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PART A

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PART A

CHANCELLOR'S 1988 PAPERS ON THE BRITISH STEEL CORPORATION (BSC)

PO -CH /NL/0185
PART A

Begins: 28/9/88
Ends: 22/12/88

DD: 25 years
6/9/95

28 SEP 1988

dti
the department for Enterprise

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

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

Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET
Switchboard 01-215 7877
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| | |
|---|---|
| FINANCIAL SECRETARY | |
| REC. | 28 SEP 1988 |
| ACTION | Mr Bent |
| COPIES TO | PPS, Sir P. Middleton, |
| | Mr Anson, Mr Monck, |
| | Mrs Lomax, Mr Moore, |
| | Mrs Brown, Mr Ilett, |

Mr Gray, Mr Neilson, Mr Rutnam.

Direct line 215 5422
Our ref PS1BLE
Your ref
Date 28 September 1988

Dear Norman,

**BRITISH STEEL PRIVATISATION**

When we last exchanged letters on British Steel privatisation in July, I made clear that we would need to consider the question of the structure of the offer again in the autumn. We have now done so and also taken further advice from our City advisers.

As I indicated in July, my pre-disposition in this matter is towards tender mechanisms whenever market conditions allow, since in strong market conditions in particular they offer the prospect of enchanced proceeds. I also noted however that if market conditions were not strong we would need to consider a fixed price offer.

We have now reviewed those market conditions as we move into the autumn. In July conditions in the capital markets were generally relatively stable and improving; but since then the market has undoubtedly deteriorated and the institutions have shown no sign of wishing to move back into equities. Moreover, recent interest rate movements, trade figures and other statistics, however transient, are clearly having an impact on market sentiment.

Against that background, I do not see this as a privatisation on which to take risks. In the terms of our long term privatisation programme it is much more important that British Steel is successfully underwritten than that we force the pace on the price. And, for my part, I regard it as a high priority to ensure the return of British Steel's business to the private sector at the earliest possible opportunity in order to give them the commercial flexibility they need in the post-quota market.

Moreover, I am persuaded that the risk to the offer arising from a tender is real and not merely City caution. Our brokers believe that the institutions are certainly ready to stay out of any offer if they do not like the structure, however illogical that may be when they could make a tender offer at the minimum price. (I recognise of course that it might just be possible to make up for indifferent UK demand by overseas interest. But in present market circumstances, I regard it as highly likely that a BP structure could lead to as much as 50% of the stock going overseas and, as I have indicated in earlier correspondence, this is simply not politically acceptable). I should perhaps also add that Jeffrey Stirling, who has of course an independent line on these issues, believes strongly that the British Steel float will be difficult enough without introducing any novel arrangements (the BP structure never, of course, having been put to the test). He is therefore strongly in favour of a fixed price offer on this occasion.

Having considered the views expressed I have concluded therefore that it would not be sensible to proceed with a tender mechanism on this occasion. You will appreciate that in view of the many legal documents and other logistical arrangements this is an issue which must be decided at this stage.

A number of detailed points emerge from this conclusion. First, I believe it inevitable that the offer will need to involve some element of firm placing. Given political constraints on overseas offers, we could only be assured of avoiding firm placing if we were confident that we could put as much as 70% of the shares in the public offer, a figure I regard as well beyond realistic expectations at present. Clearly however no decision is needed on the exact proportions of the offer at this stage and I would certainly wish to leave the door open for a good level of retail demand if we see it emerge. (You will be interested to know that we are planning, for logistic purposes, for one and a half million applicants and could cope with more if necesary). Moreover we are, as you know, mounting an extensive campaign to inform the public of the offer and I would not rule out widespread interest.

Second, if we do not pursue the tender route, we need to consider the dual fixed price route. Again I fully recognise the attractions of this route and have asked our advisers and officials to consider this route in detail urgently, even though I understand there are a number of quite major difficulties with the concept in practice. I will write to you again as soon as officials have reported as this is again an issue we need to decide very quickly for logistical reasons.

I would be very grateful for an early response to the issues raised in this letter.

.pe2.bk/meb/25.9.2 CONFIDENTIAL

FROM: MRS M E BROWN

DATE: 29 SEPTEMBER 1988

1. MR MOORE

2. FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mr Odling-Smee
Mr Lyne
Mr Bent
Mr Guy
Mr Call

Sadly we think that in present markets it is prudent to retreat to a fixed price offer — or preferably to a dual fixed price with institutions paying more than Sid. If markets have improved by the end of 89 a Steel sale on this basis now should not prejudice the chances of a tender in Water and Electricity. But a flop on Steel could damage those sales.

AGW 29/9

A straightforward fixed price offer, with no firm placing, looks the best bet.

**STEEL PRIVATISATION**

I Offer Structure

Lord Young's letter to you of today proposes

- a fixed price offer, with no tender;
- a significant element of firm placing, but with no commission;
- urgent further work on the possibility of one fixed price for institutions and a lower fixed price for retail.

2. We recommend you to agree (reluctantly) that a significant tender on BP lines is not appropriate; to question whether firm placing is really essential in current markets conditions; and to welcome Lord Young's intention to consider further the possibility of a dual fixed price offer.

I see difficulties with allocation policy in the event of oversubscription of the course so followed.

Background

3. DTI have until now - with your encouragement - kept open the possibility of a BP-style offer. But Lord Young now believes that is too risky:

- market conditions are uncertain;

- Rowe & Pitman (and Sir Jeffrey Stirling) advise that in the present climate the UK institutions will be unwilling to participate in a tender at all. This could have a knock-on effect on the Government's ability to sub-underwrite the offer;

- Lord Young is not prepared to face the consequences of that, and to let as much as 50% of the stock go overseas.

4. In official-level discussions, we have pressed all the advisers very hard on this, and their unanimous view is that using a tender to sell all the shares destined for institutional investors could undermine the sale. We are getting the same feedback from all our other merchant banking contacts in the City. We have reluctantly concluded that we should recommend you to accept that there should not be a major tender element in this sale. However, we are conscious that a decision to go back to a fixed price offer for Steel will make it much more difficult to secure a tender approach for the water and electricity sales, unless market conditions improve considerably. You will want to weigh this in deciding whether to challenge Lord Young; but we do not realistically think he will be prepared to move on this.

4a. If you do agree to rule out a BP-style tender, DTI would like to tell the overseas advisers at a meeting tomorrow that the offer will be on some kind of fixed price basis - though not ruling out dual fixed pricing at this stage. It would be very helpful if we could let their officials know your conclusion on a tender today, even if you are still considering the rest of this advice.

5. We are less inclined to accept the arguments for firm placing. Lord Young suggests that without firm placing, some 70% of the offer (ie all except a 30% overseas element) would have to be offered to the retail public. This seems misconceived. Why should a 'UK public offer' not be open to institutional and retail applicants alike, but with a stated intention to give priority in allocation to retail investors? Since retail investors are not expected to flood in to this offer, the institutions should have no real worries about being starved of stock. Nevertheless, the advisers recommend that the UK institutions are much more likely to take the shares, and to sub-underwrite, if they are offered a guaranteed element of firm placing. The overseas advisers believe that the knowledge that shares have been firmly placed in the UK will encourage overseas investors. This latter point is probably the most forceful.

6. We recommend you to tell Lord Young that you are not prepared to endorse firm placing at this stage, and to press him on his reasons for thinking it essential. At the same time, you might indicate that you would only contemplate firm placing on condition that

(i) there was no commission (Lord Young recommends this himself, and it represents an important advance on previous sales which have involved firm placing);

(ii) any firm placing element was kept to a minimum. The institutions could apply for further shares in the 'public offer'.

7. Lord Young says that his firm preference is to offer all the shares at a single fixed price. But he is aware of Treasury concerns that institutions may be prepared to pay a higher price than that which is necessary to attract retail applicants. He is therefore asking the advisers to review within a week the possibility of a dual fixed price offer. Under this approach, a segment (say 1/3) would be offered solely to retail applicants. The rest would be sold at a higher price to UK institutions (through an open offer or - as Lord Young prefers - a placing) and to overseas

institutions (through a public offer). This approach would be presented publicly as securing a "market" price from professional investors, with a discount for small retail applications. It would appear to offer the prospect of higher proceeds, and would demonstrate the Government's determination to try to avoid excessive premia, whilst encouraging wider share ownership. Lord Young, however, suggests that this approach might not secure higher proceeds - because he believes that the retail price would simply be set at an even greater discount than in a single fixed price offer. He also points out that the Stock Exchange or the overseas exchanges might find it objectionable in principle.

8. Lord Young does not refer to an alternative approach which has been floated by Samuel Montagu with DTI and Treasury officials. Under this option the offer would be divided into four segments:

25% fixed price retail offer;

25% placing to UK institutions at the fixed price offer;

25% overseas offer, also at the fixed offer price;

25% tender to UK and overseas institutions.

This would both preserve a tender element, and guarantee some firm placing. The drawbacks are that if overseas applicants outbid the UK institutions in the tender, up to 50% of the offer might go overseas. Moreover, different territories might receive different combinations of fixed price and tender stock, resulting in different average prices. The advisers are strongly opposed to introducing such complications at this stage of the sale, and in present market conditions. On balance we recommend you not to press Lord Young to examine the possibility for a tender element on these lines, but to welcome his intention to look further at the possibility of a dual fixed price offer.

9. Finally, Lord Young is not yet proposing the exact proportions of the offer which should be targeted to the UK institutions, overseas, and retail. He is planning for logistics purposes for 1½ million retail applicants, which would imply rather more than

one third of a £1.5 billion offer going to the retail market. The system could cope with more if necessary. Lord Young is assuming a maximum of 1/3 going overseas, leaving a further third or more (depending on the number of retail applications) for UK institutions. We recommend you to welcome Lord Young's planning assumption on retail demand.

10. A draft reply is attached. It suggests that it may be sensible for you and Lord Young to meet quickly to consider the outstanding questions on offer structure, once he has assessed the case for a dual fixed price offer.

Mary Brown

**MRS M E BROWN**

DRAFT LETTER FROM: THE FINANCIAL SECRETARY

TO : THE CHANCELLOR OF THE DUCHY

**BRITISH STEEL PRIVATISATION**

Thank you for your letter of 28 September.

I note the advisers' strong view that in present market conditions a tender is too risky, and I reluctantly accept that we should plan for a fixed price offer. But I am concerned that we should not be seen in this sale to give ground on other issues where our approach must be fully defensible, and where we may be setting precedents for future sales.

For this reason I should like to press you on whether a major element of firm placing really is essential. I do not quite follow your point that we must otherwise put as much as 70% of the shares in the public offer (assuming that 30% are sold overseas). We would presumably invite applications for such an offer from both the institutions and retail alike (assuming a single fixed price), and I would have thought that this would give the institutions a good expectation of securing sufficient stock. I would much prefer to avoid <u>guaranteeing</u> any portion of the offer to UK institutional applicants, since this would then put a cap on our ability to tap whatever demand materialised from the retail sector.

My preference would be to defer a decision on firm placing until nearer the time of the sale. I could in any case only agree to firm placing on the basis that (i) there were no commission (you recommend this, and I very much welcome it); and (ii) any placing was kept to an minimum, with institutions invited to apply for further shares in the public offer.

I welcome your decision to ask the advisers to review quickly the possibility of a dual fixed price offer, and I understand that my officials are being closely involved with this work. I understand that the brokers to the sale agree in principle that institutional investors - both in the UK and overseas - would be prepared to pay somewhat more for the shares than the price which we would need to offer in order to attract retail applications of any size. I believe that the offer structure should reflect that if at all possible and present it as a discount to the retail investor rather than a premium on the institutional price. I would have much less difficulty with including an element of firm placing in the sale if the placed shares were at the higher of two fixed prices. I will look forward to hearing from you further on the possibility of a dual fixed price offer, and would be glad to have a quick meeting on that if it would be helpful.

Finally, I recognise that it is too soon to take firm decisions about the exact proportion of the offer to be targeted to the retail, UK institutional and overseas sectors. I note that your planning assumptions leave the door open for a good level of retail demand if it emerges, and I welcome that.

**NORMAN LAMONT**

dti
the department for Enterprise

28 SEP 1988

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

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

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| FINANCIAL SECRETARY | |
| REC. | 28 SEP 1988 |
| ACTION | Mr Bent |
| COPIES TO | PPS, Sir P. Middleton, |
| | Mr Anson, Mr Monck, |
| | Mrs Lomax, Mr Moore, |
| | Mrs Brown, Mr Ilett, |

Mr Guy, Mr Neilson, Mr Rutnam.

Department of
Trade and Industry

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Direct line 215 5422
Our ref PS1BLE
Your ref
Date 28 September 1988

Dear Norman,

BRITISH STEEL PRIVATISATION

When we last exchanged letters on British Steel privatisation in July, I made clear that we would need to consider the question of the structure of the offer again in the autumn. We have now done so and also taken further advice from our City advisers.

As I indicated in July, my pre-disposition in this matter is towards tender mechanisms whenever market conditions allow, since in strong market conditions in particular they offer the prospect of enchanced proceeds. I also noted however that if market conditions were not strong we would need to consider a fixed price offer.

We have now reviewed those market conditions as we move into the autumn. In July conditions in the capital markets were generally relatively stable and improving; but since then the market has undoubtedly deteriorated and the institutions have shown no sign of wishing to move back into equities. Moreover, recent interest rate movements, trade figures and other statistics, however transient, are clearly having an impact on market sentiment.

Against that background, I do not see this as a privatisation on which to take risks. In the terms of our long term privatisation programme it is much more important that British Steel is successfully underwritten than that we force the pace on the price. And, for my part, I regard it as a high priority to ensure the return of British Steel's business to the private sector at the earliest possible opportunity in order to give them the commercial flexibility they need in the post-quota market.

Moreover, I am persuaded that the risk to the offer arising from a tender is real and not merely City caution. Our brokers believe that the institutions are certainly ready to stay out of any offer if they do not like the structure, however illogical that may be when they could make a tender offer at the minimum price. (I recognise of course that it might just be possible to make up for indifferent UK demand by overseas interest. But in present market circumstances, I regard it as highly likely that a BP structure could lead to as much as 50% of the stock going overseas and, as I have indicated in earlier correspondence, this is simply not politically acceptable). I should perhaps also add that Jeffrey Stirling, who has of course an independent line on these issues, believes strongly that the British Steel float will be difficult enough without introducing any novel arrangements (the BP structure never, of course, having been put to the test). He is therefore strongly in favour of a fixed price offer on this occasion.

Having considered the views expressed I have concluded therefore that it would not be sensible to proceed with a tender mechanism on this occasion. You will appreciate that in view of the many legal documents and other logistical arrangements this is an issue which must be decided at this stage.

A number of detailed points emerge from this conclusion. First, I believe it inevitable that the offer will need to involve some element of firm placing. Given political constraints on overseas offers, we could only be assured of avoiding firm placing if we were confident that we could put as much as 70% of the shares in the public offer, a figure I regard as well beyond realistic expectations at present. Clearly however no decision is needed on the exact proportions of the offer at this stage and I would certainly wish to leave the door open for a good level of retail demand if we see it emerge. (You will be interested to know that we are planning, for logistic purposes, for one and a half million applicants and could cope with more if necesary). Moreover we are, as you know, mounting an extensive campaign to inform the public of the offer and I would not rule out widespread interest.

Second, if we do not pursue the tender route, we need to consider the dual fixed price route. Again I fully recognise the attractions of this route and have asked our advisers and officials to consider this route in detail urgently, even though I understand there are a number of quite major difficulties with the concept in practice. I will write to you again as soon as officials have reported as this is again an issue we need to decide very quickly for logistical reasons.

I would be very grateful for an early response to the issues raised in this letter.

chex.nh/jt/26 **CONFIDENTIAL**

PMP

FROM: J M G TAYLOR

DATE: 30 September 1988

**PS/FINANCIAL SECRETARY**

cc PS/Chief Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mr Odling-Smee
Mr Lyne
Mr Bent
Mr Guy
Mr Call
Mr D J L Moore
Mrs M E Brown

**STEEL PRIVATISATION**

The Chancellor has seen Mrs Brown's note of 29 September, which advises on Lord Young's proposals for the offer structure.

2. The Chancellor has commented that a straightforward fixed price offer, with no firm placing, looks the best bet. He has noted the suggestion that urgent further work be carried out on the possibility of one fixed price for institutions and a lower fixed price for retail. He sees difficulties with allocation policy in the event of over-subscription, if this course is followed.

JT

**J M G TAYLOR**

085JRF42.2 CONFIDENTIAL

cc. PPS, CST.
Sir P Middleton
Mr. Monck.
Mrs. Lomax.
Mr Odling Smee.
Mr. Moore
Mr. Lyne
Mr Bent
Mr. Guy.
Mr. Call.

FINANCIAL SECRETARY TO THE TREASURY

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

30 September 1988

Dear David

**BRITISH STEEL PRIVATISATION**

Thank you for your letter of 28 September.

I note the advisers' strong view that in present market conditions a tender is too risky, and I reluctantly accept that we should plan for a fixed price offer. But I am concerned that we should not be seen in this sale to give ground on other issues where our approach must be fully defensible, and where we may be setting precedents for future sales.

For this reason I should like to press you on whether a major element of firm placing really is essential. I do not quite follow your point that we must otherwise put as much as 70% of the shares in the public offer (assuming that 30% are sold overseas). We would presumably invite applications for such an offer from both the institutions and retail alike (assuming a single fixed price), and I would have thought that this would give the institutions a good expectation of securing sufficient stock. I would much prefer to avoid guaranteeing any portion of the offer to UK institutional applicants, since this would then put a cap on our ability to tap whatever demand materialised from the retail sector.

My preference would be to defer a decision on firm placing until nearer the time of the sale. I could in any case only agree to firm placing on the basis that (i) there were no commission (you recommend this, and I very much welcome it); and (ii) any placing was kept to an minimum, with institutions invited to apply for further shares in the public offer.

I Welcome your decision to ask the advisers to review quickly the possibility of a dual fixed price offer, and I understand that my officials are being closely involved with the work. I would have much less difficulty with including an element of firm placing in the sale if the placed shares were at the higher of two fixed prices. I will look forward to hearing from you further on the possibility of a dual fixed price offer, and would be glad to have a quick meeting on that if it would be helpful.

Finally, I recognise that it is too soon to take firm decisions about the exact proportion of the offer to be targeted to the retail, UK institutional and overseas sectors. I note that your planning assumptions leave the door open for a good level of retail demand if it emerges, and I welcome that.

Yours
Norman

NORMAN LAMONT

- 3 OCT 1988

dti

the department for Enterprise

CONFIDENTIAL

Fo 5/10
6/10

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

FINANCIAL SECRETARY
REC. - 3 OCT 1988
ACTION Mr Brown
COPIES TO PPS, Sir P. Middleton, Mr Anson, Mr Monck, MR Lomax, Mr Moore, Mr Bent, Mr Ilett, Mr Guy, Mr Neilson, Mr Rutnam.

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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

Direct line 215 5422
Our ref LQ1AGX
Your ref
Date 4 October 1988

Dear Norman,

**BRITISH STEEL PRIVATISATION : STRUCTURE**

Thank you for your letter of 30 September.

I welcome your agreement that we should abandon, reluctantly, the tender option. I also note your reservations on firm placing and can assure you it would be our intention to reduce firm placing to the lowest level consistent with a successful sale. Similarly it would certainly be my aim to have no commissions on any firm placing we eventually consider necessary. As you say, however, these decisions need not be taken yet.

That does not apply, however, to the question of dual fixed pricing where a decision is needed very quickly as to whether to pursue that route. As you indicate the advisers and our officials have been looking at this and I am now writing with my conclusions on the issue.

I start from the fundamental premise that our primary concern is to ensure that the British Steel offer is successful and that there is a healthy base of individual private shareholders. The possibility of giving a discount to such shareholders - and I cannot see that a dual fixed price offer would be interpreted in any other way - could be extremely helpful in encouraging more private investors to apply for shares. It would also allow us to be slightly more generous to this particular group of investors than we would wish to be to the main institutional investors and to overseas markets.

the Enterprise initiative

Nevertheless, I am afraid I would have some real difficulties with the prospect of a dual fixed price. First, it would be innovatory and in that respect must increase the overall level of uncertainty and risk. In current conditions, that cannot be attractive. Second, there are a number of technical points - for example clearance with the Stock Exchange - which I have no doubt could be overcome but would nonetheless be time consuming and unwelcome. Third, I think it would not be an easy task to defend the dual fixed price concept both from initial public criticism and, in due course, before the PAC. As it will clearly be necessary to underwrite the issue, at least in part, at the higher price, we would be foregoing proceeds rather more obviously than under previous structures simply in order to achieve wider share objectives.

