D

Mr.
cc Ingram
Mr. Walters

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

16 July 1981

The Rt. Hon. Sir Keith Joseph, MP.,
Secretary of State for Industry

P..

Dear Keith

ICL: PREFERENCE SHARES

Thank you for your letter of 10 July and for the detailed way you have dealt with our doubts about the proposal to issue £50m preference shares under the £200m loan guarantee.

I have discussed this matter further with the Chief Secretary and other Ministerial colleagues in the Treasury, and I find their arguments against issuing these shares highly persuasive. There is little point in me going over the ground yet again, but it may be worth noting two relatively minor objections which nevertheless are not without their importance. I have, too, a major concern which I imagine you will share with me to some extent. The two points are:

(i) There is no obligation on the Government to support the issue of preference shares. The provision in the Loan Guarantee agreement was permissive. To this extent, therefore, it is misguided for Mr. Laidlaw to argue that he is being treated more badly than the previous management. He can be assured that we would have been just as reluctant to agree to this procedure if the previous management had stayed in office.

(ii) I do not think that the increase in tax payers' exposure in the event of receivership or liquidation, which would be implied by the conversion of £50m of the guarantee into preference shares, can be dismissed quite as easily as your letter suggests. It is not a situation which we can accept lightly. I understand that your officials were questioned by the Chairman of the PAC when they appeared before the Committee on 8 July on whether the Government had any security in respect of the Guarantee; it was implicit in this line of questioning that the Government's acceptance of the position of an unsecured creditor needed some defending. In the case of the preference shares there would, of course, be no possibility of receiving anything back in the event of a liquidation.

/But

But my major objection is more fundamental. The figures emerging from the monitoring meetings seem to me to throw considerable doubt on whether the guarantee and the appointment of new management will be sufficient to pull the company through. I suspect that the company may be too weak now for this combination to succeed. I note for example that on present forecasts the company's net worth is likely to fall as low as £20m. But this is based on what appear to be some optimistic forecasts on orders over the remainder of the company's financial year, and it is quite possible that net worth by September could be down to zero or even negative. On this very tight base it is planned to build borrowing of up to £400m. Even if the £50m preference shares is added to the equity (and whether the market will regard it as real equity is open to question), the debt/equity ratio could be so large as to strain credibility.

Yet a computer company needs to maintain the confidence of its creditors and its customers in order to carry on trading. I cannot really believe that the issue of the preference shares will help to establish this necessary confidence. I am aware that Mr. Laidlaw's judgement is otherwise, but I continue to think that the device is so transparent in its purpose that it will achieve very little other than to highlight how close the company is to financial collapse. I am sure you will agree with me that a major objective for the Government is to avoid becoming too closely tied to the fortunes of this company; but as I see it the preference share issue would have just this kind of impact on the public mind.

You will see from the foregoing that I share fully in Leon Brittan's objections. On the other hand I take the point made in your letter, and in Jim Prior's letter of 14 July and Robin Ibbs' letter of 13 July that the provision to make a preference issue was included in the guarantee agreement, and that to rest on the permissive character of the provision might precipitate a crisis of confidence in the company. With considerable reluctance therefore, and I may say with some misgivings, I am prepared to go along with the proposal; but subject to the following conditions on which I place considerable importance.

First, the form of the preference shares must be acceptable to us. I understand that the details are being discussed between our officials and I will not burden this letter, therefore, with details. But it is important to bear in mind that a preference share carrying a Government Guarantee takes on much of the character of a gilt edged security. This needs to be borne in mind in devising the details of the share. Similarly the Government commitment must not be extended in any way. The guarantee covers principal as well as accrued interest; it lapses two years from the date of the original agreement; and we would not envisage having to meet the guarantee, other than in conditions of receivership or liquidation.

