

CONFIDENTIAL FILING

CROWN AGENTS TRIBUNAL OF ENQUIRY

FUTURE OF THE CROWN AGENTS

GOVERNMENT

MACHINERY

PART 1: JUNE 1979

PART 2: NOV 1987

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
18.11.77							
20/1/88							
3.2.88							
8.12.88							
5.6.90							

PREM 19/3008



*Upon
(unless the
Hearings comment)*

QUEEN ANNE'S GATE LONDON SW1H 9AT

5 June 1990

John Gifford

On 14 February 1983, in response to a question from Lord Allen of Abbeydale, in the wake of the Report of the Tribunal of Inquiry set up to look into the affairs of the Crown Agents as financiers [HL 149, HC364], Lord Elton made an announcement in the House of Lords in the following terms:

"The Government accept the Crown Agent Tribunal's conclusions on procedure and accordingly consider that the proper safeguards for persons involved in inquiries - the need for which the Government do recognise - can be adequately applied by tribunals under the provisions of existing legislation, to which no amendment is therefore needed". [Hansard 14.2.83. Cols 4 & 5].

There is thus no amendment required to the basic Act, the Tribunals of Inquiry (Evidence) Act 1921; but the resulting situation is still unsatisfactory. In order to discover the Government's guidance on appropriate procedure, any future tribunals would, as things presently stand, have to conjure with the 1966 Report of the Royal Commission on Tribunals of Inquiry (Cmd 3121), the 1973 Government White Paper responding to the 1966 Report (Cmd 5313), the note entitled "Procedure and the Royal Commission on Tribunals of Inquiry" beginning at page 569 of the Report of the Crown Agents Tribunal (1982, HL 149, HC 363), and Lord Elton's Parliamentary reply on 14 February 1983. Lord Allen of Abbeydale, himself a member of the Crown Agents Tribunal, followed up his question in the House of Lords by writing to Lord Elton to point out the numerous different sources to which a tribunal would have to pay regard in establishing its procedure. In reply Lord Elton agreed that there was force in the argument for a single document setting out guidelines.

There is no doubt that an untidy situation exists. A consolidated statement of guidance from the Government would be a valuable aid to any future tribunal and would save it from having to wade through several papers with slightly differing viewpoints stretching back nearly 35 years. My officials have, therefore, been working on a possible solution, in liaison with officials of various Departments, and have produced a set of draft guidelines, which I propose to publish by means of placing them in the Libraries of both Houses of Parliament. I think that it is right to have one broad set of rules and that witnesses should know what they are. The drafted guidelines draw together recommendations and information which is available in three separate published documents and it is therefore anomalous to keep

The Rt Hon Sir Geoffrey Howe, QC., MP.
Lord President of the Council
Privy Council Office
WHITEHALL, S.W.1.

/over....

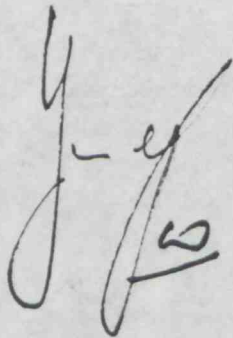
them confidential. Publication would be in line with general policy on open government and would be helpful both to witnesses and to the media.

I do not suggest that inquiries of this sort are the best, or even a particularly good way of investigating a particular matter of national concern. Tribunals of Inquiry under the 1921 Act are substantially different from other kinds of inquiries and tribunals inasmuch as their proceedings are strongly influenced by legal and evidential considerations; so what such tribunals do is not necessarily a good guide for other kinds of inquiry. However, should it be decided to set up a 1921 Act tribunal at some time in the future, it would be as well to have guidelines in a readily accessible and public form.

The purpose of this letter is to seek your and colleagues' agreement to my proposals. Subject to that I would propose to seek comments on the text of the guidelines from the following outside bodies before publication:

- (1) the Law Society;
- (2) the Bar Council;
- (3) the Incorporated Law Society of Northern Ireland;
- (4) the Bar Council of Northern Ireland;
- (5) the Council on Tribunals;
- (6) the Chairmen of some recent inquiries;
- (7) Lord Allen of Abbeydale.

I am copying this letter to Cabinet colleagues and to Sir Robin Butler.

A handwritten signature in dark ink, appearing to be 'J. G. [unclear]', written in a cursive style.

GUIDELINES ON PROCEDURE
FOR TRIBUNALS OF INQUIRY

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DRAFT NO 4
GUIDELINES ON PROCEDURE FOR
TRIBUNALS OF INQUIRY

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I INTRODUCTION

1 The Tribunals of Inquiry (Evidence) Act 1921* enables a Tribunal to be set up by a resolution of both Houses of Parliament to inquire into a definite matter of "urgent public importance". The purpose of this paper is to issue recommended guidelines on procedure to such a Tribunal, which has exceptional inquisitorial powers. It should be emphasised, however, that the guidelines are only an indication of procedures which in the experience of the Home Office have been found appropriate in the past, and Tribunals are entirely free to regulate their own procedure and to depart from the guidelines if they wish, subject only to the provisions of the 1921 Act.

2 In drawing up these guidelines the Government has had regard to three previously published sources: the Report of the Royal Commission on Tribunals of Inquiry published in November 1966 (Cmnd 3121); the White Paper of May 1973 containing the Government's views on the 1966 Report (Cmnd 5313); and the Note entitled "Procedure and the Royal Commission on Tribunals of Inquiry" included at pages 569-574 of the Report of the Crown Agents Tribunal published on 26 May 1982 (HL 149, HC 364). The Government has sought the advice of [], the Chairmen of recent Tribunals.

* See Appendix
+ Key to abbreviations
1 RC = Royal Commission on Tribunals of Inquiry
4 CA = Note, "Procedure and the Royal Commission on Tribunals of Inquiry" at pages 569-574

We are convinced that much can be done in this direction. In the end, however, one must accept that it is impossible to eliminate all risk of personal hurt and injustice. This risk is inherent in any procedure which is effective for arriving at the truth, but the risk can and should be minimised. Even in the normal judicial processes innocent persons are sometimes forced to attend court and give evidence and are subjected to accusations which may be hurtful to them and damaging to their reputations. This is the inevitable price that has to be paid for arriving at the truth. And in matters with which Tribunals of Inquiry are concerned it is vital in the public interest that the truth should be established.

30 There are important distinctions between inquisitorial procedure in an ordinary civil or criminal case. It is inherent in the inquisitorial procedure that there is no lis. The Tribunal directs the inquiry and the witnesses are necessarily the Tribunal's witnesses. There is no plaintiff or defendant, no prosecutor or accused; there are no pleadings defining issues to be tried, no charges, indictments, or depositions. The inquiry may take a fresh turn at any moment. It is therefore difficult for persons involved to know in advance of the hearing what allegations may be made against them."

5 The Royal Commission went on to identify six cardinal principles which should guide a Tribunal in dealing with witnesses. To quote again from its Report:-

"32 The difficulty and injustice with which persons involved in an inquiry may be

faced can however be largely removed if the following cardinal principles which we discuss in Chapter IV are strictly observed:-

1 Before any person becomes involved in an inquiry, the Tribunal must be satisfied that there are circumstances which affect him and which the Tribunal proposes to investigate.

2 Before any person who is involved in an inquiry is called as a witness he should be informed of any allegations which are made against him and the substance of the evidence in support of them.

3 (a) He should be given an adequate opportunity of preparing his case and of being assisted by legal advisers.

