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From the Secretary of State

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Whitehall
SW1

*This is marked
too much
must come before
E.*

*1. Mr Sanders
2. Prime Minister*
*I have sat you
a separate note
about the statement
timetable through
to the recess
MS*

*To note at this
stage: I suggest
we wait to see
the Chancellor's comments*

13 July 1979

TL

13/7

Dear Chancellor of the Exchequer,

FINANCING OF BRITISH AIRWAYS

At E(DL) last Thursday there was a general welcome for my proposal for reconstituting British Airways within the framework of the Companies Acts. This would provide the basis for a sale of part of the equity to the private sector. The revenue thus raised will be a useful contribution to our programme for the disposal of public assets but this proposal will also provide the basis for removing the airline's investment programme of nearly £1 billion over the next five years from the public sector borrowing requirement. It was agreed that the necessary provisions should be included in the Civil Aviation Bill already planned for the present Session. There are strong reasons why I should make an early announcement of our intentions in general terms:

- a) In order to take the plan forward, and to frame the legislation, we need to put in hand detailed discussions with a wider group of people in British Airways than the handful of the most senior Board members who have so far been involved. It would be impossible to carry out this work and at the same time maintain the very high degree

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of confidentiality which has so far been observed. We therefore need to take the initiative in explaining our plan and not allow it to become public merely through leaks about the work in progress.

- b) The British Airways Board are publishing their annual Report and Accounts for 1978/79 on Thursday 26 July and the Chairman, Mr Ross Stainton, will be holding the usual press conference on that day. It will be highly desirable that my own statement should have been made some time in advance of that, so that Stainton will be able to answer questions about the Board's attitude towards the plan. As you know, I have every reason to believe that, properly handled, this measure can secure support from the Board and its active co-operation which we shall need.
- c) The timing of my statement must take account of the timetable for Keith Joseph's consultations and announcement about his plans for British Aerospace. He has told me that, if I can get in first with my statement about British Airways, so that there is no confusion between the two operations, he will be content.

I would, therefore, like to make my statement about British Airways as soon as possible, ideally in the week beginning 16 July, and for preference on Wednesday 19 July. However, I recognise that this does not give colleagues a great deal of time to consider the matter and would therefore be prepared to hold it over until Monday 23 July if
..... that would be more convenient. I enclose a draft statement, together



with a list of possible supplementary questions and answers. In view of the E(DL) conclusions I should not think that this should cause any difficulty for you and other colleagues concerned, and I should be grateful for your agreement.

This material has been drafted so as not to involve questions of detail which might require collective Ministerial discussion, though such a discussion will no doubt be required at a later stage when our proposals have taken more concrete form. I hope that any points arising on the draft could be cleared by correspondence or through consultation at senior official level. However, if you did feel that a meeting with colleagues should be held before any statement I would, of course, be perfectly happy though it would have to take place soon to meet the timetable which I have suggested.

Finally, I should add one important point. Our chances of obtaining the co-operation of British Airways' management and labour will be greatly improved if I am able to reassure them that we have no present intention of breaking up or of hiving off individual parts of the airline. British Airways would also like me to say that the Government proposes to retain a majority shareholding and I feel that I need at any rate to say that what I am announcing does not involved more than the sale of a minority shareholding. I hope you will allow me to present our proposals in a way which is least likely to arouse controversy on these points. This would allow us to introduce a scheme which will not pre-empt the Government from moving further at a later stage.

I am sending copies of this letter and enclosures to the Prime Minister, to other members of E(DL), the the Chancellor of the Duchy of Lancaster, to the Paymaster General and the Chief Whip and to Sir John Hunt.

T. C. Ellis

pp. JOHN NOTT

(Approved by the Secretary of State and signed in his absence.)



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DRAFT STATEMENT

FINANCING OF BRITISH AIRWAYS

British Airways has embarked on a major programme of fleet replacement and expansion and I believe that it has excellent growth prospects. This is an increasingly competitive market and the world energy situation creates uncertainties, but I am confident that the airline will face these challenges successfully.

To meet its objectives it will require a substantial increase in capital investment from both internal and external sources over the next few years. For this reason I have been looking at its capital structure and financial requirements, and I should like to let the House have my views and proposals on the financing of this programme.

?
First, the Government will give British Airways its full support and encouragement in carrying out its programme.

Second, it should have fullest possible access to capital markets both at home and overseas for its future investment needs.

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Third, I propose that the framework of the Companies Act should be used to provide British Airways with a capital structure enabling part of its financial requirements to be raised by the sale of a minority shareholding in the enterprise.

Fourth, my proposal does not involve a separate disposal of any part of British Airways.

C-1 Fifth, I should see strong advantages in offering part of the proposed share issue on favourable terms to employees of British Airways so that they can participate in its future and share in its growth.

Sixth, I envisage the fullest possible process of consultation with the airline's management and employees. This is principally a matter for the British Airways Board themselves, but I will be glad to meet representatives of the trade unions concerned.

Seventh, I will put forward proposals in the autumn for the legislation which will be required.

Eighth, at the same time I will set out the Government's thinking on the licensing provisions administered by the

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Civil Aviation Authority. However, I can say now that there will be no arbitrary reallocation of routes and the new financial arrangements are not designed to have any adverse effects on the route structure of British Airways.