These are however rather detailed points and my main objection is more substantial. In short, I believe that the dual fixed price notion would be clearly interpreted as suggesting that the Government has wider share ownership objectives for the British Steel sale. As I have indicated in earlier correspondence, I very much hope that significant retail demand will be generated for the shares and we are finalising a marketing campaign which will give the private investor every opportunity to apply. But following BP and the generally unsettled market conditions of the past year, I believe that we simply cannot assume at this stage of the campaign that private investors will wish to apply in large numbers, even with the attraction of a discount; and it is important that we avoid the risk of a perception of failure if the level of retail demand we hope for does not materialise. I believe that the choice of a dual fixed price option considerably increases this risk when set against the Government's objectives. In view of the longer term interests of the privatisation programme, I regard that as an undesirable and indeed unnecessary risk, when it is of fundamental importance that the overall programme is put firmly back on course.

In contrast, I believe the single fixed price offer retains considerable flexibility. As I have indicated, I believe some level of firm placing will almost certainly be necessary. But, the degree of firm placing should be kept to the minimum consistent with our expectations of retail demand as they develop and we do not need to decide that yet.

dti

the department for Enterprise

As I indicated, we need to make a very early decision on the dual fixed price route, as I understand that it is not really feasible to develop underwriting agreements which retain both options. On that basis, I can see no other course than to proceed on a single fixed price basis, and I would welcome your agreement to that course. If you feel we should meet on this issue, I am willing to do so, but we would need to do so quickly.

Y.e.

David

the Enterprise initiative

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I agree. MCS 5/10

FROM: W GUY
5 October 1988

1. MRS BROWN

2. FINANCIAL SECRETARY

cc Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Ilett
Mr Bent
Mr Lyne
Mr Rutnam
Mr Call

Mr Farmer IR

Ch/ FST inclined to agree to "free shares only" in N America (∴ alternative of full offer too complex). Content? 
as 6/10

OK — 

BRITISH STEEL: OVERSEAS EMPLOYEES

1. You will recall that British Steel and their advisers were to research the feasibility of extending the employee share offer to overseas territories and report back by the end of September. They have now done so.

2. The aim was to establish whether overseas employee offers could be handled without complications which could get in the way of the main offer. The conclusion of their lawyers and ours is that the full employee offer should be available to employees in EC countries, and that those in Norway and Sweden could also be included without undue difficulty. Steel itself has decided to exclude all other territories with the exception of USA and Canada, on grounds of administrative difficulty and cost. But they feel strongly that the 500 or so employees in North America should be included.

3. Canada would be fairly straightforward, but the US would be complicated. The lawyers believe that an offer to US employees could be done, without complications for the main sale, but that the cost would be very high. Steel would meet this cost. They have therefore proposed that only the first leg of the employee offer (the free shares; ie not the matching, discount or priority offers) should be made in the US. Logistically this would be much simpler. As Steel claim that they cannot distinguish managerially between employees in the US and employees in Canada, they propose that Canadian employees should also receive the free shares only. Steel maintain that if this is not agreeable, they will wish the full employee offer to proceed in North America, regardless of costs to themselves. They resist the idea that other ways could be found to motivate North American employees.

4. Lord Young has been consulted and is content with offering free shares only in North american territories.

5. There is a precedent for offering free shares only in the US, in the Airways sale. Slaughters, the Steel advisers, are aware of this because they arranged it. But it is not a good precedent. As it was explained to me by Slaughters, it arose as an expedient response to a last minute discovery that it would not be possible to limit the allocation of shares to US BA employees if the full employee offer proceeded in the US. The present case should therefore be judged on its own merits.

6. Free shares only does not have much to commend it. We see free shares for employees as part of a package, the overall aim of which is to encourage employees to invest somme of their own money in the company, to identify with it thereby, and to spread UK wider share ownership. Offering free shares in isolation looks odd.

7. But against this, it is well established practice to include overseas employees in this sort of sale, and where a full employee offer is made there is no compulsion for individuals to take up more than their free share entitlement; many do take up only the free shares. Steel maintain that it would therefore be illogical for the Government to baulk at a free share only employe offer where, as in the present case, that is the simplest way to involve overseas employees. They argue also that as we would presumably have no difficulty with a full employee offer in North America, allowing employees there to take up only the free shares if they wished, we should not be nitpicking about offering free shares alone.

8. The following considerations are relevant:

(i) we could not maintain that a full employee offer in the US would be so difficult as to jeopardise the main sale, and though it would be expensive that is a matter for Steel not us;

(ii) although the terms of employee offers are for the Government to decide and Steel cannot dictate to us, we would not wish to appear unreasonable and the choice therefore is between allowing free shares only or full employee offers in North America;

(iii) although it looks odd to offer free shares to 'foreigners' in this way, it is the normal practice to extend to them employee offers including free shares, and we have already conceded that overseas employees can in principle be included in the Steel employee offer;

(iv) although the exclusion from the employee offer in North America of everything but the free shares highlights the give away nature of this leg of the offer, the same give away would feature if full employee offers were to proceed there;

(v) Steel feel very strongly about it, and Lord Young supports them.

9. On balance it does not seem worth objecting to Steel's proposals unless you feel that to accept them would set an unwelcome precedent, in which case it would probably be necessary for you to write to Lord Young insisting that the full employee offer should proceed in North America. If you are content with offering free shares only in North America we can handle it at official level. Either way a decision is needed urgently.

Bill Guy.

W GUY

pe2.bk/meb/min 5.10

PMP

**FINANCIAL SECRETARY**

**FROM: MRS ME BROWN**
**DATE: 5 OCTOBER 1988**

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mr Moore
Mr Lyne
Mr Bent
Mr Guy
Mr Call

**STEEL PRIVATISATION: OFFER STRUCTURE**

1. Lord Young has replied to your letter of 30 September, agreeing that the question of firm placing can be held open until nearer the sale, and agreeing that firm placing should in any event be kept to a minimum.

2. However, he needs to decide now whether to base the offer on two fixed prices, or one. He has come down in favour of a single fixed price, and suggests a quick meeting if you do not agree.

**Background**

3. Lord Young's main reason for rejecting dual pricing is that it would be clearly interpreted as suggesting that the Government has wider share ownership objectives for this sale. Although Lord Young hopes that private investors will come into the sale, he considers it unwise to plan on that as a firm assumption. He wants to avoid the perception of failure which would result from earmarking a set proportion of the offer for retail investors (at a discounted price), and finding that the level of demand did not materialise.

4. In deciding your response you will want to consider the Government's objectives for this sale. If there is a firm objective of directing, say, 30 per cent or more of the UK offer to retail investors, then it will almost certainly be necessary to

discount the price below that which the institutions would be prepared to pay. Dewe Rogerson's latest assessment is that the number of people saying they are "certain to buy" may end up at around 100,000 - 400,000. Assuming average applications of £1000, that would bring in up to £400 million, or just over 15 per cent of a £2.5 billion offer.. Dewe Rogerson point out that favourable press comment will be needed to trigger even this level of demand. To increase it will require a widespread belief that there is surplus demand - both from institutions and from the retail sector. At least some retail investors would need to perceive an opportunity for stagging in order to come in. Rowe and Pitman agree that a lower price would be necessary to attract any significant number of retail rather than institutional investors.

5. Against this background, if you think it likely that at the pricing meeting Ministers will want to set a "retail" price for the shares, there is a strong case on proceeds grounds for fixing a separate and higher price for the institutions. (Presentationally, the emphasis would be on giving retail investors a discount from the "correct" - ie. institutional - price). This approach would bring higher proceeds than a single price directed at retail investors.

6. The alternative approach is to price the offer at the level necessary to attract the institutions, whilst making it as simple as possible for small investors to apply if they wish. In that case, there is no reason to offer retail investors a discount, and proceeds would be maximised by offering all the shares at the same "institutional" price.

7. In correspondence with Lord Young before the summer holidays you said that you hoped that retail applications might account for 30 per cent of the UK offer - and preferably more. The more gloomy PR and broking advice which DTI are now receiving suggests that that objective will be difficult to achieve. Unless you wish to make wider share ownership a more explicit objective of the sale, I think it unlikely that Lord Young will move from his preference for a single, one-price offer. In his view that offers

maximum flexibility, and would avoid the need to specify in advance a target number of shares for retail applicants.

8. Lord Young advances some subsidiary arguments against a two-price offer: that it is innovatory and therefore risky; that the Stock Exchange may raise technical difficulties; and that there could be public and PAC criticism. These points are not convincing: in our view the issue boils down to the question of whether or not the Government should make wider share ownership an explicit objective of this sale.

9. Because of the need to make progress with drafting the underwriting agreement, DTI would welcome a response this week if possible. If you continue to favour a two-price structure, Lord Young's office will arrange an early meeting. If you accept his conclusion that there should be a single price, we will provide a short draft letter to that effect.

10. We should be glad to discuss further if you would like to.

Mary Brown

**MRS M E BROWN**

APPOINTMENTS IN CONFIDENCE

pe2.bk/meb/min 6.10.3

FINANCIAL SECRETARY

FROM: MRS M E BROWN
DATE: 6 OCTOBER 1988

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mr Moore
Mr Lyne
Mr Bent
Mr Guy
Mr Call

Miss Wheldon (T.Sol)

**BRITISH STEEL: APPOINTMENT OF LEAD UNDERWRITER**

DTI have now offered Rothschilds this appointment. Michael Richardson agreed to accept a fee of £100,000, together with underwriting of £100 million at the average rate which emerges from the competition. Rothschilds will enter the competition for further underwriting. The appointment will be finally confirmed once Rothschilds have seen the draft prospectus and draft underwriting agreement and have confirmed that these cause them no fundamental difficulties.

Mary Brown

MRS M E BROWN

dti

the department for Enterprise

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

The Rt Hon Lord MacKay of
Clashfern
Lord President of the Council
Privy Council Office
68 Whitehall
LONDON SW1

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

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Direct line 215 5422
Our ref PB1AAA
Your ref
Date 10 October 1988

Dear Lord President,

**SALE OF SHARES IN BRITISH STEEL PLC: MINISTERIAL STATEMENTS**

I am writing about the offer of shares in British Steel plc to investors, which is planned to take place in late November. As we get closer to the time of the offer, and during the offer period itself, colleagues will need to consider carefully any references they may wish to make to the company or the share offer.

Unguarded or unverifiable statements in speeches, or in response to questions from the media or constituents, could have very serious consequences for the share offer, and could even make it necessary for us to postpone the offer. If at all possible, therefore, colleagues should sidestep questions about the share offer. Annex A sets out guidelines for dealing with such questions, together with a series of Questions and Answers to illustrate how the guidelines should be interpreted in practice. You will see from this material that the rules have been tightly drawn, but this approach is absolutely necessary in the circumstances. Any public statement referring to British Steel to be made in the UK or abroad must be specifically cleared in advance with my Department.

I am copying this letter and attachments to the Prime Minister and to all other members of the Cabinet: I should be grateful if they would circulate it to Ministerial colleagues within their Departments. I am also copying it to Sir Robin Butler.

Yours sincerely,

Gareth Jones

(Approved by the Secretary of State and signed in his absence)

the Enterprise initiative

ANNEX A

**STATEMENTS ON BRITISH STEEL SHARE SALE**

There are four basic rules which must be followed:

(i) anything said about the share offer, British Steel itself or British Steel's trading environment must be factual, accurate and fair;

(ii) statements made outside the UK must have specific regard to the requirements of the local regulatory laws. the offer is also being made overseas in the USA, Canada, Europe and Japan;

(iii) although comments about the general benefits of privatisation and expressions of the belief that British Steel will benefit from it are acceptable, no opinion should be expressed, and no prediction made, about the prospects for the shares or for British Steel's business or about British Steel's competitors or the steel industry generally (beyond whatever forecasts are set out in the Prospectus after its publication - and even these statements must be set in context);

(iv) enquirers should be urged to obtain their own copies of the Prospectus, once it has been published, and to make up their own minds after reading it. No statements should be made which could be interpreted as an inducement or recommendation to buy British Steel shares.

**RESPONSES TO QUESTIONS**

1. **<u>Why is the Government selling British Steel shares?</u>**

The British Steel share sale is part of the Government's overall privatisation programme. We believe that British Steel is now in a position to benefit from a return to the private sector.

2. **<u>When will the shares be offered for sale?</u>**

In the second half of November. Both the full Prospectus and a shortened version of the Prospectus will be widely available at that time.

3. **<u>Why is the Government advertising the sale? Does the advertising reflect a lack of confidence that the public will buy shares?</u>**

The advertising is designed to inform people who might be interested in buying shares how they can get the information they need to make their choice. It is up to individual investors to decide on the basis of the information in the Prospectus which is available to them whether they want to invest in British Steel shares or not.

**4. Should I buy British Steel shars? Will they go up in value?**

Your must decide for yourself. Shares can go down in price as well as up.

**5. How much is this sale going to cost Government by way of fees, advertising etc?**

All the costs of the flotation will be presented to Parliament after the sale.

BL2ACX

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pe2.bk.meb/10.10.1

PMP

**NOTE FOR THE RECORD**

FROM: M E BROWN
DATE: 10 OCTOBER 1988

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Moore
Mr Sedgwick
Mr Turnbull
Mr Gieve
Mr Lyne
Mr Bent
Mr Guy
Miss Gaseltine
Mr Rutnam
Mr Call

Ms Wheldon )
Mr Hyett ) T Sol

**STEEL PRIVATISATION: IMPACT DAY**

1. Impact Day is now firmly set for Wednesday 23 November, instead of Tuesday 22 November as previously planned. This date is not yet public: the Press has been told that the sale will take place "in the second half of November".

2. The pricing meeting, in which Treasury Minister(s) will be involved, will take place on 22 November. There is no specific time yet.

Mary Brown

MRS M E BROWN

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pe2.bk/meb/11.10.5

**FINANCIAL SECRETARY**

**FROM: MRS M E BROWN**
**DATE: 11 OCTOBER 1988**

cc Chancellor
Sir P Middleton
Mr Monck
Mrs Lomax
Mr Moore
Mr Ilett
Mr Lyne
Mr Bent
Mr Guy
Mr Rutnam
Mr Call

**STEEL: MINIMUM INVESTMENT LEVEL**

1. DTI officials have proposed that the minimum investment level should be "around £500". The precise figure will be determined by decisions on the price and number of shares, but the Share Information Office would start giving the indicative figure now.

2. Samuel Montagu and Dewe Rogerson both advise that £500 gives investors the right signals:

- it is clearly affordable by many, without being as low as the "Sid" precedents (see Annex);

- a higher figure - around, say, £1,000 - would cut out smaller investors who tend to come in on a long-term basis, whilst keeping in the stags;

- Rolls Royce, which was targeted like Steel at informed investors, was rather higher at £680. But that was set in rising markets, and some discount is required in present conditions.

3. Lord Young has agreed, subject to your views, that the SIO should be authorised to say that the minimum investment level would be around £500. It has been announced that there will be two instalments, although the precise balance between them, and

the timing of the second call, have not yet been decided. So investors who want to apply at the minimum level will know that they will have to find between about £200 (40%) and £250 (50%) this December.

4. I should be grateful to know whether you are content with a minimum investment level of £500.

Mary Brown

MRS M E BROWN

pe2.bk/meb/11.10.3

ANNEX

## MINIMUM INVESTMENT LEVELS

| Company | Sale Date | No. of Instalments | Minimum Investment (£) |
|---|---|---|---|
| BT | Nov '84 | 3 | 260 |
| Gas | Nov '86 | 3 | 135 |
| BA | Jan '87 | 2 | 500 |
| Rolls Royce | May '87 | 2 | 680 |
| BAA | July '87 | 2 | 368 |

1. MRS BROWN 20/10

2. FINANCIAL SECRETARY

From:R M BENT
Date:20 Oct 1988
cc Chancellor
Mr Monck
Mr Moore
Mr Ilett
Mr Lyne
Mr Guy

BRITISH STEEL: APPLICATIONS FROM PEP MANAGERS

Further advice has now been received from Samuel Montagu on the above. This confirms the problems we foresaw in setting aside firmly placed shares for PEP Managers.

2. Briefly, these problems are as follows:

(i) the Brokers to the Offer will be allocating to SubUnderwriters a package of firm placing, provisional placing subject to clawback and subunderwritten shares in a fixed proportion. Although it is open to SubUnderwriters to allocate the firmly placed shares to any PEP Managers in their Group, in practice they choose not to do this, and we have no leverage over them. Since PEP Managers will not be able to accept an underwriting risk on behalf of their clients, they will not be able to accept the subunderwriting package. If we request permission to allocate only firm placing to PEP Managers, and compensate for this by allocating a different package of firm placing, provisional placing and subunderwritten shares to the SubUnderwriters, the Stock Exchange may question why PEP Managers are the only investors allowed this special treatment. As we have seen on previous occasions, the Stock Exchange look for non-discrimination between investors;

(ii) PEP Managers themselves, when faced with a decision whether or not to accept firm placing between, say, 8am and noon on Impact Day, which is when the subunderwriting is done, may be reluctant to commit themselves to buy shares until they can guage the reaction of the market over the Offer period. Looking back to BP, they may well be concerned that, in the event of a Stock Market crash during the Offer period, their clients will not forgive them for buying shares on Impact Day that they would not have bought at Lists Closing;

(iii) meanwhile, the Brokers face a timing dilemma on Impact Day. If they offer the PEP Managers firm placing, and start distributing the rebalanced package of firm placing, provisional placing and subunderwritten shares to the SubUnderwriters, and then find that the PEP Managers do not want some or all of the firm placing, the Brokers must find other purchasers quickly (because the Government has promised investors that the shares will be placed firmly on Impact Day): however, it will then be obvious to the market that the subunderwriting has not gone well, and this may rebound on the Offer during the Offer period. If the Brokers hold off distributing the subunderwriting package until after the PEP Managers have decided to buy or not to buy (by which time the Brokers can accurately rebalance the subunderwriting package), they will expose the Primary Underwriters to risks not normally accepted: indeed, the Primary Underwriters would almost certainly veto any operation that frustrated the SubUnderwriters coming on-risk, and the Primary Underwriters going off risk, at the earliest opportunity.

3. In the light of these concerns, we recommend that the option of offering PEP Managers firmly placed shares should not be pursued further.

4. As on BP, PEP Managers will be supplied with special application forms for submission by Lists Closing, though - as we noted earlier - the absence of guaranteed allocations for those registering with the Share Information Office means, in practice, that PEP Managers will probably decide not to apply for shares because of the risks of scaling down.

R M Bent

R M BENT
PE2 Division

Ch, 'x' below. PE's strong advice is that, since this is now firmly in the Commission machinery, and since we are likely to win, no useful purpose would be served by stirring things up with Tietmeyer.
25
20/10

From: Sir G.Littler
Date: 20 October 1988

MR ALEX ALLAN

c.c. Mr Monck

**BRITISH STEEL: STOLTENBERG**

It was @ Travemünde last May!

The Chancellor must have raised with Stoltenberg during one of their recent private talks a question or request about the legal action of German steel producers alleging forms of subsidy in the 1983-85 period.

2. During a short private visit I made to the Tietmeyers at the end of my recent holiday, he asked me to convey a message to the Chancellor that Stoltenberg had not forgotten the conversation, but on enquiry had been unable to see his way to any immediately helpful action: apparently he wished to be sympathetic but could not countermand what had been done and the matter was now effectively in the Commission machine.

3. Unfortunately, neither Tietmeyer nor I had sufficient knowledge of the conversation or the present state of play on the subject to carry this further. Since my return, I have consulted Mr Monck and attach a copy of a note he has just sent me.

x 4. I shall see Tietmeyer again on Tuesday next week. Is there a point I could usefully follow up or any return message that the Chancellor would like me to convey?

Thanks. No need to follow up. Thank Stoltenberg / S'berg & say that we hope this will now be sorted out satisfactorily.

