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Secretary of State for Trade and Industry

14 January 1985

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

R. Vogel.

BRITISH AEROSPACE

I was grateful for your agreement in your letter of 9/January to my proposal that the whole of the Government's residual shareholding in British Aerospace should be sold early in the financial year 1985-86, in conjunction with the raising of new equity capital by the company. My officials have now held discussions with the company and respective City advisers, at which your officials have been present. Subject to certain outstanding points they have agreed the main features of the sale which need to be settled before a public announcement is made. I am writing to seek your agreement to these proposals and to the terms of a Parliamentary statement which I would hope to make this week.

Timing of Sale

2 I propose that, subject to market conditions at the time, impact day should be in the week beginning 29 April with applications opening and closing the following week. I also believe it will be necessary to issue a preliminary prospectus, containing all information except the price, at least three weeks previously. At the same time existing shareholders will be asked to disapply their pre-emption rights to the new shares and the preliminary prospectus will meet the information requirements imposed by the Companies Acts in these circumstances. The preliminary prospectus will not, however, be as full or as voluminous as the "pathfinder" used for the BT sale.

Marketing

3 The company's advisers, Kleinwort's, have argued strongly that an offer of this size (at over £500m it will be the largest ever apart from British Telecom) will require a substantial retail marketing effort, involving pre-sale advertising and the use of a

with AT.
*This is beginning to look
and N Peltat wishes to announce
tomorrow.*

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regional network of brokers. The advice is that there is no natural institutional demand for more BAE stock, and that demand will have to be stimulated in part through the retail market, even though some 75% of the stock will have to be taken by the institutions. I am anxious that we should not market a relatively high-risk stock to the general public in an unduly aggressive manner, and that we should be satisfied that any publicity measures undertaken are cost-effective. However while there should be no question in this case of the kind of financial inducements offered to the general public on BT I am convinced that a substantial retail marketing effort is essential, and our own advisers, Lazards, support this view. The exact form and cost of the campaign can be settled later, but I would propose to say in answer to questions on my statement that the shares will be marketed widely to both institutional and retail investors.

4 It will be essential as part of a retail marketing campaign to offer a substantial incentive to regional stockbrokers to encourage their clients to apply for the shares. The company's advisers originally proposed selling commissions of 2%, following the British Telecom precedent and contrasting with the practice on previous secondary Government sales where stockbrokers have received selling commissions of no more than 1/8%. I am sure we do not need to go as far as we did on British Telecom; on the other hand I accept the view put by the City advisers that commissions as low as 1/8% will not provide a real incentive to relatively small provincial stockbroking firms. This point is still being negotiated with the company. I believe it would be reasonable to accept commissions of 1/4% on applications up to £10,000, with 1/8% thereafter. *(This now looks like being agreed at 1 1/4% for under £10,000, <math>\lt;math>1/2\%*

Payment by Instalments

5 Both Kleinworts and Lazards have advised that it would be unwise to ask investors to put up all the money being raised in a single payment. The cost of getting some of the money later should be more than outweighed by the marginally higher price that should be obtainable on a sale by instalments. I am persuaded by these arguments, provided of course that the full proceeds are received during 1985-86, and would envisage two payments, the first of rather more than half (perhaps £2.00 at today's price) with the balance payable not more than six months later.

Priority for Existing Shareholders

6 It is intended that existing shareholders should have a prior right to apply for shares to the extent of the new shares being issued, but not for the proportion of the offer representing the sale of the Government's holding. In effect, though not in form, the raising of new money by the company will thus be a rights issue probably in the ratio of one new share to every four existing ones. A complication is that the Government, although holding nearly half

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the existing shares, will not wish to take up its rights. This raises the question of whether the Government's rights should be available to the other existing shareholders, and whether the Government can obtain value for foregoing those rights. In principle it should be possible to sell rights to take up new shares at a price which represents part of the difference between the offer price and the market price before the issue. We are not yet clear whether a mechanism can be devised for selling the Government's rights or whether such a device would tend to depress the offer price and would therefore be counter-productive. We have asked Lazards to investigate the point.

