but Mr Buchanan queried the justifications being advanced for this; eventually, Mr Einollahi said that he thought that “everyone should note [Mr Buchanan’s] view before ignoring it and moving on.” The question was debated again with Mr Towers and Mr Beale present. According to Halliwells’ attendance note:

“JT [i.e. Mr Towers] said that the motivation behind the shares in PVH is that in practical terms they feel it is a safe place, and in the circumstances, they have to be responsible. The directors would like the rationale for this to be put together by their advisors and as directors, this is the best they can expect.

... PB [i.e. Mr Beale] said that for MGRG unless they sign off on the transaction, it will go bust and they will get nothing. JT said that there was an understanding between PVH and MGRG; PVH and [Powertrain]; PVH and the property companies, and PVH and some businesses outside of the deal.

... JT said this is not an MGRG transaction, they cannot do it by themselves. The shares as an asset or benefit are not attributable to MGRG if you are looking to trade what is part of the transaction. The holding company will not do the deal where the shares are held by MGRG, SAIC will only deal with the holding company.

... JT said the MGRG directors need to do a deal that shares are held by PVH or there is no deal.”

81. Mr Towers told us that, so far as he was concerned, whatever Mr Einollahi said at this meeting was said without instructions. In contrast, Mr Einollahi said that “the directors had independently considered the issue of the JV shareholder, determined that it was to be PVH,

37 As noted at footnote 12 above, Halliwells were initially instructed on behalf of the PVH directors, but in January 2005 it was decided that Halliwells’ terms of engagement should be extended to include the board of directors of MGRG.
and then instructed [him] as their adviser to advocate their position”; more specifically, he thought that his instructions had come from Mr Towers and Mr Beale.

82. By February, it was clear that SAIC wanted MGRG to be the shareholder. Mr Patrick Lau of Baker & McKenzie touched on this in an email to Ms Lewis of 11 February 2005, in which he wrote:

“... We understand that Mr Zhao has discussed with Nick Stephenson SAIC’s proposal of not having a hive-up of assets (and employees) from MGR [i.e. MGRG] to PVH. We further understand that Nick was agreeable to leave employees at MGR, but as for the hive-up of assets, he expressed a preference for PVH, instead of MGR, to be the shareholder of the JV(CH) and JV(UK), and offered to come up with possible legal solutions to effect the relevant asset contributions required of PVH without going through the hive-up of assets. SAIC’s position is that we do not want a hive-up of assets from MGR to PVH.”

A deal summary apparently prepared by Deloitte on the same day provided for MGRG to transfer its equity interests to PVH in consideration for the following:

- negotiation and arrangement of the deal with SAIC by PVH;
- procurement by PVH of [Powertrain] transferring its business to MGRG;
- procurement by PVH of the property sub-leases;
- provision by PVH [of] a parent company guarantee to SAIC in respect of its subsidiaries obligations under this transaction;
- procurement by PVH of the Rover trademark licence from BMW to JVC; and
- waiver of the £40 million funding loan in place between PVH and MGRG ...”

Commenting on the deal summary, Mr Beale said, “This is an essential step for us.” A few days later, Mr Beale told a meeting of the MGRG sub-committee that “the PVH board has the view that if the MGRG directors do not agree they will not do the deal.” On 17 February, however, Baker & McKenzie said:

“Since MGR [i.e. MGRG] will be the contributor of assets into JVCH and JVUK, unless there is a good reason given by MGR, MGR, not PVH, shall be the shareholder of JVCH and JVUK.

The various considerations cited by MGR appear to be of insufficient value to warrant a 30% interest in JVCH and a 49% interest in JVUK and may constitute unfair preference.”
Nonetheless, Mr Beale was insistent that PVH should be the shareholder. On 22 February he told the MGRG sub-committee that the point was “a deal breaker for us” and that PVH would “not do the deal if MGRG is a shareholder”. He provided the sub-committee with a note on the question. This set out the rationale for PVH being the shareholder as follows:

- This shareholding will represent our major asset & good practice shows that holding assets in Top Co is sensible

- Our ability to borrow/attract investors will be increased substantially by the shares being held by PVH. Conversely the ability to borrow if held by MGRG will be very difficult given mass of contingent/potential liabilities surrounding MGRG

- The way the deal is structured the company most likely to face an insolvency is MGRG. Therefore holding our shares in our least secure company is not sensible.

- There is likelihood that disgruntled creditors (most likely in connection with supplier liability claims) could decide to individually or jointly attack MGRG if they felt there were assets that could realise some value. Clearly the shares in China JV could be a tempting target

- We have come up with a structure that protects SAIC from this arrangement ...

- A cynical view would be that if shares are held by MGRG and if SAIC have ability to acquire shares on an insolvency that they could (by behaving awkwardly) force MGRG into insolvency. Whilst it seems unlikely that this is a deliberate thought process in SAIC currently the situation may change post completion. At that point it might be putting too much temptation in their way. It could also be a very good negotiating position for them to adopt in the event of us falling out post transaction

- Even if we were tempted to try and oblige SAIC by keeping the shares in MGRG we do need to ensure that we are acting responsibly as PVH directors. Given the persuasive case put forward for holding the shares in PVH it would be difficult to defend our actions to disgruntled shareholders if the deal was completed & we then lost our shareholding in China JV.”

When commenting on the 28 February letter of intent, Mr Beale referred to “PVH as shareholder” as the “single biggest worry for us”. At the MGRG sub-committee meeting on 2 March Mr Millett said that “if MGRG is insolvent after the deal would the creditors be better therefore if the shares were held in MGRG”, to which Mr Beale said that this was an “academic question” since “if the shares are held by MGRG, PVH will not do the deal.” On the following day, Mr Buchanan and Mr Millett debated the identity of the shareholder in a lengthy telephone conversation; Mr Millett said that he found some of the contents of Mr Beale’s note questionable, but accepted that the deal on offer was nonetheless probably the “best in town”. On 8 March the identity of the shareholder was the subject of discussion.
between Mr Buchanan, Ms Ruston and Mr Jeremy Goldring of Baker & McKenzie; Mr Goldring sought “comfort on why the shares were not going to MGRG.” Following this conversation, there was a perception on the Group side that Mr Goldring was content that PVH should be the shareholder, but it quickly became clear that that was not the case. Nonetheless, the Group continued to insist that PVH should have the shares; Mr Beale expressed the view that, if SAIC wanted a reason for PVH holding the shares, he “would have thought that the fact that we will not do the deal if MGRG was the shareholder was a ... pretty good reason”.

83. In his evidence to us, Mr Beale said that “the overriding reason [for wanting PVH to be the shareholder] is because Maghsoud [Einollahi] advised us that was the way to do it.” He said, too, that “it was very troubling that [SAIC] didn’t have a very valid reason as to why MG Rover Group should be the shareholder” and that he was concerned that SAIC “had got some ulterior motive for it being held by MG Rover Group.” Mr Towers told us that he did not care which entity was shareholder. He said:

“If the deal could be done through an MGRG process – I didn’t think it could be done through an MGR process, but if it could be done – and as it turned out it eventually was configured in this way – if it could be done through an MGRG-only process, then fine, but I couldn’t understand how it could be done that way.”

84. It seems to us, however, that the main reason Mr Beale, Mr Towers and (perhaps 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 “D” shareholders) regardless of what became of MGRG. We do not think Mr Beale and Mr Towers would have been so insistent that PVH should be the shareholder, in the face both of SAIC’s expressed wish that MGRG be the shareholder and of the doubts expressed by, in particular, Mr Buchanan, had they been concerned merely as to the propriety or practicality of MGRG being the shareholder. Further, Mr Beale himself said in the note mentioned in paragraph 82 above that it seemed unlikely that SAIC had it in mind to force MGRG into insolvency. Moreover, the Group had in the past been restructured for reasons including ring-fencing from MGRG38. In addition, a number of witnesses told us of a feeling that the D shareholders were due the shareholding. Thus, when we asked Mr Stephenson what reasons were given for PVH being the shareholder, he said:

“There was a whole host of technical reasons. I actually think it was an overriding emotional reason of the rightness of it from my colleagues ... They probably felt more strongly at this point than I ..., but put it like this, PVH had done the initial deal, PVH were very much doing this deal, and therefore there was a rightness about it.”

When asked by us whether his colleagues felt that they or PVH deserved the shareholding, Mr Stephenson said, “Possibly so.” For his part, Mr Petrie said that he “undoubtedly” got the impression that Mr Beale, Mr Stephenson and Mr Towers wanted PVH as the shareholder to

38 See chapter XV (Reasons for Group structure).
ensure that any value accrued to the benefit of PVH and themselves as shareholders; he thought that this was “part of a view that they hold that they through their own actions created the original value and therefore they deserved to have any benefits that flowed from it”. Mr Einollahi assumed that the directors’ underlying concern was that the asset value should be in the company they directly owned. Ms Ruston said:

“My principal understanding of the reasons for PVH being the shareholder was that the argument was that PVH was responsible for delivering the deal. It had led the deal negotiations, the deal couldn’t happen without PVH, and therefore it was appropriate for PVH to be recognised and rewarded in some way for the part it had played in the transaction.”

85. It is to be noted that the shareholdings were regarded as valuable. As Mr Beale noted in an email of 10 March 2005, the perception was that a holding in the Chinese joint venture “would one day have a significant value.” In evidence to us, Mr Towers confirmed that the shareholding was seen as having value “ultimately”.

86. PVH finally agreed that MGRG could be the shareholder at a meeting between Mr Stephenson and Mr Zhao on 26 March 2005. The relevant whiteboard notes state (somewhat cryptically):

“… if DH [i.e. Donghua] insist MGR being the sharehold is the CP. PVH Board will agree MGR being the sharehold with right to transfer shares to PVH after 2 years. But both side advisers must find and agree solutions to above issues.”

On 31 March Mr Beale told the MGRG sub-committee that:

“… it had … been agreed that if SAIC can get PVH and MGRG comfortable with MGRG being the shareholder in such a way as MGRG is protected in terms of retaining equity value in the joint venture in any eventuality then they will agree to do the deal in this way. PVH had reached the decision that they would not allow this to stand in the way provided that they were happy that there was no risk of prejudice in the longer term to MGRG or its creditors.”

MGRG’s financial position in early 2005

87. Despite its tax deferment, referred to earlier in this chapter, MGRG’s financial circumstances became increasingly pressing during 2005.

88. At an MGRG sub-committee meeting on 22 February Mr Millett said that there would be “a creditor stretch”. However, at the sub-committee meeting on 2 March Mr Millett reported that “the creditors stretch was lower for the end of February than they were expecting because of timing of the income streams.”

39 I.e. the vehicle through which SAIC and NAC were to invest: see paragraph 99.1 below.
Continuing uncertainties

89. There remained uncertainty as to important matters. For example, in a note of 10 February 2005 to Mr Stephenson, Mr Beale noted that Baker & McKenzie were insisting that the £87 million which was to be paid to PVH[^40] should go into a separate collateral account; Mr Beale commented that “this bloody issue of the £87 million into collateral makes it look like we may not be solvent post deal as contracts currently drafted.”

90. The date on which the UK joint venture was established was of particular importance. In his note to Mr Stephenson of 10 February, Mr Beale explained:

“What is becoming very clear is that the formation of the UKA and the ongoing funding of the working capital requirement (sounds so much better than losses!) is much more critical than the formation of China JV and the payment of £87 million. Obviously this is because at the point UKA starts trading we [crystallise] our total liability ...”

He went on to suggest, “Whatever the timing problem make sure that it is technically possible for UKA to be started on 28 March 2005”, and concluded:

“To be clear the reason the above is so important is because to be able to enter into this deal we need to be sure as directors that PVH remains is solvent ... It is very very tight and another 4-6 weeks of losses may stop us from being able to make this statement ...”

On 19 February, in another note to Mr Stephenson, Mr Beale said:

“... Our projections show that if we complete on 28 March 2005 we can still commit to this list but it will be very tight (in fact we will need to find £20-£30 million during 2006 but move back into positive cash towards end of 2007 early 2008. We have ideas which we could use to solve this shortfall which may or may not stand up to scrutiny by D&T. Question mark as to whether they stand up to scrutiny by E&Y

... There is a sound piece of logic that as completion has been delayed we should have re-visited this agreement on transformation costs. During the period Jan – Mar 05 we will have lost a further £70 million. Accordingly given £192 million was the right figure in Dec 04 then the right figure at Mar 05 is £192 plus £70 but then reduced by any transformation costs we had incurred during this period.

... The huge problem we will face is that if completion is delayed to say 28th April 05 we may not even be able to convince ourselves (let alone D&T or E&Y) that PVH ‘Remains’ is solvent because of an additional month’s loss deteriorating our cash position – as we go past this date the position clearly gets worse & worse.

[^40]: See paragraph 49.6 above.
... As discussed a little while ago one solution to this is to ensure UKA starts trading on 28\textsuperscript{th} March even if China JV is delayed.

... For the avoidance of doubt borrowing money does not help the above. We can obviously cope with the cash effect of timing by borrowing money (e.g. Bank of America or UK Government Rescue Aid) but this has to be repaid. If we do not have the ability to repay then we cannot borrow the money in the first place.

... Smoke & mirrors which we have been running on for past 4 years will not help because the new PVH remains business is so small that the ability ... for example to delay creditors or present figures in an imaginary way will be lost.”

Commenting on the 28 February letter of intent, Mr Beale said:

“I continue to worry that they will one day wake up to harsh reality of all the problems of UKA & will decide to do due diligence on UKA business & then [inevitably] decide to delay UKA. This will obviously be fatal to us.”

\textit{Request for rescue aid}

91. The possibility of the DTI providing rescue aid emerged when Mr Millett and Mr Beddow met the DTI on 11 February 2005 to discuss the possibility of Government assistance with redundancy payments. The DTI was made aware at that meeting that there might be a need for rescue aid. At a further meeting on 21 February, Mr Howe explained that MG Rover directors had concluded that it would be prudent to ask for a lending facility from the Government and made a formal request for a facility of £125 million.

92. The DTI and Treasury had already had the possibility of an application for rescue aid in mind. An internal report on MGRG prepared within the DTI as long ago as April 2004 had referred to rescue aid, stating, “The option of granting rescue and restructuring aid to the company should not be pursued” on the basis that “Public funds are likely to be better spent on helping individuals and the region cope with a collapse of MGRG rather than trying to prop up the company itself”. In December 2004, a DTI submission to Ministers had included a comment to the effect that financial assistance “either to remedy a cash-flow shortfall before a deal is signed or to help fund trading losses until the release of new models” was unlikely to offer value for money. In January 2005, officials within the Treasury had expressed the view that a bridging loan would be “deeply undesirable”.

93. In contrast, Ms Hewitt, the Secretary of State for Trade and Industry, did not think that the possibility of granting rescue aid should be excluded. On 31 January 2005, therefore, she asked officials to examine circumstances in which rescue aid should be considered. On 3 February the Automotive Unit provided a draft set of criteria for rescue aid and these criteria were then developed and refined in the light of comments from within the DTI and from the Treasury.
94. The request for rescue aid was discussed at a meeting on 24 February 2005 attended by, among others, the Secretary of State herself, senior DTI officials, Mr Roger Sharp (special advisor to the Secretary of State), Mr Norris from Number 10, Mr Richard Price from the Treasury and Mr Charles Randell from Slaughter and May, a firm of solicitors instructed by the DTI to advise them regarding the possible provision of rescue aid to MGRG. In advance of this meeting, Mr Alty had prepared a submission rehearsing the arguments for and against pursuing the option of rescue aid but observing, “Considerations of broader economic and industrial policy and reputational risk would in our view argue against.” At the meeting, it was agreed that a letter should be sent to the Group on 28 February setting out the full criteria for providing a loan facility and also that a “communications strategy”, in which Mr Norris would be “closely involved”, would be worked up urgently. By 28 February, however, the DTI had heard from Rothschild that SAIC was now looking to arrange prepayments (of £56 million in March and £25 million in April) for intangible assets. In the light of this information, the Secretary of State decided, following discussion between DTI officials, Mr Norris and the Treasury, that the Group should be sent a short letter stating that at that stage a Government loan facility was unnecessary41.

Government support in China

95. During February 2005 the Government expressed support for the proposed deal to the Chinese Government. When visiting the Ministry of Foreign Affairs on 17 February, the British Ambassador, Sir Christopher Hum, stressed the importance which British Ministers attached to the joint venture. On the following day the Ambassador called on Mr Zhang Guobao, a Vice Minister in the National Development and Reform Commission (“NDRC”, the Chinese Government’s planning department, somewhat comparable to the British Treasury), to highlight British Government support for the transaction and to encourage the Chinese Ministry to assist with the swift conclusion of the approval process. At this meeting, Mr Zhang said that the Chinese Central Government was in principle supportive of the deal, but explained that, once it had received the feasibility documents (which had not yet happened) it would take the NDRC at least a month to evaluate them, after which the papers would need to be considered by the State Council (equivalent to the British Cabinet) for up to a month. When, a few days later, the Chancellor of the Exchequer, Mr Gordon Brown, visited China, he “urged a speedy and positive decision” by the Chinese Government on the deal during meetings with the Chinese Premier, the Chinese Finance Minister and the Chairman of the NDRC, Minister Ma Kai, who said that he would do all that he could to expedite matters. On 23 February there was a follow-up meeting attended by Mr John Kingman, a senior Treasury official, representatives of the British Embassy and Mr Liu Tienan, the Director General of the NDRC’s Industry Department.

Other possible sources of funding

96. Efforts were also made to obtain commercial funding. Those approached included Bank of America Corporation, ABN Amro Bank NV, Bank of Communications Co Limited in China and Shanghai Pudong Development Bank.

41 See further paragraph 103 below.
97. There was a feeling that SAIC would or might provide financial support. For example, on 22 February 2005 Mr Beale told the MGRG sub-committee that it had been “agreed with SAIC that if the deal is delayed into April they would need to give some support to MGRG” and that a “solution could be to take the rescue aid but SAIC to commit to repay it if MGRG is unable to.”

*Ernst & Young’s “Phase 1” report*

98. Ernst & Young issued their first report, in draft, on Friday 25 February 2005. The report reviewed (a) the business plan for the PVH residual business (“PVHR”) which the Group had first supplied to Ernst & Young on 21 February and a revised version of which was provided on 24 February and (b) a cash flow forecast for 2005 which Ernst & Young had been given on 22 February and (in a revised form) on 24 February. Ernst & Young summarised their conclusions as follows:

- ... **PVHR will not be able to continue trading for more than a few months after completion.**

- *We have discussed the results of our work and our conclusion with representatives of Deloitte and Touche. They agree with our conclusion and have communicated a similar view to Peter Beale of PVH.***

- *In addition to our review of the PVH Short Term Cash flow and the PVHR Business Plan, we have identified a number of potential issues from PVHR post-completion. These are:*  
  - Warranty would not be honoured  
  - Employees could be dismissed  
  - Leased Assets could be withheld  
  - National Sales Companies could be lost

*Based on all of these issues, we consider that:*

- *It would not be prudent for SAIC to enter into any definitive deal or binding commitment until further due diligence work can be completed to the satisfaction of SAIC.*

- *We have recommended additional work in Section 5. This work may enable us to refine, or at least narrow the range of the total potential cash shortfall. You should note ..., however, that we do not at the moment believe that this will enable us to eliminate or reduce the cash shortfall.*

- *PVHR should not retain ownership of any assets that are critical to the operation of the UKJV*
SAIC or the UKJV should take security over PVHR assets to support guarantees to be provided by PVHR.”

Ernst & Young explained that they had identified “Restricted and Trapped Cash” (i.e. “cash not available for use in the business because held by third parties as collateral or retained as working balances in operating subsidiaries”), “Sensitivities” (where Ernst & Young had “concluded that PVH has either underestimated a cash outflow or overestimated a cash inflow”) and “Open Issues” (i.e. “primarily favourable assumptions made by PVH not yet agreed by SAIC”). Ernst & Young calculated that adjustments for these items produced the following cash shortfalls:

<table>
<thead>
<tr>
<th>31 December 2005 £ million</th>
<th>31 December 2006 £ million</th>
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<tbody>
<tr>
<td>“Free Cash before Sensitivities”</td>
<td>(12)</td>
</tr>
<tr>
<td>“Sensitised Free Cash”</td>
<td>(31)</td>
</tr>
<tr>
<td>“Sensitised Free Cash after Open Issues”</td>
<td>(101)</td>
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</tbody>
</table>

The report noted that “UK JV will need a substantial working capital facility from the outset”.

Letter of intent of 28 February 2005

99. Ernst & Young’s report had an influence on a new letter of intent which was agreed on 28 February 2005. The respects in which this letter of intent departed from that of 17 December 2004 included the following:

99.1. NAC was a party to the letter of intent. It was proposed that SAIC and NAC would invest in the joint ventures through a new vehicle called Donghua Automobile Investment Holding Corporation (“Donghua”);

99.2. Donghua was to have a 75 per cent interest in both the Chinese and UK joint ventures (respectively, “JVCH” and “JVUK”). The Group’s interest in each joint venture was reduced to 25 per cent;

99.3. the registered capital of JVCH was to be £138 million (down from £370 million);

99.4. SAIC was to purchase the MG brand and its derivatives for £56 million;

99.5. either JVCH or SAIC was to purchase assets including intellectual property in the Rover 25, Rover 75, MGZR, MGZS and MGZT for £25 million;

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42 Mr Zhao explained to us that Donghua should have had a larger share, but 25 per cent is the minimum stake for a foreign joint venture company.
99.6. PVH and its affiliates were listed as retaining its business relating to sports and racing vehicles (including the MGTF) (other than in China) and the CityRover and Tata vehicles, tooling relating to the Rover 800 and the Old Mini, historic trade marks, the Gibbs amphibious vehicle engine business (though only certain engines and on terms to be agreed) and all corporate entities (other than the NSCs); and

99.7. the feasibility study was to be completed and submitted to the Chinese Central Government by 28 February 2005, with the objective of obtaining approval by 28 March, and the establishment of JVCH was also to be completed by 28 March.

100. An internal Rothschild email of 27 February 2005 explained as follows:

“In short, the current structure will lower the registered capital of JVC from £370 million to £138 million, and changing the shareholding structure from 70%/30% to 75%/25%. In addition, SAIC rather than JVC will buy MG brand for £56 million and ZR/ZT/ZTT IPR for £25 million. The net effect is to increase consideration to PVH by £76.5 million.”

It was envisaged that the £56 million would be paid in the course of March, thereby easing MGRG’s cash flow problems.

101. On 2 March 2005 Mr Beale told the MGRG sub-committee that when Mr Stephenson saw the Ernst & Young report on 26 February he “thought it was disastrous.” However,
Mr Beale went on to explain that the report “had actually assisted because it had brought home the reality of the situation to [Mr Zhao] that dealing with the PVH Residuals was an extremely difficult task” and had “focused the minds of the Chinese on getting more cash to MGRG quickly.” Mr Beale also said that there was a slight concern that “the Chinese are now in celebration mode and think that the deal is done.”

102. In fact, however, SAIC was now uncertain as to whether the deal would be concluded successfully. Mr Zhao told us that by this stage he thought that the chances of a deal being concluded were below 50 per cent. A Rothschild email of 28 February mentions that Mr Zhao had asked them “to start thinking about transaction alternative in case the financial DD [reaches] an unfavourable conclusion.” A note made by Mr Duggins on the same day records, “Transaction may not go ahead, depending on risk level, i.e. might abandon the transaction.” To assist with the decision, SAIC instructed Ernst & Young to carry out additional work.

103. Having learned of the proposed prepayments of £56 million in March and £25 million in April, Mr Russell of the DTI wrote to PVH on 2 March declining to provide a loan facility. The letter concluded:

> “Bearing in mind the difficulties, including in relation to the EU state aids regime, involved in any Government facility, financing the Group’s cash needs from the parties to the transaction would appear the most promising option.”

After receiving the letter, Mr Howe quickly requested a meeting with the DTI. The meeting took place on 7 March and was attended by, among others, Mr Russell and Mr Alty from the DTI, a number of people from Deloitte (including Mr Einollahi) and Mr Buchanan. In the course of the meeting, Mr Einollahi said that, while SAIC had offered to bridge the transaction by acquiring the MG brand for £56 million, “the lawyers had indicated that they were reluctant to see the MG brand transferred in this way unless there were committed contracts in place for the balance of the project even if the balance of the project was to be completed at a future time.” Mr Russell pressed Mr Buchanan on whether “if it absolutely comes to it you will advise the directors to proceed with the MG transfer in isolation” and explained that rescue aid could be made available only where the DTI was satisfied that it could be repaid within six months. Matters were left on the footing that the DTI would “consider their position and revert.”

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43 See paragraph 94 above.
Chinese government approval

104. At about the beginning of March 2005, a feasibility study was finally submitted to the Shanghai Government. The novelty of what SAIC was attempting (investment in a collaboration with a foreign entity) meant that there was a lack of clarity as to quite what the Chinese Government approval process for Project 528 would involve. However, on 1 March Mr Ting-Jie Zhang of Rothschild explained his understanding of the approval process as follows:

“1. SAIC submits feasibility study (‘FS’) to Shanghai NDRC (1st of March)

2. Shanghai NDRC submits the FS to national NDRC (may take 1 or 2 days up to a week)

3. National NDRC will pass the feasibility study to International Engineering Consulting Company (‘IECC’) for review (time required unknown)

4. IECC submits its report [to] national NDRC

5. National NDRC submits report to State Council

6. State Council approves the project (time required unknown) ...”

On 4 March Mr Cowburn reported his understanding that the feasibility study had been issued to the Shanghai Government where it would be “reviewed by various departments, for tax impact, foreign exchange implications etc” over a period of one or two weeks before being passed to Beijing; Mr Cowburn noted that this arrangement was “completely different to [his] understanding of what was going to happen to the China [feasibility study] report following its signature last [Tuesday] as based on [Mr Stephenson’s] and [Dr Li’s] feedback from [their] discussions in Beijing, [he] believed the report would be submitted directly to Central government.” On about 8 March Mr Stephenson told Mr Cranshaw, a commercial officer in the British Embassy in Beijing, that a delay had been encountered with the Shanghai Government, because one of the manufacturing facilities comprised in the deal had been approved by the Shanghai Government, but the National Government had not been notified.

44 Mr Cox told us:

“... if we go back to the fact that M and A is very - at its very infancy in China at all, and international M and A, at that point you could count the number of transaction[s] on the fingers and thumb of one hand that had happened. That question presumes clarity as to what process exists and that the government knows what it is, Shanghai Auto know what it is and they could communicate it to us. The government did not know what the process was; therefore it was impossible for any of the rest of us to know what it was ... It was at a very early stage because, as I said, the government in its various different entities did not know what approvals it thought it ought to give, even at this stage.”

Further, Mr Duggins told us:

“... I do not think I ever really understood how that process worked because it seemed to be - I remember having - being at a presentation where they described the process and it seemed to involve multiple agencies who had to approve various parts of the transaction, and it was certainly not clear to me at any point when the thing would have ever been formally approved and how that happened and how it was communicated.”
proved to be outside the jurisdiction of the Shanghai Government. By 10 March Rothschild had been told by Mr Liu of SAIC:

“… Commitment letter from banks required before Intl Engineering Consultancy (IEC) report finalised and submitted to State Council

• IEC report will take c.15-20 days from commencement, estimate commence next week sometime. Exact timing to be clarified with Mdm Li [of SAIC] when she gets back to Shanghai tomorrow …”

Ernst & Young’s “Phase 2” report

105. Ernst & Young produced a further report on 11 March 2005. They gave their “KEY FINDINGS” as follows:

• **PVH Group** has net liabilities as at 30 November 2004, and the extent of its net liabilities continues to increase due to trading losses.

• **PVH Group** does not have sufficient cash to enable it to trade beyond 31 March 2005, therefore we believe it is imperative that a weekly cash flow forecast for April and May should be produced and provided to [Donghua] and its advisers as a matter of urgency.

• **Our view remains** that PVHR will run out of cash within months of the Transaction (assuming completion on 30 April 2005).

• **PVHR has insufficient assets** available to offer as security for loans to bridge the funding shortfall.

• **We estimate that** to keep PVHR solvent until 31 December 2006 additional cash of up to £117 million would be needed, this amount could be greater, depending on the resolution of open issues which we have been unable to quantify.

• **We are concerned that PVHR Group** could continue to show net liabilities. We recommend that PVH should produce a detailed pro forma balance sheet to clarify this issue.

• **We consider that [Donghua] is exposed** to a number of significant risks from the Transaction as currently envisaged in the LOI [i.e. Letter of Intent]:
  
  – [Donghua] will need to provide additional funding to PVHR to enable it to continue to trade.

  – **If [Donghua] does not provide** additional funding and PVHR becomes insolvent within two years of completion:
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- The Transaction could be attacked as a transaction at undervalue (unlikely to succeed in practice, provided all sale proceeds are paid into the correct legal entity).

- An Administrator could hold the JV’s to ransom over leased assets and employees within MGR [i.e. MGRG] ...

- [Donghua] would have to honour pre completion warranties to avoid brand damage.

- We believe that any forecasts which have been prepared for JVUK/JVCH will be subject to significant risk of adjustment/sensitivity.”

The report included a review of a revised business plan for PVHR which Ernst & Young had received on 4 March. This plan envisaged cash balances of £65 million on 31 December 2005 and £77 million on 31 December 2006. Making adjustments for “Restricted and Trapped Cash”, “Proposed Sensitivities” and “Open Issues”45 Ernst & Young arrived, however, at the following figures:

<table>
<thead>
<tr>
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<th>31 December 2005</th>
<th>31 December 2006</th>
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<tbody>
<tr>
<td>Cash balances as per PVHR revised business plan</td>
<td>65</td>
<td>77</td>
</tr>
<tr>
<td>Restricted and trapped cash</td>
<td>(47)</td>
<td>(34)</td>
</tr>
<tr>
<td>Free cash balances pre sensitivities</td>
<td>18</td>
<td>43</td>
</tr>
<tr>
<td>Proposed sensitivities</td>
<td>(65)</td>
<td>(106)</td>
</tr>
<tr>
<td>Additional funding requirement</td>
<td>(47)</td>
<td>(63)</td>
</tr>
<tr>
<td>Open issues</td>
<td>(33)</td>
<td>(51)</td>
</tr>
<tr>
<td>Additional funding requirement post open issues</td>
<td>(80)</td>
<td>(114)</td>
</tr>
</tbody>
</table>

The report noted that management had reported a draft trading loss of £253 million for 2004 (suggesting “a run rate of £21 million per month and £63 million for a 3 month period”) and were forecasting a loss of £76 million in the three months ending 31 March 2005. Mr Zhao confirmed to us that the report caused SAIC concern.

106. Rothschild prepared a report supplementing that of Ernst & Young. The report noted that “Even after increased consideration paid to PVH under the revised deal structure, the estimated cash shortfall for PVHR as at December 2006 has not changed materially from E&Y’s phase 1 report, as additional downside sensitivities have been modelled”. Some of the main offsetting factors were identified as “Completion delay impact”, “MGTF sales volume reduction”, “Global sourcing” (where Ernst & Young believed the savings assumed under the global sourcing programme to be challenging) and “[Powertrain] supplier increase”. The report concluded:

45 See paragraph 98 above.
“Rothschild believes that the financing plan for the China/UK JVs currently represents the area of highest degree of transaction risk and exposure for SAIC, and recommends that (1) SAIC should not sign off on the legal documentation, and (2) should carefully consider whether further payments of monies to PVH/MGR are appropriate, prior to the receipt and agreement of a committed financing plan for the JVs ...”

**Events in China in mid-March**

107. On 15 March 2005 SAIC discovered that it could not, after all, make the proposed £56 million prepayment for the MG brand. It had emerged that the acquisition of a trademark required the approval of a trademark department within the China Industrial and Commerce Administration Bureau and it was thought that the grant of approval was likely to take several months.

108. On the following day it transpired that SAIC had not hitherto realised the scale of MGRG’s losses. When Mr Duggins attended a meeting with SAIC, he was told by Mr Zhao that SAIC had previously been proceeding on the footing that MGRG was losing £100 million per annum and that the feasibility study had been prepared on that basis. Now that it was appreciated that MGRG was losing money at the rate of £250 million a year (as Ernst & Young had mentioned in their 11 March 2005 report), there was a question as to whether the business case was viable. In interview, Mr Duggins described the discovery that SAIC had not known of the extent of MGRG’s losses as a “quite staggering revelation”. Mr Zhao commented that he needed to tell Mr Stephenson about his concern that day.

109. Mr Zhao and Mr Stephenson met on the evening of the same day (16 March 2005). According to a letter sent to Mr Stephenson on 18 March, Mr Zhao explained the following at the meeting:

- SAIC believes that the strategic attractions of the transaction have not changed.

- However, the strategic value of the transaction has been potentially seriously eroded by 2 principal issues:

  (i) The heightened insolvency risk of PVH, MGR [i.e. MGRG] and the PVH Residual business (‘PVHR’);

  (ii) Questions as to whether PVHR can provide its portion of the necessary support for the JVUK financing plan.

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46 In evidence, Mr Stephenson said that “the numbers hadn’t changed radically” from when he had shown Mr Zhao cash projections in January 2005. If that is right, it is perhaps indicative of the imprecision which could arise from the manner in which the negotiations were conducted.

47 See paragraph 105 above.

48 Mr Duggins explained to us that “once you accepted that that was the actual level of losses, then the cash funding requirement of the UK joint venture was much higher than it had previously been estimated at …”
To enable us to have a better assessment of the insolvency risk of PVH, MGR and PVHR, we require:

(i) Ernst & Young ... to review the Deloittes report regarding the PVHR business plan;

(ii) E&Y to discuss assumptions with Deloittes, with a view to forming certain joint conclusions, to the extent they are able to do so;

(iii) Production of a PVHR financing plan by PVH for SAIC’s review.

Support for a JVUK financing plan probably requires a 25% guarantee from PVH. Please let us have your detailed proposals as to how PVHR will provide such support for the JVUK financing plan.

The MG trademark assignment (‘TM Assignment’) is an integral part of the overall transaction. There are 2 principal hurdles why the TM Assignment cannot be completed by the end of March:

(i) SAIC cannot proceed with the TM Assignment without receiving reasonable comfort that (a) the insolvency risks of MGR, PVH and PVHR are manageable; and (b) there will be a viable JVUK financing plan in place.

(ii) we have received definitive notification that the requisite governmental approvals in the PRC cannot be obtained before the end of March.”

110. On the next day, 17 March 2005, without consulting any other director first, Mr Stephenson delivered an ultimatum to SAIC. Chairman Hu referred to the meeting in the following terms in a letter to Mr Towers dated 22 March:

“... On 17 March 2005, during a meeting between Nick Stephenson, Mr. Zhao Feng Gao and others, Mr. Stephenson told us in unequivocal terms that since the meeting on 16 March concluded that the MG trademark assignment consideration will not be paid by the end of March, the PVH directors had concluded that they will prefer to declare insolvency of PVH rather than to continue negotiating the current transaction with SAIC.

Mr. Stephenson indicated that the PVH directors would not proceed with this if:

(i) SAIC confirms that it will use its best endeavours to complete the transaction by the end of April 2005; and

(ii) if delays are envisaged, SAIC must fund the project from the end of April regardless.”
Mr Stephenson read out a document, which SAIC understood to be a letter from Mr Towers but which was in fact something Mr Stephenson had written himself, suggesting that SAIC was being misled by its advisors and had lost its spirit of entrepreneurialism.

111. While Mr Stephenson doubtless acted with the best of intentions, the approach he took on 17 March 2005 was a mistake. SAIC declined to accept either of the conditions specified by Mr Stephenson. When, two weeks later, representatives of the DTI came to Shanghai, SAIC explained to them that Mr Stephenson’s proposal had been “groundless and outrageous”. Mr Zhao told us that Mr Stephenson’s “behaviour was not sensible or logical” and that his (Mr Zhao’s) “very deep impression was that [Mr Stephenson] was very emotional at this time, not an attitude that would help to solve the problems.” Mr Duggins told us that Mr Stephenson’s ultimatum was “taken pretty badly” by SAIC and Dr Li said that SAIC were “slightly shocked at the time”. Following the 17 March meeting, consideration of the feasibility study was suspended. As Chairman Hu explained in his 22 March letter:

> “Based on what Mr. Stephenson told Mr. Zhao about the PVH directors preferring the insolvency option, we have duly informed certain PRC regulatory bodies of this, and based on this information, we have been informed that their review of our feasibility study has paused.”

In the event, review of the feasibility study never resumed.

The DTI’s consideration of a bridging loan facility

112. However, the same day, 17 March 2005, brought a letter addressed to Mr Towers expressing the DTI’s willingness, subject to a variety of conditions, to provide a loan. Mr Russell explained as follows:

> “The Secretary of State has given careful consideration to the basis on which it might be possible for the DTI to provide a bridging loan facility. I am attaching a set of the criteria which would need to be met before any loan could be considered. In essence we would need to be satisfied that the loan would be repaid on completion of the transaction and that there was no doubt that the transaction was going ahead.

> We could consider a bridging loan facility only on the basis that it would be repaid in full from funds received from SAIC on completion of the JV transaction and would not be available to fund any trading losses after completion. We would also be looking to you and your colleagues to contribute personally to any facility in order to demonstrate your confidence that the deal with SAIC will be concluded and reduce the exposure of public funds. To this end we would require a statement of your net assets.”

The criteria enclosed with the letter stressed that a loan facility “would only be provided on the basis that it was interim bridge financing to be repaid in full from receipts from SAIC on
completion of the JV transaction and would not be available for the funding of trading losses after completion.” Amongst the criteria were the following:

“... The Group provides a copy of the signed JV documentation (including all principal legal agreements and funding agreements) in a form satisfactory to the [Secretary of State] and ... the JV transaction documentation provides for the repayment of the loan by SAIC in full with interest and HMG costs on completion ...”

The DTI Accounting Officer is satisfied that the loan is a proper, appropriate and a defensible use of public money.

... Messrs. Beale, Edwards, Howe, Stephenson and Towers ... agree ... to contribute a proportion of their personal assets to the loan funding, the amount to be decided in the light of advice to the [Secretary of State] on their value and liquidity, and to guarantee a proportion of the loan facility using a significant proportion of their personal assets as collateral ...

Loan to be repaid by 31 May 2005. The loan will become due and payable on completion of the JV if earlier than 31 May or earlier than 31 May if [the Secretary of State] determines that, in her opinion, (i) the JV transaction is likely not to be completed by that date or (ii) the facility is likely not to be sufficient to fund the Group’s working capital requirements to completion of the JV transaction.”

113. A week or so earlier, the Secretary of State had endorsed a recommendation that Mr Howe should be sent a letter reiterating that she remained of the view that the best course was for the Group to seek to finance its cash needs from the parties to the transaction. However, on 10 March Mr Howe had warned Mr Evans that such a letter would probably lead him to convene an emergency board meeting. On 14 March Mr Towers had written to Mr Russell explaining the detail of the Group’s current position including its views on the present status of the deal and the implications of any professional advice given to it. On 15 March Mr Towers had told Mr Russell of SAIC’s discovery that the acquisition of the MG trademark required approval from the trademark department. That same day, DTI officials had discussed the position with Mr Sharp, Mr Norris, Ms Shriti Vadera (an advisor in the Treasury49) and Treasury officials, concluding that the DTI should now take active steps to engage with Rover and to discover whether the criteria which had been developed could be met. On 17 March, DTI officials, Mr Norris, Ms Vadera, Treasury officials and Mr Randell had attended a meeting with the Secretary of State and Ms Jacqui Smith, the Minister of State at the DTI. It had been at that meeting that the decision had been taken that Mr Russell should send his 17 March letter to Mr Towers.

114. In his reply to the letter of 17 March 2005, Mr Towers said that he and his fellow PVH directors found “the wording of the personalised aspects of this proposal very irritating”,

49 Ms (now Baroness) Vadera was a member of the Council of Economic Advisors in the Treasury. The terms of her employment were similar to those of a special advisor and she was referred to as such, but the role involved having some policy or specialist knowledge of commercial and economic matters.
but expressed willingness to make personal financial commitments. On 18 March Mr Towers wrote confirming that he and his colleagues accepted the conditions the DTI had set.

Deloitte’s review of PVHR’s cash flows

115. Two days earlier, on 16 March, Mr Wisker had made available to Ernst & Young a summary cash flow prepared by Deloitte. At least at first sight, this gave a rather more favourable picture of PVHR’s cash flow than Ernst & Young’s reports. It showed the closing cash balance, after taking account of both restricted/trapped cash and sensitivities, as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Closing Cash Balance £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 March 2005</td>
<td>197.0</td>
</tr>
<tr>
<td>30 April 2005</td>
<td>166.7</td>
</tr>
<tr>
<td>31 May 2005</td>
<td>108.5</td>
</tr>
<tr>
<td>30 June 2005</td>
<td>61.8</td>
</tr>
<tr>
<td>31 July 2005</td>
<td>51.6</td>
</tr>
<tr>
<td>31 August 2005</td>
<td>46.8</td>
</tr>
<tr>
<td>30 September 2005</td>
<td>41.7</td>
</tr>
<tr>
<td>31 October 2005</td>
<td>32.4</td>
</tr>
<tr>
<td>30 November 2005</td>
<td>25.7</td>
</tr>
<tr>
<td>31 December 2005</td>
<td>9.1</td>
</tr>
<tr>
<td>31 January 2006</td>
<td>4.1</td>
</tr>
<tr>
<td>28 February 2006</td>
<td>3.0</td>
</tr>
<tr>
<td>31 March 2006</td>
<td>7.2</td>
</tr>
<tr>
<td>30 April 2006</td>
<td>(1.9)</td>
</tr>
<tr>
<td>31 May 2006</td>
<td>(0.7)</td>
</tr>
<tr>
<td>30 June 2006</td>
<td>3.8</td>
</tr>
<tr>
<td>31 July 2006</td>
<td>1.8</td>
</tr>
<tr>
<td>31 August 2006</td>
<td>8.6</td>
</tr>
<tr>
<td>30 September 2006</td>
<td>18.3</td>
</tr>
<tr>
<td>31 October 2006</td>
<td>16.8</td>
</tr>
<tr>
<td>30 November 2006</td>
<td>19.7</td>
</tr>
<tr>
<td>31 December 2006</td>
<td>16.4</td>
</tr>
</tbody>
</table>

However, Deloitte explained that their figures depended on a number of assumptions, including for example:

115.1. “Confirmation that transformation costs are capped at £120.5 million”;
115.2. “Confirmation of the timing of the deal and funding of losses as a result of potential delay in completion”; and

115.3. “Confirmation that there are no additional pension costs over and above those assumed in the Forecasts”.

Commenting on the Deloitte document on 16 March, Mr Tom Lukic of Ernst & Young said, “other [than] key assumption on transformation costs, don’t believe we are that far apart in terms of key issues”, “broadly they raise the same [open issues] as we do” and “In fact they raise some additional points, all of which seem reasonable and in some cases (pension) fundamental.”

**Ernst & Young’s “Phase 3” report**

116. On 18 March 2005 Ernst & Young produced an updated version of their second report (of 11 March) and also a third report, which covered similar ground. The third report included a revised sensitised cash flow forecast:

<table>
<thead>
<tr>
<th>£ million</th>
<th>December 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>PVHR Updated Closing Cash Balance</td>
<td>70.3</td>
</tr>
<tr>
<td>Sensitivities agreed with D&amp;T</td>
<td>(39.5)</td>
</tr>
<tr>
<td>D&amp;T Sensitivities not included by E&amp;Y (£14.4m)</td>
<td>0.0</td>
</tr>
<tr>
<td>E&amp;Y Additional Sensitivities</td>
<td>(57.6)</td>
</tr>
<tr>
<td><strong>Closing Cash Pre Transformation Cost Sensitivities</strong></td>
<td>(26.8)</td>
</tr>
<tr>
<td>Transformation Cost Sensitivities</td>
<td>(53.4)</td>
</tr>
<tr>
<td><strong>Closing Cash Pre Quantifiable Open Issues</strong></td>
<td>(80.2)</td>
</tr>
<tr>
<td>Quantifiable open issues</td>
<td>(51.0)</td>
</tr>
<tr>
<td><strong>Closing Cash Post Quantifiable Open Issues</strong></td>
<td>(131.2)</td>
</tr>
</tbody>
</table>

**SAIC’s consideration of a purchase out of insolvency**

117. At this stage, SAIC considered whether it would be possible to buy assets from a managed insolvency process. The possibility was, however, quickly dismissed. A Rothschild email of 22 March 2005 recorded that it had been concluded that a managed insolvency process:

“… does not work because (1) committed financing of c. GBP100m needed up front which only UK Govt can provide, (2) liabilities too uncertain to suggest Chinese regulatory bodies would approve, and (3) economic result of such a deal is negative except on most optimistic scenario, based on what SAIC would be prepared to put into such a deal …”

50 In the event, Ernst & Young also produced a “Phase 4” report dated 1 April 2005 – see footnote 55 below.
Chapter XX
The events leading to administration

On the same day, Mr Duggins reported to others at Ernst & Young, “SAIC ... have no interest in acquiring either a going concern business or specific assets from an insolvency of PVH/MGR”. Mr Duggins told us, “fundamentally, Shanghai Automotive simply were not prepared to do that kind of transaction.”

118. When we spoke to Mr Woodley, the general secretary of the Transport and General Workers’ Union, he was convinced that Rothschild had advised SAIC that it would be in their interests to see MGRG go into liquidation. In this, however, he was mistaken. We find that Rothschild did not give SAIC any such advice.

Views on the deal’s prospects in March 2005

119. SAIC was increasingly pessimistic about the deal’s prospects. Mr Zhao told us that on 19 March 2005 he saw the chances of the deal being successfully concluded as lower than 20 per cent.

120. Directors of PVH were much more hopeful. On 15 March 2005 Mr Stephenson expressed “110%” confidence that the deal would be agreed to Mr Cranshaw of the Beijing Embassy. On 21 March Mr Towers and Mr Beale dismissed PVH solvency issues as a “storm in a teacup” which would be resolved within 48 hours. On 23 March Mr Towers told Mr Russell that he thought that good progress was being made on all fronts and that the key points would be resolved.

121. Others expressed varying views about the chances of a deal being successfully concluded. On 23 March 2005 Mr Peter Yu of Rothschild said that there was “renewed hope for the transaction” and that Mr Chris Brooks of Rothschild put the probability above 60 per cent. On 28 March Mr Stephenson said that Mr Cowburn was “being very negative regards UKA funding” and that there was a “need to control [Mr Cowburn] not to be so negative”. On 31 March, Mr Duggins commented, “Still too close to call, but no lack of determination to get the deal over the line.”

Government consideration of the provision of a loan

122. To assist it in deciding whether to grant a loan, the DTI made contact once again with the Chinese Government. In a letter dated 18 March 2005, the Secretary of State explained to Minister Ma of the NDRC that “any further indication [he] could give at this stage that the venture is expected to be approved by the Chinese Government would be of great assistance to the UK Government in considering whether it will be possible to provide financial support, in order to assist a successful outcome to this very significant venture.” The plan was for the Ambassador to call on Minister Ma to deliver the letter. By 22 March, however, the Embassy had still not been able to secure an appointment with Minister Ma or Mr Zhang Guobao. A diplomat reported:
“... I am afraid that the fact that SAIC have now been in direct dialogue with NDRC, asking them to freeze consideration of the papers, raises the possibility that we shall not get a call at all.”

Eventually, on 24 March, the letter was faxed to Minister Ma. Efforts were subsequently made to arrange either for the Ambassador to call on the NDRC or for the Secretary of State to speak to Minister Ma, but these were unsuccessful.

123. From quite an early stage in the DTI’s involvement, it was recognised within the DTI that a grant of rescue aid could give rise to Accounting Officer issues. The DTI, in common with other Government departments, had an Accounting Officer whose responsibility it was to “assure Parliament and the public of high standards of probity in the management of public funds.” If the Accounting Officer would not approve a transaction, it was open to the Secretary of State to proceed, by giving a direction. Such directions were, however, relatively rare and every direction had to be reported to the National Audit Office, which would in turn inform the chairman of the Public Accounts Committee that a direction had been given.

124. In a submission to the Secretary of State of 23 February 2005 giving officials’ views, Mr Alty warned that “this case could well raise Accounting Officer issues”. On 21 March Ms Catherine Bell, who had become the DTI’s Accounting Officer when she became the DTI’s acting permanent secretary on 1 March, met DTI officials to discuss Accounting Officer issues. On 24 March Ms Bell sent the Secretary of State a submission in which she concluded:

“... Unless we can significantly reduce the exposure of the DTI budget to a bridging loan to MGR of the scale currently contemplated, I would have to take the view that a loan to MGR would not represent value for money and would require immediate disruptive action on other programmes. Hence for the above reasons I would need to seek a Direction from you.”

125. There were others who doubted whether any loan would be repaid. Mr Price told us that the Treasury view was that “there was a fairly small probability of a deal to bridge to.”

Increasing financial pressures on MGRG

126. The financial pressures on MGRG became yet more intense. MGRG had been, in Mr Millett’s words, “in many ways, one of the purest in the industry for paying suppliers on time”. An article in the Financial Times on 21 March 2005 reported that “Six large suppliers contacted by the Financial Times said they had shortened payment periods or were enforcing payment more strictly, reducing their exposure to the possible failure of a rescue deal with Shanghai Automotive Industry Corp”. At a meeting on 31 March, Mr Millett told the MGRG sub-committee that creditor deferrals had increased in March. It was also reported that:
“... in terms of available cash MGRG can carry on until the end of next week, albeit with inevitable creditor deferrals, but by Friday 8 April 2005 £20 million cash is needed or it will not be able to pay its creditors and workforce in the mid month run.”

Notes of the meeting record:

“If the DTI do not decide on Monday or Tuesday to provide the rescue aid funding, then the Sub-Committee opinion is that MGR will be unable to manage its cashflow at some stage during week commencing Monday 4 April and in any event no later than Friday 8 April.”

Mr Millett told us that, where payments to creditors were deferred, MGRG tried to “do it across the board ... as fairly as we could.”

**Principal outstanding issues in March 2005**

127. SAIC identified four principal outstanding issues in a letter from Chairman Hu to Mr Towers dated 22 March 2005. Chairman Hu assured Mr Towers that the strategic attractions of the transaction had not changed, but said that “some challenging issues” remained unresolved, that the “results of our financial due diligence to-date have not given us sufficient confidence to sign the transaction documents” and that “further clarity as to the likelihood of concluding a deal between us is dependent on us reaching a sufficient level of comfort on the four principal outstanding issues ... and any others that may arise in ongoing negotiations between our respective teams.” The four principal issues listed in Chairman Hu’s letter were as follows:

“(a) Both PVH and SAIC to be satisfied that PVHR will not become insolvent post-completion.

(b) It is intended that JVUK will set up a new defined contribution pension scheme for the transferring employees. Both PVH and SAIC must be satisfied that the resulting impact on the existing defined benefit pension schemes will not cause PVHR to become insolvent post-completion. SAIC believes that the resolution of the MGR pension schemes issue between PVH and the scheme trustees to SAIC’s satisfaction is critical to the deal.

(c) A firm offer of committed finance facilities to be available to support the JVUK financing plan.

(d) Both PVH and SAIC to be satisfied that the redundancy payments included in PVHR’s financial forecast (presently, 9 months for each employee to be made redundant) will be sufficient to secure the level of redundancies necessary for the transition to JVUK and JVCH without causing any industrial relations problems or disruption to the business of JVUK and JVCH.”
128. Earlier on 22 March 2005, there had been a meeting between SAIC and its advisors. President Chen had concluded the meeting by stating that SAIC would not take on the risks related to the four principal issues, because they could not be controlled. A Rothschild note of the meeting inferred from President Chen’s remarks that SAIC was “unlikely to alter significantly its existing negotiating position in taking its discussions with PVH forward.”

129. On the following day, Mr Russell of the DTI wrote to Chairman Hu of SAIC. He warned that, under European Union law, a key requirement for the grant of any bridging finance was that it should be in the form of a loan which would need to be repaid within a maximum of six months. He explained that, having regard to the limitations imposed by European Union law, the UK Government would need to obtain agreement from SAIC on a number of points before giving final approval to any bridging loan facility. He identified the main points as follows:

“(a) confirmation that the proposed transactions with MGR had received the necessary board approvals within SAIC and as to SAIC’s continuing commitment to the transactions;

(b) confirmation that the commercial negotiations with MGR had effectively been concluded, with all essential due diligence completed and the only material outstanding issue being the need for approval from the Chinese Government;

(c) an acknowledgment by SAIC that it is content that the loan should be made and understands that its transactions with MGR must provide for the entire balance of any loan, including interest accrued and the UK Government’s costs, to be repaid immediately on completion; and

(d) confirmation from SAIC that alternative sources of bridging finance for MGR were unavailable, on the basis that SAIC was unable to make any further pre-payment without separate Chinese Government approval and would not be able to guarantee a 3rd party loan to MGR.”

Mr Russell suggested that the UK Government would need to be in a position to reach a final decision on whether to provide a facility by 1 April and asked whether representatives of SAIC could come to London for discussions.

130. SAIC gave its substantive response in a letter from Chairman Hu dated 29 March 2005. Chairman Hu explained that SAIC was not in a position to give Mr Russell the confirmations he sought. He said:
“... there are risks remaining in these transactions in respect of which our Board, at present, feels it cannot draw sufficient comfort to be able to give you the confirmations that you seek, within your specified time frame. Although we are prepared to continue in discussions as appropriate, we do not envisage that by 1 April we will have gained sufficient additional comfort to give you the assurances outlined in your letter.”

Chairman Hu stated that, since there was “not yet a clear resolution of the four critical issues” listed in his 22 March letter, “a meeting at this point in time is premature” although if Mr Russell “felt there would be benefit in us meeting with the Consul General here in Shanghai to discuss these issues, we would be pleased to do so.” Chairman Hu observed:

“Although much work has been done to assess and mitigate the risks, there will be an underlying level of exposure which will exist that will be, in reality, difficult to reduce further through additional work. This leaves SAIC in a position where it can only assess the remaining risks carefully and consider whether that provides a robust basis for us to make a final decision.”

Mr Cox of Rothschild told us, “The reason the meeting did not happen ... was because it became plain that the state aid was a loan that would only be made in circumstances where broadly it was not necessary to make a loan, i.e. circumstances where a commercial bank would make a loan, which rendered it effectively useless.” Similarly, Mr Zhao confirmed that SAIC’s feeling was that what the British Government had in mind could not help so there was no point in a meeting.

131. Following receipt of Chairman Hu’s letter, Mr Alty asked that the Secretary of State provide a steer on future strategy. He explained that there were two broad ways forward: the DTI could either step up its engagement with SAIC and the Chinese Government or, alternatively, disengage from the process at that point. The Secretary of State decided in favour of stepping up engagement, taking the view that it was “too soon to pull the plug”.

132. Speaking to Mr Norris that evening, Mr Cox said that the DTI’s letter had “crystallised things by forcing SAIC to take a decision precipitately, and one where they could not meet HMG’s conditions, so avoid losing face.” Mr Norris, however, said that the criteria were negotiable. Mr Cox told us that Mr Russell’s letter was “Pretty irrelevant”; “had the government been able to provide aid of a different form, that might have made a difference”. Mr Zhao, likewise, told us that the DTI involvement was in the end irrelevant. He explained that “whether or not [the British Government and the DTI] were involved in the deal did not matter”, they “did not have a positive or negative impact on the co-operation between PVH and SAIC”.

133. On the evening of 29 March 2005, the three firms of accountants involved (Ernst & Young, Deloitte and KPMG) attended a lengthy meeting with the DTI; Mr Cox of Rothschild was also involved, by telephone. The main reason for the meeting was to allow the DTI to determine whether the outstanding issues between SAIC and the Group were merely process issues, with a high probability of resolution, or more substantive issues that were less likely
to be resolved. Much of the time was spent discussing the four principal issues identified in
the 22 March letter and, in particular, PVHR’s solvency. As regards the financing of the
UK joint venture, Mr Einollahi argued that PVH need only provide a £25 million guarantee,
which it could do by offering cash collateral. With respect to PVHR’s cash flow,
Mr Duggins’ contemporaneous account described events as follows:

“... D&T portrayed the cash shortfall as £14.5 million at 12/06, with a ‘peaking’
problem ... of an additional £24 million at 4/06. The peaking problem will be solved
by careful cash management – [Mr Cox] and I pointed out that this might not be easy
to do with a much smaller business post-completion, and it is misleading to describe
it as a peaking requirement, but D&T brushed this aside. The requirement to cash
collateralise PVH’s £25 million guarantee therefore gives a cash shortfall of
£40 million (14.5 + 25), which will be covered by advance payment of equipment
lease rentals (already proposed by PVH and rejected by SAIC – [Mr Cox] to try to
find out why), and the proceeds of a sale and leaseback of the dealer properties ...
Further funds will be generated by raising debt on used vehicles (not quantified) and
on the OUVs [i.e. “own use vehicles”] in the NSCs. I explained that the OUVs in
the NSCs are assumed to be sold by PVHR in the six months following completion so
would not be available to borrow against. D&T were unaware of this and agreed to
check the point ... When asked about the sensitivities themselves, D&T acknowledged
that these were agreed as between EY and D&T but said that the PVH directors
don’t accept them as having a cumulative effect.”

134. So far as “advance payment of equipment lease rentals” is concerned, Mr Cox was able
to report to Mr Duggins on 30 March 2005 that SAIC would “not be able to get it through
NDRC or SAIF, as it will be seen as a 100% [guarantee] of the UK JV – which it is – and
that is not permitted.” Mr Stephenson told us that “the advance payment on equipment lease
rentals was a very complex issue that is tied up with Chinese central government policy as
to when payments can be made for equipment that the Chinese companies had bought
overseas.” When we asked Mr Zhao whether SAIC had considered an advance payment for
equipment lease rentals, he said:

“We did not consider that. The perceived risk was already very high, how could we
reach such a decision? The only possible solution we thought of was to sell the
engine equipment to SAIC with cash upon delivery of the equipment. We never
considered making an advance payment for equipment rentals.”

135. The basis for Mr Einollahi’s argument at the 29 March 2005 meeting that PVH need only
provide a £25 million guarantee for the financing of the UK joint venture is apparent from
an explanation Mr Beale gave at the 31 March meeting of the MGRG sub-committee.
Mr Beale said that:

51 See paragraph 127 above.
52 See e.g. X/1.
53 See the previous paragraph.
54 See paragraph 133 above.
“The business needs £200 million funding. £100 million can be obtained from its own assets with the principals putting up the remaining £100 million in the form of £25 million from PVH and £75 million from SAIC.”

By the weekend, however, PVH accepted that it would be responsible for funding the UK joint venture to the tune of about £45 million.

136. The £14.5 million and £24 million figures quoted at the 29 March 2005 meeting reflected additional work performed by Ernst & Young on the cash flows. As a result of further work and discussion with both SAIC and PVH, Ernst & Young prepared on 24 March a revised cash flow forecast for PVHR giving a shortfall as at December 2006 of £14.5 million (down from £131.2 million)\(^{55}\). Ernst & Young’s calculations showed, however, a shortfall £24 million higher (viz. £38.8 million) at April 2006. Whereas the previous cash flow forecast had assumed that delay in completion would worsen matters by £25 million, the new forecast took a £40 million figure for completion delay.

137. Ernst & Young made additional adjustments to their calculations on 31 March 2005, having reviewed points made by PVH. The adjustments improved the closing cash position at December 2006 to a shortfall of £6.9 million (as compared with £14.5 million), but the peak shortfall remained £38.8 million. Moreover, Ernst & Young’s calculations suggested that additional funding would be needed from June 2005 onwards.

138. The pension and redundancy problems (issues (b) and (d) in paragraph 127 above) were increasingly seen as manageable. As regards redundancy costs, Mr Beale wrote to Mr Duggins on 24 March 2005:

> “Whilst I understand and sympathise with sensitivities around some of the numbers in the PVH Residual Plan this subject is not one where I feel there should be any need for concern either by way of note or sensitivity. Our organisation has a proven track record of managing these issues ...”

On 31 March Ms Ruston sent Baker & McKenzie a paper explaining how and why the Group believed that it was possible to ensure that the cost of reducing the headcount could be achieved without suffering expensive Employment Tribunal defeats. On 1 April Mr Towers gave an oral presentation to SAIC on how redundancies could be managed.

139. Turning to the pension problem, the impact of the pension deficit on the SAIC deal was discussed at a number of meetings of the trustees of the MGRG pension scheme. On 10 March 2005, Mr Millett, attending the meeting as a representative of MGRG, told the pension trustees that MGRG was looking for agreement from them and the Occupational Pensions Regulatory Authority (“OPRA”) “that they will not pursue SAIC or the new joint venture companies for any deficit if, for example, PVH or MG Rover could not pay the deficit”; absent such an agreement, Mr Millett explained, there would be no deal with SAIC.

\(^{55}\) The £14.5 million cash shortfall was also shown in Ernst & Young’s “Phase 4” report dated 1 April 2005.
Mr Millett acknowledged the need to agree a recovery plan for the scheme and said that PVH had agreed to address the deficit out of its future income streams (arising primarily from its shareholdings in the joint ventures). He warned that there was unlikely to be any contribution towards the deficit during 2005/2006, but said that it was hoped that profits would begin to be generated from 2007 onwards. The trustees reconvened on 15 March and agreed that they would not seek to pursue any debt from SAIC or the joint venture companies. Mr Frost had explained that Garvins’ advice was that the trustees should agree to Mr Millett’s proposal on behalf of MGRG, and Mr Glyn Ryland of Wragge & Co, the trustees’ solicitors, who was also present, had advised that the trustees could reasonably agree to the proposal based on the information presented to them. Wragge & Co were represented, too, at a trustees’ meeting on 29 March. On this occasion, Mr Millett explained that PVH would be willing to agree to a recovery plan which included payments of 20 per cent of each year’s net cash inflow towards the pension scheme deficit. Mr Millett said that there may be no payments during the first two years, other than for continuing accrual of benefits, but that MGRG would ensure that the deficit would not widen as a result of expenses payable by the scheme. The trustees decided that, subject to their general duties to keep matters under review and to comply with statutory valuation and funding requirements, the funding plan would be reasonable and should be agreed for the foreseeable future. Additionally, to give SAIC further reassurance, Mr Beale confirmed to SAC in a letter dated 31 March that MGRG would not in the next two years make available to the pension scheme funding to provide for costs of enhanced early retirement (with the result that the trustees would not be able to grant enhanced early retirement over the two-year period). On 1 April Mr Frost also made contact with the Pensions Regulator, with a view to the Regulator providing SAIC with reassurance as to the trustees’ decision-making; the response was that the Regulator would try to turn the matter around by the end of the next week.

140. The issues as to PVHR’s solvency and financing the UK joint venture (issues (a) and (c) in paragraph 127 above) in effect coalesced. Mr Cowburn explained:

“... at the end we put both solvency and JV UK into one by saying, ‘We will cash collateralise the JV UK requirement into a cashflow’, and therefore you only have one issue, which is cash solvency, effectively.”

Meetings with SAIC in China on 1 and 2 April 2005

141. Following the Secretary of State’s decision on 29 March 2005 that the DTI should step up its engagement with SAIC and the Chinese Government, Mr Russell wrote to Chairman Hu proposing a meeting, preferably in London but alternatively in Shanghai. Chairman Hu replied on 30 March, saying that he himself was about to embark on a visit to the United States but suggesting that Mr Russell meet Mr Chen, the President of SAIC Group, in Shanghai. On the next day, Mr Russell flew to Shanghai with Mr Randell, arriving on Friday 1 April. Mr Towers travelled to Shanghai on the same plane, and Mr Einollahi also arrived in Shanghai on 1 April or thereabouts. Mr Stephenson and Mr Petrie, among others, were already in China (Mr Petrie having arrived on 31 March).
142. At much the same time, Mr Mark Gibson, another senior official within the DTI, went to Beijing with a view to a meeting with the NDRC. In the event, it did not prove possible to arrange such a meeting.

143. On 1 April 2005, soon after their arrival in Shanghai, Mr Russell and Mr Randell attended a meeting with President Chen and Mr Zhao and others from SAIC and NAC. Representatives of Rothschild, Ernst & Young and Baker & McKenzie were also present, as was Ms Bishop, the Consul General. While, however, Mr Towers, Mr Stephenson, Mr Petrie and Dr Li were there at the beginning of the meeting, and returned later in the day to discuss issues relating to redundancy and pensions, they were not invited to attend the majority of Mr Russell and Mr Randell’s meeting. In the course of that meeting, President Chen said that he felt that PVH should be given the opportunity to address the outstanding issues. Mr Randell told us that he understood SAIC “to be communicating to us that they thought that there were very significant difficulties in the way of the transaction”. Ms Bishop thought that President Chen was “pretty plain-speaking in this meeting”, “more than [she] would normally expect from a senior Chinese person”. To her, “from a complete layperson’s point of view”, “the four obstacles seemed insurmountable” and the deal appeared to have no prospects.

144. When giving evidence to us, Mr Stephenson was critical of the DTI for failing to have its own interpreter when meeting SAIC. He told us:

“The normal format always in China, protocol is both sides have to have a translator so they can ensure that ... what is being said is being said. Actually, our DTI made a really fundamental error when they came to China without a translator not understanding that protocol ...”

There is, however, no substance in this complaint since the British Consulate-General provided Mr Russell and Mr Randell with an interpreter for each of their meetings with SAIC.

145. Mr Russell and Mr Randell met representatives of SAIC and NAC for a second time on the next day, Saturday 2 April 2005. During this meeting, President Chen expressed the view that substantial progress had not been made on the four main issues of concern and said that MG Rover’s recent history meant that SAIC needed to take a cautious view of the risks associated with the deal. In SAIC’s view, PVH had not yet provided a satisfactory solution to the problems. In the words of Ms Bishop’s note of the meeting:

“Chen said that the key issue was that, according to the figures in the EY report (which PVH had accepted), PVH did not have enough operating cashflow to keep the company solvent. PVH therefore had to sell some/all their remaining assets or use them as security for a loan. Two questions arose: how much were the assets worth, and how long would it take to realise those assets? PVH needed a financing plan for both the residual business and the joint venture company. For this plan to be acceptable to SAIC, a commitment letter from the bank was required. These issues need time to be resolved. Chen said that his personal view was that it was very challenging to make sufficient progress in 24 hours.”
Mr Russell told us that he came away from this meeting “feeling more pessimistic about the chances of a deal” or “Certainly the chance of a deal very quickly.” Mr Randell said that he “certainly didn’t come away with a more hopeful message from SAIC.” Likewise, Ms Bishop did not come away with a more optimistic message – “Either the same or less.”

146. No one from PVH was present during the meeting mentioned in the previous paragraph, but PVH met SAIC afterwards. At the latter meeting, the PVH representatives were given a letter from Mr Zhao setting out “the remaining specific steps that PVH needs to take, and information that it needs to provide to SAIC’s satisfaction, before SAIC would be able to proceed with [the transaction].” The letter then addressed the outstanding issues as follows:

“1. **The four outstanding principal issues**

1.1 **Solvency of PVH residual business (‘PVHR’)**

<table>
<thead>
<tr>
<th>Issue</th>
<th>Steps to be taken or information to be provided by PVH</th>
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| Insolvent, or marginally solvent, financial state of PVHR post completion | (i) Monthly cashflow forecasts for period to 31 December 2006 that include agreed sensitivities, the additional amounts of cashflow set aside outlined below, which reflect the effect of providing the bank guarantee for PVH’s share of the JVUK financing, and which shows a minimum appropriate level of headroom through the period.

(ii) To the extent that (i) above includes asset disposals, or borrowing is secured on PVHR assets or future income streams, credible, documentary support (either in the form of binding offers from third parties, or professional valuations from an independent third party satisfactory to SAIC) for timing and quantum of cashflows assumed to arise.

(iii) Professional valuation from an independent third party satisfactory to SAIC, together with detailed documentary support, of [Xpart] buy-back option, which has not been included in information provided by PVH to date |

| Rescue aid / bridging finance | To the extent that rescue aid / bridging finance is included in the monthly cashflow forecasts of PVHR, please supply third party evidence to support the inclusion of such finance, and detailed explanation of how refinancing of such rescue aid / bridging finance is |
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#### 1.2 JVUK financing

**Issue**

- Ability of PVHR to provide guarantee satisfactory to lending banks in order to provide committed financing for UKJV term loan of c.GBP180m

**Steps to be taken or information to be provided by PVH**

1. **Committed bank guarantee to provide PVH 25% share of UK JV finance, satisfactory to lead arranger and underwriter**

2. **PVHR revised monthly cashflow forecast (see 1.1 above)**

**Existing HBOS facilities to be made available to JVUK**

- Letters of comfort that existing finance facilities of MG Rover (including dealer floorplan and OUV / leaseplan facilities) will be made available to JVUK

#### 1.3 Redundancy plan

**Issue**

- Assuming full and proper procedures are complied with, and assuming PVHR solvency, there is a risk that there may be some employee labour tribunal claims as a result of executing the redundancy plan

**Steps to be taken or information to be provided by PVH**

- PVH to set aside a cash sum for possibly losing some labour tribunal cases, whether for unfair dismissal or otherwise, including legal and other expenses, which SAIC estimates to be c.GBP1.5m, based on a potential 40 claims
1.4 MG Rover pension schemes

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<tr>
<th>Issue</th>
<th>Steps to be taken or information to be provided by PVH</th>
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<tr>
<td>JVUK employees are also members of the existing MG Rover pension schemes, so a viable and reliable deficit recovery plan is important to SAIC, from an industrial relations perspective</td>
<td>(i) Appoint Mercer at PVH’s cost to independently review and recommend a deficit recovery plan. Mercer to have access to all working papers available to [Garvins] as well as all relevant financial information.</td>
</tr>
<tr>
<td></td>
<td>(ii) After receipt of Mercer’s deficit recovery plan, PVH to forward to SAIC a plan to generate sufficient resources to enable such plan to be implemented in a timely manner.</td>
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</tbody>
</table>

2. Other items

<table>
<thead>
<tr>
<th>Item</th>
<th>Steps to be taken or information to be provided by PVH</th>
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</thead>
<tbody>
<tr>
<td>Assignment of BMW loan to DH / PVH</td>
<td>Direct discussions between SAIC and BMW resulting in an assignment of the BMW loan to DH / PVH for a nominal consideration on execution of the transaction documents, conditional only on Completion.</td>
</tr>
<tr>
<td>New licence of Rover trademark from BMW</td>
<td>Direct discussions between SAIC and BMW resulting in the execution of the new licence from BMW for the Rover trademark on execution of the transaction documents, conditional only on Completion.</td>
</tr>
<tr>
<td>Possibility of claims from Honda re PG1 Gearbox and R45 model</td>
<td>Obtaining an independent counsel’s opinion at MG Rover’s cost to address level of risk of claim and likelihood of Honda being able to successfully obtain an injunction, as well as likely level of damages payable.</td>
</tr>
</tbody>
</table>
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Possibility of representation and warranty claims under the transaction agreements

SAIC will only want to purchase unencumbered assets

Agreement of a reasonable amount or assets set aside to address representation and warranty claims under the transaction documents

PVH to ensure that any security obtained by the UK Government in respect of any bridging finance will be released on Completion.”

**PVH’s response on the principal outstanding issues**

147. PVH and its advisors worked intensively on their reply to the 2 April 2005 letter, and a lengthy response was provided in the early evening of Sunday 3 April in the form of a letter from Mr Towers. A diary which some of the PVH team produced later in April, after MGRG had gone into administration, records, “PVH considered all matters resolved.” While, however, PVH and its advisors had done the best they could with the materials available to them, Mr Towers’ letter patently did not fully satisfy the requirements listed in Mr Zhao’s 2 April letter. For example, where Mr Zhao had asked for “credible, documentary support (either in the form of binding offers from third parties, or professional valuations from an independent third party satisfactory to SAIC) for timing and quantum of cashflows” assumed to arise from assets disposals or secured borrowing, Mr Towers offered “substantial evidence of third party support for a much higher valuation of our assets.” Again, PVH was unable to supply, as asked, a “Professional valuation from an independent third party satisfactory to SAIC ... of [Xpart] buy-back option”. Similarly, PVH could not provide the “Committed bank guarantee to provide PVH 25% share of UK JV finance, satisfactory to lead arranger and underwriter”. As to this, Mr Towers’ letter stated, “We can confirm that PVH will supply a committed bank guarantee to cover PVH’s 25% share of JV UK finance which will be available at the time JV UK is established.”

148. Further, some of the valuation information included in Mr Towers’ letter was clearly open to debate. For instance, appendices to the letter suggested that the MGTF business was worth £140 million and would be disposed of by January 2006 for £44 million; PVH was unable, however, to provide either an independent valuation or an offer in support of its figures. Again, PVH valued its interests in heritage brands (in particular, Austin, Austin Healey, Morris and Vanden Plas) at £43 million, but the figures were not referable to independent valuations or offers.

**Government consideration of a post-completion loan**

149. Mr Towers enclosed with his letter a cash flow forecast which assumed that “Bridging Finance in Progress” would provide £65 million between April and September 2005 and that PVHR would have the benefit of “Bridging Finance to be arranged” between October 2005 and September 2006 (initially to the extent of £64 million, but gradually
reducing). The “Bridging Finance in Progress” related to the facility which was being sought from the DTI. While, therefore, the DTI had referred in (say) its 17 March letter to the possibility of providing a bridging loan facility up to completion of the SAIC deal\textsuperscript{56}, PVH was now proceeding on the basis that a DTI loan would extend beyond completion.

150. This possibility was the subject of discussion in London. In a submission to the Secretary of State dated 2 April 2005, Mr Rimmington explained that an issue had arisen as to whether the DTI “could provide a further ‘bridge’ for [PVH], beyond the completion of the SAIC deal, until a commercial banking facility to provide cover for potential losses in residual PVH can be put in place”; Mr Rimmington noted that such a “bridge” might raise “difficult legal and financial issues”\textsuperscript{57}. By the following day, officials were suggesting to the Secretary of State, via advice submitted by Mr Rimmington, that she should rule out the possibility of a post-deal bridge. The submission commented:

“... Further consideration of the matter has suggested this is not a realistic option. In order to provide such a facility, we would need to be confident there was a realistic prospect of a commercial facility being obtained by residual PVH post-completion. However, Mark Russell and IDU colleagues consider it improbable that any bank would be attracted to the provision of such a facility given the substantial size of the losses in E&Y’s forecast. As SAIC have pointed out in negotiations, if a commercial lender were interested in the post-completion risk, MGR ought to be able to obtain a conditional agreement at this stage – but they say they are unable to do so.

... Mark has therefore made it very clear to MGR in Shanghai that they need to consider alternative solutions to filling the hole in the books of the residual PVH business. However this option continues to feature in their proposals to SAIC.”

151. KPMG were also doubtful about whether it would be possible to arrange a post completion commercial loan. A DTI email summarised KPMG’s views as follows on 2 April:

“[KPMG] acknowledge that it would be highly unlikely for a commercial lender to commit at this time to a facility for PVHR, when there is so much change forecast between now and then. They further acknowledge that the trading period from completion to 30 September 2005 will be relatively short, and is forecast to be loss-making and that these are not ideal conditions to try and arrange a substantial working capital facility.”

152. Nonetheless, the possibility of a post completion bridge was referred to during a meeting with the Secretary of State on 4 April. Mr Russell (who was attending by telephone) said:

\textsuperscript{56} See paragraph 112 above.
\textsuperscript{57} When giving evidence to us, Mr Russell and Mr Randell both thought that the question of a post-deal bridge had been raised for the first time on 2 April.
“... in the last few days PVH had raised the idea of an additional £65m DTI bridging loan facility to the ongoing PVH after joint venture completion, to cover the period until a commercial facility could be set up. This would cover PVH’s projected cash deficit (peaking at £60m in December 2005), and so ease SAIC concerns over PVH’s solvency. So effectively DTI was being asked to provide a facility in two tranches:

[(a)] a first tranche of up to £130m to enable MGR to reach completion of the joint venture, for which DTI’s exit route would be payment by SAIC after completion; and

[(b)] a second tranche of £65m post-completion, for which the exit route would be a replacement commercial facility.”