(b) His legal expenses should normally be met out of public funds.

4 He should have the opportunity of being examined by his own solicitor or counsel and of stating his case in public at the inquiry.

5 Any material witness he wishes called at the inquiry should, if reasonably practicable, be heard.

6 He should have the opportunity of testing by cross-examination conducted by his own solicitor or counsel any evidence which may affect him."

The Government attaches great importance to the aims underlying these principles, and for this reason has thought it right to highlight them in this introduction. The guidance, however, covers other matters also and the cardinal principles cannot be considered in isolation. The material in this paper is therefore set out so far as possible in chronological order, with procedures relating to the cardinal principles being covered in Section III, all but one being in Section III(b).

II PRELIMINARY PROCEDURES

References*

RC 84-89
RC rec 36,37
WP 15

The Tribunal's Solicitor

6 In England and Wales a Tribunal should appoint Treasury Solicitor to act for it.

7 In Scotland, either the Crown Agent (where criminal matters are enquired into) or the solicitor to the Secretary of State for Scotland (on all other matters) should normally be appointed.

8 In Northern Ireland, the Crown Solicitor should be appointed. He will be able to call upon the support of the Treasury Solicitor where that is necessary.

RC 90-97
RC rec 38, 39
WP 11

Counsel for the Tribunal

9 A Tribunal should be free to choose its own counsel.

10 The Attorney General or the Lord Advocate should be consulted before deciding whether a Law Officer should appear, and about the choice of other counsel. If a Law Officer appears, he might take a full part in proceedings, or he might in appropriate cases confine his appearance to opening the particular issues involved in the terms of reference, thereafter being available to the Tribunal to deal with specific matters such as public interest immunity or the grant of immunity from prosecution.

RC 80-83
115, 119, 122
RC rec 35,
43, 45
WP 13, 18-19
38-40

Proceedings to be held in public

11 The proceedings of a Tribunal should be conducted generally in public so that the press is free to report them day by day.

* see key on

12 The Tribunals of Inquiry (Evidence) Act 1921 gives a Tribunal discretion to sit in private. Section 2 prohibits the exclusion of the public from hearings "unless in the opinion of the Tribunal it is in the public interest expedient to do so for reasons connected with the subject matter of the inquiry or the nature of the evidence to be given". This discretion to sit in private should be exercised with the greatest reluctance and care, but is not confined to cases in which the hearing of evidence in public would constitute a security risk. Trade secrets, infancy cases, the constraints on the disclosures of classified official information, or the interests of humanity and justice are examples of considerations which might lead a Tribunal to decide that certain evidence should be given in private. It should, however, be a most rare occurrence.

13 A preliminary investigation in private by a Tribunal, at which evidence might be called and submissions made to enable a Tribunal to decide whether there was a prima facie case against any persons concerned, is not an appropriate way of protecting innocent persons against any possible injury to their reputations. An announcement by a Tribunal following an investigation in private will not carry conviction or allay public disquiet. Groundless rumours and allegations are best destroyed by evidence given in public.

RC 79,
101-107
RC rec 34, 40
WP 14, 33

The holding of preliminary public meetings

14 The Tribunal should hold one or more preliminary meetings in public at the earliest opportunity.

15 At these meetings the terms of reference should be read out, with the Tribunal's interpretation of the terms of reference, an explanation of the extent of its intended lines of inquiry and of the matters which will be investigated. Where the terms of reference contain words the construction of which is open to argument, the Tribunal should decide whether or not to hear arguments on behalf of interested persons and by counsel for the Tribunal before announcing the interpretation to be adopted. The Tribunal should also give directions as to the venue and times of hearing of the evidence and should indicate whether it intends to hold any part of the proceedings in private session.

RC 103

16 The Tribunal should explain the duties of the Solicitor to the Tribunal, of counsel instructed on behalf of the Tribunal and of counsel or the Solicitor(s) appearing for witnesses and interested persons. An announcement should be made about the way in which legal costs will be met, and applications for legal representation should be dealt with (see paragraph 26-29 below). The Tribunal has discretion to ascertain and prescribe the particular issues in which an applicant for representation is an interested person.

RC 107, 50, 51
RC rec 12, 13
WP 20,31

Other action to be taken before the public hearing begin

a Information for witnesses

17 During the period between the preliminary meeting and the hearing of an individual's evidence, if it has not been done already, the Solicitor to the Tribunal should provide all witnesses with copies of their statements and should give to those witnesses whose conduct is under scrutiny a document indicating those

matters in respect of which it appears to the Tribunal that their conduct may be called into question and the substance of the evidence relating to those matters. The form of such a document is at the discretion of the Tribunal. Adequate time should be allowed for witnesses to prepare their cases before the hearing begins. Further guidance about the treatment of witnesses is to be found in Section III below, particularly paragraphs 20-32.

RC 66-67
RC rec 24
WP 31, 51-52
CA 18

b Previous convictions of witnesses

18 Before the hearing begins the Tribunal should be able to consider any information obtained by the Solicitor to the Tribunal about previous convictions of any of the witnesses.

19 It will clearly be important for the Tribunal to test the credibility of any witness, but particularly so in cases where the evidence has a close bearing on the subject matter of the inquiry. The criminal record of a witness may be of relevance in this respect. The Tribunal will decide in its discretion and in the circumstances of each case whether to use this information during the hearing, bearing in mind the provisions of the Rehabilitation of Offenders Act 1974 insofar as "spent" convictions are concerned.

III SAFEGUARDS FOR WITNESSES

References

RC 29,30,32

48

RC rec 3(i)

CA 1

(A) The involvement of witnesses

Involvement in an inquiry

20 No-one should become involved unnecessarily in the proceedings of a Tribunal.

21 Before calling any person as a witness to the inquiry, the Tribunal must be satisfied that there are circumstances which affect him and which the Tribunal proposes to investigate. The Tribunal has discretion over the summoning of witnesses and control over the amount of evidence it hears. It is not obliged to summon every person whose evidence might be material. The Solicitor to the Tribunal will interview people who volunteer that they may have information relevant to the inquiry, and others, and will take statements if he sees fit. The people concerned should be told that they may have a legal adviser present when a statement is being made to the Solicitor to the Tribunal (As regards legal representation and costs see paragraphs 26-29). The Tribunal should decide on the basis of these statements which persons to call as witnesses. See also paragraphs 44-46 below.

22 Some individuals may ask to be witnesses or to be legally represented at the inquiry, perhaps because they are at risk of being prejudicially affected by the inquiry or think they may be mentioned by another witness in evidence. The Tribunal should use its discretion to decide whether to call such persons as witnesses or to allow them representation, usually asking to see a statement made to its Solicitor. See also paragraph 29.

WP 13

23 A Tribunal will be allowed as much time as is practicable for the preparation of an inquiry before public hearings begin, to enable it to define its objectives and discard irrelevant material.

RC 63-64

Immunity of witnesses from criminal prosecution

RC rec 22

WP 35-6, 51-52

CA 14-18 and

para 1.19 of

the report

24 The witness has a statutory entitlement, under section 1(3) of the Tribunals of Inquiry (Evidence) Act 1921* to the same immunities and privileges as if he were a witness in civil proceedings before the High Court or the Court of Session, but this does not prevent any evidence which he gives being used against him in subsequent civil or criminal proceedings. If the Attorney General (or the Lord Advocate in Scottish inquiries) has announced that any evidence given by a witness and any statements and documents provided by him for the purpose of the inquiry will not be used against the witness in any criminal proceedings, save in the event of his being charged with having given false evidence to the Tribunal or with having conspired with or procured others to do so, such announcement is made with a view to ensuring that a witness cannot refuse to answer questions on the ground that to do so would incriminate him, and thus that all material evidence is made available to the Tribunal.

