# 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.

## 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 it[1].

10. MGRG was subsequently, on 9 May 2000, sold to Techtronic, a company owned by the four members of the Phoenix Consortium[2]. In summary[3]:

    10.1. the members of the Phoenix Consortium acquired MGRG (including the Rover parts business) for a nominal sum[4]; 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 years[6]. 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 MGRG[7].

11. The members of the Phoenix Consortium each invested £60,000 in Techtronic shortly before its acquisition of MGRG was completed[8]. Members of the Phoenix Consortium also incurred some costs and losses in connection with the acquisition, but the sums involved were relatively small[9]. 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 fruition[10].

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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[11] and sell Powertrain to Techtronic for a nominal amount[12].

**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*".[13]

**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[14], that was because the hive-out of Land Rover had created exceptional profits of £1,154.8 million[15]; the company sustained an operating loss from continuing activities of £503 million[16]. 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[17]. Draft figures for 2004 show an operating loss for the year of £118 million[18], producing total operating losses[19] of £962 million in the five years ended 31 December 2004[20]. By March 2005 it had been calculated that the company was losing money at the rate of about £250 million a year[21].

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[22]. However, during the eight months to 31 December 2000, MGRG attained 111,800 retail sales (equivalent to about 168,000 in a full year)[23]. In 2001 there

[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[24], in 2002 148,500 such sales[25], and in 2003 144,900 such sales[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[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[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)[29], but MGRG would almost certainly have escaped administration and liquidation[30]. The negotiations did not in the end come to fruition, but SAIC was genuinely interested in entering into joint venture arrangements[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[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[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[34].

19. The British Government was considering seriously the provision of bridging finance[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[36]. From that stage, if not before, the

[24] See XVI/18.
[25] See XVI/26.
[26] See XVI/36.
[27] See chapter XIX (Joint ventures).
[28] See XIX/67 to 89.
[29] See XX/6, 7, 49 to 51 and 99.
[30] See XX/117.
[31] See XX/8 and 102.
[32] See XX/167.
[33] See XX/167; see also XX/127 to 140, 146 to 148 and 153 to 155.
[34] See XX/168.
[35] See e.g. XX/171.
[36] See XX/160.19.

DTI could not properly have made a loan[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*"[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[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[40]. A note which Mr Norris, another special advisor, had drafted for the previous Saturday's newspapers[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[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.[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[44]. However, the idea of the members of the Phoenix Consortium being given loan notes was revived after the acquisition had been concluded[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[46].

[37] See XX/170.
[38] See XX/216.
[39] See XX/ 206 and 217 to 221.
[40] See XX/222.
[41] See XX/207 to 212.
[42] See XX/223.
[43] See III/62.
[44] See III/62.
[45] See V/43 to 51.
[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/96.
[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[63] 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:

| **Tax year** | **Mr Beale** | **Mr Edwards** | **Mr Stephenson** | **Mr Towers** | **Mr Howe** |
|---|---|---|---|---|---|
| | **£** | **£** | **£** | **£** | **£** |
| 2000-2001 | 783,410 | 783,038 | 775,978 | 756,035 | 592,296 |
| 2001-2002 | 1,763,715 | 1,763,443 | 1,763,536 | 1,766,141 | 1,133,431 |
| 2002-2003 | 2,544,783 | 2,555,389 | 2,548,696 | 2,548,306 | 2,025,613 |
| 2003-2004 | 3,594,683 | 3,627,369 | 3,592,678 | 3,592,329 | 1,452,127 |
| 2004-2005 | 294,764 | 294,764 | 294,764 | 294,764 | 504,925 |
| **Total** | **8,981,355** | **9,024,003** | **8,975,652** | **8,957,575** | **5,708,392** |

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

[59] See V/99, VII/103 and XXI/81.
[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[67]. 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[68]; 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[69]. 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)[70].

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[71], (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[72] and (c) whether PVH's affairs were conducted in a manner that was "*unfairly prejudicial*" to PVH's other shareholders[73].

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[74]. 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"[75]. Further, the expenditure and risks that the members of the Phoenix Consortium had to bear in connection with MGRG's acquisition were relatively insubstantial[76], 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[77], 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[78], which were also large when compared with remuneration paid in

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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[79] and which were not obviously demanded by their qualifications and experience[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[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*"[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[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*"[84]. At the beginning of June 2001 a confidentiality agreement was concluded with MGRG[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)[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.[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[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

[79] See XXI/99 to 105.
[80] See XXI/111 to 114.
[81] See chapter VII (Project Platinum).
[82] See VII/9.
[83] See VII/65.
[84] See VII/65 and 66.
[85] See VII/67.
[86] See VII/68.
[87] See VII/15, 16, 24.6, 108, 114 and 216.
[88] See VII/70 to 72.

but the Phoenix Partnership[89]. The principal reason was that they wanted to secure the anticipated profits for the Phoenix Partnership (comprising themselves and Mr Howe)[90].

