

SECRET



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mr

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

PRIME MINISTER

GAS PRIVATISATION

with ORN?  
↓

Peter Walker copied to me his minute to you of 20 May, with his proposals for special provisions for customers and employees in the British Gas flotation. These proposals have political and financial implications.

On the employee share scheme, it really seems unnecessary to pitch the maximum benefit some 28% up on British Telecom and the likely average actual benefit (taking account of the take up of the offer) over 40%. These increases would have substantial repercussions for other sales such as Royal Ordnance, Rolls Royce and BA as well as being likely to upset employees of companies already privatised such as BT. Union opposition to the British Gas sale now seems pretty muted.

John Moore has already suggested to Peter Walker a package which is a significant increase on the BT employee share package. This would provide a maximum benefit some 13% above BT and a likely actual benefit over 18% higher. This package does offer a real improvement on BT despite the fact I am in general keen to avoid the employee benefits being bid up in real terms with each privatisation. I am also prepared to see a free offer of shares to BGC pensioners. This would be quite unprecedented.

Turning to the customer share scheme, there are real problems



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with the suggestion that there should be benefits exclusively for gas customers.

Some 22% of households do not have gas. These people would be excluded from the scheme. Some of them could get gas if they wanted, but there still remains 13% of households unable to get gas. These households tend to be in rural areas and so are more likely to be our supporters. We are likely to face widespread criticism if we put these people at a disadvantage in applying for British Gas shares. This is not the time for us to be disadvantaging our own supporters.

There are also technical problems with guaranteeing a minimum allotment of £200 to up to 16 million domestic gas customers. We just might not have enough shares to meet all the demands of gas customers.

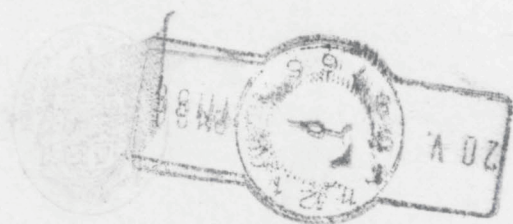
In view of the political nature of these issues, I think we can only resolve them by a meeting. I am copying this to Peter Walker, John Wakeham and John Moore.

*Handwritten signature/initials.*

N L

20 May 1986





Re BGC Privatisation



10 DOWNING STREET

Prime Minister

To be aware of this  
agreement between Mr  
Walker and the Chancellor  
about employee and  
customer shares in BGC.

The merits are very  
unclear, and a meeting  
will be needed. There  
is no need to read the  
papers ~~about~~ at this stage.

DLW

21/5.

I mention it to you in case  
the Chancellor raises it  
at your bilateral.

(papers' back in box 27/5  
G:U)



PRIME MINISTER

GAS PRIVATISATION

Substantial progress has been made since we last discussed gas privatisation at E(A) before Christmas. The Gas Bill is well into Committee Stage in the House of Lords and is on target for Royal Assent during July. The financial package for the new company has been settled in line with my earlier proposals to colleagues. We are on course for flotation in November with good prospects of realising a capital value around the top end of the £6-8 bn range I held out.

It is just six months to impact day. Nigel Lawson and I are agreed on referring to you two issues which have particular importance for the marketing campaign now getting underway. These concern customer shares and employee shares.

The British Gas flotation is, as we have been clear from the outset, a unique opportunity to extend and consolidate the property owning democracy. If we organise carefully, it should be possible during the campaign to build up and cater to unprecedented levels of response from small investors.

Michael Richardson, who is leading the Rothschilds' team, believes that the key to this is through capturing the interest of British Gas' 16 million customers with an approach similar to that adopted for the TSB issue. Rothschilds have devised, with my Department, British Gas and our other advisers, a customer share scheme which is described at Annex A. The main features are a guaranteed minimum allotment for gas customers, a separate customer register alongside the general register and reliance on British Gas' ability - with the guarantee - to attract a significant level of early registrations from the customers (76% of homes in Great Britain) they serve. Our City advisers are all clear that with this scheme - and a good parallel response from other small investors through the general register - we stand real chances of securing up to 5 million shareholders.

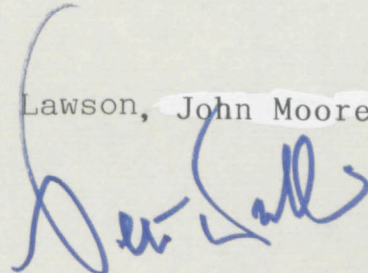


The totality of the package we offer to small investors must be highly attractive. Nigel Lawson and John Moore rightly point to the minority who have opted not to have gas or who live beyond the grid, many of whom will not be easily persuaded into share purchase and with whom we shall need to work hard. It will be our intention to give preference to non-customers over the institutions and to offer attractive incentives for all small investors. Rothschilds have identified no alternative means of building up the personal shareholding that promises to be as cost effective as the customer share scheme. Without it, a considerably enhanced range of incentives would probably be needed to carry the shareholding beyond the 2 million or so achieved in the BT sale.

