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10/07/1990

FILE TITLE

GIROBANK AND
GIROLEASING

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TO:
PRIME MINISTER

FROM:
KENNETH CLARKE
17 November 1987

Paul

CH/EXCHEQUER	
REC.	J 17 NOV 1987
ACTION	FST
COMES TO	

GIROBANK

Last year colleagues decided that privatisation was right in principle for Girobank and should be considered soon after the Election. I have reviewed the position in the light of an update by Hambros of their 1985 study and discussed it with both Sir Ronald Dearing, who relinquished the Post Office Chairmanship at the end of September, and his successor Sir Bryan Nicholson. My conclusion is that we should seek to privatise Girobank before the end of 1988-89. I have invited the Post Office Board formally to give me their view.

2 Girobank is now successful and profitable and there is no reason in principle why it should remain in the public sector.



It would have greater opportunities to exploit its full potential, at greater risk, in the private sector.

Risks to Counters

3 Privatising Girobank would involve risks for the Post Office. The Counters business and Girobank are interdependent, with Girobank providing a third of the growth in Counters traffic in recent years. The Post Office can ensure that there are binding contractual arrangements between the two subsidiaries while they remain in Post Office ownership but could not expect to bind Girobank for more than five years after privatisation. Girobank would then be free to withdraw from the post office network. If Counters had by then failed to tackle its problems and to develop profitable new business, loss of the Girobank business would probably mean cutting back the post office network.

Risks of not privatising

4 Failure to privatise would also involve risks. It would almost certainly precipitate the departure of Girobank's MD, Malcolm Williamson, and many of his recent recruits at top



management level. It is improbable that a successor of comparable quality could be found if there were no prospect of privatisation. At a time when Girobank is facing increasing competition in its traditional market niches, the loss of senior management would have serious implications for the bank's future.

Timing

5 A very early sale would be difficult to achieve and not, in my view, in Girobank's best interests. The reference of Crown offices to the Monopolies and Mergers Commission (MMC) probably makes privatisation impracticable at least until the MMC have reported and possibly later. I have pressed the MMC to report in less than six months if possible; publication will probably take another month and the Post Office will then have up to three months to make its initial response. This points to a sale date of late summer next year at the earliest. The timing will of course depend on the state of the market, other privatisations and the need to try to maximise proceeds. We will also need to bear in mind the potentially severe damage that could be caused by industrial action in Girobank or the Post Office.



Method of disposal

6 Hambros advice, which I accept, is that flotation would not be possible for another two or three years. A trade sale or management buyout are the only options in the meantime. I doubt that the management could mount a buyout bid that would represent a reasonable deal for the Post Office and satisfy the Bank of England on terms that were acceptable to us, but I believe that we should give management the chance of pursuing the possibility. However, any such bid should be required to compete against a possible private treaty sale. Only when merchant bank advisers have begun to test the market will we know for sure whether acceptable buyers are prepared to come forward, and how their proposals compare with those of the management team.

Requirements of the Bank of England

7 The Bank of England have indicated that they would find it easier to recognise a privatised Girobank if the Post Office were to retain a substantial stake in it and give the Bank of England a letter of comfort. Such a letter would have the effect of leaving the Post Office with unlimited liability. The position will need to be negotiated further with the Bank.

Conclusion

8 There is clearly a lot of work to be done in drawing up detailed proposals for privatisation but I believe that we should now take the decision to press ahead, with a view to an announcement early in the New Year and completing the sale before the end of the year. I invite you and colleagues to agree.

9 I am copying this minute to Willie Whitelaw, Nigel Lawson, David Young and to Sir Robert Armstrong.

KENNETH CLARKE

SECRET



*From the Chancellor of the Duchy of Lancaster
and Minister of Trade and Industry*

DEPARTMENT OF TRADE AND INDUSTRY

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THE RT HON KENNETH CLARKE QC MP

Andy Bearpark Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

17 November 1987

Dear Andy,

GIROBANK

As you will be aware the Chancellor has today written to the Prime Minister about the privatisation of Girobank. I am attaching for your information a paper which sets out in greater detail the background to this issue.

I am copying this letter to the private secretaries to the Lord President, the **Chancellor of the Exchequer** and Sir Robert Armstrong.

Yours sincerely,

Alastair

**ALASTAIR MORGAN
PRIVATE SECRETARY**

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GIROBANK: PRIVATISATION

Introduction

1 In 1986 Ministers collectively decided that Girobank should not be privatised in advance of the General Election, mainly for reasons of industrial relations in the Post Office and the risk to the current reorganisation of the corporation and important business efficiency initiatives. However, Ministers agreed that privatisation was right in principle for Girobank and should be reconsidered very soon after the Election, together with the future of the rest of the Post Office.

2 During the Election campaign the Prime Minister ruled out privatisation of 'the Royal Mail'. She said that other parts of the Post Office were not closed off to privatisation, but that she doubted very much that the Government would have time to privatise them in the coming parliament. Girobank is the only part of the Post Office that is a possible early candidate for privatisation, and disposal need not require legislation.

3 Girobank is a wholly-owned subsidiary of the Post Office. The Secretary of State may direct the Post Office to dispose of Girobank, or the Post Office may do so, with the consent or authority of the Secretary of State, if it considers that course to be in the best interests of the Post Office. The Board's public position before the Election was that ownership was a matter for the Government, but that if privatisation were proposed, it should apply to the Post Office as a whole and the group should remain intact. However, the then chairman - Sir Ronald Dearing - also made clear to the Government the Board's readiness to comply with the Government's decisions on the future of Girobank. The new Chairman, Sir Bryan Nicholson, is reported as saying that the Board will need to consider the implications of the Prime Minister's statement.

Background

4 The feasibility of privatising Girobank was studied in 1985 by Hambros. On the basis of that study, Mr Brittan wrote to the Chancellor of the Exchequer in January 1986 to say that privatisation was feasible in the life-time of that parliament and should be undertaken, with completion expected in November 1986. The Treasury's reply supported early privatisation in principle but asked for collective discussion of the issues, including the implications for Counters, prior to any announcement. When Mr Channon subsequently came to review the prospects, he concluded that announcement of early privatisation would exacerbate the worsening industrial relations situation and constitute an unacceptable threat to the reorganisation of the Post Office and other objectives. Ministers collectively agreed to shelve the proposition until after the Election. In the meantime the Post Office Board commissioned, on its own initiative, merchant bank advice on privatisation of either Girobank or the Post Office as a whole. Also Hambros have recently conducted a short study to update their earlier work.

Reasons for privatising Girobank

5 After a financially shaky start Girobank has become successful and profitable, recording increased profits almost every year since 1974/75. Building upon its longstanding policy of free banking and use of the extensive post office network, it has developed a base of 2 million personal current account holders. It has also secured a pre-eminent and profitable niche in corporate banking, by taking in retailers' cash and supplying the Post Office with the cash it needs to make social security and pension payments for the DHSS. But its success in banking the unbanked and in becoming the prime handler of corporate retail deposits has left the bank with a narrow profit base. Changes in the financial market threaten Girobank's position unless it responds competitively. A major barrier to expansion is the need for capital support at the level required to satisfy the prudential limits applied to banks generally by the Bank of England. To enable Girobank to take a modest step towards expansion into more profitable and riskier business, Ministers agreed earlier this year to a capital injection of £20 million (in two £10 million tranches, this year and in 1988/89). In the private sector Girobank would have greater freedom to attract capital to sustain more profitable expansion in areas of business which public expenditure constraints on its capital at present prevent it from entering.

6 The MD of Girobank was recruited from the private sector in 1985 in the expectation that the bank would be privatised in the next two or three years. Since then he has built up a team of some 50 banking specialists who have seen attraction in getting in on the ground floor of a business about to be privatised. It is doubtful how long these newcomers would wish to stay if privatisation were ruled out or a decision were deferred for another year.

Main problems

7 Two major points that require close consideration in deciding on privatisation are the risk of industrial conflict and the possible impact on the Counters business.

Industrial action

8 Most staff at the Girobank Centre, at Bootle, are represented by the National Communications Union (Clerical Section) or the Society of Civil and Public Servants. They include a number of activists aligned to the Militant Tendency who would oppose the sale vigorously, and sustained action by a few key workers in Bootle could seriously damage the business. Nevertheless, in the view of the Post Office the Bootle workforce would not carry their opposition to the point of jeopardising their jobs. More problematical is the attitude of the Post Office unions. Officially they are strongly opposed to privatisation, and they have it in their power to cripple Girobank, either by non-cooperation at post office counters or by blockading mail to and from Girobank. The Prime Minister's remarks during the campaign will have given some reassurance. This would be

enhanced if the Government made clear that they had no plans to privatise any other part of the Post Office provided there were no serious interruption to services nor union obstruction to Girobank privatisation. Privately, the leaders of the main Post Office union, the Union of Communication Workers (UCW), have made it clear that (although committed publicly to oppose privatisation) if privatisation were in prospect they would expect their members to have an opportunity to participate on preferential terms. Meanwhile, industrial relations remain fragile and there is the possibility of major trouble before Christmas over the UCW's claim for a shorter working week.

Girobank relationship with Post Office Counters

9 Girobank and Counters' operations are inter-linked. Post offices provide Girobank with its retail outlets, the significance of which is reflected by the proportion of Girobank's costs (50 per cent) made up by Counters' charges for services. Girobank represents 18 per cent of Counters' business and its importance as a source of business to Counters has grown as Government, chiefly DHSS, work has become less secure.

10 Girobank's Business Plan proposes expansion into areas of activity which will be handled by mail or telephone rather than over post office counters. The prospect is therefore for only modest growth in Girobank transactions over counters whether Girobank is sold or not, although a wider range of services will benefit Counters' volume by retaining personal customers using counters who might otherwise drift away.

11 Girobank and Counters have an agreement, negotiated at arm's length, for a five-year relationship. The agreement is thought to be insufficiently robust in commercial terms and, because it imposes constraints on both sides, it would contravene restrictive trade practices legislation if Girobank left the Post Office group. The terms of the agreement are therefore being reviewed to determine the changes necessary to overcome these problems. Irrespective of contractual arrangements, however, a privatised Girobank would in practical terms be unable to withdraw quickly from Counters because of the nature of the business - and a purchaser intending to do so would anyway not be acceptable. The Post Office would wish to safeguard Counters' interests by binding the purchaser (albeit at the cost of reduced sale proceeds), but it is unlikely that such protection could be assured for more than five years after sale.

12 A purchaser might wish to make more selective use of the network, for instance using his own outlets where available. Ultimately Girobank, which negotiates with Counters at arm's length, will decide on the use of the network (as will any other user) on the basis of the cost and efficiency of Counters' services, regardless of whether Girobank stays in the public sector or is privatised. However, so long as it remains in the Post Office group, Girobank will inevitably be under heavy pressure to continue to use the whole of the Counters network. Counters aims to retain traffic by improved competitiveness. The beneficial impact of automation and the

extension of Counters' powers would be of advantage to Girobank whatever its status.

Other issues

13 (i) Non-competition covenant

It was previously thought that a short Bill might be needed to allow the Post Office to enter into a legally-binding contract not to compete with a privatised Girobank, as its present statutory powers cannot be fettered in this way. However, with the establishment of the Counters business as a subsidiary of the Post Office on 1 October this year (as Post Office Counters Ltd), it is now possible, subject to the constraints of UK and EC competition law, for Counters (as a separate legal entity) to agree with a purchaser of Girobank not to provide banking-agency services at Counters' outlets to anyone else for as long as Girobank continues to use these services. This would not fetter the Post Office's powers to provide banking services. In practice this arrangement is likely to satisfy a purchaser and so avoid the need for short but controversial legislation.

(ii) Potential foreign or undesirable purchasers. Foreign banks were among the possible categories of purchasers identified by Hambros. It could be a source of controversy if one of these made the highest offer. A statement at the start of the privatisation process excluding foreign bids would hold difficulties in relation to the EC. Other prospective purchasers, whether foreign or not, might be objectionable to the Government or the Bank of England for a variety of reasons, including monopoly considerations.

(iii) Government Direction: The Law Officers advise that the Post Office may dispose of subsidiaries voluntarily only if it is in its best commercial interests. The Government's policy on privatisation cannot be a proper consideration of the Board, and if the Post Office came to a formal view that privatisation was against the Post Office's best interests, the Secretary of State would need to issue a statutory direction. A purchaser could well expect this protection before proceeding with the purchase. Provided, however, that there was no challenge (say, by the unions) to the Board's starting the process of sale without a Direction, the issue of a formal Direction could be delayed until late in the process. This would avoid its being a focus for political controversy. Moreover, the informal influence which the Government and the Bank of England would wish to have over the final choice of purchaser would be

safeguarded if the issue of a Direction were delayed until unacceptable purchasers had been eliminated. Nevertheless, in order to ensure that the Board was acting within its powers in incurring expenditure on privatisation, it would be necessary for the Government to inform the Board of their intention to issue a Direction in due course. While the Board's attitude is cooperative, it is possible that, if industrial relations worsened, it would not wish to take any steps towards a sale without a Direction.

- (iv) Taxation: The transfer of assets to Girobank plc in 1985 would attract Capital Gains Tax if it is sold within six years. This tax, perhaps £20 million, would be payable by the purchaser and would tend to depress the price commensurately. The PBSR effect would be neutral. A potentially more serious problem would arise if VAT were payable on the services provided by Counters to Girobank: it would wipe out Girobank's profits at a stroke. HM Customs and Excise will need to be asked to confirm its preliminary view that VAT would not be chargeable because the services covered by the contract are within the definition of banking services.
- (v) Possible loss of Government business. DHSS business alone made up £53 million (or around 16 per cent) of Girobank's income in 1986/87. If DHSS were to feel that its close relationship with Girobank after privatisation were no longer appropriate, this would affect the sale price. Because of this vulnerability, Girobank is exploring with DHSS the possibility of concluding a five-year contract and is optimistic on the basis of progress so far.
- (vi) Contingency centre. The need for a contingency centre is an issue that is likely to be of considerable interest to potential investors seeking to minimise their risk. Such a centre would provide on a separate site emergency back-up in the event of major dislocation of operations at Girobank's main processing centre at Bootle. All other banks own or have access to such back-up facilities, and it is a provision to which the Bank of England attaches importance. Girobank is discussing with DTI the possibility of securing grant assistance before formulating a detailed plan but hopes to make a start on the project next spring. This would mean the Government being expected to approve this large investment in advance of privatisation, even though some purchasers might have facilities that would make some or all of the additional investment by Girobank unnecessary.

Method of privatisation

14 In 1985 Hambros rejected flotation as a viable option at least for a few years, mainly because of the need to remedy a number of operating difficulties (such as deficiencies in the computer and information systems) in order to retain Bank of England confidence after the withdrawal of the Post Office's support. Since 1985 the new MD has done much to remedy these weaknesses: new systems are being installed, new staff have been recruited, and new products have been developed. Nevertheless, Hambros judge that flotation cannot be contemplated until these improvements are implemented and have begun to bear fruit: 1990 seems the earliest date for flotation.

15 If disposal before then is desired, the options are a trade sale or a management buyout. The Post Office's advisers did not favour a trade sale, both because of the difficulty of restricting the sale to a list of acceptable candidates and because even an acceptable buyer might subsequently sell the bank to another body which might have less commitment to the Counters network. The Post Office was accordingly advised to consider a "leveraged management buyout", with the Post Office retaining a stake of say 20 per cent, and some 10-15 financial institutions as equity partners with none having more than say a 15 per cent holding. In support of continuing Post Office involvement it is argued that the Post Office unions and the sub-postmasters would regard it as a statement of good intentions towards the Counters network, thus helping to allay opposition to privatisation. Potential investors might value the Post Office's continuing involvement if they attach importance to ultimate renewal of the contractual relationship with Counters. Such a leveraged buyout might pave the way for a public flotation in two-three years' time when Post Office staff and sub-postmasters might have the opportunity of preferential share applications.

16 The MD of Girobank believes it will be possible to mobilise a group of institutional investors to fund such a leveraged management buy-out and is personally very committed to this solution. There is a potential conflict of interest between the management team, as promoters of a buy-out, and the Post Office as seller to which all parties, including the Government, will need to be alert.

17 As regards a trade sale, with Girobank accounting for about 18 per cent of Counters' business the Post Office is understandably concerned both to protect its Counters business and about the impact of a sale on industrial relations in Counters. However, sale to a buyer who undertook to continue to use Counters would overcome these difficulties. For Girobank it would be important that the buyer should undertake to provide continued employment to the Bootle workforce. The question arises whether buyers could be found to meet these requirements. They will also need to be buyers who are acceptable to the Bank of England as "fit and proper" entities of sufficient standing to own a major banking organisation. Both Hambros and the Post Office are agreed that such buyers could be found, although no approaches have been made to any such bodies. It would be

possible to isolate acceptable buyers by limiting the buyers to whom Girobank is offered; since the motivation in doing this will be the public interest (preserving jobs in high unemployment areas and protecting the viability of the Counters network) Ministers would presumably be willing to defend such a decision.

18 So far the Government have expressed no view as to the preferred method of sale, but have opposed the retention of a Post Office stake in a privatised Girobank. More crucial to the question of a management buyout is the Bank of England's attitude, since the Bank's recognition is essential for Girobank to continue trading. The Bank would be willing to consider any specific proposition; in general, however, its attitude will be governed by the strength of the consortium, on whom it would seek to lay a joint and several liability. The Bank's initial reaction suggests that, though not objectionable in principle, a leveraged buyout is likely to gain the Bank's approval only on very stringent terms. In particular the Bank would require a letter of comfort from each member of the buyout consortium with a significant stake (10-15 per cent or more). Indeed, in view of the close interdependence of Girobank and Counters, the Bank has not ruled out the possibility of seeking a letter of comfort from the Post Office even if the Post Office had no stake in a privatised Girobank. However, such a demand would be unprecedented and could probably be resisted.

19 The Bank of England's requirement of a letter of comfort from the consortium participants raises difficulties so far as the Post Office is concerned. Such letters are not legally enforceable, but when given by a nationalised industry are regarded by the Government as morally binding, in the same way as if given by the Government. But it is contradictory to the principle of privatisation for the Government (even indirectly) to retain a contingent liability in respect of a former nationalised undertaking. The Post Office's own interest could be protected by the presence of a director on the board of the new company, but this might raise the question of control in the new company: in other words, could Girobank be properly described in those circumstances as having left the public sector?

Transfer of staff and pensions

20 Girobank's 5850 staff formally remain employees of the Post Office but with Girobank bearing all staff costs. It would be technically straightforward to make the staff direct Girobank employees, but handling of this would require care in order not to inflame union hostility.

21 Girobank staff employed since before 1 April 1987 are members of the Post Office Staff Superannuation Scheme (POSSS). More recent recruits are members of the new Post Office Pension Scheme (POPS). The POSSS and POPS Trust Deeds prevent the direct splitting-off of assets to fund a separate Girobank scheme which could be carried over to the privatised company. A new scheme would have to be established, or arrangements made for Girobank employees to be accommodated in the purchaser's existing pension scheme. The transfer of part of the assets of POSSS or POPS to an

outside scheme is barred by the Trust Deeds, but the Trustees can make 'transfer value payments' in respect of each employee, the sum of which is estimated to require only about £1 million to make the amount transferred up to the full value of assets referable at present to Girobank employees in POSSS and POPS.

Potential proceeds

22. Hambros were unable to approach potential purchasers in view of the need for confidentiality. If the capitalisation of the subordinated debt in Girobank held by the Post Office is assumed to be £29 million at the time of sale, the present net asset value of Girobank is around £120 million. However, Hambros believe that - on the basis of an appropriate price/earnings ratio - Girobank has a total value of almost £140m, or £110 million for the share capital, a premium of 17 per cent to net assets. Hambros also believe that if the planned growth in profits in 1988-89 were achieved and if market factors remain the same, the business could be valued at £200-230 million by the end of that financial year, of which £170-200 million would be attributable to the equity. The full proceeds less the agreed costs of the sale and any tax payable in connexion with it will be reflected in the Post Office EFL for that year, and would have a positive PSBR effect, but not produce direct revenue to the Consolidated Fund.

23 The Post Office would have to consider whether to allow a discount to facilitate a management buyout. A maximum of 5 per cent was granted for buyouts of bus companies.

Timing

24 It is estimated that the process of sale might take about eight or nine months from the date of an announcement. The timing of such an announcement will always be problematical but there is a major industrial relations issue on the boil: the UCW Conference in May demanded a three-hour cut in the working week, to be agreed by September. Post Office management has made it plain that it is not prepared to go beyond the one-hour reduction (at nil cost to the Post Office) that was tabled in negotiations before the May conference. The UCW is balloting its members on strike action, and the result is expected by about mid-November. It would be desirable to defer any announcement on Girobank privatisation until the industrial relations scene had quietened down considerably - but this could be a formula for indefinite delay. An announcement late this year would pave the way for a sale date in the summer or autumn of next year at the earliest but that now seems likely, in any case, to follow from the reference of the Crown post office network to the Monopolies and Mergers Commission (MMC). Buyers of Girobank are unlikely to be willing to proceed while union hostility is focused on pending charges to the counters network.

25 Sir Ronald Dearing, who relinquished the Post Office Chairmanship at the end of September, believed decisions on the Counters network must be taken before proceeding with privatisation. He arranged for the internal post office network

review to be expedited so that the Board might reach some broad conclusions in the autumn. Detailed proposals will not be ready until next spring, but it is probable that the review will suggest shedding half of the present 1,500 Crown offices, some by mergers but most by conversion into sub-offices or the new type of 'franchised' in-store post office. Any such radical changes will involve difficult negotiations with the unions and the sub-postmasters, and will inevitably create a climate of uncertainty that would jeopardise a successful sale. Sir Ronald hoped that sufficient progress might have been made to permit sale of Girobank to be launched in mid-1988. He asked that the duration of the MMC reference should be confined to four months to facilitate this. The MMC have undertaken to limit their inquiry to six months and, if possible, to complete it sooner. However, their report is unlikely to be published until April at the earliest.

26 However, if the sale were deferred until the spring or summer of 1989, or preferably 1990, the proceeds could well be substantially greater. Girobank management assert that those higher proceeds will come only if the Business Plan is achieved, and the Plan is achievable only if Girobank has the flexibility available outside the public sector. Hambros believe that, although management stand to gain personally from an early management buyout, their comments on this should be taken seriously. Indeed, failure to respond to these views would be a serious blow to management morale and its ability to recruit.

27 Hambros accordingly recommend that, if privatisation is to be deferred for another two years or more (with flotation in 1990), the regime under which Girobank operates should be amended so that:

(a) management have flexibility over the remuneration packages they can offer including the ability to offer share options to management and staff (these could become exercisable at around the likely time of flotation);

(b) Girobank has greater flexibility to undertake new types of business, for example by setting up or even acquiring its own insurance broking capability; and

(c) capital expenditure (up to stated limits but including such major investments as the contingency centre) can be committed without official authorisation and to the extent that funding is internally available.

Such a regime would be a radical departure from the principles currently underlying the relationship between the Government and Girobank as a nationalised industry.

28 If the Government are not willing to devise such a special regime for Girobank as a preparation for its ultimate flotation in 1990, Hambros take the view that the Government should not risk the asset they have by losing the support of Girobank's management. The lesser risk would, in Hambros' view, be to allow management to proceed with an immediate buyout, should they be

able to raise the funds to do so, but on the basis that any such proposal would need to compete with (but not necessarily match the price of) a sale to an acceptable third party.

Conclusions

29 Most of the problems outlined above are superable though the industrial relations climate makes the consequences of an early announcement of a decision to consider privatisation unpredictable. On the other hand, continued uncertainty about the status of Girobank will have a damaging effect on the business. It is very desirable to make the Government's intentions known to at least a group of Girobank senior managers as soon as possible.

DTI
November 1987



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CH/EXCHEQUER	
NOV 17 1987	

TO:
PRIME MINISTER

FROM:
KENNETH CLARKE
17 November 1987

FINANCIAL SECRETARY	
REC.	17 NOV 1987
ACTION	MR D.J.L. MOORE
COPIES TO	PPS, CST, EST SIE. P. Middleton MR. Marsh MRS. Lane AX MR. Calman MR. CASH Mrs Brown

*It is not...
Mr. Clark to...
Mrs. Lane...
Mr. Moore...
Mrs. Brown...
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9 I am copying this minute to Willie Whitelaw, Nigel Lawson, David Young and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to be 'K. Clarke', written in a cursive style.

KENNETH CLARKE



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From the Chancellor of the Duchy of Lancaster
and Minister of Trade and Industry

THE RT HON KENNETH CLARKE QC MP

Andy Bearpark Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

17 November 1987

Dear Andy,

GIROBANK

As you will be aware the Chancellor has today written to the Prime Minister about the privatisation of Girobank. I am attaching for your information a paper which sets out in greater detail the background to this issue.

I am copying this letter to the private secretaries to the Lord President, the Chancellor of the Exchequer and Sir Robert Armstrong.

Yours sincerely,

Alastair

ALASTAIR MORGAN
PRIVATE SECRETARY

MORGAN
TO
BEARPARK
17 NOV

NO3ABX

GIROBANK: PRIVATISATION**Introduction**

1 In 1986 Ministers collectively decided that Girobank should not be privatised in advance of the General Election, mainly for reasons of industrial relations in the Post Office and the risk to the current reorganisation of the corporation and important business efficiency initiatives. However, Ministers agreed that privatisation was right in principle for Girobank and should be reconsidered very soon after the Election, together with the future of the rest of the Post Office.

2 During the Election campaign the Prime Minister ruled out privatisation of 'the Royal Mail'. She said that other parts of the Post Office were not closed off to privatisation, but that she doubted very much that the Government would have time to privatise them in the coming parliament. Girobank is the only part of the Post Office that is a possible early candidate for privatisation, and disposal need not require legislation.

3 Girobank is a wholly-owned subsidiary of the Post Office. The Secretary of State may direct the Post Office to dispose of Girobank, or the Post Office may do so, with the consent or authority of the Secretary of State, if it considers that course to be in the best interests of the Post Office. The Board's public position before the Election was that ownership was a matter for the Government, but that if privatisation were proposed, it should apply to the Post Office as a whole and the group should remain intact. However, the then chairman - Sir Ronald Dearing - also made clear to the Government the Board's readiness to comply with the Government's decisions on the future of Girobank. The new Chairman, Sir Bryan Nicholson, is reported as saying that the Board will need to consider the implications of the Prime Minister's statement.

Background

4 The feasibility of privatising Girobank was studied in 1985 by Hambros. On the basis of that study, Mr Brittan wrote to the Chancellor of the Exchequer in January 1986 to say that privatisation was feasible in the life-time of that parliament and should be undertaken, with completion expected in November 1986. The Treasury's reply supported early privatisation in principle but asked for collective discussion of the issues, including the implications for Counters, prior to any announcement. When Mr Channon subsequently came to review the prospects, he concluded that announcement of early privatisation would exacerbate the worsening industrial relations situation and constitute an unacceptable threat to the reorganisation of the Post Office and other objectives. Ministers collectively agreed to shelve the proposition until after the Election. In the meantime the Post Office Board commissioned, on its own initiative, merchant bank advice on privatisation of either Girobank or the Post Office as a whole. Also Hambros have recently conducted a short study to update their earlier work.

