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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Norman Fowler MP
Minister of Transport
Department of Transport
2 Marsham Street
LONDON
SW1

\ August 1980

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NATIONAL FREIGHT CORPORATION: DENATIONALISATION

You wrote to the Chancellor on 23 July proposing the early incorporation of the National Freight Corporation (NFC) on a wholly equity basis as the next step towards its privatisation.

I do not think it is realistic to think in terms of incorporating NFC on an equity basis at such an early stage. I entirely agree with your objective of moving towards privatisation as soon as possible, but this does not necessarily entail early incorporation and the considerable problems which would be associated with such a move. These were set out in general terms in Geoffrey Howe's letter of 8 July to Adam Butler on British Aerospace, which you have seen, and which in my opinion apply with even more force in the case of NFC. I ... am copying that letter to those who have not already seen it.

We are faced with particular uncertainties about the prospects for the sale of NFC in the immediate future. The Corporation will need to meet its testing profit forecasts if even the possibility of a sale in 1981 is to remain open, and the merchant bank involved has spoken of 1982 or 1983 as favourable years for a sale. Moreover, there are substantial deficiencies in the Corporation's pension funds which will have to be made good out of the proceeds. If, as seems quite likely, these deficiencies exceed the expected proceeds, it is difficult to see how a sale could take place in the foreseeable future. This is something we will not be able to judge until the New Year when we have the results of the actuarial valuation now under way. It seems inconceivable that we should take the step you propose without waiting to satisfy ourselves that this major potential obstacle to a sale can be resolved.

Since the uncertainties about timing are at least as great as in the case of British Aerospace, Geoffrey Howe's comment that the political arguments do not all point one way is also relevant to the NFC: since

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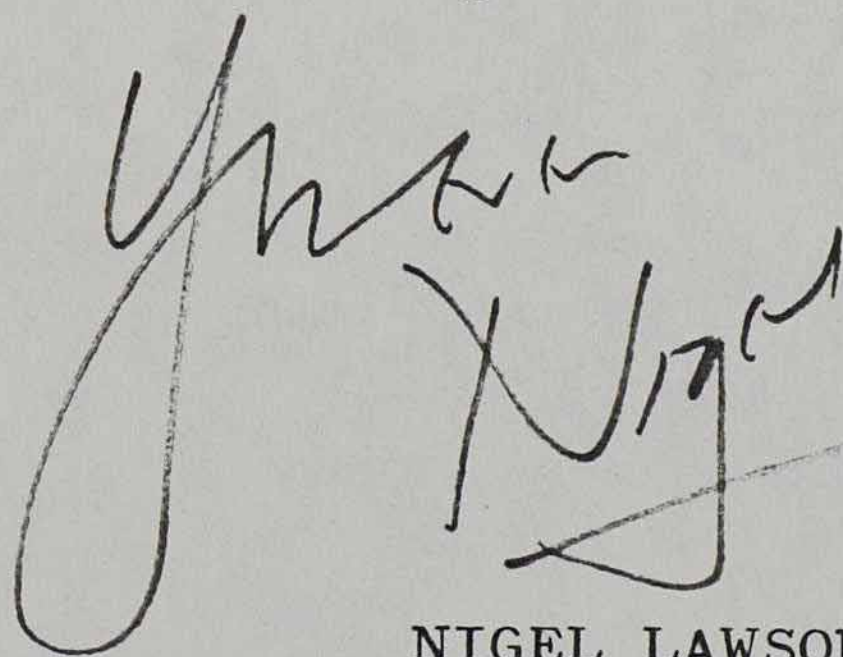
we cannot privatise now, it might seem that we were going for the shadow when the substance was unattainable.

Against this background, early incorporation offers few advantages. On the financial side it would lead to an effective subsidy from the tax-payer to the company without in any way guaranteeing that the prospects of an early sale would be improved. If the Corporation is in need of such financial assistance, then I would not choose to give it in this sort of open-ended way that has the effect of reducing our control over its less than strong financial position. If we are concerned simply to enhance the prospects for an ultimately successful sale, then incorporation seems unnecessary. We have always envisaged giving NFC an appropriate capital structure at the time of sale. To unnecessarily pre-determine this structure now will not only have financial repercussions but will reduce the options open to us at that time.

The problems of control which Geoffrey Howe set out in his letter to Adam Butler also seem to arise in particularly acute form in the case of NFC, where the interim period may be a long one. As you point out, we would need to maintain extremely tight control over the company's finances if there was to be no increase in public expenditure. You do not, however, outline how in practice you would intend to do this. As Geoffrey pointed out, past experience suggests that real problems arise in attempting to rest on the theoretical powers of a shareholder to dismiss the Board even where these are exercised through some memorandum of understanding with the company.

I am sure that early incorporation on a wholly equity basis would be welcomed by NFC itself, not least because the task of achieving profitability would be eased, at some cost to the Exchequer. But we cannot allow plans for privatisation to become in practice - though I know that is not your intention - an excuse for relaxing financial discipline. I hope that, whatever the status of the Corporation, the Board will continue to work towards getting the business into a shape in which it can be sold. In the meantime, I am sure we cannot made an exception to our general policy of incorporating only when definite sale arrangements are in hand.

I am copying this letter to the Prime Minister, Sir Keith Joseph, members of E(DL) and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Nigel Lawson', is written over a faint horizontal line. The signature is stylized and cursive.

NIGEL LAWSON