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MR TURNBULL

8 June 1984

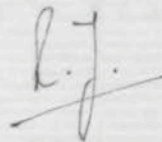
BRITISH AIRWAYS - EMPLOYEE SHARE SCHEMES

CF
By hand → We like Mr Ridley's proposals. (Contrast his crisp approach with that of DTI on Jaguar!)

We think it entirely right to support Mr Ridley's intention to reject the easing of restrictions which BA proposed for Schemes A, B and C. It is difficult to see what benefits BA's intended generosity would procure for the airline, but easy to see that costs would mount and arguments open up.

We strongly approve the idea that the Options Schemes should be put to the new shareholders for ratification.

One point which Mr Ridley does not deal with is whether we want to compel employees who take up free shares (Scheme B) to keep them for a minimum period. The free offer is not a large one per capita, but there could be some embarrassment if employees are seen to profit from the giveaway by selling their shares shortly after receiving them.



ROBERT YOUNG

JMGAAC



NBM

19/6

CCPO

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Nicholas Ridley MP
Secretary of State for Transport
2 Marsham Street
LONDON SW1P 3EB

15 June 1984

Ree N. d. d. d.

BRITISH AIRWAYS - EMPLOYEE SHARE SCHEMES

Thank you for your letter of 7 June.

I have carefully considered your proposals for free and matching offers of shares to BA employees but am bound to say they are too expensive both in absolute terms and also by comparison with the levels of inducements offered in other privatisations. I am afraid I cannot accept them.

I attach for comparison a table showing some of the relevant figures. You will see that your proposal involves a maximum matching offer over twice the size of anything offered before; that its total cost is likely to be substantially higher as a proportion of proceeds; that the maximum incentive is again over double the size of any previous maximum and the estimated cost per employee (based on the assumptions about take-up in your letter) is £650 by comparison with about £200 for the BT offer.

I recognise you feel constrained by what John Nott said in the House in July 1980. But the following considerations are relevant to how far, after such a long interval, those commitments should be updated:

- John Nott had in mind a sale of only 49 per cent of BA; moreover it has been general practice not to offer further employee share incentives for secondary sales such as those of Cable and Wireless and BP;
- John Nott estimated the total cost of his proposals in 1980 at £6 million;
- British Airways has since that time gone heavily into the red and has had to completely reorganise itself, we are now talking about a quite different sale;

- BA has introduced a generous profit sharing scheme (about which Nigel Lawson expressed reservations from the point of view of its likely impact on privatisation proceeds); under this scheme employees get 10 per cent of pre-tax profits above £150 million, which in 1984-85 should give them some £20 million (worth perhaps £80 million in share proceeds);
- all the pattern of precedents for actual privatisations since 1980 point to much lower incentives; to concede incentives as large as you propose now would undermine the offer being made on BT which has been reasonably well received by the BT unions, and considerably add to the cost of future sales after that.

For these reasons I believe that we must keep the estimated total cost and the cost per employee down to levels, which, in the light of the bonus scheme ought to be below those of previous sales. A total cost figure of the order of that envisaged by John Nott, ie £6 million, would be as much as I would feel was reasonable.

You will have your own views about the appropriate balance to be struck between the free and matching offers. One possibility would be to have only a matching offer on the grounds that the profit bonus scheme replaces the free offer. Allocations under the matching offer might too be limited to a maximum amount (say, £6 million) as they were for British Aerospace. Thus there would be scaling down of any applications by employees in excess of this amount. This would enable the matching offer to be more generous than otherwise while limiting the total cost. (Even so however I doubt whether it would be feasible to make an offer with a maximum as high as £1000).