Reasons for privatising Girobank

5 After a financially shaky start Girobank has become successful and profitable, recording increased profits almost every year since 1974/75. Building upon its longstanding policy of free banking and use of the extensive post office network, it has developed a base of 2 million personal current account holders. It has also secured a pre-eminent and profitable niche in corporate banking, by taking in retailers' cash and supplying the Post Office with the cash it needs to make social security and pension payments for the DHSS. But its success in banking the unbanked and in becoming the prime handler of corporate retail deposits has left the bank with a narrow profit base. Changes in the financial market threaten Girobank's position unless it responds competitively. A major barrier to expansion is the need for capital support at the level required to satisfy the prudential limits applied to banks generally by the Bank of England. To enable Girobank to take a modest step towards expansion into more profitable and riskier business, Ministers agreed earlier this year to a capital injection of £20 million (in two £10 million tranches, this year and in 1988/89). In the private sector Girobank would have greater freedom to attract capital to sustain more profitable expansion in areas of business which public expenditure constraints on its capital at present prevent it from entering.

6 The MD of Girobank was recruited from the private sector in 1985 in the expectation that the bank would be privatised in the next two or three years. Since then he has built up a team of some 50 banking specialists who have seen attraction in getting in on the ground floor of a business about to be privatised. It is doubtful how long these newcomers would wish to stay if privatisation were ruled out or a decision were deferred for another year.

Main problems

7 Two major points that require close consideration in deciding on privatisation are the risk of industrial conflict and the possible impact on the Counters business.

Industrial action

8 Most staff at the Girobank Centre, at Bootle, are represented by the National Communications Union (Clerical Section) or the Society of Civil and Public Servants. They include a number of activists aligned to the Militant Tendency who would oppose the sale vigorously, and sustained action by a few key workers in Bootle could seriously damage the business. Nevertheless, in the view of the Post Office the Bootle workforce would not carry their opposition to the point of jeopardising their jobs. More problematical is the attitude of the Post Office unions. Officially they are strongly opposed to privatisation, and they have it in their power to cripple Girobank, either by non-cooperation at post office counters or by blockading mail to and from Girobank. The Prime Minister's remarks during the campaign will have given some reassurance. This would be

enhanced if the Government made clear that they had no plans to privatise any other part of the Post Office provided there were no serious interruption to services nor union obstruction to Girobank privatisation. Privately, the leaders of the main Post Office union, the Union of Communication Workers (UCW), have made it clear that (although committed publicly to oppose privatisation) if privatisation were in prospect they would expect their members to have an opportunity to participate on preferential terms. Meanwhile, industrial relations remain fragile and there is the possibility of major trouble before Christmas over the UCW's claim for a shorter working week.

Girobank relationship with Post Office Counters

9 Girobank and Counters' operations are inter-linked. Post offices provide Girobank with its retail outlets, the significance of which is reflected by the proportion of Girobank's costs (50 per cent) made up by Counters' charges for services. Girobank represents 18 per cent of Counters' business and its importance as a source of business to Counters has grown as Government, chiefly DHSS, work has become less secure.

10 Girobank's Business Plan proposes expansion into areas of activity which will be handled by mail or telephone rather than over post office counters. The prospect is therefore for only modest growth in Girobank transactions over counters whether Girobank is sold or not, although a wider range of services will benefit Counters' volume by retaining personal customers using counters who might otherwise drift away.

11 Girobank and Counters have an agreement, negotiated at arm's length, for a five-year relationship. The agreement is thought to be insufficiently robust in commercial terms and, because it imposes constraints on both sides, it would contravene restrictive trade practices legislation if Girobank left the Post Office group. The terms of the agreement are therefore being reviewed to determine the changes necessary to overcome these problems. Irrespective of contractual arrangements, however, a privatised Girobank would in practical terms be unable to withdraw quickly from Counters because of the nature of the business - and a purchaser intending to do so would anyway not be acceptable. The Post Office would wish to safeguard Counters' interests by binding the purchaser (albeit at the cost of reduced sale proceeds), but it is unlikely that such protection could be assured for more than five years after sale.

12 A purchaser might wish to make more selective use of the network, for instance using his own outlets where available. Ultimately Girobank, which negotiates with Counters at arm's length, will decide on the use of the network (as will any other user) on the basis of the cost and efficiency of Counters' services, regardless of whether Girobank stays in the public sector or is privatised. However, so long as it remains in the Post Office group, Girobank will inevitably be under heavy pressure to continue to use the whole of the Counters network. Counters aims to retain traffic by improved competitiveness. The beneficial impact of automation and the

extension of Counters' powers would be of advantage to Girobank whatever its status.

Other issues

13 (i) Non-competition covenant

It was previously thought that a short Bill might be needed to allow the Post Office to enter into a legally-binding contract not to compete with a privatised Girobank, as its present statutory powers cannot be fettered in this way. However, with the establishment of the Counters business as a subsidiary of the Post Office on 1 October this year (as Post Office Counters Ltd), it is now possible, subject to the constraints of UK and EC competition law, for Counters (as a separate legal entity) to agree with a purchaser of Girobank not to provide banking-agency services at Counters' outlets to anyone else for as long as Girobank continues to use these services. This would not fetter the Post Office's powers to provide banking services. In practice this arrangement is likely to satisfy a purchaser and so avoid the need for short but controversial legislation.

(ii) Potential foreign or undesirable purchasers. Foreign banks were among the possible categories of purchasers identified by Hambros. It could be a source of controversy if one of these made the highest offer. A statement at the start of the privatisation process excluding foreign bids would hold difficulties in relation to the EC. Other prospective purchasers, whether foreign or not, might be objectionable to the Government or the Bank of England for a variety of reasons, including monopoly considerations.

(iii) Government Direction: The Law Officers advise that the Post Office may dispose of subsidiaries voluntarily only if it is in its best commercial interests. The Government's policy on privatisation cannot be a proper consideration of the Board, and if the Post Office came to a formal view that privatisation was against the Post Office's best interests, the Secretary of State would need to issue a statutory direction. A purchaser could well expect this protection before proceeding with the purchase. Provided, however, that there was no challenge (say, by the unions) to the Board's starting the process of sale without a Direction, the issue of a formal Direction could be delayed until late in the process. This would avoid its being a focus for political controversy. Moreover, the informal influence which the Government and the Bank of England would wish to have over the final choice of purchaser would be

safeguarded if the issue of a Direction were delayed until unacceptable purchasers had been eliminated. Nevertheless, in order to ensure that the Board was acting within its powers in incurring expenditure on privatisation, it would be necessary for the Government to inform the Board of their intention to issue a Direction in due course. While the Board's attitude is cooperative, it is possible that, if industrial relations worsened, it would not wish to take any steps towards a sale without a Direction.

- (iv) **Taxation:** The transfer of assets to Girobank plc in 1985 would attract Capital Gains Tax if it is sold within six years. This tax, perhaps £20 million, would be payable by the purchaser and would tend to depress the price commensurately. The PBSR effect would be neutral. A potentially more serious problem would arise if VAT were payable on the services provided by Counters to Girobank: it would wipe out Girobank's profits at a stroke. HM Customs and Excise will need to be asked to confirm its preliminary view that VAT would not be chargeable because the services covered by the contract are within the definition of banking services.
- (v) **Possible loss of Government business.** DHSS business alone made up £53 million (or around 16 per cent) of Girobank's income in 1986/87. If DHSS were to feel that its close relationship with Girobank after privatisation were no longer appropriate, this would affect the sale price. Because of this vulnerability, Girobank is exploring with DHSS the possibility of concluding a five-year contract and is optimistic on the basis of progress so far.
- (vi) **Contingency centre.** The need for a contingency centre is an issue that is likely to be of considerable interest to potential investors seeking to minimise their risk. Such a centre would provide on a separate site emergency back-up in the event of major dislocation of operations at Girobank's main processing centre at Bootle. All other banks own or have access to such back-up facilities, and it is a provision to which the Bank of England attaches importance. Girobank is discussing with DTI the possibility of securing grant assistance before formulating a detailed plan but hopes to make a start on the project next spring. This would mean the Government being expected to approve this large investment in advance of privatisation, even though some purchasers might have facilities that would make some or all of the additional investment by Girobank unnecessary.

Method of privatisation

14 In 1985 Hambros rejected flotation as a viable option at least for a few years, mainly because of the need to remedy a number of operating difficulties (such as deficiencies in the computer and information systems) in order to retain Bank of England confidence after the withdrawal of the Post Office's support. Since 1985 the new MD has done much to remedy these weaknesses: new systems are being installed, new staff have been recruited, and new products have been developed. Nevertheless, Hambros judge that flotation cannot be contemplated until these improvements are implemented and have begun to bear fruit: 1990 seems the earliest date for flotation.

15 If disposal before then is desired, the options are a trade sale or a management buyout. The Post Office's advisers did not favour a trade sale, both because of the difficulty of restricting the sale to a list of acceptable candidates and because even an acceptable buyer might subsequently sell the bank to another body which might have less commitment to the Counters network. The Post Office was accordingly advised to consider a "leveraged management buyout", with the Post Office retaining a stake of say 20 per cent, and some 10-15 financial institutions as equity partners with none having more than say a 15 per cent holding. In support of continuing Post Office involvement it is argued that the Post Office unions and the sub-postmasters would regard it as a statement of good intentions towards the Counters network, thus helping to allay opposition to privatisation. Potential investors might value the Post Office's continuing involvement if they attach importance to ultimate renewal of the contractual relationship with Counters. Such a leveraged buyout might pave the way for a public flotation in two-three years' time when Post Office staff and sub-postmasters might have the opportunity of preferential share applications.

16 The MD of Girobank believes it will be possible to mobilise a group of institutional investors to fund such a leveraged management buy-out and is personally very committed to this solution. There is a potential conflict of interest between the management team, as promoters of a buy-out, and the Post Office as seller to which all parties, including the Government, will need to be alert.

17 As regards a trade sale, with Girobank accounting for about 18 per cent of Counters' business the Post Office is understandably concerned both to protect its Counters business and about the impact of a sale on industrial relations in Counters. However, sale to a buyer who undertook to continue to use Counters would overcome these difficulties. For Girobank it would be important that the buyer should undertake to provide continued employment to the Bootle workforce. The question arises whether buyers could be found to meet these requirements. They will also need to be buyers who are acceptable to the Bank of England as "fit and proper" entities of sufficient standing to own a major banking organisation. Both Hambros and the Post Office are agreed that such buyers could be found, although no approaches have been made to any such bodies. It would be

possible to isolate acceptable buyers by limiting the buyers to whom Girobank is offered; since the motivation in doing this will be the public interest (preserving jobs in high unemployment areas and protecting the viability of the Counters network) Ministers would presumably be willing to defend such a decision.

18 So far the Government have expressed no view as to the preferred method of sale, but have opposed the retention of a Post Office stake in a privatised Girobank. More crucial to the question of a management buyout is the Bank of England's attitude, since the Bank's recognition is essential for Girobank to continue trading. The Bank would be willing to consider any specific proposition; in general, however, its attitude will be governed by the strength of the consortium, on whom it would seek to lay a joint and several liability. The Bank's initial reaction suggests that, though not objectionable in principle, a leveraged buyout is likely to gain the Bank's approval only on very stringent terms. In particular the Bank would require a letter of comfort from each member of the buyout consortium with a significant stake (10-15 per cent or more). Indeed, in view of the close interdependence of Girobank and Counters, the Bank has not ruled out the possibility of seeking a letter of comfort from the Post Office even if the Post Office had no stake in a privatised Girobank. However, such a demand would be unprecedented and could probably be resisted.

19 The Bank of England's requirement of a letter of comfort from the consortium participants raises difficulties so far as the Post Office is concerned. Such letters are not legally enforceable, but when given by a nationalised industry are regarded by the Government as morally binding, in the same way as if given by the Government. But it is contradictory to the principle of privatisation for the Government (even indirectly) to retain a contingent liability in respect of a former nationalised undertaking. The Post Office's own interest could be protected by the presence of a director on the board of the new company, but this might raise the question of control in the new company: in other words, could Girobank be properly described in those circumstances as having left the public sector?

Transfer of staff and pensions

20 Girobank's 5850 staff formally remain employees of the Post Office but with Girobank bearing all staff costs. It would be technically straightforward to make the staff direct Girobank employees, but handling of this would require care in order not to inflame union hostility.

21 Girobank staff employed since before 1 April 1987 are members of the Post Office Staff Superannuation Scheme (POSSS). More recent recruits are members of the new Post Office Pension Scheme (POPS). The POSSS and POPS Trust Deeds prevent the direct splitting-off of assets to fund a separate Girobank scheme which could be carried over to the privatised company. A new scheme would have to be established, or arrangements made for Girobank employees to be accommodated in the purchaser's existing pension scheme. The transfer of part of the assets of POSSS or POPS to an

outside scheme is barred by the Trust Deeds, but the Trustees can make 'transfer value payments' in respect of each employee, the sum of which is estimated to require only about £1 million to make the amount transferred up to the full value of assets referable at present to Girobank employees in POSSS and POPS.

Potential proceeds

22. Hambros were unable to approach potential purchasers in view of the need for confidentiality. If the capitalisation of the subordinated debt in Girobank held by the Post Office is assumed to be £29 million at the time of sale, the present net asset value of Girobank is around £120 million. However, Hambros believe that - on the basis of an appropriate price/earnings ratio - Girobank has a total value of almost £140m, or £110 million for the share capital, a premium of 17 per cent to net assets. Hambros also believe that if the planned growth in profits in 1988-89 were achieved and if market factors remain the same, the business could be valued at £200-230 million by the end of that financial year, of which £170-200 million would be attributable to the equity. The full proceeds less the agreed costs of the sale and any tax payable in connexion with it will be reflected in the Post Office EFL for that year, and would have a positive PSBR effect, but not produce direct revenue to the Consolidated Fund.

23 The Post Office would have to consider whether to allow a discount to facilitate a management buyout. A maximum of 5 per cent was granted for buyouts of bus companies.

Timing

24 It is estimated that the process of sale might take about eight or nine months from the date of an announcement. The timing of such an announcement will always be problematical but there is a major industrial relations issue on the boil: the UCW Conference in May demanded a three-hour cut in the working week, to be agreed by September. Post Office management has made it plain that it is not prepared to go beyond the one-hour reduction (at nil cost to the Post Office) that was tabled in negotiations before the May conference. The UCW is balloting its members on strike action, and the result is expected by about mid-November. It would be desirable to defer any announcement on Girobank privatisation until the industrial relations scene had quietened down considerably - but this could be a formula for indefinite delay. An announcement late this year would pave the way for a sale date in the summer or autumn of next year at the earliest but that now seems likely, in any case, to follow from the reference of the Crown post office network to the Monopolies and Mergers Commission (MMC). Buyers of Girobank are unlikely to be willing to proceed while union hostility is focused on pending charges to the counters network.

25 Sir Ronald Dearing, who relinquished the Post Office Chairmanship at the end of September, believed decisions on the Counters network must be taken before proceeding with privatisation. He arranged for the internal post office network

review to be expedited so that the Board might reach some broad conclusions in the autumn. Detailed proposals will not be ready until next spring, but it is probable that the review will suggest shedding half of the present 1,500 Crown offices, some by mergers but most by conversion into sub-offices or the new type of 'franchised' in-store post office. Any such radical changes will involve difficult negotiations with the unions and the sub-postmasters, and will inevitably create a climate of uncertainty that would jeopardise a successful sale. Sir Ronald hoped that sufficient progress might have been made to permit sale of Girobank to be launched in mid-1988. He asked that the duration of the MMC reference should be confined to four months to facilitate this. The MMC have undertaken to limit their inquiry to six months and, if possible, to complete it sooner. However, their report is unlikely to be published until April at the earliest.

26 However, if the sale were deferred until the spring or summer of 1989, or preferably 1990, the proceeds could well be substantially greater. Girobank management assert that those higher proceeds will come only if the Business Plan is achieved, and the Plan is achievable only if Girobank has the flexibility available outside the public sector. Hambros believe that, although management stand to gain personally from an early management buyout, their comments on this should be taken seriously. Indeed, failure to respond to these views would be a serious blow to management morale and its ability to recruit.

27 Hambros accordingly recommend that, if privatisation is to be deferred for another two years or more (with flotation in 1990), the regime under which Girobank operates should be amended so that:

(a) management have flexibility over the remuneration packages they can offer including the ability to offer share options to management and staff (these could become exercisable at around the likely time of flotation);

(b) Girobank has greater flexibility to undertake new types of business, for example by setting up or even acquiring its own insurance broking capability; and

(c) capital expenditure (up to stated limits but including such major investments as the contingency centre) can be committed without official authorisation and to the extent that funding is internally available.

Such a regime would be a radical departure from the principles currently underlying the relationship between the Government and Girobank as a nationalised industry.

28 If the Government are not willing to devise such a special regime for Girobank as a preparation for its ultimate flotation in 1990, Hambros take the view that the Government should not risk the asset they have by losing the support of Girobank's management. The lesser risk would, in Hambros' view, be to allow management to proceed with an immediate buyout, should they be

able to raise the funds to do so, but on the basis that any such proposal would need to compete with (but not necessarily match the price of) a sale to an acceptable third party.

Conclusions

29 Most of the problems outlined above are superable though the industrial relations climate makes the consequences of an early announcement of a decision to consider privatisation unpredictable. On the other hand, continued uncertainty about the status of Girobank will have a damaging effect on the business. It is very desirable to make the Government's intentions known to at least a group of Girobank senior managers as soon as possible.

DTI
November 1987



FROM: J M G TAYLOR
DATE: 18 November 1987

MR COLMAN


cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mr D J L Moore
Mrs Brown
Mr Call

GIROBANK

The Chancellor has seen Mr Clarke's minute of 17 November to the Prime Minister.

2. He has noted the statement that 'the Bank of England have indicated that they will find it easier to recognise a privatised Girobank if the Post Office were to retain a substantial stake in it and give the Bank of England a letter of comfort'. He thinks this is absurd. A trade sale (which is the only satisfactory way of privatising Girobank) to a financially robust institution, or consortium of institutions, should be perfectly acceptable to the Bank.

3. He has commented further that it is most reprehensible of DTI to have opened up consultations with the Bank on this without having discussed the matter with us first.


J M G TAYLOR

*copy with CH scribbles
accidentally destroyed
this minute incorporates
all his comments*

SECRET



FROM: J J HEYWOOD
DATE: 24 NOVEMBER 1987

MR MOORE

cc PS/Chancellor
PS/Chief Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mrs Brown
Mr Colman
Mr Call

GIROBANK

The Financial Secretary has read Mr Clarke's minute to the Chancellor of 17 November.

2. He has commented "Very good news - another variable in the proceeds timetable. What is paragraph 7 all about?"

3. The Financial Secretary also asked what the value of Girobank is. Flicking through the detailed DTI paper it looks as though the answer might lie in the range £100-200 million. Is that a reasonable ball-park estimate?

9/2

J J HEYWOOD
PRIVATE SECRETARY

SECRET

FROM: J G COLMAN
DATE: 26 November 1987

1. MR D J L MOORE *Note at end JGC/afu*
2. FINANCIAL SECRETARY

- cc **Chancellor**
 Chief Secretary
 Economic Secretary
 Sir P Middleton
 Mr Monck
 Mrs Lomax
 Mrs M E Brown
 Mr Lyne
 Mr Board
 Mr Hood
 Mr Call

GIROBANK PRIVATISATION

Mr Clarke's minute of 17 November proposes that:

- a decision should be taken now to press ahead with privatisation of Girobank;
- an announcement should be made in the New Year;
- the aim should be to complete the sale before the end of 1988-89.

This is good news, as you have commented, and we recommend that you should agree to (a) and to (b). There is, however, a possible problem over the proposed timing.

The principle of privatisation

We entirely agree with Mr Clarke (para 2) that there is no reason why Girobank should remain in the public sector. It is true that privatisation would involve the risks to the PO Counters business described in Mr Clarke's paragraph 3, leading either to costs falling on public expenditure or cuts in the PO network or, more probably, both. But the existence of these risks does not justify retaining Girobank in the public sector and restraining Girobank's commercial freedom simply to disguise the potential commercial failure of Counters.

*Note by JG Colman
yesterday p.p.*

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no: you have 26/11
... in addition... we should be made to look... cheap... @ a

*CIT/imp
M.*

Timing of the announcement

4. This, and the security classification of Mr Clarke's minute, are determined by industrial relations considerations. The PO unions are thought likely to be opposed to privatisation of Girobank, and at Girobank's computer centre in Bootle there is a loud, and possibly powerful, group of Militant staff. Because of the high degree to which Girobank's operations are centralised, it is very much at risk from industrial trouble at Bootle.

5. The handling of the announcement of the decision will require the greatest care. Mr Clarke's proposes an announcement in the New Year to avoid adding to the existing industrial relations problems in the PO as a whole. As you know, there is a real risk of a national postal strike before Christmas over the issue of the working week. That timing may well be right but will need to be considered further in the light of developments with the PO unions generally.

Timing of the sale and proceeds

6. The note by DTI officials circulated simultaneously with Mr Clarke's minute discusses (paras 25-28) an issue not addressed by Mr Clarke. This is the question of whether the sale should be deferred until 1989 or 1990: by then the new business plan should have been achieved and Hambros advise that proceeds might rise from the £110m they estimate for a sale in 1988 to £170-200m on the basis of the forecast 1988-89 profits.

7. The catch is that Hambros think that the top management of Girobank will resign if they are not allowed to mount a buyout before 1989 or 1990 and if the regime under which Girobank operates is not fundamentally changed. The management say that they would want:

SECRET

- flexibility on remuneration packages, including share options.
- greater flexibility for Girobank to take on new types of business.
- greater freedom to commit capital expenditure within stated limits.

8. In my view, this proposed regime has been drawn up to look worse than it needs to be. As to pay, Girobank and the PO already have flexibility on remuneration below PO board level. Only the Girobank Managing Director, Mr Williamson, is on the PO board, and, if it were thought necessary to pay him more in order to retain him, there is some flexibility in the pay regime for nationalised industry board members to permit this. Alternatively, any pay problem for Mr Williamson might be sidestepped so far as HMG is concerned if he were to stand down from the PO board (as, arguably he should if he is leading the buyout team), and draw his salary from Girobank. That salary would not be controlled by Government. Even share options for exercise after privatisation might be arranged (as being a matter between the buyout team and their backers). Freedom within limits on types of business and on capital expenditure does not, I think, raise issues of principle. This need be no more than some revision of the delegated authorities of Girobank within the existing controls on external finance. (There could however be no question of permitting Girobank to take the decision on the contingency centre, as that could affect the prospects of a sale of Girobank to other bidders).

9. There is a middle way between an early sale of 100% of Girobank and deferment until 1990 in the hope of much higher proceeds. This would be for an early sale of say, 51% of Girobank with the PO to retain a substantial minority holding for disposal when the business plan has been achieved.

10. It is not necessary to decide now on the precise timing of the sale. We recommend that you should invite Mr Clarke to consider the question of timing further in the light of the points made above, and of the views of the PO on timing (which DTI have not had).

Bank of England Requirements

11. As the Chancellor has commented, the fact that DTI have had discussions with the Bank of England without consulting us is reprehensible. We believe, however, that no permanent harm has, on this occasion, resulted.

12. Mr Clarke's minute and the DTI paper give a somewhat confusing picture of the Bank's approach. We think that the position is, in fact, as follows:

- a. a management buy-out of a clearing bank would present the Bank with an unprecedented situation from the point of view of banking supervision;
- b. the Bank would want to be very cautious (as we would want them to be);
- c. purely from the supervisory viewpoint, the Bank might need some kind of parent company guarantee, or letter of comfort from one of the major backers of the buyout. And if the PO were shareholders after the buyout the Bank might want to look to the PO for comfort. This could indeed land the PO with an unlimited liability and we would need to consider very carefully whether that would be acceptable;
- d. Even if the PO were not shareholders, but in view of the intimate involvement of the PO Counters in Girobank's business, the Bank might want to be satisfied that Girobank was properly protected from risks arising from action by the PO. That protection might take

the form of a letter of comfort;

- e. if Girobank did not go to a management buyout, but were sold in a trade sale, the Bank's supervisors would want to look closely at the new proprietor. If the PO were not shareholders, the case for a PO letter of comfort would not be strong: how strong would depend on who the new proprietor was.

13. The conclusion we draw from this is that the fact that the Bank will need to be satisfied in due course should not interfere with a decision now to privatise Girobank, to announce that decision, and to proceed with the detailed work which will be necessary to get the sale off the ground.

Conclusion

14. I attach a draft minute.

J. G. C.

J G COLMAN

The sale will be by the PO. On past precedents^{for} sales of subsidiaries the proceeds would not score as privatisation proceeds but as a reduction in the PO's EFL ie as a reduction in National Industries public expenditure. If the sale were deferred to get better proceeds a flotation - rather than a trade sale or management buyout - could cause us difficulties if we had to find room among the series of Water and Electricity sales we hope could start from November 1989. But that is not an argument against looking further at the options for timing and form of sale.

DJM.

D J L MOORE

DRAFT MINUTE FROM THE FINANCIAL SECRETARY
TO THE PRIME MINISTER

GIROBANK

I have seen Kenneth Clarke's minute of 17 November to you.

2. This is very good news. I entirely agree that we should decide now, in principle, to privatise Girobank, and that this should be announced in the New Year if that continues to be his and the Post Office's judgement of the best time from the point of view of the industrial relations in the Post Office. As the DTI note makes clear, the industrial relations aspects will need to be handled with the greatest care.

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100%

4. I agree that the supervisory requirements of the Bank of England will have a bearing on the sale and will need to be considered further with the Bank. That need not stop the further

detailed work of preparations for sale which Kenneth Clarke rightly identifies as being necessary. It is essential that the Treasury should be involved in all consultations (as regrettably we were not in the past) with the Bank on their questions.

NL

SECRET

FROM: J G COLMAN

DATE: 26 November 1987

1. MR D J L. MOORE *Note at end of memo*
2. FINANCIAL SECRETARY

cc Chancellor
 Chief Secretary
 Economic Secretary
 Sir P Middleton
 Mr Monck
 Mrs Lomax
 Mrs M E Brown
 Mr Lyne
 Mr Board
 Mr Hood
 Mr Call

GIROBANK PRIVATISATION

Mr Clarke's minute of 17 November proposes that:

- a. a decision should be taken now to press ahead with privatisation of Girobank;
- b. an announcement should be made in the New Year;
- c. the aim should be to complete the sale before the end of 1988-89.

2. This is good news, as you have commented, and we recommend that you should agree to (a) and to (b). There is, however, a possible problem over the proposed timing.

The principle of privatisation

3. We entirely agree with Mr Clarke (para 2) that there is no reason why Girobank should remain in the public sector. It is true that privatisation would involve the risks to the PO Counters business described in Mr Clarke's paragraph 3, leading either to costs falling on public expenditure or cuts in the PO network or, more probably, both. But the existence of these risks does not justify retaining Girobank in the public sector and restraining Girobank's commercial freedom simply to disguise the potential commercial failure of Counters.

COLMAN
 TO
 FGT
 26 NOV

Timing of the announcement

4. This, and the security classification of Mr Clarke's minute, are determined by industrial relations considerations. The PO unions are thought likely to be opposed to privatisation of Girobank, and at Girobank's computer centre in Bootle there is a loud, and possibly powerful, group of Militant staff. Because of the high degree to which Girobank's operations are centralised, it is very much at risk from industrial trouble at Bootle.

