Prime Minister

Are you content with Sir Keith's proposals - essentially to stand by the existing compensation terms? If not, you will presumably want to discuss with him.

cc Mr Hilton
Mr Hoskyns

No

I cannot agree with either the conclusion or the (flimsy) arguments.

PRIME MINISTER

COMPENSATION FOR AIRCRAFT AND SHIPBUILDING NATIONALISATION

Flag A

1. My accompanying minute sets out the position under the 1977 Act as it stands, and concludes that there should be no change in the legislation. In this minute I am commenting further on the political aspects of the problem.

2. Criticism of the Government's attitude stems from 2 sources:-

a stockholders with a financial interest;

b Parliamentary colleagues who have been approached by the former stockholder companies or shareholders in those companies.

3. The former stockholders principally concerned are:-

a Vosper Ltd
b Yarrow and Co Ltd
c Vickers Ltd)
d The General Electric Company (GEC) Ltd) qua British Aircraft Corporation
e Rea Brothers Ltd qua Hall Russell
f Dowsett Holdings Ltd qua Brooke Marine

4. So far, overt political activity has been undertaken by Vosper Ltd, where Sir David Brown has a substantial and controlling interest. More discreet initiatives at the political level have been taken

by Sir Eric Yarrow and by Mr Salomon of Rea Brothers. Vickers Ltd and GEC Ltd have largely held their fire, because they hope for a negotiated settlement.

5. All our Parliamentary colleagues have been approached by Sir John Rix of Vosper Ltd, on which the Act arguably bears more harshly than in any other case. They have received reasoned (?) replies from Department of Industry Ministers. It is our impression that, while Parliamentary colleagues are not happy about the compensation provisions in view of our attitude in Opposition, most of them recognise the formidable difficulties detailed ... in my attached minute.

6. This is the hornet's nest we face if we stand fast and refuse to amend. Sir Arnold Weinstock and Mr Salomon may add their formidable voices.

7. If we change our policy and agree to amend the compensation terms we shall be attacked by:-

a the Opposition. They would fight any suggestion that the Act was unjust; would attack any changes as lacking in a defensible rationale and as raiding the Exchequer to help a select few; and would use the opportunity to seek to subvert our privatisation plans; and to justify declarations that they would renationalise without compensation;

b those of our Parliamentary colleagues who would think

it wrong in priciple to amend the compensation terms enacted by a previous Parliament;

c probably the City, because of the retroactive creation of a false market in securities. Mullens, the Government's brokers, have advised that City reaction to a change in terms would be unfavourable and we understand that at least one major institution (the Prudential) considers that settlements under the Act represent rough justice. We would almost certainly be attacked on behalf of and by;

very rough.

d shareholders in former holding companies who have disposed of their shares in the belief that the existing compensation terms would not be changed. There are very many of these. In the particular case of Vosper, a majority of shares other than those held by Sir David Brown interests appears to have changed hands since the beginning of 1975;

8. I cannot guarantee that this will amount to as damaging a hornet's nest as the first, but it could be even worse.

9. Whatever we do, amend or not amend, there will be a political row. If we amend, this row will be very protracted, because of the legislative process, and we shall be exposed to attack on principle. If we do not amend, there will be bitterness spread by Sir Eric Yarrow and Sir John Rix, perhaps fanned by the two even more powerful voices mentioned; it may remain as a blot on our record amoung many supporters. But in Parliamentary terms

row will be very much shorter, perhaps one adjournment debate, and we shall be less exposed to attack on principle and also to attack on privatisation.

10. I am copying this minute to the Chancellor of the Exchequer, the Secretary of State for the Environment, the Chancellor of the Duchy of Lancaster, the Chief Secretary and Sir Robert Armstrong.

KJ

2 K J
July 1980

Department of Industry
Rm 11.01 Ashdown House
123 Victoria Street

PRIME MINISTER

COMPENSATION FOR BRITISH AIRCRAFT CORPORATION (HOLDINGS) LTD (BAC) AND FOUR SHIPBUILDING COMPANIES

1. The Aircraft and Shipbuilding Industries Act, 1977, nationalised 25 privately owned companies. Negotiated settlements have been concluded and announced for 14 companies, 3 since we assumed office. Formal settlement and announcement of one very small case is in suspense at the request of the stockholders' representative (SR). Arbitration has been initiated in 2 cases and appears inescapable in respect of 2 financially weak companies in the shipbuilding sector: these 4 companies raise no significant political issue.

