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PREM 19/990

MT

PART 8

173

Confidential

Policy towards:-
Privatisation
Disposal of Public Sector Assets
Contracting out of Public Sector Functions

ECONOMIC POLICY

Part 1 June 1979
Part 8 October 1983

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~18.10.83~~		~~8.12.83~~					
~~21.10.83~~		~~9.12.83~~					
~~24.10.83~~		~~12/12/83~~					
27.10.83		~~13/12/83~~					
~~28.10.83~~		~~20.12.83~~					
~~3.11.83~~		~~23.12.83~~					
7.11.83		~~29/12/83~~					
~~18.11.83~~		~~16/1/84~~					
~~18.11.83~~		~~20.1.84~~					
~~24.11.83~~		29.12.83					
~~25.11.83~~							
~~28/11/83~~		-PART 8 ENDS-					
~~30.11.83~~							
~~2.12.83~~							

PREM 19/990

PART 8 ends:-

DB to PM 29 Jan 1983

PART 9 begins:-

Ch/Ex to PM + att 16 Jan. 1984

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(DL)(83)5	11.10.83
E(A)(83)13	19.10.83
E(DL)(83)8	18.11.83
LCA to E(DL)(83) 1st Meeting, Minutes	24.11.83

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed C Wayland Date 15 March 2013

PREM Records Team

(1)

10 DOWNING STREET

pa
DMB
30/12

Prime Minister

The attached minute from the Financial Secretary echoes your own views on increasing competition in the gas market, and on the need to make progress also on electricity.

Content just to note at this stage, pending discussion in E(A)?

Yes

DMB
29/12

FROM: FINANCIAL SECRETARY
DATE: 23 December 1983

PRIME MINISTER

PRIVATISATION AND THE ENERGY INDUSTRIES

Peter Walker's minute of 20 December sets out very helpfully his current thinking in this area. As he says, I have had a valuable discussion with him.

I am sure Peter is right in saying we need a strategic plan in the energy area and I welcome the fact that he has made a preliminary bid for legislation in the 1984-85 session. Peter at present envisages this legislation covering gas alone but it would be worth considering a bill providing powers for the eventual sale of both gas and electricity.

I would accept his judgement that it would not be right to privatise the NCB's main activities in this Parliament. I hope we can make good progress on the subsidiaries.

E(A) will want to consider carefully the detailed points he makes about British Gas (BGC) and the Electricity Supply Industry (ESI). While I would not want to underestimate the problems of electricity, it may be that when we come to look at the options in more detail we may be able to see a way through them. For example, the regional imbalance in the location and capacity of power stations would be less of an inhibition on breaking up the CEGB if we wanted to restructure the industry along functional lines rather than on regional lines. I am also not sure the issue of providing a market for British Coal need in practice loom large now that NCB coal is aligned to market prices and capacity for importing coal is limited.

On BGC, Peter suggests the timetable he has in mind may limit the scope for radical restructuring. The aim of such restructuring would be to bring as much competition into the industry as possible and to enable gas prices to be determined in the market place. Increasing competition is one of our main objectives in this area. We will need to consider carefully how far the various options secure this objective for electricity as well as gas.

As Peter says, this is not the moment to take decisions. We will need to consider carefully the detailed papers he is preparing covering all the options on gas and electricity before we start to firm up our thinking.

I am copying this to the Chancellor of the Exchequer and the Secretary of State for Energy.

J M

Econ Pol, Privatization pt 8

cc NO

NBPM AT 23/12

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01 ~~930 7022~~ 218 6169

MO 21/8/5

23rd December 1983

Dear Dinah,

SEALINK PRIVATISATION

Your Secretary of State wrote on 22nd December to Mr John Lee about the proposed sale of Sealink, and about our concern over the possible defence implications of such a sale.

We agree that there is no overriding objection to going ahead with the preparation of a sale document. We nevertheless note that the only proviso mentioned in your Secretary of State's letter suggests that at least one of the potential buyers should be acceptable. We would prefer to see a somewhat tighter safeguard than this, in that we hope it may be possible to devise some means of ensuring that Sealink's facilities should remain available to us in a crisis situation for as long as we feel that they are an essential part of our reinforcement, or other defence, plans. This is why Mr John Lee asked in his letter of 20th December, for a little extra time to consider our position.

However, on the understanding that British Rail do not take any action that will constitute an irrevocable commitment, I can confirm that we are content that your Secretary of State should authorise the BR Board to proceed along the lines suggested. For our part, we will do what we can to speed up the consultation between our officials, and aim to provide a final view earlier than the suggested date of the end of January.

Copies of this letter go to Andrew Turnbull at No 10, to the Private Secretaries to E(DL) members, Foreign and Home Secretaries, Secretaries of State for Northern Ireland, Scotland and Wales; and to Richard Hatfield in Sir Robert Armstrong's office.

Yours sincerely,

Barry Neale

(B P NEALE)
Private Secretary

Miss Dinah Nichols
Private Secretary to the Secretary of State for Transport

Elon PO
Privatisation
pg 8

SECRET

2x file to cc/FM

8

10 DOWNING STREET

From the Private Secretary

22 December 1983

PRIVATISATION AND THE ENERGY INDUSTRIES

The Prime Minister has seen your Secretary of State's minute of 20 December and was grateful for the progress he has made in defining the programme for privatisation in the energy industries. She accepts that privatisation of electricity will take longer to complete and that it makes sense to start with gas. Nevertheless, it would be desirable to start planning for changes in the electricity industry, given the time they will take to implement.

On gas, the Prime Minister has noted the provisional bid for legislation in 1984/85 and the reasons for it. While it is obviously difficult to introduce competition into the gas industry, the Prime Minister hopes that every effort will be made to do so in order to reduce the reliance that has to be placed on regulation. She looks forward to receiving the paper in E(A) in due course.

I am copying this letter to John Kerr (H.M. Treasury), and Andrew Hudson (Financial Secretary's Office).

ANDREW TURNBULL

Michael Reidy, Esq.,
Department of Energy.

SECRET

cc No

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

NBPM AT 23/12

John Lee Esq MP
Parliamentary Under-Secretary of State
Ministry of Defence
Main Building
Whitehall
LONDON
SW1A 2HB

22 December 1983

Dear John

SEALINK PRIVATISATION

I have today received your letter of 20 December, which appears to have been delayed in transit.

Let me first say that I had, of course, given careful attention to the possible defence implications of a Sealink sale, as it is incumbent on me to do so as the Minister responsible for planning the use of our merchant fleet in time of emergency. I believe that many of your worries can be answered, and I shall be happy for our officials to get together to produce a report for us on all these issues during January.

But what I cannot accept is that I should hold back in giving a clear steer to British Rail until that work is complete. To do so would set back the timetable to such an extent that we would miss the opportunity to sell Sealink for a whole year, (since all our advisers agree that a sale can only be undertaken before the summer season starts to get under way.) Such a delay would be contrary to the privatisation programme which colleagues have agreed.

At present all that we are seeking to do is set in train the process of preparing a sale document on which to seek bids. The issue of such a document will not commit BR to selling if none of the potential buyers is acceptable - and acceptability in defence planning terms will clearly be high on my list of priorities when I consider giving my consent to the sale. There is therefore nothing to be lost by my proceeding now as I suggested in my letter of 19 December.

As I have said the timetable is urgent; BR need to take the decisions necessary to start sale preparations at their Board meeting at the beginning of January, and so I wish to write to the Chairman giving my views before the Christmas holiday.

I am copying this to the Prime Minister, the Chancellor of the Exchequer, the Foreign and Home Secretaries, and the Secretaries of State for Northern Ireland, Scotland, Wales and to Sir Robert Armstrong.

Yours ever
Nicholas

NICHOLAS RIDLEY

ECON POL: Privatisation
pt 8

SECRET

21 December 1983

7

MR TURNBULL

Prime Minister (1)
Agree I write welcoming Mr Walker's report but asking for competition to be fully taken account of.

PRIVATISATION AND THE ENERGY INDUSTRIES

Yes MT AT 21/12

Peter Walker's letter is to be welcomed in that:

1. He promises a paper to E(A) looking at all the options in the case of the gas industry as requested under the remit given to him.

2. He is proposing dealing with gas first which makes sense, as the problems are less intractable than coal and electricity.

3. He wishes to make a bid for 1984/5 session for legislation: this implies a welcome urgency in tackling these problems.

4. The E(A) Paper apparently will include serious options for introducing competition in the electricity and gas industries and will review scope for selling some assets in electricity.

In replying, the Prime Minister should stress these favourable points to confirm that they will be included in the E(A) Paper. At the same time, she could argue that it is vital that as much competition as possible be introduced when legislation is framed for gas privatisation, to avoid the sale of a monopoly and the need for unduly complex regulation.

JOHN REDWOOD

SECRET

PRIME MINISTER

PRIVATISATION AND THE ENERGY INDUSTRIES

I think it may be useful if I let you know how my thinking is developing on privatisation and the major energy industries. I recently had a valuable discussion about this with the Financial Secretary. I hope to put papers to E(A) Committee early in February about the gas and electricity industries. A good deal of work is going on in the Department of Energy to identify and evaluate the options which will be set out in those papers, including some difficult work on the vexed question of regulation if monopoly elements have to be transferred to the private sector. But I am anxious to arrive as soon as possible at a strategic plan for action in the energy field in the lifetime of this Parliament because I fear that a really major privatisation may be a very close-run affair indeed if we miss the 1984/85 Session for the necessary legislation. With this in mind I have made a provisional bid for a place for a major Bill in that Session. But time is already short for planning and preparing such a Bill: that is why I would like to let you and Nigel Lawson know some of my thinking in advance of papers for E(A).

My impression at present is that the next major privatisation to follow British Telecom and British Airways in this Parliament could well be British Gas. The Financial Secretary and I agreed that there was no question of privatising the NCB in this Parliament, on either the deep mined or even the opencast side; though there might be some scope with its subsidiaries. The main field is therefore gas and electricity.

Electricity presents us with a number of major problems. The generating side of the industry is usually regarded as much less of a natural monopoly than the distribution side, but the generating side runs us into the question whether at this stage it would be acceptable to sell off nuclear power stations. The sheer scale of the industry (£32 billion of investment, or more than three times the size of British Gas), also raises acutely the question of dividing up the industry. But then one faces first, the problem of large

regional imbalances in the location and capacity of power stations; and secondly, the question whether one could sell in this Parliament untried organisations created by breaking up the CEGB. In any event we would face very large write-offs because of over-capacity in the industry.

The relationship between the coal and electricity industries is another complication. Would we, could we continue to make a privatised electricity generating industry a captive market for British coal? We would certainly not be promoting competition if we did. But if we did not, we risk adding to the present over-capacity in the coal industry, giving Scargill the rallying issue he so desperately wants and inviting electricity workers and miners to make common cause against us.

If one concludes from this that it might be a mistake to try to put electricity privatisation ahead of gas privatisation, that should not exclude looking at steps towards greater competition in the electricity industry, or examining some partial privatisation in this Parliament or full privatisation in the next. But it looks very ambitious indeed to try to make electricity the main privatisation thrust in energy in this Parliament.

There are problems enough in privatising the gas industry, but they would be much simpler than those in electricity. There is nothing analogous to the nuclear problem and no problem of over-capacity. The gas industry is much smaller. It already draws the bulk of its natural gas supplies from the private sector. If we can make an early effort there is a real prospect of completing privatistion in this Parliament, provided the market is not totally pre-empted or spoiled by British Telecom and British Airways.

But even with gas the timing is quite tight. Even assuming a 5 year Parliament, it would probably be necessary to complete any major sale of shares by mid-1987. One possibility might be to sell shares on a partly-paid basis, as for British Telecom, with calls spaced over 1986/87. Certainly it would be better to avoid a situation in which we had sold only 51% of the shares or less, whether in the whole or a large part of the industry, by the

time of an election; or in which most of the money on partly-paid shares was outstanding at such a time. It would also be much better if the industry had been able to run in private hands for at least a year before the next election. All this argues strongly for legislation in the 1984/85 Session with a view to beginning sale in, say, the early part of 1986. That would mean facing a substantial demand on legislative time in the 1984/85 Session. But a delay of a year would, on the best assumptions, leave us dangerously little time for sale before we reached the election "shadow".

If this timetable is right, it may limit our scope for radical restructuring of the gas industry. Nevertheless, my paper to E(A) will look at all the options, including the scope for genuine elements of competition. It already seems clear however that under any conceivable form of privatisation a regulatory system will be necessary because large elements of monopoly, at least for the domestic and small commercial and industrial consumer, will remain. My aim would be to get as much simplicity in it as would be consistent with effectiveness.

I do not of course seek any immediate decisions on this. My own thinking is in any event still at a formative stage and in particular I need to do more work on what would be involved in gas privatisation in 1984/85. I know too that the Financial Secretary will be putting an overview of privatisation candidates to E(A). But I hope that this note may help in forming a policy perspective for this Parliament, and explaining my provisional bid for the 1984/85 legislative programme.

I am copying this to the Chancellor of the Exchequer and the Financial Secretary to the Treasury.

Peter Walker

SECRETARY OF STATE FOR ENERGY

20 December 1983

cc NO

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 6666 (Direct Dialling)
01-218 9000 (Switchboard)

PARLIAMENTARY UNDER-SECRETARY OF STATE
FOR DEFENCE PROCUREMENT

Prime Minister (2)
A late reservation from Mr Heseltine, but one which should prove capable of resolution.
AT 20/12

MO 21/8/5

20 December 1983

Dear Nick

SEALINK PRIVATISATION

In Michael Heseltine's absence, I am replying to your letter of 6th December to Nigel Lawson. I have also seen your letter of 19th December. Unfortunately we had very little time in which to comment, but there are significant defence implications in the proposed sale which need to be considered.

There was a good deal of correspondence on this subject in September and October of 1981, when the discussions centred on the possibility that Sealink might pass into Danish or Finnish ownership. Peter Blaker, who was then Minister for the Armed Forces, expressed two reservations and was supported by other Ministers who saw the same dangers. The first area of concern, namely that Sealink's port facilities might pass into foreign hands at a time when we did not have emergency powers over ports (lost in the Transport Act 1981) has largely been overcome by the restoration of those powers as a result of the passing of the Transport Act 1982. Although there could conceivably be problems if Sealink's port facilities were under foreign, possibly non NATO ownership, I am satisfied that the powers we now have are adequate to meet any reasonably foreseeable circumstances.

However, there remains the risk that Sealink's fleet might at some time in the future be sold to a foreign buyer. Here the situation has deteriorated since 1981. At that time, Sealink's fleet comprised about one sixth of the total lift available to us for reinforcement, and while there was always the risk that we might be short of shipping once US requirements were better defined, we were not at that time unduly worried by

/the

The Rt Hon Nicholas Ridley MP

the prospect. But since then the total number of available vessels has declined - and will probably continue to do so - though the number of Sealink vessels has remained largely the same. As a result, the Sealink fleet now represents approximately one third of the total UK shipping resources available for the reinforcement of BAOR, and its loss would obviously have a far more serious impact on our reinforcement capability. In particular, the train ferries owned by Sealink are the only ones available and could well be needed. Moreover, we have an additional requirement for the use of Sealink ships for the UK/Netherlands amphibious force and in support of the US/UK lines of communication arrangement.

I feel it is vital, therefore, that a sale of Sealink be carried out in such a way as to preserve the Government's right of access to those ships in the Sealink fleet that are essential to the execution of our reinforcement and war plans. I propose that our officials should consider, as a matter of high priority, how our defence requirements can be reconciled with the sale of Sealink, and report back to us by the end of January.

I am copying this letter to the recipients of yours.

With kind regards
Ever
John

JOHN LEE

ECON POL: Privatisation
Pt 8

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

cc NO

Prime Minister
Mr Ridley, in the light of comments from colleagues, intends to press ahead with a trade sale in early summer 1984
AT 19/12

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

19 December 1983

MT

Dear Nigel

I refer to my letter to colleagues of 6 December about privatisation of Sealink. I am grateful for the comments received, and the general support expressed for an early sale. That is, of course, in line with the timetable we have discussed for the future programme of privatisations.

I did consider carefully whether a flotation in early 1984 was a possibility. But both my own and BR's merchant bankers advised that a normal flotation before the 1984 results are available would produce very little money. The information made available to purchasers would have to be limited to that which could be included in the Prospectus, and there would be little opportunity to convince selected buyers of the underlying prospects of the company. We also considered whether a flotation could be mounted using shareholders' travel concessions as an additional attraction. But we concluded that to do that would complicate the preparations to such an extent that a sale before the start of the summer season would be impracticable, and once that window was missed it would be preferable to wait for the 1984 results. I therefore concluded that early flotation is not an option.

We cannot be certain whether or not the company would fetch more if sold with its harbours separated from ships although Morgan Grenfell formed the preliminary view that this would not improve the price and that it made commercial sense to sell the company as a single entity. But in any case the option is not available unless we are prepared to delay the sale for at least a year, because the separation process, including the negotiation of contracts for each of the harbours and the resolution of staffing problems, could not be completed until after the 1984 summer season.

The abolition of "no-passport excursions" would damage the business of Sealink, like that of other ferry operators - and I hope that my colleagues responsible for these negotiations will be able to find a satisfactory solution. If they cannot, that will, I am afraid, depress the profitability and therefore the value of the company. But either way I believe it would be wrong to let this possibility influence the timing of the sale; that could lead to criticism that the Government was withholding relevant information. I understand that it is proposed to inform the ferry companies very soon of the present state of negotiations with the French. If that is done it will be public knowledge before the sale documents are issued.

Several colleagues had concerns about the character of the possible purchaser, and, for example, of the need to maintain competition. That is well recognised and will be taken fully into account in considering bids.

