

*papers psl BF18*  
*4*

*Alex*  
*we are trying*  
*to fix this for*  
*Fri 20/4 m*

From : D L C Peretz  
Date : 13 April 1988

PS/CHANCELLOR

cc PS/Sir P Middleton  
Mr Scholar  
Miss O'Mara

*psp*

PERETZ  
PS/CH  
13/4

**COMMUNITY CHARGE AND THE RPI : INDEXED GILTS**

You will remember that the Chancellor asked us to get urgent legal advice on this from the Law Officers (Mr Allan's minute of 7 April).

2. The Attorney General has now confirmed that he wishes Treasury Counsel (John Mummery) to be consulted first. We are putting this in hand, as quickly as possible (Miss Wheldon is drafting instructions).

3. Perhaps you could take an opportunity to mention this on the 'phone to Mr Allan in Washington.

*DLCP*

D L C PERETZ



M.L. SAUNDERS  
LEGAL SECRETARY

LAW OFFICERS' DEPARTMENT  
ROYAL COURTS OF JUSTICE  
LONDON, WC2A 2LL

9 May 1988

Miss J L Wheldon  
Treasury Solicitor's Department  
Queen Anne's Chambers  
28 Broadway  
LONDON S W 1

*Jean Juhel,*

TREATMENT OF THE COMMUNITY CHARGE IN THE RPI - INDEXED GILTS

The Attorney General has considered the Instructions enclosed with your letter to me of 18 April. He has also seen the attached note of advice given by Treasury Counsel in Conference.

The Attorney has noted that Article 23 of the Prospectus posits a change in the "coverage" of the Index, not in the nature of the Index, or the nature of the coverage of the Index. If an item in the Index disappears, there is a sound argument that its disappearance does not constitute a change in the coverage of an Index that used to cover the expenditure it represented. Coverage can be exercised only over something that is there to be covered. The disappearance of something that used to be covered constitutes, following this argument, a change in the field available to be covered, not in the coverage.

*← Article 14 of current prospectus*

Nevertheless the Attorney has concluded that the courts are more likely to approach the interpretation of Article 23 by asking themselves what was the purpose of the insertion of Article 23 of the prospectus. It is very likely that the courts would determine that its aim was, inter alia, to protect the investor, whose interest lay in his proposed investment being protected against 'inflation', from the consequences of the disappearance from the RPI of an item as significant as rates. In that event they would consider its disappearance as falling clearly within the mischief of the provision.

The Attorney therefore agrees with the conclusions reached by Treasury Counsel.

Yours ever,  
P. Chad.

M L SAUNDERS

NOTE OF A CONFERENCE WITH MR JOHN MUMMERY

THURSDAY 28 APRIL 1988

Treatment of the Community Charge in the RPI - Indexed Gilts

Treasury Counsel advised that the questions submitted to him and to the Attorney General did not involve a consideration of the propriety of including or excluding the community charge in the calculation of the RPI. The answers to the questions turned solely on an interpretation of the terms of Article 23 of the Prospectus. That Article provided that "If any change should be made to the coverage or the basic calculation of the Index, which, in the opinion of the Bank of England, constitutes a fundamental change in the Index which would be materially detrimental to the interests of stockholders, H.M. Treasury will...". In the view of Treasury Counsel, the removal of rates from the Index (or rather their near removal), with or without their substitution by the community charge, would be regarded by the courts as a "change" to the "coverage" of the Index. Rates were separately identified as an item in Enclosure 2 to the Instructions. It would be extremely difficult to persuade any court that "coverage" did not mean the items listed in that document. Whilst there was a sound intellectual argument along the lines of paragraph 6 of the Instructions that the removal of rates from the list, on the ground that they no longer existed, would not change the basic "coverage" of the RPI, the courts would not be likely to accept it. The courts might well approach the matter by asking the question whether there had been any material detriment to the stockholders. If they concluded that there had been such detriment, it would be very difficult to persuade them, in the light of their likely view of the mischief of the Article, that there had been no relevant "change" in the coverage.

Counsel concluded therefore that Option C would involve a change in the coverage of the RPI and that it would trigger the option of redemption, if - as was probable - the Bank of England advised that there was a material detriment.