/The second

The second point to some extent follows from the first. Since the share would be a form of gilt edges it is important that it should be firmly held in a few banks over the period of its life. It is essential, therefore, to secure that the agreement of the participating banks to take up the issue between them. The banks may be reluctant to do so, and if they cannot be persuaded I fear the proposal will need to lapse. The negotiation is a matter for ICL and the banks, but no doubt your Department will be expected to help. It would not be appropriate, I think for Treasury or the Bank of England to intervene in a matter of this kind.

I am prepared to leave the question of the future rights issue to your judgement and that of ICL's and their merchant bank advisers. But I do share Robin Ibbs' doubts as to the value of incorporating a reference of this kind into the statement. It would have been a different matter if a rights issue could have been announced simultaneously with thepreference share issue, but that clearly is not on. In the circumstances I for my part would not wish to press for such a reference.

I am copying this to the Prime Minister, Peter Carrington, Christopher Soames, Jim Prior, John Biffen and Robin Ibbs.

GEOFFREY HOWE

16 JUL 1981

VS.

Econ

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CONFIDENTIAL bc Mr Hoskyns

10 DOWNING STREET

From the Private Secretary

17 July 1981

ICL Preference Shares

I have shown the Prime Minister the recent correspondence on the proposal that ICL should convert £50 million of the Government's £200 million loan guarantee into redeemable preference shares. She reluctantly accepts that approval should be given.

I am sending copies of this letter to Brian Fall (FCO), Jim Buckley (Lord President's Office), Richard Dykes (Department of Employment), John Rhodes (Department of Trade), Gerry Spence (CPRS) and David Wright (Cabinet Office).

M.P. LANKESTER

Ian Ellison, Esq.,
Department of Industry.

CONFIDENTIAL

JU CONFIDENTIAL

cc Duguid
Walters
ECW
PJL

DEPARTMENT OF INDUSTRY
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SWITCHBOARD 01-212 7676

Secretary of State for Industry

24 July 1981

Richard Tolkien Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street SW1

R.
27/7

Dear Richard

ICL: PREFERENCE SHARES

My Secretary of State has asked me to pass on his thanks to the Chancellor for his letter of 16 July.

2 I understand that officials are dealing with a number of outstanding issues and that progress is being made. You may wish to know that my Secretary of State has agreed that ICL should not be committed to a rights issue in early 1982.

3 I am copying this letter to Tim Lankester (No 10), Roderick Lyne (FCO), Jim Buckley (Lord President's Office), Richard Dykes (Employment), John Rhodes (Trade) and to Mr Ibbs.

Yours ever
Richard Riley

RICHARD RILEY
Private Secretary

CONFIDENTIAL

Prime Minister

See below

1

15 July 1981
Policy Unit

MR LANKESTER

ICL PREFERENCE SHARES

1. ICL's balance sheet badly needs strengthening. The new management and their merchant bankers want to convert £50m of the present loan guarantee into guaranteed preference shares. Without this, ICL's very high prospective gearing ratio will cause serious concern to customers and creditors. This would be a gift to ICL's competitors to exploit.

Flag A
Flag B
Flag C

2. DoI's merchant bankers, Keith and Kenneth Baker, accept these arguments. They are supported by Jim Prior and also by Robin Ibbs, who anticipated this need for preference shares when the agreement was drawn up.

3. Some Treasury Ministers are reluctant to approve this change. In theory, there is some reduction in Government's security. But in practice, the assets offer very little security if the company collapsed.

4. We think that Keith and Jim Prior are right in saying that the key decision was whether to provide the guarantee or not. Now we've crossed that bridge, it is necessary to follow it through by meeting the new management's first request. Denying it - especially when it was anticipated in the agreement - would really make no sense at all at this stage. It would make the already difficult job of trying to rebuild confidence in ICL just about impossible. It would be very hard to explain.

5. Robin Ibbs has queried the wisdom of requiring the company to make a commitment to a rights issue in "early 1982". We understand this was Kenneth Baker's idea in order to placate the Treasury. We think Ibbs is right. It would be better for management simply to indicate their broad intentions, without being tied down to a deadline that may be impossible to fulfil.