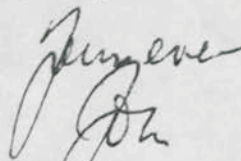
Turning, finally, to your other proposals. I have little difficulty with any of them. Specifically:

Preferential Allotment. I agree with the line you propose to take both on the 10 per cent Stock Exchange limit and on preference for pensioners;

Option Schemes. I agree that BA's proposal to encourage their employees to use their profit bonus to invest in BA shares is attractive. I strongly agree that it would be right for the company to wait until they have private shareholders before introducing their other proposed option schemes. This is very much the line taken on similar proposals in other privatisation. The prospectus can of course reflect the intention subject to shareholders' views.

I am sorry that this letter will not enable you immediately to conclude arrangements with Lord King and let him get ahead with the necessary changes to the profit sharing scheme. The main problem however stems from the statements made in 1980. I do not think we either can or should be bound by these. I hope therefore that you can reconsider your initial views on this matter.

I am sending a copy of this letter to the Prime Minister.

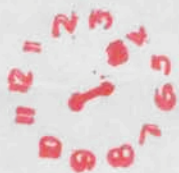


JOHN MOORE

Aerospace Pt 2

future of BA

18 JUN 1984



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	Free Offer	Maximum Matching Offer	Total Cost	Max Incentive P/employee	Actual Cost P/employee
Britoil	£58.5	£400 (1:1)	£0.49m	£458	£247
B. Aerospace	£49.5	£450 (1:1)	£6.54m	£499 (limit of £3.3m)	£ 99
ABP	£59.33	£252 (1:1)	£1.12m	£311	£126
B. Tel	£70	£200 (2:1)	£45m (est)	£470	£196 (est)
EA proposal	£50	£1000 (1:1)	£22.75m (est)	£1050	£650 (est)



BF with Treasury
response ref 7/10

CC NO.

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AG

7 June 1984

Dear Nigel

BRITISH AIRWAYS - EMPLOYEE SHARE SCHEMES

When I made my statement in the House last December about the privatisation of British Airways I confirmed that in line with other privatisations there would be a share scheme for employees. The intention to encourage BA employees to acquire shares had been announced on behalf of the Government in July 1980 by John Nott; I attach the relevant Hansard extract. British Airways are anxious to agree details of their employee share schemes and have submitted proposals to me (details of which are already with your officials); I would like to give BA a prompt response.

GENERAL CONSIDERATIONS

Several of the proposals will involve the Government sacrificing some of the proceeds of the sale. We have therefore to weigh the likely cost of the various items (which cannot be estimated precisely because it depends

on how fully the offers are taken up by employees) against the benefits of employee involvement - which are primarily to give employees a greater incentive to work for the company's long-term future, to reassure other investors by a sizeable employee shareholding, and to establish a body of employees who, with a financial interest in the company, would be less likely to support renationalization if the prospect ever arose. Of course, the more money employees are willing to invest the less we shall have to raise from elsewhere. We also have to honour the commitments made in 1980.

THE PROPOSALS

BA's proposals contain the following elements:-

- A. An offer of free shares to match those purchased by employees.
- B. An unconditional offer of free shares to each employee.
- C. An allotment of shares for the purchase of which employees' applications would take precedence over those from other members of the public ("preferential allocation").
- D. Certain share option schemes.

Our main concern is with A and B above, as these are the elements that will cost the Government money; for C and D our interest is simply that of vendors of the company, in ensuring that what is proposed will not impair the success or the issue or our expectation of proceeds.

I set out below under the above headings how I think we should proceed:

A. The Matching Offer

BA propose that employees be offered one free share for each one they buy, up to a limit of £1,000, so that an employee can buy £2,000 worth of shares for an outlay of £1,000 without being taxed on the free ones; they also propose that any free shares not taken up by eligible employees should be available to other employees up to a further £1,000 each.