Option B would also trigger the gilts redemption provision, the detriment to stockholders having to be compared either with Option A or with a projected continuation of the status quo.

Option A would probably be held by the Bank not to be detrimental and therefore would not trigger the change. In this context, the courts would be very unlikely to accept an argument that, by virtue of the different nature of rates and the community charge, there had been two separate "changes", the first being the removal of rates, itself triggering the redemption provision, the second being the addition of the community charge.

Counsel also advised that it was unlikely that there could be a change in the coverage or calculation of the RPI which was materially detrimental to stockholders but not "fundamental" for the purposes of the redemption clause.

*Approved note drafted in conference*

*John Manning  
Jincoln*

*21<sup>st</sup> April 1982.*

9/5/88.

M-Peretz

CONFIDENTIAL



THE TREASURY SOLICITOR  
Queen Anne's Chambers  
28 Broadway London SW1H 9JS

Telephones DIRECT LINE 01-~~273~~ 210-3049  
SWITCHBOARD 01-273 3000  
Telex 917564 GTN 273

Please substitute the attached for page 3 of the Instructions "Treatment of the Community Charge in the RPI - Indexed Gilts". There is a small change at the end of paragraph 3.

With the Compliments of

*John Holden*

# CONFIDENTIAL

3. Referring to income tax and certain other payments that are excluded from the RPI the 1956 Advisory Committee (Paragraph 24 of Enclosure 5) said "most expenditure [of this type] is excluded from the weighting pattern because of the variable and non-measurable nature of the services acquired in return for the payments made and because of the difficulty or impossibility of identifying a "unit" the price of which could be measured from date to date (see para 7 of Enclosure 4)". It has in the past been suggested that rates should be excluded from the RPI (para 41 of Enclosure 5) as they are a form of local taxation, rather than a direct payment for services provided. It has been concluded however that as the taxation is on the occupation of property, it is appropriate to include it as a housing cost, just as other expenditure taxes are included as a cost of the product or service to which they relate. Rates are therefore included in the RPI as are VAT, excise duty, TV licences and vehicle excise duty (which, like rates, is separately listed in Enclosure 2) and the principle was reaffirmed in 1987.
4. The community charge is not related to the consumption of a specific service - unlike rates which are assessed on the rental value of a particular property - and it should, according to the principles outlined above, be excluded from the RPI. The Central Statistical Office are for the same reasons minded not to classify the community charge as a tax on expenditure, which is how they classify rates, and are considering drawing a new distinction in the national accounts between direct taxes, which will include the community charge, and indirect taxes, which would include rates (Enclosure 6).

4591 Rec. 4.5.88

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Not to be copied



M.L. SAUNDERS  
LEGAL SECRETARY

LAW OFFICERS' DEPARTMENT  
ROYAL COURTS OF JUSTICE  
LONDON, WC2A 2LL

9 May 1988

SAUNDERS  
WHELDON  
9/9

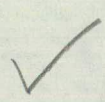
Miss J L Wheldon  
Treasury Solicitor's Department  
Queen Anne's Chambers  
28 Broadway  
LONDON S W 1

Jean Inheldt,

TREATMENT OF THE COMMUNITY CHARGE IN THE RPI - INDEXED GILTS

The Attorney General has considered the Instructions enclosed with your letter to me of 18 April. He has also seen the attached note of advice given by Treasury Counsel in Conference.

← Article 14 of current prospectus



The Attorney has noted that Article 23 of the Prospectus posits a change in the "coverage" of the Index, not in the nature of the Index, or the nature of the coverage of the Index. If an item in the Index disappears, there is a sound argument that its disappearance does not constitute a change in the coverage of an Index that used to cover the expenditure it represented. Coverage can be exercised only over something that is there to be covered. The disappearance of something that used to be covered constitutes, following this argument, a change in the field available to be covered, not in the coverage.

Nevertheless the Attorney has concluded that the courts are more likely to approach the interpretation of Article 23 by asking themselves what was the purpose of the insertion of Article 23 of the prospectus. It is very likely that the courts would determine that its aim was, inter alia, to protect the investor, whose interest lay in his proposed investment being protected against 'inflation', from the consequences of the disappearance from the RPI of an item as significant as rates. In that event they would consider its disappearance as falling clearly within the mischief of the provision.