6. Unless the Prime Minister wants to reconsider the Government's support for ICL, I suggest that she should make it clear that she would like Keith to proceed with his proposal to guarantee £50m of preference shares.

Flag D/ The Chancellor has now conceded. Are you content to go along with Sir Keith's proposal?

Reluctantly yes

JOHN HOSKYNS

T. 17/7

10 DOWNING STREET

Andrew Duguid

Could we have a word pls. I think we need a summary note of the issues, ~~the status~~ and a recommendation.

It seems to me that Jim Prior makes the crucial point, in the light of which (Arnold Lovell has told me) Treasury

Ministers are likely to

concede.

It will be all

but impossible to arrange

a PM chaired mtg

before the end of July.

A decision is needed

before then.

R.

14/7

CONFIDENTIAL

B

Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400 GTN 213

Switchboard 01-213 3000

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury
Great George Street
LONDON SW1

14 July 1981

Dear Geoffrey,

ICL

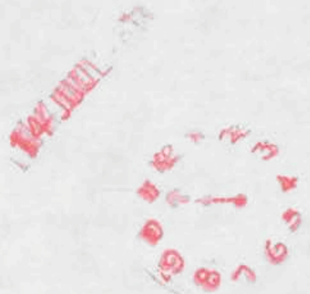
I have seen a copy of Keith Joseph's letter to you of 10 July about the proposal that £50 million out of the £200 million guaranteed by the Government should be converted into redeemable preference shares. I note that this proposal is supported by ICL's Chairman and Finance Director, their financial advisers (Warburgs) and by Lazards who are advising the Department of Industry, and that the grave consequences of ICL's over-gearing, if the proposal is not accepted, may mean the resignation of the Chairman whom we installed less than two months ago.

I take the Treasury's point that this conversion would reduce the degree of security attaching to that portion of our guarantee. But as Keith points out this is in all the circumstances more a theoretical than a practical consideration. What I think is the nub of the matter is that rejection of the proposal might well have the effect of subverting the decision we took two months ago to support ICL, for all the reasons that were then fully deployed. Given that the guarantee agreement expressly provides for the sort of conversion now proposed, it would in my view be difficult, if not impossible, for us to explain to our supporters why we had decided to bring the company down on such an issue just when the new Chairman and his team are taking vigorous action to pull it round. I very much hope that on reflection you can agree to what Keith is proposing.

I am copying this to the Prime Minister, Peter Carrington, Christopher Soames, John Biffen, Keith Joseph and Robin Ibbs.

Yours ever

Jim



cc Mr Duguid
Mr Walters

C

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CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: J. R. Ibbs

CONFIDENTIAL

Qa 05623 13 July 1981

Dear Secretary of State,

ICL Preference Shares

Thank you for sending me a copy of your letter to the the Chancellor dated 10 July.

Since the Government guarantee for ICL was first proposed my concerns have been:

i. A belief (to which you refer in your paragraph 3) that additional shareholders funds would be needed because further loans on their own would result in a totally unacceptable capital gearing ratio;

ii. A fear that confidence, profit improvement and cash flow would prove worse than was assumed in the figures provided when the guarantee was being discussed;

iii. A belief that the new management were being over optimistic in the plan they put forward before they took over, in which they hoped to reduce the immediate impact of redundancies on cash flow by resorting to extensive short time working.

All these concerns have proved well founded.

The guarantee was agreed to by Ministers because the alternative of receivership/liquidation looked so unattractive and expensive in view of the need to keep the Government's extensive range of ICL equipment

The Rt Hon Sir Keith Joseph Bt MP
Secretary of State for Industry
Ashdown House
S W 1

running. Receivership/liquidation remains just as unattractive now as it was a few months ago. Because the Government decided to offer a guarantee which included a provision to convert part of it to cover redeemable preference shares, I do not think it would be sensible for them to back away now from the issue of preference shares. To do so would further damage confidence and put the new management in an invidious position. I therefore support your proposal on the issue of redeemable preference shares.