(Geoffrey Littler)

ind.rj Oct Littler.20

FROM: N MONCK

DATE: 20 October 1988

**SIR GEOFFREY LITTLER** cc Mr Moore

**GERMAN COMPLAINT ABOUT FINANCE FOR BRITISH STEEL**

You mentioned this subject and Stoltenberg's remark about the German Government's inability to restrain the German steel producers earlier this week. You may be interested to see the attached extract from the draft prospectus for BSC which takes a pretty robust line with the support of the Commission.

2. (d) deals with a separate case brought by the Commission about an alleged stainless steel cartel. There are currently various references in the press to this.

N MONCK

EXTRACT FROM DRAFT PROSPECTUS FOR BSC FLOTATION

was ended. The agreement was expressed to be without admission on the part of British Steel or HM Government and without prejudice to the right of any of the parties to raise any issue referred to in future proceedings.

(b) During the period from 1974 to 1988 British Steel was subject to claims from both present and past employees in respect of injury caused by exposure to excessive noise (industrial deafness). Such claims have been met, and future claims will be met, through external insurance and self-insurance effected by the Group (see section 12).

(c) On 1 July 1988 the Wirtschaftsvereinigung Eisen-und Stahlindustrie (the West German Iron and Steel Industry Federation 'the Federation') brought an action before the European Court of Justice pursuant to Articles 33 and 35 of the Treaty of Paris. The Federations's action requests the annulment of the Commission's Decision of 26 May 1988 ('the 1988 Decision') insofar as it concerns the Commission's refusal to act against the grant of aid to British Steel during the period from mid-1983 to the end of 1985; it alleges that payment of certain aid to Bristish Steel infringed the Treaty of Paris and resulted in a disproportionate distortion of competition. In particular, the Federation alleges that up to £713 million of aid authorised by the Commission during that period was in excess of the amount needed to restore British Steel to viability and was therefore not authorised in accordance with the State Aid Code of 1981 (the successor to the State Aid Code or 1980, which was introduced in relaxation of the general prohibition on state aid contained in the Treaty of Paris). Furthermore, it is alleged that an additional £217 million of aid granted to British Steel by HM Government subsequent to mid-1983 was 'illegal' in that it was not duly authorised by the Commission. On [●] October 1988, HM Government [was granted leave to intervene] in the proceedings brought by the Federation against the Commission.

State Aids

The Commission is resisting the Federation's action vigorously. It has applied to the Court for a procedural decision that the action should be rejected as inadmissible, believing that there are strong grounds for considering that the Court would so rule. However, if this application were not to succeed and if, following a hearing on the merits of the Federation's application, the 1988 Decision were to be annulled, the Commission might be required to reconsider the aid in question and then might direct HM Government to recover from British Steel all or part of any amount of aid found to be in contravention of the State Aid Code. HM Government and British Steel would be entitled to bring an action for the annulment of any such direction and,if necessary and appropriate, would do so.

Following an exchange of letters between HM Government and the Commission, both HM Government and the Directors share the view of the Commission that the Federations's allegations are ill-founded and without substance and that while it is for the Court to reach a judgement where a government properly executes a decision publicly taken by the Commission it is in principle undesirable that such individual decisions be re-opened years later.

In view of the foregoing, and in the light of a review by HM Government with the Commission and with British Steel of payments of aid made to British Steel during the period in question and of legal advice received, HM Government and the Directors consider that: (a) for a number of reasons, it is unlikely that the action against the Commission will be held to be admissible or, if it were, that the action would, in any part, succeed; (b) even if the Court were to find against the Commission, it is unlilely that, unless it were requred to do so, the Commission would seek repayment of any aid; and (c) even if the repayment of aid were sought by the Commission, HM Government and British Steel would have valid defences against such a direction on the grounds, inter alia, of their legitimate expectations and the length of time that has elapsed.

For these reasons, HM Government and the Directors consider that, although it is not possible to give any assurance as to the ultimate outcome of the Federation's proceedings or the amount of any possible liability on the part of British Steel, the likelihood of British Steel suffering loss by being required to make repayment of any aid is remote.

(d) The Commission recently initiated procedings under Article 65 of the [ESCC] Treaty [of Paris] against European steel producers, including British Steel, in relation to alleged arrangements relating to stainless cold rolled flat products. Article 65 prohibits restrictive agreements which prevent, restrict or distort normal competition within the EC for ECSC products. Any finding that Article 65 was infringed could lead to a fine by the Commission. British Steel does not believe that any fines, if imposed, would have a material adverse effect on the financial position of British Steel. Stainless

**12. Insurance**

The Group effects insurance through the external market and arranges self-insurance through

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COMMERCIAL IN CONFIDENCE

pe2.bk/meb/21.10.2

FINANCIAL SECRETARY

FROM: MRS M E BROWN
DATE: 21 OCTOBER 1988

cc Chancellor
Sir P Middleton
Mr Anson
Mr Lankester
Mr Monck
Mrs Lomax
Mr Moore
Mr Lyne
Mr Bent
Mr Guy
Mr Call

**STEEL PRIVATISATION: VALUATION AND OFFER STRUCTURE**

1. This minute reports decisions on the profit forecast and dividend for 1988-89; and seeks your agreement to various features of the offer structure to be announced at the Pathfinder Press Conference next Friday, 28 October.

**Profit forecast and dividend**

2. The Pathfinder will include a profit forecast for 1988-89 of £550 million before tax (£480 million after tax). This compares with 1987-88 pre-tax profits of £418 million. There will be a dividend forecast for 1988-89 of £150 million net. This figure has been agreed after negotiations during the last week in which Treasury was involved. British Steel's opening position was £130 million and DTI's was £160 million. We consider this a good outcome.

3. Since Steel is expected to be valued as a yield stock, the dividend decision is of course crucial to the eventual pricing decision, to be taken on 22 November. The advisers' present view is that the market will look for a yield in the 7.0 - 8.0 per cent range. As an illustration, the company would be valued at £2.5 billion on an 8.0 per cent yield and at £2.75 billion on a 7.3 per cent yield. These are "full" values, and would need to be

discounted by, say, 5-10 per cent in the offer price. An offer price of £2.5 billion would imply a PE multiple of 5.7, based on British Steel's expected average tax charge for the next few years of 20 per cent.

4. We will be keeping in very close touch with DTI and the advisers on the pricing outlook over the next month, and will provide full briefing in the lead up to the pricing meeting. At the Pathfinder Press Conference next Friday, and when the brokers start their rounds with the institutions, the plan is to establish £2.5 billion as a floor price, and to aim to talk it up from there.

**Distribution of the offer: UK/overseas**

5. Samuel Montagu recommend that it should be announced at the Pathfinder Press Conference that:

(i) a third of the issue will be offered overseas, reducing to around 25 per cent after clawback;

(ii) the remaining two thirds will be offered in the UK, of which a "substantial proportion" will be firmly placed'

(iii) some shares will also be provisionally placed in the UK in addition to shares clawed back from the overseas offer) would be added to the UK public offer.

6. Final decisions on the allocations between overseas markets; the amount of firm and provision placing in the UK; and trigger levels for clawback would be decided nearer to Impact Day.

7. Decisions on how much of the offer should go overseas rest on the assessment of total demand for the offer. The indications are:

- Overseas: around £1 billion (40 per cent of a total £2.5 billion offer). This is felt to be a reasonably conservative estimate. The death of the Japanese Emperor, when it happens, could affect Japanese demand;

- UK Institutions: Rowe & Pitman are confident that they could place firm at least a third of the offer (around £825 million) and probably considerably more. Assuming that a third was placed firm, we have asked how much more institutional demand might come into the public offer. They say they cannot predict that, since it depends entirely on whether a bandwagon effect can be generated in the offer period. Rowe & Pitman are extremely nervous of making any prediction of demand if there were no firm placing and all the shares were offered publicly. They say this approach would be extremely unwise in present market conditions.

- UK retail: Dewe Rogerson are also very reluctant to make firm predictions. There have been about 750,000 responses to the Share Information Office, although the rate is now expected to level off. On the basis of these figures, Dewe estimate that there could be upwards of ½ million applicants. Assuming an average application of £1700 that would suggest demand of £850 million or more (33 per cent of the total offer). However, Samuel Montagu and Rowe & Pitman are extremely sceptical that this level of demand can be counted on. They point out that there was a high level of pre-registration for the Eurotunnel offer, but virtually no retail demand emerged on the day.

8. Against this background, Samuel Montagu recommend that as much as possible overseas demand should be tapped, and that the enthusiasm being shown for the offer in the US and Japan, particularly, should be used to help drive the UK offer. A third (reducing to 25 per cent post clawback) is high by comparison with past primary offers: Gas was 19 per cent (12 per cent after clawback) and BA 21 per cent (16 per cent after clawback). BP was

nearly 50 per cent, but then the Company was also raising money and wished a high proportion of its shares to go overseas. However, we recommend you to agree. We believe that in present market conditions institutional demand has to underpin this sale, and it is prudent to draw on as much overseas demand as possible. Two thirds of the offer, and up to three quarters after clawback, will remain for the UK market.

**Firm placing**

9. In correspondence with Lord Young, you have said you wish to keep open the question of firm placing, and that it should in any case be kept to a minimum. The firm advice from Samuel Montagu and Rowe & Pitman is now that there should be a substantial amount of firm placing, and that this should be announced before the brokers begin their rounds immediately after Pathfinder. No precise figures would be given at this stage, but the advisers have in mind something on the following lines:

| | Before Clawback | After Clawback |
|---|---|---|
| UK Offer | % | % |
| Firm placing | 33 | 33 |
| Provisional placing | 12 | - |
| Public application | 22 | 42* |
| | 67 | 75 |
| Overseas Offer | 33 | 25 |
| | 100 | 100 |

*Clawback comprises 12 per cent from UK provisional placing and 8 per cent from overseas. These amounts could be varied, and the possibility of two-stage clawback (in case retail demand is weak) is being considered.

10. The Stock Exchange will allow no more than half the shares offered in the UK to be firmly placed. Assuming that a third of the total offer goes overseas, the maximum amount of UK firm placing is thus a third of the total (around £825 million), as shown in the table above.

11. We recommend you to agree that a "substantial amount" of firm placing should be announced at the Pathfinder Press Conference. We accept the advisers' view that this will be necessary to bring in the institutions, and to secure their commitment to sub-underwrite the public offer.

**Commissions**

12. You have already agreed with Lord Young that there will be no firm placing commission. The advisers recommend a commission of 1.25 per cent for sub-underwriting and provisional placing. This would not be disclosed publicly until Impact Day, but the brokers need to tell the institutions after Pathfinder. You will recall that we got this commission down to 1.0 per cent for BP. However, Rowe & Pitman believe that it is necessary to go back to 1.25 per cent in order to sub-underwrite the Steel offer in present market conditions. We have pressed them very hard, but they point out that there has been no movement from 1.25 per cent in any private sector issues since the crash, and that Steel is of exceptional size (cf the £100 million UK tranche of Vodaphone).

13. The choice is between insisting on 1.0 per cent, recognising that there is a possible risk to getting the sub-underwriting away; or agreeing to 1.25 per cent. We reluctantly recommend 1.25 per cent. The abolition of firm placing commissions is some compensation here. Paradoxically, the more firm placing, the lower the total cost of commissions (although of course the cost would be lower still if sub-underwriting were held at 1.0 per cent).

Conclusions

14. I should be grateful to know whether you agree that:

(i) a third of the total offer (25 per cent post clawback) should go overseas, divided between the US, Japan, Canada and Europe. The allocation between these markets will be decided closer to Impact Day;

(ii) two thirds should be sold in the UK, including a "substantial amount" of firm placing;

(iii) there should be clawback from both the overseas and UK offers. The amount of UK clawback, and the precise mechanisms including trigger level, will be decided nearer to Impact Day;

(iv) Sub-underwriting commissions should be 1.25 per cent.

15. Items (i)-(iii) would be announced at the Pathfinder Press Conference. Item (iv) would be disclosed by the brokers in their meetings with institutions starting immediately after Pathfinder.

16. DTI officials are putting the same proposals to Lord Young over the weekend. It is hoped to tell the overseas advisers on Tuesday what proportion of the offer will be sold overseas, and it would therefore be helpful to have your views on Monday if at all possible.

B. Vinahan

p.p. **MRS M E BROWN**

chex.ps/jt/35 RESTRICTED

FROM: J M G TAYLOR
DATE: 21 October 1988

SIR G LITTLER cc Mr Monck

BRITISH STEEL: STOLTENBERG

The Chancellor was grateful for your note of 20 October.

2. He has commented that there is no need to follow up on the substance of this. He would be grateful if you could thank Tietmeyer (for onward transmission to Stoltenberg) and say that we hope that this is now being sorted out satisfactorily.

J M G TAYLOR

chex.rm/jmt/28

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

FROM: J M G TAYLOR
DATE: 24 October 1988

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Mr Anson
Mr Lankester
Mr Monck
Mrs Lomax
Mr Moore
Mr Lynn
Mr Bent
Mr guy
Mrs Brown
Mr Call

**STEEL PRIVATISATION: VALUATION AND OFFER STRUCTURE**

The Chancellor has seen Mrs Brown's note of 21 October. He has commented that he hopes that the yield will be nearer 7 than 8 per cent.

J M G TAYLOR

RS56FST.42

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

FINANCIAL SECRETARY TO THE TREASURY

PJP

FROM: R C M SATCHWELL
DATE: 24 October 1988

MRS BROWN

cc PS/Chancellor
Sir P Middleton
Mr Anson
Mr Lankester
Mr Monck
Mrs Lomax
Mr Moore
Mr Lyne
Mr Bent
Mr Guy
Mr Call

**STEEL PRIVATISATION: VALUATION AND OFFER STRUCTURE**

The Financial Secretary was grateful for your minute of 21 October. He is content with all the proposals in para 14 of your minute, namely that;

- a third of the offer should go overseas (25% post clawback), divided between the US, Japan, Canada and Europe

- two thirds should be sold in the UK, with a "substantial amount" of firm placing

- there should be clawback from both the overseas and UK offers

- sub-underwriting commissions should be 1.25%

R.C.M.S.

R C M STACHWELL
Private Secretary

pe.sh.misc.mb.2

CONFIDENTIAL

FROM: MRS M E BROWN

DATE: 25 OCTOBER 1988

FINANCIAL SECRETARY

cc: Chancellor
Economic Secretary
Sir P Middleton
Mr Lankester
Mr Monck
Mrs Lomax
Mr Moore
Mr Ilett
Mr M Williams
Mr Bent
Mr Neilson
Mr Guy
Mr Call

**BRITISH STEEL: PRIMARY UNDERWRITING CIRCLE**

We need to decide whether the usual circle of UK merchant banks is invited to the Steel underwriting competition, or whether UK subsidiaries of foreign-owned banks and other financial institutions should also be invited. For the BP sale, you decided that although there were no regulatory objections to widening the circle, this would give the wrong signal to the traditional UK underwriters at a time when they were under pressure for various other reasons.

2. PE and FIM Divisions' advice is that the objective should be to open the underwriting competition to a wider range of competitors in time for the Water and Electricity sales; but not to widen the circle for Steel.

3. The primary underwriters of recent privatisation issues are shown in the Annex.

**Options**

4. The main alternatives for tapping a wider pool of capital for primary underwriting are:

i. Underwrite a higher proportion of the offer abroad (usually 25-30 per cent is the maximum, corresponding to the number of shares actually offered overseas). We do not recommend this. US and Japanese banks cannot lay off their underwriting to sub-underwriters during the Offer period. In the light of BP, we want to spread underwriting risks, not concentrate them.

ii. **Invite overseas management groups to the UK underwriting competition.**

In effect, this would be the same as option (i). We would encounter the same problem that banks registered in the US and Japan could not legally lay off their underwriting.

iii. **Invite the UK subsidiaries of overseas and securities houses banks to the UK underwriting competition.**

This is the most promising option, since UK-registered companies could lay off their risk to sub-underwriters in London. The rest of this minute is accordingly based on this option.

**Assessment**

5. We consider that there should be a clear presumption in favour of opening up the underwriting for UK privatisations. This is in line with the Government's policy of promoting competition. It offers the prospect of keeping commission levels as low as possible (even if in current conditions we cannot maintain the lowest-ever BP rate of 0.018%). It also reduces the risk, in difficult or extra large issues, of an actual shortfall in underwriting capacity. The latter point may be particularly relevant for the mega Water and Electricity issues.

6. However, Samuel Montagu have recommend strongly against changing the underwriting arrangements for Steel, and DTI officials agree with their advice. Montagus' arguments are:

i. Widening the circle will upset the London merchant banks. The Steel issue is going to be difficult, and we should avoid any unnecessary rows with the City;

ii. it could also be taken as a signal that the Government was worried that the UK banking community would not support the Steel issue. This point particularly concerns Samuel Montagu and DTI;

iii. we do not need extra underwriting capacity for Steel. The Bank of England is comfortable that underwriting up to 70% of the Offer (ie, up to around £1.75 billion) is within the capabilities of the existing UK circle. Samuel Montagu are confident, from their soundings in the City, that the Steel Offer will be supported by the UK merchant banks;

iv. the lobbying which the Government has received on previous sales, especially from Phillips & Drew and Citicorp, has not so far materialised on Steel.

7. There will be difficulties with the UK merchant banks at whatever time the Government decides to let in foreign-owned underwriters. The question is whether to face these on Steel. The alternative would be to wait until Steel is over, and signal the Government's intention to change well in advance of the Water and Electricity sales, stressing the very large underwriting capacity which will be needed for both.

8. We recommend the latter course. Although we should aim off for the advisers' caution, selling some £2.5 billion stock (albeit in two instalments) will be no easy task in current market conditions. Any indication of nervousness on the Government's part should be avoided, and we accept Montagus' view that there is some risk that extending the usual underwriting circle at this time could give that impression. If you did wish to propose a change, Lord Young will be firmly advised to resist, and we think you would have a considerable fight to shift him.

* These would need to be agreed with DOE and Energy Ministers

9. If you agree, PE and FIM will prepare firm proposals for extending the underwriting circle for Water and Electricity.* Our present view is that the competition should be opened to any UK subsidiary (not branch) of a foreign-owned bank or other financial institutions, where the subsidiary is:

a. using its own capital under the rules of the TSA or the Bank;

b. is able to commit itself to underwrite a specified percentage of the underwriting, which would be laid down in advance by the Government.

10. We would need to check further with TSA and the Bank how to handle subsidiaries which wish to draw on parental capital from a foreign parent. This raises more complex issues of equity. For example, TSA will satisfy themselves that parental capital is actually available from abroad, but will not necessarily know how the foreigner regulator will handle the parent's exposure, ie whether the foreign regulator imposes costs on the parent. If it costs a foreign parent less than a UK parent to commit capital to a UK subsidiary, UK houses will have grounds for complaint. On the other hand, foreigners would complain if the ability to call on parental capital were limited to UK - owned houses - for whom some arrangements to call on parental capital already exist. There are issues of the same kind on the banking supervision side.

## Conclusion

11. Do you agree that:

i. the underwriting circle should not be extended for Steel; but

ii. PE and FIM should prepare firm proposals to open up the competition in time for the Water and Electricity sales; and that the Government's intention to do so should be announced well in advance.

