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PRIME MINISTER

Cable and Wireless
(E(81) 27 and E(DL)(81) 1)

BACKGROUND

The Secretary of State for Industry's memorandum (E(81) 27) is in response to your wish that the Committee should discuss whether the Government should sell just under 50 per cent of its shares in Cable and Wireless (C and W) - as agreed by the sub-committee on Disposal of Public Sector Assets on the basis of E(DL)(81) 1 - or more.

2. The present aim is to sell the shares on 21st October. The highly provisional estimate is that the yield might be in the order of £150 million; this would be a major contribution to the target of £500 million total cash disposals in 1981-82, which will be published in the Public Expenditure White Paper, and to the confidential target endorsed by E(DL) of £600 million plus.

3. 99 per cent of C and W's revenue comes from abroad, and about 66 per cent is from business subject to periodic "concessions" from overseas governments, with business in Hong Kong and Bahrain currently providing about 80 per cent of the company's profit. It is essential both to the proposed sale, and to the future of the company, that these concessions should not be broken off prematurely, and that the chances of negotiating their extension and maintaining other overseas business should not be prejudiced. The formula of 50 per cent less one share was based on E(DL)'s judgment that this was necessary to satisfy overseas governments that there would be a continuing close relationship between the Government and C and W, backed up by a degree of control which, in those governments' eyes, would be sufficient to protect their local interests.

Approximately 30 governments have now been consulted on the formula, and the Commonwealth Telecommunications Organisation and its members have been informed. The Secretary of State for Industry is firmly of the view that the decision of E(DL) should stand. He accepts privately, however, that there might be a further sale of shares at some later date, if this can be done without jeopardising the company's overseas operations.

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4. The E(DL) decision is open to the criticism that since the Government is explicitly giving up commercial control of the company - to ensure that it will score henceforth as part of the private sector - there could be a case of retaining only 25 per cent of the shares, that is sufficient to block changes in the Articles of Association. This could perhaps yield up to £75 million more to the disposals target in 1981-82.

5. On the other hand it is common ground that, if the possibilities of selling a higher proportion of shares were to be explored, the Government would have to consult overseas governments again. The objections to following this course are set out in paragraphs 4 - 10 of E(111)(81) 27. They are:-

- (i) the reactions of overseas governments are likely to "become more negative, the more our residual shareholding is diminished"; and in particular they would be sensitive about the possibility of substantial foreign shareholdings in C and W (paragraphs 5 and 6);
- (ii) the attempt could wreck the crucial current negotiations with the Hong Kong government on their concession which expires in 1987, and with the Bahrain government over their concession expiring in July 1982 - see paragraph 7, and for Hong Kong in particular the letter of 2nd March from Mr. David Young to Mr. Lankester annexed to E(111)(81) 27; *Flag C*
- (iii) the strongly held view of Mr. Eric Sharp, the Chairman of C and W (and formerly Chairman of Monsanto UK) and his Court of Directors is that in the first instance the Government should not sell more than half of its shares - see paragraph 8;
- (iv) the fear that the world-wide extension of C and W's new high speed digital network could be prejudiced - paragraph 9;
- (v) Kleinwort's advice that any blocking provisions in the Articles of Association, to provide for Government veto of decisions taken by the Court of C and W, would depress the value of the shares - paragraph 10;

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- (vi) Concern that if further consultations went badly wrong this could not only stop a sale this year but also depress the company's long term business prospects.

HANDLING

6. After the Secretary of State for Industry has introduced his paper, you will wish to hear, in particular, the views of the Foreign and Commonwealth Secretary on the likely consequences of further consultations with overseas governments and of the Chancellor of the Exchequer on the financial balance of advantage in going immediately for the sale of a higher proportion of shares. The Secretary of State for Defence also has a strong interest in the future of C and W, because they provide for transmission of military and classified traffic to Hong Kong and beyond, and because of their involvement in a contract for a communications system for the Saudi National Guard.

7. Granted that any change in the objective now would require further consultations with other governments, the main questions seem to be:-

- (i) How real is the risk that further consultations, which would not necessarily lead to the sale of a higher proportion of shares, would spark off reactions by overseas governments (and by Hong Kong and Bahrain in particular) damaging to the commercial prospects of the company and to the prospects of the sale?
- (ii) If it were accepted that consultations should be undertaken:
- (a) could the sale still be concluded in time for the proceeds to contribute to the disposals target for 1981-82?
- (b) should the aim be to retain only 25 per cent of the shares, or should the Secretary of State have flexibility on this?
- (c) to what extent might the prospective yield be abated by any delay and by the inclusion of blocking provisions in the Articles of Association?


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CONCLUSIONS

8. In the light of the discussion you will wish to record conclusions:-
- Either inviting the Secretary of State for Industry to arrange for further consultations with overseas governments with a view to selling a higher proportion of shares - stipulating whether the aim should be a sale of 75 per cent of the shares or giving him flexibility between 50 and 75 per cent in the light of his consultations;
- Or reaffirming the E(DL) decisions in favour of a sale of 50 per cent minus one share this autumn, on the understanding that steps to sell additional shares will be taken as soon as this can be arranged consistently with securing the future of C and W's overseas operations; and authorising the Minister of State, Department of Industry to make a statement, at a time to be agreed by the business managers, on the lines of the draft annexed to his Private Secretary's letter of 19th February to the Private Secretary to the Chancellor of the Duchy of Lancaster.



(Robert Armstrong)

4th March 1981