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DEPARTMENT OF TRANSPORT
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The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
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see page 5

23 July 1980

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24/7

Geoffrey

NATIONAL FREIGHT CORPORATION: DENATIONALISATION

I now have the necessary powers in the new Transport Act and we need to decide on the next steps to be taken towards the privatisation of the National Freight Corporation.

It is, I believe, of particular importance that we should move as speedily as possible towards our objective in this particular case, not only to fulfil an explicit manifesto undertaking but also to establish that we mean business with the further privatisation proposals in the transport field which I shall be putting to Parliament next session. Indeed, I am already coming under a good deal of pressure from some of our supporters to move now that I have the necessary powers.

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During the passage of the Bill I made it clear that our intention was complete privatisation, and that if there was to be any residual shareholding by the Government it would be a small one. I said, following advice from Schroeders, that flotation would not be possible before 1981 at the earliest. I refused to be drawn on the question of likely proceeds, but given NFC's modest trading results, the need to make good their pension deficit out of the proceeds and the generally depressed state of the market, it is well understood that the next capital receipt to Government will be small - probably well under £10m.

As I see it, there are in practice only two realistic options: to do nothing until much nearer the time of flotation (ie probably the Spring of 1981, but possibly a good deal later); or to go ahead immediately with incorporation on a 100% equity capital structure, as I would strongly prefer. Such a course would, I believe, increase the chances of a successful flotation in due course (and ease the Company's cash position in the meantime). It would however have the immediate effect of reducing the flow of income to the Exchequer which would otherwise have been due in the form of interest payments. I should have to explain the financial consequences to Parliament.

I must add that, on Schroder's best estimate, the size of the proceeds would not be increased by the full amount of the likely interest which the Echequer would forego. They estimate that if incorporation takes place on 1 October, and

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flotation on 1 May 1981, the interest foregone would be some £6.3m, against a likely increase in the proceeds of sale of some £2-4m. But you will recognise that even a small increase in the proceeds would be crucial for success. If flotation were delayed beyond May 1981, the net loss would, of course, increase. (The next opportunity for flotation would be some six months later.) Nevertheless, I am firmly of the view that our overall policy objective of early flotation justifies accepting a loss.

Although the market outlook is not particularly encouraging Schrodgers are sticking to their view that a successful flotation in 1981 remains a real possibility. I believe that it would be right to back this view by taking the bolder of the two options and making an early change to Company status on a 100% equity structure. This would strengthen NFC financially and provide a period before flotation in which the new Board, their managers and work force can adjust to the new conditions, a point to which Schrodgers attach a good deal of importance.

A further important point is that it would show that we mean business, and would thereby have an invigorating effect on the morale of the Company. The Chairman tells me that, at all senior levels, the NFC is now poised to make the most of the new and wider commercial opportunities which they see coming from incorporation, and in particular from the clear removal of the statutory duty under the 1968 Act to attempt to promote an integrated transport policy, and the removal of doubts as to how far they can properly move into such more profitable fields as cold storage and the provision of ancillary services to the road haulage industry at large.

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There is a further important point which Schroders have been at pains to emphasise in their advice all along. In their view, the £9m a year which we are taking in fixed interest payments from the NFC is too big a drain on the undertaking. Their present assets and trading performance are not sufficient to support any more debt than they have already to leasing companies and to banks. During the run-up to flotation Schroders - as would I - would prefer to see this money used to strengthen the Corporation's cash position by reducing their indebtedness to the banks and leasing companies.

I know from your correspondence with Adam Butler that you are concerned about the problem of controlling a public sector company with 100% Government shareholding. Let me emphasise therefore that I envisage maintaining more or less the identical financial controls over borrowing and investment as we have at present. I would use these controls to ensure that NFC Ltd conformed with agreed external finance limits. In order to neutralise the effect on public expenditure, I would propose reducing these limits in recognition of the prospective loss in interest payments to the Exchequer. This would ensure that the money left in NFC would in fact increase their financial health, and hence saleability, by reducing their debt to leasing companies and banks. I see no difficulty at all about an amicable agreement with the NFC Board on this. The present Chairman and the Directors whom I would appoint to the new Company are already attuned to Treasury methods of control. The position of companies such as Rolls Royce that have been brought into the public sector in very different circumstances is not comparable.

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I have of course considered whether the new capital structure might initially consist largely of convertible loan-stock. In that way, we could maintain until flotation our interest payments at or about their present level. But the Corporation would not then get any financial benefit from the change of status. Indeed they might lose. Once the new Company is set up, I shall no longer have power to guarantee their borrowings. This would have an immediate, small, effect on their rate of borrowing, probably about half per cent, which could add about £150,000 per annum to their expenses.