12. This minute is agreed with FIM.

Mary Brown

MRS M E BROWN

## ANNEX 1: PRIMARY UNDERWRITERS OF RECENT PRIVATISATION ISSUES

| | British Telecom (Nov 1984) | British Aerospace (May 1985) | Britoil (Aug 1985) | Cable & Wireless (Dec 1985) | British Gas (Dec 1986) | British Airways (Feb 1985) | Rolls-Royce (May 1985) | BAA (Jul 1987) | British Petroleum (Oct 1987) |
|---|---|---|---|---|---|---|---|---|---|
| Barclays de Zoete Wedd Limited | X | | | | X | | X | X | X |
| Baring Brothers & Co., Limited | X | | X | | X | X | X | X | X |
| The British Linen Bank Limited | | | | | | | | X | X |
| Charterhouse Bank Limited | X | | | | X | X | X | X | X |
| County NatWest Limited | X | | | X | X | X | X | X | X |
| Robert Fleming & Co. Limited | X | | | | X | X | X | X | X |
| Guinness Mahon & Co. Limited | | | | | | | X | X | |
| Hambros Bank Limited | X | | | | X | | | X | X |
| Hill Samuel & Co. Limited | X | X | | | X | X | X | X | X |
| Kleinwort Benson Limited | X | X | X | X | X | X | | | X |
| Lazard Brothers & Co., Limited | X | X | X | | X | X | | | |
| Lloyds Merchant Bank Limited | X | | | | X | X | X | X | X |
| Morgan Grenfell & Co. Limited | X | X | X | X | X | X | X | | X |
| N M Rothschild & Sons Limited | X | | X | | X | X | X | X | X |
| Samuel Montagu & Co. Limited | X | | | | X | X | X | X | X |
| J. Henry Schroder Wagg & Co. Limited | X | X | X | X | X | X | X | X | X |
| Singer & Friedlander | | | | | | | | X | |
| Standard Chartered Merchant Bank Limited | | | | | | X | X | | X |
| TSB Group plc | | | | | | | X | X | X |
| S.G. Warburg & Co. Ltd | X | | X | | X | X | | X | X |

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CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: R C M SATCHWELL
DATE: 27 October 1988

MRS BROWN

cc PS/Chancellor
PS/Economic Secretary
Sir P Middleton
Mr Lankester
Mr Monck
Mrs Lomax
Mr Moore
Mr Ilett
Mr M L Williams
Mr Bent
Mr Neilson
Mr Guy
Mr Call

**BRITISH STEEL: PRIMARY UNDERWRITING CIRCLE**

The Financial Secretary was grateful for your minute of 25 October. He agrees with your recommendation that the underwriting circle should not be extended for Steel. But he is also very strongly in favour of widening the circle for Water and Electricity, and believes that we should make that clear well in advance of the sales.

R.C.M.S.

R C M SATCHWELL
Private Secretary

dti

the department for Enterprise

CONFIDENTIAL

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
SW1A 3AG

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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Direct line 215 5423
Our ref PS1BRG
Your ref
Date 31 October 1988

Dear Jonathan,

**BRITISH STEEL PRIVATISATION : PUBLICITY**

As you know, the Government's preparations for the privatisation of British Steel are continuing and the Pathfinder Prospectus was published on 28 October.

It is now necessary to issue guidance about the release of information relevant to the sale during the period between now and the opening of dealings on 5 December.

... I therefore attach a note which has been prepared by this Department about the release of such information by the DTI.

Following precedent, and because of the need to exercise tight control over the release of such information, it is necessary that release of information relevant to the sale should be limited within Whitehall to the DTI. My Secretary of State would be grateful if his colleagues in charge of other Departments would arrange for any enquiries which their Departments might receive which are relevant to the British Steel sale to be directed to the DTI.

dti

the department for Enterprise

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This arrangement should be brought into effect as soon as possible.

I am copying this letter and enclosures to the Prime Minister's Private Secretary, Private Secretaries to other Ministers in charge of Departments and to Sir Robin Butler.

Yours

Gareth Jones

GARETH JONES
Private Secretary

dti
the department for Enterprise

BRITISH STEEL: PUBLICITY

Note by IMM Division

1. HMG proposes to sell its existing shareholding in British Steel at the end of November.

2. The Offer will be made by means of a Prospectus to be available from 25 November, the price of the shares having been announced on 23 November. A "pathfinder" or draft Prospectus was published on 28 October. This is expected to be almost identical to the final Prospectus, except that it does not price the shares.

3. The purpose of this note, which has been prepared by IMM Division, in consultation with the Department's solicitors, is to establish Guidelines for the release of information which might be relevant to the share offer by the DTI to anyone outside Government, whether the general public or a particular person. This Guidance is effective from now until the commencement of dealings on 5 December. It should, however, also be taken to cover matters which are being considered before that date but which are not expected to become public until after that date.

Relevant information

4. Relevant information is information which -

(a) in any way relates to the offer for sale, its timing, terms or mechanics; or

(b) reflects on the merits of British Steel ie relates to British Steel's operations, finances or prospects, or to the steel industry generally, and any other information capable of influencing an investor's decision to acquire shares in British Steel; or

(c) encourages or otherwise affects interest in the sale.

5. Answers given to written Parliamentary Questions are also covered by this note where they relate to British Steel or might in any way relate to the Offer of Shares in the company.

6. Within the DTI only authorised persons (see paragraph 7 below) may disclose information, and disclosure may not be made by them without prior clearance with one of the following officials of IMM Division: Richard Rogers, David Saunders or Peter Waller. They will consult the Department's solicitors and the Company as necessary.

Disclosure by authorised persons

7. The channels of communication from DTI are limited to Ministers and specified staff in the Press Office. This means they

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and no other staff are authorised to release information. It has been agreed that disclosure within Whitehall shall be limited to the DTI to which other Departments are being requested to direct enquiries.

## Detailed guidance

8. Information released by those authorised to do so will be factual in nature and avoid any expression of opinion about the prospects of the Offer or the merits of British Steel. It will refer to the fact that a prospectus will be issued which will contain details of the offer and the business and activities of British Steel and enquirers will be recommended to read it or, until the Prospectus is issued, the Pathfinder. They will be told where copies of these documents may be obtained and no additional information will be given. At no time will any information be given as to the amount of cash expected to be raised.

9. At all times care will be taken not to release information that might prejudice the success of the Offer or amount to HMG's endorsement of British Steel as "a good investment". Nor will information be released which is not in or which is inconsistent with the Prospectus.

IMM Division
October 1988

1. MRS M E BROWN

2. FINANCIAL SECRETARY

Ch,
To be aware.

From: R M BENT
Date: 2 Nov 1988
cc Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Lyne
Mr Guy

2/11

BRITISH STEEL: AVAILABILITY FOR PRICING MEETINGS

This is to confirm the message I gave your private office earlier today about the timing of the pricing meetings on British Steel.

2. DTI Officials have asked the Secretary of State to set aside time for two meetings as follows:

(i) Monday 21 November at 2pm: this is intended to be an open-ended meeting to collect and review the views of advisers, and the evidence on market demand. The desired outcome is either a provisional price, or a choice between two prices no more than 5p apart;

(ii) Tuesday 22 November at 2pm: there will be strict time constraints on this meeting, reflecting the State opening of Parliament in the morning, and the need to proceed with the primary underwriting competition at 4.30pm. This meeting will confirm, or decide, the Steel offer price.

R M Bent.

R M BENT
PE2 Division

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

1. MR MOORE DW 4/11.

2. FINANCIAL SECRETARY

From: R M BENT
Date: 4 Nov 1988
cc Chancellor
Sir P Middleton
Mr Anson
Mr Lankester
Mr Monck
Mrs Lomax
Mrs Brown o/r
Mr Lyne
Mr Guy
Mr Call

BRITISH STEEL: OFFER STRUCTURE

Mrs Brown's submission of 21 October reported various features of the British Steel offer structure, as they were announced at the Pathfinder Press Conference on 28 October.

2. More flesh will need to be put on the bones of the offer structure next week when Samuel Montagu write round to invite the primary underwriters to participate in the primary underwriting competition.

3. Although the underwriting memorandum is not a public document, and is supposed to be confidential to those that receive it, there is a risk that parts of it may leak. The memorandum circulates to about 20 banks in the City, and each of these banks will need to obtain clearances from their Budgetary Committees before being able to confirm that they can participate in the underwriting competition.

4. Against this background, DTI are proposing to give new details of the offer structure as follows:

(i) whereas at Pathfinder, we said that the overseas underwriters would account for about one third of the offer preclawback, and about one quarter postclawback, we did not then breakdown this figure between the different overseas markets. Next week's underwriting memorandum will detail the provisional distribution as being US (12%), Canada (3%), Europe (8.33%) and Japan (10%);

(ii) within the UK portion of the offer - two-thirds preclawback rising to three-quarters postclawback - the memorandum will say that firm placing with City institutions, declared at the Pathfinder to be "substantial", will account for between one quarter and one third of the total offer. DTI intend that this range should be kept open until just before pricing to allow maximum flexibility to respond to market conditions and

UK retail demand;

(iii) the proportion of the overseas offer and the UK institutional offer clawed back to the UK in the event of oversubscription, which we had previously envisaged to lie in the range 20-25%, will now be set at 25%;

(iv) the clawback will be triggered first from the overseas investors (at a level of 1.5 times subscribed if firm placing is 25%, or at 1.75 times subscribed if firm placing is 33.33%). It will subsequently be triggered from the UK institutions (at a level of 2 times subscribed if firm placing is 25%, or at 2.25 times subscribed if firm placing is 33.33%).

5. I attach two annexes illustrating the offer structure first assuming firm placing of 25% and second assuming firm placing of 33.33%.

6. These proposals are consistent with the broad structure of the offer put to you earlier. May I take it that you are content?

R M Bent

R M BENT
PE2 Division

Appendix 1

Illustrative distribution of UK sub-underwriting and effect of clawback

On the basis that the units offered to Priority Applicants will comprise 37.5% Firm Placing Shares, 12.5% Provisional Placing Shares and 50.0% Commitment Shares, the effect of the clawback provisions described in paragraph 21 would be as follows:

| | Before clawback | After withdrawal from overseas | After recall of UK Provisional Placing |
|---|---|---|---|
| | % | % | % |
| UK | | | |
| Firm placing | 25.00 | 25.00 | 25.00 |
| Provisional placing | 8.33 | 8.33 | - |
| UK Public and Employee Offer | 33.33 | 41.67 | 50.00 |
| | 66.67 | 75.00 | 75.00 |
| Overseas | | | |
| US | 12.00 | 9.00 | 9.00 |
| Canada | 3.00 | 2.25 | 2.25 |
| Japan | 10.00 | 7.50 | 7.50 |
| Continental Europe | 8.33 | 6.25 | 6.25 |
| | 33.33 | 25.00 | 25.00 |
| | 100.00 | 100.00 | 100.00 |
| Trigger (Note 1) | | 1.5x | 2.0x |

Notes

1. Trigger is a multiple of available shares under UK Public and Employee Offer other than non-underwritten Shares).

2. This illustration does not include Shares allocated to the Free and Matching Offers, which will not be underwritten.

## Illustrative distribution of UK sub-underwriting and effect of clawback

On the basis that the units offered to Priority Applicants will comprise 50.00% Firm Placing Shares, 16.67% Provisional Placing Shares and 33.33% Commitment Shares, the effect of the clawback provisions described in paragraph 21 would be as follows:

| | Before clawback | After withdrawal from overseas | After recall of UK Provisional Placing |
|---|---|---|---|
| | % | % | % |
| **UK** | | | |
| Firm placing | 33.33 | 33.33 | 33.33 |
| Provisional placing | 11.11 | 11.11 | - |
| UK Public and Employee Offer | 22.23 | 30.56 | 41.67 |
| | 66.67 | 75.00 | 75.00 |
| **Overseas** | | | |
| US | 12.00 | 9.00 | 9.00 |
| Canada | 3.00 | 2.25 | 2.25 |
| Japan | 10.00 | 7.50 | 7.50 |
| Continental Europe | 8.33 | 6.25 | 6.25 |
| | 33.33 | 25.00 | 25.00 |
| | 100.00 | 100.00 | 100.00 |
| Trigger (Note 1) | | 1.75x | 2.25x |

Notes

1. Trigger is a multiple of available shares under UK Public and Employee Offer other than non-underwritten Shares).

2. This illustration does not include Shares allocated to the Free and Matching Offers, which will not be underwritten.

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**FINANCIAL SECRETARY**

**FROM: MRS M E BROWN**
**DATE: 17 NOVEMBER 1988**

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Moore
Mr Lyne
Mr Bent
Mr Guy
Mr Call

We have fixed bilateral @ 10AM on Monday

## BRITISH STEEL: PRICING

The count down to the sale next week is:

| | |
|---|---|
| Monday 3.0 pm: | pricing meeting with Lord Young and advisers. Aim is to reach as firm a conclusion as possible, subject to review on Tuesday; |
| Tuesday 2.30 pm: | review meeting with Lord Young and advisers <u>if necessary</u>; |
| 4.30 pm: | primary underwriting competition; |
| Wednesday 10.30 am: | Impact Day Press Conference. |

This minute provides initial briefing for Monday's meeting. We are due to have a first discussion of it with you tomorrow (Friday). We will update you on Monday morning following weekend meetings with the overseas advisers, Rowe and Pitman and Dewe Rogerson.

We are not making a specific recommendation at this stage, but we suggest various points to make in order to probe Rowe and Pitman (who will be bearish). Samuel Montagu, freed from underwriting responsibilities, are being helpful to DTI in trying to stiffen the brokers, but they too will inevitably lean to a safe decision. Some consensus was emerging among the advisers this week that the price should be somewhat above 125p - possibly 128p. DTI officials were leaning to something between 130 and 135p. But these views will be very sensitive to market conditions and expectations between now and Tuesday afternoon.

There are two decisions to be taken on Monday afternoon:

- price
- amount of UK firm placing.

**PRICING**

Annex A shows a range of prices between 125p (£2.5 billion) and 140p (£2.8 billion), and the instalment sizes, P/Es and dividend yields which they imply;

Annex B gives P/Es, dividend yields and dividend covers for a range of comparable UK companies.
(Lord Young will have the same Annexes in his briefing pack).
The main factors to be considered are as follows:

(i) Yield.
This is the single most importan~~c~~t criterion, since Steel will be sold as a yield stock. The yields in Annex A are prospective yields, based on the company's own forecast dividend for 1988-89. They range from 7.1 per cent at the top price to 8.0 per cent at the lowest.

In looking at the comparator companies' yields (Annex B) we need to bear in mind that we will price for a premium of around 5--10 per cent in the aftermarket. Accordingly you will want first to form a view of the appropriate comparator yield; then to make some addition to that to allow for an aftermarket premium; and finally to work back to the price which will secure that (adjusted) yield.

The brokers say that the market will take British Gas as the closest comparator because of its size and yield stock character. Note that Gas and BP have the two highest yields in Annex B at 7.3 per cent and 7.23 per cent respectively.

Points to make

- Why is Gas the right comparator? What about industrial processing companies such as Pilkington (5.53 per cent), GEC (5.75 per cent), BOC (5.3 per cent)?

- even if these yields are raised by 10 per cent to allow for an aftermarket premium, Steel compares well at 7 per cent;

- BP yield may be influenced by KIO overhang. Cf Shell at 6.8 per cent;

- very wide range of brokers' forecasts for Gas - considerable uncertainty about next year's earnings and dividend. This year's yield [ ] per cent may be a more reliable yardstick;

- whatever comparator(s) identified, remember that with two instalments, the initial yield on Steel will be at least double the long-term one.

(ii) P/E's

Not the main criterion. The market recognises that Steel's future earnings may fluctuate, so investors' primary concern will be with the maintainable dividend. Nevertheless you will want to note that the P/E is low compared with those of most comparator companies. That must be an additional advantage to investors.

(iii) Demand

The latest indications are:

(a) Overseas (30 per cent of total offer pre-clawback)
Each market expects to be able to absorb its allocation provided the offer goes successfully in the UK. No specific price indications yet, but Japanese said to be "relatively insensitive" to price; Europeans regard 130 - 135p as attractive offer price; and Americans now seeking higher allocation, having previously been bearish.

(b) UK Institutions
We will get an assessment from Rowe and Pitman on Sunday (presentations to UK institutions have been taking place this week). They seem confident of putting away firm placing at around 125 - 130p, but say that extra institutional demand in the public offer will depend on price and media/retail reactions during the offer period. A summary of brokers' reports is at Annex C.

(c) Retail

Dewe Rogerson expect retail demand to range between a lower estimate of £260-390 million and an upper estimate of around £1 billion. See their letter at Annex D. At a price of 125p, and assuming a public offer of only 22 per cent, retail demand of £555 million would be needed simply to cover the offer (assuming no institutional applications). Retail demand of £833 million would be needed to trigger the first clawback point, and of £1,111 million to trigger the second clawback point. Dewe say that the success of the retail offer depends entirely on media endorsement. They believe a price of 125p is necessary to secure this.

You will want to probe these assessments. Although the retail reports are gloomy, those from overseas are good. It is Dewe Rogerson's job to make sure that the media and the institutions take account of that. You will want to stress the importance of avoiding another BA, where insufficient attention was paid to the strength of overseas demand.

(iv) British Steel - cyclical business

It may be argued that investors will be cautious about Steel because it is a cyclical business, and 1988-89 is expected to be at the top of the cycle.

The main consideration here is that Steel will be sold on dividend expectations, not earnings. The prospectus states (page 45) that the Directors will seek to pursue a progressive dividend policy; and that if profits were reduced as a result of a short-term fall in steel demand, they would expect to recommend that the level of dividend should be maintained. These statements are subject to caveats about unforeseen circumstances, but should nevertheless be reassuring to investors. So although there is bound to be some uncertainty about Steel's future business, it should not induce too cautious an attitude to pricing.

(v) Market uncertainty

You will of course want to bear in mind the much more uncertain market conditions now prevailing compared with previous primary privatisation offers. At a time when the institutions are holding much higher proportions of their assets in cash, and with uncertainty about retail interest post-BP, the advisers will recommend that the Steel price should err on the side of caution. You will want to weigh these factors, together with the need to pave the way for Water and Electricity, against the more bullish arguments suggested above. We recommend that your objective should be first to establish the tightest price achievable, before aiming off for these less tangible factors.

**DISTRIBUTION OF THE OFFER**

Annex E gives two alternative distributions of the UK portion of the offer (66 per cent of the total). Basis A provides for firm and provisional placing (before clawback) of 33 per cent, with another 33 per cent for the public offer. Clawback could increase the public offer in two stages to 42 per cent and 50 per cent. Basis B provides more placing (44 per cent before clawback) and a smaller public offer of 22 per cent. Clawback could increase the public offer to 31 per cent and 42 per cent.

The indications of retail demand point to basis B. That is Dewe Rogerson's advice, and unless conditions change markedly over the weekend we recommend you to accept it.

Mary Brown.

MRS M E BROWN

ANNEX A

## BRITISH STEEL: ILLUSTRATIVE P/E RATIOS AND YIELDS

| | | | | |
|---|---|---|---|---|
| Market capitalisation at Offer price | £2500m | £2600m | £2700m | £2800m |
| Estimate of privatisation costs | £70m | £70m | £70m | £70m |
| Estimate of net proceeds of sale to HMG | £2430m | £2530m | £2630m | £2730m |
| Offer price | 125p | 130p | 135p | 140p |
| Instalments | | | | |
| First instalment | 60p | 65p | 65p | 70p |
| Second instalment | 65p | 65p | 70p | 70p |
| P/E ratios | | | | |
| On forecast tax charge | 4.9x | 5.0x | 5.2x | 5.4x |
| On 20% tax charge | 5.7x | 5.9x | 6.1x | 6.4x |
| Gross dividend yields | | | | |
| On annual dividend of £150 million (net) | 8.0% | 7.7% | 7.4% | 7.1% |
| On first instalment to first dividend payment of £100 million (net), at an annual rate | 16.7% | 15.4% | 15.4% | 14.3% |

### Assumptions

| | |
|---|---|
| Profits before tax 1988/89: | £550 million |
| Forecast tax charge 1988/89: | £35 million |
| Forecast earnings 1988/89: | £515 million |
| Ongoing average tax rate: | 20% |
| Earnings (1988/89) after 20% tax: | £440 million |
| Notional dividends for full year 1988/89: | £150 million (net) |
| First dividend payable August 1989: | £100 million (net) |
| Dividend cover on actual tax: | 3.4 times |
| Dividend cover after 20% tax: | 2.9 times |

### Notes

1. Estimate of privatisation costs is provisional and very rough. It includes the cost of Free and Matching shares for employees, and will be affected by the amount of Firm Placing.

2. Instalments are equal when the Offer price is an even number. When the Offer price is an odd number, the first instalment is lower than the second instalment.

3. Calculation of the gross yield from first instalment to first dividend payment of £100 million (net), at an annual rate: (133.33 ÷ market cap. x price ÷ first instalment x 12 ÷ 8)%.

