



SECRET

CCB/UP

8

PG1955

PRIME MINISTER

British Airways Privatisation and
Negotiations over the UK/US Air Services Agreement (Bermuda 2)

A - MISC 112(86) 1

BACKGROUND

1. The purpose of this meeting is to consider the current state of play on plans for the privatisation of British Airways (BA), and relations with the USA over anti-trust law and its application to civil aviation.
2. It had been intended that BA should be privatised this summer, subject to the successful conclusion of the outstanding US litigation arising from the collapse of Laker Airways. Once the main cases have been settled, the plan had been to destroy BA's documents currently blocked under the Protection of Trading Interests Act, while British Caledonian (BCAL) would meanwhile repatriate and destroy the comparable documents now in their possession in the USA. This would have substantially reduced the risk of further litigation in the USA, leaving BA much less exposed to the possibility of further major losses arising from anti-trust cases.
3. In his memorandum MISC 112(86)1 the Secretary of State for Transport sets out the position on the risks and propriety of proceedings with early privatisation, and concludes that it would not be safe to proceed at present. He also reviews the state of current relations with the USA over the renewal of Bermuda 2, which expires in July 1986.

MAIN ISSUES

4. The main issues are:



SECRET

- (i) whether the privatisation of BA should be postponed;
- (ii) the tactics to be used in negotiations over Bermuda 2, and in particular whether the threat to terminate the agreement may be used.

The Propriety of Early Privatisation

5. It had been hoped that with the settlement of the liquidator's suit and the class action, the main obstacles to privatisation would have been overcome, notwithstanding the existence of a number of the documents described above. Since then there have been two further claims lodged by the US contingency fee lawyer Beckman on behalf of a travel agent and of former Laker employees. These cases have very little merit, but are nevertheless relevant to the flotation because the documents must be retained until the actions are settled. The principal difficulty is the need for the flotation prospectus to disclose all material considerations.

6. It had been hoped that the problem could be overcome by:

- (i) setting aside £25 million to meet any further claims, and disclosing this in BA's accounts;
- (ii) taking out an insurance indemnity for a further £40 million to cover anti-trust risks other than those arising from the Laker collapse;
- (iii) including in the prospectus a carefully drafted piece disclosing enough of the facts, but not too ostentatiously.

7. The Attorney General has advised that the draft prospectus passage (Annex 1 to the paper), which is substantially franker than earlier drafts, is sufficiently candid about the risks and the precautions BA have taken to satisfy the legal requirements as to disclosure. But the Transport Secretary has concluded that on balance it would be risky



SECRET

to proceed with privatisation, on the current timetable, because the disclosure of large provision and the insurance policy together would draw undue attention to the problem. The effect could be to stimulate still further litigation, and the risks would inhibit the successful marketing of the issue. Furthermore, privatisation while the future regime for regulating trans-Atlantic air traffic remains unclear could prove difficult: either BA would have to be sold at a discount reflecting the uncertainty, or the Government would have now to surrender its main negotiating cards.

8. On the other hand delay would not itself be free of difficulties: Lord King is already campaigning vigorously for early privatisation and will be exceedingly upset if it is postponed; and Beckman may be encouraged by the sight of the Government on the defensive. It will also knock a large hole in the privatisation programme. Some £1.25 billion has been expected from this sale during 1986-87, although the Treasury seem to think that it might be possible to fill at least most of the gap by some reordering of the programme elsewhere (eg gas).

9. If privatisation is delayed, the next available slot will be early 1987. Allowing three months for marketing, the Government would have to make final arrangements in September in the light of the position on litigation and on negotiations on Bermuda 2 and their implications for the relevant Prospectus texts. The Transport Secretary is likely to suggest that officials should also review before then possible alternative solutions to the anti-trust problem, including a Government indemnity, creating a new (shell) company to separate past liabilities from current operations, and establishing a compensation fund. These have all been considered and rejected before, but there is no harm in looking at them again.

Negotiation with the US

10. BA's difficulties stem from the extra-territorial application of US anti-trust legislation. The Transport Secretary has for some time

There needs to be a good press line to deal with the hole - we do not want the markets wobbly before the budget.
N.C.V.



SECRET

been seeking a bilateral competition regime to replace the unilateral application of US anti-trust law. But the UK's approaches have been largely rebuffed, and the Transport Secretary's judgement is that there will be no substantive changes in the anti-trust law (beyond those already under consideration) during the remainder of President Reagan's term. The furthest the US Department of Transportation is prepared to go is to grant UK airlines some degree of immunity from US proceedings, but this would imply recognition of the principle that US law apply to trans Atlantic aviation.

11. In the meantime, negotiations have been proceeding on the regulation of North Atlantic capacity. The most recent US proposals have been totally unsatisfactory since they would allow US airlines to exploit their position to drive out BA and BCAL from many routes. The Department of Transport's view is that the gap is wide and may not be bridged, and that if a new agreement cannot be negotiated, the UK might ultimately have to suspend Bermuda 2, relying instead on individual licensing of flights. But the North Atlantic route is very important to BA (25 per cent of their revenue), and if the Government were prepared to contemplate termination, then it would not be realistic to go ahead with the privatisation this summer, especially because of the difficulty of handling this issue in the Prospectus. However, great care would be needed in referring to these negotiations as a reason for postponing privatisation; it would be some years before satisfactory permanent arrangements were agreed, and it might well be reasonable - given a solution to the other difficulties - to go ahead at some point with privatising BA while some form of interim air traffic regime was in force.

HANDLING

12. You will wish to ask the Transport Secretary to introduce his paper. The Attorney General may wish to expand on his legal advice. The Chancellor of the Exchequer will wish to state the Treasury viewpoint, both on the merits of the question and on the implications of postponement for the privatisation programme as a whole. The Trade and



SECRET

B --- Industry Secretary will not be able to be present, but has minuted you with his views (minute of 10 March). All members will wish to comment on the case for postponing privatisation, and on bilateral trade relations with the USA.

CONCLUSION

13. You will wish to reach decisions on:

(i) whether the risks associated with an early privatisation are too great to be acceptable;

(ii) subject to (i), whether to invite the Transport Secretary to report again in September, after examining a range of options;

(iii) whether to accept that it is unrealistic to invest further capital in challenging the extra territorial application of US anti-trust law;

(iv) whether the Government wishes to keep open the possibility of terminating, or at least threatening to terminate, Bermuda 2 in the context of the current negotiation of the North Atlantic air traffic regime;

(v) how any postponement of privatisation should be presented, ie how far this should be attributed to the position of the negotiations on replacing Bermuda 2.

J B UNWIN

10 March 1986
Cabinet Office