7/16



The Attorney therefore agrees with the conclusions reached by Treasury Counsel.

Yours ever,  
P. Hood.

M L SAUNDERS

NOTE OF A CONFERENCE WITH MR JOHN MUMMERY

THURSDAY 28 APRIL 1988

Treatment of the Community Charge in the RPI - Indexed Gilts

Treasury Counsel advised that the questions submitted to him and to the Attorney General did not involve a consideration of the propriety of including or excluding the community charge in the calculation of the RPI. The answers to the questions turned solely on an interpretation of the terms of Article 23 of the Prospectus. That Article provided that "if any change should be made to the coverage or the basic calculation of the Index, which, in the opinion of the Bank of England, constitutes a fundamental change in the Index which would be materially detrimental to the interests of stockbrokers, H.M. Treasury will...". In the view of Treasury Counsel, the removal of rates from the Index (or rather their near removal), with or without their substitution by the community charge, would be regarded by the courts as a "change" to the "coverage" of the Index. Rates were separately identified as an item in Enclosure 2 to the Instructions. It would be extremely difficult to persuade any court that "coverage" did not mean the items listed in that document. Whilst there was a sound intellectual argument along the lines of paragraph 6 of the Instructions that the removal of rates from the list, on the ground that they no longer existed, would not change the basic "coverage" of the RPI, the courts would not be likely to accept it. The courts might well approach the matter by asking the question whether there had been any material detriment to the stockholders. If they concluded that there had been such detriment, it would be very difficult to persuade them, in the light of their likely view of the mischief of the Article, that there had been no relevant "change" in the coverage.

Counsel concluded therefore that Option C would involve a change in the coverage of the RPI and that it would trigger the option of redemption, if - as was probable - the Bank of England advised that there was a material detriment.

Option B would also trigger the gilts redemption provision, the detriment to stockholders having to be compared either with Option A or with a projected continuation of the status quo.

Option A would probably be held by the Bank not to be detrimental and therefore would not trigger the change. In this context, the courts would be very unlikely to accept an argument that, by virtue of the different nature of rates and the community charge, there had been two separate "changes", the first being the removal of rates, itself triggering the redemption provision, the second being the addition of the community charge.

Counsel also advised that it was unlikely that there could be a change in the coverage or calculation of the RPI which was materially detrimental to stockholders but not "fundamental" for the purposes of the redemption clause.

*Approved note drafted in accordance*

*John Munnery  
Lincoln Inn*

*21<sup>st</sup> April 1988.*

TENDERS MUST BE LODGED AT THE BANK OF ENGLAND, NEW ISSUES (Y), WATLING STREET, LONDON, EC4M 9AA NOT LATER THAN 10.00 A.M. ON THURSDAY, 5TH JANUARY 1984, OR AT ANY OF THE BRANCHES OF THE BANK OF ENGLAND OR AT THE GLASGOW AGENCY OF THE BANK OF ENGLAND NOT LATER THAN 3.30 P.M. ON WEDNESDAY, 4TH JANUARY 1984.

29/12/83

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ISSUE BY TENDER OF £300,000,000

