

17 December 1982

Policy Unit



PRIME MINISTER

BRITISH TELECOM AND THE MONOPOLIES AND MERGERS COMMISSION

We are in a tangle. I suspect this is because we are trying to do two things at the same time when we ought to be doing only one.

Either we prepare to privatise British Telecom and use that stimulus to improve its efficiency.

Or we leave it in the hands of the state and send in the MMC.

Naturally, after privatisation if BT is still performing badly and abusing the monopoly powers it will still enjoy, then it would be right to send in the MMC.

But to send in the MMC now would be the very worst time, because the nature of those monopoly powers - their statutory underpinning, their relationship with Mercury etc - will be changing fast. Many of the MMC's recommendations would be out of date almost as soon as they were written. And it would be almost impossible to hypothesise about how a privatised BT would perform.

I think this is probably a stronger objection than the damage that an MMC report would do to the flotation or the amount of BT management time which it would consume.

An MMC report on the telephone service would make absorbing reading. But I don't think that now is the moment for one.



FERDINAND MOUNT

*I take the view that - must not be jeopardised Prime Minister*  
*Ms 17/12*







*Handwritten initials and number 2*

*Prime Minister*

CABINET OFFICE  
Central Policy Review Staff

*WR  
11/1*

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: John Sparrow

Qa 06213

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10 January 1983

The Rt Hon Patrick Jenkin MP  
Department of Industry  
ASHDOWN HOUSE  
S W 1

*Handwritten signature*

*Dear Patrick,*

Telecommunications Bill

Over the last few weeks my staff have had discussions with your officials and with British Telecom and the Monopolies and Mergers Commission on certain aspects of the new framework that is being established for regulating BT.

On a few key issues I believe that further consideration is necessary before legislation and the framework are finalised.

Guidelines

Clause 3 of the Bill is fundamental to the development of telecommunications in the UK and to effective regulation of licensees. This clause sets out the guidelines which the Secretary of State and the Director General of Telecommunications shall take into account, and which the MMC shall have regard to, when considering licence conditions and amendments.

I am concerned that these guidelines, as drafted, do not take sufficiently into account the need to provide modern services, particularly in view of the rapid technological changes that are experienced in this industry. In order to ensure that modern services are provided, the rate of return on capital will need to be sufficiently large to attract capital and stimulate investment, so that the 'telecommunications services' referred to in Clause 3(i)(a) can be as up-to-date as the customer is prepared to pay for.



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I am also concerned that sufficient incentive should be given to BT to improve its efficiency - in the interest of consumers. For some time, despite present efforts to introduce competition, BT will have a monopoly in most of its markets and will be able to pass on additional costs caused by inefficiency, restrictive working practices and poor management in the form of higher prices. BT management needs to be given some incentive to remove these inefficiencies through increased financial reward to shareholders (and possibly also to themselves by linking remuneration to performance).

Although the guidelines contain (in Clause 3(i)(c)) the requirement to have regard to 'the desirability of promoting the interests of consumers', I consider that 'the desirability of promoting efficiency' should be specifically spelt out. The advice currently being sought from Professor Littlechild will have a direct bearing on the form of regulation, and I would suggest that the determination of the mechanism for promoting efficiency and the precise wording of Clause 3 be deferred until his report has been considered by Ministers.

Right of appeal to the MMC

Where the Director General of Telecommunications wishes to amend a licence but cannot obtain the agreement of the licensee, he is empowered to refer the matter to the MMC. However, licensees do not appear to have similar rights where in their view licence conditions become too onerous, with the passing of time, and where they cannot persuade the Director General that modification of the licence is necessary.

I consider that licensees should have the right to appeal to the MMC in such instances.

I am sending copies of this letter to the Prime Minister, other members of E(TP), and to Sir Robert Armstrong.

*Yours sincerely,*

*John*

John Sparrow

Post & Tel, Future of the Post Office, 196

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ph.  
wm  
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Prime Minister

The note you asked for.

mk

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21/12

LIBERALISATION OF TELECOMMUNICATIONS: MR BUTCHER'S INTERVIEW  
ON RADIO 4

BACKGROUND NOTE

1. The two central complaints were:

a. that the fees for approval of apparatus were unreasonably high and would prevent small firms entering the market; and

b. that by being allowed to carry-out the approval tests, British Telecom was being put in a position where it could squeeze out its potential competition.

2. The testing of telecoms equipment is expensive because of capital costs and qualified engineering time spent on the task. BT has tended not to charge up to full costs. This fact is appreciated by the majority of manufacturers although there have been some complaints, notably from those smaller distributors who are hoping to supply apparatus manufactured overseas but who do not themselves possess substantial financial and engineering resources.

3. Applications are presently being received for approval of items of small telephone call routing apparatus, the test fees for which have been estimated at between £20,-30,000. Capital expenditure for test gear for this particular apparatus is over £160,000 and the microprocessor controlled apparatus needs a good deal of software testing expertise as well - and this is expensive. This 'high cost' has prompted the recent complaints. However, these fees do not appear to have discouraged small and medium sized firms since about 35-40% of the applications so far received are within that category.