In the light of the general support expressed by colleagues, and in view of the reasoning set out above I propose now to tell BR that at this stage the only course

which would lead to my giving consent is that of a sale to a commercial buyer or consortium as described in my previous letter.

I am copying this to the Prime Minister, members of E(DL), to the Foreign and Home Secretaries and the Secretaries of State for Northern Ireland, Scotland, Wales and Defence, and to Sir Robert Armstrong.

Yours ever
Nicholas

NICHOLAS RIDLEY

Econ Pol.
Privatisation
pt 8

Prime Minister ② cc NO

Treasury and DTI content with an early trade sale of Sealink.

AT 13/12

Treasury Chambers, Parliament Street, SW1P 3AG

13 December 1983

The Rt Hon Nicholas Ridley FICE MP
Secretary of State for Transport
Department of Transport
2 Marsham Street
LONDON SW1P 3EB

Dear Nicholas.

SEALINK

Thank you for your letter of 6 December to the Chancellor.

If a flotation is not possible in the first half of 1984, I share your view that a trade sale is much to be preferred. Not only would a placement not test the market, but if Sealink's results are as forecast, a placement could result in windfall capital gains for the institutions, and consequent criticism of the Government. Although a trade sale may raise industrial relations concerns, these should not be insuperable.

It is a matter of judgement now that we have a specific proposition on the method of sale as to whether it is worth holding on for a better price. On the one hand, Sealink's results may improve; the company has a strong market share and a substantial asset base. The City advisers are bullish about the profit forecasts. So we have to acknowledge that a sale now at £60-70 million could forego a possible higher sale price in Spring 1985 based on a profit forecast in late 1984. The higher price would have benefits for both BR and the Government. On the other hand, I accept that there are strong arguments for selling Sealink as soon as possible. We have given the industry a deadline, and there is a good reason to suppose that private sector ownership will get a better return on the assets than Sealink have managed to obtain in the past.

I understand however that you have considered this point and are content that the balance of payment argument is for sale now; and so I would not contend that the prospect of a better price in a year's time should be an overriding consideration.

So far as your proposed conditions on the sale are concerned, I share your view that it is important to provide if possible for employee shareholdings, although previous examples have tended to be in the context of a flotation or a management buy-out. There may be technical difficulties in devising a suitable scheme as part of a trade sale, and some buyers may be deterred from bidding if this condition is too restrictive. I understand. however, that your intention is to ask bidders to indicate what provisions they would make for employee shareholdings. Decisions on whether a scheme is practical will need to await these responses.

I have considered also your proposal that the shipping and ports businesses should be sold together. I can see that the public commitments made in 1981 may be inescapable, but we have to acknowledge that these were given with half an eye to the known concerns of BR management and the rail unions, and before we had any specific proposition for a sale in view. I accept that a bidder would be happy to buy harbours for his sailings, but this may not be a decisive consideration. All the calculations have been done on the basis of selling Sealink as a whole, although the harbours subsidiary is comfortably in profit; so we do not know if the overall price would be bettered by selling the ports separately. I imagine that you will want to satisfy yourself on this point if you have not already done so. If we proceed by a single sale it should be possible to drive a hard bargain on the price for the harbours subsidiary.

Subject to these points, I would be content for you to go ahead as you suggest. The Chancellor will write further as Chairman of E(DL) once colleagues views are known and in light of any further comments you may wish to make.

I am copying this letter to the Prime Minister, to E(DL) colleagues, to the Foreign Secretary, the Home Secretary, the Secretaries of State for Northern Ireland, Scotland, Wales and Defence, and to Sir Robert Armstrong.

Yours
John

JOHN MOORE

ECON POL: Privatisation Pt 8

cc NO

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215)
(Switchboard) 215 7877

JU186
Secretary of State for Trade and Industry

13 December 1983

CONFIDENTIAL

The Rt Hon Nicholas Ridley MP
Secretary of State for Transport
Department of Transport
2 Marsham Street
London SW1

Dear Nick,

SEALINK PRIVATISATION

– with AT

Thank you for copying me your letter of 6 December to Nigel Lawson on this.

2 I agree with your proposal that British Rail should be authorised to proceed with preparations for the negotiated sale of 100% of the shares in Sealink (UK) Ltd to either a commercial buyer or a consortium on the conditions proposed in your letter.

3 One of these conditions is that certain possible buyers should be excluded on competition grounds. There are in fact a number of competition considerations in relation to the privatisation of Sealink. These arise from two Monopolies & Mergers Commission reports. One covered the supply of cross channel car ferry services; following its findings and recommendations, Sealink - and presumably any successor - is obliged to refrain from various restrictions on competition. The other found against the merger proposed in 1980-81 between European Ferries and Sealink; following this finding, European Ferries are bound by an understanding not to merge with Sealink. Against this background, thought will need to be given to how best to frame the conditions for privatisation. I suggest that officials of our two Departments should consult on this aspect of the privatisation operation.

4 I am copying this letter to the Prime Minister, the Chancellor, E(DL) colleagues, the Foreign Secretary, Home Secretary and the Secretaries of State for Northern Ireland, Scotland, Wales, and Defence and to Sir Robert Armstrong.

Yours
Norman

NORMAN TEBBIT

Econ Pol: Privatisation

CONFIDENTIAL

NGM AT 12/12

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

The Rt Hon Nicholas Ridley MP AMICE
Department of Transport
2 Marsham Street
LONDON
SW1P 3EB

12 December 1983

Dear Nicholas

SEALINK PRIVATISATION

Thank you for copying to me your letter of 6 December to Nigel Lawson.

My main concern in the sale of Sealink centres on the future of the ferry services from Scotland to Northern Ireland which are now of central strategic significance to the Northern Ireland economy. These are operated by Sealink (from Stranraer to Larne) and by European Ferries (from Cairnryan to Larne). It is important to Northern Ireland that the element of competition arising from the presence of two carriers on these routes - which has resulted in improvements to the service - should not be prejudiced by the sale of Sealink. I am therefore grateful for the assurance in your letter that some possible buyers may not be regarded as acceptable because of problems of competition, and I take it that you would regard the preservation of competition on the Scotland-Northern Ireland routes as an essential consideration in the approval by Government of a buyer.

I am grateful for having been consulted and would be glad to be kept informed of further developments.

Copies of this letter go to the recipients of yours.

Yours
Jim

KW

CONFIDENTIAL

Econ Pol, Privatisation, Pt 8

CONFIDENTIAL

cc BI
NO

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

TI
12/12

Charles Marshall Esq
Private Secretary to
The Rt Hon John Biffen MP
Lord Privy Seal and
Leader of the House of Commons
House of Commons
LONDON SW1A OAA

9 December 1983

Dear Charles

STATEMENT ON BRITISH AIRWAYS PRIVATISATION:
MONDAY 12 DECEMBER 1983

I wrote to you on ~~2~~ attached. December, and subsequently received confirmation from your office, the Whips' Office and No 10 that we could go ahead with our statement on Monday 12 December (baring emergencies).

A draft of the statement was circulated by my Secretary of State under cover of his letter to the Chancellor of the Exchequer of 7 December. I now attach what is intended to be the final version, incorporating points made by E(DL) colleagues.

Please let me know if you have any comments at this stage. This invitation applies also to Tim Flesher at No 10 and Murdo Maclean in the Whips' Office, to whom I am copying this letter.

Yours sincerely,

Henry Derwent

H C S DERWENT
Private Secretary

CONFIDENTIAL

KG

BRITISH AIRWAYS: DRAFT PARLIAMENTARY STATEMENT BY SECRETARY OF STATE FOR TRANSPORT ON 12 DECEMBER 1983

1. With permission, Mr Speaker, I should like to make a statement about British Airways.

2. The Government's intention of moving British Airways into the private sector was announced by my rt hon Friend the then Secretary of State for Trade in July 1979. Legislation to achieve this was passed in the Civil Aviation Act 1980.

3. Our original intention was to go ahead with a sale soon after the passing of the Act, but the decline in the airline's profits in 1979/80 and the large losses in the two subsequent years made that impracticable.

4. Over the last two years, however, decisiveness on the part of management and determined co-operation from the workforce have sharply improved British Airways' productivity; and the airline industry is now emerging from the world recession. British Airways made a net profit of £77m in the financial year ended last March; and they are set to make significantly higher profits this year.

5. British Airways have also begun to restore their balance sheet. Since March they have repaid well over £100m of borrowings without any assistance from the Government. Their external finance limit fixed for 1984/85 means we expect British Airways to repay at least £160m of borrowings next year.

6. Following this transformation of British Airways' financial prospects I have decided to aim for privatisation as soon as possible, hopefully in early 1985. To this end I propose to establish British Airways as a public limited company under Government ownership in accordance with the 1980 Act.

7. I am accordingly arranging for the registration of a public limited company under the name of British Airways Plc without at this stage giving it the right to trade, and I shall shortly make an order nominating it as the successor company to the British Airways Board under section 3(2) of the 1980 Act. I shall place a copy of the memorandum and articles of association of the new company in the library of the House. I also propose soon to make an order under section 10(1) of the 1980 Act appointing 1 April 1984 as the day on which the property, rights, liabilities and obligations of the British Airways Board in the UK are vested in British Airways Plc. All this needs to be done well in advance of vesting to allow time for the necessary administrative steps, such as arranging the transfer of overseas property and rights from the British Airways Board to British Airways Plc.

8. Shortly before vesting British Airways Plc should be issued with a certificate to trade under section 4 of the Companies Act 1980, so that it can take over the airline's business from 1 April. At that stage I shall provide British Airways Plc with the statutory minimum of £50,000 share capital. I shall be seeking a supplementary vote for this purpose in due course.

9. From 1 April 1984 onwards, therefore, British Airways will be trading as a Companies Act company wholly owned by the Government. During this period we shall exercise the degree of financial control appropriate to our role as sole shareholder. I shall inform the House early next year of the regime that will govern relations between the Government and British Airways in the period between vesting and the offer for sale: but one element will be an assurance in similar terms to that given in 1980 to British Aerospace in similar circumstances, declaring that the Government continues to stand behind the company and will not allow it to default on its debts. This commitment will not of course extend to any debts falling due after the offer for sale.

10. Final decisions on the timing of privatisation will depend on the airline's financial performance in the meantime, on the state of the stock market and on the general prospects for the airline industry.

11. There has been considerable interest in the press lately, and in some parts of the airline industry, about whether a capital reconstruction of the airline will be necessary. I have reached no firm decision about this. It will depend in part on British Airways' financial performance over the coming year. My aim is that as far as possible the necessary improvement to the airline's balance sheet should come through its own efforts.

12. Mr Speaker, British Airways has remained for too long preparing for take-off. It is a great tribute to Lord King, the British Airways Board and the entire staff of the airline that I can today position the airline on the runway for take-off into the private sector.

CAP1
Department of Transport
9 December 1983

Econ Pol - Privatisation P48

cc NBPM

NBPM AT 12/12

QUEEN ANNE'S GATE LONDON SW1H 9AT

9 December 1983

Dear Nick,

SEALINK PRIVATISATION

with TF/AZ

Thank you for copying to me your letter of 6 December to Nigel Lawson about the privatisation of Sealink. I have no comment on the substance of what you propose, but I wonder whether our current difficulties with the French over no-passport excursions to France, in which the FCO are taking the lead, might affect the timing. As you know, Sealink are very much involved in this business and the strong possibility of the French denouncing the current agreement would, we understand, have a considerable effect on companies such as Sealink which operate day excursions.

It is possible that the launching of a Sealink prospectus in January could coincide with a French announcement terminating the agreement, in which case the Government might be open to criticism.

I am copying this letter to the recipients of yours.

Yours,

Leon

The Rt Hon Nicholas Ridley MP

EZON PUL: Privatisation Pt 8

cc HMT CAB
DTI FCO
MAFF HO
DOE NIO
D/N SO
FSO WO
MOD CO

CONFIDENTIAL FILE

da

be. N. Owen

10 DOWNING STREET

From the Private Secretary

9 December 1983

Sealink Privatisation

The Prime Minister has seen your Secretary of State's letter to the Chancellor of 6 December. She endorses his wish to press ahead with the privatisation of Sealink as soon as it can be done. She wonders however whether it really is the case that this could not be done by flotation before Spring 1985. The fact that Sealink has only this year returned to profit need not be a bar. If trade bidders are able to project forward the improvement in performance which should be made in private ownership the market should be able to do so as well. The Prime Minister assumes that sale in 1984 would not clash with other privatisation exercises.

I am copying this to the Private Secretaries to Members of E(DL), the Foreign Secretary, the Home Secretary, the Secretaries of State for Northern Ireland, Scotland, Wales and Defence, and to Sir Robert Armstrong.

Andrew Turnbull

Miss Dinah Nichols,
Department of Transport.

CONFIDENTIAL

Ref

10 DOWNING STREET

Prime Minister

Endorse Mr Ridley's wish to privatise Sealink as soon as possible but register Policy Unit point that the arguments why a flotation would take longer than a negotiated sale is not very strong?

AT 8/12

Yes - but what else is going to market in 1984?

MT

CONFIDENTIAL

cc Mr. Mount

MR. TURNBULL

SEALINK PRIVATISATION

Nicholas Ridley proposes to privatise Sealink by means of a negotiated sale in 1984 with a Stock Exchange flotation in 1985 as a fallback if suitable bids do not materialise.

We are encouraged by the plan for an early disposal of Sealink. We are inclined to discount the asset valuation problem mentioned in Mr. Ridley's letter (a possible realisation of £60 million against an asset valuation of £90 million). All the property and shipping companies quoted on the London Stock Exchange (including consistently profitable ones) sell at a discount to asset value. The nearest parallel, Euroferries, currently sells at more than 20% discount to net asset value. We question whether the flotation need be delayed until 1985 and suspect that it reflects a degree of foot-dragging by Sealink managment who are nervous about the consequences for them of privatisation. We would urge that a negotiated sale be attempted in, say, March 1984, with flotation in April or May 1984.

Mr. Ridley's note argues that 1984 is not an option for flotation because Sealink has "only this year returned to profit". This is a familiar kind of argument (usually advanced when the company in question "has not yet returned to profit") which is not convincing because:

i. it disregards the improved performance which a company could achieve under private ownership. To wait until a public sector management has established a profitable position misses the essential point, namely, that a private sector management is better able and/or better motivated to improve performance;

ii. the market is just as well equipped to judge the potential of Sealink in 1984 as it will be in 1985;

iii. the arguments for pressing ahead with negotiated bids, so well expressed in Mr. Ridley's note (eg "waiting for an upturn in performance cannot be relied upon to help ... desirable changes in the company's operations would be inhibited") apply equally to the flotation route. If trade bidders can judge prospects well enough in 1984, so can the market generally.

iv. time is money for governments, as for anyone else.

If the Prime Minister agrees, you might observe that the proposal for an early sale is encouraging and then register the point with Mr. Ridley's office that the arguments for proceeding with negotiated bids in early 1984 seem to apply with equal force to a flotation soon after, rather than in 1985.

NICHOLAS OWEN
8 December 1983

CONFIDENTIAL

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

8 December 1983

Miss Dinah Nicols
Private Secretary to the
Secretary of State for Transport
Department of Transport
2 Marsham Street
LONDON SW1

DR 7/12

Dear Dinah,

BRITISH AIRWAYS PRIVATISATION: STATEMENT TO PARLIAMENT

The Chancellor has seen the draft statement on the privatisation of British Airways which your Secretary of State enclosed with his letter of 7 December.

TPM

The Chancellor is generally content with the text, subject to any comments which other colleagues on E(DL) Committee may have. However, he has proposed one small amendment to the first line of paragraph 4 where he suggests the word "courage" should be replaced by "decisiveness". He feels that the use of the word "courage" in this context could lead to unnecessary adverse comment.

I am copying this letter to Andrew Turnbull (No 10), the Private Secretaries to other members of E(DL), to Janet Lewis-Jones (Lord President's office), David Heyhoe (Lord Privy Seal's office), Murdo MacLean (Chief Whip's office), David Beamish (Lord Whip's office) and Richard Hatfield (Cabinet Office).

Yours sincerely,

Margaret O'Mara

MISS M O'MARA

ECON POL: Privatisation: Pt 8.

CONFIDENTIAL

NO

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

7 December 1983

Dear Nigel

BRITISH AIRWAYS PRIVATISATION: STATEMENT TO PARLIAMENT

In accordance with E(DL)'s decision of 24 November I am planning to announce to Parliament next Monday, 12 December the steps I am about to take towards the privatisation of British Airways, hopefully in early 1985.

I attach a draft of my statement. It has already been discussed with your officials. If you or other colleagues have any comments I should be glad to receive these by Thursday evening 8 December.

I am copying this letter and the enclosed statement to the Prime Minister, the members of E(DL), the Lord President, the Lord Privy Seal, the Chief Whip, Lord Denham and Sir Robert Armstrong.

Yours ever
Nick.

NICHOLAS RIDLEY

CONFIDENTIAL

BRITISH AIRWAYS: DRAFT PARLIAMENTARY STATEMENT BY SECRETARY OF STATE FOR TRANSPORT ON 12 DECEMBER 1983

1 With permission, Mr Speaker, I should like to make a statement about British Airways.

2 The Government's intention ~~of selling a controlling stake~~ ~~in~~ that British Airways ~~to the~~ should become a private sector company was announced by my Rt Hon Friend the then Secretary of State for Trade in July 1979. Legislation to achieve this was passed in the Civil Aviation Act 1980.

3 Our original intention was to go ahead with a sale soon after the passing of the Act, but the decline in the airline's profits in 1979/80 and the large losses in the two subsequent years made that impracticable.

4 Over the last two years, however, courage on the part of management and determined co-operation from the workforce have sharply improved British Airways' productivity; and the airline industry is now emerging from the world recession. BA made modest profits in the financial year ended last March; and they have now reported significantly higher profits - of £162m - for the six months from April to September this year.

