

SECRET

Copy no 2 of 3



Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY

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30 April 1984

SECRET AND PERSONAL

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

D. Nigel.

BRITISH TELECOM - RPI-X

The Board of British Telecom discussed yesterday our proposals for BT's capital structure and the RPI-X formula. I enclose a copy of the letter that Sir George Jefferson sent to me after that board meeting. (I must emphasize that I have given an undertaking to Sir George that only three copies of this letter will be made - one which Sir George is retaining in his safe, the copy which I now enclose and the copy which I am sending to 10 Downing Street. I have promised Sir George that my Private Office will retain the original and I must ask you to do the same).

2 You will see that the BT Board has concluded that it can live with our proposals. This is welcome. But it is clear from Sir George's letter that we have not obtained BT's wholehearted support: this could have implications for the flotation. Nor is BT prepared to provide the assurance in respect of residential rentals that we would have found politically attractive. I regard both developments as unfortunate. I appreciate that you felt unable to agree to my proposal that we should reduce the formula to RPI-2 if inflation fell to 3 per cent or less. I remain of the view that a relatively minor concession of this kind would have secured BT's full commitment to the package.

3 Sir George Jefferson suggests that we should carry out informal discussions among institutions about our proposals. I see no advantage in this. I propose instead announcing the principles of our decisions on capital structure, RPI-X, the subscriber voucher scheme, and employee incentives by means of an oral statement in the House of Commons next Wednesday, 2 May. I am enclosing a draft

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SECRET AND PERSONAL

of a statement on which I should be grateful for early comments. I shall also be consulting Sir George Jefferson on the terms of the announcement.

4 I am copying this minute, and the attachments, to the Prime Minister.

A handwritten signature in black ink, appearing to read 'Norman Tebbit', with a large flourish above the name.

NORMAN TEBBIT

Encls

JH2AFP

DRAFT STATEMENT ON BT PRIVATISATION

With permission, Mr Speaker, I should like to make a statement about the privatisation of British Telecom.

The Government intend that the BT flotation should provide an opportunity to promote wider share ownership by both the public and employees of the company.

Employees who work at least 16 hours per week for BT and who have been in continuous employment with BT from 2 April 1984 until a date shortly before the flotation will benefit from a special scheme.

They will be offered about £70 worth of free shares paid for by the Government. For every share purchased by the employee, the Government will provide a further two free shares, up to a maximum of £200 of free shares for £100 of purchased shares. Employees will therefore have the opportunity to acquire about £370 worth of shares for an investment of about £100. As in past sales, these shares will have to be vested in a trust for a minimum of two years.

In addition, a discount of 10 per cent off the public offer price will be offered to all employees at the time of

flotation on purchases of up to £2000 worth of shares, provided that they are held for a specified period.

Both BT employees and those in receipt of a BT Staff Superannuation Scheme pension at the time of the flotation will be given priority allotment rights when applying for shares.

Second, there will be a special offer to telephone subscribers in the form of vouchers which can be used to offset part of the cost of their quarterly telephone bills for a subsequent period. The details of this offer will be announced closer to the flotation.

As a result of these measures we are confident that very many of BT's employees and customers will become shareholders in BT plc.

I turn now to the broad outlines of the capital structure with which BT plc will enter the private sector. We have concluded that the initial debt of the company to the Government in the form of debentures should have a capital value of £2,750m, carrying interest at between 12 1/4% and 12 3/4%. An order under Section 62 of the Telecommunications Act 1984 effecting the replacement of BT's present debt will be laid before Parliament in due course. The Government will assign sufficient of these debentures to the residual statutory corporation to enable

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it to meet the deed of covenant obligation to BT and the Post Office Staff Superannuation Schemes, as required by the Telecommunications Act 1984.

BT plc will also issue to the Government preference shares to the value of £750m. These preference shares carrying a gross dividend of 11.75% will be non-voting and redeemable at BT's option, or in any case after 30-35 years. Apart from BT's continuing foreign and short-term borrowing, the remainder of the company's assets will be financed by ordinary shares and reserves.

Turning to BT's future operating environment - we announced last year that the tariff increases on some of BT's services should be kept below the rate of inflation. We have now concluded that the services concerned will include local calls, business and residential rentals and trunk calls. The constraint will apply to a weighted average of these services. Its level will be RPI-3, that is 3% points less than the increase in retail prices generally over the preceding year. We are satisfied that this will reassure BT's customers and ensure real pressure for efficiency - whilst allowing BT to adjust tariffs on these services to reflect market demands. [To protect low users BT has given an undertaking that the residential rental charge will be

BT are still resisting a
commitment to the low user rental
scheme. If agreement is not reached
tomorrow, this sentence will be
dropped.

kept as low as possible; ~~and~~ will in any case not exceed
RPI+2 in any year; and that a low-user rental rebate scheme
will be maintained.]

