

PO-CH/NL/0181 PT H

PART H

Clex
Lawson

CONFIDENTIAL

(Circulate under cover and
notify REGISTRY of movement)

cu



PO -CH /NL/0181



PART H

Begins: 22/11/88

DD: 25 years

Ends: 22/12/88

6/9/95

CHANCELLOR'S PAPERS
ON PRIVATISATION POLICY

1810/71
/NL/0181
-CH
PO

PART H

CONFIDENTIAL



- cc:
- PS/Chancellor
- PS/FST
- Sir Peter Middleton
- Mr Anson
- Mr Monck
- Mr Luce
- Mr Burgner
- Mr Dixon
- Mr Wood
- Mr Bent
- Mr H M Roberts

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Lord Young of Graffham
 Secretary of State for Trade and Industry
 Department of Trade and Industry
 1 - 19 Victoria Street
 London
 SW1H 0ET

27th November 1988

PRIVATISATION OF NATIONAL ENGINEERING LABORATORY

Thank you for your letter of 28 October which made proposals on how to proceed with the NEL privatisation. I understand from Malcolm Rifkind's letter of 14 November that these have now been overtaken. This letter comments on Malcolm's proposals and responds to the specific points raised in your letter.

I welcome the way forward which you and Malcolm propose. I shall be focusing on the value for money from the options put forward.

Your letter invited my views on the prospect for general legislation to avert the obligation to make redundancy payments to staff transferring under the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE). As far as general legislation is concerned, as you know, this was considered and abandoned a few years ago. I am not sure that the legal risks are any less now but I agree that there may be a case for re-examining the issue. My officials are therefore identifying likely candidates for prospective privatisation in the central Government field. The number of such cases - and the likely balance between firm and speculative privatisation candidates - would allow us to judge whether a Bill to deal with TUPE, which would undoubtedly be very controversial, would be justified. In the light of such a trawl, we could then put the issue to lawyers. Even if we were to overcome all these hurdles there would of course be no prospect for legislation for 12-18 months.

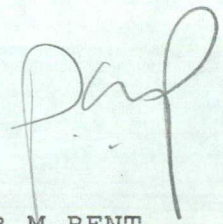
You also invited my views on whether making technical redundancy payments to NEL staff on privatisation might be acceptable. I hope that a more open approach to the options for NEL will make this unnecessary. It would be hard to justify on both value for money grounds and presentationally. And the precedent set for other privatisations would be damaging. Moreover the 2 year timetable indicated in Malcolm Rifkind's letter allows for a legislative solution for NEL, by way of specific or possibly general legislation.

I am copying this letter to the Prime Minister, Malcolm Rifkind and to Sir Robin Butler.

*Yours truly,
John Major*

JOHN MAJOR

CONFIDENTIAL



- 23
1. MRS M E BROWN
2. CHANCELLOR OF THE EXCHEQUER

From: R M BENT
Date: 22 Nov 1988
cc CST
FST
Sir P Middleton
Mr Anson
Mr Byatt
Mr Monck
Mr Burgner
Mr Moore
Mrs Lomax
Mr Burr
Mr Houston
Mr Lyne
Mr M Williams
Mr Holgate
Mr Tarkowski
Mr Call
Ms Wheldon T Sol

**ELECTRICITY AND WATER PRIVATISATION:
SPECIAL SHARES AND MERGER POLICY**

You are chairing a meeting with colleagues at 3pm on 23 November to discuss the above. My submission of 14 November set out the issues.

Relevant papers

2. These are:

- behind (not seen before)*
- (i) Mr Parkinson's letters of 25 October and 17 November; and of 22 November (just received) - *behind*.
 - (ii) Mr Ridley's letters of 4 and 17 November;
 - (iii) Lord Young's letter of 11 November;
 - (iv) Mr Rifkind's letter of 17 November; and
 - (v) your letter of 17 November.

Agenda

3. We suggest three agenda items:

- (i) Special shares;
- (ii) Merger policy;
- (iii) AOB.

CONFIDENTIAL

ITEM 1: SPECIAL SHARES

4. In opening the meeting, you may wish to remind colleagues of the background. In particular:

(i) your meeting with colleagues on 28 April to discuss Special Shares. At that meeting, Mr Ridley saw no need for Special Shares for the water companies, whereas Mr Parkinson wanted Special Shares for all the electricity companies. The meeting agreed to plan on the basis of Special Shares for both the generating and distributing companies, but the Secretaries of State for Energy and Scotland agreed to consider the scope for time-limiting these Special Shares;

(ii) the imminence of the introduction of the Water and Electricity Bills. These emphasise the importance of demonstrating a consistent Government policy (subject, of course, to legitimate differences between the two industries).

5. The propositions now on the table can be summarised as follows:

(i) Mr Parkinson argues that "strategic" rather than "fledgling industry" justifications apply to each of the electricity companies, and presses for timeless Special Shares for all the English and Welsh electricity companies;

(ii) Mr Rifkind also seeks timeless Special Shares for the Scottish electricity companies;

(iii) Mr Ridley, on the other hand, sees no justification for timeless Special Shares for the water companies, but might go as far as adopting "fledgling industry" Special Shares expiring automatically after 2 years;

(iv) Lord Young is not persuaded that all the E+W electricity companies should have timeless Special Shares (he envisages Big G, possibly Little G and Gridco having timeless Special Shares), and sides with Mr Ridley in accepting a 2 year Special Share for the water companies. Lord Young has not yet addressed Scottish electricity;

(v) you have proposed that Big G, Gridco and the 2 Scottish electricity companies should have timeless Special Shares, and that Little G, the 12 Distcos and the 10 water companies should have fledgling industry Special Shares, expiring automatically after 5 years.

6. The central issue for the meeting to resolve is which of

record (Hassell) behind. Also minute of 12/5 to PM.

CONFIDENTIAL

the Special Shares should be timeless, and which should expire automatically after a period. Mr Parkinson claims a "strategic" position for each Distco, but - given that the operating licence will ensure that the company will be run competently - it is not obvious that it matters who owns the company. And on Little G, why should the privatised fossil fuel generator get timeless Special Share protection when the new entrant generators get none at all?

7. A subsidiary issue is the planned life of the Special Shares which expire automatically: the choice between a 2 year life, or a 5 year life, or somewhere in between, is essentially political. The period should, however, be the same in both water and electricity.

8. Other issues, such as the precise form of the Special Share powers, might be remitted to officials and lawyers for further work, once the basic assumptions have been set.

ITEM 2: MERGER POLICY

9. The background considerations here are:

(i) the benefits of privatisation will be the more attenuated the greater the additional constraints placed on the industry. Additional constraints will of course be needed to ensure that the privatised companies do not abuse their monopoly position, and do provide satisfactory levels of service to the public. But, beyond this, there must be a presumption that merger policy should approach, as closely as practicable, the normal regime for the private sector;

(ii) so the question essentially becomes, assuming the redemption of the Special Shares at some time, what are the minimum protections that need to be built into statute, operating licence and/or competition policy to cater effectively for a privatised water and electricity industry.

10. The propositions on the table are:

(i) Mr Ridley wants a condition in the operating licence to ban any licensee holding a majority stake in more than one water company above a certain size at any time;

(ii) neither Mr Parkinson nor Mr Rifkind envisages the early redemption of any of their Special Shares, although they recognise the possibility in principle, and do not bid for extra controls;

(iii) Lord Young opposes Mr Ridley's proposals for water (which he believes would undermine confidence in the MMC), and suggests instead that the Water Bill be

CONFIDENTIAL

amended to provide that the MMC will have regard to the need to maintain comparative competition in looking at mergers in the industry;

(iv) you too are on record as preferring more appropriate terms of reference for the MMC in considering mergers between regulated regional monopolies, whether water or electricity.

11. The central issue to be decided here is whether there should be a blanket ban on mergers of certain types (and if so what type), or whether mergers should be assessed by the normal rules of competition policy amended to take account of comparative competition.

12. Again, once the basic assumptions have been set, officials and lawyers can be asked to take forward the precise drafting.

ITEM 3: AOB

13. Mr Ridley has mentioned in his letters 2 pairs of mergers among the water companies, and the acquisition of Portals (the leading water equipment manufacturer) by Thames. On these, you might: *a stake in*

(i) agree that the proposed merger between Northumbrian and Yorkshire should be rejected;

(ii) note that further advice is being sought on the proposed merger between SouthWest and Wessex;

(iii) warn that the nationalisation of one business to ease the privatisation of another, as well as being questionable in principle, carries real risks in practice. Vendors are under no obligation to reveal the correct state of the business, and poor judgement by the acquiring company can wreck a privatisation (witness Unipart).

Conclusion

14. You might close the meeting by asking that officials dealing with the Water and Electricity Bills should keep their opposite numbers, and Treasury officials, in close touch with the drafting that follows from this meeting. In the event that further differences of approach become apparent, the issues may need to be referred to Ministers again for collective consideration.

RMBent

PE2.

Papers in an Folder



Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switsfwrdd)
01-270 (Llinell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switchboard)
01-270 (Direct Line)

From The Secretary of State for Wales

THE RT HON PETER WALKER MBE MP

CH/EXCHEQUER	
REC.	23 NOV 1988
ACTION	FST
COPIES TO	

23/11

23 November 1988

Dear Chancellor

I have seen the correspondence between you, Nicholas Ridley and Cecil Parkinson on the question of special shares in the electricity and water industries.

My particular concern is with the water industry in Wales. It seems to me that a wide spectrum of public opinion in Wales would regard any takeover of the prospective privatised Welsh Water by either foreign interests or by another privatised water company as a highly regrettable outcome and that whatever decisions may be reached regarding the English companies, I need to have adequate powers to prevent such a situation arising.

I am therefore attracted by your proposal of special shares, which I should prefer to be permanent at any rate in the case of Welsh Water, and also by Nicholas Ridley's proposal to take powers to control mergers.

I am sending copies of this letter to the Prime Minister, Nicholas Ridley, David Young, Paul Channon, Malcolm Rifkind, Douglas Hurd, George Younger, Geoffrey Howe and Sir Robin Butler.

Yours sincerely
Keith Jarvis

Approved by the Secretary of State
and signed in his absence

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Parliament Street
London
SW1P 3AG

LORD CHELWOOD MC DL



23 November 1988

Dear Lord,

I have been giving some careful thought to your reply to my written question on Tuesday the 8 November about the Treaty of Rome. I fear that I may not have drafted the question sufficiently clearly. The 'Articles' to which I hoped you would draw attention are the Articles in the amended Treaty, and have nothing to do with hypothetical Bills.

My reading of the Treaty is that, for example, the re-nationalisation of steel would be bound to fall foul of the Articles in the Treaty which insist on free competition. If I am right in thinking this, I am sure you will agree that at a time when the Labour Party is looking with much more favour on the Community and our future role in it, it would be helpful to know why re-nationalisation of major industries would not be consistent with the spirit or letter of the Treaty.

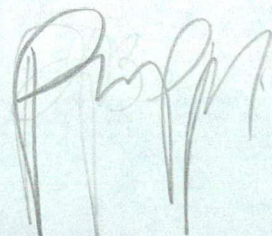
Forgive me please if I have got hold of the wrong end of the stick, but I would much value your comments.

*Yours
Tuftor*

The Rt Hon Lord Young of Graffham
Secretary of State
Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET



This assumes that you do not wish to press for the STG Chairman to be replaced (Mr Guy's separate minute of today) M&S 24/11



FROM: W GUY
DATE: 24 NOVEMBER 1988
cc: Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Revolta
Mr A M White
Mr Rutnam
Mr T Davies
Mr Tyrie
Mr Call

- 1. MRS BROWN
- 2. FINANCIAL SECRETARY

PRIVATISATION OF THE SCOTTISH BUS GROUP

Mr Rifkind would like a reply on 25 November to his letter of 22 November. He is preparing an announcement next week to accompany the introduction of the Transport (Scotland) Bill.

2. You have written to him separately about the future of Caledonian MacBrayne, and you will wish to check the relevant references in the statement when it has been drafted. The issue addressed in the latest letter is what to say about the basis on which the Bus Group will be sold.

3. Instead of selling each of the existing eleven local bus companies separately, Mr Rifkind wants to merge four of them into two, leaving nine companies. The long distance coach services and the engineering subsidiary would be sold separately, making eleven sales in all.

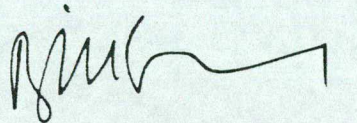
4. The proposed mergers are not very important to us but they are irritating. I would not recommend you to press for a different approach unless you felt very strongly about it.

5. The aim of the mergers would be to create stronger SBG operations in the Glasgow area, where SBG faces competition from the local authority-owned Strathclyde Buses Limited. The mergers

are necessary in large part because STG management made a complete mess of their response to Scottish bus deregulation in 1986, wrecking the operations of their bus subsidiaries in the process. Without mergers it would be difficult to sell two of the companies.

6. Prospects would be improved if Strathclyde Buses were to be split up and privatised, but the Council is unlikely to volunteer to do this and as yet there are no legislative powers to force them.

7. The attached draft reply to Mr Rifkind accepts his proposal.

A handwritten signature in black ink, appearing to read 'W Guy', with a long horizontal flourish extending to the right.

W GUY

DRAFT LETTER TO MR RIFKIND

PRIVATISATION OF THE SCOTTISH BUS GROUP

Thank you for your letter of 22 November.

I think it is a pity that the privatisation should involve a reduction in the number of bus companies operating in Scotland. Your letter does not explain why the existing companies in Glasgow should, when privatised, be unable to sustain competition from the PTC. You refer to the number of buses (750) operated by the PTC but I understood current wisdom to be that there ^{we} ~~was~~ no significant economies of scale in having a bus fleet of above 300 or so vehicles. This does not point to the need for a merged Kelvin-Central company with 680 vehicles.

The ^{problem} ~~point~~ seems to be that without mergers we should be left with some existing companies which were difficult to sell because they would be in ~~such bad~~ ^{financial} condition. The recent Quayle-Munro report on the Clydeside company attributes this to mistaken strategies imposed by SBG. It is too late to do anything about that now, and given where we are I agree with your proposal for restructuring. But this does, again, call into question the competence of STG to manage the forthcoming disposals programme successfully. ^{I welcome} ~~Your~~ decision to have your own officials and advisers draw up the disposals programme instead of relying in the first instance on the corporation, ~~As in the NBC case~~ ^{this} ~~may limit the damage which the STG Board can do,~~ But at the end of the day STG will be

executing the programme and there is no substitute in that process for a competent and committed Board.

I understand your reluctance to remove the Chairman prematurely, although I am still wary of the unhelpful influence which he may have. I note, however, that a number of other Board appointments are due to be made next month, and I hope you will ^{be able to} use this opportunity to ~~reform~~ and strengthen the Board membership during this critical period.

I look forward to reading the Quayle-Munro report on SMTI, and to seeing the draft of your statement.

I am sending a copy of this letter to other members of E(NI).

NORMAN LAMONT

CONFIDENTIAL



cc: PS/Chancellor
PS/CST
Sic. P. Middleton
Mr. Anson
Mr. Monck
Mr. Moore
Mr. Revell
Mr. A.M. White
Mr. Rintoul

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Malcolm Rifkind QC MP
Secretary of State for Scotland
Scottish Office
Whitehall
LONDON SW1

25 November 1988

Mrs. Brown
Mr. W. Guy
Mr. T. Davies
Mr. Tyndal
Mr. Cull

Dear Malcolm

PRIVATISATION OF THE SCOTTISH BUS GROUP

Thank you for your letter of 22 November.

I think it is a pity that the privatisation of SBG should involve a reduction in the number of bus companies operating in Scotland. Your letter does not explain why the existing companies in Glasgow should, when privatised, be unable to sustain competition from the PTC. You refer to the number of buses (750) operated by the PTC. But I understood current wisdom to be that there are no significant economies of scale in having a bus fleet of above 300 or so vehicles. This does not point to the need for a merged Kelvin-Central company with 680 vehicles.

The problem seems to be that without mergers, we should be left with some existing companies which were difficult to sell because they would be in bad financial condition. The recent Quayle-Munro report on the Clydesdale company attributes this to mistaken strategies imposed by SEG. It is too late to do anything about that now; and given where we are, I agree with your proposal for restructuring. But this does, again, call into question the competence of STG to manage the forthcoming disposals programme successfully. I welcome your decision to have your own officials and advisers draw up the disposals programme instead of replying in the first instance on the corporation. But at the end of the day STG will be executing the programme and there is no substitute in that process for a competent and committed Board.

I understand your reluctance to remove the Chairman prematurely, although I am still wary of the unhelpful influence which he may have. I note, however, that a number of



other Board appointments are due to be made next month, and I hope you will be able to use this opportunity to strengthen the Board membership during this critical period.

I look forward to reading the Quayle-Munro report on SMTI, and to seeing the draft of your statement.

I am sending a copy of this letter to other members of E(NI).

Yours
Norm

NORMAN LAMONT



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Immer
Phy

CONFIDENTIAL

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
Department of Trade & Industry
1-19 Victoria Street
LONDON
SW1H 0ET

CHIEF SECRETARY	
REL	2 ENCV 1983
SECTION	Ms Roberts
COPIES TO	Mr. FSI, Sir Philip [unclear] 25
	Mr. Bensen, Mr. M. [unclear] R,
	Mr. Burgess, Mr. [unclear]
	Mr. Dixon, Mr. Wood

Your Ref: PS6APV

November 1988

Dear Secretary of State,

Mr Bent.

NATIONAL ENGINEERING LABORATORY (NEL)

Thank you for your letter of 18 November enclosing proposed terms of reference for the consultancy study of NEL and for the draft of your proposed Parliamentary announcement, sent under separate cover.

I understand that you now intend to make an announcement on Tuesday 29 November. I am generally content with the proposed terms of reference. My only remaining concern is about the reference to "some parts of NEL" in the second sentence of paragraph 1. As you know, I have been most anxious to ensure that we avoid appearing to pre-empt the consultants' review in any way and I remain opposed to a fragmentation of NEL. But I suggest the point could be covered by substituting for that sentence, the following:-

"some of NEL's work for HMG may need to continue to be managed by DTI (or contracted out), for example flow measurement".