5 As well as becoming once more profitable, British Airways has begun to restore its balance sheet. Since March they have repaid well over £100m of borrowings without any assistance from the Government. Their external finance limit fixed for 1984/85 means we expect British Airways to repay at least a further £160m of borrowings next year.

6 Following this transformation of British Airways' financial prospects I have decided to aim for privatisation as soon as possible, hopefully in early 1985. To this end I propose to establish British Airways as a public limited company under Government ownership in accordance with the 1980 Act.

7 I am accordingly arranging for the registration of a public limited company under the name of British Airways plc without at this stage giving it the right to trade, and I shall shortly make an order nominating it as the successor company to the British Airways Board under section 3(2) of the 1980 Act. I shall place

a copy of the memorandum and articles of association of the new company in the library of the House. I also propose soon to make an order under section 10(1) of the 1980 Act appointing 1 April 1984 as the day on which the property, rights, liabilities and oblgiations of the British Airways Board in the UK are vested in British Airways plc. All this needs to be done well in advance of vesting to allow time for the necessary administrative steps, such as arranging the transfer of overseas property and rights from the British Airways Board to British Airways plc.

8 [To be included if necessary: Shortly before vesting it will be necessary for BA plc to be issued with a certificate to trade under section 4 of the Companies Act 1980, so that it can take over BA's business from 1 April. At that stage I shall have to provide BA plc with the statutory minimum of £50,000 share capital. I shall be seeking a supplementary vote for this purpose in due course.]

9 From 1 April 1984 onwards, therefore, British Airways will be trading as a Companies Act company wholly owned by the Government. During this period we shall exercise the degree of financial control appropriate to our role as sole shareholder. I shall inform the House early next year of the regime that will govern relations between the Government and BA in the period between vesting and the offer for sale: but one element will be a guarantee in similar terms to that given in 1980 to British Aerospace in similar circumstances, declaring that the Government continues to stand behind the company and will not allow it to default. This guarantee will not of course extend beyond the offer for sale.

10 Final decisions on the timing of privatisation will depend on the airline's financial performance in the meantime, on the state of the stock market and on the general prospects for the airline industry.

11 There has been considerable interest in the press lately, and in some parts of the airline industry, about whether a capital reconstruction of the airline will be necessary. I have reached no firm decision about this. It will depend in part on BA's financial performance over the coming year. My aim is that as far as possible the necessary improvement to the airline's balance sheet should come through its own efforts.

12 Mr Speaker, British Airways has remained for too long preparing for take-off. It is a great tribute to Lord King, the British Airways Board and the entire staff of the airline that I am in a position today to position the airline on the runway for take-off into the private sector.

CAP1
Department of Transport
6 December 1983

Econ pol.
Privatisation
Pk 15

File

CC: E(DL)
HMT
DTI
MAFF
DOE
+ LPO
LPSO
CWO
Capt/Gnt/Arms
Co
D/Energy
CSO, HMT
FSO, HMT

10 DOWNING STREET

From the Private Secretary

8 December 1983

BRITISH AIRWAYS PRIVATISATION: STATEMENT TO PARLIAMENT

The Prime Minister has seen the draft Statement attached to your Secretary of State's letter to the Chancellor of 7 December. She is content with it and content that it should be made next Monday, 12 December.

I am sending copies of this letter to the Private Secretaries to the members of E(DL) and to the Private Secretaries to the Lord President, the Lord Privy Seal, the Chief Whip, Lord Denham and Sir Robert Armstrong.

Andrew Turnbull

Miss Dinah A. Nichols,
Department of Transport.

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary 7 December 1983

Sale of British Airways

The Prime Minister has seen your letter to me of 2 December. She is content with the Chancellor's suggestion that the further report to E(A) should cover the possibility that revaluation of BA's assets might obviate the need to seek a reduction of capital in the Court, as well as the question of route transfers and a capital reduction.

I am sending copies of this letter to the Private Secretaries to the Secretaries of State for Energy, Scotland, the Environment, Trade and Industry, the Minister of Agriculture, Fisheries and Food, the Secretary of State for Transport, the Financial Secretary to the Treasury, and to Sir Robert Armstrong.

Andrew Turnbull

Miss M. O'Mara,
HM Treasury.

CONFIDENTIAL

CONFIDENTIAL

PRIME MINISTER

BRITISH AIRWAYS PRIVATISATION: STATEMENT TO PARLIAMENT

I attach the draft of Mr. Ridley's Statement on British Airways privatisation. I have suggested an amendment at paragraph 2. The original draft repeated the formulation about selling a controlling stake. Since it is the intention to sell 100%, this could be held to be misleading. DOT do not want to go firm on 100% as in the event market circumstances may not permit them to achieve this. The revised wording I have suggested, which parallels that in the Manifesto, leaves the 100% option open without appearing to repeat the 51% formulation.

Mr. Ridley will certainly be questioned about route transfers. Authority for this lies with the CAA and the Secretary of State is in an appellate position vis-a-vis the CAA and this limits what he can say. He is likely to use a formulation such as "I have no powers to effect a transfer of routes but if airlines can themselves reach agreement on transferring routes and related assets, I would have no objection."

Since he came to see you, Mr. Ridley has spoken to Lord King, indicating that the Government favours a transfer of routes. Lord King acknowledged that he was being given a clear political steer. He has gone back to talk to his Board, but no more has been heard since then.

AT

7 December 1983

CONFIDENTIAL

10 DOWNING STREET

Prime Minister

To note Chancellor's gloss on revaluation of BA's assets.

Agree I minute saying that work on BA's balance sheet should include possibility of revaluation which might make recourse to Court unnecessary?

AT
6/12

cc NO

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
SW1

6 December 1983

Dear Nigel

Sealink Privatisation

British Rail have now almost completed the processes of physical separation of Sealink from the railway business, and an early sale is now a practical proposition. However Sealink has only this year returned to profit, after a period of losses, and so a Stock Exchange flotation would not be an option until the Spring of 1985 - and even then only if the company continues to fulfil the expectations of its management. I enclose an aide memoire with key facts on the Company.

We and BR are at one in wishing to achieve private sector status at the earliest possible moment, since that will give the company the best prospect of a successful future. I propose therefore to ask BR to press ahead in seeking a negotiated sale either to a commercial buyer, or to a consortium involving, perhaps, some trade investors and some financial institutions. BR have had a number of tentative inquiries which suggests that there should be some bidders of each of these types.

BR's own preference would have been for their merchant bankers (Morgan Grenfell) to organise a consortium to purchase only part of the shares (though sufficient to achieve private sector status). If the company does improve its profit record in future years BR would then have shared in that profit through an ultimate sale of that residual shareholding. This arrangement would also have the attraction for them that it would preserve the company and its management in very much its present form (although the Company does not know that BR plans some necessary strengthening of the management in senior positions) and so would be less likely to create industrial relations problems with the unions.

I have concluded however that such a sale could not be defended, since it would do nothing to test the market. But I believe that if the sale prospectus gives emphasis to a number of matters where Government policy impinges on the sale, then several of BR's fears will, in fact, prove groundless. First, I propose that they should stipulate that the buyer must provide a scheme for employee shareholding - this has been an attractive feature of previous privatisations, and I believe it would be very helpful in this case, both as a means of encouraging future efficiency in the company, and as a means of diminishing the inevitable political outcry about a commercial sale.

Next, I propose that BR should specify that the ports and the shipping business should be bought as a single entity. This is right commercially for the company; it is in line with repeated statements made during the passage of the enabling legislation in 1981 that this was the preferred course, and any other course would delay a sale by at least a year.

BR should also require the purchaser to take on the business with its employees on existing terms and conditions, so that BR would not be saddled with redundancy obligations; it would of course be open to the buyer to negotiate new arrangements subsequently if he wished. BR might also seek assurances about the intentions of the purchaser with regard to the future of the company. (A special blocking shareholding to maintain British registration of Sealink's ships would be contrary to our policy of freedom to bring ships on and take them off the British Registry). Some possible buyers would of course present problems of competition policy, and so would need to be excluded on those grounds. BR would retain the right to refuse to negotiate with bidders who did not satisfy the above criteria, and, if necessary, to reject all offers, if none seemed sufficiently attractive. Since the sale requires my consent, that decision would ultimately be for Government to judge.

It is difficult to forecast the level of potential bids but Morgan Grenfell, and my own advisers, Hill Samuel, suggest that a figure of about £60-70m might be obtained for a sale of 100% of Sealink in the Spring of 1984, provided the buyer has control of the company. This is substantially below the historic book value (of about £90m excluding leased assets), and so would inevitably attract public controversy. But the plain fact is that past investment and borrowing by Sealink cannot be fully remunerated by present or likely future earnings of the company, unless their performance can be improved considerably. That is unlikely to happen until they face the stimulus of the private sector. Thus BR are almost inevitably going to face a book loss because of faults in their past investment and management decisions. Waiting for an upturn in performance cannot be relied on to help; it might well never come, since this is a fiercely competitive market, and meanwhile desirable changes in the company's operations would be inhibited. We should not be in the position of speculating on the Company's future.

I propose therefore to tell BR to proceed on the lines I have indicated. I need to do that quickly since there is still a good deal of work to be done on the Prospectus, which must be issued in January if a sale is to be completed before the early summer. If BR miss this timescale they are advised that a sale would not be practicable until the 1984 results are available, i.e. until early 1985.

I hope that unless any of our colleagues raises objections, you will be able, as Chairman of E(DL), to authorise me by 9 December to proceed as I propose.

I am copying this to the Prime Minister, to E(DL) colleagues, to the Foreign Secretary, the Home Secretary, the Secretaries of State for Northern Ireland, Scotland, Wales, and Defence and to Sir Robert Armstrong.

NICHOLAS RIDLEY

SEALINK (UK) Ltd

Fixed Assets

Operates some 40 ships, of which	owns	-	£40m
	leases	-	£85m

Owns and operates 7 harbours:
- Folkestone
- Parkeston Quay, Harwich
- Heysham
- Holyhead
- Newhaven
- Stranraer
- Fishguard

Total assets employed (including leased ships)- £170m

TURNOVER £230m

PROFIT / (LOSS) AFTER INTEREST

1979	1980	1981	1982	1983 (Budget)
£6m	(£2.8m)	(£9.6m)	(£6.4m)	£7m

ROUTES

23 ferry routes between Britain and Holland, Belgium, France, Isle of Wight, Channel Islands, Republic of Ireland, Northern Ireland. Virtually all services are multipurpose carrying foot passengers, accompanied cars and Ro/Ro freight.

MANPOWER

Seagoing	4600	(Merchant Navy and Airline Officers Association, National Union of Seamen)
Shorestaff	4300	(Confederation of Shipbuilding and Engineering Unions, NUR)
HQ	700	(TSSA)

Econ Pol
Privatisation
AT 7/12

cc NO

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

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

2 December 1983

?
Interest
Entd 6/12

Dear Andrew,

SALE OF BRITISH AIRWAYS

The Chancellor has seen your letter of 30 November recording the Prime Minister's comments on his report of the discussion at E(DL).

The Chancellor has commented that, while none of the routes for correcting BA's balance sheet is wholly without difficulty, there is still some hope that it will be possible to avoid going to the Court if the BA Board are persuaded that their capital assets are now somewhat undervalued. This is likely to be the case.

Your letter did not mention this possibility. However, it will be necessary to review the existing balance sheet valuations in any case for the prospectus and for all parties to the sale to be satisfied that they are fairly assessed. The Chancellor is anxious that the essential work on this should be done now before embarking on the potentially hazardous Court route, not least in order to guard against the risk of a capital reduction being subsequently criticised for being unnecessary.

Our understanding is that work on the valuation issues is already in hand and need not delay the proposed timetable in any way.

The Chancellor has suggested that the further report to E(A) for which the Prime Minister has asked should cover the outcome on revaluation, as well as the question of route transfers and a capital reduction.

I am copying this letter to those who received yours and to Richard Hatfield.

Yours sincerely,

Margaret O'Mara

MISS M O'MARA
Private Secretary

ECON POL : Privatisation Pt 8.

TF No policy objection. AT
though we need to see the content of the statement

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

Charles Marshall Esq
Private Secretary to
Rt Hon John Biffen MP
Lord Privy Seal and Leader of
the House of Commons
Privy Council Office
68 Whitehall
LONDON SW1A 2HB

2 December 1983

Agreed to
✓ by phone
PT
2/12.

Dear Charles

STATEMENT ON BRITISH AIRWAYS PRIVATISATION: MONDAY 12 DECEMBER 1983

I had a word with you on the telephone about this statement, and you offered a choice of dates: 7, 8, 11 and 12 December. I heard subsequently from the Government Whip's Office and No.10 that 7 December was less acceptable, and of the three remaining we would like to go for Monday 12.

The privatisation of British Airways was discussed in E(DL) on 24 November. Agreement was given to steps including an early announcement to Parliament. The announcement my Secretary of State proposes to make would mark the beginning of the formal process of privatisation. There has been considerable political interest on both sides of the House in this matter. The press too have been giving substantial coverage to it, particularly in the light of the proposals canvassed by Sir Adam Thomson of British Caledonian.

We will naturally show you a draft of the statement in due course, but its main message will be that the Secretary of State proposes to vest British Airways PLC under the powers contained in the Civil Aviation Act 1980 on 1 April 1984, with a view to a sale in early 1985 (as particularly requested by E(DL); and that he proposes to tell the Board of BA to make the necessary preparations for vesting.

✓ I would be very grateful if you, Tim Flesher at No.10 and Murdo MacLean in the Government Whip's Office (to whom I am copying this letter) could ask for agreement to our making the statement on that day.

Yours sincerely,

Henry Derwent

H C S DERWENT
Private Secretary

Econ Pol: Privatisation #8

SECRET

file KB5

pc: NO

10 DOWNING STREET

From the Private Secretary

30 November 1983

SALE OF BRITISH AIRWAYS

The Prime Minister has seen the Chancellor's report on the discussion at E(DL). She agrees with the view of the Committee that we should aim for the flotation of BA in early 1985 after BT, but with an option on late 1984 being kept open should a market opportunity arise then. She also agrees that 100 per cent of BA should be sold, subject to mechanisms to protect against foreign management or ownership.

The Prime Minister has noted the doubts of the Committee about a reduction in BA's capital through the Court and also about route transfers. She has commented that if both are ruled out the only course remaining for correcting BA's balance sheet is to wait for profits to accumulate, with the risk that this would delay privatisation. She therefore agrees that further work should be done on the question of a capital reduction. She also endorses the proposal to hold further talks with Lord King on route transfers.

In view of the importance of these issues, she has requested that when this work has been done it should be reported back to E(A).

I am copying this letter to the Private Secretaries to the Secretaries of State for Energy, Scotland, the Environment, Trade and Industry, the Minister of Agriculture, Fisheries and Food, the Secretary of State for Transport, the Financial Secretary to the Treasury and to Sir Robert Armstrong. As with the Chancellor's minute, copies of this letter should be seen only by those with a clear need to know of its contents.

ANDREW TURNBULL

John Kerr Esq
HM Treasury

SECRET

SECRET

4

I think we had better have the next meeting at 12. MT

PRIME MINISTER

Sale of British Airways

To see E(DL) minutes and Chancellor's report. E(DL) agreed:-

(i) flotation in early 1985 after BT, but with an option on late 1984 being kept open in case BT runs into problems;

(ii) sale of 100%, subject to mechanisms to protect against foreign management or ownership;

But the Committee then

(iii) had serious doubts about writing off capital through the Court, and agreed to consider this further;

(iv) was lukewarm about route transfers, but agreed that there should be more talks with Lord King.

John Redwood's note points out that the Committee failed to see the connection between (iii) and (iv) since route transfers can reduce, and perhaps eliminate the need for, the reduction in capital. If asset sales and capital reduction are both ruled out, all that is left is waiting for profits to accumulate to restore the capital base.

Agree (i) and (ii)?

Endorse the further study of capital reduction, while indicating the hope that the difficulties can be resolved, as otherwise privatisation would be delayed?

Yes Endorse further talks with Lord King on route transfers?

28 November, 1983.

AT

SECRET

PRIME MINISTER

28 November 1983

3

THE SALE OF BRITISH AIRWAYS

We think you should welcome the proposals of Nick Ridley for the sale of British Airways.

E(DL) were a little unhelpful in attacking both the idea of a capital write-down and the idea of selling assets. One way or another, in order to sell British Airways the balance sheet has to be reconstructed. Nick Ridley is well aware of the difficult task he faces in attempting to negotiate a solution to the balance sheet problem. It would be best to give him every encouragement as a successful resolution is essential if the Committee's desired result of early sale of 100 per cent of British Airways is to be achieved.

JOHN REDWOOD

2 mp's

cc No

2

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

PRIME MINISTER

SALE OF BRITISH AIRWAYS

The Ministerial Sub-Committee on Disposal of Public Sector Assets (E(DL)) met on 24 November under my chairmanship to discuss a memorandum by the Secretary of State for Transport on the sale of British Airways (BA). The Secretary of State also reported orally on his discussions with Lord King regarding possible transfers of routes and assets to private sector airlines. This minute reports our conclusions.

in PM's Box

2. The Secretary of State for Transport told the Sub-Committee that he was anxious to keep open the possibility of floating BA in late November or early December 1984: there was a good deal of enthusiasm for privatisation within the airline, and it was important to keep up the momentum. His plans were as follows:

i. The immediate registration of British Airways PLC as a 'paper' company. This would be followed by preparations to transfer BA's overseas rights and assets to BA PLC on vesting day, and approaches to overseas governments to designate BA PLC, in place of BA, under air services agreements with them.

ii. Making an order, by the beginning of February 1984, appointing 1 April 1984 as vesting day.

iii. The issue, by 1 April 1984, of a Government guarantee to BA PLC to cover the period up to flotation.

