318.34

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

BRITISH TELECOM FLOTATION - EXECUTIVE AND EMPLOYEE SHARE OPTION SCHEMES

As you will have seen from Geoffrey Pattie's letter of 19 October to John Moore, the BT Board are keen that an executive share option scheme should be put in place before the BT flotation. We resisted such schemes in previous privatisations until the BL Board, against our better judgement, committed us to introducing one for Jaguar. Permitting something similar for BT will make it impossible to resist the introduction of these schemes in future privatisations and you will therefore want to be aware of the implications before any decision is taken to proceed in the case of BT.

2. Generally, we wish to encourage share option schemes and the last Budget enhanced their attractiveness. Coupling them with privatisation does, however, carry the risk of criticism that the Government is placing large potential benefits in the hands of a small number of senior executives. Because of this, we have hitherto maintained that such schemes may be trailed in the prospectus but should not be implemented until approved by the privatised company's new shareholders.

3. In the case of BT, we are advised that having share option schemes in place at the point of privatisation would help the flotation and should mean

that the taxpayer secures a better price for the shares. It is clearly of the first importance that the BT flotation is a success and I have therefore weighed this factor against the possible disadvantages. Bearing in mind that the Jaguar decision did not in the event give rise to criticism, I consider that on balance we should allow BT to adopt an executive share option scheme prior to privatisation, provided that the following conditions are observed:

(i)there should also be an employee-share scheme for BT employees generally;

(ii)options should not be granted at the offer price but at some subsequent date reasonably distanced from the flotation. A price averaged over some days' trading might be preferable;

(iii)Inland Revenue and IPC guidelines must be followed in full and the schemes should not be seen to be unusually generous.

4. I accept that in practice this means that all future privatisations, including BA, are likely to include similar schemes.

5. I am sending a copy of this minute to Peter Walker, Nicholas Ridley and Geoffrey Pattie and to Sir Robert Armstrong.

Margaret O'Mara

N.L.

22 October 1984

(approved by the Chancellor and signed in his absence)

COMMERCIAL IN CONFIDENCE

Pte 881
cc Peter Warry

10 DOWNING STREET

From the Private Secretary

23 October 1984

BT Floatation: Executive and Employee Share Option Schemes

The Prime Minister has seen Mr Pattie's minute of 22 October and the Secretary of State for Transport's letter to the Financial Secretary of the same date. She agrees, subject to the conditions set out in paragraph 3 of the Chancellor's minute, that BT should be allowed to put in place executive and employee share option schemes before privatisation. She recognises that this is likely to mean that this practice will be followed in future privatisations.

I am copying this letter to David Peretz (H M Treasury), Michael Reidy (Department of Energy), Dinah Nicholls (Department of Transport) and Richard Hatfield (Cabinet Office).

Andrew Turnbull

Neil McMillan, Esq.,
Department of Trade and Industry

COMMERCIAL IN CONFIDENCE

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COMMERCIAL IN CONFIDENCE

PRIME MINISTER

Prior to Jaguar, share option schemes were put in place after privatisation, thereby distancing government from their terms. The senior executives of Jaguar were able to exploit special circumstances to push through a scheme before privatisation but it was intended that this should not create a precedent. BT are pressing for a scheme before privatisation and DTI are prepared to accede to this.

Mr. Ridley is opposed to this as he would be unable to hold the line against BA. The Chancellor and Policy Unit are prepared to agree, arguing that the market regards such deals as favourable for future business prospects. The Chancellor's only reservation is whether the price on which the option is based should be the average of several days rather than a single day.

Agree DTI's proposal subject to the Chancellor's reservation?

AT

22 October 1984

COMMERCIAL IN CONFIDENCE

RESTRICTED

MR TURNBULL 22 October 1984

BT FLOTATION: EXECUTIVE AND EMPLOYEE SHARE SCHEMES

Treasury are opposing DTI bouncing through outline share schemes for senior executives and rank and file employees. They now accept the proposal technically complies with the IPC guidelines.

The employee share scheme is unlikely to create any political furore and should be allowed through on the nod.

The senior executive scheme could be held out as a handsome present on leaving public ownership. However, no details will be finalised for individual directors until it is in the private sector; and they will not be able to exercise the option at the offer price but that prevailing a few weeks later.