Limit on Size of Allocations

7 I propose that there should be a limit of 10% of the shares offered on the allocations that will be made to any individual applicant or group of applicants acting in concert. As well as following recent precedents, this would ensure that GEC or any other predator could not acquire a controlling interest in the company directly as a result of the Government's sale. There is of course the possibility that such a predator could, subject to a possible MMC reference, acquire a large holding on the market subsequently, but I do not believe that is something the Government should seek to influence except on OFT/MMC advice according to the normal competition criteria; this is consistent with the line we took at the time of the Thorn EMI merger talks that the company's future should be determined by its private shareholders.

Employees

8 In accordance with practice in other secondary Government sales, I do not believe we should offer any financial incentives for employees to buy shares. They should however have priority in allocation, over and above their individual rights as existing shareholders, up to say 5% of the offer. BAe may also wish to extend their existing share option scheme to the new shares on offer.

Special Share and Government Directors

9 BAe have agreed to recommend to shareholders a resolution to create a special share whose purpose will be to ensure that the Government's consent is required for any amendment to the existing provisions of the articles which limit the total foreign ownership to 15% of the issued shares and require all directors to be British nationals. It will be a precondition of the sale that such a special share should have been created. When privatisation of British Aerospace was first announced in 1979 the Government undertook that it would retain at least 25% of the shares in order to block any such change to the articles, and that undertaking was repeated in the 1981 prospectus: ownership of a special share will have the same effect and will enable us to rebut criticism that we

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have gone back on the undertaking. I also intend that the special share should provide a power for the Government to nominate one director, which I believe is justified in particular because of our continuing guarantees in relation to BAe's membership of Airbus Industrie. I do not however consider it necessary to retain two Government-nominated directors as we have at present.

Appointment of Advisers and Costs

10 Several of the advisers and contractors are automatic choices because of their established relationships with the company. These include Hoare Govett as lead brokers, Lloyds as receiving bankers and Peat, Marwich as reporting accountants. Beauty contests, in which my officials will involve yours, will be held for others including public relations consultants and solicitors to the offer. So far as costs are concerned, the company are insisting that they should be split in proportion to the money raised (which given the present market price would mean the Government paying around 70%) and that any greater contribution by the company might be ultra vires because it would favour one shareholder as against others. I believe we have no alternative but to accept this basis for sharing costs. The company will of course meet the whole of Kleinwort's fees, as we will Lazards', and the whole cost of any corporate as distinct from sale-related advertising and of any work which they would have had to undertake anyway.

Structure of Sale

11 There are several important issues, including the need for and structure of underwriting and the question of whether the Government shares could be sold by tender rather than fixed price offer, which require further discussion but which do not need to be settled before an announcement. My officials will of course involve yours in the consideration of these questions.

Timing in Relation to other Government Sales

12 The company and its advisers have pressed my officials for assurances that the timing of other Government sales, notably British Airways, and any advance publicity associated with them should not damage the BAe sale and our own advisers Lazards are similarly concerned. Naturally the Government's interests on this are at one with the company's, since we must all be at pains to ensure that one sale does not interfere with the success of another. At the same time we must retain the Government's freedom of manoeuvre, and must ourselves be the judges of whether the timing of one sale might jeopardise another. Your officials have helpfully prepared the attached draft which provides an assurance in general terms, and which would be acceptable to the company, but which preserves maximum flexibility for the Government in the planning of other sales. I hope you will be content for such a letter to be sent to the company.