5. The handling of the announcement of the decision will require the greatest care. Mr Clarke's proposes an announcement in the New Year to avoid adding to the existing industrial relations problems in the PO as a whole. As you know, there is a real risk of a national postal strike before Christmas over the issue of the working week. That timing may well be right but will need to be considered further in the light of developments with the PO unions generally.

Timing of the sale and proceeds

6. The note by DTI officials circulated simultaneously with Mr Clarke's minute discusses (paras 25-28) an issue not addressed by Mr Clarke. This is the question of whether the sale should be deferred until 1989 or 1990: by then the new business plan should have been achieved and Hambros advise that proceeds might rise from the £110m they estimate for a sale in 1988 to £170-200m on the basis of the forecast 1988-89 profits.

7. The catch is that Hambros think that the top management of Girobank will resign if they are not allowed to mount a buyout before 1989 or 1990 and if the regime under which Girobank operates is not fundamentally changed. The management say that they would want:

SECRET

- flexibility on remuneration packages, including share options.
- greater flexibility for Girobank to take on new types of business.
- greater freedom to commit capital expenditure within stated limits.

8. In my view, this proposed regime has been drawn up to look worse than it needs to be. As to pay, Girobank and the PO already have flexibility on remuneration below PO board level. Only the Girobank Managing Director, Mr Williamson, is on the PO board, and, if it were thought necessary to pay him more in order to retain him, there is some flexibility in the pay regime for nationalised industry board members to permit this. Alternatively, any pay problem for Mr Williamson might be sidestepped so far as HMG is concerned if he were to stand down from the PO board (as, arguably he should if he is leading the buyout team), and draw his salary from Girobank. That salary would not be controlled by Government. Even share options for exercise after privatisation might be arranged (as being a matter between the buyout team and their backers). Freedom within limits on types of business and on capital expenditure does not, I think, raise issues of principle. This need be no more than some revision of the delegated authorities of Girobank within the existing controls on external finance. (There could however be no question of permitting Girobank to take the decision on the contingency centre, as that could affect the prospects of a sale of Girobank to other bidders).

9. There is a middle way between an early sale of 100% of Girobank and deferment until 1990 in the hope of much higher proceeds. This would be for an early sale of say, 51% of Girobank with the PO to retain a substantial minority holding for disposal when the business plan has been achieved.

SECRET

10. It is not necessary to decide now on the precise timing of the sale. We recommend that you should invite Mr Clarke to consider the question of timing further in the light of the points made above, and of the views of the PO on timing (which DTI have not had).

Bank of England Requirements

11. As the Chancellor has commented, the fact that DTI have had discussions with the Bank of England without consulting us is reprehensible. We believe, however, that no permanent harm has, on this occasion, resulted.

12. Mr Clarke's minute and the DTI paper give a somewhat confusing picture of the Bank's approach. We think that the position is, in fact, as follows:

- a. a management buy-out of a clearing bank would present the Bank with an unprecedented situation from the point of view of banking supervision;
- b. the Bank would want to be very cautious (as we would want them to be);
- c. purely from the supervisory viewpoint, the Bank might need some kind of parent company guarantee, or letter of comfort from one of the major backers of the buyout. And if the PO were shareholders after the buyout the Bank might want to look to the PO for comfort. This could indeed land the PO with an unlimited liability and we would need to consider very carefully whether that would be acceptable;
- d. Even if the PO were not shareholders, but in view of the intimate involvement of the PO Counters in Girobank's business, the Bank might want to be satisfied that Girobank was properly protected from risks arising from action by the PO. That protection might take

the form of a letter of comfort;

- e. if Girobank did not go to a management buyout, but were sold in a trade sale, the Bank's supervisors would want to look closely at the new proprietor. If the PO were not shareholders, the case for a PO letter of comfort would not be strong: how strong would depend on who the new proprietor was.

13. The conclusion we draw from this is that the fact that the Bank will need to be satisfied in due course should not interfere with a decision now to privatise Girobank, to announce that decision, and to proceed with the detailed work which will be necessary to get the sale off the ground.

Conclusion

- 14. I attach a draft minute.

J. G. C.

J G COLMAN

The sale will be by the PO. On past precedents^{for} sales of subsidiaries the proceeds would not score as privatisation proceeds but as a reduction in the PO's EFL ie as a reduction in National~~ised~~ Industries public expenditure. If the sale were deferred to get better proceeds a floatation - rather than a trade sale or management buyout - could cause us difficulties if we had to find room among the series of Water and Electricity sales we hope could start from November 1989. But that is not an argument against looking further at the options for timing and form of sale.

DJM.

D J L MOORE

**DRAFT MINUTE FROM THE FINANCIAL SECRETARY
TO THE PRIME MINISTER**

GIROBANK

I have seen Kenneth Clarke's minute of 17 November to you.

2. This is very good news. I entirely agree that we should decide now, in principle, to privatise Girobank, and that this should be announced in the New Year if that continues to be his and the Post Office's judgement of the best time from the point of view of the industrial relations in the Post Office. As the DTI note makes clear, the industrial relations aspects will need to be handled with the greatest care.

3. The DTI note also brings out, however, that there could be some disadvantages in proceeding simply to a sale in 1988-89. Hambros envisage the possibility of greatly increased proceeds if the sale were delayed until Girobank's business plan had visibly borne fruit, in 1990. Although I am very keen for Girobank to be sold as soon as practicable, I hesitate to conclude now that the sale should definitely be in 1988-89. I suggest that some more work should be done on the options identified by Hambros, and any others, for example, the possibility of an early sale of less than 100% of Girobank.

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NL

SECRET



FROM: J J HEYWOOD
DATE: 24 NOVEMBER 1987

MR MOORE

cc PS/Chancellor
PS/Chief Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mrs Brown
Mr Colman
Mr Call

GIROBANK

The Financial Secretary has read Mr Clarke's minute to the Chancellor of 17 November.

2. He has commented "Very good news - another variable in the proceeds timetable. What is paragraph 7 all about?"

3. The Financial Secretary also asked what the value of Girobank is. Flicking through the detailed DTI paper it looks as though the answer might lie in the range £100-200 million. Is that a reasonable ball-park estimate?

J J
J J HEYWOOD
PRIVATE SECRETARY



of. with reply or
23/11
Be ask when we can expect a reply

FROM: J M G TAYLOR
DATE: 18 November 1987

MR COLMAN

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mr D J L Moore
Mrs Brown
Mr Call

4924

GIROBANK

The Chancellor has seen Mr Clarke's minute of 17 November to the Prime Minister.

2. He has noted the statement that 'the Bank of England have indicated that they will find it easier to recognise a privatised Girobank if the Post Office were to retain a substantial stake in it and give the Bank of England a letter of comfort'. He thinks this is absurd. A trade sale (which is the only satisfactory way of privatising Girobank) to a financially robust institution, or consortium of institutions, should be perfectly acceptable to the Bank.

3. He has commented further that it is most reprehensible of DTI to have opened up consultations with the Bank on this without having discussed the matter with us first.

J M G TAYLOR

SECRET



FROM: J M G TAYLOR
DATE: 30 November 1987

PS/FINANCIAL SECRETARY

cc: PS/CST
PS/EST
Sir P Middleton
Mr Monck
Mrs Lomax
Mr D J L Moore
Mrs Brown
Mr J G Colman
Mr Lyne
Mr Board
Mr Hood
Mr Call


GIROBANK PRIVATISATION

The Chancellor has seen Mr Colman's submission and draft letter of 26 November.

2. He has amended the second paragraph of the draft letter so that it reads:

"The DTI note also brings out, however, that there could be some disadvantages in proceeding simply to a 100 per cent sale in 1988-89. Hambros envisaged the possibility of greatly increased proceeds if the sale were delayed until Girobank's business plan had visibly borne fruit, in 1990. Although I am very keen for Girobank to be privatised as soon as practicable, it might be more sensible for this to be achieved by a sale of 51 per cent of the shares in 1988-89, with the remainder sold later. I suggest that more work should be done on this and other options identified by Hambros."

3. He has commented, however, that the letter needs further amendment, since it does not adequately convey the reservations he has already expressed about a management buy-out (as against a trade sale). A management buy-out is most unlikely to provide a viable entity. In addition to the points he has already made about this, the Government would be made to look very foolish indeed if Girobank were sold to the management only for them to sell out at a vast profit to a large financial institution.


J M G TAYLOR

SECRET



FROM: J M G TAYLOR
 DATE: 30 November 1987

PS/FINANCIAL SECRETARY

cc: PS/CST
 PS/EST
 Sir P Middleton
 Mr Monck
 Mrs Lomax
 Mr D J L Moore
 Mrs Brown
 Mr J G Colman
 Mr Lyne
 Mr Board
 Mr Hood
 Mr Call

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 J M G TAYLOR

JMGT
 TO
 PS/FST
 30 NOV

SECRET

FROM: J G COLMAN

DATE: 1 December 1987

PS/FST

cc Chancellor
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mrs M E Brown
Mr Lyne
Mr Board
Mr Hood
Mr Call

GIROBANK

Mr Taylor's minute of 30 November.

2. I suggest that the best way to amend the draft letter to take account of the Chancellor's reservations about a management buy-out would be to add an additional paragraph at the end on the following lines:

"Nigel Lawson and I have considerable reservations about the idea of a management buy-out. We doubt whether a management buy-out of Girobank would produce a viable entity as a business. The difficulty of meeting supervisory requirements of the Bank of England without throwing liability on the Post Office illustrates this point. In addition, the Government would look very foolish indeed if Girobank were sold to the management only for them to sell out at a vast profit to a large financial institution."

3. It is obviously right to warn Mr Clarke of these reservations. We cannot stop the management bidding if they wish to, although in looking at their bid HMG will have to have viability, price, and risk to the Post Office very much in mind.

J.G.C.

J G COLMAN

SECRET

FROM: J G COLMAN

DATE: 1 December 1987

PS/FST

cc Chancellor
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Monck
Mrs Lomax
Mrs M E Brown
Mr Lyne
Mr Board
Mr Hood
Mr Call

COLMAN
TO
PS/FST
1 DEC

GIROBANK

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J.G.C.

J G COLMAN



A handwritten signature in black ink, appearing to be 'M. J.' or similar.

Treasury Chambers, Parliament Street, SW1P 3AG

PRIME MINISTER

GIROBANK

I have seen Kenneth Clarke's minute of 17 November to you.

This is very good news. I entirely agree that we should decide now, in principle, to privatise Girobank, and that this should be announced in the New Year if that continues to be his and the Post Office's judgement of the best time from the point of view of the industrial relations in the Post Office. As the DTI note makes clear, the industrial relations aspects will need to be handled with the greatest care.

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SECRET

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I am copying this minute to Willie Whitelaw, David Young, Kenneth Clarke and to Sir Robert Armstrong.

NORMAN LAMONT

DECEMBER 1987

SECRET



Treasury Chambers, Parliament Street, SW1P 3AG

PRIME MINISTER

CC Chancellor
 Chief Sec
 Economic Sec
 Sir P. Middleton
 Mr Menck
 Mrs Lemax
 Mrs Brown
 Mr Colman
 Mr Lyne
 Mr Board
 Mr Hood
 Mr Call

F6T
 TO
 PM
 2 DEC

GIROBANK

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I am copying this minute to Willie Whitelaw, David Young, Kenneth Clarke and to Sir Robert Armstrong.



NORMAN LAMONT

2 DECEMBER 1987

CONFIDENTIAL



10 DOWNING STREET
LONDON SW1A 2AA

Handwritten signatures and initials, including 'PUP'.

CH/EXCHEQUER	
REC.	08 DEC 1987 <i>2/12</i>
ACTION	FST
COPIES TO	

From the Private Secretary

7 December 1987

Dear Peter,

GIROBANK

The Prime Minister has seen the Chancellor of the Duchy's minute of 17 November about privatising Girobank and the Financial Secretary's comment in his minute of 2 December. The Prime Minister would like to discuss this in E(A) in view of the possible effects on the Post Office counters business, and I should be grateful if the Cabinet Office could arrange for this. The Prime Minister takes it that the sale of Girobank would not require legislation.

I am copying this letter to Mike Eland (Lord President's Office), Alex Allan (HM Treasury), Alison Brimelow (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

John,
David

David Norgrove

Peter Smith Esq
Chancellor of the Duchy of Lancaster's Office.

CONFIDENTIAL

CONFIDENTIAL
APPOINTMENTS IN CONFIDENCE

M

FROM: T Tarkowski
DATE: 28 January 1988

FINANCIAL SECRETARY

✓

cc Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Moore
Mrs Brown O/R
Mr M Williams
Mr Lyne
Mr Bent
Mr Hood
Mr Call

GIROBANK PRIVATISATION: MERCHANT BANK ADVICE

This minute is to let you know the outcome of the limited private competition held by DTI for advice on the Post Office's detailed proposals for the disposal of Girobank, which are due to arrive at the end of the month. (The Post Office, who will be the vendors, is advised by Schrodgers, and Girobank is advised by Charterhouse Japhet.)

2. The appointment, which is subject to a ceiling of £10,000, is solely to advise on the PO proposals and on their immediate implications for a possible sale. It has been made clear that there is no commitment that selection will lead to appointment to advise on the subsequent conduct of the sale. However, the bank appointed will be among the contenders for that role, and we were conscious of the advantage in having a team in place who could take on subsequent phases of the work if called on to do so.

3. After consulting the Treasury, DTI made an initial confidential approach to 4 banks. This was subsequently widened to include seven in all, since four banks (Barings, County Bank, Lazards and Rothschilds) declined to compete, mostly citing (one unspecified) potential conflicts of interest. This left the following list:

Hambros (who had advised DTI on Girobank in October 1985 and again in October 1987)

CONFIDENTIAL
APPOINTMENTS IN CONFIDENCE

Warburgs

BZW

4. Each submitted a short paper and were seen by the panel. Warburgs' performance was very weak, both on paper and orally. The decision between Hambros and BZW was much closer. Hambros were solid but relatively unexciting, and showed a slight reluctance to commit themselves to firm judgments which was worrying in the light of their advantaged knowledge of Giro. But they were notably strong on specific banking expertise. BZW's Jeremy Seddon gave a sparkling presentation, but prompted worries about the strength of the back-up available. BZW are already extensively involved in advising IIMG on Scottish electricity and in advising British Steel, NBC and BREL. There could also have been a potential conflict of interest (BZW were unable to give an assurance that Barclays, their parent, was not a potential purchaser, though they said they regarded that as unlikely.)

5. In practice, it might have been possible to deal satisfactorily with BZW's potential conflict of interest. But subsequent inquiries have not resolved the worries that BZW, and Mr Seddon in particular, might be over-stretching themselves. DTI have therefore decided, with our support, on the safer option of continuing with Hambros. This has the incidental advantage, for us, of extending the "privatisation club": Hambros have not, apart from their earlier work on Giro, had much involvement with privatisation work. DTI intend to make it clear to Hambros that they came close to being pipped at the post, and the need to make their contribution more positive.

6. Hambros have accepted the ceiling of £10,000 on this phase of the work, though they point out that if the PO proposals are inadequate there may be a need for further work subsequently which could not be included within the ceiling. We have also extracted a commitment that the daily rate for the team as a whole should not exceed £850.

Tomasz Tarkowski
T TARKOWSKI



CHIEF SECRETARY	
REC.	29 JAN 1988
ACTION	<i>Ms Brown / Mr McInyre</i>
TO	<i>CX FST Mr Anson</i>
	<i>Mr Kemp Mr Mouch</i>
	<i>Mr Brugner Mr Moore</i>
	<i>Ms Peison Mr Turnbull</i>

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Richmond House, 79 Whitehall, London SW1A 2NS

Telephone 01-210 3000

From the Secretary of State for Social Services

Mr Call.

The Rt Hon Kenneth Clarke QC MP
 Chancellor of the Duchy of Lancaster
 Department of Trade and Industry
 1-19 Victoria Street
 LONDON
 SW1H 0ET

JG January 1988

Kenneth Clarke

GIROBANK AND LETTER MONOPOLY

The discussion at E(A) of these two subjects, rightly, kept very much to matters of principle but there are some important, Departmental points which I would like to make. The DHSS operational interest in both areas is considerable - we pay Girobank around £50 million a year to process, among other items, around 110 million Giro cheques annually and we pay a similar sum to the Post Office for using the letter service (we are possibly their largest letter service customer). Both services are absolutely critical to the delivery of pensions and benefits to millions of people.

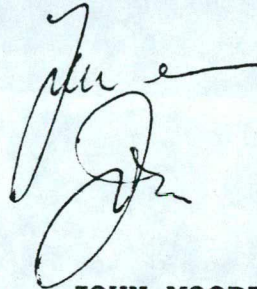
My officials are on the point of concluding a three year agreement with Girobank on the fee to be paid. Clearly any prospective purchaser will seek assurances on the retention of the DHSS business and there is provision in the agreement for the terms to be extended if both parties agree to it. We, in turn, will wish to be satisfied as to any purchaser's plans and in particular the future relationship with the Post Office Counters business. If Girobank did decide to withdraw from the Post Office network my Department would have to develop an alternative system of payment to those without access to banking outlets and we would require several years notice to achieve this.

The E(A) discussion also highlighted the need to reassure post office managers and sub-postmasters that they would not face a substantial loss of business from privatisation. Your letter of 5 January to Nick Scott had in any case agreed that we would need to consider the issue of subsidy of the sub-post office network in the light of our continuing development of benefit payment direct to bank accounts.

There are also important industrial relations aspects to both proposals. If Post Office Counter staff or Girobank staff take industrial action against either or both proposals, which lasts more than a few days, my Department and Department of Employment would probably face severe problems in maintaining payment of benefits. It would be as well to assess these risks and the potential counter measures before your plans become public knowledge. Our officials will need to consult on this.

You have my full support in pressing ahead with further work on both fronts. I would, however, ask that my officials are kept closely in touch with your plans as they develop.

I am copying this letter to other members of E(A) and to Sir Robin Butler.

A handwritten signature in black ink, appearing to read 'John Moore', with a long horizontal stroke extending to the right.

JOHN MOORE



mp

CH/EXCHEQUER	
REC.	29 JAN 1988 ✓ 29
ACTION	CST
COPIES TO	

MOORE
TO
CLARKE
29 JAN

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Richmond House, 79 Whitehall, London SW1A 2NS

Telephone 01-210 3000

From the Secretary of State for Social Services

The Rt Hon Kenneth Clarke QC MP
 Chancellor of the Duchy of Lancaster
 Department of Trade and Industry
 1-19 Victoria Street
 LONDON
 SW1H 0ET

JG
[Signature]
 January 1988

[Red checkmark]

[Handwritten signature: Ken Clarke]

GIROBANK AND LETTER MONOPOLY

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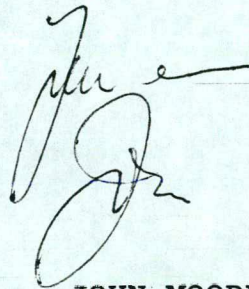
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The E(A) discussion also highlighted the need to reassure post office managers and sub-postmasters that they would not face a substantial loss of business from privatisation. Your letter of 5 January to Nick Scott had in any case agreed that we would need to consider the issue of subsidy of the sub-post office network in the light of our continuing development of benefit payment direct to bank accounts.

There are also important industrial relations aspects to both proposals. If Post Office Counter staff or Girobank staff take industrial action against either or both proposals, which lasts more than a few days, my Department and Department of Employment would probably face severe problems in maintaining payment of benefits. It would be as well to assess these risks and the potential counter measures before your plans become public knowledge. Our officials will need to consult on this.

You have my full support in pressing ahead with further work on both fronts. I would, however, ask that my officials are kept closely in touch with your plans as they develop.

I am copying this letter to other members of E(A) and to Sir Robin Butler.

A handwritten signature in black ink, appearing to read 'John Moore', written in a cursive style.

JOHN MOORE

dti

the department for Enterprise

*Be with Moore
phy*

The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon John Moore MP
Secretary of State for Social
Services
Department of Health and Social
Security
Richmond House
79 Whitehall
LONDON SW1A 2NS

**Department of
Trade and Industry**

1-19 Victoria Street
London SW1H 0ET

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01-215 7877

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Fax 01-222 2629

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REC.	24 FEB 1988
ACTION	CST
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Direct line 215 5147
Our ref
Your ref
Date **24** February 1988

CLARKE
TO
MOORE
24 FEB

Dear John,

GIROBANK AND LETTER MONOPOLY

Thank you for your letter of 29 January. I have also seen your progress report of 25 January to the Prime Minister about your department's operational strategy and the letter of 27 January recording the Prime Minister's reaction.

I acknowledge what you say about the implications for your department of possible developments on Girobank and the letter monopoly. Equally I am conscious of the implications for the Post Office of your operational strategy in the short term from the impact on Counters of beneficiaries opting for ACT, and in the longer term from the options which may emerge from the plastic card technologies to which you refer.

I have asked my officials to discuss with yours the issues raised in your letter and progress report which most immediately concern Girobank.

I am copying this letter to other members of E(A) and to Sir Robin Butler.

J. Clarke

KENNETH CLARKE

EC7ABP

CONFIDENTIAL

FROM: T TARKOWSKI
DATE: 22 April 1988

1. MRS BROWN ^{22/4}
2. FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Moore
Mrs Lomax
Mr Odling-Smee
Miss Peirson
Miss Noble
Mr Lyne
Mr Kroll
Mr Morgan
Mr Cropper
Mr Call
Mr Tyrrie

W. P. Morgan

E(A) MONDAY 25 APRIL: GIROBANK PRIVATISATION

I attach a brief for Monday's E(A).

2. As you will see, Mr Clarke has not done everything asked of him by E(A) at its January meeting, and in some respects he has come back to E(A) prematurely. Although there is still a good deal of work to be done before the proposed June announcement is possible, this needs to involve the Post Office and their advisers Schrodgers as much as DTI and Hambros. We think it right that E(A) should give a further steer now to ensure that this happens. The remaining issues are important to the Treasury, but could be settled bilaterally if E(NI) is prepared to agree Mr Clarke's basic proposals.

Tomasz Tarkowski
T TARKOWSKI

CONFIDENTIAL

E(A) 25 APRIL: GIROBANK PRIVATISATION**1. The proposal**

(i) Subject to the conclusions of the MMC report on Counters (Crown network) in mid-May, and finalisation of a satisfactory contract between Girobank and Counters, to announce in June intention to privatise as early as possible, and before end-1988-89, and invite bids from trade buyers;

(ii) To say now that a management buy-out bid is ruled out;

(iii) To consider requiring trade bidders to include management/employee share options amounting to about 10% of the equity, in order to counter any loss of morale from ruling out an MBO.

2. Treasury objectives

(i) Secure agreement in principle to a June announcement followed by privatisation before end 1988-89;

(ii) Keep open option of 51 per cent sale, followed by further disposal at a later date;

(iii) Reserve Treasury's position on the principle and the scale of management/employee share options until Hambros have advised.

3. Line to take

Support Proposal for June announcement and early privatisation, before end-1988-89;

Welcome Mr Clarke's success in dissuading the Post Office from pursuing only the MBO option;

Agree Trade sale the best way of privatising Girobank; but

Probe Mr Clarke on tactics of ruling out an MBO from the outset.

*Not important -
pursue the
option*

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Reserve Option of 51 per cent sale at this stage.

Reserve Treasury's position on principle/scale of requiring bids to contain management/employee share options.

4. Background

E(A) affirmed the principle of privatisation in January, but asked Mr Clarke to return with more detailed proposals before making a public announcement, in view of the presentational issues which might arise. Mr Clarke's paper does address the question of management/employee participation, but it is clear that DTI and Hambros are still not yet ready to make definite proposals. The paper does not address the question of ensuring tangible benefits to customers.

5. However, Mr Clarke's paper reports substantial progress, and we do not think a decision should be further postponed. E(A) agreed in January that a trade sale was the best option. Girobank itself wanted a buyout, however, and the Post Office's formal proposals to Mr Clarke endorsed their plan for an MBO without any opportunity for trade buyers to compete. Mr Clarke reports that the PO have now been weaned off this. Both Hambros and Schroders have investigated the feasibility of a trade sale (with and without the opportunity for management to bid against other buyers), and several discussions have been held with the Bank of England (in which we have been fully involved). Mr Clarke's paper accurately reflects the main factors in their position. Attached is a useful note by Hambros of one of the meetings which sets out the position in more detail. We are all agreed on the feasibility of completing a sale on this basis before the end of 1988-89, market conditions permitting, provided the imminent MMC report on Crown Counters (due next month) does not prevent speedy finalisation of a satisfactory Giro/Counters contract. Mr Clarke proposes a public announcement, coupled with an invitation to bid, as soon as this has been established. He envisages this would be in June. We think sufficient work has been done to justify E(A)'s agreement subject to the provisos noted in the brief. Although

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substantial issues remain to be clarified, it will be for the Post Office and their advisers, Schroders, to work up the detail. A firm steer by E(A) on timing, and the nature of the sale will unlock the necessary activity.

6. The three issues for Ministers at this stage are:

(a) The MBO. The Chancellor has expressed doubts about the viability of an MBO, and also the presentational problems which would arise if Girobank's management realized substantial profits on subsequent disposal or merger, which could be within a relatively short timescale. The question therefore is what tactics to adopt in view of the enthusiasm of Girobank's own management for an MBO. Hambros have advised that a competition in which the management were allowed to bid against other purchasers could be arranged successfully. This would be seen as fair - we have encouraged MBOs for some previous privatisations - and avoid the inevitable loss of morale involved in ruling out an MBO from the outset. The risks are that the MBO would complicate, and possibly delay, the sale process and might even, in the event, win the competition (eg if other purchasers backed off). This last point is probably the conclusive argument for ruling out the MBO at this stage. Against this we must face the risk that loss of morale in Girobank may lead to public accusations of unfairness, key management losses, and a reduction in co-operation. Our judgement, however, is that the Managing Director Malcolm Williamson would stay, given a definite green light for privatisation, and would work to restore momentum within Girobank. On balance, we agree that ruling out the MBO now is probably the best course.

(b) Alternative management/employee participation to restore motivation. We can agree Mr Clarke's proposal to explore with Hambros a requirement on bidders to include share option schemes, though the Treasury should clearly reserve its position until the full implications and the costs - which could be significant - are known.

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Clearly Girobank and the Post Office will need to work up proposals and if the principle is accepted this should then begin as soon as possible. It will be necessary to sort all this out in time for the public announcement.

*James
1/2/88*

(c) 100 per cent disposal or 51 per cent. Planning has proceeded, so far, on the assumption of a 100 per cent sale, and for a sale of this size this seems sensible in market terms. However, the Chancellor asked you to suggest that Hambros should consider the option of an initial 51 per cent disposal with the remaining shares sold later. This was included in your 2 December 1987 minute to the Prime Minister. The issue is not however addressed in Mr Clarke's paper. The potential advantage is the opportunity to realise higher proceeds. The disadvantage would be the Bank's requirement for a letter of comfort from the Post Office (which would lapse when the remaining stake was sold). A decision will be needed before the public announcement, but the omission need not prevent E(A)'s endorsement of Mr Clarke's proposals.

