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PRIME MINISTER

30th April 1991

COAL PRIVATISATION

You are to see the Chancellor, John Wakeham and the Financial Secretary tomorrow on British Coal. This meeting follows the discussion at Chequers on 24th March, when you asked John Wakeham to prepare a note on coal privatisation. Your concerns then were:

- i) the need to be clear in our own minds before the election as to the future of coal;
- ii) what could be said in the Manifesto, particularly with regard to employee participation;
- iii) the extended timetable proposed by DEN, which would result in privatisation only occurring in the second half of the new Parliament.

Timing of the Sale

John Wakeham's subsequent minute of 27th March endorsed his view that consultation should be postponed until after the election and privatisation itself not occur until 1994-5. The Financial Secretary believes that a radically shorter timetable is both possible and desirable, and that we can be looking for the completion of the sale by the summer of 1992.

John Wakeham's position is that sale of the industry prior to the renewal of the generators' contracts in March 1993 would be hazardous if not impossible. 80 per cent of BCC's sales are to the generators, so no private buyer would accept the

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degree of uncertainty that the renegotiation of the contracts involves without a huge financial incentive to do so. Moreover, the fast track would heighten the political profile of the coal industry during the election campaign. There are six Conservative seats containing UDM pits, the majority in three of which is less than 5,000.

Francis Maude's response is that, given Ministerial drive, an early sale is possible. A Bill could be introduced in the autumn, leading to the formation of the new companies in the spring of next year. The advantage of this rapid timetable is that it would introduce new management prior to the negotiations with the generators. With the resulting more radical approach to cost and productivity improvements, the industry would be in a stronger position in the negotiations. Furthermore, the quick sale of BCC would enable an earlier privatisation of British Rail.

A bull point for the Treasury point of view is a report that John Wakeham commissioned from an external expert on the scope for further productivity improvements in the industry. The Oakes Report is damning of the management of BCC. British productivity in deep mines is only about 25 per cent of that in the US and 40 per cent of that in Australia. Only part of this difference can be put down to adverse geological conditions. Mostly, the explanation lies in management resistance to international best practice in roof support systems, mining machinery and transport systems. Management culture and workforce incentives also need to change. New private management should quickly introduce these innovations.

Although this debate on timing will dominate the meeting, both sides accept that advisers should be appointed

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immediately to advise on coal privatisation. Their first task should be to provide a view as to whether the quick route is feasible, and if so how the sale should be structured. You will want to ensure that the terms of reference of the advisers are not loaded against the fast option and that this advice is complete before the summer recess. That would keep your options on timing open.

It would also put the pressure on Neil Clarke to respond positively to Oakes' recommendations. He has been in the job for three months now, and must begin to show the new broom management for which he has been brought in. He can use the Oakes Report to push change. If by the end of the three month period during which the advisers are reviewing the situation little positive has come from Clarke and his team, that would reinforce Francis Maude's argument for quick privatisation as a way to shake up the management.

Structure of the Sale

One of the reasons for John Wakeham's caution on heightening the profile of the coal debate prior to an election is that it is clear that a further radical restructuring will be needed to secure the sustainable future of the industry. The new generators' contracts will determine the size of the industry over the next five years, but it is clear that the generators will be taking sharply less coal from BCC (perhaps by as much as 50 per cent) and that this will result in more than a proportionate number of closures of the 70 odd remaining pits and redundancies among BCC's 85,000 employees. The Oakes report estimates that with new methods, 30 deep mines have a future producing 40 million tonnes a year, but without the changes only 15-20 mines would survive (20-30 million tonnes per annum). To these figures should be added

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the 18,000 tonnes of cheap open-cast production.

Colleagues agree that the future industry will be smaller, and that competition must be built into it. Three possible structures present themselves:-

- i) Sale of BCC as a single entity;
- ii) Break-up into 2-5 companies;
- iii) Sale of individual pits, with or without a central marketing organisation.

Arguments for free competition in the industry will suggest a greater number of units. However, there is a legitimate need for the new industry to retain the scale and management to be able to stand up to the generators. Natural variations in the seams and qualities of coal from any individual pit also argue for multi-pit units. Without pre-judging professional advice, it seems likely therefore that we will be selling several medium-sized companies.

Advice is also needed on the handling of a number of more technical issues. These include, most importantly, the ownership of the coal (whether in the Crown and leased, or sold outright), and the arrangements for the long term liabilities associated with the industry (redundancy costs, subsidence, site reclamation).

These considerations will lead the Advisers to a recommendation as to how the industry should be sold. Given the economics and the size of the management task, trade sales are the more likely option rather than public flotation. Significant management and/or employee

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involvement is also possible.

Manifesto Considerations

At Chequers, it was agreed that maximum employee involvement in the industry was desirable. However, it was unclear as to whether a commitment to employee involvement should be included in the Manifesto. There are clear political advantages in such a commitment, but it would pre-judge and thus complicate the method of sale. John Wakeham has been giving this issue further thought, and has reviewed previous Manifesto statements on other privatisations. Careful drafting should secure a middle course by referring to the principle of employee involvement without giving a full undertaking to employee share stakes. In the event of one or more trade sales, for instance, employees might enjoy profit sharing or shares in the parent company rather than direct equity in the mines.

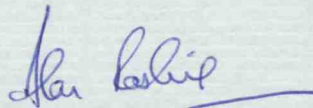
Conclusion

The meeting should conclude that advisers now be appointed with terms of reference to formulate a view by the end of July on:

- i) the timing of the sale, and in particular the practicality of a rapid track sale;
- ii) the structure of the new industry, given the Government desire to have a competitive and sustainable industry;
- iii) the ownership of the coal reserves, whether vested in the Crown or sold freehold;

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- iv) the handling of future liabilities;
- v) the means of sale, having regard to the Government desire to maximise employee participation.



ALAN ROSLING

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