From the experience of similar matching offers made in other privatisations, it seems prudent to assume that about 60% of BA's workforce might qualify for up to £1,000 worth of shares. If they all drew the maximum entitlement (which I think is inherently unlikely) that would cost about £21m. At the limit, if every employee bought £1,000 worth, the cost of matching would be £35m but it would be unrealistic to expect that degree of demand. The £1,000 maximum is higher than in other privatisations hitherto. It was however included without qualification in John Nott's announcement in 1980, and I do not think we could offer something less generous now, when the proceeds of the sale are expected to be substantially higher and the number of employees in BA is substantially reduced. That would be seen by BA, its staff, and the public at large as a breach of faith. At the level of takeup which now seems likely it would represent less than 3% of likely gross proceeds - a smaller percentage of proceeds than the 1980 offer was expected to use up

when the announcement was made. However, since the £1,000 is generous compared with other privatisations, I am not disposed to extend the limit in the way that BA suggest by allowing the transfer of unused allocations to other employees.

B. The Free Offer

BA propose that each employee should be offered (without preconditions as to purchase etc) £100 worth of free shares - an offer that, if taken up by all eligible employees, would cost about £3½m. In 1980 John Nott in his announcement promised an offer of "about £50 worth" of shares to each employee. More recently Associated British Ports' employees were offered £60 of free shares each; and BT employees are to be offered £70. There is no precedent for an offer of as much as £100.

Although a case could be made out for offering BA employees the same as employees at ABP or even BT, I am not myself persuaded that we need increase the £50 offer John Nott announced in 1980 (costing about £1¾m).

C. Preferential Allotment

A Stock Exchange rule restricts the number of shares allotted by priority to employees to 10% of the total number of shares offered for sale. BA propose seeking a dispensation from this restriction.

In 1980 John Nott announced that employees would have priority in the allocation of shares during the offer for sale, and I am sure that this is right. Such an arrangement is quite normal in offers for sale generally, and it would cause great surprise if one were not included for BA. However, I am not persuaded of the case for a waiver of the Stock Exchange's 10% limit; my merchant bank advisers, Hill Samuel, are examining the case for this, and I propose to await their advice before deciding whether to support BA here.

I am also being asked whether I would agree to extend the preferential allotment to BA pensioners. My present inclination is to resist this: the main reasons for a preferential allotment apply to present employees rather than pensioners; and though I hope many BA pensioners will invest in BA shares, I cannot see any justification for treating them differently from other members of the public.

D. The Option Schemes

BA have proposed three option schemes: a profit sharing scheme, a Save As You Earn scheme, and an executive option scheme.

For the profit sharing scheme BA want to change their two-year cash profit sharing scheme, announced last November, so that employees can take their bonus tax-free in shares rather than in cash subject to tax. The first bonus due next month would, for those who chose, be paid into a trust and earn interest until

it was used to buy shares in the offer for sale. The shares would then have to be held in trust for them in accordance with the Finance Act provisions. There would be no cost to Government, as the shares would be paid for. For my part I see no reason to object to this proposal. It is of course subject to Inland Revenue approval, and this is already being sought.

Similarly the other two proposed option schemes would be subject to Inland Revenue rules, and apart from that I regard them as primarily a matter for the company. However, I believe that it would be desirable to defer their introduction until the detailed proposals can be approved by the shareholders after privatisation. The intention to introduce them would, of course, have to be explained in the prospectus.

RESPONSE TO BA

I am therefore minded to respond to BA proposals in the following way:-

A. The Government adheres to the £1,000 matching offer for BA employees which it announced in July 1980, but rejects the proposal to extend the offer to allow the transfer of rights from one employee to another.

B. We reject BA's proposal for a £100 free share handout to each employee and stick to the £50 announced in 1980.

C. We approve the proposal for preferential allotment to BA employees (but not to pensioners); but we do not commit ourselves to support BA in seeking a relaxation of the Stock Exchange's 10% limit pending Hill Samuel's advice.

D. We support the modification of the current profit sharing scheme to allow employees to elect to invest their bonuses tax-free in BA shares when available. We also approve in principle the BA scheme for Save As You Earn and executive options, but ask BA to submit them first to their shareholders for ratification after privatisation.