4. When the liberalisation programme was announced in 1981, it was made clear that it would be phased over a three year period, to allow British manufacturers time to adapt to the new market conditions. Under these arrangements a new procedure is being developed for independent standard-writing, testing and approval of apparatus. This is already in operation for more straightforward apparatus. In order to bring the benefits of liberalisation to the user as soon as possible however, the Department of Industry has introduced several interim measures, such as that referred to above for call-routing apparatus, for approving a limited number of items of equipment. The only laboratories that are currently properly staffed and equipped to carry out the testing of complex telecoms equipment are those of British Telecom. But the schemes are run by the Department of Industry and testing procedures are monitored by DoI to ensure fair play.

#### LINE TO TAKE

I should be most concerned if I thought that small firms were not being allowed fair opportunity to compete in this important growth area. The Government's programme for the liberalisation of telecommunications has already allowed small firms to earn profits and create jobs in the telecoms industry and I expect to see this increase considerably as the programme rolls on. 35 to 40% of the applications for small call routing apparatus are from small firms who understand the reasons for testing costs.



*Poste  
JCB*

**10 DOWNING STREET**

MR. MOUNT

British Telecom and the Monopolies  
and Mergers Commission

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The Prime Minister has  
written on your note of  
17 December "I take the view  
that denationalisation must not  
be jeopardised".

*MCS*

*Reserve*

20 December 1982



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bc. F. Mount.

10 DOWNING STREET

*From the Private Secretary*

20 December 1982

*Dear Jonathan,*

BRITISH TELECOM AND THE MONOPOLIES AND MERGERS  
COMMISSION EFFICIENCY INVESTIGATION

The Prime Minister saw your Secretary of State's paper for E(NI) Committee, E(NI)(82)33, on this subject over the weekend.

She has commented as follows:

"I take the view that denationalisation must not be jeopardised".

I am sending a copy of this letter to the Private Secretaries to the other members of E(NI) and to Richard Hatfield (Cabinet Office).

*Yours sincerely,*

*Michael Scholar*

Jonathan Spencer, Esq.,  
Department of Industry.

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MR MOUNT

cc Mr Scholar ✓

MONOPOLIES AND MERGERS COMMISSION EFFICIENCY INVESTIGATION  
INTO BRITISH TELECOM

I do not think the Prime Minister will care very much for the attached paper for E(NI) next Wednesday. Mr Jenkin argues that the launching of the proposed MMC Investigation into BT will damage the prospects for flotation; and quotes the views of bankers in support. He concludes that we can leave it to BT to put their own house in order.

But the give-away is in paragraph 4: to remedy the existing serious deficiencies in BT would delay flotation for a substantial period, or lower the share price. So the DoI is now arguing what we have argued all along - that there is no point in privatising an inefficient monopoly: we must get it efficient first.

I suspect that when the Prime Minister sees this paper she will conclude that the MMC should go ahead, and flotation should be delayed. That may be right: but the Government has invested considerable political capital in privatising BT, and it is the major piece of legislation this session. There may be a middle course. MMC investigations are not black and white affairs, and the reference of BT to the MMC could perhaps restrict the extent of the inquiry in a way which would limit the damage to BT's market prospects.

The immediate question is what to do about the E(NI) discussion. The Prime Minister could Chair it herself; but it might be best to encourage E(NI) to do the necessary preparatory work, and to report the outcome to her. I understand that both the Chancellor and the Secretary of State for Trade are sceptical of DoI's case, and are being briefed to argue vigorously against it. If you agree, I will so suggest to Michael Scholar. Meanwhile I am sending him a copy of this note to keep him in the picture.

16 December 1982

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From the Secretary of State

cc ✓ JV

Prime Minister ②

MUS 3/12

The Rt Hon Patrick Jenkin MP  
Secretary of State for Industry  
Department of Industry  
123 Victoria Street  
London SW1

2 December 1982

MONOPOLIES AND MERGERS COMMISSION: REFERENCE OF BRITISH TELECOMMUNICATIONS

I should like to announce before the Recess the 1983 programme of efficiency investigations of nationalised industries by the Monopolies and Mergers Commission. Nicholas Ridley told the House of Commons on 30 November 1981 that the Government would announce a programme of references annually for the year ahead.

My proposals for 1983 depend on a decision on the inclusion of British Telecom. When E(NI) committee discussed the matter on 26 July, they felt that the balance of advantage was firmly in favour of a reference of BT to the MMC in the first six months of 1983; and you were invited to discuss the Government's intention in this sense with Sir George Jefferson. I should be grateful if you could let me know as soon as possible where matters now stand.

I am sending copies of this letter to members of E(NI), Sir Robert Armstrong and John Sparrow.

LORD COCKFIELD