



Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000 8 July 1980

Hon Adam Butler MP
Minister of State
Department of Industry

A handwritten signature in dark ink, appearing to read 'Adam Butler'.

BRITISH AEROSPACE

R 1/8

You wrote to me on 17 June setting out what you saw as the advantages of early incorporation of British Aerospace - a course which you mentioned at our meeting with the Governor on 12 June - and enclosing a paper setting out how the company would operate and be controlled while it was wholly owned by Government.

I of course agree on the importance of making a move towards privatisation as soon as is possible. But before taking the step you propose, we must weigh the risk of the gesture appearing empty if, as you accept might be the case, there is a prolonged period before flotation. We would have to make clear that the Government retained control in the interim period and the very act of vesting would raise questions about the timing of flotation. In these circumstances, it might seem that we were going for the shadow when the substance was unattainable. The political arguments do not all point one way.

As you will recognise I am bound to be concerned in this case, as in others where early incorporation might be proposed, both in the immediate financial consequences and in the question of control over the company for PSBR and public expenditure purposes in the period before it can leave the public sector. I have seen the Governor's letter in which he advises that early incorporation per se would not affect the prospects of an eventual flotation and in which he also draws attention to very important questions about the control and financing of the Company during a 100 per cent ownership. These problems are much more substantial than your paper implies.

/On the financing,



On the financing, there are two main issues. First, there is the difficult question of setting the Corporation's CCD and the interest and dividend payments due on it noted in paragraph 2(iv) of your paper. The consequences of early incorporation for this need spelling out further. It would be difficult to defend unnecessarily putting ourselves in a position where the CCD was set at an artificially low level and the Exchequer forewent the appropriate interest and dividend payments. This is perhaps a point of propriety. Secondly, and still more significantly, there is the question of the Company's commercial borrowing lines which BAE have already negotiated. You suggest that it would be necessary for the Government to continue to stand behind the wholly owned company and you quote RR as a precedent. The Aerospace Act is silent on the status of liabilities incurred after vesting day and it is not clear to me how you would propose to indicate and implement any HMG backing for new liabilities undertaken by the Company. Parliament will have a strong interest in this and in the question of whether it would be appropriate for the Company to draw substantial sums on loan facilities the terms of which were negotiated for circumstances in which there would be no Government backing.

On control, I welcome and endorse your view that the Government's ultimate liability during a 100 per cent ownership means that controls over the Company must remain effectively at their present level while the Company remains in the public sector. This seems to me to cast some doubt on the contention that a company framework will have real advantages for the business. Moreover, although in theory it should be possible within a company framework to reproduce the same level of control as in the case of a statutory corporation, I am doubtful about this in practice, especially over what could be an extended period. Experience with Cable and Wireless suggests that even where a satisfactory memorandum of understanding has been negotiated, its implementation may well be less than satisfactory, moreover, as with Rolls-Royce, it may be difficult to negotiate a sufficiently restrictive memorandum. Over a long period there is bound to be conflict and tension between the directors' role and responsibility in a Companies Act framework and the Government's need to control the company for broader public sector reasons.

/If things go wrong,



(id)

If things go wrong, sanctions are very limited. Dismissal of the board is unwieldy and in a Companies Act framework, and there are a few intermediate forms of pressure.

Because of these problems, I believe that we should rule out early incorporation and should stand by our general policy of incorporating only when definite sale arrangements are in hand.

I am copying this letter to John Nott, to whom you copied yours and also to Norman Fowler who may be interested in connection with the National Freight Corporation, as well as to the Governor.

GEOFFREY HOWE

A handwritten signature in cursive script, appearing to be "John", written in dark ink.

- 1 AUG 1980

