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LONDON SW1A 2AA

From the Private Secretary

22 January 1990

Dear Tae,

PRIVATISATION OF TRANSMISSION: METHOD OF SALE

The Prime Minister has seen your Minister's letter of 11 January to the Financial Secretary. She strongly supports his proposed approach.

I am sending copies of this letter to the Private Secretaries to the members of Misc 128 and to Sir Robin Butler.

Yours,
Paul Gray

PAUL GRAY

Miss Jane Harrison,
Mr. Mellor's Office,
Home Office.

QTS.



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HOME OFFICE
QUEEN ANNE'S GATE
LONDON SW1H 9AT

cepu.

11 January 1990

Dear Mr Lilley,

PRIVATISATION OF TRANSMISSION : METHOD OF SALE

We have recently received preliminary financial advice from Price Waterhouse on the privatisation of the IBA's terrestrial transmission system. One of the issues which we need to consider in the light of that advice is the method of sale.

It would be premature at this stage to take firm decisions about the method of sale, but we do need to consider what attitude we should take to the proposed Management Buy Out (MBO) and what other steps should be taken to give the management and staff incentives to prepare for privatisation.

with AG?

As Douglas Hurd mentioned in his minute of 19 September to the Prime Minister, a group of senior IBA staff are preparing an MBO proposal. We understand from Price Waterhouse that the plans are at a fairly advanced stage: they have prepared a business plan, and have provisionally arranged a financial package with Lloyds Merchant Bank. They have requested financial assistance in meeting their advisers' fees throughout the rest of the process (on the basis that this would be repaid if their bid was successful). George Russell is unhappy at the prospect of an MBO. He doubts whether those concerned have sufficient commercial acumen to run the transmission system as a private company; and he is concerned that a highly geared company (as it inevitably would be after an MBO) would be tempted to under-invest and asset-strip in order to repay its borrowings.

/Douglas Hurd

Peter Lilley Esq MP

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Douglas Hurd argued that, despite George Russell's reservations, it would be wrong to rule out an MBO at that stage. He did, however, make clear that the MBO team should not be given preferred bidder status: if they were to bid it would have to be in open competition against others. Colleagues agreed that on that basis it would be sensible not to take a view on whether or not to rule out an MBO until the assessment of our financial advisers was to hand.

Price Waterhouse consider that the IBA's arguments against an MBO have been rather overstated. The concern about the running down of the system does not take full account of the regulatory arrangements we are proposing (of which the IBA have only recently seen the details) to underpin the quality and reliability of the transmission system. And, as Douglas Hurd argued, the commercial ability of the MBO team must ultimately be for their potential financial backers to judge. In the light of the advice from Price Waterhouse, I would be reluctant to rule out an MBO a priori. The general principle must be that the sale should be conducted as openly and competitively as possible. It would be inconsistent with that principle to rule out a potential bidder over a year in advance of the sale, unless we had very strong reasons to believe that they would be bound to be undesirable owners of the new company.

At the same time, I do not think that we should offer the MBO team financial assistance. I understand that there are precedents for offering such assistance, but that this has normally been done where it appears that the management are the only likely buyers, or where there are grounds for thinking that they could run the company markedly better than any other potential buyer. Neither of these criteria are fulfilled in this case. I am also concerned to ensure, as colleagues said in the earlier round of correspondence, that the sale should be as fair as possible. This too points against offering financial assistance to the MBO team.

It may well be that the MBO team will withdraw if they learn that they are not to receive financial assistance. This would not be a disaster; but I am keen to ensure that we have some other incentives in place to encourage IBA management and staff to prepare for privatisation. The clear message from Price Waterhouse is that there is a great deal of work to be done in restructuring the transmission operation to put it in

/a saleable form.

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a saleable form. Although the IBA have made some progress with this, an enormous amount remains to be done. Much of this work will necessarily fall to the IBA management, particularly the engineering management. Management and staff therefore need to be given some incentives to carry through the restructuring, particularly given the ambitious timescale we have set. Price Waterhouse have advised us strongly that we should offer incentives by indicating soon that, whatever the exact form of the eventual sale, we would be looking to ensure that the buyer gave management and staff an opportunity to acquire equity in the company. Similar incentives have, of course, been given in past privatisations. I think that this will be very important in ensuring that privatisation is successful.

We need to make our views on the MBO proposal clear soon, and also to give any incentives to management and staff as early as possible. I should therefore be grateful for a response by 18 January.

Yours sincerely

Jane Hain

cc Prime Minister
Other Members of
MISC 128
Sir Robin Butler
Ms Dent
Mr Scoble
Mr Yates
Mr Langdon
Mr Malone-Lee
Mr Mower
Mr Wright
Mr Hickson
Mr cooke
Mr Eagle
Mr Sibson
Mr Godfrey

PP DAVID MELLOR

Approved by the Minister
and signed in his absence

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