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BGC PRIVATISATION

After your meeting with Peter Walker on 25 March, Energy and Treasury officials were asked to consider the feasibility of achieving a successful flotation of BGC as an integrated whole around the end of 1986. They conclude that this can be done, provided high priority is given both to the legislation and the flotation. It will mean that other legislation in 1985/86 will have to be sacrificed to make room for it, and that there will not be time to devise a more radical, competitive alternative to an Oftel-type regulatory régime for the monopolistic core of BGC's business. An enticing employee participation scheme is envisaged as a carrot to BGC's management and employees.

The game is still worth the candle. Peter Walker's paper rightly points out that natural gas is a mature business with only limited further growth potential. The immediate prospects are good, but the cost of the raw material is rising steadily as new, higher-priced supplies replace the original cheap gas. In the longer term, a high-cost gas industry will probably have to defend a declining market against competition from other fuels. The business logic is to move now in exposing a privatised BGC to tougher commercial discipline, thereby equipping it to cope in a hard-headed way with the demanding problems of the 1990s and beyond.

Arguably, it is the Nationalised Industries Bill which should be dropped to accommodate the legislation for BGC privatisation in the 1985-86 Session. The main target of this Bill would be the profitable, cash-generating industries like Gas and Electricity. The privatisation of BGC would pave the way for the privatisation of Electricity. That being so, the Nationalised Industries Bill begins to look less relevant.

An Oftel-type regulatory régime for BGC may be no worse than splitting BGC into competing elements. So far, the signs are that Oftel is a sound model to build on. Success in developing a good standard model of price regulation for natural monopolies established in the private sector would be a valuable prize; as well as Gas, there are Electricity and Water. However, our supporters will be disappointed that a monopoly remains. The two defences we need are, first a tough pricing formula, and second, employee participation.

We should not become committed to a specific form of pricing formula without careful consideration. Peter Walker proposes RPI-X+Y, according to which BGC would be expected to make economies capable of beating inflation in their onshore gas distribution and marketing, but they would be allowed to pass through to consumers the increasing real cost of gas supplies. The latter is far too soft an option. BGC should be exposed to the normal market discipline on a business faced with a seasonal pattern of demand, and the opportunity to pay significantly less for a steady offtake of supply. It needs to reorientate its marketing/pricing policy, look for costeffective seasonal storage, and search for the cheapest sources of supply.

In his paper, Peter Walker talks of "encouraging a management/employee buyout to the extent of around 10-15% of the equity". This is likely to be a bit rich for the Treasury's blood. Rightly, they will question the proposition that it "will have a very considerable (positive) impact on the price we can obtain for the business". They will see this feature as representing a net cost to Government revenue from the flotation.

That is no reason to downgrade the idea, which is good from a business point of view and is consistent with your political objectives. But again it would seem wise not to become committed to specific details when there is time to consider and develop imaginative alternatives. For example, how about making the ultimate extent and value of the employee participation option a function of BGC's performance over the 3-4 years following flotation?

Peter Walker wants to exclude Kleinwort Benson because they have already had much of the privatisation work so far, and because he was not satisfied with their performance on Enterprise Oil. We need the best talent and experience we can get. In Kleinwort's case, that experience includes the successful BT flotation. Why not ask the Treasury to provide an analysis of where the privatisation business has gone, and to carry out an initial screening of potential candidates for the BGC privatisation beauty contest? If Kleinwort's are shortlisted on merit, it would be a pity to deny ourselves access to their expertise and experience.

Conclusions

1. Political and business logic gives you the green light for BGC flotation around the end of 1986.

2. However, adherence to a tight timetable is critical. Without the resolution to do so, it would be better to abort now. Part of the resolution may have to be the dropping of the Nationalised Industries Bill.

3. Let Peter Walker prepare an early statement outlining the Government's plans for BGC privatisation. This will include references to the regulatory régime and employee participation; but, at this stage, should not tie the Government to specific details. Tight timetabling is one thing. Closing options prematurely is another.

4. Keep an open mind on Kleinwort Benson until the Treasury have made an appraisal. The needs of the job come first.

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