Details of the operation of the RPI-X provision will be set
out in the BT licence which will be laid before Parliament
soon.



S Ale Mb

10 DOWNING STREET

From the Private Secretary

1 May 1984

BRITISH TELECOM: RPI-X

The Prime Minister has seen your Secretary of State's letter to the Chancellor of 30 April, together with the letter from Sir George Jefferson of 25 April and the draft of the statement which your Secretary of State wishes to make. Subject to any points which the Chancellor may raise, she is content with the proposals and with the statement which is to be made on Wednesday.

I am copying this letter to David Peretz (H.M. Treasury).

ANDREW TURNBULL

Callum McCarthy, Esq.,
Department of Trade and Industry.



10 DOWNING STREET

Prime Minister ①

Mr Tebbit wishes to make a
statement on Monday. I
believe the Treasury are
content as are Policy
Unit.

Content?

AT

30/4

PS. I can understand
why Sir George Jefferson
does not want his
wingeing letter to be
made public.

MT MS



from the Chairman
Sir George Jefferson CBE

British Telecommunications

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IN STRICTEST CONFIDENCE

The Rt Hon Norman Tebbit MP
Secretary of State for Trade & Industry
Department of Trade & Industry
1 Victoria Street
LONDON
SW1H 0ET

25 April 1984

Dear Norman,

"RPI-x" AND CAPITAL STRUCTURE

As you know, I put the position we have reached in our negotiations on these issues to our Board this morning. The Board were conscious that the four issues of "RPI-x", the capital structure, dividend policy and the regulatory regime all interact and that they all need to be considered as a whole.

The Board's concern is, of course, to establish a satisfactory basis both for the flotation of BT and for its future existence as a robust private sector company, while at the same time recognising that those customers whose network services will not be subject to significant competition in the next few years will need reasonable reassurance on our pricing strategy.

Having considered the present proposals, the Board remains most concerned at the lack of flexibility in managing the business, as well as the potential impact on the marketability of the shares.

In particular, on "RPI-3" the Board has asked me to emphasise the downside risks to the company in respect of income and expenditure over the five year period and the potential adverse consequences on cash flow for our modernisation programme and the development of new ventures. Any radical reassessment of our modernisation programme would have, quite apart from the implications for our customers, serious consequences for our supply industry. The risks arise from the very high element of fixed costs and the serious problem in the short term of being able to cut costs to match a shortfall on call income, which as you know is largely dependent on the general level of economic activity.

Furthermore the Board's own belief, reflecting the advice of its advisers and brokers, is that a figure of x greater than 2 will be a significant factor in the market's perception of the acceptability of this issue, and is at best likely to require a significantly higher yield than would otherwise be the case and could affect the ability to achieve a satisfactory take up.

The Board

The Board, therefore, very much doubts the wisdom of the proposed RPI-3, and feels that the Government should give serious further consideration to these points. At the very minimum it feels you should follow the suggestion, which I have already made to Kenneth Baker, that further soundings should be made in the financial markets before any announcement or irrevocable decision is made.

On the supplementary assurance you sought on residential rentals, the Board fully recognises the political and consumer difficulties. Nevertheless, it is concerned about the restraint which a ceiling of RPI+1 on our residential rentals would place on our ability to rebalance our tariffs during the five year period, given the failure of residential rentals to cover marginal costs, let alone make an adequate return, and the difficulties likely to be faced by BT if it is forced to maintain markedly unbalanced tariffs in a competitive environment. The Board therefore concluded that it would prefer a ceiling of RPI+2 with the assurance itself expressed in terms of the Board's intention.

Given the Government's determination to reduce still further the rate of inflation, should you decide to proceed on the basis of RPI-3, the Board feels that the change to RPI-2, if inflation were to fall to 3% or less, is an important safeguard and would be of some reassurance to the market.

Furthermore, the Board has also asked me to make clear that with RPI-3 it would not be prepared to agree a higher opening dividend than that currently assumed, since it is already concerned about the cash flow implications of price constraint and would not be prepared to contemplate a further cash drain through increased dividends. Clearly this could have significant implications on the issue price.

As I said at the outset the capital structure, dividend policy RPI-x and competition policy issues all need to be seen together and the Board is concerned in particular that there should be a mutually satisfactory solution to the competition issues, set out in my letter of 13 April to Kenneth Baker.