25 Any such undertaking by the Attorney General or the Lord Advocate will not prevent the evidence being used against the witness in civil proceedings.

(B) The hearing of evidence in public

RC 59-62, 50

Legal expenses of witnesses

RC rec 3(iii)bm

11, 19, 20, 21

26 The Tribunal should announce at the outset

WP 23, 51
CA 3, 4, 18

* see Appendix

WP 22

the principles which determine whether those who apply to be represented at the hearing will have the costs of that representation met out of public funds. At the end of the hearings the tribunal will make recommendations and these will be considered sympathetically by Ministers. Decisions in earlier cases have established the following principles. The costs of legal representation for any person injured (or the families of any persons who died) as a result of the events under investigation will be met from public funds, as will those costs of any individual who reasonably believes that he may be prejudiced by the inquiry. The costs of companies (and other private associations), local authorities (and other public bodies), and trade unions will not be met from public funds unless there are exceptional circumstances. However, there can be cases where a trade union provides the representation for an individual who would otherwise be legally represented at public expense under the principles discussed earlier, and in such cases that part of the union's costs will be met from public funds.

WP 22

27 The costs of legal representation recommended by the Tribunal in relation to the issues prescribed by it will be met by ex-gratia payments on a standard costs basis. (This is the general rule in relation to litigation in the courts and in the absence of the courts machinery for taxing costs the solicitors bills will be taxed on an informal basis by the Treasury Solicitor's Department.) As regards the grant of legal representation see paragraphs 28 and 29 below.

RC 54-56
RC rec 3(iii)a
15, 16
WP 22

A witness is to be enabled to prepare his case

28 A person who conduct is likely to be called into question at an inquiry should have adequate

opportunity of preparing his case and of being represented and assisted by legal advisers, at the discretion of the Tribunal. The Tribunal may prescribe issues for which representation is appropriate. Any person may have a legal adviser present when making a statement to the Solicitor to the Tribunal provided this does not give rise to too much delay. See also paragraph 21.

29 The Tribunal may also allow legal representation to anyone not a witness who can satisfy the Tribunal that he is at risk of being prejudicially affected by the inquiry. See also paragraph 22. The Tribunal should encourage joint representation of witnesses in appropriate cases, making it clear that a subsequent application for separate representation will be considered at any time. Ultimately it is a matter for the witness's own choice whether to be represented separately or jointly. See paragraph 27 regarding the payment of legal costs..

RC 49-51
RC rec 3(ii)
WP 20-21
CA 7-11

Advance information to witnesses

30 Before any person whose conduct is likely to be called into question appears at an inquiry as a witness, he should be informed in writing of the allegations likely to arise (so far as they are known) and of the substance of the evidence on which they are based (so far as it is available). See also paragraph 17.

31 A witness should be allowed adequate opportunity of obtaining legal advice (see paragraphs 26-29 regarding legal expenses and representation) and of preparing his case before being called to deal with the evidence.

32 Where fresh evidence emerges in the course of an inquiry, any person likely to be affected should be notified in writing in the same way as

is recommended above, and should be given the opportunity of taking legal advice and preparing his case before being summoned to deal with the evidence.

RC 65

RC rec 23, 32

The opening statement at the Inquiry

33 The Tribunal should decide, in its discretion, whether an opening statement should be made by counsel appearing for it, bearing in mind the need to avoid the risk of injustice to any individuals about to be involved in the proceedings.

34 Opening statements sometimes contain strong criticisms of persons to be called as witnesses before the Tribunal; wide publicity might result, and yet it may not be possible to call the persons concerned to give evidence until a much later stage in the inquiry. Witnesses before an inquisitorial tribunal are sometimes in an exceptionally difficult position and should be accorded every possible safeguard. Tribunals should consider in their discretion whether an opening statement is appropriate and if so whether to accord to the solicitor or counsel appearing for the witnesses criticised the opportunity of making a very short statement (of say about five minutes duration) immediately after the opening speech. This is not an advantage enjoyed in the ordinary civil or criminal courts, but it is felt appropriate in the particular circumstances of a Tribunal inquiry.

RC 57, 114

RC rec 3(iv)

17, 42

WP 25-26

CA 5, 6, 12

A person whose conduct is called into question should be able to state his case in public

35 A person whose conduct is called into question should, unless in an exceptional case where the Tribunal is sitting in private, have the opportunity of stating his case in public at the inquiry and of being examined by his own solicitor or counsel.

36 If the witness is legally represented, he should be examined by his own solicitor or counsel on his statement to the Solicitor to the Tribunal. If he is not legally represented, he should be examined by one of the counsel appearing for the Tribunal. No witnesses should be examined and cross-examined by the same counsel.

RC rec 42
para 114

37 There should be one counsel in the team of counsel acting on behalf of the Tribunal who is appointed to examine and re-examine any witness who is not legally represented.

38 In some cases Tribunals may find it useful, in the interests of time, to ask witnesses to read out the statements they have made to the Tribunal's Solicitor, which can be added to in response to questions from their counsel. A Tribunal may decide to allow witness statements to be taken as read, so that cross-examination on them may commence at once. Where this course is adopted, it would be appropriate for the Inquiry to make copies available in the Tribunal Chamber to all concerned, including the Press.

39 It should be noted that under the 1921 Act a witness cannot be compelled to make a statement to the Tribunal's Solicitor prior to the hearing, but Tribunals have power to enforce the attendance of a witness to give oral evidence, and to regulate the way in which his evidence is elicited.

RC 58
RC rec 3(v),
18
WP 27

A represented party should be able to have other material witnesses called

40 At the discretion of the Tribunal, any witness or evidence considered to be material (on the basis of further statements to the Tribunal's Solicitor) which a represented party wishes to be

heard should, if reasonably practicable, be called by the counsel for the Tribunal.

RC 113
RC rec 3(vi)
WP 28

A represented party should be enabled to cross-examine

41 The Tribunal should give leave, in its discretion, to counsel representing interested persons to cross-examine a witness after he has been cross-examined by counsel for the Tribunal and before he is finally re-examined by his own counsel. Members of the Tribunal may question the witness at any stage.

WP 34

Allegations arising in the course of an Inquiry

42 The Tribunal should decide, in its discretion, whether a witness against whom allegations have been made in the course of an inquiry should be given the opportunity to make a short statement at the close of his evidence, to bring out any relevant factors which have not been dealt with during his evidence.

RC 125
RC rec 46
WP 29
(and 18)

Revelation of sources of information

43 In the context of evidence given by the press, the Tribunal should insist on the revelation of sources of information only where this is of vital importance, and they should then explain fully to the witness concerned why the information is vital to the inquiry.

44 If necessary the witness may be given the opportunity of referring back to his source.

45 In the last resort, the power to require disclosure in the interests of justice or national security or for the prevention of disorder or crime applies to a Tribunal of

Inquiry [Contempt of Court Act 1981 sections 10 and 20(1).]

WP 33

The final speech at the Inquiry

46 Save in exceptional circumstances, the final speech at a hearing should be made by counsel for the Tribunal.

(C) The report

RC 133

Rec 149

WP 30

CA 13

Unfounded criticisms of witnesses

47 Tribunals should consider in the circumstances of each case whether to emphasise in their report cases where criticisms made of witnesses are shown to be unfounded. Factors which might have a bearing on the decision are the publicity given to the criticisms, the scale of the inquiry and the number of witnesses involved, but above all, the interests of doing justice to innocent persons, and being seen by them to have done justice.

