



cc No 2 pp's
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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

SALE OF BRITISH AIRWAYS

in PMS-600
The Ministerial Sub-Committee on Disposal of Public Sector Assets (E(DL)) met on 24 November under my chairmanship to discuss a memorandum by the Secretary of State for Transport on the sale of British Airways (BA). The Secretary of State also reported orally on his discussions with Lord King regarding possible transfers of routes and assets to private sector airlines. This minute reports our conclusions.

2. The Secretary of State for Transport told the Sub-Committee that he was anxious to keep open the possibility of floating BA in late November or early December 1984: there was a good deal of enthusiasm for privatisation within the airline, and it was important to keep up the momentum. His plans were as follows:

- i. The immediate registration of British Airways PLC as a 'paper' company. This would be followed by preparations to transfer BA's overseas rights and assets to BA PLC on vesting day, and approaches to overseas governments to designate BA PLC, in place of BA, under air services agreements with them.
- ii. Making an order, by the beginning of February 1984, appointing 1 April 1984 as vesting day.
- iii. The issue, by 1 April 1984, of a Government guarantee to BA PLC to cover the period up to flotation.



The timetable was necessary in order to allow for the complicated process of transferring BA's extensive and important overseas rights and property, and to demonstrate to the airline that the Government was anxious to make early progress. Even the first of the steps would quickly become public knowledge; it would therefore be necessary to make an early Parliamentary statement on the action proposed.

Timing of flotation

3. The Sub-Committee agreed that it would be right to keep open the option of a flotation in late 1984; and that the Secretary of State for Transport should embark on the plan of action which he proposed. However, it was clearly unlikely that the market could digest the flotation of both British Telecom (BT) and BA within a short space of time; and the flotation of BT must take priority. It was essential to say nothing which might cast doubt on, or appear to conflict with, the Government's determination to go ahead with the sale of BT. In his Parliamentary statement and elsewhere the Secretary of State for Transport will therefore suggest early 1985 as the likely date of flotation of BA: this will not, of course, preclude an earlier sale if events should make that desirable.

Extent of sale

4. The Secretary of State for Transport proposed that the aim should be to dispose of 100 per cent of the Government's interest in BA, though possibly in two steps rather than one. He recognised, however, that there might be a case for restricting the extent to which either the ownership or the management of the company could pass overseas. He will consider these aspects further and bring forward proposals in due course.

Restructuring of the balance sheet

5. The Secretary of State for Transport pointed out that for flotation to be possible on the timescale he envisaged, it



would be necessary to restructure BA's balance sheet: relying on the accumulation of profits would take too long. BA should be kept under pressure to achieve the necessary improvements in the balance sheet themselves, notably through revaluation of assets, and perhaps by sales of assets at a profit over book value. It might also be right to apply some of the proceeds of flotation, in effect, to repayment of debt. But if such measures were insufficient, the Secretary of State suggested that an application should be made to the Court for a reduction in the share capital of BA PLC.

6. The Sub-Committee had reservations about all the possible ways of rectifying the deficiencies in BA's balance sheet. As the Secretary of State for Transport had pointed out, to rely on the accumulation of profits would delay flotation by two or three years. This would be politically objectionable and it would dissipate the momentum within the airline towards privatisation. It would be right - indeed, necessary - to revalue BA's assets during the preparation of the prospectus for sale. But the extent of revaluation would be a matter for the commercial judgement of the board. Anything further would be objectionable in itself and, after the substantial write down of assets in the recent past, expose BA and the Government to accusations of sharp practice.

7. The Sub-Committee saw particular objection to an application to the Court for a reduction in capital. The circumstances of such an application would have no true parallel in the private sector. It would be likely to be criticised as unfair by existing private sector airlines. It would also be open to objections of Parliamentary propriety as an attempt to evade the provisions of the Civil Aviation Act 1980.

8. This is an aspect to which the Sub-Committee will need to return at a later stage.



Route transfers

9. It is possible that transfers of some of BA's routes, with the sale of assets that would accompany such transfers, might help with the balance sheet problem. They would also, of course, go far to meet the points that Sir Adam Thomson, in particular, has made about 'unfair competition'. As you know, these points command a good deal of sympathy among our supporters in the House.

10. Nevertheless, there are strong reasons for a cautious approach. The Government has no power to require BA to divest themselves of any routes. Nor can we decide who should take over such routes as BA might be willing to surrender: that is a matter for the Civil Aviation Authority. Any premium on the sale of assets associated with particular routes would be conditional on the eventual decision of the CAA, and would be treated as of uncertain value by potential investors until the CAA had reached their decision. But to wait for the decision could seriously delay flotation.

11. Some members of the Sub-Committee indeed regarded route transfers as intrinsically undesirable. In the airline business size is often strength; and BA, both before and after flotation, will face formidable overseas competition. It may be better from the national standpoint to meet that competition mainly by one large airline than by two medium-sized ones. Any suggestion that route transfers were a necessary condition of privatisation would risk seriously damaging morale within BA and stirring up opposition to privatisation.