7. As noted above, E(A) asked Mr Clarke to consider how to ensure tangible benefits to Girobank's customers. This will clearly depend on who the purchasers are. It would be possible to include this objective among the criteria against which bids were judged, and to explain this in the detailed information document supplied to those expressing an interest in bidding. If this is attractive, we can pursue the idea with DTI. We do not believe E(A) need discuss it.

8. Other points:

(a) Foreign ownership. The bank have indicated they would not rule out a foreign owner and Mr Clarke proposes to leave the competition open. We support this: it is the best way of securing a fair price.

(b) Competition. Mr Clarke argues that a trade sale would increase competition in the banking sector. This

would not be true if the purchaser were one of the existing big four. In any case, this is not an overriding consideration: the banking sector is already under considerable competitive pressures. What matters is a sensible solution which gives Girobank a viable future. It would be advisable not to comment publicly on the contribution of Girobank privatisation to competition in the banking sector until we are clearer about the range of seriously interested purchasers.

(c) Future of PO Counters. Mr Clarke rejects Schroders' argument that Counters' long-term interests are better secured by an MBO. We agree that the only real protection - which is likely to be limited to 5 years (rolled forward each year) - is in the contract negotiated with Girobank.

Tomasz Tarkowski
T TARKOWSKI

FILE NOTE OF MEETING AT BANK OF ENGLAND ON 18TH MARCH, 1988

Present:

R. J. Priddle)	T. Tarkowski	Treasury	
Mrs E Jones)			
S. K. Basu)	DTI	J. Atkinson)	Bank of England
J. Cook)		C. Lloyd)	

A. N. Ridley)	
W. J. Nabarro)	Hambros
D. Curtis)	
M. E. Edge)	

This note is not intended to be exhaustive and is written in light of the DTI's note dated 21st March, 1988

The purpose of the meeting was to learn the Bank's views in relation to the privatisation of N either through a trade sale or an MBO and the implications of these alternatives on the regulatory ratios. The Bank had read copies of Schroders' report and the Hambros' paper.

Introduction

RJP stated that it is the Government's intention to privatise N. An MBO is proposed in the Schroder's document but the decision as to the method of sale has not yet been taken. The privatisation must be in N's best interest whilst protecting the G/Counters relationship.

RJP recognised that the Bank can only give a guarded response to questions, but he is aware that the Bank's decisions can determine the alternatives available to Ministers. It was generally agreed to be desirable that the Bank should not be seen publicly to be in the position of blocking particular courses of action.

Trade Sale

The Bank regards N as "not core, but fairly central" to the UK banking system.

The intentions of any trade purchaser would need to be examined by the Bank at an early stage. JA made the following suggestions as to the Bank's likely attitude to various categories of purchaser:

- a) In general terms, another bank would be an acceptable owner, "domestic or perhaps foreign". JA appreciated that there might be problems in relation to P with a UK wide domestic clearer.

In the case of a foreign bank, its international standing, its regulatory environment and its freedom to give financial support to N would be important. For example, (in response to various questions) the system of supervision in Hong Kong is "pretty comprehensive", as is that in Australia. Prima facie, banks in the G-10 countries and the EEC countries would have "a greater likelihood of acceptability". Banks from the OECD are also a possibility. South African banks suffer from exchange controls, which the Bank would have to consider.

- b) Industrial or commercial companies, including retailers, would not be acceptable.
- c) The financial sector outside banking, e.g. insurance, is a possibility. Size and resources available to support N would be critical, as would the intentions of the buyer towards N.

JA suggested that an early shortlist of possible buyers be prepared for discussion with the Bank, prior to their being approached, in order to avoid the Bank being in a position of the ultimate arbiter. However, although the Bank's preference would appear to be for controlled approaches to be made to potential purchasers on a "cleared" list, it is not in principle opposed to a public announcement of the intention to sell, in order to attract trade offers.

MBO

The Bank's main concern would be the viability of N. Some 65% of N's income derives from Counters and the DHSS. To cut off the basic money transmission business would not be prudent, so this business must be safe-guarded. Therefore, a continuing "involvement" on P's part is fundamental. The Bank would "attach considerable importance" to the role of P as a shareholder.

As far as letters of comfort are concerned, the normal rules apply. Any shareholding in excess of 15% would require a letter of comfort to be given, and any shareholding below this level would tend not to, although the Bank reserves the right to consider this under particular circumstances, e.g. when several shareholders were below 15% but were similar or connected. The Bank would not apply different rules to P.

Under an MBO, if no letter of comfort were forthcoming from any of the investors, the supervisory ratios would be "tightened" in order to safe-guard depositors.

The Bank would apply similar criteria to the investors in an MBO consortium as it would to a trade purchaser, though clearly dependent upon their relative sizes as members of the consortium. The Bank would look at the "totality of the package" before deciding how its rules would be applied.

Supervisory Ratios

The Bank regards an RAR of at least 2 percentage points above the present minimum (i.e 12%) as a floor in the context of a change of ownership and would want to see an operational RAR level somewhat above this trigger level to provide N with a cushion.

The required ratios would also need to take into account the quality of management, of systems and the business plan. In the Bank's view, management and systems while - in was implied - currently adequate, both need further strengthening if it is planned that the activities of N should be significantly developed.

The future payment of dividends would depend upon the need to retain capital in the business.

As far as the MBO exit route is concerned, the Bank can not be specific over and above the points given above. It would expect to be consulted in advance of any action being taken, and would expect to be told of any planned exit route prior to an MBO taking place. If the MBO planned a major change of any sort after 5 years, the Bank would have to take this into account at the outset.

If N privatised by MBO encountered difficulties, the Bank's position to stipulate or preclude courses of action by the shareholders was emphasised.

The Bank is concerned

- a) about the prospect of P having a right to re-negotiate the Counters contract in the event of a change in ownership - the Bank wants N to have a secure future of at least 5 years; and
- b) about Schrodgers' suggestion that the DHSS contract be transferred to P, since it regards the income stream as important to N.

Order of Events

The DTI and Hambros should address the points given above and consider any follow-up questions, which the Bank will then answer. At an early stage in any sale process, the Bank needs to be closely involved - in order that it may in due course approve - in the revision of N's business plan. The Bank would also require further information on the Government's plans for Counters which, if radical, "argue for a stronger starting position". The Bank is concerned to learn of the findings of the MMC report, and is concerned that the management of N is being left in limbo until this whole issue is finally decided.

JA feels that, once the Government's plans have been clarified and the Business Plan revised on a basis agreed with the Bank, the timetable in the Schrodgers' report of 180 days should be feasible.

6th April, 1988

CONFIDENTIAL

Pho
not rec'd till 28/4
Pyg

FROM: MISS C E C SINCLAIR
DATE: 27 April 1988

FINANCIAL SECRETARY

- cc Chancellor ✓
- Chief Secretary
- Sir P Middleton
- Mr Anson
- Mr Monck
- Mr Lankester
- Mr Culpin
- Mr Moore
- Mr Mountfield
- Mr Peretz
- Mrs Brown
- Miss Noble
- Mr L Watts
- Mr Tarkowski
- Mr Michie

Note

Told PS/FST that Ch's
Committee were

- ① What is Inland Revenue's news? (see below for answer)
- ② If Treasury & IR officials support this on balance, we should tell DTI so, & get them to consult their minutes. We should say Tsy minutes have not yet formed a

GIROBANK: CAPITAL INJECTION FROM A JAPANESE SYNDICATE

view (particularly on the political aspect),
& DTI minutes might well want to talk
to Tsy Min. *AA 28/4*

Girobank, who are a subsidiary of the Post Office, plan to borrow around £29 million from a Japanese syndicate of banks. Girobank intends to form a Dutch subsidiary and route the loan through it to avoid the 10 per cent withholding tax which would apply under the UK/Japan double taxation agreement. They need approval by close of play tomorrow, when the offer lapses.

I'm suspicious of this.

2. PE regard the loan as an attractive opportunity to reduce the scale of Girobank's dependence on the Post Office for long term finance, thus simplifying the task of disengaging on privatisation. Girobank would use the proceeds to repay the Post Office loans of £19 million and to increase its own capital resources by £10 million. (Which has already been agreed in last year's public expenditure Survey.) There are no public expenditure implications.

3. The consent of the Secretary of State at Trade and Industry is needed for the creation of the subsidiary, and the loan itself would require the approval of both the Secretary of State and

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the official Treasury. Thus, in effect, Girobank's plans - which some may construe as tax avoidance - can only be undertaken with the specific approval of the Secretary of State for Trade and Industry and the Treasury. An unusual feature of the loan itself is that it would be unguaranteed (like a similar loan arranged last year). Whatever attempts are made to keep the details of the loan confidential, there is a risk of these becoming public knowledge particularly because the Japanese syndicate consists of a number of banks. In that case, the possibilities for mischief-making on the part of the opposition and sectors of the media are fairly evident.

4. We understand that a similar proposal of this kind from BNFL was considered but rejected last year. Both the Inland Revenue and FP feel that the risks involved in giving formal approval to a plan for tax avoidance need careful consideration, notwithstanding the fact that such arrangements are commonplace in the private sector.

5. However, PE consider that there are other material considerations. Some public corporations are eligible for statutory exemption from withholding tax, which the Treasury has the right to confer by Order. For technical reasons, Girobank is ineligible: it is not a statutory corporation itself (though it is a subsidiary of one). If Girobank were eligible PE suspect it would have applied for such an exemption.

6. Also the route Girobank propose, through the creation of an offshore subsidiary, is common practice in the private sector and involves no illegality. PE's view is that it may be odd to insist on higher standards for Girobank than any of their competitors observe.

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7. If we close off this route, Girobank will have to refinance its Post Office loans onshore, attracting withholding tax, thus raising costs.

8. PE have discussed the position with the Bank who do not object to the proposal. Department of Trade and Industry are conscious of the presentational issue, which they will put to their Ministers if Treasury consent is forthcoming.

Conclusion

9. The proposal is not illegal and has the advantages described for privatisation. Against this there are the serious risks of awkward questions arising about Ministers endorsing the use of a tax vehicle. Given the sensitivity of this issue, we would welcome your views as to whether Treasury approval ought to be given to the loan.

R. George Mielke

R.P. CAROLYN SINCLAIR



Inland Revenue
Policy Division

CONFIDENTIAL

cc. Mr Tarkowski
Mrs M Brown
Miss Noble
Mr L Watts
Mr Milne - B/E
Mr Bryce
Mr O'Connor
Mr Hall
Mr Hunter

Miss M O'Mara
HM Treasury
MG Division
Parliament Street
London SW1P 3AG

Date

25 April 1988

Dear Mrs O'Mara

GIROBANK : CAPITAL INJECTION FROM JAPANESE SYNDICATE

Perhaps it would be useful to set out our current thinking here, to clear up any misunderstandings that may have arisen, through past informal contacts, on our attitude to public sector companies having recourse to tax avoidance transactions. There is no question of our giving our blessing, as it were, to such arrangements, but our approach would generally be similar for public and private sector companies.

It has, in the past, been not uncommon for UK companies to set up Dutch fund-raising subsidiaries, which receive interest gross from the UK under the UK/Netherlands Double Taxation Agreement, and then pay the interest on to a third party gross, as is permitted under Dutch law. We have tolerated this route in the past. Nowadays it is possible for major British institutions to raise funds without the use of a Netherlands subsidiary by issuing Eurobonds and the like - although I accept that what is here involved is a private placement and not a quoted issue covered by Section 35 FA 1984. We have received advice that this sort of arrangement whereby institutions 'shop around' for the use of suitable countries to take advantage of relevant double taxation agreements, may be within the scope of the principle laid down in the Ramsay/Furniss case (where the Revenue successfully attacked a tax avoidance scheme). In consequence we can not give any assurance that Ramsay/Furniss would not apply. In saying this we make no distinction between the public and the private sector. Whether, in the event we would seek to invoke Ramsay/Furniss in any particular case, must of course depend on the precise form of the transaction which is ultimately carried out.

This sort of approach ties in with our earlier expressed reservations about proposals for providing further privileged tax treatment, for example as regards payment gross, for public corporations.

I am copying this to recipients of your note of 19 April.

Yours sincerely
Tony Gray

A C GRAY



FROM: J J HEYWOOD
DATE: 28 April 1988

PRINCIPAL PRIVATE SECRETARY

cc Sir P Middleton
Mr Anson
Mr Monck
Mrs M E Brown
Miss Sinclair
Ms Goodman
Mr Tarkowski
Mr Michie
Mr Lyne

*Thank you
I await
for the
FST's
reply.*

GIROBANK: JAPANESE LOAN

The Financial Secretary discussed this very briefly with officials before going off to Scotland.

2. The Financial Secretary does not see why this needs to be decided today and Mr Tarkowski has now told DTI officials that we will not be reaching a final view until Tuesday.

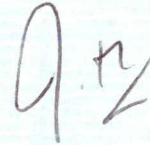
3. The Financial Secretary thinks that the case for approval stands or falls on propriety. A number of arguments suggest that this financing route is perfectly "proper":

- it is legal;
- it is a well-established and often-used route;
- the "Dutch subsidiary" would actually be Dutch, and not located in the Netherlands Antilles or some other tax-haven.

4. However, since the Financial Secretary's meeting, it has been established that we have twice in the past stood back from endorsing or approving offshore schemes (we have rejected proposals

from BNFL and CDC). Therefore, it might be difficult to explain why the Girobank loan was being approved against this background. It would certainly be uncomfortable to cite impending privatisation as the reason for approving the Girobank loan, having rejected similar schemes twice in the past.

5. In a telephone call with the Financial Secretary, Mr Monck said that in his view these precedents swung the balance of argument against approval. The Financial Secretary said that he would reflect further.



JEREMY HEYWOOD
Private Secretary



Handwritten signature

FROM: J M G TAYLOR
DATE: 29 April 1988

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Mr Anson
Mr Monck
Mrs M E Brown
Miss Sinclair
Ms Goodman
Mr Tarkowski
Mr Michie
Mr Lyne
Mr J J Heywood

GIROBANK: JAPANESE LOAN

The Chancellor was grateful for your minute of 28 April. He awaits the Financial Secretary's further reflections.

Handwritten signature

J M G TAYLOR



FROM: J J HEYWOOD
DATE: 3 May 1988

PRINCIPAL PRIVATE SECRETARY / 2

cc Sir P Middleton
Mr Anson
Mr Monck
Mrs M E Brown
Miss Sinclair
Ms Goodman
Mr Tarkowski
Mr Michie
Mr Lyne

Contract

GIROBANK: JAPANESE LOAN

Further to my minute of 28 April, the Financial Secretary has now considered this again.

2. My minute outlined the arguments suggesting that the proposed financing route is perfectly proper.

3. The Financial Secretary believes that there are three main arguments against approving the loan:

(i) In recent years both CDC and BNFL have had similar proposals turned down, on propriety grounds. If we approved the Girobank loan we might have to tell both CDC and BNFL of our change of stance, and we certainly would have to tell them if they approached us again. The BNFL proposal was rejected as recently as late-1987;

(ii) The formal Revenue advice (attached) is that the loan arrangement "may be within the scope of the principle laid down by the Ramsay/Furniss case we cannot give any assurance that Ramsay/Furniss would not apply". We have to put some weight on that advice;

(iii) It would be embarrassing if we were seen to be endorsing a tax-avoidance scheme to ease the passage of Girobank to privatisation.

4. Although the Financial Secretary does not believe that the balance of agreement points firmly in one direction, he is marginally against approving the loan.

I understand that FST has asked for this conclusion to be conveyed to DTI (at official level). 26/3/5

J.H.

JEREMY HEYWOOD
Private Secretary

ENC



Inland Revenue
Policy Division

CONFIDENTIAL

cc. Mr Tarkowski
Mrs M Brown
Miss Noble
Mr L Watts
Mr Milne - B/E
Mr Bryce
Mr O'Connor
Mr Hall
Mr Hunter

Miss M O'Mara
HM Treasury
MG Division
Parliament Street
London SW1P 3AG

Date

25 April 1988

Dear Miss O'Mara

GIROBANK : CAPITAL INJECTION FROM JAPANESE SYNDICATE

Perhaps it would be useful to set out our current thinking here, to clear up any misunderstandings that may have arisen, through past informal contacts, on our attitude to public sector companies having recourse to tax avoidance transactions. There is no question of our giving our blessing, as it were, to such arrangements, but our approach would generally be similar for public and private sector companies.

It has, in the past, been not uncommon for UK companies to set up Dutch fund-raising subsidiaries, which receive interest gross from the UK under the UK/Netherlands Double Taxation Agreement, and then pay the interest on to a third party gross, as is permitted under Dutch law. We have tolerated this route in the past. Nowadays it is possible for major British institutions to raise funds without the use of a Netherlands subsidiary by issuing Eurobonds and the like - although I accept that what is here involved is a private placement and not a quoted issue covered by Section 35 FA 1984. We have received advice that this sort of arrangement whereby institutions 'shop around' for the use of suitable countries to take advantage of relevant double taxation agreements, may be within the scope of the principle laid down in the Ramsay/Furniss case (where the Revenue successfully attacked a tax avoidance scheme). In consequence we can not give any assurance that Ramsay/Furniss would not apply. In saying this we make no distinction between the public and the private sector. Whether, in the event we would seek to invoke Ramsay/Furniss in any particular case, must of course depend on the precise form of the transaction which is ultimately carried out.

This sort of approach ties in with our earlier expressed reservations about proposals for providing further privileged tax treatment, for example as regards payment gross, for public corporations.

I am copying this to recipients of your note of 19 April.

*Yours sincerely
Tony Gray*

A C GRAY



FROM: J M G TAYLOR

DATE: 4 May 1988

A large, stylized handwritten signature in the top right corner of the page.

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Mr Anson
Mr Monck
Mrs M E Brown
Miss Sinclair
Ms Goodman
Mr Tarkowski
Mr Michie
Mr Lyne

GIROBANK: JAPANESE LOAN

The Chancellor has seen your minute of 3 May. He is content with the Financial Secretary's conclusion that we should not approve the loan.

Handwritten initials, possibly "JMGT", located below the main text.

J M G TAYLOR

dti

the department for Enterprise

10/11
2-pmp

The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

CONFIDENTIAL

Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

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Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5147

Our ref

Your ref

Date 7 June 1988

Dear Chief Secretary,

GIROBANK: WAGE NEGOTIATION

I understand that Girobank wishes to open negotiations towards the end of this month with the trade unions on the 1988 wage round.

The two principal Girobank unions - the National Communications Union (NCU) and the National Union of Civil and Public Servants (NUCPS) - have submitted a claim incorporating a number of different elements as well as increases in pay and allowances. Although no figure has yet been put on the package, Girobank management considers that the unions are looking for an unconditional 7% increase in basic rates. They are supporting their claim by pointing to some settlements in excess of 6% reached so far this year in some private sector banks and building societies.

Girobank management has decided that the increase to the total wage bill under the new proposals this year should be no more than 5.5%. It will be seeking the introduction of a system of performance-related pay and the application of penalties for

MY5ACQ



the department for Enterprise

departments in which there is an above average rate of sickness absenteeism. Girobank management claim that the latter, if introduced, would effectively provide a basis for a type of regional pay differentiation, albeit on a modest scale. There is, in addition, a long-standing productivity bonus scheme, whereby employees are able - if increased productivity targets are met - to gain a cash bonus, and a small percentage increase consolidated into pay (amounting to some 0.5%). Girobank does not propose to make alterations to the scheme this year.

The management has not firmly decided on the opening offer it will make to the unions towards the end of June; but it is likely to be between 4.75 and 5%.

Bearing in mind that we are about to sell this business, the parameters within which Girobank is working seem to me to be reasonable. They are aiming to keep the basic rate increase below those conceded in some comparable private sector organisations and generally in line with the agreements reached by the other Post Office businesses with the leadership of their major union, the UCW. I am afraid that Girobank considers that an attempt to move to a fully-fledged regional pay system is too ambitious for this pay round but they claim that their proposal on penalties for sickness absenteeism would, if agreed, at least provide the basis for some regional differentiation. Finally, the emphasis on the introduction of performance pay below senior management grades - to which Girobank attaches great importance - could lead to potential long term benefits in terms of increased flexibility in the pay structure and incentives to greater efficiency.

I am therefore seeking your agreement to Girobank's proposal to make an opening offer of 4.75-5% and to settle the new arrangements this year within a 5.5% increase to the total wagebill. Since negotiations are expected to start towards the end of the month, I should be grateful for a response by 17 June.

Copies of this letter to go to the Prime Minister, members of E(PSP) and Sir Robin Butler.

Yours sincerely,

Linda Joyce

pp KENNETH CLARKE

(Approved by the Chancellor and signed in his absence)

MY5ACQ

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COMMERCIAL IN CONFIDENCE

pe2.ss.tt.min/71

- 5
1. MRS BROWN
2. FINANCIAL SECRETARY

FROM: T TARKOWSKI
DATE: 5 SEPTEMBER 1988

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mr Tyrie
Mr Call

Ms Wheldon (T.Sol)

GIROBANK SALE

1. The deadline for receipt of initial bids for Girobank has now passed. Seven bids have been received by the Post Office as follows:

Bidder	Indicative bids (£m)
Credit Lyonnais	170 - 200
Westpac	130 - 160
N. Brown	161
Bank of Scotland	104 - 178
Unity Trust	92
XI GUS/ <u>Credit Agricole/Globe</u>	not less than 91
HFC Bank	62

2. This is an adequate, if not overwhelming, response from among the 90-odd requests for copies of the sale memorandum. The better bids are in line with - indeed a little better than - the sums suggested by our merchant bank advisers.

3. The Post Office Board is due to decide on a shortlist at its meeting on 16 September. This will not, of course, be made public, though there must be a risk that some information about

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COMMERCIAL IN CONFIDENCE**

bidders will come out. Those shortlisted will be invited to put in firm bids by the end of October.

4. In view of the relatively small field, the Post Office, advised by Schrodgers, - take the view that bidders should be eliminated at this stage if, but only if, the Post Office, the Government or the Bank of England would be unhappy to see them emerge from the second round as the victors. We agree. It would be much harder at the culmination of the final bidding round than now to rule out a high bid for non-price reasons.

5. The Bank of England have been kept closely in touch with the sale process and are considering their position on each bidder. Unsurprisingly, they have reservations about the suitability of N Brown - a mail order business - as a prospective owner of Girobank. If the Bank remain unsatisfied - as we expect - N Brown should clearly not proceed to the second round. The Bank have not indicated difficulties, on the basis of the information so far provided, over the suitability any of the other six bidders.

6. The key decision for Ministers is whether Credit Lyonnais - which is in the French public sector - should be allowed to go into the second round. The purely commercial arguments point to letting it do so. CL is a leading retail bank with a high reputation. They already have a presence in the UK (and indeed recently acquired Alexander, Laing & Cruickshank). The Bank of England have raised no objection. Their indicative bid is the highest of those received, and ruling it out would make it harder to negotiate up the other bids. The problem is of course their public sector status. They are 100 per cent owned by the French Government, and earlier plans for its privatisation appear to have been put on ice indefinitely. It can be argued that the main objective of liberating Girobank from UK public sector controls would nonetheless be achieved: the French system allows a much more hands off relationship. Sir Adam Ridley (Hambros) who has been advising DTI contacted Mr Tyrie on Friday to urge these points. Against this it remains the case that sale to Credit Lyonnais would not be a privatisation as normally understood.

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7. Either way, the decision will be open to criticism. The Credit Lyonnais bid is a serious one, and there must be a possibility of representations from the French Government, and possibly accusations of unfair discrimination if the bid is rejected. If this is the decision we will need to take care over the position under EC law. If, as looks likely, the sale subsequently fetched a lower price, Credit Lyonnais might be tempted to reveal the price they would have been prepared to pay, which could also be an embarrassment.

8. DTI are consulting Mr Newton, who is expected to write to colleagues seeking endorsement for his conclusions. We will, of course, provide advice and a draft reply when we have his letter.

9. You will wish to consider further once we have Mr Newton's views. Our own conclusion is that the Credit Lyonnais bid should, with regret, be rejected now.

10. Once the position on N Brown and Credit Lyonnais has been established the Post Office will also want to take a view on whether HFC - who have entered only a very low bid - and Unity Trust, whose commitment to bid appears to be in some doubt - should proceed. Their aim will be to ensure sufficient remaining bidders in the second round to secure real competition.

Tarwes Tarkowski
T TARKOWSKI

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

FROM: MARK CALL
DATE: 6 September 1988

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mr Tarkowski
Mr Tyrie

GIROBANK SALE

Against my free - trade instincts, I agree with Mr Tarkowski that Credit Lyonnais would not be a suitable buyer. The argument can be simply put. Privatisation is about achieving Private ownership, not the selling of state assets at all costs. For this purpose CL is an agent of the French Government, and so to sell it to them would not be privatisation.

It would cause enormous public confusion and debate about the aims and wisdom of the privatisation programme. Electricity and Water are contentious enough without adding to the difficulties.

Furthermore the position would be consistent with our action to cut the KIO stake in BP.

Mc
MARK CALL

CALL
→
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[BF 8/9]



the department for Enterprise

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The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry
Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AQ

TT to ring back
[4931]

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

CH/EXCHEQUER	
REC.	06 SEP 1988 ✓ 6/8
ACTION	FEST
COPIES TO	

1 entry
agree.

215 5147

Direct line
Our ref
Your ref
Date

6 September 1988

Dear Chancellor,

Ch/ Advice behind wams of this letter
and tends towards reluctant agreement
that CL shd be eliminated. So does
Mark Call - his note behind.
m pv.

SALE OF GIROBANK

Indicative bids for the purchase of Girobank were received by the Post Office on 26 August. The next stage is for the Post Office to draw up a short list for further negotiation.

This letter discusses whether Credit Lyonnais (CL) a French Public Sector Bank, should be included in the short list. The decision presents some difficulties. In a field which is not particularly strong, CL's bid is attractive in many respects, but in my view its acceptance would not be consistent with our policy on privatisation.

My predecessor said publicly that no one was excluded from bidding for Girobank and all bids would be considered against the published criteria agreed between the Government and the Post Office. These were that the price offered would be a major determinant but that, in addition, the following considerations would be taken into account:

Newton
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PS. Is Credit Lyonnais also State owned? (see X). If so, a vltal issue for the Govt. All the Govt. considerations, too.

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- (i) the prospective purchaser's plans for the future development of Girobank and in particular their likely impact on the Post Office's continuing operations, especially those of Post Office Counters Limited;
- (ii) the arrangements proposed by any prospective purchaser to enable management and staff to share directly in the success of the business;
- (iii) the promise any purchaser brought of widening customer choice in the market place in which Girobank operates;
- (iv) the need for any prospective purchaser to be approved in due course by the Bank of England.

He also said during the debate in the House on 7 June that he could see nothing wrong in dealing with bids from overseas on exactly the same footing as those from this country. The specific issue of disposal to the private rather than the public sector only arose when I appeared before the Trade and Industry Select Committee on 27 July. In answering a question from the Select Committee, I suggested that a bid by UK local authorities might not qualify as privatisation. I promised to submit a note to the Select Committee on this. No local authority has, in fact, bid and my intention had been to submit a short, dismissive note. In the light of the developments concerning CL, however, there will be an opportunity to place on record our position on what is meant by privatisation as opposed to the mere sale of public sector assets.