I have read the proposed Parliamentary announcement carefully. I understand that it is intended to amend the version circulated by moving the words "over the next 2 years" to the end of the first sentence in paragraph 1 of the announcement. I was content with the wording in the draft as circulated, but would not wish it to be altered as now contemplated. There is a considerable difference between restructuring over 2 years and privatisation over 2 years. The latter implies an intention that a progressive, and therefore fragmentary, privatisation should take place and would I am sure be read as such. I am also most concerned about the penultimate sentence in paragraph 1. There may certainly be at the end of the day activities within NEL which cannot be privatised and are not needed by Government, but I think by making this statement - which goes further than paragraph 2(e) in the draft terms of reference - and referring to parts of NEL rather than programmes, we will fuel uncertainty on the part of staff rather than resolving it. We agreed that a period of stability was required to achieve the restructuring in a constructive atmosphere. But I fear this statement would be read as meaning that the consultants are being asked to draw up an agenda for major closures.

I attach a suggested redraft of paragraph 1 of your draft Parliamentary reply which would meet these points and provide at least some measure of reassurance to the staff. No doubt your officials will be explaining the implications to the staff of NEL in more detail.

I am grateful for your invitation to nominate a Scottish Office official as a member of the Supervisory Board. I should like to nominate Mr Hugh Morison, Under Secretary in the Industry Department for Scotland, based in Alhambra House, Glasgow. No doubt your officials will be in touch with him in due course.

I am copying this letter to the Prime Minister, John Major and to Sir Robin Butler.

Yours sincerely
MS Jones
(Private Secretary)

MALCOLM RIFKIND

Approved by the Secretary of State
and signed in his absence

Enc

CONFIDENTIAL

DRAFT

Draft Parliamentary Reply (also serving as Press Notice)

Privatisation of the National Engineering Laboratory (NEL)

Following the withdrawal of YARD Ltd from negotiations to acquire NEL, I have concluded that some restructuring is likely to be necessary over the next 2 years in order to achieve successful privatisation. To this end, Touche Ross Management Consultants have been commissioned to undertake a detailed study of the laboratory (to be completed by 15 April 1989), to plan the restructuring and the way forward towards privatisation. The study will examine those of NEL's activities which will continue to be needed to support Government functions as well as identifying any scope for involvement of higher education institutions for example by creating a Technology Centre. It will look at the scope for future development of the NEL site in order to reduce overheads and attract additional employment. Finally the study will advise whether there are programmes within NEL for which there is no current or future Government need and which receive inadequate industrial support. The terms of reference of the study have been placed in the libraries of both Houses.

IDS/IPT

November 1988



FROM: J M G TAYLOR

DATE: 25 November 1988

MR MONCK

SPECIAL SHARES

The Chancellor had a word with me this morning about the endgame on the Water and Electricity Special Shares.

2. He thinks we should aim for an agreed position between ourselves, Industry and Environment and isolate Energy. This would probably involve:

- (a) Timeless Special Shares for the nuclear generators and the grid (and we will probably need to concede a timeless Special Share for Powergen);
- (b) a common policy for the electricity distributors and the water authorities, involving their being fully within the ambit of the MMC; time limited Special Shares of (for compromise) three years' duration; (something like) a rule saying that no one can own more than one company without permission of the Secretary of State.

3. He would then plan to minute the Prime Minister and get her agreement to this proposal, without a further Ministerial meeting.

4. The Chancellor did, of course, sum up very much in this sense at Thursday's meeting. The next step is for you to see how far you get with officials in the other Departments. I suggested to the Chancellor that one way forward might be for him then to



circulate a proposal to the other interested Ministers (having ascertained first that it will meet the approval of Industry, and Environment). He was provisionally content with this but suggested that we should take stock when you have completed your discussions with officials.

A handwritten signature in dark ink, appearing to be "JMG".

J M G TAYLOR

Jonathan

CONFIDENTIAL

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

David Crawley Esq
Private Secretary to the Secretary
of State for Scotland
Scottish Office
Dover House
Whitehall
LONDON SW1A 2AU

pmf

**Department of
Trade and Industry**

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5423
Our ref PS2BPN
Your ref
Date 28 November 1988

CHIEF SECRETARY	
REC.	28 NOV 1988
ACTION	Ms Roberts
COPIES TO	CX, FST, SEP, M, D, G, W, H, J, K, L, N, P, R, S, T, V, X, Y, Z
	Mr Anderson, Mr Mowbray
	Mr Brennan, Mr Luce
	Mr Dixon, Mr Woods
	Mr Bent

Dear David,

NATIONAL ENGINEERING LABORATORY (NEL)

I refer to your Secretary of State's letter of 25 November to my Secretary of State about the proposed Parliamentary announcement next week and the terms of reference of the Touche Ross study.

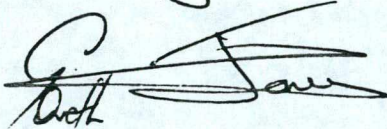
My Secretary of State shares Mr Rifkind's concern to avoid appearing to pre-empt the consultants review in any way, and we are concerned to accept the amendment suggested to the consultants' terms of reference. My Secretary of State, as you know, sees the privatisation of NEL to a single purchaser to be the preferred outcome. However, we do not at this stage wish to exclude completely any possibility of parts of NEL being privatised separately were the report by the consultants to recommend this course as a sensible way forward.

As regards the draft Parliamentary announcement, our wish to place the words "over the next two years" at the end, rather than in the middle, of the first sentence was to avoid any implication that might be drawn by NEL staff that privatisation was ruled out before 2 years had elapsed. To meet this point

CONFIDENTIAL

I propose that we should adopt the revised wording for the Parliamentary announcement suggested by your Secretary of State's letter but at the end of the first sentence add the words "as soon as practicable".

I am copying this letter to the Private Secretaries to the Prime Minister, and to the Chief Secretary and to Sir Robin Butler.

Yours sincerely,


GARETH JONES
Private Secretary



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CH/EXCHEQUER	
REC.	28 NOV 1988
ACTION	FST
COPIES TO	

28 November 1988

Jeremy Heywood Esq
Private Secretary to
The Rt Hon Norman Lamont MP
Financial Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Dear Jeremy,

SCOTTISH TRANSPORT GROUP - PARLIAMENTARY STATEMENT

My Secretary of State wrote to the Financial Secretary on 31 October and 22 November about Privatisation of the Scottish Bus Group and the future of Caledonian MacBrayne, respectively.

As requested I now enclose a draft of the statement Mr Rifkind intends to make in the House on Wednesday 30 November. I would be grateful for your clearance and that of copy recipients by Tuesday 29 November.

Copies of this letter go to Nigel Wicks and the Private Secretaries of other members of E(NI), Alison Smith (Lord President's Office), Murdo MacLean (Chief Whip, Commons), Rhodri Walters (Chief Whip, Lords), Bernard Ingham (No 10) and Robert Woolley (Cabinet Office).

*Yours sincerely
Margaret Jones*

MRS MARGARET JONES
APS/Secretary of State

SCOTTISH TRANSPORT GROUP

WITH PERMISSION, MR SPEAKER, I SHOULD LIKE TO MAKE A STATEMENT ABOUT THE FUTURE OF THE SCOTTISH TRANSPORT GROUP.

IN MY STATEMENTS TO THE HOUSE ON 27 JANUARY AND 24 MAY I SAID THAT I HAD DECIDED TO PRIVATISE THE SCOTTISH BUS GROUP AND TO DO SO IN ABOUT 10 UNITS. I ALSO SAID THAT I WOULD GIVE FURTHER CAREFUL CONSIDERATION TO THE IMPLICATIONS FOR THE FUTURE OF CALEDONIAN MACBRAYNE. AS THE HOUSE WILL KNOW, IT WAS ANNOUNCED IN THE QUEEN'S SPEECH THAT LEGISLATION TO PRIVATISE THE SCOTTISH BUS GROUP AND MAKE ARRANGEMENTS FOR THE FUTURE OF CALEDONIAN MACBRAYNE, WOULD BE INTRODUCED THIS SESSION. THE TRANSPORT (SCOTLAND) BILL IS BEING LAID BEFORE THE HOUSE TODAY.

I WILL DEAL FIRST WITH CALEDONIAN MACBRAYNE WHICH PROVIDES A WIDE RANGE OF SHIPPING SERVICES ON THE WEST COAST OF SCOTLAND. MANY OF THESE SERVICES PROVIDE A LIFELINE TO THE ISLANDS THEY SERVE. IT IS ESSENTIAL THAT THESE SERVICES SHOULD BE MAINTAINED TOGETHER WITH THE GREATLY IMPROVED STANDARDS WHICH WE HAVE BUILT UP SINCE WE CAME TO OFFICE, WITH NEW SHIPS AND NEW PIERS. WITH THIS BACKGROUND VERY MUCH IN MIND, WE HAVE LOOKED CAREFULLY AT A RANGE OF OPTIONS IN CONSIDERING THE FUTURE OF CALEDONIAN MACBRAYNE. THERE ARE CERTAIN QUITE DISTINCTIVE TYPES OF SERVICE PROVIDED AND DIFFERENT SOLUTIONS MIGHT WELL BE APPROPRIATE IN THE INTERESTS OF BOTH CUSTOMERS AND TAXPAYERS. FIRST THERE ARE THE SERVICES PROVIDED WITHIN THE RELATIVELY SHELTERED WATERS OF THE CLYDE, SECOND THE SERVICES PROVIDED BY MAJOR SHIPS ON THE MORE DIFFICULT WATERS OF THE WEST COAST AND THIRD THE SHORT CROSSINGS TO INDIVIDUAL ISLANDS PROVIDED BY SMALLER VESSELS. IN THE UPPER CLYDE THERE IS A CLEAR ANOMALY IN THE CASE OF THE GOUROCK-DUNOON ROUTE WHERE CALEDONIAN MACBRAYNE IS RUNNING A SUBSIDISED SERVICE ON A SIMILAR ROUTE TO A COMMERCIAL OPERATION PROVIDED BY WESTERN FERRIES. THIS ROUTE SHOULD BE ABLE TO OPERATE SATISFACTORILY ON THE BASIS OF PRIVATE FUNDING AS COULD CALMAC'S

WEMYSS BAY-ROTHESAY ROUTE WHICH IS PROVIDED BY THE SAME GROUP OF VESSELS. HOWEVER, WE FULLY RECOGNISE THAT FOR THE REMAINING SERVICES OPERATED BY CALEDONIAN MACBRAYNE, SIGNIFICANT SUBSIDIES WILL FOR THE MOST PART CONTINUE TO BE NEEDED IN ORDER TO MAINTAIN THE PRESENT LEVEL OF SERVICE. OUR EXAMINATION OF THE PRESENT STRUCTURE AND METHODS OF OPERATION OF CALMAC HOWEVER HAS LED ME TO CONCLUDE THAT THERE IS CONSIDERABLE SCOPE FOR GETTING BETTER VALUE FOR THE MONEY WHICH WE - AND THE PASSENGERS - SPEND ON THESE SERVICES.

IN THE LIGHT OF THE EARLY DISSOLUTION OF THE SCOTTISH TRANSPORT GROUP; OF OUR EXAMINATION OF THE OPTIONS; AND TAKING ACCOUNT OF THE MANY VIEWS EXPRESSED TO US, I HAVE DECIDED THAT THE BEST ARRANGEMENT FOR CALEDONIAN MACBRAYNE IS THAT IT SHOULD BECOME A COMPANY OWNED IN THE FIRST INSTANCE BY THE SECRETARY OF STATE. A NEW BOARD FOR THE COMPANY WILL BE APPOINTED AND WILL CONTAIN SOME PEOPLE WITH COMMERCIAL EXPERTISE AND SOME WITH FIRST HAND KNOWLEDGE OF THE ISLANDS SERVED AND THEIR NEEDS. I BELIEVE IT IS RIGHT FOR THE HEADQUARTERS OF THE NEW COMPANY TO BE NEARER THE CENTRE OF THE AREA WHICH IT SERVES AND CONSIDER THAT OBAN WOULD BE LIKELY TO PROVE THE MOST SUITABLE PLACE TO OPERATE FROM.

I WILL ASK THE NEW BOARD TO EXPLORE THE POSSIBILITY OF TRANSFERRING TO THE PRIVATE SECTOR THE GOUROCK-DUNOON AND WEMYSS BAY-ROTHESAY ROUTES. FOR THE REMAINING SERVICES I WILL ASK THEM TO EXAMINE CAREFULLY EXISTING PRACTICES IN ORDER TO FIND MORE EFFICIENT AND COST-EFFECTIVE WAYS OF DELIVERING THE PRESENT STANDARD OF SERVICE. NO OPTIONS FOR THE LONGER TERM WILL BE EXCLUDED SUBJECT TO THE OVERRIDING PROVISIO THAT THEY MUST ENSURE AT LEAST THE PRESENT QUALITY OF SERVICE TO THE ISLANDS.

AS FAR AS THE SCOTTISH BUS GROUP IS CONCERNED, I HAVE WITH MY FINANCIAL ADVISERS, QUAYLE MUNRO, GIVEN FURTHER CONSIDERATION TO THE PATTERN OF PRIVATISATION. I HAVE DECIDED THAT THE SCOTTISH BUS GROUP SHOULD BE OFFERED FOR SALE AS 11 UNITS. NINE OF THESE UNITS ARE EXISTING SUBSIDIARIES OF THE SCOTTISH BUS GROUP. THEY ARE THE 7 EXISTING GEOGRAPHICAL OPERATING

SUBSIDIARIES: LOWLAND, EASTERN, STRATHTAY, HIGHLAND, FIFE, NORTHERN AND MIDLAND, THE COACHING FIRM, SCOTTISH CITYLINK AND THE ENGINEERING SUBSIDIARY, SBG ENGINEERING.

THE OTHER 2 UNITS FOR PRIVATISATION WILL BE CREATED BY THE COMBINATION OF 2 PAIRS OF EXISTING GEOGRAPHICAL SUBSIDIARIES WESTERN AND CLYDESIDE, WHICH WILL BE PRIVATISED AS ONE UNIT, AS WILL CENTRAL AND KELVIN. THIS PATTERN OF PRIVATISATION IS DESIGNED TO CREATE VIABLE COMPANIES AND THE BASIS FOR SUSTAINED AND BALANCED COMPETITION WITHIN THE SCOTTISH BUS MARKET TO THE BENEFIT OF BUS TRAVELLERS. THE COMBINATION OF SUBSIDIARIES ROUND GLASGOW TAKES ACCOUNT OF THE COMPETITIVE SITUATION THERE.

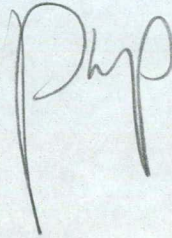
I AM KEEN THAT THIS PRIVATISATION SHOULD INCREASE EMPLOYEE PARTICIPATION. I KNOW THAT THERE IS ALREADY CONSIDERABLE INTEREST AMONG EMPLOYEES IN TAKING PART IN THE PRIVATISATION. I WELCOME THIS. IT WILL BE ENCOURAGED BY THE PROVISION OF FINANCIAL ASSISTANCE TO MANAGEMENT-EMPLOYEE TEAMS WANTING TO BID FOR THEIR COMPANIES AND OFFERING THE PROSPECT OF LOCALLY BASED MANAGEMENT WITH REAL EMPLOYEE PARTICIPATION.

THE ARRANGEMENTS I AM ANNOUNCING TODAY FOR BOTH CALMAC AND THE SCOTTISH BUS GROUP WILL PROVIDE THE BASIS FOR MAINTAINING AND IMPROVING SERVICES TO THE SCOTTISH PUBLIC, FOR CREATING VIGOROUS NEW SCOTTISH COMPANIES WITH WHICH LOCAL COMMUNITIES WILL IDENTIFY AND FOR GETTING BETTER VALUE FOR MONEY WHERE PUBLIC SUBSIDY WILL STILL BE REQUIRED.

FROM: T J DAVIES

DATE: 29 November 1988

- 29
1
1. MRS BROWN
 2. FINANCIAL SECRETARY



cc Chancellor
Chief Secretary
Mr Anson
Mr Monck
Mr Moore
Mr Revolta
Mr A M White
Mr Guy
Mr Rutnam
Mr Tyrie
Mr Call

SCOTTISH TRANSPORT GROUP - PARLIAMENTARY STATEMENT

Mr Rifkind's Private Office wrote to yours on 28 November enclosing a copy of his statement regarding the privatisation of the Scottish Bus Group and the future of Caledonian MacBrayne (CalMac) which he intends to make tomorrow (Wednesday). If you are content, we have two comments relating to CalMac that you will wish your Private Office to phone through to Mr Rifkind's.

2. The first concerns the relocation of CalMac's headquarters to Oban. Although you agreed in your letter of 14 November that there are presentational attractions in relocating its headquarters, you could not agree to its announcement until we had seen an estimate of the costs relative to other options. Although there are no such estimates, Mr Rifkind proposes to say that he believes it right for the headquarters to be relocated and that Oban is the likely option. Given Mr Rifkind's strong views, (we understand from his officials that this is his own edited version) rather than press for the total withdrawal of this sentence, I suggest you ask him to modify it. I suggest the following:

"They (the Board) will need to consider whether the headquarters of the new company should be nearer the centre of the area which it serves. Oban would be one possibility."

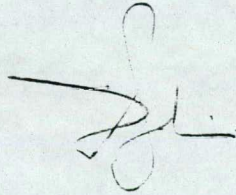
3. The second point concerns the appointment of islanders to CalMac's new Board. Your letter of 14 November agreed to one Board appointment to represent island interests with the remainder

being dominated by commercial expertise. Mr Rifkind's statement, however, proposes to say:

"...and will contain some people with commercial expertise and some with first hand knowledge of the Islands served and their needs."

Although Scottish Office officials have assured us that the latter people will also have commercial expertise and are not there just to represent the islands interests, I suggest we make this clear in the statement and substitute with the following:

"...and will contain people with commercial expertise, ^{including} some with first hand knowledge of the islands served and their needs".



T J DAVIES

12/114
CONFIDENTIAL until 1 December

PS/Secretary of State

cc: PS/Mr Spicer
PS/Baroness Hooper
PUS
Mr Guinness
Mr Wilcock
Mr Macintyre
Mr Rickett
Mr Dart
Mr Higson
Mr Granatt
Mr Pascho
Mr Morris

=

PRIVATISATION PRESS CONFERENCE: NUCLEAR BRIEFING

I attach revised nuclear briefing for Thursday's press conference. Copies are being sent to our advisers, DTI, the Treasury and the Scottish office.

J M Bird
J M BIRD
ELB1
Room 1131
Ext 6810
29 November 1988

CONFIDENTIAL until 1 December

NON FOSSIL OBLIGATION

Line to Take

- Security of supply is vital: recent history proves this.
- Obligation will ensure diversity of generation and so achieve greater security well into the next century.
- Non-fossil generation will help to combat the damage which burning fossil fuels does to the environment.
- Renewable sources will be able to make their full contribution, but nuclear bound to be the major contributor for a number of years to come.
- Those who oppose the obligation are suggesting that we shall be at the mercy of the miners and the oil sheikhs.