APPENDIX

[11 Geo 5]

Tribunals of Inquiry (Evidence)

[Ch 7]

Act 1921

CHAPTER 7

An Act to make provision with respect to the taking of evidence before and the procedure and powers of certain Tribunals of Inquiry. [24th March, 1921.]

Be it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:-

1 - (1) Where it has been resolved (whether before or after the commencement of this Act) by both Houses of Parliament that it is expedient that a tribunal be established for inquiring into a definite matter described in the Resolution as of urgent public importance, and in pursuance of the Resolution a tribunal is appointed for the purpose either by His Majesty or a Secretary of State, the instrument by which the tribunal is appointed or any instrument supplemental thereto may provide that this Act shall apply, and in such case the tribunal shall have all such powers, rights, and privileges as are vested in the High Court, or in Scotland the Court of Session, or a judge of either such court, on the occasion of an action in respect of the following matters:-

- (a) The enforcing the attendance of witnesses and examining them on oath, affirmation, or otherwise;
- (b) The compelling the production of documents;
- (c) Subject to rules of court, the issuing of a commission or request to examine witnesses abroad;

and a summons signed by one or more of the members of the tribunal may be substituted for and shall be equivalent to any formal process capable of being issued in any action for enforcing the attendance of witnesses and compelling the production of documents.

(2) If any person -

- (a) on being duly summoned as a witness before a tribunal makes default in attending; or

- (b) being in attendance as a witness refuses to take an oath legally required by the tribunal to be taken, or to produce any document in his power or control legally required by the tribunal to be produced by him, or to answer any question to which the tribunal may legally require an answer; or
- (c) does any other thing which would, if the tribunal had been a court of law having power to commit for contempt, have been contempt of that court;

the chairman of the tribunal may certify the offence of that person under his hand to the High Court, or in Scotland the Court of Session, and the court may thereupon inquire into the alleged offence and after hearing any witnesses who may be produced against or on behalf of the person charged with the offence, and after hearing any statement that may be offered in defence, punish or take steps for the punishment of that person in like manner as if he had been guilty of contempt of the court.

(3) A witness before any such tribunal shall be entitled to the same immunities and privileges as if he were a witness in civil proceedings before the High Court or the Court of Session.

2 A tribunal to which this Act is so applied as aforesaid -

- (a) shall not refuse to allow the public or any portion of the public to be present at any of the proceedings of the tribunal unless in the opinion of the tribunal it is in the public interest expedient so to do for reasons connected with the subject matter of the inquiry or the nature of the evidence to be given; and
- (b) shall have power to authorise the representation before them of any person appearing to them to be interested to be by counsel or solicitor or otherwise, or to refuse to allow such representations.

3 This Act may be cited as the Tribunals of Inquiry (Evidence) Act 1921.

CONFIDENTIAL

FILE (MM SA).



10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

8 December 1988

Dear Stephen,

THE FUTURE OF THE CROWN AGENTS

The Prime Minister has noted the Foreign Secretary's minute of 6 December about the future of the Crown Agents and agrees that Parliament should be informed by means of a written PQ.

I am copying this letter to the Private Secretaries to members of OD and to Sir Robin Butler.

Yours sincerely,

C. D. POWELL

Stephen Wall, Esq.,
Foreign and Commonwealth Office

CONFIDENTIAL

2)



PM/88/065

PRIME MINISTER

ceh (2)
Prime Minister

CD
7/xii

mt

The Future of the Crown Agents

1. My minute of 18 ^{*Dec*} January 1988 to you reported on a review by Price Waterhouse, which Nigel Lawson and I had put in hand, of options for the future of the Crown Agents.
2. Our preferred option continued to be privatisation. However that option had been blocked for four years by pressure on the legislative programme. I concluded that if we were once again unable to provide time in the 1988/89 session, we should put an end to the uncertainty about the Crown Agents' future by deciding to retain them indefinitely in the public sector, slimmed down and with a modified capital structure.
3. In the event we were unable to allocate a place in the legislative timetable in 1988/89. Accordingly, Nigel Lawson and I established a Working Group of officials to investigate and make recommendations as to the basis on which the Crown Agents should continue in the public sector.
4. Having considered the Working Group's recommendations, Nigel Lawson and I have agreed that:
 - the Crown Agents should continue their core procurement agency and financial services activities but discontinue a number of peripheral activities. The latter include speculative

/trading



trading and the production and sale of stamps, which have proved unprofitable and have taken up a disproportionate amount of senior management time;

- an overall required rate of return on capital will be set, and in the context of the Crown Agents' annual Corporate Plan the ODA will agree specific, quantified, time-bound performance targets for different parts of the business. Activities which fail to demonstrate underlying profitability by December 1989 will be considered for sale or closure;
- ODA's policy of subjecting Crown Agents to competition for aid programme procurement business, in the interests of maximising value for money and promoting efficiency, should be continued. A corollary of this is that Crown Agents should continue to diversify the sources of their procurement business;
- the Crown Agents' capital base should be restructured by converting a proportion of their fixed debt into equity to provide a gearing ratio more appropriate to the nature of their business.

5. I am satisfied that the measures described above, which are consonant with the approach suggested by Price Waterhouse in the event that privatisation was not possible, and which have been agreed by the Crown Agents' Board, provide a suitable operational and financial framework within which the Crown Agents should operate while remaining within the public sector.

6. The last substantive statement to Parliament on the future of the Crown Agents was Timothy Raison's statement on 23 February 1984, to the effect that the Government



intended to privatise the organisation. We propose to inform Parliament of what has now been agreed and, will do this by means of a written PQ.

7. The Crown Agents expect a trading profit this year of some £1.3 million. They have secured contracts with the Japanese Government to manage procurement under Japan's untied non-project grant aid to Africa intended to support economic policy reform. I understand that so far British firms have secured a substantial proportion of the business. Crown Agents also regularly secure European Development Fund and World Bank funded procurement contracts.

8. I am copying this minute to other members of OD and to Sir Robin Butler.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
6 December 1988

GOVT MACH: Crown Agents



RESTRICTED



Je e
cpc.

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

3 February 1988

Future of the Crown Agents

Thank you for your letter of 3 February seeking the Prime Minister's agreement that the Foreign Secretary should show the report on the future of the Crown Agents in confidence to the Crown Agents Board and Executive Committee. The Prime Minister agrees that this makes sense, without prejudice to the eventual decision on legislation in the next session.

(CHARLES POWELL)

R.N. Culshaw, Esq., MVO,
Foreign and Commonwealth Office.

RESTRICTED

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Foreign and Commonwealth Office

London SW1A 2AH

3 February 1988

Dear Charles

Yes Mr

Prime Minister

His words desirable

Agree?

CP 3/2

The Future of the Crown Agents

Thank you for your letter of 19 January, in response to mine of 18 January, recording that the Prime Minister is to discuss the future of the Crown Agents - and the legislative implications - with the Lord President.

Sir Geoffrey Howe has given an undertaking to consult the Board of the Crown Agents before final decisions are taken, and thinks it would be sensible for that process of consultation to begin without further delay. Given that the report itself does not contain recommendations which are likely to embarrass the Government, he hopes the Prime Minister will agree to our showing the report now, in confidence, to the Crown Agents Board and Executive Committee. Delay until after a decision is taken on the legislative timetable might either close off options before the Board has had a chance to express a view, or reduce the time available to appoint a successor to the Crown Agents Managing Director, who retires in May.