ANNEX B

## RATINGS OF SELECTED UK COMPANIES

| Name (Date of latest annual results) Share price/market capitalisation | P/E ratio | Gross dividend yield | Dividend cover |
|---|---|---|---|
| ASW (31 December 1987) 203p/£132m | 7.3x | 5.48% | 3.3x |
| BA (31 March 1988) 162p/£1,167m | 6.9x | 6.26% | 3.1x |
| BOC (30 September 1988) 416p/£1,892m | 8.7x | 5.32% | 2.9x |
| BP (31 December 1987) 246p/£14,965m | 11.5x | 7.38% | 1.6x |
| BT (31 March 1988) 254p/£6,028m | 9.6x | 5.59% | 2.5x |
| British Gas (31 March 1988) 163p/£6,765m | 7.3x | 7.23% | 2.5x |
| GEC (31 March 1988) 178p/£4,747m | 9.9x | 5.75% | 2.4x |
| GKN (31 December 1987) 316p/£775m | 7.8x | 7.01% | 2.4x |
| ICI (31 December 1987) 1008p/£6,815m | 7.8x | 6.02% | 2.9x |
| Jaguar (31 December 1987) 269p/£488m | 19.5x | 4.96% | 1.4x |
| Pilkington (31 March 1988) 225p/£1,654m | 8.0x | 5.48% | 3.1x |
| Rolls-Royce (31 December 1987) 134p/£1,074m | 7.6x | 6.16% | 2.9x |
| Shell (31 December 1987) 984p/£10,872m | 9.9x | 6.79% | 2.0x |

Source: Warburg Securities; Phillips & Drew; BZW Research; County NatWest Wood Mac; James Capel; Scrimgeour Vickers. Average of six estimates in each case except ASW (Warburg Securities only).

Notes: (a) Prices are at 1 pm on 17 November 1988. (b) Ratings are based on forecasts for each company's current year (i.e. the year to December 1988, March 1989 or September 1989). (c) Figures are based on estimates of each company's forecast actual tax charge.

ANNEX C

## BRITISH STEEL: BROKERS' CIRCULARS

| Broker | Circular |
|---|---|
| BZW | None permitted. |
| Capel Cure Myers | Commentary being sent. |
| Chase Manhattan Securities | Circular due after Impact. |
| Citicorp Scrimgeour Vickers | Likely to be a circular before Impact. To be sent early next week. |
| County NatWest Wood Mac | 'Even should HMG opt to price British Steel at 140p it would still comfortably rank in the top yield decile of the FTSE 100' (11 November 1988).<br><br>'Income Funds. Take advantage of the particularly attractive prospective yield on the partly paid shares but be prepared to maintain a wary eye on the prospects for earnings and thus dividends in 1989/90. It may well prove prudent to sell the partly paid as soon as the shares go ex-dividend in July 1989.'<br><br>'Index Funds. Be fully weighted as soon as possible, and certainly by end December 1988.'<br><br>'Growth Funds. The partly paid shares are only likely to offer significant outperformance if priced at 130p or lower. Whilst at higher offer prices the shares may well outperform in the short term, the outperformance is unlikely to be significant and sustainable on a six month view, unless the demand outlook for the latter part of 1989 starts to look more positive.' |
| James Capel | '..we believe that a price of about 135p would be appropriate to ensure a sensible premium on the partly-paid shares and to facilitate a healthy aftermarket.' (16 November 1988). |
| Kitcat & Aitken | Not before Impact. |
| Kleinwort Grieveson | 'We expect a price in the range of 130-140p' (28 October 1988). |
| Laing & Cruickshank | Circular Friday/Monday. |
| Panmure Gordon | Not before Impact. |
| Smith New Court | Circular possible before Impact. |

Dewe Rogerson Limited

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Telephone: 01-638 9571. Telex: 883610. Fax: 01-628 3444.

ANNEX D

Our Ref: AC/GR

14 November 1988

R Rogers Esq
Department of Trade and Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

Dear Richard,

British Steel Flotation: Distribution and Pricing of Offer

I am writing, following my letters of September 29th and November 10, to give some further input towards decisions on the offer structure and pricing, looking in particular from the perspectives of the retail market and of the media.

1. The primary objective, of course, is to secure a successful flotation with optimum proceeds.

   Self-evidently, this demands over-subscription and a reasonable premium in the after market.

   In any share offer, there would also be the need to look further forward and to pitch the price at a level from which there can be confidence that it will show longer-term growth, in order to ensure that the investor rating of a company, and thus its ability to trade effectively, is not damaged by over-aggressive offer pricing.

   At the very least, for British Steel with its part-payment structure, this means looking to a price, which, subject to market conditions being reasonable, can be felt likely to appreciate significantly by September next year. The company's perspective on this point no doubt would be likely to be longer.

2. Success for the British Steel flotation demands more than oversubscription and a healthy aftermarket.

   On the narrow front, given the structure of the combined offer, it means oversubscription of each of the offers in each of the markets, and, if clawback is confirmed, it means the retail market triggering at least the lower level.

More broadly, the British Steel share offer has considerable significance for the future of the Government's privatisation programme and its policy of wide share ownership, and also for the perception by capital markets and by media of the credibility of retail investment.

3. The accompanying table is based on Samuel Montagu's Underwriting Arrangements paper of 9th November, in which are set out illustrative distributions of UK sub-underwriting and the effect of clawback.

The table shows the amount of stock that would be distributed to the retail public on the basis of the two illustrative models of distribution, pre and post-clawback, at three possible pricing levels. It juxtaposes this with the levels of retail demand necessary to trigger clawback, and it sets alongside this the most recent indications of likely retail applications. As described in our November 10 letter, these amount to a low level of £260 to 300 million and a possible high level of around £1 billion, depending upon price and consequent media comment.

The clear conclusion is that, based on the most recent research observations, the retail offer would be substantially undersubscribed at the low level. At the high level, retail demand would cover the pre-clawback UK public and employee offer. It would not, however, trigger both levels of clawback at any price level, except possibly the 125p level on the basis of the smaller (22%) initial distribution. It would trigger the first level of clawback at each of the three illustrative prices on the basis of an initial 22% distribution, but not on an initial 33% distribution, except at the 125p pricing level.

As things currently stand, our judgement is that, the weight and tenor of media judgement necessary to secure the high level of retail investment would only be forthcoming at 125p.

Given this analysis, it would seem prudent to go for the lower, 22 per cent, level of initial distribution to the retail public. Secondly, on the basis of having two levels of clawback, considerable care needs to be taken over their manner of presentation, in order to avoid any subsequent perception of failure should the second level not be reached. Thirdly, unless demand signals strengthen markedly, or the Stock Market rises strongly, the pointers at present would be to a 125p pricing level.

4. It could be argued that the strength of demand amongst institutions, especially overseas, is such that the British Steel share offer could be oversubscribed by institutions at a price significantly above 125p - perhaps at 135p or even at 140p.

Demand among markets, however, is inter-dependent. The strength of demand in any one market sector is at least in part dependent upon its presuming healthy demand in the other sectors.

At present, the retail marketing programme is sending positive signals into the total mix - most importantly, the fact of over 1.4 million Share Information Office enquirers has placed the prospect of significant retail demand back into all investors' and commentators' minds.

Should this situation change, it would seem probable that institutional interest would dip and a damaging unwinding of tensions between the markets could ensue.

The apparent strength of retail demand stems, first, from the impact of the marketing programme in creating awareness and arousing interest and, secondly, in particular from the tenor of media comment about both British Steel and the share offer.

The quality of media comment has also been a vital contributor to institutional confidence in the company and the offer.

From this point forwards, media comment, which is interactive with analysts' views, is likely to be seen as the single most important barometer of the offer's probable success.

It is clearly vital that media comment be as positive and visible as possible.

The media will inevitably take a view on the appropriateness and attractiveness of the offer to private investors as well as to institutions and overseas investors. In order to keep the tensions building positively, it is necessary that the media endorse the offer as equally for retail as they do for institutional investors.

Not our aim?

The Observers' commentary last Sunday is a clear reminder of how fast media comment can turn against us either if journalists judge pricing aspirations too high for (private) investors or, as in this case, market jitters (or worse) bring back doomsday reviews and memories of last October/BP.

All this further supports a conservative pricing approach.

5. Retail demand has an importance beyond its contribution to securing the essential perception of scarcity.

The stagging element of retail demand is an important contributor to the aftermarket. Since the retail sector tends to be favoured during allocation, the institutions fall short of their desired weighting and thus buy in the market to increase their holdings from short-term investors, who tend predominantly to be an element of the overall retail market.

Retail demand also has a wider significance beyond its contribution to the British Steel offer.

Retail marketing has been deployed in this share offer not to secure wide share ownership, but (a) publicly to establish British Steel's corporate credibility amongst all the investor audiences as the essential pre-requisite of any investment decision and (b) to send signals to the UK and overseas institutions that there would be competition for the stock.

Whilst wide marketing at the corporate level in the first instance suited British Steel's corporate strategy - hence the corporate "In Shape for Things to Come" campaign - its continuation and extension into flotation marketing has been an essential contributor to building the perception of scarcity, and this wide marketing could only be conducted on the scale it has been by presenting it as a drive to attract retail demand.

To date, this marketing effort has been extremely successful (a) in leading everyone to believe that Steel is not only floatable, but that the offer will be a success; (b) in raising the feasible capitalisation level in the public, media and investor minds from around £2,000 million to at least £2,500 million and (c) in protecting British Steel's corporate image and positioning.

The role of retail marketing in contributing in these ways to the success of an offer is one which the Government will wish to exploit again in future privatisations.

6. The marketing effort has also been highly successful in combatting the cynicism of journalists, their great caution in again becoming involved as agents of creating demand through their editorial judgements and their equally great scepticism that "Sid" or even "Sidney" would ever come back.

It is necessary, not just for the Steel offer, but also for future offers and any desire further to widen and deepen share ownership, for there to be a substantial level of retail demand; for clawback to be invoked; and for there to be many long-term private investors as well as stags.

If there is not significant retail demand for Steel the task of engaging media support in future - or even of maintaining the credibility of the Government's marketing judgement on Steel - will be daunting, and the chances of Water and Electricity being successful wide ownership floats will be severely diminished.

7. The upshot of our thinking is that attractive pricing is needed to secure a successful offer; to serve the aftermarket, the second call and British Steel's longer term investor relations; to restore the retail market and the confidence of media and institutions; and to provide helpful memories in the run-up to Water and Electricity - both at the close of the offer and after the second call.

Secondly, as things stand, "attractive pricing" means 125p, both because of the need to attract supportive editorial (and the tightrope that is being walked in this respect) and because of the research indications of retail demand levels contrasted with the proposed distribution of the offer and clawback arrangements.

Only a marked improvement in market conditions and sentiment towards the offer could alter the view on appropriate pricing.

Conversely, of course, this analysis presumes that stock markets will stay firm and that last week's drop on Wall Street is only a temporary blip. If it is not, the prospect exists of sliding markets and of commentators speculating about a revisit of last October, which could torpedo the offer.

8. It is recognised that the perversity of this analysis is that "attractive pricing" could trigger a level of media support, which, if markets rise, could lead to a marked increase in final levels of retail demand - in the mould of Telecom, TSB, Rolls Royce, Airways and Airports.

The facts of the matter, however, are that (a) with this float, in these markets, against past memories of last year, such an outcome is not currently likely (b) that the borderline between high success and failure is always narrow and (c) that successful retail demand is critically important for the success of Steel and for sentiment among the media and the investment markets towards flotations to come.

I hope the above is helpful in the run-up to this coming Sunday's meeting.

Kind regards,

Tony.

Anthony Carlisle

cc: J Mogg, P Waller - DTI
D Moore, M Brown - HMT
O P Richards - SM
S Stradling - R&P
C Martin

## Two Illustrative Distributions of the UK Offer Pre and Post Both Clawback Levels at Three Possible Prices

| | 125p | | 130p | | 140p | |
|---|---|---|---|---|---|---|
| Price: | 125p | | 130p | | 140p | |
| Capitalisation: | 2.5bn | | 2.6bn | | 2.8bn | |
| | A | B | A | B | A | B |
| Distribution | £ Million | | £ Million | | £ Million | |
| **Pre Clawback:** | | | | | | |
| Firm Placing | 625 | 833 | 650 | 866 | 700 | 933 |
| Provisional Placing | 208 | 277 | 216 | 288 | 233 | 311 |
| UK Public | 833 | 555 | 866 | 577 | 933 | 622 |
| **Clawback 1:** | | | | | | |
| Firm Placing | 625 | 833 | 650 | 866 | 700 | 933 |
| Provisional Placing | 208 | 277 | 216 | 288 | 233 | 311 |
| UK Public | 1,041 | 764 | 1,083 | 794 | 1,166 | 855 |
| **Clawback 2:** | | | | | | |
| Firm Placing | 625 | 833 | 650 | 866 | 700 | 933 |
| Provisional Placing | - | - | - | - | - | - |
| UK Public | 1,250 | 1,041 | 1,300 | 1,083 | 1,400 | 1,166 |

### Levels of Retail Demand Needed to Trigger Clawback

| | 125p A | 125p B | 130p A | 130p B | 140p A | 140p B |
|---|---|---|---|---|---|---|
| Clawback 1 | 1,250 | 833 | 1,300 | 866 | 1,400 | 933 |
| Clawback 2 | 1,666 | 1,111 | 1,733 | 1,155 | 1,866 | 1,245 |

### Latest Indications of UK Retail Demand

Low Level: £260-£300 million
High Level: £1,000 million

(Based on analysis of November 9th - 11th research).

ANNEX E

## ILLUSTRATIVE DISTRIBUTION OF UK SUB-UNDERWRITING AND EFFECT OF CLAWBACK (BASIS A)

On the basis that the units offered to Priority Applicants will comprise 37.5% Firm Placing Shares, 12.5% Provisional Placing Shares and 50.0% Commitment Shares, the effect of the clawback provisions described in paragraph 20 would be as follows (all expressed as percentages of the Combined Offer):

| | Before clawback % | After withdrawal from overseas % | After recall of UK Provisional Placing % |
|---|---|---|---|
| **UK** | | | |
| Firm placing | 25.00 | 25.00 | 25.00 |
| Provisional placing | 8.33 | 8.33 | - |
| UK Public and Employee Offer | 33.33 | 41.67 | 50.00 |
| | 66.67 | 75.00 | 75.00 |
| **Overseas** | | | |
| US | 12.00 | 9.00 | 9.00 |
| Canada | 3.00 | 2.25 | 2.25 |
| Japan | 10.00 | 7.50 | 7.50 |
| Continental Europe | 8.33 | 6.25 | 6.25 |
| | 33.33 | 25.00 | 25.00 |
| | 100.00 | 100.00 | 100.00 |
| Trigger (Note 1) | | 1.5x | 2.0x |

**Notes**

1. Trigger is a multiple of available shares under the UK Public and Employee Offer (other than non-underwritten Shares).

2. This illustration does not include Shares allocated to the Free and Matching Offers, which will not be underwritten.

## ILLUSTRATIVE DISTRIBUTION OF UK SUB-UNDERWRITING AND EFFECT OF CLAWBACK (BASIS B)

On the basis that the units offered to Priority Applicants will comprise 50.00% Firm Placing Shares, 16.67% Provisional Placing Shares and 33.33% Commitment Shares, the effect of the clawback provisions described in paragraph 20 would be as follows (all expressed as percentages of the Combined Offer):

| | Before clawback % | After withdrawal from overseas % | After recall of UK Provisional Placing % |
|---|---|---|---|
| UK | | | |
| Firm placing | 33.33 | 33.33 | 33.33 |
| Provisional placing | 11.11 | 11.11 | - |
| UK Public and Employee Offer | 22.23 | 30.56 | 41.67 |
| | 66.67 | 75.00 | 75.00 |
| Overseas | | | |
| US | 12.00 | 9.00 | 9.00 |
| Canada | 3.00 | 2.25 | 2.25 |
| Japan | 10.00 | 7.50 | 7.50 |
| Continental Europe | 8.33 | 6.25 | 6.25 |
| | 33.33 | 25.00 | 25.00 |
| | 100.00 | 100.00 | 100.00 |
| Trigger (Note 1) | | 1.75x | 2.25x |

Notes

1. Trigger is a multiple of available shares under the UK Public and Employee Offer (other than non-underwritten Shares).

2. This illustration does not include Shares allocated to the Free and Matching Offer which will not be underwritten.

chex.md/aa/77 **SECRET AND PERSONAL**

**FROM: A C S ALLAN**
**DATE: 18 November 1988**

**MR D J L MOORE**

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mrs Brown

**BSC AND TRADE FIGURES ETC**

You passed to the Chancellor the form of words which it was proposed that the merchant banks should use if questioned by the underwriters about whether the price took account of the trade figures to be published on Friday 25 November. The line to take (if and only if the question was raised) was:

> "We (the merchant banks) have no knowledge of the trade figures. We understand that, in setting the price, the Government has taken full account of both British Steel's commercial prospects and all market conditions. (Trade developments are one of many factors which can influence market conditions.)"

2. The Chancellor is most concerned about the handling of this issue. He feels that we must take very great care not to give any hints whatsoever to the merchant bank advisers. There should be no question of thrusting a line to take on them, and DTI should only provide them with a line if one is specifically requested. And if it is, the line should be a much more neutral one, on the lines:

> "The Government has an usual taken account of all relevant factors."

3. The Chancellor will want to discuss pricing issues separately, with the Financial Secretary and others.

ACSA

A C S ALLAN

chex.ul/mw.ph/7

SECRET

FROM: MISS M P WALLACE

DATE: 18 NOVEMBER 1988

CHANCELLOR

At Alex's suggestion, I rang Michael Scholar to let him know the evening's developments, and to suggest that he get in touch with Eddie to find out his views. In the event, Michael could not get hold of Eddie, but he did report a conversation they had had earlier this afternoon, obviously before we knew about Hosker's advice. At that point, Eddie was in favour of not disclosing, but thought instead we should merely take opportunities to push for a lower price, where we could, without raising suspicion. On interest rates, Eddie's view was that it would be best to make our move simultaneously with an announcement, or half an hour later. But this was not a strongly held view, and he did also see some arguments for letting the thing go, and allowing ourselves to be led by the markets. Generally, he felt that the figures were not dramatically awful, and we could make a lot out of the picture taking this month and last month together.

2. As far as any meeting at the weekend is concerned, Paul Gray has left it up to you to decide whether you want anyone from the Bank along. I get the impression that it would be slightly difficult to have Eddie along on his own. The Governor, as you know, has been put in the picture, and has declared himself willing to attend if called, and adds that if so, he would want to bring Eddie along. If you want us to have any Bank people invited, let us know and we will tell Paul tomorrow. If not, you might like to give Eddie a ring yourself - his number is 693 1500.

MPW.

MOIRA WALLACE

CHANCELLOR OF THE EXCHEQUER

Ch

## BSC/Trade figs etc.

D Moore went to a meeting @ DTI yesterday. DTI are likely to want to press for a price at the bottom of the 125p – 140p range as insurance against market turbulence etc. My worry is that DTI will siege on this as further excuse to underprice. D Moore will be briefing FST.

DTI also feel they need a line on whether price takes account of trade figures – see draft attached. This makes me v nervous. If we do have to do this, I'd prefer something much more neutral on the lines "... Gov't has as usual taken account of all relevant factors".

AA

(PS DTI lawyers confirm no disclosure problems over trade figures).

chex.ul/jt.ph/3

SECRET

FROM: J M G TAYLOR
DATE: 18 NOVEMBER 1988

CHANCELLOR

**BSC/TRADE FIGURES**

Lord Young's Private Secretary, and Paul Gray, have been in touch.

2. The view of the DTI's legal advisers is that the Government could successfully be sued if we went ahead with the sale without informing the underwriters of the trade figures (assuming that those figures affect the markets detrimentally) I understand this view is shared by Gerald Hosker.* Lord Young's view is that - regardless of the legal question, to which he attaches weight - the Government's good faith would be called into question. He agrees, however, that it is quite unacceptable to give out privileged information to the underwriters.

3. His preferred option is that we should make an early announcement of the trade figures. DTI officials advise that it is possible to provide good indicative figures early. Lord Young favours releasing these at 9.00am on Monday 21 November. This would give 24 hours before PM's Questions. It would also give time for the markets to absorb the figures, and react, before closing discussions with the underwriters. DTI would say that they were making this early announcement because of the BSC sale.