**DTI meeting with SAIC in China on 4 April 2005**

153. Mr Russell and Mr Randell met SAIC once more, on Monday 4 April 2005. On this occasion, President Chen noted that while PVH had provided supporting documents with regard to the value of residual assets, SAIC was “not confident on value or timings.” He also said that SAIC was not interested in itself purchasing any of the assets and that the deal could not proceed if PVH could not come up with solutions. When Mr Russell asked whether it would be possible to have a further meeting the next day, President Chen commented that “If no substantial progress, then reduced need for meeting.” Mr Randell told us that he had thought the message that was being communicated at this meeting was “substantially more downbeat than the messages that we had received on 1st April.” Mr Russell said that he “wouldn’t have been very optimistic” at the end of the meeting.

154. On the same day, Rothschild told Mr Russell and Mr Randell that President Chen “wants ‘absolute certainty’ as to solvency” and “Firm evidence of asset sales.” President Chen wrote to Mr Russell in similar vein. In a letter dated 4 April 2005, he said:

“PVH has recently provided information on its valuation of certain assets within PVHR, but at this stage we are not in a position to be confident in the value at which such transactions would take place. As a result, we are not confident in the ongoing solvency of PVHR post completion.

... Whilst SAIC is prepared to take on its fair share of the risk associated with making JVUK a successful joint venture, it must have a high level of confidence that PVHR can remain solvent post completion. SAIC believes that it is unacceptable for the risk caused by PVHR’s insolvency to be borne by JVUK. SAIC will not form a joint venture when it perceives a strong risk that JVUK may not survive as a result of PVHR insolvency.”
155. Mr Duggins described SAIC’s position as follows in an internal Ernst & Young email of 5 April:

“SAIC has stated its position clearly to PVH and DTI. The pension and redundancy issues, from a liability perspective, are manageable as long as PVH remains solvent ... UKJV financing will be achieved as long as PVH has the cash collateral, which it can only provide by worsening its insolvency risk. In summary, everything hinges around insolvency risk. SAIC will only proceed with the JV transactions if they have certainty on PVH’s insolvency risk. This will require a confirmed bank guarantee for £45m and binding offers for the sale of assets. Anything less will not be acceptable. As it was put to PVH, SAIC want to know who will buy the assets, when and for how much.

... Hard evidence of external buyers is needed, and has been asked for on the basis that the whole world knows PVH is for sale, so buyers should have [made] approaches. So far, PVH have provided no evidence of bid approaches.”

Pressure from suppliers

156. Pressure from MGRG’s suppliers became very intense around this time. Mr Millett told us:

“... from Monday, 4th April, there were increasing levels of supplier discontent because various leaks were coming through, the media were hot on the trail of reporting virtually what they wanted to report and any hint that the deal was foundering, which did come through I think around then, was causing them to do some quite terrible things in terms of stopping supply unless we paid cash on delivery, effectively.

... That had dramatically changed in two days from only a handful who had stopped supplying us who were paid cash on delivery to a number of people.”

By way of example, on 4 April 2005 one supplier sent an email to the effect that, “due to the recent press reports”, it was not prepared to ship any further product without full payment of outstanding amounts and payment for future supplies on collection. On the same day, another supplier asked for payments to be brought up to date immediately “Following the weekend press reports”. On 5 April a third supplier said that it “would require a substantial payment ... to ensure that material procurement continues” due to “the recent communications regarding the Chinese deal”.

The requirement for a direction from the Secretary of State

157. It remained Ms Bell’s position that a loan would require a direction from the Secretary of State. In a submission to the Secretary of State dated 31 March, Ms Bell judged the

58 See paragraphs 123 and 124 above as to the possibility of a direction.
prospects of repayment of a loan as “no better than 33/66 against.” On 3 April Ms Bell put the prospects of any loan being repaid at “no better than one third”. By 4 April, a draft submission had been prepared with a view to Ms Bell sending it to the Secretary of State if she decided to proceed with the loan. This concluded as follows:

“... I recognise that in the absence of written assurances from SAIC on the key criteria, this issue comes down to a judgment, against the available evidence, of whether the deal will go ahead and the loan will be repaid within six months. My judgement of the evidence is that the chances of a deal going ahead are deteriorating and, even if it were signed, I am not confident that the counter-parties would be able to repay the loan in full within 6 months. This leads me to the view that a loan facility carries disproportionate financial and legal risks for the Department.

... If you wish me to proceed with making the bridging loan facility, then you will need to provide me with a written instruction. Both Treasury and the National Audit Office will be notified of any Direction and it may prompt an investigation by the Public Accounts Committee.”

158. Although the draft submission that Ms Bell might eventually send to the Secretary of State had not yet been finalised, work was done on a draft direction for the Secretary of State, in turn, to send to Ms Bell. By 4 April, a draft had been prepared which ended:

“... As you say, this issue comes down to a judgment, against the available evidence, of whether the deal will go ahead and the loan will be repaid within six months. Based on my assessment of the reports we have received about the attitude both of the SAIC and the Chinese Government I am more sanguine about the prospects of repayment.

... I am satisfied that we have sufficient assurances that the joint ventures should go ahead and that there is a reasonable expectation of the loan being repaid within six months. I am therefore directing that a bridging loan facility of up to £130m should be provided to MG Rover under the rigorous terms I have agreed.”

(The DTI draftsman commented:

“The bit which stretches credulity most is the part saying that she is confident that the JV will go ahead – particularly in the light of the letter today.

It is however essential that she believes this in order to issue a direction – so I have simply asserted it.”)

A slightly revised draft was circulated at 5.36 pm on 5 April. This referred to a bridging loan facility of £110 million (rather than “up to £130m”) and contained a new paragraph in the following terms:
“My judgement is therefore that there is a reasonable expectation of repayment of the facility because ...

a. (further letter from SAIC)

b. (personal commitment by directors)

c “59

159. Ms Bell was not the only one to doubt the prospects of repayment. Ms Vadera told us that her view “was that [the Chinese] were not interested and that they were too embarrassed to say so”; her “opinion was the Chinese were not going to do a deal” and she thought that “that was the opinion of the Treasury and other officials, and a lot of other people.”

Events during 5 and 6 April 2005

160. The crunch came in the evening of Tuesday 5 April 2005 (UK time) or the early hours of Wednesday 6 April (Shanghai time). In chronological order (taking account of the fact that Shanghai time was seven hours ahead of UK time), the following events occurred on 5 to 6 April:

160.1. at some stage, in the words of the diary later produced by some of the PVH team, Mr Stephenson and Mr Towers “explained to Mr Russell and Mr Randell robustly how business was actually done in China.” Mr Randell told us that Mr Stephenson and Mr Towers had “expressed the view that for cultural reasons [they] would not be able to get the level of confirmation that [they] had been seeking about the prospects for the transaction.” Mr Stephenson and Mr Towers “maintained that all the indications that they had had from SAIC were entirely positive and that they believed the transaction was going very well and that what was needed was for the government to make a loan available to MG Rover and everything else would then fall into place”;

160.2. at 2.30 pm Shanghai time (7.30 am UK time) Mr Einollahi told Mr Randell that he had “a duty to present the interests of [his] clients”, but he did not “disagree with the view everyone else is taking on those cashflows” (i.e. the cash flows required by PVH to continue trading). Mr Randell took Mr Einollahi’s comment to mean that “he was being an advocate for ... the DTI to make a loan available, but actually personally shared the scepticism that the cashflows would stack up and that the loan would be repaid”;

160.3. at 5.00 pm Shanghai time (10.00 am UK time) Mr Russell told Mr Chris Brooks of Rothschild that the DTI wanted SAIC’s “agreement not to contradict our announcement”;

59 Note that point “c” was left blank on the draft direction.
160.4. at about 11.30 am UK time (6.30 pm Shanghai time) Mr Rimmington submitted advice from officials to the Secretary of State, which recommended that she “agree the basic structure and overall size of the facility we would propose should [she] conclude that a loan should be provided”. Mr Rimmington explained as follows:

“... This proposal would entail the offer of a facility with a ceiling of £110m and a final deadline for payment of end-May. Our requirements in making it available would be that by that point:

- the parties should have entirely completed the transaction, Chinese Government approval for it having been secured;
- PVH should have put in place a commercial banking facility to cover the liabilities of the residual PVH business (estimated at £65m), to take effect immediately upon completion and be available to pay off our loan;
- we would take maximum security available in respect of it (currently estimated at around £40-50m); and
- the facility would be repaid in its entirety within a maximum of six months of its being made available.”

Mr Rimmington warned of the following risks:

- given SAIC’s concerns over solvency of residual PVH, there must be a significant risk that if the parties do not reach commercial agreement sufficiently swiftly to allow Chinese Government approval and completion by end-May;
- that being the case, we would no doubt be faced with another approach from MGR for further funding in mid-May. If completion was by that stage held up only by lack of Chinese Government approval, it might be politically difficult for HMG to turn down a further request;
- delay beyond end-May would, however, increase our exposure and, as a result, doubts as to whether the loan would ultimately be repaid. If for instance there was a delay until June this would add a further £20m to the size of the loan;
- even for an end May deadline £110m may not be sufficient: KPMG suggested a ‘buffer’ of £15-20m might be needed; and
KPMG’s initial view is that it will be challenging for MGR to obtain a commercial banking facility of the scale required. The fundamental difficulty they face is the apparent lack of assets in residual PVH to provide the necessary amount of security.

... There remains of course the fundamental risk that PVH and SAIC cannot agree commercial terms because SAIC cannot get comfortable with PVH solvency”;

160.5. at 8.55 pm Shanghai time (1.55 pm UK time) Mr Russell, Mr Randell, Mr Richard Gillingwater (chief executive of the Shareholder Executive) and Mr Norris took part in a conference call lasting some 36 minutes with Mr Chris Brooks and Mr Cox of Rothschild. Mr Randell’s note of the conversation includes the following passages:

“GN [Mr Norris]: Basic proposition is that we (HMG) will take quite a lot of risk in order that SAIC and MGR will continue to negotiate. Surely SAIC can say that they will negotiate?

RG [Mr Gillingwater]: Can we put language in front of President Chen and say looking for affirmation that constructive set of negotiations towards constructive end? Want agreed language ...

GN: We are prepared to take risk to get time for discussions ...

GN: Very candidly, it would be better to make negative decision later to avoid adverse publicity ...

GN: PM and CX indicated very, very clearly that need to do the transaction. Understand all of the risks on the £65m.

⇒ need commitment from Towers that he can raise the £65m.

Combination of measures.

Evidence sufficient to enable transaction to proceed.

Best efforts; to be defined in legal documentation.

What would be consequence? At end of May.

RG: ‘We would have a tough decision to make.’”
Mr Russell thought that the idea was that the DTI would make the loan if SAIC could say that it would continue to negotiate and said that it was his understanding that there had been a decision or provisional decision at the highest level that the loan needed to be made. Mr Randell told us that the purpose of the conversation was “to explore whether SAIC would agree to a form of words which encapsulated the prospects for the transaction in a sufficiently positive light that the ... government would be able to make financing available”, but the “Rothschilds response was that they didn’t think that would be possible”;

160.6. at 2.04 pm UK time (9.04 pm Shanghai time) Mr Alty was emailed “Draft and final letter to SAIC”. The “final” version included the following:

“I believe that over the past few days we have made significant progress towards a successful resolution of the issues facing MG Rover, SAIC and Her Majesty’s Government ...

I am now in a position to confirm my Government’s willingness to extend to MG Rover a bridging loan facility of up to £110 million to the end of May 2005.”

When we spoke to Ms Bell, she agreed that it would have been difficult to draw back had SAIC said that it would continue to negotiate;

160.7. at 10.00 pm Shanghai time (3.00 pm UK time) Mr Duggins said in an email, “It is becoming clear that the DTI wants to put the money in (£110 million) and is just looking for an exchange of letters tonight”;

160.8. at about 4.00 pm UK time (11.00 pm Shanghai time) the Secretary of State telephoned Mr Towers and told him that she hoped to take a decision on the Rover issue that evening;

160.9. at 11.29 pm Shanghai time (4.29 pm UK time) Mr Duggins said in an email, “DTI have sent draft letter to SAIC hoping for [a] draft response which can be worked up to something which justifies Rescue Aid. They will get a formal response (being drafted as I type) which will re-affirm SAIC’s position of yesterday. This will be sent in about an hour. It will not justify RA [i.e. rescue aid]”; 

160.10. at 5.00 pm UK time (midnight Shanghai time) the DTI prepared a draft press release which included the following:

“The joint venture deal with SAIC is now well advanced. However it is clear that some bridging finance is necessary to support MGR’s cash flow until the outstanding commercial points can be resolved. As a consequence, the Government has agreed to provide a £110m bridging loan to help facilitate completion of the joint venture”;
at 5.20 pm UK time (12.20 am Shanghai time) a Treasury official distributed among officials the “latest draft submission” to the Chief Secretary to the Treasury. This included the following:

“... we advise that, in our view, the loan would be poor value for money, crowding out other more productive uses of DTI resources. We therefore recommend that you reject Patricia Hewitt’s request to grant Treasury consent to the loan.

If, on balance given the evidence available, you wish to support her judgement and to provide Treasury consent to the loan, we recommend that you write expressing severe misgivings about the proposal, but provide consent on the basis of the Secretary of State having satisfied herself:

- **Of the propriety of the loan, in particular that** –
  - the loan would be approved by the European Commission under EU State Aid rules,
  - she is confident that it will be repaid in full, and
  - she is confident that she will not be exposed to liability to third parties under provisions of the Insolvency Act 1986 relating to any fraudulent or wrongful trading by the company with the benefit of the loan, and

- **that the loan is a good value for money use of DTI resources ...”**

An annex to the draft submission included details of the respects in which the criteria sent to Mr Towers on 17 March 2005 had not been met;

at 1.06 am Shanghai time (6.06 pm UK time) Mr Duggins said in an internal email, “It seems the DTI is going to make [the] loan without any comfort from SAIC.” In evidence to us, Mr Cox said that there was a feeling that the Government “clearly wanted to go ahead” and that the Government was “minded to go ahead” even though SAIC had provided no comfort; in Mr Cox’s view, there was “great pressure to find a way to make this work”, though “they were very, very clear they could only do it ... in the context of EU law”;

at 1.33 am Shanghai time (6.33 pm UK time) a letter from President Chen was faxed to Mr Russell warning that SAIC continued to have a “very high level of concern in respect of the solvency of the PVH residual business ... post completion”, that even if a successful resolution of SAIC’s concerns over PVHR’s solvency could be reached “there are still other important issues on which progress would still need to be made” and that SAIC had no control, either as to timing or outcome, over Chinese Government approvals. The letter was faxed on

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60 See paragraph 112 above.
to the Treasury at 6.45 pm UK time (1.45 am Shanghai time). Ms Vadera told us that she regarded the letter as “an absolute point blank no.” However, Mr Russell told us that his understanding was that the letter did not discourage Ministers from proceeding with the loan. Mr Alty said that “the receipt of the letter ... did not cut out the possibility of the loan being given”;

160.14. at 1.41 am Shanghai time (6.41 pm UK time) Mr Duggins said in an email;

“A letter has been faxed to the DTI making it crystal clear that the decision and its consequences are for the government only, there are significant risk issues unresolved and SAIC makes no commitment as to whether or when they will be [resolved]. Furthermore SAIC can not control the Chinese government approval process ... The DTI is going to issue a press release which we will see shortly but expect it to say only that negotiations with SAIC are well advanced”;

160.15. at 7.00 pm UK time (2.00 am Shanghai time) various officials met Ms Bell “to discuss Accounting Officer issues”. In the course of the meeting, two officials put the chances of repayment at less than one in three; another said that “it was unlikely that the loan would be repaid in full but thought it was unrealistic to put a figure on the chances.” Mr Gillingwater “noted that he had been the most optimistic about repayment chances but had now revised his estimate down to less than 50/50 (1 in 2).” It was also reported that Mr Randell thought that a “1 in 3 chance of repayment was too optimistic”. Ms Bell “concluded that the likelihood of any bridging loan being repaid had moved from 1 in 3 to 1 in 4”;

160.16. at 2.01 am Shanghai time (7.01 pm UK time) Mr Duggins said in an email, “DTI draft press release just seen – overstates the likelihood of a deal happening so telecon about to happen to make it clear probability of completion is low and if [they] want to interpret that as no deal they may do so”;

160.17. at 2.30 am Shanghai time (7.30 pm UK time) Mr Stephenson and Dr Li spoke to Mr Zhao on the telephone. Dr Li told Mr Zhao that the DTI had read to them the last part of SAIC’s recent letter and that that had given the DTI the impression that SAIC did not wish to proceed. Mr Zhao said that he felt the letter was a bit too negative when he read it, but said that SAIC still needed to see confirmation either of asset disposals or that a bank would make a post-completion loan. When asked whether SAIC would complete without a second loan in place, he said: “No, we do need to see bank confirmation letter”;

160.18. at about 7.30 pm UK time (2.30 am Shanghai time) the Secretary of State met DTI officials and special advisors from the DTI, the Treasury and Number 1061;

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61 See further paragraph 173 below as to the purpose of the meeting.
160.19. at about 7.45 pm UK time (2.45 am Shanghai time) Mr Rickards, head of Asia at Rothschild, telephoned Mr Gillingwater and said that he had “difficult news.” He explained:

“... they had now seen our draft press announcement and had only just learned that their client, SAIC, did not wish to proceed with the transaction. The recent letter from SAIC was SAIC’s way of telling us that they did not wish to proceed.”

Mr Rimmington told us that “Legal advice became clearer at that point”;

160.20. at about 3.00 am Shanghai time (8.00 pm UK time) Mr Towers was told to meet Mr Russell and Mr Randell and informed that the DTI had “received the bad news that SAIC wished to withdraw”;

160.21. at about 8.30 pm UK time (3.30 am Shanghai time) Mr Gillingwater telephoned Mr Rickards back to confirm the position. Mr Rickards said that:

“... there was ‘no backtracking’. However, his client did not want to speak to MGR; it was up to the UK Government now to form a view. The letter written to us by SAIC [was] meant to convey their view.”

Mr Rickards confirmed that he “entirely understood that Towers [would] want to speak either to SAIC or possibly to Rickards, himself”;

160.22. at 3.32 am Shanghai time (8.32 pm UK time) Mr Duggins said in an email, “DTI told SAIC want to proceed but believe there is a very low [probability] of success. On that basis, DTI will not make RA [i.e. Rescue Aid] available”;

160.23. at 3.45 am Shanghai time (8.45 pm UK time) Mr Gillingwater spoke to Mr Towers, Mr Russell and Mr Randell on the telephone. He said that he had taken a call from Mr Rickards in which he had explained that Rothschild had learned that the Chinese did not want to proceed. He also said that he had called Mr Rickards back to confirm the position. In the words of Mr Randell’s note, Mr Gillingwater conveyed that:

“Chinese in their way have been trying to say they don’t wish to proceed. Rothschild knew that message lost on us and felt duty bound to call”;

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62 Mr Cox of Rothschild, although not involved himself, knew about the call and what was to be discussed prior to it taking place.
160.24. shortly after this, Dr Li telephoned Mr Zhao. A note which Mr Petrie distributed by email at 6.16 am Shanghai time (11.16 pm UK time) records as follows:

“Following receipt of this news, Ms Qu Li contacted Mr Zhao who was unaware of the situation.

Mr Zhao contacted Mr Chen who confirmed the story.

Ms Qu Li then made further enquiries as to the reason for this decision.

Apparently, ‘because of the current situation, it is felt that the project stood little chance of ... Chinese Government approval. The problem seems to be associated with a letter from the UK Government to SAIC, asking SAIC to commit to completing the Chinese Government approval process by the end of May 2005. It is also possible, but not confirmed, that the letter from the UK Government, asked SAIC to confirm that SAIC would repay the UK Government bridging facility, in the event that the project did not proceed to completion’”; and

160.25. the PVH representatives expected to meet SAIC later in the morning of 6 April and went to SAIC’s headquarters for that purpose. The meeting was, however, cancelled by SAIC.

161. It was also on 5 April 2005 that the general election was called by the Prime Minister, Mr Tony Blair.

162. At some point Mr Towers (through Dr Li) seems to have told Mr Zhao on the telephone that he and his fellow directors had already put their money in and could not now get it back. In his evidence to us, Mr Towers denied that he had done this. However, Mr Duggins referred to this, and Dr Li recalled such a conversation. In reality, neither Mr Towers nor any other director was yet committed to providing any financial contribution.

**Discussions during 6 and 7 April 2005**

163. During 6 and 7 April 2005 there were recriminations and lingering hopes. Mr Towers was concerned that the draft letter that the DTI had given SAIC the previous day was responsible for the difficulties and urged “we must now leave no stone unturned to clarify SAIC’s position following their receipt of [that] letter”. Mr Russell responded by drafting a letter to SAIC to clarify certain points; Mr Beale, at Longbridge, referred to a “general feeling ... that as long as the DTI letter is sufficiently apologetic or respectful, it will be impressive enough to encourage SAIC to come back to conversations”. Mr Russell also spoke to Mr Chris Brooks and Mr Gowlland of Rothschild, who confirmed that there was a “very low likelihood of success”; the main theme of Rothschild’s response, as Mr Randell remembered events, was that “the issue was not what had happened in the way the letter had been communicated, but ... whether this (£65 million facility could be completed so as to provide
for the solvency, the longer-term solvency of PVH.” In addition, the Prime Minister spoke to
Premier Wen of China, and attempts were made (without success) to arrange for the
Chancellor of the Exchequer to speak to Minister Ma. On 7 April Mr Towers wrote to the
Secretary of State, “I am here, on the ground with SAIC and NAC people, who are still keen
to do a deal”. On the same day there was a heated exchange between Dr Li and Mr Randell,
in which Dr Li (and perhaps others) rehearsed what they regarded as “the blunders … that
had led to this state of affairs”. All concerned were doubtless very tired.

The appointment of administrators and SAIC’s withdrawal from the negotiations

164. In reality, there was no longer any real prospect of the negotiations with SAIC being
concluded successfully. By the evening of Thursday 7 April the PVH side, faced with
overwhelming pressure from suppliers and convinced, now, that rescue aid would not be
forthcoming, accepted that MGRG could no longer continue to trade. Meeting at about
8.15 pm, MGRG’s board resolved urgently to instruct Mr Ian Powell of PwC to advise on
the “probable imminent administration of MGRG and [Powertrain] (and possibly other
subsidiary companies).” At about 10 pm the Secretary of State announced that MGRG’s
board had “decided to call in the receivers”. At a board meeting the following morning,
MGRG’s board formally concluded that an administration appointment should be made.
Powertrain was also placed in administration on the same day63.

165. In a letter dated 14 April 2005, President Chen informed the Secretary of State that SAIC
had:

“... concluded that we are not willing to acquire either the whole or parts of the
MGR or Powertrain businesses on a going concern basis out of administration, nor
are we willing to establish a UK joint venture incorporating the whole or parts of the
MGR or Powertrain businesses.”

Reasons put forward for the collapse of the negotiations

166. The PVH team felt frustrated that they were not more closely involved in the discussions
Mr Russell and Mr Randell had with SAIC and Rothschild. Mr Petrie, for example, referred
to “a kind of absence of togetherness between Mark [Russell] and Charles [Randell] and our
team.” He explained:

“… I think we kind of expected that if the DTI were sending out two relatively senior
people that they were actually – of course they were doing due diligence, for want of
a better term, as far as the DTI’s position was concerned, but they were representing
the DTI in support of a UK business seeking to do business in a foreign country. In
that mode you do kind of expect a DTI official to actually be with you and be
supportive and help you and guide you and so on, and they weren’t in that mode.

63 As noted in chapter VIII (Group structure), the following Group companies also subsequently went into
administration: MG Sport and Racing (12 April), Phoenix Venture Motors (18 April), Edwards Cars and MG Rover
Exports Limited (21 April), Phoenix Distribution (26 April), MGR (OUV) and MGR (Leaseplan) (4 May).
Maybe we kind of misread what they should have been doing, but it was certainly different to what we had expected.”

For his part, Mr Stephenson said that the “DTI in China chose to act independently of the directors of MG Rover Group and appeared to operate uncomfortably closely with SAIC’s advisers, Rothschilds, not the advisers to DH [i.e. Donghua].” Mr Stephenson further referred to the “DTI people” as “very remote and mysterious.” While, however, we can understand these feelings of frustration, it was wholly legitimate for the Government to speak direct to both Rothschild and SAIC; it had, after all, to try to assess the likelihood of SAIC concluding a deal with the Group. When giving evidence to us, Ms Bishop doubted whether “SAIC would have been as open and frank about the situation as they were had the PVH people been in on the meeting.”

167. Mr Cox expressed the view that the “deal fell apart because the solvency of a counter-party was not adequate, in very simple terms.” The deal, Mr Cox thought, might have worked if it had been possible to conclude it between six and twelve months earlier (when MGRG’s losses would not have been as high). Mr Duggins told us, “By the end, the absolutely unsolvable problem was the fact that they just could not fund their share of the joint venture finance”. Mr Duggins also said, “if they had done the deal six months earlier, I think there is a chance they would have got there.”

168. However, while it may be possible to say with the benefit of hindsight that the deal needed to be concluded, if at all, months before April 2005, we think that the Group’s directors were justified in continuing to believe that there was a real chance of the deal being completed and in trading on that basis. In fact, they were not alone in thinking that the negotiations could be brought to fruition. Mr Heis of KPMG told us:

“... until the very end it was quite clear that with the right frame of mind at SAIC, there was nothing that suggested [that the deal] couldn’t work and there was nothing that suggested that people were wasting their time.”

The proposed Government loan

169. Mr Beale told us that he was certain that the deal would have happened if the DTI had made the loan. He explained that “nobody thought that these four issues [i.e. the solvency of the PVH residual business, JVUK financing, redundancy plan and MG Rover pension scheme]

In his evidence, Mr Towers said that the “context of this bridging loan ... became completely corrupted”. He explained:

“The concept was not for SAIC to assure the DTI that there would be a final agreement ...; the concept was for the DTI to get to a point themselves through their advisers, through the work that they did, such that they believed that there was a sufficient probability of the deal proceeding and therefore a sufficient probability that the loan would be repaid and that they were supporting a process that would prove successful; not to gain from the counterparty guarantees and assurances that that would be the case but to satisfy themselves.”

This, however, assumes a dichotomy between (a) assessing SAIC’s thinking and (b) determining the probability of the deal proceeding. In reality, there was no such divide. The DTI needed to understand SAIC’s views in order to determine the probability of the deal proceeding (and, hence, the probability of repayment of the loan).
were actually the real issues that SAIC were worried about” and said that “SAIC ... were just simply waiting for the UK government to make a decision.” In his view, the four “principal outstanding issues” would have been “incredibly easy” to resolve if the DTI had made the loan. He reminded us that he, Mr Edwards, Mr Stephenson and Mr Towers had been willing to commit their own money “to back that judgment” and said that other directors of MGRG had also been prepared to put up personal money in support of the deal. Similarly, Mr Stephenson took the view that “there was a solution” – the Government loan.

170. It seems to us, however, that the DTI could not properly have made a loan. Once Mr Gillingwater had been told by Mr Rickards that SAIC did not wish to proceed with the transaction (if not before), the Secretary of State could not sensibly have concluded that there was a real prospect of a loan being repaid in full. Absent some new development, the Secretary of State could not have decided that there was a reasonable chance of the parties finalising an agreement for a “bridging loan” to bridge to. To make a loan in such circumstances could hardly have been a proper use of public funds and would (as we understand it) have been illegal under EU law.

171. There is reason to think that, but for Mr Rickards’ telephone call to Mr Gillingwater, the DTI would have proceeded to make a loan. Thus:

171.1. Ms Bell said that the Secretary of State had indicated on 5 April, and possibly slightly earlier, that she was minded to issue a direction;

171.2. Ms Hewitt acknowledged that the “political will” was there to make the loan. She said, “we wanted to make the loan if we possibly could” and “in principle ... , we wanted to make the loan”;

171.3. Mr Norris told us that during 5 April “probably we thought that this is now looking more possible”, that “there was a possible lowering of the bar” and that he “would have gone into the conversation [at the evening meeting with the Secretary of State] with a bias towards doing a deal, if at all credible and if at all possible”; 

171.4. Ms Hewitt said that Mr Norris was “very, very experienced” and that he was “very close to the Prime Minister and knew the Prime Minister’s mind". She therefore “always took him seriously”. Mr Sharp commented that “Like any departmental Secretary of State [Ms Hewitt] was very interested in the views of the Chancellor and the Prime Minister at the time”;

171.5. Ms Vadera told us that she was sure that the Secretary of State “was aware of the strategic view that [the Prime Minister and Chancellor] would take.” She also said that the Secretary of State “clearly wanted the deal to work”;

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65 See paragraph 160.18 above.
66 In evidence to us, Mr Tony Blair himself said that it would be “absolutely fair” to say of Mr Norris that he was “very close to the Prime Minister and knew the Prime Minister’s mind”.

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171.6. the events mentioned in paragraphs 160.5 and 160.13 suggest that there was an expectation, in particular on the part of Mr Norris, that the Secretary of State would authorise a loan if SAIC did no more than say that it would continue to negotiate;

171.7. when SAIC failed to give the confirmation sought, preparations for the grant of the loan continued (as illustrated, for example, by the preparation of the draft press release mentioned in paragraph 160.10 above);

171.8. Ms Hewitt said that she did not read the letter from SAIC to Mr Russell mentioned in paragraph 160.13 as saying, “it is all off”;

171.9. Mr Russell told us that “up to the point at which [he] received the call from Richard [Gillingwater], [he] had thought ministers had decided they were going to go ahead with this facility.” By the evening of the Tuesday, he said, “all of us in Shanghai ... saw that this was going to happen, thought that this was going to happen”;

171.10. as mentioned above, Mr Cox understood the Government to be “minded to go ahead” without any comfort from SAIC67;

171.11. Ms Bell agreed that it was fair to assume that a steer must have been obtained from the Treasury that it would consent to a loan, and Ms Hewitt accepted that the Treasury had been lined up to give consent to a loan if she decided to approve one;

171.12. Mr Sharp told us that “there was very real fear at the time about the political implications of a collapse of the company particularly in the run-up to or during a General Election campaign.” Mr Norris said that he was “not going to be so crass as to say the fact that there was a general election just about to happen ... was a million miles from [his] thoughts”, but denied that he was “merely interested in the political issues”; and

171.13. on 6 April 2005 the Prime Minster told Premier Wen that “The Government was willing to provide a bridging loan to MG Rover if we could be sure that SAIC would remain at the negotiating table.” He could hardly have said this unless he had known that Ms Hewitt was willing or could be persuaded to make a loan in such circumstances.

172. Had a loan been approved on the evening of 5 April, there would have been room for argument as to whether it should have been made. On the one hand, it seems to us that it should have been apparent (and was apparent to many) even before Mr Rickards telephoned Mr Gillingwater that there was relatively little chance of a deal being concluded with SAIC and, hence, of full repayment. The likelihood is therefore that, had a loan been made, a considerable amount of public money would have been lost. On the other hand, it might be

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67 See paragraph 160.12 above.
said that the consequences of MGRG collapsing were likely to be sufficiently serious to justify the risk being taken\footnote{Speaking generally about the decision whether to make a loan (rather than specifically about the position in the evening of 5 April), the then Prime Minister, Mr Tony Blair, referred to the decision as a “borderline” one. He told us that there was “no way we could authorise doing this loan if there wasn’t a realistic prospect that you ... could get a deal”, but that he would probably have taken the view that “given the consequences of failure, collapse at Rover, that if you have a chance of doing this it was worth trying to do”.}. We do not think it is for us as inspectors to express a concluded view on what was essentially a political decision, especially when no loan was in fact made.

173. In the event, the moment of decision never came. Ms Hewitt told us (and we accept) that the “crunch” meeting was to have been that at about 7.30 pm (UK time) on 5 April 2005. That, she stressed, “was the meeting in which [she] was going to make the decision and ... gather the information and have the discussion that [she] would need to come to a judgment.” She also said that she “was very clear in [her] own mind ... that [they] might get to a point where [her] view was that [they] should not make the loan, and [she] would not be prepared to make a direction because [she] would not feel able to justify it either publicly or privately.” She said, too, that she “was quite prepared to say so to the Prime Minister and the Chancellor, even though they might have wished me to arrive at a different decision.” In the circumstances, it is impossible to say with certainty what course would have been taken if Mr Rickards had not called Mr Gillingwater to tell him that SAIC did not wish to proceed with the transaction.

**Particular topics**

*Dr Li’s remuneration*

174. Dr Li was born and brought up in China. As she explained to us\footnote{Dr Li provided us with details of her career history in interview; we have not independently checked these details.}, she obtained a bachelor’s degree from a Chinese university in 1984 and then worked for Dongfeng Motor Corporation and NAC. Dr Li told us that, at that time at least, a Chinese graduate initially needed to work on the shop floor. She herself worked in a forging factory, heat treatment factories and a research and development centre. Within a few years, however, she embarked on a master’s degree in China, successfully completing that in about 1988. After graduating, Dr Li worked for a couple of years for China’s National Automotive Industry Corporation (“NAIC”), an organisation which evaluated and recommended inter-company collaborations. Dr Li became the director of one of the sections of the NAIC’s international cooperation department, a department which had some 20 to 25 people in it. In that capacity, Dr Li was concerned with general cooperation affairs and involved with ventures which companies such as Dunlop Industrial Products (Pty) Limited (“BTR Dunlop”), Tokyo-Toyota Motor Corporation (“Toyota”) and Volkswagen were undertaking or contemplating. In the middle of 1990, Dr Li came to the UK and began studying for a doctorate at Leeds University; she was awarded a Ph.D. in 1996 for a thesis concerned with metallurgy. While working on her thesis, Dr Li also (and increasingly) spent time on business. At first, she would help NAIC when Chinese delegations visited the United Kingdom. That work gradually diminished and NAIC was anyway dissolved after a time. By then, however, Dr Li was working with the RDS group of companies. Although the ultimate parent is incorporated in Bermuda, the
RDS group included a number of British companies. Dr Li was involved with two subsidiaries, RDS International Projects Limited (a company set up to handle Chinese business) and RDS Automotive Interiors Limited. Dr Li was a director of both these companies (in the case of RDS International Projects Limited between 1 January 1995 and 31 March 2004 and in the case of RDS Automotive Interiors Limited from 1 May 2003 until the company went into administration in May 2005). Dr Li also held one of RDS Automotive Interiors Limited’s three issued shares.

175. We were given somewhat divergent accounts of how Dr Li came to be recruited by PVH. Dr Li herself said that in November or December (of 2003), Mr Riley, whom she already knew, asked her to meet Mr Howe and the latter subsequently arranged a meeting with other directors of PVH. In similar vein, Mr Stephenson stated that Mr Howe knew Dr Li well and recommended her “royally”. In contrast, Mr Howe told us that he did not know Dr Li at all until after she had already been engaged as a consultant. For his part, Mr Towers said that Dr Li was recommended by Mr Brian Miles, who was running RDS; as Mr Towers recounted events, the first introduction to Dr Li’s skills and capabilities came from Mr Miles, following which Dr Li was invited to come to Longbridge for a discussion.

176. On 9 January 2004, PVH and Dr Li entered into a written contract. The contract, which was drafted by the Group’s legal department, provided for Dr Li to be retained on a full-time basis to provide consultancy services in connection with potential business collaborations and other opportunities with Chinese companies. Dr Li was to have the use of a car and to be paid a retainer of £1,000 per week plus £1,000 a day for each day Dr Li supported overseas negotiations and £750 a day for each day she supported negotiations in the UK. The agreement stated, moreover, that the parties agreed “to the principle of a reasonable success fee the details of which shall be agreed by the parties on a case by case basis.” The arrangement was to continue until 26 February 2004 in the first instance, but the parties were to meet to discuss whether to extend the agreement and, if so, on what terms. The contract was signed on behalf of PVH by Mr Stephenson.

177. Two of PVH’s directors, Mr Edwards and Mr Howe, appear to have had no involvement in the negotiation of the contract between PVH and Dr Li. Mr Beale told us that he was probably responsible for negotiating the contract. In contrast, Mr Stephenson said that it was he who negotiated the contract, although he suspected that Mr Beale and Mr Towers were aware of it. Mr Towers stated that Dr Li’s first meeting was with himself and Mr Beale, that thereafter Mr Beale took over the negotiations but kept him informed, that he and Mr Beale decided what the terms of the contract should be or (elsewhere in his evidence) that the terms of Dr Li’s appointment were debated between him, Mr Beale and Mr Stephenson. While, however, Dr Li was clear that she had spoken to Mr Beale and Mr Stephenson, she was far more equivocal about Mr Towers’ role, saying variously that she thought she had negotiated with Mr Towers, that Mr Towers had “possibly” been present at a meeting to discuss her appointment and terms, that the directors she remembered were Mr Beale and Mr Stephenson and that she could not remember Mr Towers “precisely” at the first meeting. On balance, it is our view that Mr Towers exaggerated his own role in the negotiations and minimised that of Mr Stephenson. In fact, the likelihood is that Mr Towers did not meet Dr Li until after the contract had been concluded and that the contract was negotiated on
behal of PVH by Mr Beale and Mr Stephenson. Mr Towers’ evidence on this aspect was unconvincing and derived little support from the evidence of other witnesses. It seems, too, that at this period Mr Towers was leaving the day-to-day affairs of PVH to Mr Beale and Mr Stephenson.

178. In the event, although it was provided that the agreement between PVH and Dr Li was to last only until 26 February 2004, it in fact continued until the appointment of administrators in April 2005. In total, in respect of the period between 1 January 2004 and 8 April 2005 (just over 15 months) PVH paid China Ventures Limited (“CVL”), a company incorporated in England and Wales in December 2003 of which Dr Li was throughout the sole shareholder and director, £352,794 plus £23,976 in respect of expenses (in each case inclusive of VAT) under the terms of the January 2004 agreement. Over the same period, CVL was also paid by PVH sums totalling £29,001 for services provided and expenses incurred by Mr Tim Yuan and Mr Alex Camron.

179. In the course of 2004, an intimate relationship arose between Dr Li and Mr Stephenson. When giving evidence, Dr Li and Mr Stephenson were inclined to play down this relationship. Dr Li maintained that it was wrong to speak of a “personal relationship” at all; according to her, there was intimacy on an “intermittent occasional” basis over maybe “a couple of months” towards the end of the SAIC negotiations but this had come to an end by March 2005. Mr Beale also suggested that the relationship had been short; he said that he was aware that the relationship lasted “a couple of weeks”.

180. In contrast, Mr Stephenson told us that the relationship “was started in the early period of 2004 and was dead and buried ... probably ... towards the end of that year”. That the relationship existed by the spring of 2004 is confirmed by evidence indicating that Mr Stephenson informed Mr Beale of it at that stage. Both Mr Stephenson and Mr Beale told us of this conversation. Mr Stephenson said that the conversation was “way before” September 2004. Likewise, Mr Beale said that it was his recollection that the conversation “was in the early days of our relationship with Qu rather than the later days of our relationship with Qu.” He also recalled that the conversation took place in a hotel room in, probably, Hong Kong or Shanghai and that he stopped travelling to the Far East in the first half of 2004. Mr Cowburn thought that Mr Beale “stopped travelling to an extent at the end of March 2004”, suggesting that Mr Stephenson must have told Mr Beale of his relationship by no later than March 2004.

181. Mr Stephenson told us that that it was “difficult to say” whether the relationship was continuing in September 2004. However, several pieces of evidence indicate that it was. As mentioned above, Dr Li herself dated the relationship to the latter stages of the SAIC negotiations. Ms Lewis said that when she was in China in the early part of 2005 there was “lots of speculation” about the relationship between Dr Li and Mr Stephenson. Further,
when Mr Petrie went to Shanghai in March 2005\textsuperscript{71}, he surmised from the way in which Dr Li and Mr Stephenson behaved together that there was a relationship between the two.

182. The evidence suggests, too, that, despite Dr Li’s rejection of the expression, there was what would commonly be regarded as a “personal relationship” between her and Mr Stephenson. Mr Stephenson himself spoke of a “close relationship”. It is, perhaps, also noteworthy that the relationship was such that MG Rover engineers observed the closeness of the two on a trip to China in, probably, the second half of 2004.

183. It seems, however, that Mr Beale was the only director whom Mr Stephenson told of his relationship with Dr Li. Mr Stephenson said in interview that he did not believe that any other director of PVH or MGRG was aware of the relationship. In fact, Mr Millett was told by Mr Welford Winton that Mr Stephenson and Dr Li had been seen to be close on a plane and, as mentioned above, Mr Petrie guessed that there was a relationship when in China in April 2005\textsuperscript{72}. However, Mr Edwards, Mr Howe and Mr Towers all confirmed that they were unaware of the relationship. Ms Ruston and Mr Cowburn, too, knew nothing of the relationship until after the appointment of administrators.

184. In September 2004, SAIC paid £37 million for intellectual property rights relating to the Rover 75, Powertrain products and “L” series engines\textsuperscript{73}. This triggered the payment on 16 September 2004 of sums totalling £740,000, representing two per cent of the £37 million, to a Singaporean account with UBS in the name of China Ventures Industrial Limited (“CVIL”). CVIL, a company associated with Dr Li which was incorporated in the British Virgin Islands on 29 June 2004, had rendered invoices to MGRG and Powertrain for respectively £400,000 and £340,000. Both sums were paid out of MGRG’s treasury account.

185. A “manual payment request” was completed in respect of each payment. Both requests were dated 15 September 2004, were signed by Mr Stephenson by way of authorisation and were countersigned by Mr Phil Sutton, MGRG finance controller working on business planning and analysis, to confirm “finance concurrence”. Mr Millett’s recollection was that he was himself on holiday at the time, but that before going away Mr Stephenson had told him that Dr Li would be entitled to a success fee amounting to two per cent of the £37 million, that he had an agreement that the money for Dr Li would be paid extremely promptly and that he therefore wanted a fast turnaround of the paperwork. Mr Stephenson himself accepted that he had probably told Mr Millett that the payments had been triggered.

186. A number of witnesses gave evidence about how it had been agreed that Dr Li should have a two per cent success fee. Mr Beale told us that Dr Li indicated at a very early stage, before the agreement of January 2004 was entered into, that she “would want a success fee as and when something became successful.” Mr Beale thought that he had discussed the success fee with Mr Stephenson and that the fee proved to be more reasonable than they had perhaps expected. He said that they “must have all got comfortable with what the amount of the

\textsuperscript{71} See paragraph 141 above.

\textsuperscript{72} See paragraph 181 above.

\textsuperscript{73} See paragraph 31 above.
success fee would be” at some point between January and June of 2004. In contrast, Mr Stephenson thought that Dr Li’s success fees had been agreed long before September 2004 between himself and Dr Li and that others (probably Mr Beale, Mr Towers and Mr Howe) had known of them; according to Mr Stephenson an important point was that the Group could “step away from [the contract]”, “at any time”. Mr Stephenson said that Dr Li had indicated that between three and five per cent would be acceptable as a success fee, that that had not been acceptable to the PVH side and that a fee of two per cent had ultimately been agreed.

187. On 13 January 2005, MGRG entered into a written consultancy agreement with CVIL (erroneously called “China Venture Holdings Limited” rather than “China Ventures Industrial Limited” in the agreement). The agreement provided for the engagement by MGRG of CVIL “to provide consultancy services to [MGRG] relating to setting up of a joint venture company in China and the UK with a Chinese collaborative partner.” The agreement was to commence on 13 January and to continue until terminated by either party giving to the other not less than seven days’ notice. With regard to payment, the agreement provided as follows:

“[MGRG] shall pay [CVIL] a Fee only on the occasion of the receipt by [MGRG] of payments made to it by a Chinese company as part of the establishment of a Chinese joint venture agreement. [CVIL] shall be entitled to receive 2% of the net amount received by [MGRG] in this manner and this amount shall be paid to [CVIL] forthwith on receipt by [MGRG] of [CVIL’s] invoice.”

The agreement further provided that CVIL was to be “entitled to benefit from shareholder participation in some or all of the newly [established] companies arising out of the Chinese joint venture arrangement”. The agreement was signed on behalf of MGRG by Mr Stephenson.

188. The consultancy agreement with MGRG was drafted by Ms Ruston on 12 January 2005. Ms Ruston told us that she had taken instructions on the agreement from Mr Beale and Mr Stephenson with, she thought, Mr Towers also in the room. In contrast, Mr Beale said that he had no recollection of providing instructions for the preparation of the agreement and was not sure that he was aware of the agreement at the time. Mr Stephenson said that he was not quite sure who raised the document and Mr Towers told us that he was not aware of the contract itself but he believed there to be an arrangement in place to the effect of what was recorded in the document.

189. Mr Stephenson suggested that that the contract between MGRG and CVIL had been prepared by the time the £740,000 was paid in September 2004. He thought that Ms Ruston or someone else had dug the document out and dated it in January 2005. That hypothesis cannot, however, be reconciled with other evidence, in particular the fact that computer records demonstrate that the contract was not drafted until January 2005.
190. On the day after the consultancy agreement with MGRG was signed, CVIL rendered an invoice to the company for £600,000 as the “Success Fee ... for the completion of R25IPR transfer to SAIC”. That same day, 14 January 2005, a “manual payment request” was completed to authorise the payment of the £600,000. Mr Young signed the request by way of authorisation and Mr Millett signed to confirm “finance concurrence”. The £600,000 was paid to CVIL’s account with UBS AG (“UBS”) in Singapore from MGRG’s treasury account on 17 January.

191. Mr Millett’s recollection was that he had been asked to pay the £600,000 by Mr Stephenson. He believed that, before signing the payment request, he would have asked Ms Ruston to confirm that the money was due. Ms Ruston’s recollection was that Mr Millett might have checked with her to see whether the assignment of the IPR had been completed.

192. Several witnesses told us that there was a possibility that Dr Li would become a shareholder in PVH. Mr Beale said that each of the four existing D shareholders would have given her part of his shareholding. Mr Stephenson also attested to the suggestion. On the other hand, Mr Edwards, Mr Howe and Mr Petrie said that they were unaware of such a suggestion.

193. Three main issues appear to us to arise from the Group’s dealings with Dr Li. First, were the arrangements with, and payments to, her companies authorised in an appropriate manner within the Group? Second, should the Group have paid or agreed to pay sums as large as those which it in fact paid or agreed to pay? Third, did any director of any company in the Group benefit or stand to benefit from the payments to Dr Li’s companies?

194. With respect to the first issue, Mr Edwards told us that he had no knowledge of the financial arrangements between PVH/MGRG and Dr Li and her companies and Mr Stephenson agreed that this was possible. Mr Stephenson also said that it was probably the case that most of the directors of MGRG and Powertrain did not know of MGRG’s contract with CVIL or the payments to it. Mr Howe told us that he knew that Dr Li was to receive a fee if a deal were secured, but that he was not given any understanding of the scale of the payments and was unaware of the payments made in September 2004 and January 2005. Mr Petrie, too, had no knowledge of what Dr Li was being paid, of the consultancy agreement between MGRG and CVIL or of that agreement being considered from a board point of view; had he been aware of the £600,000 payment made in January 2005, he “would have been asking all sorts of questions”.

195. Mr Stephenson said that he did not think he had ever worked in a company where consultants’ fees of this type were discussed by all the board members. Mr Howe said that Messrs Beale, Edwards, Stephenson and Towers “did own the company” and would not have “felt the need to get [his] sanction to hire an employee.” Mr Millett said that it was not part of his job “to negotiate a consultant’s fees and arrangements when that was done with Peter Beale and Nick Stephenson, presumably.”

196. Mr Beale informed us that, when he was told of the relationship with Dr Li, Mr Stephenson said that if he (Mr Beale) ever felt that Mr Stephenson’s relationship with Dr Li was affecting his decisions, her decisions or the business generally, he “shouldn’t be shy to point
that out”. Likewise, Mr Stephenson said that he had informed Mr Beale of his relationship with Dr Li to ensure that there was an independent view of his business judgment.

197. Our own view is that the way in which the agreement and payment of the two per cent fees were authorised was thoroughly unsatisfactory. Mr Stephenson was the person principally responsible for them (instigating the payment of the £740,000 in September 2004\textsuperscript{74}, playing at least a central role in the agreement of the two per cent figure\textsuperscript{75}, giving instructions in respect of the consultancy agreement with MGRG\textsuperscript{76} and signing that agreement on MGRG’s behalf\textsuperscript{77}) even though he had a personal relationship with Dr Li. Most of the other directors of the companies paying the fees (viz. MGRG and Powertrain) were not consulted, and only one other MGRG director (namely, Mr Beale) had been told by Mr Stephenson of his relationship with Dr Li.

198. With regard to the second issue, Mr Beale maintained that Dr Li’s services were worth what was paid for them and that he would have “expected somebody similar to be paid similar amounts of money”. On the other hand, Mr Beale also said that he had probably known very little about what levels of remuneration Dr Li had received in the past, that there was no attempt to find out what the market rate was for services such as those Dr Li provided and that no one looked around to see what other consultants were available. Further, while Mr Beale apparently understood Dr Li to be a “very wealthy lady”, she was not in fact especially wealthy at the time. Mr Stephenson, too, did not know what Dr Li had been paid in the past and did not claim to have checked on what the going rate was for services such as hers; he commented that they “had lost a lot of time to save the company and [he] was certainly prepared to invest in the right people to achieve that.”

199. Mr Petrie told us that, had he known of the success fee arrangement for which the consultancy agreement between MGRG and CVIL provided, he would have thought it “extraordinary”. He explained that at the time he was under the misapprehension that Dr Li was merely an interpreter, but said that he would have considered the arrangement to be “extraordinary” even if he had known that Dr Li’s role went beyond interpreting; the arrangement would still have been “completely out of proportion to the rest of the fee and salary structure within the company.” Mr Millett said that he thought that “the level of consultancy fee, success fee, was way too high.” He explained that, if he had been asked in September 2004 about whether Dr Li should have a two per cent success fee:

“... I could not have commented on [Dr Li’s] value to the deal because I wasn’t there, it was all done in China. I would have remarked that I thought 2 per cent of 200 million, which ultimately was going to be 268 million, was a huge amount of money for a role that was, you know, at best, supporting Nick and others in doing the negotiations. If I had been asked that question much later on, when I have seen Qu Li back in England in the late part of 2004 and 2005, I would have questioned whether she was worth 2 per cent undoubtedly ... If I had known she was being paid

\textsuperscript{74} See paragraphs 184 and 185 above.
\textsuperscript{75} See paragraph 186 above.
\textsuperscript{76} See paragraph 188 above.
\textsuperscript{77} See paragraph 187 above.
Ms Lewis told us that the view of the Eversheds team was “pretty much that apart from translation [Dr Li] didn’t seem to add much” and that Ms Ruston had told her that the Group was not getting value for money.

200. Our own view is that the sums which the Group paid, and for the payment of which the consultancy agreement with MGRG provided, were, in the aggregate, much too high. In total, companies associated with Dr Li were paid (excluding reimbursement of expenses and payments made for the services of Mr Yuan and Mr Camron) £1,692,794 for Dr Li’s services over a period of some 15 months. Moreover, the MGRG consultancy agreement meant that CVIL would have received considerably more money had the negotiations with SAIC ultimately come to fruition. Accepting (as we do) that Dr Li had knowledge and skills of potential value in those negotiations and also that she worked hard, we still take the view that the two per cent fees, in particular, were plainly excessive. Dr Li suggested to us that she would not have agreed to anything less. Were that right, it seems to us that the Group should, if necessary, have sought assistance elsewhere. However, we do not accept that Dr Li would in fact have refused to work for the Group without the two per cent fees. It is to be noted that Dr Li had not previously received remuneration on the scale of that she received from the Group. In the years before 2004, Dr Li derived all or most of her remuneration from RDS International Projects Limited and RDS Automotive Interiors Limited. The former company is recorded in its financial statements as having paid total directors’ remuneration of £122,807 in 2000-2001, £124,065 in 2001-2002, £79,962 in 2002-2003 and £81,500 in 2003-2004; much at least of this money will have been paid to Dr Li, who told us that she had had “a retainer, or a fixed ... annual fee” of £70,000. RDS Automotive Interiors Limited’s financial statements for the period from 1 May to 30 November 2003 show it to have purchased services to the value of £50,000 from CVIL. Dr Li told us that she had, in addition, received a payment of $339,000 in 2003 (“calculated”, she said, “on 20 per cent of the profit of [investment] made and the sales”). Even if all these sums are added together, they do not approach the amounts the Group paid in 2004-2005.

201. As for the third issue, we found no significant evidence that any director of any company in the Group benefited or stood to benefit from the payments to Dr Li’s companies.

**Briefing the press**

202. On Friday 1 April 2005 the DTI special advisors’ office sent Mr Alty and Ms Vickie Sheriff, then the DTI’s chief press officer, an email reading as follows:

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78 As to which, see paragraph 178 above.
79 I.e. the sum of £352,794 (paragraph 178 above), £740,000 (paragraph 184 above) and £600,000 (paragraph 190 above).
“We understand that there will be extensive coverage of the MGR situation over the weekend. We suggest that these lines are used by DTI press office.

They represent a more open approach that explains what we are actually doing to support the deal, principally because of what is going to be said.

We would not want to offer any further comment beyond these lines, particularly in terms of the size of any potential bridging loan facility, the terms under which it could be offered and details of the contingency planning scenarios and work.”

There followed the “lines” which the press office was to use. These were in the following terms:

“Throughout this process, the Government has done all it can to help support the joint venture between MG Rover and SAIC. A team of DTI officials is in China this weekend holding discussions with both SAIC and with the Chinese Government.

If there is the prospect of a commercial deal being done, both MG Rover and SAIC are aware that the Government would consider the option of providing a bridging loan facility to that deal. If it were to be offered, any potential bridging loan facility would be provided under strict criteria to ensure the proper use of taxpayers’ money and would of course be fully repayable.

This is, however, a commercial deal between the two companies and the offer of a bridging loan facility would not necessarily guarantee its success. The Government is therefore also considering a package of immediate support and financial assistance for the workers, their families and communities affected in case that happens.”

203. Mr Alty told us that he understood the first sentence of this email (“We understand that there will be extensive coverage of the MGR situation over the weekend”) to refer to the fact that “there would be some briefing of the government’s position … leading to coverage.” He said that he could not be absolutely sure, but that his “best understanding” was that the briefing was done by one of the DTI’s special advisors and that his “understanding was that this reflected discussions that ministers had had with special advisors”, though he warned that his information in this respect was “rather second-hand.” In similar vein, Mr Rimmington (to whom the 1 April email was copied) told us that the email alerted him to the fact that there would be some briefings by the special advisors’ office.
204. Also on 1 April 2005 Mr Cox sent Mr Chris Brooks (also of Rothschild) an email stating:

“DTI is briefing widely three things:

- £100m rescue aid – bridging loan
- Fab four have to put in personal money
- Fall back plan of retraining, admin and find a buyer if all falls apart

There will be a lot of coverage in the papers tomorrow.”

205. In the event, there was extensive press coverage of MG Rover on Saturday 2 April 2005 (as Mr Cox had predicted) and Sunday 3 April. Moreover, newspaper articles referred to the three points on which Mr Cox had said that the DTI was briefing. By way of example, an article in the Times included the following passages:

“Ministers have offered MG Rover a [£]100 million ‘bridging loan’ in a last-ditch attempt to secure a rescue deal with a Chinese car manufacturer ...

Ministers will also ask MG Rover directors ... to contribute ‘several million pounds’ of their own money to the [£]100 million loan in order to share the risk with the taxpayer.

... There are fears that the deal will not go ahead, and Department of Trade and Industry officials are also understood to be discussing how best to help the Longbridge workforce if the company is put into administration.”

206. At this stage, there were two special advisors at the DTI, Mr Jim Godfrey and Mr Sharp. The former, Mr Godfrey, was predominantly a media and press relations special advisor, and he accepted that, were a DTI special advisor to have briefed the press, he would probably have been the one who did so. He was, however, reluctant to accept that he could have sought to put out messages going beyond the “lines” given to the press office. When asked whether there were “occasions on which, not as a result of getting into a dialogue with the journalist but deliberately, [he] would set out to put out into the press messages that were not part of the agreed lines”, he initially denied it, with the caveat that he might have been responsible for answering questions “that would come to us which were in relation to how this was affecting the Labour Party as a political party and MPs and that sort of thing”. However, he later confirmed that there might be occasions when he would have a steering position that was not reflected in agreed “lines” for the press office, although he insisted that the “vast majority” of any such briefing was “reactive” and questioned whether there was ever an occasion when he was trying to get over a steering position that was not included in
the press office “lines”. We sometimes had to ask Mr Godfrey substantially the same question a number of times, and his answers were not always clear or consistent.\(^{80}\)

207. We also spoke to Mr Norris about press briefings. When we asked him how far he was responsible for what the press was told in relation to MG Rover, he said, “I don’t do press relations.” He went on to tell us that he did not recall having any say in what DTI special advisors told the press, that he was “not a communications person”, that he was “not involved in the crafting of soundbytes and the briefing of journalists”, that he had no knowledge of the press briefings of which Mr Alty told us\(^{81}\), that he did not know whether special advisors were given a wider remit than departmental press offices (though he noted that it was “certainly said that some special advisors brief in that way on behalf of their ministers”), and that he did not know where the newspaper stories of 2 to 3 April 2005, or 5 April\(^{82}\), were derived from. “What I would contribute to”, he said, “is a discussion of, what is the Government’s overall narrative, ie, when we were thinking about were there to have been a deal, I would have certainly contributed to discussions in which we said, ‘We are doing this deal because of X, Y and Z’.”

208. Subsequent, however, to Mr Norris’ interview, the Cabinet Office located a minute composed by Mr Norris on 1 April 2005 to which he attached “the note I have written for a briefing for tomorrow’s (Saturday) newspapers.” The note included the following passages:

“Patricia Hewitt, with the backing of the PM and Chancellor, has sent a team of top DTI officials to Shanghai this weekend in a bid to speed progress on completing the proposed link up of MG Rover and SAIC. The move reflects Ministers frustration at the lack of progress in finalizing the proposed joint venture. The Chinese and MG have been talking for months. Everyone keeps saying they want a deal, but it is all progressing at a snail’s pace.

... DTI officials will confirm the government’s willingness to provide MG with a ‘bridging loan’ – understood to be over £100 million – to tide the company over for the next few months ...

... Ministers have made it clear that MG directors ... should share some of this risk and make a personal contribution (of several million pounds) to the bridging loan.

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\(^{80}\) Representations made to us on Mr Godfrey’s behalf acknowledge that “in places, his evidence, as recorded in the transcript, is unclear, inconsistent and confusing” and that he “had often to be asked the same question many times by the Inspectors before giving an answer to the question”. The representations go on to note that Mr Godfrey’s “professional skills and experience do not equip him well to listen to carefully phrased questions and to give short precise answers” and that he was called to give evidence at very short notice, with the result that “those advising the Government did not have an opportunity to brief him in detail about the ‘do’s and don’ts of giving evidence’ and that “he had no time to read the full materials provided to him” and “was relying entirely on memory to recall events relevant to detailed questions which occurred nearly three years before”. While these matters (especially the last) may help to explain the way in which Mr Godfrey gave his evidence, we do not think that they provide by any means a complete justification.

\(^{81}\) See paragraph 203 above.

\(^{82}\) As to which, see paragraph 216 below.
The Chinese walking away is, regrettably, a possibility ... Industry minister Jacqui Smith has been leading the work on contingency plans to help the Longbridge workforce, the supply chain and local economy, should the worst happen and the MGR goes into administration.”

It is to be observed that the note contained more information than the “lines” given to the press office as regards, among other things, “the size of any potential bridging loan facility” (which the note said was “understood to be over £100 million”) and “the terms under which it could be offered” (in that the note said that directors would have to “make a personal contribution (of several million pounds) to the bridging loan”), on each of which Mr Alty and Ms Sheriff had been told that “further comment beyond these lines” would not be wanted.83

209. Following the discovery of the minute and note mentioned in the previous paragraph, Mr Norris told us:

“...I did draft a ‘narrative’ that was used by press offices. My recollection, prompted by seeing this document is that, very exceptionally, I ended up extensively rewriting something that had been drafted and was not very good. I am sorry that my original recollection of this was mistaken.”

210. When we asked the former Prime Minister, Mr Blair, about the attachment of the note “for tomorrow’s (Saturday) newspapers”, he confirmed that this would not have caused him to be surprised because it was the sort of thing that he would have expected to happen; he also observed, “it wouldn’t surprise me that Geoffrey [Norris] was quite involved in this.” With regard to the evidence that it was agreed on 24 February 2005 that Mr Norris was to be “closely involved” in a “communications strategy”84, Mr Blair said that “if there’s an issue as sensitive as this ... you’d expect Geoffrey [Norris] to be involved” in a “communications strategy” (which he agreed would connote what information is or is not given to the press), though he doubted whether Mr Norris would be talking to the press himself; “what he’s doing”, Mr Blair said, is “sort of shaping this”. As Mr Norris pointed out in representations he made to us, Mr Blair did not say that Mr Norris’ role was “akin to special advisors within No. 10 who are specifically employed to work in the Press Office on press relations, media and communications”.

211. Some of the press articles from the weekend of 2 to 3 April 2005 used wording taken directly from Mr Norris’ note85. For instance, the Birmingham Post referred to “Ministers’ frustration” over “lack of progress finalising an agreement”. The Guardian and the Sunday Mercury both referred to the “snail’s pace” of the talks. Several newspapers wrote of the Group’s directors being required to contribute “several million pounds” to share the risk.

83 See the email from the special advisors’ office quoted in paragraph 202 above.
84 See paragraph 94 above.
85 As to which, see paragraph 208 above.
212. In the circumstances, it is now clear that that the weekend press was briefed on the basis of a note written by Mr Norris. Further, while we have no reason to believe that Mr Norris would speak to the press himself, we consider that his evidence to us\textsuperscript{86} downplayed his role in relation to press strategy. Taken together, the matters mentioned in paragraphs 73 and 94 above, Mr Norris’ drafting of the note for the weekend press and the evidence we were given by Mr Blair suggest that it was not unusual for Mr Norris to make a significant contribution to decisions as to what the press should be told and, in doing so, to go beyond merely expressing views on “the Government’s overall narrative” as to the reasons for the Government’s decisions on a particular issue. It seems to us, moreover, that Mr Norris would have been likely to remember writing the note for the weekend press had that represented a radical departure from his normal role.

213. By Sunday 3 April 2005, it was being reported that Ms Hewitt was planning to “override” Ms Bell. The Sunday Telegraph reported:

“PATRICIA HEWITT, the trade and industry secretary, is planning to override the views of her most senior official by providing a £100m bridging loan to MG Rover. Catherine Bell, the acting permanent secretary at the Department of Trade and Industry, has told Ms Hewitt that the loan would deprive the DTI of much-needed resources. ‘Bell has made her views completely clear to the secretary of state, that she cannot recommend making the loan,’ said an official. ‘The help for Rover will prevent us from doing more valuable things. The decision to do it is a political one; the economic arguments don’t stack up’.

... officials believe that if the deal with SAIC were to collapse, the Government would lose around £80m of the £100m. ‘The risk of big losses on the loan is too great,’ said an official, ‘We really should not be doing this."

On the next day, the Sun said:

“TRADE Secretary Patricia Hewitt was caught up in a cash-for-cars row last night.

She has offered a £100 million loan to stop the collapse of MG Rover – and save 6,000 jobs.

But her top civil servant is REFUSING to back the deal.”

214. Such articles must have been based on information from one of the relatively small number of people who were aware that a loan would be likely to require a direction from the Secretary of State. However, we are unable to identify the source. We do not believe that any of the officials to whom we spoke was responsible for the leak. In this instance, however, we also doubt whether any of the special advisors provided the press with information. Mr Godfrey told us that the Sunday Telegraph article was one that “we found

\textsuperscript{86} As to which, see paragraph 207 above.
deeply infuriating” and that he “wouldn’t have wanted to get into any of this kind of detail because it was such a sensitive issue”. Nor do we believe that Ms Hewitt blessed any press briefing in this respect. She herself told us that she was sure that she had not authorised the disclosure of this information. Moreover, it must have been on this occasion that the Secretary of State telephoned Ms Vadera and said (as Ms Vadera remembers events), “I’m calling you because actually I’m calling everybody and I’m telling you that this is not an acceptable – you know and she kind of ran through a riot act: do you know anything about it?”

215. Monday 4 April’s newspapers brought stories referring to the work being undertaken by Ernst & Young, Deloitte and KPMG. The Times, for example, reported that a “confidential Ernst & Young report commissioned by the Shanghai Automotive Industry Corporation ... concluded that MG Rover’s parent company would be insolvent by the end of last week” and that reports had also been commissioned from Deloitte and KPMG. While, however, Ernst & Young suspected at the time that information about their report had come from the DTI, it is far from clear that that was the case. The newspapers did not attribute their knowledge of Ernst & Young’s role to (say) “Whitehall sources”, “sources in Whitehall”, “UK government sources” or “a government insider” (all of which phrases were used in the weekend coverage).

216. On Tuesday 5 April various newspapers reported that the talks with SAIC had “stalled”. The word “stalled” was used by the Birmingham Post, the Daily Telegraph, the Financial Times, the Guardian, the Independent and the Times. The Daily Telegraph, the Financial Times and the Guardian all used “stalled” in relation to Government sources: the Daily Telegraph stated that “One official” had said that the talks had “stalled”, the Financial Times said that “UK government insiders had warned that the negotiations ... were stalled”, and the Guardian observed that “Whitehall sources (who, it should be said, have been spot-on so far) say the talks have stalled.” Although not linking their use of “stalled” to Government sources, the Independent reported that “DTI officials” had said that “it now appeared that PVH would remain technically insolvent, even after the provision of an emergency £100 million bridging loan from the Government” and that “UK government sources” had said that “the onus was on the four directors of MG Rover’s parent company ... to come up with guarantees to break the deadlock”, while the Times said:

“A DTI source said: ‘MG Rover’s finances are worse than either SAIC or we had thought. There still remains a question mark over its solvency even if the deal is done.”

217. There is reference to these stories in an attendance note which Halliwells prepared in respect of their visit to Longbridge on Wednesday 6 April 2005. A passage which we understand to record what Halliwells were told by Mr Beale reads as follows:

87 Ms Vadera said that Ms Hewitt had had “the courtesy at the end to say of course I’m saying this to you all but I understand you don’t talk to the press, you never have, but nevertheless I’m doing this to everybody.”
“On Monday evening the DTI had apparently decided to provide the rescue monies and PB’s understanding was that someone in the PR department for the DTI thought that there should be a sense of theatre and leaked the story that the SAIC talks had stalled. This was a three paragraph statement that journalists had read to PVH and told PB it had come from the DTI.

... The PVH camp spoke to Roger [Sharp], the political advisor to the DTI and on Monday afternoon he denied knowing anything about the leaks, but by Tuesday morning admitted to Daniel Ward that it had been a ‘cock up’ that the story ran.”

218. Mr Daniel Ward, to whom there is reference in this passage, had joined the Group as its communications director in September 2004. In some respects, his recollection of the events mentioned in the attendance note was (not unreasonably) imprecise; for example, he could not say whether he had spoken to Mr Sharp on more than one occasion or remember the detail of his discussions with Mr Sharp. He explained, however, that he had been “just furious” and that the “key thing that came out of ... this incident was the DTI actually admitted that they had leaked it.” Mr Ward thought that Mr Sharp had also admitted that “he had misjudged the impact of the leak.”

219. For his part, Mr Sharp told us that he did not recall the conversation with Mr Ward, but was not saying that it did not take place. He said, “It could have been that there was an instance where, you know, departmental briefing had gone beyond the agreed line.”

220. When we asked Mr Godfrey about the newspaper reports of Tuesday 5 April 2005, he said:

“... these briefings could well have been me but I don’t recall the specific briefings for any of these.”

He stressed that if he had done that sort of briefing, it would “only have happened as a result of conversations with other people involved in the process.” He also said, “The idea that I would be in any way in any briefing that Patricia [Hewitt] wasn’t already aware of is wrong.” In contrast, Ms Hewitt told us that she had not authorised anyone to put out the Tuesday story.

221. It seems to us that a Government source must have been responsible for briefing the press that the talks with SAIC had “stalled”. The person briefing the press was probably Mr Godfrey, but the briefings may well have been endorsed by someone else, though probably not, we accept, by Ms Hewitt. We do not think that officials are likely to have been responsible for these briefings. A comment made by Mr Ward is apposite: “the civil servants at the DTI are a very straightforward, honest bunch and they hated the leaks as much as anybody and they were as embarrassed by their leaks as anybody”.

88 As to whom, see paragraph 206 above.
222. In the course of his evidence to us, Mr Beale said, “the press coverage basically stopped our company trading eventually.” In our view, MGRG would in fact have had to cease trading soon even without the press coverage. There was, though, an obvious danger that press briefings which referred to the talks having “stalled” would aggravate MGRG’s problems with its suppliers – as indeed they probably did. Mr Beale told us:

“Our suppliers reacted okay-ish to this on the Monday but during the course of the Monday and by Tuesday our suppliers had basically stopped the company from trading because of these adverse press reports that were just coming.”

In her evidence, Ms Hewitt said that she could see that a story that talks had broken down “would have been very destabilising to suppliers.” On 7 April, Mr Shine reported to Mr Beale:

“Following the deluge of press reports on Tuesday, indicating that negotiations with SAIC had stalled and that our financial situation was worse than expected, we experience an influx of demands from suppliers requesting payment of outstanding debts before they would resume supply of production material.”

While, therefore, we have no doubt that MGRG would, in the event, have gone into administration in April 2005 with or without the press reports of the period, we consider that telling the press, without consulting the Group, that the talks with SAIC had “stalled” was irresponsible.

223. Although the note drafted by Mr Norris for the Saturday newspapers contained passages which might have been thought capable of causing concern to suppliers (referring, as it did, to the need “to tide the company over”, to the “possibility” of the Chinese “walking away” and to what would be done “should the worst happen and ... MGR goes into administration”), it was far less likely to cause difficulties for MGRG. Further, it was argued as follows in representations made to us on behalf of the Government:

“MGRG had been briefing the press in terms that were seriously misleading in circumstances where HMG was closely involved (to the knowledge of the public) in negotiations with the Chinese. MGRG’s actions were materially prejudicing negotiations with the Chinese as over-optimism in the press was liable to prejudice the progress of the talks with SAIC and the positive involvement of the Chinese government ... Further, HMG was entitled to have regard both to the general public interest that a fair picture of the position be presented, and the particular interest of MGRG’s suppliers to be able to assess where their own commercial interests lay, again based on a fair picture of what was happening.”

However, we have been referred to relatively little evidence that MGRG had been briefing the press in “seriously misleading” terms, we are aware of no evidence of any significance

89 See paragraph 208 above.
that any such actions were “prejudicing negotiations with the Chinese”, and it is by no means obvious from the evidence we have been given that the Government’s press briefings were motivated by concern for the interests of suppliers. In any case, we question whether it was appropriate for the Government, unattributably, to brief the press in the terms it did without consulting, or even informing, the Group.

224. We are struck by how little knowledge officials, even the most senior, knew of what the press was being told. While “lines” used by the DTI press office were known to, and carefully worked out with, officials, they could only guess at what special advisors were telling the press. Ms Bell told us:

“There was certainly some briefing of the press by special advisors. Specifically what was done here, I cannot say and I did not know.”

She explained that it is not the practice for permanent secretaries necessarily to be given great detail about briefings that special advisors are giving and that:

“... in terms of the detail of many discussions with special advisors, not specific to Rover, I think it is correct to say you wouldn’t expect to be sighted on all of that.”

Payment of £417,201 to Eversheds

225. Eversheds’ engagement in respect of Project 528 was formally recorded in a letter from Ms Lewis dated 3 March 2005. The letter was addressed to “Jane Ruston Phoenix Venture Holdings Limited” and countersigned by Ms Ruston “For and on behalf of Phoenix Venture Holdings Limited and its subsidiaries”. It referred to Eversheds having been instructed “to act for Phoenix Venture Holdings Limited and its subsidiaries” and also to Eversheds’ standard terms of engagement. These provided that, where Eversheds received instructions from or on behalf of more than one person or company to deal with any particular matter, each such person or company was to be separately responsible for the full amount of Eversheds’ fees.


227. On Wednesday 6 April 2005 a “manual payment request” was prepared to authorise payment of the £417,201. In its original form, this provided for the payment to be made by “MG Rover” by cheque and included the comment, “Please send cheque out Friday 8-4-05 urgent”. The request was signed by Ms Ruston and Mr Beale.

228. During the morning of 6 April 2005 Mr Beale advised Mr Millett not to allow any money to go out of MGRG’s bank account without discussing it with him first. Later in the day, Ms Ruston asked Mr Buchanan, who was also at Longbridge, whether it was “ok to pay
some £400,000 to Eversheds in respect of an outstanding invoice billed to PVH.” An attendance note prepared by Halliwell's records:

“AKB [i.e. Mr Buchanan] said he is not acting for PVH but if either the DTI or SAIC have withdrawn then they should not pay the invoice. AKB said JR [i.e. Ms Ruston] should speak to Eversheds who act for PVH and seek their opinion. The question is whether they will down tools if they are not paid and would this prejudice the transaction. It may be that Eversheds assistance is not required in the hours prior to a definitive decision in which case the fees unfortunately should not be paid. Eversheds are however drafting the DTI documentation, the charges debenture, loan agreement and are negotiating them. JR said that she had agreed that the payment would be made a few days ago … AKB reminded JM [i.e. Mr Millett] that the directors ran the risk of personal liability and possibly the requirement to make a contribution to the deficit if they reduce available assets by making a ‘non-ransom’ payment at this time. JM would discuss again with PB [i.e. Mr Beale].”

Ms Ruston raised the issue with Ms Lewis, who herself referred it to Ms Pheasant of Eversheds. In an email sent to Ms Ruston at 6.46 pm on 6 April 2005, Ms Pheasant said:

“Sue has asked me to confirm that the directors of PVH cannot be criticised for creating a preference by paying Eversheds’ fees if PVH enters into administration or liquidation within six months’ of the date of the payment.

... As you know from your conversations with Sue, unless Eversheds is paid it will have to stop work ... the directors are not creating a preference but honouring a pre-existing obligation to pay fees which if not paid will result in a cessation of legal work and the corresponding failure of the strategy.”

In keeping with this email, the Halliwell's attendance note for 6 April states:

“JR said she has spoken to Susan Lewis and Louise Pheasant of Eversheds and they are comfortable with their invoice being paid. They have advised that it is not a preference.”

When giving evidence to us, both Ms Lewis and Ms Pheasant stressed that they had not been asked to consider whether it would be proper for MGRG (as opposed to PVH) to pay the £417,201. Ms Lewis stated that Eversheds regarded their engagement as being with PVH. Ms Pheasant said that “it is quite hard to say the advice was exclusively given to PVH or was exclusively given to MG Rover” and that all she could say “as a matter of fact is that our engagement was with PVH.” Ms Pheasant also told us that she would have regarded
payment by MGRG as “an improper use of MG Rover’s money.” Ms Ruston agreed that the question aired with Eversheds was, “can PVH pay?”

231. At around 10.15 am on the next day, Thursday 7 April 2005, Eversheds faxed to Ms Ruston their bank details. Following receipt of this letter, the “manual payment request” in respect of the £417,201 was amended to provide for payment by telegraphic transfer. The transfer was effected by Barclays Bank at 2.13 pm. The payment was made by MGRG.

232. Mr Buchanan was again at Longbridge on 7 April 2005 and the attendance note in respect of his visit refers to the question of whether Eversheds should be paid. The attendance note includes the following:

“JM [i.e. Mr Millett] then brought an Eversheds invoice addressed to PVH and told AKB [i.e. Mr Buchanan] that PB [i.e. Mr Beale] had told JM that he thought AKB had cleared it for payment by MGRG. AKB said that he had not cleared the bill, he had told JR and PB yesterday that if Eversheds were refusing to provide further labour and in effect were going to block the transaction and the directors believe the DTI loan and the SAIC deal are up in the air, and if he was advising PVH, then they should probably pay if Eversheds were required to bring that decision to its conclusion. However if the SAIC deal and the DTI loan are off then they should not pay.