Yours truly

(R N Culshaw)
Private Secretary

C D Powell Esq
10 Downing Street

GOVT MAIL: Crown Agents PT2



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cc/c
②

Ric Nintu

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

CDN
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PRIME MINISTER

Dep.

The Foreign Secretary sent me a copy of his minute of 18 January about Crown Agents. I have discussed this with him briefly. I completely agree with his main conclusions. The report is a useful one. It shows conclusively that closure (an option which the Treasury particularly wanted to have considered) is expensive. The choice between privatisation and retention in the public sector is more finely balanced on quantifiable costs and benefits. But the unquantified risks associated with attempting to run this vulnerable commercial business in the public sector point firmly towards preferring privatisation.

To achieve this, and to avoid risks of a deteriorating prospect before we do so, early legislation (in the 1988-89 Session) is essential, and I therefore strongly support the Foreign Secretary's bid for a place in the programme.

I recognise the implications of the proposal for the National Loans Fund. But it is overall the cheapest and least risky solution so, having consulted the Accounting Officer for the Fund, I am prepared to accept them.

I am sending copies of this minute to members of OD, to the Lord President and to Sir Robin Butler.

N.L.

N.L.

20 January 1988

CONFIDENTIAL



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8/21

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

19 January 1988

THE FUTURE OF THE CROWN AGENTS

The Prime Minister has considered the Foreign Secretary's minute of 18 January about the future of the Crown Agents. As a first step, she wants to discuss this with the Lord President. I will be in touch again thereafter.

I am copying this letter to the Private Secretary to the Lord President and to Sir Robin Butler.

(C. D. POWELL)

A. C. Galsworthy, Esq., C.M.G.,
Foreign and Commonwealth Office.

8/21

CONFIDENTIAL

CPC ①



Will see Lord President ^{Prime Minister} but will probably want to hear the Lord President's views before deciding whether to call a meeting (unless you want it to go to L)

PM/88/004

PRIME MINISTER

The Future of the Crown Agents

at floor

C.D.P.
19/11

1. In my minute to your of 18 November, I reported that the Chancellor of the Exchequer and I had put in hand a review of the options for the Crown Agents' future. That report, from Price Waterhouse, has now been completed and I attach the executive summary. John Vereker's group of ODA and Treasury officials have worked closely with Price Waterhouse, have agreed their methodology and the factual basis, and consider that the report is a good, thorough analysis of the options.

2. The report concludes that winding up the Crown Agents would be expensive (some £17 million of new money) and unnecessary, and warns that it could be controversial. It would require legislation. Privatisation (which might yield the Exchequer some £5 million, and which for four years now has been our publicly stated objective, but blocked by pressures on the legislative programme) remains feasible and desirable. It could in fact take place through a trade sale as early as 1990, without the need for further development of the business. That would require a Bill of some 25 clauses, largely modelled on the British Aerospace precedent. This would give powers to transfer the Crown Agents business to a PLC and then to sell that PLC. If that option is not acceptable, Price Waterhouse conclude that the present uncertainty should be ended and that the Crown Agents should be retained indefinitely in

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the public sector, slimmed down and with a modified capital structure. That course, too, would require legislation, albeit simpler.

3. As I mentioned in my earlier minute, the Crown Agents now foresee a trading loss for 1987. This bears on the subsidiary issue of interest payments on their Commencing Capital Debt. Price Waterhouse have concluded that the Crown Agents could not safely afford to make payments of interest on their commencing Capital Debt. Subject to Nigel Lawson's agreement, therefore we should confirm to the Crown Agents that we shall not call for interest on the Commencing Capital Debt before reconstruction or sale (unless there is a wholly unexpected improvement in their fortunes).

4. Officials strongly recommend the option which keeps us on the privatisation track. I agree. So does Nigel Lawson, whom I have consulted. But there is no point in choosing this if we once again fail to provide time for the necessary legislation, which will have to be in the 1988/89 session. Only if it proves impossible once again to find time should we consider the third option. This would mean keeping a slimmed down Crown Agents indefinitely in the public sector. Even that requires legislation sooner or later. We have always recognised that the functions of the Crown Agents are not naturally carried out in the public sector: they are agency services which the private sector, at least in time, should be able to provide with equal or greater efficiency. The ODA are already exposing the Crown Agents to private sector competition for these services. The worst of all worlds would be to go on with what we have been doing since 1984 - encouraging the Crown Agents

/to



to prepare themselves for privatisation by diversifying the business and taking risk, but without finding the necessary legislative time.

5. There is much in the report that is critical of the Crown Agents' management. A new Managing Director is already being sought. The choice will depend on our choice of future strategy. If we adopt my preferred option of privatisation, we shall need somebody capable of taking the Crown Agents swiftly into the private sector. We shall have to be ready to pay the market rate to get such a person.

6. I have undertaken to consult the Board before final decisions are taken, and after I have initial reactions from you and other colleagues I propose to show the full report to members of the Crown Agents Board and Executive Committee.

7. I recommend therefore that:

- (i) we reconfirm our policy of privatising the Crown Agents and agree to find time for that in the 1988/89 legislative programme with a view to sale in 1990. An announcement to this effect should be made as soon as possible;
- (ii) we appoint a Managing Director from the private sector; and
- (iii) we show the full report to the Board and the Executive Committee and seek their reactions on the detailed proposals.



8. If this set of proposals is not acceptable, then the only alternative is to reconcile ourselves to retaining the Crown Agents in the public sector indefinitely. We could not responsibly let the current uncertainty continue. An indication that we might find legislative time in 1989/90 would lack credibility after our failing to do so in the four previous sessions. We should accept - and announce - that the Crown Agents should stay in the public sector indefinitely, that we are proposing to limit their functions to agency services required in support of the aid programme, and that appropriate legislation would be prepared in the 1989/90 session to enable their capital to be restructured accordingly. We should of course also be looking for a different kind of Managing Director, quite possibly from within the public sector. I hope we can avoid this solution, but it would be better than continuing indecision.

9. Legislative priorities are a key factor in all this. If you felt that it would be useful for there to be a short meeting of interested colleagues to discuss this, you may wish to involve our colleagues with responsibilities for the legislative timetable.

10. I am copying this minute to members of OD, to the Lord President (with a copy of my earlier minute) and to Sir Robin Butler.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

18 January 1988

CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONSIntroduction

- 1 Crown Agents' recent history has been chequered; they have suffered a number of setbacks including significant losses arising from the property collapse of the mid 1970's, the loss of the Brunei investment management contract in 1983 and this year the major turnaround from a budgeted operating profit of £900,000 to a forecast loss of £1.6 million.
- 2 This period has also been characterised by a lack of a clear sense of purpose and direction. Whilst management has sought to pursue an increasingly commercial approach with the ultimate objective of privatisation, the organisation has failed to convince the Government that it is ready for greater commercial freedom and privatisation. A number of reviews of the Crown Agents' future have been undertaken, and this is the latest. We hope that following this report a clear strategy can be developed leading to a secure and certain future for Crown Agents.