Defensive

Size of Obligation?

- Already stated that level for 2000 will not be below the present level of existing and committed nuclear and renewable generating capacity. [If pressed] If AGR's performance continues to improve, obligation could be around 12.2GW. But no point in setting an unattainable obligation. If AGR's cannot be contracted at their design output, obligation will be lower.

After 2000?

No need to decide now. Economics of fossil may change markedly to reflect their impact on the environment.

Before 2000?

Diversity is as important now as it will be in 2000. Shall set an obligation for the intervening period which maintains appropriate level of diversity.

Distortion of the market

-) - We have taken this opportunity to give a clear lead to the market
o to meet a vital national need.

Featherbed for nuclear

- Renewables are likely to play an increasing role in the longer term, but nuclear is the mature technology which now offers the main guarantee of safe supplies in the near future.

Anti coal

- Coal will continue to be the major fuel for electricity generation for many years to come.

Environmental benefits outweighed by problems of nuclear waste

- / - Nuclear is the only safe proven commercial fuel which does not
o contribute either to the greenhouse effect or to acid rain. All sources of energy involve clear-up costs. Nuclear's clear-up costs are firmly in hand.

NON FOSSIL OBLIGATION

Background

After privatisation the first tier supply companies (the successors to the Area Boards) will be required to have available for use a specified minimum amount of non fossil fuelled generating capacity. They can fulfil this obligation either by contracting with a generator, or by owning (via a subsidiary) and running the plant themselves. Non Fossil generation includes nuclear power and the renewable sources of generation such as wind and tidal power. It does not include either energy efficiency - since it is not a form of generation - or Combined Heat and Power schemes unless they use a non-fossil fuel.

In accordance with provisions in the Bill, each first tier supply company will be required to submit plans to the Director to show that they have made appropriate plans to meet the part of the obligation placed on it. If they fail to do so, or if their plans are inadequate, or if they then fail to meet their obligation, they can be fined. There is no limit to the size of the fine.

In a Parliamentary Answer on 11 May 1988 the Government stated that the level of the obligation for the year 2000 would not be below the present level of existing and committed nuclear and renewable generating capacity. In other words the Government anticipates setting the obligation at a level which is broadly consistent with the industry's existing plans.

NON FOSSIL LEVY

Line to Take

- All users of electricity enjoy the benefits of reliable supplies. All should therefore share in any cost of achieving this.
- It would be grossly unfair, if all of the costs of diversity were loaded onto customers who had little opportunity to contract with other suppliers or generators.
- Fossil fuel prices are bound to rise in due course. The economics of nuclear will then be favourable. It could be foolish to throw away this vital option now.
- For the first time ever we will be able to see the true price we are paying for having safe supplies of electricity.
- The Regulator will watch over the administration of the levy to ensure that it is fair to everybody.

Defensive

Levy will increase prices

- The cost of diversity is already in electricity prices. The levy will simply identify this element. Prices^{''} will not go up as a result of the introduction of the levy. The fresh stimulus of competition in the industry will put strong downward pressure on prices.

Subsidy to nuclear

- No. Consumers will continue to pay the full economic cost for their electricity. The levy merely ensures that any costs of achieving diversity are fairly shared out.

Customers will be forced to pay for the PWR programme

- Electricity prices have always contained an element to cover the cost of replacing power stations. This will not change.

Size of the Levy?

- This will depend on the prices struck in the non-fossil and fossil contracts between generators and first tier licensees. It is likely to reduce as the PWRs come on stream and the environmental costs of fossil fuel increase.

Levy is anti-competitive

- No. All customers benefit from diversity. Levy is pro-competitive in that it permits fair competition between first tier licensees and others.

Levy will penalise existing generators

- Recognise this will be an additional cost. But private generators will gain the benefit of a proper competitive market for their electricity, rather than having to rely on the 1983 Energy Act.

Levy will add to costs of large industrial users

- Large users recognise the benefit of nuclear power. And they will gain from competitive direct access to generators and other suppliers. they should be able to negotiate extremely competitive deals.

Area Boards will fiddle the figures so that only others pay

- The levy regime will be enforced by the DGES. This independent scrutiny will ensure fairness.

NON FOSSIL LEVY

Background

Although, largely for reasons of practicality, the obligation is to be placed on the first tier licensees, all customers connected to the Grid, whether they are customers of a first or a second tier licensee, will enjoy the benefits of reliable supplies which the Non Fossil Fuel Obligation will give. It is therefore only fair that all customers should share in the cost, if any, which has been paid in achieving that security. It would be unfair and would distort the market, if only the customers of the first tier licensees were to bear these costs.

The Non Fossil Levy is the means by which any additional cost incurred in meeting the obligation will be identified and shared out amongst all who benefit from diversity. Where first tier licensees contract for their non fossil capacity collectively through a central agency, they will be able to recover the difference between the price they have paid for that power, and the price they would have paid if that power had come from a fossil generating station. The method by which this will be done will be set down in the Regulations. The calculation of the levy will be watched over by the Regulator. The levy is likely to be set annually in advance based on an estimate of the additional cost of non-fossil generation in that year.

The levy will be paid by both first and second tier supply companies on the number of units of the fossil fuel priced electricity they have sold. In the case of the first tier licensees this will include the non-fossil electricity bought through the central purchasing agency which they have only paid a fossil related price for.

Some sales will not attract the levy. First there will be sales by a supplier who is too small to need a licence. Second there will be those who generate their own electricity, and finally any non-fossil fuel supplies which licensees have contracted for directly, rather than through the central agency, will not attract the levy.



NUCLEAR REGULATION

Line to Take

- From the outset there will be competition between a wide range of non fossil generators.
- The supply companies will be under an obligation to choose the least cost source of non fossil power.
- The costs of nuclear power will be rigorously ringfenced within National Power's accounts. Cross subsidies will be prohibited.
- The Regulator will have to be satisfied that the obligation has been met at least cost. The initial nuclear contracts will have to be approved by the Government.
- National Power will retain a strong incentive to keep a tight rein on its nuclear costs.

Defensive

National Power will be able to charge what they like

- No. NP will be in competition with other non fossil generators and will have incentives to hold down costs. Initial contracts will be approved by the Government. They will contain incentives to good performance.

Taxpayers will be taking the risk of nuclear power;
shareholders will get the profit

- The Government will ensure that the rate of return available under the initial contracts is commensurate with risk faced by National Power. Thereafter contracts will be struck competitively.

NUCLEAR REGULATION

Background

The regulation of non fossil generation will follow the same pattern as regulation for fossil generation. After privatisation there will be a competitive market to supply non fossil capacity. Likely competitors for this guaranteed market will include, in the case of nuclear power, National Power, supplies through the French Link, supplies from Scotland, BNFL and the AEA. They will be in competition with each other, but also with the suppliers of capacity from renewable sources such as wind and tidal power. With this level of competition a market price for non fossil capacity will emerge.

There will be a condition in the licences of the supply companies requiring them to demonstrate to the Director that they have purchased their supplies at least cost. This requirement will include their purchases of non fossil generation capacity. There will therefore be pressure from the supply companies to keep the price of non fossil power down after privatisation. Consequently there will be no need for regulation of generators' prices by a pricing formula as there will be for suppliers prices.

However the initial contracts for both fossil and non fossil power will not be struck in a free market. It will therefore be necessary for these contracts to be approved by the Government. This will include the contracts for all the existing nuclear stations and up to 4 PWRs needed to meet the NFFO.

After privatisation National Power as the principal supplier of nuclear capacity will be required by its licence to ringfence its nuclear costs so that it can not cross subsidise its fossil from its nuclear contracts.

The price of nuclear will feed through into the price control formula for the supply companies. The first tier licensees are likely to have bought a large part of their non fossil capacity through the central agency. They will therefore receive this at a fossil related price and it will be regulated as if it were fossil generated power. The additional element will be the non fossil levy which will be paid by all supply licensees. This will be passed through the pricing formula as a separate additional element.

LIMITING NUCLEAR LIABILITIES

Line to Take

- Most energy sources have "back end costs": subsidence from coal mining, North Sea abandonment costs, acid rain and the greenhouse effect.
- Size, uncertainty and timescale of nuclear backend costs could prejudice viability of industry and would certainly raise cost of capital to an unacceptable level.
- The uncertainty will be shared with Government in recognition of value of nuclear to the nation. In the public sector the Government stands behind all the organisations concerned.
- All parts of the nuclear industry currently make full provision for all the anticipated costs of nuclear generation, including decommissioning and disposal. CEGB provisions already total £3.4 bn. £700m put aside last year alone from electricity revenue.
- Consumers pay now and will continue to pay for all anticipated costs through electricity prices.
- All the companies involved will retain "strong incentives" to minimise nuclear costs.

Defensive

Subsidy to nuclear

- Consumers will pay as now the full anticipated cost of nuclear power. Government currently stands behind all of

these costs. In future, National Power's shareholders will also have an interest.

Runs counter to the whole purpose of privatisation

- While the industry is in the public sector the taxpayer is effectively underwriting all of the risks. Privatisation will open up National Power to market forces. It is only in a few closely targeted areas where future risks are to be shared.

Breaches the concept of 'the polluter pays'

- The polluter will pay. National Power will continue to make full provision for the costs of waste treatment, management and disposal. What is being shared is the risk of unforeseen costs.

Could lead to an enormous call on the taxpayer

- Because these costs are by definition unforeseen it is impossible to predict whether the Government may be required to make any payments, and over what timescale.

Not just selling NP cheap, but paying people to buy it!


- We shall be limiting investors' risks. But we shall expect a higher price from them in return. This is quite normal and well understood by investors, if not by the Opposition. The taxpayer should not lose; he may gain.

Unfair to other forms of energy e.g. renewables

- Costs largely a legacy of the past. Keen to promote renewables, but nuclear too important to leave to chance.

Bill limits amount payable

- Bill provision should last for a number of years. Government will stand behind BNFL to ensure it can honour contracts with nuclear generators.



Background

Most energy sources have associated with them costs that continue after the energy has been consumed: for example, subsidence from coal mining, abandonment costs for North Sea oil platforms, and the "greenhouse effect" for fossil fuels generally. Those associated with nuclear power (reprocessing, nuclear waste management and disposal, and decommissioning of nuclear plant) are particularly uncertain in part because of the extremely long period over which they occur and the possibility of changes in that time to the safety and environmental controls that apply to nuclear power. To leave this level of uncertainty with the industry could, at worst, prejudice company viability.

*Rev
3/11/82 - P*

The electricity consumer will continue to pay the anticipated costs associated with the nuclear "back end". But where costs increase later for reasons unforeseen at the time, it would be unreasonable to expect future electricity consumers to meet the cost. The Government has therefore decided to take powers to make a contribution to these costs. Clause 88 and Schedule 12 provide for the Secretary of State to give grants, loans and guarantees in respect of the reprocessing and storage of nuclear fuel, the treatment, storage and disposal of radioactive waste and the decommissioning of nuclear installations.

It is intended that, in general, these powers will be used to enable British Nuclear Fuels plc to contract on commercial terms with nuclear generators for such activities assistance being given to BNFL in the event that costs rise subsequently for reasons to do with changes to safety or environmental requirements or in other clearly specified circumstances. This will mean, in effect, that the Government will be the ultimate back stop for long-term costs whilst ensuring that customers pay the best estimate at the time of consumption of the costs and that the industry and BNFL retain sufficient incentives to minimise them. Similar arrangements will apply in relation to the final decommissioning of nuclear power stations.

The Bill will place financial limits on the provisions (£1000 million, raisable by Order to £2500 million). This is to permit adequate Parliamentary scrutiny from time to time of the Government's policy. The Government will nevertheless stand behind the contracts negotiated by BNFL and, in the event that the provisions appear likely to be insufficient, it will return to Parliament to seek an increase.

PWR PROGRAMME

Line to Take

- Vital that we have a new generation of nuclear stations coming on stream around the turn of the century to replace the Magnoxes as they are retired.
- All new stations will of course be subject to the Secretary of State's consent, and will be required to meet safety and environmental standards.
- PWRs are a well-tried, economic and efficient means of nuclear generation. The safety case was proved at Sizewell.

Defensive

NP will demand excessive premium for these stations


- National Power will have considerable incentives to keep nuclear costs down. They will also be in competition with other suppliers of non fossil power.

Public Inquiry system is a farce when Government and NP are committed to build these stations.

- Government is committed to the obligation being met. It is up to the industry how they choose to do this. Consent will be handled on a case by case basis, with public inquiries being held as necessary. Each application will be treated on its merits.

How many PWRs will be built?

- For the supply companies to decide how they will meet their obligation and who they will purchase power from. The Government has said that when the NFFO is set, it will be at a level consistent with existing and committed non fossil capacity.



PWR PROGRAMME

Background

The CEBG currently operates 13 nuclear power stations, 8 Magnox stations and 5 Advanced Gas cooled reactor (AGR) stations. Over the next ten to fifteen years several of these stations are scheduled to close. To replace them the CEBG is planning to build a small 'family' of Pressurised Water reactor (PWR) stations. The first of these will be at Sizewell. After a Public Inquiry, consent was granted for that station and construction work has now begun.

A public inquiry is presently under way to look at the CEBG's application to build the second in the family of PWRs at Hinkley Point in Somerset. The CEBG have said that they intend to submit an application for a third PWR station at Wylfa in Anglesey in the Spring of next year.

CONTRACTING FOR EXISTING NUCLEAR

Line to Take

- Important that we preserve the diversity we already have.
- Existing plant should be contracted at cost-related prices to avoid any cross-subsidy of fossil generation.
- Likely therefore that the obligation will come into force immediately the new companies take control.

=

Defensive

Why bringing in the obligation/levy earlier than you have to?

- The need for diversity is a continuing need. We must protect the diversity we already have until the PWR's come on stream

[This means NP will run the Magnoxes forever

- There are obviously merits in running nuclear stations for as long as it is safe and economic to do so.]

=

CONTRACTING FOR EXISTING NUCLEAR PLANT

Background

National Power's existing nuclear capacity is more expensive to run than its fossil fuelled stations. This is largely a result of the increased costs associated with managing spent fuel more stringent controls on reprocessing the waste from the Magnox stations required by the Nuclear Installations Inspectorate (NII) and Her Majesty's Inspectorate of Pollution (HMIP), and the disappointing performance of some of the AGR stations to date.

While this situation remains, to protect the level of diversity which we already have in electricity generation, it will be necessary for the existing stations to be contracted at a level which reflects the cost of running them. The extra cost of doing so will be shared out among all consumers through the non fossil levy.

This will mean that the Non Fossil Fuel Obligation will have to be set for the period up to 2000, as well as for 2000 itself.

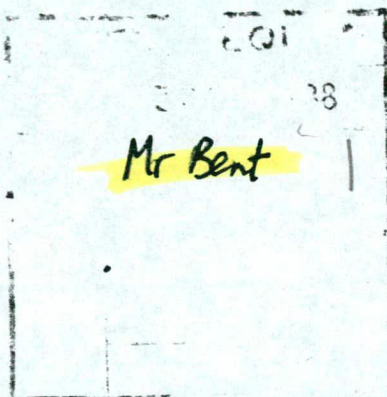
Opening up generation to competition is likely to encourage many more companies to enter the market. This in itself will make supplies more secure because England and Wales will no longer be dependent on a single generating company. In addition, the Non Fossil Obligation will ensure that there is continued diversity in the fuels used for generation so that we are not over reliant on any one type of generation.

The obligation will also give us protection against future fossil fuel price shocks and will help to limit the harmful effect which the burning of fossil fuels has on the environment.

It is necessary to place a legal obligation on the first tier supply companies to give them the clear statement of the Government's priorities which they, as private companies, will need to make their plans.

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Jonathan Taylor Esq
H.M. Treasury
Parliament Street
London
SW1P 3AG



✓
30/11

**Department of
Trade and Industry**

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5424
Our ref JW2ABQ
Your ref
Date 29 November 1988

Dear Jonathan,

I attach a copy of a letter Lord Young has received from Lord Chelwood.

I should be grateful if you would provide a draft reply for Lord Young's signature, to reach me by 6 December please.

Yours

Jeremy Godfrey

JEREMY GODFREY
Private secretary

HM TREASURY - MCU	
REC'D.	- 2 DEC 1988
ACTION	
SIGNATURE	
REF. No.	

LORD CHELWOOD MC DL



23 November 1988

Dear Lord,

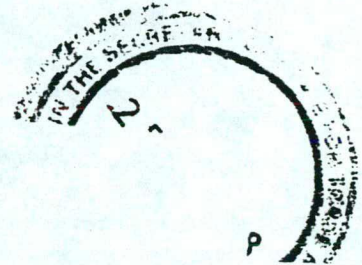
I have been giving some careful thought to your reply to my written question on Tuesday the 8 November about the Treaty of Rome. I fear that I may not have drafted the question sufficiently clearly. The 'Articles' to which I hoped you would draw attention are the Articles in the amended Treaty, and have nothing to do with hypothetical Bills.

My reading of the Treaty is that, for example, the re-nationalisation of steel would be bound to fall foul of the Articles in the Treaty which insist on free competition. If I am right in thinking this, I am sure you will agree that at a time when the Labour Party is looking with much more favour on the Community and our future role in it, it would be helpful to know why re-nationalisation of major industries would not be consistent with the spirit or letter of the Treaty.

Forgive me please if I have got hold of the wrong end of the stick, but I would much value your comments.

*Yours
Trufter*

The Rt Hon Lord Young of Graffham
Secretary of State
Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET



To:

MISS JUGGAPAH
Secretary of State's Office

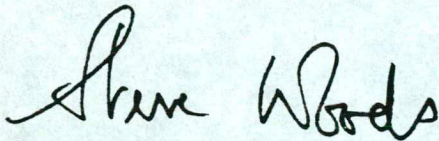
From:

STEVE WOODS
IEP1A
Rm 412
1 Victoria Street
215 4650
29 November 1988

LETTER FROM LORD CHELWOOD

We spoke about this Minister's case which should be transferred to the Treasury.

Lord Chelwood has written as a follow up to a written PQ that Lord Young answered on behalf of the Treasury. I have spoken to the Section in the Treasury that drafted the PQ answer and they have agreed that they should also answer the letter. Richard Bent in PE2 will be dealing.



STEVE WOODS

To:

MISS JUGGAPAH
Secretary of State's Office

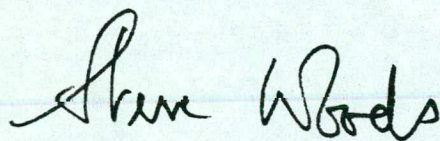
From:

STEVE WOODS
IEP1A
Rm 412
1 Victoria Street
215 4650
29 November 1988

LETTER FROM LORD CHELWOOD

We spoke about this Minister's case which should be transferred to the Treasury.