38. The members of the Phoenix Partnership now[91] stand to obtain the following returns from MGR Capital[92]:

| | **Each of Mr Beale, Mr Edwards, Mr Stephenson and Mr Towers** | **Mr Howe** | **Total to Phoenix Partnership** |
|---|---|---|---|
| | **£million** | **£million** | **£million** |
| Preference dividends from incorporation to 2008 | 0.689 | - | 2.756 |
| 50% profit share from "B" shares | 2.550 | 1.400 | 11.600 |
| **Total** | **3.239** | **1.400** | **14.356** |

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[93]. Various board and shareholder resolutions were, on the face of it, passed to this end[94], but there are grounds for questioning the validity of some of the resolutions, and also their sufficiency[95]. 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[96].

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[97]. 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

89 See VII/73 and 74.
90 See VII/73 and 83.
91 Based on the latest financial information available to us.
92 See VII/221.
93 "*Whitewashing*" was needed because the Phoenix Partnership's involvement in the acquisition of the Rover loan book arguably engaged both the "*no conflict*" and "*no profit*" rules. These rules can mean that a fiduciary (such as a company director) "*must account to the person to whom the* [fiduciary] *obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain or (ii) which was obtained or received by use or by reason of his fiduciary position or of opportunity or knowledge resulting from it*" (see *Chan v Zacharia* (1984) 154 CLR 178, quoted in *Don King Productions Inc v Warren* [2000] 1 BCLC 607).
94 See VII/185 to 189.
95 See VII/190 to 199.
96 See VII/200.
97 See VII/201 to 207.

points should rather, it seems to us, be aired, if and so far as necessary, in Court proceedings with full legal argument[98]. 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[99], 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[100]. 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[101]. 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[102].

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[103] 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[104]. 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[105]. 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[106].

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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:

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[113], dealer properties were transferred from MGRG to MGRDP[114], and the Heritage Companies were transferred from MGRG to Heritage[115]. A year later, Xpart was transferred from MGRG to PVH[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[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[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[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[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[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[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[123]. For the same purpose, MGRG also entered into sale and leaseback arrangements with PVL in relation to the MGTF tooling[124]. Nonetheless, there was no provision for MGRG to receive any benefit from the schemes, and it did not do so[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)[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 XIII/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)[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[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[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[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[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[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[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[134]) regardless of what became of MGRG[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[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 pay[137].

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 million[138]. 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 loan[139].

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' duties[140]. 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 sum[141]. 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 Cars[142]. In addition, Techtronic paid £308,000 (excluding VAT) to Edwards Cars during 2000[143]. Without the financial support it received, Edwards Cars would have incurred very large losses and been most unlikely to be able to continue trading[144].

[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

[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[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[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[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[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[157]. We also consider that the manner in which the agreement and payment of CVIL's fees were authorised was thoroughly unsatisfactory[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[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[160]. Mr Beale subsequently ran Evidence Eliminator with a view to deleting material from his computer before it was accessed by us[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[162]. Mr Beale's use of Evidence Eliminator makes it impossible for us to assess the importance (if any) of the

153 See XXII/45.
154 See chapter VI (Development agreement with St. Modwen).
155 See XX/174 to 201 and XX/13 to 27.
156 See XX/200.
157 See XX/200.
158 See XX/197.
159 It is to be noted that Mr Stephenson was not himself a director of Powertrain.
160 See XXIV/1 to 5.
161 See XXIV/37.
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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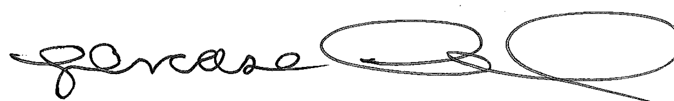
[163] See XXIV/38.
[164] See chapter XXIII (Financial statements and audit).
[165] See XXIII/169 to 294.
[166] See XXIII/51. Total audit fees amounted to £1.9 million compared to £28.75 million for non-audit work.
[167] The events leading up to the administration of MGRG are set out in chapter XX of 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[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[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.



**Guy Newey QC** **Gervase MacGregor FCA**

11 June 2009

[170] See XXIII/167.
[171] See XXIII/94.