There is, however, one further point I should like to raise. I continue to have doubts about the rate at which confidence, orders and financial results can reasonably be expected to improve. I find it hard to imagine that by early next year performance will be such that an investor would voluntarily participate in a rights issue. In view of this I doubt the wisdom of including any reference to early 1982 in the draft statement to shareholders attached to your letter. The danger is that this will give rise to expectations that cannot be fulfilled. The chances of being able to come forward with a credible capital reconstruction early in 1982 seem to me small; failure to do so will further damage confidence if such a move is half promised now. If it is essential to mention future capital reconstruction, I think all reference to such an early date should be avoided.

I am sending a copy of this letter to the recipients of yours.

yours sincerely,

J R Ibbs

14 JUL 1981

~~BF~~ 14/7 JR

A

cc Mr Hoskyns
Mr Wolfson
Mr Duguid

Mr return to
me as soon
as you
Laura

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
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Secretary of State for Industry

10 July 1981

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Whitehall SW1

Dear Geoffrey,

JR

below

ICL: PREFERENCE SHARES

1 When I wrote to you on 11 June I recommended that the Government should agree to ICL's proposal that the provision in the loan guarantee agreement should be activated to permit £50 million of the £200 million loan guarantee to be converted into redeemable preference shares. Leon Brittan replied on 15 June saying that you and your colleagues were still not convinced of the case for doing this. There have now been further discussions involving ICL, its financial advisers, the Treasury and the Department of Industry in which Kenneth Baker and Sir Peter Carey have participated. The Department has sought views from Lazards, who are now advising on the affairs of ICL.

2 These investigations have confirmed my view that the company's proposal is well founded and that to accede to it would be consistent with our original objectives when agreeing the loan guarantee. I understand, however, that you still consider that we should refuse ICL's request. I am concerned that we seem far apart on an issue which the new Chairman of ICL considers so serious that he has said that he will reconsider his personal position if his recommendation is rejected. I should like to spell out once more, therefore, my view of the main issues, partly to reply to Leon Brittan's comments and partly to bring up to date our other colleagues with an interest in ICL.

3 In the past few months we have decided collectively: first, to save ICL, because we are so dependent on them as suppliers, from financial collapse by providing a loan guarantee; secondly, to appoint a new Chairman and Managing Director to guide the company back to financial health within the period of the guarantee; and thirdly, to endorse the new management's plans for substantial redundancies. We should continue to act according to the spirit of these earlier decisions bearing in mind that it is less than two months since we asked the new management to take over and that, at the time, they made it clear that ICL's position would worsen before it could improve. The present problem is essentially a practical one and raises no new issue of principle. We knew when we offered the guarantee that ICL's forecast losses would damage its balance sheet by

reducing shareholders' funds. I understand that Robin Ibbs, in particular, drew attention to the need to make some provision to avoid both the Directors' borrowing powers being exceeded and too exposed a gearing ratio. The loan guarantee agreement itself includes an express provision for converting £50 million of the guarantee into guaranteed preference shares.

4 In practice, however, the scale of the problem is greater than anticipated; shareholders' funds are likely to be even more seriously reduced through a combination of greater trading losses and provision for major redundancies. As a Government, we have accepted, indeed encouraged, the redundancies and these have been accelerated so that as much of the cost as possible can be carried on this year's balance sheet. The greater trading losses now foreseen reflect reductions in the forecast level of revenue-earning deliveries, in turn an indication that the market remains sluggish and that customer confidence is slow in returning. ICL forecast that, when the new balance sheet is struck on 30 September, shareholders' funds may have sunk to as low as £20 to £25 million from £142 million. Given that ICL need to establish a borrowing limit of £400 million, including ECGD cover, the ICL Chairman and Finance Director, the company's financial advisers and the Department's merchant bank advisers, all consider that the company would face a gearing ratio which would cause serious concern to customers and creditors, especially overseas, and which might be used against ICL by their competitors. Hence the request to us to guarantee £50 million of preference shares, which would increase shareholders' funds and allow the borrowing limit to be held at £350 million.