The timetable was necessary in order to allow for the complicated process of transferring BA's extensive and important overseas rights and property, and to demonstrate to the airline that the Government was anxious to make early progress. Even the first of the steps would quickly become public knowledge; it would therefore be necessary to make an early Parliamentary statement on the action proposed.

Timing of flotation

3. The Sub-Committee agreed that it would be right to keep open the option of a flotation in late 1984; and that the Secretary of State for Transport should embark on the plan of action which he proposed. However, it was clearly unlikely that the market could digest the flotation of both British Telecom (BT) and BA within a short space of time; and the flotation of BT must take priority. It was essential to say nothing which might cast doubt on, or appear to conflict with, the Government's determination to go ahead with the sale of BT. In his Parliamentary statement and elsewhere the Secretary of State for Transport will therefore suggest early 1985 as the likely date of flotation of BA: this will not, of course, preclude an earlier sale if events should make that desirable.

Extent of sale

4. The Secretary of State for Transport proposed that the aim should be to dispose of 100 per cent of the Government's interest in BA, though possibly in two steps rather than one. He recognised, however, that there might be a case for restricting the extent to which either the ownership or the management of the company could pass overseas. He will consider these aspects further and bring forward proposals in due course.

Restructuring of the balance sheet

5. The Secretary of State for Transport pointed out that for flotation to be possible on the timescale he envisaged, it

would be necessary to restructure BA's balance sheet: relying on the accumulation of profits would take too long. BA should be kept under pressure to achieve the necessary improvements in the balance sheet themselves, notably through revaluation of assets, and perhaps by sales of assets at a profit over book value. It might also be right to apply some of the proceeds of flotation, in effect, to repayment of debt. But if such measures were insufficient, the Secretary of State suggested that an application should be made to the Court for a reduction in the share capital of BA PLC.

6. The Sub-Committee had reservations about all the possible ways of rectifying the deficiencies in BA's balance sheet. As the Secretary of State for Transport had pointed out, to rely on the accumulation of profits would delay flotation by two or three years. This would be politically objectionable and it would dissipate the momentum within the airline towards privatisation. It would be right - indeed, necessary - to revalue BA's assets during the preparation of the prospectus for sale. But the extent of revaluation would be a matter for the commercial judgement of the board. Anything further would be objectionable in itself and, after the substantial write down of assets in the recent past, expose BA and the Government to accusations of sharp practice.

7. The Sub-Committee saw particular objection to an application to the Court for a reduction in capital. The circumstances of such an application would have no true parallel in the private sector. It would be likely to be criticised as unfair by existing private sector airlines. It would also be open to objections of Parliamentary propriety as an attempt to evade the provisions of the Civil Aviation Act 1980.

8. This is an aspect to which the Sub-Committee will need to return at a later stage.

Route transfers

9. It is possible that transfers of some of BA's routes, with the sale of assets that would accompany such transfers, might help with the balance sheet problem. They would also, of course, go far to meet the points that Sir Adam Thomson, in particular, has made about 'unfair competition'. As you know, these points command a good deal of sympathy among our supporters in the House.

10. Nevertheless, there are strong reasons for a cautious approach. The Government has no power to require BA to divest themselves of any routes. Nor can we decide who should take over such routes as BA might be willing to surrender: that is a matter for the Civil Aviation Authority. Any premium on the sale of assets associated with particular routes would be conditional on the eventual decision of the CAA, and would be treated as of uncertain value by potential investors until the CAA had reached their decision. But to wait for the decision could seriously delay flotation.

11. Some members of the Sub-Committee indeed regarded route transfers as intrinsically undesirable. In the airline business size is often strength; and BA, both before and after flotation, will face formidable overseas competition. It may be better from the national standpoint to meet that competition mainly by one large airline than by two medium-sized ones. Any suggestion that route transfers were a necessary condition of privatisation would risk seriously damaging morale within BA and stirring up opposition to privatisation.

12. Despite these difficulties, the Sub-Committee thought it right to explore the possibilities with BA. It could well be to BA's own commercial advantage to transfer some of their Iberian routes out of Gatwick to British Caledonian. The

Secretary of State for Transport will therefore discuss the situation with Lord King, pointing out to him the political as well as the commercial considerations. But this must be a matter of persuasion, not compulsion. Other objections apart, if we sought to compel, we should have to promote legislation.

13. I am sending copies of this minute to the Secretaries of State for Energy, Scotland, the Environment, and Trade and Industry, the Minister of Agriculture, Fisheries and Food, the Secretary of State for Transport and the Financial Secretary, Treasury, and to Sir Robert Armstrong. The possible inter-action between the flotation of BA and BT, and the whole subject of route transfers, are sensitive; and I should therefore be grateful if you and the other recipients of this minute would ensure that copies are seen only by those with a clear need to know of its contents.

Margaret O'Mara

N.L.
28 November 1983
(approved by the Chancellor and signed in his absence)

ECON POL: Privatisation

Pt 8

cc NO.

NBPM

AT 28/11

JMS

CONFIDENTIAL

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My Ref: R/PSO/29232/83

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

28 November 1983

Dear Nigel

BRITISH AIRWAYS PRIVATISATION

with AT?

Thank you for your letter of 11 November.

I do agree that Gordon Dunlop's remarks - at least as reported in the Sunday Times - were unhelpful. I have taken this up with John King as you suggested.

I am copying this letter to the Prime Minister, Norman Tebbit and Sir Robert Armstrong.

Yours

Nicholas

NICHOLAS RIDLEY

CONFIDENTIAL

Econ Pol: Disposal of Public Sector Assets

NBPM

AT 25/11

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

25 November 1983

Andrew Turnbull Esq
No 10 Downing Street
LONDON SW1

Dear Andrew,

CABLE AND WIRELESS SHARE SALE

Sub-underwriting for the sale has now been successfully completed. The terms on which the sale has been underwritten are those agreed yesterday with the Bank of England and reported to you.

The offer will be for 100 million shares at a minimum tender price of 275p which represents a discount of 6.14 per cent on yesterday's closing price of 293p. The shares will be paid for in two instalments, the second call coming 17 February 1984. The first payment will be £1. Application lists will open and close on Friday 2 December. The striking price will be decided over the following weekend.

The arrangements for the sale are in other respects very similar to those for BP, with applications of up to 1,000 shares from UK employees of Cable and Wireless being accepted in full.

... For your information I am enclosing copies of the two Press Notices which the Bank of England is issuing today and the associated briefing.

Finally, you should know that because of the threat that industrial action may prevent the publication of some or all of the national newspapers over the next few days, we are having to take steps for the sale to be advertised on television on the evenings of Sunday 27 and Monday 28 November. The advertisements will be purely factual, drawing attention to the existence of the sale, and indicating where the full prospectus and application forms may be obtained.

Yours sincerely,

Margaret O'Mara

MISS M O'MARA

2ND DRAFT PRESS NOTICE

UNDERWRITING OF CABLE AND WIRELESS OFFER IN PROGRESS

The Bank of England announces that underwriting is in progress in respect of an Offer for Sale by Tender on behalf of HM Government of 100 million Ordinary Shares of 50p each of Cable and Wireless plc. The Offer is being managed by the Bank of England in conjunction with Kleinwort, Benson Limited.

The minimum tender price will be 275p per share, payable as to 100p per share on application and the balance by 17 February 1984.

A further announcement will be made later today.

25 November 1983

2ND DRAFT PRESS NOTICE

UNDERWRITING OF CABLE AND WIRELESS OFFER COMPLETED

The Bank of England announces that underwriting has now been completed in respect of the Offer for Sale by Tender on behalf of H M Government of 100 million Ordinary Shares of 50p each of Cable and Wireless plc at a minimum tender price of 275 p per share. 100 p per share will be payable on application. The balance of the purchase price will be payable by 17 February 1984. The shares are being sold with the right to receive the interim dividend of 2.40p (3.43p gross) payable on 31 March 1984.

The Offer is being managed by the Bank of England in conjunction with Kleinwort, Benson Limited. It has been underwritten by Kleinwort, Benson Limited, Baring Brothers & Co.,Limited, Morgan Grenfell & Co. Limited and J.Henry Schroder Wagg & Co.Limited. The brokers to the Offer are Mullens and Co., Cazenove & Co., James Capel & Co. and Rowe & Pitman.

The Applications Lists will open at 10.00 am on Friday, 2 December 1983 and will close at any time thereafter on the same date. Applications, which will be irrevocable until 13 December 1983, must be for a minimum of 100 shares. All shares will be sold at the same price (the Striking Price), which will be not less than the minimum tender price. The Striking Price may however be higher than the minimum tender price.

A person applying for not more than 1,000 shares may make either a Tender Application or a Striking Price Application. A Tender Application means an application at the minimum tender price or at any higher tender price per share which is a whole multiple of 1p. A Striking Price Application means an application under which the applicant does not have to decide at what price he should tender but will be deemed to have tendered at the Striking Price. A person applying for more than 1,000 shares must make a Tender Application. Tender Applications at prices above the Striking Price and Striking Price Applications will be eligible for preferential consideration.

The Striking Price may be set above the minimum tender price if both (i) Tender Applications at or above the Striking Price have been received for at least half the Ordinary Shares being offered for sale; and (ii) Tender Applications at or above the Striking Price, together with Striking Price Applications, are accepted in respect of all the Ordinary Shares being offered for sale. In other circumstances the Striking Price will be the minimum tender price. The Striking Price will not necessarily be the highest price at which sufficient Tender Applications, together with Striking Price Applications, are received in respect of all the Ordinary Shares being offered for sale.

All cheques are liable to be presented for payment, but presentation of cheques accompanying applications in respect of which no allocation of shares is expected to be made will be avoided as far as is practicable. Letters of Acceptance and cheques in respect of refundable application moneys may be retained pending clearance of applicants' cheques. The right is reserved to reject, in whole or in part, any application regardless of the price tendered or deemed to have been tendered.

It is expected that the Striking Price and the basis of allocation will be announced on Monday, 5 December 1983. Dealings are expected to commence in partly-paid form shortly after such announcement. Letters of Acceptance will be despatched as soon as practicable to successful applicants. Dealings prior to receipt of Letters of Acceptance will be at applicants' risk.

Prospectuses and application forms will be published in newspapers on Sunday and Monday, 27 and 28 November 1983 and will be available from Monday, 28 November 1983 from the Bank of England, the branches and the Glasgow Agency of the Bank of England, main UK branches of many banks, main branches of Trustee Savings Banks, main Post Offices, the underwriters and the brokers to the Offer.

Special application forms are being made available to employees of Cable and Wireless and its United Kingdom registered subsidiaries engaged in and currently working in the United Kingdom and any such employee may apply on that form for up to 1,000 Ordinary Shares at the Striking Price. Such applications will be accepted in full.

A commission of 0.3p per share will be paid to recognised banks and licensed institutions (within the meaning of the Banking Act 1979), to Trustee Savings Banks, to National Girobank and to members of The Stock Exchange on acceptances in respect of applications (other than special employee applications) bearing their stamp. However, no payment will be made to anyone who would receive total commissions of less than £10.

In November 1981 H M Government reduced its 100% holding in Cable and Wireless by means of a public offer for sale of 133,285,000 Ordinary Shares. Following that offer for sale, and taking into account the shares committed at that time by H M Government to the Cable and Wireless Group's Employee Share Schemes, H M Government held just over 50% of the issued share capital of Cable and Wireless. In March this year Cable and Wireless issued 30,000,000 Ordinary Shares in connection with the purchase of shares in Hong Kong Telephone Company Limited, thus reducing H M Government's holding to just over 45%. This Offer by H M Government will result in its holding being reduced to per cent. H M Government has no plans at this stage to sell any more of its present holding in Cable and Wireless and will not do so in the next two years.

25 November 1983

(24.11.83)

OFFER FOR SALE OF CABLE AND WIRELESS SHARES:
BACKGROUND BRIEF FOR PRESS OFFICES

1 On Friday 25 November the Government will offer for sale by Tender 100 million ordinary shares in Cable and Wireless plc at a minimum tender price of 275p. The offer will remain open until 10.00 am on Friday, 2 December. The offer is on a partly-paid basis, with the initial payment of 100p per share due on 2 December and the balance on 17 February 1984. The proceeds of the sale at the minimum tender price would amount to some £262 million (after expenses). It is hoped that the striking price and the basis of allocation will be announced before the opening of dealings on Monday, 5 December so that dealings in the partly-paid shares may begin on that day. (This is, however, open to delay and no indication of our intentions should be given in advance of the announcement itself.)

2 Background

In a Statement to the House of Commons on 27 October the Financial Secretary to the Treasury announced that, as part of their continuing programme of privatisation, the Government were now considering disposal of a further tranche of their shareholding in Cable and Wireless plc during the current financial year and that the Government had in mind a sale of approximately half their present shareholding through an offer for sale to the public.

3 Structure of the Offer

The Offer is being made by the Bank of England on behalf of the Government (formally, the Lords Commissioners of Her Majesty's Treasury) in conjunction with Kleinwort, Benson Limited. Underwriters to the issue are Kleinwort Benson, Baring Brothers, Morgan Grenfell and Schroder Wagg. Brokers to the issue are Mullens, in the lead, with Cazenove, James Capel and Rowe & Pitman.

4 The form of tender is essentially the same as that used successfully in the recent BP sale. All Shares for which applications are accepted will be sold at the same price (the

"Striking Price"). The Striking Price may be the Minimum Tender Price or a higher price in multiples of 1p: it will be determined by HMG and the Bank in the light of applications received, subject to certain technical constraints set out in the prospectus (see Appendix). Anyone applying for not more than 1,000 Shares may, instead of entering the tender, put in a Striking Price Application, which means that he does not have to bid a price but will be deemed to have tendered at the Striking Price: this is the mechanism for non-competitive applications by the small investor that worked so successfully in the BP sale. Applications for above 1,000 Shares have to be on a tender basis.

5 Employees of Cable and Wireless and its United Kingdom registered subsidiaries engaged in and currently working in the United Kingdom may additionally apply for between 100 and 1,000 Shares at the Striking Price and will be guaranteed allotment in full for that amount. The non-competitive Striking Price Applications, and Tender Applications at prices above the Striking Price, will be eligible for preferential consideration but the right is reserved to vary the basis of allocation as between different types of application, differing sizes of application and differing levels of prices at which tender applications are made.

6 Advertising and Distribution

Prospectuses and Application Forms will be widely distributed. They will be available to the public at a large number of banks, TSBs and Post Offices in England, Wales, Scotland and Northern Ireland, as well as from the Bank of England and its branches, the underwriters and brokers to the issue, on Monday, 28 November.

7 It is hoped that the Prospectus and Application Form will be published in full in the Sunday Times, Sunday Telegraph and Observer on Sunday, 27 November and in the Financial Times, the Times, Daily Telegraph, Guardian, Scotsman, Glasgow Herald and Aberdeen Press & Journal on Monday, 28 November. In addition, it is intended to publish abridged particulars of the offer in most of the other national Sunday and daily papers and in the main regional, Scottish and Northern Irish papers.

8 Commissions and Expenses

The Government will pay a commission of 1 1/4% to the sub-underwriters for their commitment. Underwriting will not be undertaken until the sub-underwriting is complete. The Government will pay a commission of 1/8% to be shared by the four brokers and four underwriters. In addition, an allotment commission of 0.3p per share will be paid to intermediaries, eg, banks and brokers, who lodge successful applications on behalf of their clients. As in previous sales, the Government will pay the stamp duty due on the sale. The Government's total expenses, including the commissions and the costs of legal fees, printing and advertising, but excluding stamp duty and VAT are estimated to be around £6 million. Stamp Duty and VAT are estimated to be around £6 1/2mn.

9 Dividend

The Shares are being offered cum the right to the interim dividend of 2.4p net per ordinary Share declared by the Company on 16 November; the dividend is payable on 31 March 1984.

10 Future Intentions

As on previous similar occasions the Government has given an assurance about its plans for any further sales of Cable & Wireless Shares. On this occasion it is stated that "H M Government has no plans at this stage to sell any more of its present holding in Cable & Wireless and will not do so in the next two years." Any questions on this point should be answered only by reference to those words, which should not be amplified.

11 Non-Intervention

The Government has recently reaffirmed that it does not intend to use its rights as a shareholder to intervene in the Company's commercial decisions. Nor does it expect to vote its shareholding at general meetings of the Company in opposition to resolutions supported by a majority of the Court of Directors, although it retains the right to do so. Any questions on this point should be answered only by reference to the words above which should not be amplified.

12 Previous sales and Government Shareholding

In November 1981 the Government reduced its 100 per cent holding in Cable and Wireless by means of a public offer for sale of 133,285,000 Ordinary Shares of 50p each. Following that offer for sale, and taking into account the shares committed at that time by the Government to the Group's Employee Share Schemes, the Government held just over 50 per cent of the issued share capital of the Company. In March this year the Company issued 30,000,000 Ordinary Shares in connection with the purchase of shares in Hong Kong Telephone Company Limited, thus reducing the Government's holding to just over 45 per cent. There was a 1 for 2 capitalisation issue in September 1983.

13 Following this Offer for Sale, the Government will hold 103,786,252 Ordinary Shares, representing approximately 23 per cent of the issued ordinary share capital. The Government is committed, under arrangements agreed in October 1981, subject to certain profit targets being met, to allocate a total of 1,286,251 Ordinary Shares to the trustees of the Group's Employee Share Schemes.