12. Despite these difficulties, the Sub-Committee thought it right to explore the possibilities with BA. It could well be to BA's own commercial advantage to transfer some of their Iberian routes out of Gatwick to British Caledonian. The



Secretary of State for Transport will therefore discuss the situation with Lord King, pointing out to him the political as well as the commercial considerations. But this must be a matter of persuasion, not compulsion. Other objections apart, if we sought to compel, we should have to promote legislation.

13. I am sending copies of this minute to the Secretaries of State for Energy, Scotland, the Environment, and Trade and Industry, the Minister of Agriculture, Fisheries and Food, the Secretary of State for Transport and the Financial Secretary, Treasury, and to Sir Robert Armstrong. The possible inter-action between the flotation of BA and BT, and the whole subject of route transfers, are sensitive; and I should therefore be grateful if you and the other recipients of this minute would ensure that copies are seen only by those with a clear need to know of its contents.

Margaret O'Mara

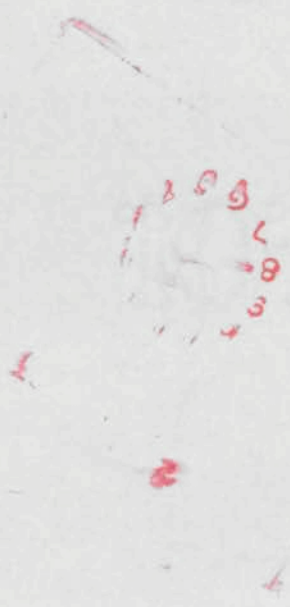
N.L.

28 November 1983

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

Econ for Privatisation

Pt 8





10 DOWNING STREET

file 165
pc: NO

From the Private Secretary

30 November 1983

SALE OF BRITISH AIRWAYS

The Prime Minister has seen the Chancellor's report on the discussion at E(DL). She agrees with the view of the Committee that we should aim for the flotation of BA in early 1985 after BT, but with an option on late 1984 being kept open should a market opportunity arise then. She also agrees that 100 per cent of BA should be sold, subject to mechanisms to protect against foreign management or ownership.

The Prime Minister has noted the doubts of the Committee about a reduction in BA's capital through the Court and also about route transfers. She has commented that if both are ruled out the only course remaining for correcting BA's balance sheet is to wait for profits to accumulate, with the risk that this would delay privatisation. She therefore agrees that further work should be done on the question of a capital reduction. She also endorses the proposal to hold further talks with Lord King on route transfers.

In view of the importance of these issues, she has requested that when this work has been done it should be reported back to E(A).

I am copying this letter to the Private Secretaries to the Secretaries of State for Energy, Scotland, the Environment, Trade and Industry, the Minister of Agriculture, Fisheries and Food, the Secretary of State for Transport, the Financial Secretary to the Treasury and to Sir Robert Armstrong. As with the Chancellor's minute, copies of this letter should be seen only by those with a clear need to know of its contents.

ANDREW TURNBULL

John Kerr Esq
HM Treasury

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SECRET

PRIME MINISTER

Sale of British Airways

To see E(DL) minutes and Chancellor's report. E(DL) agreed:-

- (i) flotation in early 1985 after BT, but with an option on late 1984 being kept open in case BT runs into problems;
- (ii) sale of 100%, subject to mechanisms to protect against foreign management or ownership;

But the Committee then

- (iii) had serious doubts about writing off capital through the Court, and agreed to consider this further;
- (iv) was lukewarm about route transfers, but agreed that there should be more talks with Lord King.

John Redwood's note points out that the Committee failed to see the connection between (iii) and (iv) since route transfers can reduce, and perhaps eliminate the need for, the reduction in capital. If asset sales and capital reduction are both ruled out, all that is left is waiting for profits to accumulate to restore the capital base.

Agree (i) and (ii)?

Endorse the further study of capital reduction, while indicating the hope that the difficulties can be resolved, as otherwise privatisation would be delayed?

Yes Endorse further talks with Lord King on route transfers?

28 November, 1983.

SECRET

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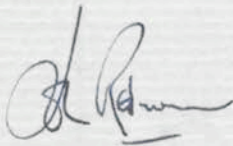
I think we had better have the next meeting at 15. MS

AT

THE SALE OF BRITISH AIRWAYS

We think you should welcome the proposals of Nick Ridley for the sale of British Airways.

E(DL) were a little unhelpful in attacking both the idea of a capital write-down and the idea of selling assets. One way or another, in order to sell British Airways the balance sheet has to be reconstructed. Nick Ridley is well aware of the difficult task he faces in attempting to negotiate a solution to the balance sheet problem. It would be best to give him every encouragement as a successful resolution is essential if the Committee's desired result of early sale of 100 per cent of British Airways is to be achieved.



JOHN REDWOOD