

CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

E(DL)(79)12
17 July 1979

CABINET

COPY NO 41

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY
SUB-COMMITTEE ON DISPOSAL OF PUBLIC ASSETS

SALE OF SHARES IN THE NATIONAL FREIGHT CORPORATION

Memorandum by the Minister of Transport

1. Future Legislation Committee (4th Meeting 7 June) has agreed that Parliamentary time be found for the legislation necessary to implement our manifesto promise to introduce private investment into the National Freight Corporation (NFC). This note sets out detailed proposals.

Background

2. The NFC is a statutory Corporation set up under the Transport Act 1968 to manage the road freight businesses in the public sector and to cooperate with British Rail in providing an "integrated" system of freight transport services. In practice the concept of integration has not been pursued and the NFC has concentrated on managing its road haulage subsidiaries, the best known of which are British Road Services, Pickfords, Roadline and National Carriers Ltd (NCL). The NFC incurred substantial losses in the mid seventies, and was given a financial reconstruction in the Transport Act 1978. This reconstruction reduced its debt to the Government to £100m, and provided for some grants specifically to help NCL; the most significant of these grants being an annual contribution of £4m per year to make good deficiencies in the pension funds in respect of those NCL employees who had previously worked for British Rail. The reconstruction had the limited objective of making NFC financially viable without recourse to on going subsidy, or to further loans from the Government for at least the next few years. But NFC's profit levels are currently only just sufficient to cover the interest on its outstanding debt. And it still has substantial deficiencies in the pension funds in respect of service before 1971 of employees who did not previously work for British Rail.

Timing of main changes

3. To attract private investment we must first take powers to convert the NFC into a company with a suitable capital structure with the equity held by the Government, and to remove statutory obligations or commitments not normally found in the private sector. On transfer of its assets to the Company, the NFC would

CONFIDENTIAL

cease to exist as a Statutory Corporation. The way would then be open for the Government to sell its shareholding in the Company at a time (or over a period) of its own choosing; we would decide this in the light of NFC's trading performance and the prospectus we could offer, on which we would take expert advice from a Merchant Bank appointed to handle the sale.

4. I envisage setting up the successor company next year as soon as I have the powers to do so. This would establish that we mean business and provide an interim period, before going to the market, during which the Company, both management and employees could adjust to private sector conditions. Probably the earliest we could go to the market would be Spring 1981, when NFC's 1980 results will be available. It will be most important that we sell most or all of the equity so as to remove NFC firmly from the public sector. That is necessary both to convince the private investor that the Company will not be subject to Government interference, and to establish that there is no question of the Government ever again 'bailing out' the NFC.

Capital Structure

5. To facilitate sale to private investors all or most of the Government's interest in the company will have to be expressed as equity shares rather than fixed interest debt to the National Loans Fund. It will be necessary therefore for the legislation to cancel the Corporation's present £100m debt; and for the Memorandum of Association of the successor Company to provide for an appropriate capital structure with equity shares and possibly some fixed interest borrowings. I would expect to finalise the figures in the light of circumstances, and after consulting the Treasury, at the time the Company is set up. The capital structure would take account of the full range of the NFC's assets and liabilities, including debt to leasing companies, at the time; and would provide the best possible basis for the subsequent sale of shares.

Pensions

6. The value of shares in NFC Ltd will be reduced if the Company has deficiencies in its pension fund, or commitments to employees or ex-employees beyond those normal in the private sector. If the shares are to be marketable, it will almost certainly be necessary for the Government to deal with the present substantial deficiencies in the NFC pension fund nearly all of which relate to obligations in respect of service before the fund was set up in 1971. This will also make the whole operation less vulnerable to obstruction from the Unions. I propose therefore to take powers for the Government to eliminate these particular deficiencies, the precise amount of which will not be known for some months when an actuarial assessment will be available (it could well be within the range £30m - £40m). These deficiencies are additional to those relating to former British Rail employees who were members of British Rail pension funds, and which are being dealt with separately under the Transport Act 1978. There are different ways of dealing

with the non-BR deficiencies: a once-for-all lump sum payment to the pension fund (which could be financed from the proceeds of the sale); or by staged payments over 5 to 10 years. The same Bill will include measures for varying the basis on which the Government is at present funding the very much larger deficiencies in the British Rail pension funds. But as British Rail will inevitably have to remain as a state owned service we can justify differences in the treatment of these deficiencies. An important issue for the new company will be to decide whether or not to close its present pension scheme, which provides index-linking, to new entrants. I would want to encourage the adoption of a new scheme more in line with those common to large employers in the road haulage industry.