## 2 per cent INDEX-LINKED TREASURY STOCK, 1990

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PAYABLE IN FULL WITH TENDER

INTEREST PAYABLE HALF-YEARLY ON 25TH JANUARY AND 25TH JULY

1. The Stock is an investment falling within Part II of the First Schedule to the Trustee Investments Act 1961. Application has been made to the Council of The Stock Exchange for the Stock to be admitted to the Official List.
2. THE GOVERNOR AND COMPANY OF THE BANK OF ENGLAND are authorised to receive tenders for the above Stock.
3. The principal of and interest on the Stock will be a charge on the National Loans Fund, with recourse to the Consolidated Fund of the United Kingdom.
4. The Stock will be registered at the Bank of England or at the Bank of Ireland, Belfast, and will be transferable, in multiples of one penny, by instrument in writing in accordance with the Stock Transfer Act 1963. Transfers will be free of stamp duty.
5. If not previously redeemed under the provisions of paragraph 14, the Stock will be repaid on 25th January 1990. The value of the principal on repayment will be related, subject to the terms of this prospectus, to the movement, during the life of the Stock, of the United Kingdom General Index of Retail Prices maintained by the Department of Employment, or any Index which may replace that Index for the purposes of this prospectus, such movement being indicated by the Index figure issued monthly and subsequently published in the London, Edinburgh and Belfast Gazettes.
6. For the purposes of this prospectus, the Index figure applicable to any month will be the Index figure issued seven months prior to the relevant month and relating to the month before that prior month; "month" means calendar month; and the Index ratio applicable to any month will be equal to the Index figure applicable to that month divided by the Index figure applicable to January 1984.
7. The amount due on repayment, per £100 nominal of Stock, will be £100 multiplied by the Index ratio applicable to the month in which repayment takes place. This amount, expressed in pounds sterling to four places of decimals rounded to the nearest figure below, will be announced by the Bank of England not later than the business day immediately preceding the date of the penultimate interest payment.
8. Interest will be payable half-yearly on 25th January and 25th July. Income tax will be deducted from payments of more than £5 per annum. Interest warrants will be transmitted by post.
9. The first interest payment will be made on 25th July 1984 at the rate of £1.1333 per £100 nominal of Stock.
10. Each subsequent half-yearly interest payment will be at a rate, per £100 nominal of Stock, of £1 multiplied by the Index ratio applicable to the month in which the payment falls due.
11. The rate of interest for each interest payment other than the first, expressed as a percentage in pounds sterling to four places of decimals rounded to the nearest figure below, will be announced by the Bank of England not later than the business day immediately preceding the date of the previous interest payment.

12. If the Index is revised to a new base after the Stock is issued, it will be necessary, for the purposes of the preceding paragraphs, to calculate and use a notional Index figure in substitution for the Index figure applicable to the month in which repayment takes place and/or an interest payment falls due ("the month of payment"). This notional Index figure will be calculated by multiplying the actual Index figure applicable to the month of payment by the Index figure on the old base for the month on which the revised Index is based and dividing the product by the new base figure for the same month. This procedure will be used for each occasion on which a revision is made during the life of the Stock.

13. If the Index is not published for a month for which it is relevant for the purposes of this prospectus, the Bank of England, after appropriate consultation with the relevant Government Department, will publish a substitute Index figure which shall be an estimate of the Index figure which would have been applicable to the month of payment, and such substitute Index figure shall be used for all purposes for which the actual Index figure would have been relevant. The calculation by the Bank of England of the amounts of principal and/or interest payable on the basis of a substitute Index figure shall be conclusive and binding upon all stockholders. No subsequent adjustment to such amounts will be made in the event of subsequent publication of the Index figure which would have been applicable to the month of payment.

14. If any change should be made to the coverage or the basic calculation of the Index which, in the opinion of the Bank of England, constitutes a fundamental change in the Index which would be materially detrimental to the interests of stockholders, Her Majesty's Treasury will publish a notice in the London, Edinburgh and Belfast Gazettes immediately following the announcement by the relevant Government Department of the change, informing stockholders and offering them the right to require Her Majesty's Treasury to redeem their stock. For the purposes of this paragraph, repayment to stockholders who exercise this right will be effected, on a date to be chosen by Her Majesty's Treasury, not later than seven months from the last month of publication of the old Index. The amount of principal due on repayment and of any interest which has accrued will be calculated on the basis of the Index ratio applicable to the month in which repayment takes place. A notice setting out the administrative arrangements will be sent to stockholders at their registered address by the Bank of England at the appropriate time.

15. Tenders must be lodged at the Bank of England, New Issues (Y), Watling Street, London, EC4M 9AA not later than 10.00 A.M. ON THURSDAY, 5TH JANUARY 1984, or at any of the Branches of the Bank of England or at the Glasgow Agency of the Bank of England not later than 3.30 P.M. ON WEDNESDAY, 4TH JANUARY 1984. Each tender must be for one amount and at one price which is a multiple of 25p. Tenders will not be revocable between 10.00 a.m. on Thursday, 5th January 1984 and 10.00 a.m. on Tuesday, 10th January 1984. TENDERS LODGED WITHOUT A PRICE BEING STATED WILL BE REJECTED.