The incentive scheme will slightly help in the sale, and will motivate senior management.

These arguments will apply to all similar privatisations. We believe the benefits outweigh any mudslinging damage, and therefore the precedent to be created by BT, and by Jaguar already, cannot be undesirable.

We would support approval of both share schemes.

Peter Warry

PETER WARRY

RESTRICTED

COMMERCIAL IN CONFIDENCE

PRIME MINISTER

BT FLOTATION: EXECUTIVE AND EMPLOYEE SHARE OPTION SCHEMES

British Telecom have put to us proposals for an Executive Share Option Scheme and also an Employee Sharesave Scheme. BT wish to adopt both schemes while we are sole shareholder, and to operate them immediately after next month's flotation - basing the scheme on the Offer for Sale price. The Executive Option Scheme would be for 200 senior employees (including the full-time directors chosen by the Board, and would offer them an option of up to 4 times their annual salary to be exercised between 3 years and 10 years after the Offer for Sale. While believing strongly the need for such a scheme, I am uncertain that it should be adopted exactly as proposed.

This is not accurate. It would be more correct to say "Before Jaguar, colleagues had ....."

Following the Jaguar flotation, colleagues have come to accept that such schemes should only be put in place by the new shareholders after the flotation, and should not operate upon the Offer for Sale price. This would have the effect in BT's case of ~~the option not be~~ being available to senior executives for at least 9 months after the Offer for Sale, because of the time it will take to compile the BT register and because of certain rules such schemes must have.

In view of colleagues' concern, but also because I felt that as a Government we wished to encourage management motivation by the use of such schemes, I have put forward a compromise solution. This is that we agree to adopt these schemes while we are sole shareholder, but that we remove what seems to me to be the most undesirable feature of the proposed arrangements - dependence upon the price of BT shares at the time of Offer for Sale. Under my proposal the initial grant of the options would take place shortly after the flotation, and would be based on a price prevailing on some day soon after the start of trading.

I believe that it is very important that we accept this compromise. Such schemes are common in the private sector, this scheme will not cause surprise in the City, and it is very important that we motivate BT's senior management now. Their enthusiastic co-operation over the next critical month will be vital to the success of the flotation. I think it is important we give them our clear backing by making this scheme available. I also believe that we can proceed on this basis while agreeing that all future cases should be considered on their merits case-by-case.

OC3/OC3AAX

I know that you are aware of the urgency of this. I hope we can have a favourable view by Tuesday morning so that this arrangement can be incorporated in the "Pathfinder" Prospectus to be published on Friday.

I am sending copies of this letter to the Secreatries of State for Energy and Transport and to the Chancellor of the Exchequer.

Nick Monck

for GEOFFREY PATTIE

22 October 1984

approved by the Minister + signed in his absence

OC3/OC3AAX

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

Andrew Turnbull Esq
10 Downing Street
London
SW1

22 October 1984

Dear Andrew

BRITISH TELECOM FLOTATION - EXECUTIVE AND EMPLOYEE SHARE OPTION SCHEMES

I understand from Margaret O'Mara in the Chancellor's Office that the Prime Minister is being asked to decide on this matter tonight.

I am, therefore, attaching a copy of a letter that my Secretary of State has sent this morning to the Financial Secretary, setting out his views.

Yours sincerely,

Henry Derwent

HENRY DERWENT
Private Secretary

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

pel

John Moore Esq MP
Financial Secretary
HM Treasury
Parliament Street
London
SW1

22 October 1984

Dear Financial Secretary

BRITISH TELECOM FLOTATION - EXECUTIVE AND EMPLOYEE SHARE OPTION SCHEMES

Geoffrey Pattie sent me a copy of his letter of 16 October in which he sought your agreement to a proposal that in advance of the British Telecom flotation the Government should approve executive and employee share option schemes.

I do not know the details of the British Telecom proposals. But I am afraid that I have serious reservations about the suggestion to put them in place before privatisation. When a similar issue arose in relation to the Jaguar sale I made the point both that such matters were properly left for the approval of the company's new shareholders after privatisation, and that any approval of share option schemes in advance of a sale could have serious implications for future privatisations, in particular British Airways. In the event, the Jaguar schemes were approved before sale, but this was on the clear understanding that the case would not provide a precedent for future sales.