14 The Government also holds the one Special Rights Preference Share of £1, which was issued to them on 23 November 1983 when shareholders passed a special resolution recommended by the Directors. This carries no rights to vote at general meetings but requires the prior written consent of the Government for certain events such as an amendment to Article 35 (which essentially limits shareholdings in the Company of individuals (other than the Government) and persons acting in concert to a maximum of 15%) or Article 120 (which requires the chief executive of the company to be a British citizen) of the Company's Articles of Association, the voluntary winding up of the Company, a material disposal of assets or the creation or issue of shares with different voting rights from those of the Ordinary Shares. The purpose of these provisions is to safeguard the independence of the Company.

15 Company Developments

CARE: The remainder of this brief is for background information only. Any questions on the Company's business should be referred to Cable and Wireless.

The Company announced its interim dividend (up from 2.1p per Share to 2.4p per Share) on 16 November, together with the results for the six months to 30 September 1983. The profits before tax for this period were £80 million compared with £69 million for the comparable period of 1982.

16 The following is the text of the comment on the results which was contained in the Interim Report:

> The pre-tax profit of £80 million (£69 million-1982) is an increase of 15 per cent over the comparable period of last year. Turnover increased by 11 per cent. Trading profits including associated companies increased by 25 per cent. Traffic volumes originating at Group locations continued to increase at an overall average rate of almost 15 per cent.
>
> Results expressed in sterling for a Group which has most of its activities overseas have been helped by current sterling exchange rates. The trading profit has increased over the comparable period of last year by some £2 million currency gain.
>
> Investment continues in the US, the Far East and the UK. Telecommunications projects have characteristically extended periods before earning profits. The acquisition of almost 35 per cent of the Hong Kong Telephone Company was partly financed with some £26 million cash. Lower cash balances and reduced interest rates have led to a reduction in interest income.

The prospectus reads as follows:-

Striking Price and Basis of Allocation

The Striking Price may be set above the minimum tender price if both:

(i) Tender Applications at or above the Striking Price have been received for at least half the Ordinary Shares now offered for sale; and

(ii) Tender Applications at or above the Striking Price, together with Striking Price Applications, are accepted in respect of all the Ordinary Shares now offered for sale.

In other circumstances the Striking Price will be the minimum tender price.

The Striking Price will not necessarily be the highest tender price at which sufficient Tender Applications, together with Striking Price Applications, are received in respect of all the Ordinary Shares now offered for sale.

QUESTIONS AND ANSWERS (FOR USE IN TALKING TO THE PRESS)

Q1 Why has the Government chosen the present moment for its offer?

A1 The Financial Secretary to the Treasury announced on 27 October that the Government were now considering disposal of a further tranche of their shareholding in Cable and Wireless plc during the current financial year. It seemed sensible to bring the offer as soon as possible after the announcement of the Company's interim figures on 16 November. This will ensure receipt of the proceeds of the offer within the timescale envisaged by the Financial Secretary.

Q2 How much are you expecting to raise?

A2 After all expenses, the minimum net amount raised, based on the minimum tender price of 275p, will be some £262 million. The outcome of the tender may of course be higher than this.

Q3 Why a tender? Why not a placing? Why not a tap?

A3 The choice of method of sale is reviewed in the context of each operation and the judgment was made on this occasion that a tender in this form was the most likely way of achieving a successful sale of the Shares. This form of tender worked very successfully for the recent sale of BP Shares.

Q4 Would not a fixed price issue have achieved a higher underwriting price?

A4 When comparing one method with another, you have to consider the operation as a whole, not just the parts. A tender gives the Government a chance to benefit from a favourable response in the market during the offering period. A fixed-price offer gives no such opportunity.

Q5 What makes you think that 275p is the right price?

A5 The market will determine the 'right' price. The minimum tender price of 275p, at which the offer is underwritten, ensures that the Government will receive at least that price for its shares, and the tender gives the Government the chance to benefit from a favourable response in the market during the offering period.

Q6 Why have you chosen this particular method of tender? Is it not too complicated?

A6 No. It is a conventional common-price tender with just two additional features which are familiar to the market from other issues. These are:-

(i) The facility for small investors to make applications at the striking price (and the preferential treatment their applications may receive).

(ii) The possibility of preferential treatment for tender applicants who tender at prices above the striking price.

Both features were successfully employed in the recent Offer for Sale of BP Shares.

Q7 The striking price will not necessarily be the highest tender price at which sufficient Tender Applications, together with Striking Price Applications, are received in respect of all the Shares now offered for sale. In the event that it were not, would it not reduce the proceeds to the Government?

A7 The striking price will be set in the light of applications received. The wording is a standard feature of equity tenders.

Q8 Why may the striking price not be set above the minimum tender price unless Tender Applications at or above the striking price have been received for <u>at least half</u> the ordinary shares now offered for sale?

A8 This is a protection for striking price applicants against a freak result. It removes the possibility that striking price applicants (ie, small investors) might receive allotments at an unusually high price in the event that there were only a small number of tender applicants.

Q9 Why are employees guaranteed allotment for up to 1,000 Shares?

A9 The Government feels it appropriate, when selling Shares in the Company, to offer employees preferential treatment.

Q10 Why is there no preferential treatment for shareholders?

A10 This is a secondary market sale, not a rights issue. In a rights issue, the new Shares are offered to existing shareholders so that their shareholding is not diluted. The present sale is a secondary market offer of existing, not new, Shares and there is thus no element of dilution.

Q11 Why is the guarantee of allotment for employees limited to 1,000 Shares?

A11 This strikes a reasonable balance between the interests of the employees and those of the wider market. Employees are, of course, free to apply for more shares on forms available to the general public.

Q12 Why is the guaranteed allotment not extended to foreign employees of the Company?

A12 Because this would cause formidable legal and logistical problems in the many overseas countries in which the Company operates.

Q13 Why limit striking price applicants to 1,000 Shares?

A13 The facility to apply at the striking price was designed to help the small investor.

Q14 Why cannot applicants submit both Striking Price and Tender Applications?

A14 Because this would open the facility to apply at the striking price to applicants other than the small investors.

Q15 Why is the offer for sale on a partly-paid basis?

A15 This is a standard feature.

Q16 Why are the Shares being offered cum the interim dividend?

A16 Because that is the basis on which the Company's Shares are currently trading in the market.

Q17 Why was the offer for sale underwritten?

A17 Because the Government needs to be sure of receiving the proceeds in the present financial year.

Q18 Why has prior sub-underwriting been undertaken?

A18 This method minimises the cost of the underwriting provided that the vendor has the confidence that the market has sufficient capacity to take the sale.

Q19 Why have you chosen these underwriters and brokers?

A19 Apart from Mullens, who are the Government's brokers, they are all firms who have worked with the Company and are thus most familiar with its business.

Q20 Why is the Bank of England managing the offer?

A20 The Bank is acting as the Government's agent, as it has done for a number of other Government sales of shares in the secondary market.

Q21 The offer is described (in our press notice) as being managed by the Bank of England in conjunction with Kleinwort Benson. What does 'in conjunction with' mean?

A21 The Bank of England is acting as the Treasury's agent. Kleinworts are the Company's merchant bankers. The phrase 'in conjunction with' accurately reflects the respective roles of the Bank of England - responsible for the overall management of the Offer for Sale on behalf of the Government - and Kleinwort Benson - who are acting as issuing house for the Offer.

Q22 What about the commissions?

A22 These are normal and are the same as in the offers for sale of BP shares.

Q23 What about the expenses?

A23 Excluding stamp duty and VAT, the expenses are presently estimated at around £6 million. Stamp Duty and VAT are estimated at around a further £6 1/2 million.

Q24 Why is there no separate offer for sale in the USA?

A24 The capacity of the market in London is judged to be ample for this Offer. Cable and Wireless shares are not listed in the USA.

Q25 What is the meaning of the Government's future intentions statement?

A25 CARE Press offices must stick to the words and not attempt to interpret them. They mean what they say.

Q26 Is the Government worried that its holding of Cable and Wireless Shares is past the 25% level?

A26 You must ask the Treasury.

Q27 Some unsuccessful applicants for the recent BP share sale had their cheques presented even though they were not allocated any shares. Do you expect this to recur in the present Offer for Sale?

A27 In the BP sale, we tried as far as possible to avoid presenting cheques attaching to unsuccessful applications but in an operation of that size, with around 100,000 applications, it was simply not possible to avoid presenting a few. It happened, however, in only a very few cases. The prospectus for the present Offer states "All cheques are liable to be presented for payment, but presentation of cheques accompanying applications in respect of which no allocation of shares is expected to be made will be avoided as far as is practicable." It is very much our intention to avoid presenting cheques from those applicants who prove to be unsuccessful and we shall be making every effort to avoid doing so. But in the last resort if the volume of applications again proves to be very large, we could not absolutely guarantee that a few such cheques might not be presented: hence the words in the prospectus.

PS/Prime Minister

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215
SWITCHBOARD 01-215 7877

MT

From the Minister of State
for Industry and Information Technology

KENNETH BAKER MP

John Selwyn-Gummer Esq MP
Chairman
Conservative Party
Central Office
32 Smith Square
LONDON SW1

25 November 1983

Prime Minister

To note. I have drawn to the attention of Mr Baker's office the exchange of correspondence with Mr Jenkin over an information unit (in the latter case to put across Government policy on local authorities) I have emphasised the importance of separating Party and Government and asked that if the "mechanism" involves civil servants
(i) you should be informed
(ii) Sir Robert should be informed

AT 25/11

Dear Kenneth.

THE SALE OF BT SHARES

The sale of 51% of British Telecom is planned for the Autumn of next year. It is very important that this is a success because it is the largest measure of de-nationalisation that has ever occurred anywhere in the western world. If it is not successful, or if sufficient feelings of doubt are allowed to grow about the whole principle of privatisation in the course of the next few months, it will be a severe morale blow to the Government as it is so central to our policy.

I believe that we have a big selling job to do on the concept of privatisation. Norman Tebbit, John Butcher and I make speeches about it, there have been debates in the House and we brief journalists from the heavies, putting over what is a very complicated and intricate story. There are many different lobbies and it is very difficult to satisfy them all.

I do feel that we must now take an initiative to explain more fully to our supporters in the country the advantages of liberalisation and privatisation. What I have in mind is to set up a team of MPs, the nucleus of this would be the people who have been on the Telecoms Bill this session and one or two from the previous session. The idea is that they would be fully briefed on the various issues and they would be available to speak at various party meetings, like area meetings and area CPC meetings and at constituency events. We should plan such

M19/M19ABN

meetings to discuss BT and privatisation. We would collectively produce material which would set out the main selling points. We should consider a Party Political broadcast on it. This would have to be done well in advance of flotation since we can't be seen to be pushing the shares.

The main points are:

1. Liberalisation and privatisation puts the customer in charge for his choice is key. Already significant improvements.

2. Liberalisation by itself is not enough. If BT or parts of BT are left in the public sector with the possibility of subsidy there cannot be fair competition. (SDP/ Liberals say liberalise not privatise).

3. Privatisation changes the whole ethos and management style of businesses eg Cable and Wireless. We are opening the cages for the birds to fly free.

4. Mercury must be established as a major competitor to BT otherwise BT would be surrounded by a lot of minnows which it could swallow or destroy. There is a small but vociferous lobby advocating much wider competition which would lead to many minnows.

5. We have a unique system of access charges to protect the social service elements, post-privatisation - public call box, the 999 service and rural and remote areas. We get more letters on this than any other aspect of BT's privatisation.

6. Consumer protection is enhanced by the Bill. BT can be sued for poor performance and OFTEL is the only consumer complaints body with a power of direction.

7. We have improved both in statute and in the licence the position of the disabled as regards BT's services in the future.

You will see we have a very good story to tell.

The unions are conducting quite a sophisticated campaign against the Bill. They are exploiting anxieties in the rural areas on call boxes and remote telephones; they are alleging that the disabled will be worse off and that when BT has to make profits

they will tend to neglect residential subscribers. They are also using opinion polling techniques to show that there is a declining enthusiasm for privatisation in general and for the privatisation of BT in particular.

It seems to me that we have a real job to do and I'd like to consider with you setting up a mechanism to put the Government's case strongly since I think it will be a major reversal if we fail to win the hearts and minds of the country on this. Perhaps we could meet early next week to discuss these points. It may be helpful to work with Michael Spicer on this.

I am copying this to the Prime Minister and John Moore.

Yours
Kenneth

KENNETH BAKER

M12/M12AES

SUBJECT

cc MCS

SECRET

FILE

B/C MR KERR HMT R M

MR P GREGSON C.O.

cc J Bedwood

10 DOWNING STREET

From the Private Secretary

18 November, 1983

cc Aerospace
Future of BA

Your Secretary of State came to see the Prime Minister today. Also present was Mr. Alison.

He began by outlining his thinking on the privatisation of British Airways. He was considering an arrangement under which BA would appeal to the Courts for a reduction of capital. Sufficient new arrangements would be issued to the market which would reduce HMG's holding below 50 per cent, thus avoiding the transfer of BA to the private sector. The funds raised from the share sale would be used to re-pay part of BA's debts.

Your Secretary of State said he was sympathetic to the proposals which British Caledonian had made recently for a transfer of routes and assets. In his view, there would be merit in building up B.Cal (and possibly other airlines) so that the UK industry was less dominated by one airline. It was not, in the short term at least, a question of competition since B.Cal would rarely be competing directly with British Airways on any particular route. It was more a question of adjusting the financial strength of the two companies.

He had no powers to require British Airways to shed routes and assets but if he had the backing of the Prime Minister he would speak to Lord King to persuade him of this course. This would also make sense financially, as selling assets would be a contribution by BA to the reduction of its own debts.

The Prime Minister said that she too was sympathetic to evening up the balance between BA and B.Cal. She admired the way Sir Adam Thomson had built up an effective airline without Government subsidy. She agreed that your Secretary of State should take this up with Lord King.

/The

The meeting then considered the timing of privatisation. Lord King was pressing for this to take place in the autumn of 1984. Your Secretary of State doubted whether all the necessary steps could be completed in time for that; in any case that part of the market calendar was blocked off by BT and he did not favour delaying BT to make room for BA. The spring of 1985 looked a more likely time though the timetable could be accelerated in the unlikely event that BT were delayed. He would be producing a paper for colleagues shortly on his proposals.

The meeting then turned to a discussion of the Severn Bridge. Your Secretary of State said that it could be strengthened and would remain usable for many years but that a crisis of confidence was developing which could damage growth in South Wales. Announcement by the Government of its intention to build a second bridge, even some years hence, would serve to allay fears.

The Prime Minister said she recognised the force of these arguments. It was agreed however that your Secretary of State would study the issues over the next few months before reaching any conclusions.

Your Secretary of State said he was concerned about the regime for the bus industry which was absorbing over £600 million in subsidies. His priority was to examine the whole regime of regulation and subsidy rather than turning over NBC, with its 80 per cent market share, into a regulated, subsidised and unionised regime. In consequence he did not wish to proceed with the NBC privatisation proposals for the time being. The Prime Minister was content with this approach.

MR T TURNBULL

Miss D.A. Nichols,
Department of Transport

10 DOWNING STREET

PRIME MINISTER

I attach a brief for your meeting with Mr. Ridley. You may also wish to note David Wolfson's comments, in the course of his note at Flag A, about the possibility of Walter Goldsmith heading the new NHS management team.

DAB

DAVID BARCLAY

17 November 1983

File 8H

Subject: Aerospace: future of British Airways 5/82

PRIME MINISTER

MEETING WITH SECRETARY OF STATE FOR TRANSPORT

Mr. Ridley is likely to raise the following topics at his meeting with you.

1. British Airways/British Caledonian
See David Wolfson's note about this, attached at Flag A and Policy Unit advice at Flag B.

2. British Airways Privatisation
Mr. Ridley is considering the possibility of proceding without legislation. It might be possible to apply to the Companies Court for a write down of capital. This would mean that the timetable could be speeded up, but there is a significant risk of accusations of privatisation by the back door.

3. National Bus Company Privatisation
Mr. Ridley is inclined to go slow. There is no prospect of legislation this session so he would prefer to take time to get the competition framework and the subsidy regime right.

4. London Transport
Mr. Ridley is worried about concessionary fares. The Boroughs are supposed to be taking over responsibility when the GLC is abolished. They are using this as a lever to oppose abolition, and Mr. Ridley is some way from a satisfactory solution.

/ 5. Non-rail transport

5. Non-rail Transport Subsidies

The Secretary of State believes that transport subsidies other than rail subsidies (which he regards as inevitable) provide at best indeterminate value for money. He may propose a measure of transfer of resources from revenue subsidies to highway construction.

6. Ministerial Responsibilities

Finally, Mr. Ridley may wish to raise with you the possibility of some reinforcement of his Ministerial team at the Department of Transport.

DAVID BARCLAY

17 November, 1983

A

SUBJECT FILES on Aerospace: Future of B. Airways

10 DOWNING STREET

Prime Minister.

Nov.15, 1983.

1. You are seeing Nick Ridley and will no doubt discuss British Caledonian's offer for British Airways routes.
The Policy Unit have advised you to ignore Adam Thompson's bid. Ivan Fallon would advise you differently. I draw to your attention that there are, in my opinion, two sides to the case. A Privatised British Airways, with over 80% of the market, making £150 Million per annum, would be able to destroy British Caledonian whenever it chose. The threat implied by a near-monopolist would be enough to inhibit competition.

There is a real dilemma: speed of privatisation, and simplicity, may speak in favour of leaving British Airways as it is, but the creation of a properly competitive market for British Scheduled passengers favors a partial break-up sale before privatisation.

2. I feel sure that we are going to face continuing attack on the Health Service over the next two years, during which time hopefully better management will be introduced to help the service provide more for less. While Walter Goldsmith has all the talents to head the management team, his political vibrations would be of the "axeman" variety. On reflection, I doubt that he would get a real chance to do the job. The fears of privatisation of the NHS would run riot, and a less publicly right wing choice seems more likely to succeed.

DW.

David Wolfson.