5 Leon Brittan has suggested that the issue of preference shares would be essentially cosmetic and that its effect might even be to reduce confidence. I do not agree. The recent round of discussions has shown that ICL is concerned about the attitude of the leasing companies and about the willingness of those banks not covered by the Government guarantee to continue their facilities. ICL and Warburgs consider that a balance sheet showing such a low level of shareholders' funds might well precipitate a crisis on these fronts, with serious implications for the general structure of financial support for ICL. I believe it would be wrong for the Government to force the company to take such a risk and that the proposed issue of preference shares would avoid it.

6 There are two other aspects to confidence. First, both Laidlaw and Wilmot believe that a number of factors have to come together to turn round the market view of ICL. They see my agreement to the preference shares proposal as an essential part of rebuilding confidence. Secondly, there is the confidence which we as a Government show in the new management and the confidence that this can engender in its turn.

7 The company have asked me to agree to their announcing the issue of preference shares at an EGM to be held during August. They must hold the EGM then, in any case, in order to agree new borrowing limits before the start of the new company year. They believe that, if they are to avoid damaging speculation, they must say something about capital restructuring at the same time. In the circumstances I think we must consent to the preference share proposal as soon as possible.

8 I recognise Leon's concern that in doing so we shall be increasing the taxpayers' exposure beyond the strict limits of the loan guarantee, but in practice I do not think that this is a point of substance. Leon believes there would be a reduction in security on that portion of the loan guarantee which is converted into preference shares. This would be important if there were any real difference in the amount the taxpayer would be likely to recover if the company collapsed, but there is little real security in terms of assets for the whole of the £200 million. We have always accepted this and the conversion of £50 million of the guarantee into preference would not change the position.

9 Leon is also concerned about the possibility that, at the end of the guarantee period, the company might find it hard to redeem the preference shares and that we might need either to take up the shares or to extend the guarantee. There is no denying that this could happen. But it is also possible that the guarantee for £200 million may be called; that is the risk we have taken. If, despite all Laidlaw and Wilmot's efforts, ICL could not redeem the preference shares at the end of the guarantee period, it would mean that all their plans for attracting new capital would have been abortive, that confidence would still be lacking and that the balance of the loan guarantee would be similarly at risk. In such a situation the fact that we had agreed to convert part of our guarantee to preference shares would make very little difference. In any case, I think we must accept that any risks which would arise if we agree to the preference shares proposal stem from the inclusion of the provision for such a conversion in the guarantee agreement.

10 As you know, the company are also willing to issue a statement at the EGM which would link the issue of preference shares with an intention to raise new capital by way of a rights issue at the earliest opportunity next year. I attach a copy of the latest draft of the circular to shareholders. I believe it would be most helpful to have the conversion to preference shares presented in this positive context.

11 Behind all this, the key issue seems to me to be whether or not we back the judgement of the men we appointed less than two months ago to run the company and fulfil the undertaking which in their view we have already given. We should surely give weight to their judgement of what will best contribute to ICL's recovery. In our own self interest as guarantor we should be chary of denying them the measures they believe necessary. They already appear to be taking a grip on ICL's affairs and the Department has been given an impressive preliminary outline of their thinking on the major issues of product policy, collaborative ventures and senior management changes. We could not realistically expect them to have restored confidence in the short time since they have been appointed. We have asked Laidlaw and Wilmot to undertake a difficult task. If they fail, the taxpayer will have to meet not only the full cost of the guarantee but also the immense cost of adapting the Government's computers. Confidence is the key issue; they need to rebuild consumer confidence and confidence among the financial institutions. To do so they need to be sure that we have confidence in them, which in turn requires us to back their judgement and to implement the provision about preference shares to which we agreed in principle when issuing the loan guarantee.