JM said that John Cowburn had told him that in his view MGRG and not PVH should pay the bill because it is the recipient of the services which is the advice from Eversheds.93

... PB then came in to discuss the Eversheds bill and said that provided the MGRG directors are comfortable with the ongoing services required he thought it would be ok. AKB said that he was not certain there was a contractual relationship between Eversheds and MGRG. PB said that his view is that PVH is obtaining no benefit from the transaction and PB considered that there remained good logic as to why MGRG should pay as a matter of urgency. PB said he is conflicted at this point. As an MGRG director the last thing he would want is no support from Eversheds. There is a new proposal on the table now being discussed and Eversheds support is required to sort matters out. It could endanger the process without it and PB considers it needs to be paid.

JM reviewed the evidence and checked the engagement letter which was to act for PVH and the subsidiaries which were signed by JR on behalf of both. AKB agreed that there appears to be a collective responsibility on behalf of the PVH group.

However on current information AKB said [absent more certainty as to the current position] he would struggle to advise an MGRG director to pay this bill as it is a

93 When giving evidence to us, Mr Cowburn said that he had no specific recollection of expressing this view to Mr Millett, but did not doubt that he had done so.
substantial sum. If the directors reasonably believe that the DTI loan is imminent and will not be without the payment to and involvement of Eversheds then he would feel better about things. AKB would ideally want a board meeting first so everyone knows where things are up to in China. LAW [i.e. Ms Lisa Williams of Halliwells] heard JM tell Celia [i.e. Dalley, Mr Millett’s secretary] to put on hold the transfer to Eversheds.94

JM subsequently advised AKB at 4:00pm that Eversheds had been paid through MGRG. JM had discussed this with PB and he had thought they had paid the bill for good reasons.95

233. Mr Millett told us that he had not himself been willing to authorise the payment. He had “got to a stage where [he] thought on balance [he] would take Buchanan’s advice and ... err on the side of ... holding on to that piece of paper for the time being.” However, Mr Millett said, Mr Beale had been keen that the payment should be made and had thought it fair and proper. Mr Millett thought that he had said to Mr Beale, “well, if you think it should be paid, Peter, well, you authorise the payment”. Mr Millett said that Mr Beale had authorised the payment. Likewise, Ms Ruston said that it was her impression that the payment had been Mr Beale’s decision. For his part, Mr Beale said that he did not recall authorising the payment, but that he had no reason to doubt that he had done so.

234. Representations made to us on behalf of the members of the Phoenix Consortium put matters as follows:

“It [i.e. the decision whether to pay] was one that Mr Millett was not prepared to make so it fell to Mr Beale as the more senior executive. This does not mean that it was the wrong decision. The fact that the issue was the subject of discussion, the fact that Mr Millett had reservations and declined to authorise the payment himself and deferred to the more senior executive Mr Beale is the mark of a properly functioning board.”

235. A Halliwells attendance note in respect of the next day, Friday 8 April 2005, includes the following:

“AKB speaking to Jane Ruston on Friday afternoon regarding the payment of Eversheds fees. Jane was aware that Halliwells had not advised to make the payment and that Peter Beale and John Millett had made a judgement call based on the circumstances known to them at the time of payment. Jane Ruston pointed out that she had previously, some days ago, agreed to make the payment to Eversheds of that and other fee notes at a time when they were in the thick of matters with the DTI and SAIC and that they felt contractually obliged to make what was effectively a ransom

94 Mr Buchanan told us that he remembered being told by Ms Williams at the time, or shortly afterwards, that she had heard this.

95 Mr Beale said that he had no reason to think that these paragraphs were not accurate.
payment. Obviously the necessity to keep Eversheds on board at the time of payment was a factor considered by the directors in assessing the suitability of the payment.

Jane Ruston had only become aware on Friday that the payment had been made by [MGRG] and not PVH and she had had another word on Friday with Susan Lewis who had again confirmed advice that Eversheds regarded it as an appropriate payment.96

236. With regard to the last part of this, Ms Lewis told us that she did not remember giving such confirmation, although she thought she could possibly have said something like, “don’t worry about it”. In her evidence, Ms Pheasant said that on 8 April 2005 Ms Ruston had told her that she had just found out that the £417,201 had been paid by MGRG rather than PVH. As Ms Pheasant remembered events, Ms Ruston “was almost saying: how can we make this right? How can we correct this?” At all events, Ms Pheasant expressed the view that “PVH should reimburse [MGRG] for the amount that [MGRG] had paid essentially on behalf of PVH”. Ms Pheasant’s evidence substantially accorded with Ms Ruston’s. Ms Ruston remembered telling Ms Pheasant that the payment had been made by MGRG and that Ms Pheasant had “expressed discomfort about that.” Ms Ruston went on to explain:

“[Ms Pheasant] suggested that this wasn’t the right thing to do and that I should reverse the transactions, which I couldn’t really understand how I was going to do that at this stage. So I went and spoke to Peter Beale about it and said that Eversheds were concerned about this and suggested that we reverse the transactions. He said I should go and speak to Sue Lewis about it, explain what the situation is, explain that the directors had taken advice from Andrew Buchanan prior to making the payment and had decided that it was an appropriate thing to do based on the advice and the issues that had been raised by Andrew, but if Sue was uncomfortable about it then she could pay the money back. So I telephoned Sue and I explained to her what the situation was, so that she understood that this had happened and these conversations had been had with Andrew. She said, ‘That is great, thanks very much, thanks for letting me know,’ but she didn’t – she didn’t confirm that Eversheds still regarded it as an appropriate payment. She didn’t.”

237. In his evidence to us, Mr Beale said that he did not remember the “distinction between who was paying what” or “having a conversation about who should pay [the Eversheds invoice]”. It seems clear, however, that at the time Mr Beale was alive to the issue as to which company (PVH or MGRG) should make any payment to Eversheds and expressed views on the point.

238. While it seems to us that by 7 April 2005, when the payment to Eversheds was made, there was no real prospect of the negotiations with SAIC coming to fruition, we accept that Mr Beale had not yet abandoned hope. Even so, we do not think Mr Beale was justified in authorising the payment as he did:

96 Mr Buchanan confirmed to us that the attendance note was consistent with his recollection.
238.1. in the first place, to whatever extent authority to make payments may have been formally delegated to individual directors, we do not think it can have been appropriate for any individual director to decide to pay such a large sum in circumstances where:

(a) there was known to be a very real risk that MGRG would have to go into administration imminently;

(b) other creditors were not being paid;

(c) the invoice was addressed to a different company;

(d) if MGRG was also legally liable in respect of the invoice, so was every other company in the Group;

(e) Eversheds’ services could not sensibly be regarded as having been supplied only to MGRG;

(f) Mr Buchanan had questioned whether the payment should be made;

(g) Mr Buchanan had referred to the desirability of a board meeting; and

(h) it was very questionable how far Eversheds’ services would really be needed that day;

238.2. secondly, as he is himself recorded by Halliwell as having said, Mr Beale, as a director of PVH as well as MGRG, had a conflict of interest; even, therefore, if it had been appropriate for an individual director with no conflict of interest to make the decision, it would not have been right for Mr Beale to do so; and

238.3. thirdly, it seems to us that Mr Beale probably authorised the payment with a view to benefiting PVH – so that PVH would not have to pay.

Contrary to the representations quoted in paragraph 234 above, we do not consider that the circumstances in which the payment was made to Eversheds by MGRG manifest the “mark of a properly functioning board”.

239. It is to be noted that it is PVH rather than Eversheds which would appear to have benefited from the fact that MGRG made the payment. On any view, PVH was contractually liable to Eversheds. If, therefore, MGRG had not paid, Eversheds could have pursued PVH, which has not entered into any insolvency regime, for payment. In contrast, PVH has been relieved of the need to pay Eversheds. Moreover, were MGRG to assert a claim for reimbursement against PVH, PVH could seek to set off that claim against the sums it is owed by MGRG.
Summary of Project 528 negotiations

240. During the first half of 2004 the Group continued its search for a collaborative partner and various Chinese vehicle manufacturers were considered. However, by June the Group had decided to proceed with SAIC. The initial proposals involved a joint venture company in which SAC was to have a 60 per cent interest to the Group’s 40 per cent. SAIC was to pay PVH a total of £192 million. The Rover 25 and 45 were to move to China, but MG sports cars were to be built at Longbridge and the Rover 75 and the New Medium Car might also be assembled there. A letter of intent was subsequently signed between the parties on 16 June 2004. A revised letter of intent was entered into soon after, on 2 July, which acknowledged that NAC and General Motors had expressed interest in investing in the Chinese joint venture.

241. The negotiations with SAIC were led on behalf of the Group by Mr Stephenson in conjunction with Dr Li. Our view is that Mr Stephenson’s skills and experience were not such as to equip him well to lead the negotiations, at least without more assistance from appropriate corporate finance advisors, for whom Dr Li was not an adequate substitute.

242. At first it was hoped that a contract could be concluded quite quickly. However, timing slipped on a regular basis. Nonetheless, in September 2004, the Group received consideration of £37 million in respect of intellectual property rights relating to the Rover 75, Powertrain products and “L” series engines that it had sold to SAIC Group.

243. In August 2004 it was recognised that MGRG would have difficulty in paying creditors from the end of that month in the absence of further funding, but cash inflows in excess of £100 million were expected from the disposal of the Xpart business in addition to the funds anticipated from SAIC. Mr Buchanan of Halliwell’s was consulted for insolvency advice on several occasions in the latter part of 2004. Notes to the Group’s 2003 financial statements, filed in late October 2004, brought out the importance of the deal with SAIC coming to fruition. The financial statements, and the adverse press coverage they triggered, caused concern to SAIC and led it to seek changes to the proposed deal. However, at the time of approval of the Group’s 2003 financial statements it was still envisaged that a contract would be signed by the end of January 2005.

244. In December 2004 SAIC appointed Rothschild as a financial advisor. Around this time, a third letter of intent was entered into, which included NAC within the arrangements between

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97 The NAC and Guangzhou proposals are discussed in XIX/133 to 136 and XIX/145.
98 See paragraph 7 above.
99 See paragraph 12 above.
100 See paragraph 31 above.
101 See paragraph 32 above.
102 See paragraph 37 above.
103 See paragraph 38 above.
104 See paragraph 40 above.
105 See paragraph 28 above.
106 See paragraph 46 above.
SAIC and PVH\textsuperscript{107}. In January 2005 Ernst & Young were asked to report on PVH’s forecasts\textsuperscript{108}. However, Rothschild and Ernst & Young were dissatisfied with the financial information that the Group could make available to them and were unable to gain comfort on the long term solvency of the Group\textsuperscript{109}.

245. A fourth letter of intent was agreed on 28 February 2005\textsuperscript{110}. This envisaged that SAIC would arrange prepayments of £56 million in March and £25 million in April for intangible assets. By now, however, SAIC was uncertain as to whether the deal would be concluded successfully, Mr Zhao believing the chances to be below 50 per cent\textsuperscript{111}. Then, on 15 March, SAIC discovered that it could not, after all, make the proposed £56 million prepayment without the approval of a Chinese government agency\textsuperscript{112}. Further, SAIC realised on the following day that MGRG was losing money at the rate of £250 million per year, not £100 million as it had understood\textsuperscript{113}.

246. On the next day, 17 March 2005, without consulting any other director first, Mr Stephenson delivered an ultimatum to SAIC in which he said that, since the £56 million would not be paid by the end of March, the PVH directors had concluded that they would prefer to declare PVH insolvent than to continue negotiating the current transaction with SAIC and insisted that SAIC agree to endeavour to complete by the end of April 2005\textsuperscript{114}. While Mr Stephenson doubtless acted with the best of intentions, the approach he took was a mistake. Five days later Chairman Hu wrote to Mr Towers to tell him that SAIC had informed the Chinese regulatory bodies of what Mr Stephenson had said about the PVH directors preferring the insolvency option and, as a result, their review of the feasibility study had paused. In the event, review of the feasibility study never resumed\textsuperscript{115}.

247. The possibility of the DTI providing rescue aid emerged when Mr Millett and Mr Beddow met the DTI on 11 February 2005\textsuperscript{116}, although the DTI and Treasury had in fact had such a possibility in mind for some time\textsuperscript{117}. On 17 March 2005, the DTI wrote to Mr Towers expressing its willingness, subject to a variety of conditions, to provide a loan\textsuperscript{118}. Mr Towers wrote the next day confirming that he and his colleagues accepted the conditions the DTI had set\textsuperscript{119}. To assist it in deciding whether to grant a loan, Ernst & Young, Deloitte and KPMG attended a lengthy meeting with the DTI on 29 March 2005 to allow the DTI to
determine whether the outstanding issues between SAIC and the Group were likely to be resolved.\(^{120}\)

248. On 31 March, Mr Russell from the DTI flew to China with Mr Randell of Slaughter and May,\(^{121}\) and both attended meetings with representatives of SAIC on 1, 2 and 4 April.\(^{122}\) At the last of these meetings, President Chen noted that while PVH had provided supporting documents with regard to the value of residual assets, SAIC was “not confident on value or timings”.\(^{123}\)

249. There was extensive press coverage of MG Rover on Saturday 2 and Sunday 3 April. Articles based on a briefing note which Mr Norris, a special advisor, had drafted explained that the size of any potential bridging loan facility was understood to be over £100 million and that the directors would be required to make a personal contribution of several million pounds to the bridging loan.\(^ {124}\)

250. On 5 April 2005 it was reported in the press that the talks with SAIC had “stalled”. The stories to this effect will also have been derived from a Government source; the likelihood is that the person briefing the press was Mr Godfrey, a special advisor in the DTI, but the briefings may well have been endorsed by someone else, though probably not the Secretary of State.\(^ {125}\)

251. Nevertheless, there were numerous discussions between and within the parties on 5 April 2005. The British Government was seriously considering making a loan. However, at about 7.45 pm on 5 April Rothschild telephoned Mr Gillingwater to deliver the news that SAIC did not wish to proceed with the transaction.\(^ {126}\) The next day there were recriminations and lingering hopes, but in reality there was no longer any real prospect of the negotiations with SAIC being concluded successfully.\(^ {127}\) By the evening of Thursday 7 April PVH accepted that MGRG could no longer continue to trade, and the following morning MGRG’s board formally concluded that an administration appointment should be made.\(^ {128}\)

252. Although the negotiations did not in the end come to fruition, SAIC was genuinely interested in entering into joint venture arrangements and there is an argument that the deal could have succeeded had it been concluded months before April 2005. As time passed, however, the prospects of a deal being achieved were impaired by MGRG’s mounting losses and ultimately SAIC was not satisfied that the proposed joint venture was financially viable.\(^ {129}\) Nonetheless, we think that the Group’s directors were justified in continuing to

\(^{120}\) See paragraph 133 above.
\(^{121}\) See paragraph 141 above.
\(^{122}\) See paragraphs 143, 145 and 153 above.
\(^{123}\) See paragraphs 205 to 209 above.
\(^{124}\) See paragraphs 216, 220 and 221 above.
\(^{125}\) Mr Cox of Rothschild, although not involved himself, knew about the call and what was to be discussed prior to it taking place.
\(^{126}\) See paragraph 160.19 above.
\(^{127}\) See paragraph 163 above.
\(^{128}\) See paragraph 164 above.
\(^{129}\) See paragraph 167 above.
believe that there was a real chance of the deal being completed and in continuing to trade on that basis\textsuperscript{130}.

253. It has been put to us that the British Government was in part responsible for the collapse of the negotiations. We do not find that the Government acted improperly in relation to its dealings with SAIC or in deciding not to provide a loan\textsuperscript{131}. Further, although we consider that it was irresponsible to tell the press that the talks with SAIC had “\textit{stalled}” without consulting, or even informing, the Group, we have no doubt that MGRG would have gone into administration in April 2005 in any case\textsuperscript{132}. Articles appearing in the previous weekend’s newspapers based on the briefing note which Mr Norris had drafted were far less likely to cause difficulties for MGRG, but we question whether it was appropriate for the Government, unattributably, to brief the press even in the terms of that note\textsuperscript{133}.

254. Had the proposed deal with SAIC concluded successfully, it seems to us that MGRG could have managed its operations in a way that ensured its creditors were satisfied, and indeed SAIC would not have proceeded with the deal unless it could be satisfied that the Group would not become insolvent post transaction. However, the joint venture arrangements that were envisaged would have involved much of MGRG’s production being transferred to China, possibly leaving little more than the MG sports cars manufactured at Longbridge.

\textsuperscript{130} See paragraph 168 above.
\textsuperscript{131} See paragraphs 166 and 170 above.
\textsuperscript{132} See paragraph 222 above.
\textsuperscript{133} See paragraph 223 above.
CHAPTER XXI
FINANCIAL REWARDS
Chapter XXI
Financial rewards

1. This chapter sets out and comments on the financial rewards which the members of the Phoenix Consortium and the other directors of MGRG and PVH received in the period of approximately five years between MGRG being acquired by Techtronic in May 2000 and its going into administration in April 2005.

**Remuneration from MGRG**

*The members of the Phoenix Consortium*

2. The members of the Phoenix Consortium each received a relatively modest salary from MGRG. This was fixed at £36,000 by late 2000, rising to £37,934\(^1\) by 2005.

3. The members of the Phoenix Consortium also received certain benefits from MGRG (including the use of one or more cars and fuel benefit)\(^2\).

4. In total, the members of the Phoenix Consortium received gross remuneration and benefits from MGRG as follows:

4.1. *Mr Beale*

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<td>Salary</td>
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<td>£36,000</td>
<td>£36,675</td>
<td>£34,514</td>
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4.2. *Mr Edwards*

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<tr>
<td>Salary</td>
<td>£72,116</td>
<td>£36,000</td>
<td>£36,000</td>
<td>£36,675</td>
<td>£34,514</td>
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<tr>
<td>Benefits</td>
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<td>Total</td>
<td>£87,921</td>
<td>£54,170</td>
<td>£49,817</td>
<td>£57,181</td>
<td>£34,514</td>
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\(^1\) This is based on a gross monthly salary of £3,161.17. Multiplied by 12 months this equates to £37,934 per annum.

\(^2\) Mr Towers also received private medical insurance from MGRG.

\(^3\) Whereas those for previous years are taken from Mr Beale’s tax returns, this figure is derived from Mr Beale’s payslips.

\(^4\) Plus any benefits.

\(^5\) Whereas those for previous years are taken from Mr Edwards’ tax returns, this figure is derived from Mr Edwards’ payslips.

\(^6\) Plus any benefits.
4.3. **Mr Stephenson**

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<tr>
<td><strong>Salary</strong></td>
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4.4. **Mr Towers**

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<td><strong>Total</strong></td>
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<td>£54,231</td>
<td>£57,674</td>
<td>£34,514</td>
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**Mr Howe**

5. When Mr Howe rejoined the Group as chief executive in 2000\(^{11}\), he received the net sum of £100,000 as a “signing-on bonus” and a salary of £250,000. The salary increased to £299,572\(^{12}\) by September 2004. Mr Howe also received bonuses from MGRG.

6. In total, Mr Howe received gross remuneration and benefits from MGRG as follows:

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<td>£653,718</td>
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<td><strong>Benefits</strong></td>
<td>£8,442</td>
<td>£339</td>
<td>£3,182</td>
<td>£4,025</td>
<td>Unknown</td>
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<tr>
<td><strong>FURBS(^{15})</strong></td>
<td>£250,454</td>
<td>£64,483</td>
<td></td>
<td>£32,928</td>
<td>Unknown</td>
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<tr>
<td><strong>Total</strong></td>
<td>£373,546</td>
<td>£538,581</td>
<td>£721,383</td>
<td>£627,657</td>
<td>£294,925</td>
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5. Whereas those for previous years are taken from Mr Stephenson’s tax returns, this figure is derived from Mr Stephenson’s payslips.

8. Plus any benefits.

9. Whereas those for previous years are taken from Mr Towers’ tax returns, this figure is derived from Mr Towers’ payslips.


11. As noted in V/6.1, Mr Howe left MGRG in December 1999 but was persuaded to return as chief executive at the end of May or beginning of June 2000.

12. This is based on a gross monthly salary of £24,964.34. Multiplied by 12 months this equates to £299,572 per annum.

13. The £365,104 consists of approximately nine and a half months’ salary at £20,833 per month and the gross signing-on bonus of £166,667 (i.e. £100,000 net of tax: see paragraph 5 above).

14. Whereas those for previous years are taken from Mr Howe’s tax returns, this figure is derived from MGRG’s records.

15. I.e. Funded Unapproved Retirement Benefit Scheme.
7. Mr Howe also had membership of an MGRG pension scheme.

Financial rewards from PVH

**Salary, bonuses and benefits**

8. The members of the Phoenix Consortium each received an annual salary of £250,000 from PVH.

9. PVH also paid bonuses to the members of the Phoenix Consortium, and to Mr Howe, as detailed in the next three paragraphs (in addition to the sums paid to the Guernsey Trust as considered in paragraphs 14 to 51 below).

10. The following bonuses were paid in December 2000:

<table>
<thead>
<tr>
<th>Mr Beale</th>
<th>Mr Edwards</th>
<th>Mr Stephenson</th>
<th>Mr Towers</th>
<th>Mr Howe</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>500,000</td>
<td>500,000</td>
<td>500,000</td>
<td>500,000</td>
<td>218,750</td>
</tr>
</tbody>
</table>

The payments to the members of the Phoenix Consortium are described in a document dating from, it seems, 2001 as “in respect of salary for period May 2000 to Dec 2000, bonus for period, payment for non-receipt of benefits or pension contributions in the period”. The payment to Mr Howe is termed an “Annual bonus” in the same document. Mr Stephenson said that he saw his bonus as “part of the reward for having done an extremely unusual and extremely challenging deal in raising a large sum of money”.

11. The following bonuses were paid in June 2001:

<table>
<thead>
<tr>
<th>Mr Beale</th>
<th>Mr Edwards</th>
<th>Mr Stephenson</th>
<th>Mr Towers</th>
<th>Mr Howe</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>500,000</td>
<td>500,000</td>
<td>500,000</td>
<td>500,000</td>
<td>150,000</td>
</tr>
</tbody>
</table>

Each of the payments is called a “Success bonus – acquisition of Powertrain” in a document dating from, it appears, 2001. Minutes for a PVH board meeting dated 14 June record that the board resolved that a bonus of £500,000 be paid to each of the four members of the Phoenix Consortium. The minutes state:

“The Chairman reminded the meeting that at the time of the acquisition of the entire issued capital of [MGRG] … (the ‘Acquisition’) each member of the Consortium had invested a significant amount of their own money and time in order to make the Acquisition a success …

---

16 Plus any benefits.
17 The “large sum of money” referred to by Mr Stephenson was the BMW “dowry”: see III/51 to 56.
The Chairman reminded the Board of the significant risk which each of the Consortium took at the time of the Acquisition and subsequently together with the level of personal time and commitment that each of them had contributed. The Directors unanimously agreed that the unique combination of skills and experience that each of them had had enabled the Acquisition to take place and the Completion Accounts Dispute\textsuperscript{18} to be settled and that the level of bonus should be commensurate to these factors."

12. Mr Howe received the following further bonuses from PVH (in addition to those paid to the Guernsey Trust\textsuperscript{19}):

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 2002</td>
<td>192,500</td>
</tr>
<tr>
<td>February 2003</td>
<td>150,000</td>
</tr>
<tr>
<td>March 2004</td>
<td>200,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>542,500</strong></td>
</tr>
</tbody>
</table>

13. In total, Mr Beale, Mr Edwards, Mr Stephenson, Mr Towers and Mr Howe received salary, bonuses and benefits (excluding payments to the Guernsey Trust\textsuperscript{20}) from PVH as follows:

13.1. **Mr Beale**

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Salary\textsuperscript{21}</strong></td>
<td>£112,500</td>
<td>£250,000</td>
<td>£250,000</td>
<td>£252,250</td>
<td>£260,250</td>
</tr>
<tr>
<td><strong>Bonus</strong></td>
<td>£500,000</td>
<td>£500,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Benefits</strong></td>
<td></td>
<td></td>
<td>£6,940</td>
<td><strong>Unknown</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£612,500</strong></td>
<td><strong>£750,000</strong></td>
<td><strong>£250,000</strong></td>
<td><strong>£259,190</strong></td>
<td><strong>£260,250</strong></td>
</tr>
</tbody>
</table>

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\textsuperscript{18} See V/79 to 101.

\textsuperscript{19} As to which, see paragraph 50 below.

\textsuperscript{20} As to which, see paragraph 50 below.

\textsuperscript{21} These figures have been based on Mr Beale’s salary for each calendar year and then pro-rated to give his salary for each tax year.
### Chapter XXI
#### Financial rewards

#### 13.2. Mr Edwards

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>£112,500</td>
<td>£250,000</td>
<td>£250,000</td>
<td>£252,250</td>
<td>£260,250</td>
</tr>
<tr>
<td>Bonus</td>
<td>£500,000</td>
<td>£500,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benefits</td>
<td></td>
<td></td>
<td>£11,902</td>
<td>£38,875</td>
<td>Unknown</td>
</tr>
<tr>
<td>Total</td>
<td>£612,500</td>
<td>£750,000</td>
<td>£261,902</td>
<td>£291,125</td>
<td>£260,250</td>
</tr>
</tbody>
</table>

These figures have been based on Mr Edwards' salary for each calendar year and then pro-rated to give his salary for each tax year.

#### 13.3. Mr Stephenson

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<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>£112,500</td>
<td>£250,000</td>
<td>£250,000</td>
<td>£252,250</td>
<td>£260,250</td>
</tr>
<tr>
<td>Bonus</td>
<td>£500,000</td>
<td>£500,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benefits</td>
<td></td>
<td></td>
<td>£2,703</td>
<td>Unknown</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>£612,500</td>
<td>£750,000</td>
<td>£250,000</td>
<td>£254,953</td>
<td>£260,250</td>
</tr>
</tbody>
</table>

These figures have been based on Mr Stephenson’s salary for each calendar year and then pro-rated to give his salary for each tax year.

#### 13.4. Mr Towers

<table>
<thead>
<tr>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>£112,500</td>
<td>£250,000</td>
<td>£250,000</td>
<td>£252,250</td>
<td>£260,250</td>
</tr>
<tr>
<td>Bonus</td>
<td>£500,000</td>
<td>£500,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benefits</td>
<td></td>
<td></td>
<td>£3,342</td>
<td>Unknown</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>£612,500</td>
<td>£750,000</td>
<td>£250,000</td>
<td>£255,592</td>
<td>£260,250</td>
</tr>
</tbody>
</table>

These figures have been based on Mr Stephenson’s salary for each calendar year and then pro-rated to give his salary for each tax year.

#### 13.5. Mr Howe

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonus</td>
<td>£218,750</td>
<td>£342,500</td>
<td>£150,000</td>
<td>£200,000</td>
<td></td>
</tr>
<tr>
<td>Benefits</td>
<td></td>
<td></td>
<td></td>
<td>£4,470</td>
<td>Unknown</td>
</tr>
<tr>
<td>Total</td>
<td>£218,750</td>
<td>£342,500</td>
<td>£150,000</td>
<td>£204,470</td>
<td></td>
</tr>
</tbody>
</table>

22 These figures have been based on Mr Edwards' salary for each calendar year and then pro-rated to give his salary for each tax year.

23 These figures have been based on Mr Stephenson’s salary for each calendar year and then pro-rated to give his salary for each tax year.

24 These figures have been based on Mr Stephenson’s salary for each calendar year and then pro-rated to give his salary for each tax year.
Chapter XXI
Financial rewards

Payments to the Guernsey Trust

14. PVH’s minutes record that the board resolved to establish an employee benefit trust, to be known as “The MG Rover Holdings Limited Family Benefit Trust”, on 20 December 2001. The trust (i.e. the Guernsey Trust) was constituted by a declaration of trust dated 3 January 2002. Walbrook Trustees (Guernsey) Limited (“Walbrook”), a Guernsey company carrying out, among other things, trustee services, was appointed as the trustee of the trust.

15. Offshore employee benefit trusts (commonly known as EBTs) were set up by an employer to remunerate employees and directors in a tax efficient way. The tax efficiency arose as the payments made by the employer were treated as tax deductible expenses in the employer’s financial statements but the employees and directors did not incur income tax until the moneys were repatriated into the UK.

16. During the period 9 May 2000 to 8 April 2005 PVH made payments to the Guernsey Trust totalling £17.03 million. These payments are considered below.

£770,000 contribution

17. Minutes of a PVH board meeting dated 4 February 2002 record that the board resolved that the company should “make a contribution of £770,000 to the Trust for the period ended 31 December 2001”, with the recommendation that the funds be appointed to be held on sub-trusts for the benefit of the four members of the Phoenix Consortium as to £192,500 each. The minutes state:

“The proposed level of contribution was reviewed in the context of the favourable performance of the company as compared to the business plan and in the light of the level of bonus payments made to the board members of [MGRG].”

The £770,000 was paid to Walbrook on 4 February.

18. We were told in representations made to us on behalf of the PVH directors that, as regards the reference in the minutes to the “favourable performance of the company as compared to the business plan”, “what was meant ... is that the PVH group as a whole had performed favourably as compared to the strategic group business plan”.

19. However, MGRG at least had not been fulfilling its business plan. Mr Millett said that it was “definitely likely that the performance [of MGRG] in 2001 was adverse to the business plan rather than favourable to it”. Mr Parkinson told us that MGRG was not performing favourably as compared with its business plan in February 2002. Mr Howe confirmed that MGRG had not achieved the sales volumes that it had forecast for the years between 2000 and 2002.
20. This evidence is borne out by contemporary documents. For example:

20.1. Mr Howe stated in the group chief executive’s statement enclosed with PVH’s 2001 financial statements that MGRG’s loss for the year “fell short of our objectives as targeted in our 5-year business plan” and that the “level of retail sales was lower than our business plan target of over 180,000 units”;

20.2. the minutes of an MGRG board meeting on 25 January 2002 include the following:

“Mr Millett stressed that the cash position for February was of great concern to him and that careful attention was required by the Board. He stressed that the cash reserves available for use by the Company in February dropped to as low as £8m but that this would be the case only if the sales campaign ... was successful. If that campaign was unsuccessful by any significant margin then the Directors would need to give careful consideration to the solvency of the Company”; and

20.3. a document circulated on 4 February 2002 which was to be used to respond to media inquiries referred to the fact that MGRG’s sales in 2001 had not achieved the company’s “180,000 target” and also mentioned a higher target, noting that the “business plan aim” was “to sell, on average, 200,000 cars a year in the first five years”.

21. Further, while PVH’s 2001 financial statements record that the company itself made a profit of £10.8 million in 2001, with the result that it had net assets of the same amount at the end of the year, they also report a consolidated loss for 2001 of £103.3 million and consolidated net liabilities as at 31 December 2001 of £76.1 million (including the loan from BMW which at 31 December 2001 totalled £350 million).

22. In our view the rationale given in the 4 February 2002 PVH minutes did not adequately justify the £770,000 contribution to the Guernsey Trust.

£2,674,910 contribution

23. Draft minutes for a PVH board meeting dated 26 February 2002 record that the board resolved that the company should make a contribution of £2,674,910 to the Guernsey Trust, with the recommendation that the funds be appointed to be held on sub-trusts for the benefit of the four members of the Phoenix Consortium as to £605,640 each and Mr Howe as to £252,350. The minutes state:

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25 See also XVI/18 and 20.
“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 [MGRG]. It was noted that as a result of the acquisition of [RFS] that the group now has much greater control over the second hand value of MG Rover vehicles. This had always been a long-term strategic aim of the company given the volume of vehicles which would be released into the market in 2003.”

The £2,674,910 was paid to Walbrook on 27 February.

24. As a result of their interests in MGR Capital, the members of the Phoenix Consortium and Mr Howe already, of course, stood to benefit financially from the acquisition of RFS.

**£600,000 contribution**

25. Minutes for a PVH board meeting dated 21 May 2002 record that the board resolved that the company should make a contribution of £600,000 to the Guernsey Trust, with the recommendation that the funds be appointed to be held on sub-trusts for the benefit of Mr Edwards as to £200,000 and the other three members of the Phoenix Consortium and Mr Howe as to £100,000 each. The minutes state:

“The proposed level of contribution was reviewed in the context of the operational performance of the Holding Company since the start of the year.”

The £600,000 was paid to Walbrook on 21 May.

26. The minutes state that all five directors of PVH were present, but Mr Edwards told us that he “wasn’t actually at this meeting”, pointing out that stamps in his passport confirmed that he was in India on 21 May 2002.

27. It was argued in representations made to us on behalf of the PVH directors that there had been “a significant improvement in the financial performance of PVH during the period between the start of the year and 21 May 2002”.

28. However, it is not clear to us in what way the “operational performance” of PVH was thought to have improved.

29. As regards MGRG, minutes of a board meeting on 3 May 2002 include the following:

“Mr Sanders reported to the Board on the Company’s Sales Performance at April 2002. He advised the Board that the forecast for the year was bleak ...”

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26 See chapter VII (Project Platinum), especially at VII/217 to 221.
Mr Millett presented to the Board on the financial position for the end of March 2002. He explained that the total variance to the original budget/business plan in respect of the profit and loss account was £19.8 million adverse.”

**£7,705,125 contribution**

30. Draft minutes for a PVH board meeting dated 31 May 2002 record that the board resolved that the company should make a contribution of £7,705,125 to the Guernsey Trust, with the recommendation that the funds be appointed to be held on sub-trusts for the benefit of Mr Edwards as to £1,537,420, the other three members of the Phoenix Consortium as to £1,637,825 each, Mr Howe as to £1,054,230 and Ms Ruston as to £166,667\(^27\). The minutes state:

“The proposed level of contribution was reviewed in the context of the achievement of the Directors in successfully implementing the key business aim of establishing a joint venture partnership, with China Brilliance Holdings, which included funding contributions to new product development. The meeting acknowledged that without these contributions MG Rover would be unable to implement a full product strategy.”

The £7,705,125 was paid to Walbrook on 26 June.

31. As explained in chapter XIX (Joint ventures), MGRG and China Brilliance entered into a “Strategic Alliance and Cooperation Agreement”, and a suite of other agreements, on 15 March 2002\(^28\). The agreements provided for funding of up to £267 million to be made available to MGRG via Win Win, a Bermudan company jointly owned by MGRG and China Brilliance\(^29\). MGRG received the first instalment, amounting to £23.4 million, on 2 April\(^30\).

32. By 31 May 2002, press reports were suggesting that the position of Mr Yang, the chairman of China Brilliance, was under threat\(^31\). A Financial Times article dated 11 April reported:

“... over the last year, investors have started to worry that the enigmatic Mr Yang ... has performed a few tricks too many, with his group’s complex structure, controversial share dealings and multiple tie-ups with foreign companies.”

An article in the Daily Telegraph of 29 May said, “MG ROVER’S dream of securing its future in China looked in tatters yesterday as a Chinese provincial government signalled its determination to oust the chairman of its local partner, Brilliance China Automotive”. On 31 May, the Financial Times stated:

\(^{27}\) The balance of £33,333 was paid into the main fund.
\(^{28}\) See XIX/69.
\(^{29}\) See XIX/69 to 72.
\(^{30}\) Since the Group incurred product development costs of £12.3 million in connection with the China Brilliance relationship, the net benefit to the Group was £11.1 million: see XIX/74.
\(^{31}\) See also XIX/85.
"Several senior executives at Brilliance China Automotive are under investigation over suspected asset stripping among the group’s sprawling network of subsidiaries, industry insiders and Chinese officials said yesterday.

One of those under investigation is Yang Rong, the chairman ...

About five others in the company, which has a proposed joint venture with MG Rover of the UK, are also being questioned in a probe conducted partly by officers from the ministry of state security, the insiders said. Investigations into ‘economic irregularities’ in China can take months to yield results."

33. Mr Towers told us that he would probably have seen such articles as they appeared, and Mr Stephenson said that he would “almost certainly” have known by the time of the PVH board meeting of 31 May of what was being suggested in the Financial Times. Mr Millett said that there was “no doubt we would have seen the press articles” by 31 May. Nonetheless, Mr Towers said that on 31 May he had no doubt as to the China Brilliance deal proceeding. Similarly, Mr Stephenson said that “there was no reason to believe that the show wasn’t on the road”. Mr Howe observed (with some reason):

“... when you looked at the number of press articles that we actually dealt with about what was going on inside our company, most of which were usually proven to be complete rubbish, one didn’t tend to get terribly excited about what you read in the press."

34. On Monday 24 June 2002 a meeting of Win Win’s board was held in Bermuda. The meeting was attended by, among others, Mr Howe and Ms Ruston. On his return to the United Kingdom, Mr Howe told MGRG’s board at a meeting on 28 June that China Brilliance’s next payment would be delayed32. The board minutes record as follows:

“Mr Howe advised the Board ... that Mr Huang had reported that the next instalment payment which was due to be made by China Brilliance Industrial Holdings Limited to the Company on the 1st July 2002 in the amount of £23.4 million would be delayed. Mr Huang further reported that whilst the funds were available they may not be payable until such time as the Board Director of Shanghai Brilliance had been reconstituted. To this end a shareholders meeting was due to take place at Shanghai Brilliance on the 19th July 2002 at which four directors would be removed and Chairman Yang confirmed as Chairman of that Company. Following that Mr Huang had reported that it would be possible to release the funds to Win Win Co Limited for them to make the second instalment payment to MG Rover Group pursuant to the Design and Development agreement. Therefore, it had been requested by China Brilliance that the payment due on the 1st July 2002 be delayed until the 1st August 2002. Mr Howe reported that reluctantly he and Mr Millett who

32 On 25 June 2002 Mr Nicholson of the British Consulate-General in Shanghai, sent Mr Burden MP, who had recently visited China, a note dated 24/25 June in which he said, “As had been trailed in the press, Yang Rong Chairman of Brilliance was sacked from his post”.

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had represented the Company at the Joint Venture Board meeting had agreed to this cause of action and it remained to be seen that whether or not the payment would therefore be made. However, he confirmed that China Brilliance had been advised that if the payment was not forthcoming on the 1st August 2002 then he reserved his rights to seek to take whatever remedies were appropriate under the Agreements to recover the money from China Brilliance Industrial Holdings Limited.”

35. Mr Towers thought that he would quickly have learned of the delay, but said that he continued to consider that the China Brilliance deal was going ahead and that in any case “it wouldn’t have occurred to [him] at the time that the payment [to the Guernsey Trust] hadn’t been made”. Similarly, Mr Howe said that he would not have known when the £7,705,125 was actually paid. Mr Stephenson said that he did not know why the payment had happened at that date (i.e. on 26 June).

36. While in Bermuda, Ms Ruston expressed some concerns to a friend on the telephone. When giving evidence to us, Ms Ruston remembered that she had been “concerned slightly about the conversations about the £25 million that had been had at around about the time of the Powertrain deal”34. Ms Ruston told us that, following the Bermuda board meeting, she “was concerned that the transaction was faltering slightly” and that she spoke to Mr Howe about whether the bonuses should be paid back; she was particularly concerned, she said, about the quantum of her own bonus. However, she said that Mr Howe had “reassured [her] ... that it was entirely reasonable and justifiable for the efforts that [she] had made and the work that [she] had put in and that that was the case in respect of the bonuses generally”. Ms Ruston also told us that her concerns over this payment to the Guernsey Trust were ultimately allayed when she “... took advice, with John Millett, from Ashursts”35.

37. In the event, as explained in more detail in chapter XIX (Joint ventures)36, no further payments were ever made by China Brilliance and the deal did not proceed.

**£1,400,000 contribution**

38. Minutes for a PVH board meeting dated 18 February 2003 record that the board resolved that the company should make a contribution of £1,400,000 to the Guernsey Trust, with the recommendation that the funds be appointed to be held on sub-trusts for the benefit of the four members of the Phoenix Consortium as to £350,000 each. The minutes state:

“The proposed level of contribution was reviewed in the context of the achievement of the Directors during 2002 in their successful negotiations with Tata Group and their continued efforts to conclude a deal with Daewoo in Poland. The meeting acknowledged that these contributions were crucial to MG Rover’s future strategy.”

33 See further XIX/76 to 79.
34 See V/95 to 98.
35 As mentioned elsewhere in this report (see VII/233), privilege has not been waived in respect of the advice given by Ashurst, as a result of which we cannot comment further.
36 See XIX/90.
Chapter XXI
Financial rewards

The £1,400,000 was paid to Walbrook on 12 March.

39. While a suite of agreements with Tata had been signed in December 2002 with a view to MGRG selling a small car based on Tata’s “Indica” model, the car was not launched until the autumn of 2003 and it then received poor reviews and was beset by safety and quality issues. As a result, MGRG ceased to buy or sell the car in substantial numbers and, while it was envisaged that an improved model would be re-launched at a lower price with new marketing, that had not happened by the time MGRG went into administration in April 2005.

40. As regards the Polish negotiations, Mr Stephenson reported to the MGRG board in September 2003 that progress “remained slow”, and, although Mr Beale confirmed as late as March 2005 that the Group was still interested in pursuing a Polish deal, nothing had been concluded when MGRG went into administration in April 2005.

41. While PVH’s 2002 financial statements record that the company itself made a profit of £10.1 million in 2002, with the result that it had net assets of £20.9 million at the end of 2002, they also report a consolidated loss for the Group for 2002 of £75 million and consolidated net liabilities as at 31 December 2002 of £154 million.

42. With regard to MGRG’s position in February 2003 (when PVH’s board resolved to make the £1,400,000 contribution):

42.1. MGRG sold only 148,500 cars in 2002, down from 170,200 in 2001;

42.2. MGRG’s 2002 financial statements record that the company incurred a loss that year of £68.4 million and had net liabilities of £243.3 million as at 31 December 2002;

42.3. the minutes of a management meeting on 31 January 2003, attended exceptionally by the members of the Phoenix Consortium as well as MGRG’s functional directors, include the following:

“J Towers instructed that spend must be stopped on anything not linked to ‘keeping the tracks running tomorrow’ ...”

37 The CityRover: see XIX/54 to 55.
38 See XIX/49 to 50.
39 See XIX/54.
40 See XIX/54 to 59.
41 See XIX/47.
42 See XIX/36 to 48.
43 See also XVI/18 and 26.
44 The financial statements are considered in more detail in chapter XVI (Financial and trading performance of MGRG).
45 As noted in V/15, the members of the Phoenix Consortium were not normally present at such meetings.
Must push all essential expenditure to the latest timing possible (risks need to be taken).

... all spend must be committed from a zero base, essential only and profiled as late as possible”; and

42.4. a sales and marketing report in respect of February 2003 stated that MGRG had sold fewer cars both than budgeted so far that year\(^{46}\) and than in the corresponding period in 2002\(^ {47}\). The report also stated that the company’s losses in the first two months of 2003 were £8.311 million higher than the £3.887 million budgeted.

**£3,632,500 contribution**

43. Minutes for a PVH board meeting dated 13 October 2003 record that the board resolved that the company should make a contribution of £3,632,500 to the Guernsey Trust, with the recommendation that the funds be appointed to be held on sub-trusts for the benefit of the four members of the Phoenix Consortium as to £740,000 each, Mr Howe as to £620,000 and Ms Ruston as to £52,500. The minutes state:

“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.”

The £3,632,500 was paid to Walbrook on 13 October.

44. Like the other minutes relating to payments to the Guernsey Trust, all five directors of PVH are recorded as having been present. However, it is doubtful whether Mr Edwards was in fact at any meeting on 13 October 2003. Mr Edwards told us that he did not recall some of the meetings relating to payments to the Guernsey Trust, and his passport shows him to have entered Iran on 13 October.

45. Representations made to us on behalf of the PVH directors contended as follows in relation to the £3,632,500 contribution:

“The release back of the £16.5 million of the money which MGRG had paid to RV Capco in order to limit its exposure to residual value guarantees was achieved because of the successful scheme which was put in place to ensure that vehicles returned from finance customers were sold for the maximum price possible. It was appropriate for PVH to make bonus payments to its directors and officers in recognition of the success of the scheme which they had worked to implement.”

\(^{46}\) The adverse variances were 2,658 on retail sales and 897 on wholesale sales.

\(^{47}\) The adverse variances were 2,658 on retail sales and 3,781 on wholesale sales.
46. As already mentioned, the members of the Phoenix Consortium and Mr Howe, already stood to benefit from Project Platinum, to facilitate which transaction RV Capco was established\(^{48}\), as a result of their interests in MGR Capital\(^{49}\). Indeed, the very fact that it was possible to release money from RV Capco\(^{50}\) will have meant that residual value risks were adequately catered for and, hence, confirmed the profitability of MGR Capital.

47. The financial pressures on the Group at this stage are apparent from the following:

47.1. in November 2003 PVH had to lend MGRG £23 million. Minutes of the PVH board meeting at which the loan is recorded as having been approved state:

“The Chairman reported that the meeting had been called to consider a request from MG Rover Group for a transfer of £23 million from PVH’s Royal Bank of Scotland account to MG Rover’s bank account with HSBC as short term bridging finance. These monies are to be used to fund November’s supplier payment run for MG Rover Group and will be repaid to PVH’s bank account in the first 2 weeks of December 2003”; and

47.2. in late 2003 land at Longbridge was sold to provide MGRG with funding\(^{51}\). In November Deloitte prepared a memorandum for a “financing transaction” in relation to land at Longbridge which referred to “maximising up front cash proceeds”. On 2 December Mr Cowburn said in an email to Deloitte that “We at MGR are particularly keen to progress a deal as soon as possible ...” and by 12 December SMP had been told of a “wish to secure an unconditional exchange by 24 December 2003”. On 23 December Property Holdings’ board resolved to transfer the proceeds of sale to MGRG to discharge inter-company indebtedness and otherwise by way of loan\(^{52}\).

\textit{£245,000 contribution}

48. Minutes for a PVH board meeting dated 3 September 2004 record that the board resolved that the company should make a contribution of £245,000 to the Guernsey Trust, with the recommendation that the funds be appointed to be held on sub-trusts for the benefit of Mr Howe as to £210,000 and Ms Ruston as to £35,000. The minutes state:

“The proposed level of contribution was reviewed in the context of:

\(^{48}\) See chapter VII (Project Platinum), especially at VII/22.
\(^{49}\) See VII/217 to 221.
\(^{50}\) See VII/24.6 to 24.8 and XXIII/247 to 254.
\(^{51}\) See IX/28 to 34.
\(^{52}\) See IX/32 to 33.
1. 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.

2. The achievement of the Group’s Legal Director in completing the sale of Xpart Ltd to Caterpillar."

The £245,000 was paid to Walbrook on 13 September.

Summary

49. PVH thus contributed sums to the Guernsey Trust as follows:

<table>
<thead>
<tr>
<th>Date of payment</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>04.02.02</td>
<td>770,000</td>
</tr>
<tr>
<td>27.02.02</td>
<td>2,674,910</td>
</tr>
<tr>
<td>21.05.02</td>
<td>600,000</td>
</tr>
<tr>
<td>26.06.02</td>
<td>7,705,125</td>
</tr>
<tr>
<td>12.03.03</td>
<td>1,400,000</td>
</tr>
<tr>
<td>13.10.03</td>
<td>3,632,500</td>
</tr>
<tr>
<td>13.09.04</td>
<td>245,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>17,027,535</strong></td>
</tr>
</tbody>
</table>

50. Contributions to the Guernsey Trust were allocated to the members of the Phoenix Consortium, Mr Howe and Ms Ruston as follows:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr Beale</td>
<td>798,140</td>
<td>2,087,825</td>
<td>740,000</td>
<td>3,625,965</td>
<td></td>
</tr>
<tr>
<td>Mr Edwards</td>
<td>798,140</td>
<td>2,087,420</td>
<td>740,000</td>
<td>3,625,560</td>
<td></td>
</tr>
<tr>
<td>Mr Stephenson</td>
<td>798,140</td>
<td>2,087,825</td>
<td>740,000</td>
<td>3,625,965</td>
<td></td>
</tr>
<tr>
<td>Mr Towers</td>
<td>798,140</td>
<td>2,087,825</td>
<td>740,000</td>
<td>3,625,965</td>
<td></td>
</tr>
<tr>
<td>Mr Howe</td>
<td>252,350</td>
<td>1,154,230</td>
<td>620,000</td>
<td>210,000</td>
<td>2,236,580</td>
</tr>
<tr>
<td>Ms Ruston</td>
<td>166,667</td>
<td>52,500</td>
<td>35,000</td>
<td>254,167</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3,444,910</strong></td>
<td><strong>9,671,792</strong></td>
<td><strong>3,632,500</strong></td>
<td><strong>245,000</strong></td>
<td><strong>16,994,202</strong></td>
</tr>
</tbody>
</table>
51. The difference between the total figures in the tables above is £33,333 being the contribution to the main, non specific, fund, part of the £7,705,125 contribution paid to Walbrook on 26 June 2002\(^{53}\).

*Loan notes*

52. As explained in chapter V (Rover under new ownership), on 18 December 2000 PVH issued loan notes to the value of £2.5 million to each member of the Phoenix Consortium\(^ {54}\). The loan notes bore interest at 1.5625 per cent above the three month LIBOR rate, subject to a minimum of 6.5 per cent.

53. On 10 October 2001 PVH deposited £10 million in a “Blocked Guarantee Account” with Co-op Bank to enable the members of the Phoenix Consortium to borrow money on the security of their loan notes and, hence, to fund their acquisition of preferred shares in MGR Capital\(^ {55}\). At this stage, the members of the Phoenix Consortium agreed that the interest rate payable on the loan notes should be reduced by 0.25 per cent\(^ {56}\).

54. Each member of the Phoenix Consortium received the following sums by way of interest on the loan notes he held:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Net payment after tax</th>
<th>Gross amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>2000-2001</td>
<td>66,094</td>
<td>82,617</td>
</tr>
<tr>
<td>2001-2002</td>
<td>128,906</td>
<td>161,133</td>
</tr>
<tr>
<td>2002-2003</td>
<td>125,000</td>
<td>156,250</td>
</tr>
<tr>
<td>2003-2004</td>
<td>31,250</td>
<td>39,063</td>
</tr>
<tr>
<td>Total</td>
<td>351,250</td>
<td>439,063</td>
</tr>
</tbody>
</table>

55. By the autumn of 2002, if not before, Mr Beale was keen for the loan notes to be redeemed. A letter to Mr Beale from Deloitte dated 20 September refers to Mr Beale having mentioned that he “hoped the loan notes could be redeemed in December 2002”. At that stage, however, Mr Hume of Deloitte advised that the loan notes “should not be encashed until after the 5 April 2003 so that if there is an income tax charge payment will be deferred until the 31 January 2005”.

56. In the event, PVH purchased the loan notes from the members of the Phoenix Consortium in July 2003. £2,500,000 was paid to each member of the Phoenix Consortium on 1 July. PVH board minutes record that the directors considered the purchase to be in the best interests of the company in that:

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\(^{53}\) See paragraph 30 above.

\(^{54}\) See V/55.1 to 55.2.

\(^{55}\) See VII/25.

\(^{56}\) See VII/156. This was to compensate PVH for the cost to it of the bank guarantee with which the members of the Phoenix Consortium were provided.
“(a) the Company would be relieved from its obligations to pay interest to [the members of the Phoenix Consortium] at 6.25% per annum which amounted to £625,000 each year being an amount of £199,748.00 more than the interest which the Company was receiving from the funds deposited with the Bank [i.e. the Co-op Bank] to secure the Loan Notes;

(b) the funds held in the blocked deposit account\(^\text{57}\) (which was not otherwise available to the Company) could be released and used to buy the Loan Notes and the facility could be terminated thus saving the Company £25,000 per annum in charges.”

57. In total, therefore, each member of the Phoenix Consortium received £2,939,062.50 gross (i.e. £2.5 million plus £439,062.50 of interest) from his loan notes.

58. Mr Millett told us that he was “definitely concerned” by the loan notes and that they were one of the reasons he (together with Ms Ruston) sought advice from Ashurst\(^\text{58}\).

**Funding of remuneration payments by PVH**

59. Aside from bank interest (which had amounted in total to £1,898,141 by April 2005), the income from which PVH funded the payments between December 2000 and April 2005 of salaries and bonuses, and to the Guernsey Trust, derived from essentially two sources: the aircraft transactions described in chapter XI and dividends from Techtronic.

60. As explained in chapter XI (Aircraft), PVH obtained net benefits, after deduction of professional fees, of £8.511 million from the first aircraft scheme (Project Aircraft)\(^\text{59}\) and £3.283 million from the second scheme (Project Trinity)\(^\text{60}\). Both sums were derived from the exploitation of tax losses, for the most part MGRG’s tax losses. For the reasons given in chapter XI, we consider that the £7.7 million payment to the Guernsey Trust on 26 June 2002 can be attributed, at least for the most part, to money received from Project Aircraft\(^\text{61}\) and that the £3,632,500 payment to the Guernsey Trust on 13 October 2003 is likely to have been made because receipt of the dividend from PVL2 was known to be imminent\(^\text{62}\).

61. With regard to dividends from Techtronic (received entirely by Techtronic’s sole shareholder PVH), Techtronic’s board minutes refer to the following dividends:

61.1. draft minutes dated 21 December 2000 state that it was resolved that a dividend in the amount of £9.8 million be declared, to be paid by way of a payment of

\(^{57}\) As to which, see paragraph 53 above.

\(^{58}\) See paragraph 36 above and VII/231 to 233.

\(^{59}\) See XI/14 to 15.

\(^{60}\) See XI/55.

\(^{61}\) See XI/21.

\(^{62}\) See XI/57.
£4.8 million and the writing off of a £5 million loan from Techtronic to PVH. The minutes record that Mr Beale “explained that the only income received was the sum of £9,946,229.00 from the loan made to [MGRG]”, as a result of which the company “would have reserves available for distribution of in excess of £9,850,000”63;

61.2. minutes dated December 2001 state that it was resolved that a dividend in the amount of £10 million be declared, to be paid by way of a cash payment. The minutes record 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”64;

61.3. minutes dated December 2002 state that it was resolved that a dividend in the amount of £18 million be declared, to be paid by way of a payment of £9 million and the writing off of a £9 million loan from Techtronic to PVH. The minutes record that Mr Beale explained that the company “had received income in the sum of £11,947,344 being interest from the loan made by the Company to [MGRG] ... together with interest on other cash deposits”; and

61.4. minutes dated 22 December 2003 state that it was resolved that a dividend in the amount of £32.5 million be declared, to be paid by way of a payment of £2 million and the writing off of a £30.5 million loan from Techtronic to PVH. The minutes record that Mr Beale explained that the company “had received income in the sum of £10,909,103 being interest from the loan made by the company to [MGRG] ... together with interest on other cash deposits” and that “the company had received cash of in excess of £33,500,000 during the year released from [its] escrow account65 with Landrover”.

62. Techtronic made the following payments to PVH either in payment of dividends or by way of loans made and subsequently written off when dividends were declared:

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63 We are aware of two versions of the draft minutes. The quotations are from one of the two versions, but the other version is not significantly different. See further V/59 to 60.
64 See further XXII/18.7 and 20.
65 As to which, see paragraphs 64 to 66 below and V/90 to 101.
Chapter XXI
Financial rewards

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>19.12.00</td>
<td>5,000,000</td>
<td>Loan written off when 2000 dividend declared</td>
</tr>
<tr>
<td>22.12.00</td>
<td>4,800,000</td>
<td>Part of the 2000 dividend of £9.8 million&lt;sup&gt;66&lt;/sup&gt;</td>
</tr>
<tr>
<td>21.09.01</td>
<td>10,000,000</td>
<td>Deposited by PVH in the “Blocked Guarantee Account” with Co-op Bank for the purposes of Project Platinum&lt;sup&gt;67&lt;/sup&gt;; funded the 2001 dividend of £10 million&lt;sup&gt;68&lt;/sup&gt;</td>
</tr>
<tr>
<td>27.11.01</td>
<td>4,000,000</td>
<td>Paid by MGRG to PVH in respect of interest due by MGRG to Techtronic; posted to Techtronic’s inter-company account with PVH.</td>
</tr>
<tr>
<td>11.01.02</td>
<td>4,000,000</td>
<td></td>
</tr>
<tr>
<td>27.02.02</td>
<td>2,000,000</td>
<td>Loans written off when 2002 dividend declared</td>
</tr>
<tr>
<td>14.05.02</td>
<td>3,000,000</td>
<td></td>
</tr>
<tr>
<td>25.02.03</td>
<td>9,000,000</td>
<td>Part of the 2002 dividend of £18 million&lt;sup&gt;69&lt;/sup&gt;</td>
</tr>
<tr>
<td>18.07.03</td>
<td>4,252,739</td>
<td></td>
</tr>
<tr>
<td>08.10.03</td>
<td>9,100,000</td>
<td>Loans written off when 2003 dividend declared</td>
</tr>
<tr>
<td>11.11.03</td>
<td>10,700,000</td>
<td></td>
</tr>
<tr>
<td>18.12.03</td>
<td>2,000,000</td>
<td>Part of the 2003 dividend of £32.5 million&lt;sup&gt;70&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>67,852,739</strong></td>
<td></td>
</tr>
</tbody>
</table>

63. MGRG made the following payments to, or for the benefit of, Techtronic in respect of interest:

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>9,946,229</td>
<td>MGRG paid sums totalling £16,050,000 to Techtronic in August 2000, but Techtronic repaid £4,374,801 on 28 December 2000 and also made a variety of payments on MGRG’s behalf, leaving a balance only slightly in excess of the £9,946,229 charged by way of interest; used to fund payment to PVH of sums totalling £9.8 million in December 2000</td>
</tr>
<tr>
<td>27.11.01</td>
<td>4,000,000</td>
<td>Paid by MGRG into a PVH account, but treated as a payment of interest by MGRG to Techtronic</td>
</tr>
<tr>
<td>31.12.01</td>
<td>5,813,771</td>
<td>Interest; used to fund payment to PVH of sums totalling £6 million in January/February 2002</td>
</tr>
<tr>
<td>09.05.02</td>
<td>3,066,000</td>
<td>Interest; used to fund payment to PVH of £3 million on 14.05.02</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>22,826,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

<sup>66</sup> See paragraph 61.1 above.
<sup>67</sup> See paragraph 53 above and VII/25.
<sup>68</sup> See paragraph 61.2 above. As mentioned in chapter VII (Project Platinum), Techtronic appears to have funded the £10 million payment in part from the second tranche of the BMW “dowry” and in part from money which Techtronic received on Powertrain’s behalf at the time of Powertrain’s acquisition (see VII/25.5).
<sup>69</sup> See paragraph 61.3 above.
<sup>70</sup> See paragraph 61.4 above.
64. MGRG also paid a total of £14.1 million on Techtronic’s behalf into the escrow account set up in 2001 at Ford’s request when Powertrain was acquired from BMW71 ("the Powertrain Escrow Account") as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>31.05.01</td>
<td>5,000,000</td>
</tr>
<tr>
<td>31.07.01</td>
<td>2,000,000</td>
</tr>
<tr>
<td>01.10.01</td>
<td>2,000,000</td>
</tr>
<tr>
<td>30.11.01</td>
<td>2,000,000</td>
</tr>
<tr>
<td>31.12.01</td>
<td>3,100,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>14,100,000</strong></td>
</tr>
</tbody>
</table>

65. The £14.1 million deposited by MGRG into the Powertrain Escrow Account was set against the debt owed by MGRG to Techtronic, thus reducing MGRG’s liability. However, in doing so MGRG was reducing a debt that was not due for immediate repayment at the expense of depleting its cash balance by £14.1 million.

66. BMW also contributed to the Powertrain Escrow Account. Its contribution, which amounted to £25 million, was made as part of the settlement of the Completion Accounts dispute72. This dispute arose from BMW’s obligation under the SPA to pay to MGRG, by way of share subscription, the difference between £740 million and the value of MGRG’s net assets as at the completion of Techtronic’s acquisition of the company73. As explained elsewhere in this report, the settlement involved, among other things, BMW selling Powertrain for a nominal sum to Techtronic (Ford being unwilling to countenance MGRG as Powertrain’s owner), and the Powertrain Escrow Account was established to facilitate that sale74. The fact remains, however, that BMW’s £25 million contribution can be traced back to a contractual provision for BMW to compensate MGRG.

67. From July 2002 onwards, Techtronic received large sums from the Powertrain Escrow Account. It was these receipts which funded the dividend payments made to PVH in 2003. The receipts were as follows:

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71 See V/91.
72 See V/79 to 101.
73 See III/88.8.
74 See V/90 to 94, XV/22 and XVIII/4 to 5.
Chapter XXI
Financial rewards

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>01.07.02</td>
<td>6,100,000</td>
<td>Largely used to fund the payment to PVH of £9 million on 25.02.03</td>
</tr>
<tr>
<td>03.01.03</td>
<td>5,800,000</td>
<td></td>
</tr>
<tr>
<td>02.07.03</td>
<td>4,900,000</td>
<td>Largely used to fund payment to PVH of £4,252,739 on 18.07.03</td>
</tr>
<tr>
<td>30.09.03</td>
<td>9,100,000</td>
<td>Used to fund payment to PVH of £9.1 million on 8.10.03</td>
</tr>
<tr>
<td>07.11.03</td>
<td>10,700,000</td>
<td>Used to fund payment to PVH of £10.7 million on 11.11.03</td>
</tr>
<tr>
<td>03.12.03</td>
<td>3,046,887</td>
<td>Used in part to fund payment to PVH of £2 million on 18.12.03</td>
</tr>
<tr>
<td>20.09.04</td>
<td>80,598</td>
<td>The total of these sums was transferred to MGRG on 29.10.04</td>
</tr>
<tr>
<td>20.09.04</td>
<td>2,508,430</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>42,235,915</strong></td>
<td></td>
</tr>
</tbody>
</table>

68. The upshot appears to be as follows:

   68.1. the bonuses which PVH paid to the members of the Phoenix Consortium and Mr Howe between December 2000 and February 2002, as detailed in paragraphs 10 to 12 above, were funded using dividends from Techtronic which were themselves primarily financed from interest paid by MGRG\(^{76}\);  

   68.2. the contributions which PVH made to the Guernsey Trust during 2002, as detailed in paragraphs 17 to 37 above, were funded from Project Aircraft and using dividends from Techtronic which were themselves financed for the most part from interest paid by MGRG\(^{77}\); and  

   68.3. the sums which PVH paid into the Guernsey Trust and by way of bonuses in 2003 and, to a limited extent, 2004 were primarily funded from Project Trinity and dividends from Techtronic which were themselves financed for the most part from money released from the Powertrain Escrow Account to which BMW had contributed £25 million as a result of a contractual obligation to compensate MGRG and to which MGRG had itself contributed £14.1 million on behalf of Techtronic\(^{78}\)\(^{79}\).

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\(^{75}\) We assume that the difference between this figure and the £39.1 million contributed to the Powertrain Escrow Account by BMW and MGRG is attributable to interest.  
\(^{76}\) See paragraphs 61 to 63 above.  
\(^{77}\) See paragraphs 60 to 63 above.  
\(^{78}\) See paragraphs 61, 62 and 64 to 67 above.  
\(^{79}\) It is perhaps noteworthy that another use of PVH’s income was to support Edwards Cars. As explained in chapter XIV (Edwards Cars), PVH paid sums totalling £3,877,958 between December 2000 and the end of 2002 (see XIV/4) and sums amounting to £1,718,953 between January 2003 and April 2005 (see XIV/6).
Summary of financial rewards from MGRG and PVH

Aside from returns from MGR Capital, the members of the Phoenix Consortium received the following financial rewards from MGRG and PVH during the period of approximately five years between Techtronic’s acquisition of MGRG in May 2000 and the appointment of administrators in April 2005:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Mr Beale</th>
<th>Mr Edwards</th>
<th>Mr Stephenson</th>
<th>Mr Towers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-2001</td>
<td>£807,834,10</td>
<td>£81,783,038</td>
<td>£82,775,978</td>
<td>£83,756,035</td>
</tr>
<tr>
<td>2001-2002</td>
<td>£81,763,715</td>
<td>£85,163,443</td>
<td>£86,163,536</td>
<td>£87,166,141</td>
</tr>
<tr>
<td>2002-2003</td>
<td>£88,2,544,783</td>
<td>£89,2,555,389</td>
<td>£90,2,548,696</td>
<td>£91,2,548,306</td>
</tr>
<tr>
<td>2003-2004</td>
<td>£92,3,594,683</td>
<td>£93,3,627,369</td>
<td>£94,3,592,678</td>
<td>£95,3,592,329</td>
</tr>
<tr>
<td>2004-2005</td>
<td>£96,294,764</td>
<td>£97,294,764</td>
<td>£98,294,764</td>
<td>£99,294,764</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8,981,355</strong></td>
<td><strong>9,024,003</strong></td>
<td><strong>8,975,652</strong></td>
<td><strong>8,957,575</strong></td>
</tr>
</tbody>
</table>

See paragraphs 4.1, 13.1 and 54 above.
See paragraphs 4.2, 13.2 and 54 above.
See paragraphs 4.3, 13.3 and 54 above.
See paragraphs 4.4, 13.4 and 54 above.
See paragraphs 4.1, 13.1, 50 and 54 above.
See paragraphs 4.2, 13.2, 50 and 54 above.
See paragraphs 4.3, 13.3, 50 and 54 above.
See paragraphs 4.4, 13.4, 50 and 54 above.
See paragraphs 4.1, 13.1, 50 and 54 above.
See paragraphs 4.2, 13.2, 50 and 54 above.
See paragraphs 4.3, 13.3, 50 and 54 above.
See paragraphs 4.4, 13.4, 50 and 54 above.
See paragraphs 4.1, 13.1, 50 and 54 above.
See paragraphs 4.2, 13.2, 50 and 54 above.
See paragraphs 4.3, 13.3, 50 and 54 above.
See paragraphs 4.4, 13.4, 50 and 54 above.
See paragraphs 4.1 and 13.1 above.
See paragraphs 4.2 and 13.2 above.
See paragraphs 4.3 and 13.3 above.
See paragraphs 4.4 and 13.4 above.
70. Mr Howe received the following financial rewards over the same period:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Mr Howe</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
</tr>
<tr>
<td>2000-2001</td>
<td>100592,296</td>
</tr>
<tr>
<td>2001-2002</td>
<td>1011,133,431</td>
</tr>
<tr>
<td>2002-2003</td>
<td>1022,025,613</td>
</tr>
<tr>
<td>2003-2004</td>
<td>1031,452,127</td>
</tr>
<tr>
<td>2004-2005</td>
<td>104504,925</td>
</tr>
<tr>
<td>Total</td>
<td>5,708,392</td>
</tr>
</tbody>
</table>

**MGR Capital**

71. On top of the financial rewards from MGRG and PVH, the members of the Phoenix Consortium and Mr Howe stand to obtain the following returns (in addition, in the case of Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers, to the return of their original £2 million investment) from their shares in MGR Capital as explained in chapter VII (Project Platinum):

<table>
<thead>
<tr>
<th></th>
<th>Each of Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers</th>
<th>Mr Howe</th>
<th>Total to Phoenix Partnership</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£ million</td>
<td>£ million</td>
<td>£ million</td>
</tr>
<tr>
<td>Preference dividends from incorporation to 2008</td>
<td>0.689</td>
<td>-</td>
<td>2.756</td>
</tr>
<tr>
<td>50% profit share from “B” shares</td>
<td>2.550</td>
<td>1.400</td>
<td>11.600</td>
</tr>
<tr>
<td>Total</td>
<td>3.239</td>
<td>1.400</td>
<td>14.356</td>
</tr>
</tbody>
</table>

**Remuneration from Edwards Cars**

72. Mr Beale and Mr Edwards also received gross remuneration and benefits from Edwards Cars as follows during the years after Techtronic’s acquisition of MGRG:

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100 See paragraphs 6 and 13.5 above.
101 See paragraphs 6, 13.5 and 50 above.
102 See paragraphs 6, 13.5 and 50 above.
103 See paragraphs 6, 13.5 and 50 above.
104 See paragraphs 6, 13.5 and 50 above.
105 See VII/217 to 221.
106 These dividends were in part paid prior to 8 April 2005.
107 These moneys have yet to be realised.
108 As to which, see chapter XIV (Edwards Cars).
<table>
<thead>
<tr>
<th>Tax year</th>
<th>Salary/benefits</th>
<th>Mr Beale</th>
<th>Mr Edwards</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-2001</td>
<td>Salary</td>
<td>£20,039</td>
<td>£20,045</td>
</tr>
<tr>
<td></td>
<td>Benefits</td>
<td>£3,179</td>
<td>£2,001</td>
</tr>
<tr>
<td>2001-2002</td>
<td>Salary</td>
<td>£2,512</td>
<td>£2,029</td>
</tr>
<tr>
<td></td>
<td>Benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002-2003</td>
<td>Salary</td>
<td>£2,512</td>
<td>£1,663</td>
</tr>
<tr>
<td></td>
<td>Benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003-2004</td>
<td>Salary</td>
<td>£2,512</td>
<td>£1,852</td>
</tr>
<tr>
<td></td>
<td>Benefits</td>
<td></td>
<td>Unknown</td>
</tr>
<tr>
<td>Total</td>
<td>Salary</td>
<td><strong>33,266</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Benefits</td>
<td></td>
<td><strong>27,590</strong></td>
</tr>
</tbody>
</table>

73. Cash flows described in this chapter are shown diagrammatically on the following page.
* Refer to paragraph 65 above for an explanation as to how this cash was accounted for
The other directors of MGRG

74. The other directors of MGRG received the following gross remuneration (including bonuses and car allowance) from the Group between 9 May 2000 (when Techtronic acquired MGRG) and 8 April 2005 (when MGRG went into administration):

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Mr Beddow</td>
<td>185,000</td>
<td>191,359</td>
<td>211,365</td>
<td>314,819</td>
<td>149,075</td>
</tr>
<tr>
<td>Mr Bowen</td>
<td>176,667</td>
<td>210,798</td>
<td>197,003</td>
<td>319,479</td>
<td>159,216</td>
</tr>
<tr>
<td>Mr Millett</td>
<td>482,869</td>
<td>320,238</td>
<td>513,134</td>
<td>700,179</td>
<td>356,475</td>
</tr>
<tr>
<td>Mr Oldaker</td>
<td>160,956</td>
<td>258,767</td>
<td>315,459</td>
<td>446,124</td>
<td>199,233</td>
</tr>
<tr>
<td>Mr Parkinson</td>
<td>248,226</td>
<td>229,318</td>
<td>Not a director after 26.04.02</td>
<td>Not a director</td>
<td>Not a director</td>
</tr>
<tr>
<td>Mr Petrie</td>
<td>Not a director</td>
<td>Not a director</td>
<td>Not a director</td>
<td>Not a director</td>
<td>76,459</td>
</tr>
<tr>
<td>Mr Ramsay</td>
<td>Not a director</td>
<td>Not a director</td>
<td>Not a director</td>
<td>Not a director</td>
<td>Unknown</td>
</tr>
<tr>
<td>Mr Sanders</td>
<td>Not a director</td>
<td>Not a director</td>
<td>150,892.96</td>
<td>111,33,281</td>
<td>Not a director</td>
</tr>
<tr>
<td>Mr Shine</td>
<td>173,931</td>
<td>209,602</td>
<td>220,761</td>
<td>366,165</td>
<td>156,642</td>
</tr>
</tbody>
</table>

75. The directors also had medical insurance and membership of a pension scheme.

The directors’ approach

76. In May 2001, on the first anniversary of the acquisition of MGRG, the four members of the Phoenix Consortium went on holiday to Portugal together. Mr Edwards told us that during the holiday Mr Beale and Mr Stephenson discussed “ways in which we should be appropriately remunerated” and that it became apparent that they had gained Mr Towers’ support or at least concurrence. Mr Edwards said that, after staying “awake all one night on the couch”, he pointed out to the other members of the Phoenix Consortium that the remuneration the four received “must be appropriate to what [they] were achieving, that it must be taken under advice and that it should be benchmarked in a way that could be seen as an industry standard or something that was appropriate, with visibility, should people on the outside want to take issue with it”. Mr Edwards’ recollection was that, on returning from Portugal, he spoke to Mr Einollahi, who, Mr Edwards said, “assured [him] that [the members of the Phoenix Consortium] were underpaid” but said that “he would talk to Peter [Beale] and come up with an appropriate solution for it”.

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109 Mr Parkinson remained a director of other companies in the Group, in particular Xpart, see XIII/12, 29 and 30.
110 Mr Sanders became a director of MGRG on 26 April 2002.
111 Mr Sanders resigned as a director of MGRG on 30 June 2003.
112 Mr Petrie did not receive medical insurance.
77. Mr Towers and Mr Beale gave evidence to rather different effect. Mr Towers said that during the holiday “there was no discussion, absolutely no discussion on how much [the members of the Phoenix Consortium] should be paying [themselves]”. He also said:

“... I do think if John [Edwards] had been in a sort of mental decline as a result of him worrying about issues of payment that I would have noticed it. I certainly didn’t.”

For his part, Mr Beale said:

“... I have no reason to disbelieve that there was a debate about bonuses at some point; I just don’t think it would have been in Portugal, when we had our wives with us.”

78. However, Mr Einollahi was told at the time that remuneration had been discussed during the Portuguese holiday. Mr Einollahi’s recollection was that, following the holiday, Mr Beale or Mr Stephenson had told him that “they had resolved this matter” and “had persuaded John”, which Mr Einollahi took to mean Mr Towers. Mr Einollahi told us:

“... they went on to say, what they will do is they will give themselves bonuses where they have created the value. They won’t take anything out of the car business.”

79. Mr Einollahi’s evidence confirms, in our view, that questions of remuneration were aired during the Portuguese holiday. The likelihood is, moreover, that Mr Edwards raised concerns about remuneration. Mr Einollahi probably misunderstood, or has misremembered, which “John” (Towers or Edwards) needed to be persuaded.

80. Notes made by Mr Birkett of Deloitte of a conference call on 16 August 2001 involving others from the firm (namely, Mr Einollahi, Mr Hume and Mr Bushill) include the following:

“Bonuses for

... £100k/yr in lieu of pensions

... Studley exit from capital

... Powertrain cash payment from BMW”.
Chapter XXI
Financial rewards

It appears, therefore, that by mid-August the idea was in circulation that the members of the Phoenix Consortium would take bonuses in lieu of pension provision (of £100,000 each a year) and also in respect of Studley Castle and BMW’s contribution to the Powertrain Escrow Account\textsuperscript{113}.

81. As explained in chapter VII (Project Platinum)\textsuperscript{114}, in September 2001 Ms Lewis of Eversheds was “roundly ticked off” by Mr Beale, who said that Eversheds “were not anybody’s moral guardians” and, in essence, that it was not for Ms Lewis to judge the morality of the directors taking benefits for themselves. Ms Ruston said that Ms Lewis had come to see her after the meeting with Mr Beale and that she thought that Mr Beale had suggested to Ms Lewis “that it wasn’t her position to be raising questions about the directors’ remuneration and that she had done it on a number of occasions in a way that he had thought was inappropriate”.

82. A document dating from 2003 which we found in the Group’s files reads as follows:

“Background:

- Loan notes – Deloitte & Touche ... agreed with BMW that the Phoenix Consortium (‘PC’) ... would be issued with 75 million of loan notes
- PC agreed to take 10 million & have performance/risk related bonuses (but subsequently that the 10 million loan notes would be secured with a cash deposit)
- PC agreed to take an annual bonus equivalent to K Howe bonus levels
- PC agreed to take an annual payment (currently 100,000 per individual) for non-participation in company pension scheme
- Agreed to pay PC one off bonuses based on achievement of key business deals or achievement of cash flow profits outside of normal MG Rover trading activities
- The intention was that the above bonuses would over a 5 year period equate to the 65 million shortfall in loan notes

Studley Castle

... 

\textsuperscript{113} It is evident from Mr Birkett’s notes that Project Platinum was also discussed during the conference call. It was on that same day (16 August 2001) that BoS was sent a fax (see VII/73) in which Mr Einollahi, responding to “BoS’s preference for MGR being the JV partner” for Project Platinum, stated that the members of the Phoenix Partnership “firmly believe it is inequitable that they should now be deprived the opportunity to be rewarded for their enterprise”.