Not such a King-sized BA

COMMENT by Ivan Fallon

FOR the past two years the aviation world, the Government and a large chunk of the public has watched Lord King's progress through British Airways with considerable astonishment.

There have been redundancies, massive losses (£540 million in a single year when everything including the kitchen sink was written down or written off), management changes, dissent and jubilation from opponents and supporters—and towards the end of the day the growing belief that King can actually achieve what he set out to do which is take the airline out of the State sector and privatise it.

Watching even more closely than the rest of us were Sir Adam Thomson and his men at the independent, fully-privatised British Caledonian, who have viewed it all with mixed feelings. Competing with an overblown inefficient, uncaring and unprofitable State-owned airline is one thing. Flying against a slim, motivated, private—and most important of all — decently financed airline, which is what BA could become by this time next year, is another.

So Sir Adam and his managing director Alastair Pugh concocted a plan of their own, one which Lord King does not like at all, but which the Government, in the guise of new Transport Secretary Nicholas Ridley (for starters) will have to take seriously, even if it does potentially endanger the BA privatisation timetable.

The British Caledonian scheme is an ingenious and intellectually attractive one.

> British Airways at present is seven times the size of Caledonian, and if nothing is done to change that on privatisation, four-fifths of Britain's scheduled air transport business will be controlled by one operator.

If BA had its debt wiped off and came to the stock market with a cleaned up balance sheet, which is about the only way it *could* attract outside investors, then the competition would become more unequal still.

The imbalance between the two airlines is paralleled by the imbalance between London's two airports, Heathrow and Gatwick. Again Heathrow is seven times larger on scheduled services. BCal represents the heart of Gatwick's scheduled business.

Operating out of Gatwick puts it at quite a disadvantage—and if the more formidable King-sized BA moved into the private sector, BCal might even move to Heathrow with all the implications that would have for both airports.

Such is the scene, viewed from Caledonian House, at Gatwick. So what to do about it?

If BA is to be sold, BCal wants to buy at least a part of it. It has put itself first in the queue, before the City institutions, private investors or even BA's management.

It has picked out a series of routes which it reckons would boost both its own operations and Gatwick Airport, and offered £200 million for the assets that go with them.

These routes are still on the secret list, but are listed in BCal's blue book — and apparently include routes to the Caribbean, the Middle East, and Japan. BCal insist they are by no means BA's most profitable routes, but obviously they are not loss-makers either.

But the independent airline and Sir Adam Thomson have gone a stage further. They also suggest that BA be relieved of regional operations as well. BCal itself does not want them. But it suggests that operations based on the "mini-hubs" of Glasgow and Manchester, and possibly even the German internal routes, should be sold for cash to other specialist independents who could create strong locally-based concerns and run the routes more effectively than BA.

Now the effect of all this would be considerable. BCal itself

would increase in size by perhaps two-thirds — a quantum leap which otherwise would take it 10 to 15 years of hard slog. Its share of scheduled services would grow from 17 to 29 per cent, while other independents such as British Midland and Dan-Air would rise from 2 per cent to 5 per cent.

And British Airways? Instead of having four-fifths of British Scheduled passengers, it would drop to a healthy enough two-thirds. At that level it would still be the giant, but no longer quite so dominant. And if he could get his extra routes, Sir Adam and his friends would no longer kick up a fuss about write-offs of BA debt and cleaned up balance sheets.

In the past 10 years 14 independent British airlines have gone out of business, including of course Laker, Invicta, Skyways, Channel, IAS and so on. It is difficult enough just to survive. To make headway in an industry dominated by state concerns is exceptionally difficult, which makes BCal's achievement all the more laudable.

What then is the argument against Sir Adam's plan? The sale of £200 million of assets would make BA a smaller airline, and, therefore, more easy to sell — and of course, there would be £200 million of cash up front before the operation got under way.

But whatever argument Sir Adam presents, the plan would tear a hole in BA's profitable operations, result in major redundancy payments all over again (BCal would not necessarily take all the people that went with its routes) and set back the privatisation timetable.

King himself might get so disillusioned that he would seek other pastures, and without him the privatisation momentum would run down, and so too would the drive for efficiency.

> But maybe there is room for a delicate compromise. It does not have to be £200 million of assets — even a £100 million shift from BA to BCal, and of routes from Heathrow to Gatwick, would make a great deal of difference.

> BCal is willing and able to offer the Government hard cash for assets independently valued in what is a genuine attempt to introduce greater long-term competition into the British airline business.

Prime Minister (4)

AT 15/11

Press Notice

Department of Trade and Industry

1 Victoria Street, SW1H 0ET Press Office: 01-215 3793
Out of hours: 01-215 7877

Ref: 484

November 15, 1983

MT

NATIONAL SECURITY IMPLICATIONS OF SALE OF BT SHARES

Mr Kenneth Baker MP, Minister of State for Industry and Information Technology, has today responded to a letter from Mr Andrew Rowe, MP for Mid-Kent, about the national security implications of the sale of shares in British Telecommunications plc to overseas investors. Mr Rowe had written to Mr Baker on 31st October, enclosing a letter from the British Telecommunications Unions Committee, Canterbury Telephone Area, expressing concern on this subject.

Mr Baker's reply to Mr Rowe is attached.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

From the Minister of State
for Industry and Information Technology

KENNETH BAKER MP

Andrew Rowe Esq MP
House of Commons
LONDON SW1H 1RA

15 November 1983

Dear Andrew.

Thank you for your letter of 31 October enclosing one from Mrs Anne Shenow, Secretary of the British Telecoms Union Committee, Canterbury Telephone Area about the national security implications of selling BT plc shares overseas.

I am sure that you will understand that I cannot discuss detailed arrangements for safeguarding defence telecommunications or other telecommunication arrangements essential for national security. It is, however, untrue to say that the entire British telephone network is designed to convert into an emergency communications network in times of war.

Telecommunications are of overwhelming importance to defence and national security both in peace time and in time of war. I am entirely confident that the privatisation of British Telecom will do nothing to prejudice the use of BT's telecommunications network in emergencies, whether or not a limited proportion of the shares are held by foreign investors. There is no need for the Government itself to control the telecommunications system to guarantee the provision of necessary services. In the United States for example the telecommunication networks are in private hands and in this country the supply of petrol and oil, which are similarly vital to defence and emergency services, has long been in private hands.

But we are also taking special measures in both the Bill and the BT licence to safeguard the telecommunications requirements of defence and national security. Conditions 6-10 of the draft BT licence require BT to continue to provide services to the emergency organisations and, in Condition 9, to formulate plans for such arrangements as may be required by emergency authorities. In addition Clause 85 of the Bill empowers the Government to issue directions to all public telecommunication operators including BT, in the interests of national security. This will enable the Government to require BT plc and other

operators to take such steps as they consider necessary in the interests of national security.

As I have told the Committee currently considering the Telecommunications Bill, a US merchant bank Morgan Stanley will be giving advice in December on the feasibility of a flotation of some BT shares on the North American market as was done with the BP share issue in 1977.

When they have made their report we will decide whether to follow this course. We have not asked for any study at this stage of a placing on other financial markets. One thing of which I would like to assure you is that the overwhelming majority of the shares in this British company will be sold in Britain.

There is no question of foreign investors nominating directors since the company's Articles of Association will contain provisions preventing any single foreign or UK interest taking a holding of more than 15% in the company. This 15% limit will keep individual shareholders below the level which normally enables a shareholder to secure the appointment of his candidate to a company Board.

In view of the public interest in this issue, I hope you will not object to my releasing this letter to the press.

Yours ever

Kenneth

KENNETH BAKER

cc: Mr. Alison

SUBJECT FILES ON: Aerospace: Future of B. Airways

MR. TURNBULL

MEETING WITH THE SECRETARY OF STATE FOR TRANSPORT

The Prime Minister has agreed to see the Secretary of State for Transport next week.

I understand from Dinah Nichols that he is likely to raise three topics:-

(i) British Airways Privatisation - He is considering the possibility of proceeding with BA privatisation without legislation. Apparently it would be possible to apply to the Companies' Court for a write down of capital. This would mean that the timetable could be considerably speeded up, so that flotation could proceed at a decent interval after British Telecom, or at the time currently scheduled for British Telecom if this slips. On the other hand, there must be a considerable risk that such a procedure would be criticised as unfair circumvention of Parliament.

(ii) London Transport - Mr. Ridley will wish to discuss particularly concessionary fares. As you know, the current proposal is that when the GLC is abolished the London Boroughs should take over full responsibility for concessionary fares. This is a sensitive political issue, which the London local authorities are exploiting in their opposition to local government reform, and Mr. Ridley is apparently by no means confident that a satisfactory solution is at hand.

/(iii)

(iii) Ministerial Responsibilities - I understand that Mr. Ridley may also ask the Prime Minister for some reinforcement of his Ministerial team at the Department of Transport, to reflect his enlarged responsibilities.

DMB

DAVID BARCLAY

11 November 1983

cf For meeting with S of S for Transport on Thursday please.
SUBJECT: AEROSPACE: Future of B Airways
DMS 15/11

MR. TURNBULL

c Mr Alison

Meeting with the S/S for Transport

Since I dictated the attached note to you about the Prime Minister's meeting next week with Mr. Ridley, Dinah Nichols has suggested two further topics.

They are:

i. NBC privatisation - Mr. Ridley is inclined to go slow on this. There is no prospect of legislation in the current session, so he would prefer to take his time in getting the competition and subsidy framework right.

ii. Non-rail transport subsidies - Mr. Ridley may express a general view that transport subsidies (other than rail subsidies, which he regards as inevitable) provide indeterminate value for money. He may say that he is aiming to transfer resources from revenue subsidies to highway construction.

DMB

11 November 1983

CONFIDENTIAL

Prime Minister
To note
AT 14/11

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

11 November 1983

The Rt Hon Nicholas Ridley MP
Secretary of State for Transport
Department of Transport
2 Marsham Street
LONDON SW1P 3EB

Dear Nick

BRITISH AIRWAYS PRIVATISATION

I am rather concerned by the stories appearing in the press, apparently largely inspired by members of the BA Board, which are promoting early privatisation for BA, at the expense of BT, if necessary. In this week's Sunday Times, for instance, Gordon Dunlop was quoted as saying that "The October slot for floating British Telecom is dead".

I need hardly say that such comments are very unhelpful. I understand BA's natural desire for early privatisation and I welcome the improvement in their financial results which makes it a possibility. But it is generally recognised that we must allow the capital markets some months to digest the BT sale. The policy we have announced in the House is to aim to float BT next autumn. The operation will in any case be a difficult one because of the vast sums involved and we shall need to build up expectations and confidence in the City well in advance of the sale. But our task will be made very much harder if doubts are continually being cast on the timetable from the sidelines. At the same time, if BA press too strongly for a sale in autumn 1984, they may well begin to raise doubts about their ability to sustain adequate profits after that date. I therefore think it would be very helpful if you could have a word with John King to dissuade him and his Board from pursuing this line.

Of course circumstances could arise in which the sale of BT had to be delayed and BA might then be able to take their place in the queue. But that would be a very different matter.

I am copying this letter to the Prime Minister, Norman Tebbit and to Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

NBPM
AT 3/11

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~930 7022~~ 218 6169

MO 26/2

3rd November 1983

Dear Margaret,

PRIVATISATION AND COMPETITION

Part 7

In my letter of 26th September I gave details of this Department's potential candidates for privatisation, following the Chancellor's minute to the Prime Minister of 25th July.

Pt. 7.

You may be interested to learn of another possible candidate in this area, involving the future requirement for and use of the Procurement Executive Stores Depot at Aston Down, Gloucestershire. The Stores Depot, which employs about 120 staff and which will cost just over £2M this year, is used for the storage of various categories of machine tools, jigs and miscellaneous materials for the Ministry of Defence, the Royal Ordnance Factories and other (repayment) customers.

An internal study team will be examining the future requirement for the Depot, including the possibility of private sector involvement. Arrangements are in hand to notify local MPs of the study, and Trade Unions and other interested parties will also be told.

A copy of this letter goes to Andrew Turnbull (No 10), and to Richard Hatfield in Sir Robert Armstrong's office.

Yours sincerely,
Barry Neale

(B P NEALE)
Private Secretary

Miss Margaret O'Mara

PRIME MINISTER

Rather than discussions of particular cases, except gas and electricity, Treasury are looking to secure a strong mandate for John Moore in his bilaterals.

I suspect talk of bottlenecks in the legislative programme and congestion in the capital markets may be alarmist. The problem may be getting Departments to work up proposals.

As agreed I have sent the Policy Unit note (Flag C) to E(A) colleagues but with the note on BL to Norman Tebbit only. He is seeing BL later this week and will not have been able to make up his mind whether the Department's approach is too soft.

John Redwood wishes to attend for Policy Unit. Agree?

Yes

AT

26 October 1983

P.01142

PRIME MINISTER

Competition and Privatisation
(E(A))(83)13)

BACKGROUND

flag A

In his minute to you of 25 July the Chancellor of the Exchequer invited colleagues to put forward a detailed timetable for their privatisation candidates, so that a full privatisation programme could be drawn up for this Parliament.

flag B

2. Most colleagues have now submitted returns. The memorandum by the Chancellor of the Exchequer (E(A)(83)13) summarises the responses and suggests how the work necessary to draw up the privatisation programme should now be carried forward. The Chancellor seeks the agreement of the Sub-Committee to the following:

a. the pace of work on the privatisation programme should be accelereated; and more emphasis should be laid on adopting forms of privatisation which promote competition;

b. options for gas and electricity should be put forward quickly;

c. the Financial Secretary should pursue bilateral discussions with the main sponsor Ministers and draw up a coordinated programme of action for further discussion early in the New Year.

MAIN ISSUES

3. The purpose of the meeting is to discuss the privatisation programme and its objectives, and to decide on the administrative arrangements for drawing it up quickly and efficiently.

Objectives

4. The Sub-Committee may wish to consider the broad objectives of privatisation, specifically how much weight should be attached to:

- the sale of assets in order to reduce the PSBR;
- the promotion of a more competitive environment; and
- other objectives, such as securing the wider ownership of assets.

– decisions to be taken at a commercial rather political level.

Views on this will affect both the pattern and the timing of the privatisation programme.

5. E(A)(83)13 argues that more weight should be given to increasing competition in order to improve resource allocation and efficiency. Certainly it is a prime aim of the privatisation programme to increase competition. On the other hand, setting up a satisfactory competitive regime is likely to take time (especially if it requires legislation); this will defer receipts and the benefits of transfer to the private sector which do not depend on full competition (eg the stimulus to efficiency from the threat of bankruptcy or takeover). Other relevant considerations are as follows.

i. The receipts from the sale of assets will be higher if the industry enjoys a monopoly position.

ii. Resistance to privatisation from employees and management is likely to be less.

But neither of these arguments would be easy to defend in public or to reconcile with the Government's wish to foster competition.

6. There are also other points which the Sub-Committee will wish to take into account.

iii. It is desirable to spread the ownership of assets.

iv. Sometimes existing management and employees are the only likely buyers of public sector assets. But leaving the existing management and staff in place, especially if this is not coupled with a significant increase in competition, may do little to improve performance. Is a change of management intrinsically desirable, other things being equal?

But their own savings are at stake.

7. It will be helpful for the conduct of the proposed bilateral discussions between the Financial Secretary and other Ministers if the Sub-Committee can give guidance on the priorities to be attached to these sometimes conflicting considerations. However, the eventual substantive decisions are bound to turn on the circumstances of individual cases; and general guidance at this stage is unlikely to be decisive. You may therefore wish to invite the Chancellor of the Exchequer to bring forward, when the Financial Secretary has completed his bilateral discussions, a programme which seeks to maintain a reasonable balance between the conflicting considerations, and which identifies for specific decision any particular cases where the conflict of priorities is difficult to resolve.

Particular cases

7. It is likely that any substantial programme of privatisation, whether designed to maximise receipts or to increase competition, will need to include certain candidates, particularly from the monopoly utilities such as gas and electricity. E(A)(83)13 singles these out for mention; the Sub-Committee will wish to

discuss their prospects for early privatisation. It would also be useful to establish whether there are any other industries which the Sub-Committee regard as having similar priority.

Procedure and timetable

8. It is unlikely that the Sub-Committee will dissent from the proposal that the Financial Secretary should hold bilateral discussions with his colleagues, or will take serious issue with the suggested aim of further discussion early in the New Year. You will no doubt wish to stress the need to make good progress.

Legislative considerations

9. The Financial Secretary's discussions will need to pay full regard to potential bottlenecks in the legislative programme. The returns from departments annexed to E(A)(83)13 suggest that perhaps 10 of the "major privatisation candidates" might need fresh legislation; the number could well be significantly higher if the "other privatisation candidates" were included. It cannot be taken for granted that room can be found without difficulty in the programme for legislation on this scale. That supports the Chancellor's proposal that a detailed programme of action should be drawn up. You may wish to invite him to consult the Lord President of the Council and the Lord Privy Seal on the implications for the legislative programme before he puts forward further proposals to the Sub-Committee.

HANDLING

10. You will wish to invite the Chancellor of the Exchequer to introduce the discussion. The Secretaries of State for Energy, Scotland, the Environment, Trade and Industry and Transport and Mr Pattie (in the absence of the Secretary of State for Defence) may wish to comment on the major privatisation candidates for which they are responsible. The Lord Privy Seal may wish to offer some preliminary comments from the standpoint of the legislative programme.

CONCLUSIONS

11. You will wish the Sub-Committee to reach conclusions on the following:

i. the need to press ahead with work on the privatisation programme;

ii. so far as guidance can usefully be given at this stage, the relative priority to be attached to sales receipts, early privatisation, increasing competition, and other objectives;

iii. whether the Financial Secretary should now hold bilateral discussions with sponsoring Ministers with a view to a further report to the Sub-Committee in the early New Year;

iv. the matters to be covered in such a report, for example:

- the need to identify for specific decisions any cases where there is a conflict of priorities;
- the legislative implications;

v. whether specific options for

- gas and electricity;
- any other industries

should be produced more quickly.

