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P 01905

PRIME MINISTER

Privatisation of British Airways

BACKGROUND

MISC 112 is meeting on 11 February to consider the current state of play on plans for the privatisation of British Airways (BA).

2. It had been intended that BA should be privatised this coming Summer, subject to the successful conclusion of the outstanding US litigation arising from the collapse of Laker Airways. Once these cases had been settled, the plan had been to destroy BA's documents currently blocked under the Protection of Trading Interests Act, while British Caledonian would meanwhile repatriate and destroy the comparable documents now in their possession in the US. This would have substantially reduced the risks of further litigation in the US, leaving BA much less exposed to the possibility of major losses arising from further anti-trust cases.

3. BA have meanwhile provided £25 million in their accounts over the last three years against possible losses arising from such litigation, and taken out an insurance policy for £40 million against losses from anti-trust cases not connected with the Laker liquidation. A draft text has been prepared for the privatisation prospectus with the objective of achieving sufficient disclosure of the risks of further anti-trust cases while at the same time reassuring potential investors that there was little likelihood of BA sustaining 'material' losses therefrom. Because they would constitute an incitement to further litigation, the draft text mentions



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neither the provisions nor the insurance policy; omission of any mention of the latter would need to be cleared with the Stock Exchange.

4. Three developments have brought the prospects for privatisation into question:

(i) it has taken longer than expected to settle the 'class action' on behalf of passengers arising out of the Laker liquidation, and a final settlement is not now expected until next month, and may not be achieved even then;

(ii) Cravaths, the US legal advisers to the banks involved in the offer and to the UK solicitors to the issue (Slaughter and May) have indicated that for 'ethical' reasons they would not wish to be associated with an offer this summer shortly after the destruction of the documents in question - in other words they would only take part if the documents were still in existence; and

(iii) two further cases, on behalf of a travel agent and some Laker employees, have been filed in the US by Mr Beckman (the lawyer representing the plaintiffs in the action by the Laker liquidator and in the class action).

Against this background the feasibility and propriety of going ahead with a summer flotation of BA has been reconsidered in consultation with the Department of Transport's banking and legal advisers, and the Attorney-General has been consulted. City advice was that it would be just about acceptable to go ahead on the basis of the draft prospectus text previously intended, although this was on the assumption that there would be no further outstanding litigation arising from the Laker liquidation. This judgment reflected the view that the



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£35 million not covered by insurance or provisions of the total £100 million estimate of BA's exposure to anti-trust litigation could just be regarded as non-material for the purposes of the prospectus. The Transport Secretary and the Attorney General have considered, with the advice of officials, whether this is good enough; essentially because the Government must maintain the highest standards in the privatisation programme, the unanimous view has been that it would not be appropriate to go ahead this summer with the privatisation of BA on the basis previously intended.

MAIN ISSUES

5. The main issues before MISC 112 are

(i) Is the conclusion that privatisation cannot go ahead as previously intended generally accepted?

(ii) Is there any other basis on which privatisation could go ahead this summer?

(iii) Can a decision be taken when privatisation should go ahead, if not this summer?

(iv) If privatisation is not to go ahead this summer, how and when should the decision be announced, and in what terms?

Privatisation as previously intended

6. For the reasons already given, the risks of going ahead as previously intended, particularly with new litigation now pending in the US, do not appear to be acceptable.

Privatisation on another basis

7. It might in principle be possible to privatise BA

(a) by disclosing more of the risks arising out of anti-trust litigation, or



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(b) by pursuing the possibility of a management buy-out which would avoid the need for a public offer of shares.

In practice a higher degree of disclosure hardly seems a realistic possibility; the more that is disclosed, the greater the risk of a wave of contingency fee litigation in the US, which would precipitate demands for the disclosure of documents (with particular risks in the case of British Caledonian, whose documents are in the US and so not blocked under UK legislation), fines for non-disclosure of documents which would be blocked, and potential losses far in excess of the estimate of £100 million. Nor does the alternative of avoiding a public offer of shares provide a satisfactory alternative route; the standard of disclosure in order to achieve placements with institutional investors, as would be essential in the case of a company as large as BA, would not be significantly less than in the case of a public offer of shares, and the proceeds would almost certainly be a good deal lower.