Both my points arise in relation to the present proposal. If anything this proposal causes me greater concern, both because, unlike Jaguar, the British Telecom sale is being handled directly by the Government, and because we are much nearer to the British Airways sale. Moreover British Airways have put us on notice that they will submit key executive share option schemes for approval prior to privatisation; and, following our correspondence in June, we have taken the firm line with them that such schemes should not be introduced until they have been approved by the shareholders after privatisation. Any concession on British Telecom, whatever terms might be agreed, would make this position virtually impossible to maintain. I do not find it acceptable that we should be asked to disregard the understanding we reached that the Jaguar sale should not provide a precedent, and given the implications for British Airways I hope that we can resist very strongly any proposal that the Government should approve share option schemes for British Telecom in advance of flotation.

I am copying this letter to Peter Walker and to Geoffrey Pattie.

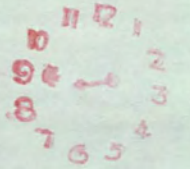
Yours sincerely

H C St Dorrient (Private Secretary)

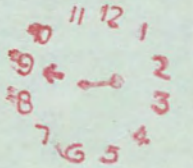
for NICHOLAS RIDLEY

(Approved by the Secretary of State but signed in his absence)

22 OCT 1984



22 OCT 1984



NMPM AT 22/10 cc to

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 5147
(Switchboard) 215 7877

From the Minister of State
for Industry and Information Technology

AT o/r

HMT + DTI are trying to sort this out

GEOFFREY PATTIE MP

John Moore Esq MP
Financial Secretary
HM Treasury
Parliament Street

19 October 1984

Dear John,

BT FLOTATION: EXECUTIVE AND EMPLOYEE SHARE SCHEMES

I am writing to confirm the understanding we reached yesterday on the proposal in my letter of 16 October to allow BT to institute before flotation both an employee and senior executive share option scheme in principle.

We agreed that we would be open to criticism if we appeared to be endorsing schemes that would seem to be over-generous and subject to criticism on the grounds that they are linked to the offer price. I said I thought that in the special circumstances of the BT case - where the offer for sale will be of such massive proportions - the proposals set out in my letter were defensible.

You felt that there were no acceptable watered down variants and resisted the proposal on the grounds that it would be presented as a precedent for the future, would not be in line with IPC provisions, and BT would have the opportunity to change it subsequently. On the other hand schemes such as these are now totally commonplace particularly following the action which you were able to take in the last Budget and would fully meet some of the enquiries which have come our way. There is no doubt in my mind that the inference will be drawn by institutional investors that the transformation will be complete and that BT will have all the hallmarks of a progressive company.

You said that Treasury would not oppose these proposals on financial grounds but as the Chancellor believes that they would represent a change of the general policy the final decision would have to be taken on political grounds by collective discussion, possibly at E(A).

There is no question that BT management are already strongly behind our privatisation plans. But the inclusion of these schemes will allow management to identify more closely as shareholders themselves and will put the finishing touches to the creation of the sort of dynamic and entrepreurial management

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POST + TEL : Future Pg

which you and I both want to see. As I said in my letter of 16 October I am not asking for any approvals to share options for individual executives in advance of the flotation. I am also proposing that the option should not be available to the executive to buy at the offer price; the option will be to buy at the rate applicable on one particular day, a few weeks after the Offer for Sale.

This is, I fear, a case where we must move very quickly indeed since the decision needs to go into next week's pathfinder prospectus and to be adopted at an Extraordinary General Meeting on Monday. I shall be seeking discussion on Monday.

I am copying this letter to members of E(A) together with a copy of my earlier letter.

Yours ever

Geoffrey

GEOFFREY PATTIE

M12/M12AES

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
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From the Minister of State
for Industry and Information Technology

GEOFFREY PATTIE MP

John Moore Esq MP
Financial Secretary
HM Treasury
Parliament Street
SW1

16 October 1984

Dear John

BT FLOTATION: EXECUTIVE AND EMPLOYEE SHARE SCHEMES

I was most grateful to you for finding the time to see Jeffrey Sterling and me yesterday to discuss this subject.

In writing to you I am well aware of Norman Tebbit's undertaking at the time of the Jaguar flotation that the executive share option scheme in that case was not to be a precedent for future privatisations.