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now
agreed
at 70.30



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Parliamentary Announcement

13 I believe it will be essential to announce our plans by means of an oral statement because of the need to explain why we are abandoning the previous commitment to retain at least 25% of the shares, and are instead taking a special share to protect the foreign control restrictions. The news is already beginning to leak, with 15p knocked off the BAe share price this afternoon. Subject to resolution of the outstanding issues with the company at a meeting later this afternoon - of selling commissions, the sharing of costs, and the form of undertaking in relation to British Airways - I would therefore propose to make a statement tomorrow. I attach a draft; the Chairman of British Aerospace would make a statement about the company's plans for raising new capital at the same time.

14 I should be grateful to know if you are content with what I propose.

15 I am sending copies of this letter to the Prime Minister and to Willie Whitelaw, John Biffen, Michael Heseltine and Nicholas Ridley, and to Sir Robert Armstrong.

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DRAFT LETTER FROM: DTI

TO: BAe

You asked about the relationship between the planned sale of British Aerospace shares in early May and other share sales that the Government might be intending to carry out.

Ministers fully share your company's objective that the sale should be a success and I can assure you that there is no intention of allowing other Government share sales to jeopardise this. ^{or to prejudice the future of your company} The planning and timing of other sales will take this fully into account.



DRAFT PARLIAMENTARY STATEMENT

1. With permission, Mr Speaker, I should like to make a statement about the Government's residual shareholding in British Aerospace PLC.

2. My hon friend the Chief Secretary to the Treasury told the House on 14 March last year that it was the Government's policy to sell minority residual shareholdings in privatised companies as the circumstances of the companies, the prospectus undertakings and market conditions permit. The Government have decided that circumstances are now appropriate for the sale of its residual shareholding in British Aerospace. We therefore intend, subject to satisfactory market conditions, to offer for sale all our shares in British Aerospace (48.43% of the company's issued share capital) in the spring or early summer of this year.

3. The company has agreed that, before the sale is made, it will recommend to shareholders a resolution providing for the Government to retain a special share in the company. The purpose of this special share will be to ensure that no change may be made without Government consent to the provisions of the company's Articles of Association which restrict the foreign ownership of shares in the company and require the directors to be British nationals. When British Aerospace was privatised, the Government said they would retain at least 25% of the shares in the company so as to be able to block any changes to those Articles. The special share will have the same effect and therefore renders the retention of a Government share-



holding unnecessary. The Government will not sell its shares till the special share is in place.

There will also be a right for the Government to continue to nominate a director to the company.

4. It is the company's intention to raise new equity capital at the same time as the Government's shares are sold. The British Aerospace chairman, Sir Austin Pearce, is making a statement about this this afternoon. Subject to the approval as necessary of the company's shareholders, it is intended that the offer for sale should take the form of a simultaneous offering of the Government's existing shares and new shares issued by the company.

DTI

10.1.85

14 JAN 1985

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Treasury Chambers, Parliament Street, SW1P 3AG
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The Rt Hon Norman Tebbit
Secretary of State for Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

15 January 1985

Dear Norman.

BRITISH AEROSPACE SALE

Attached.
You wrote to the Chancellor on 14 January setting out your proposals for a sale of the Government's residual shareholding in British Aerospace in conjunction with the raising of new equity capital by the company. We are generally content with your proposals.

Although I accept that the offer will need some retail marketing, we will clearly need to keep this within reasonable bounds. I understand that officials have discussed a formulation with the company that is intended to restrain total selling commissions to around 0.4 per cent of gross proceeds and, subject to detailed proposals, something on these lines would seem satisfactory.

I would prefer not to retain the right to appoint a government director once our shareholding is sold. I am sure that, in general, our privatisation philosophy requires that we should not do this. However in this instance, because of the existence of HMG's continuing guarantees in relation to BAe's membership of Airbus Industrie, there is a case for having a government director. I think the appointment should be tied to the existence of these guarantees and publicly presented as such.

I am sending copies of this letter to the Prime Minister and to Willie Whitelaw, John Biffen, Michael Heseltine and Nicholas Ridley, and to Sir Robert Armstrong.

John Moore
JOHN MOORE

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