\textsuperscript{114} See VII/103.
Chapter XXI
Financial rewards

- *Purchase was by PVH & agreed any profit or loss would be to benefit/cost of PC*

**Powertrain Escrow release**

- ...
- ... agreed that monies would be paid to PVH and PC would take 75% of funds released
- **N.B. Due to tax planning delays (re possibility of restructuring loan notes) the payment in respect of June 02 & December 02 have not yet been made**

**RV Capco Fund**

- *PC agreed to accept personal liability for exposure of HBOS in excess of value of fund and agreed to take a 75% share of any surplus as bonus*

**Aircraft Leasing -2**

- *Agreed that PC would take 75% of any surplus as bonus*

*In addition to the above PVH has agreed certain bonus arrangements with K Howe outside his contract of employment as follows:*

- *Annual bonus cap would be increased from 100% of annual salary to 1 million per annum*
- *A share of profit on Studley Castle equal to one half of an individual PC share*
- *A payment schedule based on release of Powertrain Escrow monies as follows:*
  
<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>30/06/02</td>
<td>150,000</td>
</tr>
<tr>
<td>31/12/02</td>
<td>150,000</td>
</tr>
<tr>
<td>30/06/03</td>
<td>150,000</td>
</tr>
<tr>
<td>30/09/03</td>
<td>150,000</td>
</tr>
<tr>
<td>31/12/03</td>
<td>150,000</td>
</tr>
<tr>
<td>2004</td>
<td>750,000</td>
</tr>
</tbody>
</table>

*PVH has also agreed to the payment of bonuses to all MG Rover Board members on the achievement of a surplus in the RVCapco fund.*

83. Mr Beale said that, while he did not recall this document, it was “the sort of thing [he] would have prepared” and that his best guess was that it had been produced with a view to discussion between the four members of the Phoenix Consortium. Mr Beale commented that the section of the document headed “Background” was “fine”, as was the part referring to
The other members of the Phoenix Consortium queried the document. Mr Towers told us that he had never seen it before, that he was “very puzzled with it on a number of fronts” and that there were “words in [it] that ... for [him] would have been unacceptable”. Mr Towers said, more specifically, that there had been no intention that bonuses should equate to any particular figure over any period. Mr Stephenson stated that he did not remember seeing the document before and that, while the members of the Phoenix Consortium “believed in objective-driven bonusing” and there was discussion at some point of “the fact [the members of the Phoenix Consortium] were not participating in any pension scheme”\(^\text{115}\), he did not remember an intention that bonuses should “over a five-year period equate to the 65 million shortfall in loan notes” or anything along those lines “in those specific terms” and it was not his understanding that the Phoenix Consortium were to take 75 per cent of any surplus from the “RV Capco fund” or the second aircraft transaction. Mr Edwards told us that he had not seen the document before and was “somewhat surprised” by it. He did “not ever recall having a structured conversation about remuneration at any point in the past”.

However, Mr Einollahi confirmed to us that it was an ambition of the Phoenix Consortium that bonuses of £65 million (being the shortfall in loan notes) should be paid over five years; by way of background, Mr Einollahi told us that the Phoenix Consortium’s view was “they had become entitled to that £75 million [i.e. the £75 million contributed by BMW during the original acquisition in lieu of warranties]”. Mr Einollahi also told us that the idea of paying “one off bonuses based on achievement of key business deals or achievement of cash flow profits outside of normal MG Rover trading activities” represented the “main premise for [the Phoenix Consortium’s] rationale for their own bonuses”.

With regard to the section of the document quoted in paragraph 82 above which refers to him, Mr Howe told us that he was told that his potential bonus would be increased to £1 million, but that that had never happened. He also told us that he remembered the Phoenix Consortium “talking about potential possible sums” but not as being from Powertrain escrow moneys. He said that the reference to a share of profit on Studley Castle was “complete news” to him.

The question of bonuses was evidently the subject of comment between Mr Einollahi, Mr Dillon of Deloitte and Mr Cowburn (by then employed by PVH) on 14 May 2003, in the context of Project Battens (the joint venture with Mr Yang under discussion in 2003)\(^\text{116}\). A

\(^{115}\) It is to be noted that Mr Stephenson was in fact already in receipt of a relatively large pension as a result of his earlier service with MGRG; in 2003-2004, for instance, Mr Stephenson received a gross pension of £65,835. In the same year, Mr Towers received a pension of £50,452 from the same source.

\(^{116}\) See XIX/91 to 100.
note made by Mr Dillon headed “Summary of meeting with ME 14.5.03” includes the following:

“Before the deal is completed certain steps must be taken to protect the interest of the D shareholders re bonuses due in excess of the £16m already paid out:

(i) Studley Castle is to be removed from PVH group by way of dividend in specie for D shareholders. This dividend will be paid after the loan due from Studley Castle Limited to PVH of £2.9m has been waived to leave the company clean of liability. The estimated market value of the property makes this dividend an effective £5m bonus to D Shareholders.

(ii) CY [i.e. Mr Yang] to be made aware of an obligation to pay D Shareholders £20m bonus from Powertrain escrow account ... The BMW funding was regarded by D Shareholders from the outset as cash that should be used to pay bonuses to them. Some £8m has been drawn down so far, a further £17m is available. This has been rounded to £20m in this summary.

(iii) CY to be made aware of an obligation to pay D Shareholders £9m from profits made in RV CapCo Limited. The total profits are estimated at £15m, of which £1m is to be set aside for the benefit of the MGRG board. The remaining £14m is approx 75% available to PVH hence £9m request.

Taken together these three matters present a further £34m bonus to D Shareholders achieving their target of £50m in total ...”

For his part, Mr Cowburn sent Mr Beale an email on 15 May 2003 referring to the meeting he had had with Mr Einollahi the previous day. In this, he said:

“Outline proposal is

(a) Waive amounts due from Studley to PVH and divi shares in Studley to Phoenix value c.£5million

(b) Provide for future bonus payments as follows: RV Capco £15million

Escrow balance £17million

Tax PVL2 £3million
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The above excludes c£3 million from RV Capco for MGR bonuses and only takes up the escrow balance input by BMW ie £25 million. The above gives a future total of £40 million to take as realisations are made over the next couple of years, taken together with bonuses already drawn to date of £16 million this would give a total pot of £66 million including the £10 million of loan notes …”

Mr Cowburn told us that he thought that he had been given the information in the email by Mr Einollahi, but that “the guys may have had a conversation previously with Maghsoud as to … what their aspirations were”. In contrast, Mr Einollahi said that he had been given the information by Mr Cowburn.

88. When we asked Ms Ruston about Mr Dillon’s note, she said that it was her understanding that “in respect of the £25 million that was the money that BMW introduced into … the Powertrain deal, it had been decided that … it would be distributed by way of bonuses to the D shareholders and to Kevin Howe” when it was released from the blocked bank account (though Ms Ruston said that she did not know how much of the money was to be treated in this way). Mr Einollahi, too, told us that the members of the Phoenix Consortium “were thinking of taking a bonus out of the £25 million which went into Powertrain escrow account”. He also observed that by this stage the members of the Phoenix Consortium had “downgraded their ambition to target at 50 million rather than a higher number”.

89. On the other hand, Mr Towers said that he did not have a £50 million target for remuneration and that he knew “nothing” about such a target. Mr Stephenson said as regards Mr Dillon’s note that he had “no knowledge of this document or this debate” and that he had no recollection of the content of Mr Cowburn’s email being discussed with him. Mr Edwards told us that he was not aware of there being a £75 million benchmark for remuneration or of anyone reckoning that BMW’s contribution to the Powertrain Escrow Account should be used to pay bonuses to the members of the Phoenix Consortium or Mr Howe, that he did not perceive there to be an obligation to pay the “D” shareholders £9 million from profits made in RV Capco and that “Peter Beale would have had to translate” for him the proposal relating to Studley Castle Limited.

90. Mr Beale clearly played the leading role in working out exactly when and how payments should be made for the benefit of the members of the Phoenix Consortium and Mr Howe. Mr Edwards told us that “matters of remuneration were left very much with Peter [Beale] in terms of the rationale and the quantum”. Mr Howe told us that it would be Mr Beale and/or Mr Towers with whom he talked about monetary issues, be it “what … the four consortium members were paying themselves or whether it was paying [him] or paying [his] team”. Mr Stephenson said that “the person in the group who gave thought and usually commenced the discussion as to whether we had met our next target and what an appropriate sum might be was Peter [Beale]”. Mr Towers agreed that Mr Beale “was mainly the one who … administered this type of process and led this type of conversation”.

91. Mr Towers did not, however, attempt to suggest that Mr Beale was solely responsible for decisions about financial rewards. He said:
“... it would be wrong to say that it was purely [Mr Beale’s] opinion, and position. It was the position of all four of us.”

Mr Beale told us that he could “certainly remember having discussions [about remuneration] with Nick Stephenson in greater detail than, say, John Towers”. He also said that Mr Edwards would sometimes be interested on the “same level that Nick Stephenson was”, but “perhaps if car sales were not going as well, not so much”.

92. Mr Edwards himself told us that he was “not naïve enough or stupid enough to say that [he] wasn’t happy to be well paid”, but that he “wasn’t particularly motivated by remuneration” and did not pay particular attention to it. As far as he was concerned, matters were resolved after the holiday in Portugal mentioned in paragraph 76 above and he “didn’t feel the need to revisit remuneration from that point onwards”. He had no involvement in remuneration decisions but would be told, “It has been decided that we will be paid this level of bonus”. He “never totally understood the EBT [i.e. the Guernsey Trust]” and never really applied himself to the sources of PVH’s money.

93. Mr Einollahi’s impression was that Mr Towers “was the most adamant in not wanting ... bonuses”. In contrast, Mr Stephenson “was of the view that they should be rewarded”. Mr Beale, Mr Einollahi thought, “fell somewhere between John Towers and Nick [Stephenson]”. Mr Einollahi said that Mr Edwards “would say he was uncomfortable but that ... [he (Mr Einollahi)] was not necessarily persuaded that that was completely meant”.

94. With regard to Mr Howe’s role, Mr Howe told us that he played only a limited part in decisions about the remuneration of PVH’s directors. He said that “the decision of what was the achievement of a milestone was with the four”. He explained:

“... the way the process would work is they would have had whatever discussions they were having about what they thought was warranted for a particular milestone achievement, and then they would have the discussions between themselves, as opposed to with me. And then, effectively, there would have been a meeting to authorise those payments, by which time ... they will have reached an agreement, and then it only really comes down to whether we feel that those payments ... were warranted for the achievement of the milestone.”

As regards, for instance, the £7,705,125 contribution to the Guernsey Trust, Mr Howe said that he “was not involved in the conversations about how they’d arrived at the particular values for each of them”. Mr Howe also told us that he was not aware of a target of £50 million.

117 In respect of which see paragraph 30 above.
Mr Einollahi said that he remembered an occasion on which Mr Howe “uttered something to John Millett by way of, ‘Well, if it was your business would you be doing anything different?’” In evidence to us, Mr Howe said:

“... they were the owners of the business. So, I didn’t feel it was my place to particularly challenge how they constructed what they paid each other in relation to each other, for example. It was their business, they owned it. But that doesn’t mean I just sat there at a meeting, you know, sitting on my hands, because they were the owners and I wasn’t.”

Our own conclusion is that, as Mr Beale said, there was a general idea that over a period the members of the Phoenix Consortium were entitled to take bonuses of a certain sort of level and then, as and when particular opportunities presented themselves, they would take bonuses with that larger scheme in mind. We consider, moreover, that Mr Beale, Mr Edwards, Mr Stephenson, Mr Towers and Mr Howe all bear some responsibility for the payments PVH made to them or for their benefit. All five individuals were directors of PVH, and all are recorded in the board minutes as having attended every relevant board meeting. Even if, as appears to be the case, the minutes are not wholly reliable, each of the five directors must have known of the payments made to or for him and should have known of the payments made to or for the other directors. Each director should, moreover, have been sufficiently familiar with PVH’s affairs to understand its sources of funding.

**Particular topics**

**Past remuneration**

None of PVH’s directors had previously enjoyed rewards on the scale of those they received from the Group.

Taking the directors briefly in turn:

98.1. in the years before Techtronic acquired MGRG, Mr Beale and Mr Edwards were both directors of Edwards Cars. In 1999 the emoluments of Mr Edwards, his wife and Mr Beale amounted in total to £110,061, and the emoluments of the highest paid director (excluding pension contributions and benefits in kind) were £36,250. Further, Mr Edwards told us that he could not recall earning money from any source other than Edwards Cars; while he and Mr Beale also had interests in Stratford Auto Body Centre and a car leasing business, he thought that he was “centrally remunerated”. Mr Beale commented that he “never used to draw very much salary at all from any of [his] companies”, but Stratford Auto Body Centre nevertheless generated profits of only £15,073 in the year ended 30 June 1999 and £2,463 in the next year (so that the company had net assets of £72,061 at 30 June 2000) and Advanced Management (the company through which the leasing business was

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118 As to which, see chapter XIV (Edwards Cars).
119 Advanced Management’s 1999 financial statements state that no director’s remuneration was paid during the year.
carried on) produced profits after tax of just £6,771 in the year ended 31 August 1999 and £3,520 in the following year (with the result that the company had net assets of £52,175 at 31 August 2000); Edwards Cars’ retained profit for 1999 was only £57,031. In evidence to us, Mr Edwards accepted that the sums he received from the Group were very substantially in excess of any remuneration or income he had ever had before. Mr Beale similarly accepted that he had not previously been remunerated at levels which began to approach those he received during his involvement with the Group;

98.2. Mr Stephenson was a full-time employee and director of MGRG during the period it was owned by BMW. In 1998, the last full year before Mr Stephenson resigned as a director on 30 April 1999, the emoluments paid to or receivable by the company’s highest paid director were £284,095; Mr Stephenson’s remuneration will therefore have been no more than (and in all probability less than) this figure. After leaving MGRG, Mr Stephenson became a consultant for Lola, for which he was paid “a salary and a commission based on a percentage of the turnover he generated”. Mr Stephenson’s tax return for 2000-2001 shows that he had self-employment income that year (during which, of course, most of his time will have been devoted to the Group) of £12,000. When we asked Mr Stephenson to confirm that he had never previously been remunerated at levels approaching his remuneration from the Group, he said, “In terms of an annual receipt that probably would be fair”;

98.3. in the period before Techtronic’s acquisition of MGRG, Mr Towers was chief executive of Concentric. The financial statements of Concentric for the year to 30 September 1999 record that the group’s highest paid director received that year emoluments of £240,000, company pension contributions of £24,000 and accrued pension benefits of £16,000. In evidence to us, Mr Towers said that he thought that he had been paid “£200,000-something, plus whatever bonuses were paid”; and

98.4. as managing director of Rolls Royce’s fan systems division, Mr Howe had an annual salary of about £100,000. When giving evidence to us, Mr Howe reckoned that his total package, including car and other benefits, might have been worth about £170,000 a year, in addition to which he had the benefit of a share option scheme.

**Comparative remuneration**

99. One justification advanced for the rewards which the members of the Phoenix Consortium and Mr Howe received related to earnings in other organisations. Mr Einollahi referred to Mr Beale or Mr Towers drawing a comparison on one occasion with remuneration in the City and for corporate finance. He also said:

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120 See IV/8.
121 An invoice to Lola from “NJS Solutions” dated 1 February 2001 indicates that Mr Stephenson charged £4,000 for his role as “Non Executive Director Special Projects” over the period October 2000 to January 2001, suggesting that his annual fee for this role would be £12,000.
122 See V/6.1.
“... the examples [the Phoenix Consortium] used to use were disparaging remarks about City bonuses; some young men were receiving substantial bonuses for having contributed very little, or in their view very little. And also, occasionally disparaging remarks about Deloitte’s fees.”

In similar vein, Mr Howe said that he remembered:

“... occasionally, typically Nick [Stephenson], I think, the odd tirade about the amount of money earned by other executives in other car companies, some of them earning very, very significant sums of money, multiple millions, in other organisations which weren’t necessarily doing so well themselves”

Mr Edwards told us that Mr Stephenson and Mr Towers “were always on about if you were working for Ford and doing this much work or working for Jaguar in doing this work or indeed if we were still working for BMW at this time and doing this much work, you would be earning more money and bonuses than we were actually taking at that time”.

100. It is, in fact, far from easy to identify a company comparable to MGRG or PVH. We do not think that comparisons with remuneration in the City or for corporate finance are of any relevance. Nor was any company in the car industry quite like the Group. Mr Towers recognised this in his evidence. He commented:

“... I would venture to say that it would probably be very difficult to identify a comparator-type salary position and benefits position even within the car industry.”

101. We have seen no contemporaneous documentary evidence that indicates that the Phoenix Consortium obtained comparative remuneration rates when setting their own remuneration.

102. Nonetheless, we set out below the emoluments of the highest paid director of a number of companies in the automotive industry in the period between 2000 and 2004, as taken from the companies’ published financial statements:

<table>
<thead>
<tr>
<th>Company</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ford Motor Company Limited123</td>
<td>£387,470</td>
<td>£181,237</td>
<td>£114,289</td>
<td>£148,918</td>
<td>£179,135</td>
</tr>
<tr>
<td>Honda Motor Europe Limited124</td>
<td>£382,142</td>
<td>£423,060</td>
<td>£466,467</td>
<td>£422,014</td>
<td>£532,817</td>
</tr>
<tr>
<td>Land Rover Holdings Limited</td>
<td>£176,692</td>
<td>£176,495</td>
<td>£226,565</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

123 Ford Motor Company Limited had a turnover far in excess of that of the Group (£7.2 billion in 2004) and was profitable in 2002 and 2004 (though not in the other years).
124 Honda Motor Europe Limited had a turnover very substantially in excess of that of the Group (£3.9 billion in 2004) and was profitable in 2003 and 2004 (though not in the other years).
Chapter XXI
Financial rewards

<table>
<thead>
<tr>
<th>Company</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Morgan Motor Company Limited(^{125})</td>
<td>£132,164</td>
<td>£133,623</td>
<td>£248,419</td>
<td>£145,402</td>
<td>£173,134</td>
</tr>
<tr>
<td>Nissan Motor Manufacturing (UK) Limited(^{128})</td>
<td>£232,000</td>
<td>£245,000</td>
<td>£338,000</td>
<td>£243,000</td>
<td>£139,000</td>
</tr>
<tr>
<td>Toyota Motor Manufacturing (UK) Limited(^{130})</td>
<td>£345,000</td>
<td>£237,000</td>
<td>£231,000</td>
<td>£258,000</td>
<td></td>
</tr>
<tr>
<td>Volkswagen Group United Kingdom Limited(^{133})</td>
<td>£211,000</td>
<td>£251,000</td>
<td>£273,000</td>
<td>£301,000</td>
<td>£303,000</td>
</tr>
</tbody>
</table>

103. Representations made to us on behalf of the members of the Phoenix Consortium draw a comparison with the remuneration paid to directors of the main board of Ford. However, Mr Howe recognised when giving evidence to us that the issues facing a company like Ford were not the same as those the Group faced; he said:

“*They are obviously different ... They are different scale; their losses were a different scale as well for that matter.*”

Mr Howe said that the Group would look at “Jaguar and Landrover as opposed to Ford directly”. For his part, Mr Stephenson agreed that the hive-outs\(^{134}\) effected in advance of the transfer of MGRG to Techtronic meant that it was a shadow of its former self.

104. Representations made to us on behalf of PVH’s directors also drew comparisons with “Number One” and “Number Two” directors of FTSE 100 companies and with main board directors with professional roles of large public companies (with turnovers of between £1 billion and £5 billion annually). Since no company in the Group was even listed, let alone included in the FTSE 100, we do not find comparisons with FTSE 100 companies helpful.

\(^{125}\) Morgan Motor Company Limited’s turnover was a fraction of that of the Group (£15.7 million in 2003, the last year for which full financial statements are available), the company was largely profitable.

\(^{126}\) This figure is for the 19-month period to 31 December 2002.

\(^{127}\) While this figure includes pension contributions, that is not invariably the case with earlier years.

\(^{128}\) Nissan Motor Manufacturing (UK) Limited had a turnover significantly in excess of that of the Group (£2 billion in 2004) and was, moreover, profitable.

\(^{129}\) The figures do not include pension contributions.

\(^{130}\) Toyota Motor Manufacturing (UK) Limited was profitable in 2004, but not in the other years. The company’s turnover and vehicle sales were not dissimilar to those of MGRG in 2000 to 2003. In 2004, however, the company sold 243,171 vehicles from its Burnaston assembly plant.

\(^{131}\) The figure is for the 15 month period to 31 March 2002.

\(^{132}\) The figures do not include pension contributions.

\(^{133}\) Volkswagen Group United Kingdom Limited is a sales organisation, the principle activity being the “importation and distribution” of vehicles and parts. Volkswagen Group United Kingdom Limited had a turnover very substantially in excess of that of the Group (£4.9 billion in 2004) and was profitable in every year except 2003.

\(^{134}\) See III/7.2 and 89.
With respect to the remuneration of large public companies, the representations made to us included the following statistics:\(^{135}\):

<table>
<thead>
<tr>
<th>Main board professional roles</th>
<th>Lower quartile</th>
<th>Upper quartile</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>large plcs (turnover £1bn-£5bn)</td>
<td>£'000</td>
<td>£'000</td>
<td>£'000</td>
</tr>
<tr>
<td>Basic salary</td>
<td>213</td>
<td>336</td>
<td>275</td>
</tr>
<tr>
<td>Bonus</td>
<td>128</td>
<td>202</td>
<td>165</td>
</tr>
<tr>
<td>Share options</td>
<td>64</td>
<td>101</td>
<td>83</td>
</tr>
<tr>
<td>Performance options</td>
<td>128</td>
<td>202</td>
<td>165</td>
</tr>
<tr>
<td>Other benefits (excl. pension)</td>
<td>5</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td><strong>Total remuneration</strong></td>
<td><strong>538</strong></td>
<td><strong>849</strong></td>
<td><strong>695</strong></td>
</tr>
</tbody>
</table>

The annual financial rewards which the members of the Phoenix Consortium and Mr Howe received amounted to more than even the upper quartile figure\(^{136}\).

105. BMW certainly did not consider the levels of payment which the members of the Phoenix Consortium received to be appropriate. Mr Brooks of Norton Rose told us that BMW had a reaction of “extreme horror” when reports of the extent of the benefits the members of the Phoenix Consortium had derived from the Group appeared in the press. Dr Reul of BMW said that he thought that the members of the Phoenix Consortium had been “entitled to make what directors in similar positions in other companies would make”, but “that personal pension fund of 30 or more million pounds is way over the top; “nobody in our company,” he said, “has access to a pension fund that goes anywhere near that”\(^{137}\).

106. As regards Mr Millett, representations made to us on his behalf included the following table:

<table>
<thead>
<tr>
<th>Average annual pay for a FTSE250 finance director</th>
<th>Year 2003</th>
<th>Year 2004</th>
<th>Year 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£'000</td>
<td>£'000</td>
<td>£'000</td>
</tr>
<tr>
<td>Base salary</td>
<td>218</td>
<td>231</td>
<td>250</td>
</tr>
<tr>
<td>Annual bonus *</td>
<td>174</td>
<td>144</td>
<td>180</td>
</tr>
<tr>
<td><strong>Total annual pay</strong></td>
<td><strong>392</strong></td>
<td><strong>375</strong></td>
<td><strong>430</strong></td>
</tr>
</tbody>
</table>

* Excludes share/stock options, deferred bonuses and longer-term incentive

However, Mr Millett’s total remuneration was as high as £700,000 in 2003-2004\(^{138}\).

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\(^{135}\) The source is given as PwC Review of Parliamentary Pay and Allowances April 2004.

\(^{136}\) See paragraph 69 to 70 above.

\(^{137}\) As noted in paragraph 49 above, sums totalling £17.03 million were paid to the Guernsey Trust which included contributions on behalf of Mr Howe and Ms Ruston.

\(^{138}\) See paragraph 74 above.
Financial contributions and risks

107. Mr Petrie told us that the justification for the financial rewards that he had heard most frequently used was “the relationship between the remuneration that they took from the company, and the risk that they took ... at the early stages of the acquisition”. Mr Petrie, however, observed:

“If you really analyse that, it was relatively small beer for them and there wasn’t really any proportionality between what they actually individually put at risk and what they actually individually ended up with.”

108. We agree. As we explain in chapter III (The sale of Rover), the financial contributions made, and risks undertaken, by the members of the Phoenix Consortium when MGRG was acquired were quite modest.\(^{139}\)

Financial performance

109. While PVH itself, taken in isolation from the rest of the Group, was profitable over the years between 2000 and 2005 (essentially because of the aircraft transactions and the dividends it received from Techtronic - see paragraphs 59 to 68 above), the Group as a whole incurred very large, even if diminishing, losses. The consolidated profit and loss accounts included in PVH’s financial statements for the years ended 31 December 2001 to 2003 record as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£ million</td>
<td>£ million</td>
<td>£ million</td>
</tr>
<tr>
<td>Loss</td>
<td>103.3</td>
<td>75.0</td>
<td>64.1</td>
</tr>
</tbody>
</table>

MGRG made, overall, still larger losses, as explained in chapter XVI (Financial and trading performance of MGRG).

110. The matters mentioned in paragraphs 20, 29, 42 and 47 above also testify to the financial pressures on the Group.

Qualifications and experience

111. Mr Towers (a former chief executive of MGRG\(^{140}\)) and Mr Stephenson (an engineer who had worked in the automotive industry for many years and been a director of MGRG for several of them\(^{141}\)) had experience of obvious relevance to their roles as directors of companies in the Group. Mr Beale, too, seems to us to have shown himself to have had

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\(^{139}\) See III/64, 69 to 83 and 92.  
\(^{140}\) See IV/4.  
\(^{141}\) See IV/7 to 8.
relevant skills. A former chartered accountant\(^{142}\), he exhibited a good grasp of the Group’s affairs and played an important part in them. In evidence to us, Mr Einollahi expressed the view that Mr Beale was “a competent finance man” and said that “there was nothing about his ability [he (i.e. Mr Einollahi)] ever doubted”.

112. In contrast, we doubt whether Mr Edwards’ skills and experience made him well suited to his responsibilities as a director of Group companies. Mr Edwards had long been a Rover dealer and had served on major Rover dealership networks (for example, the Rover Franchise Board). We question, however, whether such experience equipped him to be a director of a manufacturer with an annual turnover significantly in excess of £1 billion.

113. Mr Edwards showed his lack of knowledge and understanding of financial matters on numerous occasions when giving his evidence to us; by way of example, we have mentioned in this chapter that Mr Edwards said that “Peter Beale would have had to translate” for him a proposal relating to Studley Castle Limited\(^{143}\), that he “never totally understood the Guernsey Trust”\(^{144}\) and that he never really applied himself to the sources of PVH’s money\(^{145}\).

114. We do, however, acknowledge that more than one witness has testified to Mr Edwards’ commitment to the Group, commenting on his contribution to those projects in which he was involved, for example the collaboration with Tata\(^{146}\).

**The legal context**

115. PVH’s articles of association incorporated regulation 82 of Table A in the First Schedule to the Companies (Tables A to F) Regulations 1985 (which provided model articles of association). That regulation provided:

> “The directors shall be entitled to such remuneration as the company may by ordinary resolution determine …”

Of itself, this regulation provided for directors’ remuneration to be determined by the company’s shareholders rather than by the directors themselves.

116. Article 18 of PVH’s articles of association (entitled “Gratuities and Pensions”) empowered the company’s directors to “exercise any powers of the Company conferred by its Memorandum of Association to give and provide pensions, annuities, gratuities or any other benefits whatsoever to or for past or present directors or employees (or their dependants) of the Company or any subsidiary or associated undertaking ... of the Company and the

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\(^{142}\) See IV/15. As Mr Beale confirmed, he ceased to be a member of the Institute of Chartered Accountants simply because he “stopped paying [his] subscriptions”, not because of any suggestion of impropriety.

\(^{143}\) See paragraph 89 above.

\(^{144}\) See paragraph 92 above.

\(^{145}\) See paragraph 92 above.

\(^{146}\) See XIX/49 to 59.
directors and such other persons shall be entitled to retain any benefits received by them or any of them by reason of the exercise of any such powers”. It has been argued in representations made to us on behalf of PVH’s directors that this article vested in PVH’s board (as opposed to its shareholders) “the power ... given to the company in Regulation 82 of Table A, namely to remunerate directors”. There may be scope for argument about this since (a) article 18 provides for the exercise of powers “conferred by [the company’s] Memorandum of Association” whereas regulation 82 of Table A forms part of PVH’s articles of association and (b) article 18 is more obviously concerned with “Gratuities and Pensions” (its heading) than directors’ remuneration generally. Assuming, however, that PVH’s articles did authorise its board to determine directors’ remuneration, it will presumably have been incumbent on the company’s directors to exercise their powers in accordance with the general duties of directors and so (a) for proper purposes, (b) with reasonable care, skill and diligence and (c) so as to promote the success of the company for the benefit of its members as a whole.

117. Aside from the general duties of directors, case law indicates that the exercise of a power to award remuneration to a director can be impugned if the transaction in question was not “a genuine exercise of the power”. The position was explained as follows by Mr Justice Oliver in Re Halt Garage (1964) Ltd\(^\text{147}\):

> “Those who deal with a limited company do so on the basis that its affairs will be conducted in accordance with its constitution, one of the express incidents of which is that the directors may be paid remuneration. Subject to that, they are entitled to have the capital kept intact. They have to accept the shareholders’ assessment of the scale of that remuneration, but they are entitled to assume that, whether liberal or illiberal, what is paid is genuinely remuneration and that the power is not used as a cloak for making payments out of capital to the shareholders as such.”\(^\text{148}\)

The label used is not conclusive. Mr Justice Oliver explained:

> “... what the company’s articles authorise is the fixing of ‘remuneration’, which I take to mean a reward for services rendered or to be rendered; and, whatever the terms of the resolutions passed and however described in the accounts or the company’s books, the real question seems to me to be whether the payments really were ‘directors’ remuneration’ or whether they were gratuitous distributions to a shareholder out of capital dressed up as remuneration.

> ... If your intention is to make a gift out of the capital of the company, you do not alter the nature of that by giving it another label and calling it ‘remuneration’.”

\(^\text{147}\) [1982] 3 All ER 1016
\(^\text{148}\) [1982] 3 All ER 1016
“In the absence of any evidence of actual motive,” Mr Justice Oliver said, “the court must ... look at the matter objectively and apply the standard of reasonableness.”

118. Section 994 of the Companies Act 2006 (replacing section 459 of the Companies Act 1985) allows a shareholder in a company to apply for relief from the Court on the basis that the company’s affairs are being or have been conducted in a manner that is “unfairly prejudicial” to the interests of all or some of the company’s shareholders (including the applicant). On appropriate facts, the grounds of such an application can include (a) the payment of excessive remuneration to directors and (b) (which may be the opposite side of the same coin) failure to pay dividends.

119. It has been argued on behalf of PVH’s directors that “all the voting shareholders [in PVH] ratified and approved the payments to [the] Guernsey Trust pursuant to the principle in Re Duomatic.” As mentioned in chapter VII (Project Platinum), it is an open question whether the Duomatic principle (under which conduct can be approved by shareholders informally) can apply where the shareholders entitled to vote at a shareholders’ meeting (here, 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) has not been notified. In any case, the Duomatic principle will not necessarily be an answer to an application based on “unfair prejudice” even if it would be one to a complaint of breach of directors’ duties.

Remuneration/distributions

120. Representations made to us on behalf of PVH’s directors maintained that, whereas the loan notes issued by PVH in December 2000 were “consideration to Messrs Beale, Edwards, Stephenson and Towers as the shareholders of Techtronic, not ... a reward for their efforts as directors” and “any profit or gain earned through MGR Capital ... was a return on an investment made by Messrs Beale, Edwards, Stephenson and Towers”, the sums paid by way of salaries and bonuses and to the Guernsey Trust represented remuneration for the directors’ services as such. We were told, for example, that the payments were “payments to directors qua directors” and that:

“... each payment made to the Guernsey Trust by PVH was made either to a director or employee of PVH as remuneration for work undertaken by that director or employee. The remuneration was assessed on the basis of the achievement of certain milestones that the directors of PVH and its voting shareholders considered significant.”

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149 [1982] 3 All ER 1016
150 For a recent example, see Irvine v Irvine (No 1) [2007] 1 BCLC 349.
151 [1969] 2 Ch 365
152 See VII/201.2.
153 See V/49.
“The financial contributions made and risks undertaken by Messrs Beale, Edwards, Stephenson and Towers in connection with the purchase of MGRG by Techtronic” were, it was argued, “irrelevant to the question of the appropriateness of the levels of remuneration received by Messrs Beale, Edwards, Stephenson and Towers as directors of group companies.”

121. However, some of the evidence is more equivocal about the reasons for the bonuses and the payments to the Guernsey Trust. Thus, the minutes relating to the bonuses paid to the members of the Phoenix Consortium in June 2001 refer, not only to the “skills and experience” of the members of the Phoenix Consortium and to the “level of personal time and commitment that each of them had contributed”, but to the fact that “each member of the Consortium had invested a significant amount of their own money” and “the significant risk which each of the Consortium took at the time of the Acquisition [of MGRG]”. Mr Beale told us that his view was that the “starting benchmark” was the £65 million in loan notes which he perceived the members of the Phoenix Consortium as having foregone, which he acknowledged as “shareholder value”. Mr Stephenson said that he considered that “there was an appropriate element of [the £75 million figure] which we [i.e. the members of the Phoenix Consortium] would use to reward ourselves for the risks, the considerable risks we had taken”. He also said:

“... we had done a venture capital deal, we had secured a large sum of money ... We ended up if you like at the same time a venture capitalist and then the people running the company. So we would take sums of money to reward ourselves for doing the big deal and sums of money in way of salary for working in the companies that we were employed in.”

When we asked Mr Towers whether he had at any point thought that his rewards should be for ownership as distinct from services, he said:

“I am not sure we ever segregated the two issues or debated the two issues in those terms. The only debate on this issue was a reward for progress and achievement of certain specific objectives; not whether we were employees of the business or owners of the business or not.”

Asked what he knew about what top people within MGRG were paid when it was owned by BMW, Mr Towers replied, “nowhere near as much as the BMW owners”, indicating perhaps that he was thinking of himself also as an owner rather than merely a director.
122. There are, accordingly, indications in the evidence that the sums paid by way of bonus and to the Guernsey Trust were not viewed exclusively as remuneration for the recipients’ services as directors. Nonetheless, it is plain that the members of the Phoenix Consortium did not consider paying dividends (which could have accrued to the “A”, “B” and “C” shareholders as well as to themselves as the “D” shareholders154). Mr Towers said that he could not remember a conversation about dividend payments. Mr Stephenson said that he did not consider whether sums should be paid by way of dividend and, specifically, that he could not recall considering the interests of PVH’s “A”, “B” and “C” shareholders when deciding whether to make the £7.705 and £1.400 million payments155. Mr Howe was also clear that he had not thought about paying dividends and could not recall anyone else doing so either. Mr Beale said:

“... we didn’t ever expect to pay a dividend. We had always assumed that any A, B, C and D shareholders would be achieved on a disposal. There was never any intention or even thought given to paying a dividend.”

Mr Einollahi’s role

123. There were references to Mr Einollahi’s role in the evidence given to us by directors of PVH. For example, Mr Towers said that there were “a lot of comments ... initially, that we weren’t being remunerated properly” and that these comments were mainly made by Mr Einollahi. Mr Beale said that, given the nature of the relationship between himself and Mr Einollahi, he had an expectation that if Mr Einollahi were uncomfortable with the level of bonuses the members of the Phoenix Consortium were paying themselves he would say so.

124. On the other hand, Mr Towers commented that Mr Einollahi was “the last person in the world we would ever pay to advise on remuneration”.

125. Mr Einollahi himself maintained that he had not advised on remuneration. He said that it was “not [his] skill set to advise on remuneration” and that he was “never engaged ... to advise directors how to pay themselves or what to pay themselves” and “did not discuss with [the Phoenix Consortium] what they should take into account in deciding their remuneration”. He said that the Phoenix Consortium had tried to get Deloitte involved in remuneration matters, but that they had not succeeded. He stated:

“What the [Phoenix Consortium] chose to pay themselves was entirely a matter for them.”

154 The precise extent to which “A”, “B” and “C” shareholders would have shared in any dividends would have depended on whether any of the relevant distributable profits did not represent “MG Rover Profits” (within the meaning of PVH’s articles of association) because they did not derive from and were not fairly attributable to the “MG Rover Group” (within the meaning of the articles) – see V/49.

155 In respect of which see paragraph 30 and paragraph 38 above respectively
126. We consider that Mr Einollahi’s account is likely to be substantially correct and do not hold him responsible for the level of remuneration paid to the Phoenix Consortium, Mr Howe or Mr Millett.

**Explanations to MPs and shareholders**

127. When information relating to the Phoenix Consortium’s remuneration came into the public domain, concerns were raised by certain MPs.

128. Mr Beale wrote as follows in a letter to Mr Burden MP dated 11 November 2003:\(^\text{156}\):

“The Phoenix consortium has not taken any of the reported amounts from MG Rover all funds have been paid from separate Phoenix sources.

The individuals in the Phoenix consortium have invested considerable personal funds (including monies from personal pension investments) and put personal assets as security for loans for the benefit of MG Rover. This was done at a time when best professional advice suggested this was at best a high risk strategy …

... The Phoenix Consortium members made a significant personal investment in the acquisition of Rover Group from BMW and also personally underwrote certain professional fees and expenses (the total of which would have been in excess of £1,000,000) in the event of our bid to acquire Rover Group being unsuccessful … It was agreed at that time that in return for this investment risk that we would be entitled to a significant immediate reward. After taking over the Company we decided to not pay ourselves this reward immediately but would leave this money within the Group for a period of up to five years in exchange for the reported interest bearing loan notes …”

129. Mr Towers gave similar explanations in letters of 24 and 25 November 2003 to, respectively, Ms Julie Kirkbride MP and Dr Lynne Jones MP. Each of these letters, like Mr Beale’s letter to Mr Burden MP, stated that the sums which had been taken by the Phoenix Consortium had been “paid from separate Phoenix sources” and that the members of the Phoenix Consortium had “invested considerable personal funds (including monies from personal pension investments) and put personal assets as security for loans for the benefit of MG Rover” when “best professional advice suggested that this was at best a high risk strategy”. Mr Towers also wrote:

“The four of us took a huge financial risk in May 2000 and have continued to take financial risk over the last three years.”

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156 Mr Towers told us that he did not believe that he had seen this letter before it had been sent.
130. Much the same points were made in a paper which was agreed among PVH’s directors at about this time with a view to it being used as a basis for briefings to dealers, trade unions, senior management and others.

131. On 5 March 2004 the members of the Phoenix Consortium sent a letter to other (i.e. “A”, “B” or “C”) shareholders in PVH in which they stated:

“... what is not subject to opinion is the fact that we were the only people who took substantial financial and reputational risk in saving this business. Having done that and then being the only people in the business not to have, for example, normal benefits such as pension provision, would have been ridiculous.”

132. Mr Beale told Mr Burden MP in a letter dated 26 March 2004:

“... Techtronic receives income ... and incurs expenditure. Any surplus of income over expenditure is paid up to PVH by way of dividend. PVH receives this dividend income from Techtronic and also receives other income from other Group companies. PVH uses this income to cover its own costs ... Any surplus cash remaining in PVH is then lent back to MG Rover as it is required by MG Rover.”

133. When giving evidence to the Trade and Industry Committee on 30 March 2004, Mr Beale said:

“We certainly had personal liabilities in excess of £1 million on day one. We put £240,000 of our own money into the company which we would lose. We had to put up £500,000 cash each for MGR Capital and put quite a lot of personal assets at stake for that business which for me personally would have been personal devastation if anything had gone wrong over the last two years since we did that deal ...”

He also said that the interest which MGRG was charged by Techtronic was “put ... back into MG Rover to fund projects”.

134. In reality:

134.1. as explained in paragraphs 59 to 68 above, funds paid to the Phoenix Consortium were derived, even if indirectly, from MGRG. In particular, the contributions to the Guernsey Trust with which the correspondence and briefing note of November 2003 were concerned (viz. those revealed by the Group’s recently published 2002 financial statements) can be traced back to interest paid by MGRG and to the exploitation of MGRG’s tax losses;
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Financial rewards

134.2. as explained in chapter III (The sale of Rover), the Phoenix Consortium had invested relatively little in the Group and undertaken only limited risks\(^{157}\);

134.3. the Phoenix Consortium had not provided personal security for any obligations of MGRG. They had obtained a loan in 2001 on the security of the loan notes which they had had issued to them by PVH, but that was to fund the acquisition of their preferred shares in MGR Capital\(^ {158}\);

134.4. as explained in chapter III (The sale of Rover)\(^ {159}\), the Phoenix Consortium had not underwritten substantial professional fees and expenses; and

134.5. as explained in chapter III\(^ {160}\), the Phoenix Consortium did not have personal liabilities of in excess of £1 million in May 2000.

Conclusions

135. When they were acquiring MGRG, the members of the Phoenix Consortium were perceived to be acting for the public good and enjoyed public support accordingly\(^ {161}\). 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”. The perception was that the members of the Phoenix Consortium were taking on the challenge with a view to saving jobs and preserving the business.

136. To a very considerable extent, the members of the Phoenix Consortium were responsible for setting their own financial rewards\(^ {162}\). Furthermore, as described in this chapter, the PVH directors were able to create profits within PVH that could have arisen in MGRG, or could have been passed down to MGRG.

137. The members of the Phoenix Consortium sought to justify the amounts that they obtained by referring to specific achievements and milestones and to the risks they were taking. We accept that MGRG continued to trade, and thus jobs were secured and business was generated for MGRG’s suppliers, for five years from the time of Techtronic’s acquisition of MGRG. However, the Group failed to secure a major joint venture partner, a step that was identified as being necessary for its long term survival\(^ {163}\), and MGRG made substantial losses throughout the period\(^ {164}\). Indeed, MGRG’s losses in the five years were on such a scale that MGRG exhausted the BMW dowry and then used up the proceeds from sales of key assets such as the Longbridge land and the parts business, yet still had large net liabilities when it went into administration. Given the financial performance of MGRG, we

\(^{157}\) See III/64, 69 to 83 and 92.
\(^{158}\) See VII/25.
\(^{159}\) See III/69 to 75.
\(^{160}\) See III/76 to 83.
\(^{161}\) See III/38 to 43.
\(^{162}\) See V/67.
\(^{163}\) See III/93 to 98.
\(^{164}\) See chapter XVI (Financial and trading performance of MGRG).
do not consider that the achievements justify the rewards that the Phoenix Consortium obtained. We have also explained how in fact the members of the Phoenix Consortium did not take substantial financial risks in acquiring MGRG, and we do not consider that those risks justified the amounts that the Phoenix Consortium members obtained.

138. In summary, we consider that the money and benefits which the members of the Phoenix Consortium sought to obtain for themselves from the Group, and those which they in fact succeeded in obtaining (in respect of salaries, benefits, bonuses, loan notes and contributions to the Guernsey Trust), were unreasonably large having regard to the following:

138.1. the remuneration which the members of the Phoenix Consortium had commanded in the past and which was being paid in other companies\(^\text{165}\);

138.2. the relatively insubstantial financial contributions made, and financial risks undertaken, by the members of the Phoenix Consortium when MGRG was acquired in 2000\(^\text{166}\);

138.3. the fact that the members of the Phoenix Consortium did not subsequently make any financial contribution to the Group;

138.4. the qualifications and experience of the members of the Phoenix Consortium\(^\text{167}\);

138.5. the financial performance of the Group\(^\text{168}\);

138.6. the sources of the money which PVH paid in bonuses and to the Guernsey Trust\(^\text{169}\); and

138.7. the fact that the members of the Phoenix Consortium also stood to benefit from their involvement in MGR Capital\(^\text{170}\).

139. We also consider that the money and benefits which Mr Howe received from the Group (in respect of salary, benefits, bonuses and contributions to the Guernsey Trust), were unreasonably large having regard to matters such as the following:

139.1. the remuneration which he had commanded in the past and which was being paid in other companies\(^\text{171}\);

139.2. the fact that he did not make any financial contribution to the Group;

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\(^{165}\) See paragraphs 97 to 105 above.

\(^{166}\) See III/64, 69 to 83 and 92.

\(^{167}\) See paragraphs 111 to 114 above.

\(^{168}\) See paragraphs 109 and 110 above.

\(^{169}\) See paragraphs 59 to 68 above.

\(^{170}\) See VII/217 to 221.

\(^{171}\) See paragraphs 97 to 105 above.
139.3. the financial performance of the Group\textsuperscript{172};

139.4. the sources of the money which PVH paid in bonuses and to the Guernsey Trust\textsuperscript{173}; and

139.5. the fact that he also stood to benefit from his involvement in MGR Capital\textsuperscript{174}.

140. We feel, too, that the remuneration and benefits which the members of the Phoenix Consortium and Mr Howe caused to be awarded to Mr Millett were, in the aggregate, excessive, the more so since Mr Millett’s terms of employment were such that PVH guaranteed to pay Mr Millett a sum equal to three times his gross annual salary, plus pension contributions, in the event of an insolvency\textsuperscript{175}.

\textsuperscript{172} See paragraphs 109 and 110 above.
\textsuperscript{173} See paragraphs 59 to 68 above.
\textsuperscript{174} See VII/217 to 221.
\textsuperscript{175} On 27 November 2001 PVH entered into a cash deposit agreement with St. Paul International Insurance Company Limited under which PVH deposited £3.473 million in favour of certain MGRG employees for termination and pension payments. Of this, £570,000 was deposited in favour of Mr Millett in respect of a termination payment and £975,000 was deposited in favour of Mr Millett in respect of pension payments. The amounts deposited in favour of Mr Millett were amended on 20 October 2003 to £598,856 (termination payment) and £953,600 (pension payment).
CHAPTER XXII

ASPECTS OF CORPORATE GOVERNANCE
1. This chapter is concerned with aspects of corporate governance within the Group and, in particular, with the extent to which directors other than the members of the Phoenix Consortium (namely, Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers) were involved in decision-making.

**Directors’ involvement in decision-making**

*MGRG*

2. MGRG’s “functional” directors\(^1\) met on a regular basis between 2000 and 2005. As explained in chapter V (Rover under new ownership), the meetings were initially referred to as “executive board” meetings and later as “Executive Board Management Meetings” or “Board Management Meetings”\(^2\). In evidence to us, Mr Howe called them “weekly management meetings” and Mr Shine “operational management meetings”\(^3\).

3. Numerous aspects of the management and performance of MGRG would be discussed at these meetings. A typical agenda might include sales, finance, operations and human resources reports, as well as items relating to particular issues of the moment (for instance, “MGTF Bumper Blackout Viewing” or “MGZR Warranty and Quality Status”). Mr Howe told us that it was in these meetings that the functional directors tended to be most interested. The meetings appear to have been well minuted, mainly by Mr Phil Sutton, finance controller working on business planning and analysis in the finance and strategy department.

4. The full board of MGRG, including both the functional directors and the members of the Phoenix Consortium, also met many times. Between September 2000 and the end of 2002, meetings of the whole board were held about once a month. During 2003 and 2004, full board meetings were less frequent: in fact, we know of only four such meetings in 2003 (in June, September (when there were two meetings) and December) and four in 2004 (in February, June, October and December). In 2005 full board meetings were once again held on a monthly basis\(^4\).

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\(^1\) I.e. directors other than the four members of the Phoenix Consortium: see V/6 and XVII/3 to 14.

\(^2\) See V/13 and 15.

\(^3\) We are aware of only one occasion when the members of the Phoenix Consortium attended an “operational management meeting”. The meeting in question was on 31 January 2003 and is referred to at XXI/42.3.

\(^4\) The minutes of the MGRG board meeting on 17 December 2004 include the following:

> “The Chairman [i.e. Mr Beale] reported that due to the importance of the issues that were facing the Company it should have regular Board meetings to review the progress of the SAIC project. Accordingly, he requested that full Board meetings be scheduled for once a month rather than once a quarter which was the current situation.”
5. Like “operational management meetings”, the full board meetings would include discussion of a variety of aspects of the management and performance of MGRG. The meetings would generally feature updates on “CQ” and warranties, sales and marketing, production and finance and strategy. More specific issues might also be aired. Ms Ruston appears to have kept very good minutes of these meetings.

6. There are minutes recording numerous other, more ad hoc, board meetings. Some of these relate to particular transactions: for example, those generated in connection with Project Platinum, the transfers to Property Holdings, MGRDP and Heritage, the sale and leaseback of the MGTF tooling or the sale of Xpart to PVH. Other minutes concern decisions for which there was a legal or similar requirement, such as changing the company’s registered office, the grant of security to a bank, bank mandates or treating the appointment of Deloitte as the company’s auditors as extending to the firm as enlarged by the admission of former partners in Arthur Andersen.

7. While the functional directors normally attended the full board meetings mentioned above, they are rarely recorded as having attended ad hoc board meetings. The minutes of these meetings often state that no more than a few directors were present; for instance, the minutes in respect of the transfers to Property Holdings, MGRDP and Heritage say that meetings were attended by the four members of the Phoenix Consortium plus Mr Howe, while the minutes regarding the change in MGRG’s registered office list those present as Mr Millett and Mr Parkinson.

8. Further, not all of those recorded as attending ad hoc meetings necessarily did so. Thus:

8.1. minutes record that Mr Howe was present at board meetings of MGRG on 4 December 2001 relating to the sale of the Heritage Companies to Heritage when he was not in fact present;

8.2. minutes record that Mr Howe was present at a board meeting of MGRG on 28 December 2001 relating to the sale of Longbridge land to Property Holdings when he was not in fact present.

5 CQ appears to refer to “customer quality”.
6 See VII/187 and 189.
7 See IX/23 to 26.
8 See IX/61 and 62.
9 See IX/85 and 86.
10 See XI/22 to 28.
11 See XIII/20.
12 See paragraphs 4 and 5 above.
13 See IX/86.
14 See IX/24.
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8.3. minutes record that Mr Howe was present at a board meeting of MGRG on 28 December 2001 relating to the sale of dealer properties to MGRDP when he was not in fact present15;

8.4. some of the directors of MGRG who are recorded as having been present at a board meeting of that company on 20 December 2002 relating to the sale of Xpart to PVH were not in fact present16; and

8.5. minutes dated 8 August 2004 relating to the sale of Xpart to CAT17 record that Mr Petrie attended an MGRG board meeting that day, but Mr Petrie said that he was not present at a board meeting on that day. The explanation advanced in representations to us on behalf of Mr Howe and Ms Ruston was to the effect that the minutes are misdated, the meeting in fact having taken place on 8 July. Not, however, having joined MGRG’s board until 21 July, Mr Petrie will not have attended any board meeting on 8 July either.

9. Not only would functional directors not be present at ad hoc meetings, they might not be invited to them. In the course of this report, we have referred to a number of occasions when directors of MGRG were not given notice of board meetings. Thus, some directors of MGRG were not given notice of:

9.1. the board meetings of that company purportedly held on 18 December 2000 in connection with the establishment of PVH and the payment of interest to Techtronic18;

9.2. the board meetings of that company recorded as having been held on 8 November 2001 in connection with Project Platinum19;

9.3. the board meetings of that company recorded as having been held on 4 December 2001 in connection with the sale of the Heritage Companies to Heritage20;

9.4. the board meeting of that company recorded as having been held on 28 December 2001 in connection with the sale of land at Longbridge to Property Holdings21;

9.5. the board meeting of that company recorded as having been held on 28 December 2001 in connection with the sale of dealer properties to MGRDP22;

15 See IX/62.
16 See XIII/20.
17 See XIII/44.
18 See V/55 to 61.
19 See VII/194.
20 See IX/86.
21 See IX/25.
22 See IX/62.
9.6. the board meeting of that company recorded as having been held on 28 June 2002 in connection with the sale and leaseback of the MGTF tooling to PVL\textsuperscript{23}; and

9.7. the board meeting of that company recorded as having been held on 20 December 2002 in connection with the sale of Xpart to PVH\textsuperscript{24}.

There were many other occasions on which functional directors of MGRG were given no notice of ad hoc meetings for which minutes exist. Mr Beddow said that he was a “pretty regular attendee” of board meetings to which he was invited, but that he had not been invited to various meetings. Mr Bowen and Mr Oldaker likewise said that they would generally attend meetings to which they were invited; Mr Bowen thought that he had been invited to board meetings dealing with specific approvals or more technical matters “when they involved [his] knowledge, [his] skill, and [his] area of responsibility”. Mr Parkinson stated that he generally had no recollection of having been invited to ad hoc meetings, and that the other directors would not have been invited to, say, the meeting concerned with the change in the registered office. Mr Shine told us that he could not recall being invited to any of the ad hoc meetings, and Mr Millett similarly said that he had no recollection of being invited to meetings of that type. Asked about the minutes relating to former partners in Arthur Andersen joining Deloitte, Mr Oldaker said, “if a resolution of this nature was required then the appropriate quorum was pulled together and quickly decided”.

10. In evidence to us, members of the Phoenix Consortium were inclined to say of any particular meeting that they had no reason to think that other directors were not invited to it. However, whatever they may remember now, it must have been obvious that functional directors were not always being invited to meetings; otherwise, more of them would have been present.

11. It has been suggested to us in representations on behalf of the members of the Phoenix Consortium that “Generally speaking, the matters that were not addressed by the full board of MGRG were decisions that related to specific transactions” which were “being undertaken with detailed assistance and guidance from both external and internal legal advisors”. While, however, some of the ad hoc meetings to which functional directors were not invited related to particular transactions, many others did not do so. Moreover, it was not incumbent on external solicitors to give directors notice of any board meetings\textsuperscript{25}. Further, we cannot see why the fact that lawyers are present at board meetings to give advice and guidance should in any way dispense with the requirement that all directors be invited to such board meetings.

12. In many instances, the functional directors would clearly have had no objection to the matters which the minutes record as having been approved at ad hoc meetings. There is no reason to suppose that any director would have had the slightest concern about, for example, the change in the registered office, the security granted to Barclays, the bank mandates or former Arthur Andersen partners joining Deloitte. In fact, functional directors might not

\textsuperscript{23} See XI/24 to 28.
\textsuperscript{24} See XIII/20.
\textsuperscript{25} See V/62.
have welcomed invitations to attend meetings concerned with such matters. Mr Millett said of one such meeting that he “would have probably thought it was a complete waste of time”.

13. However, it cannot be assumed that the functional directors would have had nothing to say about other, more significant decisions. When Project Platinum was considered by MGRG’s board on 12 October 2001, there was “a discussion amongst the Board at some length on the commercial issues”, and Mr Millett in particular raised a number of concerns.26 When Project Patto was put before MGRG’s board on 13 December 2002, concerns were again voiced, specifically by Mr Shine and Mr Millett.27 Had, say, the payment of interest to Techtronic, the intra-group transfers of dealer properties and Xpart or the sale and leaseback of the MGTF tooling been tabled for approval at board meetings attended by the full board, there must be a real possibility that functional directors would have inquired into the transactions and caused them to be at least modified. In this connection, Mr Oldaker told us that Mr Millett had been “very uncomfortable with the disclosure that … interest would be borne by [MGRG]” and Mr Shine agreed that he thought that he would have made inquiries if the proposed transfer of Xpart had been put to him.

14. Representations to us on behalf of the members of the Phoenix Consortium made the point that “If decisions were made without the direct involvement of each director it does not follow that such a director was not made aware of such decisions nor given the opportunity to make himself so aware”. With regard, for example, to the decision in December 2000 that MGRG should pay interest to Techtronic, the representations referred to the fact that the minutes of an MGRG board meeting on 2 February 2001 record that there was discussion as to the likely impact of the interest charge on MGRG’s business plan. On this basis, it was argued that “Should there have been any concerns regarding the payment of interest by MGRG to Techtronic, the full board were all given an opportunity to raise such concerns”.

15. However, knowledge that a decision is in prospect or has been made is by no means equivalent to participation in the making of the decision; a director is much more likely to inquire into, and voice opinions on, a decision if he attends the meeting at which it is made than if he is merely told that it is in the offing or has already been taken. Moreover, functional directors did not always become aware of decisions. For instance, Mr Shine told us that he only became aware of the transfer of Xpart to PVH for £228 after MGRG had gone into administration. In addition, a number of MGRG’s directors did not learn of the sale and leaseback of the MGTF tooling until after MGRG had gone into administration.

16. The fact that functional directors were not given notice of ad hoc meetings meant that the decisions which are recorded as having been taken at them were sometimes taken exclusively by directors with conflicting interests. Thus, certain resolutions relating to transactions in which the duties of the members of the Phoenix Consortium as directors of MGRG potentially conflicted with their interests and duties as directors and shareholders in PVH were passed exclusively by members of the Phoenix Consortium; this was the case.

26 See VII/180.
27 See XII/23.
28 See XIII/20.
29 See XI/24 to 28.
with, for example, the December 2001 transfers to Property Holdings, MGRDP and Heritage. As regards Project Platinum, those attending the MGRG board meetings on 8 November 2001 (namely, Mr Beale, Mr Edwards and Mr Howe) were all subject to conflicts of interest as a result of being both directors of MGRG and members of the Phoenix Partnership.

17. There were also occasions when decisions were taken by one or more members of the Phoenix Consortium alone, without any board meeting being held or minutes produced, notwithstanding that, in our view, it was inappropriate for decisions to be made in that way. As we have explained earlier in this report:

17.1. Mr Stephenson was the person principally responsible for the agreement and payment of two per cent success fees for the benefit of Dr Li notwithstanding that (a) he had a personal relationship with Dr Li and (b) most of the other directors of MGRG and the directors of Powertrain knew neither of the personal relationship nor of the payments made to CVIL (the British Virgin Islands company associated with Dr Li) or the consultancy agreement with it; and

17.2. Mr Beale alone authorised the payment to Eversheds of £417,201 by MGRG on 7 April 2005 notwithstanding that, as a director and shareholder of PVH, he had a conflict of interest.

Techtronic

18. Mr Ames told us that he attended every Techtronic board meeting to which he was invited. He was not, however, invited to all the board meetings for which there are minutes. We have referred earlier in this report to the fact that Mr Ames was given no notice of the following meetings:

18.1. the Techtronic board meeting recorded as held on 26 October 2000 in relation to Mr Parker’s resignation as a director;

18.2. the Techtronic board meetings recorded as held on 18 and 21 December 2000 in connection with the establishment of PVH, the payment of interest to Techtronic by MGRG and the payment of a dividend of £9.8 million by Techtronic to PVH; and

18.3. the Techtronic board meeting recorded as held with respect to Project Platinum.
Mr Ames also confirmed that he had not been invited to the following board meetings for which minutes exist:

18.4. meetings on 1 June 2001 in connection with Techtronic’s acquisition of Powertrain;

18.5. a meeting on 1 November 2001 dealing with company general meetings;

18.6. a meeting on 26 November 2001 in relation to Mr Bowes’ resignation as a director; and

18.7. a meeting apparently held in December 2001 at which a dividend of £10 million is recorded as having been declared.

19. Mr Bowes gave evidence to similar effect. Although he did not resign as a director of Techtronic until 20 November 2001, he said that he had not been aware of any board meetings after 7 March. That account accords with an email Mr Bowes sent on 19 December, in which he observed that “there hadn’t been a meeting since 7th March” when there had in fact been at least two board meetings by the time he resigned. Mr Bowes told us, too, that he recalled Mr Ames expressing concern about the fact that “there was a lot going on ‘above and below’ that they did not really understand”.

20. It cannot be assumed that, had they been consulted about them, Mr Ames and Mr Bowes would inevitably have agreed to the decisions which are recorded as having been made at the meetings to which they were not invited. Mr Bowes might have had little comment to make on whether, say, annual general meetings should be held. Likewise, Mr Ames would probably have raised no objection to the decisions relating to the holding of annual general meetings, and he could hardly have prevented the resignations of Mr Parker and Mr Bowes. However, Mr Ames would have been much more likely to have something to say about such matters as the interest which Techtronic charged on its loan to MGRG, the dividends declared when he was a director (of £9.8 million in 2000 and £10 million in 2001) and Project Platinum. Similarly, there must be a possibility that Mr Bowes would have sought to influence Project Platinum.

21. Minutes of Techtronic board meetings are, however, relatively few in number. Minutes referring to discussion of business and management issues are even rarer. The minutes of which we are aware very largely concern ad hoc meetings such as are referred to above (relating to particular transactions or more formal matters). So far as we are aware, no meeting of a more general nature was ever held after 7 March 2001. The reality is that, especially after PVH had been established at the end of 2000, few decisions were put before Techtronic’s board. Mr Ames told us:

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38 There are signed minutes recording such a meeting, but the date of the meeting is given merely as “( ) December, 2001”.

39 See paragraph 18 above.

40 See V/21.
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“... it became very obvious that it was them and us; this is now ours, you know, we are going to do this, that and the other. You know, you two [i.e. Mr Ames and Mr Bowes] are basically sort of excess to requirements.”

22. Techtronic’s board does not even appear to have been consulted, as such, about the company’s financial statements. Two sets of financial statements were filed at Companies House before Mr Ames left the company’s board in late 2002: the financial statements for 2000 reached Companies House on 28 August 2001 and those for 2001 arrived at Companies House on 31 October 2002. It was a legal requirement that a company’s financial statements should be approved by its board41, and each balance sheet was “Signed on behalf of the Board of Directors” (by Mr Beale in the case of the 2000 financial statements, and by Mr Edwards in the case of the 2001 financial statements). However, we have not found any minutes recording the approval by the Techtronic board of the financial statements. Further, Mr Bowes told us that he had not been invited to any board meeting at which the 2000 financial statements had been approved, and Mr Ames confirmed that he had never attended a Techtronic board meeting where financial statements had been put before the board for approval. Mr Ames explained, too, that he and Mr Bowes had not received the 2000 financial statements until they had already been published. He said:

“Were we shown any accounts? No. We got the same accounts as everybody else got in the published, you know, Deloittes glossy brochure job.”

The evidence given to us by Mr Ames and Mr Bowes is, moreover, supported by the correspondence referred to below42, which arose in part out of a complaint by Mr Bowes that he had not been aware of a meeting at which the 2000 financial statements had been approved. Ms Ruston told Schilling & Lom LLP (“Schilling & Lom”), a firm of solicitors acting for MGRG in respect of media management issues, that Mr Ames and Mr Bowes had not been given notice of a meeting43. It seems unlikely, however, that any formal meeting was held at all, either in 2001 (in relation to which Mr Bowes complained) or even, despite the correspondence, in the following year.

23. Mr Beale accepted that he would normally have been responsible for notifying the other directors of the company of board meetings. As with MGRG, however, it should have been apparent to all the members of the Phoenix Consortium that Mr Ames and Mr Bowes were not being invited to all board meetings.

24. In about November 2002 Mr Ames was asked to resign as a director of Techtronic. Mr Ames said that he had been asked to go to Longbridge where he had been told by Mr Towers and Mr Beale that they thought it would be better if he ceased to be a director of Techtronic and became a consultant instead. From mid-December onwards, Techtronic’s board comprised only the four members of the Phoenix Consortium.

41 Companies Act 1985, section 233.
42 See paragraphs 36 and 37 below.
43 Likewise, representations made to us on behalf of the members of the Phoenix Consortium refer to the failure to give notice as “an accidental omission”.
25. Minutes of a Techtronic board meeting on 7 December 2000 record that Mr Beale “stated that both [Mr Ames] & [Mr Bowes] would be invited to join the new holding company [i.e. PVH] as non-execs”. However, on 7 March 2001, when Techtronic’s board met to discuss general business and management matters for the last time, “[Mr Towers] asked [Mr Ames] & [Mr Bowes] to remain as non-execs of Techtronic rather than become non-execs of [PVH] which was agreed”. Until July 2004, therefore, PVH’s board consisted only of the four members of the Phoenix Consortium and Mr Howe. Mr Petrie, however, joined the board as a non-executive director on 21 July.

26. PVH board minutes tend to be of a relatively formal nature, generally relating to particular transactions (including the establishment of the Guernsey Trust and contributions to it) or to matters such as share transfers and bank mandates. The members of the board, and especially the members of the Phoenix Consortium, would however, discuss the Group’s affairs between themselves informally. Until February 2003, when Mr Edwards moved to the sales and marketing building, the members of the Phoenix Consortium shared an office at Longbridge.

27. We do not regard PVH’s board minutes as wholly reliable. Thus:

27.1. Mr Edwards is recorded as having been present at a PVH board meeting at Longbridge on 21 May 2002 at which it was resolved that the company should make a £600,000 contribution to the Guernsey Trust. Mr Edwards pointed out to us, however, that he was in fact in India on 21 May;

27.2. Mr Edwards told us that he did not recall being present at some of the other PVH board meetings relating to payments to the Guernsey Trust and that he was not involved in remuneration decisions. In this connection, it is noteworthy that Mr Edwards’ passport shows him to have entered Iran on 13 October 2003 although PVH minutes record him as attending a board meeting at Longbridge that day, and

27.3. a board meeting of PVH is recorded as having been held on 30 December 2002 in connection with the acquisition of Edwards Cars notwithstanding that no such meeting took place on that date or (probably) at all.

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44 See XXI/14.
45 See XXI/14 to 51.
46 See V/65.7.
47 See XXI/25 to 29.
48 See XXI/43, 44 and 92.
49 At the PVH board meeting on 13 October 2003 a contribution of £3,632,500 to the Guernsey Trust was approved.
50 See XIV/23 to 26.
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28. Even if a PVH board meeting was held in connection with the acquisition of Edwards Cars, Mr Howe was not given notice of such a meeting. Further, Mr Howe was not even made aware of the acquisition of Edwards Cars until after it had happened.\(^{51}\)

*Other companies*

29. In the course of this report, we have referred to certain further occasions when directors of companies in the Group were not given notice of board meetings. Thus:

29.1. one or more directors of Heritage were not given notice of the board meetings of that company recorded as having been held on 4 December 2001 in connection with its acquisition of the Heritage Companies;\(^{52}\) and

29.2. one or more directors of Property Holdings were not given notice of the board meeting of that company recorded as having been held on 28 December 2001 in connection with its acquisition of land at Longbridge.\(^{53}\)

*Legal requirements*

30. PVH’s articles of association provided in terms for every director to be given notice of every board meeting. Article 19.6 stated:

> “Notice of every meeting of the directors shall be given to every director ... but the non-receipt of notice by any director shall not of itself invalidate the proceedings at any meeting of the directors.”

Article 19.7 provided for regulation 88 of Table A\(^{54}\) (which contained model articles of association) to be amended to include the following:

> “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.”

31. The articles of association of MGRG and Techtronic did not contain similar provisions, but in the case of these companies too every director should have been given notice of each board meeting. There is a general rule of law that all directors of a company must be given notice of a board meeting.\(^{55}\) In evidence to us, Ms Lewis of Eversheds observed:

\(^{51}\) See XIV/27.
\(^{52}\) See IX/87.
\(^{53}\) See IX/27.
\(^{54}\) I.e. Table A in the First Schedule to the Companies (Tables A to F) Regulations 1985.
\(^{55}\) 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.
“... 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.”

32. Mr Beale confirmed to us that he had known that directors ought to be invited to board meetings. Others do not appear to have had such a good understanding of the legal position. Mr Edwards told us that he was not familiar with the idea that all the directors of a company needed to be given notice of a board meeting. When giving evidence about Project Platinum, Mr Stephenson suggested:

“In a transaction of this type, if a company is doing it and a number of board directors are doing it, and there is a requirement, for example, for a quick impromptu board meeting to rubber stamp it, my experience in other companies would be the board members delegated to do it would call that meeting and actually they would not invite all the other board members. You just have to have a quorum of members present.”

Mr Beddow said that he did not think all directors needed to be given notice of all meetings; he explained that he would not have expected to be invited to meetings “which just require perhaps a couple of people there to endorse documents or bank mandates or whatever” or “even necessarily if there were items that didn’t directly impinge on [him] or the business as a whole that may have been specific to some function or activity; engineering, for example”.

33. There was reference to the notice to be given of board meetings in some draft guidelines which were produced by Ms Ruston in September 2000. On 4 August 2000 it had been decided at an MGRG “executive board meeting” that a “Corporate Governance document” should be prepared. On 13 September Ms Ruston sent Mr Howe and Mr Millett draft “Guidelines for the board of directors of Rover Group Limited”, which, she said, she hoped were “in final form for you to be able to present to the other directors of the company”. This document included the following passages:

“All business of the Company shall be conducted at meetings of the Board or meetings of committees constituted in accordance with these Guidelines ... [No] decision of a material nature may be taken otherwise than at a Board meeting or meetings of committees of the Board which may have an effect directly or indirectly on the business of the Company ...

[Meetings] may be called by any of the Directors on not less than 24 hours’ notice to all Directors. All Directors shall be entitled to attend meetings of the Board ...”

In the event, however, the guidelines were not distributed to other directors. Mr Howe assumed that the document had “dwindled off the radar” and Mr Millett thought that the guidelines could have been overtaken by events. One reason may have been that the

56 It is of course possible for a board to delegate the implementation of a particular scheme to a smaller group, but the evidence (in particular, the board minutes) does not show the matters to which the ad hoc board minutes relate to have been so delegated.
document was framed on the basis that the members of the Phoenix Consortium were non-executive directors of MGRG, but in about September the members of the Phoenix Consortium decided against non-executive status.

34. Ms Ruston told us that the guidelines document “was not intended to reflect the law” and that she did not know what her understanding of the law was at the time. Nonetheless, the document referred to notice of board meetings being given “to all directors”.

35. The requirement for all directors to be given notice of board meetings was highlighted in late 2001. On 16 December an article appeared in the Sunday Express entitled “Fury over MG Rover share split”. The article included the following:

“... David Bowes, managing director at Lola, has told the Sunday Express that despite being a director of Techtronic 2000 he had not been invited to, or told of, any board meetings since March.

... It is also understood that a fellow non-executive director of Techtronic 2000, Suffolk Rover dealer Richard Ames, was unaware of at least one crucial board meeting.

Bowes claims he was effectively left in the dark over the crucial move to transfer the assets of the company to the ultimate owner, MG Rover Holdings.

Accounts filed recently for Techtronic 2000 show results from May to December 31 last year. The accounts state: ‘The financial statements were approved by the board of directors on July 9, 2001.’ They are signed by Peter Beale, a director.

But Bowes and Ames were not present at the meeting and Bowes claims neither of them was even aware of it.”

36. This article led to correspondence between, on the one hand, Schilling & Lom, and, on the other hand, Mr Bowes (who appeared to have spoken to Mr Parsley, the journalist who wrote the article) and Richards Butler (solicitors instructed by Lola) and Express Newspapers plc. For the purposes of this correspondence, Ms Ruston asked Eversheds to consider the law relating to the giving of notice of board meetings. On 19 December 2001, Eversheds faxed to Ms Ruston a memorandum which they had prepared on the subject. This noted that a company’s articles of association could set out specific requirements in relation to the giving of notice of board meetings, but that in the case of Techtronic’s articles “there are no requirements imposed which are over and above those contained in the Companies Act 1985 (as amended), Table A or under common law”. The note continued:

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57  As regards whether board meetings could be held without giving notice to all the directors.
58  As noted at paragraph 22 above, Schilling & Lom were instructed by MGRG in respect of media management issues.
“Importantly, notice of board meetings **MUST:**

- be given to all directors of the company for the time being notwithstanding if the number notified and who subsequently attend constitute a quorum; and

- must be given to all directors who state that they cannot attend a meeting even if summoned, i.e. a director cannot waive his right to notice even if he could not attend the meeting in any event.”

The note ended as follows:

“In conclusion,

- notice must be given to all the directors for the time being of the company

- if such notice is not given, unless all the directors attend nevertheless, the business transacted is not valid even if those notified and present constitute a quorum

- a third party who relies on the board resolution passed at an irregular meeting is entitled to rely on it as having been passed by the board so long as the third party is acting in good faith

- the only recourse open to the director(s) who did not receive notice is to ask for a second meeting and this request must be made within a reasonable period of the irregular meeting

- the board can remedy the procedural irregularity by holding a further board meeting duly convened and constituted.”

The next day, Ms Ruston sent a fax to Schilling & Lom in which she wrote:

“The Articles of Association of Techtronic (2000) Limited are effectively Table A articles with certain special articles … Except that the Articles of Association require that due and proper notice to have been given to all directors in accordance with Table A. There is nothing in the special articles that exempt the Company from this …

What should have happened in accordance with Techtronic’s Articles of Association, is that notice of Board meetings must be given at a reasonable time before the meeting is held …
What actually happened is that notice was given of the meeting to those Directors who were present at the Company’s premises at the time. That was Mr Towers, Mr Edwards, Mr Beale and Mr Stephenson. Mr Ames and Mr Bowes who were considered to be ‘non-executive directors’ live and work some considerable way away from Longbridge. A notice was not given to them. They were overlooked by accident …

Nothing sinister whatsoever happened about failure to give notice. It was an accidental omission and there was no conspiracy to exclude them from attending the meeting. The view of the Directors who attended the meeting to approve the accounts was that this was simply a formality.”

37. Despite this correspondence, it continued to be the case that directors were not necessarily given notice of board meetings. For example, functional directors were not invited to the MGRG board meeting on 28 June 2002 at which the sale of the MGTF tooling is recorded as having been approved. Ms Ruston told us in relation to this meeting:

“… I think it is possible that it may not have been appreciated that all of the [MGRG] directors needed to be given notice to the meeting for it to be a valid meeting and that … two directors would be a quorum in order for the transaction to be properly and validly approved.”

It is hard, however, to understand why there should still have been any misapprehension as to the legal position.

*Legal consequences*

38. In principle, a meeting to which only some directors have been invited does not amount in law to a board meeting and resolutions passed at it will be invalid. The practical effects of a failure to give a director notice of a meeting may, however, be mitigated in a number of ways. In particular:

38.1. a decision taken at the meeting might cease to be open to challenge if all the directors knew of it and acquiesced in it;

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59 See XI/24 to 28.

60 Compare *Ford v Polymer Vision Ltd* [2009] EWHC 945 (Ch).
Chapter XXII
Aspects of corporate governance

38.2. a third party dealing with the company in good faith may possibly be protected by section 35A of the Companies Act 1985; and

38.3. there may be scope for invoking the legal principle to the effect that the shareholders of a company, acting unanimously, may sanction a course of conduct without the prescribed procedure being followed.

39. We do not think it appropriate for us to comment in a report such as this on what (if any) legal consequences the failure to give all directors notice of any particular meeting, or indeed the failure to hold a board meeting at all, may have. It seems to us that those consequences should be determined, if at all, in Court proceedings.

Reasons for errors in minutes

40. Asked about apparent errors in the minutes of ad hoc meetings, Ms Ruston explained as follows:

“The minutes were prepared by a number of different people, including myself ... but also by people in my department, by Eversheds, by John Cowburn, by the directors themselves.

Some minutes were prepared before the meeting happened and therefore were read through by the directors and approved by the directors; other minutes were put together after a decision had been taken to formalise and to ratify that decision and were then signed off.

In some circumstances I would be simply told this decision had been made and these attendees were present at this particular meeting and I would produce a set of board minutes that would reflect that decision and would reflect those attendees.

61 Section 35A(1) of the Companies Act 1985 provides that “In favour of a person dealing with a company in good faith, the power of the board of directors to bind the company, or authorise others to do so, shall be deemed free of any limitation under the company’s constitution”. The precise scope of this provision is unclear, but it seems to be engaged where a genuine decision is taken by a person or persons who can on substantial grounds claim to be the board of directors acting as such, even if the proceedings of the board are marred by procedural irregularities of a more or less serious nature, save to the extent that the “person” dealing with the company was himself personally responsible for the irregularity: see Smith v Henniker-Major & Co [2003] Ch 182.