Conditions of Employment

7. It has been customary when staff have been statutorily transferred between transport undertakings in the public sector, to provide for statutory compensation in the event of their pay or conditions being worsened for reasons "properly attributable to" the transfer; and the Government in 1971 did this when Thomas Cook's was sold to the private sector. For this and some other transfers NFC is at present the compensating authority, and although there have been very few successful claims for compensation, we will be expected to honour the present arrangements and to provide similar, or better, protection for NFC's staff transferred to NFC Ltd. I propose to provide the same conditions of statutory protection for transferred staff in this case, and would resist any attempts by the Unions to improve these conditions: and in the absence of any other appropriate body to take myself the statutory function of "Compensating Authority", both for this transfer and for the earlier ones involving NFC. The cost of this should be very small, and far outweighed by the benefit to the value of our shareholding in the Company.

Control of the Company

8. While the Government remained the sole shareholder of the Company it would control the appointment of directors and I would see no difficulty in practice in maintaining the same financial controls over the NFC as at present eg in relation to major investment or borrowing (including leasing), and the declaration of dividends. It is also for consideration whether we should maintain the arrangements whereby the NFC uses the Government's credit in borrowing, and to guarantee the credit-worthiness of its subsidiary companies. These arrangements are estimated to save the NFC about £1m a year in interest charges, and would enable it to weather severe setbacks without the danger of bankruptcy. On the other hand, the Government's guarantee must be withdrawn when shares are sold and there is a lot to be said for NFC having prior experience of operating under a private sector financial regime. On balance I recommend that we should set the Company up without any

CONFIDENTIAL

of the formal Government guarantees enjoyed by nationalised industries. We should also abandon the powers to make loans from the NLF: NFC's present plans do not envisage the need for external capital finance (apart from vehicle leasing) during the next few years.

9. Our ownership of the shares in the Company would of course enable us to decide the arrangements for sale, including such matters as the terms relating to our policies for employees share-holdings, and whether any new capital should be raised.

Public Expenditure Implications

10. The immediate public expenditure effects will be the loss of interest on the debt written off, partly offset by dividends (which would of course cease once all the shares were sold). The cost of making good pension fund deficiencies would be either £30 - 40m with a once-for-all payment or, say, about £5m per year for a 10 year period. A very preliminary estimate of the proceeds from selling the equity in 1981 would be £60m. Although this is a modest contribution to the immediate requirement to reduce public expenditure, I believe that in the longer run we could be saved very much more by getting rid of the contingent liability to guarantee the NFC's losses. The NFC's failure in 1975 has cost the Government £82m in grant assistance over the last four years.

Legislative Requirements

11. I seek the approval of colleagues to proceed with legislation

- (a) to create a Company under the Companies Act to inherit the assets and liabilities of NFC (which would be abolished);
- (b) to write off NFC's debt to the Government; and provide for Government ownership of the equity in the new Company;
- (c) to provide for payments to the Company to make good those deficiencies in its Pension Fund which relate to service before the Fund was set up in 1971; and a right to statutory compensation to employees adversely affected by the change;
- (d) to provide for the Government's present powers to lend and guarantee loans to the NFC to be removed as and when the new Company is set up;
- (e) to make consequential amendments to the Transport Act 1968 arising from the abandonment of the concept of "integrating" freight transport, in

CONFIDENTIAL

CONFIDENTIAL

which NFC would have had a major role. In particular I would wind up the Freight Integration Council and repeal the powers to set up a special licensing system for long distance road transport.

NF

Department of Transport
2 Marsham Street
London SW1

17 July 1979

CONFIDENTIAL