My proposal, departing from Enterprise Oil, is that we as shareholders should give approval before flotation to both an employee and a senior executive share option scheme in principle. This would of course be subject to Inland Revenue approval and the implementation by a Board share options committee composed of members of the Chairman and the non-executive directors. I am persuaded by the need to do this by the three considerations that follow:-

1 Schemes of this kind are commonplace in private industry now. They are readily approved by the general meetings of the companies in question. The institutions, who will be the dominant shareholders in BT, can be expected to welcome any scheme which clearly falls within the IPC guidelines. The approval therefore by the sole shareholder prior to sale will not therefore be viewed by the institutions as in any way odd or controversial.

2 There is a need for BT to have these schemes - the one for ordinary employees quite as much as the one for senior executives - in place now. This is a part of the transformation Sir George Jefferson is seeking to achieve in

OC2/OC2ABE

POST + TEL : Future BG

the inherited culture of BT. He has lost one recent recruit to his board - Colin Crook - to another employer in the last few days. I am not saying that in the absence of any such scheme there will be a wholesale exodus of BT directors and senior executives to other firms but introducing such a scheme right away would be a positive encouragement to entrepreneurial effort and the attraction of outside talent.

3 If we do not approve a scheme now BT will not get the benefits for nine months or longer. The reason for this is that the IPC guidelines provide a window for the giving of options for a six week period following the Offer for Sale and another following the publication of the next report and accounts in July 1985. There is no way by which an EGM could be convened in time to permit the company to use the first window - the shareholder register will not by then have been compiled. We need therefore to galvanize BT now.

You will see that I am not asking for any approvals to share options for individual executives in advance of the flotation. I am also proposing that the option should not be available to the executive to buy at the offer price; the option will be to buy at the rate applicable on one particular day, a few weeks after the Offer for Sale. This would get over the particular difficulty that would exist in presentational terms if the directors had a personal interest in the issue being underpriced.

I recommend in short that we do put in place both those schemes in advance of flotation that we ensure they meet the IPC and Revenue guidelines; but that the price at which the senior executives schemes should be related should be as at a date some days or weeks after the opening of dealings.

I do hope you can see your way to agree with my proposal. I think it is a positive step much within your own thinking on using stock options in the interest of the economy.

Because of the possible repercussions on other privatisations I am sending copies of my letter to the Secretaries of State for Energy and for Transport.

Yours ever

Geoffrey

GEOFFREY PATTIE

M12/M12AES

8/249

B/F with Parliament
file clause
[illegible]

E(A)

AT
17/10

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Geoffrey Pattie Esq MP
Minister of State
Department of Trade and Industry
1 Victoria Street
LONDON SW1

17 October 1984

Dear Geoffrey,

I am replying to Norman Tebbit's letter to the Chancellor of 10 October which attached a draft exchange of correspondence with a backbencher dealing with certain competition aspects of the BT sale.

I endorse the general approach to informing the public about the likely attitude of the Office of Fair Trading to the acquisition of substantial holdings in BT. Nevertheless I am concerned by the absence of any quantitative indication of the size of holding which would be acceptable. We have agreed that there should be a limit of 10 per cent on allocations in the initial issue to individual or concerted bidders. I think it is very important that the draft reply should be able to say that it is unlikely that the OFT would consider a holding up to 10 per cent as "material influence".

As far as I know there is no reason to believe that they would and moreover this would be consistent with the Director General of OFTEL's views. Companies wishing to acquire a 10 per cent holding would then not be discouraged from tying up substantial funds in the somewhat lengthy process of applying for shares in the issue. I am sure it is important that they should not be so discouraged. Of course any further acquisitions after the sale between 10 and 15 per cent would be at their own risk. But as the draft at present stands they cannot even be certain that they can safely acquire up to 10 per cent and this is a real drawback.

Some such phrase as: 'It would be unlikely that the Director General of Fair Trading would consider a holding up to 10 per cent as giving rise to material influence" is all that is needed. I would very much hope he would feel able to agree to this.

I am copying this letter to other members of E(A) and to Sir Robert Armstrong.

JOHN MOORE

Post & Telecommunications: ~~Future~~ of Post Office & B.T.

Part 9.