62 This principle is referred to as the “Duomatic” principle, after Re Duomatic Ltd [1969] 2 Ch 365. See VII/200.

63 Representations made to us on behalf of Ms Ruston explained as follows:

“... in 2001 [Ms Ruston] discussed the role of the Company Secretary with [Mr] Howe ... She informed him that she and her legal staff were being asked by various directors of companies within the group to attend Board meetings and to minute them. Often the legal officers in question were not otherwise involved in the underlying transaction or business of the company in question. Those legal officers were also stretched work wise and did not have time to attend to such meetings or to deal with formalities associated therewith. Accordingly, [Ms Ruston] and [Mr] Howe agreed that directors would conduct and minute their own meetings.”

For his part, Mr Howe indicated that, although he did not recall discussion concerning directors being responsible for minuting their own meetings generally, he had no particular reason to doubt Ms Ruston’s version of events.
I wouldn’t have been at that meeting myself and I therefore wouldn’t be able to confirm the veracity of that. I would rely on the chairman who was signing the board minutes off to be happy that they properly reflected the business that took place at that meeting.

In other cases, it is entirely possible that I will have used a precedent or someone will have used a precedent and set out a number of directors being present at a meeting with a view to that being used and the people being crossed off.”

41. Ms Scott told us that she drafted and prepared some board minutes as “set pieces” in advance of any such board meetings taking place. However, she also noted:

“... I did not ensure that such board meetings were subsequently called and held, and I did accept signed and dated minutes from directors on this basis. The reason for this ... is that – rather like an external lawyer – I did not consider these additional requirements to form part of my responsibilities. My role was to prepare the necessary documentation; it was not to oversee the calling and holding of board meetings nor the conduct of directors during such meetings ... It follows ... that, from time to time, a director whom I had listed as 'present' on a draft board minute, would not in the event be present at that board meeting. In general, when drafting the minute I would list as present all of the directors of the Company in question. If any such director did not, in due course, attend the meeting, then it would have been the responsibility of the Chairman signing the minute to delete his name.”

42. When we asked Ms Scott how often board minutes were produced retrospectively, she said:

“Sometimes. I mean, hopefully not very often, but from time to time, it would happen that something which, you know, for the sake of good practice should probably have been minuted, for one reason or another it slipped through and didn’t get done; you would then seek to try and, if it wasn’t too late, to try and, you know, document what should have happened.”

Other corporate governance matters

43. We have referred earlier in this report to the following:

43.1. no form 288a was filed at Companies House in respect of Mr Parker’s appointment as a director of Techtronic. A deliberate decision was made not to file the form;  
43.2. Mr Ames’ date of appointment as a director of Techtronic was given as 26 November 2000 in the form 288a which was filed at Companies House in respect

64 As noted in IX/24, Ms Scott was a solicitor in the Group’s legal department.  
65 See III/63 and V/27.
of his appointment, but he was considered to be legally a director substantially earlier than this; 66;

43.3. documents relating to PVH’s acquisition of Edwards Cars were backdated; 67 and

43.4. the 2004 financial statements of Xpart and PVH record the payment of a dividend which was not in fact declared; 68

Concluding comments

44. As Mr Howe told us, “the modus operandi with the four guys [i.e. the members of the Phoenix Consortium] was very informal”. He explained:

“The consortium ... almost had an aversion to formality for formality’s sake. Obviously, formal meetings were fine but they had an aversion to formality and to some degree, almost chastised too much formality. For example, if we were having management meetings that took place regularly without their attendance, so they were not formal board meetings, they would pick up on the fact that there were presentations that were done on a computer and typed minutes were totally unnecessary ... To some extent they were right, because we had to run at such a pace at the beginning, but equally, that manifested itself into the way that we met. It was not a very formal process.”

Representations made to us on behalf of Ms Ruston likewise noted that the Group’s “ultimate shareholders were individuals who favoured informality”; the representations went on to observe that Ms Ruston “was a young legal officer who tried to impose order where there might otherwise have been chaos”. For his part, Mr Stephenson maintained, “if you are sitting in board meetings examining the minutiae of your business, you are not responsibly running a business”.

45. It is obviously desirable to dispense with unnecessary bureaucracy. It is doubtless also the case, as was suggested in representations to us on behalf of Ms Ruston, that there are other companies which do not fully comply with legal requirements in relation to, say, the calling of board meetings. Even so, we consider that the members of the Phoenix Consortium paid insufficient regard to legal requirements. With respect, in particular, to board meetings, it seems to us that all directors should have been notified of all board meetings of their companies both because there was a legal requirement to do so and because that obviously represented proper corporate governance. It is of little significance in this context that transactions can sometimes be legally effective even where meetings were not properly called or minuted or directors were excluded from decision-making. Legal efficacy need not connote good corporate governance.

66 See V/19.
67 See XIV/24.
68 See XIII/58.
69 See paragraphs 38 and 39 above.
46. The failure to notify directors of meetings is likely to stem from the members of the Phoenix Consortium’s general aversion to formality but also to an extent from a preference for other directors not to be involved in decision-making. It is indicative that, having been told on 7 December 2000 that they would be invited to join PVH’s board, Mr Ames and Mr Bowes were instead asked in March 2001 to remain as directors of Techtronic\(^{70}\) and that, from then on, there appear to have been no further Techtronic board meetings at which there was any kind of general discussion of business and management issues\(^{71}\); some or all of the members of the Phoenix Consortium must have wished to limit the role of Mr Ames and Mr Bowes in decision-making. When giving evidence to us, Mr Beale rejected the suggestion that Mr Ames had not been invited to the 21 December 2000 Techtronic board meeting at which the dividend in favour of PVH was declared because his involvement in such a matter was not welcome, and Mr Edwards and Mr Stephenson expressed surprise at the suggestion that he had not been invited to the meeting on 18 December 2000. Nonetheless, the likelihood is that the fact that Mr Ames and Mr Bowes were not invited to Techtronic board meetings was born in part of a preference that they should not be involved in decision-making, reflecting probably a feeling on the part of members of the Phoenix Consortium that they were the owners of the Group and should be able to do as they wished; as Mr Ames said, he and Mr Bowes were treated as “basically sort of excess to requirements”, the Phoenix Consortium proceeding on the basis that “this is now ours, ... we are going to do this, that and the other”.

\(^{70}\) See paragraph 25 above. Mr Stephenson and Mr Towers both told us that they could not recall why Mr Ames and Mr Bowes had not after all become directors of PVH.

\(^{71}\) See paragraph 21 above.
CHAPTER XXIII
FINANCIAL STATEMENTS AND AUDIT
Introduction

1. In this chapter of the report we consider Deloitte’s role as auditors to the Group.

2. Understanding the respective responsibilities of directors and auditors is essential to any assessment of the adequacy of an audit. Similarly, an audit should be considered in light of the auditors’ appointment, the audit approach, staffing, the controls over quality and the access to technical advice. We address these matters under the following headings:
   
   - Responsibilities of directors and auditors and the “expectation gap”\(^1\)
   - Appointment of Deloitte as auditors to the Group\(^2\)
   - Deloitte’s audit approach\(^3\)

3. The auditors’ treatment of three matters requires particular consideration. These are as follows:
   
   - Independence and objectivity\(^4\)
   - Transfers of MGRG’s assets to other Group companies\(^5\)
   - Going concern in respect of the Group’s 2003 financial statements\(^6\)

4. Deloitte’s independence and objectivity warrant attention because of the large fees earned by Deloitte from non-audit work undertaken on behalf of the Group and the concern that this might influence their approach to the Group’s audit.

5. We have referred earlier in this report to transactions that resulted in a transfer of assets, arguably at less than their market value, from MGRG to other companies controlled by the Phoenix Consortium\(^7\). In this chapter we consider Deloitte’s audit work in respect of these transactions.

6. Deloitte’s audit work in respect of going concern requires consideration in the light of MGRG going into administration on 8 April 2005, less than six months after the audit reports on the financial statements of MGRG and other Group subsidiaries for the year

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\(^1\) See paragraphs 9 to 18 below.
\(^2\) See paragraphs 19 to 23 below.
\(^3\) See paragraphs 24 to 37 below.
\(^4\) See paragraphs 38 to 73 below.
\(^5\) See paragraphs 74 to 95 below.
\(^6\) See paragraphs 96 to 168 below.
\(^7\) See chapter IX (Property and share transfers), chapter XI (Aircraft) and chapter XIII (Xpart).
ended 31 December 2003 were signed by Deloitte on the basis that the companies were going concerns.

7. In addition, as we note in chapter I (Introduction)\(^8\), on 15 April 2005 the Secretary of State for Trade and Industry, then Ms Hewitt, asked the Financial Reporting Council (“the FRC”) 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”)\(^9\), which submitted its report on 26 May 2005. A copy of the FRRP report is attached as an exhibit.

8. We have considered the matters raised in the FRRP report and, where we considered necessary, we have investigated these matters further and set out our findings in this chapter\(^10\) or elsewhere in our report.

Responsibilities of directors and auditors and the “expectation gap”

9. As noted in Statement of Auditing Standards (“SAS”) 100, “Objective and general principles governing an audit of financial statements” (“SAS 100”), “Generally, financial statements are prepared with the objective that they present a true and fair view\(^11\) of the state of the affairs of the entity at the period end and of the profit or loss for that period.”\(^12\) It is inevitable that there will be a certain amount of imprecision in most, if not all, financial statements as a result of inherent uncertainties and the need to apply judgement when making accounting estimates and selecting appropriate accounting policies. As a result, financial statements may be prepared in different ways while still presenting a true and fair view.\(^13\)

10. Auditing standards and company law specify that responsibility for the preparation and presentation of an entity’s financial statements lies with the directors, while auditors are responsible for forming and expressing an opinion on whether the financial statements show a true and fair view.\(^14\).

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\(^8\) See I/2.

\(^9\) The FRRP was established in 1990 as part the Financial Reporting Council. The FRRP seeks to ensure that the provision of financial information by public and large private companies complies with the relevant accounting requirements.

\(^10\) See paragraphs 169 to 294 below.

\(^11\) According to paragraph 12 of the “Statement of principles for financial reporting” issued by the Accounting Standards Board in December 1999, “financial statements will not give a true and fair view unless the information they contain is sufficient in quantity and quality to satisfy the reasonable expectations of the readers to whom they are addressed.”

\(^12\) SAS 100 paragraph 3.

\(^13\) SAS 100 paragraphs 3 and 4.

\(^14\) SAS 100 paragraph 6 and the Companies Act 1985, sections 234(1), 235(2) and 237(1).
11. The auditors’ opinion lends credibility to the financial statements by providing reasonable assurance from an independent source that the financial statements present a true and fair view and are free from material misstatement. However, the audit report is not a guarantee of the entity’s viability in the future, nor does it provide assurance with regard to the manner in which the directors have managed the business. It is necessary for auditors to exercise judgement when undertaking an audit, in particular with regard to the gathering of audit evidence and the drawing of conclusions based on that evidence. In addition, it is generally impractical for auditors to examine all items within an account balance or class of transactions.

12. It is widely acknowledged that there is a disparity between auditors’ actual responsibilities and the public’s perception of those responsibilities. Many members of the public incorrectly believe, for example, that auditors’ responsibilities include the detection of all fraud, that auditors perform a complete check of all of the information included within financial statements, that an unqualified audit opinion guarantees that the financial statements are “correct”, and that auditors provide an early warning about the possibility of a business failing.

13. This last point in particular gives rise to debate about auditors’ responsibilities in respect of future events. The auditors’ opinion is provided in respect of a balance sheet at a date in the past and a profit and loss account for a period ended on that date. Essentially, therefore, an audit is concerned with the past. However, the value of some assets and liabilities is dependent on future events; for example, the amount of warranty claims for which a provision has been made will not be known with certainty until all the claims have been received nor will the true value of debtors be known until the extent of any bad debts has been determined. As a result, auditors will need to assess the directors’ estimates in respect of future events in arriving at their opinion.

14. We consider below the auditors’ responsibilities in relation to the preparation of financial statements by the directors on a going concern basis, another area in which auditors are required to assess the directors’ approach to dealing with future events. However it should be emphasised that, while auditors are required to assess the reasonableness of the directors’ approach in this regard, there is no question that an audit report guarantees the financial reliability of a company; for example, the auditors are neither opining on the company’s business model nor its pricing structure.

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15 As noted in paragraph 8 of SAS 100, “When reporting on financial statements auditors provide a level of assurance which is reasonable in that context but, equally, cannot be absolute.”

16 According to paragraphs 3 and 4 of SAS 220, “Materiality and the audit”, (“SAS 220”): “A matter is material if its omission would reasonably influence the decisions of an addressee of the auditors’ report; likewise a misstatement is material if it would have a similar influence ... The assessment of what is material is a matter of professional judgment and includes consideration of both the amount (quantity) and the nature (quality) of misstatements.”

17 SAS 100 paragraphs 5 and 8.

18 SAS 100 paragraph 5.

19 SAS 100 paragraph 9.

20 SAS 100 paragraph 10.

21 See paragraphs 96 to 168.
15. In an attempt to bridge the expectation gap, SAS 600, “Auditors’ reports on financial statements” (“SAS 600”)\textsuperscript{22}, required auditors to differentiate between their responsibilities and those of the directors in their audit report\textsuperscript{23}.

16. With regard to directors’ responsibilities, SAS 600 provided the following suggested disclosure for inclusion in an entity’s financial statements:

“Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to

\begin{itemize}
\item select suitable accounting policies and then apply them consistently;
\item make judgements and estimates that are reasonable and prudent;
\item state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements\textsuperscript{24};
\item prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business\textsuperscript{25}.
\end{itemize}

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.\textsuperscript{26}

17. SAS 600 also provided example disclosure for the auditors’ report. This was intended to clarify the auditors’ role and basis for their opinion, and included statements that:

17.1. “the company’s directors are responsible for the preparation of financial statements. It is [the auditors’] responsibility to form an independent opinion, based on [their] audit, on those statements and to report [their] opinion to [the members of the company]”;

\textsuperscript{22} SAS 600 has been superseded by International Standard on Auditing (“ISA”) 700, “The auditor’s report on financial statements” (“ISA 700”), which is effective for audits of financial statements for periods commencing on or after 15 December 2004. However, SAS 600 was closely aligned to ISA 700 and so this change did not have a significant impact on the wording included in the audit report. A revised version of ISA 700 (“ISA 700 (Revised)”) has recently been issued, which is effective for UK companies with accounting periods ending on or after 5 April 2009. Also see footnote 165 below.

\textsuperscript{23} SAS 600 paragraph 20.

\textsuperscript{24} This was applicable to large companies only.

\textsuperscript{25} This was applicable if there was no separate statement on going concern made by the directors.

\textsuperscript{26} SAS 600 appendix 3.
17.2. an audit includes the examination of evidence “on a test basis” and “an assessment of the significant estimates and judgements made by the directors”; and

17.3. the auditors have “planned and performed [their] audit so as to obtain all the information and explanation which [they] considered necessary in order to provide [them] with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement.”27

18. However, an audit report does not explain or quantify these areas of judgement. Moreover, an audit report does not explicitly state what the auditors have not done.

**Appointment of Deloitte as auditors to the Group**

19. Deloitte first became auditors to the Group for the year ended 31 December 2000. The intention to appoint Deloitte as auditors was reflected in a clause in the SPA between BMW and Techtronic dated 9 May 2000, which stated that “The parties shall join in procuring that ... the Buyers [Techtronic] Accountant [Deloitte] are appointed auditors of each Group company [MGRG and its subsidiaries] in place of the Auditors [BMW’s auditors, KPMG] ...”

20. It appears that the appointment of Deloitte as auditors was agreed in a corporate finance advisory engagement letter dated 4 May 2000, addressed to the directors of Techtronic, which stated:

> “We recognise that there are many issues that will arise in the period following completion which will require professional input. As your financial advisers we are looking to build a long term and ongoing professional relationship, so that we can help your business to grow successfully following completion of the buy-out.

> In addition you have agreed that [Deloitte] will be appointed auditors to Techtronic and [MGRG] at Completion.”

21. Gaining the audit appointment as well as the corporate finance work was hailed as a great success within Deloitte, and internal email correspondence at the time indicates how significant a win the Group was as a client. For example, Mr Philip Johnson (who subsequently became the national risk partner (“NRP”) at Deloitte in respect of the Group28) wrote in an email of 9 May 2000:

> “Just a short note to let you know that Maghsoud [i.e. Mr Einollahi] and his team have pulled it off!! ... I thought you should all know about this incredible business win by Maghsoud. We also get appointed auditors as a condition of the deal.”

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27 SAS 600 appendix 2.
28 See paragraph 31.5 below.
22. However, acceptance of the Group as an audit client did not take place until the engagement had been discussed at the highest level in Deloitte. Deloitte noted in representations to us:

“... the approval to accept the new client in respect to the initial appointment as auditors for the year ended 31 December 2000 was a joint decision between a number of highly experienced partners taken at a meeting in June 2000. The discussions were documented and signed off at the very highest level within Deloitte (by Gerry Paisley, the head of the Practice Protection Group and John Connolly, the senior partner and chief executive officer) before the firm agreed to act as auditor.”

23. This did not represent the entirety of Deloitte’s audit engagement procedures, which also required Deloitte to consider and document the acceptability of acting as auditors to the Group each year. This is considered in further detail below.

**Deloitte’s audit approach**

24. Deloitte are currently one of the four major audit firms in the UK and have a large client portfolio, including a number of high profile and public companies. We have found Deloitte’s audit approach to be robust and appropriate if applied properly. It places considerable emphasis on assessing the risk inherent in the audit engagement and then planning to minimise that risk.

25. The audit file itself is managed and documented through an electronic program called AuditSystem/2 (“AS/2”). Although Deloitte also generated manual working papers, the majority of their audit work is documented using this program. The AS/2 audit file is broken down into standard sections and subsections, providing a framework for the consideration of planning, reporting, audit management, controls and substantive testing.

26. Auditors may place some reliance on the systems of internal control operated by their client when determining the nature and extent of their audit work. However, on their working paper entitled “Assess Engagement Risk and Control Environment”, Deloitte concluded that controls operated by the Group were lacking, noting:

“Inability to rely on financial controls due to the non-operation of the management reporting process in the post acquisition period. Accordingly detailed substantive approach to be adopted addressing specific risks as identified.”

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29 As set out in paragraph 8 of SAS 300, “Accounting and internal control systems and audit risk assessments” (“SAS 300”):

“‘Internal control system’ comprises the control environment and control procedures. It includes all the policies and procedures (internal controls) adopted by the directors and management of an entity to assist in achieving their objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to internal policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.”

30 Paragraph 30 of SAS 300 states, “Where auditors obtain satisfactory audit evidence from tests of control as to the effectiveness of the accounting and internal control systems, the extent of substantive procedures may be reduced.”
27. As a result Deloitte’s audit of the Group would have to place greater emphasis on the testing of detailed transactions, requiring more detailed audit work and a larger audit team.

28. When planning each of their 2000 to 2003 audits of the Group Deloitte concluded that the “engagement risk”\(^{31}\) was “MUCH GREATER THAN NORMAL”\(^{32}\). Deloitte also identified a number of risks associated with conflicts of interest and threats to their independence and objectivity; these are considered separately below\(^{33}\).

29. However, having considered the risks associated with their audit of the Group, for each of their 2000 to 2003 audits Deloitte concluded:

> “Risk associated with accepting appointment has been considered at all levels within the firm in accordance with the firm’s procedures. Documentation supporting this decision is on file and therefore it is acceptable to accept appointment based on this risk assessment.”

The audit team

30. Deloitte’s audit team for the Group comprised many different individuals with differing levels of experience. For example, Deloitte’s MGRG “Audit briefing pack” listed 20 different people, including partners and managers, to be involved in the 2000 audit.

31. The key senior Deloitte personnel responsible for the Group’s audit were as follows:

31.1. **Mr David Fletcher (audit engagement partner, 2000 to 2002\(^{34}\))**

The audit engagement partner assumes ultimate responsibility for the audit being undertaken and the opinion issued on the financial statements\(^{35}\).

In 2000 Mr Fletcher was the head of Deloitte’s manufacturing automotive group, having had considerable experience auditing motor manufacturers and associated businesses such as automotive components, motor finance and dealerships. The appointment of the engagement partner had to be approved by Mr Martin Eadon, who is now Deloitte’s managing partner for clients and industries.

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\(^{31}\) To use the words of Mr Johnson, “‘Engagement risk’ ... means the legal, ethical or reputational risk to which acceptance of a particular client or engagement gives rise.”

\(^{32}\) Deloitte’s assessment of engagement risk had three levels: “normal”, “greater than normal” and “much greater than normal”.

\(^{33}\) See paragraphs 38 to 73.

\(^{34}\) Mr Fletcher was involved in the audits of the Group for the years ended 31 December 2000 and 2001; he retired in March 2003. Also see footnote 36 below.

\(^{35}\) SAS 240, “Quality control for audit work” (“SAS 240”), paragraph 3(a).
31.2.  *Mr Mark Mullins (audit engagement partner, 2002 to administration of MGRG)*

In April 1996 Mr Mullins was promoted to partner in Deloitte’s Bristol office, where he ran the audit practice in the three years leading up to his transfer to Birmingham in the summer of 2002. In Birmingham he was the partner in charge of the Midlands audit practice, where he “picked up a portfolio of corporate clients including MG Rover and Phoenix”. He remained in Birmingham until the spring of 2004 when he transferred to the Reading office, becoming head of the audit practice in the South of England, retaining his role as the Group’s engagement partner.

31.3.  *Mr Peter Gallimore (audit manager, 2000 to administration of MGRG)*

The day to day operations of the audit were generally the responsibility of the audit manager, Mr Gallimore. He described his role as follows:

“I think the broad answer is that I am responsible for managing the audit and reporting to the partner. Managing the audit has many facets from the sort of administration of the audit and billing, cash collection, all of those aspects, through to the actual performance of the audit ... the planning section, the field work section, the reporting section.”

Mr Gallimore became a manager on 1 January 2000. He was subsequently promoted to senior manager on 1 January 2002 and to director on 1 June 2004.

31.4.  *Mr Les Platts (engagement quality assurance review ("EQAR") partner, 2000 to administration of MGRG)*

Mr Gallimore described the role of the EQAR partner to us as follows:

“The second partner [or] what we call the engagement quality assurance review, EQAR, partner ... is responsible for assisting the audit partner on the audit being available for consultation by that partner, and also being available to the client to discuss if there is any reason they are potentially unable to contact the first partner or have any reason to want to speak to a second partner.”

Mr Platts was an experienced senior partner who became a partner in 1986. Based in Deloitte’s Liverpool office, he had management responsibility for the audit practice in the North and Midlands and, from 2002 after transferring to the Leeds office, was the senior partner for the Deloitte practice in the North East.

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36 Mr Mullins became the engagement partner for the Group’s 2002 audit when Mr Fletcher announced, in September or October 2002, his intention to retire.
Mr Platts explained the background to his appointment as EQAR partner for the Group as follows:

“Back in 2000 when we took on the engagement I recollect that there were discussions that took place amongst the management of the firm about what the engagement team should be ... the view was that in view of the size, profile and risk classification of that engagement we should have a senior audit partner in the team as the EQAR, and eventually it was decided that I should take on that role, not just by me, I hasten to add, but by the management of the firm ...”

31.5. Mr Philip Johnson (NRP (i.e. national risk partner), 2000 to administration of MGRG)

Mr Johnson was the NRP “in respect of all Deloitte engagements carried out for the MG Rover Group after the original transaction in May 2000”. He described the role of the NRP to us as follows:

“In broad terms, an NRP is appointed when any particular engagement or client is considered to give rise to a significant engagement risk for the firm ... The basic rationale of the NRP role is ... to ensure that significant engagement risks are subject to the consideration of a senior partner who is independent of both the client and the engagement team.”

At the time of his appointment as NRP Mr Johnson had over 20 years experience as a partner and had been involved in many corporate finance engagements and large audits. He was senior partner of the Deloitte Manchester office until 2002 and from 2003 was head of quality and risk management for the UK audit practice.

Mr Johnson also undertook the role of independent review partner (“IRP”) for the Group’s audit from 2001 onwards.

32. In addition, Mr Chris Robertson was appointed the engagement partner specifically for the Powertrain audit for the years ended 31 December 2002 and 2003.

33. Deloitte also had a role of lead client service partner (“LCSP”) who, while having no formal responsibility for the audit, was responsible for the overall Deloitte relationship with the client. The LCSP for the Group audit for the years ended 31 December 2000 to 2003 was

Deloitte introduced the IRP role in 2001. An IRP was required for audit engagements for all listed companies and any other companies for which it was justified on the grounds of public interest or audit risk. The IRP provided an independent assessment of the quality of the audit including the key decisions and significant judgements made. The extent of his review depended on the complexity of the engagement, the risks associated with the audit and the experience of the audit engagement partner and staff. The IRP had to be fully independent, and must not be engaged in the performance of the audit (and therefore will not normally meet or liaise directly with the client), or be involved in the provision of other services to the client, i.e. he must have no responsibilities other than serving as IRP.
Mr Einollahi. He reviewed and provided comments on a draft of the Group’s 2000 financial statements but only in the role, he told us, of “an interested partner who has [an] equity interest in the firm who is signing these accounts.” He had no other audit involvement.

**Quality control and technical advice**

34. In addition to the various advisory roles carried out by partners, Deloitte’s systems required the involvement of the professional standards review (“PSR”) function to carry out an independent review of financial statements and all other documents in which Deloitte stated an opinion on financial, auditing and accounting matters. The PSR department undertakes quality control checks to determine that Deloitte’s policies are met and to ensure compliance with Deloitte’s procedures and relevant statutory and other regulations.

35. PSR file reviews are carried out for audit engagements with, inter alia, audit fees over a set threshold, those identified as having greater than normal risk, and first and last year audits. PSR typically reviews for completeness and compliance of the audit files with Deloitte’s AS/2 methodology. This includes a review of the audit work performed and the judgements reached to confirm that they have been properly arrived at and documented. The PSR reviewer is not responsible for the quality of the professional work performed or for any opinions which they express on behalf of Deloitte (these are the responsibility of the engagement partner and, where appropriate, the EQAR partner). The PSR reviewer for the Group audit changed year on year as the PSR team is staffed principally on the basis of a revolving system of secondees from service lines.

36. Technical advice on complex auditing and accounting matters is provided to the audit engagement team by the national accounting and auditing (“NAA”) team. The NAA team is led by a number of partners. Consultation with the NAA team may take the form of a telephone call, an e-mail, a memorandum, or a standard form known as a research consultation document (“RCD”) depending on the nature and the extent of the consultation. Consultations with the NAA team are most likely to be documented where specialist NAA team knowledge is required to interpret accounting or auditing standards in the context of an individual client’s circumstances. There was not a NAA partner allocated specifically to respond to queries in respect of the Group audit; queries were either directed to the NAA hotline or, where a particularly complicated or specialised issue arose, the audit team might contact the appropriate NAA partner directly.

37. In summary, there was in place a review process involving partners at the highest level to ensure that Deloitte’s audit was technically robust and appropriately performed, along with systems to ensure that the quality and efficiency aspects of Deloitte’s audit were properly managed.
Indepedence and objectivity

The ICAEW’s framework

38. As noted above, the purpose of an audit is to provide reasonable assurance as to the truth and fairness of the financial statements prepared by the company’s directors. However, the directors have considerable sway in the appointment and reappointment of the auditors and the power to engage the audit firm to advise in other areas such as corporate finance and taxation. As a result a conflict potentially exists between the auditors’ duty to report to the shareholders and their effective employment by the directors.

39. Where this conflict exists, it is capable of being a threat to the objectivity of the auditors’ examination of a company’s financial statements.

40. The ICAEW considers objectivity in detail in statement 1.201, Integrity Objectivity and Independence within the “Guide to Professional Ethics” included in the ICAEW Members’ Handbook (“the Guide”). This defines objectivity as follows:

“Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other. It is sometimes described as ‘independence of mind’.”

41. The Guide identifies five ways in which an auditor’s objectivity may be threatened:

“The self-interest threat ...

A threat to the auditor’s objectivity stemming from a financial or other self-interest conflict. This could arise, for example, from a direct or indirect interest in a client or from a fear of losing a client.

The self-review threat ...

The apparent difficulty of maintaining objectivity and conducting what is effectively a self-review, if any product or judgement of a previous audit assignment or a non-audit assignment needs to be challenged or re-evaluated in reaching audit conclusions.

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38 As noted in section 235 of the Companies Act 1985, while it is the “company” (that is the shareholders) who appoint the auditors for the following year at the AGM, it would be very rare for the company to go against the wishes of the directors. In the case of the Group the members of the Phoenix Consortium not only controlled the board of directors but also held the only shares with voting rights – see V/24 and 55.4.


40 The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 2.2.

41 The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 2.3.
Chapter XXIII
Financial statements and audit

The advocacy threat ...

There is an apparent threat to the auditor’s objectivity, if he becomes an advocate for (or against) his client’s position in any adversarial proceedings or situations. Whenever the auditor takes a strongly proactive stance on the client’s behalf, this may appear to be incompatible with the special objectivity that audit requires ... 42

The familiarity or trust threat ...

A threat that the auditor may become over-influenced by the personality and qualities of the directors and management, and consequently too sympathetic to their interest. Alternatively the auditor may become too trusting of management representations so as to be inadequately rigorous in his testing of them – because he knows the client too well or the issue too well or for some similar reason 43.

The intimidation threat ...

The possibility that the auditor may become intimidated by threat, by dominating personality, or by other pressures, actual or feared, by a director or manager of the client or by some other party.” 44

42. The thrust of the ICAEW’s guidance relates to identifying threats and implementing safeguards, although it recognises that there may be occasions when refusing to act may be the only course open to an auditor. However, the public’s perception of a threat to objectivity should not necessarily bar an auditor from acting 45.

43. While acknowledging that the provision of other, non-audit, services may on occasion threaten or appear to threaten objectivity 46, the Guide warns that companies may be adversely affected if such services are not offered 47.

44. The Guide describes specific areas of risk and the safeguards that the auditors can implement to offset the threats posed 48. Those of particular relevance to the audit of the Group and the way in which they were addressed by Deloitte are dealt with below.

Acceptance and reacceptance of the audit engagement

45. Deloitte’s approach to independence and objectivity is built into the AS/2 audit system as part of the planning process which prompts the audit team to consider various issues.

42  The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 2.4.
43  The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 2.5.
44  The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 2.6.
45  The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraphs 3.9 and 3.10.
46  The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.55.
47  The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.56.
48  The Guide, Section 1.201, Integrity, Objectivity and Independence.
Deloitte’s assessment of the engagement risk as “much greater than normal”\(^{49}\) resulted in independence and objectivity being considered at the highest level within the firm.

46. As noted above\(^{50}\), before audit planning started, a decision to accept the appointment as Group auditors was made at a very senior level in June 2000. This decision was followed by the documentation driven by the Deloitte audit process to safeguard their independence and objectivity. In particular:

46.1. audit form 1210, the “assessment of engagement risk and control environment”, led to the conclusion that the “engagement risk” was “MUCH GREATER THAN NORMAL”;

46.2. the same form shows that Mr Johnson approved the “engagement acceptance” as “Risk Management Partner”;

46.3. also on audit form 1210 it was noted that:

   “Risk associated with accepting appointment has been considered at all levels within the firm in accordance with the firms procedures. Documentation supporting this decision is on file therefore it is acceptable to accept appointment based on this risk assessment”;

46.4. audit form 1211, the “summary of independence and objectivity”, records that Mr Fletcher was satisfied that there were adequate objectivity and independence safeguards in place to accept the audit;

46.5. audit form 1212, the “independence check”, was submitted by Mr Gallimore to the Compliance Department on 22 February 2001 and signed, as completed, by Mr Michael Holmes, a compliance manager on 22 February 2001;

46.6. the form also records, under “Financial interests in the client”, that there was a “contingent fee on ongoing forensic work”; and

46.7. audit form 122*, the “new client acceptance memo”, records the approval of the new engagement. The form makes provision for three different people to sign it; in the event, it was signed by five as follows:

\(^{49}\) See paragraph 28 above.
\(^{50}\) See paragraph 22 above.
The conclusions on audit form 122* were expressed as follows:

“*Conclusions (including brief explanation):*

**Reputation of people involved**

Four consortia members all appear of appropriate reputation having a history in motor industry and meetings have identified no weaknesses. Other senior management also of good reputation and no risk noted (see 1210 for further details)

**Risks to the firm**

Engagement risk assessed as much greater than normal with a very large number of specific audit risks. Included in audit approach in thorough and rigorous process. Risk deemed acceptable and will be addressed in detail through audit process.

[Deloitte] independence and conflicts of interest (See form 1211, Summary of Independence and Objectivity)

Other engagements ongoing not involving audit team - no independence or conflict issues noted.

**Competence**

UK Automotive sector partner is audit service partner assisted by Central Partner in Charge of Audit, Les Platts as Second Partner. Lead manager, Peter Gallimore has had extensive involvement in the review of the completion accounts and has detailed understanding of the business.

**Commercial considerations**

Audit fee set at £495,000. Level appears sufficient to match nature of work required to draw appropriate opinion on consolidated financial statements of Techtronic (2000) Limited and MG Rover Group Limited and its subsidiary companies.
**Chapter XXIII**

**Financial statements and audit**

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**General conclusion as to acceptability**

* Satisfactory *

47. The above describes the process by which Deloitte accepted the audit in the first year. In subsequent years the process was similar but excluded the new client acceptance memo, audit form 122*. Nonetheless approval was required and obtained each year from both the national director of risk, Mr Paisley, and the managing partner, Mr Connolly to reaccept appointment as auditor. With the exception of the 2001 audit, this approval was evidenced by their signatures on audit form 1210, the assessment of engagement risk and control environment.

48. While not evidenced on the audit form 1210, the decision to accept reappointment for 2001 was approved by Mr Connolly and Mr Paisley, the latter entering into an email exchange with Mr Gallimore. In representations to us Mr Paisley said:

> “I was involved ... in 2002 in reviewing the issue of audit independence and objectivity in respect of the 2001 accounts when consideration was given as to whether Deloitte should accept reappointment as auditors to the Group. The reappointment of the audit engagement for 2001 was approved by Mr Connolly and myself. As demonstrated by ... email exchanges between Peter Gallimore and myself on 1 and 13 May 2002, I also reviewed and commented on the Form 1213 (appendix to Form 1210). Although neither my name nor signature appears on any of the Forms 1210, 1211 or 1212, I believe that I would have reviewed these as part of the procedure in relation to the consideration of independence and objectivity.”

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**Specific areas of threat and Deloitte’s approach**

**Level of fees**

49. The first risk addressed by the Guide is *undue dependence on an audit client*51. The Guide states:

> “... If the recurring fees from a client company or group of companies constitute a substantial proportion of the fee income of an audit firm, a self-interest threat is likely to arise, so as to imperil objectivity.”52

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51  The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.1.
52  The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.1.
... Accordingly a member should not accept an audit appointment or similar financial reporting assignment from an entity which regularly provides him, his firm or an office within the firm with an unduly large proportion of his or its gross practice income. An unduly large proportion would normally be 15 per cent, or, in the case of listed or other public interest companies the appropriate figure would be 10 per cent ...

... The fees from a number of one-off assignments could contribute to a problem of undue dependence. One-off assignments which by their special and repetitive nature become regular assignments should be regarded on the same basis as recurring fees ...

... Where a member is dependent for his income on the profits of any one office within a firm and the gross income of that office is regularly dependent on one client or a group of connected clients for more than 15 per cent (in the case of listed or other public interest companies 10 per cent) of its gross fees, a partner from another office should take final responsibility for any report ...

... While the overall criteria set out in paragraph 4.2 [of the Guide] do not indicate the presence of a serious threat, individual engagement partners may be faced with a personal threat because their personal portfolio is dominated by a single client, on whom they might become so dependent as to lose objectivity.

50. The Guide recognises that the provision of other services to audit clients presents an area of risk but warns against unnecessarily denying clients access to other services:

“... There are occasions where objectivity may be threatened or appear to be threatened by the provision to an audit client of services other than the audit. All the safeguards described in paragraphs 3.2 to 3.9 [of the Guide] may have an application to the provision of other services.”

53 Other public interest companies are defined in paragraph 7.7 of Section 1.201, Integrity, Objectivity and Independence, in the Guide as follows:

“Various paragraphs of this Statement refer to ‘other public interest companies.’ Where this occurs the phrase is intended to include those unlisted companies and organisations, in both the private and public sectors, which are ‘in the public eye’ because of their size or the product or service they provide. Examples of such companies and organisations would be large charitable organisations and trusts, major monopolies, duopolies, building societies, industrial and provident societies or credit unions, deposit-taking organisations, and those holding investment business client money.”

54 The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.2.

55 The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.5.

56 The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.6.

57 The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.7.

58 The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.55.
... There is no objection to a firm providing advisory services to a company which are additional to the audit. Care must be taken to ensure not to perform management functions or to make management decisions. It is economic in terms of skill and effort for professional accountants in public practice to be able to provide other services to their clients since they already have a good knowledge of their business. Many companies (particularly smaller ones) would be adversely affected if they were denied the right to obtain other services from their auditors.\footnote{The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.56.}

51. The following table, provided to us by Deloitte, summarises Deloitte’s fees for the years 2000 to 2005:

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Audit</strong></td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
</tr>
<tr>
<td></td>
<td>0.47</td>
<td>0.30</td>
<td>0.47</td>
<td>0.40</td>
<td>0.26</td>
<td></td>
</tr>
<tr>
<td><strong>Non audit</strong></td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
</tr>
<tr>
<td></td>
<td>6.04</td>
<td>3.62</td>
<td>11.17</td>
<td>3.27</td>
<td>3.97</td>
<td>0.68</td>
</tr>
<tr>
<td><strong>Total fees billed</strong></td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
</tr>
<tr>
<td></td>
<td>6.04</td>
<td>4.09</td>
<td>11.47</td>
<td>3.74</td>
<td>4.37</td>
<td>0.94</td>
</tr>
<tr>
<td>Revenue of UK practice</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
</tr>
<tr>
<td></td>
<td>689</td>
<td>822</td>
<td>924</td>
<td>1,228</td>
<td>1,246</td>
<td>1,355</td>
</tr>
<tr>
<td>Fee percentages (%)</td>
<td>0.9%</td>
<td>0.5%</td>
<td>1.2%</td>
<td>0.3%</td>
<td>0.4%</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

52. It is apparent from the above that the total fees earned in any one year by Deloitte from the Group for all types of work were not “an unduly large proportion”\footnote{The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.2.}, as defined by the Guide, of the UK practice’s income. Nonetheless Deloitte, in their audit planning, considered each year the additional, non-audit, work that they were undertaking and, from 2002 where possible, estimated the fees associated with each piece of work.

53. Furthermore, Deloitte separated the work so that the majority of the non-audit work was carried out by partners in other offices, in particular the corporate finance work, was carried out from the Manchester office under Mr Einollahi. Additionally, throughout Deloitte’s involvement with the Group, there was never just one partner associated with the audit engagement. The association of not just an EQAR partner but also a national risk partner directly with the audit engagement and the independent check provided by the professional standards review ensured that Deloitte’s own checks on objectivity and independence exceeded the requirements laid down by the ICAEW.

Contingent fees

54. Some of Deloitte’s non-audit fees were on a contingent basis; in some cases these were, or stood to have been, very substantial. For example, as noted in chapter VII (Project Platinum)\footnote{See VII/115.5.}, Deloitte’s fee in respect of the Project Platinum transaction was £7.5 million. Further, Deloitte’s initial engagement letter in respect of the Project Slag transaction\footnote{As to which see V/69 to 76.}
(which, in the event, did not proceed\textsuperscript{63}) provided for Deloitte to receive as much as £17.8 million\textsuperscript{64}; although Deloitte issued a revised engagement letter in September 2000, following changes to the proposed split of tax benefits between the Group and Barclays, it was still anticipated that Deloitte’s fee “may be in the region of £10 million”\textsuperscript{65}.

55. However, a distinction has to be drawn between the contingent fees for work such as Projects Platinum and Slag and the contingent fee for Deloitte’s work in respect of the acquisition of Powertrain. Whereas Deloitte’s fee for Project Platinum was “contingent upon successful completion of the Acquisition” of the Rover vehicle finance portfolio owned by RFS, and that for Project Slag contingent on the successful outcome of a scheme to exploit the Group’s tax losses, the fee for the acquisition of Powertrain, as discussed below, at one stage contained a ratchet element dependent on the company’s working capital. Whereas the success of Projects Platinum and Slag were wholly independent of the auditors, the level of Powertrain’s working capital, being derived from the financial statements, fell within the compass of the audit.

56. The Guide states that a self-interest threat can arise if an element of the fees charged by a firm is in some way related to its results\textsuperscript{66}. Deloitte’s fees for the Powertrain transaction were originally set out in a letter dated 9 May 2001 and were to be on a contingent basis:

“[Deloitte’s] fixed fee for the acquisition of Powertrain Limited will be £1,250,000. This fee is contingent on completion of the acquisition. In addition our fee will include a ratchet element dependent upon the level of working capital that is delivered in Powertrain Limited at completion and any cash placed in escrow by BMW, including interest accrued on these monies up to the date on which these total monies are finally released to Powertrain Limited.”

57. The Guide makes no specific reference to contingent fees. Arguably, however, an arrangement such as this could be regarded as a mutual business interest – the greater the value of the assets received by the Group in Powertrain, the higher Deloitte’s fee would be. The Guide recognises mutual business interest as a potential self-interest threat\textsuperscript{67}.

\textsuperscript{63} See V/77.
\textsuperscript{64} Deloitte’s engagement letter with Techtronic dated 26 May 2000 provided for Deloitte to receive 15 per cent of the net cash received by Techtronic or any of its subsidiaries as a consequence of the Project Slag transaction, plus VAT. At this stage, the benefit of the transaction to MGRG was to be 66 per cent of 30 per cent, equivalent to 19.8 per cent of the tax losses. Deloitte’s fee would represent 15 per cent of this, equivalent to 9.9 per cent of the tax saving. By way of illustration, had losses of £600 million been utilised as initially envisaged, Deloitte’s fee under this engagement letter would have been £17.8 million (£600 million x 66 per cent x 30 per cent x 15 per cent) plus VAT.
\textsuperscript{65} In addition, a letter from Deloitte dated 28 September 2000 to Mr Abrahams at Barclays stated that 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.
\textsuperscript{66} The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 2.2.
\textsuperscript{67} The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.30.
58. It should be noted that the Guide does not forbid mutual business interests; it merely advises that appropriate safeguards need to be put into place. In this instance, the threat was identified and a discussion ensued between Mr Paisley, Mr Johnson and Mr Einollahi which resulted in an amendment to the terms of the Powertrain engagement. The engagement letter for the Powertrain work was amended to remove the contingent element on 15 April 2002, with Mr Beale confirming the agreement on behalf of Techtronic on 18 April. While the audit would have commenced by this date the financial statements for the Group were not signed off until 10 July.

59. Deloitte’s corporate finance department, which was responsible for the majority of the non-audit fees shown in the table above, took a prominent role in many of the transactions entered into by the Group. While Deloitte’s fees from these transactions are considered above, a further question arises as to whether their action on behalf of the Group could have detracted from their objectivity and independence in relation to Deloitte’s audits of the Group.

60. With such high fees being earned from non-audit work, it would be natural for someone outside of Deloitte, without any knowledge of their procedures, to think that this might lead to some internal conflict within Deloitte, and that Deloitte’s audit might have been influenced by any representations made by the corporate finance department in fulfilling their advisory function. Nonetheless, we find that the segregation of functions within Deloitte, both departmentally and geographically, together with the oversight mechanism provided by the various levels of review required to accept or re-accept an audit appointment and to sign off an audit, were sufficient to ensure that the independence and objectivity of Deloitte’s audit of the Group was not compromised.

Staff and former staff working for the Group

61. The Guide identifies a principal or senior employee joining a client as an area of risk.

62. At least three members of Deloitte’s staff went on secondment to the Group. Two of them eventually left Deloitte and joined the Group’s staff:

62.1. Mr Paul Spiby, audit manager in charge of Techtronic’s audit in 2000, was seconded to the Group in 2001 and became the Group’s international accounting manager by 2002;

62.2. Mr Cowburn, from the corporate finance department in Deloitte’s Manchester office, was seconded to the Group in 2001 to assist the Group’s directors with the making of accounting entries and general business planning. He joined the Group prior to the start of the 2002 audit work in February 2003; and

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69 See paragraph 51 above.
70 As to which, see paragraphs 22 and 45 to 48 above.
71 The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraphs 4.26 to 4.29.
62.3. Mr Iain Collett towards the end of 2001 assisted the Group with the reconciliation of the VAT control account.

63. While he was not mentioned by name, Mr Cowburn’s secondment was specifically mentioned in the “memo documenting matters impacting on Deloitte & Touche independence on the audit of Phoenix Venture Holdings and its subsidiary companies”, which was appended to audit form 1210 for the year ended 31 December 2001, as follows:

“Independence consideration

... Deloitte & Touche employee on secondment making accounting entries and reporting transactions for Phoenix Venture Holdings and Techtronic (2000) Limited. The employee is also involved in business planning and forecasting.

Action taken

- Secondment engagement letter reviewed to confirm employee acting under direction of Phoenix management under secondment arrangement.
- Detailed audit of transactions processed by employee by senior members of audit team.

Clarification:

Phoenix Venture Holdings and Techtronic (2000) Limited are the holding companies for the Group — therefore, transactions being recorded are primarily directors salaries and expenses. The Deloitte & Touche employee has no involvement in strategic decision making within these companies.

Similarly, statutory accounts are purely being prepared from the underlying financial records for Studley Castle Limited, a small subsidiary which is peripheral to the Group’s core activity.

His involvement in business planning and forecasting is to inform MG Rover Group management of the revised group structure and plans of the Phoenix Board. No strategic decision making is involved as part of his role.”

64. The above was typical of the disclosure of Mr Cowburn’s secondment in the Deloitte planning documentation in subsequent years. While neither Mr Spiby’s nor Mr Collett’s secondments to the Group were mentioned specifically in 2001 or later years, we believe that the safeguards that had been put in place in respect of Mr Cowburn’s secondment and other threats would have been more than sufficient to safeguard any threat to Deloitte’s independence and objectivity.
65. Furthermore, having joined the Group, neither Mr Spiby nor Mr Cowburn became an officer of the company and would therefore not have been a threat of the kind envisaged by paragraphs 4.26 and 4.27 of the Guide. Mr Cowburn never had any involvement with the audit\textsuperscript{72} and Mr Spiby’s involvement in the mechanics of the consolidation would not have threatened Deloitte’s independence and objectivity even if it had been known that he would have joined the Group by the time of the following year’s audit.

66. In addition, one ex-Deloitte employee subsequently became a director of Xpart. Mr Peter Dillon, who in 2000 was based in Deloitte’s corporate finance department in Manchester, worked on Project Feniks\textsuperscript{73} until March 2003. He left Deloitte in July 2003 following a “restructuring in Deloitte’s corporate finance subsequent to the Andersen transaction...”. He then had a “year where [he] did not do anything in particular of relevance.” In August 2004 Mr Dillon was brought in by Mr Einollahi, with the authorisation of Mr Beale, to help with the post-completion accounting for Xpart, following the sale of the underlying business to CAT\textsuperscript{74}, and was appointed a director of Xpart on 26 October 2004.

67. This might have posed a threat to objectivity in the terms envisaged by paragraph 4.26 of the Guide. However, the fact that Mr Dillon was appointed just three days before the Xpart 2003 audit report was signed, together with the various safeguards employed by Deloitte as a matter of course, would have countered this threat.

\textit{Shadow director}

68. Under the general heading of “\textit{provision of other services to audit clients}”, the Guide makes specific reference to the threat arising from involvement in management:

\textit{“\ldots The objections to an auditor becoming involved in a management role should be apparent. All of the threats to objectivity discussed above would affect the auditor who took management decisions, and their combined weight would make it virtually impossible for a member to claim to have retained objectivity in audit reporting ...”}\textsuperscript{75}

69. While “\textit{a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity}”\textsuperscript{76}, Deloitte were alive to the possibility that Mr Einollahi might be perceived as a shadow director. In audit form 1210 on the Powertrain

\textsuperscript{72} In representations to us, Deloitte stated that Mr Cowburn “was making certain accounting entries in the books of PVH and Techtronic.” They added:

\textit{“\ldots the terms of [Mr Cowburn’s] secondment had ... been reviewed carefully to ensure that the secondee was operating fully under PVH control and was not involved in any strategic decision making ... specific consideration had been given to this issue and the role of John Cowburn reviewed. This review led to the conclusion that Mr Cowburn was not involved in making key accounting entries; he was posting primarily directors’ fees and expenses in the holding companies’ ledgers (in respect of which there would not be difficult accounting judgements) and under the direction of client management.”}

\textsuperscript{73} As to which, see XIX/37.

\textsuperscript{74} As to which, see XIII/38 to 47.

\textsuperscript{75} The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.75.

\textsuperscript{76} Companies Act 1985, section 741(2).
2001 audit file assessing engagement risk and the control environment, Deloitte noted under “Details of risk”, “Significant level of CF fees and involvement of Maghsoud Einollahi in shadow director capacity.” A version of the “Memo documenting matters impacting on Deloitte & Touche independence on the audit of Phoenix Venture Holdings and its subsidiary companies” on the MGRG 2001 audit file77 questioned:

“... Whether a close advisory relationship existed between Maghsoud Einollahi and the Board that might be interpreted as acting as a shadow director.”

70. The disposal of the point recorded on the same working paper was:

“After due consideration of the matter, there is no evidence that Deloitte & Touche is acting in other than a normal advisory relationship.”

71. The extent of that consideration is not recorded on the working paper. However, in representations to us Mr Paisley stated:

“[He] was aware that discussions had been held with Mr Einollahi to the effect that he should only attend board meetings for specific reasons, consistent with his advisory role, to curb any perception of being too close to the Group. The potential issues that might be raised by Mr Einollahi’s perceived closeness to the Group were always borne in mind and Mr Einollahi had agreed to ensure that he kept the appropriate degree of separation.”

Conclusion on independence and objectivity

72. It is apparent that the fees for auditing the Group were relatively small compared to the non-audit fees that had already been earned and were likely to be earned in the future. However, the ethical guidelines applicable make it clear that the determining factor is not the relative sizes of the audit and non-audit fees but the importance of the client as a whole in relation to the practice’s fee income78. It is clear that the total fees to be earned from the Group as a proportion of Deloitte’s total income were nowhere near the level that would be regarded by the ICAEW as unduly large.

73. Furthermore, it is apparent that Deloitte’s own procedures for safeguarding its independence and objectivity met, or even exceeded the standard required by the ICAEW. While the ratio of Deloitte’s non-audit fees to audit fees since their appointment as auditors to the Group might be perceived as having been a threat to their independence and objectivity, we have found no evidence to suggest that Deloitte’s independence and objectivity were in fact compromised.

77  Another version of this document on Deloitte’s audit file does not include these comments but concludes, “This document will be reviewed by Maghsoud Einollahi to confirm matters documented and to confirm there are no further independence considerations that we should be aware of as part of the audit engagement.”

78  The Guide, Section 1.201, Integrity, Objectivity and Independence, paragraph 4.58.
Transfers of MGRG’s assets to other Group companies

The transfers

74. As explained in other chapters in this report\(^79\), between May 2000 and April 2005 MGRG entered into transactions in which its assets were transferred to other companies within the Group.

The Longbridge land and buildings

75. 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 sale was carried into effect by a contract that 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”.\(^80\)

76. In the event, the sale was effected at net book value. The tangible fixed assets note to the Property Holdings 2001 financial statements shows that the Longbridge land was transferred from a fellow group undertaking at its net book value, given as £37.626 million.\(^81\)

77. As explained in chapter IX (Property and share transfers), we consider that the Longbridge land was transferred for less than its market value.\(^82\)

Dealer properties

78. Board minutes for MGRG and MGRDP state that the two boards approved the sale of dealer properties to MGRDP on 28 December 2001. Like the contract relating to the sale of the Longbridge land, 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”.\(^83\)

79. In the event, the dealer properties, like the Longbridge land, were transferred at net book value. MGRDP’s 2001 financial statements recorded it as having acquired during the year tangible fixed assets valued at £13,926,742.\(^84\)

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\(^79\) See chapter IX (Property and share transfers), chapter XI (Aircraft) and chapter XIII (Xpart).
\(^80\) See IX/5 and 6.
\(^81\) See IX/7.
\(^82\) See IX/21.
\(^83\) See IX/46 to 48.
\(^84\) See IX/49.
80. As explained in chapter IX (Property and share transfers), it seems to us that the transfer of dealer properties to MGRDP was effected for somewhat less than the properties’ market value.  

Xpart  

81. Minutes record that Xpart was transferred to PVH for £2 on 20 December 2002. It was suggested to us that £2 was considered to be an appropriate value at which to transfer the company because it was intended that Xpart would repatriate all the profits earned from the parts business to MGRG by way of a mark up on goods sold by MGRG to Xpart. However, as explained in chapter XIII (Xpart), we consider that Xpart was transferred for less than its market value.  

Transfer of tax losses  

82. As explained in chapter XI (Aircraft), in June 2002 MGRG surrendered tax losses of £100,002,128 to PVL for no consideration.  

83. In our view, it was not in MGRG’s interests to surrender its tax losses for no consideration. Further, when MGRG was in BMW ownership, it was fully compensated for tax losses it surrendered. Mr 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 and, in fact, MGRG’s 2002 financial statements referred to a reduction in its tax credit for the year of £36.7 million in relation to “group relief surrendered for no consideration”. In the event, PVH did obtain benefits (after payment of all costs) of £8,510,505 from utilising the losses transferred.  

Responsibilities of Deloitte as auditors of MGRG  

84. Deloitte told us in representations that it was not their responsibility as auditors to determine whether the directors had made commercially reasonable judgements regarding the price at which assets were bought or sold, nor was it their responsibility to assess whether the directors had complied with their fiduciary duties. They told us:  

“Our responsibility as the auditor was, rather, to express a view upon whether or not the financial statements gave a true and fair view of the state of affairs of an entity and the transactions it had entered into.”

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85 See IX/60.  
86 See XIII/22 and 23.  
87 See XI/35.  
88 See XI/63.  
89 See XI/30.  
90 See XI/14 and 15.
We largely agree with this assessment of an auditor’s responsibilities\(^{91}\).

85. However, in reaching an opinion as to the truth and fairness of the financial statements, it would have been necessary for Deloitte to consider the financial implications of transactions that were carried out at less than their market value and the possible effect on the financial statements.

86. Further, Deloitte should have considered the possibility that these transactions constituted distributions as defined in section 263 of the Companies Act 1985\(^{92}\). That section required that “\textit{A company shall not make a distribution except out of profits available for the purpose.}”\(^{93}\) As explained in chapter XVI (Financial and trading performance of MGRG), MGRG had net assets of only £12 million as at 31 December 2000 and net liabilities for all subsequent years\(^{94}\). Since the \textit{Aveling Barford} case\(^{95}\), an inter-group transfer of assets at less than market value can be regarded as a distribution in kind, and thus subject to the statutory rules on distributions. Therefore, if a company with no distributable profits\(^{96}\) transfers an asset at less than market value, that transfer can potentially be considered an unlawful distribution.

87. In this respect, while auditors “\textit{are not expected to have the expertise of a person trained for, or qualified to engage in, the practice of another profession or occupation}”\(^{97}\), auditors do have a responsibility to consider law and regulations as part of their audit. SAS 120, “\textit{Consideration of law and regulations}” (“SAS 120”), provided guidance on laws and regulations that relate directly to the preparation of the financial statements and specifically identifies “\textit{those [laws and regulations] which determine the circumstances under which a company is prohibited from making a distribution except out of profits available for the purpose, such as section 263 of the Companies Act 1985}”\(^{98}\) (emphasis added).

\textit{Audit work undertaken}

88. In representations to us Deloitte stated that it was not evident to the audit team at the time that the transactions were made at less than market value:

88.1. in relation to the transfer of the Longbridge land and the dealer properties they told us:

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\(^{91}\) We consider the respective responsibilities of auditors and the directors of an entity at paragraphs 9 to 18 above.

\(^{92}\) Section 263(2) of the Companies Act 1985 states that, “distribution’ means every description of distribution of a company’s assets to its members, whether in cash or otherwise, except [in certain circumstances].”

\(^{93}\) Companies Act 1985, section 263(1).

\(^{94}\) See XVI/8, 16, 24, 35 and 45.

\(^{95}\) \textit{Aveling Barford Limited v Perion Limited and others} [1989] BCLC 626.

\(^{96}\) Section 263(3) of the Companies Act 1985 states that, “a company’s profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made.”

\(^{97}\) SAS 520, “Using the work of an expert” (“SAS 520”), paragraph 4.

\(^{98}\) SAS 120 paragraph 23.
“... there was nothing which led the audit team to believe that net book value was not an appropriate figure at which to record the transfer. In light of the above, further testing was not performed in respect of the value”;

88.2. in relation to the transfer of Xpart to PVH, Deloitte stated, “The audit team did not consider the transfer of Xpart to be a significant or material transaction in light of Xpart’s essentially nominal value as a standalone company”; and

88.3. in relation to the transfer of tax losses in 2002, they said, “When the audit was performed there was no reason why Deloitte should have been on notice that the tax losses had any value in the hands of MGRG”.

89. Furthermore, Deloitte told us that it was “common and accepted practice at the time for transfers of assets internal to a group to be made at the value at which the assets were stated in the transferring company’s books of account.”

90. We have seen no evidence on Deloitte’s audit working papers that the audit team considered the appropriateness of any of the transactions referred to above or the potential implications that these transactions being conducted at less than market value would have on the financial statements.

91. Deloitte told us in representations that the relevant guidance in place at the time required that auditors only “record in their working papers their reasoning on all significant matters which require the exercise of judgement”99. In respect of the transfer of Xpart and the tax losses in 2002, Deloitte told us that because, in their view, neither had any substantial value to MGRG, the transfer of these assets did not constitute a “significant matter” and the audit team’s consideration of these transfers did not, therefore, need to be explicitly recorded.

92. We recognise that it is not a requirement for auditors to document every matter arising during the course of their audit. However, these transfers were of significance to MGRG, particularly since MGRG had negative distributable reserves at the time of the transfers, and we would have expected there to have been significant discussion within the Deloitte audit team and between Deloitte and MGRG’s directors as to the true value of the assets being transferred, as well as documentation of Deloitte’s considerations. Whatever Deloitte might now think about the value of the assets that were transferred, it is not clear to us that Deloitte gave the question the attention it required and, notwithstanding Deloitte’s assertions that the question of value was considered at the time of their audits, we have seen no evidence that they did.

93. It is not possible to predict with any certainty what Deloitte would have done had they considered that the values at which MGRG’s assets were transferred were less than their market values, or were less than the values that MGRG was entitled to insist on. Deloitte

99 This being a reference to paragraph 6 of SAS 230, “Working papers” (“SAS 230”).
might have concluded that these transfers constituted distributions as defined in section 263 of the Companies Act 1985.

94. Further, while it might be common for assets to be transferred at net book value within other groups of companies, or for tax losses to be transferred for no consideration, it seems to us that a reader of MGRG’s financial statements would have been better informed had the true or potential value of these assets been explained, even though accounting standards did not require such disclosures to be made. It is possible that Deloitte would have recommended that the financial statements include notes that explained the full circumstances of the transfers.

95. Indeed, whenever assets are transferred between parties at values below their true or potential value, it seems to us that a reader of that company’s financial statements would be better informed if the true or potential value of these assets is explained. Accounting standards do not require such disclosures to be made; however we are of the view that making such disclosures mandatory would improve transparency and help readers of all financial statements to gain a better understanding of a company’s financial performance.

**Going concern in respect of the Group’s 2003 financial statements**

*Background*

96. The PVH 2003 consolidated financial statements were signed by the directors and by Deloitte on 26 October 2004. The majority of PVH’s subsidiaries’ 2003 financial statements, including those of MGRG and Powertrain, were signed by the directors on 28 October 2004, and Deloitte signed the audit reports on 29 October 2004. As we note in chapter XX (The events leading to administration), by this time discussions with SAIC were well underway and it was anticipated that the deal would complete in January 2005.

97. At the same time, it was by now apparent that the Group could not survive for much longer without the injection of additional funding, and therefore the going concern status of PVH and its subsidiaries was called into question.

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100 It is arguable that FRS8 “Related party disclosures”, which requires the disclosure of “any other elements of [related party transactions] necessary for an understanding of the financial statements” would require an explanation of the true or potential value of the assets transferred. However that standard “does not require disclosure of transactions entered into between two or more members of a group provided, that any subsidiary undertaking which is a party to the transaction is wholly owned by a member of the group”. The minimum disclosures required under IAS 24, the international standard on related party disclosures, do not include an explanation of the true or potential value of the assets transferred.

101 See XX/28.

102 See XVI/52 to 56 and 58 and XX/9 to 11, 32 and 37.
Technical considerations

Preparation of financial statements on a “going concern” basis

98. Financial statements are generally prepared on a going concern basis, that is, on the assumption that an entity “will continue in operational existence for the foreseeable future”\(^{103}\). Although “the foreseeable future” is not specifically defined, the technical guidance relevant to the Group’s 2003 financial statements suggested that the period considered in assessing going concern should be one year from the date of signing the financial statements\(^{104}\).

99. FRS 18, “Accounting policies” (“FRS 18”), which was applicable to the Group’s 2003 financial statements, required that:

> “An entity should prepare its financial statements on a going concern basis, unless

(a) the entity is being liquidated or has ceased trading, or

(b) the directors have no realistic alternative but to liquidate the entity or to cease trading.

in which circumstances the entity may, if appropriate, prepare its financial statements on a basis other than that of going concern.”\(^{105}\)

100. Standards and guidance for auditors in their consideration of going concern at this time were provided in SAS 130, “The going concern basis in financial statements” (“SAS 130”). In respect of evidence obtained by the auditors, the SAS required that:

> “The auditors should assess the adequacy of the means by which the directors have satisfied themselves that:

(a) it is appropriate for them to adopt the going concern basis in preparing the financial statements; and

(b) the financial statements include such disclosures, if any, relating to going concern as are necessary for them to give a true and fair view.

For this purpose:

\(^{103}\) SAS 130 paragraph 5.
\(^{104}\) SAS 130 paragraphs 9 and 45.
\(^{105}\) FRS 18 paragraph 21.
(i) the auditors should make enquiries of the directors and examine appropriate available financial information; and

(ii) having regard to the future period to which the directors have paid particular attention in assessing going concern, the auditors should plan and perform procedures specifically designed to identify any material matters which could indicate concern about the entity’s ability to continue as a going concern.” 106

Disclosures in the financial statements in respect of going concern

101. Where there were significant doubts about an entity’s ability to continue as a going concern, FRS 18 required the following information to be disclosed in the financial statements:

“(a) any material uncertainties, of which the directors are aware in making their assessment, related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern.

(b) where the foreseeable future considered by the directors has been limited to a period of less than one year from the date of approval of the financial statements, that fact.

(c) when the financial statements are not prepared on a going concern basis, that fact, together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern.” 107

102. SAS 130 also required auditors to consider whether the financial statements should include disclosures in respect of going concern in order that they gave a true and fair view108 and that:

“If the going concern basis is inappropriate at the balance sheet date or significantly uncertain in the foreseeable future, this affects the manner in which the other fundamental accounting concepts are applied in the financial statements. It is thus important, where there is concern as to the entity’s ability to continue as a going concern, that readers of the financial statements have a proper understanding of the context in which the directors have satisfied themselves that the financial statements prepared on the going concern basis show a true and fair view. Therefore, in such cases, if the financial statements do not include disclosures relating to the entity’s ability to continue as a going concern, the auditors consider:

• whether the financial statements give a true and fair view; and hence

106 SAS 130 paragraph 21.
107 FRS 18 paragraphs 23 and 61.
108 SAS 130 paragraph 36.
Implications for the auditors’ report

103. SAS 130 required auditors to issue an adverse audit opinion if they disagreed with the preparation of the financial statements on the going concern basis\textsuperscript{110}, but also that:

“Where the auditors consider that there is a significant level of concern about the entity’s ability to continue as a going concern, but do not disagree with the preparation of the financial statements on the going concern basis, they should include an explanatory paragraph when setting out the basis of their opinion. They should not qualify their opinion on these grounds alone, provided the disclosures in the financial statements of the matters giving rise to the concern are adequate for the financial statements to give a true and fair view.”\textsuperscript{111}

104. Where the auditors concluded that there was a significant level of concern about the entity’s ability to continue as a going concern, SAS 130 provided the following guidance:

“... the auditors do not normally regard the disclosures as adequate unless (in addition to any disclosures otherwise required, for example by accounting standards) the following matters are included in the financial statements:

- a statement that the financial statements have been prepared on the going concern basis;
- a statement of the pertinent facts;
- the nature of the concern;
- a statement of the assumptions adopted by the directors, which should be clearly distinguishable from the pertinent facts;
- (where appropriate and practicable) a statement regarding the directors’ plans for resolving the matters giving rise to the concern; and
- details of any relevant actions by the directors.”\textsuperscript{112}

105. Further to this, SAS 600 provided specific guidance in terms of “fundamental uncertainties”:

\textsuperscript{109} SAS 130 paragraph 37.
\textsuperscript{110} SAS 130 paragraph 49.
\textsuperscript{111} SAS 130 paragraph 42.
\textsuperscript{112} SAS 130 paragraph 44.
“Where resolution of an inherent uncertainty could affect the view given by the financial statements to the degree that the auditors conclude that it is to be regarded as fundamental, they include an explanatory paragraph when setting out the basis of their opinion describing the matter giving rise to the fundamental uncertainty and its possible effects on the financial statements, including (where practicable) quantification. Where it is not possible to quantify the potential effects of the resolution of the uncertainty, the auditors include a statement to that effect. Reference may be made to notes in the financial statements but such a reference is not a substitute for sufficient description of the fundamental uncertainty so that a reader can appreciate the principal points at issue and their implications.”\textsuperscript{113}

“Communication with the reader is enhanced by the use of an appropriate subheading differentiating the explanatory paragraph from other matters included in the section describing the basis of the auditors’ opinion.”\textsuperscript{114}

\textit{Disclosures in the Group’s 2003 financial statements and Deloitte’s audit opinion}\textsuperscript{115}

106. The chief executive’s statement in the PVH 2003 consolidated financial statements included the following narrative setting out progress of the SAIC negotiations:

“We announced in June 2004 that PVH has signed an agreement with the Shanghai Automotive Industry Corporation (SAIC). This initiated an exclusivity arrangement to enable the companies to develop a far reaching strategic relationship. This cooperation will fund the development of new model programmes and will facilitate the exploitation of the global car market for the MG and Rover brands, including the very important Chinese market.

\textsuperscript{113} SAS 600 paragraph 61.
\textsuperscript{114} SAS 600 paragraph 62.
\textsuperscript{115} Note that paragraph 4 of SAS 160, “Objective and general principles of audit” (“SAS 160”), states:

“An audit of financial statements is directed towards the expression of an opinion by the auditors as to whether the financial statements give a true and fair view. Accordingly, auditors have no responsibility to report that the other information is properly stated.”

Such other information includes the directors’ report and chairman’s statement, in respect of which paragraph 6 of SAS 160 required that:

“Auditors should read the other information. If as a result they become aware of any apparent misstatements therein, or identify any material inconsistencies with the audited financial statements, they should seek to resolve them.”

Also see paragraphs 9 to 18 above regarding the respective responsibilities of auditors and directors.
Since then discussions have proceeded at a great pace leading to the signing of more detailed agreements. This has resulted in an initial tranche of funds being received by MG Rover and Powertrain. These events have served to reinforce our view that the necessary regulatory approvals will be granted and that the overall final joint venture agreement can be signed early in 2005. The agreement will represent the culmination of an immense amount of work in 2003 by the Group’s senior executives in assessing a variety of alternative collaboration ventures with the objective of achieving a viable long-term product strategy. Once the SAIC agreement has been approved we can expect renewed confidence in the future of the Group and the continuation of MG Rover vehicle production both at Longbridge and elsewhere in the world.”

107. Deloitte included a “fundamental uncertainty” paragraph in their audit opinion in the PVH 2003 consolidated financial statements as required by SAS 600\textsuperscript{17}. This read as follows:

“\textit{Going concern}

In forming our opinion, we have considered the adequacy of the disclosures made in Note 1 to the accounts. These relate to the satisfactory completion of the negotiations with Shanghai Automotive Industry Corporation, who may provide additional sources of finance to the Group, and the necessary regulatory approvals. In view of the significance of this uncertainty we consider it should be drawn to your attention. However our opinion is not qualified in this respect.”

108. Note 1 to the PVH 2003 consolidated financial statements included the following in respect of going concern:

“\textit{In June 2004 the Group announced that an agreement had been signed with Shanghai Automotive Industry Corporation (SAIC). This initiated an exclusivity relationship to enable the Group and SAIC to develop a far reaching strategic relationship.}

\textit{Since this date, discussions have proceeded at a great pace, which has lead to the signing of more detailed agreements and this has resulted in an initial tranche of funds being received by the Group. Final negotiations on these arrangements and the necessary legal documentation are in progress and it is anticipated that in the next few months an overall joint venture agreement will be signed resulting in substantial additional funds being received by the Group. These negotiations are not yet complete and require final regulatory approval. However, given the financial and other major commitments already made by SAIC, the directors have a very high level of confidence that the overall transaction will be completed successfully.}”

\textsuperscript{116} Similar disclosure was also included in note 27 to the financial statements (post balance sheet events).

\textsuperscript{117} See paragraph 105 above.
This cooperation will fund the development of the new model programmes and will facilitate the exploitation of the global car market for the MG and Rover brands, including the very important Chinese market.

The directors have assumed the necessary additional funding will be received in the profit and cash flow forecasts they have approved. Consequently, the directors continue to believe that the going concern basis is appropriate in the preparation of these accounts.

If the adoption of the going concern basis was inappropriate, adjustments would be required to write down assets to their recoverable value, to reclassify fixed assets as current assets and to provide any further liabilities that may arise.”

109. The audit opinion of the MGRG 2003 financial statements included an additional paragraph as follows:

“Going concern

In forming our opinion, we have considered the adequacy of the disclosures made in Note 1 to the financial statements concerning the ability of the ultimate parent undertaking, Phoenix Venture Holdings Limited, to provide adequate and continuing financial support to the company. In view of the significance of this uncertainty we consider it should be drawn to your attention. However our opinion is not qualified in this respect.”

110. Note 1 to the MGRG 2003 financial statements included the following in respect of going concern:

“The company is dependent on funding from its ultimate parent undertaking, Phoenix Venture Holdings Limited ("PVH"). The directors have received confirmation from PVH, that insofar as it is able to do so, it will provide financial support as is necessary to enable the company to meet its liabilities as they fall due for a period of at least 12 months from 28 October 2004 the date of signing these financial statements. The basis on which this support is provided is described in Note 1 to PVH’s financial statements for the year to 31 December 2003 ...”

111. The disclosure from note 1 to the PVH 2003 consolidated financial statements118 was then repeated, before the note continued as follows:

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118 See paragraph 108 above.
Based on the letter of support and the explanations from the directors of PVH, the directors have assumed such support will be provided by PVH. Consequently, the directors continue to believe that the going concern basis is appropriate in the preparation of these financial statements. The financial statements do not include any adjustments, which would result from the inability of the parent company to continue to provide adequate financial support.

If the adoption of the going concern basis was inappropriate, adjustments would be required to write down assets to their recoverable value, to reclassify fixed assets as current assets and to provide any further liabilities that may arise.”

112. These disclosures were also included in the audited 2003 financial statements of the other Group subsidiaries that were signed at this time.

113. The reference to financial support from PVH described above119 was set out in a letter of support dated 28 October 2004, which stated that:

“The Phoenix Venture Holdings Limited accounts have been prepared on a going concern basis as detailed in Note 1 to the accounts.

On this basis we confirm that Phoenix Venture Holdings Limited, as ultimate parent company, will continue to provide financial support to all of its subsidiary companies until at least 31 December 2005 …”

Adequacy of disclosures

114. Deloitte told us that they considered whether their opinion on the Group’s 2003 financial statements should be qualified120 on the basis of going concern. However, Mr Platts explained:

“… to the extent it was discussed, it was discussed relatively quickly, I think, because I think everybody reached the conclusion relatively quickly given the auditing standards and, you know, common practice as we all understood it that it is relatively unusual to make a – or very unusual to make a qualification on going concern on a business that is continuing to trade.”

115. Instead, Deloitte concluded in their working papers:

119 See paragraph 110 above.
120 As set out in paragraph 33 of SAS 600:

“A qualified opinion is issued when either of the following circumstances exist:

there is a limitation on the scope of the auditors’ examination ... ; or

the auditors disagree with the treatment or disclosure of a matter in the financial statements ...;

and, in the auditors’ judgment, the effect of the matter is or may be material to the financial statements and therefore those statements may not or do not give a true and fair view of the matters on which the auditors are required to report or do not comply with relevant accounting or other requirements.”
“... the PVH group would appear to be able to continue to be a going concern for the next 12 months on the basis that the £152m cash injection was received from SAIC ...”

116. However, Deloitte also noted that the negotiations with SAIC were continuing and that “there remains uncertainty [regarding the completion of the transaction] that should be reported in the financial statements”. Mr Mullins told us:

“... having looked at the forecasts, the key to going concern from an accounting point of view, and the judgment that the directors were taking on the accounts, it all revolved around, in my judgment and our judgment ... the receipt of the monies from SAIC. And in terms of 12 months from the date of signing the accounts, that was the key issue.”

“... our position was: if you conclude a deal, and it is all done and the money comes in, then we probably don’t have – then we don’t have a going concern issue. If you don’t – or until the point in time you do conclude the deal, if you as directors wish to sign these accounts off in view of the uncertainty that we think is there until you have done a deal, then the going concern position does need to be referred to by way of an emphasis of matter paragraph in the audit report.”

Discussions surrounding the disclosures in the Group’s 2003 financial statements

117. In the run up to the signing of the Group’s financial statements in October 2004 there was a large amount of correspondence and discussion between Deloitte and Group personnel regarding the wording of the disclosures relating to going concern. As part of these discussions the Deloitte audit team, namely Mr Gallimore and Mr Mullins, consulted Mr Platts, Mr Martyn Jones (national technical partner) and Mr Johnson. Mr Mullins told us:

“... I kept running – or we kept running the various versions of the report through our technical review, and that is why we ended up – or why we were comfortable that we ended up where we did.”

118. Mr Mullins and Mr Platts told us that Deloitte and the Group had very different views as to what should be included in the disclosures in the 2003 financial statements. Mr Mullins said:

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121 Mr Platts described his involvement in respect of the going concern discussions as follows:

“A number of discussions with the engagement team and with Philip Johnson probably, as the national risk partner, and attendance at a meeting at Longbridge with Peter Beale and Kevin Howe, and one of the other Phoenix directors, it might have been Nick Stephenson, was there as well, and other members of management, at which it was extensively discussed.”

He then explained that his role in those discussions was:

“Well, same as on the other things; considering all of the evidence, discussing it with the engagement team, specifically in that meeting at Longbridge discussing it with the directors and the management and dealing with the contrary views, discussing those and forming a conclusion.”
“Their starting point with us was that they did not believe it was necessary to discuss or disclose that there were any potential issues around going concern ... in some of the minutes they had a position; we said we disagreed with it. I had a meeting with them [i.e. representatives of the Group, including Mr Beale, Mr Millett, Mr Young and Mr Petrie], myself and Peter Gallimore, set out my views; they listened, didn’t agree ...”

“They were challenging us on why we were raising [going concern] as [an] issue and thought it was necessary to include this in the accounts ...”

119. Similarly, Mr Platts told us:

“Theyir contention was that [the completion of the deal and receipt of the funding] was so certain as to be something that required no reference in the accounts whatsoever. It didn’t need an emphasis of matter and it didn’t need the note 1 to the accounts with the explanation of the uncertainties. And our contention was that, no, there was some uncertainty and that should be disclosed.”