2. However, 5 unsettled cases, covering 6 companies, pose a major policy issue for the Government. These are British Aircraft Corporation (Holdings) Ltd (BAC) and 4 relatively small and profitable shipbuilding companies or company groups: Vosper Thornycroft (UK) Ltd with Vosper Shiprepairers Ltd(Vosper); Yarrow (Shipbuilders) Ltd (YSL); Brooke Marine Ltd (BM) and Hall Russell & Co Ltd (HR).

The problem

3. The issue arises because the Act relates compensation to notional stock market value in the 6 months reference period ended 28 February 1974, while the profits of these 5 companies rose substantially in the 3 years thereafter before vesting date in 1977.

/In ...

In their negotiating posture the SRs have been influenced by their view of the vesting date value of their companies, although the BAC claim has been greatly reduced in negotiation. They are reluctant to have recourse to the arbitration tribunal established under the Act, since the tribunal must relate compensation to the reference period and since proceedings could involve a further delay of about 2 years. All SRs are looking for a "generous" interpretation of the Act from this Administration because in Opposition we argued strongly that the compensation terms were unfair. In the case of BAC and 3 of the shipbuilding companies, the SRs have threatened to pursue a claim for "fair compensation" under the European Convention on Human Rights. Vosper Ltd has publicly pressed for statutory amendment to the compensation terms and the other stockholders could well mount a similar campaign.

4. The Department of Industry has legal advice that no weight can be given under the Act to the value at vesting date. It is advised on the reference period valuation by 3 City firms (accountants, stockbrokers and a merchant bank) and, within the limits of such advice, is constrained by the need to be able to defend before the Public Accounts Committee, as a matter of prudent and economical administration, any settlement made.

5. The Act allows for Ministerial discretion in deciding what offers for compensation should be made within the terms of the Act. However, my discretion is limited by the top of the valuation range of the Department's financial advisers. In practice this

/means ...

means that I could increase the Department's final offers in 4 cases, but only by relatively small amounts.

6. For ease of reference the various positions are tabulated in the ... Annex. The BAC stockholders have so far said that they are not prepared to settle at the maximum figure that could be offered within the exercise of Ministerial discretion (ie £95m). I do not consider that the exercise of my discretion would achieve a settlement in any of the other cases concerned: even if such a possibility emerged, I should need to consider very carefully whether I could justify it as a matter of even-handed administration of the Act.

7. The options before the Government in practice, therefore, are either to change the statutory basis of compensation or not to go beyond the final offers which the Department thinks it can defend under the present Act, that is offers which do not involve the use of Ministerial discretion.

The rationale of the present Act

8. The Act followed well-established precedent in basing compensation on the actual or notional Stock Exchange values of the shares to be nationalised. The choice of the 1 September 1973 - 28 February 1974 reference period was more controversial but had a certain logic. The previous Administration came into office in March 1974 with a manifesto commitment to nationalise the aircraft and shipbuilding industries. They published on 17 March, 1975 a detailed "safeguarding statement" setting out the basis

of nationalisation. Effectively under the Act ownership of the companies being nationalised passed to the Government on 17 March, 1975, with legally enforceable safeguarding provisions applying thereafter. A reference period in the future, for example one related to vesting date, would have been inconsistent with this effective transfer of ownership from March, 1975. If a past reference period had to be designated, their choice of the 6 months ended 28 February 1974 had some merit, not only because this period immediately preceded their entry into office but also because the year thereafter saw a very sharp decline in Stock Exchange prices. (The FT Actuaries Industrial Group Index fell from a reference period average of 151.45 to a low of 59.01 on 13 December 1974 and by 17 March 1975 had recovered only to 117.09).