16. Tenders must be accompanied by payment in full, i.e. the price tendered for every £100 of the nominal amount of Stock tendered for. A separate cheque must accompany each tender; cheques must be drawn on a bank in, and be payable in, the United Kingdom, the Channel Islands or the Isle of Man.

17. Tenders must be for a minimum of £100 nominal of Stock and for multiples of Stock as follows:—

<i>Amount of Stock tendered for</i>	<b>Multiple</b>
£100—£1,000	£100
£1,000—£3,000	£500
£3,000—£10,000	£1,000
£10,000—£50,000	£5,000
£50,000 or greater	£25,000

18. Her Majesty's Treasury reserve the right to reject any tender or part of any tender and may therefore allot to tenderers less than the full amount of the Stock. Tenders will be ranked in descending order of price and allotments will be made to tenderers whose tenders are at or above the lowest price at which Her Majesty's Treasury decide that any tender should be accepted (the allotment price). All allotments will be made at the allotment price: tenders which are accepted and which are made at prices above the allotment price will be allotted in full; tenders made at the allotment price may be allotted in full or in part only. Any balance of Stock not allotted to tenderers will be allotted at the allotment price to the Governor and Company of the Bank of England, Issue Department.

19. Letters of allotment in respect of Stock allotted, being the only form in which the Stock may be transferred prior to registration, will be despatched by post at the risk of the tenderer, but the despatch of any letter of allotment, and the refund of any excess amount paid, may at the discretion of the Bank of England be withheld until the tenderer's cheque has been paid. In the event of such withholding, the tenderer will be notified by letter by the Bank of England of the acceptance of his tender and of the amount of Stock allocated to him, subject in each case to payment of his cheque, but such notification will confer no right on the tenderer to transfer the Stock so allocated.

20. No allotment will be made for a less amount than £100 Stock. In the event of partial allotment, or of tenders at prices above the allotment price, the excess amount paid will, when refunded, be remitted by cheque despatched by post at the risk of the tenderer; if no allotment is made the amount paid with tender will be returned likewise. Non-payment on presentation of a cheque in respect of any Stock allotted will render the allotment of such Stock liable to cancellation. Interest at a rate equal to the London Inter-Bank Offered Rate for seven day deposits in sterling ("LIBOR") plus 1 per cent per annum may, however, be charged on the amount payable in respect of any allotment of Stock for which payment is accepted after the due date. Such rate will be determined by the Bank of England by reference to market quotations, on the due date for such payment, for LIBOR obtained from such source or sources as the Bank of England shall consider appropriate.

21. Letters of allotment may be split into denominations of multiples of £100 on written request received by the Bank of England, New Issues, Watling Street, London, EC4M 9AA, or by any of the Branches of the Bank of England, on any date not later than 9th February 1984. Such requests must be signed and must be accompanied by the letters of allotment. Letters of allotment, accompanied by a completed registration form, may be lodged for registration forthwith and in any case they must be lodged for registration not later than 13th February 1984.

22. Tender forms and copies of this prospectus may be obtained at the Bank of England, New Issues, Watling Street, London, EC4M 9AA, or at any of the Branches of the Bank of England, or at the Glasgow Agency of the Bank of England, 25 St. Vincent Place, Glasgow, G1 2EB; at the Bank of Ireland, Moyne Buildings, 1st Floor, 20 Callender Street, Belfast, BT1 5BN; at Mullens & Co., 15 Moorgate, London, EC2R 6AN; or at any office of The Stock Exchange in the United Kingdom.

BANK OF ENGLAND  
LONDON

29th December 1983

PERETZ  
CHEX  
11/5

From : D L C Peretz  
Date : 11 May 1988

CHANCELLOR

*"In the opinion of the AG"*  
*Reference of how to RPI Adv. Cttee*  
*? grant*  
*Coverage of*

cc Chief Secretary  
Sir P Middleton  
Mr Anson  
Sir T Burns  
Mr Scholar  
Mr Sedgwick  
Mr J Hibberd  
Miss O'Mara

Miss J Wheldon -  
Tsy. Sol.