Seven indicative bids have been received for Girobank: five from the UK, two from overseas - CL and an Australian bank. CL's bid of £170-200 million is the best. It compares with a lowest bid for £62 million and an average range of £116-135 million. Sifting of the bids against the stated criteria is continuing. But at this stage, apart from the Australian bank and a Scottish bank whose bid is conditional on its identity not being disclosed, the other four bidders look weak. One offers an unacceptably low price. Another's bid is very tentative, although it might be talked into pursuing it. The business rationale of a third, a consortium, is unclear and will, at least, require considerable explanation to the Bank of England. A mail order firm has put in a relatively high bid, but may be unacceptable to the Bank of England and its bid is contingent on a Stock Exchange listing which introduces considerable uncertainty.



the department for Enterprise

Thus, without CL, we could be left with only the Scottish and Australian banks as serious contenders. The view of the Post Office, and of both their and our merchant bank advisers, is that a fully competitive second round of bidding ideally requires a longer short list than two. If it were only two, and one were to withdraw for any reason, the Post Office would be left in a very weak negotiating position.

Apart from this consideration and that of price, the case for entertaining CL's bid on other grounds is also far from negligible. Although in public ownership since 1946, it has since 1983 operated under a deliberately liberal regime which has included freedom to raise debt on its own credit and to issue non-voting equity; and it can probably be claimed that, at least in its international operations, it is operating in fully competitive conditions. There is no reason to doubt that it is a dynamic and aggressive bank with good access to finance, proven experience of computerisation, and a reputation for highly effective conclusion of commercial deals, which would be capable of developing Girobank into a major force in British banking. Its elimination from the bidding could lead to French accusation of discrimination on national grounds, and there would be some risk of intervention by the European Commission on grounds of discrimination and/or competition policy.

Nevertheless, the political case against entertaining CL's bid is self-evident and in my view overwhelming. To sell Girobank to a bank in the French public sector could not be described as privatisation. To attempt to justify such a sale on the grounds that the French public sector enjoys commercial freedoms and disciplines akin to those of the private sector would be to invite the retort that we should allow our own public sector companies similar freedoms rather than selling them into the public sector abroad.

More importantly, our commitment to privatisation is based on the view that market forces provide the most efficient and effective basis for conducting business. Despite the freedoms that CL is now said to have, it is still underwritten by the French Government and its exposure to risk and the disciplines of the market place are therefore quite different from those for a private sector company. At the same time we need to bear in mind our existing high street banks with which we are aiming to promote competition following the sale. CL already has some branches and three subsidiaries in the UK with some 1,400 employees engaged mainly in commercial banking and broking. But

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the department for Enterprise

with a move into retail banking the high street banks could reasonably be expected to claim that such competition was unfair on the grounds that it was regulated neither wholly by market forces nor, as has been the case through the disciplines we have exerted on the Girobank, by UK Government policy.

I have considered whether to keep CL temporarily in play to strengthen the negotiating hand of the Post Office, but do not regard that as a tenable option. The short list must contain only those names to whom a sale would be fully defensible. Sir Bryan Nicholson, with whom I have discussed the issue confidentially, has said that, if the present attractions of the CL bid were maintained during the next stage, his Board may well have no choice but formally to recommend acceptance. This would simply aggravate the problem.

I should therefore welcome your agreement, by 9 September, that there is no option but to exclude CL from the short list. I would then seek to set the scene for this, and establish a line to meet subsequent criticism, in the note to the Select Committee to which I referred earlier.

Because of the sensitivity of the subject, I am copying this letter only to the Prime Minister, Geoffrey Howe and Norman Lamont and to Sir Robin Butler.

Yours sincerely
R. A. COPE

pp TONY NEWTON

(approved by the Chancellor, and signed in his absence)

SE1AAV

**CONFIDENTIAL
COMMERCIAL IN CONFIDENCE**



FROM: MISS M P WALLACE

DATE: 7 September 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mrs M E Brown
Mr Tarkowski
Mr Tyrie
Mr Call
Miss Wheldon (T.Sol)

GIROBANK SALE

The Chancellor has seen Mr Newton's letter of 6 September, together with minutes from Mr Call (6 September) and Mr Tarkowski (5 September). He entirely agrees with their conclusions. He has also noted that the status of Credit Agricole must be checked out - if it is also state owned, a view will need to be taken on the GUS consortium, too.

mpw.

MOIRA WALLACE

MAW
PSJ/ST
7/9

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mp

FROM: T TARKOWSKI
DATE: 8 SEPTEMBER 1988

- 1. MRS BROWN
- 2. FINANCIAL SECRETARY

cc: Chancellor
 Sir P Middleton
 Mr Anson
 Mr Monck
 Mr Moore
 Mrs Lomax
 Mr Bent
 Mr Tyrie
 Mr Call

✓
✓

Miss Wheldon TSOL

GIROBANK SALE

The Chancellor asked about Credit Agricole's status (Miss Wallace's 7 September minute). This is not a problem. The bank comprises 94 regional banks, which are mutual bodies owned by their depositors, and a holding company, the CNCA, which was privatised earlier this year when the state sold 90 per cent of its shareholding to the regional banks (10 per cent has been reserved for present and past employees of the CNCA). Moreover, Credit Agricole will not have a majority stake in the consortium. Precise shares have yet to be settled, but Globe would expect to take 10-15 per cent with the balance divided equally between the two other partners.

2. Treasury Solicitor's (Miss Wheldon) and Foreign Office lawyers have now had some preliminary discussion of the EC position. A decision based on CL's public sector status ought not to fall foul of EC law. The fact that Credit Agricole and Westpac had not been excluded would provide additional evidence that the decision had not been taken on nationality grounds. Nevertheless, the decision does need careful consideration by lawyers, both on the substance of the legal position and on the handling of any challenge. The attached draft asks for the position to be checked carefully and notes that the Government and the Post Office would have to agree on the line

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Proposed in the
PS/BT: he
will conduct his
signature,
J.

Jonathan

I thought you might want
to put his clean copy
into the CX for his
approval.

9.

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OK?

AA

One or 2
successive memos
char. OK.

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COMMERCIAL IN CONFIDENCE**

each should take. Presumably the Post Office would say simply that they had acted in accordance with Ministers' wishes, which Ministers would have to defend.

3. I attach a draft. Mr Newton requested a reply by 9 September.

Tomasz Tarkowski

T TARKOWSKI

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DRAFT LETTER FROM: FINANCIAL SECRETARY
TO: CHANCELLOR OF THE DUCHY OF LANCASTER

SALE OF GIROBANK

Thank you for your letter of 6 September to Nigel Lawson.

He and I agree very strongly with your conclusion that Credit Lyonnais should be excluded from the short list.

We must obviously be ready to explain this decision to Credit Lyonnais - and if necessary others. Credit Lyonnais, or the French Government, may be tempted to allege unfair discrimination. Your lawyers will need to check carefully that a decision based on the public sector status of CL would not expose us to successful challenge - either of having discriminated directly on grounds of nationality or by having judged the bids against criteria not set out in the sale memorandum. It will be important to take into account the statements made in the House as well as in the sale memorandum. Mutually acceptable formulations will have to be agreed with the Post Office covering both their position and the Government's. Care will also be needed in drafting the note you have promised the Select Committee on Trade and Industry. I would be grateful if my officials could be kept closely in touch with these discussions.

I am copying this letter to the Prime Minister, Nigel Lawson, Geoffrey Howe and Sir Robin Butler.

NORMAN LAMONT



13 SEP 1988

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

12 September 1988

Proposed by

Dear Peter

SALE OF GIROBANK

The Prime Minister has seen the Chancellor of the Duchy's letter of 6 September to the Chancellor of the Exchequer. She agrees with his conclusion that there is no option but to exclude Credit Lyonnais from the short list.

I am sending copies of this letter to Stephen Wall (Foreign and Commonwealth Office), Jeremy Haywood (Financial Secretary's Office, HM Treasury) and to Trevor Woolley (Cabinet Office).

GRAY
→
SMITH
12/9

FINANCIAL SECRETARY	
REC.	13 SEP 1988
ACTION	MR. T. JAKKOWSKI
COMES TO	PPS, CSI
	Sir P. Middleton
	Mr. Ansar, Mr. March
	Mrs. Lamm

Mrs. Blew
Mr. Tyrie
Mr. Call
Mrs. Wheldon (T. sd)

Paul Gray

Peter Smith, Esq.,
Office of the Chancellor of the Duchy of Lancaster.

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FROM: T TARKOWSKI
DATE: 27 SEPTEMBER 1988

- 27
1. MRS BROWN
2. FINANCIAL SECRETARY

cc Chancellor
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mr Tyrie
Mr Call

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GIROBANK SALE

1. This note reports progress since my 5 and 8 September minutes. No action is required.

2. The Post Office have now told Westpac, Bank of Scotland and the GUS/Credit Agricole/Globe consortium that they have been shortlisted and have provided them with further detailed information on Girobank. Site visits and talks with Girobank, the Post Office and the Bank of England will take place during October. Final bids are required at end October.

3. Credit Lyonnais (French public sector) N Brown (unacceptable to the Bank of England) HFC and Unity Trust (very low bids) have received rejection letters. There has been some to-ing and fro-ing between the PO board and Unity Trust about the extent of their commitment to their bid, and whether the indicative figure should be regarded as an absolute ceiling or not. The issues were not fully resolved though it did become clear that Unity were most unlikely to raise their bid: the agreement eventually reached with the PO was that Unity should not be shortlisted, but that the Board reserved the possibility of returning to Unity "if circumstances change."

4. Credit Lyonnais appear to have accepted the decision. DTI have explained the reason to the French Embassy, in order to avoid any misunderstanding. The Embassy subsequently contacted us

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(Mrs Lomax) to double check the position, but appear satisfied, on the basis of that conversation, that the decision was a proper one.

George Keyne

PP T TARKOWSKI



the department for Enterprise

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

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NEWTON
→
CHEX
9/10

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AQ

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

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COPIES TO	

(Check Act. This really is ~~the~~ Lloy's main concern! Spoke from yesterday!)

Direct line 215 5147
Our ref
Your ref
Date 6 October 1988

Den Nigel.

GIROBANK

My letter of 6 September recommended excluding a possible overseas public sector bidder whilst noting that this would further reduce a none too strong field of bidders. In the event, the final shortlist included only three - a Scottish bank, a consortium of a foreign bank and two British institutions, and an Australian bank. Sir Bryan Nicholson has just informed me that the first two have said they are not pursuing their bids. The reason appears to be uncertainty about the Counters network which will be available to Girobank given the current threats of industrial action. We are therefore down to one bidder.

I do not think we can go back to bidders who have been rejected and say that we are now prepared to consider their bids. Subject to any other possibilities emerging from discussion with our advisers, the alternatives are to continue negotiations with the Australian bank or to put off the sale. The Australian bank's indicative offer was a good one. Hambros, who are advising my Department, have recommended that the Post Office should pursue negotiations with the Australian bank. I agree with this.

The question is whether the Post Office should disclose to the Australian bank that it is now the only bidder. When discussions start at Girobank centres, it will almost certainly become known that only one bidder is concerned and that that bidder will find out. I therefore propose to make a virtue of necessity and agree to the Post Office telling the bidder before negotiations start. The Post Office would say that their indicative offer was attractive and that, provided it was

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the department for Enterprise

maintained at a good figure following the negotiations and that there were no unexpected complications, they would be prepared to conclude a deal.

I have not discussed with the Post Office what minimum price would be acceptable. From the indicative bids we have some idea of a market valuation of Girobank in addition to the estimates of Hambros and the Post Office's financial advisers before the sale process started. However, I think we need to hear how the discussions proceed before deciding finally what minimum price is acceptable. I would of course discuss this with you.

If the sale were not to go through we would need to look again at the available options. I would propose to do this in the paper I shall be putting to colleagues on the future of the Post Office. Our critics would of course attempt to use any decision to withdraw Girobank to attack our privatisation policy and we would need to present a strong defence with a coherent strategy for future disposal. I have therefore asked my officials to start work on a contingency basis on other options.

Negotiations with the Australian bank are due to start very soon. Subject to your views I propose to ask the Post Office to proceed as set out above.

I am sending a copy of this letter to the Prime Minister and to Sir Robin Butler.

TONY NEWTON

OCLACY

BF10/10



FROM: MISS M P WALLACE

DATE: 7 October 1988

PS/FINANCIAL SECRETARY

cc PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mrs Brown
Mr Tarkowski
Mr Call
Miss Wheldon - T.Sol

GIROBANK

The Chancellor has seen Mr Newton's letter of 6 October. He reports that, in the margins of another meeting yesterday morning, Lord Young mentioned to him that we were now down to one bidder for Girobank. Lord Young's view at that time was that this was not very satisfactory, and he was therefore considering whether Cr dit Lyonnais should be encouraged to re-enter the field, as part of a consortium in which they would have a less than 50 per cent stake. The Chancellor therefore finds it puzzling that this possibility is not mentioned in Mr Newton's letter. He wonders whether the DTI's legal advice has ruled it out, or whether Cr dit Lyonnais were not interested, or if the proposal was ruled out for other reasons. I have passed this query on to Mr Tarkowski, who has undertaken to investigate with DTI.

2. The Chancellor reports that the reaction he gave Lord Young in their discussion was that:

- (i) if we allowed Cr dit Lyonnais back into the competition, he would hope that it would be with a stake considerably smaller than 49 per cent. A stake of that size could still leave them in a dominant position, and fall foul of our earlier concerns;

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- (ii) in itself, the prospect of concluding a deal with the Australian Bank was not objectionable; but
- (iii) it would be a pity to have to tell them that they were the only bidders.

Mpw.

MOIRA WALLACE

FROM: MARK CALL
DATE: 10 OCTOBER 1988

CHANCELLOR

cc Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mrs Brown
Mr Tarkowski
Mr Wheldon

GIROBANK SALE

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u
I have seen Moira Wallace's minute of 7 October. It is truly astonishing that Mr Newton did not mention in his letter the possibility that Credit Lyonnais would be encouraged to re-enter the field. In the wake of KIO-BP our policy on the overseas element of privatised companies could look a real mess. Unless CL were restricted to 10% or less the KIO would kick up even more fuss. We could, of course, say that oil is a strategic industry, while banking is not. But I would rather rest on the principle of not privatising simply to allow the agents of other States to take over, than the concept of strategic industries. The former would be much easier to present, while the latter is supposed to be somewhat out of fashion. The very act of asking CL to re-enter, having barred them, would need some careful handling.

Mc
MARK CALL

CALL
→
CHEX
10/10

[R to wingback]

MP

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FROM: T TARKOWSKI
DATE: 10 OCTOBER 1988

- 1. MRS BROWN
- 2. FINANCIAL SECRETARY

- cc Chancellor
- Economic Secretary
- Sir P Middleton
- Mr Anson
- Mr Monck
- Mr Moore
- Mrs Lomax
- Miss Noble
- Mr Tyrie
- Mr Call

Ch/ Are you happy with this line. And do you want to write on this?

upw. I have sub-substantively cut: it is up to CL to make the CL with the OK for the 15. 15/10/88

Miss Wheldon (T.Sol)

GIROBANK

1. We have delayed advising on Mr Newton's 6 October letter while trying to establish what the collective view of DTI Ministers is on how we should now proceed. (Miss Wallace's 7 September minute set out an alternative proposition which Lord Young had floated with the Chancellor before Mr Newton wrote.)
2. However, DTI remain at sixes and sevens, and in view of the need for rapid decisions if we are to influence the Post Office's actions we think it would be helpful to write as soon as possible setting out our views. A self-explanatory draft letter is attached.
3. As far as we can ascertain, Lord Young and Mr Newton have still not discussed the suggestion that Credit Lyonnais should be approached to put together a consortium bid with majority private sector participation. DTI officials and Mr Newton are reported to have doubts on the lines reflected in the attached draft. In addition there must be a risk that Credit Lyonnais would nurse ambitions to increase its stake in due course.
4. A fact finding team from Westpac has been in London for the last few days, and Schrodgers report no signs of any tailing off in their interest. They are due to leave for Australia on Wednesday.

TARKOWSKI
FST
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DTI officials believe that if they are told they are the preferred purchasers it should be then.

Tancred Tarkowski
TANCREC TARKOWSKI

pe2.bk/tt./10.10.4

DRAFT LETTER FROM: FINANCIAL SECRETARY TO:
CHANCELLOR OF THE DUCHY OF LANCASTER

GIROBANK

You wrote to Nigel Lawson on 6 October suggesting that Westpac should now be told that they are the sole remaining bidder for Girobank.

However, I understand that you and David Young are also considering the possibility of stimulating further interest, possibly by approaching some of those who dropped out from the competition at an earlier stage.

Clearly we should explore the possibilities for generating competition, provided this can be done discreetly, and without prejudicing the need for the Bank of England's approval for any purchaser or purchasers. This will take time. It follows that - unless you receive clear legal or financial advice to the contrary - ^(believe) it would be preferable not to tell Westpac that they are sole bidders. To do so would either foreclose any late alternative which ^{conceivably} may emerge, or put us in a very difficult position vis-à-vis Westpac.

However, we do clearly need to do everything we can to encourage Westpac to push ahead rapidly ^{with} on their bid. I would have no objection to the Post Office telling them that on the basis of

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COMMERCIAL-IN-CONFIDENCE

their indicative bid they were at this stage the preferred purchasers, or some similar formula, if your judgment is that this would help the Post Office to clinch an agreement quickly. You would no doubt wish to consult the Bank of England on such a formula.

You will also want to emphasise to the Post Office the importance of taking every possible step to avoid further industrial action in Counters while these negotiations are continuing.

X While I am sure that we should continue to explore the alternatives, we have doubts about the wisdom of making any immediate approach to Credit Lyonnais. At the least it would require extremely careful handling. I think we would also want some assurance that CL's stake in any consortium would be well below 49 per cent, and that they were not a dominant force in it. There must be doubts about the practicability of achieving a satisfactory solution on these lines within the time available. I hope you will keep me in touch with your thinking on this.

I would also be grateful if my officials could be kept in touch with any further thoughts on the reserve price we should put on Girobank.

Finally, you will be as conscious as I am of the damage which could be done to Steel privatisation if news of any difficulties on the Girobank sale were to leak. I hope this will be stressed to all involved, both on the Government side and with the Post Office.

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I am copying this letter to the Prime Minister, the Chancellor and Sir Robin Butler.

[NORMAN LAMONT]

ppp pl BF B 14/10

FROM: T TARKOWSKI
DATE: 11 October 1988

17/10

MR CALL *

cc PPS
PS/FST
Sir P Middleton
Mr Anson
Mr Monck *
Mr Moore *
Mrs Brown *
Mr Bent *
Miss Wheldon-T.Sol

19/10

20/10

21/10

discuss with Mr Newton

* with attachment

mp

GIROBANK SALE

I have seen your note of 10 October to the Chancellor.

2. As you will know, the Chancellor has decided that the Treasury should not comment on the Credit Lyonnais idea in the response to Mr Newton's letter which will go out today.

3. However, you will want to be aware that a search has uncovered one precedent for a partial foreign government stake in a trade sale privatisation.

4. Leyland Truck and Freight Rover (LTFR) was privatised in April 1987 in a complicated transaction involving a merger between LTFR and the truck subsidiary of DAF, a Dutch company. DAF took a 60 per cent of the shares in the newly merged company. Rover group took a 40 per cent share.

5. In turn, DAF is ultimately between 40% and 48.44% owned by the Dutch Government. (Details attached - not copied to all).

6. At the time of the sale, foreign government ownership does not appear to have been an issue.

*TARKOWSKI
CALL
11/10*

Tarward Tarkowski

T TARKOWSKI

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MP

CH/EXCHEQUER	
REC.	11 OCT 1988
NOTES	
COPIES TO	

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Tony Newton MP
Chancellor of the Duchy of Lancaster
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

// October 1988

GIROBANK

You wrote to Nigel Lawson on 6 October suggesting that Westpac should now be told that they are the sole remaining bidder for Girobank.

Unless you receive clear legal or financial advice to the contrary I believe it would be preferable not to tell Westpac that they are sole bidders. To do so would either foreclose any late alternative which may conceivably emerge, or put us in a very difficult position vis-a-vis Westpac.

However, we do clearly need to do everything we can to encourage Westpac to push ahead rapidly with their bid. I would have no objection to the Post Office telling them that on the basis of their indicative bid they were at this stage the preferred purchasers, or some similar formula, if your judgment is that this would help the Post Office to clinch an agreement quickly. You would no doubt wish to consult the Bank of England on such a formula.

You will also want to emphasise to the Post Office the importance of taking every possible step to avoid further industrial action in Counters while these negotiations are continuing.

I would also be grateful if my officials could be kept in touch with any further thoughts on the reserve price we should put on Girobank.

Finally, you will be as conscious as I am of the damage which could be done to the Steel privatisation if news of any difficulties on the Girobank sale were to leak. I hope this will be stressed to all involved, both on the Government side and with the Post Office.

I am copying this letter to the Prime Minister, the Chancellor of the Exchequer and Sir Robin Butler.

NORMAN LAMONT

LAMONT
NEWTON
11/10

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pe2.bk/tt/20.10.4

- [agreed in draft]
1. MRS BROWN
 2. FINANCIAL SECRETARY

FROM: T TARKOWSKI
DATE: 20 OCTOBER 1988

cc Chancellor ✓
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Turnbull
Mrs Lomax
Mr Gieve
Mr Bent
Mr Tyrie
Mr Call

Ms Wheldon (T.Sol)

[Ch - I don't know
how this squares with
your talk with Mr Newton
this morning -
mpw]

GIROBANK

1. We have just learned that Westpac, the sole remaining bidder, has withdrawn.
2. Mr Newton is expected to write shortly to say that he does not propose to make any public statement about the sale for the time being. He will follow this up as soon as possible with his assessment of the chances of finding a buyer in the time left before we are forced into making an announcement.
3. This note reports the main issues we identified in a series of discussions with DTI, the Post Office, and both advisers last week on how we might handle the situation we now face.
4. We can advise more fully when Mr Newton writes and report any further points which have been identified.

Public position

5. Westpac did not know they were the sole bidder. To date they have maintained strict confidentiality. So it is not inevitable that the true position will become known at once, even if Westpac talk.

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6. However it seems unlikely that we have much more than, say, two weeks left in which the advisers can try to kindle new interest. It is known publicly that final bids are due at the end of this month. And DTI Ministers have promised the unions that they will be consulted before a sale is finalised. Giro staff at Bootle are also almost certainly expecting site visits to happen shortly. It would be possible to let it be known that the timetable had been extended, but this is unlikely to buy much additional time.

7. Finally, there may well be pressure from the press, and from Parliament, as the end-October deadline nears.

Alternative bidders

8. The advisers are continuing with discreet soundings. But the scope is obviously very limited without serious risk of starting speculation that all is not well.

9. We understand that two members of the failed consortium are still interested and that is being pursued.

10. There is also the possibility of returning to the two bidders who were ruled out at the first round on grounds of price. DTI are giving urgent consideration with Hambros to what might be considered the lowest acceptable price. We have warned them that this is a judgement which only Ministers can make. However it seems most unlikely that you or colleagues would wish to proceed with the lowest bid (£62 million). The other (£91 million) from Unity Trust should certainly be considered seriously, though we are strongly advised against assuming that this bid is serious, or relying on the confidentiality of any discussions with Unity Trust.

11. The Post Office have indicated, informally, that they would wish the decision to rule out an MBO to be reviewed. This is an issue on which we should expect to be lobbied if it is announced that the sale is off.

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12. The PO may also revive an earlier suggestion that they might retain a stake if it appears that this would help put together a deal quickly.

13. Clearly the odds against finding any last minute solution in the time we are likely to have available are very high. Even if one could be found, the Bank's approval would also be needed.

Nature and timing of any announcement

14. We assume Ministers would wish to reaffirm a commitment to Giro privatisation. An announcement might also say, for example, that no bidders had emerged who were satisfactory in the light of the criteria set [and price offered].

15. But you will want to consider very carefully what precisely would be said in the light of:

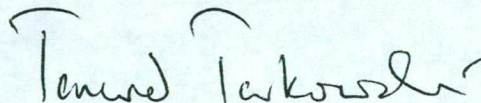
(a) the BSC privatisation (the Pathfinder is due to be published on 28 October. If possible it might be best to keep a Girobank announcement till shortly after that, but well before Impact Day and the start of the Steel Offer period on 23 November);

(b) the work that the Prime Minister has commissioned on the prospects for privatising PO counters. Mr Newton is expected to report back to E(A) within a month or so;

(c) the proposals which the Economic Secretary has been considering for privatising the ~~PO~~ Ordinary Account.

Conclusion

16. You can accept that no announcement should be made yet. For as long as it remains true, we can say discussions are continuing and decline further comment. But thought needs to be given now to the content of any announcement and its timing.



TANCRED TARKOWSKI



the department for Enterprise

- ii. Unity Trust with the Co-operative Bank, which made an indicative bid but was not shortlisted for several reasons including that its bid was low;
- iii. another stores group taking the place of GUS in the Charterhouse consortium. Littlewoods has refused but Woolworths might be interested;
- iv. one or more building societies might want to take a minority interest in a consortium;
- v. the management of Girobank might revive its proposal for a management buyout, possibly in association with Credit Agricole. We discouraged an MBO in the spring but without altogether ruling out; and
- vi. possible "white knights". Our advisers have in mind one or two overseas banks that could be approached.

X | There is of course a risk in pursuing these options. It will increase speculation and possibly arouse press interest. I also have to say that I frankly doubt whether any of them can be translated in to a firm bid, let alone an eventual sale. I therefore think we need to be prepared to take the initiative shortly after 31 October by making a statement. We agreed this morning that this could be along the lines that we had not found a buyer that could meet the firm criteria we had set the Post Office and that this demonstrated that we were, as always, continuing to pay close attention to the interests of the business concerned and of the taxpayer.

We could then go on to say that we were extending the period for bids for a further short time or that we were withdrawing Girobank from the market for the time being. I shall be considering these and other alternatives further in the next week or so and will write to you again. By then the Post Office should have a clearer view as to whether any of the above options is likely to prove fruitful. In the meantime I should be grateful for your confirmation that you are content to proceed in the way I have proposed.

I am copying this letter to the Prime Minister, and to Sir Robin Butler.

TONY NEWTON

TN7ABV



FROM: MISS M P WALLACE
DATE: 21 October 1988

M

MR TARKOWSKI

cc PS/Financial Secretary
Mrs Brown

GIRO BANK

I mentioned to you on the phone today that the Chancellor had one initial comment on Mr Newton's letter of 20 October. He commented that what he agreed with Mr Newton when he saw him in the margins of Cabinet yesterday was that we should make a statement saying that none of the bidders was prepared to pay an adequate price. The Chancellor is not clear what is meant by "the firm criteria we had set the Post Office" in Mr Newton's account of the discussion.

MPW
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21/10

Mpw.

MOIRA WALLACE

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BF 26/10



FROM: G R WESTHEAD
DATE: 24 OCTOBER 1988

MR TARKOWSKI

cc: PS/Chancellor
Mr Monck
Mr Moore
Mrs Lomax
Mr Peretz o/r
Mr Gieve
Mrs Brown
Miss O'Mara o.r
Mr Kroll
Ms Wheldon, T/Sol

GIROBANK

The Economic Secretary has seen Mr Newton's letter of 20 October to the Chancellor. He has commented that there could well be problems in the light of this if a building society applies for the reasons we considered in the past. He would be grateful if the papers about building societies' interest in the sale of Girobank could be reviewed. You will notice nevertheless that I have not at this stage copied these papers to the Building Societies Commission. You may wish to do so.