9. The Act is complex and can be criticised on many grounds. In the present context, however, the main weakness is that, in view of the great delay in the passing of the Act, the fortunes of companies changed radically (some for the better, most for the worse) between the reference period and vesting date. Naturally it is the stockholders of those companies whose fortunes changed for the better who make their dissatisfaction heard.

10. The rationale of the previous Government in maintaining the safeguarding statement's terms despite the delay in the Act's passage was no doubt partly the need to avoid a change in terms having implications for the Stock Market. Much more fundamentally, however, it was an acceptance of the rough (companies of declining value) with the smooth (companies with rising value) on the basis

that the safeguarding statement date in March, 1975 was the effective date of the "contract" being entered into (albeit on a compulsory basis), the vesting date in 1977 being no more than the "completion date" on which the assets would be handed over to their new owners.

Problems of rationale and principle in changing the Act

11. If we were to amend the Act, we would need to have a defensible rationale. Work within the Department suggests that the only practical course would be to give the stockholders of all companies nationalised the choice of an alternative and later reference period, say the last 6 months of 1976. In practice, only the stockholders of those companies whose notional stock market value had risen rather than fallen since the first reference period (the 5 now in question and possibly 1 or 2 others) would choose the second. The Government would no longer be taking the rough with the smooth but accepting the worst of both worlds at an additional cost to the Exchequer estimated to be at least £130m including accrued interest to date. However unfairly the existing compensation terms bear on the stockholders of the 5 companies, it is not clear that there is a defensible rationale for such acceptance.

12. Apart from the question of rationale, there is a major difficulty of principle. The shares of Vickers Ltd, Yarrow & Co Ltd and Vosper Ltd (former parent companies), whose value would be radically altered by any change in the compensation terms, have, according to advice from our stockbrokers, been traded

substantially during the 5 years since the basis of the compensation terms was announced in March 1975. In opposing the nationalisation Bill we gave no undertaking to amend the compensation terms, nor did we suggest in our 1979 Manifesto that this would be done. The Act had been law for 2 years, and compensation agreed for 11 companies, before the present Government took office. Our stockbrokers advise that, since we took office, there have been bouts of speculative share purchases (and concommitantly sales by their former owners) in all these companies based on hopes of more generous compensation. However, Ministers of this Administration, who have settled 3 further compensation cases on the basis of the present Act, have said on more than one occasion to interested parties that it would be impractical and unfair to amend the Act and have consistently in widely quoted correspondence pointed to the difficulties in the way of changing the compensation terms. For the Government to change the statutory basis of compensation at this stage would retroactively create a false market in the shares of these 3 former parent companies (and perhaps in the shares of the former parents of 1 or 2 other companies already settled), expose us to the criticism that our action had resulted in the misleading of investors, create a whole new range of problems and fresh unfairness and set a very dangerous prededent by reversing the compensation terms of a previous Parliament. We should be changing the rules of the game after the match had been played.

13. Michael Grylls has suggested that the market place would treat

/a ...

a change in compensation terms "in the way it does any other piece of Government policy eg Petroleum Revenue Tax (PRT)'s effects on BP shares that have been sold on the basis of a different tax regime earlier". I do not find this argument persuasive. The BP prospectus drew attention to the existence of PRT, made clear that BP's operations could be affected "by developments", and gave no profit forecast. It is normal for a Government to make tax changes from time to time which may have an effect on Stock Exchange prices. Such changes are of general application or apply without discrimination to a complete sector: while they may have some retroactive effect, they are not specifically retroactive in application. In contrast, a change in the compensation terms enacted by a previous Parliament would in practice be specific to selected companies within a sector and totally retroactive in application.

Practical and political difficulties in changing the Act

14. In addition, statutory change would create considerable practical difficulties. The Government would be in no position to announce precise alternative compensation terms for some months. Any suggestion that alternative terms were to be examined, whether internally within the Government or by way of some kind of outside enquiry, would promote intense speculation in the shares of the 3 companies, with the risk of recrimination if expectations were disappointed. It would be eqully unacceptable to allow the situation to drift for some months and neither make final offers for the 5 companies nor say that alternative terms were being examined.