4. DTI are consulting the Solicitor General (also *). They have also asked officials to advise on the best alternative course. However they feel that a decision by Ministers is needed by Sunday lunchtime so that officials can do the necessary preparatory work, if there is to be an early announcement of the trade figures.

5. Paul Gray advises that the most preferable course from the PM's point of view would be to hold a meeting tomorrow afternoon. He thinks that you should first hold a bilateral meeting with the Prime Minister so that you

* Paul Gray telephoned late tonight. Hosker had spoken to the Solicitor General. The Solicitor's "unequivocal advice" was that the terms of the Underwriting Agreement required the Secretary of State to disclose to the underwriters the information he now has.

can discuss the wider implications of early announcement for the markets. This would then be followed by a meeting involving Lord Young, Mr Newton, and the Law Officers.

* 6. We have informed Michael Scholar, who will speak to Eddie George. We have also spoken to the Governor's Private Secretary. We have not be able to reach Peter Middleton tonight, but I have passed on all of this to his Private Secretary, who will inform him first thing in the morning.

7. We are getting in touch with Steve.+ If he is not available, we will arrange cars through the Government Car Service.

8. I have said that we will get back to Paul Gray early tomorrow morning to say whether we can manage a meeting tomorrow afternoon. If it proves impossible then Paul's fallback is a meeting at 9.30am on Sunday.

JT

**J M G TAYLOR**

PS We've kept Alex fully in the picture. He's at home tomorrow, + ready to speak. (He has rung Terry, and put him in touch, and he has also spoken to Paul Gray).

* See Moira's note, behind

+ Steve is available.

dti

the department for Enterprise

expmts over £1bn

COPY NO 2 OF 19.

SECRET AND MARKET SENSITIVE

NAMED DISTRIBUTION ONLY

BRITISH STEEL AND THE OCTOBER TRADE FIGURES

Paper by Officials

The Problem

The British Steel privatisation timetable requires the price to be set and underwriting to be completed during Monday - Wednesday next week. The October trade figures are published on Friday. It is now known to Government that these figures will show a record current account deficit of £2.4 billion. The Solicitor General's preliminary advice is understood to be that, because this is outside the range reasonably expected in the market, the legal agreements associated with the sale impose on the Government an obligation to disclose these figures to the underwriters and others (copy of relevant clause 6(d) attached at Annex A). This disclosure would however conflict with the established principle that no one outside Government can be put in a position where they have this market-sensitive information, unless it is released to the market as a whole.

The Options

2. Four options are set out in the annexes:

Option 1 Bring forward the public release of the main features of the October trade figures to Monday 21 November.

Option 2 Announce postponement of the offer for a week or, more probably, until next year.

Option 3 Proceed to offer on current timetables but with intention to pull offer or compensate if market circumstances so require.

Option 4 Seek to amend the legal agreements.

Background

3. The present timetable is as follows:

Monday 21 November Presentation to primary underwriters. Substantive pricing discussions with advisers.

Tuesday 22 November Price to be set by about 3 pm, followed immediately by primary underwriting competiton. All legal agreements to be signed by about 8pm.

Wednesday 23 November Impact Day. Press Conference at 10.30 am, when the Secretary of State will announce the price.

Friday 25 November October trade figures released at 11.30 am. Prospectus widely available. Application forms in Press.

Friday 2 December 10.00 am Offer closes: latest point for pulling the offer.

Monday 5 December Dealings start.

Monday 12 December Renounceable Letters of Acceptance (enabling private shareholders to deal) despatched.

4. In assessing the options:

(i) Officials have taken it as axiomatic that there can be no selective disclosure of the trade figures.

(ii) Officials have of course been precluded from consulting financial advisers on the privatisation.

(iii) Officials have not had final advice from the Law Officers on Option 3.

Department of Trade and Industry
HM Treasury
19 November 1988

the department for Enterprise

SECRET

Option 1

Bring forward public release of the trade figures to Monday 21 November

- Imports, exports, trade balance, invisibles balance and the current account could be placed directly on the Topic screen and given to news agencies as early as possible on Monday.

- Early and exceptional release of the trade figures would be explained by the Government's obligation under the terms of the British Steel flotation to disclose any knowledge which may be material to the flotation.

Disastrous precedent not so
opps for [illegible] commentators
maximises mkt impact
minimises public attention
loses repn?
why change [illegible]?
[illegible]?
trouble overseas (esp US)

The announcement on Topic and to the news agencies could read:

"DTI is issuing a press release which reads as follows:

& hence action req?

Trade Figures

Because of the Government's obligation under the terms of the legal agreements relating to the British Steel flotation to disclose any knowledge which may be material to the flotation, the Government is exceptionally announcing the aggregate trade figures ahead of the due release date. The current account for October, seasonally adjusted, is estimated to have been in deficit by £2.4 billion. Exports, seasonally adjusted on a balance of payments basis, were valued at £6.8 billion and imports at £9.7 billion so that trade in goods was in deficit by £2.9 billion. The balance on invisibles is projected to have been in surplus by £0.5 billion. The detailed disaggregated trade figures will be published, as usual, at 11.30 am on Friday 25 November."

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PROs

- Allows the flotation to go ahead at a price reflecting market conditions after announcement of the trade figures. — The worst possible position

- Honours beyond all doubt the Government's obligations to the underwriters, the company and its directors in the legal agreements, without incurring the legally and morally unacceptable disadvantages of selective disclosure.

- Absolves the Government from accusations of bad faith, particularly in the event of the underwriters being left with the stock.

CONS

- Risk that the early and exceptional release of very bad trade figures, despite the explanation, could destabilise both the equity and foreign exchange markets, perhaps severely.

- Risk that destabilised markets could result in the failure of the flotation to be underwritten with the consequent postponement of the flotation.

- The price would have to be fixed before the market settled, and might be at a level which over-compensated for the effect of the trade figures to ensure successful underwriting.

- Despite use of the Topic screen and news agencies, accusations that departure from the long-pre-announced release date had unfairly disadvantaged some investors.

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- Timing ahead of State Opening of Parliament

- Would intensify pressure on Government to give advance indication of economic statistics, especially during periods of economic uncertainty. Might oblige Government to consider disclosure of all bad economic news ahead of sales of any kind eg gilts.

- looks wrong : (choice of announcement date)
- markets worldwide (esp US) – taken by surprise)

JF5AAE

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SECRET

Option 2

## Announce Postponement of the Offer

There could be an announcement on Monday that, for what we would have to describe as "technical" reasons, the offer was being postponed for a week or more probably, until next year. The Government would reaffirm its commitment to privatise British Steel.

### PROs

1. There could be no accusation of bad faith from, or threat of, litigation by the underwriters.

2. In the case of a week's delay the market would be given slightly more time to settle should there be severe disruption as a result of the figures.

### CONs

3. There would be damage to the confidence in the privatisation programme.

4. Postponement would undermine the confidence of the underwriters and the sponsor to the offer (Montagu's) and could undermine the market's confidence in the offer.

5. The announcement of postponement could excite speculation about poor trade figures possibly precipitating severe market volatility.

6. Since there could be no reference to the trade figures we could offer no credible explanation for the delay.

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SECRET

V. much doubt

7. A week's delay would present severe logistical problems. We might find on advice that it is indeed impossible. It would risk severe criticism since many investors might be unable to deal for up to three weeks (renounceable letters of acceptance would be despatched on or around 19 December).

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Option 3

Proceed to offer without early announcement of trade figures but taking them into account in setting the price and declaring that all relevant factors have been taken into account.

No!

In order to provide a defence against subsequent charges that the Government had acted in bad faith, the Government would need to have it in mind that, if the market's reactions to the trade figures so required, it would either pull the offer or introduce a scheme of compensation.

[illegible]

In addition, the Secretary of State would

(a) in answer to questions at the Impact Day press conference on Wednesday, say that all relevant factors had been taken into account in setting the price. If asked if these included the forthcoming trade figures, he would reply that the trade figures were obviously among the many factors tkaen into account;

NO

[illegible] comment

(b) when the trade figures are announced on Friday, say that he had lowered the price, possibly by a specific amount, in relation to the figure that would otherwise have been chosen, in order to take the trade figures fully into account.

Certainly not

[illegible]

PROs

1. Little likelihood of destabilising the equity and foreign exchange markets.

2. We have a good chance of getting the issue underwritten.

3. The announcement of the trade figures would be unchanged.

dti

the department for Enterprise

[NB a matter some of market reaction to trade figs: matter of whether market does to when starts]

SECRET

4. In the event of a less severe reaction to the trade figures from the Stock market, there is a fair chance of the sale proceeding satisfactorily provided the market perceives the price as reasonable in all the circumstances.

<u>CONs</u>

1. The underwriters could still accuse the Government of bad faith and breach of obligations under the legal agreements.

2. If the markets react very unfavourably to the trade figures, the underwriters would very probably seek to invoke the termination procedures.

3. Any subsequent pulling of the offer would be damaging both to British Steel's prospects for privatisation and to the prospects of underwriting future sales.

4. HMG's exposure in any compensation scheme could be very large - and sub-underwriters who are also institutional investors would have every interest in maximising it. At 1.25p the proceeds would be £2.5 billion. A 5% fall could cost £125 million. The practical details of a compensation scheme would need to be worked over in considerable detail.

5. The offer period may well coincide with a period of maximum market turbulence if the market picked up subsequently and HMG could be accused of overcompensating the underwriters.

JF5AAF

Option (1) best [illegible] for [illegible]

Dangerous market fall of 8 some 18%, or 270 points.

888-273

SECRET

Option 4

## Amend the Legal Agreements

We could seek to amend the legal agreements so as to exonerate HMG from any obligation to disclose the trade figures in advance of publication. The Solicitor General's advice is that explicit reference would have to be made to the trade figures in the agreements themselves.

### PROs

1. Satisfactory amendments, provided they are agreed, would allow the flotation to proceed.

### CONs

1. It is extremely unlikely that at this late stage, the agreement of all the other parties could be secured.

2. Other parties could hardly fail to realise from our seeking to amend the agreement that the trade figures were bad.

3. This would amount to selective disclosure.

4. When the trade figures were announced, there would be accusations of Government bad faith.

JF5AAH

Secretary of State and the Company with respect to such costs, charges or expenses.

5.05 If VAT is properly chargeable on any payment by the Secretary of State under Clause 5.04, the Secretary of State agrees that the amount of such payment shall be an amount exclusive of VAT and that the Secretary of State shall in addition pay an amount representing VAT thereon.

6. WARRANTIES BY THE SECRETARY OF STATE

The Secretary of State warrants and represents to and undertakes with each of the Underwriters (to the intent that such warranties, representations and undertakings shall remain in full force notwithstanding completion of the Offers and/or the UK Offer and the sale of the Offered Shares and/or the UK Offered Shares pursuant thereto, and notwithstanding the provisions of paragraph 3(k) of the section of Part XII of the Prospectus headed "Terms and Conditions of Application") that:

(a) each of the Offered Shares will, subject to any interest of, or derived from, any purchaser of such shares from the Secretary of State under the Offers, be beneficially owned by the Secretary of State, free of any mortgage, charge, lien or encumbrance until the Allocation Announcement;

(b) the Secretary of State has the power:

   (i) to make the UK Offer (through the agency of Samuel Montagu) and to perform the obligations on his part arising thereunder;

   (ii) to enter into and perform the obligations on his part contained in this Agreement and in connection with the Offers; and

   (iii) to authorise Samuel Montagu to act on his behalf for the purpose of, and in connection with, the making of the UK Offer and the co-ordination and supervision of the Offers and for all purposes which are reasonably incidental thereto;

(c) all statements of fact contained in the parts of the Prospectus for which the Secretary of State alone accepts responsibility, as specified in section 22(x) of Part XI of the Prospectus, are true and accurate in all material respects and are not misleading in any material respect and all statements of intention by HM Government in such parts of the Prospectus are honestly made:

(d) there is no fact known (or which should on reasonable and proper enquiry within HM Government have been known) to the Secretary of State which is not disclosed in the Prospectus and which renders the Prospectus or any statement in it untrue or misleading to a material extent or which, in the reasonable opinion of the Secretary of State, having regard to his knowledge of the Company and its subsidiaries and to matters which should on reasonable and proper enquiry within HM Government have been known to him, is or is likely to be material for disclosure to a prospective purchaser of Ordinary Shares pursuant to the UK Offer: and

(e) all necessary consents, approvals, authorisations and other orders of any Minister of the Crown and of all regulatory authorities in the United Kingdom (other than as referred to in Clause 2.01) required for or in connection with the Offers have been given.

7. INDEMNITIES BY THE SECRETARY OF STATE

7.01 The Secretary of State hereby undertakes with each of the Underwriters (for themselves and for the benefit of the several Priority Applicants and, in the case of liabilities arising pursuant to the matters referred to in paragraph (v) below, each person who controls any Underwriter (or Priority Applicant) within the meaning of either Section 15 of the Securities Act of 1933 or Section 20 of the Securities Exchange Act of 1934 of the US) to hold each of the persons to or for whose benefit such undertaking is given fully and effectively indemnified from and against:

(a) any and all losses, liabilities and damages which such person may suffer and all costs and expenses (other than those comprised in (b) below) which such person may properly and reasonably suffer or incur; and

(b) all liability in respect of any claim or action which may be brought or threatened to be brought against such person (whether or not such claim or action is successful, compromised or settled) including (but without prejudice to the generality of the foregoing) all costs and expenses which such person may properly and reasonably suffer or incur in disputing any such claim or action,

in each case arising out of, in relation to, or by reason of:

(i) the Prospectus not containing (or in the case of the indemnity specified in Clause 7.01(b) being alleged not to contain) in the context of the UK Offer all material information with regard to the Company and its subsidiaries or any statement therein being (or in the case of the indemnity specified in Clause 7.01(b) being alleged to be) untrue, incorrect or misleading in any material respect;

(ii) any misrepresentation (or in the case of the indemnity specified in Clause 7.01(b) any alleged misrepresentation) (by whomsoever made) contained in the Prospectus:

(iii) any breach (or in the case of the indemnity specified in Clause 7.01(b) any alleged breach) of the warranties, representations or

10 DOWNING STREET

RESTRICTED DISTRIBUTION REQUIRED

SECRET

SEE INSTRUCTIONS IN LETTER

SECRET

COPY NO. 2 OF 6 COPIES

CH/EXCHEQUER
REC. 21 NOV 1988
ACTION
COPIES TO

10 DOWNING STREET

LONDON SW1A 2AA

*From the Private Secretary*

20 November, 1988.

**BRITISH STEEL AND THE OCTOBER TRADE FIGURES**

The Prime Minister held a meeting this morning to discuss the joint paper by officials dated 19 November. Those present were the Chancellor of the Exchequer, your Secretary of State, the Chancellor of the Duchy of Lancaster, and the Solicitor General.

I should be grateful if you and copy recipients would ensure that no other copies of this letter are taken without authority from this office.

Summing up the discussion the Prime Minister said it was agreed that Options 1, 2 and 4 in the paper by officials were not acceptable. The approach to be followed should be based on Option 3. The Government should proceed with the flotation of British Steel on the existing timetable, with nothing being said to the underwriters about the trade figures. It was agreed that the issue of disclosure of the trade figures was separate from whether they were material and that, based on the appropriate construction of Clause 6(d) of the Underwriting Agreement, there was a respectable and honourable legal case for proceeding with the offer without contemplating any payment of compensation to the underwriters; that would only arise if a legal case against the Government was established. It would, however, be appropriate in fixing the issue price for account to be taken of the need to ensure that the issue should be a success; further consideration should be given in consultation with the Law Officers to the way in which that action should be recorded. The meeting had also noted that the final decision on whether or not to pull the offer need not be taken until 3 December, by which time market reaction to the trade figures would be clearly visible. Although there was no question of changing the form of the Underwriting Agreement for the purposes of the British Steel flotation, there was a case for considering whether its form should be changed for the purposes of future privatisations.

Copies of this letter go to the Private Secretaries of those present at the meeting.

(PAUL GRAY)

Neil Thornton, Esq.,
Department of Trade and Industry.

FINANCIAL SECRETARY

From: R M BENT
Date: 22 Nov 1988
cc Chancellor
Mr Monck
Mr Moore
Mrs Brown
Mr Lyne
Mr Guy
Mr Call

**BRITISH STEEL: PRIMARY UNDERWRITING COMPETITION**

This is to report that the British Steel offer has been successfully underwritten in the UK.

2. The primary underwriting competition was held this afternoon, and resulted in an average commission rate of 0.0717 per cent. The rates achieved in previous competitions were as follows:

| | |
|---|---|
| Cable and Wireless (1985) | 0.2625% |
| British Gas (1986) | 0.175% |
| British Airways (1987) | 0.111% |
| Rolls-Royce (1987) | 0.0614% |
| BAA (1987) | 0.0531% |
| BP (1987) | 0.018% |

3. All 13 banks in the competition were successful, and all will appear on the face of the British Steel prospectus.

4. The UK sub-underwriting, of course, will take place tomorrow, and should be complete by about 3pm.

R M Bent.

R M BENT
PE2 Division

Reference ....................................

CONFIDENTIAL

TO:
MR MOGG IMM

FROM:
GARETH JONES
PS/Secretary of State
for Trade & Industry
Room 803
1 Victoria Street
215 5423

22 November 1988

cc
PS/Chancellor of the Duchy
PS/Sir Brian Hayes
Mr Williams
Mr Rogers IMM
Mr Saunders IMM
Mr Waller IMM
PS/Financial Secretary
to the Treasury
Mr Moore Treasury
Mrs Brown Treasury
PPS

**BRITISH STEEL FINAL PRICING MEETING: 22 NOVEMBER 1988**

Those present: The Secretary of State
Mr Mogg
Mr Rogers
Mr Thornton
Mr Jones
Financial Secretary to the Treasury
Mr Moore Treasury
Mr McIntosh Samuel Montagu
Mr Richards Samuel Montagu
Mr Stradling Rowe & Pitman
Mr Sitwell Rowe & Pitman

Mr Stradling confirmed that the London and Wall Street markets were basically stable and that nothing untoward had happened since yesterday's meeting.

2 The Secretary of State, therefore, confirmed that the sale should go ahead at the issue price of £1.25p.

3 Mr McIntosh said that it was Samuel Montagu's intention to keep the offer price as quiet as possible before the press conference the following day.

**CORRIGENDA**

4 The Treasury have asked for the following amendment to be made to my minute of 21 November recording the first pricing meeting with advisors:-

Replace paras 9 and 11 with the following:

"Mr Lamont asked why British Gas, which had a relatively high yield was a suitable comparator to British Steel and why other industrial firms with even lower yields were not more appropriate. Linking to British Gas in this way led to proposals for a lower price. Mr Stradling said that the feedback that they had had from institutions was that British Gas was perceived as a good alternative for investment, and was therefore a reasonable comparator. Other companies with lower yields had much more growth potential for earnings than had British Steel."

Gareth Jones

GARETH JONES

JW2AAR

Covering SECRET
MARKET SENSITIVE

TO:

MR HIGGINS SOLS C

cc PPS/Secretary of State
Mr Liesner
Mr Mogg IMM
Mr. Moore HMT
MR SCHOLAR HMT

FROM:

ALAN WHITING
US/Ec2
Room 163
1 Victoria Street
215 5073

22 November 1988

BRITISH STEEL PRICING

... I am attaching questions and answers dealing with the trade figures issue for four separate meetings/occasions which arise this week.

2 As agreed, I would be grateful if you could confirm that the Law Officers are content with the wording.

Alan Whiting

A WHITING

SECRET

Tuesday afternoon: 22 November

Meeting of Secretary of State and Financial Secretary with financial advisers [2.30 this afternoon]

Q. What factors have you taken into account in setting the price?

A. I have taken account of all relevant factors. I have received a great deal of advice and a variety of different recommendations for the price has been put forward. I have set the price at a level which will, I believe, ~~to~~ ensure a successful sale with a healthy after-market when dealings begin on 5 December.

[if pressed] Q. But have you taken account of the October trade figures to be released on Friday?