“... the general tone of [the discussions] was that they were trying to put as optimistic and positive a spin on the story that they put in note 1, and we were trying to make sure that it was kept as factual and relevant to the circumstances as we thought it should be.”

120. An example of the divergent views as to the information to be included in the Group’s 2003 financial statements is to be found in a memorandum from Mr Millett to Mr Howe and Mr Petrie dated 11 October 2004, following a conference call with Deloitte on 8 October 2004:

“Basically, for the SAIC information (in the note [being note 1 to the financial statements]) they are stating robustly that they would require the quantum of the cash injection, the fact that without this the business does not survive and they would insist on the use of the word ‘uncertainty’ in both our note and their note [Deloitte’s opinion] to the accounts ... Having submitted our Going Concern note 1 to them it is clear that there is a huge gulf between our simplistic and imprecise wording against their demands stating orders of magnitude of the cash injection.”

121. In the event, the word “uncertainty” appeared in Deloitte’s audit opinion122 but not in note 1 to the Group’s 2003 financial statements.123 With regard to the survival of the business, we think that a reader of the financial statements could have inferred that an additional cash injection was necessary from the information included in note 1 to the Group’s 2003 financial statements. However, the quantum of the cash injection was not included in the disclosures.

122 See paragraph 107 above.
123 See paragraph 108 above.
122. A file note entitled “Amendments offered by Deloittes on 13th October – Discussion between Mark Mullins and John Millett” set out suggested wording for note 1 to the PVH 2003 consolidated financial statements. A reference to the Group receiving substantial additional funds “in excess of £150 million” had been struck out, as had the sentence: “The current financial position of the group means that without substantial funding being received, the group is unlikely to be able to trade as a going concern.”

123. When we asked Mr Mullins about Deloitte’s position regarding disclosure of the amount of funds to be received by the Group, he told us:

“My thinking at the time was there was clearly a requirement for a substantial cash injection and it would be helpful to include it, include details of the quantum ... I can’t remember the specific thinking as to why we ended up with the answer that we did. There was a lot of internal discussion about what requirements you did have to disclose in terms of SAS130, and I think where we got to was a disclosure of the absolute financial amount wasn’t necessary as long as you indicated that there was a significant amount of funding required.”

124. With reference to the 13 October file note referred to above124, Mr Mullins said:

“I don’t specifically recall the discussion, this specific discussion, but I do recall that there were a number of discussions about the wording of this note ... I mean, this clearly was the directors’ wording and we were satisfied that by striking out these words, the accounts still appropriately flagged up this issue. And this is all about waving red flags and this was a big red flag.”

125. The “red flag”, Mr Mullins said, was:

“The fact that we are drawing out the fact that there are issues around going concern and the inclusion of the emphasis of matter paragraph. It is not something that you see in lots of sets of accounts.”

126. With regard to Deloitte’s discussions with the Group, Mr Mullins added:

“I think as ever in any negotiation you start from your absolute ideal position and then through the course of discussion, things get changed and you decide what you can and can’t live with.”

Compliance with technical guidance

127. In our view the specific points of disclosure required by FRS 18 and SAS 130125 could be inferred by a reader of the financial statements from the “fundamental uncertainty”

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124 See paragraph 122 above.
125 See paragraphs 101 and 104 above.
paragraph included in Deloitte’s audit reports\textsuperscript{126} and the extracts from the disclosures relevant to going concern that were included in the Group’s 2003 financial statements\textsuperscript{127}.

128. Mr Mullins told us:

“There [are] lots of things you could include within the accounts. I think the key thing, the key uncertainty, was the conclusion of a deal. There are lots and lots of details theoretically you could include. But the principal uncertainty was the one of concluding a transaction.

I mean, I don't recollect seeing sets of accounts that verbatim repeat or draw out lots of the detailed discussions and negotiations that are happening. Much in the same way if a company is in negotiations with its bankers and you include some sort of emphasis of matter, you don't go through all the detail of all the ins and outs of the arrangements. It is: what is the fundamental uncertainty? The fundamental uncertainty in this instance was the conclusion of that deal.”

Conclusions on disclosures included in the Group’s 2003 financial statements

129. We note that the disclosures in the Group’s 2003 financial statements did not include details of the operational structure of the Group in the future. Furthermore, at the time of signing the Group’s 2003 financial statements, negotiations between the Group and SAIC were still in progress and no contractual commitments had been entered into; the future shape of the Group and the involvement of PVH and its subsidiaries in the proposed joint venture with SAIC had not yet been agreed\textsuperscript{128}. Although we consider that it may have been helpful to a reader of the financial statements to have been provided with such information, we recognise that the relevant technical guidance at the time did not specifically state that such disclosure was required\textsuperscript{129}.

130. We are therefore of the view that the disclosures in the Group’s 2003 financial statements, including the fundamental uncertainty paragraph included in Deloitte’s audit opinion, were adequate in terms of the details that needed to be disclosed according to the relevant technical guidance in place at the time. Nonetheless, as we discuss below, a wider question

\textsuperscript{126} See paragraphs 107 and 109 above.
\textsuperscript{127} See paragraphs 108 and 110 above.
\textsuperscript{128} As noted at XX/7 and 12, neither the LOI of 16 June 2004 nor the MOU and LOI of 2 July 2004 were, in general, legally binding. Indeed, as explained at XX/40, the Group’s 2003 financial statements, and the adverse press coverage they triggered, caused concern to SAIC and led it to seek changes to its proposed deal with the Group.
\textsuperscript{129} Note that SAS 130 has since been superseded by ISA 570, “Going concern” (“ISA 570”), which is effective for audits of financial statements for periods commencing on or after 15 December 2004. Paragraph 9-2 of ISA 570 states that “The auditor’s procedures necessarily involve a consideration of the entity’s ability to continue in operational existence for the foreseeable future. In turn, that necessitates consideration both of the current and the possible future circumstances of the business and the environment in which it operates” (emphasis added).
remains as to whether improvements could be made to the audit report to make it (and perhaps financial statements as a whole) more informative and useful to a reader\textsuperscript{130}.

Deloitte’s audit of going concern

Deloitte’s approach

131. Rather than completing a separate going concern review for each individual subsidiary, Deloitte (quite reasonably) documented their consideration of going concern for the Group on working papers on the PVH audit file\textsuperscript{131}.

Audit evidence obtained by Deloitte

MGRG’s business plan

132. The majority of Deloitte’s “Going concern review” working paper focussed on the audit team’s review of MGRG’s business plan, which included forecast figures up to the end of December 2005. Deloitte recorded in their working papers that the PVH board had approved the forecasts on 6 and 7 October 2004 and obtained a copy of the relevant board minute (although we note that this board minute was not signed).

133. Deloitte concluded:

“From review of the forecasts ... the PVH group would appear to be able to continue to be a going concern for the next 12 months on the basis that the £152m cash injection was received from SAIC and it is on this basis that the forecasts have been prepared and the directors have approved them. Our analysis then discussed the other main savings inherent in the plans of which the largest was the £60m global sourcing savings. From looking at the assumptions behind these forecasts it appears that they have been built up sensibly and suggest that savings in this region are possible. We have not tested the remaining £95m of savings since if these £60m savings are achieved, these alone will generate significant headroom. However, we have no evidence to believe these savings are also not achievable. This would support the directors’ conclusion that the company will continue to be a going concern for the next 12 months, on the basis that the funding discussed above is received from SAIC.”

134. Deloitte’s review seems to have been at a very high level and it seems to us that they should have challenged the business plan more. For example, we note that in a memorandum to Mr Stephenson and Mr Cowburn dated 13 October 2004 Mr Millett stated that the creditor

\textsuperscript{130} See paragraphs 162 to 168 below.
\textsuperscript{131} In representations to us, Deloitte stated:

“It is normal for group auditors to record going concern work for the whole group particularly when (as in this case) the parent entity provides a letter of support to all its subsidiaries and the group companies are dependent upon each other.”
deferrals within the business plan “would be a difficult task to achieve”. In addition, at an MGRG board meeting earlier that day Mr Millett noted that “there were a number of risks to achieving” the sales forecasts.

135. Furthermore, in representations to us, Deloitte stated that the MGRG directors had prepared the business plan on the basis that the funds provided by SAIC would be passed down to MGRG, as had been the case with the funds received from the transfer of the Rover 75 IPR\textsuperscript{132} and from China Brilliance as part of the Project Sunrise\textsuperscript{133} transaction. Deloitte added that the PVH and MGRG directors represented to the audit team that they were satisfied that the SAIC funds could, and would, be passed down from PVH. The representation from the directors took the form of the letter of support referred to above\textsuperscript{134}. Although a copy of the letter of support was retained on Deloitte’s audit files, none of this thought process was documented on their working papers in respect of going concern.

136. In addition, we question whether it was reasonable for Deloitte to place reliance on the business plan given that the forecasts contained within it did not appear to take account of any restructuring that would have taken place after the SAIC transaction had been concluded\textsuperscript{135}. As we note in chapter XX (The events leading to administration)\textsuperscript{136}, the solvency of the residual Group that would remain after the SAIC transaction had completed does not appear to have been considered before the Group’s 2003 financial statements were signed: it was only in early 2005 that work on this area began.

137. At the same time, the key consideration in Deloitte’s assessment of going concern was the completion of the SAIC transaction rather than the business plan, provided that the funds to be received were considered to be sufficient to ensure that the Group continued to be a going concern. As Mr Mullins told us, in terms of Deloitte’s review of the business plan:

“... our approach to this is to look at what the overall head room was ... with an injection of £152 million or thereabouts, together with some of the actions that management were trying to take, that gave, in terms of the going concern window that we were looking at for the purposes of signing off on the 2003 audit report, there was a lot of head room.

And therefore the key from my perspective and our perspective to all these forecasts was the conclusion or otherwise of – or the receipt or otherwise of the SAIC monies. The rest of it was not – whilst it was relevant, it was not key to the going concern assumption that was being made.”

\textsuperscript{132} Of which £20 million was allocated to MGRG and £17 million to Powertrain. See XX/31 for further details.

\textsuperscript{133} As to which, see XIX/74.

\textsuperscript{134} See paragraph 113 above.

\textsuperscript{135} For example, the only adjustments between the figures included in the PVH 2005 “Balance sheet” and the “Balance sheet adjusted for SAIC investment” schedules contained within the business plan were to reflect the anticipated £152 million capital injection from SAIC.

\textsuperscript{136} See XX/57 to 59.
The memorandum of understanding (“MOU”) and letter of intent (“LOI”) dated 2 July 2004

138. As we note in chapter XX (The events leading to administration)\(^{137}\), the LOI followed a MOU of the same date between PVH and SAC. In their working papers Deloitte referred to the LOI as evidence of the £152 million cash contribution that was expected to be received from SAIC.

139. As Deloitte noted in subsequent representations to us, the terms of the MOU and LOI indicated that the Group might continue to trade in some form. For example, the letter of intent specifically excluded “sports cars to be defined in the feasibility study ... and [Powertrain] products which are currently under development by [MGRG] and [Powertrain]” from the products to be manufactured and sold by the prospective Chinese joint venture company (“JVC”) or its affiliates. The intellectual property rights relating to the MG TF were also specifically excluded from those to be acquired by the JVC.

140. Furthermore, the letter of intent provided for the establishment of a UK subsidiary of the JVC. This subsidiary would:

“... be granted the right by JVC to manufacture and sell vehicles in territories to be agreed to by the Parties. Subject to the agreement of the Parties, such UK subsidiary may be authorized by the JVC to retain certain manufacturing assets and tooling in order that the UK subsidiary can manufacture or assemble products for and on behalf of the JVC.”

141. However, such a thought process was not documented on Deloitte’s contemporaneous audit working papers in respect of going concern, nor do the copies of the MOU or LOI retained on the audit file appear to have been marked up in any way by Deloitte.

142. In representations to us, Mr Gallimore stated that the audit team discussed the MOU and LOI with Mr Millett and Mr Young and that:

“Both Mr Millett and Mr Young appeared confident that the arrangements foreshadowed by the document would not change the trade of MGRG from that set out in the product plan and the business plan that had been approved by the PVH Board. I do not recall any of the PVH directors indicating anything to the contrary of Mr Millett’s and Mr Young’s understanding in this respect.”

143. Again, such discussion was not recorded on Deloitte’s contemporaneous audit working papers in respect of going concern.

144. At the same time, as Deloitte themselves noted in subsequent representations to us, the negotiations with SAIC were continuing and, by October 2004, the proposed form of the

\(^{137}\) See XX/12.
deal had moved on from that envisaged in the MOU and the LOI. In addition, as noted above\textsuperscript{138}, these documents were not legally binding (except in respect of certain clauses regarding confidentiality, publicity and exclusivity). Such uncertainty led Deloitte to include the additional “fundamental uncertainty” paragraph in their audit report\textsuperscript{139}.

\textit{The assignment of IPR in respect of the Rover 75 and engines}

145. As we note in chapter XX (The events leading to administration)\textsuperscript{140}, in September 2004 the Group entered into an agreement for the sale of Rover 75 and engine IPR to SAIC Group (“the IPR agreement”). A copy of the IPR agreement was retained on Deloitte’s 2003 audit files, as was the PVH special resolution assigning the IPR to SAIC Group.

146. We note that the IPR agreement contained a lease-back arrangement that allowed for the continued manufacture and sale of vehicles by MGRG and engines by Powertrain subject to the transferred IPR. Furthermore, the IPR agreement related to the Rover 75 and certain engines; at that stage there was no indication that the IPR for the Rover 25 and Rover 45, for example, would be transferred imminently. As Deloitte noted in subsequent representations to us, these were indications that the Group would continue to trade. However, again, no such thought process was documented on Deloitte’s contemporaneous audit working papers in respect of going concern.

147. In terms of whether the IPR assignment provided comfort that the deal would complete, Deloitte noted on their working papers:

\begin{quote}
\textit{“Receipt of £37m payment in respect of transfer of intellectual property rights. The Group assesses these are worthless without the completion of the transaction and the transfer of know how and tooling ... ”}
\end{quote}

148. However, as Deloitte also noted:

\begin{quote}
\textit{“A down-payment is not sufficient evidence in itself. [SAIC] has received an asset for this payment ... and is able to walk away without proceeding further with the transaction. The Group has previously received a £23 million payment from a Chinese investor (Win Win joint venture)\textsuperscript{141}. However, this transaction did not conclude.”}
\end{quote}

\textit{Jointly signed minutes of meetings with SAIC in October 2004}

149. These were minutes of meetings that took place between PVH and SAIC on 18, 19 and 22 October 2004. The minutes indicated that the negotiations were progressing

\textsuperscript{138} See footnote 128 above and XX/7 and 12.
\textsuperscript{139} See paragraph 107 above.
\textsuperscript{140} See XX/31.
\textsuperscript{141} As to which, see chapter XIX (Joint ventures).
and included “Key Project Milestones” for the completion of the transaction and receipt of funding in January 2005. A timetable included in the minutes that was described as “Version for Approval” suggested that production in Shanghai would not start until at least 2006, and that production in the UK would continue in the meantime.

150. In evidence to us, Mr Mullins said:

“I don’t recall whether I saw [these minutes] at the time. I was aware that we had requested this information. And the reason we were asking for information, and this was via Nick Stephenson, was to demonstrate that there were substantive discussions ongoing with the Chinese.”

“This was giving us corroborative evidence that there was ... a substantive discussion/negotiation going on towards delivering a deal. But there was still a lot of work that needed to be done to deliver it.”

151. However, again, none of this thought process was documented on Deloitte’s contemporaneous audit working papers in respect of going concern. In fact, we note that the minutes were faxed by Mr Millett and initialled by Mr Gallimore on 27 October 2004, a day after the PVH 2003 consolidated financial statements were signed by Deloitte (as noted above the PVH subsidiaries’ 2003 financial statements, including MGRG and Powertrain, were signed on 29 October 2004). When we raised this with Deloitte, they said:

“In light of the other extensive audit evidence obtained ... and the disclosures being made, in the audit team’s judgement it was not necessary to have sight of the minutes prior to the audit opinion on the PVH financial statements being signed.”

Management representations

152. Deloitte listed discussions with Ms Ruston on 24 October 2004 and Mr Stephenson on 26 October 2004 amongst other audit evidence on their “Going concern review” working paper, notes of which were retained as separate working papers on the audit file.

153. We would not have expected Deloitte to have contacted SAIC or its advisors directly given the sensitivity of the negotiations. However, a number of assertions were made in the notes of meetings with Ms Ruston and Mr Stephenson that we expect Deloitte could, and should, have substantiated with third party evidence142. These included representations that:

142 Paragraphs 4 and 16 of SAS 400, “Audit evidence” (“SAS 400”), state that “Usually, audit evidence is persuasive rather than conclusive, and auditors therefore often seek audit evidence from different sources or of a different nature to support the same assertion”, and that “evidence in the form of documents and written representations is more reliable than oral representations.”
153.1. there was ongoing legal work to prepare a contract to enable the Group to perform funded development work on the New Medium Car and at Powertrain on SAIC’s behalf;

153.2. the Group had considered an alternative strategy if Honda did not provide consents required in respect of the Rover 25 and 45 IPR\textsuperscript{143};

153.3. it was not expected that the completion of the SAIC transaction would trigger repayment of the BMW loan note (Deloitte referred only to an email from Ms Ruston to Mr Gallimore dated 21 October 2004, in which she stated:

“... I can confirm that the manner in which we are proposing to re-structure the Company and the completion of the SAIC deal will have no effect on the BMW loan note. The loan note does not prevent or restrict a disposal of assets only shares and there is no current intention to sell the shares in MG Rover or any other company within the Group.”);

153.4. “A number of real time projects were ongoing including the funding of product development [subject to] final approval”; and

153.5. “The Chinese government have a ‘ratio rule’ on the amount which can be funded relative to the due diligence valuation. Nick Stephenson commented that initial valuations from the draft due diligence look positive in this respect.”

154. In addition, in their working papers Deloitte listed a number of factors which management had represented to them provided evidence that the Group had “significant confidence” in the deal completing. These were:

154.1. the receipt of £37 million from the IPR assignment\textsuperscript{144};

154.2. the advanced stage of the due diligence work;

154.3. the support of the central Chinese government;

154.4. SAIC’s desire to fund development on Powertrain and on the New Medium Car in the next three months; and

154.5. the knowledge that other Chinese manufacturers would take over the transaction at short notice if SAIC withdrew.

\textsuperscript{143} As noted at paragraph 155.5 below, the Group recognised that a number of third party consents would be required prior to the completion of the SAIC transaction.

\textsuperscript{144} As to which, see paragraph 145 to 148 above.
155. At the same time, Deloitte noted:

155.1. the £37 million did not mean that SAIC was bound to proceed with the deal;

155.2. the due diligence work was not completed, and “whilst we understand this is proceeding satisfactorily, the lead of Legal Affairs has stated that there remain questions to resolve”;

155.3. the Chinese government was still to approve the deal:

“Whilst we understand the circumstances are different to previous transactions where the central government was not properly involved (see representations from management above), these transactions did not conclude primarily due to the inability to obtain central government approval”;

155.4. the time taken to introduce a new Chinese partner if SAIC withdrew might not enable the Group to continue as a going concern in the meantime; and

155.5. a number of third party consents would be required prior to the completion of the transaction.

156. In light of these points, Deloitte concluded that there remained uncertainty surrounding the completion of the deal that should be reported in the financial statements, which we discuss above \( ^{145} \).

Mr Beale’s letter of 26 October 2004

157. Deloitte also obtained a letter from PVH dated 26 October 2004 and signed by Mr Beale, the purpose of which was to “confirm the latest status of the PVH/SAIC joint venture programme”. Again, this included a number of assertions that we would have expected Deloitte to have substantiated with third party evidence, such as the following:

157.1. in respect of the due diligence work, “it has been indicated to us that the responses from the advisors to their clients suggest that there are no major issues arising”;

157.2. PVH and SAIC had agreed and issued a “New Model Product Plan” in September 2004, which covered the period from 2005 to 2010 and was to be funded by SAIC;

157.3. the assertion that the Chinese Government had waived the normal requirement for a pre-feasibility report; and

\[ ^{145} \text{See paragraph 116 above.} \]
157.4. SAIC had engaged PVH to start development work, including on the New Medium Car, which would be reimbursed by SAIC (this was also referred to by Ms Ruston as noted above).

The PVH representation letter dated 26 October 2004

158. We note that Deloitte also included the following paragraphs relating to the SAIC transaction in their management representation letter\textsuperscript{146} from PVH, which was also dated 26 October 2004:

\begin{quote}
\begin{itemize}
\item \textbf{10.} We confirm that we are of the opinion that the company / group is a going concern, that we have disclosed to you all relevant information of which we are aware and which relates to our opinion, and that all relevant facts are disclosed in the financial statements.
\item \textbf{11.} Other than the disposal of the Xpart business\textsuperscript{147} and the SAIC arrangement described in Note 27 to the accounts, there have been no events since the balance sheet date which necessitate revision of the figures included in the financial statements or inclusion of a note thereto. Should further material events occur, which may necessitate revision of the figures included in the financial statements or inclusion of a note thereto, we will advise you accordingly."
\item \textbf{23.} We confirm, based on the evidence currently available, that we know of no reason why the SAIC arrangement should not proceed to completion in line with the anticipated timetable and that the product plan we have presented to you is consistent with the product plan currently being followed with SAIC.
\item \textbf{24.} We confirm that based on the discussions to date, the RDX 130 (previously RDX 60) and Rover 75 facelift remain within the joint product plan\textsuperscript{148} being agreed with SAIC. Therefore, we would expect the designs for tooling incurred in respect of these cars to be utilised in the future.”
\end{itemize}
\end{quote}

Conclusions on Deloitte’s audit work in respect of going concern

159. In summary, Deloitte’s approach to the audit of the Group’s going concern status appears to have been as follows:

\textsuperscript{146} Paragraphs 4 and 11 of SAS 440, “Management representations” required that “Auditors should obtain written confirmation of appropriate representations from management before their report is issued”, which included “matters material to the financial statements when those representations are critical to obtaining sufficient appropriate audit evidence.”

\textsuperscript{147} As to which, see chapter XIII (Xpart).

\textsuperscript{148} In representations to us, Deloitte noted that the “joint product plan” referred to in paragraph 24 of the management representation letter was the “New Model Product Plan” referred to in Mr Beale’s letter of 26 October 2004 mentioned in paragraph 157 above.
159.1. Deloitte obtained evidence concerning the state of the SAIC negotiations, including the MOU, LOI and IPR agreement and representations from management;

159.2. Deloitte noted that the MGRG business plan showed that, without an injection of additional funding, “Rover would not have sufficient cash to continue to trade for the next 12 months ... with cash deficits being reported in January, February, August and September.” However, with the injection of £152 million from SAIC, it appeared that the Group would have sufficient funds to enable it to continue to trade until at least December 2005. From their review of forecasts within the business plan, Deloitte concluded that the Group “would appear to be able to continue as a going concern for the next 12 months on the basis that the £152m cash injection was received from SAIC”; 

159.3. however, Deloitte were of the view that there was still uncertainty surrounding the completion of the SAIC transaction and that this should be referred to in the Group’s financial statements. As a result, Deloitte included a “fundamental uncertainty” paragraph in their audit report. Extensive discussions took place between Deloitte and the Group as to the wording to be included in this paragraph, and in note 1 to the financial statements, which we refer to above; and

159.4. with regard to PVH’s subsidiaries, which were dependent upon the uncertain receipt by PVH of the funds from SAIC, Deloitte were satisfied that the letter of support from PVH enabled the financial statements of its subsidiaries to be prepared on a going concern basis, albeit with reference to the uncertainty surrounding the receipt of the funds in their audit report.

160. However, Deloitte’s audit working papers in respect of going concern show the following:

160.1. Deloitte’s review of the business plan appears to have been at a very high level. As noted above, we question whether it was reasonable for Deloitte to place reliance on the business plan given that the forecasts contained within it did not appear to take account of any restructuring that would have taken place after the SAIC transaction had been concluded. Furthermore, the solvency of the residual Group that would remain after the SAIC transaction had completed does not appear to have been considered until some time after the Group’s 2003 financial statements were signed. Had the proposed deal with SAIC concluded successfully, it is possible that the Group would have continued to trade more or less in its existing form for 12 months after the 2003 financial statements were signed while the transaction was completed and effected, and/or that the £152 million would have been sufficient

149 See paragraph 107 above.
150 See paragraphs 117 to 126 above.
151 See paragraph 111 above.
152 See footnote 135 above.
153 See paragraph 136 above and XX/60 to 61.
154 As apparently envisaged by a timetable included in the jointly signed minutes between PVH and SAIC mentioned at paragraph 149 above.
to cover the costs of the Group’s restructuring. However, it is unclear whether these points were considered by Deloitte, as such a thought process was not documented on their contemporaneous audit working papers in respect of going concern;

160.2. other than their review of the business plan, Deloitte’s audit opinion appears to have been mainly based on management representations that were largely unsubstantiated by Deloitte. Copies of a number of documents were retained on Deloitte’s audit files but there is very little documentation within the working papers setting out how Deloitte assessed the evidential value of these documents as support for their opinion. Indeed, the jointly signed minutes referred to above\(^{155}\) were not even obtained by Deloitte before the PVH 2003 consolidated financial statements were signed. We recognise that going concern is a difficult issue for both the directors of a company and its auditors in terms of the judgement involved in the preparation of the financial statements. This is exacerbated, of course, when the company is in financial distress; however this means that it is even more important for auditors to document clearly their thought processes and conclusions, with specific references to the audit evidence they have (or have not) obtained; and

160.3. we also note that Deloitte’s “Going Concern Review” working paper for the Group and the Group audit summary memorandum (which included much of the wording from the “Going Concern Review”) were marked as reviewed by Mr Gallimore and Mr Mullins, but not by Mr Platts\(^{156}\).

161. Nevertheless, with reference to the FRS 18 guidance set above\(^{157}\), we are of the view that, had the SAIC transaction completed, the Group would not have been liquidated or ceased trading within 12 months of the signing of its financial statements\(^{158}\). Indeed, the SAIC transaction would have provided the directors with a “realistic alternative” to liquidation or ceasing trading. Therefore we consider that it was appropriate for the Group’s 2003 financial statements to have been prepared on a going concern basis, with a reference to the uncertainty surrounding the completion of the transaction and receipt of funding within the financial statements, as in fact happened.

Consideration of the “expectation gap” in the context of going concern

162. For the avoidance of doubt, we reiterate our views that, in light of the relevant technical guidance in place at the time:

162.1. the disclosures in the Group’s 2003 financial statements were adequate in terms of the details that needed to be disclosed; and

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\(^{155}\) See paragraphs 149 to 151 above.

\(^{156}\) Deloitte’s UK A&A Practice Manual states that the EQAR partner should review the audit summary memorandum.

\(^{157}\) See paragraph 99 above.

\(^{158}\) See also XX/254.
162.2. it was reasonable for the Group’s 2003 financial statements to have been prepared on a going concern basis.

163. Even so, the fact remains that PVH and its subsidiaries were given unqualified audit reports in October 2004, yet the negotiations with SAIC collapsed and MGRG went into administration less than six months later. This raises the question of whether improvements could be made to the audit report to make it (and perhaps financial statements as a whole) more informative and useful to a reader, and also to narrow the “expectation gap” between auditors’ actual duties and the public’s perception of those duties.

164. With regard to going concern, Deloitte’s audit reports in respect of the Group’s 2003 financial statements did not, for example, state that their audit work did not include detailed consideration of the ongoing commercial rationale of the Group following the SAIC transaction or of the viability of the proposed joint venture with SAIC; the extent to which Deloitte had relied upon management representations surrounding the completion of the transaction was also not apparent. We should note that this is not intended to be a criticism of Deloitte, and that the technical guidance in place at the time did not require them to include such information in their audit reports. However, in our view, where such uncertainty exists it would be helpful to a reader of the financial statements if auditors were required to disclose fully the nature and extent of the uncertainty and readers of the financial statements were provided with sufficient information to enable them to form their own views. In this case, such information could include specific statements that there was a large amount of uncertainty as to when, and if, the transaction with SAIC would complete, and details of the anticipated effect of the completion (or failure) of the transaction on the Group’s remaining business.

165. Further, we are of the view that the question of going concern is of such importance (an importance highlighted by the current economic climate) that it should be plain to readers of the financial statements what work the auditors have (and have not) undertaken, including the extent to which they have independently verified and relied upon representations from management. This transparency would enable readers of the financial statements to make a more informed assessment of the company’s financial position. Indeed, current auditing standards in respect of the audit report provide that:

“If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditors’ judgement, is relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report and this is not prohibited by law or

159 See XX/164.
160 As to which, see paragraphs 12 to 18 above.
161 Paragraph 2-1 of ISA 580, “Management representations” (“ISA 580”), which is effective for audits of financial statements for periods commencing on or after 15 December 2004, requires auditors to obtain written confirmation of appropriate representations from management before issuing their report. Paragraphs 7 and 8 of ISA 580 note that “Representations by management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available”, but acknowledge that “In certain instances, audit evidence other than that obtained by performing inquiry may not be reasonably expected to be available; therefore the auditor obtains a written representation by management”.

regulation, the auditor should do so in a paragraph in the auditor’s report, with the heading ‘Other Matter’, or other appropriate heading.”

“‘Other Matter’ paragraphs may be used in a number of different situations, including, “To provide further explanation of the auditor’s responsibilities in the audit of the financial statements or of the auditor’s report thereon.”

162. Further, current auditing standards in respect of management representations state that:

“In some exceptional cases, the matter may be of such significance the auditor refers to the representations in the auditor’s report as being relevant to an understanding of the basis of the audit opinion.”

163. We suggest that the inclusion of management representations in the audit report (or even the attachment of the management representation letter to the financial statements) is considered by auditors as a matter of course rather than in “some exceptional cases”.

164. There is a great deal of interest in the present form and content of the audit report, and also with regard to reporting on going concern in the context of the current economic climate, and we are of the view that this would be an ideal opportunity to make improvements and seek to close the “expectation gap”.

Consideration of matters raised by the FRRP

165. As noted above, we have considered the matters raised in the FRRP report (which is attached as an exhibit) and, where we considered necessary, we have investigated these matters further. We summarise the matters raised by the FRRP, and our findings, below.

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162 ISA 700 (Revised) paragraph 55.
163 ISA 700 (Revised) paragraph 56.
164 ISA 580 paragraph 8-1.
165 In December 2007 the APB issued a Discussion Paper entitled “The Auditors’ Report: A time for change?”, in which it sought views on what steps should be taken to reflect the Companies Act 2006 as well as whether broader changes should be made to the auditor’s report. In response, views were expressed that the audit report should be shorter and more informative. ISA 700 (Revised) is intended to facilitate more concise audit reports in the “first phase” of the APB’s work to respond to these views. The APB’s “second phase” will be “to undertake research to better understand what can realistically be done to make auditor’s reports more informative.” However, the APB also notes, “pending future possible changes to the standards in this area … [ISA 700 (Revised)] does not preclude auditors from including additional comment in the auditor’s report to highlight matters which they regard as relevant to a proper understanding of their work.” (ISA 700 (Revised), an explanation of APB’s approach to revising ISA (UK and Ireland) 700 to facilitate more concise auditor’s reports).
166 In May 2009 the FRC published an Exposure Draft of updated guidance for directors of UK companies to assist them with their assessment of going concern and in evaluating the nature and extent of disclosures. Once published in final form the Draft will replace the FRC’s 1994 guidance for directors of listed companies in respect of going concern and financial reporting. This guidance does not seek to influence the way in which auditors report.
Negotiations with SAIC – 2003 disclosures

170. The FRRP stated that, unless there was evidence from the SAIC negotiations that had taken place up to the signing of the Group’s 2003 financial statements that sufficient funds to ensure the continuing solvency of the Group would be available upon completion of the transaction, the disclosures in the financial statements may have been misleading.

171. We consider above the disclosures included in the Group’s 2003 financial statements in respect of the SAIC negotiations as part of our consideration of going concern. As noted above, we are of the view that the disclosures in the Group’s 2003 financial statements were adequate in terms of the details that needed to be disclosed according to the relevant technical guidance in place at the time.

172. We consider the SAIC transaction itself in further detail in chapter XX (The events leading to administration).

Going concern and letters of support

173. The FRRP raised questions as to the adequacy and appropriateness of the disclosures included in the Group’s 2003 financial statements in respect of going concern and letters of support, noting that the issues raised called into question the going concern basis upon which the Group’s 2003 financial statements were prepared.

174. The FRRP also questioned whether PVH should have repaid the PVH directors’ £10 million loan notes in 2003 given the other potential calls upon its assets.

175. We consider above the preparation of the Group’s 2003 financial statements on a going concern basis. As noted above, we consider that it was appropriate for the Group’s 2003 financial statements to have been prepared on a going concern basis, with a reference to the uncertainty surrounding the completion of the transaction and receipt of funding within the financial statements, as in fact happened.

176. We discuss the repayment of the £10 million loan notes issued to the members of the Phoenix Consortium in chapter XXI (Financial rewards).

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167 See paragraphs 106 to 130 above.
168 See paragraph 130 above.
169 See paragraphs 131 to 161 above.
170 See paragraph 161 above.
171 See XXI/55 to 58.
Release of provisions

177. The FRRP questioned whether provisions included in MGRG’s financial statements may have been overstated at the time of Techtronic’s acquisition of MGRG (i.e. 9 May 2000) to enable the management of releases or smoothing of results in later years.

178. The FRRP also commented that disclosures required by the Companies Act 1985 and accounting standards in respect of provisions were omitted from the Group’s financial statements and that the narrative explanation of the purpose of the provisions and their classification in the profit and loss account did not comply with accounting standards.

179. We have carried out an in-depth review of Deloitte’s audit work in respect of provisions included in MGRG’s financial statements and undertaken a detailed profit and loss analysis. We found that the provisions included in MGRG’s 2000 to 2003 financial statements do not appear to have been materially misstated and their release did not account for a significant enough proportion of the reduction in losses to support a claim of profit smoothing.

180. Although we concur with the matter raised by the FRRP with regard to the disclosures in respect of provisions, we are of the view that this was a relatively minor disclosure point that would not, in itself, have warranted qualification of the Group’s financial statements.

PVH / Techtronic merger

181. As discussed in chapter V (Rover under new ownership), in December 2000 Techtronic was acquired by a new holding company, PVH. The FRRP noted that the PVH directors invoked a “true and fair override” in the PVH 2001 consolidated financial statements to account for this transaction using “merger accounting” rather than “acquisition accounting”.

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172 See V/55.2.
173 It is recognised that “The requirement to give a true and fair view may in special circumstances require a departure from accounting standards” (Foreword to accounting standards issued June 1993, paragraph 18). In circumstances where there is a material departure from the requirements of an accounting standard, a UITF Abstract or companies legislation, paragraph 62 of FRS 18 required disclosure of the particulars of the departure, the reasons for it and (where possible) its effect.
174 Note 1 (corporate restructuring) to the PVH 2001 financial statements states: “As the non-equity consideration exceeds 10% of the nominal value of the new shares issued, compliance with the detailed requirements of the Companies Act 1985 would have required the corporate restructuring to be accounted for as an acquisition … The directors do not believe that this would have given a true and fair view of the state of the affairs of the Group and of its result as, in substance, the restructuring represented a change in the identity of the holding company rather than the acquisition of a business. Consequently, the restructuring has been accounted for using merger accounting principles as the directors consider that this is necessary in order to meet the overriding requirements of the Companies Act 1985 to show a true and fair view.”
182. The FRRP noted that the transaction did not meet the conditions for merger accounting set out in the Companies Act 1985, nor did the adoption of merger accounting accord with the requirements of accounting standards (namely FRS 6, “Acquisitions and mergers” (“FRS 6”)).

183. We agree with the FRRP that the conditions for the use of merger accounting as set out in the Companies Act 1985 and FRS 6 were not satisfied. However, we are of the view that the use of the “true and fair override” was appropriate. To adopt acquisition accounting in respect of this transaction would have required the directors to record at fair value\footnote{Paragraph 2 of FRS 7, “Fair values in acquisition accounting” (“FRS 7”), defined “fair value” as “The amount at which an asset or liability could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale”.} the assets and liabilities acquired, to recognise any goodwill and to make subsequent impairment charges which, in our view, would not have fairly reflected the substance of the transaction.

\textit{Techtronic write down}

184. The PVH 2003 consolidated financial statements included an impairment charge of £10 million through which the value of PVH’s investment in Techtronic was written down to £nil. The FRRP questioned whether the original investment valuation of £10 million was made to support the issue of the £10 million loan notes to the members of the Phoenix Consortium, and also if the investment in Techtronic was written down when the loan notes were repaid as there “was no obvious reason or accounting justification for writing down the investment by this amount.”

185. In our view, Deloitte’s audit of the original valuation of the investment in Techtronic was adequate: it was agreed to the relevant documentation, and there was no requirement for the audit team to consider whether the valuation of £10 million was appropriate.

186. We discuss the issue of the £10 million loan notes, and their repayment, elsewhere in this report\footnote{See V/48 and XXI/52 to 58.}.

\textit{Negative goodwill amortisation}\footnote{Paragraph 2 of FRS 10 defined purchased goodwill as: “The difference between the cost of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities. Positive goodwill arises when the acquisition cost exceeds the aggregate fair values of the identifiable assets and liabilities. Negative goodwill arises when the aggregate fair values of the identifiable assets and liabilities of the entity exceed the acquisition cost.”} \footnote{Paragraph 15 of FRS 10 required that, where goodwill was regarded as having a limited useful economic life, it should be amortised on a systematic basis over its life.}

187. The FRRP noted that negative goodwill of £434 million arose on Techtronic’s acquisition of MGRG on 9 May 2000, and that the basis upon which this goodwill was amortised appears to change between 2000 and 2003. The FRRP commented that, in the absence of further
information, it was not possible to determine whether or not the amortisation credits were reasonable.

188. We have reviewed the calculations of negative goodwill releases and find them to be reasonable. However, we identified a deficiency in disclosures included in the PVH 2001 to 2003 consolidated financial statements in relation to negative goodwill.

189. The accounting policy note to PVH’s 2001 consolidated financial statements states, in respect of goodwill and intangible fixed assets:

“... negative goodwill ... is capitalised in the period in which it arises and is amortised over the estimated useful life of the non-monetary assets of the company.”

190. The same disclosure appears in the PVH 2002 and 2003 consolidated financial statements.

191. FRS 10, “Goodwill and intangible assets” (“FRS 10”), required the following disclosures to be included in consolidated financial statements where negative goodwill has arisen:

“The financial statements should disclose the period(s) in which negative goodwill is being written back in the profit and loss account.

Where negative goodwill exceeds the fair values of the non-monetary assets, the amount and source of the 'excess' negative goodwill and the period(s) in which it is being written back should be explained.”

192. In our view the PVH 2001 to 2003 consolidated financial statements did not include adequate disclosure in respect of the period over which negative goodwill was being amortised.

193. In representations to us Deloitte stated that the “consolidated PVH financial statements for 2001 to 2003 ... disclosed information from which a knowledgeable reader could make a reasonable estimation of that period”.

194. However, in our view this is not sufficient to comply with the specific disclosure requirements set out in FRS 10, as a reader of the financial statements in these later years would need to have knowledge of the original transaction in 2000 to determine that the negative goodwill was only being released in line with the utilisation of tangible fixed assets (which have relatively longer lives), rather than also in line with stock (as in the earlier years). If Deloitte had identified that the disclosure in the financial statements was deficient in this respect, but considered it not so material as to affect their audit opinion, we would have expected to see this thought process documented on the audit working papers. We have not seen any such documentation on Deloitte’s audit working papers.

179 FRS 10 paragraphs 63 to 64.
195. However, we are of the view that this was a relatively minor disclosure point that would not, in itself, have warranted qualification of the Group’s financial statements.

_Acquisition of Powertrain_

196. As we note in chapter V (Rover under new ownership), Powertrain was acquired by Techtronic from BMW in 2001 as part settlement of the Completion Accounts dispute.\(^{180}\)

197. The FRRP noted that the “Review of the MG Rover Group business” included with the Techtronic 2000 consolidated financial statements states that:

   “... in May [2001] we resolved the outstanding issues with BMW and settled the completion accounts balance sheet. This resulted in [MGRG] receiving £65M in cash plus the Longbridge Powertrain business.”

198. The FRRP questioned the accuracy of this disclosure for two reasons. First, it was Techtronic, rather than MGRG, that acquired the share capital of Powertrain. Secondly, it was unclear whether MGRG or any other Group company had actually received the £65 million.

199. The FRRP also noted that MGRG’s 2001 financial statements state that a further ordinary share was to be issued to BMW for consideration of £65 million as part of the settlement of the Completion Accounts dispute. However, this share was still showing as “to be issued” in MGRG’s 2003 financial statements.

200. As noted by the FRRP, it was Techtronic rather than MGRG that acquired Powertrain.\(^{181}\) Therefore the disclosure referred to above was incorrect in this respect. We note, however, that the post balance sheet events note to the Techtronic 2000 consolidated financial statements correctly states that Powertrain was acquired by Techtronic.

201. We have confirmed that the £65 million cash (less certain deductions) was in fact received by MGRG on 1 June 2001. Therefore the disclosure in the Techtronic 2000 consolidated financial statements was correct in this respect.

202. Documents filed at Companies House show that an ordinary share was issued by MGRG to BMW for consideration of £65 million on 1 June 2001, but also that this share was transferred to Techtronic for £1 on the same date. Therefore the disclosure stating that this share was “to be issued” in MGRG’s financial statements was incorrect. However, we are of the view that this was a relatively minor disclosure point that would not, in itself, have warranted qualification of the Group’s financial statements.

\(^{180}\) See V/90.  
\(^{181}\) See V/90 to 91.
Car stockpile received from BMW

203. The FRRP noted that the assets of MGRG at the date of purchase from BMW (i.e. 9 May 2000) included a stockpile of 65,000 cars. In the financial statements for the year ended 31 December 2001, the closing stock is reported as comprising 34,000 cars while the opening number of cars in stock reported in the following year’s financial statements (which ostensibly should be the same figure) is 23,000.

204. The FRRP noted that the value of stocks at 31 December 2001 shown in the PVH consolidated financial statements at 31 December 2001 and 2002 remained the same. They also noted that the description of the stocks changed from “vehicle pipeline stock (dealer and company stock)” to “finished vehicle inventory”.

205. We were unable to locate the Deloitte working papers dealing with the number of vehicles included in 2001. However, we understand that a possible reason for the change in description and the reduction in the number of vehicles was that the disclosure in the PVH consolidated financial statements changed from including both company stock and dealer stock in 2001 to being only company stock in 2002.

206. In our view this is a relatively minor disclosure point and we have not investigated it further.

Related party transactions

207. The FRRP noted inconsistencies between the related party transactions disclosures included in the PVH consolidated financial statements and the financial statements of Edwards Cars and MGR Capital.

208. In our view these are relatively minor disclosure points and we have not investigated them further.

BMW loan

209. The FRRP stated that it appeared that the £427 million loan that Techtronic was due to receive from BMW upon its acquisition of MGRG was not lent on to MGRG in full by 31 December 2003.

210. In addition the FRRP noted that Techtronic charged interest on its loan to MGRG while its loan from BMW was interest free.
211. As we note in chapter XII (Project Patto) most, but not all, of the £427 million lent by BMW was passed on to MGRG$^{182}$. We discuss the decision to pay interest on the loan in chapter V (Rover under new ownership)$^{183}$.

**Consideration for Xpart**

212. As discussed in chapter XIII (Xpart), in August 2004 Xpart sold its trade and assets to CAT$^{184}$.

213. The FRRP noted that different amounts of consideration arising from the sale of Xpart were disclosed in the post balance sheet events notes to the PVH, Xpart and MGRG 2003 financial statements.

214. The trade and assets of Xpart were sold for gross consideration of £101.9 million and therefore the disclosure in the PVH consolidated financial statements was accurate. The Xpart 2004 financial statements state that, of this consideration, £66.39 million was due to Xpart and £26.45 million$^{185}$ to certain NSCs (i.e. National Sales Companies), and thus the disclosure in the Xpart 2003 financial statements was also accurate.

215. However, Xpart’s 2004 financial statements state that MGRG was not allocated any of the profit on sale and was therefore not entitled to any of the consideration proceeds, yet the MGRG 2003 financial statements state that “the company [i.e. MGRG] completed the sale of its parts business to [CAT] for a consideration of in excess of £35 million.” In our view this disclosure was misleading.

216. In representations to us Deloitte stated:

> “What was relevant to MGRG … was the effect upon its open-ended parts supply arrangement with Xpart. On completion of the sale, MGRG was repaid the intercompany account balance owing to it for supply of stock … the consideration paid by CAT included £34.7 million for Xpart’s stock … the stock sold to Xpart was funded by MGRG.”

217. We do not accept this; as explained in chapter XIII (Xpart)$^{186}$, MGRG did receive £75.8 million of the consideration moneys, but as settlement of its inter-company debt with Xpart whilst the remainder served to increase its indebtedness to PVH and/or Xpart. MGRG did not sell “its parts business … for a consideration of in excess of £35 million”.

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$^{182}$ See XII/3.
$^{183}$ See V/52 to 54 and 57.
$^{184}$ See XIII/47 to 57.
$^{185}$ After taking account of a £5 million provision against deferred consideration and £4.1 million relating to professional fees, the net consideration was therefore £92.8 million.
$^{186}$ See XIII/52.
218. Further, the following disclosure given in the same note to the 2003 MGRG financial statements was incorrect, as it stated:

“The company retains ... an option to buy back the business in four to five years.”

219. This implied that MGRG had an option to repurchase the parts business in four or five years. However it was PVH that had been granted the option to buy back the business; MGRG was not party to it. Nonetheless, we are of the view that this was a relatively minor disclosure point that would not, in itself, have warranted Deloitte’s qualification of the audit report to MGRG’s 2003 financial statements.

220. The FRRP also questioned which company within the Group received the cash arising from the sale of Xpart to CAT. This is discussed in detail in chapter XIII (Xpart).

221. We have identified further issues relating to Xpart in the financial statements of one or more companies of the Group which were not mentioned in the FRRP report. We address these in the paragraphs below.

2000 and 2001 disclosure of subsidiary

222. Xpart became a subsidiary of MGRG on 9 May 2000 when its share capital was acquired from BMW under the terms of a sale and purchase agreement of that date. The share capital remained under MGRG’s ownership until 20 December 2002 when MGRG sold Xpart’s share capital to PVH\textsuperscript{187}. Therefore, as at 31 December 2000, Xpart was a subsidiary of MGRG.

223. MGRG was not required under section 228 of the Companies Act 1985 to produce consolidated financial statements\textsuperscript{188}. However, MGRG was still required, under the Companies Act 1985, to disclose the “name of each subsidiary undertaking”\textsuperscript{189}. Xpart should therefore have been disclosed as a subsidiary under the investments held as fixed assets note to the MGRG 2000 and 2001 financial statements. However, MGRG’s 2000 and 2001 financial statements do not disclose that Xpart was a subsidiary of MGRG.

\textsuperscript{187} See XIII/20.

\textsuperscript{188} Section 228(1) of the Companies Act 1985 states: “A company is exempt from the requirement to prepare group accounts if it is itself a subsidiary undertaking and its immediate parent undertaking is established under the law of a member State of the European Economic Community, in the following cases –

(a) where the company is a wholly-owned subsidiary of that parent undertaking;

(b) where the parent undertaking holds more than 50 per cent of the shares in the company and notice requesting the preparation of group accounts has not been served on the company by shareholders holding in aggregate –

(i) more than half of the remaining shares in the company, or

(ii) 5 per cent. of the total shares in the company ...”

\textsuperscript{189} Companies Act 1985, paragraph 1 of schedule 5.
224. In addition, Techtronic was required under section 227 of the Companies Act 1985 to produce consolidated financial statements for the period ended 31 December 2000\(^{190}\). The relevant technical guidance in place at the time required that the results of all subsidiary undertakings, whether directly or indirectly held, should be consolidated in the financial statements prepared by a parent entity\(^{191}\).

225. However, the Techtronic consolidated financial statements for the period ended 31 December 2000 did not include and consolidate the financial information of Xpart.

226. In not incorporating Xpart’s financial information into Techtronic’s consolidated financial statements, the consolidated balance sheet reported a materially understated stock figure of £28.3 million and a materially understated creditors figure of £28.3 million, although the net effect on Techtronic’s 2001 consolidated balance sheet would have been only £2.

227. Notes of a meeting between the Deloitte audit team and Ms Ruston retained on the MGRG 2000 audit file indicate that Deloitte were informed that Xpart had been sold to PVH on “18 December” and therefore Xpart was outside of the Techtronic group as at 31 December 2000.

228. We have seen no evidence on Deloitte’s audit files, aside from the meeting notes with Ms Ruston referred to in the previous paragraph, of the sale of Xpart’s share capital to PVH. With reference to guidance set out in SAS 400\(^{192}\), we would have expected Deloitte to have obtained additional evidence in respect of the sale of Xpart, for example board minutes where the transaction was approved or a sale and purchase agreement. We have seen no evidence on the MGRG 2000 and 2001 audit files that Deloitte attempted to obtain such information. Had they done so, it should have been apparent that no such sale had in fact taken place.

229. However, we are of the view that this was a relatively minor disclosure point that would not, in itself, have warranted qualification of MGRG’s 2000 and 2001 financial statements.

230. As discussed in chapter XIII (Xpart)\(^{193}\) and noted above, on 27 August 2004 Xpart sold its trade and assets to CAT for gross consideration of £101.9 million. The profit made on sale, being £61.5 million (including £5 million deferred consideration which was provided against), was recognised in the profit and loss accounts of various Group companies, with

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\(^{190}\) Section 227(1) of the Companies Act 1985 states: “I

\(^{191}\) Section 229 of the Companies Act 1985 states: “

\(^{192}\) See footnote 142 above.

\(^{193}\) See XIII/47 to 57.
Xpart recognising profit of £31.69 million (after fees of £4.07 million\(^{194}\)) and the NSCs £20.75 million\(^{195}\).

231. Xpart’s 2004 financial statements, which were approved by Mr Beale\(^{196}\) as the company’s only director on 28 June 2006, state that the payment to PVH of the net proceeds on the sale of Xpart was “accounted for as a dividend of £33,982,000 paid by [Xpart] to PVH and an inter company loan”. Further, PVH’s 2004 consolidated 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 declared\(^{197}\).

232. On 31 March 2006 Mr Cowburn sent an email to Mr Gallimore attaching the advice of a solicitor from Herbert Smith, who made the following comments:

“I understand that an interim dividend was paid in August 2004 and that the Auditors are concerned that there is no evidence of a Board Resolution authorising the dividend. The question has therefore arisen as to whether the payment of the dividend is irregular and whether or not that irregularity can be ratified post payment.

...

I can confirm that where the irregularity in the dividend has arisen as a result of a failure to follow an internal procedure, eg. because it has not been properly approved by the board (provided there is no other irregularity), it can be rectified by an ordinary resolution of shareholders (or possibly a rectifying board resolution). We recommend that both an ordinary resolution of the shareholders and a board resolution of MGR Paw [i.e. Xpart] is passed.”

233. In the Xpart audit summary memorandum Deloitte acknowledged that the dividend was not formally approved by the board at the time it was purportedly declared (on 27 August 2004), but stated that it “has been done so on 4 April 2006.”

234. In representations to us Deloitte stated:

“The audit team were satisfied that the directors had taken appropriate legal advice that the dividend was not illegal and that the group would complete the necessary documentation.”

235. However, we have seen no evidence on the Xpart 2004 audit file that Deloitte obtained or saw a copy of either an ordinary resolution of shareholders or a rectifying board resolution.

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194 See XIII/49.
195 See XIII/49 to 50.
196 Mr Beale was appointed as a director of Xpart on 8 August 2005.
197 See XIII/58.
Chapter XXIII
Financial statements and audit

Transfer of tax losses at nil value

236. The FRRP noted that the 2002 and 2003 financial statements of PVL and PVL2 respectively showed that tax losses were surrendered to these companies by MGRG for nil consideration. Although the losses could not be used by MGRG, the FRRP assumed that they had value in that they had potential to be used by other companies within the Group.

237. The FRRP stated that MGRG was insolvent by the end of 2001 on the basis that its liabilities exceeded its assets. In such circumstances, the FRRP noted, directors are bound to take the interests of creditors into account, and the consent of shareholders may no longer be a defence to an action for breach of duty owed to the company. In addition, the FRRP suggested that these transactions could have amounted to distributions.

238. The FRRP noted that:

“If the directors of MGRG were found to be guilty of a breach of fiduciary duty and could not show that they acted honestly and reasonably and ought to be excused they could be asked to account for any profits they had made, so that MGRG might require the directors who were shareholders of PVH to account for the benefits received by PVH.”

239. In addition, the FRRP noted that a number of other Group companies surrendered tax losses to other, profitable, Group companies for nil value while insolvent and that similar considerations may apply to the surrender of these tax losses.

240. We discuss auditors’ responsibilities in respect of such transactions above198. We consider the overall transactions involving PVL and PVL2 in chapter XI (Aircraft).

Sale of Longbridge site

241. As we note in chapter IX (Property and share transfers), MGRG sold part of the Longbridge land and buildings to Property Holdings, a direct subsidiary of PVH, at net book value of £37.6 million in December 2001199. The land and buildings were subsequently sold by Property Holdings, which received proceeds of almost £60 million200. The £37.6 million owing to MGRG was repaid, and the remaining cash was passed to MGRG as an unsecured loan in 2003201.

242. The FRRP questioned whether the directors of MGRG were in breach of their fiduciary duties by transferring the Longbridge property to Property Holdings “at an undervalue”. In

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198 See paragraphs 84 to 95 above.
199 See IX/5 to 7.
200 See IX/31.
201 See IX/33.
addition, they questioned whether the transaction could have amounted to an unlawful distribution.

243. We discuss the transfer of the land at Longbridge from MGRG to Property Holdings in chapter IX (Property and share transfers)\textsuperscript{202}. In addition, we consider auditors’ responsibilities in respect of such transactions above\textsuperscript{203}.

\textit{MGR Capital and RV Capco}

244. As we discuss in chapter VII (Platinum), in November 2001 PVH bought RFS from BMW and most of its loan book was then sold on to MGR Capital, a company jointly owned by HBOS and the Phoenix Partnership. MGR Capital was protected from residual value risks by the establishment of 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 (i.e. Guaranteed Minimum Future Values\textsuperscript{204}). This transaction was known as “Project Platinum”.

245. The FRRP raised the following points in respect of this transaction:

245.1. the FRRP noted that the purchase of the loan book for £312 million was largely funded by a £300 million loan from HBOS. The FRRP questioned where the additional £10 million of funding required to purchase the loan book was obtained from;

245.2. the FRRP noted that the financing liability, being the £300 million HBOS loan, was matched by an asset, being the lease book receivables of £312 million. Only £2 million of capital was injected into MGR Capital. The FRRP questioned why this could not have been made available within the PVH Group;

245.3. the FRRP stated that the preference share dividend of 20 per cent did not appear to be compatible with the limited risks involved, and questioned whether such a high dividend would have been appropriate if MGR Capital had been capitalised by the PVH Group rather than the members of the Phoenix Consortium personally;

245.4. the FRRP questioned why it would not have been possible to establish a subsidiary of MGRG to purchase the loan book, managed in such a way as to ring-fence profits and cash flows sufficiently to provide HBOS with the security it required. The FRRP also questioned the validity of the directors’ claim that the addition of matching

\textsuperscript{202} See IX/5 to 42.  
\textsuperscript{203} See paragraphs 84 to 95 above.  
\textsuperscript{204} As to which, see VII/3.
assets and liabilities of approximately £300 million, which would reduce to almost nothing within two years, could have damaged Group’s balance sheet205;

245.5. the FRRP stated that there was an accounting issue in that RV Capco did not appear to have taken on any of the risks and rewards of the transaction. The FRRP noted that the provisions transferred to RV Capco appeared to have been conservative and that surplus provisions were transferred back to MGRG when the lease book was wound down. With reference to FRS 5, “Reporting the substance of transactions” (“FRS 5”)206, the FRRP suggested that MGRG did not transfer any of the risks and rewards of ownership of the provisions and cash to RV Capco and that, instead, these should have continued to be recognised within MGRG; and

245.6. the FRRP questioned whether, overall, those directors of MGRG who were also owners of MGR Capital could be asked to account for the profits they made through MGR Capital as a result of the opportunities available to them as directors of MGRG.

246. We discuss below the accounting issue mentioned at paragraph 245.5. We consider Project Platinum in detail in chapter VII (Project Platinum). We also consider financial rewards, including those obtained from Project Platinum, in chapter XXI (Financial rewards).

247. RV Capco was incorporated on 20 July 2001 to facilitate the completion of Project Platinum. In consideration for depositing £41 million into RV Capco’s bank account, RFS agreed to release MGRG from its obligation to fund residual value losses incurred on the resale of vehicles financed through certain PCP (i.e. personal contract plan) arrangements207.

248. By way of novation deed RFS transferred all of its obligations to buy vehicles from MGR Capital and hence its exposure to residual value losses to RV Capco. In return RFS paid RV Capco £12.6 million208.

249. In addition to depositing funds in RV Capco’s bank account, MGRG and RFS also transferred their provisions in respect of RV losses as at 30 September 2001 to RV Capco.

250. RV Capco’s financial statements for the period ended 31 December 2002 show that the opening provision in respect of RV losses was £52.67 million. A working paper on the RFS

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205 The FRRP referred to Mr Beale’s statement to the Select Committee:
“Unfortunately our financial advisors 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.”

206 As noted at paragraph 255 below, FRS 5 required an entity to account for the substance of a transaction rather than its legal form in its financial statements.

207 See VII/3.

208 As to the £12.6 million see paragraph 253 below. The actual amount deposited into RV Capco’s bank account was £6.6 million, being £12.6 million less £6 million in respect of losses incurred on contracts which had expired or terminated between 30 September 2001 and 8/9 November 2001.
2001 audit file indicates that this figure was calculated in line with PwC’s original calculation of the cash collateral\footnote{As a condition of entering into Project Platinum, HBOS required that a certain amount of money (i.e. cash collateral) should be ring fenced and available to cover RV losses to ensure that MGR Capital would not suffer any exposure in this regard. PwC calculated the cash collateral required to be £65.7 million.} \footnote{The difference between the cash collateral figure and the provision figure is an adjustment to the “Doomsday” figure, reducing it from £15.1 million to £3 million.}.

251. An internal document prepared by HBOS explained that PwC had calculated the required cash collateral as follows:

“In calculating our overall exposure and related collateral requirement, PwC utilised CAP Used Car Monitor and discounted the resulting residual values by a further 15% in line with Motor Division provisioning policy. This is regarded as prudent as our current experience would indicate that we could expect to recover between 92-98% of CAP price. The Chief Economist at CAP advised that their used car monitor reflects the “Doomsday” scenario in respect of MGR, therefore our additional collateral sum of £15.1m should provide more than sufficient comfort.”

252. This indicates that the opening provision in RV Capco’s financial statements was calculated with reference to CAP Used Car Monitor, which incorporated a “Doomsday” scenario and was then discounted by a further 15 per cent. In addition to this, the provision allowed for a further £3 million in respect of “Doomsday” or “Contingency”.

253. The bank account into which MGRG and RFS deposited £41 million and £12.6 million respectively was charged in favour of MGR Capital and it was agreed that the funds could only be used “subject to the prior written consent of [MGR Capital]” as follows:

- “any payments due to be made to [MGR Capital] under the Vehicle Sale Agreement or the Novation Agreement; and
- any payments due to be made to MGR under the Remarketing Agreement; and
- any monies agreed to be released from the Bank Account following a periodic Review RFS agrees with MGR that any such monies released will be paid to MGR; and
- any payments made by RV Capco under the terms of an indemnity contract ... of the Warranty Sharing Deed made between [PVH,] RV Capco and [MGR Capital]”.

254. In our view, by transferring £41 million to RV Capco it could be argued that MGRG did not, for practical purposes, alter its exposure to residual value losses for the following two reasons:
254.1. The provision was calculated in such a way as to incorporate a “Doomsday” scenario. The payment of £41 million made by MGRG, although stated to limit MGRG’s exposure, was so high that it was unlikely that RV Capco would ever require all of the funds in settlement of RV losses; and

254.2. MGRG was entitled to receive back any moneys that were not required by RV Capco to fund the RV losses, and actually did receive £19.97 million in 2003 and £2.72 million in 2004.

255. In light of FRS 5, which required an entity to account for the substance of a transaction rather than its legal form in its financial statements, it is arguable that it would have been more appropriate if the £41 million provision (and, therefore, the corresponding cash balance) had not been derecognised in the MGRG 2001 financial statements and thereafter.

256. In representations to us Deloitte stated that “the commercial substance of ... Project Platinum ... is consistent with the legal agreements” and as a “result of Project Platinum ... the substance of the leasing arrangements and the nature of the activities, obligations, assets and liabilities of each of the parties ... changed significantly” and “the fact that any eventual surplus that may have arisen with RV Capco was to be passed to MGRG does not diminish the commercial necessity of the two companies being separate entities.”

257. We acknowledge that this is a judgemental area, but we would nevertheless have expected Deloitte’s working papers to have included evidence to show that Deloitte considered the application of FRS 5 and had documented their deliberations and conclusions in accordance with SAS 230, “Working papers” (“SAS 230”), which required:

> “Auditors should record in their working papers their reasoning on all significant matters which require the exercise of judgement, and their conclusions thereon.”

258. We have seen no evidence on RV Capco’s audit files that indicates that the audit team considered any alternative ways in which the financial results of RV Capco could be accounted for, or whether any alternative ways would have been more appropriate.

259. In addition to the accounting issue discussed above we have identified other matters relating to Project Platinum and the financial statements of one or more companies in the Group. These are discussed below.

**Overstatement of RV Capco’s provision**

260. RV Capco prepared its first set of financial statements for the period to 31 December 2002. Note 10 to the financial statements states:

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211 See paragraph 252 above.
212 Paragraphs 16 to 21 of FRS 5 are particularly relevant in this regard.
213 SAS 230 paragraph 6.
“The company has committed to purchase second hand vehicles at contracted prices. The residual value provision covers losses arising on the sale of these vehicles and is likely to be utilised within the next two years.”

261. As discussed above the opening provision in RV Capco’s financial statements was calculated with reference to CAP Used Car Monitor, which incorporated a “Doomsday” scenario, and was then discounted by a further 15 per cent. In addition to this, the provision allowed for a further £3 million in respect of “Doomsday”.

262. The financial statements show that £17.48 million of the original £52.67 million provision was utilised and set against actual residual value losses incurred over the period to 31 December 2002, leaving a provision at the year end of £35.20 million.

263. Deloitte tested the reasonableness of the year end provision balance but made no reference in their working papers to either PwC’s calculation of the cash collateral or the calculation of the opening provision balance in the RV Capco audit working papers.

264. Deloitte did not document whether they considered the value of the year end provision as at 31 December 2002 to be reasonable. However, the RV Capco audit summary memorandum for the period ended 31 December 2002 contains the following comments in respect of the provision:

“On this basis an overall loss … of £49,384k is predicted. This compares to a provision in place of £53,586k at the beginning of the agreement.

This suggests that it may be possible to release £4,202k of the provision.”

265. Deloitte continued:

“On the basis that the calculation is subjective due to the number of assumptions used to get to the provision release figure and that HBOS, who hold the collateral cash on behalf of this agreement, have not agreed to release any of the collateral, it appears correct not to recognise any of the provision release as at 31/12/02.”

266. FRS 12, “Provisions, Contingent Liabilities and Contingent Assets” (“FRS 12”), required that the “amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.”

267. In our view the opening provision in RV Capco’s financial statements for the period ended 31 December 2002 did not represent the “best estimate” of the future liability in respect of RV losses for the following reasons:

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214 See paragraph 252 above.
215 See paragraph 252 above.
216 FRS 12 paragraph 36.
267.1. the provision provided for a “Doomsday” element of £3 million; and

267.2. the PCP loss element of the provision was calculated using CAP Monitor Used Prices, which already incorporated a “Doomsday” element and were then further discounted by 15 per cent.\(^{217}\)

268. We are satisfied that the utilisation of the provision in the period to 31 December 2002 was not materially misstated, but as a consequence consider that the provision at the year end was materially\(^{218}\) overstated for the reasons mentioned above.

269. In addition, working papers on the RV Capco 2003 audit file indicate that it was identified by RV Capco during that year that the provision had been too high and, as a consequence, £19.56 million of the provision was released to MGRG. While this evidence would not have been available at the time of the 2002 audit, this further indicates that the provision was materially overstated as at 31 December 2002.

270. We acknowledge that there were restrictions over the level of money that was required to be held in RV Capco’s bank account.\(^{219}\) However, the provision in respect of residual value losses had no such restrictions attached to it and was not therefore required to be reported at such a high level.

271. We are of the view that it would have been misleading for any excess provision to have been released to RV Capco’s profit and loss account, and that it would have been more appropriate for the excess provision to have been reclassified as a creditor balance in favour of MGRG. However, we note that such a reclassification would not have affected RV Capco’s net asset balance.

**RV Capco cash collateral account**

272. As explained above MGRG deposited £41 million into RV Capco’s bank account in November 2001 to defray losses which RV Capco was liable to incur through its obligation to purchase vehicles from MGR Capital at their GMFV.\(^{220}\)

273. The level of cash held by RV Capco was set by HBOS and subject to regular review as set out in a letter dated 8 November 2001.

274. The RV Capco and PVH 2002 to 2004 financial statements all included reference to the cash collateral bank account and the restrictions on it as described below.

\(^{217}\) See paragraph 252 above.

\(^{218}\) Materiality was set at £501,673 for RV Capco in the period ended 31 December 2002.

\(^{219}\) See paragraph 253 above.

\(^{220}\) See VII/24.6 to 24.8.
275. The PVH 2001 consolidated financial statements included the following disclosure:

“Included within Group cash at bank and cash held on deposit are the following amounts:

- £58 million (Company – £10 million) held in respect of specific liabilities that are fully provided in the accounts
- £20 million (Company – £nil) that is available to a specific subsidiary but not available to other Group companies
- £25 million (Company – £nil) in respect of collateralised amounts on which all restrictions have been released since the year end
- £74 million (Company – £3 million) on which there are external arrangements restricting its use.”

276. The £58 million referred to in the above note includes £48 million in respect of RV Capco’s cash balance.

277. The related party transactions note to the PVH 2001 consolidated financial statements included the following:

“During the year, the Group purchased £1,986,199 (2000 - £nil) of used vehicles from MGR Capital Limited, of which J Edwards and P Beale are directors and J Towers, P Beale, J Edwards, N Stephenson and K Howe are significant shareholders. The year end balance with MGR Capital Limited was a debtor of £2,306,140 (2000 - £nil).”

278. PVH’s 2002 and 2003 consolidated financial statements included similar disclosure.

279. RV Capco’s financial statements for the period ended 31 December 2002 make the following disclosure in respect of related party transactions with MGR Capital:

“During the period, the Company purchased vehicles to the value of £65,150,725 from MGR Capital Limited, of which P R Beale and J K Edwards are both directors and shareholders. The year end balance due to MGR Capital Limited was £5,272,764.”

280. In respect of the RV loss provision the following disclosure is made:

“The company has committed to purchase second hand vehicles at contracted prices. The residual value provision covers losses arising on the sale of these vehicles and is likely to be utilised within the next two years.”
281. In respect of the restrictions on RV Capco’s bank account\textsuperscript{221}, the following disclosure is made:

“The use of the cash at bank and in hand is restricted to settling the losses arising on the sale of second hand vehicles.”

282. RV Capco’s 2003 and 2004 financial statements included similar disclosure.

283. The definition of a related party in FRS 8 includes the following:

“A party is related to an entity if ... the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with directly or indirectly, any ... key management personnel of the entity or its parent”\textsuperscript{222}

284. In addition, FRS 8 defined a related party transaction as “The transfer of assets or liabilities or the performance of services by, to or for a related party irrespective of whether a price is charged.”\textsuperscript{223}

285. Mr Edwards and Mr Beale were appointed directors of MGR Capital on 11 October 2001 and have not resigned their office.

286. The Phoenix Partnership held 2 million preferred ordinary shares in MGR Capital.

287. Mr Edwards and Mr Beale each held 100 of the Ordinary “B” shares individually and jointly held 49,799 of the Ordinary “B” shares, being 50 per cent of the total ordinary share capital. The remaining half of the ordinary share capital was owned by Uberior, a subsidiary of HBOS.

288. In our view, with reference to the FRS 8 definition set out above, MGR Capital was related to the PVH Group of companies, being at least “significantly influenced by” members of the Phoenix Partnership.

289. FRS 8 also sets out disclosure required in the financial statements of an entity that has transacted with a related party, including “any other elements of the transactions necessary for an understanding of the financial statements.”\textsuperscript{224}

\textsuperscript{221} See paragraph 253 above.
\textsuperscript{222} FRS 8 paragraph 2.5.
\textsuperscript{223} FRS 8 paragraph 2.6.
\textsuperscript{224} FRS 8 paragraph 6.
290. In addition the Companies Act 1985 required that the consolidated financial statements of a parent company contain disclosure of transactions and agreements entered into by “the company or by a subsidiary of the company for a person who at any time during the financial year was a director of the company or its holding company, or was connected with such a director.”

There are similar requirements for an individual entity.

291. In representations to us Deloitte stated:

“The audit team considered that the disclosure made by the directors satisfied their disclosure requirements, and determined that further information about related party transactions was unlikely to influence the economic decisions of users of the financial statements.”

292. In our view the related party disclosures in the PVH consolidated financial statements referred to above did not provide sufficient information for a reader of those financial statements properly to understand the relationship and nature of the transactions between the Group and MGR Capital.

293. In particular PVH’s and RV Capco’s financial statements did not disclose that:

293.1. the cash held in RV Capco’s bank account was charged in favour of MGR Capital;

293.2. RV Capco had entered into a contract with MGR Capital to purchase vehicles at their GMFV which was likely to generate a loss in RV Capco; and

293.3. as a consequence of purchasing vehicles at their GMFV RV Capco was incurring a loss that would otherwise be incurred in the financial records of MGR Capital, a company in which the Phoenix Consortium had a shareholding.

Additional points

294. In addition to the matters discussed above, the FRRP identified a number of other points in an appendix to their report. We have considered these points in the course of our investigation and, although in some cases we have identified areas of deficiency in the financial statements, we are of the view that they are relatively minor in nature and do not warrant any further comment.

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CHAPTER XXIV

EVIDENCE ELIMINATOR
The purchase, installation and operation of Evidence Eliminator

1. At 10.50 am on 1 June 2005, the day after our appointment as inspectors was publicly announced, Mr Beale purchased a single user licence for a computer software program called Evidence Eliminator v5.058 (“Evidence Eliminator”).

2. Evidence Eliminator is a software program which claims it “deep cleans” a computer’s hard disk of any “sensitive material” which would otherwise have remained despite any “normal” efforts to delete it.

3. Such deletion methods, including pressing the delete key and emptying the recycle bin, do not permanently delete data. The data is merely hidden from view and the system designates the disk space previously occupied by the data as free space available for use. Until the old disk space is overwritten the deleted data remains on the hard drive and can be “undeleted” using readily available software. Evidence Eliminator is able to “clean” the hard disk by overwriting the previously allocated disk space ensuring that any data that was present is no longer accessible. Evidence Eliminator, as the product name suggests, aims to erase permanently all traces of unwanted data from a computer hard disk.

4. In June 2005, Evidence Eliminator was marketed using claims such as:

“It is a proven fact ... routine Forensic Analysis equipment such as EnCase and F.R.E.D used by Private and Business Investigators, Law-Enforcement and others, can recover evidence from parts of your hard drive that you thought were empty, parts that you had cleaned.”

It was also publicly advertised as being:

“... designed, tested and proven to defeat the exact same ‘Forensic Analysis’ equipment as used by police and government agencies, etc.”

and it claimed to enable users to:

“... purge [their] PC of hidden computer data which could later be recovered with Forensic Software to be used as evidence against [them].”

5. At 12.20 pm, one and a half hours after purchasing the program, Mr Beale installed a copy of Evidence Eliminator on his personal computer. Mr Beale then ran Evidence Eliminator on his computer at least once between 9 and 13 June. As a result, Mr Beale caused material on his computer to be deleted prior to our review and to be deleted in such a way that the material was no longer recoverable using standard computer forensic tools.
6. On 20 June, approximately one week after Mr Beale ran Evidence Eliminator on his computer, the computer was imaged\(^1\) as part of our investigation.

**The deleted material**

7. It is impossible to determine to what extent (if any) material of significance to our investigation was deleted. However, evidence found on the image taken of Mr Beale’s computer indicates that Mr Beale deleted a sub-folder called “MG Rover”\(^2\) from his hard disk between 2 and 20 June\(^2\), being the period after our appointment but before Mr Beale’s computer was imaged.

8. Furthermore, we found evidence of ten documents which previously resided in this “MG Rover” sub-folder which were not, with the exception of one document (document number 1 in the table below), found elsewhere on Mr Beale’s computer\(^3\). The file names and original file paths of these ten documents are set out in the table below:

<table>
<thead>
<tr>
<th>Document no.</th>
<th>File name</th>
<th>Original file path</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>jt mgr income.xls</td>
<td>D:\Documents\MG Rover\jt mgr income.xls</td>
</tr>
<tr>
<td>2</td>
<td>jt summary.xls</td>
<td>D:\Documents\MG Rover\jt summary.xls</td>
</tr>
<tr>
<td>3</td>
<td>NetWorth2.xls</td>
<td>D:\Documents\MG Rover\NetWorth2.xls</td>
</tr>
<tr>
<td>4</td>
<td>JointAssets.xls</td>
<td>D:\Documents\MG Rover\JointAssets.xls</td>
</tr>
<tr>
<td>5</td>
<td>KH NETA.xls</td>
<td>D:\Documents\MG Rover\KH NETA.xls</td>
</tr>
<tr>
<td>6</td>
<td>JT NETA.xls</td>
<td>D:\Documents\MG Rover\JT NETA.xls</td>
</tr>
<tr>
<td>7</td>
<td>PB NETA.xls</td>
<td>D:\Documents\MG Rover\PB NETA.xls</td>
</tr>
<tr>
<td>8</td>
<td>NS NETA.xls</td>
<td>D:\Documents\MG Rover\NS NETA.xls</td>
</tr>
<tr>
<td>9</td>
<td>JE NETA.xls</td>
<td>D:\Documents\MG Rover\JE NETA.xls</td>
</tr>
<tr>
<td>10</td>
<td>2004 balance Sheet &amp; Man accounts.doc</td>
<td>D:\Documents\MG Rover\2004 balance Sheet &amp; Man accounts.doc</td>
</tr>
</tbody>
</table>

9. Document number 1, called “jt mgr income.xls”, was later discovered as an attachment to an email stored on Mr Beale’s computer. This document, a Microsoft Excel spreadsheet created on 4 May 2005, contained details of the income and benefits received by Mr Towers from MGRG in the 2003, 2004 and 2005 tax years.

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\(^1\) Forensic imaging refers to the process where 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 is taken certain procedures are carried out to verify the integrity of the image file.

\(^2\) As a result of the running of Evidence Eliminator, we cannot identify the exact date on which Mr Beale deleted this sub-folder (and potentially its contents).

\(^3\) As a result of the running of Evidence Eliminator, we cannot identify all the documents which previously resided in the “MG Rover” sub-folder. However, through the use of forensic computing experts, we have been able identify some of the documents which previously resided in the sub-folder.
10. We cannot be certain of the contents of the remaining nine documents, but, based solely on their file names, Mr Beale thinks that eight of these documents, documents numbered 2 to 9 in the table above, “are documents which were created at the time of the proposed [DTI] bridge funding to show the directors’ net asset positions.” This conclusion seems to us likely given that:

10.1. in March 2005 Messrs Beale, Edwards, Howe, Stephenson and Towers were asked to prepare individual statements of net assets in connection with the proposed bridging loan facility\(^4\) and they (or their advisors) did in fact do so; and

10.2. each of the documents numbered 6 to 10 above contained the phrase “NETA” in their file names, presumably an abbreviation of “net assets”, along with the initials of either Mr Beale, Mr Edwards, Mr Howe, Mr Stephenson or Mr Towers. Therefore, it is probable, for instance, that document 6 called “KH NETA.xls” was Mr Howe’s statement of net assets.