2. The Economic Secretary has also commented that if Girobank withdraws, the option of merging the National Savings Ordinary Account re-emerges.

Guy Westhead.

GUY WESTHEAD
ASSISTANT PRIVATE SECRETARY

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pps pl.

FROM: T TARKOWSKI
DATE: 25 October 1988

- 1. MRS BROWN
- 2. CHANCELLOR

- cc Financial Secretary
- Economic Secretary
- Sir P Middleton
- Mr Anson
- Mr Monck
- Mr Moore
- Mrs Lomax
- Mr Turnbull
- Mr Gieve
- Mr Bent
- Mr Tyrie
- Mr Call
- Miss Wheldon(T.Sol)

*Ch/ content with
proposed draft,
and with officials'
proposed line with DTI?*

GIROBANK

Mr Newton's letter

*OK; tho' I wd like to see
continued a motion. Also
check: are there any such
as some question. I wd
go to some of the Girobank
drafts etc*

Mr Newton's letter of 20 October adds little of substance to the position reported in my submission of the same date. You have already agreed with Mr Newton that there should be no immediate public announcement, though it is clearly important to be ready with an agreed line to take. The attached exchange between Allan Roberts (the constituency MP responsible for the Girobank centre at Bootle) and Mr Wakeham last Thursday demonstrates the pressure for a statement. I attach a draft letter confirming your agreement.

2. Miss Wallace's 21 October minute asks about Mr Newton's reference to the "firm criteria" which were set for the Post Office. This refers to criteria agreed in correspondence between Mr Clarke and Sir Bryan Nicholson and published when the sale was announced (see attached press releases). We see some advantage in referring to these criteria (which include price as a major determinant) in any announcement. Price was not, in practice, the only factor. N Brown was ruled out on grounds of acceptability to the Bank of England, and Credit Lyonnais because of their public

pps behind

*banks. There is
play of competition
in banking has said.
I am, however, interested
in pursuing the criteria
Girobank & Credit
Lyonnais*

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sector status (which was not even one of the published criteria). The attached draft letter simply asks for Mr Newton's draft announcement to be cleared with us.

Alternative trade purchasers

3. We saw the Post Office and Schrodgers again on Friday afternoon with DTI and Hambros to review the likelihood that any of the possibilities referred to in Mr Newton's letter could be successfully be converted into a bid.

4. The Post Office began by arguing for an immediate announcement that the sale was off. They eventually agreed, with some reluctance, that further enquiries by Hambros and Schrodgers should continue, subject to a further stock-taking in a week's time. The advisers will pursue two lines of enquiry:

i. approaches to possible sole bidders (including Credit Agricole, which was part of the shortlisted consortium bid, a high street clearing bank, and one or two other overseas banks);

ii. discussions on putting a consortium back together on the lines described in Mr Newton's letter, probably revolving around Credit Agricole.

However, it has to be said that in the light of the reports by the Post Office and Schrodgers, any last minute deal seems unlikely. If there were a serious bidder, the sale timetable would have to be extended, which would have to be announced.

5. The PO again questioned whether the Government might be prepared to allow an MBO to proceed, possibly backed by letting the PO retain a stake. We did not rule out the possibility that Ministers would be prepared to reconsider, though we did not encourage any optimism either. The Post Office argued that, apart from re-opening the question of an MBO with Girobank's management - which they have not done, and will not do unless we first agree - we should also be willing to consider any proposals involving

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either the continuation of a Post Office stake, or "elements of a buy-out" (presumably some management equity participation backed by debt), if this seemed likely to assist the discussions with possible trade buyers. We made it clear that neither Schroders nor Hambros should raise such a possibility in their discussions with possible trade buyers, but that if the question were put to them they could explore further, though without commitment.

A full management buy-out

6. However, the Post Office are also angling for reconsideration of a full-scale MBO, which they originally proposed as their preferred sale method. You will recall your view, when the issue was discussed by E(A), that Girobank's management should not be allowed to mount an MBO, principally on the grounds that on-sale in say 3 or 4 years time at a significantly higher price would be embarrassing. We were also doubtful whether the financial strength of an MBO would be sufficient to satisfy the Bank of England and guarantee a successful future in the private sector for Girobank. However, the Bank did not at that time rule out an MBO per se: they said they would want to judge the quality of the financial backing proposed.

7. The force of these arguments stands. But you will want to weigh them again against the risk of losing Girobank privatisation altogether, or at least for this Parliament. We will want to commission a full analysis of what went wrong from the advisers. But it seems clear that the failure of the present sale would rule out any immediate return to the market. It may be, if their present business plans materialise, that Girobank's attractiveness can be enhanced, but against this there must now be a serious risk of morale problems and losses from the management team. A further sale attempt might have to wait several years. In the meantime we would expect a public sector Girobank to propose a substantial increase in capital, combined with a relaxation of the present constraints on the business.

8. An alternative possibility might be to look at the prospects for privatising Girobank and the Counters network together. (MR

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Newton is currently preparing a paper for E(A) on options for counter's' privatisation alone). This might overcome some of the problems - especially Giro's current vulnerability to industrial relations in the Post Office. But other problems - Giro's reliance on non-specialist counter staff, its downmarket customer list and its under-developed internal systems - will remain. To these would be added the additional problem of Counters' declining businesses and low returns. In other words, it is by no means clear that a restructuring could be made to yield a privatisable entity.

9. An MBO may therefore provide the best prospect of an early privatisation, although there is no certainty at this stage that financial backers would be found. The MBO plan - produced by Schroders - was for a competition for backers. It is not clear that, given the failure of a conventional trade sale, this would be successful, or achieve an acceptable price. There is also the risk of an early exit - at a profit - though it might be possible to get a restriction on on-sale within a certain period and to claw back a proportion of excess proceeds (as in the case of NBC). All these would further depress price, of course, and could inhibit sale altogether.

Options

10. The main options appear to be:

- i. ruling out an MBO firmly now;
- ii. allowing the Post Office to revive the MBO plan now, in parallel with continuing discussions with possible trade purchasers, and before a public statement is made; or
- iii. telling the PO that they must have no discussions with Girobank on an MBO while other possibilities are still being pursued. But once Ministers have agreed that hope of a trade sale is exhausted, and a public statement has been made to

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that effect, the Government could tell the Post Office that it was prepared to consider representations on an MBO.

11. We would recommend against i. and ii. We want the Post Office and advisers to concentrate on identifying a trade buyer if at all possible. Option iii. might be handled by indicating, in announcing that the trade sale offer was withdrawn, that the Government remained committed to transferring Girobank to the private sector when possible, and that no options would be ruled out. It could be made clear in questions subsequently that this included any MBO proposal from Girobank's management.

12. We have not yet discussed these conclusions with DTI, and the draft attached merely asks if Mr Newton sees any grounds for reopening E(A)'s decision against an MBO. Mr Newton will want to write with his views. However, we believe that the Post Office may press us for a firm indication of Ministers' views on an MBO. Are you content for us to proceed, in our discussions with DTI and the PO, on the basis that:

a. the Government would be prepared to consider any proposals which involve "elements" of an MBO and/or PO stake, arising from Schrodgers and Hambros' present discussions with possible trade purchases but that there should be no attempt to stimulate or encourage this;

and to put it to DTI officials:

b. that the idea of a full MBO should not be pursued unless and until other possibilities have fallen and a public statement has been made to that effect.

13. We would be happy to discuss.

Tarced Tarkowski
T TARKOWSKI

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DRAFT LETTER FROM: CHANCELLOR
TO: MR NEWTON

GIROBANK

Thank you for your letter of 20 October.

I am content that no announcement should be made for the moment, while Schrodgers and Hambros continue to explore the remaining possibilities.

I agree that

~~As you suggest~~ we should if asked say no more than that confidential discussions are continuing. But, as you say, we will need to be ready for a further statement as the end-October deadline approaches, announcing either an extension of the sale timetable or, alternatively, withdrawal of the sale offer. No doubt you are putting briefing in hand on both bases. I would be grateful if my officials could be consulted on the drafts.

I should also be grateful if you could keep me closely in touch on the timing of any announcement which you propose to make. This will of course need to take account of the possible repercussions on the British Steel flotation.

Your letter refers to the option of a management buyout, which E(A) ruled out when we discussed it in the Spring. I would be interested in your views on whether the balance of arguments has in fact changed since we took that decision.

I myself am not persuaded that it has.

NIGEL LAWSON

APPENDIX II
SALE ANNOUNCEMENTS

dti

the department for Enterprise

press notice

Press Office
Tel: 01-215 5067/5068
Out of Hours
Tel: 01-215 7877

7th June, 1988

KENNETH CLARKE ANNOUNCES PLANS FOR GIROBANK PRIVATISATION

Girobank is to be taken out of the public sector and sold, Kenneth Clarke, Chancellor of the Duchy of Lancaster and Minister for Trade and Industry, announced today.

He told the House of Commons that Girobank is ready to expand, and that the Government believes that expansion can be best achieved in the private sector.

Its sale by the Post Office to a financial institution or organisation will provide a major opportunity to promote competition and widen customer choice in the banking market, Mr. Clarke said.

And he added that the Post Office, and Girobank and its staff and customers, would benefit by the big developments the sale would bring.

In an oral statement, Mr. Clarke said:—

“Mr. Speaker, with permission, I should like to make a statement about Girobank plc, a subsidiary of the Post Office Corporation.

“Since 1968 the Girobank has grown into a successful banking arm of the Post Office, with a particular strength in money transmission and in handling deposits of corporate cash. It now has about 2.5 million customers and in 1986/7 made a profit before tax of £23.1m.

“Girobank now needs to expand vigorously and take on other activities in order to develop in the competitive world of modern banking. The Government believe that this expansion can best be achieved in the private sector. I therefore asked the Post Office to consider this and the Post Office Board have agreed that taking Girobank out of the public sector is indeed the best way to proceed. The Post Office and Government have therefore agreed that the Post Office should plan to offer Girobank for sale to a financial institution or other suitable Company. Suitable bidders will now be given the opportunity to tender.

“The Post Office Board and its Chairman, Sir Bryan Nicholson, have agreed with me on the main factors which will be taken into account in evaluating bids. Price will, of course, be a major consideration in order to ensure a fair deal for the taxpayer. We also agree that weight should be given to the prospect of selling to a purchaser who will widen choice for the general public in banking services. It will also be important to safeguard the close links between Girobank and Post Office Counters Ltd. A new rolling contract has been concluded between Girobank and Counters which will govern their relationship under new ownership. We will be looking for a purchaser capable of developing and expanding Girobank's business. Post Offices Counters can expect to see increased business opportunities from that expansion as it is achieved.

“The management of Girobank is today explaining and discussing this decision with its employees and their Unions. Prospective purchasers will be invited to propose arrangements to enable management and employees to share directly in the future success of the business. The successful purchaser will, of course, also have to satisfy the strict requirements of the Bank of England.

“This is a major opportunity to promote competition and to widen customer choice in the banking market through the trade sale of a nationalised Bank. I believe that the Post Office, Girobank, Girobank's staff and its customers will all be well served by this new and important stage in the Bank's development.”

APPENDIX II

continued

SALE ANNOUNCEMENTS



Schroders

J. Henry Schroder Wagg & Co. Limited

Press Release

(for immediate release)

THE POST OFFICE

Sale of

GIROBANK PLC

The Chancellor of the Duchy of Lancaster announced in Parliament this afternoon that the Post Office's banking subsidiary Girobank plc ("Girobank") is to be sold.

Girobank has grown rapidly from its origins as a cash transmission service and is now a successful financial institution offering a range of services to both personal and corporate customers. In the year to 1st April, 1987, Girobank made a historical cost operating profit of £23.1 million. The results for 1987/88 will be available shortly. The Bank expects to have met its financial targets.

Girobank has over 2 million personal accounts. These are serviced mainly by post or telephone and through the Post Office Counters network which gives access to some 20,000 outlets throughout the UK. The Bank handles over £35 billion p.a. of cash deposits from the retail sector and in addition offers a wide range of other services to the corporate sector.

Girobank is a member of the Association for Payment Clearing Services. It is also a member of the LINK organisation, offering automated banking facilities, and produces its own VISA credit card.

The Post Office will be responsible for conducting the sale of Girobank. In the assessment of bids, the price offered by the prospective purchaser will, of course, be a major determinant. But in addition the following criteria will be taken into account:—

- (i) The prospective purchaser's plans for the future development of Girobank and in particular their likely impact on the Post Office's continuing operations, especially those of Post Office Counters Ltd.
- (ii) The arrangements proposed by any prospective purchaser to enable management and staff to share directly in the success of the business.
- (iii) The promise any purchaser brings of widening customer choice in the market place in which Girobank operates.
- (iv) The necessity for any prospective purchaser to be approved in due course by the Bank of England.

The Chancellor of the Duchy of Lancaster and the Post Office Board will be concerned to ensure that in any trade sale, proper regard is paid to the interests of employees.

The Secretary of State for Trade and Industry is required to approve the final terms of sale.

The sale of Girobank is being conducted by Schroders on behalf of the Post Office. Prospective purchasers are being asked to register their interest by Friday, 24th June with:—

Mr. Gerry Grimstone,
J. Henry Schroder Wagg & Co. Limited,
120 Cheapside,
London EC2V 6DS.

Mr. Wakeham: My right hon. and noble Friend the Secretary of State has a statutory duty in these matters, and it would not be right for me to comment while he is considering his duty.

Mr. Nicholas Budgen (Wolverhampton, South-West): Since the European Communities (Finance) Bill, with which the House will be dealing on Monday, envisages an 80 per cent. increase in European structural funds, a measure that will finance Euro-Socialism, will my right hon. Friend undertake, in view of the change in the Government's position as signalled by the Prime Minister's recent speeches about Europe, that the Government will be voting against that 80 per cent. increase?

Mr. Wakeham: The appropriate Minister will deal with the Bill on Monday when it comes before the House. However, I know that my right hon. Friend the Prime Minister fully supports the Bill, and I hope that my hon. Friend does as well.

Mr. Allan Roberts (Bootle): Will the Leader of the House arrange for a statement to be made next week on the privatisation of Girobank? Will he ask the Minister to explain why the short list of those who have put in bids has not yet been announced, although it was promised that it would be announced during the recess? Will he ask the Minister to say whether there is any truth in the fact that the Bank of Scotland was on the short list and has withdrawn and that great difficulties are being experienced by the Government in their attempt to privatise Girobank?

Mr. Wakeham: I do not know whether that is correct. I do not believe it to be so. I shall refer the matter to my right hon. Friend the Minister, who I am sure will make a statement, if a statement is needed.

Sir Michael McNair-Wilson (Newbury): Is my right hon. Friend aware that during the summer recess I had an opportunity to visit a unit at the Royal Berkshire hospital which is keeping premature babies alive? I was told that it is now possible to enable a 22-week-old baby to survive. In view of the grave implications of that, in terms of the Infant Life (Preservation) Act 1929, for medical teams which may be terminating pregnancies after that age, may I suggest that he should find time for the House to reach a final decision on the Abortion (Amendment) Bill introduced by the hon. Member for Liverpool, Mossley Hill (Mr. Alton)?

Mr. Wakeham: I recognise the concern, but I cannot add anything to what I have said before. Private Members' Bills are dealt with under procedures that the House has agreed. I cannot arbitrarily make a change in those arrangements.

Mr. Tony Banks: Will the Leader of the House arrange for a debate next week on the corrupt and incompetent policies being pursued by Tory-controlled Westminster city council, so that we can have an opportunity to discover more about the scandalous deal between Westminster city council and the Conservative party over the freehold sale of the office in Smith Square? It is clear that that cost Westminster ratepayers a great deal of money. If we are to talk about efficient local government, the activities of Westminster city council deserve much wider discussion.

Mr. Wakeham: The partial way in which the hon. Gentleman asked his question showed that he does not expect me to be very forthcoming in my answer. I cannot promise such a debate, but no doubt he can find a way of raising any points that he believes to be important.

Mr. John Browne (Winchester): Does my right hon. Friend recall that, in his statement, our right hon. Friend used the word "exceptional" to describe the Barlow Clowes affair? Quite apart from any legal obligation that may or may not come from reading the report and further investigations, many Conservative Members feel that the Government have an exceptional moral responsibility. Would it be possible to make the proposed debate on Barlow Clowes a matter of urgency before the Government make further statements on proposals without having sensed the feelings of Conservative Members?

Mr. Wakeham: I still think that the advice that I have given to read the report over the weekend and think how best to proceed, is the right advice for the House.

Mr. Bob Cryer (Bradford, South): May I suggest that the Leader of the House resurrects the Salmon commission's report on standards of conduct in public life? It would enable us to discuss the responsibility of the Secretary of State for Trade and Industry in the Barlow Clowes affair and why he has not resigned, as used to be the case when Ministers behaved in a crass and incompetent way. It would enable us to discuss the responsibilities of members of local government and the lord mayor of Bradford, who is using his casting vote in an unscrupulous and cheating way to maintain the Tories in Office so that they can sack 9,000 employees, close 25 community centres and half a dozen benefit shops and make savage cuts elsewhere. Surely it is a matter of concern for the House that these massive cuts and attacks on the city of Bradford are being made in this unfair, cheating and gerrymandering way. We should discuss the matter, and the Salmon report contains the basis on which to do so.

Mr. Wakeham: I am sure that, when Lord Salmon wrote his report, he did not expect it to be used in the sort of question that the hon. Gentleman puts to me today.

Mr. Peter Thurnham (Bolton, North-East): May we have an early debate on the need for legislation to deal with the dumping of toxic and other waste materials and for heavier fines to stop illegal dumping?

Mr. Wakeham: This is an important matter. I cannot promise a debate specifically on this subject, but, with a little skill, my hon. Friend might be able to make a point or two on Friday 28 October.

Mr. Ivor Stanbrook (Orpington): Since my right hon. Friend says that he has a note on all motions on the Order Paper, will he say what progress has been made with the implementation by the Government of what is required under early-day motion 6?

That this House deplores the fact that, alone among public service pensioners, those whose service was overseas cannot count pre-appointment war service towards their pensions; and calls upon Her Majesty's Government to remedy this injustice to a dwindling group of elderly people whose working lives were spent in adverse conditions while dedicated to the service of British interests overseas.

CONFIDENTIAL
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FROM: MARK CALL
DATE: 26 OCTOBER 1988

CHANCELLOR

cc Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mr Turnbull
Mr Gieve
Mr Bent
Mr Tarkowski
Mrs Chaplin
Mr Tyrie

[see also Rachel
↓ ESTY connect
behind]

Miss Wheldon (T/Sol)

GIROBANK

The balance of argument on an MBO may have changed. This was ruled out because of the potential embarrassment of large profits being made by managers in the event of an on sale. Since it has been so difficult to attract a trade purchaser it suggests that the market view is that there is little value to be unlocked in Girobank. Therefore the ability of an MBO team to sell at a profit within a few years must be slim, and hence the risk of embarrassment low.

Mr Call
Point: The MBO is not for
the same reason as the sale of
the MBO is not for the same
reason as the sale of
the MBO is not for the same
reason as the sale of

MC
MARK CALL

FROM: MRS R LOMAX
DATE: 26 OCTOBER 1988

ECONOMIC SECRETARY

cc: PS/Chancellor
Mr Monck
Mr Moore
Miss Noble o/r
Mr Dickson
Mr Kroll
Mr Tarkowski
Ms Wheldon, T/Sol

GIROBANK AND BUILDING SOCIETIES

Mr Westhead's minute of 24 October recorded your request for past papers on building societies' interest in the Girobank sale to be reviewed.

2. We have already warned the Building Societies Commission that there could, just possibly, be late interest from a building society, either on its own account or, more likely, as part of a consortium. They are happy to review the issues once again, if a serious proposition is put to them.

3. The only half way serious building society runner seems to be the Birmingham Midshires, who are said to be still involved with the Charterhouse consortium. Charterhouse have spoken to Mr Tarkowski, and Schrodgers have given the same message, informally, to the Building Societies Commission. On my advice, both PE and the BSC have stressed that the Birmingham Midshires should approach the Commission at the earliest opportunity, if they do have a serious interest: nothing is being ruled out, but, as the society already knows, the Commission identified a number of problems when Midshires spoke to them before about Girobank. While these would need to be looked at again, we have tried to convey the message that the BSC would be prepared to do so in a constructive spirit.

4. In the absence of a direct approach from Midshires, Mr Watson finally rang them this morning, and set up a meeting tomorrow afternoon which we (Mr Dickson) will also attend.

5. I gather that the advisers may also be thinking of trawling one or two of the larger societies. I should be most surprised if that leads anywhere, but once again the message is the same: any society with a serious interest needs to speak to the BSC as soon as possible.

RL.

RACHEL LOMAX

mpw



FROM: MISS M P WALLACE

DATE: 26 October 1988

MR T TARKOWSKI

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr D J L Moore
Mrs Lomax
Mr Turnbull
Mrs Brown
Mr Gieve
Mr Bent
Mr Tyrie
Mr Call

Miss Wheldon - Tsy Sol.

GIROBANK

The Chancellor was grateful for your minute of 25 October, and will send your draft, slightly amended.

2. He has also commented, however, that he would only be prepared to countenance a modest MBO element: in his view an MBO as such is out of the question. He would sooner see Girobank go to one of the big high street banks. There is plenty of competition in banking nowadays. However, he says he is interested in pursuing the combined Girobank/Counters idea.

M P Wallace

MOIRA WALLACE

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Turnbull
Mr Gieve
Mrs Brown
Mr Bent
Mr Tarkowski
Mr Tyrie
Mr Call



Treasury Chambers, Parliament Street, SW1
01-270 3000

Miss Wheldon - Tsy Sol.

26 October 1988

Rt Hon Antony Newton MP
Chancellor of the Duchy of
Lancaster
1 Victoria Street
LONDON
SW1

MP

GIROBANK

Thank you for your letter of 20 October.

I am content that no announcement should be made for the moment, while Schrodgers and Hambros continue to explore the remaining possibilities. I agree that we should, if asked, say no more than that confidential discussions are continuing. But, as you say, we will need to be ready for a further statement as the end-October deadline approaches, announcing either an extension of the sale timetable or, alternatively, withdrawal of the sale offer. No doubt you are putting briefing in hand on both bases. I would be grateful if my officials could be consulted on the drafts.

I should also be grateful if you could keep me closely in touch on the timing of any announcement which you propose to make. This will of course need to take account of the possible repercussions on the British Steel flotation.

Your letter refers to the option of a management buyout, which E(A) ruled out when we discussed it in the Spring. I would be interested in your views on whether the balance of arguments has in fact changed since we took that decision. I myself am not persuaded that it has.

I am copying this letter to the Prime Minister and Sir Robin Butler.

NIGEL LAWSON

CHEX
→
NEWTON
26/10



FROM: MISS M P WALLACE

DATE: 26 October 1988

MR T TARKOWSKI

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr D J L Moore
Mrs Lomax
Mr Turnbull
Mrs Brown
Mr Gieve
Mr Bent
Mr Tyrie
Mr Call

Miss Wheldon - Tsy Sol.

GIROBANK

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A handwritten signature in cursive script, appearing to read 'M. Wallace'.

MOIRA WALLACE

MPO
→
TARK
CASE 1
26/10



mp

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

8 November 1988

Ms Linda Joyce
APS/Chancellor of the Duchy of Lancaster
Department of Trade & Industry
1 Victoria Street
LONDON SW1

Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Gieve
Mr Bent
Mr Call
Mr Tyrie

*Mrs Brown (w)
Mr Moore*

Dear Linda,

T TARKOWSKI

GIROBANK

The Chancellor and Mr Newton met at 6.15pm on 3 November at No.11 to discuss Girobank privatisation. Also present were Mr Moore (Treasury) and Mr Priddle (DTI).

Mr Newton said that he had originally thought that in the wake of press speculation at the weekend, there was a case for using the priority written question put down by Roger Stott for answer on Friday 4 November to make it known, in a low key way, that an adequate buyer had not yet been found, but that talks were continuing, and the timetable was therefore being extended. This would have the advantage of clarifying the position in advance of next Thursday's adjournment debate, without actually having to make another statement in an already congested parliamentary week.

However, Hambros had now passed on to DTI officials their advice that the bidding process should effectively be abandoned, and that instead we should embark on 4-6 months of marketing talks. An announcement of this kind could certainly not be made via a written PQ, and so Mr Newton now felt the answer to Mr Stott's question should be a noncommittal holding formulation, promising confirmation of the position in due course. However, Mr Newton took the view that it might be very difficult to give no more than this noncommittal formulation at next week's adjournment debate. We therefore now needed to move quite quickly in deciding whether to accept Hambros' advice, and announce the conclusion of one attempt to sell Girobank and the beginning of another.



The Chancellor asked what progress had been made in interesting other bidders. He added that he had been interested to learn that Barclays were considering the matter, although he recognised the awkwardness of negotiating with a high street bank, in view of the terms of Mr Clarke's original announcement. Mr Newton reported that at present, Barclays were considering how they could satisfy the competition criteria. He had discussed the Barclays interest briefly with Lord Young, who was concerned about the competition questions that would be raised, and the possibility of a MMC reference. This risk needed to be properly considered. We would also need legal advice on whether we could legitimately negotiate with a clearing bank under the terms of the existing offer, or whether we would need to make clear publicly that our view had changed. The fact that the TSB had earlier expressed interest, but been deterred by the terms in which the offer was announced, made this particularly important.

The Chancellor recalled that when E(A) had discussed this in the Spring, the view had not been that sale to an existing clearing bank would be intolerable, but rather that it would be preferable to sell to some other institution. If the latter course proved to be impracticable, he would rather see Girobank sold to a clearing bank than remain in the public sector. If necessary the present criteria should be revised to allow for this. It should also be recognised that any purchaser was likely to rationalise the operation with implications for employment. Mr Newton said that some of the clearing banks might be reluctant to take on the task of rationalisation. If Barclays pursued their interest, they were thought to be keen to keep Girobank at arm's length, so as to avoid having to offer its employees the same terms and conditions as their own.

The Chancellor and Mr Newton also discussed the line that should be taken with the Post Office on the possibility of an MBO. The Chancellor said he was still strongly against. The Bank would have to be satisfied that any buyer was fit and proper, and it seemed unlikely that any bid with a substantial MBO element would clear this hurdle. In any he felt that we could not take prudential risk of an overwhelmingly MBO - based bid. He thought it would be sensible for Mr Newton to make this clear to the Post Office. He added, however, that there might be less objection to a proposal, for example, for a clearing bank to take 70 per cent with the management taking 30 per cent.

Mr Newton reported that the Post Office were continuing to investigate whether a consortium could be formed, on the lines of the earlier bid from Great Universal Stores. The Co-operative Bank had been approached in this connection, although they might be more interested in going in on their own. The retail chain Next had also expressed some interest, and the Chancellor thought that this had some attractions, although, clearly, an established bank would have to have a substantial involvement.



The Chancellor mentioned that one reason why Girobank was not attracting as much interest as had been expected must be its reliance on PO counters. This must raise the possibility, as a fallback, of taking Counters away from the Post Office and privatising them together with Girobank. However, Mr Newton pointed out that this would inevitably take longer - perhaps at least two years. It would be preferable to dispose of Girobank before then.