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BRITISH AIRWAYS STATEMENT
NOTES FOR SUPPLEMENTARIES

1. Q. WHAT IS THE PURPOSE OF THIS PROPOSAL?

A. International civil aviation is a highly competitive business. Our proposals will give BA the flexibility and freedom from Governmental interference that is crucial to success in that market.

2. Q. WHAT IS THE ATTITUDE OF THE BRITISH AIRWAYS BOARD TO THESE PROPOSALS?

A. I have informed the chairman of my proposals so that he can convey them to the Board, to management and to representatives of the employees. There will now have to be detailed discussions about the plan. [Add something more positive in consultation with the chairman before the statement is made.]

3. Q. IS THE SECRETARY OF STATE AWARE THAT THE WORKERS AT BA HAVE ALREADY EXPRESSED THEIR OPPOSITION TO ANY SUCH PLAN?

A. I see no reason why the employees should be opposed to a scheme which maintains the integrity of the airline and will be of benefit to everyone involved in it.

4. Q. WILL THE GOVERNMENT GIVE AN UNDERTAKING TO RETAIN A MAJORITY SHAREHOLDING IN BRITISH AIRWAYS?

A. My proposal involves a sale of only a minority of the shares.

5. Q. BUT WHAT ABOUT SUBSEQUENTLY?

A. That is a hypothetical question.



6. Q. WHEN WILL SHARES BE OFFERED FOR SALE?

A. We shall of course need the legislation first. Suitable dates will then be chosen for the issue of the shares.

7. Q. WHAT SPECIAL ARRANGEMENTS WILL BE MADE FOR EMPLOYEES TO ACQUIRE SHARES?

A. I propose to give special attention to this in preparing the detailed arrangements.

8. Q. HOW MUCH DOES THE GOVERNMENT EXPECT TO RAISE FROM THE SALE OF BA SHARES?

A. I expect the issue to realise a substantial amount but, it is far too early to put a figure on it.

9. Q. WILL THE GOVERNMENT SELL OFF ANY OF BA'S SUBSIDIARIES?

A. I have made it clear in my statement that my proposals do not involve this.

10. Q. WHAT ARE BA'S FUTURE CAPITAL REQUIREMENTS/HOW WILL PUBLIC EXPENDITURE BE REDUCED?

A. BA's total capital expenditure is ^{provisionally estimated} ~~likely~~ to run at an average of £500m a year for the next 5 years, of which some £200m a year ^{could} ~~will~~ take the form of external finance. Thus my proposals entail a saving to the PSBR of £1 billion over 5 years.

11. Q. WHY CAN'T BA FUND A GREATER PROPORTION FROM THEIR OWN RESOURCES?

A. The self-financing ratio for the capital investment programme is nearly 60% which is a reasonable proportion by commercial standards, given the size of the programme involved.



12. Q. WHY SO MUCH CAPITAL EXPENDITURE?

A. British Airways faces a heavy fleet acquisition programme to replace a large number of aircraft which will not meet new noise regulations due to be applied from 1 January 1986 and which are in any case reaching the end of their useful lives and becoming increasingly uneconomic to operate. The rising cost of fuel, combined with increasing price competition in international aviation, make it essential for BA to re-equip with the aircraft which are most efficient for their route structure.

13. Q. WHAT SAFEGUARDS WILL THERE BE AGAINST TAKEOVER OF BA BY FOREIGN INTERESTS?

A. The Government already has such a safeguard under Section 22(3) of the Civil Aviation Act 1971. This provides that the Civil Aviation Authority shall refuse to grant an air transport licence if it is not satisfied that the applicant is:

- a) a United Kingdom national; or
- b) a body which is incorporated under the law of any part of the United Kingdom or the law of a relevant overseas territory or an associated state and is controlled by United Kingdom nationals,

unless the Secretary of State specifically consents to the issue of such a licence.

14. Q. WHAT IS THE GOVERNMENT'S POLICY ON FUTURE COMPETITION FOR BA FROM OTHER UK AIRLINES?

A. We shall in due course be putting proposals to Parliament to replace the existing Guidance but, as I have made clear in my statement, there will be no arbitrary reallocation of routes.

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HMT
D/Ind
MAFF
D/Env
D/N
Chief Sec.
Fin. Sec.

CDL
PMG
CWO
CO

16 July 1979

The Prime Minister has read your Secretary of State's letter of 13 July to the Chancellor of the Exchequer about the financing of British Airways.

The Prime Minister is concerned that the Government may be rushing into decisions on this issue without adequate preparation, and she has asked that Mr. Nott's proposals should be discussed by Ministers collectively. I understand that it could be put on the agenda for E(DL) on Thursday of this week. Since I also understand that there is no possibility of a statement on Wednesday 18 July, which was Mr. Nott's preferred date, and that Friday 20 July has been provisionally set aside, this should not cause any difficulty.

I am sending copies of this letter to the Private Secretaries to the members of E(DL) Committee, to John Stevens (Office of the Chancellor of the Duchy of Lancaster), Richard Prescott (Office of the Paymaster General), Murdo Maclean (Chief Whip's Office) and Martin Vile (Cabinet Office).

T.G. Harris, Esq.
Department of Trade.

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