12 I hope you will therefore agree that I should tell ICL that I approve their proposal to convert £50 million of the £200 million loan guarantee into redeemable preference shares, subject to -

a confirmation by the banks that they will take up the shares;

b confirmation by ICL that the announcement at the EGM will also mention a future rights issue, in terms we approve; and

c completion of detailed discussions between officials and the company's advisers on the terms of the preference share issue.

13 In view of their interest in ICL, I am sending copies of this letter to the Prime Minister, Peter Carrington, Christopher Soames, Jim Prior, John Biffen and Robin Ibbs.

Yours ever, Keith

DRAFT: 1.7.81

DRAFT CIRCULAR TO ICL SHAREHOLDERS

CHANGE IN BORROWING POWERS

I wrote to you on 8th June giving you details of the unaudited results of the ICL Group for the first half of the current financial year which ended on 31st March, 1981. Against the background of the results of the first half of the year and the continuing difficult trading, it is likely that a substantial trading loss will be recorded for the year as a whole. Significant exceptional losses are also likely, in particular redundancy costs, as sales have not expanded as originally expected and technological changes are significantly reducing the number of people needed in manufacturing. This will result in a substantial reduction in reserves by 30th September, 1981. Borrowings have already risen significantly since the last balance sheet date, namely 30th September, 1980, and are expected to rise further before the corner is turned.

Whilst your Board are confident that, with the £200 million Government guarantee, adequate bank facilities are available for current trading, it is likely that the present borrowing powers under your Company's Articles of Association will not be sufficient. These powers are presently limited to three times capital and reserves, and are likely to be exceeded because of the anticipated erosion of capital and reserves. In these circumstances, particularly because of current uncertainty as to the exceptional costs and provisions that may be necessary, your Board believe that it would be more appropriate to express the limit on borrowings which may be incurred without the sanction of shareholders as a fixed sum.

A resolution will therefore be proposed at the Extraordinary General Meeting to be held on o August, 1981 to change such limit to the sum of £350 million. (This may be compared with the present limit of £424 million, which is three times capital and reserves as at 30th September, 1980.) This resolution is set out as resolution number 1 in the Notice convening the

Extraordinary General Meeting on page o of this document.

ISSUE OF REDEEMABLE PREFERENCE SHARES

You will find in the Notice convening the Extraordinary General Meeting a resolution (number o) to create a new class of redeemable guaranteed preference shares which it is proposed should be issued to the principal bankers to your company to raise £50 million. The detailed terms of these preference shares which are guaranteed by HMG are set out in Appendix o to this circular. In the light of the substantial reduction in ICL's share capital and reserves, due to current trading losses and the costs of the proposed manpower reductions, your Board has decided that at the same time as obtaining shareholder approval for changed borrowing powers their approval should be sought for the issue of preference shares which would subsequently take place as soon as possible. The facility of £270 million will upon the issue of the preference shares be reduced to £220 million and HMG's guarantee of the facility to £150 million. Provision for part substitution of preference shares for bank lending in such circumstances was included in the agreements supporting the facility.

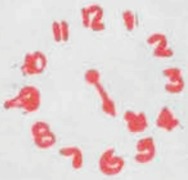
Your Board recognises that this can only go part of the way to restoring a proper relationship between borrowings and share capital and reserves. As soon as practicable there will need to be a major restructuring of the capital of ICL and your Board intends that this should include an invitation to shareholders to participate in a rights issue. It will only be appropriate to propose this, however, when detailed industrial and commercial plans have been completed for the future of the company, including the full implementation of our manpower reductions and relocation arrangements, full assessment of the opportunities for collaboration with other companies and a clear picture of our order prospects for the future. Your Board do not expect to have reached this point before early 1982.

RECOMMENDATION

Your Board, which has been advised by S.G. Warburg & Co. Ltd. in these matters, strongly recommends you to vote in favour of both the resolutions, namely to change the borrowing powers and to create the preference shares. You should do so by completing the enclosed form of proxy and returning it to o not less than 48 hours before the time appointed for the meeting. Completion of the form will not preclude your attendance at the meeting if you so wish.