PG

P L GREGSON

25 October 1983

FILE CONFIDENTIAL da

cc CSO MAFF DOT CAB DTI DOE WO SO DTN NIO HMT FSO

10 DOWNING STREET

From the Private Secretary

24 October 1983

Dear John,

Competition and Privatisation

The E(A) meeting is now being rearranged. Meanwhile the Prime Minister has suggested that colleagues might like to see the attached note produced by the Policy Unit.

I am copying this to the Private Secretaries to members of E(A) and to Andrew Hudson (Financial Secretary's Office).

Yours sincerely
Andrew

Andrew Turnbull

John Kerr, Esq.,
HM Treasury.

CONFIDENTIAL

da

COMPETITION AND PRIVATISATION

In the light of the responses to the Chancellor's letter of 25 July, it may be helpful to re-emphasise certain points which have been made in previous debate. It is hoped that these points will assist in the forthcoming discussions between the Financial Secretary and departments concerned with privatisation.

1. Our objective is to displace state ownership and control both by private ownership and, wherever possible, by the discipline and pressures of the marketplace. The introduction of competition is therefore an essential element of our policy and one which is more relevant for the public utilities and so-called "natural monopolies" than for manufacturing industries where a competitive environment already exists. We must ensure that all barriers to competition, including legislative barriers, are removed and that structural changes are considered which encourage competition.

Using Existing Legislation

2. To avoid crowding the Parliamentary timetable, we must use to the maximum the powers under existing legislation to sell off parts of the nationalised industries, particularly those areas which can operate in a competitive environment.

Splitting up Conglomerates

3. The claimed benefits for vertical integration in many state industries should be critically examined. Large, unsuccessful conglomerates should not be held together in the belief that in due course they will become more successful and profitable overall, enabling sale of the whole. Experience shows that it is usually better to split them up and gain the benefits from management diversity and access to private capital for the separate bits.

Reducing the Natural Monopoly

4. It is often possible to separate the parts of a nationalised industry which could operate in competitive markets from those which are natural monopolies. In most cases, the extent of natural monopoly is small and confined to the common-carrier infrastructure. The natural-monopoly elements can be left in the public sector, or privatised and regulated. Whichever route is preferred, we should do everything possible to provide a competitive environment for those who buy from or sell to a natural monopoly.

Long-Term Contracts and Franchising

Long-term contracts for the use of the services of a common carrier, in effect leasing part of the network, can be an effective way of increasing market pressures. Similarly, franchising does allow for periodic competition and gives scope for the entry of new producers within a network industry.

Regionalisation

Although regionalisation would produce local monopolies in those industries where effective competition is not possible, there is scope for stimulating competition between the management of different regions by means of inter-regional comparisons of price and performance. The opportunity for innovation and emulation amongst regional companies does offer a better chance for a more dynamic and efficient industry than a centralised organisation. Economies of scale are unlikely to be prejudiced by a regionalised industry. The problems of economic and union monopoly power are more likely to be tackled by a regionalised system of independent, privatised companies.

Regulation

There is a need to keep the requirements for regulation to a minimum. There may be a need to provide protection for developing competition until it is able to compete on fair terms in the market-place. In general, however, a system of regulation by exception which is independent of Government is to be preferred. This reduces the bureaucratic and administrative activities of the regulatory agency, and enables it to concentrate on those cases where abuse of power is in question. Although local monopolies will still require some degree of regulation, a simpler system is more likely if the performances of a range of private companies can be compared.

Loss-Making Industries

We should not be mesmerised by the idea of making the business profitable before selling it. Experience has shown that on many occasions, losses grow worse with time, making disposal more difficult, whilst we believe that private ownership is more likely to achieve the business's recovery more rapidly. If the business is never likely to be profitable, then the City are the best judge of the real worth of the assets.

Waiting for Better Figures

9. In particular, sales should not be held up on the grounds that the following year's profits are likely to be better, thus leading to a higher sale price. Markets are quite able to discount ahead if profits forecasts can be proposed in a credible way. Similarly, we should not pump in subsidy in order to achieve a sell-off price that looks good in the House of Commons.

Transparency of Subsidy

10. We do need to appreciate, however, the likely consequences of privatisation in such cases where we are making an implicit decision about potential closures. The desired balance between commercial criteria and social objectives must be made explicit. This will usually require a greater degree of transparency on cross-subsidisation, in order that we can identify and decide the level of support which an uneconomic social service should receive.

Writing off Debt

11. Privatisation should not be held up through alleged difficulties with the level of debt. In many cases, the money has already been lost and it makes sense to write off a substantial proportion of the debt in order to give the new business a better balance sheet if it is then being sold to new owners.

C

21 October 1983

Policy Unit

PRIME MINISTER

COMPETITION AND PRIVATISATION

The Chancellor's July initiative is in danger of losing its way. We will certainly fail to meet our objectives on privatisation and competition during this Parliament if we accept the disappointing replies from Departments.

The Treasury's paper for E(A) does introduce a sense of urgency. It is now essential for you to put your full authority behind the privatisation programme.

We suggest that at the E(A) meeting, you:

1. Endorse Nigel's paper calling for a co-ordinated timetable for action for this Parliament.

2. Announce your intention of chairing regular progress meetings to ensure that the momentum is maintained.

3. Request Sponsor Ministers who have not yet reached final decisions to produce timetable options for their industries.

This will give John Moore sufficient backing to ensure that Sponsor Ministers expose their thinking and, equally importantly, provide the political commitment which appears to be required before Sponsor Departments carry out the detailed work which this programme requires.

It is not as if the Chancellor's July letter began this exercise. Departments should have been thinking about privatisation and competitition since 1979. By December, we shall be 6 months into our second term.

We cannot allow Peter Walker and others to opt out of this exercise. Preferred solutions for gas and electricity are still being developed, but Peter could at least produce alternatives which can be modified later on. We cannot agree a co-ordinated programme which omits the energy industries. Peter may argue that these issues have to be handled with great secrecy, but there is no secret about our Manifesto commitment to introduce private capital into the gas and electricity industries.

To give you some idea of the lack of commitment in Departments, I attach a copy of John Redwood's report on the British Leyland submission.

The replies from Departments have also failed to take proper account of the points mentioned in Nigel's paragraph 5, such as the introduction of competition and the treatment of the loss-making industries. Some of these were explored at the Chequers seminar and in earlier reports, eg from the CPRS. But they still do not seem to have sunk in. We attach a summary of these points which might help John Moore to extract proper responses on the second round.

Would it be useful to circulate these to colleagues?

Agree?

FERDINAND MOUNT

The British Leyland memo under private cover from me to Norman Tebbit only. The other memos on competition can be circulated

Done AT 24/10

20 October 1983

MR MOUNT

BRITISH LEYLAND

The Department of Trade and Industry's submission concerning privatisation plans for British Leyland are woefully inadequate and conceal potential risks and dangers for the Government if it continues to follow Department of Industry policy.

1. Jaguar

There is no reason why the whole of Jaguar should not be sold in 1984. The proposal that one quarter of Jaguar should be sold then with the remainder floated in 1985 is based on the premise that Jaguar's profitability will continue to improve and that therefore a higher sale price will be achieved by delay for the bulk of the equity sale. Investors are quite able to discount ahead, and the prospectus in 1984 can make clear the management and Department of Industry's view of the rising trend of profitability.

2. The sale of Unipart is possible in 1984, and there should be a clear resolve to dispose of it within that calendar year.

3. Four-wheel drive vehicles

The British Leyland Board and DoI have decided to link the fortunes of the four-wheel drive operation to those of Leyland Trucks. Leyland Trucks is hopelessly adrift, probably heading for losses of around £100 million in the current year, when taking into account interest charges. There is little common ground between the trucks business and the four-wheel drive operation. The four-wheel drive business is losing market share rapidly, but still has some good products and a prospectus can be drawn up on the basis of it being profitable in the future. This should be done in 1984 and the business sold before it:

(a) is contaminated by the general problems of the group;

(b) has insufficient capital to renew its model range at a time of intensifying competition;

(c) suffers from a lack of management concentration on its problems in view of the greater problems elsewhere.

Austin Rover

The prospectus for Austin Rover which DoI and BL are writing envisages sale to investors after 1990. It is a bogus prospectus.

Their cash flow projections assume a continuing outward flow of cash from the business until some magic in 1990 transforms the business into profit and modest cash inflow. The figures conceal the fact that Austin Rover is to embark on a very expensive, 3 new model programme between 1984 and 1989, where the ultimate paymaster must be the taxpayer in view of the continuing drain on the business's finances, and the gross deterioration in the balance sheet which will take place on DTI figures over that time period.

We require from the DTI a paper setting out the detailed options for the future of Austin Rover. These options should include a strategy for speeding up the disposal of Austin Rover on the back of the successful introduction of the Acclaim, Metro and Maestro models. This disposal could take place within the next 2 years and may entail a dowry. A second option should be to continue with Government ownership of Austin Rover, but with a reduced new model-building programme, and a tapering of the financial commitment of the Government under the Varley-Marshall assurances. The third option would be a splitting up of the different operating units of Austin and Rover, and the partial sale of some of these units. The fourth option would be to explore the scope for collaboration with a foreign car producer and a sharing of the risks and capital. There has been little work on the likely future shape of Honda involvement in BL following the XX.

Without such a paper setting out the options for Austin Rover, it will be extremely difficult to judge the commitment to the privatisation plans within the DTI and BL. The Government will be faced with the need to sign a blank cheque, where the numbers involved in Government support could become very large indeed if any small thing goes wrong with Austin Rover strategy as currently set out.

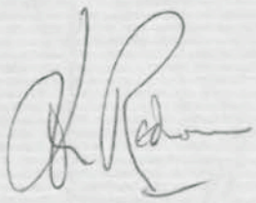
5. Truck and Bus

The current state of the truck business at BL illustrates the dangers of delaying disposal in the belief that things will get

better. Some years ago the case for disposing of trucks when it was still breaking even was rejected on the grounds that the business would strengthen. We are now heading for the worst trading year on record, and there is no sign of any relief. There needs to be a more rapid exploration of the options for collaboration with other companies in the truck division, and also a more serious exploration of the possibilities of sale of the truck business, even with a dowry if necessary.

Conclusion

The strategy towards BL is drifting. The statements about the extent of privatisation commitments are misleading and as the DTI submission on BL illustrates, there is a lack of commitment to the policy by both BL and the DTI.



JOHN REDWOOD

COMPETITION AND PRIVATISATION

In the light of the responses to the Chancellor's letter of 25 July, it may be helpful to re-emphasise certain points which have been made in previous debate. It is hoped that these points will assist in the forthcoming discussions between the Financial Secretary and departments concerned with privatisation.

1. Our objective is to displace state ownership and control both by private ownership and, wherever possible, by the discipline and pressures of the marketplace. The introduction of competition is therefore an essential element of our policy and one which is more relevant for the public utilities and so-called "natural monopolies" than for manufacturing industries where a competitive environment already exists. We must ensure that all barriers to competition, including legislative barriers, are removed and that structural changes are considered which encourage competition.

Using Existing Legislation

2. To avoid crowding the Parliamentary timetable, we must use to the maximum the powers under existing legislation to sell off parts of the nationalised industries, particularly those areas which can operate in a competitive environment.

Splitting up Conglomerates

3. The claimed benefits for vertical integration in many state industries should be critically examined. Large, unsuccessful conglomerates should not be held together in the belief that in due course they will become more successful and profitable overall, enabling sale of the whole. Experience shows that it is usually better to split them up and gain the benefits from management diversity and access to private capital for the separate bits.

Reducing the Natural Monopoly

4. It is often possible to separate the parts of a nationalised industry which could operate in competitive markets from those which are natural monopolies. In most cases, the extent of natural monopoly is small and confined to the common-carrier infrastructure. The natural-monopoly elements can be left in the public sector, or privatised and regulated. Whichever route is preferred, we should do everything possible to provide a competitive environment for those who buy from or sell to a natural monopoly.

Long-Term Contracts and Franchising

5. Long-term contracts for the use of the services of a common carrier, in effect leasing part of the network, can be an effective way of increasing market pressures. Similarly, franchising does allow for periodic competition and gives scope for the entry of new producers within a network industry.

Regionalisation

6. Although regionalisation would produce local monopolies in those industries where effective competition is not possible, there is scope for stimulating competition between the management of different regions by means of inter-regional comparisons of price and performance. The opportunity for innovation and emulation amongst regional companies does offer a better chance for a more dynamic and efficient industry than a centralised organisation. Economies of scale are unlikely to be prejudiced by a regionalised industry. The problems of economic and union monopoly power are more likely to be tackled by a regionalised system of independent, privatised companies.

Regulation

7. There is a need to keep the requirements for regulation to a minimum. There may be a need to provide protection for developing competition until it is able to compete on fair terms in the market-place. In general, however, a system of regulation by exception which is independent of Government is to be preferred. This reduces the bureaucratic and administrative activities of the regulatory agency, and enables it to concentrate on those cases where abuse of power is in question. Although local monopolies will still require some degree of regulation, a simpler system is more likely if the performances of a range of private companies can be compared.

Loss-Making Industries

8. We should not be mesmerised by the idea of making the business profitable before selling it. Experience has shown that on many occasions, losses grow worse with time, making disposal more difficult, whilst we believe that private ownership is more likely to achieve the business's recovery more rapidly. If the business is never likely to be profitable, then the City are the best judge of the real worth of the assets.

Waiting for Better Figures

9. In particular, sales should not be held up on the grounds that the following year's profits are likely to be better, thus leading to a higher sale price. Markets are quite able to discount ahead if profits forecasts can be proposed in a credible way. Similarly, we should not pump in subsidy in order to achieve a sell-off price that looks good in the House of Commons.

Transparency of Subsidy

10. We do need to appreciate, however, the likely consequences of privatisation in such cases where we are making an implicit decision about potential closures. The desired balance between commercial criteria and social objectives must be made explicit. This will usually require a greater degree of transparency on cross-subsidisation, in order that we can identify and decide the level of support which an uneconomic social service should receive.

Writing off Debt

11. Privatisation should not be held up through alleged difficulties with the level of debt. In many cases, the money has already been lost and it makes sense to write off a substantial proportion of the debt in order to give the new business a better balance sheet if it is then being sold to new owners.

10 DOWNING STREET

Prime Minister (2)

This paper is on the agenda for the E(A) scheduled for Wednesday - subject to whether you attend NHS Rebate.

There will be a Cabinet Office brief in due course. Meanwhile you might like to see Policy Unit paper.

AT
21/10

Will attend NHS debate

CONFIDENTIAL

File

DSS

18 October 1983

NATIONAL BUS COMPANY PRIVATISATION

The meeting of E(DL) which was due to take Mr. King's paper on the privatisation of the National Bus Company was postponed in order to allow Mr. Ridley an opportunity to make up his own mind on this subject. I understand that the Treasury may have had a number of reservations about Mr. King's original proposals. These doubts were shared by the Policy Unit here and the Prime Minister has suggested that the Chancellor might like to see the note which they had prepared.

Andrew Turnbull

John Kerr, Esq.,
H.M. Treasury.

CONFIDENTIAL

10 DOWNING STREET

Prime Minister (2)

To be aware of Policy Unit doubts about the wisdom of privatising NBC as a whole without tackling problem of competition

Political Office have reservations about privatising without settling bases of subsidies for rural services eg. danger that if NBC withdraws services, blame and/or cost of keeping them will fall on H.M.G.

AT 17/10

CONFIDENTIAL

Prime Minister ②

AT 17/10

MR. TURNBULL

NATIONAL BUS COMPANY - PRIVATISATION

Please let the chairman have this paper.

E(DL) is due to take Mr. King's paper of 11 October tomorrow. Since the Prime Minister does not chair E(DL) I am minuting you for information only; but you are welcome to make wider use of the minute if you so wish.

The proposals made in paper 83(5) are still at such a formative stage that they should not yet be approved, even in principle.

Mr. King wishes, rightly, to consider other methods of sale than management buy-out. Methods of sale are heavily influenced by what should be made available for sale and therefore by NBC's structure. That in turn is influenced by considerations of competition .

The DTp officials' paper is lightweight - even fatalistic - on all three topics. Its prescriptions would leave Government with a large shareholding in a de facto monopoly which would require heavy regulation and continuing subsidy - surely the worst of all worlds? Annex A reconsiders competition, structure and methods of sale. It raises questions, cogent responses to which might form the basis of firmer proposals for privatisation.

E(DL) would be well advised to note Mr. King's preliminary recommendations, but to make no public announcement yet and to call for substantive proposals before the Christmas recess. No violence would be done thereby to his own timetable.

R.J.

ROBERT YOUNG

17 October 1983

CONFIDENTIAL

ANNEX A

1. COMPETITION

National Bus Company (NBC) competes generally with rail transport and the private motorist, whether on inter city, inter urban or short distance (stage carriage) services. Within public road transport, however, NBC enjoys a monopoly in some areas and a dominant position in others. There is no reason in principle why competition should not be introduced where little or none now exists. After all, NBC itself benefited from a single Government measure (deregulation) which was intended, successfully, to promote competition between bus and rail transport.

The DTp officials' paper and the NBC published accounts make it clear that NBC's biggest financial problem resides in the provision of urban and rural stage carriage services, a large proportion of which are supported by subsidy. DTp appear to accept that this state of affairs must continue; therefore that NBC should be privatised whole in order to permit continuing cross subsidy (as well as ratepayer subsidy); and therefore that further deregulation must be prohibited for some years to come.