Lord King is pressing me for an early restatement of the Government's position, particularly on A above - the matching shares - because he wants to encourage employees to commit their 1983/84 bonus money, due to be paid later this month, to the purchase of shares rather than take it in cash. This is an aim that I am sure we should support, and I therefore hope that you will be able to give your early agreement to the response to BA that I have proposed above. We have in fact just heard from BA that they must have a decision by 15 June in order to make the necessary arrangements for BA staff to take their bonus in shares.

I am sending a copy of this letter to the Prime Minister.

Tomson
Nicholas

NICHOLAS RIDLEY

[Mr. Nott.]

Although part I of the Bill contains the legislative framework for the change of status to a company on an appointed day, we intend to retain complete flexibility about the timing of the sale of shares.

The international civil aviation market is at present going through a difficult time, due largely to the rapid increase in fuel prices over the last year or so, together with some falling off in demand for air travel. British Airways has not escaped these problems, and the results for 1979-80, which will be announced shortly, will fall considerably below what the board had earlier expected. British Airways continues to face problems in the current year and, as the House will know, the board has developed a plan of action to maximise profits and maintain its competitive position.

The industry faced similar problems before in the mid-1970s, and British Airways showed its ability to recover then. In the past few years, airline traffic has grown at an average of 8 per cent. per annum, and I do not believe that the present difficulties will be long-lived. I am confident that when the market does recover British Airways has the right plans and the right policies to continue to operate profitably and to achieve a successful flotation. The earliest possible date for such a flotation would be the summer of 1981. However, I emphasise again that it is too early to take any decisions. We have no commitment to any particular date, and we shall continue to preserve flexibility on this issue.

Throughout the debates on the Bill, my hon. Friends and the official Opposition have rightly raised many points about the interests of the employees, and in particular about employee shareholding. In my statement on 20 July last year I said:

"special arrangements will be made to enable employees of British Airways to take up shares in the enterprise should they wish to participate in its future and share in its growth."
—[Official Report, 20 July 1979; Vol. 970, c. 2183.]

That is our intention. We believe that the employees should be given the opportunity to acquire a more tangible stake in the company and should be able to do so on favourable terms. We are working out four ways of making employees into shareholders. The principal

offer that we would like to make to the employees of British Airways is to make "two shares for the price of one" available on the same lines as the recent BF offer. The idea is that for every share that an employee is willing to buy at the ordinary offer price, another share will be given to him free, provided the both shares are held by trustees. The value of the free share will then not be subject to income tax. Under the new concessions in clause 46 of the Finance Bill the shares need be held by the trustees only for a minimum period of two years instead of five years under the Finance Act 1978. If the employee decides to withdraw his shares from the trustees and sell them during the next five years, the tax concession is wholly or partially withdrawn.

The Finance Bill also raises the maximum value of shares which can be given to an employee in any one year from £500 to £1,000. I hope that a large number of British Airways employees with more than a qualifying period of service will take advantage of the bargain offer—which could entitle them to a substantial investment of up to £2,000 at about half the offer price to outside shareholders, and with considerable tax advantages in train.

Mr. John Smith (Lanarkshire, North): Perhaps the Secretary of State will be good enough to explain why this announcement, which appears to me to be quite a new matter, was not announced earlier by the Government so that it could have been considered in detail and with care by hon. Members, sitting both as a House and in Committee. It is extremely odd that the Government should produce a new statement at the last gasp of consideration in the House of Commons. I submit that this is not a proper way to treat Parliament.

Mr. Nott: I do not think that that is correct. When the proposals for British Airways employee shareholding were discussed in Committee my hon. Friend the Under-Secretary of State said that the development of our ideas must wait until we saw what my right hon. learned Friend the Chancellor presented in his Budget. We now know that he made two valuable tax concessions available in the Budget to encourage growth of employee shareholdings in general. I thought that it was appropriate to

notice now of this to be help sure why the rig consider it unb news to the Ho slightly lost.