On handling, the main question was whether the Government would be in a position to say anything more substantive in time for the adjournment debate next Thursday. The Chancellor felt that it would be perfectly acceptable to stick to the line that none of the bids received so far had been adequate, that the Government were still committed to privatising Girobank, were discussing with the Post Office what the best way forward was, and would make a further announcement in due course. Mr Newton felt that this strategy carried the risk of provoking a parliamentary row with demands for statements, PNQ's etc. He would prefer, if possible, to make an announcement that set a clear time-frame for future action. The Chancellor agreed that work should certainly proceed with this end in view. But he thought the holding formula discussed would be a more than acceptable fallback, if it was not possible to finalise a definitive announcement by Thursday.

Yours,

Moira Wallace

MOIRA WALLACE

Assistant Private Secretary



Ch

MAJ.

Gerry Grimstone rang me to say Standard Chartered were seriously interested, were studying information urgently and would want to take a decision at a board meeting at the end of the month. He was not telling DM because he didn't trust them not to leak it. I took note.

I passed this to DMoore & RLomax - who had heard this from the Bank supervisors, & strongly suspected Gerry was passing this on Standard Chartered rather than vice versa. She is v dubious about whether this wd be a sensible move for S.C.

~~What the hell~~
I don't think there's any reason to press for changes in Newton's statement on this account - but see letter below for other points.

{could raise with Gov?} - yes. AA

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

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Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

*The draft USA seen
unacceptable; but
I must write further to
M^r N I think I will
I check to see that I will
submit to the committee
5 a*

CH/EXCHEQUER	
REC.	- 8 NOV 1988 ✓ 8/11
ACTION	MR T TARLOWSKI
COPIES TO	PS/EST, PS/EST SIR P. M. DOLETON MR ANDSON, MR MONCK MR O. MOORE, MRS LOMAX MR TURNBULL, MRS BROWN MR GIEVE, MR BEAT, MR TYRIE MR CALL

Direct line 215 5147
Our ref
Your ref
Date 8 November 1988

MISS WHELDON - TSY 501

*UK clear
bank name
man state owned or
to state -
control factory
bank.*

Nigel

GIROBANK

As I explained when we met on 3 November, I propose to make an early statement on Girobank in order to allow further efforts to sell the bank to proceed smoothly. It is publicly known that final bids were expected by 31 October. There are reports in the press, including a well informed one in yesterday's Independent claiming that none of the short-listed bidders was acceptable and we were changing the bidding criteria. The Post Office is under heavy pressure from its staff to say something about Girobank. Perhaps most importantly, the Speaker has allowed an Adjournment debate on Thursday 10 November. I am sure we should if possible make our position clear before then.

The Board of the Post Office has discussed the matter and has written to me recommending that I should make an interim statement to indicate that more time is needed for the sale and that further discussions with potential bidders are taking place. I propose to do so in terms of the attached draft.

This makes clear that the discussions will take place against the factors that have been taken into account in assessing the bids so far. Foremost amongst these was that the sale would be expected to widen choice for the general public in banking services.

public sector?

X | When we met you said you would prefer Girobank to be sold to a clearing bank than to a foreign bank. Your officials have proposed that the statement should accordingly make no reference to the competition factor, or any of the other factors previously announced, as relevant to the next round of the sale. I am afraid I would find it difficult to agree to this, especially in view of David Young's strong reservations which I mentioned to you. Promoting competition was a main issue in the original announcement and is of course one of our key themes for future policy in this Department. It was, for example, the central criterion which, in David's recent major speech on merger policy, he said was used in determining references to the MMC. To set it to one side in such a public instance as the Girobank sale would appear to be quite inconsistent with our having promoted it so vigorously elsewhere.

In addition to my concerns, the Post Office Board has said it could not agree to setting this factor to one side. Girobank belongs to the Post Office, which is conducting the sale, and our only statutory power is to refuse consent to a sale proposed by the Post Office or to require it to sell Girobank under a general direction. My solicitors have confirmed that we could not use a general direction to direct the Post Office how the bank was to be sold or to whom it was to be sold. It is therefore necessary to reach agreement with the Post Office about any joint statement as to the manner in which it will sell the bank.

The Managing Director of Girobank itself, Mr Malcolm Williamson, has emphasised a further factor. Girobank staff have rejected a wages settlement recommended to them by their union. The next step is likely to be a ballot for a strike. The management is doing all it can to persuade the staff that the deal offered was a good one and that a strike would be extremely damaging to the bank. But if it is clear that the factors which it was said in June would be taken into account in evaluating bids have been weakened or abandoned, Williamson's judgement is that the union would use it to try further to undermine morale. In such circumstances it could be extremely difficult to persuade them not to vote for strike action. Coming on top of the Counters strike ballot and the ensuing rash of industrial action in some Crown offices, this would be even more damaging to a sale.

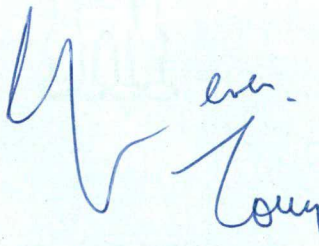
I do, however, appreciate and share your concern to secure a successful sale. I have, therefore, considered further how we might keep open the option of a clearing bank taking an interest in a way that would be consistent with the above considerations. There seem to me to be at least two possibilities. First, we could require a clearing bank, were it to take a controlling interest, to keep separate such an

interest from its other banking activities and to seek what other safeguards were necessary to ensure adequate competition. Secondly, a clearing bank might form part of a consortium without taking a controlling interest. In the latter case, we could also insist on certain competition criteria being satisfied. Either of these alternatives could be justified on the basis that, with the safeguards I have mentioned, we were promoting competition which was, after all, our main criterion. It would also be consistent with previous statements, none of which has categorically ruled out sale to a clearing bank. The attached draft statement would also allow such flexibility.

As you are aware, Barclays has expressed an interest in buying Girobank. The present position is that it is being invited to consider how it might fit in with the factors listed in the statement in June and it has asked for some information to enable it to do this. Once a statement has been made that discussions are continuing with potential purchasers, I think we should let the other clearing banks know this so that they also have an opportunity to come forward if they wish.

I hope you can agree to my making the attached draft statement before the Adjournment Debate on 10 November, in the form of an answer to a written Parliamentary Question.

I am copying this letter to the Prime Minister and to Sir Robin Butler.



TONY NEWTON

GIROBANK: DRAFT ANSWER TO WRITTEN PQ

The Post Office has informed me that the sale of Girobank by tender has not produced, within the published timescale, a buyer able to meet the requirements set for the sale.

The Government and the Post Office Board remain committed to transferring Girobank to the private sector through the sale of the bank to a suitable purchaser. The Post Office and the financial advisers for the sale are therefore holding further confidential discussions with potential purchasers taking into account the factors set out by my Rt Hon and Learned Friend the Member for Rushcliffe in his statement to the House on 7 June. This process is likely to take some time. I will of course continue to keep the House informed.

mp



FROM: MISS M P WALLACE
DATE: 9 November 1988

MR TARKOWSKI

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mr Turnbull
Mrs Brown
Mr Gieve
Mr Bent
Mr Call

Miss Wheldon - Tsy Sol.

GIROBANK

The Chancellor has seen Mr Newton's letter of 8 November. He awaits advice, but has commented that at first blush the draft written answer seems unobjectionable.*

2. He has also commented that he ought to write forthwith to Mr Newton correcting his misunderstanding that the Chancellor "would prefer Girobank to be sold to a clearing bank than to a foreign bank". The Chancellor's point was that he would sooner see Girobank go to a UK clearer than remain state-owned, or be sold to a state-controlled foreign bank. I should be grateful if you could provide a draft to register this point.

mpw

MOIRA WALLACE

* You confirmed that officials had no objections to the wording. I have now told Mr Newton's office that the Chancellor is content for the written answer to be given today, and for the speaker to be briefed accordingly when considering whether to allow Mr Gould's PNA on Girobank.

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FROM: T TARKOWSKI

DATE: 9 November 1988

- [agreed in draft]
1. MR MOORE
 2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Turnbull
Mr Gieve
Mrs Brown
Mr Bent
Mr Call
Mr Tyrie

ch / content to write as drafted.

OK

Miss Wheldon T-Sol

GIROBANK

As Miss Wallace's note today records, your private office confirmed to Mr Newton's private office this morning that you were content with the draft written PQ attached to Mr Newton's 8 November letter to you, and that in view of Mr Gould's PNQ on Girobank you were also content for it to be answered this afternoon rather than tomorrow, as Mr Newton had proposed.

2. We have now learned that the Speaker ruled against Mr Gould's PNQ in any case, and that Mr Newton has decided to defer giving the Written Answer till tomorrow, as planned.

3. In most respects the draft answer is perfectly acceptable: our main concern - which Mr Newton alluded to in his letter - was that the sale criteria agreed between Mr Clarke and the PO Board represent a significant constraint on our freedom of manoeuvre in further discussions with potential purchasers, and that we either should, if possible, begin to distance ourselves from them, or failing agreement on any way of doing this, that no reference should be made to them in the Written Answer.

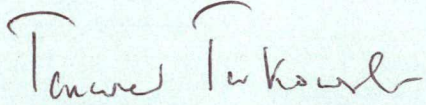
4. Mr Newton's letter explains why he feels unable to accept any move away from these criteria, namely Lord Young's views on the

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importance of competition in this instance, the views of the PO Board and the difficulty of influencing them, and the state of industrial relations in Girobank. Though Mr Newton does not refer to the fact, it transpires that DTI Ministers have made repeated public references to their view that sale of Girobank would lead to a widening of consumer choice, and in doing so they have made clear that they would not expect a clearing bank, as sole purchaser, to meet the criterion (examples attached). It has to be accepted, in view of this, that any relaxation in the criteria would constitute a substantial U-turn in the public position. Our conclusion is that we will have to live with the criteria, at any rate for the time being, and that there is nothing to be gained from insisting that the reference to them is removed.

5. Mr Newton does say, however, that he sees scope for involving a UK clearer, either as an arms-length owner or as a minority stake holder, so preserving competition, and that after the Written Answer has been given he would want to let all the clearers know the position. We should clearly encourage this.

6. I attach a draft letter which also corrects Mr Newton's misunderstanding of your position on overseas bidders.


T TARKOWSKI

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DRAFT LETTER FROM: CHANCELLOR OF THE EXCHEQUER
TO: MR NEWTON

*re type
final
ASAP*

GIROBANK

Thank you for your letter of 8 November. My private office have already confirmed that I am content with the draft answer attached to it.

I accept that it ^{*might be difficult*} ~~would be inopportune~~ to be seen now to be abandoning the criteria which Kenneth Clarke agreed with Sir Bryan Nicholson, and accordingly I am content that the reference to them should remain. However, as you know I believe we should remain ready to revise the criteria if that is necessary. As I said when we discussed the point last Thursday, I would rather see Girobank sold to a clearing bank than remain in the public sector. I think it also probable that any purchaser would wish to rationalise Girobank.

I am glad to see, therefore, that you do see some scope for participation by the clearers in a sale and that you intend to let them know the position as soon as the Written Answer has been given. I am sure it is right to do this. I would hope that, in doing so, we should aim to build on the approach set out in your letter ~~[in an open minded way]~~. It is clearly important not to ~~[set~~

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~~ourselves~~ ^{allow} further inflexible criteria ^{to develop} which may prove more of a hindrance than a help in securing a future for Girobank in the private sector.

Finally, I should clear up a ~~small~~ misunderstanding in your letter where you say I "would prefer Girobank to be sold to a clearing bank than to a foreign bank". My point was that I would sooner see Girobank go to a UK clearer than ~~remain state-owned, or~~ be sold to a state-controlled foreign bank.

I am copying this letter to the Prime Minister and Sir Robin Butler.

NORMAN LAMONT

Girobank plc

3.48 pm

The Chancellor of the Duchy of Lancaster and Minister of Trade and Industry (Mr. Kenneth Clarke): Mr. Speaker, with permission, I should like to make a statement about Girobank plc, a subsidiary of the Post Office Corporation.

Since 1968 the Girobank has grown into a successful banking arm of the Post Office, with a particular strength in money transmission and in handling deposits of corporate cash. It now has about 2.5 million customers and in 1986-87 made a profit before tax of £23.1 million.

Girobank now needs to expand vigorously and take on other activities in order to develop in the competitive world of modern banking. The Government believe that this expansion can best be achieved in the private sector. I therefore asked the Post Office to consider this and the Post Office Board has agreed that taking Girobank out of the public sector is indeed the best way to proceed. The Post Office and the Government have therefore agreed that the Post Office should offer Girobank for sale to a financial institution or other suitable company. Suitable bidders will now be given the opportunity to tender.

The Post Office Board and its chairman, Sir Bryan Nicholson, have agreed with me on the main factors that will be taken into account in evaluating bids. Price will, of course, be a major consideration in order to ensure a fair deal for the taxpayer. We also agree that weight should be given to the prospect of selling to a purchaser who will widen choice for the general public in banking services. It will also be important to safeguard the close links between Girobank and Post Office Counters Ltd. A new rolling contract has been concluded between Girobank and Counters which will govern their relationship under new ownership. We will be looking for a purchaser capable of developing and expanding Girobank's business. Post Offices Counters can expect to see increased business opportunities from that expansion as it is achieved.

The management of Girobank is today explaining and discussing this decision with its employees and their unions. Prospective purchasers will be invited to propose arrangements to enable management and employees to share directly in the future success of the business. The successful purchaser will, of course, also have to satisfy the strict requirements of the Bank of England.

This is a major opportunity to promote competition and to widen customer choice in the banking market through the trade sale of a nationalised bank. I believe that the Post Office, Girobank, Girobank's staff and its customers will all be well served by this new and important stage in the bank's development.

Mr. Bryan Gould (Dagenham): The statement prompts one basic question — why? What possible justification can there be, apart from political dogma, for disrupting a successful public enterprise of which Girobank is such a splendid example? What evidence is there that Girobank customers are dissatisfied with the service that they receive, a level of service in which Girobank, a prime example of public sector innovation, has so often set the standard? What guarantee is there that that service will be maintained in private hands? What protection is there against the takeover of Girobank by a clearing bank or other major financial institution which could only limit consumer choice and increase an already unhealthy concentration of British banking in a few hands?

Does the Chancellor accept that a continuing commercial relationship with the Post Office Counters is absolutely essential to Girobank's continued efficiency? What guarantee is there that Girobank will remain regionally based? How safe are the 5,000 or more jobs in Bootle, and what is the future of plans for a second site in the north-west?

What guarantees are there as to conditions and pensions for Girobank employees? What commitment is there to new expansion and continuing investment, and what assurance can there be that a successful public sector initiative which has widened consumer choice and set new standards in banking services will not be damaged and weakened in the hands of private sector predators?

Mr. Clarke: On the first key question asked by the hon. Member for Dagenham (Mr. Gould), it is a matter of disagreement between the Opposition and the Government that private sector ownership of businesses tends to improve their performance. We believe that the bank, which is now poised for further expansion and development, will carry that out most efficiently and effectively in the private sector where it is able to raise its capital in the ordinary way, to be free from political constraints on its management and to win its customers by offering them improved services.

The customer base in particular is extremely important. It is a very good approach to examine the whole question from the point of view of the customer. Obviously, anyone interested in merging with Girobank will regard its present customers—2.5 million of them—as one of the principal assets of the bank's business and will be looking to enhance and improve the service. I know that the bank is contemplating moving into plastic card cash dispensers and more corporate finance and is looking to extend its insurance and mortgage business. It will find it easier to do so in the private sector.

I agree with the hon. Gentleman that we must be careful not to limit choice for the public as a result of the sale or merger. When he studies my statement, he will see that this is one of the things that I agreed with the chairman we should look at when considering the bids. The Post Office will evaluate the bids bearing in mind the need to widen consumer choice if possible. At this stage, I am not cutting out anyone from entering the first rounds of bids to the Post Office, but one of the major British clearers would have considerable difficulty in satisfying our condition that one result of the sale should be a widening of consumer choice in banking services in this country.

I agree with the hon. Gentleman that a continued connection between Counters and Girobank is extremely important. That is why we have waited for the conclusion of the new contract, negotiated at arm's length between Girobank management and Counters management, which ensures a continuing relationship through a rolling five-year contract capable of being terminated only upon five years' notice either way. I expect that anyone buying Girobank will be buying, among other things, access to the Counters network, and therefore will have no intention of terminating the business connection and will be aiming to expand the business that goes over the counters.

As the hon. Member for Dagenham said, one of the main things that will be purchased by any acquirer of Girobank is the regional base—its staff and assets at Bootle and the headquarters at Bootle. I do not believe that anybody will make a bid for the bank with the

intention of running it down. In so far as the bank prospers in the future, the position of its employees will be improved. Their precise position is being explained to them by management at the moment.

Above all, one of the things we will be looking for from the purchaser of the business will be a commitment to the continued development and expansion of Girobank. It is because we want to see the bank expand and because we want to see a widening of consumer choice in this area and improved banking services that we think that the time has come to put Girobank in the private sector where we think that that is most likely to happen.

Mr. Neil Hamilton (Tatton): Will my right hon. and learned Friend accept that there will be a warm welcome from Conservative Members for his announcement? There is no reason to believe that the future for Girobank is anything other than excellent, and, freed from the ultimate control of Treasury constraints on raising capital, there is plenty of opportunity for expanding jobs in the north-west. Although the Labour party seems to be learning something from the experience of Socialist parties abroad, which have been dumping their ideological baggage, it still has something to learn from President Mitterrand, who is denationalising banks in France.

Mr. Clarke: I agree with my hon. Friend. It seems likely that the Labour party, yet again living in the past, will be almost the only Socialist party in western Europe still committed to the idea of a nationalised bank, saying to the employees of the bank in the north-west that their future lies better in nationalisation than it does in the private sector with access to fresh capital and the possibility of expansion.

Mr. Tony Benn (Chesterfield): Is the Minister aware that everybody understands perfectly why he has done this? There are enormous profits to be made out of Girobank, which it was my privilege as a Minister to carry through the Cabinet and announce in the House 22 years ago. Is he aware that the British banks bitterly oppose Girobank, which is one reason why it was not introduced earlier? Even Ray Mawby, Assistant Postmaster-General in the Government of Sir Alec Douglas-Home, was unable to get Girobank through because the banks did not want competition.

Girobank has been wildly successful and the figures given by the Minister show that. What he has announced today is a naked act of plunder of assets that do not belong to the Government, that were built up by public enterprise, public imagination and public investment and are now, as with so many other assets, to be sold off to the very people who financed the Tory party in its last three election campaigns.

Mr. Clarke: May I reassure the right hon. Gentleman that the process of inviting bidders to tender will ensure that we will get a good price from the sale of the bank which will accrue to the public good? We will ensure that the taxpayer gets a bargain and that the full value of the bank is realised and goes first to the Post Office. But with our arrangements with the Post Office, what is surplus to its requirements will be made available to the Government. I realise that originally, in what was a different political and economic era, Girobank was the creation of the right hon. Member for Chesterfield (Mr. Benn). In those days, he believed that we needed to have

a state nationalised bank on the high street. If he were to win the election for the leadership of the Labour party I have no doubt he would reinforce the commitment of the hon. Member for Dagenham (Mr. Gould), who at the moment speaks for his party, to the idea of nationalised banking. The current climate is against that.

I agree with the right hon. Gentleman about the need to inject more competition into banking services, so, as I have said, we have agreed with the Post Office that we will be looking for opportunities for increasing competition when evaluating bids. Girobank has been successful. It went through a difficult time but has been successful in recent years. Certainly it should be more successful—it will have the opportunity to be so—when it is in the private sector.

Mr. Michael Grylls (Surrey, North-West): Will my right hon. and learned Friend accept that many people will greatly welcome the Government's decision? The track record of privatisation shows that the success of Girobank in the private sector will be assured. Will he confirm that it is the Government's view that Girobank should not be allowed to go into the hands of one of the big banks, and that it must remain, as my right and learned Friend has said, in independent hands away from the big banking groups so that it will not only be moved into the private sector so that it can do better but will create more competition and more choice for the private customer and the corporate customer, who need more choice?

Mr. Clarke: I agree with my hon. Friend. The past nine years have changed the climate. Few people still cling to the notion that it is right for a business such as this to be state owned. Privatisation has proved its value to employees, customers and everybody who has an interest in the business.

I have every sympathy with my hon. Friend's second point, which he made so forcefully. It would not be right for me to say that a bank should be ruled out of putting in a bid, but we should need much persuading before we accepted a bid from a major English clearing bank. I share my hon. Friend's aim of increasing consumer choice, and I agree that it would be a mistake to narrow it in any way. A new player on the clearing bank business scene over and above Trustee Savings Bank, which we successfully privatised, will be of value to customers in this country.

Mr. Allan Roberts (Bootle): The Minister has not given, but will he please give, an assurance that the 6,000 jobs in Bootle will be secure and that the bank will not be sold to another financial institution or bank that will not need the clearing house facilities on Merseyside? Does he accept that there is much anxiety among the work force and their families? Girobank is a major public sector success story. It is the only flagship of success in providing large-scale employment in my constituency. If the Government destroy it for doctrinaire reasons and reduce competition by selling off the only bank that competes with the private sector, they will be condemned on Merseyside and throughout the country for an act of asset-stripping the like of which they have not yet undertaken. If Girobank is so successful, why do the Government want to sell it off if it is not simply for doctrinaire reasons and because they want to hand massive public-sector profits to their friends who donate to the Tory party?

Mr. Clarke: I understand the importance of Girobank to Bootle and its Member of Parliament. I completely

[Mr. Clarke]

disagree with the hon. Gentleman that this proposed sale is a threat to business in Bootle. Anybody purchasing the bank will be purchasing the facilities in Bootle and will regard them as one of the assets that they are acquiring. I find it difficult to accept that anybody will find it remotely worthwhile or sensible to contemplate acquiring the bank but then running down the business at Bootle. Nobody can guarantee a set number of jobs on Merseyside. The Post Office has never guaranteed a set number of jobs at Bootle. Those jobs have been secure and the enterprise successful because the bank has done well in recent years. If in private hands the bank continues to expand and succeed, there will be enhanced employment prospects on Merseyside and not the reverse.

Mr. Ian Gow (Eastbourne): Will the consent of my right hon. and learned Friend be required before Girobank is sold to a purchaser? Are we right to conclude from my right hon. and learned Friend's statement that he would withhold his consent if the prospective purchaser were from overseas?

Mr. Clarke: As I have explained, bids will go to the Post Office and its board will handle the sale. The Secretary of State has a right to issue a direction to the Post Office if it proposes to do something with which he profoundly disagrees. We are content for the Post Office to evaluate the bids in line with the criteria that I have carefully agreed with the chairman of the Post Office, with which the Post Office Board agrees. We shall consider foreign bids on the same basis as any other.

Mr. Dennis Skinner (Bolsover): Gnomes of Zurich.

Mr. Clarke: I gather that the widening of competition has narrow, nationalistic connotations for some Opposition Members. In addition to satisfying the Post Office, anybody who bids will have to satisfy the Bank of England, comply with its strict criteria and be subject to the advice of the Director General of Fair Trading, who will advise on the implications, if any, for competition and merger policy. I can see nothing wrong in dealing with bids from overseas on exactly the same footing as those from this country.

Mr. Matthew Taylor (Truro): Will the Minister elaborate on the guarantees given to consumers that the sub-post office network will continue to be used and on the guarantees against major clearing banks buying it not on this occasion but perhaps on a future occasion on a resale? Will the Minister clarify whether the proceeds of the sale will go to the Post Office? If not, on what basis will they be redistributed into the Government's coffers? What debate and parliamentary scrutiny will there be in the House?

Mr. Clarke: We can tell the customer that the private sector purchaser will be seeking to maintain loyalty and expand the customer base. I am sure that any purchaser will wish to endorse the present plans of Girobank's management for expanding and improving its services. It was an extremely important precondition, without which we could not have proceeded, that there should be a satisfactory conclusion to the contract with Counters, which offers it every guarantee of being able to participate in the future success of Girobank. If anybody were to try to acquire the business in the future, they would be subject

to the ordinary rules of competition law and the banking Acts; that will be relevant to any future change of ownership. The proceeds of the sale will go to the Post Office, but by the unusual accounting devices that it has always operated, there will be an agreement about how much it needs for its own purposes, and any surplus, if there is one, is loaned to the Government for general public expenditure.

Parliamentary debate is a matter not for me but for my right hon. Friend the Leader of the House. The debate about nationalisation and privatisation has become a one-way match. I should not have thought that the Opposition would have wanted to go over it again as they so plainly lost the general argument with the public.

Several Hon. Members rose—

Mr. Speaker: Order. I understand the wide interest in this matter, but I must have regard to the other business before the House. I ask hon. Members to ask questions that have not been asked before. Then most of them will be called.

Mr. Anthony Beaumont-Dark (Birmingham, Sell Oak): Will my right hon. and learned Friend accept that most hon. Members realise that there is no need for banking services to be owned by the Government or Government Departments? It is equally important that none of the big four banks should bid for Girobank because it should be a fifth force. Freedom for services and competition is important, as the Government have said.

Mr. Clarke: I take note of my hon. Friend's clearly expressed views. I cannot rule out anybody from making a bid at this stage, but I have probably given enough hints to show that I strongly agree with his instincts.

Mr. Bob Cryer (Bradford, South): Is not Girobank being sold off because it is a highly successful public enterprise? It will not be improved by selling it to the private sector. Will the Minister give a categorical assurance that no purchaser who has contributed to Conservative party funds will be allowed to bid? If not, the public will regard this as a corrupt practice by which friends of the Tory party are buying their way into a highly lucrative business. Will he confirm that the Secretary of State will not exercise a veto over any prospective buyer, including any bank of Libya that might be interested?

Mr. Clarke: The lack of corruption in public life is extremely important. The lighthearted way in which some Opposition Members toss out allegations of corruption is extremely unfortunate. Plainly we shall sell Girobank to any suitable bidder who can satisfy the strict requirements of the Bank of England and who otherwise seems well poised to expand the business. We have no intention of ruling out any bidder who is prepared to recognise a trade union for negotiating purposes if it contributes to the Labour party's funds.

Mr. Derek Conway (Shrewsbury and Atcham): What my right hon. and learned Friend has said will be welcomed by the majority of hon. Members. Will he assure those who represent large rural constituencies about the safeguards for the rural sub-post office network and the amount of information that will be given by the chairman of the Post Office to sub-post masters?

Mr. Clarke: My hon. Friend's constituency is more rural than mine. I share his sensitivity about the interests

of rural sub-post office network, which is why it was so important to get the contract agreed before we offered the bank for sale. Any purchaser will be bound by it, and I do not believe that anyone will buy the bank intending to give five years' notice. One of the assets that will be acquired is the network of counters over which they can trade. If the purchaser is successful in expanding the business, our rural sub-post masters and mistresses can look forward to an expansion in the work coming over their counters.

Mr. Alex Salmond (Banff and Buchan): Is the Minister aware that, since the Trustee Savings bank was stolen from its customers by the Government, Girobank is the only alternative not in the private sector for low income families who predominate in its customer base? What guarantees can the right hon. and learned Gentleman offer those low income families that their banking charges will not rise as a result of the privatisation?