15. Beyond that, any alternative reference period would involve not only controversial legislation but also considerable work for our financial advisers, particularly if more than the 5 companies became involved. Legislation and substantive new negotiation would almost certainly take at least 2 further years, with no certainty of agreed settlements in all cases. Moreover, once the question of an alternative reference period had been reopened, other features of the Act would no doubt come under attack and present us with other difficult issues. For example, the Act makes no provision for the effects of inflation since the reference period: to remedy this on the basis of existing settlements or offers could cost the Exchequer over £250m.

16. There is then the question of our privatisation policy. I believe that most of our Parliamentary colleagues would accept, if reluctantly, a decision that the compensation terms cannot now be amended. However, some might find it very difficult to accept the sale of shares of identifiable companies at a price substantially higher than the compensation offered (or subsequently awarded by the tribunal), most particularly if sold back to the previous owners. This situation is, for a variety of reasons, unlikely to arise with British Aerospace. It would certainly arise if, say, Vosper were sold separately in due course. Against this, however, there is the problem that a change in the compensation terms, without an apparently defensible rationale, could lead the Oppostion to make much stronger statements about "re-nationalisation without compensation" which would damage if not vitiate our privatisation policy. I think that our Parliamentary colleagues would take this point.

European Convention on Human Rights

17. Our legal advisers consider that the adequacy of compensation is a question on which a ruling can be obtained under the European Convention on Human Rights. However, they think it unlikely that the European Court would regard the principle of making nationalisation financially effective from 17 March 1975 (the safeguarding date) though vesting the assests in 1977, as a breach of the Convention. The complaint about the compensation terms involves a contrast between valuations in 1977 and share values in the reference period 1973/1974. The contrast is not the same when the safeguarding date is taken and not the vesting date. In any event the compensation terms were enacted by a democratically elected Parliament and this is a point which should weigh with the Commission and the Court if an application were made under the Convention. But the mere threat of action against the Government under the Convention is not in any case an acceptable reason for a change in the compensation terms in the face of the arguments against such a change. In the unlikely event of a case being sustained, the position would have to be looked at: but that is a bridge that cannot be crossed now.

Conclusion

18. I therefore conclude that the arguments against amending the compensation terms of the Act are overriding and that, in all circumstances, we can well defend both publicly and to our Parliamentary colleagues a decision to make no change in the compensation legislation enacted by a previous Parliament and to deline to arrange for any

form of inquiry into the legislation.

19. Subject to your views, I therefore propose that:-

a we make clear that there will be no amendment to the statutory compensation terms;

b final offers should be made to the SRs at the highest levels which the Department thinks it can defend before the Public Accounts Committee (ie those set out in column 5 of the Annex) subject to any new points arising which permit the Department to go further, with the approval of the Chief Secretary, as a matter of prudent and economical administration;

c the possible use of Ministerial discretion should be considered on an ad hoc basis only if developments clearly indicate that the small increases in offers (as shown in column 6 of the Annex) would produce a settlement.

20. I am copying this minute to the Chancellor of the Exchequer, the Secretary of State for the Environment, the Chancellor of the Duchy of Lancaster, the Chief Secretary and Sir Robert Armstrong.

14

K J
2 July 1980

Department of Industry
Ashdown House
123 Victoria Street

ANNEX

(1) Company	(2) DOI's estimate of vesting date value	(3) SR's claim	(4) DOI's existing offer	(5) DOI's final offer	(6) Possible offer by Ministerial discretion	(7) Former Stockholders
	£m	£m	£m	£m	£m	
BAC	200 +	115	90	90	95	Vickers and GEC equally
Vosper	16 to 21	35.4	4.5	4.8*	4.8	Vosper Ltd (David Brown Holdings Ltd has 40% holding and voting control)
YSL	10	12	4.6	5*	6	Yarrow & Co Ltd (Vosper Ltd has 23% holding)
BM	3	4.5	1.25	1.45*	1.5	Dowsett Holdings Ltd
HR	1.5	3.5	1	1.25*	1.7	Four investment trusts managed by Rea Bros Ltd

*Note: Treasury approval being sought in the light of new advice and information.