The Business

- 3 The principal activities of Crown Agents are the provision of professional, commercial and technical services to governments, international organisations and other public sector bodies worldwide in connection with the UK and international aid programmes. Management considers, and we agree, that the provision of a complete procurement service, including shipping and quality assurance, is the core activity of Crown Agents. The bilateral aid programme administered by the ODA provides some 50% of Crown Agents' fee income and the ODA is the principal customer for Crown Agents' procurement agency services.
- 4 The diverse range of activities now performed by Crown Agents has grown around this core procurement service using their extensive overseas experience and presence. In addition to procurement their activities now include fund management and treasury, project management, training, recruitment, economic consultancy and financial advice.

Recent Developments

- 5 Crown Agents have been in a continuous process of change since the Crown Agents Act 1979 was introduced with effect from 1 January 1980. This process was advanced as a result of the loss of the Brunei investment management contract in 1983.

CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

6 A reconstruction plan was developed in 1983, and since then the following significant changes have taken place:

- employee numbers reduced from 1,053 to 738
- establishment of private sector employment terms
- relocation from Millbank to Sutton
- development of new computer systems
- diversification from core procurement agency activities.

Strategic Plan

- 7 The 1988 strategic plan re-emphasises the key objectives set out in the 1987 plan which were, in addition to privatisation, to establish and develop stable trading relationships, to develop the training and quality assurance businesses, to increase the efficiency of operating systems and to increase margins to provide cash for the future. We understand that the draft 1988 strategic plan was discussed and broadly agreed by the Board of Crown Agents on 16 December 1987.
- 8 Whilst we accept that these are valid objectives, the strategic plan does not set targets against which performance can be judged, performance measures are not identified, and there is no action plan or indication of priorities or responsibilities.
- 9 Crown Agents' major strategic goal since 1983 has been privatisation and in order to achieve this they have sought commercial freedom beyond the constraints imposed by the 1979 Act to expand the business into related profitable activities. The aim of this expansion was to create a profitable commercial business with a good track record which could in due course be transferred to the private sector.
- 10 The 1988 strategic plan identifies Commonwealth Development Corporation as a possible holding company pending privatisation. We do not believe that this is a sensible route to privatisation, because it would require primary legislation, Crown Agents would remain in the public sector, there is limited synergy with CDC and we understand that CDC are not interested in this solution.
- 11 The 1983 plan set 1987 as a target date for privatisation but it became apparent early in 1986 that this was unlikely to be achieved. The Board of Crown Agents believes that its efforts to prepare for privatisation have been frustrated by difficulties in obtaining parliamentary time. Despite the stated intention of achieving privatisation, Crown Agents do not appear to have developed an effective strategy or formulated an action plan and timetable to achieve privatisation.

CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

Financial Results

12 A summary of the actual and forecast results of Crown Agents in 1986 and 1987 is set out below:

	<u>Actual 1986</u>		<u>October forecast 1987</u>	
	<u>Revenue</u> £'000	<u>Gross Margin</u> £'000	<u>Revenue</u> £'000	<u>Gross Margin</u> £'000
Procurement	7,813	2,516	7,446	1,176
Financial services	5,373	2,097	4,668	1,595
Technical services	12,892	2,634	12,081	2,403
Other income	<u>1,278</u>	<u>950</u>	<u>816</u>	<u>644</u>
	27,356	8,197	25,011	5,818
Subsidiaries and associates	<u>3,372</u>	<u>281</u>	<u>4,328</u>	<u>415</u>
	<u>30,728</u>	<u>8,478</u>	<u>29,339</u>	<u>6,233</u>
Central overheads		(6,862)		(7,382)
Contingency		1,616		(1,149)
		<u>-</u>		<u>(500)</u>
Profit/(loss) before tax		<u>1,616</u>		<u>(1,649)</u>

13 The forecast group operating loss for 1987 of £1.6 million compares with a budgeted profit for the year of £900,000. Management attributes this deterioration to the following factors:

- delays in the agreement of aid packages
- change in the nature and mix of aid packages
- political instability in the Middle East
- poor performance of the new CASL own-account trading business.

14 Much of this shortfall was outside management's control. However, the fact that the shortfall in income was not anticipated until October 1987 and that management was unable to reduce costs in response to the falling income demonstrates the vulnerability of the business in its current structure and the weaknesses in Crown Agents' management information.



CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

- 15 Central overheads comprise the costs of the computer systems, accommodation, overseas marketing offices, the accounts department and general overheads. These costs appear to be largely fixed in the short to medium term. At present Crown Agents' information systems are unable to allocate the overheads accurately to profit centres, so true profitability and accountability measures for each activity cannot be established.
- 16 The October forecast for 1987 can be restated to show the revenue and gross margin from core activities as follows:

	<u>October forecast 1987</u>	
	<u>Revenue</u> £'000	<u>Gross Margin</u> £'000
Core Activities:		
Procurement	7,446	1,176
Quality assurance	1,680	200
Shipping	2,480	460
Pensions	2,840	970
Loan and grant administration	<u>740</u>	<u>501</u>
	15,186	3,307
 Non-core activities	 <u>14,153</u>	 <u>2,926</u>
	<u>29,339</u>	<u>6,233</u>

- 17 The sources of Crown Agents' income for the nine months to 30 September 1987 covering procurement, quality assurance, project management and training are summarised below:

	<u>Procurement</u> %	<u>Quality Assurance</u> %	<u>Project Management</u> %	<u>Training</u> %
Principals' own account	25	55	8	36
Direct work for UK				
Government	18	17	12	-
UK bilateral aid	51	26	22	33
World Bank	3	-	35	20
Other banks, aid agencies and other sources	<u>3</u>	<u>2</u>	<u>23</u>	<u>11</u>
	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>



CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

Forecast Profitability

- 15 The 1988 budget shows a sharp improvement compared with the poor result for 1987 and anticipates a group operating profit of £950,000 which is slightly in excess of the 1987 budget. The 1989 and 1990 plans anticipate continuing growth resulting in group profits of £1.3 million and £1.9 million respectively.
- 17 Management anticipates that this improvement in 1988 will result from an increase in fee income from the ODA due to higher aid expenditure reflecting in part the carry over of delayed expenditure from 1987. We understand from the ODA that the level of aid will not alter materially in the medium term although more may be available to procurement agents, including Crown Agents, than in the past. Management has incorporated some income from the Japanese contract although it believes it has been prudent with regard to the amount of income which has been recognised. The budgets do not anticipate any income from the Bolivian contract currently under negotiation.
- 20 These forecasts remain vulnerable because at present Crown Agents' costs are largely fixed in the short term, with the result that any shortfall in income is directly reflected in a reduction in profit as happened in 1987. We believe that Crown Agents must look carefully at the fixed costs, especially overheads, to ensure that they are appropriate to the sustainable level of business.
- 21 Historically, with the exception of 1987, whilst Crown Agents' actual results have been broadly in line with budget, there have been wide variances within individual business activities and cost centres. Accordingly there is not a history of accurate forecasting on which to judge the reliability of management's projections.
- 22 Although the projections for 1988 may prove to be ambitious and their attainment will depend on the timing of expenditure of agreed aid programmes we consider that the assumptions on which they are based are reasonable. We believe Crown Agents have the capacity to generate underlying profits of between £1 million and £2 million a year.

Cash Flow Forecasts

- 23 The losses in 1987, together with the continuing reorganisation and redundancy payments and the purchase of computer equipment, have resulted in a substantial decline in Crown Agents' cash balances in 1987 from £17.9 million to £9.3 million. Cash outflows are projected to continue in 1988 and 1989 with Crown Agents becoming cash positive again in 1990. Crown Agents' cash balance is projected to fall just below £2.5 million at the end of 1989.



CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

- 24 Management is unable to forecast cash movements during the year accurately, in particular they cannot identify maximum cash requirements, and it would seem unlikely that Crown Agents could safely afford to make payments of interest on the commencing capital debt. Accordingly, in order to ensure viability in the next two or three years, we would recommend that the Government continues not to charge interest.

Capital Structure

- 25 At present Crown Agents' capital is provided in the form of £17 million commencing capital debt. Crown Agents are required to repay £840,000 of principal each year, but interest payments of some £2 million per annum have not been sought since 1984 because Crown Agents has had insufficient cash flow to fund the interest cost.
- 26 We do not consider that this capital structure is appropriate in view of Crown Agents' capacity to generate underlying operating profits of only £1 million to £2 million and its net assets of around £10 million.
- 27 We consider that a more appropriate capital structure would involve funding of some £7.5 million (after further reorganisation costs reduce the net assets from £10 million), provided partly in the form of equity and partly loan capital. On the basis of a gearing ratio of 33 percent, which would represent a realistic commercial situation, the dividend and interest flow to HM Treasury should amount to about £500,000 per annum, which should be sustainable. If the privatisation option is preferred then a purchaser would choose a capital structure appropriate to its needs and a reorganisation would not necessarily be required prior to sale.
- 28 If the modification option is preferred we believe that the capital structure would have to be reorganised. We understand that no legislation would be required for the Government to grant funds to Crown Agents in order to repay part of the commencing capital debt, but legislation would probably be required in order to reorganise the capital structure with equity and loan capital.

Management Structure

Both the ODA and Crown Agents recognise that the current management structure with a Board comprising non-executive directors is not a structure which assists speedy decision taking. We believe that a more conventional board structure comprising the key executives and a small number of non-executive directors would better serve Crown Agents and make the Board a more effective management unit.



CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

- 30 A significant proportion of the middle management team has had limited commercial experience in the private sector. This shortcoming is demonstrated by the difficulties experienced during the start-up of the CASL own-account trading business where management has found that the skills required for the traditional agency role cannot be adapted easily for operation in a fully commercial environment.
- 31 This lack of commercialism is also demonstrated in the way that Crown Agents have reacted to the ODA's introduction of competition as a threat to their business which they perceive is being introduced in an unfair manner. This change could have been seen as an opportunity to exploit their recognised strengths and increase their share of the market while at the same time seeking operational efficiencies from staff.

Management Systems

- 32 Since 1983 management has embarked on an extensive reconfiguration of the computer systems at an estimated final cost of some £5 million. It appears to us that this exercise has been undertaken without a detailed and meaningful strategy and more importantly without ensuring that the resultant systems meet the users' requirements. We believe that, whatever option is chosen, management should be encouraged to examine its plans in detail in the light of anticipated changes in the business and users' needs.
- 33 Despite heavy expenditure the existing management systems are relatively unsophisticated. In particular, plans and budgets do not identify specific performance measures for each business segment, making it difficult to manage effectively.
- 34 Historically Crown Agents have had large cash balances and have not prepared conventional cash flow forecasts. Instead they have relied on projected balance sheets and movements in working capital for the overall business to monitor the flow of funds. In a business with a regular pattern of cash outflows but with a relatively uneven pattern of cash receipts this inability to forecast cash may become critical in the period to December 1990, during which time Crown Agents are forecast to have relatively low cash balances. In any event, whatever option is chosen, Crown Agents will need to improve their systems for managing and forecasting cash and indeed management is planning such improvements which should be implemented during 1988.

CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

Evaluation of Options

- 35 From our discussions with the ODA and HM Treasury it appears that primary legislation will be required to close or privatise Crown Agents and to reorganise the capital structure under the rationalisation option. We have assumed that a public announcement regarding the future of Crown Agents is made by mid-1988 at the latest and that any required legislation becomes effective by 31 December 1989.
- 36 The basis of our analysis has been to compare the additional costs and benefits to the ODA and HM Treasury of pursuing each option. We have not considered the write off of the outstanding commencing capital debt since this is neutral as regards the cash flow under each of the options.
- 37 A summary of the costs and benefits to the ODA and HM Treasury together with the resultant net present values using discount rates of 10% and 5% are set out below:

	<u>Total cash inflow/(outflow)</u> £m	<u>Net present value (10%)</u> £m	<u>Net present value (5%)</u> £m
Option 1 - Closure	(19.0)	(13.3)	(15.7)
Option 2 - Privatisation	5.0	3.8	4.3
Option 3 - Modification	6.5	3.9	5.0

Redundancy

- 38 The largest sum in the analysis and indeed the most difficult to assess accurately is the redundancy liability which would arise on a run down. This liability is estimated at some £17 million of which £2.9 million would ultimately be recovered from the pension fund.

Option 1

- 39 We do not believe that closure is an attractive option. It costs at least £24 million more than the other options and it is likely that the distribution of UK bilateral aid will be disrupted. ODA will experience difficulty in maintaining control of procurement; some time will elapse before the market responds with competitive services. Furthermore this route is likely to be politically sensitive and to attract significant adverse publicity. The major advantage of this option is that the continuing uncertainty regarding the future of Crown Agents is removed.



CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

Option 2

3 The privatisation and modification options produce similar results in terms of net present value and both allow the ODA to receive a continuing and uninterrupted service from Crown Agents.

4 In assessing the range of values for Crown Agents we have taken into account the profit potential of Crown Agents, the surplus on the pension fund and the contingent redundancy liability in the following way:

- a post tax price earnings ratio of 10, which compares with the average for overseas traders quoted in the Financial Times on 30 December 1987 of 12, produces a valuation of some £9 million when applied to Crown Agents' average annual projected results in the period 1988 to 1990;
- management estimates that the pension fund has a surplus of £4.5 million (after taxation) and we have assumed that a purchaser would ascribe this value to it;
- we believe that the contingent redundancy liability is considerably higher than an acquirer would expect to find in the private sector and that this, together with other restructuring costs, would be taken into account by a purchaser who might discount his offer by perhaps £5 million to £10 million.

Accordingly we have assumed that the proceeds from sale would be some £5 million.

5 Privatisation offers certainty to the Government and ensures the preservation of the business in the medium term at least. It should also result ultimately in a more efficient business because management will be required to cut costs in order to be able to compete on equal terms with other private sector providers of procurement and allied services. The ODA should benefit from this in terms of reduced costs and also have sufficient time to develop alternative suppliers.

6 Although following privatisation Crown Agents would no longer be directly subject to the control of the ODA the introduction of a contract, for say two years at least, should provide the ODA with the opportunity to gauge the performance of the new entity and develop alternatives. Such a contract could provide for a gradually reducing volume of committed business over its life, providing Crown Agents and the ODA with some stability while the ODA seek competing alternative agents.

CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

- 44 Crown Agents are involved in a business which does not by its nature have to be performed by the public sector. There are private sector operators in this market in the UK and overseas and we believe Crown Agents should be exposed more directly to the beneficial effects of competition.
- 45 We envisage privatisation of Crown Agents being achieved by way of a trade sale. Management has expressed a preference for a buy-out but we do not see this as a realistic option although a trade sale might involve a significant management and employee participation.
- 46 To support our views we have considered which type of organisation might be interested in purchasing Crown Agents. In practice the level of interest will not be known until the market has been tested. We believe parties would be interested in the whole business or in the fund management and procurement related businesses separately.
- 47 International trading companies, such as Lonrho, Boustead, Chillington Corporation, Inchcape and Jardine Matheson, who have extensive experience of operating in the developing world, may be interested in acquiring the whole of Crown Agents for its reputation, knowledge and contacts. Alternatively the fund management business may be of interest to private sector managers who have existing overseas funds under management. The procurement and shipping businesses could be attractive to an international inspection organisation, like the Swiss-based SGS, to one of the large consultancy practices, to provide contacts in the developing world, or possibly to international construction groups.
- 48 We see no justification for major restructuring of the organisation, further diversification or the removal of certain activities in preparation for sale because the costs involved would be unlikely to be recovered in the sale price. Restructuring might also reduce the range of potentially interested purchasers. All the activities presently conducted by Crown Agents can be undertaken in the private sector. However, the ODA might prefer that the banking activity associated with the loan and grant administration should be retained in the public sector.
- 49 Following the introduction of legislation to privatise Crown Agents we believe it would be desirable to achieve a sale as soon as possible. We see no reason why a sale should not be achieved comparatively quickly and have assumed that it would occur during 1990.

CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

Option 3

- 50 Retention of Crown Agents in the public sector will require modifications to the capital structure and the business activities. We believe that Crown Agents' activities would have to be carefully reconsidered to exclude some of the peripheral commercial activities now being undertaken which present unacceptable risks in the public sector. In particular, procurement on Crown Agents' own account rather than as agent on behalf of principals, which is undertaken by its subsidiary, CASL, and the overseas joint ventures which support this activity are unlikely to form part of a modified Crown Agents. The project management and financial fund management activities would also possibly be excluded.
- 51 Action to rationalise Crown Agents could be taken immediately and we have assumed that the process would be complete by 1990. The rationalisation of Crown Agents will involve significant costs including redundancies and we estimate that additional monies of some £2 million would be required to fund this. We understand that these additional monies could be provided without legislation. However, if the organisation is to be properly established it would be essential that a new capital structure be introduced as soon as possible. We have assumed that legislation for this purpose, which should be non-contentious and comparatively easy to introduce, would be passed before 1990.
- 52 We are concerned that if Option 3 is pursued and the business is restructured, a non-commercial Crown Agents may no longer represent the competitive and efficient procurement agency required by the ODA and other aid-granting bodies. Further, the ODA and HM Treasury will need to continue to monitor Crown Agents closely under this option and the ultimate concern is that problems will arise in the future resulting in further losses and the need for a further fundamental review of Crown Agents.
- 53 We also fear that this course of action could have a demotivating and demoralising effect on management and staff who have regarded commercialisation and privatisation as their major objectives for several years.
- 54 Nonetheless, this option is better than choosing privatisation but in the event not finding the legislative time to implement it.

CROWN AGENTS - REVIEW OF OPTIONS
EXECUTIVE SUMMARY AND RECOMMENDATIONS

Recommendations

55 In this report we have considered and evaluated both the financial aspects and the qualitative judgements with respect to each option. Closure is not an attractive option either from a financial or qualitative viewpoint. Our evaluation shows that Options 2 and 3 produce broadly the same financial result. However, we recommend that privatisation is pursued because it should ensure a competitive and efficient procurement service for the ODA and it would remove from the public sector the risks associated with Crown Agents' commercial activities.

56 We also believe that the pursuit of the privatisation option will ensure the motivation of the management team and staff. We do not believe that this would be achieved if Crown Agents were to be retained in the public sector in a modified form, particularly once Option 1, closure, is known to have been considered and rejected.

If ministers decide that the privatisation option should be pursued we consider it is essential that legislation be introduced without delay to limit the Government's exposure to the risks involved in Crown Agents' commercial activities and to avoid the possibility that the prospects for sale could be prejudiced by further adverse trading results in the future. Delaying legislation until 1989/90, particularly if even that were regarded as uncertain, would greatly increase those risks.

The uncertainty which has surrounded Crown Agents for several years is adversely affecting the morale of the staff and therefore the underlying business. We believe that whatever decision is taken, a detailed action plan should be developed to ensure that the chosen option is implemented successfully. An important first step will be to ensure that a suitable successor to the managing director is chosen who will be able vigorously to pursue the option selected.

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Foreign and Commonwealth Office

London SW1A 2AH

3144

From the Secretary of State

10 December 1987

CC *Heintz*
Mr Coates
Mr Veebo
2 Mr Kosman

RECEIVED
11 DECEMBER
ACSD.....

Mr Porter
Mr Freeman

Mr Peter R. Calvert
11/12

Thank you for your letter of 2 December about the current review of the future prospects for the Crown Agents.

I am aware of your concern about the capital structure of the Crown Agents. This matter is being studied as part of the review and we recognise that the practicability of some of the possible options may well depend in part upon our being able to do something about the capital structure.

As regards the outcome of the review, we will not be able to decide exactly what next steps to take and in what order until we have the Price Waterhouse report. I can however assure you that the Board will be fully consulted before any final Ministerial decisions are taken.

[Handwritten signature]

GEOFFREY HOWE

Sir Peter Graham OBE

Gov't Machs
Future of Com
Agents
Pt 2





PM/87/063

PRIME MINISTERThe Future of the Crown Agents

1. OD agreed in principle in February 1984 that the Crown Agents should be privatised. The timing and other matters were to be decided later. The purpose of this minute is to bring you up-to-date on what has happened since.

2. We accepted in 1984 that there would have to be a fairly long run-up to privatisation, to allow the Crown Agents to increase their profitability, using resources generated within the business, so as to improve their attractiveness to potential buyers. They prepared satisfactory plans for development, which have been reviewed annually; carried out a major reorganisation involving extensive staff reductions and moving out of London; and managed to make a profit despite a capital structure consisting entirely of loans from the National Loans Fund. But recent performance has fallen short of expectations and earnings have taken a particular down-turn this year. The Crown Agents now foresee a trading loss for the current year of more than £1 million, against previous forecasts for a modest surplus. Some of the causes are external, including the economic difficulties of both donor and developing countries, which have affected the volume and type of work available to the Crown Agents, and a tougher

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attitude by the ODA towards the cost of the Crown Agents' services. Others lie within the business itself and we have been applying pressure for improvements in economy and efficiency.

3. The Chancellor of the Exchequer and I have concluded that the time has come for a fresh, expert review of the options for the Crown Agents' future, including privatisation, winding-up, or continuation in the public sector in a modified form. We are appointing financial advisers to study and report on the options in detail by the end of the year. The work will be carried out by Price Waterhouse, under the guidance of a group of officials from the ODA and the Treasury, led by John Vereker; it will be done discreetly so as to minimise public speculation.

4. Either privatisation or winding-up would require legislation, which would probably be controversial; and even continuation in the public sector might require legislation to change the capital structure. We shall need to consider how and when to provide for that.

5. The report should also help us decide a subsidiary issue. Interest on the Crown Agents' capital debt to the NLF has not been sought in recent years, under statutory powers, in view of their financial position and plans for development. We need to decide whether to extract it from the business this year.



6. The Chancellor and I hope to reach conclusions, consulting other colleagues as necessary, early in the New Year. But I thought it right to let you and other OD colleagues know now what was in train. I will report again in due course.

7. I am sending a copy of this minute to members of OD, and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

18 November 1987

PART 1 ends:-

CDP TO FCO 29.1.06

PART 2 begins:-

FCS TO PM 18.11.07



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