X1

A. You know that I cannot say anything about the October trade figures before their public release. ~~But I have taken account of all factors which could have a bearing on market conditions during the Offer period. Clearly, the trade figures are among the many factors which I have taken into account.~~

AW1ACH

SECRET

Tuesday afternoon: 22 November

Meeting with underwriters to be attended by officials

[c. 4.00 pm this afternoon]

Q. What factors has the Secretary of State taken into account in setting the price?

A. All relevant factors have been taken into account in setting the price. The Secretary of State has received a great deal of advice and a variety of different recommendations for the price has been put forward. The price has been set ~~to~~ at a level which will, I believe, ensure a successful sale with a healthy after-market when dealings begin on 5 December.

[if pressed]

Q. But has the price taken into account the October trade figures to be released this Friday?

A. The Secretary of State has taken account of all factors which could have a bearing on market conditions during the Offer period. Clearly, the trade figures are among the many factors which the Secretary of State has taken into account.

Use line @ X

AW1ACG

SECRET

Wednesday morning: 23 November

Press Conference when Secretary of State will announce the price

(c. 10.30 am tomorrow)

Q. What factors have you taken into account in setting the price?

A. I have taken account of all relevant factors. I have received a great deal of advice and a variety of different recommendations for the price has been put forward. I have set the price ~~to~~ at a level which will, I believe, ensure a successful sale with a healthy after-market when dealings begin on 5 December.

[if pressed] Q. But have you taken account of the October trade figures to be released on Friday?

A. You know that I cannot say anything about the October trade figures before their public release. ~~But I have taken account of all factors which could have a bearing on market conditions during the Offer period. Clearly, the trade figures are among the many factors which I have taken into account.~~

AW1ACH

SECRET

Friday 25 November

Release of trade figures at 11.30 am

After release of the trade figures, in answer to queries from underwriters/advisers/press:

~~As I (the Secretary of State) made clear to all concerned earlier this week, in setting the price I (he) took account of all factors which could have a bearing on market conditions during the Offer period, including the October trade figures. The price is lower than I (the Secretary of State) would otherwise have set if the trade figures had been in line with market expectations.~~

I am perfectly satisfied with the offer price of £1.25.

AW1ACI

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

pg

Ch

Sol Gen fixed for 5-50pm this evening @ No 11

AA

dti

the department for Enterprise

SECRET AND MARKET SENSITIVE UNTIL 11.30 am ON 25/11/88 (then CONFIDENTIAL)

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

Alex Allan Esq
Principal Private Secretary to
the Chancellor of the Exchequer
HM Treasury
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

CH/EXCHEQUER
REC. 23 NOV 1988 ✓23/11
ACTION MR O L MOORE
COPIES TO FST
SIR P MIDDLETON
MR SCHOLAR
MRS ME BROWN

Direct line 215 5422
Our ref PS2BPF
Your ref
Date 23 November 1988

Copy No 1 of 10

Dear Alex

BRITISH STEEL PRICING AND THE OCTOBER TRADE FIGURES

We discussed briefly on the telephone the line the Secretary of State might take on and after this Friday about the relationship between the trade figures and the Government's decision on the price of the British Steel issue. I thought it would be helpful if I set out more fully how my Secretary of State sees the position.

Following the meeting at Number Ten on 20 November my Secretary of State has been advised by the Solicitor General that taking the trade figures into account in his decision on the price for the British Steel offer would not imply a duty to disclose; indeed it was important to take the figures into account:

(1) to avoid allegations of bad faith;

(2) to establish the reasonableness of the price fixed.

As my separate record of his meetings with the Financial Secretary on 21 and 22 November shows, in seeking to ensure a successful sale my Secretary of State therefore took account not only of advice from external advisers, but his assessment of the market conditions likely to prevail during the offer period, including an assessment of the possible impact of the known October trade figures.

dti

the department for Enterprise

My Secretary of State fully accepts the Chancellor of the Exchequer's advice on the line to take between now and Friday. In the light of the Solicitor General's advice, however, he feels it important that he should be able to confirm on or after Friday, if pressed, that he had indeed taken account of the trade figures when he set the British Steel price. Much of course depends on the market: the less marked any downturn in response to the figures, the less likely we are to be under pressure from underwriters or others. But if in the extreme case we were subsequently to find ourselves defending against legal claims or accusations of bad faith, we would then need to assert - as was the case - that account was taken of the fact that the trade figures were far worse than expectations. My Secretary of State believes that we cannot dissemble if pressed in the meantime, without undermining that eventual defence. He would of course stand by the normal practice of not discussing the trade figures themselves and will give no indication of the quantum of any adjustment to the price.

My Secretary of State is concerned about defending the Government's good faith in proceeding with underwriting the issue with foreknowledge of the trade figures. It is evidently for the Law Officers to comment on the legal implications, if any, of confirming when necessary that the Secretary of State took account of the trade figures in setting the British Steel price. But unless there is legal advice against such confirmation he does not believe that, once the trade figure are out, he could tenably decline to answer a straight question as to whether he had or had not taken them into account in setting the issue price.

I have asked our officials to contact their opposite number in the Treasury and the Law Officer's Department urgently to discuss this.

Copies of this letter go to Paul Gray (Number Ten) and to Justin Gregg (Law Officer's Department), Robert Satchwell (PS/Mr Lamont) and David Moore in the Treasury.

Yours sincerely,

Gareth Jones

pp

NEIL THORNTON
Principal Private Secretary

cc
Mr Mogg, IMM
Mr Whiting, EC2
Mr Moorey, Inf
Mr Higgins, Sols

the Enterprise initiative

dti

the department for Enterprise

SECRET AND MARKET SENSITIVE

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

Miss Moira Wallace
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1

**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 DW3BBN
Your ref
Date 23 November 1988

Mr DJL Moore
FST
Sir P Middleton
Mr Scholar
Mrs ME Brown
Mr Grieve

Dear Moira,

As discussed with Alex Allan, I enclose a draft Q&A brief prepared by our officials which reflects their understanding of the Chancellor of the Exchequer's recommended line to take on Friday. My Secretary of State will see the draft, together with a report on officials' discussions, tonight.

I understand that the Solicitor General has confirmed that adopting such a line should not prejudice the Government's legal defence against any subsequent litigation, provided we had not said or implied that we had not taken the trade figures into account in setting the British Steel price. My Secretary of State may, however, wish to discuss with the Chancellor the arguments of good faith discussed in my letter of 23 November, which do not depend on that legal view.

Yours ever,

Neil Thornton

NEIL THORNTON
Principal Private Secretary

Ch
It may be a good idea to catch Lord Young in the margins of Cabinet (he's going to OD first).

AA

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dti

the department for Enterprise

SECRET AND MARKET SENSITIVE

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

Miss Moira Wallace
Private Secretary to the
Chancellor of the Exchequer
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CH/EXCHEQUER
REC. 24 NOV 1988
ACTION Mr DJL Moore
COPIES TO FST
Sir P Middleton
Mr Scholar
Mrs ME Brown

Direct line 215 5422
Our ref DW3BBN
Your ref
Date 23 November 1988

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I understand that the Solicitor General has confirmed that adopting such a line should not prejudice the Government's legal defence against any subsequent litigation, provided we had not said or implied that we had <u>not</u> taken the trade figures into account in setting the British Steel price. My Secretary of State may, however, wish to discuss with the Chancellor the arguments of good faith discussed in my letter of 23 November, which do not depend on that legal view.

Yours ever,

Neil Th

NEIL THORNTON
Principal Private Secretary

the Enterprise initiative

## QUESTIONS AND ANSWERS : CHANCELLOR'S LINE

General line to inquiries

It is not for Government to advise potential investors whether or not to buy. They should make up their own minds. The Government remains perfectly satisfied with the offer price set.

When did the Secretary of State/officials know the figures whether provisional or firm? Did you know them when the price was set? When the underwriting agreements were signed?

It is not our practice to comment.

Did the Secretary of State take the figures into account in setting the price?

No comment.

What discount was applied to deal with the Trade Figures?

No comment.

How did you assess the reduction in the offer price?

No comment.

Won't the PAC attack this bargain basement sale?

Wholly premature : not even at the end of the offer period.

## QUESTIONS ON THE ISSUE OF DISCLOSURE TO ADVISERS/THE COMPANY/ITS DIRECTORS/UNDERWRITERS

Were advisers/the company/its directors/underwriters given any idea of the Figures?

No comment. Of course not

DW3BBL

Wasn't there a legal obligation to disclose (in the Prospectus)?

No.

Wasn't there an obligation to consult?

No. (If pressed by specific reference to Clause 6(d)) : Our legal advice is that the Government is under no obligation to provide such market-sensitive information.

Wasn't there a moral obligation to disclose?

well
It is generally understood that nothing can be said about the trade figures prior to their release.

To meet the difficulty of breaching confidentiality, couldn't the trade figures have been released early?

No. In practical terms it could not be done.

QUESTIONS ABOUT THE EFFECT OF THE TRADE FIGURES

If the Secretary of State knew the trade figures in advance, was it not irresponsible to proceed with the offer?

Not at all. We remain perfectly satisfied with the offer price set. The offer will proceed in the usual way.

What effect will these figures have on the offer?

I look forward to a successful sale.

Won't the Government have to pull the offer?

This is a hypothetical question. We remain perfectly satisfied with the British Steel offer.

Offer period still has a week to run.

DW3BBL

<u>Isn't this the end of the British Steel sale and with it of the Government's policy of privatisation?</u>

Of course not. The Queen's speech spelt out the Government's priorities and we shall stick to that programme. I am perfectly happy with the offer price set.

DW3BBL

chex.rm/aa/65 **SECRET AND MARKET SENSITIVE**

cc. ~~FST~~
Sir P. Middleton
Mr Scholar
Mrs Brown
Mr Moore
Mr Gieve

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

**24 November 1988**

**Neil Thornton Esq**
**Principal Private Secretary to the**
**Secretary of State for Trade and Industry**
**Department of Trade and Industry**
**1-19 Victoria Street**
**LONDON**
**SW1**

Dear Neil,

Thank you for your letter of 23 November to Moira Wallace. As you know, the Chancellor and your Secretary of State had a brief word about this in the margins of Cabinet this morning, and agreed that something along the lines you attached was appropriate for officials to use tomorrow, but that Lord Young himself would not be commenting tomorrow. The Chancellor thought that, in addition to the general line you attached, officials should so far as possible avoid being drawn into answering detailed questions, and should stick to points such as "everything has been done in a correct and proper manner", and "I am not going to answer hypothetical questions".

On the detailed questions, he had the following comments:

(i) In answer to the question were others given any advance idea of the figures, he did not see any harm in denying that they were.

(ii) In answer to the question about whether there was an obligation to consult, he thought it would be better to refer to "... under no obligation to provide this information", rather than "such market sensitive".

(iii) In answer to the question about whether there was a moral obligation to disclose, he thought it would be better to begin "it is well understood ..." instead of "generally".

(iv) He was surprised to see the answer "in practical terms [releasing the trade figures early] could not be done". He thought this was disingenuous. Would it not be better to stick with a simple "no"?

Yours
Alex

A C S ALLAN
Principal Private Secretary

dti

the department for Enterprise

PSE cc. ~~also~~ to CST, PMG, EST

3


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


**SECRET AND MARKET SENSITIVE UNTIL 11.30 am 25 NOVEMBER, THEN CONFIDENTIAL**


**Department of Trade and Industry**

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Alex Allan Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury Parliament Street LONDON SW1

Direct line 215 5422
Our ref DW3BBZ
Your ref
Date 25 November 1988



Dear Alex,

**BRITISH STEEL AND THE OCTOBER TRADE FIGURES**

Following earlier exchanges I attach the agreed line to take in response to immediate inquiries about the relationship between the British Steel privatisation and today's Trade Figures.

My Secretary of State and the Chancellor of the Exchequer agreed yesterday that they would review the approach as necessary in the light of market developments over the next few days.

I am sending copies of this letter to Paul Gray (No 10), Justin Greig (Law Officers' Department).

Yours ever,

Neil Thornton

NEIL THORNTON
Principal Private Secretary

the Enterprise initiative

QUESTIONS AND ANSWERS

General line to inquiries

It is not for Government to advise potential investors whether or not to buy. They should make up their own minds. The Government remains perfectly satisfied with the offer price set.

When did the Secretary of State/officials know the figures whether provisional or firm? Did you know them when the price was set? When the underwriting agreements were signed?

It is not our practice to comment.

Did the Secretary of State take the figures into account in setting the price?

No comment.

What discount was applied to deal with the Trade Figures?

No comment.

How did you assess the reduction in the offer price?

No comment.

Won't the PAC attack this bargain basement sale?

Wholly premature : not even at the end of the offer period.

QUESTIONS ON THE ISSUE OF DISCLOSURE TO ADVISERS/THE COMPANY/ITS DIRECTORS/UNDERWRITERS

Were advisers/the company/its directors/underwriters given any idea of the Figures?

No. They did not know until the figures were released, at 11.30 am on Friday 25 November.

Wasn't there a legal obligation to disclose (in the Prospectus)?

No.

Wasn't there an obligation to consult?

No. (If pressed by specific reference to Clause 6(d) : Our legal advice is that the Government is under no obligation to provide this information.

Wasn't there a moral obligation to disclose?

It is generally understood that nothing can be said about the trade figures prior to their release.

To meet the difficulty of breaching confidentiality, couldn't the trade figures have been released early?

No.

**QUESTIONS ABOUT THE EFFECT OF THE TRADE FIGURES**

If the Secretary of State knew the trade figures in advance, was it not irresponsible to proceed with the offer?

Not at all. We remain perfectly satisfied with the offer price set. The offer will proceed in the usual way.

What effect will these figures have on the offer?

I look forward to a successful sale.

Won't the Government have to pull the offer?

This is a hypothetical question. We remain perfectly satisfied with the British Steel offer.

Isn't this the end of the British Steel sale and with it of the Government's policy of privatisation?

Of course not. The Queen's speech spelt out the Government's priorities and we shall stick to that programme. I am perfectly happy with the offer price set.

DW3BBL

FROM: MARK CALL
DATE: 28 NOVEMBER 1988

**CHANCELLOR**

Thanks. Useful for [illegible]

cc PS/Chief Secretary
PS/Financial Secretary
Mr Hudson

**BRYAN GOULD ON BRITISH STEEL PRICING**

You asked me to try and get hold of Bryan Gould's remarks describing the British Steel privatisation as the "insider deal of the century". This appears to have been a press release rather than a speech, although Central Office have been unable to locate a copy of the actual release. I attach instead coverage in a number of papers, the fullest quotation being in the Morning Star.

2. Bryan Gould has written to Robert Sheldon urging the PAC to take an interest. He has also called for Lord Young to cancel the sale saying it will flop like BP. This is somewhat inconsistent with his line that the issue is underpriced. If it comes up in debate, you might press Bryan Gould on whether he thinks British Steel is indeed a risky investment (as he is reported to have said a week ago) or is underpriced. You might also ask how a well-publicised offer available to all comers, is an insider deal.

Also how it can possibly arise when the ~~[illegible]~~ market – not the Govt – determines whether a "quick buck will be made", & hence the market judges whether to come in at 125p or not.

MC

MARK CALL

ENC

NH

Morning Star

# £200 million British Steel rip-off 'insider deal of century' — Labour

THE BRITISH Steel sale is a £200 million rip-off and the "insider deal of the century," Labour warned yesterday.

The 125p share offer pricing the company at £2.5 billion, undervalues the state-owned steel concern by a staggering £200 million.

The "British Steal" give-away price is a Christmas gift to City slickers. But it robs £10 from every home in Britain.

Trade Secretary Lord Young had to price the steel grab cheaply to breathe new life into the Tories' flagging privatisation programme.

It is the first major sell-off since the stockmarket crash and subsequent BP privatisation fiasco a year ago. Sales of Girobank and Sunderland shipyards are now on the rocks.

**by TONY CLARK**

The government can't chance another failure, now that the biggest yet asset-stripping sales of electricity and water are underway.

Furious shadow trade secretary Bryan Gould said: "This is the insider deal of the century.

"To put the government's privatisation show back on the road, British Steel is being sold at well below its real value, with a nod and a wink that a quick buck will be made.

"But as with all insider dealing this is not a victimless crime. This sale undervalues British Steel by well over £200 million pounds – that is a loss of £10 for every household in Britain."

British Steel is a volatile investment. The industry's fortunes are largely dependent on the fortunes of the rest of industry – the major steel customers.

The shares are being pitched at the big fish – City institutions and foreign buyers – rather than the alleged target of Tory privatisation programmes, the person in the street.

Applications have to be in by December 2. The minimum investment is 400 shares payable in two stages.

Shareholders will make a down payment of 60p by 10am on Friday December 2, and a second instalment of 65p by September 26 next.

A full prospectus will be published tomorrow and share applications forms will be available in newspapers from then until November 29, with the offer closing on December 2.

The basis on which shares will be allocated will be announced by 9am on December 5, and trading will commence by 2.30pm.

British Steel, which has forecast profits of £550 million next year, is the fourth-largest steelmaker in the capitalist world.

But Lord Young yesterday, would not recommend that steel is a safe buy. He said grumpily: "Go and read the prospectus and make up your own mind.

"I don't know whether or not people will come unstuck. People realise that shares go down as well as up."

Bryan Gould hit back saying that steel is being offered at basement prices for "sordid political reasons."

Thursday November 24 1988

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THE TIMES

Thursday November 24 1988

## Labour attacks 'insider deal of the century'

# British Steel priced at 125p to ensure success

By Carol Ferguson and Richard Ford

British Steel, billed as one of the world's most profitable steel companies, is to be sold off at 125p a share, valuing the whole company at £2.5 billion.

Lord Young, the Trade and Industry Secretary, has pitched the price at the very bottom of City expectations. Analysts were expecting a price of 130p, or even 135p, and it is believed that SG Warburg and Samuel Montagu, advisers to the issue, were looking for more.

However, political considerations, especially the Government's desire to bring in the public, resulted in Lord Young over-riding advice that he could risk a higher price. It reflects the Government's desire that the first large privatization since the British Petroleum fiasco and the market crash should be a success.

The decision to go for a low price has pleased the market, but brought Labour criticism. Mr Bryan Gould, the Shadow Trade and Industry Secretary, said: "This is the insider deal of the century to put the privatization show back on the road. This sale undervalues British Steel by well over £200 million. It is being offered at this bargain basement price for sordid political reasons. The Government cannot afford another BP fiasco and Lord Young is using British Steel as a loss leader in the hope of gathering support for water and electricity privatization."

Analysts were unanimous that the issue would be a success. Mr David Blackwood of Hoare Govett, the broker, said, "This morning, we would have said 130p, and we're surprised it's lower." Mr Peter Green of Henry

Comment..........................27

Cooke, Lumsden, the private client broker, said he did not expect to see many of the public who were not clients of his coming in as happened with TSB and British Gas.

Mr Andy Green of Nomura Securities, said that the Japa nese would go for it whether it was 125p or 135p as steel is a favoured sector in Japan. The Americans are expected also to find it attractive.

The minimum investment will be 400 shares at a cost of £500. The subscription will be in two instalments, the first, of 60p a share on application, and the second of 65p on September 26, 1989. At the minimum subscription, the first payment will be £240, and the second £260.

At the offer price, BS will be on a price/earnings ratio of 4.9, and a gross dividend yield of 8 per cent. The gross yield on the first instalment is 16 per cent at an annualized rate.

More than 1.5 million private investors have registered their interest in the flotation with the British Steel Share Information Office. Lord Young said: "I have set the price to ensure a good sale and a healthy after market. The price is fair both to potential investors and to the taxpayer."

Of the 2 billion shares on offer, 23 per cent have been allocated to the general public and employees and pensioners of British Steel. However, if this is oversubscribed, the allocation will be increased in stages up to a maximum of 42 per cent, reducing the overseas offer from 33 per cent to 25 per cent, and the British institutional offer from 44 per cent to 33 per cent.

The prospectus and share application forms will be published on Novemeber 25, and the offer closes on Friday, December 2 at 10.00 am.

f/f

# Young's 125p steel shares 'underpriced'

Larry Elliott

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THE GOVERNMENT was yesterday accused of selling British Steel on the cheap after it fixed the share price for the £2.5 billion privatisation at 125p.

The flotation is the first test for the privatisation programme since the BP sale flop in October last year and ministers have settled on the price in an attempt to rekindle public enthusiasm ahead of the big water and electricity sell-offs.

