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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC
STRATEGY

SUB-COMMITTEE ON DISPOSAL OF PUBLIC
SECTOR ASSETS

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PRIVATISATION OF BRITISH AEROSPACE, BRITISH
AIRWAYS, AND THE NATIONAL FREIGHT CORPORATION

Note by the Secretaries

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1. At the previous meeting of the Sub-Committee, (E(DL)(79) 6th Meeting), a number of issues were left unresolved and officials were asked to give further consideration to two of them: Government guarantees for the inherited liabilities of the successor companies, and the use of the Government's powers as a shareholder in those companies.

2. This note gives officials' views on the question of guarantees and on two other issues which need to be decided urgently because they affect the drafting of the Bills: the Government's financial relations with the wholly-owned successor companies, and the Government's powers to acquire equity and other stock. The remaining issues, including the use of the Government's powers as a shareholder are less urgent and will be brought forward for decision later.

Government Guarantees

3. The Sub-Committee agreed that a common approach was desirable for the three undertakings, but recognised that none of the approaches so far identified was free from drawbacks. Officials have therefore tried to identify a common approach, but reluctantly conclude that this is not practicable. The most attractive course would be to put British Aerospace (BAe) onto the same footing as British Airways (BA). But even this does not seem feasible. It would mean issuing specific Government guarantees to cover BAe's obligations (which are mainly to customers, particularly in respect of progress payments, rather than to lenders) in place of BAe's present reliance on the Government's general undertaking not to allow nationalised industries to default. The specific

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guarantees would continue for the successor company in the same way as is proposed for BA. This would entail a massive resort to formal Government guarantees, not hitherto used, for the BAe at the very time it was being prepared for return to the private sector; and even if this is feasible (which is open to doubt), it would in itself be undesirable. An alternative approach discussed by the Sub-Committee would be to limit the Government's underwriting of obligations transferred from BAe to the successor company so that it covered only obligations to customers. Officials assume that Ministers would reject this course because it would discriminate against certain members of a natural class (BAe's creditors) and would, therefore, run a grave risk of making the British Aerospace Bill hybrid.

4. Officials therefore recommend that Ministers should be prepared to adopt different approaches towards the liabilities transferred from the statutory corporations to the successor companies. For BA, existing Treasury guarantees would be continued; ^{BAe's} ~~BA's~~ liabilities transferred to the successor company would be guaranteed only in the event of the company's liquidation; and no provision would be made for the National Freight Corporation (NFC). There might be pressure in Parliament for the BAe provision to be included in the other Bills, but it would be possible to argue that the Government was in each case reflecting the special circumstances of the previous statutory corporation in determining the form of the limited support provided in two of the cases; and that in no case was Government support being offered for the new liabilities of the successor company. On this basis, the private sector status of the successor companies would not be put in question.

Government financial relations with the wholly-owned successor companies

5. Officials have also considered whether the proposed difference in treatment for the successor companies of British Airways and British Aerospace while wholly-owned by Government presents any problems: whereas it is proposed that there should be no power to advance loans or guarantees to the British Airways or National Freight companies, it is proposed that the Government should have these powers in respect of the successor company to BAe (E(DL)(79) 14 paragraph 10) though only while it is wholly owned by the Government. This reflects the need to maintain, possibly for some time, an aircraft company wholly owned by Government if the present business of BAe were split, and the Dynamics business successfully floated off as a separate company. It is prudent for the Government to have powers to provide finance for the remaining Aerospace company analogous to those

they now possess in respect of the statutory corporation (ie to be able to give loans or guarantee borrowing). No such need arises with British Airways or NFC, where the periods during which the successor companies are wholly-owned by Government should be much shorter. In principle, all the companies, while remaining wholly-owned by Government, will count against the PSBR. Officials see no difficulty in justifying these differences, and therefore recommend that Ministers proceed as proposed.

Power to acquire equity and other stock

6. The Financial Secretary has stressed that it is essential, if a successor company is not to count against the PSBR, that it should not have access to the National Loans Fund. In view of this, it seems inappropriate that the Government should have the full power of shareholder in respect of subscribing for loan stock, since this would represent an alternative means of advancing loans to the company. Officials therefore recommend that in both BAe and BA the Government should be able to subscribe for loan stock only if conversion rights are attached, as was proposed for BAe (E(DL)(79) 14, paragraph 7(ii)). Such subscriptions would be financed from Votes.

7. The desire to subscribe for loan stock if conversion rights are attached is based on the belief that the Government should be in a position if it so chooses - but be under no obligation - broadly to maintain its proportionate shareholding when the company raises additional ^{risk} ~~rich~~ capital in the markets. If the Government were unable to subscribe for convertible loans or rights of issues, it would be prevented from exercising this option, which may prove of considerable importance in terms of trade union and Opposition reaction to the Civil Aviation and BAe Bills. Moreover a situation in which a major shareholder was precluded from subscribing to rights issues could be regarded as damaging to the other shareholders.

8. If Ministers wish to be able to preserve a particular proportionate shareholding, it will in principle be necessary also to have the power to acquire shares, as well as to subscribe for rights issues. Without such a power, the issue of new shares by the company, as will occur regularly under any employees shareholding scheme and could arise in other circumstances, will dilute the Government's shareholding. For this reason, it was proposed that the Government, subject to certain limits, should have the power to acquire shares in the successor companies to BA and BAe (E(DL)(79) 14 paragraph 7(i) and E(DL)(79) 15 paragraph 1g). No such proposal has been advanced for the NFC, since the eventual intention is to dispose of all its shares.

9. Because of the difficulty of drafting the terms of this power, it is not incorporated in the draft of the Civil Aviation Bill circulated to Legislation Committee. Those officials who questioned the practical need for it pointed out that it would hardly be possible for the Government to maintain its shareholding if a large take-over were financed by an issue of shares - the market difficulties would be too great; and insofar as the objective was specifically to reassure employees (rather than the Labour party or the present management), there would seem to be no reason to worry about dilution solely attributable to the issue of additional shares to them. Officials have not been able to reach an agreed recommendation on this point and we therefore ask Ministers to decide whether -

i. There is a need for a power to purchase shares (in addition to the recommended power to subscribe for rights issues and convertible loans).

ii. If so, whether it is necessary or appropriate to limit it either to the level held by Government immediately after privatisation; or to a limit such that the Government could maintain, but never increase, its percentage shareholding at any time.

Signed P MOUNTFIELD
G D MILES
A S D WHYBROW

Cabinet Office

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