The possible timing of privatisation

8. It does not appear that privatisation will be possible until litigation in the US has ceased and there is no immediate further threat of litigation; once this point is reached, the documents in question can be destroyed and the future exposure of BA will be reduced to levels consistent with the sum of the provisions and the insurance policy against such losses. Since the US Statute of Limitations has a period of only four years, the risks of further litigation not related to the Laker liquidation will fall away sharply at the end of this year, so further reducing the scale of any residual problems, even if the documents have not been destroyed. However, it does not appear possible at this stage to say when the way will be open for privatisation; the two new cases are thought to be of little merit, and will be expensive for the plaintiffs and Mr Beckman to pursue, and it may be possible to



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secure their withdrawal or dismissal within a matter of months. If that were to happen, privatisation in early 1987 might become a possibility; but the chances of this do not at present look very good, and it may well be that privatisation will not now be possible before the Election.

9. The postponement of the expected privatisation receipts of between £1 and 1.25 billion in 1986-87 will undoubtedly be a matter of regret to the Treasury. However, the Chancellor of the Exchequer will have some scope for rephasing the receipts from other privatisations so as to avoid problems with the public expenditure numbers. For example, airports and Rolls Royce are each expected to yield some £0.75 billion, while the staged payments in respect of the sale of gas are likely to be falling due over the same period. The capacity of the markets within a limited period is, however, constrained, and there could be problems if BA were to be privatised early in 1987.

Announcement and explanation

10. There is now a wide-spread expectation that privatisation will go ahead in the summer, and arrangements are going ahead for advertising campaigns, etc to begin within a matter of weeks. If privatisation must be postponed, an announcement in the near future is essential. However, postponement will need to be handled very carefully, given the risk that this may itself be seen as an invitation to further litigation. The Transport Secretary had originally thought that he might make the announcement in the course of a visit to Washington later this week, in which he would use the fact of postponement as a further argument addressed to the Administration and to Congress to exempt international air services from the application of US anti-trust laws. This would, however, be extremely rushed, and there seems no obvious merit in choosing this route. I understand Mr Ridley now proposes to make the announcement by way of a written Answer on Tuesday, 18 February. This will make it possible to convey



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the decision properly to Lord King, Chairman of BA, in advance of the announcement, and to coordinate the line to be taken by the Government closely with that of BA. It would, of course, carry some risk of a leak in, for example, this coming weekends press. But security has been held well so far, and you will want to enjoin your colleagues to continue to maintain the utmost discretion on these affairs.

HANDLING

11. You will wish to ask the Transport Secretary to set out the position, together with his proposals, for the Group to consider. The Attorney General will wish to comment on the proprieties of the course to be followed by the Government. The Chancellor of the Exchequer will wish to comment generally, as well as on the specific implications of postponement for the Government's privatisation programme and public expenditure plans (we understand that the Treasury have been kept closely in touch with recent developments, and that the Chancellor is unlikely to dissent from the main recommendation of the Transport Secretary). The Foreign Secretary will wish to comment on the impact of the decision on relations with the US Administration, and the Secretary of State for Trade and Industry may also wish to express views about the wider effect on commercial relations with the US. The Chancellor of the Duchy, who is being specially invited, may wish to comment on the political aspects of this issue.

CONCLUSIONS

12. You will wish the Group to reach conclusions on:

1. whether to discontinue now efforts to privatise BA in the summer of 1986;
2. whether to set an alternative timetable for BA privatisation, or to accept that action should be delayed until there is no immediate further threat of US anti-trust litigation; and



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3. the form, timing and content of the announcement of the Government's decision (you may wish to ask the Transport Secretary to circulate a draft if he has not already done so before tomorrow afternoon's meeting).

J B UNWIN

CONQUEROR

Cabinet Office
10 February 1986

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DEPARTMENT OF TRANSPORT
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01-212 3434

David Norgrove Esq
Private Secretary
10 Downing Street
LONDON SW1

5 February 1986

Dear David,

Please pass these papers
cc
to John Whybrew.

JW
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BRITISH AIRWAYS PRIVATISATION

We spoke. My Secretary of State would be most grateful if a meeting of MISC 112 could be arranged to discuss this subject, preferably on Tuesday 11 or on the morning of Wednesday 12 February. As background, I enclose a copy of my Secretary of State's letter of 22 January to the Attorney General, with enclosure, and of an interim reply from the Attorney General's office: I should be grateful if you would pass these on to John Whybrew.

I am copying this letter to John Wiggins at the Cabinet Office.

Yours,
Richard.

R A ALLAN
Private Secretary

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11. 12. 1996

COMMISSION

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11. 12. 1996