Lord Chelwood has written as a follow up to a written PQ that Lord Young answered on behalf of the Treasury. I have spoken to the Section in the Treasury that drafted the PQ answer and they have agreed that they should also answer the letter. Richard Bent in PE2 will be dealing.



STEVE WOODS



2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

30 NOV 1988

My ref:

Your ref:

Robert Satchwell
PS/Financial Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1

29 November 1988

RECEIVED
30 NOV 1988

Dear Robert,

Mr. S. Wood, LG 2
PPS, CST, PMG, EST
Sir P. Middleton
Mr. Mouch, Mr. Anson
Mr. Moore, Mrs. Brown
Mr. Burgess

PRIVATISATION OF PROPERTY SERVICES AGENCY

I am enclosing part of the text of a speech which Mr Chope is to deliver at the RIBA Construction Industry Seminar on 1 December. As you will see, in it the Minister makes explicit the Government's objective to privatise the service businesses of the Property Services Agency at an appropriate moment in the future. This was of course foreshadowed in the Secretary of State's statement in the House on 25 May on the future of PSA. (Hansard extra also attached).

I would be grateful for your confirmation that the Financial Secretary would have no objections to the text of the Minister's speech.

Yours sincerely,

Deborah

cc: Mr. Teyrie
Mr. Cull

DEBORAH LAMB
Private Secretary

From that outline of issues where Government and the construction industry interact, I hope that our respective roles emerge. It is for the Government to set the right economic climate, and keep a close eye on changes to it. But the Government should go no further and should actively seek to disengage from areas where the private sector can operate as well or better. This policy is based around the belief that the customer is king, and in order to be king has to have choice. The producer should be a servant of the consumer, not the other way round. And when that is the case the producer is under the maximum incentive to release entrepreneurial skills, initiative and energy.

Over the past 9½ years, the same thinking has informed the major policy steps which we have taken as a Government - for example, in selling council houses to tenants, or in returning nationalised industries to private ownership. It has also been the basis of our drive to streamline the actual operation of Government. Thus we have pursued contractorisation of Government services wherever this is justifiable on value for money grounds. And we have set in motion the Financial Management Initiative. This aims to give individual Government Departments control, as far as practicable, over their business operations. It reflects our commitment to the belief that better decisions are taken when the person making them also has the financial responsibility which flows from that decision. Some people might describe that as "the housewife syndrome". I do not think it is any the worse for that. It is the way we behave in our ordinary life outside our work.

I should like to turn from Government in general to the PSA in particular. Over the past few years, under Sir Gordon Manzie's leadership, the PSA has already become more commercial in outlook. But we have all been well aware of just how much further we have to go before we become a business competing for work from our customers, reaping the rewards for our success but also the consequences for our failures. So most people were probably not surprised when Nicholas Ridley last summer, on 25 May, made to the House of Commons a statement about the future of PSA which was a logical extension of policies already applied elsewhere in Government. The main features of his announcement were as follows.

From 1 April 1990 all Government Departments will pay PSA for services provided, and will have the freedom to shop elsewhere - that is, they will be untied. From 1 April 1990 as well, the PSA will be restructured into three main business areas. One of these will be primarily concerned with managing the Government's central property portfolio. The others will be service businesses responsible for design and management of new construction on the one hand and maintenance and estate surveying on the other. No later than 1 April 1993, PSA will be put on to a Trading Fund basis, and will thus no longer rely on monies voted annually by Parliament to sustain the majority of its activities. If possible, we should like to shorten this timetable. But if we are realistic, we must recognise that creation of commercial accounts to underpin the Trading Fund, depending as it does on considerable new investment in Information Technology system, is not an overnight job.

There are three particular aspects of Nicholas Ridley's statement which are worth commenting on further. The first concerns management of the central property portfolio. In line with the Financial Management Initiative, we see individual Departments taking over substantial responsibility for much of the property which they occupy. But as the all-party Select Committee on the Environment recognised in a report on PSA in 1987, PSA should be allowed to manage the central portfolio. The object here is for Departments to get the accommodation they need - but for PSA at the same time to provide positive estate management of a major property resource so as to keep costs across Government as a whole to a minimum. This will require a degree of commercial freedom for PSA. But the task will by definition remain an activity of Government alongside other accommodation functions which Government must keep (for example, for security reasons).

Secondly, management of the central property portfolio will call for supply of services which the other PSA businesses can provide. But they will not be sole suppliers. The property management business will therefore be untied from the service business like any other Government Department.

Thirdly, the move to a Trading Fund and the freedom from Vote Accounting is something that I have often heard people in PSA say that they would like. Now we are going to have that freedom. That is likely to mean pressure for further freedoms - on pay and conditions, investment decisions and so on. As far as the two service businesses are concerned, I expect that - as with other similar organisations - we will see the ultimate privatisation as the logical consequence of where we are going.

Privatisation cannot be an immediate option, because we have to be restructured into commercial businesses and start operating as such. But privatisation is in my view a desirable objective so that we can have the unfettered opportunity to sell our expertise and our services to the private sector both at home and abroad. It is very difficult to be purely commercial with one hand tied behind your back.

Michael Heseltine]

Secondly, will my right hon. and learned Friend consider, in the dispersal of the Government estate to separate Departments, urging those Departments to use contract management from the private sector for the management of those estates, as well as enjoying the additional freedom of overall responsibility that he has given them?

Mr. Ridley: I am grateful to my right hon. Friend. It is very likely that the development of the policy will lead to a strengthening of the private sector. There is no reason why it should lead to a reduction in the numbers employed by the PSA if it can continue to justify its activities by winning work from Departments.

On my right hon. Friend's second question, it will be up to the Departments to manage their own property from now on. I hope that he will urge Departments to follow the course of obtaining the best offer for managing their estates, whether it be from the PSA or from the private sector, as well as contracting out maintenance and new construction work.

Mr. Peter L. Pike (Burnley): The Secretary of State said that the Select Committee report was a good report. As a member of the Select Committee, I must say that even better reports are still awaiting his response. Will the right hon. Gentleman give a categorical assurance that the statement is not a prelude to privatisation? Will he further give an assurance that the trade unions will be consulted fully and their views given due consideration?

Will the right hon. Gentleman also recognise that one of the major problems that the PSA faces is that the Departments that it serves are sometimes very unclear in giving to the PSA work requirements, both in their initial instructions and when changing their minds? That causes major problems for the PSA. Will the Minister try to ensure that it does not occur in future?

Mr. Ridley: Whether reports from Select Committees are good ones must await my view. The hon. Gentleman cannot put those words into my mouth before I have decided.

Privatisation may become a possibility which the staff prefer when the three businesses have been separated. They may well wish to go into the private sector to compete for a greater share of the work available. We cannot prejudge that as it will be many years before we reach that position. Trade unions will be consulted from this afternoon about the announcement that I have just made.

The lack of clarity of the intentions and needs of Government Departments which has made life very difficult for the PSA in looking after its buildings has been in part the cause of the changes that I have announced this afternoon. From now on, Departments will be responsible for managing their own buildings and for paying for that management. They will therefore have a much greater incentive to seek the best value for money than if the costs of whatever changes they make halfway through fall upon the PSA, which is hardly fair on it.

Several Hon. Members rose—

Mr. Speaker: Order. I remind the House that we have a busy day ahead of us. I ask for brief questions, and certainly not questions that have been asked before.

Mr. James Coatham (Gillingham): I congratulate my right hon. Friend on his wise decision to take the PSA into a full commercial position. If I have a criticism, it is that it will take a very long time to establish it as a trading fund and 1993 seems a long way ahead. After all, we have fully privatised greater public utilities in rather less time.

In regard to the Ministry of Defence assuming responsibility for its estates, what will happen to those estate management matters which are currently in train? Will the MOD assume responsibility for those matters ahead of 1 October, or will the PSA take its responsibility beyond 1 October? My right hon. Friend is very well aware that there are matters in my constituency which are of significant importance to my constituents.

Mr. Ridley: I agree that it is a pity that it will take so long to attain a full trading fund, but that is the estimate of the PSA and our consultants, Messrs. Deloitte, who believe that it cannot be done quicker. That is the time that it will take to move a large organisation from vote accounting to having full commercial accounts in a trading fund because of the immense changes that are necessary, each of which underlines the difference between a Government Department and a commercial organisation.

I shall soon have to ask my hon. Friend to ask my right hon. Friend the Secretary of State for Defence how he will manage the contracts that he needs for the defence estate. I am sure that he will wish the smooth transitional arrangements to continue and contracts that are in train will obviously be treated differently from contracts that will be let after 1 October.

Mr. John Garrett (Norwich, South): What will be the required rate of return from the three businesses? Will it be rigged in order to make them uncompetitive compared with the private sector? Is it intended to make political appointments to head them?

Mr. Ridley: I shall be able to set targets for the three businesses once we have three businesses in a few years' time, but not now. The staff of the PSA will remain civil servants, as they are at present, until such time as the new era is reached.

Mr. Kenneth Warren (Hastings and Rye): Much as I applaud the management changes that my right hon. Friend has proposed today, will he, following his answer to the last question, make sure that the staff understand their forward terms and conditions of employment so that we avoid the turmoil that we are now experiencing on the privatisation of the Crown Suppliers?

Mr. Ridley: I confirm that there will be no change in the status or position of any PSA staff as a result of what I have announced this afternoon. They remain civil servants. The PSA is run by a permanent secretary, to whom I pay tribute, as did the hon. Member for Copeland (Dr. Cunningham). There is a small advisory board that is purely advisory, but, for the rest, all members, whether they go to the MOD or stay with the PSA, will remain in exactly the same position as at present — as civil servants.

Mr. Tam Dalyell (Linlithgow): How much were Deloitte paid for their report?

Mr. Ridley: I have no idea.

Mr. Michael Morris (Northampton, South): Is my right hon. Friend aware that, in evidence to the PAC, it was



cc: PPS, CSI

- MR. ANSON
- MR. MONCK
- MR. MOORE
- MR. REVOLTA
- MR. A.M. WHITE
- MR. GUY
- MRS. BROWN
- MR. RUTNAM
- MR. T.J. DAVIES.
- MR. TYKIE
- 30 November 1988
- MR. CALL

Treasury Chambers, Parliament Street, SW1P 3AG

Len Wright Esq
Malcom Rifkind's Office
Scottish Office
Whitehall
LONDON SW1A 2AU

Dear Len,

SCOTTISH TRANSPORT GROUP - PARLIAMENTARY STATEMENT

As we discussed yesterday, the Financial Secretary has seen Mr Rifkind's draft statement and would like to make one small amendment to the second paragraph of the second page. Where it reads "A new Board will contain some people with commercial expertise and some with first hand knowledge of the Islands etc"; he would like the "and" to be replaced by "including".

Yours sincerely
Susan Feest

SUSAN FEEST
ASSISTANT PRIVATE SECRETARY



MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

The Rt Hon Norman Lamont MP
Financial Secretary to the Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

CH/EXCHEQUER	
REC.	30 NOV 1988
ACTION	FST
COPIES TO	
	30 November 1988

Dear Norman,

PRIVATISATION OF COVENT GARDEN MARKET AUTHORITY

We corresponded earlier this year on this subject (my letter of 5 May and yours of 23 May) and there have been since then, as you requested, discussions between our officials.

I have now decided, subject to the provisions below, to commission a preliminary independent feasibility study to explore and assess the options open to us if we privatise the Authority. The proposed terms of reference for the study are attached.

I intend that the study, which, subject to detailed advice from your officials, will probably be carried out by appropriate property agents, should be put out to tender as soon as possible. It will cost about £50,000 which I am prepared to find from within my existing provision on the understanding that repayment will be made for this from the eventual proceeds of privatisation. To avoid misunderstanding, I should add that I cannot undertake to cover future - probably more substantial - privatisation costs without appropriate provision.

It will be necessary for me to announce that the feasibility study is under way, and it will then be known that the privatisation is being actively considered by Government. The Government will therefore need to be reasonably committed to legislation. I recognise that the programme is very full, and that it will not be possible to get a Bill in the 1989/90 session. I would, however, be looking for your firm support for one in the 1990/91 session.

As you suggested we have examined the likely length and complication of the necessary Bill. It should be a straightforward privatisation

/Bill ...

CONFIDENTIAL AND COMMERCIAL-IN-CONFIDENCE

Bill, with ten to fifteen clauses, and three schedules.

Once I have your agreement I propose to announce our plans in Parliament, and to inform the Chairman of the Authority, and the Market Tenants Association.

I am copying this letter, as before to the Prime Minister, and other members of E(A), Douglas Hurd and Sir Robin Butler.

*Yours ever,
John*

JOHN MacGREGOR

COVENT GARDEN MARKET AUTHORITY

Terms of Reference for a Feasibility Study on Privatisation

The purpose of the feasibility study will be to assess the options for the possible privatisation of the Covent Garden Market Authority (CGMA). The study should cover at least the following:

1. Advice on the privatisation option which would maximise the net proceeds to central government. This should include consideration of any practical difficulties (eg: planning restraints) of privatisation other than those relating to the primary legislation setting up the CGMA.
2. Comparison of the option in 1 above with an option which would require horticultural wholesale markets (one for fruit and vegetables and one for flowers) to be maintained on the site for 10 years from 1990.
3. Advice on the feasibility of selling the market to its tenants.
4. Assessment of the returns under the options in 1, 2 and 3 above, and any other options considered relevant, against those likely to accrue to central government in the absence of privatisation.
5. Advice on how the privatisation options should be implemented. In considering the method of sale particular attention should be given to ways of ensuring that abnormal capital gains do not accrue to third parties following privatisation. Timing, taking into account tenants' leases most of which expire at the end of March 1991, and sale costs, including agents costs, redundancy, compensation, etc, should also be considered.

30 NOV 1988

MP



DEPARTMENT OF THE ENVIRONMENT
2 MARSHAM STREET LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

attachments not sent. 30/11/88

Dominic Morris Esq
Private Secretary to the
Prime Minister
10 Downing Street
SW1

FINANCIAL SECRETARY	
REC.	30 NOV 1988
ACTION	Mc. S. Wood . L92
COPIES TO	PPS, CST
	Mr. Anson
	DAME ANNE Muellex
	Mr. Phillips
	Mr. Willacy
	Mr. Edwards
	Mr. Mooke
	Mr. Martin
	Mr. Partridge

30 November 1988

Dear Dominic

SPEECH BY MR CHOPE ON THE FUTURE OF PSA: 1 DECEMBER

Tomorrow (1 December) lunchtime Mr Chope will be speaking at an RIBA Seminar. His subject will be the 'Future of the Property Services Agency' (PSA). I attach a copy of his speech. It amplifies a Statement made in the House by Mr Ridley on 25 May (copy also attached) but does not say anything which was not implicit in that Statement or the subsequent questioning. However, in view of the amount of public interest in the Agency's future, and in particular in the possibility of ultimate privatisation of 2 of its 3 business segments, it is possible that this matter could be raised at Prime Minister's Questions tomorrow afternoon or subsequently. The Prime Minister will recall that PSA is to be split into 3 businesses: Project Services and Estate Services (accounting for the bulk of PSA staff engaged on the design and management of major projects or maintenance) with Common Ownership (the landlord function for the Government Estate) as the 3rd business. The first 2 businesses may well prove to be suitable candidates for privatisation, although it is extremely hard to envisage how the Common Ownership business could be successfully privatised.

cc: Mr. Call



The section in Mr Chope's speech dealing with the possibility of privatisation of the project services and estate services businesses has been agreed by the Financial Secretary to the Treasury. If this matter is raised, the line to take should be:

As far as the 2 service businesses - Project Services and Estate Services - are concerned, privatisation is an obvious option which the Government will wish to consider very carefully. It cannot, though, be an immediate option because the Agency has to be restructured into commercial businesses and start operating as such.

If pressed on the future of the 3rd PSA business, Common Ownership, the Prime Minister can say that she cannot envisage this business being a suitable candidate for privatisation.

A copy of this letter goes to Susan Frost in Norman Lamont's Office.

Yours

David

DAVID MOTTERSHEAD
Private Secretary

can't see
advice pl
-m



cc: PPS, CST

Mr. Anson
Dame Anne Muellet
Mr. Phillips
Mr. Willacy

Treasury Chambers, Parliament Street, SW1P 3AG

MP

Mr. Edwards
Mr. Mooke
Mr. S. N. Wood

David Mottershead Esq
PS/Christopher Chope MP OBE
Parly Under Secretary of State for the Environment
2 Marsham Street
LONDON SW1P 3EB

30 November 1988

Mr. Martin
Mr. Call
Mr. Packridge

Dear Mr Mottershead

POSSIBLE PRIVATISATION OF PSA SERVICES

Thank you for your letter of 29 November, covering an extract from the speech Mr Chope intends to deliver at an RIBA seminar on 1 December.

The Financial Secretary notes that the last two paragraphs of Mr Chope's speech go considerably further than Mr Ridley did in the references to privatisation he made in taking questions following his Statement on 25 May. The Financial Secretary shares Mr Chope's view that privatisation may well, when the appropriate moment for decision comes, be seen as the best option for the two service businesses of PSA. However, it is, as Mr Ridley said on 25 May, too early to take a view - which would, of course, require discussion and agreement with colleagues. The Financial Secretary therefore asks that the last sentence of the penultimate paragraph and the whole of the last paragraph should be recast on the following lines:-

"....and so on. As far as the two service businesses are concerned, privatisation is an obvious option which the Government will then wish to consider very carefully.

"Privatisation cannot be an immediate option, because we have to be restructured into commercial businesses and start operating as such. Although we cannot take a decision yet, one major advantage of privatisation for PSA is that it would give the Agency unfettered scope to sell its expertise and services to the private sector both at home and abroad. That would be a great opportunity for the Agency to demonstrate its quality and its capacity to compete with the private sector across the board."

I should be grateful if you would let me know if this gives you any difficulty.

Yours sincerely
Susan Feest
SUSAN FEEST

UNCLASSIFIED

FROM: S N WOOD
DATE: 30 November 1988

PS/FINANCIAL SECRETARY

cc PS/Chancellor Rm 12/2
PS/Chief Secretary
Mr Anson
Dame Anne Mueller
Mr Phillips
Mr Willacy
Mr Edwards
Mr Moore
Mr Martin
Mr Call
Mr Partridge

FUTURE PRIVATISATION OF PSA SERVICE BUSINESSES

You asked for comments on the extract from the speech Mr Chope plans to deliver at an RIBA seminar tomorrow, sent to you by Mr Ridley's office yesterday.