JRSB/WJH/ngm

10 JUL 1981



DEPARTMENT OF INDUSTRY
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Secretary of State for Industry

cc Mr Duguid

11 June 1981

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliamentary Street
SW1

PS/Sec
Mr Croft
Mr Lingard (on file)

Dear Geoffrey.

R 17/7

ICL: PREFERENCE SHARES

Kenneth Baker and Leon Brittan have already been in correspondence about ICL's suggestion that we should activate the provision in the loan guarantee agreement relating to redeemable preference shares. As a result, ICL were told that they should explore alternative solutions to their problem.

2 However, at a meeting which Sir Peter Carey held on 9 June (at which Treasury officials were present) the new Chairman of ICL made clear that he sees an urgent need to rectify the severe imbalance in gearing which will result from meeting the costs of the major redundancy programme just announced. The redundancy costs together with the trading loss, will reduce the shareholders' funds for the next company year to the point where, if no correction is made to the level of net worth, a multiple of 10-12 times net worth will have to be sought when the shareholders are asked to amend the reference to borrowing powers in the Articles of Association. Mr Laidlaw accepted that in practice the shareholders would have no alternative but to agree. He emphasised, however, that in his view this course of action with the acceptance of an artificially high level of gearing, would be damaging to the company's prospects of recovery and he has now requested formally that I should agree to activate the alternative course of converting £50 million of the Government's loan guarantee into a guarantee of preference shares.

3 Sir Peter Carey put it to Mr Laidlaw that the difference between adjusting the net worth and going for a very high borrowing multiple was purely cosmetic, a point which I know has concerned you and your colleagues. Mr Laidlaw argued, however, that ICL's main problem remains the restoration of confidence, in the first instance among customers and financial institutions,

but subsequently among the wider range of information technology companies with whom partnership talks are to be held. He considered that a balance sheet with a 10 or 12 to one relationship between borrowing and shareholders' funds would be both an obstacle to the creation of confidence in ICL's viability and a gift to ICL's competitors in their dealings with prospective customers. On the other hand he made it clear that he believes the Government's conversion of part of its loan guarantee into preference shares will not only improve the face of the figures but will also help to create the right atmosphere to secure a more positive attitude from such key people as the providers of leasing finance and, when the time is ripe, from the shareholders in a rights issue.

4 I believe we must give great weight to Mr Laidlaw's considered opinion. He is not making this request lightly and he is certainly not underestimating the difficulties the company faces in turning the tide of opinion about its products and its future in the present economic climate. He has concluded that we can begin to turn that tide by converting part of our loan guarantee to a guarantee of preference shares. The Department's merchant bank advisers (Lazards) agree that a good case can be advanced for that view. We have also to consider the terms of our agreement with ICL. The relevant clause certainly makes it clear that I have to agree that the company needs to increase its shareholders' funds in this way and that I am not bound to activate the provision at the company's behest. But I would be wrong to withhold consent unreasonably under that clause and Lazards consider that the company's case for securing my consent is a reasonable one in their reading of the agreement.

5 On balance, I conclude that we should do as the company have requested. The provision in the agreement was intended to cover just the eventuality that shareholders' funds would fall dangerously low, though at the time the agreement was reached we did not envisage such a rapid redundancy programme or such an early activation of the option. There will be, of course, a change in the ranking in respect of the guarantee of preference shares. But, as we recognised in agreeing to accept the position of unsecured creditor for the guarantee, the value of the company in liquidation must be open to considerable doubt and the ranking of security which we agreed on then was a part of the price of defending our user interests.

6 If you agree that we should now go down this route, I propose that this should be subject to the willingness of the banks to take up the issue of the shares. They have not yet taken a formal position on this and, with your agreement, I will ask Sir Peter Carey to meet with them to this end.

7 I am sending a copy of this letter to Christopher Soames.

Ever. Keith