**RPI AND THE COMMUNITY CHARGE : INDEX-LINKED GILTS**

A restricted meeting to discuss this is to be held tomorrow. I attach the Attorney General's advice. This is just about - though not quite - as unhelpful as it could be.

2. I am also attaching for reference a specimen index-linked gilt prospectus.

Treasury Counsel's Opinion and Attorney General's Advice

3. The question is whether or not the ending of rates, and their replacement by the Community Charge, creates a situation in which the redemption clause in the index-linked gilt prospectus is triggered because there is a change in "the coverage or basic calculation of the index which, in the opinion of the Bank of England, constitutes a fundamental change in the index which would be materially detrimental to the interests of stockholders". Treasury Counsel's opinion was that notwithstanding the intellectual arguments (which were put to him forcefully) :

(a) a court was likely to hold that removal of rates from the Index constitutes a change to the "coverage" of the index; and

(b) in any event, the court might well approach the matter back to front : first asking the question whether there

had been any material detriment to the stockholders (presumably as compared to the situation had rates continued), concluding that if there had been such detriment then there must have been a change in the coverage.

(a) if accepted would also, for example, imply that the clause might be triggered if some other item were to fall out of the index : for example if bank charges (a sub-item in calculation of the index) ceased to be levied. This possibility had never, hitherto, crossed our minds. Happily, the Attorney General does not accept (a), drawing a distinction between a change "in the field available to be covered" and in the "coverage". But he does think (b) is very likely. So we have no assurance of winning a case on this if it went to court : while what we were looking for was a fair degree of certainty of winning.

#### Possible courses of action

4. If we accept this advice we are left in the position where option A - putting the Community Charge into the RPI, despite the overwhelming intellectual case against - is the only one we could be sure would not trigger redemption of all outstanding index-linked stock. Putting the Community Charge into the RPI would clearly be a change both in its coverage and method of calculation. But the Bank of England should have no difficulty in concluding that the change would not be detrimental to the interests of stockholders.

5. This is extremely unsatisfactory. It suggests that in the index-linked prospectus we have constructed a machine for ensuring that changes to the RPI must always be such as to result if anything in a faster rate of growth in the index rather than a slower one.

6. We have therefore briefly considered other possible options :-



(a) we could redeem all the index-linked gilts outstanding. The prospectus requires us to make a redemption offer at the current redemption par value. If everyone accepted, the total amount involved is currently about £15½ billion. This is considerably in excess of the current market value of outstanding IGs, because without exception they stand below par. The difference between market value and current redemption value is around £2.9 billion, and this is probably the best measure of the "cost" of redeeming the stock and refinancing them. Indeed, since we think IGs are currently our cheapest form of financing, if the result of the operation were to destroy the IG market, and we had to refinance with conventionals, the cost would be rather larger than this. This is, of course, the capitalised value of the increase in debt servicing costs to HMG over the remaining life of the stock. The immediate impact on the PSBR would depend on the year by year increase in debt interest, which would depend on how we refinanced the IGs, but would be a much more modest annual amount.

| ( Apart from the cost, there would be some presentational  
 ) ( difficulty with this course. The Government would be  
 ) ( seen to be accepting that there was a change in the RPI;  
 ) ( that it was materially detrimental to stockholders; and  
 ) ( would be seen to be compensating holders of IGs - no  
 ) ( doubt leading to strong pressure to "compensate" others,  
 ) ( such as pensioners.

*Impossible*

(b) the prospectus may allow us to avoid redemption by asking the Bank to publish a different parallel RPI in future solely for the purpose of IGs. The prospectus refers to the RPI "or any index which may replace that index for the purposes of this prospectus". But we do not find this at all attractive. The Bank would not be able to calculate an index including rates, since they would no longer exist. If it published an index including the Community Charge then there would be

immense pressure to use this new index for benefit upratings, etc.

- (c) legislation retrospectively to change the prospectus and the rights of IG holders does not seem to be a runner. Apart from the usual objections to retrospection, we would be interfering with property rights and could be taken to the European Court.

*DL*

D L C PERETZ