Finally, I propose, in making a statement to the House explaining the development of our policy, to make it clear that the Company and the Government would work for the earliest possible flotation, but in the meantime the Government had deliberately decided to go for an all equity structure, despite the financial loss inherent in that decision, on the grounds that it would significantly contribute towards our main policy objective.

I hope you agree with this proposal, and that you will also agree that in order to make quick progress, I should make an announcement to the House before the Recess. I would envisage doing this by means of a written answer.

I should be grateful if, as a matter of urgency, our officials could proceed to work out the details on the following basis:

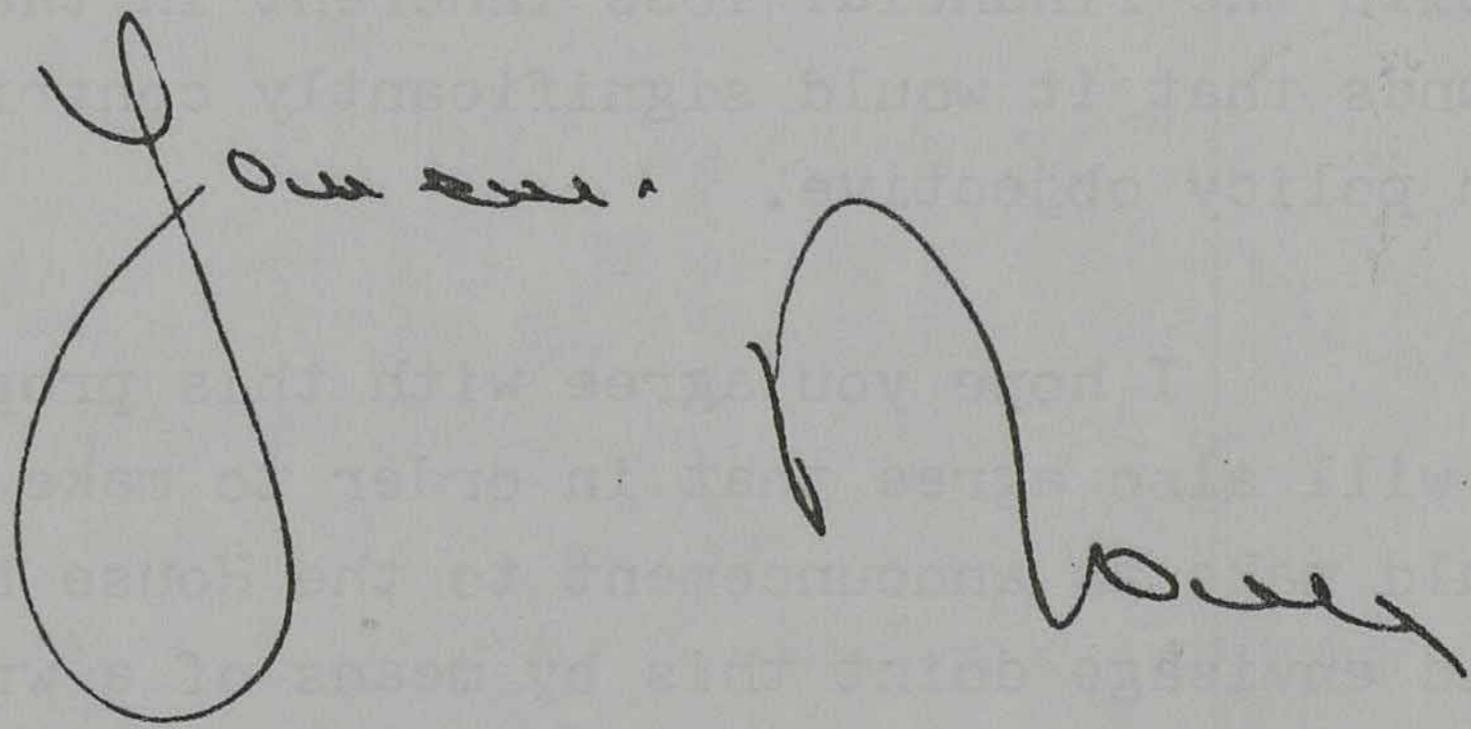
- i. The Corporation should be turned into a Company as soon as possible, on a wholly equity basis.

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- ii. Appointment should be made to the Board of the team most likely to carry conviction with the City at flotation, including the present Chief Executive, and several of the other members of his Executive Team.
- iii. I should make a statement to the House, making it clear that the Company and the Government would work for the earliest possible flotation but that in the meantime I had deliberately decided to go for an all equity structure, despite the financial cost to the Government.

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



NORMAN FOWLER

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24 JUL 1980