

SUBJECT CE MASTER



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From the Private Secretary

20 July 1990

Dear John,

PRIVATISATION OF POWERGEN

The Prime Minister held a further discussion on the privatisation of Powergen with your Secretary of State this morning. The meeting was also attended by the Chancellor and Mr. George Guise (No.10 Policy Unit).

I should be grateful if recipients of this letter could ensure that it is seen only by those with a strict need to know.

Your Secretary of State said that considerable progress had been made on the idea of a possible trade sale. Negotiations on an indicative price were well underway with "Conrad". Last night "Conrad" had put forward a price of £1.5 billion. He had indicated this would not be sufficient; and this morning "Conrad" had raised the price to £1.65 billion. Once again he had indicated this was not adequate; and further work was now being undertaken by "Conrad" to see whether they could raise the price further. In practice it was unlikely the indicative price would be raised much further. But the additional work would help remove any residual areas of uncertainty about the valuation of Powergen and hence the indicative sale price.

This indicative sale price had to be compared to that available from flotation. Kleinwort Benson had indicated that proceeds from a flotation of Powergen at a theoretical maximum might amount to £1.57 billion. In practice they considered a figure of £1.3 billion in a straight flotation was the highest realistic expectation. Powergen's view had been that a flotation, taking account of a proposed debt injection, would generate net proceeds of around £700 million, though Powergen had also indicated that under different debt and accounting treatments that figure might rise to as much as £1.1 billion. He considered however, that Powergen with a prospectus under the influence of their City advisors, would generate no more than £1 billion on flotation. It was this estimate of flotation proceeds which could best be compared with the prospective proceeds from the trade sale.

If an announcement that the Government had been approached with the offer of a trade sale were made on Monday 23 July, it might be possible to make arrangements such that a binding legal contract on "Conrad" to offer an underwriting price could be

signed on 17 August. In addition to the higher prospective proceeds from sale of Powergen, it was also necessary to take into account the repercussions for the privatisation of National Power. On balance the effect should be beneficial and increase the expected proceeds from flotation of National Power.

It was now necessary to consider whether to make an announcement on Monday. A final decision could be left till Monday morning in the light of further consideration of the indicative price by "Conrad". The form of any statement to Parliament would be that the existence of a potential trade sale would be made clear; the identity of "Conrad" would be announced; and the Government would then indicate it was interested in further bids, with "Conrad" in effect having offered an underwriting price: but the flotation option would also be kept open.

The following were the main points made in discussion.

- (i) The additional privatisation proceeds from a trade sale made that a potentially attractive course. It would be helpful to include an employee share option scheme in any final arrangements.
- (ii) There was bound to be some political criticism of a further proposed change in privatisation plans for electricity. The identity of "Conrad" might not be helpful in this regard. But there was an excellent defence: the Government could not but explore a trade sale offer in the interests of taxpayers.
- (iii) Although the indicative price would not be made public, there was a danger that it would leak.
- (iv) Under the proposed arrangements, once "Conrad" entered into a formal agreement, it would in effect provide an underwriting price. But "Conrad" had an incentive to quote a realistic indicative price now: this price would in due course become the underwriting price. Others, including possible overseas buyers and "Conrad", would be able to bid once the underwriting arrangement was firmly in place.
- (v) If the trade sale of Powergen went ahead, there would still be the flotation of the transmission companies as well as National Power. Some area boards (which would be transformed into the transmission companies) were seeking to avoid an injection of debt into their balance sheet and were trying to secure money directly through grants. This was to avoid the future burden of interest payments. But it was right to create balance sheets at the outset which reflected normal commercial practices. The implied level of gearing and the amounts of debt under consideration were well within the normal accepted levels in business. The terms of such debt would be considered further.

Summing up a brief discussion, the Prime Minister said that a final decision on whether to announce the possible trade sale of Powergen should be made on Monday morning. The discussions had gone very well and the Prime Minister was most grateful to your Secretary of State for his excellent handling of the negotiations. It would be important to prepare a rigorous defence of the proposed trade sale for use at any statement in the House on Monday.

I am copying this letter to John Gieve (H.M. Treasury).

Yours,
Barry

(BARRY H. POTTER)

John Neilson, Esq.,
Department of Energy.