Mr. Clarke: I shall not be drawn into discussing the TSB, but I remember the curious legal tangle that we got into. I think that it came as a matter of some astonishment to the average customer that he or she was regarded as having some proprietary interest in owning the bank; but that is all behind us. Anybody buying the bank will buy the bank's present customer base and I am sure will be aiming to retain and expand it. The customers will obviously stand to gain to the extent that the new proprietors succeed in broadening the services and making them more attractive. In the end, banking charges have to be determined by the management of each bank, including Girobank now.

Interest has been expressed on both sides of the House about increasing competition in clearing bank services, and it seems to me that increased competition will only exercise a downward pressure on the kind of charges that the ordinary customer has to face.

Mrs. Teresa Gorman (Billericay): In offering my congratulations to my right hon. and learned Friend, may I say how intrigued and fascinated I was by his comments on the Post Office management's attitude to this privatisation move, and how delighted I am that it acknowledges the importance of competition in creating new jobs, innovation and expansion? Will my right hon. and learned Friend use his persuasive powers to make the Post Office and the Government apply those principles to other more geriatric aspects of the Post Office's work, including the delivery of the letter post?

Mr. Clarke: I am glad to say that on this policy I am in full agreement with the Post Office Board, the Post Office chairman and the management of Girobank. The Post Office is sensitive to the criticisms made of its service. I know that the chairman and the board are determined to raise the standard of service that they provide, and, looking at this aspect of the business with a view to entering the market place and making it more commercial and efficient, I have no doubt that they will apply the same principle to those parts of the business that remain in public hands.

Mr. Peter L. Pike (Burnley): Will the Minister recognise that, when he talks of customer choice, 2.5 million people have chosen to bank with a bank that is publicly owned? Why should he deny them that option? Will he also recognise that the north-west will have little

confidence in the private sector maintaining the head office at Bootle when it looks at what the private sector has done to every other banking head office that used to be in Manchester?

Mr. Clarke: Customers are perfectly free to apply whatever criteria they want to their choice of bank. I have no doubt that a handful of eccentrics choose a nationalised bank rather than any other, but I suspect that they are a tiny minority of the 2.5 million customers who have gone to Girobank for other reasons.

I have already spoken about employment prospects in the north-west. I am glad to say that most of the bank's employees are based in Bootle and the Merseyside area. Any purchaser will be aware of that and, if the bank is successful in private hands, on balance that should be good news for the area, not bad.

Mr. Michael Fallon (Darlington): Will my right hon. and learned Friend reassure Conservative Members that this welcome addition to the enterprise culture does not mark the end of the Government's review of Post Office businesses in their determination to ensure a much more commercial approach in all of them?

Mr. Clarke: A desire to improve customer service and to run the business as efficiently and cost-effectively as possible is an agreed aim between the Government and the Post Office Board. We are not studying any other privatisations and we are committed by our election statement not to privatise the Royal Mail. However, Girobank is plainly not within the Royal Mail, and I am not sure that the rest of the business is either.

Mr. Frank Doran (Aberdeen, South): The Minister will be aware that Girobank does not just serve 2.5 million customers and make the profits that he outlined; it also serves a social purpose. What consideration has been given to the interests of those public sector institutions, particularly the Department of Health and Social Security, a major customer of the bank, to ensure that its interests and the interests of its customers—those millions of benefit claimants—are not prejudiced?

Mr. Clarke: The advantage to people such as DHSS claimants is the ready availability of the counter network. That is why the contract with Counters is so important, and that is why one of the principal attractions of the bank to someone looking to merge with it will be the immediate access to the nationwide counter network used by such a wide range of people. DHSS is a customer of the bank. That is the position now when it is nationalised, and it will be the position in future. I cannot imagine that the DHSS would contemplate moving to another network because this is the most readily accessible to its claimants. But the negotiations between the DHSS and Girobank remain those between a customer and a bank under whatever ownership.

Mr. Kenneth Hind (Lancashire, West): I congratulate my right hon. and learned Friend on his move which will remove much of the uncertainty that hundreds of my constituents who work for Girobank have felt for many months. Should there not be a suitable purchaser on the scene, will he consider floating the company, and at the same time giving the employees of Girobank an opportunity to subscribe to the shares?

Mr. Clarke: I agree that uncertainty is extremely damaging to morale in a business which at the moment is

[Mr. Clarke]

doing well and looking to expand. Therefore, we have made a clear and unambiguous statement today and we shall set out a timetable that I hope will move the business into private hands well before the end of this year.

We did consider the prospect of floating the bank, but at its present stage of development that would probably have been a fairly unsatisfactory way of proceeding, not least because newly floated as an independent bank it would have been vulnerable to early takeover. It will probably have greater strength through a trade sale to a strong financial institution which wants to come in from outside.

I hope that the announcement is reassuring to my hon. Friend's constituents. I think that when they consider carefully what has been explained to them today they will realise that this offers extremely good prospects and is an important stage in the bank's development. It is not a threat to the bank.

Mr. Skinner: Is the Minister aware that large numbers of the British people will find it somewhat alarming that, at the time of a Swiss takeover of a British company, he is refusing to say that there will not be a foreign takeover of Giro? Is not that another example of pork-barrel politics by this grubby Government who will make sure that some of their friends in business will make money out of it so that they can hand it back to the Tory party? Will he give a guarantee that Johnson Matthey will not be allowed to make a proposal? Will he also bear in mind that, since the Labour party will vote against the takeover, logically we shall then be arguing for its return to public ownership?

Mr. Clarke: As it happens, I have more friends in business in Britain than I have abroad, so the hon. Gentleman had better decide on which objection he wants to concentrate. Does he object to selling to friends in the Conservative party or foreigners? Neither consideration will be material to any sensible evaluation of any bid. We shall be looking for reputable purchasers who can satisfy the requirements of the Bank of England which are essential to give security to customers and widen customer choice in Britain. I see no reason to adopt bizarre nationalist attitudes towards the ownership of shares either in our banks or in our chocolate companies.

Mr. John Marshall (Hendon, South): Will my right hon. and learned Friend accept that his statement will be welcomed by the vast majority of customers of Girobank who recognise that when it has access to a wider capital market it will be a more effective competitor and will offer better job opportunities to its staff and better services to its customers?

However, will he confirm that the election pledge not to privatise the Royal Mail does not rule out the possibility that will be welcome to many Conservative Members of greater competition being introduced to that service?

Mr. Clarke: I agree with my hon. Friend's estimation of public opinion and the judgment of customers and those who work for the bank. It was unclear what the Labour party would do, but the hon. Member for Bolsover (Mr. Skinner) has laid down a clear line, so obviously a policy has now been determined and the Labour party will vote

against this, but I think that it will have the support of a clear minority of those who have a look at this and who have an interest in the banking service.

I hear my hon. Friend's views on his second point. At the moment we have no similar plans for any part of the Post Office business. We shall honour our election commitment, but all the time in these services, as in other industries, whether they manufacture or provide services, we are looking at means of improving efficiency, spreading the enterprise economy and getting more benefits from privatisation of the kind that we have already reaped in previous privatisations.

Mr. Dave Nellist (Coventry, South-East): Is the Minister aware that his nose grew nine inches during his statement? The real reason for privatisation is to allow his asset-stripping friends in the City cheap access to the high street properties that are worth billions and access to the DHSS benefits business, which is also worth billions? Is not the success of the Post Office to be put down to the sacrifice of the work force in addition to public investment? However, as soon as public investment makes a return, the Minister and the Government ensure that their friends in the City are allowed to take the profits for shareholders. Quite simply, it is theft.

Mr. Clarke: It always saddens me to hear that the Labour party's view of the capitalist economy is that any private share ownership is wicked theft by a few villains in the City. One of the many things that have changed since the Labour party was in office is that we now have a society in which wider share ownership is becoming an accomplished fact and has considerable public support. As I have already said, we shall be looking for a purchaser to suggest ways in which the management and the work force of Girobank might have a stake in any future success that the business earns. The hon. Member for Coventry, South-East (Mr. Nellist) may live in the past, but if he catches up with what we have achieved during our economic revival over the past few years he will realise that this is a welcome step that bodes well for the bank, its customers and its staff.

Mr. Tam Dalyell (Linlithgow): To which specific requirements of the Bank of England was the Minister referring in his opening statement, and do they related to foreign purchase?

Mr. Clarke: I was referring to the so-called prudential requirements of the Bank of England. The requirements of the Bank of England exist above all else to ensure that those who carry out transactions with a bank have complete security and that the bank is a creditworthy institution that is entitled to have a licence to operate as a banking institution in this country. We apply those provisions equally to banks from any country. Certainly for this business I see no reason to apply preconditions against foreign ownership. The provisions of the Banking Act can also be invoked in the case of an acquisition of a bank.

Mr. David Winnick (Walsall, North): May we take it that it is Government policy that if a public sector concern is not making a profit it must be virtually given away but that if it is making a substantial profit, as in the case that we are discussing today, it must also be privatised? Why does not the Minister drop his explanations and admit the

that the present proposal is simply part of a Thatcherite Right-wing dogma policy and that the Government require no particular logic to try to justify it?

Mr. Clarke: Our principle is that if a nationalised industry is losing huge amounts of money and thus draining away taxpayers' resources and diverting money away from the National Health Service or the education service, for example, we seek to improve the efficiency of the business, we let the management put things right and we return it to profitability and commercial success. We then return the business to the private sector where it can raise its capital in the ordinary way and, in all our experience so far, thrive. The best example that we have of that process is British Steel. Only six or seven years ago it was a dilapidated, rundown rust-bucket failure costing the country more than £1 billion a year following years of neglect by the Labour party. The steel industry that we are about to return to the private market is extremely profitable, successful and competitive.

Later—

Mr. Allan Roberts: On a point of order, Mr. Speaker. I am sure that you are aware—I am not sure that the whole House is—that the major proposal to privatise Girobank—it is a major proposal, equal to the privatisation of British Telecom—does not need legislation and therefore will not be brought before the House in the usual way. There will be no Second and Third Reading debates. When the negotiations are completed and when the proposals have been outlined, they cannot be scrutinised in Committee. I know that that procedure is dear to your heart, Mr. Speaker; you have explained that you believe that the Committee procedure is important. The Minister also implied that there might be no justification for a debate on the matter.

May I ask you, Mr. Speaker, to look into the question of how the House is to examine in detail the privatisation proposals and how it is to vote on them. It would be an absolute scandal if the House of Commons did not debate, examine, scrutinise and vote on privatisation proposals that affect a major concern in this country.

Mr. Speaker: I appreciate what the hon. Gentleman has said, but he knows that it is not for me to advise him on tactics. There are ways of raising these matters, either on the Adjournment of the House or by means of a motion.

Mr. Roberts: Further to that point of order, Mr. Speaker—

Mr. Speaker: Order. I cannot help the hon. Gentleman further. It is not for me to advise hon. Members on tactics. That is not my responsibility. I am responsible for order in the House, and nothing out of order has occurred.

Bengali Families (Tower Hamlets)

4.22 pm

Mr. Peter Shore (Bethnal Green and Stepney): I beg to ask leave to move the Adjournment of the House, under Standing Order No. 20, for the purpose of discussing a specific and important matter that should have urgent consideration, namely,

“the eviction yesterday by the Tower Hamlets council from bed-and-breakfast accommodation of 10 Bengali families.”

These families are in the United Kingdom lawfully and the husbands and fathers all came to Britain before 1973—many of them, well before. For the past year Tower Hamlets council has sought to deny its responsibilities for housing the families or financing them in bed-and-breakfast accommodation on the ground that, as the families must have had a home in Bangladesh, they rendered themselves intentionally homeless by coming to the United Kingdom. That wholly unexpected interpretation of the Housing (Homeless Persons) Act 1977 was upheld in the Appeal Court in May, even though, with 46 children involved, it is accepted that the families are in priority need of housing.

The families spent last night in the church hall of the United Reformed Church in Bethnal Green, following—I am proud to report—a vote of the congregation to offer shelter to the families. However, this can only be a temporary arrangement, and their plight is urgent.

It is utterly wrong of Tower Hamlets council to do what it has done. The council has brought shame upon itself and much misery to the 10 families involved and to the further 24 families threatened with similar treatment.

The issue is specific to the families involved and no one will question that it is a matter of great importance to them; but it also raises issues whose importance goes far beyond Tower Hamlets. The decision affects immigration policy, as the clear implication is that the families, who waited years for their entry certificates, should now go back to Bangladesh. That would be compulsory repatriation by the back door. It is also extremely damaging to race relations in my borough and much more widely. It reveals a totally unexpected defect in the Housing (Homeless Persons) Act as the words “intentionally homeless” were never meant to apply to lawful immigrant families. The Government are involved, because the one serious, but insufficient, excuse that Tower Hamlets council can offer for its conduct is the undoubted great shortage of accommodation in Tower Hamlets and the continued inadequacy of local authority housing finance provided by the Government.

These are matters of great importance to the House and I submit that they merit an early debate.

Mr. Speaker: The right hon. Gentleman asks leave to move the Adjournment of the House, under Standing Order No. 20, for the purpose of discussing a specific and important matter that he believes should have urgent consideration, namely,

“the eviction yesterday by the Tower Hamlets council from bed-and-breakfast accommodation of 10 Bengali families.”

I have listened with care to what the right hon. Gentleman has said, but I regret that I do not consider that the matter that he has raised is appropriate for discussion under Standing Order No. 20 and I cannot, therefore, submit his application to the House. I hope that he may find other ways of raising the matter.



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

10 November 1988

Rt Hon Antony Newton MP
Chancellor of the Duchy of Lancaster
and Minister of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr D J L Moore
Mrs Lomax
Mr Turnbull
Mr Gieve
Mrs Brown
Mr Bent
Mr Tarkowski
Mr Call
Mr Tyrrie

Dear Chancellor of the Duchy,

GIROBANK

Thank you for your letter of 8 November. My private office have already confirmed that I am content with the draft answer attached to it.

I accept that it might be difficult to be seen now to be abandoning the criteria which Kenneth Clarke agreed with Sir Bryan Nicholson, and accordingly I am content that the reference to them should remain. However, as you know I believe we should remain ready to revise the criteria if that is necessary. As I said when we discussed the point last Thursday, I would rather see Girobank sold to a clearing bank than remain in the public sector. I also think it probable that any purchaser would wish to rationalise Girobank.

I am glad to see, therefore, that you do see some scope for participation by the clearers in a sale and that you intend to let them know the position as soon as the Written Answer has been given. I am sure it is right to do this. I would hope that, in doing so, we should aim to build on the approach set out in your letter. It is clearly important not to allow further inflexible criteria to develop which may prove more of a hindrance than a help in securing a future for Girobank in the private sector.

Finally, I should clear up a misunderstanding in your letter where you say I "would prefer Girobank to be sold to a clearing bank



than to a foreign bank". My point was that I would sooner see Girobank go to a UK clearer than be sold to a state-controlled foreign bank.

I am copying this letter to the Prime Minister and Sir Robin Butler.

Yours sincerely,

Moria Wallace

pp NIGEL LAWSON

*(Approved by the Chancellor
and signed in his absence.)*

CH

~~BF~~ N/N
MP

CHANCELLOR OF THE DUCHY'S SPEECH FOR ADJOURNMENT DEBATE

I want to congratulate the Hon Member for Bootle on obtaining consent to an adjournment debate on this important subject. I also want to thank him for letting me know in advance some specific questions to which he would be seeking answers.

Girobank came into existence in 1968 to provide a fully automated system for processing transactions which would use the Post Office Counters as its business outlets. The Post Office (Banking Services) Act 1976 allowed Giro to expand. In 1978 it changed its name to National Girobank. The bank has continued to expand, acquiring listed bank status in 1979 and entering the clearing system in 1981. In 1985 the bank became a public limited company and in 1987 it adopted the name Girobank. From a very limited role centred on the transmission of money, Girobank has come a long way and is now providing a full range of services comparable to a high street bank.

The Government believes that market forces provide the most efficient and effective basis for conducting business.

Organisations in the public sector are underwritten by the state and their exposure to risk and to the disciplines of the market is quite different from that of a private sector company. The decisions of managers and their boards in the private sector can be implemented without having to be referred to politicians and

defensive / negative

? civil servants. Investment can be better planned and appraised if finance depends on the commercial judgement of the capital market, and management and the workforce in the industry lack a crucial stimulus if they know that their financial position is underwritten by the state and survival does not depend primarily on responding to the market.

We have now returned to the private sector nearly 40% of the commercial sector in state ownership since 1979. The companies we have privatised are flourishing in a competitive market. The great majority have increased their output, invested more, improved their industrial relations and made higher profits.

Girobank has over the recent past been increasingly successful in advancing its business. However the banking market is rapidly changing and extremely competitive. [Rapid decision making is vital to succeed in this sector and skilled staff are at a premium.] To continue to grow and succeed in the banking sector Girobank needs more freedom to behave like its competitors. The mangers of Girobank ^{need to be} are not always in a position to grasp commercial opportunities as and when they arise. Similarly investment decisions are delayed. Under these circumstances both the Government and the Post Office Board ^{believe} satisfied that a sale is the best way to develop Girobank's business further in the highly competitive environment of the banking sector.

On 7 June the then Chancellor of the Duchy, my Rt Hon and Learned Friend the member for Rushcliffe informed the House that the Government and the Post Office had agreed to offer Girobank for sale to a financial institution or other suitable company. The announcement of sale generated a very wide response with many enquiries and a confidential information memorandum was sent to those who had registered interest on 25 July. To protect the future interests of the bank and the taxpayer, the Government and the Post Office Board set certain factors of which account was to be taken in evaluating bids. They covered price, acceptability to the Bank of England, the prospect of widening choice for the general public in banking services, the importance of the link between Girobank and Post Office Counters, capability to develop and expand Girobank's business and arrangements to enable management and employees to share directly in the future success of the business. Those who expressed an interest in buying Girobank were informed that the Chancellor of the Duchy and the Post Office Board would also be concerned to ensure that proper regard was paid to the interests of the employees. An indicative timescale was also set.

House looks v. high profile here.

Although it provides all the services a modern bank provides Girobank has distinctive feature. It uses the 20,000 or so outlets of the Post Office Counters Ltd. Counters are open six days of the week and over longer hours compared to high street banks. On the other hand their staff are not employed by

P.O .

Girobank and provide services to others in addition to Girobank. Over the past three years Girobank has further developed its distinctive telephone and mail banking system and now has more than 2.5 million customers.

It is thus apparent that here is a very [?] complex bank which has over the recent past been increasingly successful in advancing its business. However the Post Office has informed me that the sale of Girobank by tender has not produced, within the proposed timescale, a buyer able to meet the requirements set for the sale. We now think that for selling a specialised bank like Girobank this timescale was demanding. It may not have allowed prospective bidders adequate time for assessing and understanding the great potential and the special features of Girobank and how it fitted their future strategy. We now think this may have contributed to the result that no suitable purchaser was found within the expected timescale.

The Government and the Post Office Board remain committed to transferring Girobank to the private sector through the sale of the bank to a suitable purchaser. The Post Office and the financial advisers for the sale are therefore holding further confidential discussions with potential purchasers taking into account the factors set out by my Rt Hon and Learned Friend the member for Rushcliffe in his statement to the House on 7 June. This process is likely to take some time.

cont to hp mse inf

I will now deal with the Hon Members for Bootle's specific questions.

He asked why we have not published the names of shortlisted bidders. Many bidders have requested that their bids should be awarded full confidentiality unless they are selected as the purchaser. I therefore agree that the Post Office Board is not in a position to release any names.

He asked me about the factors listed in my Rt Hon and Learned Friend the member for Rushcliffe on 7 June which he said would be taken into account in evaluating bids. As I have said, these will continue to be taken into account in the further confidential discussions with potential purchasers.

I have also been asked about the price. This is one of the factors the Post Office has set which will be taken into account in the evaluation of bids. The sale is by tender and no fixed price is set in advance.

I have also been asked whether a management buy-out is still ruled out by the Government. As I have said no proposal is ruled out but we doubt whether a management buy-out would be appropriate. A bid from a consortium of more than one body is certainly not ruled out just because it is made by a consortium. It would be judged on its merits.

088

I have been asked whether a bid from a clearing bank or a large building society would now be acceptable. As my Rt Hon and Learned Friend the member for Rushcliffe said on 7 June, no one is ruled out of putting in a bid. We should judge a bid from a clearing bank or a large building society in the light of the same factors as a bid from anyone else. The bidder would have to see how it could prepare a bid which had regard for the factors listed above and persuade us that it was acceptable.

I am not in a position to say who made bids; they were strictly confidential. Discussions with potential purchasers are continuing so there is no question of withdrawing the bank from sale. As I have made clear we are not setting a timetable for the discussions.

However the Government remains convinced that the bank would benefit from the freer and competitive environment for the private sector. We are working with the Post Office which owns the Girobank to achieve that end. The Government and the Post Office Board remain committed to transferring Girobank to the private sector through the sale of the bank to a suitable purchaser. As I said the Post Office and the financial advisers for the sale are therefore holding further confidential discussions with potential purchasers taking into account the factors set out by my Rt Hon and Learned Friend the member for Rushcliffe in his statement to the House on 7 June. This

process is likely to take some time. I will of course continue to keep the House informed.

CONFIDENTIAL

FROM: T TARKOWSKI

DATE: 10 NOVEMBER 1988

1. ~~MRS BROWN~~
2. PS/CHANCELLOR

cc: PS/Financial Secretary
 PS/Economic Secretary
 PS/Sir P Middleton
 Mr Anson
 Mr Monck
 Mr Moore
 Mrs Lomax
 Mr Gieve
 Mr Kroll
 Mr Call

*Mrs Brown
 Mr Bent*

GIROBANK: ADJOURNMENT DEBATE

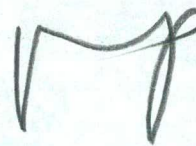
As you know, following discussion with the business managers this morning Mr Newton decided that this afternoon's Written Answer was not an appropriate vehicle, and the substantive statement of the position will thus be in the speech in tonight's adjournment debate. Mr Newton will himself deliver the speech.

2. We now have a revise of the material for tonight's debate. It is only marginally improved from the version I circulated last night (not to all). You ascertained that Mr Newton's private office were preparing a further revise which would circulate at around 7.00 pm.

3. In the meantime, you agreed to give the changes marked on the attached direct to Mr Newton's office. They are designed to bring the speech into line with the text previously agreed for the Written Answer, and to reduce the defensiveness of the draft.

4. I would be grateful if FIM would pass on the details of the form of the announcement, and a copy of the present text to the Bank of England.

T TARKOWSKI



FROM: T TARKOWSKI

DATE: 11 November 1988

MR GIEVE

cc PS/Chancellor
PS/FST
PS/EST
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mrs Brown
Mr Bent
Mr Call

GIROBANK

I attach a copy (for you only) of the actual speech Mr Newton used last night. There is no further revise of the Q&A briefing I circulated yesterday.

2. Detailed questions should be referred to DTI.
3. The main points to make are:
 - i. HMG still believes privatisation best for Girobank, its staff and customers. Discussions continue with that end in view. Details are, of course, commercially confidential;
 - ii. But sale must be to a suitable purchaser; no sense in rushing discussions;
 - iii. No-one is ruled out from bidding;
 - iv. IF ASKED about suitability: Chancellor of the Duchy referred to the factors which will be taken into account. Nothing to add to what he said;
 - v. IF ASKED about price (stories this morning that HMG looking for £200 million): Sale is by tender, as is normal for trade sale. No price has been set in advance; No link with ROFS.

vi. Is this third successive privatisation failure (following NESL, BREL)? No. Discussions continuing in each case. No link between quite different sales. In the case of Girobank Mr Newton announced decision to allow those discussions more time. UK's successful privatisation programme admired and copied worldwide.

Tomasz Tarkowski

T TARKOWSKI

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Moira Wallace
Assistant Private Secretary
Chancellor of the Exchequer
HM Treasury
Parliament Street
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TO	MR JUDGE
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Direct line
Our ref
Your ref
Date

215 5147

24 November 1988

MISS WHELDON T/SOL

Dear Moira,

GIROBANK

Thank you for your letter of 8 November recording the discussion between the Chancellor of the Exchequer and the Chancellor of the Duchy on 3 November regarding Girobank privatisation.

There is just one point that I would like to make clear, relating to the third paragraph of your letter. Hambros advice was that the sale process should continue, but without the earlier timetable and with the inclusion of new potential bidders. This Department persuaded the Post Office to accept this advice. There is no question of concluding one attempt to sell Girobank and embarking on another.

Yours,
Linda Joyce

LINDA JOYCE
PRIVATE SECRETARY

would finance the purchase by issuing equity - a first for the Co-op movement. It is possible that the RFS (as well as the Bank) might be involved in approving a sale to the Co-op.

5. Charterhouse are still trying, in discussion with Schrodgers, to put together a consortium - but progress is limited.

6. The merchant banks are also in touch with several other institutions, including the following:

i. The Swiss Banking Corporation;

ii. Singer and Friedlander. They will be looking for a price near net asset value, and are being told that this is lower than what the PO are seeking;

iii. The Royal Bank of Scotland, who are seeing Hambros again this week;

iv. The Yorkshire Bank;

v. Citicorp;

vi. Credit Agricole (in the private sector).

7. They have also been in touch with the Building Societies Commission and with the Alliance, Leeds, Halifax and Woolwich Societies. The Commission have confirmed to Hambros that they would be helpful when considering proposals involving building societies.

8. It was decided on 22 November not to contact a Clearing Bank while Standard Chartered were still showing an interest. Three of the clearers have an interest in Yorkshire Bank, and DTI are sure they will know of Hambros' approach to them. All the members of the steering group are very doubtful that an individual clearer could put together an acceptable proposal, and they have therefore decided not to go beyond the contact with Yorkshire at this stage.

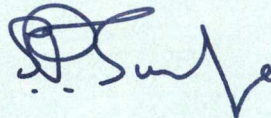
9. The PO persist in hoping that they might be allowed to form part of a consortium, despite being well aware of the difficulties DTI Ministers have with this.

Handling

10. Mr Newton's present inclination is to withdraw Girobank from the market before Christmas, if a genuine sale prospect has not emerged by then, and to relaunch it later at a more favourable time. DTI plan to review the situation at the end of next week so that Mr Newton can write to you in about a fortnight. This may be combined with a letter setting out his thoughts on the letter monopoly and further privatisation in the Post Office, although we hope this more general letter will arrive first.

11. We propose to tell DTI officials that Ministers will want an assessment from the merchant banks of the prospects of finding a buyer if the sale process continues beyond Christmas. We do not feel that the marketing process should necessarily be halted at Christmas, although clearly it cannot be allowed to drag on indefinitely.

12. Are you content with this approach?



S P JUDGE



FROM: MISS M P WALLACE

DATE: 9 December 1988

MR S P JUDGE -(PE)

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mrs Lomax
Mrs Brown
Mr Call

mpw

GIROBANK

The Chancellor was grateful for your minute of 8 December.

2. Independently, he has had an update on Girobank from Mr Newton and Sir Bryan Nicholson. Sir Bryan, does not, in the circumstances, want Girobank to be withdrawn from the market at the present time, and the Chancellor thinks he is right. Mr Newton is accordingly reconsidering. Meanwhile, the Co-operative Bank - the front runners - have not, apparently, ruled out a consortium (they have been having talks with a German bank). And apparently GUS are also expressing interest again, albeit desultory.

mpw.

MOIRA WALLACE