In conclusion the Board has asked me to restate its view that it would be more appropriate to proceed on RPI-2 rather than on RPI-3 and feels that the Government should give serious and urgent consideration to this point for the reasons stated, before finalising its position.

However should the Government having weighed all the factors conclude that it can only proceed on the basis of RPI-3, and that it can successfully launch the company on that basis, the Board would be prepared, subject to an acceptable resolution of all outstanding issues, to give its support to the Governments plans.

Yours sincerely

George Jefferson
SIR GEORGE JEFFERSON



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PS/
Secretary of State for Trade and Industry

1 May 1984

Margaret O'Mara
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Dear Margaret,

BT : ANNOUNCEMENT ON 2 MAY

attached

Following my Secretary of State's letter of 30 April and the Chancellor's letter of 1 May to my Secretary of State, I now enclose the agreed text of the Statement which my Secretary of State proposes to make to the House tomorrow, 2 May immediately following this Department's PQ's. *attached*

2 The announcement will also be made in the House of Lords by Lord Cockfield.

3 I am copying this letter and the enclosure to Andrew Turnbull (No 10), Janet Lewis-Jones (Lord President's Office), Charles Marshall (Lord Privy Seal's Office), Alex Galloway (Chancellor of the Duchy's Office) and Murdo Maclean (Chief Whip's Office), and to Richard Hatfield (Cabinet Office).

Yours ever,

Andrew Lansley

ANDREW D LANSLEY
Private Secretary

Enc

JH1A00

MASTER

STATEMENT ON BT PRIVATISATION

With permission, Mr Speaker, I should like to make a statement about privatisation of British Telecom.

2 As the House will know, it is the Government's intention to sell a majority interest of the ordinary voting shares of British Telecom.

3 I wish now to set out the broad outlines of the capital structure with which BT plc will enter the private sector. We have concluded that the initial debt of the company to the Government should be in the form of debentures with a capital value of £2750m, carrying interest at between 12 $\frac{1}{4}$ % and 12 $\frac{3}{4}$ %. The Government will assign sufficient of these debentures to the residual statutory corporation to enable it to meet the deed of covenant obligation to the BT and Post Office Staff Superannuation Schemes as required by the Telecommunications Act 1984.

4 BT plc will also issue to the Government preference shares to the value of £750m. These preference shares carrying a gross dividend of 11 $\frac{3}{4}$ % will be non-voting and redeemable at BT's option or in any case after 30-35 years. Apart from BT's continuing overseas and short-term borrowing, the remainder of the company's assets will be financed by ordinary shares and reserves.

5 Turning to BT's future operating environment - we announced last year that the tariff increases on some of BT's services should be kept below the rate of inflation. We have now concluded that the services concerned will include local calls, business and residential rentals and trunk calls. The constraint will apply for five years to a weighted average of these services. Its level will be RPI minus 3, that is 3 percentage points less than the increase in retail prices generally over the

preceding year. We are satisfied that this will reassure BT's customers - while allowing BT to adjust tariffs on these services to reflect market demands. The Board of BT has given the Government an assurance that BT plc intends during the same period that the level of its residential rental charges will be held within a ceiling of 2% over RPI; and that they further intend during that period to continue to give rebates to low users, broadly comparable in overall financial effect to the present scheme.

6 Details of the operation of the RPI minus X provision will be set out in the BT licence which will be laid before Parliament soon.

7 The Government intends that the BT flotation should provide an opportunity to encourage wider share ownership by both the public and employees of the company.

8 Employees who work at least 16 hours per week for BT and who have been in continuous employment with BT from 2 April 1984 until a date shortly before the flotation will benefit from a special scheme.

9 They will be offered about £70-worth of free shares and, for every share purchased by the employee, the Government will provide a further two free shares, up to a maximum of £200 of free shares for £100 of purchased shares. Employees will therefore have the opportunity to acquire about £370-worth of shares for an investment of about £100. As in past sales, these shares will have to be vested in a trust for a minimum of two years.

10 In addition, a discount of 10% off the public offer price will be offered to all employees at the time of flotation on purchases of up to £2,000-worth of shares, provided that they are held for a specified period.

11 Further, we have decided to offer special incentives to telephone subscribers. One possibility would take the form of vouchers which could be used to offset part of the cost of quarterly telephone bills for a subsequent period. Details will be announced closer to the flotation.

12 As a result of these measures we are confident that very many of BT's employees and customers will become shareholders in BT plc. The financial framework for BT plc is now set and work on the flotation is on schedule for a late autumn launch.