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Miss Davies 7/247.

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SECRETARY OF STATE
FOR
NORTHERN IRELAND

cc: PS/SoS (B)
PS/Mr Rossi (I&B)
PS/Mr Shaw (I&B)
PS/PUS (I&B)
PS/Mr Bell
Dr Quigley
Mr Mais
Mr Cowan

Rt Hon Sir Keith Joseph Bt MP
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
London SW1

25 July 1980

Dear Keith.

DE LOREAN SPORTS CAR PROJECT

I am writing to consult you and the other members of E(EA) about the policy decisions which I face on extra funding for the De Lorean project. Ideally, I should like to have waited, before writing in this way, until I know whether I shall have resources available for this purpose: this depends on the outcome of separate discussions which I am having with John Biffen on my resource problems in 1980/81 and the possibility of aid from the Contingency Reserve. I am, however, under great pressure from the De Lorean Company to reach an early decision, not least because the Company would actually collapse by about the end of August unless extra funds are forthcoming, and I am anxious to put the policy issues to colleagues before the summer recess, so that a decision can be taken in principle subject to the availability of resources.

You will be aware of the background to the project which is located in West Belfast, an area of exceptionally high unemployment and social deprivation and a continuing threat to security. The previous Administration decided two years ago to support it with very substantial aid from public funds. The project was to manufacture a new high performance sports car (the DMC-12) - then at only an embryonic design stage - mainly for sale in the United States. It was forecast to employ up to 2,000 workers with annual sales of up to 30,000 cars pa; and the total funding from public sources was to amount to £53m, comprising £17.76m subscribed by the NI Development Agency in the form of redeemable preference shares; grants totalling £18.7m towards capital expenditure; a loan towards the balance of the estimated building costs of £6.7m; and employment grants of £9.7m. An additional feature in the offer of assistance (which has also been in other offers made by the Department in recent years) was an undertaking by the Northern Ireland Department of Commerce to consider an application by the Company for further assistance if the expenditure projected for the establishment of the undertaking proved insufficient because of

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factors beyond the Company's control, including inflation and adverse changes in the sterling/dollar exchange rate affecting the cost of plant, machinery or tooling. I have made it publicly clear that, whatever reservations one might have about the decisions taken by the previous Government, we shall honour the commitments made by that Administration. It is also public knowledge that the Company is seeking substantial additional funding.

It is now clear that the figures on which our predecessors agreed were based on an optimistic assessment of the likely duration and cost of the development programme for the DMC-12. Frankly, it comes as no surprise that the target of bringing a brand new car from greenfield site to mass production in two years proved unattainable. For example, the entirely new moulding technique envisaged for the plastic used in the car's bodywork ran into problems and had to be replaced by an alternative; the production of detailed drawings by the development engineers has taken longer than scheduled; the car's engine will after all need to undergo no less than 13 weeks of testing to meet the requirements of the United States Environment Protection Agency which the Company had been led to believe in previous discussions with the Agency would not be necessary. What is impressive is that even on the most pessimistic revised schedules, De Lorean would still have managed to bring the DMC-12 into production in well under 3 years.

The Company's own latest estimate is that it will need about £14m more - all of it this year - to get the car into the market next January. Of this, around £8m is attributable to the impact of inflation, £2½m to a major change in building design to meet the requirements of local fire and planning regulations, and £3½m to programme slippage. McKinsey, who are monitoring the project for the Development Agency, suggest in their latest report that further delays are likely which could bring the figure nearer to £22m, of which up to £19m would be needed this year. The McKinsey figure reflects the belief that the Company will not receive cash from sales until April 1981, partly through a further delay in commencing production but also because of a need to keep early production in "quarantine" to ensure the quality of the initial shipment. A significant part of the £8m difference between the Company's figure and McKinsey's - and prudence dictates that we should assume the latter may turn out to be right - is therefore a short-term requirement for working capital.

The following factors seem to me the most important in considering our response:-

(a) The legal advice is not clear cut, but we must assume that De Lorean would take action against the Government and there is a chance that we could be held to have breached the agreement (cf para 2 above) if we refused any further funds despite inflation and other factors outside the Company's control. Whilst it is possible that we could successfully defend such an action, our defence would be costly; and if we lost, payments in damages would obviously have been better applied to keeping the project going.

(b) Whether or not a formal claim for damages against the Government succeeded, we could expect damaging and widespread publicity, particularly in the United States (John de Lorean would see to that), which would cast doubt on the certainty of agreements entered into with the NI authorities and greatly reduce our prospects of securing additional investment. The Company could argue with some force that the spirit, if not the letter, of their understanding with the Government in 1978 had been breached.

(c) To expect the Company to get further private backing at this stage would be quite unrealistic, well before the product has even been launched. Soundings taken with the European Investment Bank confirm that they too would not be attracted at this stage. Thus, if the Government does not provide the extra funds, the project will immediately collapse. Our credibility with the minority population would be severely undermined: unemployment in Northern Ireland at 14.7% is double the rate in Great Britain and is even higher in depressed Catholic areas like West Belfast. The decision would be contrasted with our treatment of Harland and Wolff; we would be accused of ignoring the worsening unemployment situation which will become even more difficult in this part of West Belfast when the Grundig factory (immediately next door to the De Lorean plant) closes in the Autumn (with the loss of 1,000 jobs); a 'spin-off' development in West Belfast to employ 400 people on the manufacture of car trim would also collapse.

(d) McKinsey's are reassuring that physical progress with the project has been and remains impressive. There is no doubt about the professionalism, experience and determination of the management team. There is still a reasonable chance that the DMC-12 project will be sufficiently successful and achieve a level of sales to pave the way for private funding of a second model which is vital if the Company is to remain in business in the long term. Despite the problems of the US car industry I am told that generally the sports car segment is holding up relatively well and that the recession in the USA is not biting as deeply on the West Coast - De Lorean's main target area for sales - as elsewhere. The 350 dealers in the USA who handle the car, all of whom have equity investments in the Company of 25,000 dollars each, have undertaken to sell in excess of 30,000 cars over the two years 1981 to 1982, which is equivalent to the McKinsey assessment that 15,000 sales pa may be attainable. In addition, a Canadian distributor has already been signed up and De Lorean also has plans for sales to Europe and the Middle East. The expected retail price of the DMC-12 is 24,000 dollars - about £10,000.

Putting these points together, I am clear that I have no realistic alternative but to make extra funds available, up to £22m if necessary, not all of which should be required in 1980/81, to enable the DMC-12 to reach the market place. I shall make it clear that the Company must from then on stand on its own feet, and that there is no question of Government funding towards a second model. Moreover, for the DMC-12 project I propose to negotiate the minimum possible amount of non-repayable assistance. If the McKinsey estimate of £22m turns out to be right, it should be possible to secure a substantial part of this by means of a short-term loan or Guarantee (cf para 4 above), and as much of the balance as the project can reasonably stand should be a repayable loan rather than grants.

I hope that you and the other members of E(EA) will feel able to endorse my proposed action, subject to the availability of the necessary resources, without a meeting of the Sub-Committee. If, however, it is felt necessary to discuss the matter I should be grateful if it could be included on the agenda at a very early date.

I am sending copies of this letter to the members of E(EA) and to Sir Robert Armstrong.

Yours ever

Humphrey

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