The allocation of local authority subsidy to each of NBCs operating subsidiaries is not revealed. But the NBC accounts show a huge variation of profitability among the subsidiaries, before and after the allocation of central government subsidy. Why should this be? Who is benefiting from the total subsidy of £138million? Does it support a genuine social need, or is it financing operating inefficiencies and/or fares calculated to hold competition at bay?

DTp should be asked to examine whether competition among stage carriage services could not permit subsidy to be reduced or eliminated; and at the same time to consider whether further deregulation would support this end. If NBC is privatised whole, before the subsidy issue is closely examined, Government will find great difficulty in containing the problem later.

2. STRUCTURE OF NBC FOR SALE

For management purposes, NBC is already divided into four geographical regions. On a historical cost counting basis, all are profitable after interest and tax:

(A) Region	(B) Profits	(C) Nett Assets Employed	% B of C
Midlands-West	£ 1.352m	£ 36.92m	3.66%
Northern	£13.31m	£101.98m	13.00%
South East	£ 6.17m	£ 54.92m	11.24%
Wales-Marches	£ 1.41m	£ 14.43m	9.73%

On the face of it, the Northern grouping looks attractive, and the South East and Wales and Marches only a little less so. (The relatively low profitability of the Midlands and West grouping warrants a closer look anyway).

If it is feasible to introduce competition into the stage carriage services in order to reduce regional dominance/monopoly, a good case emerges for selling the regional groups individually. That would permit geunuine competition on inter-region travel, both long and medium distance.

There does not appear to be a strong countervailing case that NBC should be kept together because of vital economies of scale.

At very least, DTp should be asked to consider break up before sale, with the encouragement of competition and the minimum of regulation in mind.

3. METHODS OF SALE

It is curious that E(DL) should be asked to endorse proposals in which the Secretary of State disagrees with similar advice from two merchant banks. But he is right to be cautious: if Government retains nearly half the equity in an employee buy-out, its negotiating position is weak in the run-up to privatisation, but weaker still afterwards. Government's interest does not stop short at achieving a sale. It needs also to free itself from the costly and contentious issues of subsidy and regulation.

Achieving that end may well depress NBC's sale value. But NBC will almost certainly have to be sold at a discount from book value anyway - to achieve book value implies a price/earnings ratio of 14 plus, according to NBC's 1982 accounts. A larger discount may well be a small price to pay for Government to reduce its role very substantially.

The question for DTp to examine is therefore what method of sale will best secure the reduction of Government's involvement in guaranteeing, regulating and subsidising bus and coach services?

17 October 1983

10 DOWNING STREET

Prime Minister (4)

To note.

Mr King is keen to privatise NBC but

(i) he is exploring options other than employee buy-out

(ii) problem of achieving greater competition still to be solved as ~~[illegible]~~ are

(iii) problems of subsidies and rural services.

AT
12/10

10 DOWNING STREET

(4)

Prime Minister

Mr Younger first concludes against privatizing STG as a whole; then examines case for selling parts.

Concludes:- that Caledonian MacBrayne ferries are not saleable except by guaranteeing large subsidies

- that MacBrayne Haulage should be privatised

- that Scottish Bus Group should not be privatised, at least until Scots have seen experience with NBC

AT
4/10

cc NO

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

Prime Minister (4)

SECRETARY OF STATE
FOR
NORTHERN IRELAND

AT 5/10

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

4 October 1983

Dear Chancellor

PRIVATISATION OF THE PUBLIC TRADING SECTOR

You copied to me your minute of 25 July to the Prime Minister with which you circulated some thought-provoking papers on approaches to the further privatisation of the public trading sector in GB. A parallel exercise was commissioned in Northern Ireland covering those companies and services analogous to the identified GB candidates. I agree entirely with your emphasis on the need for strengthened procedures and for thorough periodic reviews of prospects and progress. There are, of course, particular Northern Ireland considerations of which I have to take account eg security (in relation to the transport undertakings for example) and employment (in relation, for example, to Shorts and Harland and Wolff).

I have received detailed assessments from the Northern Ireland Departments. There are few major enterprises in the public trading sector in Northern Ireland. The two most significant are Harland and Wolff and Shorts. We believe that Shorts can and should be privatized within 2 years or so. I enclose a note about the present position there. Harland and Wolff is not likely to become attractive to the private sector. Both companies regularly receive separate ministerial consideration.

In addition the need to maximise the possibilities for introducing a strong private sector dimension featured in our recent ministerial considerations of the Gas Industry. Following the example in Great Britain we are also considering the position of the Northern Ireland Airports Authority, which operates Aldergrove: but the Airfield is jointly used by the RAF and there are major security considerations which will need to be considered before we can say whether there is any scope for privatisation.

/...

Finally, may I make the very important point that, because of the perceived risk, one of the major difficulties we face in Northern Ireland is getting private capital to invest. Our problem in attracting overseas companies which very much includes companies from GB is one aspect of this but it is also reflected in the attitude of the institutions towards commercial investment (eg shopping complexes, car parks etc). This has been a factor in producing the historical imbalance between the private and the public sectors. It could also hinder the efforts I am keen to make to redress the balance and I may in due course have to seek your help in considering whether there are ingenious ways in which any difficulties might be overcome.

Yours sincerely

Derek Atkill

Approved by the
Secretary of State and
signed in his absence

R.

Shorts

1. Shorts is a Government owned Company which is at present loss-making but is expected to move into profit in the near future. The Company employs 6000 people making it the biggest industrial employer in Northern Ireland. Shorts has 3 main activities - the manufacture of missile systems, aircraft and aero-structures. The missiles system division is profitable but the appeal to private investors of the aircraft and aero-structures activities would be at best marginal at present.

2. Ministers will be considering the Company's 1983 business plan in late 1983 or early 1984. If the business plan predicts reasonably healthy profits, the most likely option could be disposal at approximately market rates a couple of years thereafter. Another option could be to dispose at an earlier date, incurring a discount, and therefore any date from 1984 to 1986 would be theoretically possible. If the Company's missile systems division alone were to be sold, this could be achieved at an early date but we do not favour such a break up of the Company. Confidence that any new owner would wish to maintain the size and location of the Company's activities would be a vital consideration.

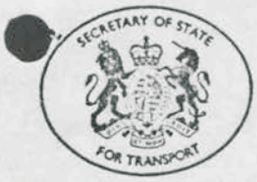
3. The disposal of the Company as a whole is most likely to be achieved by sale to an industrial grouping involved in the aerospace or a related field.

4. The normal value of the Government's shareholding is £65m excluding the very high value of the loans outstanding. The net Balance Sheet value of the shareholders fund being minimal.

JLD

ECON POL : Disposal of Public Sector Assets.

pt 8



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

(2)

CC ~~NO~~

John Moore Esq
Minister of State
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

Prime Minister
To note, in particular
BA
BAA
NBC
Sealink.

3 October 1983

AT 3/10

Dear John,

with AT

Your letter of 9 September to Cecil Parkinson asked for information about the timetable for privatisation of transport industries.

I am enclosing schedules (in the format requested by your letter) dealing with British Airports, British Airports Authority, Civil Aviation Authority, National Bus Company, Sealink and the remaining shareholding in Associated British Ports.

Our discussion on railways at E(NI) on 13 September covered the possibilities for contracting our, greater involvement of the private sector generally and the privatisation of British Rail Engineering Limited. Bob Reid is now considering this in the context of the draft Chairman's brief and I will be coming back to you and colleagues when I hear his reactions.

I am also exploring the possibility of changing the status of the public trust ports.

Looking further ahead, there may be scope for privatising municipal buses and airports. This will need to be considered in the context of local authority activities generally on which Patrick Jenkin is in the lead. I shall however be able to consider what action can be taken on buses in London once I have taken over responsibility for LT.

I am copying this letter to members of the Cabinet and Sir Robert Armstrong.

Yours

Tom

TOM KING

BRITISH AIRWAYS

I What preliminary decisions in principle need to be taken and which of these are likely to require collective discussion

(i) how BA's insolvent balance sheet should be rectified;

(ii) whether this can be done without legislation;

(iii) how soon action should proceed. (Collective discussion will be needed.)

II Whether legislation is needed

Uncertain - see I (ii) above.

III What structural changes (if any) are thought necessary

None.

IV Whether particular personnel policies need to be developed (eg on terms and conditions of service)

Changes in pension arrangements, to make them more acceptable to private investors (already in hand).

V The stage reached to date (eg including whether City advisers have been appointed)

Legislation has been passed for the vesting of BA's business in BA plc and for the flotation (Civil Aviation Act 1980); merchant bank advisers are appointed; the BA Board has restored the airline to profitability.

VI The expected date of privatisation, and the scale of equity to be sold

Sale of a controlling interest in BA's equity in autumn of 1984 at earliest (but timing will depend on answers to I above).

BRITISH AIRPORTS AUTHORITY

I Preliminary decisions

(i) whether the Authority (which controls three airports in South East England and four airports in Scotland) should be privatised as a single company, or whether there would be any advantage in sub-dividing it;

(ii) whether franchising airports, or individual terminals, might engender more effective competition;

(iii) what sort of regulatory framework would be required to prevent abuse of monopoly power and, possibly, to secure an efficient distribution of traffic;

(iv) to what extent consultation may be necessary.

To prepare proposals for colleagues by early 1984.

II Need for legislation

Primary legislation would be required for outright disposal, and would probably be needed for a significant extension of franchising.

III Structural changes

Decisions on structure have not yet been taken (see I above).

IV Personnel policies

If the BAA is privatised as a single unit, a policy on the funding of increases to pensions in payment will be needed.

If the Authority were to be split, policies on the redeployment of headquarters common service division staff would also be needed.

V Progress to date

The BAA Board have submitted a first memorandum giving their views on all privatisation and franchising options, and recommending that they should be privatised as a whole. All structural options are still being examined. No City advisers have yet been appointed, but early advice on the structural options and the market effects of any regulatory framework could be useful.

VI Expected date and scale of privatisation

Legislation to privatise the BAA could not be enacted before the 1984/85 session. It is unlikely that a flotation could take place before 1986. The scale on which equity could be sold has not yet been decided.

CIVIL AVIATION AUTHORITY

I Preliminary decisions

(i) whether the airfields, which with one exception are unprofitable, can be offered in a way which will attract private investment;

(ii) to what extent Scottish Office should continue to subsidise their operation;

(iii) whether CAA should be compensated for any loss it incurs as a result of the disposal.

II Legislation

Legislation is not required.

III Structural changes

None required. The aerodromes would be sold as items of real estate (subject to conditions on their use) and not as complete businesses.

IV Personnel policies

It is most unlikely that potential purchasers will want to employ the current workforce on the basis of their existing contracts. Some will be redeployed within the CAA. The remainder (about 100) will probably be made redundant.

V Stage reached

Interim reports on the preparations for the sale have been received from both the CAA and their merchant bank advisers. These are being considered by the Department of Transport and the Scottish Office.

VI Date of privatisation/scale of equity

The CAA should be in a position to advertise the aerodromes before the end of the year. The book value of the assets is

£6.OM but, as only one of the seven aerodromes (Sumburgh) has ever covered its operating costs under CAA management, the sale is only expected to realise a fraction of this. For some of the aerodromes a continuing subsidy may be required.

CONFIDENTIAL

NATIONAL BUS COMPANY

I Preliminary Decisions

i. Whether to privatise or de-regulate services subject to licensing.

ii. Whether to privatise NBC as a whole or split it up.

iii. Effects on rural areas.
Paper for E(DL) in October

II Need for Legislation

Primary legislation required

III Structural Changes

Decisions on structure to be taken (see I(ii) above)

IV Personal Policies

No major issues

V Stage Reached

Preliminary report from Board's advisers recommends management buy-out. Confirmed by merchant bank report to Department, but advisers not yet retained.

VI Date of Privatisation/Scale of Equity

Management buy-out could be achieved shortly after legislation which could not be enacted before 1984/85 session. It is unlikely that other options could be achieved before 1986. The scale on which equity could be sold depends on method of sale, but may be less than 100% initially.

SEALINK UK LTD

I Preliminary Decisions

Government and British Railways Board agreed in 1980 to privatise Sealink. BRB are in the lead in devising the method, but the Secretary of State's consent will eventually be required.

II Legislation

Powers to enable BRB to sell subsidiaries taken in the Transport Act 1981.

III Structural Changes

No structural changes needed if Sealink is sold as an entity. There is no natural monopoly of the shipping operation, but Sealink owns a number of ports (eg Folkestone, Newhaven, Holyhead). The current policy, publicly stated, is to seek to privatise Sealink as a whole. Some rival shipping companies would prefer Sealink to be split between ports and shipping. This would take longer and it might lower the proceeds from the sale.

IV Personal Policies

No particular personel policies needed.

V Staged Reached

BRB, in light of advice from Merchant Bankers Morgan Grenfell. due to put to Ministers this Autumn their view on whether to proceed at once to a negotiated sale with a single company or a consortium of some kind, (to be completed early 1984) or whether it would be better to delay possibly with a view to a public flotation in late 1984.

VI Expected Date and Scale of Privatisation

Date of privatisation not yet decided. BRB may wish to retain a minority shareholding.

ASSOCIATED BRITISH PORTS - REMAINING GOVERNMENT SHAREHOLDING (48.5%)

I Preliminary Decisions

None

II Need for Legislation

None

III Structural Changes

None

IV Personal Polices

Management will need to reassure unions that no change in their position is implied.

V Stage Reached

Decision in principle required on whether to go ahead with early sale. There is a need to consider the effect of a possible national dock strike, eg as the result of action to deal with the problems of the PLA.

Expected Date and Scale of Privatisation

Timing is subject to market constraints and the situation in the industry. Advisers need to be consulted on method of sale and whether to market the whole of the residual holding or whether sales should be phased.

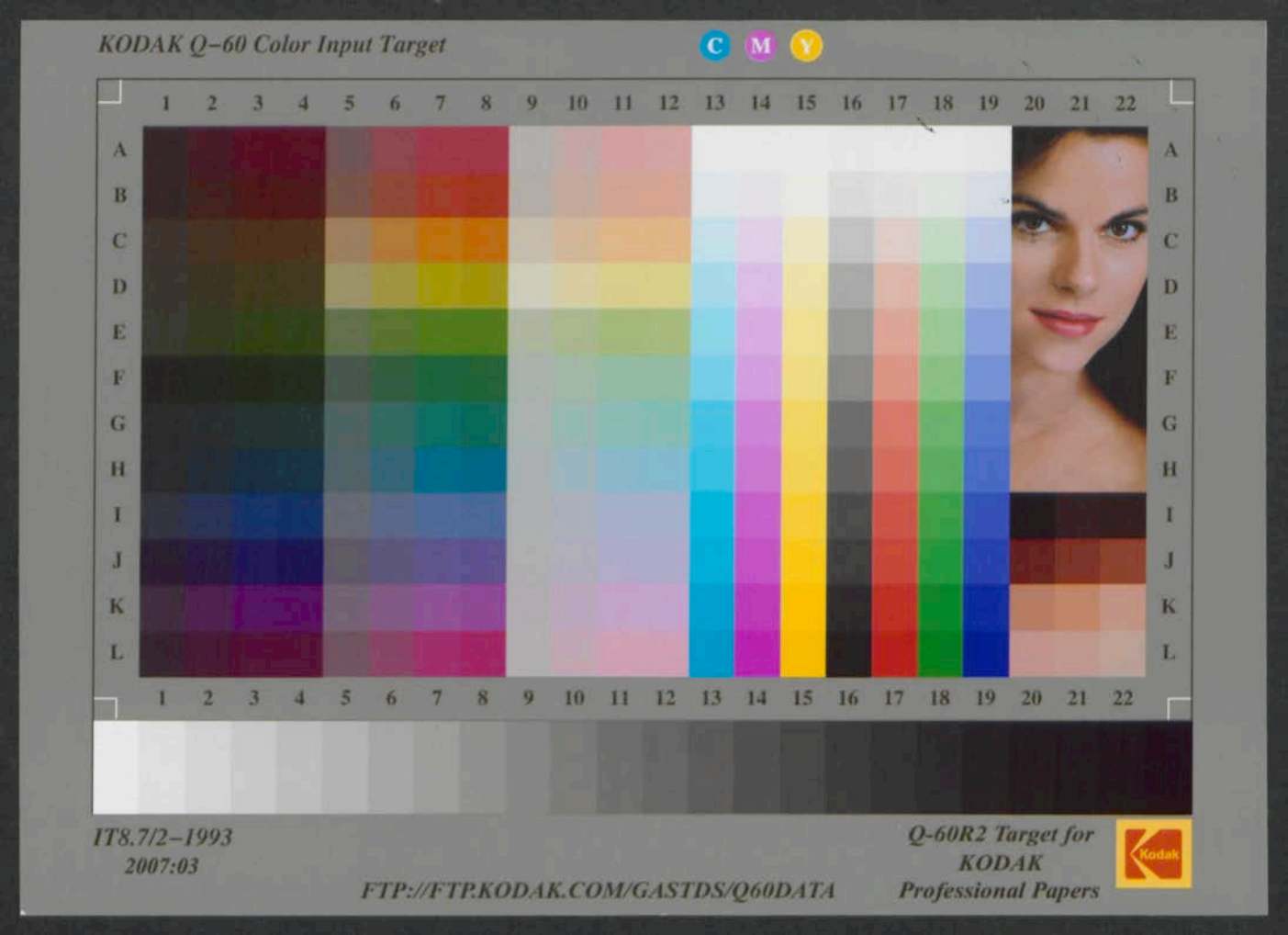
ECON POL
Privatisation
Pt 7

PART 7 ends:-

S/S Energy to Ch/Ex 30.9.83

PART 8 begins:-

S/S Transport to MfS HMT 3.10.83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