2. The passages in question are in the last two paragraphs, where Mr Chope intends to say that he expects that [the Government] will see privatisation of the two service businesses to be created from PSA (to handle major capital construction projects and to provide estate management services on behalf of central government and certain other public sector clients) as the logical consequence of the move to Trading Fund status, and that this is in his view a desirable objective so that PSA could sell its services to the private sector.

3. Contrary to the impression given by Miss Lamb's letter, this in fact goes considerably further than Mr Ridley did when taking supplementary questions on his 25 May statement on the future of PSA. Mr Ridley said, for example, in answer to Mr Fallon that whether these two businesses should be privatised would become much clearer when they became established (after 1993).

4. The Government has already announced plans to privatise the Crown Suppliers, but only after collective discussion of whether the benefits of privatisation to management efficiency outweighed

the economies that might be achieved from keeping the business within the public sector. Although Mr Chope may well be right in his prediction of what would be the right choice after Trading Fund status is achieved, in or before 1993, it is far too early to make a judgement of this issue; and collective consideration by colleagues would first be necessary. The formulation used by Mr Ridley in May is preferable.

5. I attach a draft letter to this effect.



S N WOOD

DRAFT LETTER FROM PS/FINANCIAL SECRETARY TO:

Ms Deborah Lamb
PS/Secretary of State for the Environment

POSSIBLE PRIVATISATION OF PSA SERVICES

Thank you for your letter of 29 November, covering an extract from the speech Mr Chope intends to deliver at an RIBA seminar on 1 December.

The Financial Secretary notes that the last two paragraphs of Mr Chope's speech go considerably further than Mr Ridley did in the references to privatisation he made in taking questions following his Statement on 25 May. The Financial Secretary shares Mr Chope's view that privatisation may well, when the appropriate moment for decision comes, be seen as the best option for the two service businesses of PSA. However, it is, as Mr Ridley said on 25 May, too early to take a view - which would, of course, require discussion and agreement with colleagues. The Financial Secretary therefore asks that the last sentence of the penultimate paragraph and the whole of the last paragraph should be recast on the following lines:-

"....and so on. As far as the two service businesses are concerned, privatisation will be an option the Government will then wish to consider.

"Privatisation cannot be an immediate option, because PSA has to be restructured into commercial businesses and start operating as such. A firm decision, whether or not to privatise, cannot be taken until then. But one major advantage of privatisation for PSA is that it would allow the Agency to sell its expertise and services to the private sector both at home and abroad. That would be a great opportunity for the Agency to demonstrate its quality and its capacity to compete with the private sector not just for public sector business but across the board."

I should be grateful if you would let me know if this gives you any difficulty.

R SATCHWELL

[Handwritten signature]

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon John Major MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5422
Our ref JW4ABO
Your ref
Date 2 December 1988

CHIEF SECRETARY	
REC.	05 DEC 1988
ACTION	Ms Roberts
COPIES TO	<i>[Handwritten: 2]</i> Kx FST, Sir P. M. D. [unclear] Mr. Anson, Mr. Muck, Mr. Burgess, Mr. Cuce Mr. Dixie, Mr. S. [unclear], Mr. Bent

[Handwritten signature]

PRIVATISATION OF THE NATIONAL ENGINEERING LABORATORY (NEL)

I am glad that you propose to re-examine the possibility of general legislation to avoid the obligation to make redundancy payments to civil servants transferring to the private sector under the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE). My officials will, of course, be ready to assist yours in this work.

I hope it will be possible for the results of this re-examination to be available to us well before April when I am due to receive the report on NEL from Touche Ross management consultants. The report will examine ways of transferring NEL to the private sector during the next two years. Decisions on NEL can then be taken against a more informed background.

I note your comments about the potential problems surrounding the payment of technical redundancy to NEL staff on privatisation. If the Touche Ross report suggests that it is desirable to press ahead with privatisation well in advance of legislation, however, I may then ask you to consider making redundancy payments.

I am copying this letter to the Prime Minister, Malcolm Rifkind and to Sir Robin Butler.

[Handwritten initials]
[Handwritten signature]

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Jonathan Taylor Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

EXCHEQUER	
- 6 DEC 1988 ✓ 4/12	
EST	
COF	TO

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5423

Our ref PS1BWE

Your ref

Date 5 December 1988

DEPARTMENT FOR ENTERPRISE

REC - 7 DEC 1988

Mrs. Brown
PPs, Mr. Monck.
Mr. Moore
Mr. Tighe
Mr. Call

Dear Jonathan,

I took a call from Tristan Garel-Jones MP this morning. He has recently visited Mexico where, apparently, the new Minister for Communications and Transport - Andres Caso Lombardo - had recently taken office.

The British Ambassador in Mexico City had told Mr Garel-Jones that this particular Minister was probably the most important member of the Government and that several British contracts were dependant upon his signature.

Mr Garel-Jones told me that the Mexican Government was just about to embark on a privatisation programme starting with their telecommunications industry. The Mexican Government, and Mr Lombardo in particular, would appreciate advice on:-

- the golden share and how it operates;
- other devices to control foreign participation;
- any other assistance that HMG could provide given our experience of privatisations.



Ch;

Special shares

Mr Ridley has seen a blind copy of the draft minute to the PM - he is well content with it.

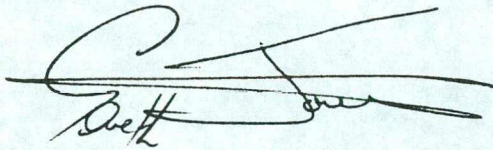
[Handwritten signature]

5/12

Mr Garel-Jones is also in contact with the Foreign Secretary's Office on his visit in general and has asked that we provide "a few sheets of paper" on the privatisation points above for Mr Lombardo, via the Foreign Office, headed something along the lines of "Specially prepared at the request of HMA, Mexico City" as soon as possible. Given the general nature of this request, I think that it is more a matter for HM Treasury to take on. Mr Garel-Jones would appreciate a prompt reaction and, of course, a copy of anything we send to Mexico sent to him in the Whip's Office.

I am copying this letter to Lyn Parker in the Foreign Secretary's office and to Anna Walker here who may have some comments to input to Treasury officials who will be taking this on; could you please let me know who this will be?

Yours Sincerely,



GARETH JONES
Private Secretary



FROM: J M G TAYLOR
DATE: 6 December 1988

phf

NOTE FOR THE RECORD

cc PS/Financial Secretary
Mr Monck
Mr D J L Moore

SPECIAL SHARES AND MERGER CONTROL

The Chancellor minuted the Prime Minister this evening on Special Shares and merger control in the water and electricity industries.

2. I should record that this minute followed considerable discussion between myself and Mr Ridley's Private Secretary. At about 6.00 pm, and after the Chancellor had approved the text, we were informed that Mr Ridley proposed to write, after the Chancellor had written, putting what he described as a "gloss" on the proposed arrangements for controlling mergers in the water industry. He intended to propose that the proposal outlined in paragraph 2(c) of the Chancellor's minute should be augmented by an arrangement similar to that which applies to newspaper mergers. This is that the Secretary of State for Trade and Industry would have the right to decide either way on a proposed merger in the water industry regardless of the recommendation of the MMC.

3. At official level, DTI said they would need to oppose this, and would advise their Secretary of State to do so. I also discussed this with the Chancellor. His view was that such a proposal would so alter the agreement as summarised in his minute that it could no longer be said that Ministers were collectively content with it. He would therefore want to restrict his minute only to the treatment of Special Shares.

4. I put this to Mr Ridley's Private Secretary. He sought to persuade me that the minute should go as originally drafted, and that his Secretary of State's proposed letter did not undermine



the agreement. I said I was sure that the Chancellor would be firm about this.

5. A long series of conversations then ensued. At the end of this, and having consulted his Secretary of State, Mr Ridley's Private Secretary said that if the Chancellor wrote as originally drafted, Mr Ridley would not send his follow-up letter. Nor would he refer to merger controls tomorrow in any way which went beyond the terms of the Chancellor's minute. He would, however, reserve the right to come back to this at a later stage.

6. I consulted the Chancellor, and on that basis he was content to write as originally proposed. He intends to speak to Mr Ridley about this in the margins of Cabinet on Thursday.

A handwritten signature in dark ink, appearing to be "JMG".

J M G TAYLOR

844 nm



pmp
(Hobart + Mr. Sp
Shorro +
manager policy)

Ch:

Mr Ridley

Mr Ridley's office professed not to know, what ^{precisely} he wanted to discuss. But from what Nick Manick has told me, it could be that he wants to suggest an (even worse) variant of his earlier MMC-related suggestion. This is: "newspaper-type powers, but with him (rather than the S/S Tr. + Industry) having the last word.

2. He may want to suggest that he writes about this, since I gather he is off to China or somewhere, leaving Mr Howard in charge. The suggestion would be resisted fiercely by LdY, I am sure, and is of course pretty unattractive to us. Do you ^{won't} want to give much encouragement.

8/12

Regrettably, the
PM is v. common
over all these.

I think I cd live
with a little bit
of water compounds
about a special site,
no-one cd own more
than one, with
the crush of the soft.
This wd mean that no
comp was safe from
takeover (a hellish spur)-
it wd just limit the
range of potential bidders.
Nick's was before I saw M^rR, per



Ch

Nick Mander not keen on gov fallback, though he understands reasons why. He feels

- (a) Would be major departure from existing competition policy
- (b) Would make it harder to secure greater liberalisation in Europe if we're erecting new barriers.

~~(c) The major split is over the
efficiency etc is not fear
of~~

(c) The most likely holders for water companies — and over

hence the source of the spur to
greater efficiency - would not
be Hanson-type conglomerates
but the water companies, who
would be delisted from bidding
under your proposal.

AT

amp

FROM: MARK CALL
DATE: 6 DECEMBER 1988

CHANCELLOR *e*

cc Financial Secretary
Mr Moore

Tom M
W...

BA

The attached article in the current edition of Fortune Magazine makes encouraging reading. Unfortunately there are few good quotes, but it might be worth keeping the following on file for the next privatisation speech.

'The respected Fortune Magazine lauded BA's achievement in a recent article, saying "If you want to know what the model global airline of the future is, you would have to say that BA is that model, the perfect example."'

I think we can skate over the distinction between their quoting an analyst and making an editorial comment.

Mc
MARK CALL

ENC

THE BIG COMEBACK AT BRITISH AIRWAYS

Who says a troubled airline can't turn around? By coddling customers this carrier has passed all international competitors in passenger volume—and profits. ■ by Kenneth Labick

THE BRITISH DELIGHT in heaping abuse on public institutions—the House of Lords, the National Health Service—that seem archaic or ineffectual. Under government ownership, British Airways slid into that sorry niche in the late 1970s. A huge, unproductive work force and lax management produced losses that reached nearly \$1 billion in 1981, and service slipped badly. Long known by its familiar initials, the national carrier had become a laughingstock. “What does BA *really* stand for?” the baggy-pants comedians used to ask on the telly. Came the answer, with a malevolent cackle, “Bloody Awful.”

Privatized in February 1987, British Airways gets guffaws no more. While once-mighty U.S. competitors such as Pan Am, TWA, and Eastern have gone into tatty decline, a new team of managers has engineered a sparkling turnaround at British Airways. In a country little noted for astute managers or employee productivity, BA's bosses have generated results to rival the performance of any U.S. carrier. Since much of the success has been built on attending to customer needs, managers of service industries everywhere can draw lessons from the British Airways story.

“If you wanted to know what the model global airline of the future is, you would have to say that BA is that model, the perfect example,” says John Pincavage, veteran airline analyst at Paine Webber. The carrier has greatly spruced up service, gone high tech in its marketing and operations, and fine-tuned its massive global route structure with acquisitions and joint ventures. Michael Derchin, airline analyst at Drexel

REPORTER ASSOCIATE Charles A. Riley II

Burnham Lambert, lauds BA's “leading edge moves that, over the next five to ten years, will be envied by other airlines.”

In the fiscal year ended in March, British Airways' profits were the highest in the industry at \$284 million on revenues of \$7 billion—though earnings have since turned down as BA absorbed the costs of a merger with British Caledonian. The carrier excels by other important benchmarks. The average revenue per passenger, \$266, is among the industry's highest. Its load factors are lofty as well. Two years ago BA, which serves 166 cities in 80 countries around the world, became the world's largest international airline in terms of passengers carried (23 million last year) and passenger-miles flown (31 billion).

CEO Colin Marshall is labeled an American-style boss.



DAVID HUNT/CONTOUR

Curiously, success has yet to turn on investors. Though British Airways stock recently sold close to its 12-month high, it commands a relatively modest price/earnings multiple of 8 on the London and New York stock exchanges. Investors worry that like most airlines, BA is both labor- and capital-intensive, as well as vulnerable to economic downturns. In a recession, high yield business travel, the lifeblood of an airline, dries up fast. A big cut in cash flow could bump management's plan to spend \$6 billion for new planes into the 1990s. Still, BA has become such a potent force in the business that security analysts expect to get more notice in the future. Says Caduce Browning of Wertheim Shroder: “Management is great. They are experienced, and they understand the importance of technology.”

The turnaround began long after Margaret Thatcher's election in 1979. The new Prime Minister was determined to turn the carrier into private hands, a task that seemed a daunting one because of the line's huge losses. To put things right, Mrs. Thatcher turned to John King, a Conservative Party stalwart and chairman of the big engineering firm Birtcher International.

A blunt, cheerful man of considerable charm, King, now had earned a splendid reputation as a manager. He was fully aware of the tough job facing him. Not only would he have to transfer the company's ingrained ways to the new owners, he would also have to take on the unions, the competition, and a host of other opponents in a series of political battles. Says the patriotic BA chairman, honored in 1987 with the title Lord King of Wiltshire: “Everyone knew that

wanted to go private, but no one thought that we could."

King's first major task was also his most unpleasant. Within a few months he reduced BA's bloated work force from 59,000 to 36,000. To ease the impact, he offered generous severance packages to all who left voluntarily. He scrounged the \$530 million or so needed for the payments by selling off surplus aircraft and some real estate holdings in the London area.

NEXT TO DRAW his attention was the airline's board. Directors got their jobs via political patronage under government ownership. The board was a largely ineffective bunch that included an economist, a union leader, the head of another nationalized industry, and a former treasury official. Convinced that British Airways needed top professional counsel, King transformed the board with some high-octane executives. Among them: Henry Lambert, former chairman of Barclays Bank International, and Robert Henderson, a director of Cadbury Schweppes. Since then Michael Angus, chairman of Unilever, has joined the board.

In part to signal change, King fired the insurance agency that had handled BA's business for 60 years. Then he switched advertising contracts from American-owned Foote Cone & Belding, BA's agency for 36 years, to the London shop run by the Saatchi brothers. "After those two moves," King recalls with obvious pleasure, "people around the place really began to listen to me."

A lot of folks outside the company discovered the new atmosphere when Saatchi & Saatchi unveiled a spectacular ad campaign featuring splashy graphics and the slogan "The World's Favourite Airline." The campaign's original TV commercial, which showed Manhattan island whirling through space to land across the Atlantic, has been called a pioneering example of the global-marketing approach now used by many advertisers.

Still up in the air was the crucial matter of a new chief executive. King refused to be rushed into a decision. He grumbles: "The way it sometimes works, you take a year to find the man, then another year and a half to find him out, then you start all over again." Convinced that British Airways needed a completely fresh outlook, King was determined not to hire an airline expert. "We were looking for someone who understood service," he says. "But there seemed to be an advantage in not knowing



BA has profited from better cabin service.



So-called hunters help fliers at Heathrow.



New business-class lounges are a big hit.

too much about the business. In my ignorance, I could do things I might not have done if I had been better informed."

King and the board settled in early 1983 on Colin Marshall, an aggressive, hands-on manager. Now 54, Marshall was then deputy chief executive of Sears Holdings, parent company of the Selfridges retail empire and no kin to Sears Roebuck. He had taken a circuitous route to the top. Raised in a middle-class home, he left school at 18 and went to sea as a purser with Orient Steam Navigation Co. At 25 he landed in Chicago as a management trainee with Hertz Corp. A few years later he moved over to Avis and rose to become a top executive at Norton Simon Inc., Avis's parent.

On taking charge at British Airways, Marshall set about lifting employees' sagging spirits. "Morale really was appalling," he says. "People had seen thousands of their colleagues go out the door, and they had no idea what would happen next. They needed some inspiration." To restore pride and, not coincidentally, announce a change in direction to the marketplace, Marshall repainted his fleet with distinctive new stripes and a company coat of arms bearing the motto "To Fly, To Serve." He also ordered up newly designed uniforms for ticket agents, ground personnel, flight crews, even baggage handlers—the first change of garb in 20 years for male staffers.

Marshall's biggest step was to launch a complete cultural change at the airline. He recognized that more and more passengers, especially business travelers, were becoming fed up with deteriorating service. While price cutting would continue to put bodies in three-abreast seats on some highly competitive routes, the business clientele was increasingly yearning for at least a semblance of the past, more gracious era of airline travel. To exploit the yearning, Marshall first needed to change the attitude of ground and air employees accustomed to dishing out basic services in a perfunctory, if not almost surly, manner.

His first stab at reintroducing some civility to operations was to order all employees to attend a two-day seminar, developed by a Danish consulting firm and called "Putting People First." The workshops attempted to put British Airways employees in the customers' shoes. Flight attendants, for example, were asked to recall their own experiences in restaurants when meals were dumped unceremoniously in front of them.

LOOKING FOR WAYS to boost the high-yield end of his business, Marshall took an entirely new, quite successful approach to marketing the supersonic Concorde service (see box). He also upgraded BA's business-class service by refurbishing lounges at major airports, putting seats with adjustable headrests in business-class cabins on most planes, and improving the food. Like several other airlines, BA has tried to lend an air of exclusivity to its business-class service, dubbing it Club World. Those changes, along with an advertising push stressing creature comforts, resulted in a 20% jump in business-class bookings in the first six months of 1988.

One key to better service was meticulous

BRITISH AIRWAYS

SALES (latest four quarters)	\$6.78 BILLION*
CHANGE FROM YEAR EARLIER	UP 30.3%
NET PROFIT	\$255.5 MILLION*
CHANGE	DOWN 4.8%
RETURN ON COMMON STOCKHOLDERS' EQUITY	21.4%
FIVE-YEAR AVERAGE	63.3%
STOCK PRICE RANGE (last 12 months)	\$22.25-\$32.50**
RECENT SHARE PRICE	\$30.50**
PRICE/EARNINGS MULTIPLE	8
TOTAL RETURN TO INVESTORS (12 months to 11/4/88)	43.2%

*Converted at average exchange rates for the period involved.
**American Depository Receipts.