11. As regards document 10 (“2004 balance Sheet & Man accounts.doc”), it was acknowledged in representations made to us on behalf of Mr Beale (and we accept) that the name of this document suggests that the document contained “accounting information”. We were told that Mr Beale did “not know what information it contains or which company it relates to” and that it is “not clear from the document name that it relates to any of the companies under investigation”, but Mr Beale “accepts that it might do” and, especially since it had been placed in an “MG Rover” sub-folder, the likelihood must be that it relates to one of the companies under investigation.

12. We have been unable to ascertain with certainty whether these ten documents were deleted before or after our appointment, due to Mr Beale installing and running Evidence Eliminator. However, as stated in paragraph 7 above, the sub-folder in which these documents previously resided was deleted after our appointment.

**Mr Beale’s evidence regarding his use of Evidence Eliminator**

13. Mr Beale was first interviewed about Evidence Eliminator in January 2006 after we became aware that a product such as Evidence Eliminator may have been used on his computer\(^5\). He was interviewed again in July 2007 regarding the same topic. There was also, at various times from January 2006 onwards, correspondence exchanged between Mr Beale’s solicitors and us regarding the issues surrounding his use of Evidence Eliminator.

14. In June 2008 Mr Beale was given notice of our provisional criticisms of him regarding this matter and in March 2009 Mr Beale, through his solicitors, provided us with a draft witness statement in which he stated that he had “decided to share some further information with the Inspectors relating to [his] use of Evidence Eliminator”.

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\(^4\) See XX/112.

\(^5\) Mr Beale’s computer was found to contain little in the way of live files or emails and very few deleted files or emails indicating that a product such as Evidence Eliminator may have been used.
15. In some respects, the statements Mr Beale made in his draft witness statement significantly differed from the evidence previously given to us by him in interview. Such discrepancies are discussed further below.

**Connection between our appointment as inspectors and Mr Beale’s purchase of Evidence Eliminator**

16. When asked in interview if there was a connection between our appointment as inspectors on 31 May 2005 and his purchase of Evidence Eliminator on 1 June, Mr Beale said:

   “Absolutely not. If you are suggesting that the DTI inspectors were appointed on 31st May and I deliberately went out and got a piece of software to suddenly delete lots of things on my computer, it is absolutely false.”

Mr Beale also said in interview:

   “I had no concept at that time of what the DTI investigation would look like and was subsequently absolutely astounded that such things would even be looked at, such as my own laptop, let alone the level of detail the DTI investigation would be in.”

17. However, in his draft witness statement Mr Beale stated:

   “When I heard that the Inspectors had been appointed I thought that there might be a possibility that the Inspectors would want to view documents on my laptop as part of the investigation process, given that I had used my laptop for business purposes. … I decided that I would delete personal documents from my laptop as I did not want the personal documents present on my computer to be viewed by those conducting the investigations into the PVH Group’s affairs. I realised that, even though I had deleted my personal documents, there was a possibility that the Inspectors might use some form of forensic technology to recover deleted items and that, if they did, they might recover some of my personal documents.

   ... As such, I decided to purchase Evidence Eliminator to clean up any traces of those deleted personal documents.”

**Mr Beale’s recollection of the events of June 2005**

18. In interview, Mr Beale was asked why he bought Evidence Eliminator on 1 June 2005. He replied:

   “... I can genuinely not recall when the sequence of events happened. I mean, I am not sure, you are saying I downloaded it, I guess I downloaded it, I do buy a lot of software on the internet by ordering it.”
19. In the same interview, when it was put to him that he installed Evidence Eliminator on 1 June and ran it more than once in the first half of June, Mr Beale replied:

“Yes. The question I am asking you, though, I suppose I am seeking for help here, is did I download it? For instance, if I had ordered it your dates would not be quite so sensational.”

20. Mr Beale was also asked if he had downloaded Evidence Eliminator on a free trial basis; he replied:

“I cannot remember, to be honest.”

21. At the conclusion of his interview Mr Beale made the point that as time went on his memory became less clear on certain matters and stated:

“... this 1st June is an absolutely perfect example of this – memories do alter. It is nine months now, so the earliest, if you want to talk to us in six months, you are talking to us about what happened 18 months ago at the earliest. If you had asked me to talk to you on the 2nd June I would probably be able to tell you very well.”

22. However, in March 2009, more than three years later, Mr Beale “decided to share some further information with the Inspectors relating to [his] use of Evidence Eliminator” by providing us with a draft witness statement. He also expressed regret at not “having provided a fuller explanation to the Inspectors regarding [his] use of Evidence Eliminator at the time that [he] was interviewed regarding these matters” and explained that this was because he “had not been told in advance of [his] interview in January 2006 what was to be discussed.” He also stated that he had “decided that [he] would like to clarify matters now, to avoid any misunderstanding.”

Mr Beale’s behaviour in June 2005

23. Mr Beale also gave evidence in interview stating that he behaved no differently in June 2005 to any other time as he had, in previous years, used programs to “clean up [his] disk on a regular basis” and, in particular, as quoted in paragraph 16 above, did not acquire software “to suddenly delete lots of things on [his] computer”.

24. However, we have found no evidence on Mr Beale’s computer indicating that he had ever previously installed a program with the capability of not just deleting files but also deleting all the underlying data.

25. It is possible that the running of Evidence Eliminator on his computer may have removed traces of other deletion software which previously existed on Mr Beale’s computer. However, we have found no trace of, and Mr Beale has provided no evidence of, any additional deletion software with the same disk-wiping capabilities as Evidence Eliminator that previously existed on his computer. Notwithstanding the running of Evidence
Eliminator, had any additional programs existed we would have expected to find some trace of them on the computer.

26. It also appears to us, based on statements he made in his draft witness statement, that Mr Beale’s purchase of Evidence Eliminator was prompted by his fear “that the Inspectors might use some form of forensic technology to recover deleted items” on his computer rather than a routine type of behaviour exhibited by Mr Beale.

27. In our view, Mr Beale’s evidence in interview that he behaved no differently in June 2005 to any other time was inaccurate and designed to mislead us.

Deletion of business documentation

28. In interview, Mr Beale referred to using disk-wiping software on his computer to “clean up [his] disk on a regular basis”. However, he gave the following evidence regarding his use of Evidence Eliminator, or any other similar program, to delete documents on his computer:

- “... I am very aware of the oath I have taken, and absolutely certainly, I did not destroy or delete any sensitive – any documents to do with this business whatsoever”; and
- “... I didn’t at any time delete any business documentation off my laptop.”

29. As quoted in paragraph 17 above, Mr Beale stated in his draft witness statement of March 2009 that he had decided to delete personal documents from his computer to prevent those conducting the investigation from viewing them. Then, to avoid the possibility of the documents being recovered through the use of computer forensic tools, he purchased Evidence Eliminator to clean up all traces of those deleted personal documents.

30. As he did in interview, Mr Beale denied in his draft witness statement that he had ever deleted from his computer documents relating to the companies under investigation. He stated:

“What I will say again, and what I think is the most important point here, is that I did not delete any documents relating to the companies under investigation. All of the documents which relate to the companies under investigation present on my computer at the time of the appointment of the Inspectors were transferred into the encrypted section of my hard drive. They were not deleted.”

Mr Beale went on admit that:

“... the effect of Evidence Eliminator having been used is that it is not possible for my expert to prove that no company documents have been deleted”,

but he pointed out that:

“... it does not follow that the fact that such positive evidence cannot be given in my favour means that I deleted company related documents.”

31. However, as we have noted in paragraph 8 above, evidence found on Mr Beale’s computer indicates that at least ten documents were deleted from Mr Beale’s computer, and

31.1. one of these documents was later found to contain details of the salary payments made by a company of which Mr Beale was a director to another of its directors;

31.2. the remaining nine are likely to have been created for the purpose of securing a Government loan for a company of which Mr Beale was a director or contained “accounting information” relating to a company under investigation; and

31.3. all of these files were previously resident in a sub-folder called “MG Rover”.6

32. In the circumstances, it appears to us that all ten documents are likely to have related to one or more of the companies under investigation and to have been relevant to that investigation. We consider, moreover, that the documents would appropriately be categorised as business documentation.

33. In representations made to us on behalf of Mr Beale it was argued that the eight documents created in connection with the proposed DTI loan are not business documents as “They are statements of the directors’ personal financial circumstances” and “The fact that they may have been produced for the purpose of trying to help the business to raise funding does not mean that those documents automatically become ‘business documents’.”

34. We disagree and point out, conversely, that the fact that the documents may contain details of the “directors’ personal financial circumstances” does not automatically preclude them from being classed as business documents. The net asset statements, for instance, were prepared by the directors of a company, i.e. PVH, for the sole purpose of securing a loan for the business and were to be used to determine how much each of them would have to contribute personally to any facility and the level of personal assets they would offer as collateral7. These statements were requested from Messrs Beale, Edwards, Howe, Stephenson and Towers because of their positions as directors of PVH and were prepared for business financing purposes. Therefore, they would, in our view, be appropriately categorised as business documentation and, in any event, would be relevant to our investigation.

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6 We note that the “MG Rover” sub-folder contained a document called “Peters Birthday.xls”. However, from the evidence remaining, this was one of a very small percentage of personal documents that we have identified within this folder.

7 See XX/112.
Reasons Mr Beale offered for not providing “further information” until March 2009

35. In his draft witness statement, Mr Beale stated:

“The reason that I have not explained this [i.e. his use of Evidence Eliminator] previously is because it relates to personal matters rather than those of the companies under investigation. Because it relates to personal matters I did not think that it was something that was appropriate to be sharing with the Inspectors, as this is not an investigation into my personal life.”

36. He also explained:

“I did not wish to have to discuss such personal matters with the Inspectors as they are just not relevant to the investigation. Not only that, but I certainly did not want to discuss such things in front of the various other individuals present for my interviews. I appreciate now that it would have been much better for me to have dealt with this issue before now, but having given my evidence in the January 2006 interview I was concerned that any steps taken by me to clarify matters would be taken as an acknowledgement that I had misled the Inspectors in some way.”

Conclusion

37. It is plain, not least from his own draft witness statement, that Mr Beale bought, installed and ran Evidence Eliminator with a view to deleting material from his computer before it was accessed by us. It is clear, too, that Mr Beale ran the program despite being aware of our intention to image and then review the contents of his computer for documents relevant to our investigation.

38. Mr Beale’s use of Evidence Eliminator makes it impossible to assess the importance (if any) of the material deleted. Mr Beale insists that the documents he intended to prevent us from viewing were personal documents. However, it is probable that the material included documents relating to the Group and of relevance to our investigation.

39. Further, having regard to the evidence highlighted in paragraphs 16 to 36 above, we consider that Mr Beale gave untruthful evidence during his interviews that:

39.1. there was no connection between our appointment and his installation of Evidence Eliminator;

39.2. he had “no concept at that time [i.e. in June 2005] of what the DTI investigation would look like” and, in particular, was unaware that in the course of our investigations we might examine his computer;

39.3. he could not recall the sequence of events between his learning of our appointment and the purchase, installation and running of Evidence Eliminator;
39.4. he behaved no differently in June 2005 to any other time as he had, in previous years, routinely used programs to “clean up [his] disk” and, in particular, did not acquire software “to suddenly delete lots of things on [his] computer”; and

39.5. he had not deleted from his laptop any documents relating to the companies under investigation.
CHAPTER XXV
CONCLUSION
1. MGRG, the manufacturer of cars bearing the “Rover” and “MG” brands, went into administration on 8 April 2005 with an estimated deficiency as regards creditors of £1,289 million.

2. As noted in chapter I (Introduction), we were appointed as inspectors by the Secretary of State for Trade and Industry to investigate the affairs of MGRG, PVH (MGRG’s ultimate parent company) and 33 other companies during the period between the Phoenix Consortium’s acquisition of MGRG in May 2000 and the date of administration.

3. In this chapter, we provide an overview of some of the matters discussed in far greater depth earlier in this report.

4. First we deal with the acquisition of MGRG from BMW in May 2000, its subsequent trading and its ultimate failure in April 2005. We then summarise and comment on the financial rewards that were obtained by the four members of the Phoenix Consortium (namely Messrs Beale, Edwards, Stephenson and Towers) and Mr Howe, the fifth director of PVH. We also comment on the allocation of assets and liabilities within the PVH group and finally we deal with a number of sundry matters.

5. In essence, though, the story of what happened to MGRG is as follows. By early 2000 BMW was receptive to an approach by Alchemy to purchase MGRG, which had been loss-making for some years. BMW decided that it was in its best interests to dispose of Rover and Land Rover and was prepared to offer a purchaser of MGRG a large “cash dowry”. In May 2000, negotiations with Alchemy broke down and shortly afterwards BMW accepted a bid from the Phoenix Consortium, via Techtronic, who were perceived as taking on the challenge with a view to saving jobs and preserving the business.

6. In addition to a cash dowry of over £400 million that BMW provided on an interest-free basis, and a further £75 million in lieu of warranties, MGRG had considerable assets. Nevertheless, the company’s longer-term survival depended on it successfully concluding a joint venture arrangement.

7. Over the next five years the Group attempted, unsuccessfully, to find a joint venture partner, the most promising negotiations being those with SAIC between 2004 and 2005. The evidence suggests that the negotiations could have succeeded had they been concluded before MGRG’s increasing losses caused SAIC to lose confidence that the proposed joint venture was financially viable. The British Government was considering seriously the provision of bridging finance until it was told by one of SAIC’s advisors that SAIC did not wish to proceed with the transaction. MGRG went into administration shortly after it became clear that the negotiations had failed.

8. During the five year period, the members of the Phoenix Consortium and Mr Howe obtained large, and we say unreasonably large, financial rewards, totalling tens of millions of pounds. They also undertook a number of transactions to allocate assets to companies in the Group other than MGRG and in which MGRG had no interest.
Chapter XXV
Conclusion

The acquisition of MGRG by Techtronic

9. At the beginning of 2000, MGRG was a wholly-owned subsidiary of BMW. In March 2000, BMW announced that it was in negotiations to sell its Rover car business to Alchemy. However, BMW’s negotiations with Alchemy broke down on 27 April 2000 after Alchemy had sought additional funding from BMW and BMW had been unwilling to supply it1.

10. MGRG was subsequently, on 9 May 2000, sold to Techtronic, a company owned by the four members of the Phoenix Consortium2. In summary3:

10.1. the members of the Phoenix Consortium acquired MGRG (including the Rover parts business) for a nominal sum4; and

10.2. BMW agreed to make an outright contribution of £75 million (in lieu of giving warranties)5 and to lend £427 million more on an interest-free basis for up to 49 years6. It also agreed that, if completion accounts showed MGRG’s net assets at completion to be less than £740 million, it would pay the difference to MGRG7.

11. The members of the Phoenix Consortium each invested £60,000 in Techtronic shortly before its acquisition of MGRG was completed8. Members of the Phoenix Consortium also incurred some costs and losses in connection with the acquisition, but the sums involved were relatively small9. Neither the members of the Phoenix Consortium nor even Techtronic (to which at least two of the relevant engagement letters were addressed) would have had any liability to Eversheds, Deloitte or Albert E Sharp (all of whom advised in connection with the acquisition) 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 in the event of the negotiations with BMW failing to come to fruition10.

1  See III/17 to 23.
2  PVH later acquired all the issued shares in Techtronic and in exchange the Phoenix Consortium were issued with 40% of the shares in PVH (being all the voting shares). Other MGRG employees, including directors, and Rover dealers were issued with the remaining 60%.
3  See III/92.
4  I.e. £10 (see III/88.1).
5  See III/58 and 88.2.
6  Techtronic did not have to make any repayment until 2049 unless (broadly) (a) it and its subsidiaries made a profit, (b) there was a change of control or (c) an “Insolvency Event” occurred (see III/90).
7  See III/88.8.
8  See III/64.
9  See III/76 to 83.
10  See III/69 to 74.
12. Following Techtronic’s acquisition of MGRG, there was a dispute as to whether MGRG’s net assets had been worth £740 million at completion. The dispute was settled in 2001 on the basis that BMW would pay a further £65 million to MGRG and sell Powertrain to Techtronic for a nominal amount.

**MGRG’s prospects**

13. 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 was at risk in the longer term. Representations made to us on their behalf confirm that they “knew that they were taking on a very real challenge and that there was a real risk that MGRG would ultimately fail.”

**Trading and failure**

14. After its acquisition by Techtronic, MGRG continued to incur very large (even if reduced) losses. While MGRG made an overall profit of £542 million for the whole of 2000, that was because the hive-out of Land Rover had created exceptional profits of £1,154.8 million; the company sustained an operating loss from continuing activities of £503 million. Between the beginning of 2001 and 31 December 2003 (the last date for which audited financial statements are available), the company incurred operating losses totalling £340 million. Draft figures for 2004 show an operating loss for the year of £118 million, producing total operating losses of £962 million in the five years ended 31 December 2004. By March 2005 it had been calculated that the company was losing money at the rate of about £250 million a year.

15. Further, MGRG failed to achieve sales as projected. A “business plan aim” was “to sell, on average, 200,000 cars a year in the first five years”, and in 2001 it was MGRG’s target to sell 180,000 vehicles. However, during the eight months to 31 December 2000, MGRG attained 111,800 retail sales (equivalent to about 168,000 in a full year). In 2001 there

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11 See V/90.
12 I.e. £20 (see V/90).
13 See III/98.
14 See XVI/8.
15 See XVI/9.
16 See XVI/8.
17 See XVI/16, 24 and 35.
18 See XVI/45.
19 Excluding the operating loss on discontinued operations in 2000 (as to which, see XVI/8).
20 See XVI/8, 16, 24, 35 and 45.
21 See XX/90, 105 and 108.
22 See XXI/20.1 and 20.3.
23 See XVI/11 and 12.
were 170,200 retail sales\textsuperscript{24}, in 2002 148,500 such sales\textsuperscript{25}, and in 2003 144,900 such sales\textsuperscript{26}. Retail sales in 2004 were put at 115,208 in a document dating from January 2005.

16. As already mentioned, MGRG’s longer term prospects depended on securing a collaborative partner. The company’s continuing losses and declining vehicle sales had implications for the search for a partner. They served to limit the period during which the search could continue before MGRG had to enter an insolvency regime. They were, moreover, liable to make the company less attractive to potential partners, both because it was not, as it stood, profit-making and because of the damage which the losses did to the company’s balance sheet position.

17. Following Techtronic’s acquisition of MGRG, extensive efforts were made to find a partner\textsuperscript{27}. In 2002, it appeared that the Group had succeeded in concluding a joint venture with China Brilliance, a Chinese automotive manufacturer, but the scheme foundered within a relatively short period\textsuperscript{28}.

18. In 2004 to 2005 the Group pursued negotiations with another Chinese automotive group, SAIC (latterly in conjunction with NAC). The proposed deal would have meant much reduced activity in the United Kingdom (specifically, at Longbridge)\textsuperscript{29}, but MGRG would almost certainly have escaped administration and liquidation\textsuperscript{30}. The negotiations did not in the end come to fruition, but SAIC was genuinely interested in entering into joint venture arrangements\textsuperscript{31}, and the negotiations could have succeeded had it been possible to conclude them somewhat earlier, when MGRG’s accumulated losses were less large than they ultimately became\textsuperscript{32}. As time passed, the prospects of a deal being achieved were impaired by the mounting losses, and ultimately SAIC was not satisfied that the proposed joint venture was financially viable\textsuperscript{33}. While, however, it may be possible to say with the benefit of hindsight that the deal needed to be concluded, if at all, months before April 2005, we think that the Group’s directors were justified in continuing to believe that there was a real chance of the deal being completed and in continuing to trade on that basis\textsuperscript{34}.

19. The British Government was considering seriously the provision of bridging finance\textsuperscript{35} until it was told by Rothschild (which was advising SAIC) during the evening of 5 April 2005 that SAIC did not wish to proceed with the transaction\textsuperscript{36}. From that stage, if not before, the
DTI could not properly have made a loan\textsuperscript{37}. It cannot be blamed for the collapse of the negotiations.

20. On 5 April 2005 it was reported in the press that the talks with SAIC had “stalled”\textsuperscript{38}. The stories to this effect will have been derived from a Government source; the likelihood is that the person briefing the press was Mr Godfrey, a special advisor in the DTI, but the briefings may well have been endorsed by someone else, though probably not the Secretary of State\textsuperscript{39}. While, in the event, MGRG would have gone into administration in April 2005 with or without the press reports of the period, we consider that telling the press, without consulting the Group, that the talks had “stalled” was irresponsible\textsuperscript{40}. A note which Mr Norris, another special advisor, had drafted for the previous Saturday’s newspapers\textsuperscript{41} was far less likely to cause difficulties for MGRG, but we question whether it was appropriate for the Government, unattributably, to brief the press even in the terms of that note without consulting, or even informing, the Group\textsuperscript{42}.

Financial rewards

21. When the acquisition of MGRG by Techtronic was being completed in May 2000, it was proposed that the £75 million which BMW was to pay in lieu of giving warranties should be reflected in the issue to the members of the Phoenix Consortium of loan notes of the same amount. Loan notes were favoured as compared with preference shares on the basis the former would not immediately become known to the public. It was not, however, anticipated that the members of the Phoenix Consortium would receive £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\textsuperscript{43}.

22. The scheme was parked at that stage because it was felt (in particular, by Ms Lewis of Eversheds) that there was insufficient time to implement it before completion\textsuperscript{44}. However, the idea of the members of the Phoenix Consortium being given loan notes was revived after the acquisition had been concluded\textsuperscript{45}. It was in large measure to facilitate the issue of such loan notes that a new holding company (viz. PVH) was introduced at the end of 2000. The hope was still that the issue of loan notes would not become public for some time\textsuperscript{46}.

\textsuperscript{37} See XX/170.
\textsuperscript{38} See XX/216.
\textsuperscript{39} See XX/206 and 217 to 221.
\textsuperscript{40} See XX/222.
\textsuperscript{41} See XX/207 to 212.
\textsuperscript{42} See XX/223.
\textsuperscript{43} See III/62.
\textsuperscript{44} See III/62.
\textsuperscript{45} See V/43 to 51.
\textsuperscript{46} See V/50.
23. In the event, loan notes to the value of £10 million were issued by PVH. The members of the Phoenix Consortium had earlier contemplated the issue of loan notes to the tune of £75 million\(^{47}\). The figure was reduced to £10 million in about October 2000\(^{48}\). It seems likely that one factor at least in this decision was an appreciation that BMW’s consent needed to be obtained and a perception that BMW would not, or might not, accede to the higher number\(^{49}\).

24. Although loan notes may originally have been seen 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\(^{50}\). There appears to have been reference to the loan notes being discharged either “on exit” or at a rate of “£15m p.a.”. Further, the fact that the loan notes were interest-bearing meant that early redemption could be (and in fact later was) justified as being in PVH’s interests (since it would relieve the company of its liability to pay interest)\(^{51}\).

25. Going forward, the £65 million difference between BMW’s £75 million contribution and the £10 million of loan notes issued by PVH was used as a benchmark for bonuses\(^{52}\). The members of the Phoenix Consortium proceeded on the basis that over a period they were entitled to take bonuses of a certain magnitude and then, as and when opportunities presented themselves, they would take bonuses with that larger scheme in mind\(^{53}\). There was an intention – as a document dating from 2003 records – that “bonuses would over a 5 year period equate to the 65 million shortfall in loan notes”\(^{54}\), but by May 2003 the members of the Phoenix Consortium appear to have “downgraded their ambition to target at 50 million rather than a higher figure”\(^{55}\).

26. When Powertrain was acquired in mid-2001 in part settlement of the Completion Accounts dispute, an escrow account had to be established to allay concerns of Ford, to which Powertrain supplied engines for Land Rover vehicles\(^{56}\). It was suggested that the £25 million which BMW was to pay into this account should accrue to the benefit of the members of the Phoenix Consortium\(^{57}\), but Ms Lewis expressed concerns about the proposal and, whether or not for that reason, it was not in fact pursued\(^{58}\).

\(^{47}\) See V/65.
\(^{48}\) See V/66.
\(^{49}\) See V/66.
\(^{50}\) See V/55.1 and 63.4.
\(^{51}\) See V/63.4.
\(^{52}\) See XXI/82 to 85 and 121.
\(^{53}\) See XXI/82.
\(^{54}\) See XXI/82.
\(^{55}\) See XXI/88.
\(^{56}\) See V/91.
\(^{57}\) See V/95 and 96.
\(^{58}\) See V/97 and 98.
27. Later in 2001, Ms Lewis was “roundly ticked off” by Mr Beale, in part on the basis that but for Eversheds “the 75 million might have happened, and possibly also the 25 million”. Mr Beale told Ms Lewis that Eversheds were “not anybody’s moral guardians” and that it was not for Ms Lewis to judge the morality of the directors taking benefits for themselves.59

28. Mr Beale considered that Mr Einollahi of Deloitte was less prone to raising objections to transactions which could be to the financial benefit of the members of the Phoenix Consortium.60 Further, Deloitte (in particular, Mr Einollahi) played a very prominent part in a number of transactions that helped, or could have helped, the Phoenix Consortium to achieve their financial ambitions.61 However, responsibility for such transactions must rest with the members of the Phoenix Consortium rather than with Mr Einollahi or, more generally, Deloitte. It was for the members of the Phoenix Consortium, and not their advisors, to decide how much money they should extract for themselves from the Group.62

29. In the event, aside from their returns from MGR Capital (as to which see paragraph 38 below), the members of the Phoenix Consortium received from MGRG and PVH financial rewards (by way of salaries, benefits, bonuses, loan notes and contributions to the Guernsey Trust) totalling about £9 million each, and Mr Howe £5.7 million, during the period of approximately five years between Techtronic’s acquisition of MGRG in May 2000 and the appointment of administrators in April 2005. The payments are explained in chapter XXI (Financial rewards) and summarised in the table below:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Mr Beale</th>
<th>Mr Edwards</th>
<th>Mr Stephenson</th>
<th>Mr Towers</th>
<th>Mr Howe</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>2000-2001</td>
<td>783,410</td>
<td>783,038</td>
<td>775,978</td>
<td>756,035</td>
<td>592,296</td>
</tr>
<tr>
<td>2001-2002</td>
<td>1,763,715</td>
<td>1,763,443</td>
<td>1,763,536</td>
<td>1,766,141</td>
<td>1,133,431</td>
</tr>
<tr>
<td>2002-2003</td>
<td>2,544,783</td>
<td>2,555,389</td>
<td>2,548,696</td>
<td>2,548,306</td>
<td>2,025,613</td>
</tr>
<tr>
<td>2004-2005</td>
<td>294,764</td>
<td>294,764</td>
<td>294,764</td>
<td>294,764</td>
<td>504,925</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>8,981,355</td>
<td>9,024,003</td>
<td>8,975,652</td>
<td>8,957,575</td>
<td>5,708,392</td>
</tr>
</tbody>
</table>

30. These payments were very largely made by PVH,64 which funded the payments principally from the proceeds of schemes designed to exploit tax losses (mainly tax losses of MGRG)65 and dividends declared by Techtronic.66 The dividends from Techtronic were themselves financed primarily from interest paid by MGRG and money released from the escrow

60 See V/99.
61 Such transactions included Project Platinum, for which Deloitte received a fee of £7.5 million (see VII/115.5), Project Aircraft, for which Deloitte received fees of £1,925,000 plus VAT (see XI/15), and Project Trinity, for which Deloitte received fees of £1,099,078 plus VAT (see chapter XI footnote 53).
62 See e.g. V/100.
63 No loan notes were issued to Mr Howe.
64 See XXI/8 to 58.
65 There is further reference to these schemes in paragraph 47.3 below.
66 See XXI/68.
account established when Powertrain was acquired by Techtronic. With regard to the payment of interest by MGRG, while Techtronic did not have to pay interest on sums it was lent by BMW, 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. As for the moneys in the escrow account, these had been contributed by BMW (as a result of a contractual obligation to compensate MGRG) and MGRG (on behalf of Techtronic).

31. To a limited extent, legal questions could arise in connection with the payments made to or for the benefit of the members of the Phoenix Consortium and Mr Howe. In particular, there might be said to be legal issues in relation to (a) the transfer by MGRG of the tax losses used to fund such payments, (b) whether the sums paid by way of bonuses and to the Guernsey Trust represented exclusively remuneration for the recipients’ services as directors rather than distributions to the members of the Phoenix Consortium as PVH’s “D” shareholders and (c) whether PVH’s affairs were conducted in a manner that was “unfairly prejudicial” to PVH’s other shareholders.

32. Aside, however, from any legal issues, we consider that the financial rewards which the members of the Phoenix Consortium and Mr Howe obtained from the Group (and which they essentially set for themselves) were unreasonably large. When BMW was disposing of MGRG, the members of the Phoenix Consortium enjoyed a “wave of employee and public support” on the basis, in part at least, that they were perceived to be acting for the public good. In the event, as already noted, they were able to acquire MGRG for a nominal sum and with the benefit of a large BMW “dowry.” Further, the expenditure and risks that the members of the Phoenix Consortium had to bear in connection with MGRG’s acquisition were relatively insubstantial, and the members of the Phoenix Consortium did not subsequently invest any money in the Group. There could nonetheless have been little objection, either legally or morally, to the members of the Phoenix Consortium (who, after all, were PVH’s controlling shareholders) deriving benefits commensurate with the Group’s performance had they succeeded in making it profitable. However, MGRG, from whose acquisition all PVH’s receipts were ultimately derived, was in fact very unprofitable and eventually went into administration. The members of the Phoenix Consortium and Mr Howe still chose to give themselves rewards out of all proportion to the incomes which they had previously commanded, which were also large when compared with remuneration paid in

67 See XXI/68.
68 See V/53, 57, 61 and 63.1.
69 See chapter XVI (Financial and trading performance of MGRG) for further details.
70 See XXI/64 to 67 and 68.3.
71 See further paragraph 47.3 below.
72 See XXI/115 to 122.
73 See XXI/118, 119 and 122.
74 See III/38 to 43.
75 See III/92.
76 See III/64, 69 to 83 and 92.
77 More specifically, MGRG was the source of tax losses and payments of interest and into the Powertrain escrow account which facilitated PVH’s payments for the benefit of the Phoenix Consortium and Mr Howe.
78 See XXI/97 and 98.
other companies\textsuperscript{79} and which were not obviously demanded by their qualifications and experience\textsuperscript{80}.

**Project Platinum**

33. In addition to the financial rewards summarised in paragraph 29 above, the members of the Phoenix Consortium and Mr Howe have derived substantial benefits from Project Platinum, which involved the acquisition by MGR Capital (a company owned by the members of the Phoenix Consortium, Mr Howe and HBOS) of most of BMW’s Rover loan book\textsuperscript{81}.

34. BMW presented the opportunity to acquire its Rover loan book to the Group itself. Thus, when BMW first wrote to Mr Edwards about the disposal of its Rover loan book, in January 2001, the letter was addressed to Mr Edwards as “Deputy Chairman MG Rover Group Limited”\textsuperscript{82}, and Mr Edwards told us that he could not think of anything that would have alerted BMW to the fact, if it were one, that he was not wearing a company director hat at this stage\textsuperscript{83}. In subsequent correspondence, Mr Edwards wrote on behalf of “MG Rover Holdings Ltd [i.e. PVH]” and was referred to as “Deputy Chairman MG Rover Holdings Ltd” and “Deputy Chairman of MG Rover”\textsuperscript{84}. At the beginning of June 2001 a confidentiality agreement was concluded with MGRG\textsuperscript{85}. It was not until 25 June 2001 that BMW was told that the plan was to ring-fence the portfolio from PVH (and also MGRG)\textsuperscript{86}.

35. Further, and importantly, MGRG deposited £41 million in an account with RV Capco, a newly formed subsidiary of PVH, so as to provide the purchaser of the Rover loan book with protection against residual value risks. The provision of this money was crucial to the transaction. We were told, for example, that without such protection HBOS would not have been willing to be involved. The returns which it was anticipated that MGR Capital would derive from the transaction can fairly, we think, be regarded as attributable to a substantial extent to the £41 million deposit which MGRG made\textsuperscript{87}.

36. Moreover, in July/August 2001 BoS (which later merged with Halifax Group plc to form HBOS) suggested that a Group company (and not individuals) should be its joint venture partner\textsuperscript{88}.

37. Despite the matters mentioned in paragraphs 34 to 36 above, the members of the Phoenix Consortium decided that HBOS’ joint venture partner should not be a company in the Group

\textsuperscript{79} See XXI/99 to 105.
\textsuperscript{80} See XXI/111 to 114.
\textsuperscript{81} See chapter VII (Project Platinum).
\textsuperscript{82} See VII/9.
\textsuperscript{83} See VII/65.
\textsuperscript{84} See VII/65 and 66.
\textsuperscript{85} See VII/67.
\textsuperscript{86} See VII/68.
\textsuperscript{87} See VII/15, 16, 24.6, 108, 114 and 216.
\textsuperscript{88} See VII/70 to 72.
but the Phoenix Partnership. The principal reason was that they wanted to secure the anticipated profits for the Phoenix Partnership (comprising themselves and Mr Howe).

38. The members of the Phoenix Partnership now stand to obtain the following returns from MGR Capital:

<table>
<thead>
<tr>
<th>Each of Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers</th>
<th>Mr Howe</th>
<th>Total to Phoenix Partnership</th>
</tr>
</thead>
<tbody>
<tr>
<td>£million</td>
<td>£million</td>
<td>£million</td>
</tr>
<tr>
<td>Preference dividends from incorporation to 2008</td>
<td>0.689</td>
<td>-</td>
</tr>
<tr>
<td>50% profit share from “B” shares</td>
<td>2.550</td>
<td>1.400</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3.239</strong></td>
<td><strong>1.400</strong></td>
</tr>
</tbody>
</table>

39. When the acquisition of the Rover loan book was being completed, steps were taken with a view to “whitewashing” the Phoenix Partnership’s involvement in it. Various board and shareholder resolutions were, on the face of it, passed to this end, but there are grounds for questioning the validity of some of the resolutions, and also their sufficiency. However, here (as elsewhere) the overarching response on behalf of the members of the Phoenix Consortium is that the transaction 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.

40. This contention raises (among others) the question of when a company’s financial circumstances will preclude its shareholders from approving a transaction which might, absent such approval, involve a breach of directors’ duties. The relevant law is in some respects uncertain, and we do not think it appropriate for us to express any concluded view on its application to Project Platinum (or indeed other transactions relating to MGRG); the
points should rather, it seems to us, be aired, if and so far as necessary, in Court proceedings with full legal argument. Regardless, however, of what the law at present is, we think there is much to be said for the view that it should not be possible for shareholders to approve transactions to the financial prejudice of their company if the company’s survival, at least in the longer term, is known to depend on the achievement of a particular event (in the case of MGRG, a partner being found) and there is substantial doubt as to whether the event will happen.

41. Another, quite different, point to emerge in relation to Project Platinum is that Mr Whyte, who was then a BMW employee, supplied information relevant to Project Platinum to Deloitte when he was both (a) one of the key people concerned with the disposal of the Rover loan book on behalf of BMW and (b) potentially involved in the “MG Rover” bid for the loan book. Mr Whyte thus had a conflict of interest and should not have continued to be involved with the sale of the loan book without informing BMW that there was a possibility of his taking part in an MBO which, in our view, he did not do. Neither should Deloitte (and Mr Edwards) have put themselves in a position where they were receiving information (and seeking it) 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 realised 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 effect, Deloitte were, as it seems to us, seeking to use the prospect of involvement in an MBO to persuade Mr Whyte to supply to them potentially confidential information, or information BMW would or might have preferred Mr Whyte not to disclose.

42. Another specific concern arising out of Project Platinum relates to the meeting on 12 October 2001 at which MGRG’s board (including the six directors who were not also members of the board of PVH or the Phoenix Partnership) was briefed on Project Platinum. In our view, the slides used for the presentation on the subject (and correspondingly the presentation itself) were inaccurate and misleading in a number of respects. It seems to us that Mr Barton of Deloitte (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. The deficiencies meant that the board was not in a position to make a decision on what was proposed on a fully-informed basis and, more specifically, that directors of MGRG were less likely to challenge the transaction.

98 See VII/208.
99 See VII/9.
100 See VII/46 and 50.
101 See VII/57 to 61.
102 See VII/61.
103 Namely, Mr Beddow, Mr Bowen, Mr Millett, Mr Parkinson, Mr Oldaker and Mr Shine.
104 See VII/177.
105 See VII/178.
106 See VII/179 and 182.
Other attempts to secure personal benefits

43. In 2002, there were two further attempts to secure benefits for the members of the Phoenix Consortium (and also in one case Mr Howe) from the Group, but neither was successful.

44. Like Project Platinum, Project Lisa (discussed in chapter X) involved an attempt to exploit an opportunity through a company outside the Group. Thus, in early 2002 it was envisaged that a company through which funding was to be raised on “leaseplan” vehicles (in the event, MGR (Leaseplan)) should be owned by the members of the Phoenix Consortium and Mr Howe rather than by MGRG\(^{107}\). The plan was abandoned (and MGR (Leaseplan) became a subsidiary of MGRG) only because it had emerged that it would give rise to tax problems\(^{108}\).

45. Project Patto (which is the subject of chapter XII) provides a further example of the members of the Phoenix Consortium seeking to derive financial benefits for themselves from the Group. In this instance, what was envisaged was that the members of the Phoenix Consortium should enter into arrangements in connection with their shares in PVH which, it was hoped, would allow Techtronic’s indebtedness to BMW (and possibly also MGRG’s corresponding liability to Techtronic) to be shown at less than face value in the financial statements. In this connection, the members of the Phoenix Consortium appear to have 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\(^{109}\). In the latter stages of the project, the scale of the proposed benefits was reduced\(^{110}\), but the members of the Phoenix Consortium agreed to forgo all such benefits only because BMW had learned that they were intended to benefit and objected to them doing so\(^{111}\)\(^{112}\).

Distribution of assets and liabilities within the Group

46. A linked theme relates to the allocation of assets and liabilities within the Group. In a variety of ways, steps were taken to allocate assets to companies in the Group other than MGRG and in which MGRG had no interest. Conversely, MGRG was required to bear a liability more naturally borne by PVH.

47. The following are relevant in this context:

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\(^{107}\) See X/6 to 9 and 18 to 23.

\(^{108}\) See X/10 to 12 and 24.

\(^{109}\) In October 2002, for example, it was being proposed that the Phoenix Consortium should receive loan notes to the tune of £77 million (see XII/15).

\(^{110}\) See XII/23 and 25.

\(^{111}\) See XII/26 and 27.

\(^{112}\) See XII/40. For the reasons explained in chapter XII (Project Patto), this paragraph represents the views of only one of us, Guy Newey.
47.1. in 2001 to 2002 the Group was restructured in a way that meant that certain properties and subsidiaries of MGRG were transferred either to PVH itself or to subsidiaries of PVH in which MGRG had no interest. Thus, in December 2001 MGRG’s Longbridge site was transferred to Property Holdings\(^\text{113}\), dealer properties were transferred from MGRG to MGRDP\(^\text{114}\), and the Heritage Companies were transferred from MGRG to Heritage\(^\text{115}\). A year later, Xpart was transferred from MGRG to PVH\(^\text{116}\). A major reason (if not the main reason) for these various transfers was to insulate assets and business activities from MGRG’s liabilities (present or future) and from Techtronic’s indebtedness to BMW\(^\text{117}\). For similar reasons, the Phoenix Consortium would have preferred Powertrain to become a subsidiary of PVH rather than Techtronic. The lawyers, however, advised against this when Powertrain was being acquired from BMW\(^\text{118}\).

47.2. further, the Longbridge site and the dealer properties were transferred for their net book values, and Xpart for just £2. In our view, each of these transfers was effected at less than full market value\(^\text{119}\). On the other hand, we do not think that the evidence establishes that the transfer of the dealer properties was carried out with the intention that the price should be less than market value\(^\text{120}\). With respect to Xpart, we find it hard to accept that Mr Beale, who was the director primarily responsible for the transfer and its terms, thought that the company was worth only £2, but we can see how some legal advice which had been received could have been taken as approving the transaction\(^\text{121}\). As regards the Longbridge site, no Group director other than Mr Beale is likely to have been closely involved with the price at which the land was sold, and net book value was thought to be acceptable on the basis that it was considered to exceed forced sale value. It seems to us, however, that the land’s forced sale value was of no relevance\(^\text{122}\);

47.3. tax losses to which MGRG was entitled were transferred to PVL and PVL2, subsidiaries of PVH in which MGRG had no interest, to facilitate schemes suggested by Barclays Capital\(^\text{123}\). For the same purpose, MGRG also entered into sale and leaseback arrangements with PVL in relation to the MGTF tooling\(^\text{124}\). Nonetheless, there was no provision for MGRG to receive any benefit from the schemes, and it did not do so\(^\text{125}\). PVH obtained net benefits (after payment of all costs) of £8,510,505 (in the case of Project Aircraft) and £3.283 million (in the case of Project Trinity)\(^\text{126}\). As

\(^{113}\) See IX/4 to 42.
\(^{114}\) See IX/43 to 75.
\(^{115}\) See IX/76 to 92.
\(^{116}\) See XIII/13 to 28.
\(^{117}\) See XV/23.
\(^{118}\) See XV/7 to 11.
\(^{119}\) See IX/13 to 22, IX/51 to 60 and XIII/21 to 25.
\(^{120}\) See IX/60.
\(^{121}\) See XII/25 and 26.
\(^{122}\) See IX/20.
\(^{123}\) See chapter XI.
\(^{124}\) See XI/22 to 28.
\(^{125}\) See XI/29 to 35 and 62.
\(^{126}\) See XI/14 to 15 and 55.
noted above, much of the money that the schemes generated provided the basis of payments to the Guernsey Trust (totalling £11,337,625)\(^\text{127}\) 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\(^\text{128}\);

47.4. in the summer of 2004, Xpart’s business was sold to CAT. Xpart had been transferred to PVH for just £2 less than two years earlier on the footing that it would buy parts from MGRG at a significant mark-up and that profit would thus continue to accrue to MGRG, but this arrangement came to an end, and MGRG lost its profit stream, with the sale to CAT\(^\text{129}\). Further, MGRG facilitated the sale to CAT by granting trade mark and other intellectual property rights, by transferring “Non-Current Tooling” to Xpart so that it could in turn provide it to CAT, and by paying sums to BMW which it would not otherwise have paid then, or possibly ever\(^\text{130}\). Nonetheless, and despite advice from Eversheds that some of the proceeds of sale should be paid to MGRG otherwise than by way of loan\(^\text{131}\), none of the profit from the sale to CAT was allocated to MGRG; in contrast, Xpart (now owned by PVH) was treated as realising a profit of £31,685,000 from the transaction\(^\text{132}\). 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\(^\text{133}\);

47.5. 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. 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\(^\text{134}\)) regardless of what became of MGRG\(^\text{135}\); and

47.6. on 7 April 2005, when there was known to be a very real risk that MGRG would have to go into administration imminently (as it in fact did the next day) and other creditors were not being paid, Mr Beale caused the company to pay Eversheds £417,201 in discharge of an invoice addressed to PVH\(^\text{136}\). It seems to us that

\(^{127}\) See XI/16 to 21 and 57.

\(^{128}\) See XI/62.

\(^{129}\) See XIII/61.

\(^{130}\) See XIII/65.

\(^{131}\) See XIII/40.

\(^{132}\) See XIII/49 to 50.

\(^{133}\) See XIII/71.

\(^{134}\) 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.

\(^{135}\) See XV/17 and XX/80 to 86.

\(^{136}\) See XX/225 to 239. It may well be that, whilst the invoice was addressed to PVH, MGRG was also legally liable to Eversheds in respect of it (see XX/225 and 232). Assuming, however, that that was the case, every other company in the Group was also so liable.
Mr Beale probably authorised the payment with a view to benefiting PVH – so that PVH would not have to pay137.

48. It is fair to say that, when Property Holdings sold the Longbridge site, at a substantial profit, in 2003, the net proceeds were used by MGRG. Even so, the transfer of the land to Property Holdings will have been to the disadvantage of MGRG and its creditors. Had it remained the owner of the land at the time of the sales, MGRG would have been entitled to the full proceeds of sale as of right. Instead, MGRG incurred indebtedness to Property Holdings, and MGRG’s liabilities were increased, to the tune of more than £16 million138. Likewise, most of the profit from the sale to CAT of the parts business was lent to MGRG. Had, however, it still been the owner of Xpart, the profit would have come to MGRG as of right and not by way of loan139.

49. Some of the matters referred to in paragraph 47 above raise once again the question of when it is (and when it should be) possible for shareholders to approve a transaction which might otherwise involve a breach of directors’ duties140. Provided that they are not entered into for the purpose of putting assets beyond the reach of creditors, transfers within groups of companies at net book value are likely to be unobjectionable if the companies making the transfers are financially secure. Similarly, there may well be no harm in tax losses being surrendered at nil consideration where the company making the surrender is of undoubted solvency. In the case, however, of a company which is insolvent, or one whose prospects of survival are uncertain, such a transaction may be to the prejudice of creditors.

**Financial support for Edwards Cars**

50. One of the other purposes for which PVH used its income was to support Edwards Cars, a company owned by Mr Edwards and his wife which was later acquired by PVH for a nominal sum141. Between December 2000 and the end of 2002 Edwards Cars charged PVH sums totalling £3,877,958 (excluding VAT), and between January 2003 (when Edwards Cars became a subsidiary of PVH) and April 2005 PVH paid £1,718,953 to Edwards Cars142. In addition, Techtronic paid £308,000 (excluding VAT) to Edwards Cars during 2000143. Without the financial support it received, Edwards Cars would have incurred very large losses and been most unlikely to be able to continue trading144.

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137 See XX/238.3.
138 See IX/34.
139 See XIII/71.
140 See paragraph 40 above.
141 See XIV/2 and 15 to 28.
142 See XIV/4 to 7.
143 See XIV/3.
144 See XIV/12.
51. We can see that there may well have been a commercial justification for giving Edwards Cars some financial support. However, we do not think that support on the very large scale in fact provided can have been commercially justified.\(^{145}\)

**Explanations to MPs and others**

52. As explained in chapters VII (Project Platinum) and XXI (Financial rewards)\(^{146}\), inaccurate and misleading explanations of some of the matters mentioned above were given to MPs and others. For example, MPs and others were led to believe in 2003 to 2004 that the members of the Phoenix Consortium had invested considerable sums and taken substantial financial risks when MGRG was acquired and that the sums which had been reported as paid to them did not come from MGRG but “from separate Phoenix sources”\(^{147}\). In reality, the relevant payments to or for the benefit of the members of the Phoenix Consortium can for the most part be traced back to interest paid by MGRG and the exploitation of MGRG’s tax losses, and the members of the Phoenix Consortium had invested relatively little in the Group and undertaken only limited risks\(^{148}\). Further, Mr Beale told Mr Burden MP in a letter dated 11 November 2003 that the only way to achieve the acquisition of BMW’s Rover loan book was for “The Phoenix Consortium members to yet again put their hands in their pockets and put personal monies at risk” and the Trade and Industry Select Committee on 30 March 2004 that “our financial advisors 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”\(^{149}\). However, HBOS had expressed a preference for having a Group company as its joint venture partner, but the members of the Phoenix Consortium had preferred that the Phoenix Partnership should be the joint venture partner because they had wanted the profits to accrue to them\(^{150}\).

**Corporate governance**

53. We discuss aspects of corporate governance in chapter XXII. As explained in that chapter, directors of Group companies were not always invited to board meetings. Thus, functional directors of MGRG were often given no notice of “ad hoc” meetings of the company’s board\(^{151}\). Similarly, Mr Ames and Mr Bowes were not invited to all board meetings of Techtronic which are recorded as having taken place when they were directors\(^{152}\). It seems to us that all directors should have been notified of all board meetings of their companies both because there was a legal requirement to do so and because notifying directors of board

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\(^{145}\) See XIV/14.

\(^{146}\) See VII/227 to 230 and XXI/127 to 134.

\(^{147}\) See XXI/128 to 133.

\(^{148}\) See XXI/134.

\(^{149}\) See VII/228 and 229.

\(^{150}\) See VII/230.

\(^{151}\) See XXII/6 to 16.

\(^{152}\) See XXII/18 to 20.
meetings helps to ensure that they are informed about, and have an opportunity to influence, decisions relating to the companies for which they have responsibility.\textsuperscript{153}

**Payment for the benefit of Mr Parker**

54. Amongst the other matters about which we express concern in this report is the payment of £100,000 by SMP (i.e. St. Modwen Properties plc) to a company associated with, and for the benefit of, Mr Parker, a former director of Techtronic who had played a part in negotiations relating to the Longbridge site, without the fully informed consent of the Group.\textsuperscript{154}

**Payments to Dr Li**

55. During 2004 and 2005 Dr Li provided consultancy services to the Group in connection with potential collaborations with Chinese companies, in particular the negotiations with SAIC.\textsuperscript{155} In total, companies associated with Dr Li (namely, CVL and CVIL) were paid £1,692,794 for her services over a period of some 15 months, and one such company (CVIL) would have received considerably more money had the negotiations with SAIC come to fruition.\textsuperscript{156} It seems to us that the sums that the Group paid, and for which a consultancy agreement signed by Mr Stephenson on MGRG’s behalf provided, were in the aggregate much too high.\textsuperscript{157} We also consider that the manner in which the agreement and payment of CVIL’s fees were authorised was thoroughly unsatisfactory.\textsuperscript{158} The person primarily responsible for them was Mr Stephenson even though he had a personal relationship with Dr Li. Most of the other directors of the companies paying the relevant fees (viz. MGRG and Powertrain\textsuperscript{159}) were not consulted, and only one other director (namely, Mr Beale) had been told by Mr Stephenson of his relationship with Dr Li.

**Use of Evidence Eliminator**

56. On the day after our appointment as inspectors was announced, Mr Beale bought and installed on his personal computer a program called “Evidence Eliminator v5.058” which was designed to “clean” a computer’s hard disk.\textsuperscript{160} Mr Beale subsequently ran Evidence Eliminator with a view to deleting material from his computer before it was accessed by us.\textsuperscript{161} He did so despite being aware that we would want to image and then review the contents of his computer for documents relevant to our investigation.\textsuperscript{162} Mr Beale’s use of Evidence Eliminator makes it impossible for us to assess the importance (if any) of the

\textsuperscript{153} See XXII/45.
\textsuperscript{154} See chapter VI (Development agreement with St. Modwen).
\textsuperscript{155} See XX/174 to 201 and XX/13 to 27.
\textsuperscript{156} See XX/200.
\textsuperscript{157} See XX/200.
\textsuperscript{158} See XX/197.
\textsuperscript{159} It is to be noted that Mr Stephenson was not himself a director of Powertrain.
\textsuperscript{160} See XXIV/1 to 5.
\textsuperscript{161} See XXIV/37.
\textsuperscript{162} See XXIV/37.
material deleted, but, although Mr Beale insists that he only ever sought to conceal personal documents from us, that material probably included documents relating to the Group\(^{163}\).

**Financial statements and audit**

57. We also consider Deloitte’s role as auditors to the Group\(^{164}\). Our criticisms of Deloitte’s audit work are relatively minor and do not warrant specific mention in this chapter. In general, we consider that the audits were well planned and executed. Likewise, although we agree with a number of matters raised by the FRRP in respect of accounting issues and disclosures included in the Group’s financial statements, we believe that these too are relatively minor\(^{165}\).

58. Fees charged by Deloitte to the Group between 2000 and 2005 totalled £30.65 million\(^{166}\). It might be suggested that the high level of Deloitte’s non-audit fees, which amounted to £28.75 million (some 15 times Deloitte’s total audit fees), might have posed a threat to Deloitte’s independence and objectivity in respect of their audits of the Group. However, we have found no evidence to suggest that Deloitte’s independence and objectivity were compromised by the level of non-audit fees.

59. A question that is often asked when a company fails is whether that failure should have been predicted in some way by the company’s auditors. MGRG went into administration on 8 April 2005, less than six months after Deloitte had signed unqualified audit opinions on the Group’s financial statements for the year ended 31 December 2003\(^{167}\).

60. We are of the view that, at the time the Group’s 2003 financial statements were signed, there was a real chance that the transaction with SAIC would proceed to completion and that, had it completed, the Group would not have been liquidated or ceased trading within the next 12 months. As noted earlier in this report, we consider that it was appropriate for the Group’s 2003 financial statements to have been prepared on a going concern basis\(^{168}\). We are also of the view that the disclosures in the Group’s 2003 financial statements were adequate in terms of the details that needed to be disclosed according to the relevant technical guidance in place at the time\(^{169}\). Thus, Deloitte quite properly discharged their duties in this respect, drawing attention to the uncertainty surrounding the completion of the SAIC transaction and receipt of the anticipated funding by the Group in their unqualified audit reports.

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\(^{163}\) See XXIV/38.

\(^{164}\) See chapter XXIII (Financial statements and audit).

\(^{165}\) See XXII/169 to 294.

\(^{166}\) See XXIII/51. Total audit fees amounted to £1.9 million compared to £28.75 million for non-audit work.

\(^{167}\) The events leading up to the administration of MGRG are set out in chapter XX of this report.

\(^{168}\) See XXIII/161.

\(^{169}\) See XXIII/130.
61. Nevertheless, we believe that improvements could be made to auditing and reporting standards that would increase transparency. We are of the view that the question of going concern is of such importance (an importance highlighted by the current economic climate) that it should be plain to readers of the financial statements what work the auditors have (and have not) undertaken, including the extent to which they have independently verified and relied upon representations from management.\textsuperscript{170}

62. In addition, while the financial statements were prepared in accordance with accounting standards in relation to the transfer of MGRG’s assets at net book value to other companies in the Group and in relation to the transfer of tax losses to other Group companies for no consideration, it seems to us that a reader of MGRG’s financial statements would have been better informed had the true or potential value of these assets been explained\textsuperscript{171}. While accounting standards do not at present require such disclosures to be made, we are of the view that making such disclosures mandatory would improve transparency and help readers of all financial statements to gain a better understanding of a company’s financial performance.

\[\text{Guy Newey QC} \quad \text{Gervase MacGregor FCA}\]

11 June 2009

\textsuperscript{170} See XXIII/167.  
\textsuperscript{171} See XXIII/94.
APPENDIX I
CHRONOLOGY
## Outline chronology

<table>
<thead>
<tr>
<th>Date</th>
<th>Description of event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td></td>
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<tr>
<td>1999</td>
<td>Alchemy approach BMW with the idea of acquiring MGRG.</td>
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<tr>
<td>2000</td>
<td></td>
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<tr>
<td>15-16 March 2000</td>
<td>A memorandum of understanding is negotiated between Alchemy and BMW.</td>
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<tr>
<td>17 March 2000</td>
<td>BMW announces its proposal to sell Land Rover to Ford.</td>
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<tr>
<td>17 March 2000</td>
<td>Mr Byers, Mr Towers, Mr Burden MP and others meet in Birmingham.</td>
</tr>
<tr>
<td>21 March 2000</td>
<td>Mr Towers sends to Mr Burden a paper headed &quot;Project Phoenix&quot;.</td>
</tr>
<tr>
<td>1 April 2000</td>
<td>&quot;March for Rover&quot; in Birmingham.</td>
</tr>
<tr>
<td>14 April 2000</td>
<td>Mr Towers and Mr Edwards write to BMW setting out an offer for Techtronic to acquire MGRG.</td>
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<tr>
<td>28 April 2000</td>
<td>BMW states in a press release that it has terminated its negotiations with Alchemy.</td>
</tr>
<tr>
<td>8 May 2000</td>
<td>The four members of the Phoenix Consortium each contribute £60,000 and receive 60,000 ordinary shares in Techtronic.</td>
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<tr>
<td>9 May 2000</td>
<td>The sale of MGRG from BMW to Techtronic is completed.</td>
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<tr>
<td>9 May 2000</td>
<td>BMW pays the first loan note instalment of £200 million to Techtronic.</td>
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<tr>
<td>15 October 2000</td>
<td>The Sunday Times features an article by Mr Parsley headed, “Towers may be ousted in Rover boardroom revolt”.</td>
</tr>
<tr>
<td>26 October 2000</td>
<td>Mr Parker resigns as a director of Techtronic.</td>
</tr>
<tr>
<td>18 December 2000</td>
<td>The MGRG board agrees to pay interest on loans from Techtronic to MGRG.</td>
</tr>
<tr>
<td>18 December 2000</td>
<td>PVH acquires the Phoenix Consortium's shares in Techtronic. In exchange, the members of the Phoenix Consortium acquire the 'D' shares in PVH and £10 million loan notes. Employees, dealers and executives are granted “A”, “B” and “C” shares.</td>
</tr>
</tbody>
</table>
## Chronology

<table>
<thead>
<tr>
<th>Date</th>
<th>Description of event</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2001</strong></td>
<td></td>
</tr>
<tr>
<td>January 2001</td>
<td>BMW has decided to dispose of the Rover and Land Rover loan books (Project Platinum and Project Gold). Mr Whyte, who is employed by BMW, is charged with finding buyers for them.</td>
</tr>
<tr>
<td>13 March 2001</td>
<td>Mr Whyte attends a meeting with Deloitte and Mr Edwards in which his participation in a management team involved with the &quot;MG Rover bid&quot; is discussed.</td>
</tr>
<tr>
<td>May 2001</td>
<td>The four members of the Phoenix Consortium holiday together during which their intentions regarding financial rewards are discussed.</td>
</tr>
<tr>
<td>9 May 2001</td>
<td>BMW pays the second loan note instalment of £150 million to Techtronic.</td>
</tr>
<tr>
<td>1 June 2001</td>
<td>Techtronic acquires Powertrain from BMW as part settlement of the completion accounts dispute.</td>
</tr>
<tr>
<td>20 July 2001</td>
<td>MGR Capital, jointly owned by HBOS and the Phoenix Partnership, is incorporated.</td>
</tr>
<tr>
<td>21 September 2001</td>
<td>Matters relating to the acquisition of the Rover loan book are considered at a PVH board meeting.</td>
</tr>
<tr>
<td>12 October 2001</td>
<td>Project Platinum is discussed at an MGRG board meeting.</td>
</tr>
<tr>
<td>8 - 9 Nov 2001</td>
<td>Project Platinum is concluded at Herbert Smith’s offices in London.</td>
</tr>
<tr>
<td>4 December 2001</td>
<td>Board minutes for MGRG and Heritage state that the two boards approved the sale of the Heritage Companies to Heritage.</td>
</tr>
<tr>
<td>28 December 2001</td>
<td>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.</td>
</tr>
<tr>
<td>28 December 2001</td>
<td>Board minutes for MGRG and MGRDP state that the two boards approved the sale of the dealer properties to MGRDP.</td>
</tr>
<tr>
<td><strong>2002</strong></td>
<td></td>
</tr>
<tr>
<td>4 February 2002</td>
<td>PVH pays £770,000 to the Guernsey Trust.</td>
</tr>
<tr>
<td>27 February 2002</td>
<td>PVH pays £2,674,910 to the Guernsey Trust.</td>
</tr>
<tr>
<td>March 2002</td>
<td>CAT takes over responsibility for the parts service from Unipart.</td>
</tr>
<tr>
<td>28 March 2002</td>
<td>Completion of the sale and leaseback on leaseplan and OUV vehicles (Project Lisa) is effected.</td>
</tr>
<tr>
<td>Date</td>
<td>Description of event</td>
</tr>
<tr>
<td>------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>9 May 2002</td>
<td>BMW pays the balance of the third loan note instalment of £77,369,500 to Techtronic.</td>
</tr>
<tr>
<td>21 May 2002</td>
<td>PVH pays £600,000 paid to the Guernsey Trust.</td>
</tr>
<tr>
<td>24 May 2002</td>
<td>PVH acquires PVL, being the first of various inter-related transactions comprising Project Aircraft.</td>
</tr>
<tr>
<td>26 June 2002</td>
<td>PVH pays £7,705,125 to the Guernsey Trust.</td>
</tr>
<tr>
<td>June 2002</td>
<td>Deloitte advise in relation to Project Patto.</td>
</tr>
<tr>
<td>31 October 2002</td>
<td>MGRG's 2001 financial statements are filed with Companies House. They report a loss in 2001 of £227.3 million.</td>
</tr>
<tr>
<td>18 December 2002</td>
<td>Project Patto is aborted.</td>
</tr>
<tr>
<td>20 December 2002</td>
<td>The transfer of Xpart to PVH for £2 is approved by the boards of MGRG and PVH.</td>
</tr>
<tr>
<td>30 December 2002</td>
<td>Date on which PVH is treated as acquiring Edwards Cars.</td>
</tr>
<tr>
<td><strong>2003</strong></td>
<td></td>
</tr>
<tr>
<td>12 March 2003</td>
<td>PVH pays £1,400,000 to the Guernsey Trust.</td>
</tr>
<tr>
<td>7 April 2003</td>
<td>Property Holdings completes Phase I of the sale of Longbridge land to AWM (relating to the South Works, North Works and part of the North Car Park).</td>
</tr>
<tr>
<td>13 October 2003</td>
<td>PVH pays £3,632,500 to the Guernsey Trust.</td>
</tr>
<tr>
<td>30 October 2003</td>
<td>MGRG's 2002 financial statements are filed with Companies House. They report a loss in 2002 of £68.4 million.</td>
</tr>
<tr>
<td>12 December 2003</td>
<td>Property Holdings completes Phase II of the sale of Longbridge land to AWM (relating to the Old West Works).</td>
</tr>
<tr>
<td>23 December 2003</td>
<td>Property Holdings completes Phase III of the sale of Longbridge land to Redman Heenan.</td>
</tr>
<tr>
<td><strong>2004</strong></td>
<td></td>
</tr>
<tr>
<td>April 2004</td>
<td>MGRG meets SAIC for the first time.</td>
</tr>
<tr>
<td>16 June 2004</td>
<td>SAIC Group, SAC and PVH enter into a letter of intent.</td>
</tr>
<tr>
<td>8 July 2004</td>
<td>Contracts for the sale of Xpart to CAT (for the net sum of £92,780,812) are exchanged.</td>
</tr>
<tr>
<td>Date</td>
<td>Description of event</td>
</tr>
<tr>
<td>--------------------</td>
<td>------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>27 August 2004</td>
<td>£82.43 million from the proceeds of the sale of Xpart to CAT is paid into a PVH bank account of which £75.8 million is transferred to MGRG.</td>
</tr>
<tr>
<td>13 September 2004</td>
<td>PVH pays £245,000 to the Guernsey Trust.</td>
</tr>
<tr>
<td>15 September 2004</td>
<td>MGRG and Powertrain sell Rover 75 and engine intellectual property rights to SAIC Group for consideration of £37 million.</td>
</tr>
<tr>
<td>29 October 2004</td>
<td>MGRG's 2003 financial statements are filed with Companies House. They report a loss in 2003 of £92.6 million and refer to the importance of the deal with SAIC coming to fruition for the Group to continue as a going concern.</td>
</tr>
<tr>
<td>17 December 2004</td>
<td>SAIC and PVH enter into a new letter of intent.</td>
</tr>
<tr>
<td>17 December 2004</td>
<td>MGRG's board establishes a sub-committee &quot;to review the trading and cash flow of the Company and the status of main projects such as SAIC &quot;.</td>
</tr>
<tr>
<td>20 December 2004</td>
<td>The DTI creates a planning group to undertake contingency planning in relation to MGRG.</td>
</tr>
<tr>
<td><strong>2005</strong></td>
<td></td>
</tr>
<tr>
<td>14 January 2005</td>
<td>DTI representatives attend a meeting at Longbridge with representatives of both MGRG and SAIC.</td>
</tr>
<tr>
<td>17 January 2005</td>
<td>Rothschild, acting for SAIC, meets Mr Norris at Number 10 and officials from HM Treasury and the DTI.</td>
</tr>
<tr>
<td>31 January 2005</td>
<td>Ms Hewitt, the Secretary of State for Trade and Industry, asks officials to examine circumstances in which rescue aid should be considered.</td>
</tr>
<tr>
<td>25 February 2005</td>
<td>Ernst &amp; Young issue their first report, in draft, which reviews the business plan for the PVH residual business and a cash flow forecast for 2005.</td>
</tr>
<tr>
<td>28 February 2005</td>
<td>SAIC and PVH agree a new letter of intent, including the intention by SAIC to arrange prepayments of £56 million in March and £25 million in April for intangible assets.</td>
</tr>
<tr>
<td>28 February 2005</td>
<td>Rothschild is instructed to start thinking about alternative transactions in case the financial due diligence reaches an unfavourable conclusion.</td>
</tr>
<tr>
<td>11 March 2005</td>
<td>Ernst &amp; Young report that the PVH group does not have sufficient cash to enable it to trade beyond 31 March 2005.</td>
</tr>
<tr>
<td>15 March 2005</td>
<td>SAIC discovers that it cannot make the proposed £56 million prepayment without the approval of a Chinese government agency.</td>
</tr>
<tr>
<td>17 March 2005</td>
<td>Mr Stephenson delivers an ultimatum to SAIC and insists that SAIC agree to endeavour to complete by the end of April 2005.</td>
</tr>
<tr>
<td>Date</td>
<td>Description of event</td>
</tr>
<tr>
<td>--------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>17 March 2005</td>
<td>The DTI writes to Mr Towers expressing its willingness, subject to a variety of conditions, to provide a bridging loan.</td>
</tr>
<tr>
<td>18 March 2005</td>
<td>Mr Towers confirms to the DTI that he and his colleagues accept the loan conditions the DTI has set.</td>
</tr>
<tr>
<td>21 March 2005</td>
<td>PVH agrees that MGRG would be the shareholder in the proposed joint venture company.</td>
</tr>
<tr>
<td>22 March 2005</td>
<td>Chairman Hu of SAIC writes to Mr Towers to tell him that at a result of Mr Stephenson's ultimatum review of the feasibility study has paused.</td>
</tr>
<tr>
<td>29 March 2005</td>
<td>Ernst &amp; Young, Deloitte and KPMG attend a lengthy meeting with the DTI to allow the DTI to determine whether the outstanding issues between SAIC and the Group are likely to be resolved.</td>
</tr>
<tr>
<td>1 April 2005</td>
<td>Mr Russell of the DTI arrives in China with Mr Randell of Slaughter and May.</td>
</tr>
<tr>
<td>4 April 2005</td>
<td>President Chen of SAIC informs the DTI that, although PVH has provided supporting documents with regard to the value of residual assets, SAIC is &quot;not confident on value or timings&quot;.</td>
</tr>
<tr>
<td>5 April 2005</td>
<td>Mr Gillingwater is informed that SAIC does not wish to proceed with the transaction.</td>
</tr>
<tr>
<td>7 April 2005</td>
<td>MGRG's board resolves urgently to instruct Mr Powell of PwC to advise on the &quot;probable and imminent administration of MGRG&quot;.</td>
</tr>
<tr>
<td>8 April 2005</td>
<td>MGRG's board formally concludes that an administration appointment should be made.</td>
</tr>
</tbody>
</table>
APPENDIX II

ABBREVIATIONS
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACOP</td>
<td>Associate Car Ownership Plan – a scheme under which employees would be lent money to buy Rover vehicles</td>
</tr>
<tr>
<td>APB</td>
<td>Audit Practice Board – part of the Financial Reporting Council which is responsible for issuing guidance on the application of audit standards</td>
</tr>
<tr>
<td>AS/2</td>
<td>AuditSystem/2 – Deloitte’s auditing software</td>
</tr>
<tr>
<td>Bickenhill</td>
<td>Offices used by MGRG at International House in Bickenhill</td>
</tr>
<tr>
<td>Completion Accounts</td>
<td>Accounts drawn pursuant to the SPA showing MGRG’s net asset position at 9 May 2000</td>
</tr>
<tr>
<td>CRS</td>
<td>Contract related scheme – a pension scheme for certain MGRG employees which guaranteed final salary pensions</td>
</tr>
<tr>
<td>Demonstrators</td>
<td>Demonstration vehicles – used by MGRG for marketing and test drives</td>
</tr>
<tr>
<td>Development Agreement</td>
<td>Agreement dated 9 July 2001 between MGRG and SMD to develop land at Longbridge (see VI/10)</td>
</tr>
<tr>
<td>DRC</td>
<td>Depreciated replacement cost – a method of valuing assets</td>
</tr>
<tr>
<td>EQAR Partner</td>
<td>Engagement quality assurance review partner – a partner involved with Deloitte’s audit process (see XXIII/31.4)</td>
</tr>
<tr>
<td>Evidence Eliminator</td>
<td>Evidence Eliminator v5.058 – a computer software program</td>
</tr>
<tr>
<td>Facility Agreement</td>
<td>Agreement dated 9 May 2000 which provided for BMW AG to lend Techtronic sums totalling £427,369,500 by subscribing for three interest free loan notes</td>
</tr>
<tr>
<td>FRS</td>
<td>Financial Reporting Standard – a standard explaining how to account for certain events and transactions in a company’s financial statements</td>
</tr>
<tr>
<td>GMFV</td>
<td>Guaranteed minimum future value – a guarantee given to customers that their cars would be worth a specified sum at the end of the finance agreement (see VII/3 to 4)</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standard – a standard explaining how to account for certain events and transactions in a company’s financial statements</td>
</tr>
<tr>
<td>IPR</td>
<td>Intellectual property rights</td>
</tr>
<tr>
<td>IRP</td>
<td>Independent review partner – a partner involved with Deloitte’s audit process (see XXIII/31.5)</td>
</tr>
<tr>
<td>LCSP</td>
<td>Lead client service partner – title of a partner at Deloitte responsible for the overall relationship between Deloitte and its client (see XXIII/33)</td>
</tr>
<tr>
<td>Leaseplan vehicles</td>
<td>Vehicles used for self drive hire purposes, generally leased out through daily rental companies such as Europcar (see X)</td>
</tr>
<tr>
<td>LLP</td>
<td>Limited liability partnership</td>
</tr>
<tr>
<td>LOI</td>
<td>Letter of intent – a document outlining a proposed agreement between</td>
</tr>
</tbody>
</table>
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>two or more parties</td>
<td>Management buy-in</td>
</tr>
<tr>
<td>MBI</td>
<td>Management buy-in</td>
</tr>
<tr>
<td>MBO</td>
<td>Management buy-out</td>
</tr>
<tr>
<td>MOU</td>
<td>Memorandum of understanding – a document outlining a proposed agreement between two or more parties</td>
</tr>
<tr>
<td>MTN</td>
<td>Medium term note – a loan note, typically paid back between five and ten years of issue (see V/72)</td>
</tr>
<tr>
<td>MVO</td>
<td>Management Vehicle Ownership – car schemes for MGRG management</td>
</tr>
<tr>
<td>NAA (team)</td>
<td>National accounting and auditing team – team within Deloitte that provides technical advice on auditing and accounting matters (see XXIII/36)</td>
</tr>
<tr>
<td>New Medium Car</td>
<td>The intended replacement for the Rover 45</td>
</tr>
<tr>
<td>New Mini</td>
<td>The redesigned Mini motor vehicle released in 2001 by BMW</td>
</tr>
<tr>
<td>New Small Car</td>
<td>The intended replacement for the Rover 25</td>
</tr>
<tr>
<td>Newco</td>
<td>A term used to refer to any new company</td>
</tr>
<tr>
<td>NRP</td>
<td>National risk partner – title of a partner within Deloitte responsible for risk management (see XXIII/31.5)</td>
</tr>
<tr>
<td>NSCs</td>
<td>National sales companies – subsidiaries of MGRG engaged in sales and distribution in Europe</td>
</tr>
<tr>
<td>Old Mini</td>
<td>The version of the Mini produced until 2000</td>
</tr>
<tr>
<td>OMVEU</td>
<td>Open market value for existing use - a method of valuing assets</td>
</tr>
<tr>
<td>OUV</td>
<td>Own use vehicle – vehicles used by MGRG for promotional purposes, staff cars or demonstrators (see X)</td>
</tr>
<tr>
<td>PCP</td>
<td>Personal contract plan – a finance agreement offered to purchasers of Rover vehicles (see VII/3)</td>
</tr>
<tr>
<td>Phoenix Consortium</td>
<td>Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers</td>
</tr>
<tr>
<td>Phoenix Partnership</td>
<td>Partnership between Mr Beale, Mr Edwards, Mr Stephenson, Mr Towers and Mr Howe</td>
</tr>
<tr>
<td>Powertrain Escrow Account</td>
<td>An escrow account established when Techtronic acquired Powertrain (see XXI/64 to 67)</td>
</tr>
<tr>
<td>Project 528</td>
<td>Negotiations in 2004 to 2005 between the Group and SAIC to establish a joint venture (see XX)</td>
</tr>
<tr>
<td>Project Aircraft</td>
<td>A scheme to generate revenues from Group tax losses (see XI)</td>
</tr>
<tr>
<td>Project Battens</td>
<td>Potential joint venture between PVH and companies associated with Mr Yang (see XIX/91 to 100)</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Description</td>
</tr>
<tr>
<td>--------------</td>
<td>-------------</td>
</tr>
<tr>
<td><strong>Project Fajar</strong></td>
<td>Potential agreement between Powertrain and Petronas to manufacture new engine (see XIX/14)</td>
</tr>
<tr>
<td><strong>Project Feniks</strong></td>
<td>Potential sale of the R45 plant to a Polish company in which PVH would take a circa 25% stake (see XIX/36 to 48)</td>
</tr>
<tr>
<td><strong>Project Fox</strong></td>
<td>The sale of Xpart’s business in 2004 (see XIII)</td>
</tr>
<tr>
<td><strong>Project Globe</strong></td>
<td>The name given to the overall project concerning the sale of the Rover and Land Rover vehicle finance portfolios by BMW (see VII)</td>
</tr>
<tr>
<td><strong>Project Gold</strong></td>
<td>The sale of the Land Rover vehicle finance portfolio (see VII)</td>
</tr>
<tr>
<td><strong>Project Iran</strong></td>
<td>Agreement to appoint an Iranian distributor for MGRG motor vehicles (see XIX/18 to 21)</td>
</tr>
<tr>
<td><strong>Project Jigsaw/ Monkey</strong></td>
<td>Potential collaboration with Proton (see XIX/6 to 13)</td>
</tr>
<tr>
<td><strong>Project Lisa</strong></td>
<td>A scheme to raise money on OUV and leaseplan vehicles (see X)</td>
</tr>
<tr>
<td><strong>Project Oscar</strong></td>
<td>Potential joint venture between PVH and SAIPA and/or Dastaan (see XIX/23 to 32)</td>
</tr>
<tr>
<td><strong>Project Patto</strong></td>
<td>Proposal to change the terms of the BMW loan notes to show the liability on the financial statements at their net present value (see XII)</td>
</tr>
<tr>
<td><strong>Project Platinum</strong></td>
<td>The sale of the Rover vehicle finance portfolio (see VII)</td>
</tr>
<tr>
<td><strong>Project Slag</strong></td>
<td>A scheme to generate revenues from Group tax losses (V/69 to 71)</td>
</tr>
<tr>
<td><strong>Project Sunrise</strong></td>
<td>Potential joint venture between MGRG and China Brilliance (see XIX/67 to 75)</td>
</tr>
<tr>
<td><strong>Project Trinity</strong></td>
<td>A scheme to generate profits from Group tax losses (see XI/53 to 59)</td>
</tr>
<tr>
<td><strong>PSR</strong></td>
<td>Professional Standards Review – part of Deloitte’s audit process (see XXIII/34 to 35)</td>
</tr>
<tr>
<td><strong>PVHR</strong></td>
<td>PVH residual business – the anticipated remaining PVH business following the completion of Project 528</td>
</tr>
<tr>
<td><strong>RCD</strong></td>
<td>Research consultation document – document provided by the NAA team on technical matters (see XXIII/36)</td>
</tr>
<tr>
<td><strong>RV</strong></td>
<td>Residual value – the value given to a motor vehicle that is returned at the end of its finance agreement</td>
</tr>
<tr>
<td><strong>SAS</strong></td>
<td>Statement of Auditing Standards – principles, procedures and guidance for the conduct of audits</td>
</tr>
<tr>
<td><strong>SPA</strong></td>
<td>The sale and purchase agreement dated 9 May 2000 under which Techtronic acquired MGRG from BMW</td>
</tr>
<tr>
<td><strong>The Acquisition Share</strong></td>
<td>Share issued to BMW pursuant to the SPA</td>
</tr>
<tr>
<td><strong>The Group</strong></td>
<td>Collectively PVH and its subsidiaries</td>
</tr>
</tbody>
</table>
### APPENDIX II