The Treasury's suggestions for the employee share scheme are set out, together with my own Department's latest, revised proposals, at Annex B. Nigel Lawson and John Moore are reluctant to go beyond BT plus a small allowance for the two year interim. But this is, I believe, false economy with a privatisation of this magnitude and in relation to the importance of creating a sizeable employee shareholding. We have made clear on a number of occasions that provision for employee participation will be on a generous scale. BGC have relied squarely on this in the successful job they have so far made of undercutting the union anti-privatisation campaign. It would be a real pity at this stage to allow disappointment with the announced terms of the scheme to breathe new life into that campaign and to weaken workforce commitment just when we want to rally it.

It has taken much persuasion to bring Denis Rooke to acceptance of the financial package Nigel Lawson and John Moore wanted. He is now putting this to his Board this Wednesday and I need to be able to tell him urgently what we intend for the customer and employee share scheme to ensure agreement and to enable work to go ahead on putting through the sale.

I am copying this minute to Nigel Lawson, John Moore and John Wakeham.



Secretary of State for Energy





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ANNEX A

CUSTOMER SHARE SCHEME

The proposed customer share scheme has been devised by Rothschilds working with D/Energy, British Gas, Kleinwort's (BGC advisers), National Westminster (registrars), Dewe Rogerson (PE advisers), Cazenoves and Hoare Govett.

2 The scheme turns on a simplified system of pre-registration for British Gas customers. They will be offered a succession of opportunities to register their interest and will be invited in the run-up to the sale to put in for

- (a) a guaranteed minimum allotment
- (b) preferential treatment above the guaranteed minimum.

3 British Gas have some 16 m. domestic customers (76% of homes in Great Britain). Rothschilds advise that the guaranteed minimum can be set at a level which generates significant response from customers but short of producing so many applications as to exceed the capacity of the system. There would be a separate customer register maintained by National Westminster and the combined capacity of the customer and general UK registers would be up to 6 m. applications. If necessary Ravensbourne could be brought in as additional registrars to increase capacity to 7 m. Subject to further assessment, the guaranteed minimum might be around £200. If 3.5 m. customers applied, this would account for up to 15% of the equity.

4 Non-customers would be invited to apply through the general register and their applications would be given preference over the institutions. There will, in addition, be arrangements for shares placed with institutions to be clawed back in the event of very strong demand from small investors.





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5 There will be incentives for both customers and other small investors. As in the Telecom sale, these will take the form of vouchers or bonus shares. We are considering whether the voucher should be made convertible into premium bonds to broaden its appeal to all small investors.

6 The two registers will be consolidated into a single register following the sale.





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ANNEX B

EMPLOYEE SHARE SCHEME

Treasury Proposals

- |                                |      |
|--------------------------------|------|
| (1) maximum value per employee | £530 |
| (2) actual cost per employee   | £300 |
| made up of:                    |      |
| (3) free offer - £75-80        |      |
| (4) matching offer - 2 shares  |      |
| for 1 up to £125 purchased     |      |
| (5) discount offer - 10% up to |      |
| £2000.                         |      |

There would be a £50 free offer for industry pensioners.

D/Energy Proposals (reduced from £745 max. value per employee)

- |                                |      |
|--------------------------------|------|
| (1) maximum value per employee | £600 |
| (2) actual cost per employee   | £360 |
| made up of:                    |      |
| (3) free offer - £70 plus      |      |
| £2 p.a. for each year of       |      |
| service                        |      |
| (4) matching offer - 2 shares  |      |
| for 1 up to £150 purchased     |      |
| (5) discount offer - 10% up to |      |
| £2000.                         |      |

There would be a free offer of £70 plus £2 p.a. for each year of service for industry pensioners.



Prime Minister 4

26/5  
16/5.

MR NORGROVE

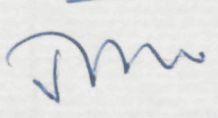
16 May 1986

BGC PRIVATISATION

The legislation is on course and the proceeds forecast is undiminished. Peter Walker and Nigel Lawson are still divided on one or two outstanding points, and may need to consult the Prime Minister at short notice.

Peter Walker wants to use BGC's computerised mailing facilities to invite BGC customers to book an allocation of shares on preferential terms. In a big flotation, the capacity of the registration arrangements constrains the number of shareholders. Peter Walker's scheme would get around this and should appeal to the public's nose for a bargain. With luck, we might end up with an additional two million shareholders.

Nigel Lawson agrees with this but is worried about the political backlash from the 15% of the population who have no access to gas and therefore the bargain offer. We feel that this is a small price to pay for the benefits of increasing the prospect of a successful flotation to a substantially larger number of small shareholders. There are many pros and cons for those living in rural areas. Resentment will be minimal.

  
JOHN WYBREW