The acquisition has caused some financial pain in the short run, raising debt to nearly 60% of total capital and crimping profits. But BA has already realized economies of scale, cutting the merged carriers' annual operating costs by \$70 million. About two-thirds of British Caledonian's 6,000 employees have been let go. The deal enhances the carrier's route structure and operating leverage. British Airways has gained attractive routes to the southern U.S., Saudi Arabia, western Africa, and South Korea, as well as dozens of gates and ground slots at Gatwick Airport.

British Airways now accounts for about 90% of the scheduled flights in and out of Britain, and its London hub has become one of the world's busiest international travel centers. BA's share of the lucrative and bitterly contested U.S.-British market has climbed from 29% in 1983 to a recent 38%. More important, the carrier's new dominance of traffic to and from Britain—a result of both the merger and success in wooing customers—has enabled it to push up fares aggressively. Business-class fares, for example, are up 18% in the past year.

THE AIRLINE has further broadened its global reach with a so-called marketing merger with the largest U.S. carrier, United Airlines. The two have begun sharing ground facilities and various customer services at several U.S. airports and feeding passengers from domestic United flights onto British Airways' international routes. Since U.S. laws prevent foreign airlines from flying routes between American cities, overseas carriers have been unable to establish effective hub-and-spoke systems within the huge American market. BA can now count on

filling up its international flights from major hubs like New York City with passengers arriving on shorter United flights from many American cities.

In the long run the deal could also provide British Airways additional revenues and a larger presence in the fast-growing Pacific market. BA serves few Pacific routes, but United has become a major player since taking over Pan Am's Asian operations several years ago. The two carriers have begun jointly marketing globe-girdling World Class Vacations. A Japanese honeymoon couple, for example, might board a United flight in Tokyo bound for the U.S. Then they would fly BA planes from New York City to Europe and on to Japan, on routes not served by United.

Marshall considers more joint agreements inevitable because "it is no longer feasible for any single carrier to serve the world as a whole." No airline can alone bear the huge expense of maintaining a fleet and ground facilities to meet swelling demand for overseas flights. International travel has been growing at a 5.5% annual rate—and more than twice as fast on some routes from the U.S. to Western Europe and the Pacific Rim. Indeed, this autumn SAS and Continental, the flagship carrier of Frank Lorenzo's Texas Air group, signed a marketing agreement similar to the BA-United deal.

United and British Airways have linked up in another significant way. Along with Swissair, KLM, and Alitalia, BA has bought a stake in United's Covia, a highly advanced computerized reservations system. The deal has been held up because of legal objections raised by American Airlines Chairman Robert Crandall, who has been attempting to market his own Sabre system in Western Europe. Once the deal goes through, as seems almost certain, BA will enjoy a vastly improved distribution system.

Travel agents, who write about 80% of all international tickets, often favor the carrier whose reservations system they are using because of financial incentives and the way flight information is displayed on computer terminals. The airline with the computerized reservations system usually lists its own flights first in each time slot, and many agents don't look any further. Says John O. Watson, BA's director of information management: "The only way to get fair treatment is to be in the business. It's almost a mechanism of defense."

The mood around British Airways'

attention to detail. Market research suggested that passengers are exceedingly pleased when an airline employee addresses them by name—"Have a good flight, Mr. Jones." To test the premise, British Airways researchers spent months studying passengers on shuttle flights from London, Glasgow and Manchester. When ticket agents made a particular point of using names, customer satisfaction scores rose about 60%. BA agents everywhere now call you by your name whenever possible.

At London's Heathrow Airport, British Airways deployed so-called hunters, or double-shooters, who speak a babel of languages and roam the terminal looking for wildered passengers in need of assistance. At Heathrow and Gatwick airports, London and at JFK in New York City, passengers can also videotape comments or criticism about service in space-booths set up near entrance ramps.

When it came to schedules in pre-March all days, the airline's convenience took precedence over the customer's. If it were more advantageous for crews to fly a certain route late in the morning, chances are the schedule would be so adjusted. Now times by and large are scheduled to take when the passengers want them to. "It's a matter of amended focus," says BA general manager Chris Swan. "It's customer, customer, customer."

BY THE BEGINNING of last year, King's and Marshall's efforts had improved the airline's financial results and reputation enough to interest private investors. The \$1.4 billion public offering for all BA's stock at \$19 a share was vastly oversubscribed; the price recently gone as high as \$32. Set loose in government rule, the airline no longer had to wade through layers of bureaucracy to lease or buy new aircraft or enter into joint ventures with other carriers.

BA's new freedom also allowed it to move far more quickly when an opportunity to expand arose. British Caledonian, the nation's second-largest carrier, went on the block early this year after posting a quarter-loss of \$58 million. Scandinavian Airlines System entered the bidding, but British Airways used its political clout and strong dose of nationalism to win the bid for about \$458 million. Marshall answers SAS charges that his team bullied its way to victory with a warrior's bravado: "When you are in a knockdown, drag-out, use whatever advantage you have."

SERVICES

headquarters near Heathrow is by no means smug. Among the major concerns is how to prepare the airline for 1992, when many pricing and route restrictions governing air travel within the European Community will be lifted. Savage fare wars, similar to those that bloodied U.S. carriers during the first years of deregulation, could break out across the Continent. BA, no longer government-owned, could find itself at a disadvantage against other carriers in the EC, all of which enjoy subsidies and are government-owned in varying degrees. But the airline's strategists are aware of another lesson learned from the American experience with deregulation: bigger is better in the airline business. BA's sheer size and marketing power will probably allow it not only to survive de-

regulation but perhaps to acquire some smaller European carriers if a shakeout takes place.

KING AND MARSHALL also think they might enjoy some important strategic advantages after 1992. Most crucial, the various European carriers will present a united front for the first time when negotiating bilateral agreements with other nations. That means British Airways and the others no doubt will attempt to remove a major irritant: agreements that permit U.S. carriers to ferry passengers between European cities but bar foreign airlines from similar privileges within the U.S. If BA's top dogs get their way, a Denver salesman may one day be able to choose the British carrier on a flight to Dal-

las. Grumps Lord King: "The Americans have been rather tiresome about picking plums over here and not allowing us to do the same there." Marshall speaks on the subject with less rancor but no less resolve: "Let us say that 1992 offers the potential for a single force strong enough to persuade the U.S. government to change its position."

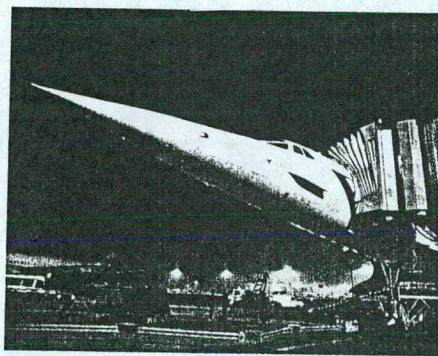
Perhaps because of his years spent working for U.S. companies, Marshall has at times been portrayed in the British press as an American-style manager. He professes to be baffled as to just what that means, but he betrays little British restraint when he talks about market challenges or taking on the regulators. You get the feeling that more and more of his competitors are going to find there is absolutely nothing funny about British Airways. **F**

IT'S A BIRD. IT'S A PLANE. IT'S A CORNUCOPIA OF CASH!

Among Colin Marshall's first acts as British Airways CEO was to rethink its Concorde service. The carrier had looked at its fleet of supersonic jetliners as a collection of fuel-guzzling white elephants. The attitude may have been understandable, since BA's seven Concorde, along with five flown by Air France, are the sole commercial result of a \$3 billion R&D effort underwritten by the French and British governments.

Marshall decided to treat the strangely beautiful planes as flagships of British Airways, proud symbols of a revitalized enterprise. He redecorated the planes' cabins and sharply raised fares. Concorde tickets had been priced near first-class fares on conventional jetliners; Marshall bumped them up to more than 30% over first class (round-trip fare from New York City to London: \$6,420).

He also changed marketing tactics. Marshall stopped trying to sell the Concorde as some sort of sybaritic delight. The plane's physical dimensions strained the credulity of that approach in any case. The cabins are narrow and somewhat cramped. The food and wines, served from limited galley space, are excellent for airline fare but no better than first-class subsonic. So Marshall decided to stress the Concorde's convenience. The new advertising message: Business travelers' time is valuable enough to warrant the high ticket price. The Concorde



A needle-nose Concorde in London

streaks across the Atlantic in about 3½ hours, half the time it takes a conventional jet.

Recently the carrier has been pitching a one-day London–New York round trip to top business travelers in Britain. They can leave London's Heathrow on a 10:30 A.M. Concorde, arrive at Kennedy in New York at 9:30 A.M. to hold a business meeting or sign legal documents, then return to London on the 1:45 P.M. flight. With any luck, they can be home in their own beds by 11 P.M. "The Concorde is basically a time-management tool," declares Michael Batt, whom Marshall hired away from candymaker Mars Corp. to handle the Concorde and some of the carrier's other special services.

The new marketing drive has been a winner. The 100-seat Concorde now fly at well over the breakeven point of 60%

occupancy on Atlantic routes. Many of the passengers are the decision-makers every airline courts. Over two-thirds of them travel on business, and 40% of this group are corporate chairmen or directors. Household names also ride the Concorde regularly—members of the British royal family, author William F. Buckley Jr., TV star David Frost, tennis ace Chris Evert, and golfer Greg Norman. BA reported revenues of more than \$356 million from Concorde service last year. Airline officials say operating profits are "substantial."

Barring some unforeseen mechanical problem, BA plans to fly its Concorde into the next century. Right now, however, it does not appear they will be replaced by a new generation of faster ships. Boeing, McDonnell Douglas, and a European consortium have all begun looking into building hypersonic jets capable of flying as much as five times the Concorde's 1,350 mph. But no aircraft manufacturer is likely to put up billions in development costs without ironclad orders for many planes, and the market for such expensive, specialized craft is limited. These days carriers must have the flexibility of using larger planes with a range of ticket prices. The best bet is that no replacement will be around after the last Concorde heads for the hangar. Says Batt: "The days when you see a plane full of nothing but high rollers will be over."

Ch. This simplifies some of the points in my earlier ms. note. One should not mention in para 4.

FROM: H J BUSH
DATE: 6 December 1988

CHANCELLOR

cc Mr Gieve
Mr Gunton

PRIVATISATION SEMINAR, PARIS 15 DECEMBER

The Embassy in Paris has asked for guidance on press arrangements for your trip to Paris on 15 December. This note discusses the possibilities.

2. Both the British and French press have been invited to the seminar. In addition to the Paris representatives of the British media, the organisers have invited Trevor Webster (Express), David Brewerton (Times), Lucy Kellaway (Financial Times), and Roland Gribben (Telegraph) to come out from London. There is no indication yet whether they will do so but, dependent as usual on other news opportunities that day, Paris representation should anyway ensure some coverage in the UK press.

3. As far as the French press is concerned, there are two issues:

(i) Whether you are open to TV or radio bids on the day. Your schedule looks very tight. The only way to slot something in would be to advance your arrival or delay departure, or if your bilateral with Beregeroy were shorter than the 1½ hours planned. All in all, the inconvenience is likely to outweigh any benefits. We might therefore tell the Embassy to turn down any TV and radio bids. None have anyway so far been received.

(ii) The Embassy point out that it is some time since you gave an interview to a French newspaper. This could not be fitted in on the day but something might be organised in advance with your visit as a peg for publication. So far one bid has been received from Le Nouvel Economist. However, this middle of the road publication

retains, according to the Embassy, a Keynesian approach to economic affairs. If you were inclined to give an interview le Figaro (or Le Monde) might be a better bet and give it wider circulation. The Embassy think that journalists concerned will be willing to come to London if there is a firm offer of an interview to cover either privatisation or economic policy more generally.

4. In conclusion:

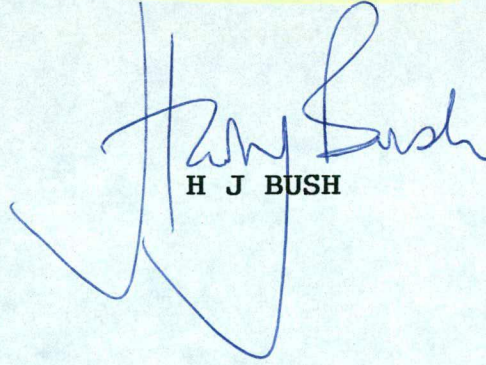
(i) Do you agree that TV and radio bids on the day should be turned down?

(ii) Would you wish to consider an interview with a French newspaper if it could be arranged in advance?

Yes

No!

Coverage of
speeches for
assignment!


H J BUSH

FROM: D J L MOORE

DATE: 6 DECEMBER 1988

SIR P MIDDLETON

cc PS/Chancellor
Mr Monck
Mrs Brown
Mr Williams

*To my contact London
These are what we know of
Goldman Sachs, which I will
be happy to provide
attached
Lombard
James
Merrill Lynch*

Nigel Wicks' letter of 2 December to you reports a conversation with Sir Jeffrey Sterling about privatisation and American banks.

2. We knew that Morgan Stanley had decided not to take part in any more privatisations after Steel, in which they were a member of the USA Management Group. They took this decision at the time of the Water and Electricity beauty competitions which were several weeks ago. It is therefore nothing to do with any frissons over Steel. It probably goes back to BP when they were rumoured to be the most nervous of the USA four, even though this did not stop them bidding for Steel.

3. It is hard to believe that Merrills and Goldman Sachs are taking the same view. Goldmans have just won the advisory appointment for Electricity and while in theory it does not follow that they will get the lead management job for a flotation that is what they will be assuming and wanting. Merrills bid hard for Water and even more so for Electricity. They were pipped at the post for both and so have never won a lead role. This history of disappointments, in spite of some very hard work, may lead them to stop bidding for future advisory posts. But that, rather than worries over the risks, would be the reason.

DJL

D J L MOORE



cc PPS ✓
Mr D Moore

10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

2 December 1988

Ch/ Sir JS might mention this to you at
Footman's lunch.
20
Dear Peter,

For what it is worth I report a conversation this morning with Sir Jeffrey Sterling, Chairman of P&O, who had just returned from a visit to the USA where he had seen the Chairman of Morgan Stanley.

The Chairman had told him that the British Steel flotation would be the last privatisation issue in which they would wish to be involved. Morgan Stanley believed that other Wall Street houses, like Merrill Lynch and Goldman Sachs, were taking the same view. They believed that the risks of handling such issues were too great. According to Jeffrey Sterling US security rules stop the US houses like Morgan Stanley from sub-underwriting issues. The rules also prevented security houses from turning over, within a defined period, any stock which might be left with them. Morgan Stanley, who are P&O's bankers, are sending Jeffrey Sterling a note of their views.

Not what you were told by the President of G.S.

I am sending a copy of this letter to John Footman (Bank of England).

Yours sincerely
Nigel

N. L. WICKS

Sir Peter Middleton, K.C.B.



FROM: FINANCIAL SECRETARY

DATE: 7 December 1988

CHANCELLOR

cc

Sir P Middleton

Mr Anson

Mr Monck

Mr Moore

Mrs Lomax

Mrs Brown

Mr M L Williams

Mr Bent

Mr Lyne

Mr Call

Miss Wheldon (T.Sol)

PRIVATISATIONS: INCENTIVE PAYMENTS

I have discussed with officials Mrs Brown's paper of 6 June, which looks at the options for increasing the incentive element in payments to financial advisers, and in particular whether in public offers, that incentive element should be linked to the size of the after-market premium.

I must say that I do not think we should go down this road. I can see its attraction, in that it might counter the natural caution of merchant banks. But as Peter Middleton has said, there are formidable practical problems. The amount of the after-market premium is set as much by the general level of the market as by the pricing decision itself. And BSC has shown we can get it right.

The alternative - a fee related to proceeds - presupposes a (possibly) long time in advance a view of what a "reasonable" level of proceeds would be. For water and electricity in particular this will be very uncertain.

On balance, therefore, I believe a move towards incentive payments would bring needless complications into our negotiations with advisers over the terms of their remuneration in return for little benefit.

NORMAN LAMONT



*Both to
the no funds:
Paul @
Institute of Balladur:
take no opp: to*

Ch.

Paris.

Michael Jay telephoned. He is getting one or two enquiries about your visit.

2. The line he proposes to take is:

"The Ch/Ex will visit Paris ~~on~~
15/12 ~~for bilateral talks with Mr Béréjgov~~
~~and~~, at the invitation of Mr Balladur,
~~will~~ address a conference on privatisation
organised by the Association of Popular

Liberalism
What is Paul to say
take no opp: of call on Mr Béréjgov?

If asked about the substance of your talks:

"This is a bilateral meeting of which
the details are, as usual, confidential"

If pressed on subjects:

"Current issues." *No particular*
person.

1/04/88

If you are content, he will put this
line to Brégnon's Cabinet.

— I have
discussed with Mr Gieve, who is
content. Are you? *Yes*
subje
basine

3. Mr Gieve assumes that you will
not want a Press Officer on this
trip. OK? *OK*

(A. I have been working on a text of
the speech, with the help of Alex
+ Andrew. I hope to get a
draft to you tonight). *Thank*

↓
Some of the old
stuff can be usefull
recycled. . . *9/12*



FROM: J M G TAYLOR
DATE: 7 December 1988

MR BUSH

cc Mr Gieve
Mr Gunton

A handwritten signature in dark ink, appearing to be 'JMG' or similar initials.

PRIVATISATION SEMINAR, PARIS 15 DECEMBER

The Chancellor has seen your note of 6 December.

2. He agrees that TV and Radio bids on the day should be turned down. He does not wish to consider an interview with a French newspaper in advance.

3. The Chancellor has also agreed a line in response to enquiries. This is:

"The Chancellor will visit Paris on 15 December at the invitation of M. Balladur, to address a Conference on Privatisation organised by the Association of Popular Liberalism. While in Paris he will take the opportunity of calling on M. Bérégovoy".

We should not be drawn on the substance of any talks with M. Bérégovoy. If pressed, we should say that there is no particular agenda.

4. He does not think a Press Officer is required on this trip.

5. I have passed all this on to Michael Jay (Paris Embassy).

A handwritten signature in dark ink, appearing to be 'JMG' or similar initials.

J M G TAYLOR



FROM: J M G TAYLOR
DATE: 7 December 1988

PS/SIR PETER MIDDLETON

cc Mr Monck
Mrs Brown
Mr Williams
Mr D J L Moore

A large, stylized handwritten signature in black ink, likely belonging to J M G Taylor.