#### Abbreviations

<table>
<thead>
<tr>
<th>The Guide</th>
<th>ICAEW Members’ Handbook – guidance issued to members of the Institute of Chartered Accountants of England and Wales</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The IPR agreement</strong></td>
<td>Agreement dated September 2004 between the Group and SAIC in relation to the sale of Rover 75 and engine IPR</td>
</tr>
</tbody>
</table>
APPENDIX III

DRAMATIS PERSONAE
(INDIVIDUALS)
### Dramatis Personae (individuals)

<table>
<thead>
<tr>
<th>Name</th>
<th>Relevance</th>
<th>Chapter(s)</th>
<th>Information provided to the inspectors$^2, 3$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iain Abrahams</td>
<td>Managing director of structured capital markets at Barclays Capital</td>
<td>V, XI, XXIII</td>
<td></td>
</tr>
<tr>
<td>Stuart Adam</td>
<td>Director of Phoenix Distribution</td>
<td>VIII, XIX</td>
<td>Formal interview; represented by Herbert Smith</td>
</tr>
<tr>
<td>Steve Almond</td>
<td>Audit partner at Deloitte</td>
<td>VII</td>
<td>Formal interview; represented by Freshfields</td>
</tr>
<tr>
<td>John Alty</td>
<td>Head of business relations at DTI</td>
<td>XX</td>
<td>Formal interview; represented by the Treasury Solicitor</td>
</tr>
<tr>
<td>Richard Ames</td>
<td>Former chairman of MG Rover Dealer Association and non-executive director of Techtronic</td>
<td>III, V, VII, XI, XV, XVII, XXII, XXV</td>
<td>Formal interview; unrepresented</td>
</tr>
<tr>
<td>Karen Ashton</td>
<td>Associate solicitor at Eversheds</td>
<td>XI, XII</td>
<td></td>
</tr>
<tr>
<td>Iain Ashworth</td>
<td>Assistant director in transaction services at Deloitte</td>
<td></td>
<td>Witness statement</td>
</tr>
<tr>
<td>Lance Ashworth QC</td>
<td>Barrister instructed by SMP in relation to this inquiry</td>
<td>I, VI</td>
<td>Information provided informally</td>
</tr>
<tr>
<td>Enrico Atanasio</td>
<td>President and managing director of MG Rover Italia SpA</td>
<td></td>
<td>Information provided informally</td>
</tr>
<tr>
<td>Natalie Atkins</td>
<td>Senior commercial counsel for PVH/MGRG, also a director of Phoenix Venture Motors and Phoenix Distribution</td>
<td>XI, XV</td>
<td>Formal interview; represented by Herbert Smith</td>
</tr>
<tr>
<td>Peter Bailey</td>
<td>Franchising and distribution strategy manager at MGRG</td>
<td></td>
<td>Information provided informally</td>
</tr>
<tr>
<td>Richard Baker</td>
<td>Property controller at MGRG</td>
<td>IX</td>
<td>Formal interview; unrepresented</td>
</tr>
</tbody>
</table>

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1. Chinese names have been expressed using western presentation and therefore appear as “given” name followed by family name.
2. We have been provided with witness statements from individuals who were also interviewed formally.
3. In respect of some individuals who were interviewed formally we have also received transcripts of interviews conducted by Lance Ashworth QC and John Randall QC.
# APPENDIX III

## Dramatis Personae (individuals)

<table>
<thead>
<tr>
<th>Name</th>
<th>Relevance</th>
<th>Chapter(s)</th>
<th>Information provided to the inspectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jenny Barnes</td>
<td>Senior manager in audit and assurance at Deloitte</td>
<td>III, V</td>
<td>Witness statement</td>
</tr>
<tr>
<td>Jonathan Bartlett</td>
<td>Head of corporate research at Albert E Sharp</td>
<td>III, V</td>
<td>Information provided informally</td>
</tr>
<tr>
<td>Ian Barton</td>
<td>Corporate finance advisor at Deloitte</td>
<td>III, VII, VIII, X, XI, XV, XXV</td>
<td>Formal interview; represented by Freshfields</td>
</tr>
<tr>
<td>Jane Beale</td>
<td>Director of Stratford Auto Body Centre and Advanced Management (2000)</td>
<td>III, IV</td>
<td></td>
</tr>
<tr>
<td>Peter Beale</td>
<td>Member of the Phoenix Consortium and director of PVH and MGRG. For full list of Group company directorships see appendix V</td>
<td>I, III, IV, V, VI, VII, VIII, IX, X, XI, XII, XIII, XIV, XV, XVI, XVII, XVIII, XIX, XX, XXI, XXII, XXIII, XXIV, XXV</td>
<td>Formal interview; represented by Herbert Smith</td>
</tr>
<tr>
<td>Bob Beddow</td>
<td>Human resources director of MGRG and director of PVR</td>
<td>V, VII, IX, XI, XIII, XVI, XVII, XX, XXI, XXII</td>
<td>Formal interview; represented by Herbert Smith</td>
</tr>
<tr>
<td>Catherine Bell CB</td>
<td>Director general of competition and markets group at DTI and acting permanent secretary</td>
<td>XX</td>
<td>Formal interview; represented by the Treasury Solicitor</td>
</tr>
<tr>
<td>Richard Bell</td>
<td>Partner in transaction services at Deloitte</td>
<td>XX</td>
<td>Witness statement</td>
</tr>
<tr>
<td>Professor Lord (Kumar) Bhattacharyya CBE</td>
<td>Head of Warwick Manufacturing Group</td>
<td></td>
<td>Information provided informally</td>
</tr>
<tr>
<td>Charles Binns</td>
<td>Director of Xpart</td>
<td>XIII</td>
<td></td>
</tr>
<tr>
<td>Nigel Birkett</td>
<td>Manager in corporate finance department at Deloitte</td>
<td>VII, X, XII, XXI</td>
<td>Formal interview; represented by Freshfields</td>
</tr>
<tr>
<td>Martin Birrane</td>
<td>Director of Lola</td>
<td>III, IV, V</td>
<td>Formal interview; represented by Bridget Birrane</td>
</tr>
<tr>
<td>Richard Bishop</td>
<td>Worked for RFS before becoming customer service manager for BMW</td>
<td>VII</td>
<td>Formal interview; represented by Norton Rose</td>
</tr>
<tr>
<td>Sue Bishop</td>
<td>British Consul General in Shanghai</td>
<td>XX</td>
<td>Formal interview; represented by the Treasury Solicitor</td>
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</table>
## APPENDIX III

### Dramatis Personae (individuals)

<table>
<thead>
<tr>
<th>Name</th>
<th>Relevance</th>
<th>Chapter (s)</th>
<th>Information provided to the inspectors</th>
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<tbody>
<tr>
<td>Right Honourable Tony Blair</td>
<td>Prime Minister</td>
<td>XX</td>
<td>Formal interview</td>
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<tr>
<td>Anne Bodkin</td>
<td>Eversheds</td>
<td>III, V</td>
<td></td>
</tr>
<tr>
<td>Mike Booth</td>
<td>Head of programmes in product development at MGRG</td>
<td>XIX</td>
<td></td>
</tr>
<tr>
<td>Brian Boothroyd</td>
<td>Director in corporate finance at Deloitte</td>
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<td>Witness statement</td>
</tr>
<tr>
<td>Christopher Bowen</td>
<td>Director of MGRG, Heritage and PVR</td>
<td>III, V, VII, IX, XIII, XVI, XVII, XX, XXI, XXII</td>
<td>Formal interview; represented by Herbert Smith</td>
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<tr>
<td>David Bowes</td>
<td>Director of Lola and Techtronic</td>
<td>III, V, VII, XVII, XXII, XXV</td>
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<tr>
<td>Professor Chris Brady</td>
<td>Author of &quot;End of the Road: BMW and Rover - A Brand Too Far&quot;</td>
<td></td>
<td>Information provided informally</td>
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<tr>
<td>Richard Bramwell QC</td>
<td>Barrister at Temple Tax Chambers</td>
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<td>Information provided informally</td>
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<tr>
<td>Paul Brice</td>
<td>Partner at KPMG</td>
<td>VII</td>
<td>Formal interview</td>
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<tr>
<td>Paul Bridges</td>
<td>Partner at Alchemy</td>
<td>III</td>
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<tr>
<td>Chris Brooks</td>
<td>Non-executive director of Rothschild</td>
<td>XX</td>
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<tr>
<td>Robin Brooks</td>
<td>Corporate finance partner at Norton Rose</td>
<td>III, V, VIII, XII, XV, XX, XXI</td>
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<tr>
<td>Daniel Brown</td>
<td>Employee of MGRG</td>
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<tr>
<td>Right Honourable Gordon Brown</td>
<td>Chancellor of the Exchequer</td>
<td>XX</td>
<td></td>
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<tr>
<td>Andrew Buchanan</td>
<td>National group head of the corporate recovery team at Halliwells</td>
<td>XX</td>
<td>Formal interview; represented by Mark Cawson QC</td>
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<tr>
<td>Richard Burden MP</td>
<td>MP for Birmingham Northfield and member of Trade and Industry Select Committee</td>
<td>III, VII, XXI</td>
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<td>Steve Burke</td>
<td>Construction director of SMP</td>
<td>VI</td>
<td>Transcript provided of interview with Lance Ashworth QC and John Randall QC</td>
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</table>

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### Dramatis Personae (individuals)

<table>
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<th>Relevance</th>
<th>Chapter (s)</th>
<th>Information provided to the inspectors</th>
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<tbody>
<tr>
<td>Simon Burney</td>
<td>Finance manager at BMW FS and subsequently commercial controller for MGRG</td>
<td>VII</td>
<td>Formal interview; represented by SJ Berwin</td>
</tr>
<tr>
<td>Janice Bushell</td>
<td>Purchase ledger senior analyst at MGRG</td>
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<td>Information provided informally</td>
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<td>Toby Bushill</td>
<td>Director in tax department at Deloitte</td>
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<td>Stephen Butcher</td>
<td>Senior manager and head of conflicts at Deloitte</td>
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<td>Witness statement</td>
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<td>Caroline Butterfield</td>
<td>Assistant director in corporate finance department at Deloitte</td>
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<td>Formal interview; represented by Freshfields</td>
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<td>Right Honourable Stephen Byers</td>
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<td>III</td>
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<tr>
<td>Simon Caffyn</td>
<td>Chief executive of Caffyns plc</td>
<td></td>
<td>Information provided informally</td>
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<tr>
<td>Andrew Caldwell</td>
<td>Valuations partner at BDO</td>
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<td>Alex Camron</td>
<td>China Ventures</td>
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<td>Simon Carter</td>
<td>Business relationship manager at the automotive unit within DTI</td>
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<td>IT department at MGRG</td>
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<td>Hong Chen</td>
<td>President of SAIC Group</td>
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<td>Professor Carl Chinn MBE</td>
<td>Historian</td>
<td>III</td>
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<tr>
<td>Alan Christie</td>
<td>Director at BoS</td>
<td>VII</td>
<td></td>
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<tr>
<td>Sir Stanley Clarke</td>
<td>Chairman of SMP</td>
<td>VI</td>
<td></td>
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<tr>
<td>Laura Coates</td>
<td>Buyer at Powertrain</td>
<td>XVI</td>
<td></td>
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<tr>
<td>Vivien Cockerill</td>
<td>Solicitor at Wragge and Co</td>
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<td>Andy Coggins</td>
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<td>XI, XXIII</td>
<td>Formal interview; represented by Herbert Smith</td>
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<tr>
<td>Iain Collett</td>
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<tr>
<td>John Connolly</td>
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<tr>
<td>Gus Corrigan</td>
<td>Managing director of MG Rover Ireland (Holdings) Limited</td>
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<td>Richard Cort</td>
<td>MG Rover Dealers Association and a dealer of MG Rover vehicles</td>
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<tr>
<td>Manuel Costa</td>
<td>Managing director of MG Rover Portugal Ldas</td>
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<td>Information provided informally</td>
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<tr>
<td>Thomas Costello</td>
<td>Director of Capital Bank</td>
<td>VII, XIX</td>
<td></td>
</tr>
<tr>
<td>John Cowburn</td>
<td>Worked in Deloitte corporate finance department, subsequently joined PVH</td>
<td>VII, IX, XI, XIII, XIV, XIX, XX, XXI, XXII, XXIII</td>
<td>Formal interview; represented by Herbert Smith</td>
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<tr>
<td>Meyrick Cox</td>
<td>Partner and head of industrial at Rothschild</td>
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<td>Formal interview; represented by Clifford Chance</td>
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<tr>
<td>Simon Cox</td>
<td>Partner at Norton Rose</td>
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<tr>
<td>Ian Cranshaw</td>
<td>Commercial officer at British Embassy in Beijing</td>
<td>XIX, XX</td>
<td>Formal interview; represented by the Treasury Solicitor</td>
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<td>David Cruickshank</td>
<td>Partner in tax department at Deloitte</td>
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<td>Witness statement</td>
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<td>Celia Dalley</td>
<td>Mr Millet’s secretary</td>
<td>XX</td>
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<tr>
<td>Min Dan</td>
<td>Strategy and development department at HAGC</td>
<td>XIX</td>
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<tr>
<td>Philip Davidson</td>
<td>Managing partner in company restructuring at KPMG</td>
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<tr>
<td>Alan Davies</td>
<td>Treasury manager at MGRG</td>
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<td>Information provided informally</td>
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<tr>
<td>Ann Davies</td>
<td>Employee of KPMG</td>
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<td>Information provided informally</td>
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<tr>
<td>Hugh Davies CMG</td>
<td>Consultant, former diplomat</td>
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<td>Formal interview; unrepresented</td>
</tr>
<tr>
<td>Bill Dawson</td>
<td>Partner in reorganisation services at Deloitte</td>
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<td>Witness statement</td>
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<tr>
<td>Philip De Voil</td>
<td>Senior manager in forensics department at Deloitte</td>
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<td>Information provided informally</td>
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<tr>
<td>Mike Dennett</td>
<td>Group financial accountant for BMW FS</td>
<td>VII</td>
<td>Formal interview; represented by Norton Rose</td>
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<tr>
<td>Thierry Depond</td>
<td>President of MG Rover France SA</td>
<td></td>
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## APPENDIX III  
Dramatis Personae (individuals)

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<th>Name</th>
<th>Relevance</th>
<th>Chapter(s)</th>
<th>Information provided to the inspectors</th>
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<tbody>
<tr>
<td>Peter Dillon</td>
<td>Worked in Deloitte corporate finance department. Subsequently joined PVH as a consultant and became finance director of Xpart</td>
<td>XIII, XXI, XXIII</td>
<td>Formal interview; represented by Herbert Smith</td>
</tr>
<tr>
<td>John Dodds</td>
<td>Regional director of the midlands at SMP</td>
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<td>Transcript provided of interview with Lance Ashworth QC and John Randall QC</td>
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<tr>
<td>David Duggins</td>
<td>Partner at Ernst and Young</td>
<td>XX</td>
<td>Formal interview</td>
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<tr>
<td>Harry Dunlevy</td>
<td>Personnel director of MGRG</td>
<td>V</td>
<td>Information provided informally</td>
</tr>
<tr>
<td>Martin Eadon</td>
<td>Managing partner for clients and industries at Deloitte</td>
<td>XXIII</td>
<td></td>
</tr>
<tr>
<td>John Edwards</td>
<td>Member of the Phoenix Consortium and director of PVH and MGRG. For full list of Group company directorships see appendix V</td>
<td>I, III, IV, V, VI, VII, VIII, IX, X, XI, XII, XIII, XIV, XV, XVI, XVIII, XIX, XX, XXI, XXII, XXIII, XXIV, XXV</td>
<td>Formal interview; represented by Herbert Smith</td>
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<tr>
<td>Marianne Edwards</td>
<td>Director of Stratford Autobody Centre and shareholder in Edwards Cars</td>
<td>III, VIII, XIV, XXI, XXV</td>
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<tr>
<td>Richard Edwards</td>
<td>Partner in transaction services at Deloitte</td>
<td>III, V</td>
<td>Formal interview; represented by Freshfields</td>
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<tr>
<td>Maghsoud Einollahi</td>
<td>Partner in corporate finance department at Deloitte</td>
<td>I, III, V, VII, VIII, IX, X, XI, XII, XIII, XV, XIX, XX, XXI, XXIII, XXV</td>
<td>Formal interview; represented by Freshfields</td>
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<td>Keith Eldridge</td>
<td>Associate director in corporate finance at KPMG</td>
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<td>Formal interview</td>
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<tr>
<td>Francis Evans</td>
<td>Member of automotive unit of DTI</td>
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<tr>
<td>Barry Fisher</td>
<td>Solicitor at Eversheds</td>
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<td>David Fletcher</td>
<td>Audit partner at Deloitte</td>
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<td>Formal interview; represented by Freshfields</td>
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<tr>
<td>Richard Froggatt</td>
<td>Land acquisitions director for SMP</td>
<td>VI</td>
<td>Formal interview; subsequently represented by Addleshaw Goddard</td>
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<tr>
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<td>Chapter (s)</td>
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<td>Mark Frost</td>
<td>Actuary for MGRG pension scheme and employee of Garvins</td>
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<td>Information provided informally</td>
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<tr>
<td>Peter Gallimore</td>
<td>Director in audit and assurance at Deloitte</td>
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<td>Formal interview; represented by Freshfields</td>
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<tr>
<td>Carl Garvie</td>
<td>Commercial litigation partner at Pinsent Masons</td>
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<td>Formal interview</td>
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<td>Philip George</td>
<td>Managing director of First National Bank</td>
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<tr>
<td>Mark Gibson</td>
<td>Senior official at DTI</td>
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<tr>
<td>Richard Gillingwater CBE</td>
<td>Chief executive of Shareholder Executive</td>
<td>XX</td>
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<tr>
<td>Stephen Gilmore</td>
<td>Lead partner at Lee Crowder</td>
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<tr>
<td>Anthony Glossop</td>
<td>Chief executive of SMP and subsequently appointed chairman</td>
<td>VI</td>
<td>Formal interview; subsequently represented by Kingsley Napley</td>
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<tr>
<td>Jim Godfrey</td>
<td>Special advisor to the Secretary of State for Trade and Industry</td>
<td>XX</td>
<td>Formal interview; represented by the Treasury Solicitor and Ashurst</td>
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<tr>
<td>Jeremy Goldring</td>
<td>Partner in business recovery at Baker and McKenzie</td>
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<tr>
<td>Nick Gowlland</td>
<td>Associate director at Rothschild</td>
<td>XX</td>
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<tr>
<td>Dr Herbert Grebenc</td>
<td>Director in charge of mergers and acquisitions at BMW</td>
<td>III, XII</td>
<td>Formal interview; represented by Norton Rose</td>
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<tr>
<td>Bob Griffiths</td>
<td>Chief executive officer at BMW Financial Services group</td>
<td>VII</td>
<td>Formal interview; represented by SJ Berwin</td>
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<tr>
<td>Garry Grove</td>
<td>Purchasing director of MGRG</td>
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<td>Information provided informally</td>
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<td>Wolfgang Guellich</td>
<td>Vice president of BMW</td>
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<tr>
<td>Michael Gurner</td>
<td>Consultant on corporate governance to MGRG</td>
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<td>Information provided informally</td>
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<tr>
<td>Rupert Hague-Holmes</td>
<td>Solicitor at Eversheds</td>
<td>V</td>
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<tr>
<td>Dr Hamzah A Hamid</td>
<td>Planning director of Petronas</td>
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<td></td>
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<tr>
<td>Dave Hartnett CB</td>
<td>Board member at HMRC</td>
<td>V</td>
<td>Information provided informally</td>
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<td>Charles Haswell</td>
<td>Commercial counsellor at the British Embassy in Beijing</td>
<td>XIX</td>
<td>Information provided informally and transcript provided of interview with Lance Ashworth QC and John Randall QC</td>
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<tr>
<td>Tim Haywood</td>
<td>Finance director of SMP</td>
<td>VI</td>
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</tr>
<tr>
<td>Richard Hazzard</td>
<td>Head of combined sureties at St. Paul International Insurance Company Limited</td>
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<tr>
<td>Xiao Qing He</td>
<td>Director in international affairs department within NAC</td>
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<td></td>
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<td>Richard Heis</td>
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<td>John Hemming MP</td>
<td>MP for Birmingham Yardley</td>
<td>III</td>
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<tr>
<td>Ian Henderson</td>
<td>Chief executive of Land Securities</td>
<td>VI</td>
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<td>Right Honourable Patricia Hewitt</td>
<td>Secretary of State for Trade and Industry</td>
<td>XX, XXIII</td>
<td>Formal interview; represented by the Treasury Solicitor and Norton Rose</td>
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<tr>
<td>Rachel Heyhoe-Flint</td>
<td>Shareholder of MG Rover Dealer Trust Company Limited</td>
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<td>Michelle Hide</td>
<td>MGRG</td>
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<td>Marketing manager for RFS</td>
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<td>Director of Xpart</td>
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<td>Director of Burdale</td>
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<td>Tax director of Deloitte</td>
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<td>Nicola Hollyhead</td>
<td>European sales and marketing at MGRG</td>
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<td>Michael Holmes</td>
<td>Compliance manager at Deloitte</td>
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<tr>
<td>T A Homer</td>
<td>Employee at MGRG</td>
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<td>Keith Horlock</td>
<td>Director of First National Motor Finance</td>
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<td>Stephen Horvath</td>
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<td>Paul Howard</td>
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<td>Kevin Howe</td>
<td>Chief executive of MGRG and director of Heritage, MG Sport and Racing, Xpart, Phoenix Distribution, PVH, PVM and Powertrain</td>
<td>V, VI, VII, IX, X, XI, XII, XIII, XIV, XV, XVI, XVII, XVIII, XIX, XX, XXI, XXII, XXIII, XXIV, XXV</td>
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<td>Mao Yuan Hu</td>
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<td>Charles Huang</td>
<td>Finance director of China Brilliance</td>
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<td>Xiaoping Huang</td>
<td>Chairman of NAC</td>
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<tr>
<td>Sir Christopher Hum KCMG</td>
<td>British Ambassador</td>
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<td>David Hume</td>
<td>Tax partner at Deloitte</td>
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<td>Robert Hunt</td>
<td>Insolvency practioner at PwC and joint administrator of MGRG</td>
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<tr>
<td>Tim Hurdiss</td>
<td>Senior development surveyor at SMP</td>
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<tr>
<td>Brad Hurrell</td>
<td>Director of Barclays Capital</td>
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<td>Tim Ingram</td>
<td>Chairman of First National Bank</td>
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<tr>
<td>Hussin Jaafar</td>
<td>Proton employee</td>
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<td>Julie Jackson-Hales</td>
<td>Employee of MGRG</td>
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<tr>
<td>John Jarvie</td>
<td>Head of finance in the sales and marketing division at MGRG</td>
<td>VIII, XIII</td>
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<tr>
<td>Christian John von Freyend</td>
<td>Director of MGRG during BMW ownership</td>
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### APPENDIX III
Dramatis Personae (individuals)

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<td>Susan Johnson-Brett</td>
<td>Assistant company secretary at SMP</td>
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<td>Transcript provided of interview with Lance Ashworth QC and John Randall QC</td>
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<td>David Jones</td>
<td>Principal in corporate finance at Deloitte</td>
<td>XIII</td>
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<tr>
<td>Graham Jones</td>
<td>MGRG general manager for manufacturing engineering</td>
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<td>Formal interview; unrepresented</td>
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<td>Dr Lynne Jones MP</td>
<td>MP for Birmingham Selly Oak</td>
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<td>Martyn Jones</td>
<td>Partner at Deloitte</td>
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<tr>
<td>Darus Kamarulzaman</td>
<td>General manager in research and development at Proton</td>
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<tr>
<td>Zbigniew Kaniewski</td>
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<tr>
<td>David Kearns</td>
<td>Investigator at Expert Investigations</td>
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<td>Information provided informally</td>
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<tr>
<td>Ingrid Kelly</td>
<td>Television producer at ITN</td>
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<td>Susan Kendell</td>
<td>Purchase accounting manager at MGRG</td>
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<tr>
<td>Petra Kerp</td>
<td>Chief executive of BMW FS</td>
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<td>Phil Kerry</td>
<td>Financial controller at BMW Financial Services</td>
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<td>Dominic King</td>
<td>Corporate researcher at Albert E Sharp</td>
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<tr>
<td>John Kingman</td>
<td>Senior Treasury official</td>
<td>XX</td>
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<td>Julie Kirkbride MP</td>
<td>MP for Bromsgrove</td>
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<tr>
<td>Datuk Kisai Bin Rahmat</td>
<td>Director of Proton</td>
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<td>Liz Kitchin</td>
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<td>Bo Jia Lai</td>
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<td>Maciej Leśny</td>
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<td>Dennis Levine</td>
<td>Chief executive of Burdale</td>
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<td>Dan Li</td>
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<tr>
<td>Dr Qu Li</td>
<td>Director of CVL, CVIL, RDS International Projects Limited and RDS Automotive Interior Limited</td>
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<tr>
<td>Peter Lingham</td>
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<td>Tienan Liu</td>
<td>Director General of NDRC in China</td>
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<td>Jane Lodge</td>
<td>Partner at Deloitte</td>
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<td>Anthony Lomas</td>
<td>Insolvency practitioner at PwC and Joint Administrator of MG Rover</td>
<td>XVIII</td>
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<td>Dr Günther Lorenz</td>
<td>Director of BMW FS</td>
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<tr>
<td>Dr Hagen Lüderitz</td>
<td>Director of corporate strategy and coordination for BMW</td>
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<td>Tom Lukic</td>
<td>Director at Ernst &amp; Young</td>
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<td>Kai Ma</td>
<td>Chairman of NDRC in China</td>
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<td>Nigel Macdonald</td>
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<td>Vim Maru</td>
<td>Corporate finance manager at Abbey National</td>
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<tr>
<td>David Mason</td>
<td>Finance and strategy at MGRG</td>
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## APPENDIX III
Dramatis Personae (individuals)

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<td>Chris Maynard</td>
<td>Director for national accounts at First National</td>
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<tr>
<td>David McClusky</td>
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<tr>
<td>Rob Meakin</td>
<td>Personnel director of MGRG</td>
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<td>Information provided informally</td>
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<tr>
<td>Kourosh Mehrabani</td>
<td>Director in corporate finance department at Deloitte</td>
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<tr>
<td>Stuart Middleton</td>
<td>Managing director of strategy and international division at HBOS and director of MGR Capital</td>
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<td>Brian Miles</td>
<td>Director of RDS Automotive Limited</td>
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<tr>
<td>John Miles</td>
<td>Group board director and chairman of the global consulting business at Arup Group Limited</td>
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<td>Formal interview; unrepresented</td>
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<tr>
<td>John Millett</td>
<td>Finance director of MGRG and director of MGR (Leaseplan), MGR (OUV), Property Holdings and Xpart</td>
<td>V, VII, VIII, IX, X, XI, XII, XIII, XV, XVI, XVII, XVIII, XIX, XX, XXI, XXII, XXIII</td>
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<td>Bryn Morris</td>
<td>Manager in IT department at MGRG</td>
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<td>Jon Moulton</td>
<td>Managing partner at Alchemy</td>
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<td>Mark Mullins</td>
<td>Partner in audit and assurance at Deloitte</td>
<td>XI, XXIII</td>
<td>Formal interview; represented by Freshfields</td>
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<td>Frank Munk</td>
<td>Chief financial officer at BMW Financial Services group</td>
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<td>Roland Nevitt</td>
<td>Director of Land Securities</td>
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<td>Barry Nicholson</td>
<td>Commercial officer with the Consulate General in Beijing</td>
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<td>Geoffrey Norris</td>
<td>Senior policy advisor to Prime Minister on business, industry and energy issues</td>
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<tr>
<td>Mike O'Brien QC MP</td>
<td>MP for Warwickshire North and Minister of State for Energy</td>
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<td>Rob Oldaker</td>
<td>Director of product development at MGRG, also a director of Heritage and MG X80</td>
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<td>Bill Oliver</td>
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<td>Lord (Martin) O'Neill</td>
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<td>Gerry Paisley</td>
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<td>Dr Helmut Panke</td>
<td>Finance director of BMW</td>
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<td>Shareholder of Landcrest Developments</td>
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<td>Brian Parker</td>
<td>Director of Techtronic, Landcrest Developments and other companies</td>
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<td>John Parkinson</td>
<td>Managing director of Xpart and director of MGRG, MG Sport and Racing, MG X80, Phoenix Distribution and Property Holdings</td>
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<td>David Parsley</td>
<td>Journalist</td>
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<td>Stephen Pearson</td>
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<td>David Pentreath</td>
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<td>Nigel Petrie</td>
<td>Non-executive director of PVH and MGRG</td>
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<tr>
<td>Louise Pheasant</td>
<td>Partner at Eversheds working in insolvency and corporate recovery</td>
<td>XIII, XX</td>
<td>Formal interview</td>
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### Dramatis Personae (individuals)

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<td>Jacek Piechota</td>
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<td>Guy Pigounakis</td>
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<td>Mike Pink</td>
<td>Director at KPMG</td>
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<td>Formal interview; represented by Freshfields</td>
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<td>Robin Potts QC</td>
<td>Barrister from Erskine Chambers</td>
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<td>Steven Poulter</td>
<td>Manager at Barclays Capital</td>
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<tr>
<td>Ian Powell</td>
<td>Insolvency practitioner at PwC</td>
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<td>Gordon Poynter</td>
<td>Director of Powertrain and head of corporate communications at MGRG</td>
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<td>Richard Price</td>
<td>Head of enterprise and business team and senior economist at the Treasury</td>
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<td>Don Prideaux</td>
<td>UK property management manager at MGRG</td>
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<td>Cheng Qian</td>
<td>Assistant to the president at Torch</td>
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<td>Rod Ramsay</td>
<td>Sales and marketing director of MGRG</td>
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<td>John Randall QC</td>
<td>Barrister instructed by SMP in relation to this inquiry</td>
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<td>Charles Randell</td>
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<td>Mohsin Rashid</td>
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<td>Brian Rawlings</td>
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<td>Dr Jürgen Reul</td>
<td>Head of international legal department at BMW and director of Powertrain</td>
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<td>Professor Garel Rhys</td>
<td>Professor in the Cardiff Business School</td>
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<td>Andrew Rickards</td>
<td>Partner and head of Asia for Rothschild</td>
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## Dramatis Personae (individuals)

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<td>Chris Robertson</td>
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<td>Geoffrey Rolls</td>
<td>Former director and owner of SGL Trading</td>
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<td>Steve Routledge</td>
<td>Partner in transaction services at Ernst &amp; Young</td>
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<td>David Ruffell</td>
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<td>Witness statement</td>
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<td>Mark Russell</td>
<td>Director of the Shareholder Executive</td>
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<td>Formal interview; represented by the Treasury Solicitor</td>
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<tr>
<td>Jane Ruston</td>
<td>Head of legal at PVH and company secretary of MGRG. Also a director of MGR ( Leaseplan), MGR (OUV), MGR Capital, PVL, PVL2, PVM and Phoenix Advanced Technology</td>
<td>V, VI, VII, IX, X, XI, XII, XIII, XIV, XV, XIX, XX, XXI, XXII, XXIII</td>
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<td>Partner at Wragge &amp; Co</td>
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<td>Lord (David) Sainsbury</td>
<td>Minister for science and innovation</td>
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<td>Professor Werner Sämann</td>
<td>Chairman and chief executive officer of MGRG under BMW ownership</td>
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<td>John Sanders</td>
<td>Director of MGRG, Xpart, Property Holdings and PVM</td>
<td>IX, XII, XIII, XVII, XXI</td>
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<td>Member of supervisory board of BMW</td>
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<td>Liz Scott</td>
<td>Senior commercial counsel for MGRG and director of PVL and PVL2</td>
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<tr>
<td>Mike Seabrook</td>
<td>Partner in the corporate team at Eversheds</td>
<td>III, V, VI</td>
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## APPENDIX III
### Dramatis Personae (individuals)

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<tbody>
<tr>
<td>Olivier Sermeus</td>
<td>Managing director of MG Rover Group Benelux SA/NV</td>
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<tr>
<td>David Sharples</td>
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<td>Maryanna Sharrock</td>
<td>Tax director at Deloitte</td>
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<td>Vickie Sheriff</td>
<td>Chief press officer at DTI</td>
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<td>Tony Shine</td>
<td>Global sourcing director for MGRG and director of MG Rover Espana</td>
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<td>John Simpson</td>
<td>Chief executive of Mayflower</td>
<td>V</td>
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<tr>
<td>Right Honourable Jacqui Smith</td>
<td>MP for Redditch and Minister of State at DTI</td>
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<tr>
<td>Simon Smith</td>
<td>Schilling and Lom</td>
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<td>Jacek Socha</td>
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<td>Paul Spiby</td>
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<td>Nick Stephenson</td>
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### APPENDIX III
### Dramatis Personae (individuals)

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<td>Brian Sun</td>
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<tr>
<td>Phil Sutton</td>
<td>Finance controller for MGRG</td>
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<td>Verity Tattum</td>
<td>Sales ledger manager for MGRG</td>
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<td>Russ Thomas</td>
<td>Business development manager at MGRG</td>
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<tr>
<td>Sue Tilstone</td>
<td>Tax director at Deloitte</td>
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<tr>
<td>John Towers</td>
<td>Member of the Phoenix Consortium and director of PVH and MGRG. For full list of Group company directorships see appendix V</td>
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<td>Manager of the MG Rover OUV scheme</td>
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<td>Chris Ward</td>
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<td>Daniel Ward</td>
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<td>Regional financial controller at SMP</td>
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<td>Bert Waterman</td>
<td>Managing director of MG Rover Benelux and MG Rover Nederland BV</td>
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<td>Dean Watson</td>
<td>Director of Wakemans Limited</td>
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<td>Statutory declaration</td>
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## APPENDIX III
### Dramatis Personae (individuals)

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<td>Jonathan Westcott</td>
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<td>Terry Whitmore</td>
<td>Joint managing director of Mayflower</td>
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<tr>
<td>Ian Whyte</td>
<td>Risk controller for BMW FS</td>
<td>VII, XXV</td>
<td>Formal interview; unrepresented</td>
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<td>Matt Widdall</td>
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<td>VII, XI, XX</td>
<td>Witness statement</td>
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<td>Lisa Williams</td>
<td>Solicitor at Halliwells</td>
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<td>Jeremy Wisker</td>
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<td>Formal interview; represented by Freshfields</td>
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<td>Tony Woodley</td>
<td>National secretary and subsequently general secretary of TGWU</td>
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<td>Formal interview; unrepresented</td>
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<td>Mark Worthington</td>
<td>Regional sales manager of RFS Limited before becoming national sales manager for BMW FS</td>
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<td>Formal interview; represented by Norton Rose</td>
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<tr>
<td>Shaoming Wu</td>
<td>Director of planning department at FAW</td>
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<tr>
<td>Xiaoan Wu</td>
<td>Succeeded Yang Rong as chairman of China Brilliance</td>
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<tr>
<td>Nan Yang</td>
<td>Vice president at Geely</td>
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<td>Rong Yang</td>
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<td>Jennifer Yu</td>
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<td>Peter Yu</td>
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<td>General manager of SAIC</td>
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<td>Enrique Zorzano</td>
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APPENDIX IV

DRAMATIS PERSONAE (COMPANIES, FIRMS AND ORGANISATIONS)
## Dramatis Personae (companies, firms and organisations)

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<th>Information provided to the inspectors</th>
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<td>Abbey National plc</td>
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<td>Alchemy Partners LLP</td>
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### APPENDIX IV

#### Dramatis Personae (companies, firms and organisations)

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### APPENDIX IV

**Dramatis Personae (companies, firms and organisations)**

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## APPENDIX IV
*Dramatis Personae (companies, firms and organisations)*

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<td>Redman Heenan Properties Limited</td>
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<td>Renault UK Limited</td>
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<td>Richards Butler (Merged with Reed Smith in 2007 and became Reed Smith LLP)</td>
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<td>Rover Cars</td>
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## APPENDIX IV
### Dramatis Personae (companies, firms and organisations)

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<td>Chinese automotive group which included SAIC Group and SAC</td>
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<td>Société Anonyme Irannienne de Production Automobile</td>
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<td>Schefenacker Vision Systems UK Limited</td>
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<td>Shareholder Executive</td>
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<td>St. Modwen Properties plc and St. Modwen Developments Limited</td>
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<td>Chapter (s)</td>
<td>Information provided to the inspectors</td>
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<td>Sun East LLC</td>
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<td>The Morris Garages Limited</td>
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<td>ThyssenKrupp Automotive Tallent Chassis Limited</td>
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### APPENDIX IV
### Dramatis Personae (companies, firms and organisations)

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<td>TUI Northern Europe Limited</td>
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APPENDIX V

GROUP COMPANY DIRECTORSHIPS HELD BY THE PHOENIX CONSORTIUM
## Group company directorships held by the Phoenix Consortium

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<tr>
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<th>John Edwards</th>
<th>Peter Beale</th>
<th>Nick Stephenson</th>
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<td>Heritage</td>
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<td>13.02.2001 onwards</td>
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<td>21.01.2004 onwards</td>
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¹ Reflecting Companies House records as at 26 May 2009.
² MG Rover Group Contract Trustees was dissolved on 17 October 2006.
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<tr>
<th>Entity name</th>
<th>John Towers</th>
<th>John Edwards</th>
<th>Peter Beale</th>
<th>Nick Stephenson</th>
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<td>PVL2</td>
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APPENDIX VI

THE DIRECTORS OF TECHTRONIC, MGRG AND PVH BETWEEN 2000 AND 2005

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<th>2005</th>
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<tr>
<td>John Edwards</td>
<td>(13 April 2000 onwards)³</td>
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<tr>
<td>Peter Beale</td>
<td>(13 April 2000 onwards)⁴</td>
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<tr>
<td>Nick Stephenson</td>
<td>(8 May 2000 onwards)⁵</td>
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<tr>
<td>Brian Parker</td>
<td>(8 May 2000 to 26 October 2000)⁶</td>
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<tr>
<td>Richard Ames</td>
<td>(26 November 2000 to 16 December 2002)⁷</td>
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<tr>
<td>David Bowes</td>
<td>(23 January 2001 to 20 November 2001)⁸</td>
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¹ Based on Companies House records as at 29 May 2009.
² See appendix V.
³ See appendix V.
⁴ See appendix V.
⁵ See appendix V.
⁶ See III/63 and V/35.
⁷ See V/19 and XI/49.
⁸ See V/18 and XVII/2.3.
The directors of MG Rover Group Limited between 2000 and 2005

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<td>John Edwards</td>
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<tr>
<td>Peter Beale</td>
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<td>Nick Stephenson</td>
<td>14 June 2000 onwards</td>
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</tr>
<tr>
<td>Kevin Howe</td>
<td>20 July 2000 onwards</td>
<td></td>
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<tr>
<td>Rod Ramsay</td>
<td>23 February 2005 onwards</td>
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<tr>
<td>Nigel Petrie</td>
<td>21 July 2004 onwards</td>
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</tr>
<tr>
<td>John Sanders</td>
<td>26 April 2002 to 30 June 2003</td>
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<tr>
<td>John Parkinson</td>
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<td></td>
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<tr>
<td>Rob Oldaker</td>
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The directors of MG Rover Group Limited between 2000 and 2005 (continued)

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</tr>
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</table>

Chris Bowen
(20 July 2000 onwards)12

Anthony Shine
(20 July 2000 onwards)13

John Millett
(20 July 2000 onwards)14

Bob Beddow
(20 July 2000 onwards)15

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1. Based on Companies House records as at 29 May 2009.
2. See appendix V.
3. See appendix V.
4. See appendix V.
5. See appendix V.
7. See XVII/11.
8. See XVII/14.
10. See V/6.6.
11. See V/6.5.
12. See V/6.4 and XVII/3.
13. See V/6.7 and XVII/3.
15. See V/6.3 and XVII/3.
The directors of Phoenix Venture Holdings Limited between 2000 and 2005¹

<table>
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<tr>
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<tr>
<td>John Towers</td>
<td></td>
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<td></td>
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<tr>
<td>(15 December 2000 onwards)²</td>
<td></td>
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</tr>
<tr>
<td>John Edwards</td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>(15 December 2000 to 4 April 2007)³</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Peter Beale</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>(15 December 2000 onwards)⁴</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Nick Stephenson</td>
<td></td>
<td></td>
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<tr>
<td>(15 December 2000 onwards)⁵</td>
<td></td>
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<tr>
<td>Kevin Howe</td>
<td></td>
<td></td>
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<tr>
<td>(18 December 2000 to 18 January 2006)⁶</td>
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<td></td>
</tr>
<tr>
<td>Nigel Petrie</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(21 July 2004 onwards)⁷</td>
<td></td>
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</tr>
</tbody>
</table>

¹ Based on Companies House records as at 29 May 2009.
² See appendix V.
³ See appendix V.
⁴ See appendix V.
⁵ See appendix V.
⁶ See V/25.
⁷ See XVII/14.
EXHIBIT
Financial Reporting Review Panel

Report to the Secretary of State for Trade and Industry of a review of the accounts of MG Rover Group Limited and associated companies

Confidential

26th May 2005
26th May 2005

Rt Hon Alan Johnson MP
Secretary of State for Trade and Industry
1 Victoria Street
London SW1H OET

Dear Secretary of State

On 15th April 2005 your predecessor, Patricia Hewitt, asked the Financial Reporting Council to arrange for a review of the accounts of MG Rover and associated companies. This review has been carried out by case officers and reviewers of the Financial Reporting Review Panel under our direction and we now submit our report.

Yours sincerely

W. J. L. Knight
Chairman

Ian Brindle
Deputy Chairman
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1 Scope of review

1.1 Introduction

The remit of the Financial Reporting Review Panel is to ensure that companies comply with the accounting requirements of the Companies Act 1985 and applicable accounting standards, and this report has been written in that context.

The Panel has reviewed the published accounts of MG Rover Group Limited and its associated companies for the years 2000 to 2003 inclusive. No accounts for any period after 2003 have been published. We have reviewed the accounts of the core companies in the Group, and of other companies where we thought it necessary.

We have received some information from the Department of Trade and Industry, mainly in the form of presentations given to the Department in the period leading up to the collapse of MG Rover earlier this year. Also, we have asked specific questions of the administrators of MG Rover, the answers to which are identified in the report. We have had no access to other information, so with these limited exceptions our review represents no more than any skilled reviewer could derive from published information.

Our review should be thought of as raising questions, rather than providing answers. All the questions we raise must be read subject to the important qualification that the directors and auditors have had no opportunity to state their case. We point this out because it is the Panel’s experience that questions that arise from a review of published accounts can often be answered satisfactorily by those who prepared them.

In this report we have set out matters where there is, or may be, a question whether the accounts comply with the Companies Act 1985. These questions fall into two categories – those where we have identified a prima facie breach
of accounting requirements are in section 2; and those where we would need more information before coming to a view are in section 3.

In the course of this review we have also identified a number of questions which raise the possibility of a failure by directors of MG Rover to comply with their fiduciary duties and the possibility of consequent claims against them by the administrators. We have dealt with these questions in section 4.

The Panel’s remit is limited to issues of accounting compliance and its only substantive power is to apply to court for an order requiring accounts to be revised. Our standard operating procedures involve an initial review of accounts (of the kind which is the subject of this report) followed by a formal enquiry in cases where we intend to seek the revision of accounts. However, we would not normally open an enquiry into the accounts of a company in administration or liquidation, as historical accounts have ceased to be of interest to those dealing with the company and it is not an effective use of the Panel’s resources to seek their revision. Administrators or liquidators have the task of identifying the company’s assets and liabilities and the powers to do so and that task is best left to them.

We are conscious of the high level of public interest in this case, but our analysis of the accounting compliance issues leads us to the conclusion that, because of the age of the accounts and the present financial condition of the group, it would not be an effective act of accounting regulation to seek the revision of accounts. Therefore we do not intend to open a Panel enquiry.

While there is no evidence of a “black hole” in the finances of MG Rover on the scale referred to in the press, our report raises wider issues in section 4 that you will wish to consider. We would be pleased to co-operate with any other authority in any further action which is thought appropriate.
1.2 Group structure

The structure of the Group at 31 December 2002 is set out in Appendix 1. Techtronic (2000) Limited (‘Techtronic’) acquired MG Rover Group Limited (‘MGRG’) in 2000 and Powertrain Limited (‘Powertrain’) in 2001, both from BMW. In 2000 Techtronic was owned by Messrs Towers, Beale, Stephenson and Edwards. In December 2000 Phoenix Venture Holdings Limited (‘PVH’), then called MG Rover Holdings Limited, acquired Techtronic from the four shareholders in exchange for D shares and £10m loan notes. At the same time A, B and C shares in PVH were issued to employees and dealers. These shares carried no votes but were entitled to a share in any dividends of PVH which represented profits of MGRG, its holding companies and its subsidiaries as they were on 18 December 2000, with similar rights to assets in a winding up. PVH has never paid a dividend and was controlled at all relevant times by Messrs Towers, Beale, Stephenson and Edwards.

As a term of the acquisition of MGRG, Techtronic borrowed £427m interest free from BMW – the timing of the drawdown of the loan is shown in section 3.4. This loan was not repayable until 2049 unless MGRG made a profit. Techtronic made substantial loans to MGRG, but charged interest. The loan by Techtronic to MGRG is shown in the MGRG accounts as ‘due after more than one year’. We have seen no evidence that it was subordinated to the other creditors of MGRG. Techtronic paid over £60m dividends to PVH in the periods we have reviewed, and its main source of funds was the interest received from MGRG.

PVH had a positive cash flow because it owned Techtronic, which had the benefit of the income it received from MGRG. Techtronic also owned Powertrain, a profitable company. Other subsidiaries of PVH also had value, but throughout the period of our review MGRG had negligible or no net assets and negative net distributable reserves.
1.3 Structure of report

Sections 2 and 3 of our report deal with possible issues of accounting non-compliance. Section 2 lists issues where we have identified a question whether the accounts comply with specific accounting requirements and section 3 deals with accounting matters in respect of which we require more information in order to draw any conclusions. Appendix 2 is a summary of other accounting issues which were identified by our review. Section 4 of our report raises questions relating to the fiduciary duties of the directors.

1.4 Sources of information

The following company accounts have been reviewed in full:

- Phoenix Venture Holdings Limited for the years ended 31 December 2001, 2002 and 2003
- MGR Capital Limited for the years ended 31 December 2002 and 2003
- RV Capco Limited for the years ended 31 December 2002 and 2003

The accounts of other subsidiaries were reviewed to the extent needed to follow up issues raised from the main company reviews.

Other sources of information were:

- Presentations to DTI dated 7 April 2004 and December 2004
- Select Committee Minutes of 30 March 2004
- The administrators of MGRG (section 3.5 and section 4.4)
2 Possible issues of accounting non-compliance

2.1 Negotiations with SAIC – 2003 disclosures

The 2003 accounts for the PVH Group say that ‘it is anticipated that in the next few months an overall joint venture will be signed [with SAIC] resulting in substantial additional funds being received by the Group’. If the venture had proceeded it seems likely that cash contributed by SAIC would have gone into the joint venture to fund development. Indeed, the accounts say that ‘this cooperation will fund the development of the new model programmes...’ and it seems possible that PVH would have been called upon to provide funding of some kind. Therefore, although the joint venture would have removed development costs from Rover, the positive impact on Group cash flows would have been limited. It is possible that the directors were confident of raising finance on the back of the improved confidence in the Group provided by a joint venture, but this is not made clear in the accounts.

The accounts make it clear that the negotiations were not complete and that final agreements had not been signed but from the passage quoted above it can be seen that the tone is positive and we question whether this accurately reflected the state of affairs at the time.

In September 2004, PVH received £37m from SAIC. The 2003 PVH Group accounts (which were finalised in October 2004) said ‘...since [June 2004] discussions have proceeded at a great pace, leading to the signing of more agreements. This has resulted in an initial tranche of funds being received by MG Rover and Powertrain.’ Subsequent events suggest that this payment did not arise from the joint venture but was a payment for the sale of intellectual property rights.

Unless there is evidence from the negotiations that had taken place to the date of signing the 2003 accounts that funds sufficient to ensure the continuing solvency of the Group would be available on conclusion of the joint venture then we would ask whether the disclosures were misleading.
2.2 Going concern and letters of support

The 2003 accounts of MGRG and all the subsidiaries within the Group which we have reviewed contain the following statement, ‘The directors have received confirmation from PVH, that insofar as it is able to do so, it will provide financial support as is necessary to enable the company to meet its liabilities as they fall due for a period of at least 12 months from 28 October 2004 the date of signing these financial statements.’ This statement, which seeks to provide justification for preparing the accounts on a going concern basis, goes on to refer to the prospect that the joint venture with SAIC would go ahead, resulting in ‘substantial additional funds’ being received by the Group and in the provision of funding for the development of new model programmes. The directors had a ‘very high level of confidence’ that the overall transaction with SAIC would be completed successfully – these issues are discussed above.

The accounts do not say that this confirmation of support from PVH was legally binding, nor do the PVH accounts disclose any contingent liability in respect of the company’s commitments to support its subsidiaries.

The question which arises is whether the directors of MGRG were justified in relying upon the PVH support. Those directors of MGRG who were also directors of PVH must have known the extent of the uncertainties facing the SAIC deal. They also knew the extent of the resources available to PVH to fund its commitments.

A further question is whether PVH should have repaid the PVH directors’ £10m loan notes in 2003 given the other potential calls upon its assets.

The auditors drew attention in their report to the disclosure about going concern in view of the significant uncertainty surrounding it but did not qualify their report. The issues raised in this section and in section 2.1 above call into question the going concern basis on which the 2003 accounts of the PVH Group were prepared.
2.3 Release of provisions

At the date of acquisition of MGRG, Techtronic recorded the fair value of MGRG provisions at £337m, including £150m of ‘other’ provisions for which no further explanation was provided. Between 2001 and 2003 £161m of provisions were released unused to the profit and loss account, so reducing reported losses. Total provisions at 31 December 2003, taking into account additional provisions made and provisions utilised during this period, were only £120m. This raises the question whether provisions may have been overstated on acquisition to allow the management of releases or smoothing of results in subsequent years.

The directors emphasised both in the annual reports and in response to Select Committee questions the speed at which losses were reduced under their management. Mr Towers stated, in reply to a Select Committee question (Q184) on the Group’s results that ‘Our loss position, basically, went from £800 million loss under BMW, and then we halved that – we went to about £378m. We then halved it again in 2002 – and they were our last audited accounts – and we came out of that with £95 million. Last year has not been published yet and I cannot give a figure until it is audited but it will be, again, a significant improvement on the £95 million’. The ability to release provisions may have assisted in painting a favourable picture.

Required accounting disclosures have been omitted. There is a lack of the disclosures required by the Companies Acts (1985 Act Schedule 4 paragraph 46(3)) and accounting standards (FRS 6 paragraph 32) that would have provided information on the provisions set up on acquisition, their use and the extent to which they were released unused. These should have been tracked in the accounts throughout their lives. The narrative explanation of the purpose of the various provisions and their classification in the profit and loss account (as operating rather than exceptional in most cases) is also not in compliance with accounting standards.
2.4 PVH/Techtronic merger

MGRG was acquired by Techtronic on 9 May 2000. At that stage Techtronic was effectively paid £100m (in the form of Powertrain assets) and given a long term interest free loan of £427m to take the Rover Group. Techtronic had no other business. In December of the same year, Techtronic was acquired by a new holding company, PVH. In that transaction, PVH issued 100 D shares and £41.67 of loan notes for each share in Techtronic. This resulted in loan notes of £10m and 24m D shares being issued to the four directors. At the same time, the share capital of PVH was reorganised to create three classes of non-voting share which were entitled to a percentage of Rover profits and which were issued to employees and dealers. In 2003 PVH repaid the loan notes (apparently two years early) and the investment in Techtronic was written down to zero.

As set out above, the transaction included the issue of non-equity consideration (loan notes) in excess of 10% of the nominal value of the consideration so that it did not meet the conditions for merger accounting (set out in Companies Act 1985 Schedule 4A paragraph 10). The directors invoked a true and fair override to use merger accounting because, as stated in PVH’s 2001 accounts ‘in substance the restructuring represented a change in the identity of the holding company rather than the acquisition of a business’ and as a result they did not believe that acquisition accounting would show a true and fair view of the transaction.

FRS 6 allows merger accounting to be used for Group reconstructions (i.e. where there is only a change in the identity of the holding company) provided certain conditions are met. One such condition is that the ultimate shareholders must remain the same and the rights of these shareholders, respective to each other, must remain unchanged. If the share reorganisation that took place on the same day is considered to be part of the same transaction, and otherwise it would be difficult to identify any consideration
for the issue of the A, B and C shares, then new classes of shareholders (A, B and C) were created and the rights of the previous shareholders altered. Where the rights of the shareholders change, the transaction is more in the nature of an acquisition than a merger and the use of merger accounting would not be appropriate.

2.5 Techtronic write down

The PVH accounts for 2003 contain an impairment charge of £10m to write down its investment in Techtronic to nil. Techtronic made a profit before dividends each year and in 2003 had net assets of £85m, although these were non-distributable. We question whether the original valuation of £10m was made to support the issue of £10m of loan notes and whether it was written down when the notes were repaid as it was thought that there was no longer any reason to retain it. There was no obvious reason or accounting justification for writing down the investment by this amount.

2.6 Negative goodwill amortisation

Negative goodwill on the acquisition of MGRG was £434m. The accounting policy stated that it was to be amortised 'over the estimated useful life of the non-monetary assets of the company acquired being a weighted average period of two years'.

The non-monetary assets acquired comprised £60m of fixed assets, mostly land and buildings and £533m of finished car stocks. The amortisation of goodwill was:

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
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<tbody>
<tr>
<td>(8 months)</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
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<td></td>
<td>284.1</td>
<td>82.4</td>
<td>7.3</td>
<td>11.4</td>
</tr>
</tbody>
</table>

The basis of amortisation is not straight line and extended beyond two years. After 2001, the accounts no longer refer to a two-year amortisation period but the company has disclosed the amortisation separately each year and its
narrative commentary reports on the result before goodwill amortisation. Without further information it is not possible to ascertain whether or not the amortisation credits are reasonable.

2.7 RV Capco

There is an accounting issue relating to the application of FRS 5, which is discussed as part of the section on MGR Capital and RV Capco (section 4.5).
3 Accounting matters where further information is needed

3.1 Acquisition of Powertrain

Powertrain was acquired by Techtronic from BMW on 1 May 2001. The acquisition was in part settlement of the acquisition of Rover Group on 9 May 2000. The Techtronic accounts for the year ended 31 December 2000 state that ‘In May [2001] we resolved the outstanding issues with BMW and settled the completion accounts balance sheet. This resulted in MG Rover [MGRG] receiving £65M in cash plus the Longbridge Powertrain business.’

This statement is questionable for a number of reasons. Firstly, it was not MGRG, but Techtronic, that acquired Powertrain. Secondly, there is no indication anywhere else that MGRG actually received £65m. The accounts of MGRG state that ‘A further ordinary share is to be issued to BMW (UK) Holdings Limited for consideration of £65,000,000. This share is to be issued as part of the settlement of a dispute arising out of the sale of the Company by BMW (UK) Holdings Limited to Techtronic (2000) Limited in May 2001.’ In 2001 the ‘share to be issued’ was credited to capital at a value of £65m. The share was still recorded as ‘to be issued’ two years later in the 2003 accounts.

The question remains whether any cash was actually received. There is no obvious item on the MGRG balance sheet that could relate to this and neither does the Group cash flow statement in PVH’s accounts show a £65m receipt from financing activities. The acquisition note in PVH’s accounts shows the receipt of only £23.2m of cash as ‘negative consideration’ together with £7m cash held within Powertrain at acquisition. It is not possible from a review of the published accounts to ascertain whether the £65m purportedly received by MGRG actually was received by the PVH Group and, if so, by which company within the Group.
3.2 Car stockpile received from BMW

The assets of MGRG at the date of purchase from BMW included a stockpile of 65,000 cars. The reduction in these stocks and the impact on results was discussed each year in the chief executive’s statement in the accounts. In 2001 the closing number of cars remaining was reported as 34,000 but in 2002 the opening balance had reduced to 23,000. The descriptions used to describe the stock changed from ‘vehicle pipeline stock (dealer and company stock)’ to ‘finished vehicle inventory’ but the reason for changing the description and the reason for the change to car stocks reported is not clear. Despite the change in the numbers of cars the value of stocks in the accounts remained unchanged.

3.3 Related party transactions

The Group accounts of PVH disclose related party transactions with Edwards of Stratford (‘Edwards Cars’), Lola Cars, Mira Consulting and MGR Capital. The accounts of Lola Cars and Mira Consulting have been reviewed briefly and no questions have arisen on these transactions. There are, however, significant inconsistencies between the amounts of balances and transactions reported by the PVH Group with both Edwards Cars and MGR Capital. The differences are set out below. The differences seem very large, even allowing for differences in cut-off between the companies at reporting dates.

3.3.1 Edwards Cars

Edwards Cars was owned by Mr Edwards until December 2002. Its directors were Mr and Mrs Edwards and Mr Beale. It was then bought by PVH for £1.
The 2001 accounts of PVH Group make some additions to the comparative disclosures for 2000 compared to the figures in the 2000 accounts. The 2001 comparatives have been used where differences exist.

### 3.3.2 MGR Capital

MGR Capital prepared its first accounts for the period from July 2001 to 31 December 2002 so the sales reported in both 2001 and 2002 by PVH Group have been combined to compare to those disclosed by MGR Capital. MGR Capital reported sales to PVH Group £1.8m higher for the period than the corresponding purchases reported by PVH Group (£66.9m compared to £65.1m). The PVH accounts also report year end balances owed to MGR Capital of £5.2m in 2002 and £0.3m in 2003. MGR Capital does not disclose these balances. Further detail on MGR Capital is given in section 4.5.

### 3.4 BMW loan

Not all of the £427m loan, which Techtronic received from BMW, appears to have been lent on to MGRG by 31 December 2003. The loan was received in three tranches.

<table>
<thead>
<tr>
<th></th>
<th>Edwards Cars</th>
<th></th>
<th>PVH Group</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2000</td>
<td>2001</td>
<td>2000</td>
<td>2001</td>
</tr>
<tr>
<td></td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Purchased from PVH Group</td>
<td>7,948,869</td>
<td>5,888,666</td>
<td>Sold to Edwards</td>
<td>1,111,181</td>
</tr>
<tr>
<td>Sales to PVH Group</td>
<td>-</td>
<td>2,355,494</td>
<td>Purchased from Edwards</td>
<td>535,500</td>
</tr>
<tr>
<td>Services charged</td>
<td>1,565,359</td>
<td>-</td>
<td>Services charged</td>
<td>-</td>
</tr>
<tr>
<td>Year end balance to PVH Group</td>
<td>227,711</td>
<td>-</td>
<td>Year end balance from Edwards</td>
<td>712,948</td>
</tr>
<tr>
<td>Year end balance from PVH Group</td>
<td>-</td>
<td>767,207</td>
<td>Year end balance to Edwards</td>
<td>-</td>
</tr>
<tr>
<td>Loan from PVH</td>
<td>625,000</td>
<td>875,000</td>
<td>Loan to Edwards – year end and max. in year</td>
<td>572,000</td>
</tr>
<tr>
<td>Interest due</td>
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<td>49,075</td>
<td>Interest due</td>
<td>1,051</td>
</tr>
<tr>
<td>Rent on leasehold</td>
<td>-</td>
<td>50,938</td>
<td>Rent on leasehold</td>
<td>38,833</td>
</tr>
</tbody>
</table>

The 2001 accounts of PVH Group make some additions to the comparative disclosures for 2000 compared to the figures in the 2000 accounts. The 2001 comparatives have been used where differences exist.
<table>
<thead>
<tr>
<th>31 December</th>
<th>Cumulative loan from BMW</th>
<th>Loan from Techtronic to MGRG</th>
<th>Amount of BMW loan not lent to MGRG</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
</tr>
<tr>
<td>2000</td>
<td>200</td>
<td>192</td>
<td>8</td>
</tr>
<tr>
<td>2001</td>
<td>350</td>
<td>337</td>
<td>13</td>
</tr>
<tr>
<td>2002</td>
<td>427</td>
<td>392(^1)</td>
<td>36</td>
</tr>
<tr>
<td>2003</td>
<td>427</td>
<td>412</td>
<td>16</td>
</tr>
</tbody>
</table>

It is possible that further funds were lent to MGRG after 31 December 2003 but this cannot be ascertained from published information. Techtronic charged MGRG interest on the loan although the loan to Techtronic from BMW was interest free. Between 2001 and 2003 MGRG paid £30m in interest on loans from Group undertakings.

### 3.5 Consideration for XPart

The post balance sheet events note in PVH’s 2003 accounts states that the Group completed the sale of the XPart business to Caterpillar on 27 August 2004 for a consideration in excess of £100m. The accounts of MGRG state that it completed the sale of its parts business to Caterpillar on 27 August 2004 for a consideration in excess of £35m.

XPart took over the trade of parts from MGRG in March 2002. It made a £2m profit in both 2002 and 2003. Its accounts for 2003 also state that it sold its business to Caterpillar for a consideration in excess of £35m.

Questions remain about the amount of the consideration (£100m v £35m) and the company within the PVH Group that received the cash. The accounting issue is the accuracy of the post balance sheet events note. The MGRG Administrators have told us that their discussions with management indicate

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\(^1\) £392m is per MGRG’s accounts. Techtronic’s accounts show loans to Group undertakings of £412m but the £20m difference could have been lent to a Group company other than MGRG.
that the gross consideration was over £100m (approximately £45m for stock and £61.5m for goodwill). Deductions included costs and settling a liability to BMW (approximately £9m). The proceeds were applied to various entities. At the time MGRG’s 2003 accounts were issued, management thought that MGRG owned some of the underlying assets and would therefore be entitled to some of the disposal proceeds, however, it subsequently transpired that PVH owned the assets concerned. Apparently the net proceeds of sale received by XPart were provided to MGRG as an interest free loan for working capital purposes.
4 Questions relating to directors’ fiduciary duties

4.1 Introduction

Directors have a fiduciary duty to act in the best interests of the company and not to misapply company assets. The duty is owed to, and enforceable by, the company. A transfer of an asset at less than market value is not normally in the interests of the company. Where a company is solvent following such a transfer, there will be no actionable breach of fiduciary duty if the transaction is unanimously approved by shareholders and does not involve an unlawful distribution. But where a company is insolvent, in the sense that its liabilities exceed its assets, directors are bound to take the interests of creditors into account, and the consent of shareholders may no longer be a defence to a breach of duty owed to the company.

Disposals at an undervalue can amount to distributions, if they are made by the company for the benefit, direct or indirect, of its shareholders. If the company does not have positive distributable reserves such distributions can offend against the statutory rules and the common law prohibition on returning capital to shareholders. This is not an issue which depends simply on solvency but on the presence of distributable profits. Directors who authorise unlawful distributions are in breach of their fiduciary duty to the company.

Directors who are found to be guilty of a breach of fiduciary duty and cannot show that they acted honestly and reasonably and ought to be excused could be liable to compensate the company by returning it, so far as money can do it, to the position that it would have been in if the transaction had not taken place. Alternatively the directors can be asked to account for any profits they have made. Where a company is in administration or liquidation these claims can be made by the administrator or liquidator.
4.2 Financial position of MGRG

The following table shows the reserves and net assets of MGRG over the period of our review. The net asset position shown includes the loan from Techtronic as a liability as this has not been stated to be subordinated.

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit and loss account reserve</td>
<td>(2,012.8)</td>
<td>(2,237.9)</td>
<td>(2,330.8)</td>
<td>(2,423.4)</td>
</tr>
<tr>
<td>Net assets / liabilities</td>
<td>12</td>
<td>(150.4)</td>
<td>(243.3)</td>
<td>(335.9)</td>
</tr>
</tbody>
</table>

MGRG has been insolvent, in the sense that its liabilities have exceeded its assets, almost throughout the whole period of ownership by PVH and it has had no net distributable reserves at any relevant time.

4.3 Transfer of tax losses at nil value

In 2002 and 2003 tax losses of £36.7m and £11.2m respectively were surrendered by MGRG for nil consideration to Phoenix Venture Leasing Limited (‘PVL’) and Phoenix Venture Leasing 2 Limited (‘PVL2’). The losses were utilised in these companies to generate post tax profits which were then paid up to PVH by way of dividend. The net gains to PVH, after netting off the cost of the investments, were £10.7m in 2002 and £3.3m in 2003. These were transactions designed to utilise the losses - the leasing companies were purchased by PVH in 2002 and 2003 respectively when they became wholly-owned subsidiaries of PVH and fellow subsidiaries of MGRG. No accounts are available for PVL2 after its acquisition by PVH.

The transfers of tax losses to PVL and PVL2 were at nil value. Although the losses could not be used by MGRG we assume they had value in that they had potential to be used by other companies within the Group (including companies within the MGRG Group as well as the larger PVH Group).
As the table in 4.2 shows, MGRG was insolvent by the end of 2001 in the sense that its liabilities exceeded its assets. As noted above, in these circumstances directors are bound to take the interests of creditors into account, and the consent of shareholders may no be longer a defence to an action for breach of duty owed to the company. Also, these transactions could have amounted to distributions.

If the directors of MGRG were found to be guilty of a breach of fiduciary duty and could not show that they acted honestly and reasonably and ought to be excused they could be asked to account for any profits they had made, so that MGRG might require the directors who were shareholders of PVH to account for the benefits received by PVH.

We noted during the course of our review that a number of other companies within the PVH Group also surrendered tax losses to other, profitable, Group companies for nil value whilst insolvent. These include:

<table>
<thead>
<tr>
<th></th>
<th>Group relief surrendered £000</th>
<th>Distributable reserves £000</th>
<th>Net assets / (deficit) £000</th>
</tr>
</thead>
<tbody>
<tr>
<td>MG Property Holdings</td>
<td>7,583</td>
<td>(16,969)</td>
<td>(16,969)</td>
</tr>
<tr>
<td>MG Sport and Racing</td>
<td>4,858</td>
<td>(25,768)</td>
<td>(25,768)</td>
</tr>
<tr>
<td>MX 80</td>
<td>346</td>
<td>(28,613)</td>
<td>(28,613)</td>
</tr>
<tr>
<td>Phoenix Distribution</td>
<td>376</td>
<td>(1,165)</td>
<td>(1,165)</td>
</tr>
</tbody>
</table>

These figures are taken from the 2003 accounts of these companies.

Similar considerations may apply to the surrender of these tax losses but we do not have enough information to comment.
4.4 Sale of Longbridge site

On 31 December 2001 MGRG sold part of the Longbridge site to MG Property Holdings Limited at book value of £37.6m. MG Property Holdings was a direct subsidiary of PVH, established in January 2001.

<table>
<thead>
<tr>
<th>Year</th>
<th>Land sold</th>
<th>Purchasers</th>
<th>Price £m</th>
<th>£000 per acre</th>
<th>Surplus on sale £m</th>
<th>Transaction type</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>288 acres</td>
<td>MG Property Holdings</td>
<td>37.6 (31.5 land)</td>
<td>130</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

The property was sold by MG Property Holdings as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Land sold</th>
<th>Purchasers</th>
<th>Price £m</th>
<th>£000 per acre</th>
<th>Surplus on sale £m</th>
<th>Transaction type</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>42 acres</td>
<td>Advantage West Midland and St Modwen Properties</td>
<td>11.3</td>
<td>269</td>
<td>6.5</td>
<td>Sale</td>
</tr>
<tr>
<td>2003</td>
<td>18 acres</td>
<td>Advantage West Midland and St Modwen Properties</td>
<td>5.6</td>
<td>311</td>
<td>3.5</td>
<td>Sale</td>
</tr>
<tr>
<td>2003</td>
<td>228 acres</td>
<td>St Modwen Properties</td>
<td>42.5 (includes buildings)</td>
<td>186</td>
<td>10</td>
<td>35 year sale and leaseback</td>
</tr>
</tbody>
</table>

187 acres at Longbridge are apparently still owned by PVH Group and are occupied by Powertrain.

The pricing of the sale and leaseback transaction was subject to public criticism at the time, with suggestions that the site could have achieved a higher value. We point out, however, that the sale and leaseback was a financial transaction rather than a sale on the open market.

MG Property Holdings received almost £60m in cash from the various property sales. The amount owed to MGRG (£37.6m) was repaid after the sale and leaseback transaction. According to the accounts the remaining cash was lent by MG Property Holdings to another Group company in 2003. This inter company debt, £24m in total, was then written off in the same year. We could not tell from the published accounts where the cash went or why it was
written off. We asked the MGRG Administrators and, following discussions with management, they have told us that it was an unsecured loan to MGRG which was written off ‘because of MGRG’s financial position’.

The sale from MGRG to MG Property Holdings was at book value. The market value at the time is likely to be the subject of debate but the prices achieved in the subsequent sales were higher.

Because of MGRG’s financial condition, the MGRG directors could have been in breach of their fiduciary duties by transferring the Longbridge property to MG Property Holdings at an undervalue and the transaction may well have amounted to an unlawful distribution, but the practical effect is complicated by the loan back to MGRG of the proceeds in excess of book value and the writing off of the loan and also by the question of whether full market value was achieved when the property was sold outside the Group. If the effect of these transactions was that MGRG received the full benefit of proceeds which represented the open market value of its property it seems to us that there is little realistic possibility of a claim by MGRG against the directors. However, so long as the loan remains outstanding as an obligation, or if the full value of the property was not received by MGRG, its assets will have been reduced by the transaction.

If the directors of MGRG were found to be guilty of a breach of fiduciary duty and could not show that they acted honestly and reasonably and ought to be excused they could be liable to compensate the company by returning it, so far as money can do it, to the position that it would have been in if the transactions had not taken place. The claim could be formulated by assessing the present value of the site, adding any rent paid by MGRG after the sale and leaseback, and deducting sale proceeds actually received and an allowance for their use.
4.5 MGR Capital and RV Capco

Despite its name, MGR Capital does not belong to the Rover Group, but is jointly owned by HBOS (50.1%) and Messrs Beale and Edwards (49.9%). The ordinary share capital issued is £1,000 in nominal value. Messrs Towers, Beale, Stephenson and Edwards also own 500,000 £1 preference shares each which pay a dividend of 20% of nominal value each year. The company was used to purchase a £312m book of finance leases from BMW in November 2001. The loan book purchase was largely funded by a £300m loan from HBOS which has now been repaid. It is not clear from the accounts where the additional £10m required to purchase the loan book came from but it would appear most likely, from the cash flow statement, to have been from further bank debt or overdraft. It is not, however, possible to confirm this from the published accounts. MGR Capital sold cars returned to it at the end of the lease period to RV Capco, a PVH subsidiary, at an agreed price. RV Capco was effectively indemnified by MGRG.

The result of these transactions is that MGRG suffered losses of approximately £30m on the resale of cars returned at the end of lease periods but the profit from the lease agreements went to MGR Capital and its owners. The directors have said that this structure enabled them to control the resale prices for the cars returned at the end of the lease period and so to influence the prices at which cars were ultimately sold, to the benefit of the Rover Group. The purchase of the lease book also enabled them to gain access to a valuable customer database for marketing purposes.

Mr Beale stated in a reply to a Select Committee question (Q239) that MGRG did not have capability to take such a large liability on to its balance sheet. ‘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’.
This argument does not seem to take account of the fact that the financing liability, a loan of £300m from HBOS, was matched by the lease book receivables (assets) of £312m. Only £2m of capital was injected into MGR Capital, and we would ask why this could not have been made available within the PVH Group, especially as the leasing business was of assured profitability. The preference share dividend of 20% does not seem compatible with the limited risks involved and the question arises whether such a high dividend would have been appropriate if MGR Capital had been capitalised by the PVH Group rather than by the directors personally.

We would also ask why it would not have been possible to establish a subsidiary of MGRG to purchase the finance leases, managed in such a way as to ring-fence profits and cash flows sufficiently to provide HBOS with such security as it required. We cannot understand the argument that the addition of matching assets and liabilities of approximately £300m, reducing to almost nothing within two years, could have damaged the PVH Group balance sheet.

Repurchase of cars on lease had previously been carried out by MGRG itself and when RV Capco was established the provisions and funds needed were transferred over from MGRG. Cars were purchased and resold, with the provisions that had been transferred used to cover deficits so that RV Capco made neither profit nor loss in the period. At the end of 2003, it transferred the balance of the provision back to MGRG as surplus to requirements. By this time, the lease book had largely been run down. The returned surplus provisions were immediately released to profit in MGRG.

There is also an accounting issue in that RV Capco does not appear to have taken on any of the risks or rewards of the transactions. The original provisions transferred into the company appear to have been conservative and excess provisions were transferred back to MGRG when the lease book was unwound. There is a strong accounting argument (FRS 5) for considering that MGRG did not transfer any of the risks or rewards of ownership of the
provisions and cash transferred to RV Capco and that these should instead have continued to be recognised as part of MGRG.

Overall, the question arises whether those directors of MGRG who were owners of MGR Capital could be asked to account for the profits they made through MGR Capital as a result of the opportunities available to them as directors of MGRG.
Appendix 1 - Group structure chart at 31.12.02 – principal companies

2 Source: DTI report
# Appendix 2 – Summary of other accounting issues

<table>
<thead>
<tr>
<th>Company/Year end</th>
<th>Issue of accounting treatment</th>
<th>Disclosure issue</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Techtronic</strong> 2000</td>
<td>1. Accounting for repurchase commitments</td>
<td>1. Disclosure of cash received by MGR 2. Acquisition of MGR - disclosure of fair value adjustments 3. Directors’ emoluments – smaller amount than reported in PVH accounts</td>
</tr>
<tr>
<td><strong>Techtronic</strong> 2001</td>
<td>1. £85m receipt of Powertrain assets wrongly credited to P&amp;L (corrected in 2002)</td>
<td></td>
</tr>
<tr>
<td><strong>PVH 2003</strong></td>
<td>1. Impairment review methodology and assumptions 2. Sales accounting in view of contingency disclosures 3. Recoverability of Edwards’ loan of £1.1m in entity accounts</td>
<td>1. Implications of guarantee given to MG Property re sale and leaseback</td>
</tr>
<tr>
<td><strong>MG Rover 2000</strong></td>
<td>1. Accounting for sales with repurchase commitments</td>
<td></td>
</tr>
<tr>
<td><strong>MG Rover 2001</strong></td>
<td>1. Accounting for write down of subsidiaries (changed in 2002)</td>
<td>1. Non-disclosure of contingency of £24.9m</td>
</tr>
<tr>
<td><strong>MG Rover 2002</strong></td>
<td>1. Accounting for write down of subsidiaries 2. Accounting for sales where guarantees given to finance company of dealers’ obligations</td>
<td></td>
</tr>
<tr>
<td><strong>MG Rover 2003</strong></td>
<td>1. Sales accounting where guarantees given to banks of dealers’ obligations</td>
<td></td>
</tr>
<tr>
<td>Company/Year end</td>
<td>Issue of accounting treatment</td>
<td>Disclosure issue</td>
</tr>
<tr>
<td>------------------</td>
<td>------------------------------</td>
<td>-----------------</td>
</tr>
<tr>
<td>RV Capco 2002/2003</td>
<td>1. Accounting for sales made with repurchase commitments under FRS 5</td>
<td></td>
</tr>
<tr>
<td>Edwards Cars</td>
<td>1. Various errors</td>
<td>1. Various other disclosures such as loan of £50,000 to undisclosed third party</td>
</tr>
</tbody>
</table>