With the financial markets unsettled by the dollar's weakness after Mr George Bush's victory in the US presidential election, Lord Young, the Trade and Industry Secretary, decided to take no chances.

Mr Bryan Gould, Labour's industry spokesman, called the sale the "insider deal of the century". He said British Steel was being sold well below its true value, "with a nod and a wink that a quick buck is to be made".

Lord Young pegged the price at 5p to 10p below the level most City commentators were looking for and hopes the next two weeks do not provide a re-run of a year ago, when the aftermath of Black Monday hit the £7.5 billion BP sale.

He said a whole range of factors had been taken into account before setting the price, but refused to discuss specific reasons for his decision.

"I think we have set a fair price, which will result in a successful sale," Lord Young said. Responding to a jibe that he was "selling off the family steel", Lord Young said: "This is a good deal for the taxpayer and the potential investor."

In the past, the Government has been attacked by the Commons Public Accounts Committee for selling off state assets too cheaply, but Lord Young said he was not concerned at potential criticism of the 125p price tag.

British Steel has been drastically slimmed down in the 1980s, with its workforce cut by 58 per cent and losses of nearly £2 billion in 1980 turned into a projected profit of £550 million this year.

Analysts said investors applying for the minimum 400 shares could expect a healthy instant profit of £60-£80 when dealing starts on December 5.

Payment for the 2 billion shares on offer will be in two instalments, 60p on application and 65p by September 26 next year.

Mr Gould said the sale undervalued British Steel by well over £200 million. "British Steel is being offered at this bargain basement price for sordid political reasons.."

The offer is not aimed at the new breed of small investor, the "Sid" of the British Gas privatisation. "It's Sidney this time," Lord Young said. "We're going slightly up market."

Initially only 23 per cent of the shares have been allocated to the UK public, 33 per cent overseas and 44 per cent for City institutions. However, strong public demand will trigger a clawback arrangement giving private investors up to 42 per cent of the shares.

Lord Young said yesterday that 1.5 million people had already registered an interest in applying for shares, and sources close to the flotation said the lower-than-expected price was almost certain to trigger the clawback.

Mr Michael Blogg, analyst with James Capel, the City broker, said: "We were predicting a price of about 135p, but the Government is making doubly sure that the issue goes well."

City notebook, page 13;
Leader comment, page 22

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Daily Telegraph Thursday November 24 1988

Picture: KEVIN HARVEY


Sir Robert Scholey and Lord Young announcing the company's share price

# British Steel shares 'a bargain' at 125p

By Roland Gribben, Business Editor

THE Government yesterday put a "bargain" 125p-a-share price on British Steel in an effort to restore confidence in privatisation stocks and pave the way to the water and electricity issues.

Financial institutions were surprised and pleased by a price which values the once lame-duck business at £2·5 billion and was at the bottom end of most forecasts.

Lord Young, Trade and Industry Secretary, denied "selling the family steel on the cheap" and rejected suggestions that there had been differences with the Treasury over the price.

The issue was swiftly and smoothly underwritten in the City and all analysts' predicted a sizeable premium when dealing starts.

They estimated a price rise of up to 30p, helped by British and foreign institutions short of stock because of the way the shares are to be allocated.

More than 1,500,000 people, considerably above the most optimistic expectations, have registered interest in the shares and the Government expects about half of them to apply.

Mr Bryan Gould, Labour's trade and industry spokesman, who said a week ago that the shares would be a risky investment, claimed that the Government was selling British Steel on the cheap.

He described the terms as the "insider deal of the century" and claimed that the company had been undervalued by more than £200 million, equivalent to a "loss" of £10 for every household.

"British Steel is being offered at this bargain basement price for sordid political reasons. The Government cannot afford another British Petroleum fiasco," he said.

The Government has been anxious from the start to ensure a successful launch for British Steel and is prepared to ride out criticism from Labour or the Public Accounts Committee that it is selling the business "on the cheap".

Lord Young decided to play safe and opt for 125p despite being told that the strength of institutional interest at home and abroad would ensure a successful flotation at 135p.

Advisers and analysts feel that the way the issue has been structured, with an initial down-payment of 60p a share, will appeal strongly to ordinary investors when compared with investments such as building societies.

The Government has adopted a cautious approach towards using steel to encourage wider share ownership, arguing that because it is a cyclical industry the shares have more appeal to professional investors.

Promotional material has been low-key and there has been little of the "hype" associated with earlier issues.

Only 23 per cent of the two billion shares are being offered to the public but this might be increased to 42 per cent if there is a rush from ordinary investors.

A third of the stock is being offered in America, Canada, Japan and continental Europe. This might be cut to 25 per cent depending on the public response in Britain. The institutional allocation in Britain might be reduced from 44 per cent to 33 per cent.

The first instalment is payable with applications and the balance by Sept 26 next year. The minimum application is for 400 shares, representing a down-payment of £240 and £500 overall.

The closing date for applications is Dec 2. A full prospectus will be published in The Daily Telegraph tomorrow.

Share allocations will be announced at 9am on Monday, Dec 5, and dealing will start in London, New York and Toronto at 2·30pm. Letters notifying shareholders about their allocations will go out on Dec 12.

British Steel is the world's most profitable steelmaker and one of the most productive after absorbing £8 billion in state aid, shedding two-thirds of its workforce and closing more than 35 plants in the past seven years.

City Comment — P31

4/7

chex.ps/ah/87 **UNCLASSIFIED**

PMP

FROM: A P HUDSON
DATE: 29 November 1988

**MR CALL**

cc **PS/Chief Secretary**
**PS/Financial Secretary**

**BRYAN GOULD ON BRITISH STEEL PRICING**

The Chancellor was grateful for your 28 November minute. He thinks this point could be useful for backbenchers.

APH

**A P HUDSON**

Confidential

pe2.bk/meb/30.11

FINANCIAL SECRETARY

FROM: MRS M E BROWN
DATE: 30 NOVEMBER 1988

[Arrived 10.30 am on 1/12]

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Moore
Mr Lyne
Mr Bent Mr Ilett -
Mr Guy
Mr Call

Went for ii (at least initially)

**STEEL: APPLICATIONS AND ALLOCATION POLICY**

1. This is a quick note before our meeting with you later this afternoon.

2. As at noon today (first post only) 131,200 public and employee applications had been received, amounting to a total value of £169 million. £565 million is needed for the public offer to be once subscribed pre-clawback.

3. This is not encouraging. The level of applications received today (about 40,000) is much the same as yesterday. DTI hope to see an improvement, in the light of reasonably favourable press reports, tomorrow and Friday when the offer closes.

4. DTI are asking the brokers to encourage the institutions to come in to the public offer. Some overseas banks, such as Nomura, are also apparently interested in acquiring some further stock through the UK offer.

5. This raises a question on allocation policy. At present levels of subscription, there is no danger of having to hold a ballot. But the brokers are saying that, to encourage the institutions, they need to indicate that all applicants will be scaled down equally.

6. If applications exceeded the number of shares available by 1/3 there would be no clawback. In this case all applicants would receive 75 per cent of their application. This would mean that small investors who had applied at the minimum application level of 400 shares would receive 300 shares. DTI consider that it would be acceptable to scale people down to 300, or possibly 200 shares.

7. I have told DTI officials that we will be discussing this with you this afternoon. I could not agree to pro-rata scaling down for all applicants until we had your views.

8. I suggest that the main options are:

(i) equal scaling down for all applicants. If there is a last minute rush, this carries the risk that small investors might be scaled down to amounts of 200 shares or less. At present, however, this seems unlikely;

(ii) asking Samuel Montagu to devise an allocation formula which ensures that applicants at the minimum level (400 shares) receive their allocation in full; but that scaling down above that level is effected in a way which is as even-handed as possible between all other applicants.

9. DTI officials are seeking Lord Young's agreement to option (i), and believe that the brokers will be seriously deterred in getting in the institutions if anything other than total parity is agreed. In view of the low level of applications so far, I recommend you to go along with this.

MRS M E BROWN

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pe2.bk/meb/1.12.7

FINANCIAL SECRETARY

FROM: MRS M E BROWN
DATE: 1 DECEMBER 1988

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Moore
Mr Ilett
Mr Lyne
Mr Bent
Mr Guy
Mr Call

Ch/ See also PS/DTI's note of today, immediately behind.
JS 1/12

**STEEL: APPLICATIONS**

1. Nearly 400,000 retail and employee applications have now been received. 265,000 public applications have been processed: their value is £419 million. If the public applications which have not yet been processed come in at roughly the same value per head, the total subscribed will be about £576 million. (Employee applications will add a little more). That just exceeds the £565 million which is needed for the public offer to be once subscribed pre-clawback. To trigger the first level of clawback there would have to be £952 million worth of applications in total.

2. There will be a final batch of applications tomorrow before the closing time of 10 a.m. But given poor press comment today, the numbers may be low.

3. Rowe & Pitman report that it is not proving easy to get the institutions to come in.

4. Nevertheless, there seems a good chance that the offer will at least be fully subscribed.

5. DTI will have a fairly good idea of the total subscription soon after 10 a.m. tomorrow. Lord Young has promised to be in touch with you on this. We will be in touch with our official-level contacts also.

6. You may like to know that the Share Information Office has received 150 phone calls from people asking for their money back!

Mary Brown

MRS M E BROWN

Robert 4.01.11.88

CONFIDENTIAL

FROM: R C M SATCHWELL

DATE: 1 December 1988

MRS BROWN

cc PS/Chancellor
PS/Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Moore
Mr Ilett
Mr Lyne
Mr Bent
Mr Guy
Mr Call

**BRITISH STEEL: APPLICATION AND ALLOCATION POLICY**

Following a discussion with the Chancellor this morning about your note of today, the Financial Secretary had a word on the telephone with Lord Young this afternoon.

Lord Young said that he was as keen as Treasury Ministers on encouraging small shareholders, but it was not yet clear whether the offer would be fully subscribed. For this reason DTI had been encouraging the institutions to come in to the public offer. He would need to see the final application figures before taking a view on whether any scaling down was necessary; and if so, how it should be done.

The Financial Secretary agreed that there could not be firm decisions on allocation policy in advance of the close of the offer. But by the same token, there was no need to give advance assurances to the institutions about their allocations. If the offer turned out to be thinly subscribed, the Government really could not be seen to scale down small investors.

Lord Young assured the Financial Secretary that he had not authorised any prior commitment to be given to the institutions that all applicants would be scaled down pro rata; and that as far as he was aware (and contrary to your understanding from DTI officials), none had been given. He suggested that he should talk to the Financial Secretary about the allocation policy after 10 a.m. tomorrow (Friday) when an indication of the final position on applications would be known. The Financial Secretary agreed.

R.C.M.S.

R C M SATCHWELL
Private Secretary

CONFIDENTIAL

pe2.bk/meb/1.12

FINANCIAL SECRETARY

FROM: MRS M E BROWN
DATE: 1 DECEMBER 1988

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Moore
Mr Lyne
Mr Ilett
Mr Bent
Mr Guy
Mr Call

Ch, FST may want a word in the margin of your meeting with Mr Lilley. 1/12

**STEEL: APPLICATIONS AND ALLOCATION POLICY**

1. Nearly 200,000 applications had been received at close of play yesterday. It is estimated that 90,000 more arrived in the first post today. By extrapolation, DTI estimate that ¾ of the £565 million which is needed for the public offer to be once subscribed pre-clawback will have been received when the offer closes at 10 a.m. tomorrow.

2. As I reported to you yesterday, DTI have asked the brokers to encourage the institutions to come in to the public offer. They think there is a reasonable chance that this will ensure that the offer is at least fully subscribed. The offer needs to be 1.75 subscribed to trigger the first level of clawback.

3. As you requested, I have spoken again to DTI officials about allocation policy. They are now saying that no firm guarantees have been given to the institutions that, if there is any scaling down, all applicants will be treated pro-rata. But they have indicated that they are sympathetic to the institutions' wish to be left with reasonable allocations. DTI think that, at current levels of subscription, there should be a reasonable chance that allocations can be done in such a way that those who apply at the minimum investment level will get their shares in full; but until they see the final figures they can give no commitment on this.

If, for instance, the offer were 1.7 times subscribed (ie. just below the first clawback trigger) it might be necessary in <u>any</u> circumstances to scale everyone down to some degree.

4. I explained your concern that it would be difficult to defend scaling down retail investors if it were known that there had been a relatively poor response to the offer, particularly in view of the money that has been spent on retail marketing. I said you might want to speak to Lord Young.

**<u>Recommendation</u>**

5. I suggest that you should telephone Lord Young to say that you would definitely want the option of protecting applications at the minimum level (400 shares) to be on the table at the allocation meeting on Saturday. If anything has been said to the brokers and institutions which precludes this, then the record should be set right.

6. You might also convey your offer to respond to press/TV enquiries over the weekend, in addition to any direct links which are arranged with Lord Young in the United States. I have already mentioned this to DTI officials.

Mary Brown

MRS M E BROWN

2/12

1. MRS M E BROWN

2. FINANCIAL SECRETARY

From: R M BENT
Date: 2 Dec 1988
cc Chancellor
CST
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Moore
Mr Gieve
Mr Ilett
Mr Lyne
Mr Gunton
Mr Guy
Mr Call

**STEEL: APPLICATIONS**

The 5.45pm assessment is:

(i) the count of public application forms has just passed 500,000, and there are thought to be perhaps 30,000 forms to come;

(ii) the number of shares applied for has reached 1.28 billion,* which represents roughly a 50% oversubscription after both sets of clawback have been triggered. On this basis, the scaling down factor will be roughly one-third: ie on average applicants will get roughly two-thirds of the number of shares they applied for;

* £1.6 billion fully paid

(iii) there will be no banding information until late tonight, but the guess is that the lower application levels can be met in full (say up to £1000), with decisions being necessary in the middle and higher bands about the appropriate degree of scaling down. Given the help given by institutions to the offer, DTI hope to ensure that there is some allocation at all levels, rather than an abrupt cut-off, but will wait to tomorrow to decide figures in the light of the further banding information available then.

2. For information, I also attach a table which summarises the offered share capital and proceeds:

(i) the three columns on the left show the numbers of British Steel shares the Government sold:

- first in their original allocation between markets (the UK public offer was 435.6m) and there were 16m free and matching shares to employees which were not underwritten;

- then after 25% was clawed back from the overseas market to add to the UK public offer (when public applications reached 762m, or 1.75 times subscribed); and

- then again after the shares provisionally placed with the UK institutions were also clawed back to the UK public offer (when public applications reached 980m, or 2.25 times subscribed).

(ii) on the basis of the clawback being triggered twice, the three columns on the right show the sale proceeds from each market:

- first on application;

- then at the second call; and

- finally, in total.

R M Bent

R M BENT
PE2 Division

BRITISH STEEL
Offered share capital and proceeds

December 2, 1988

| | No Clawback | Clawback 1 | Clawback 2 | | First Call | Second Call | Total |
|---|---|---|---|---|---|---|---|
| | | | | | £ | £ | £ |
| | | | | Price | 0.60 | 0.65 | 1.25 |
| | | | | | £m | £m | £m |
| No of shares | 2,000 | 2,000 | 2,000 | Proceeds | 1,200 | 1,300 | 2,500 |
| Non-underwritten | 16 | 16 | 16 | | 10 | 10 | 20 |
| Underwritten | | | | | | | |
| of which: | | | | | | | |
| -UK firm | 660.0 | 660.0 | 660.0 | | 396 | 429 | 825 |
| -UK provisional | 224.4 | 224.4 | 0.0 | | 0 | 0 | 0 |
| -UK public offer | 435.6 | 601.6 | 826.0 | | 496 | 537 | 1,033 |
| -Overseas | 664.0 | 498.0 | 498.0 | | 299 | 324 | 623 |
| Total | 2,000.0 | 2,000.0 | 2,000.0 | | 1,200 | 1,300 | 2,500 |

pe2.bk/meb/2.12.11

FINANCIAL SECRETARY

FROM: MRS M E BROWN
DATE: 2 DECEMBER 1988

cc Chancellor
Sir P Middleton
Mr Monck
Mrs Lomax
Mr Moore
Mr Gieve
Mr Bent
Mr Gunton
Mr Call

**BRITISH STEEL: PUBLICITY**

1. As you requested, I attach a draft on-the-record quote, which you might issue in a Press Notice over the weekend. Mr Gunton is happy with it, and so are DTI officials.

2. Lord Young is issuing a Press Notice this afternoon giving the broad outcome on applications. There will be then be another DTI Press Notice on Sunday morning with the allocation decisions. One possibility would be for your Press Notice to go out in parallel with that. Alternatively, your notice could issue tomorrow (Saturday) in order to provide something for the Sundays. DTI would prefer the latter, and Mr Gunton agrees.

3. Mr Gunton will contact you on Saturday morning about this.

Mary Brown.

MRS M E BROWN

DRAFT

pe2.bk/meb/2.12.6

"This is a very good outcome, both for the British Steel sale, and for the Government's privatisation programme as a whole.

It shows that the private investor has a continued appetite for share buying.

That is good news for the forthcoming Water and Electricity sales, in which we want to involve small investors, customers and employees as fully as possible."

dti

MP

The Hon. Alan Clark MP
Minister for Trade

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

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
London SW1

CHIEF SECRETARY
REC. 29 DEC 1988
ACTION Mr Mountfield
COPIES TO CX, EST, Sir P Middleton
Mr Wilks, Mr Lankester Mr P Davis,
2 Mr Bottrill, Mrs Brown
Mr Mace, Mr G T W Jones
Mr Call

Direct line 01-215 5144
Our ref W01AEO
Your ref
Date 22 December 1988

Dear John

US PROPOSALS FOR AN OECD BAN ON AID AND EXPORT CREDIT FOR STEEL PLANT PROJECTS

As you are no doubt aware, the US has put forward proposals which seek to impose an OECD ban on aid and export credit subsidy fpr steel plant projects in developing countries. Our officials have so far failed to reach agreement on what line the UK should take in response to these proposals and I thought it would be helpful if I were to set out why I believe that it would not be in our interests to support the US proposals.

The US proposals take as their starting point the need to eliminate government support for overseas steel plants on the grounds that these plants may have the effect of increasing steel capacity at a time when the developed world is already having to take painful steps to reduce overcapacity. The US believes that by banning the use of aid and subsidised export credits, developing countries would have less of an incentive to embark on such projects but if they did, all OECD steel plant producers would be able to compete for that business on equal terms.

Whilst these arguments have considerable attractions at the theoretical level, I am far less sure that in practical terms the US proposals would have their intended effect. In contrast to the existing sectoral agreements on nuclear power and aircraft, a ban on aid and subsidised export credits for steel plant projects would extend to many more players and would as a result be much

The Rt Hon John Major MP

more difficult to monitor effectively.

More significantly, any OECD ban would not extend to countries like the USSR, South Korea, China and Brazil all of whom have significant steel plant capabilities. These countries will be able to develop attractive financing packages in support of developing countries' steel plants, such as the Russians have recently done on the Durgapur steel project in India where the Russian bid is being supported by a rupee acccount in New Delhi. If the proposed ban were circumvented in this way, the impact on the UK's major steel plant producers would be very serious and it is hard to see how they could hope to maintain their combined annual turnover of £200m given the reduction of opportunities in the UK. It is also worth noting that most of the world over-capacity in steel is in the US - which has been slow to rationalise and has no steel plant manufacturing capability of its own - and in some EC countries notably FRG and Italy. Against this background, the UK with its efficient steel production and its expanding steel plant manufacturing sector has the most to lose from the US proposals whilst the US itself would suffer no adverse effects.

At the most recent meeting of the EC policy co-ordination group for export credits, the UK was alone in not opposing the US proposals within the EC and OECD. A report from the OECD Steel Committee also suggested that the problem of world overcapacity in steel may not be as serious as had previously been imagined. This must lead to serious doubts that the US proposals are negotiable within the OECD and strengthens the case for our not supporting what I regard as a flawed proposal. Given the damage that implementing the US proposals would do to our export effort in the steel plant sector, I hope that you will be able to agree that the UK line should be to resist US pressure to implement a ban but to accept further OECD discussion of the implications of the US proposals. The latter requirement will at least enable us to consider any evidence that the US can produce to demonstrate that the ban will have its intended effect.

I am sending copies of this letter to Chris Patten and Lynda Chalker.

ALAN CLARK