PRIVATISATION AND AMERICAN BANKS

The Chancellor has seen Mr Moore's note of 6 December, and Mr Wicks' letter of 2 December.

2. He has commented that, to his certain knowledge, it is wholly untrue that Goldman Sachs are planning to withdraw from privatisation issues. They could not be keener to participate. He has no reason to believe that it is true, either, that Merrill Lynch are looking to withdraw.

A smaller handwritten signature in black ink, likely belonging to J M G Taylor.

J M G TAYLOR



BRITISH EMBASSY

35, rue du Faubourg Saint-Honoré - 75383 Paris Cedex 08

Telephone : 42 66 91 42

J M G Taylor Esq
 PS/Chancellor of the Exchequer
 Treasury Chambers
 Parliament Street
 London SW1P 3AG

Your reference

Our reference

Date 8 December 1988

Dear Jonathan,

Ch. Useful background briefing for your talk on Thursday. Latest monthly economic report from Paris also attached, + copy of Paris telno 1281. At 12/12

CHANCELLOR'S VISIT TO PARIS, 15 DECEMBER: BALLADUR AND PRIVATISATION

1. The main reason for the Chancellor's visit to Paris next week is to speak at the privatisation conference organised by Balladur's newly founded organisation, the Association of Popular Liberalism. You may like a brief note on the Association, on Balladur's position and on privatisation in France.
2. You already have a copy of the Conference programme. The Association of Popular Liberalism itself is new and untried. Balladur heads it, and it has a small secretariat led by his former Deputy Chef de Cabinet, Pouilleute. Pouilleute tells me that the aim is to keep alive the liberal aims pursued by Balladur when Finance Minister, that it models itself on the Institute of Economic Affairs (IEA), (Lord Harris, the head of the IEA, will speak at the conference) and that while it obviously appeals to the right rather than the left of the political spectrum, it is not allied to any one political party. (Pouilleute was cagey about where its funds came from). *behind Balladur letter 4/8/11, opposite.*
3. That is no doubt all true, but from Balladur's point of view, the purpose of the Association is clearly to provide a platform to keep him in the public eye: he will be very pleased that the Chancellor is coming to the Association's first big event. Balladur himself is now a Member of the Assemblée Nationale for a Paris constituency. He remains close to Chirac (still Mayor of Paris), and may, as a result, have lost a bit of ground following Chirac's bad defeat in the Spring Presidential elections. But he remains influential in the RPR, Chirac's party, and is a leading advocate of merging the RPR and Giscard's centre-left UDF to create a French 'Liberal-Conservative' Party. He clearly retains political ambitions.
4. The privatisation programme has been suspended under the Rocard administration. The last privatisation (under Balladur) was that of Matra in February of this year, completing 40% of the previous administration's programme. 29 of the 65 companies

/on



on the list annexed to the privatisation law of 1986 were returned to the private sector. Net receipts (at the end of 1987) were F71 billion (roughly £ 7 billion), of which the lion's share (F 50 billion : £ 5 billion) has been allocated to reducing government debt through the repurchase of government bonds.

I attach lists we compiled earlier in the year showing companies brought to the market since 1986, companies privatised by other means, and companies listed as due to be privatised but still in the public sector (not exhaustive). Policy at present is:

' no more privatisations - and no more nationalisations either'.

How long this will remain in force is hard to say: one rumour has it that once the bout of local and European elections is out of the way next year the government might be tempted to start up the privatisation programme again. This is indeed possible. The governments' more objective supporters realise that the banks and large companies that remain state owned will be at a competitive disadvantage as 1992 approaches if they cannot raise money on the markets. And certainly privatisation receipts would be welcome to an administration faced with a budget deficit, the need for fiscal reform, and expenditure pressures from its left. A dilution of state control is, however, more likely than full scale privatisation: the approval given to Péchiney, the public sector aluminium company, to offer the public a minority stake in the joint subsidiary to be formed with American National Can, is already a small step in this direction.

4. But for the moment it is the accusation of 'renationalisation by stealth' that is seizing the headlines, following the revelation that around 10% of the privatised bank Société Générale has been bought by a company called Marceau Investissements and allies that include the public sector Caisse des Dépôts. Bérégovoy's explanation is essentially political: that means have to be found to loosen the grip of friends of the former administration on the 'noyaux durs' of privatised enterprises like Société Générale, so as to allow 'true pluralism' to prevail in the market. (The 'noyaux durs' are the hard core - usually around 20% - of friendly shareholders of newly privatised companies put together to provide a degree of initial financial stability and consisting, so the socialists argue, of Chirac's and Balladur's cronies.) Bérégovoy's critics, however, accuse him not just of using public sector entities to interfere in the private sector to take political revenge, but of deliberate creeping renationalisation, and of jeopardising the position of Paris as an international financial centre by so doing. I doubt myself if Bérégovoy wants to nationalise by the back door. But he will be under political pressure to reconstitute the noyaux durs, and may underestimate the effect that doing so will have on the markets, particularly if he acts through public sector companies.

5. Balladur might be tempted to dwell on this particular aspect on 15 December, in which case our advice would be for the Chancellor not to comment in public.

*Yours sincerely,
Michael*

cc: T P Lankester Esq,
HM Treasury
D Blunt Esq, WED, FCO

M H Jay

/PS.

RESTRICTED



PS. Since I signed this letter off, Bérégovoy has said he intends formally to untie the 'noyaux durs' by putting a bill before the National Assembly in the Spring to release companies that form part of them from the restrictions put on them by Balladur's 1986 privatisation law.

Mu

A: Companies brought to the market since 1986

	Sale Date	Price per Share	No of shares on sale	Proceeds of sale for state (approx)	No of share-holders	Minimum No of shares for indiv subscribers	Comment
Elf-Aquitaine	26 Sept 1986	F305	10.8 million	F3.3 billion	300,000	10	Only 11% of shares on offer. 57% of company still in government hands.
Saint-Gobain	24 Nov 1986	F310	28 million	F8 billion	1.5 million	10	Nationalised banks kept 12.5% of shares
Compagnie Financière de Paribas/Paribas	19 Jan 1987	F405	35 million	F12.2 billion	3.8 million	4	18.2% of capital sold to friendly shareholders in advance
Société Générale Alsacienne de Banque	9 Mar 1987	F125	5.6 million	F700 million	850,000	6	Société Générale retain 52.6% of shares
Banque du Batiment et des Travaux Publics	6 Apr 1987	F130	2.2 million	F400 million	1 million	1	Majority of capital sold to large shareholders in construction industry before public sale
Banque Industrielle et Mobilière Privée	21 Apr 1987	F140	2.3 million	F400 million	520,000	1 1/2	Majority of capital sold to large shareholders before public sale
Compagnie Financière de Crédit Commercial de France (CCF)/CCF + 1 subsidiary	27 Apr 1987	F107	40 million	F4.5 billion	1.6 million	10	30% of capital sold to friendly shareholders in advance
CGE	11 May 1987	F290	50 million (incl. capital increase)	F8 billion	2 million	10	12.5% of the capital retained by nationalised banks. Privatisation accompanied by capital increase of F6 billion
Havas	25 May 1987	F500	5 million	F2.5 billion	730,000	3	20% of capital sold to friendly shareholders in advance. Government has 'golden share'.
Société Générale + 1 subsidiary	15 June 1987	F407	42 million	F17 billion	2.3 million	10	20% of capital sold to friendly shareholders in advance, including Commercial Union.
TF1	29 June 1987	F165	10	F1.5 billion	416,000	10	50% of capital sold in April for F3 billion to Francis Bouygues. Not listed in annex to privatisation legislation
Compagnie Financière de Suez/Banque Indosuez + 5 subsidiaries	5 Oct 1987	F317	50 million	F20 billion	1.6 million	10	Offering coincided with stock market collapse. Provision made for public subscribers to pay in 2 installments of F158.5 at a year's interval. Initial trading at +F260. 28% of capital sold in advance to friendly shareholders.
Matra	20 Jan 1988	F110	4.6 million	n.a (est F0.5 billion)	300,000	10	Originally scheduled for Oct/Nov 87. 22% of capital sold in advance to friendly shareholders including GEC. Government has 'golden share'.

B: Companies privatised by other means

<u>Company</u>	<u>Sale Date</u>	<u>Proceeds of Sale</u>	<u>Comment</u>
CGCT	7 March 87	F500 million	Sold off to a consortium incl. Ericsson, Matra and Bouygues
Mutuelles Générales Françaises (2 companies)	1 July 87		Change of statute. A mutualist organisation
Institut de developpement industriel	1 July 87	F1.5 billion	Management buy-out. Not listed in annex to privatisation legislation
Crédit local de France	4 Nov 87		30% offered off-market at F1016 per share. Not listed in annex to privatisation legislation
Mutuelle du Mans	3 Dec 87		Change of statute. A Mutualist organisation. Not listed in annex to privatisation legislation.
Banque Chaix	Dec 87		Government's 49% stake ceded to parent bank, Crédit Commercial de France
Européenne de Banque	Dec 87		ditto
Union de Banques à Paris	Dec 87		ditto
Crédit du Nord + 1 subsidiary	Feb 88		Government's 49.7% stake ceded to parent bank, Paribas
?Crédit Agricole	Apr 88	F7 billion	Being sold to the constituent regional branches. Not listed in annex to privatisation legislation

C: Companies listed in the annex to the privatisation legislation but still in public ownership in March 1988

Compagnie des machines Bull

Pechiney
+ Crédit Chimique

Rhone Poulenc

Elf-Aquitaine

Thomson

Banque de Bretagne

Banque Hevret

Société Marseillaise
de Crédit

Crédit Lyonnais
+ Banque Laydernier

Banque Nationale de Paris

Companie Financière de Crédit Industriel Commercial
+ Banque de l'Union européenne

Banque regionale de l'Ain

Banque regionale de l'Ouest

Banque Scalbert Dupont

Crédit industriel d'Alsace et
de Lorraine

Crédit industriel de Normandie

Crédit industriel de l'Ouest

Crédit industriel et commercial de Paris

Société bordelaise de crédit industriel et commercial

Société Lyonnaise de banque

Société nancéienne de crédit industriel et Varin-Bernier

Société centrale au groupe Assurances générales de France

+ Les Assurances générales de France IARD

Les Assurances générales de France-Vie

Société centrale du groupe des Assurances nationales

+ Les Assurances nationales, compagnie française
d'assurances et de réassurances, incendie, accidents
et risques divers

Les Assurances nationales, compagnie française d'assurances
sur la vie

Les Assurances nationales, société française de
capitalisation

Société centrale du groupe Union des assurances de Paris

+ L'Union des assurances de Paris-Capitalisation

L'Union des assurances de Paris-IARD

L'Union des assurances de Paris-Vie

Banque Worms

D: Other companies still in public ownership (not exhaustive)

Renault

Usinor/Sacilor

CdF Chimie

Electricité de France

Gaz de France

COGEMA

Charbonnages de France

Air France

Aéroport de Paris

Compagnie Nationale du Rhone

SNCF

RATP

Aerospatiale

SNECMA

France Telecom

France Câbles et Radio



FROM: J M G TAYLOR
DATE: 9 December 1988

PS/FINANCIAL SECRETARY

Phf
cc Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mrs Brown
Mr M L Williams
Mr Bent
Mr Lyne
Mr Call

Miss Wheldon (TSol)

PRIVATISATIONS: INCENTIVE PAYMENTS

The Chancellor has seen the Financial Secretary's minute of 7 December. He agrees with the Financial Secretary's conclusion that we should not move further in the direction of incentive payments to advisers.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR

CONFIDENTIAL

FROM: MRS M E BROWN

DATE: 9 December 1988

FINANCIAL SECRETARY

cc Chancellor ✓
Sir Peter Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Williams
Mr Bent
Mr Judge
Mr Portes
Mr Call

WATER AND ELECTRICITY PRIVATISATION: LAND VALUES

Mr Lyne's minute (attached) described the steps which DOE are taking to ensure that land is properly valued in the water prospectuses. DOE have had some difficulty in persuading the water authorities of the need to obtain professional valuations, although they now seem to be prepared to co-operate. DOE are proposing that each water authority should appoint its valuers jointly with the department. DOE are separately appointing their own valuer to supervise the work of these joint appointees.

2. Following the PAC report on Royal Ordnance it is clearly important to demonstrate that land values are fully reflected in proceeds. It is not practicable to follow through the PAC's suggestion that planning consents be sought for all potentially surplus land, since that could delay the privatisation exercise indefinitely. But the best possible valuations must be included in the sale prospectuses.

3. It would be useful if you wrote briefly to Mr Howard, asking about the position.

4. On Electricity (England and Wales) DEN's advisers plan to value a sample of Area Board property and to seek professional assistance where sites have not been valued on a market basis but could have realisable development value. More comprehensive open market valuations are being carried out on the CEGB both for the

CONFIDENTIAL

allocation of sites between successor Companies and for potential sites for independent generators. While this is a good start, there is no harm in making the same points to Mr Parkinson and Mr Rifkind.

5. A draft letter is attached.

Mary Brown.

MRS M E BROWN

CONFIDENTIAL

DRAFT LETTER

FROM: FINANCIAL SECRETARY
TO: MICHAEL HOWARD ESQ QC MP, MINISTER FOR WATER AND PLANNING

WATER PRIVATISATION: LAND VALUES

I know that our officials have been in touch about valuing the water authorities' land assets for the sale prospectuses. I understand that you are about to appoint a professional firm of valuers to advise your Department, and that there have been extensive talks with the water authorities about the scale of the valuation exercise that is needed.

As you will appreciate, I am concerned following the PAC report on Royal Ordnance that we should have a clearly agreed approach to land valuations in forthcoming privatisations. It will be important to be able to demonstrate that appropriate steps have been taken to ensure that the value of the water authorities' assets, including in particular land holdings, are adequately reflected in proceeds.

I should be grateful if you could let me know your approach to these matters, and what progress has been made.

I know that the Department of Energy has been drawing up a valuation programme. I should be grateful if Cecil Parkinson and Malcolm Rifkind, to whom I am sending copies of this letter, could also keep me in touch with the progress being made both to value the land assets of the electricity companies, and where appropriate to secure proceeds from their sale at or before flotation.

NORMAN LAMONT

FROM: MARTIN LYNE
DATE: 15 November 1988

MRS BROWN

PS/FST
Mr Monck
Mr Moore
Mr Bent
Mr Tarkowski
Mr Morgan
Mr Ashworth
Mr Portes
Mr Call

WATER PRIVATISATION : LAND VALUES

You asked me to let you know the position on the valuation of land following the various discussions that have taken place in the Water Privatisation joint finance committee.

2. For the purpose of discussion three categories of land have been identified.

- (i) Surplus or potential surplus land
- (ii) Specialised land
- (iii) Non-specialised land.

I set out below comments on the progress of the discussions on each of them.

3. Surplus or potentially surplus land

This land is expected to be capable of realisation in the years immediately following privatisation. It can be valued by valuers on an alternative use basis in order to establish the difference between its existing book amount and the amount which it might be expected to realise in the open market. The water authorities accept that they must carry out an exercise to identify the extent of this land and the open market value on an alternative use basis that should be attributed to it. We do not yet have any

information as to the extent of this land and inevitably any valuations can only reflect hope value in connection with possible changes of use as consents for such changes will not have been obtained. As you know, the PAC recently recommended that all relevant planning consents should be obtained in advance of privatisation, and while this may be impracticable, if there are a small number of major sites which would be significantly influenced by the grant of planning consent then we may need to consider whether applications should be made for such consent. At present we are awaiting information on the extent of such land holdings.

4. Specialised land

This is land presently used for such things as water and sewerage works which are not saleable. This land was valued in the current cost accounts at 2% of fixed asset value in 1981, and has since been revalued in line with a national land price index. It is accepted that these figures are unlikely to give a good indication of open market value. There are a very large number of these sites and the water authorities consider it impracticable to review the position with each site in detail. Many of the sites will be on small parcels of agricultural land on the fringes of villages or towns the activities on which might be very costly to relocate and there would be no reason to believe that any such land vacated would have anything other than an agricultural value. However, within these specialised sites there may be land which may be of both significant size and also located in urban areas where there may be significant alternative use value. We have asked that the water authorities look initially at their larger sites and attempt to evaluate whether there may be sites where the cost of relocating the functions carried out on them is such that it would be justified by the surpluses which could be realised by changing the use of the land. The idea being that the prospectus might then, dependent on the facts, use a description of the position based on one, or a combination of the following alternatives.

- a. that the costs of relocating functions from specialised land are so high that it would not be possible to realise surpluses from such relocation.
- b. That there are a number of sites where it might be possible to realise surpluses if the functions presently carried out there could be relocated and that such sites are the subject of further study.
- c. That there are a number of sites where significant surpluses can be realised once the functions carried out on them are relocated and that steps to relocate these functions are to be taken with a view to the realisation of such surpluses which are estimated at fx.

5. At the moment we do not know which of these scenarios is the most likely and we await further information from the Water Authorities.

6. Non-specialised asset

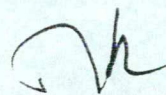
These might be offices or other commercial premises that are used for the purpose of the business but could equally well be used by others without obtaining consents for change of use. There should be no difficulty about valuation of major assets in this category.

7. The present position is that the Water Authorities have been asked to go away and do some work on these various categories of land in order to provide information to enable us to take the matter forward.

8. It is important that we see the Water Authorities land holdings in context. I understand that most of the land holdings are in relation to specialised assets and that for this category land is valued at 1% - 2% of the total value of specialised assets. Furthermore many of the Water Authorities sites are in rural areas and may not be capable of being redeveloped. I would doubt that the value of sites for amenity of leisure purposes

would differ greatly from their values as agricultural land. Our concerns therefore focus on the probably small number of large or medium-size sites in areas where open market value might be expected to be substantially greater. However, this is speculation on my part as we are at present short of factual information.

9. Once we have some more facts we will need to decide how we ensure that any significant surplus land values are reflected in proceeds. I will keep you informed of progress.



MARTIN LYNE

MP

FROM: A G FINNEGAN
DATE: 16 December 1988

1. MR BONNEY

KS 16/12

cc Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Burgner
Mr Moore
Mr Inglis
Mr Bent
Mr Call

Copies attached for:

Chancellor
Chief Secretary

2. FINANCIAL SECRETARY

PRIVATISATION OF COVENT GARDEN MARKET AUTHORITY

The Minister for Agriculture, Fisheries and Food wrote to you on 30 November asking for your agreement to a feasibility study into the privatisation of the Covent Garden Market Authority (CGMA). He suggests that the cost of the feasibility study should be refunded to his department out of the proceeds of sale if the privatisation goes ahead.

