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Prime Minister

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LAKER: AIRBUS

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Your Private Secretary wrote on 17 November to record your agreement with Geoffrey Howe's view that it is not realistic to consider providing direct financial support to Laker. I entirely agree.

Laker needs to enter into a sale/ leaseback to have any chance of survival. In this situation government interest-rate supports must cease (government support for Laker is then routed via tax relief to the lessors).  
 The government could mount a 1972 Industry Act rescue - but I assume you and the Chancellor have already ruled this out. Content to note and take no action?

ML325/4

2 Officials in the Department have been in discussion with the Bank of England to explore whether the interest rate support, which was given in respect of Laker's initial purchase of three Airbus A300 aircraft, can be continued. It might have been possible to continue the support as part of a package under which Laker would be granted a moratorium in 1982 on the capital element of his debt to the Midland Bank but the Bank of England now say that such arrangements are unlikely to prove sufficient to deal with Laker's anticipated financial problems in the first half of 1982 and with the burden of debt in the immediately following years. A proposal has now emerged for a sale and lease - back arrangement involving the banks, which appears to be the only way of lessening the medium-term burden on Laker so as to justify the banks providing further short-term credit. The Bank of England have asked whether an interest rate subsidy could be provided in support of these arrangements, which are said to be the only way that finance for Laker can be mobilised.

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3 Officials have considered the position carefully but have been forced to the conclusion that a subsidy cannot be provided in these circumstances. It is clear that the proposed leasing arrangement would involve much more than an amendment to the contractual arrangements for the purchase of the aircraft which was initially supported. The Government would not merely be using the discretion which was foreseen as part of those original arrangements, but would be offering support to an entirely new facility. The Attorney General has been consulted and his view is that the new facility would itself need to be judged against the requirements of the Civil Aviation Act 1949 which gives powers to support measures for the development and production of civil aircraft and under which the present subsidy is provided. Since Laker already has the aircraft and is not now at the point of choosing between Airbus and a competitive product, a strong justification would be required to show that the new subsidy was demonstrably necessary to avoid damage to the Airbus programme. This question has been explored with British Aerospace who take the view that, while there would be certain benefits to themselves in Laker continuing to operate the Airbus aircraft for the rest of their asset life, they would not be prepared to accept any greater exposure under their first loss guarantee as a means of assisting Laker to set up the leasing arrangements. In these circumstances, legal advice is that a decision to enter into new arrangements could not be defended as being within the vires of the 1949 Act.

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4 In any event, it seems dangerous in principle to accept the argument that subsidies should be paid not merely to enable new aircraft to be produced, but also to prevent existing aircraft from coming onto (and depressing) the market. In present circumstances, this argument could be extended indefinitely to prop up companies who would otherwise go into liquidation.

5 The Government are being asked to participate in arrangements designed to secure additional benefits for Laker at the taxpayers' expense. The benefit of the leasing arrangements lies in the fact that the lessors would have sufficient taxable profits to offset against the depreciation of the assets they would acquire. Part or all of this benefit would be passed to Laker, along with the benefits of the interest rate subsidy on the underlying loan. It is doubtful in principle whether the Government should facilitate this kind of double subsidy.

6 The rationale for giving an interest rate subsidy for domestic Airbus sales is to match the financing terms available for competing US aircraft and to remove the incentive which UK airlines would otherwise have to buy abroad. If we were to acquiesce in the arrangements now proposed, we would not merely be matching terms which might have been available through Exim Bank but would be paying a "premium" for Laker's benefit. This would certainly have implications for the pattern of support which other airlines would expect in respect of future domestic Airbus purchases.

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7 If, as is alleged, Government assistance is necessary to Laker's survival, it would be possible to mount a rescue operation using the Industry Act 1972. It would, however, be for John Biffen to propose such an operation and you and Geoffrey Howe have already made your views clear.

8 Events are now moving very rapidly and, unless I hear to the contrary by noon on Thursday 26 November, I intend to inform the Bank of England that the Government cannot provide a subsidy for the proposed leasing arrangements.

9 I am copying this minute to Geoffrey Howe, John Biffen, Humphrey Atkins, Leon Brittan, Michael Havers and to Sir Robert Armstrong.

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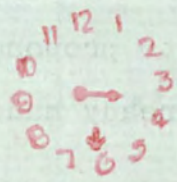
25 November 1981

Department of Industry

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