Mr. Smith: obviously does am driving at, responsibility c what the Gove fleeting appear of the various s bon. Gentleman we have spent t sing the matter ounced. In a Secretary of Sta to answer a wr be likes. The this forward at tion in the Ho respect, I believ

Mr. Nott: I c any obligation of what the s might be in th merely thought to the House i right hon. Gen ment on Repe trying to help by giving notice earliest can co the summer of think that he about.

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Finally, we v a free offer of ployees, whethe eracy or not, of shares per figures and det be worked out pectus, when w

notice now of our intentions. I intended this to be helpful, and I am not quite sure why the right hon. Gentleman should consider it unhelpful to give favourable news to the House. I am sorry, but I am slightly lost.

Mr. Smith: The right hon. Gentleman obviously does not understand what I am driving at, which is that it is the responsibility of Parliament to consider what the Government say. Despite his fleeting appearances during discussion of the various stages of this Bill, the right hon. Gentleman knows perfectly well that we have spent two days on Report discussing the matter since the Budget was announced. In addition, it is open to the Secretary of State to make a statement, or to answer a written question, at any time he likes. The truth is that he has put this forward at the last gasp of consideration in the House of Commons. With respect, I believe that to be wrong.

Mr. Nott: I do not think that there was any obligation to put forward the details of what the share offers to employees might be in the event of a flotation. I merely thought that it would be helpful to the House if I did so now. Had the right hon. Gentleman tabled an amendment on Report—[*Interruption.*] I am trying to help the right hon. Gentleman by giving notice of something which at the earliest can conceivably happen only in the summer of 1981. Therefore, I do not think that he has anything to complain about.

Secondly, the Finance Bill contains provisions for savings-related share option schemes in clause 47 and schedule 10. We are working on an offer which will take advantage of these provisions.

Thirdly, we would intend to have a system of priority allotment for as many shares as any employees care to subscribe for at the full price, although we would caution employees not to commit too great a proportion of their savings to any one investment.

Finally, we would propose also to make a free offer of shares to all eligible employees, whether they subscribe their own money or not, of up to about £50 worth of shares per employee. Naturally, the figures and details for all these offers can be worked out precisely only in the prospectus, when we know the price at which

the shares will be sold and the full financial facts.

All these proposals are within the responsibility of the Government, as the seller of the shares initially, but I am glad to inform the House that British Airways itself intends to work out an employee share ownership and profit sharing scheme for the successor company. This will mean that employees with 10, 20 or more years' service will build up quite a large shareholding in the company.

I hope that the House will feel that I have given enough detail at this stage to make it quite clear that we mean business, and that we intend to play our part in helping the employees of British Airways to identify themselves with the airline's fortunes. After all, British Airways is nothing if it is not about those who work in the airline, from the chairman to the youngest stewardess or most junior clerk.

There are still details to be settled, such as the qualifying period of service and whether there should be an upper ceiling on the total percentage of the shares which might be in the hands of employees, on which we are still happy to receive the views of the staff representatives. I would also be happy, as I have been throughout the progress of the Bill, to discuss this or any other matter with the British Airways trade unions. If they wish to change their position and offer their advice, we shall be glad to receive it and consider it.

~~**Mr. Clinton Davis (Hackney, Central):**~~

~~From the discussions that he has had with the interested parties, has the right hon. Gentleman been able to form an approximate judgment—I cannot ask for more than that—as to the proportion of the shares that are likely to be acquired by or on behalf of the employees?~~

~~**Mr. Nott:** It is impossible to judge that at this stage. We do not know what the profits of British Airways will be at the time. At present, we do not know the timing of the share issue. As I said, we want to keep this flexible. We do not yet know what the price may be. Those are all factors which would be relevant to a decision by the employees as to whether they might wish to put a small proportion of their savings into the airline. I cannot answer the hon. Gentleman's question at this stage. It is simply not~~