Background

2. The history of the CGMA was set down fairly fully in my predecessor's submission of 17 May 1988 copy attached. In your letter of 23 May 1988 you agreed that we should consider privatising the Market. You said you were not persuaded that it would be appropriate to impose conditions on a purchaser of the Market, such as requiring it to be maintained as a wholesale market for 10 years, but suggested that this and other points concerning preliminary work should be considered by officials.

3. Since you wrote your letter discussions have taken place with MAFF officials. We explained the privatisation procedures to them and assured them of our continuing advice as the exercise proceeds. They, at the instigation of their Ministers, are completely hung up on the question of funding the preliminary feasibility study. Basically I think this reveals a misunderstanding of the nature of the study: it is not really part of the privatisation process itself but a study of how best to run that part of the departmental programme which is being considered for privatisation.

45/16/12

4. Mr MacGregor's present proposal is to conduct a feasibility study, selecting the company to carry it out by competitive tender and with terms of reference agreed between us. I have proposed the changes shown on the copy at ANNEX 3 to this submission and MAFF officials have agreed to recommend them to Mr MacGregor .

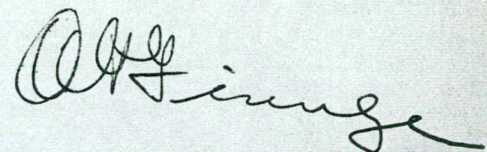
5. The stumbling block remains who should pay for the feasibility study. I recommend that you stand firm against allowing the cost to be deducted from eventual privatisation proceeds. We can however reassure Mr MacGregor that the main expenses of privatisation will be netted off the sale proceeds.

6. Mr MacGregor says that he will be making a Parliamentary announcement once he has your agreement. It is normal to make this after the consultants have been chosen to carry out the feasibility study. I suggest that they be required to clear the announcement with HM Treasury in advance but, if you wish, we can do that at official level.

Recommendation

7. I recommend that you agree to the commissioning of a feasibility study with the terms of reference as amended, confirm that if we go ahead with privatising the main expenses can be deducted from receipts but insist on the cost of the feasibility study being borne by MAFF. I also suggest that you ask that the Parliamentary announcement be cleared with us before it is made.

8. I attach a draft letter which has been agreed with CA and PE.



A G FINNEGAN
IAE1 Division

CONFIDENTIAL
and
COMMERCIAL IN CONFIDENCE

ANNEX 1

FROM: J E J DONOVAN
DATE: 17 May 1988

1. MR BONNEY
2. CHIEF SECRETARY

I agree
AB 17/5

cc Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Burgner
Mr Moore
Mr Beastall
Mrs M E Brown
Mr Bradley
Mr Call

Copies attached for:
Chancellor of the Exchequer
Financial Secretary

PRIVATISATION OF COVENT GARDEN MARKET AUTHORITY

The Minister of Agriculture, in his letter of 5 May, seeks agreement, in principle, to privatisation of the Covent Garden Market Authority (CGMA). He also seeks his colleagues' agreement to give favourable consideration to providing time for the necessary legislation and has put in bids for additional provision of some £0.8m to cover the costs (including the cost of independent advice and additional staff costs in MAFF. We would advise you to support the proposal in principle but the timetable looks optimistic in view of the need for complicated legislation; furthermore the conditions which Mr MacGregor wants to impose on future use look unattractive.

Background

2. The CGMA was set up in 1961 to manage the transfer of the market from its original site to the new location at Nine Elms and then to operate the new market. It was expected that the new market would be financed by the sale of buildings at the original site. However, most of the buildings were subsequently listed which at the time reduced their sale price. As a result the CGMA was unable to service its debt to the NLF: in 1977 £13 million of the debt was written off and the remaining debt of £30 million suspended. Since then the debt has been re-activated in stages and part of it repaid. The largest repayment followed the sale of Market Towers, an office block owned by CGMA on the Nine Elms site, at the end of 1987. The CGMA's current debt to the NLF is £1.9 million and it is currently trading profitably.

The Minister of Agriculture considers that the CGMA's present position provides an opportunity to consider privatisation; the chairman of the Authority is also reported to be positive. However, the Minister wishes to make the sale subject to conditions requiring the market to be retained for at least ten years. We agree that privatisation should be considered. There is no good reason for the Government to own a horticultural market; in fact until the CGMA was set up, Covent Garden was privately owned. But, in our view, the presumption should be that no restrictions should be imposed on a purchaser which might significantly reduce the return to the taxpayer. It would seem sensible for this issue to be considered first by officials, together with question of what advisers should be appointed and how the privatisation costs will be met.

4. One major constraint on the timetable for privatisation will be the need for legislation. Treasury Solicitor's Department has advised us that the existing legislation governing the CGMA is complex and that privatisation would require a Bill of at least twenty to twenty five clauses with two or three schedules. The pressures on the legislative programme make it unlikely that privatisation of the CGMA could be completed quickly. The Lord President's letter of 12 May supports this assessment. We doubt whether the prospect of securing receipts of between £25m and £70m (relatively small in terms of the privatisation programme) will be sufficient by itself to give this Bill automatic priority over all the competing claims next year as Mr MacGregor seems to envisage.

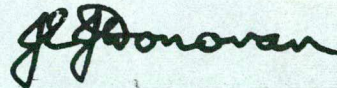
Recommendation

5. I recommend that you:

- (i) agree in principle that the prospects for privatisation of the CGMA should be studied further by officials;
- (ii) note the Minister of Agriculture's request for favourable consideration to be given to finding time for the necessary legislation but agree with the Lord President that it is not possible to prejudge QL Committee's decision on relative priorities for next year at this stage;

(iii) propose that the officials' report should cover inter alia Mr MacGregor's suggestion that restrictive conditions should be imposed on any purchaser, a preliminary assessment of the likely costs of privatisation, the PES treatment proposed and the likely length/complication of the necessary primary legislation.

I attach a draft reply which has been agreed with PE Division.



J E J DONOVAN



CC: Sir P. Middleton, CST,
Mr Anson, Mr Monck,
Mr Phillips, Mr Bonney,
Mr J.E.J. Donovan,
Mr Burgner,

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon John MacGregor OBE MP
Minister of Agriculture, Fisheries
and Food

MAFF
Whitehall Place
LONDON
SW1A 2HH

Mr D.J.L. Moore,
Mr Beavall,
Mrs M.E. Brown,
Mr Bradley,
23 May 1988 Mr Call.

COVENT GARDEN MARKET AUTHORITY

I have seen your letter of 5 May.

I agree that we should consider privatising the Covent Garden Market Authority. As you say, this is the sort of body which should be moved out of the public sector. But I am not at present persuaded that it will be necessary to impose conditions on a purchaser of the Market. I would propose that this point, and other issues concerning preliminary work, should be considered by our officials. They will also need to consider the points you raised on provision for expenditure.

A major constraint on the timing of any move to privatisation will be the need for primary legislation. It would be helpful if officials could include in their report an assessment of the likely length and complication of any necessary Bill. I agree with John Wakeham that we cannot at this stage prejudge QL Committee's decision on relative priorities for the next legislative programme.

I am copying this to the recipients of your letter.

NORMAN LAMONT

COVENT GARDEN MARKET AUTHORITY

Terms of Reference for a Feasibility Study on Privatisation

The purpose of the feasibility study will be to assess the options for the possible privatisation of the Covent Garden Market Authority (CGMA) and report within 2 months. The study should give advice on whether privatisation is feasible and if so which forms of privatisation should be considered.

Without narrowing the remit to consider all possible approaches to privatisation the study should also:

1. Advise on the privatisation option which would maximise the net proceeds to central government. This should include consideration of any practical difficulties (eg: planning restraints) of privatisation other than those relating to the primary legislation setting up the CGMA.

2. Compare the option in 1 above with an option which would require horticultural wholesale markets (one for fruit and vegetables and one for flowers) to be maintained on the site for 10 years from 1990.

3. Advise on the feasibility of selling the market to its tenants.

4. Assess the likely returns under all options identified against those likely to accrue to central government in the absence of privatisation.

5. Advise on how the privatisation option should be implemented. In considering the method of sale particular attention should be given to ways of ensuring that abnormal capital gains do not accrue to third parties following privatisation. Timing, taking into account tenants' leases most of which expire at the end of March 1991, and sale costs, including agents costs, redundancy, compensation, etc, should also be considered

CONFIDENTIAL AND
COMMERCIAL IN CONFIDENCE

DRAFT LETTER TO:

The Rt Hon John MacGregor OBE MP
Ministry of Agriculture, Fisheries and Food
MAFF
Whitehall Place
LONDON
SW1A 2HH

PRIVATISATION OF COVENT GARDEN MARKET AUTHORITY

Thank you for your letter of 30 November.

I agree that a feasibility study should now be undertaken following a confidential competitive tendering exercise to select the appropriate company. My officials will be happy to suggest names of organisations to approach and to participate in the selection procedure.

I understand that our officials have discussed the terms of reference for the study and I would be happy for the draft which you attached at Annex 1 of your letter to be used subject to the amendments shown on the enclosed copy.

On the question of funding I can confirm that if, following the feasibility study, we proceed to privatisation the main expenses will be deducted from the receipts. I cannot, however, agree that the costs of the feasibility study be deducted. By definition this study will be investigating the best way of handling that part of your department's programme which is devoted to Covent Garden Market. It is appropriate for such expenditure to be borne on normal departmental funds and it is not our

practice in privatisation exercises to deduct the cost from the receipts. In this case there is, of course, the additional factor that the cost of the feasibility study will arise well in advance of any receipts from eventual privatisation and I do not understand why you think they should be refunded in a later year.

I hope the feasibility study can now go ahead. I assume you will not make your announcement until after completion of the tendering exercise and I should be grateful for an opportunity to comment on a draft of your statement.

NORMAN LAMONT

COVENT GARDEN MARKET AUTHORITY

Terms of Reference for a Feasibility Study on Privatisation

The purpose of the feasibility study will be to assess the options for the possible privatisation of the Covent Garden Market Authority (CGMA) and report within 2 months. The study should give advice on whether privatisation is feasible and if so which forms of privatisation should be considered.

Without narrowing the remit to consider all possible approaches to privatisation the study should also:

1. Advise on the privatisation option which would maximise the net proceeds to central government. This should include consideration of any practical difficulties (eg: planning restraints) of privatisation other than those relating to the primary legislation setting up the CGMA.
2. Compare the option in 1 above with an option which would require horticultural wholesale markets (one for fruit and vegetables and one for flowers) to be maintained on the site for 10 years from 1990.
3. Advise on the feasibility of selling the market to its tenants.
4. Assess the likely returns under all options identified against those likely to accrue to central government in the absence of privatisation.
5. Advise on how the privatisation option should be implemented. In considering the method of sale particular attention should be given to ways of ensuring that abnormal capital gains do not accrue to third parties following privatisation. Timing, taking into account tenants' leases most of which expire at the end of March 1991, and sale costs, including agents costs, redundancy, compensation, etc, should also be considered



A handwritten signature in dark ink, appearing to be 'J.M.P.' or similar, located in the top right corner of the page.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

19 December 1988

S R Williams Esq
PS/Secretary of State
Welsh Office
Gwydyr House
Whitehall
LONDON
SW1A 2ER

cc PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr D J L Moore
Mrs Brown
Mr Burr
Mr M L Williams
Mr Bent
Ms Young
Mr Call

Miss Wheldon - T.Sol.

Dear Stephen

WATER AND ELECTRICITY PRIVATISATION : SPECIAL SHARES AND MERGER POLICY

At the short meeting on this subject on 8 December the Prime Minister asked those present to identify a solution quickly and to arrange to reconvene the Chancellor's earlier informal Ministerial group. As you know the Chancellor had hoped to hold such a meeting, but unfortunately your Secretary of State was unable to attend at the only time when all other colleagues were available.

It will not be possible to hold a meeting before 10 January. The Committee Stage of the Water Bill begins next week, and that for the Electricity Bill on 10 January. In order to make progress in time for the Committee stages of these Bills, the Chancellor has accordingly asked us to move this subject forward by correspondence.

The Chancellor's view is that the compromise set out in his minute of 6 December to the Prime Minister remains the best solution. It meets the criteria of defensible consistency between the proposals for electricity and of avoiding an excessive departure from our general liberal mergers policy (which inter alia would undermine the UK's initiative aimed at removing barriers to takeovers in other EC countries). However, he understands that an alternative compromise package, which has been discussed between



officials, should meet the anxieties expressed by some Ministers about aspects of his original proposals.

... The package in the attached note goes considerably further than the proposals of 6 December in giving the Government discretionary control over bids by companies that already control a UK water company (or an electricity Distco) with assets of £30 million or more. At present such a power is normally available only if the MMC has reported adversely on the bid in question. The Secretary of State does have special powers in the case of newspapers, but these are linked to the special rationale of "the need for accurate presentation of news and free expression of opinion" which obviously does not apply in water or electricity. The alternative package is therefore a large departure from the Government's general merger policy. The Chancellor considers that there could be no question of departing any further from that policy, and he understands that the Secretary of State for Trade and Industry is likely to support this view.

In view of the timetable for the Water and Electricity Bills, the Chancellor would be grateful if your Secretary of State and other colleagues could let him know by Wednesday, 4 January whether they regard this alternative package, which is a marked change from that of 6 December, as a satisfactory compromise which all relevant Ministers would back.

I am sending copies of this letter to Paul Gray (No.10), Roger Bright (Environment), Neil Thornton (DTI), David Crawley (Scottish Office), Stephen Haddrill (Energy), and Trevor Woolley (Cabinet Office).

Yours sincerely

Jonathan Taylor

J M G TAYLOR
Private Secretary

ALTERNATIVE COMPROMISE PACKAGE**(a) SPECIAL SHARES**

1. Timeless Special Shares for:

- National Power;
- Powergen;
- Gridco; and
- the two Scottish electricity companies.

2. Special Shares expiring automatically after 5 years, with discretion to permit earlier redemption, for:

- the 12 electricity distribution companies; and
- the 10 water companies.

3. There are two models for the time limited Special Shares, the latest model (British Steel) in which the control Articles of Association expire automatically upon the redemption of the Special Share, or the previous model (eg British Gas) in which the control Articles stay in place after redemption until amended by shareholders by Special Resolution in General Meeting. In the Chancellor's proposals of 6 December, it was envisaged that water would follow the Steel pattern, and electricity the Gas pattern. However, in the light of the revised proposals on merger policy at 4(ii) below, it is for consideration whether both water and electricity could be aligned on the Steel pattern, with the control Articles expiring upon the redemption of the Special Share.

(b) MERGER POLICY

4. New clauses in the Water and Electricity Bills:

(i) requiring the MMC explicitly to have regard to the need for information to make yardstick competition work, without prejudice to the generality of the public interest criterion;

(ii) requiring, for a period of 5 years after the redemption of the Special Share (unless this period was prolonged by affirmative resolution), the prior consent of the Secretary of State for Trade and Industry to the single ownership of more than one water plc or electricity distco over £30 million after receiving advice from the MMC, which would not be binding.

.It might be said in Committee Stage in the House, though not written into the Bills, that the Secretary of State for Trade and Industry would consult the territorial Secretary of State responsible for the water plc or distco company being taken into single ownership about public interest matters.

(iii) bids which do not involve the single ownership of more than one water plc or electricity distco would be subject to normal mergers policy and procedure. Government departments would be free to give give evidence to the MMC about their view of the public interest in the usual way.



FROM: J M G TAYLOR

DATE: 21 December 1988

A handwritten signature in the top right corner of the page.

MR BENT

cc Sir P Middleton
Mr Anson
Mr Monck
Mr Sedgwick
Mrs Brown
Mrs Ryding
Mr Evans

PRIVATISATION PROCEEDS: GAS DEBT

The Chancellor has seen your note of 21 December, and agrees that we should proceed on the basis of taking the Gas debt payment of £400 million on 18 April 1989.

Handwritten initials, possibly 'JMGT', located below the main text.

J M G TAYLOR

1. MR MOORE *Repayment of this £400m in 1989-90 is*
Reassumption in the forecasts.
2. CHANCELLOR OF THE EXCHEQUER *JW*

From: R M BENT
 Date: 21 Dec 1988
 cc FST

Sir P Middleton
 Mr Anson
 Mr Monck
 Mrs Brown
 Mrs Ryding
 Mr Evans

Ch. / Agree?
21/
Agreed.

Mr. Sedgwick

PRIVATISATION PROCEEDS: GAS DEBT

Under the terms of the £2.5 billion debenture issued to British Gas upon privatisation, HMG has to notify the company early in the New Year as to precisely when repayment of the third tranche of £400 million of Gas debt should take place in the period 20 March to 20 April 1989.

Options

2. Under the terms of the debenture, Government may request payment of:
- the full amount in 1988-89;
 - the full amount in 1989-90; or
 - part in 1988-89, and the balance in 1989-90.

Recommendation

3. In the event, however, privatisation proceeds are running well ahead of the original £5 billion target for 1988-89, and will be slightly over the £6 billion estimate announced at the time of the Autumn Statement. We therefore see no case for taking the Gas debt payment in this financial year, and we would propose taking it in full in 1989-90. The best day in the period 1 - 20 April 1989 is 18 April, and if you are content we will notify the company that repayment of £400 million should be made on this date.

R M Bent.

R M BENT
 PE2 Division

Susan 2.22.12.88



CC: Chancellor, 2
Mr Monck, Mr Moore,
Mrs Brown, Mr R.M. Bent,
Mr Tyrie, Mr Call.

Treasury Chambers, Parliament Street, SW1P 3AG

Ms Lyn Parker
Private Secretary to the
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET

MP
22 December 1988

Dear Lyn

Gareth Jones wrote to Jonathan Taylor on 5 December to record a call from Tristan Garel-Jones MP requesting that information be supplied to the Mexican Government on the UK privatisation programme.

I attach a summary note on the Special Share and how it operates, and on other devices to control foreign participation. The treatment latter is deliberately cautious given the sensitivities raised by the challenge the Commission are mounting against the Roll-Royce Special Share. I also attach 2 copies of an information pack on the UK privatisation programme to set the scene more generally. You may wish to forward these to the Embassy in Mexico.

On the final point raised by the Mexicans, you will no doubt be better able than I to say what, if any, sources of UK finance may be available to the Mexicans. But, if they hope for a tour or secondment by a experienced UK official, I am afraid that the pressures of the UK privatisation programme over the next few months do not allow this. There are, however, a number of merchant banks in the City who are always eager to win advisory appointments overseas, and I suggest that the Mexicans be directed to look there fore any expertise they seek.

A copy of this letter goes to Gareth Jones in Lord Young's office.

Yours sincerely
Susan.

SUSAN FEEST
Assistant Private Secretary