

Prime Minister

(2)



Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Lord Cockfield  
Secretary of State  
Department of Trade  
1 Victoria Street  
London SW1H 0ET

Please see, too,

Lord Cockfield's  
minute to you  
(attached)

Dear Secretary of State,

BRITISH AIRWAYS FINANCIAL POSITION

The situation revealed by British Airways draft accounts is as you rightly say dreadful. The accounts will show British Airways to be massively insolvent. They are expecting the taxpayer to pick up the bill. It would give quite the wrong impression and hopelessly weaken our influence over the nationalised industries generally if we were to appear to be accepting this passively and simply carrying on as before. We must let it be clearly seen that the Government views the situation with maximum seriousness.

I recognise you will be concerned at the implications for early privatisation if we require action to be taken which leads to substantial disruption. But frankly I must say that I see little prospect of achieving early privatisation if things are allowed to continue as at present. On the contrary it seems to me that our best hope lies in persuading Sir John King to take early and radical measures now. The longer these are deferred the more difficult it will be to persuade investors that BA's by now well-publicised problems have been overcome and that the corner has been genuinely turned. Without being able to carry conviction that BA has reasonable prospects of future viability, I do not believe that any amount of capital reconstruction (at the expense of the taxpayer) will do the trick.

You will be in a better position than I to judge what is needed. But it seems to me that recent developments have pointed almost inescapably to certain conclusions.

First, the corporation still lacks an effective and credible management team. Three crucial members of management have now left the company but only one new man, the Finance Director, has so far been found to replace them. The position of the Chief Executive - a vital post in view of the fact that Sir John King

X seems to me the minimum we should do, when one thinks of what happened to Lakes. The prospect for early privatisation must be very poor (unless there was massive prior Government support).

10 September 1982

Would we not be better employed in thinking of what forced staff reductions and asset disposals we wish to impose?

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I entirely agree with X - it corresponds with my previous comments

is only part-time and has other major business concerns to occupy him - is in doubt. Publicly the press has been full of rumours and these have given rise to a general impression of internal dissension and lack of decisive direction. The first requirement is surely for the Chairman to lose no further time in rectifying this state of affairs.

Second, I am bound to say that this public impression is not substantially contradicted by anything we have seen from our slightly more privileged viewpoint. It is now two years since the Government received a firm plan endorsed by the Board. The plan we discussed in July remains as I understand it unendorsed, and recent developments have suggested that its realism is still being seriously questioned within the BA organisation. A new fleet and route review is promised by the end of September, but whether that will arrive on time or be satisfactory when it does remains to be seen. Meanwhile BA are threatening once again to exceed their EFL this year. A convincing plan for recovery fully backed by the Board is an urgent necessity.

Third, I do not think it is now adequate for BA to be entering large scale financial commitments such as those recently incurred on pay and proposed on severance, as though it were simply a matter of "business as usual". No private sector concern in the same financial position could get away with this. Once the accounts are published people will rightly ask what the Government is going to do about the situation they reveal. Potential investors may well be put off if they gain the impression that BA's problems of low profitability, overmanning and industrial relations are not now going to be forcefully attacked. There is a strong case for a pay cut or at least a pay freeze rather than the 11 per cent increase recently negotiated for mid-October. Rather than a generous voluntary redundancy scheme for the latest tranche of de-manning should not the Board now get going for compulsory redundancies at minimum statutory cost? There may well be other areas where decisions are continuing to be taken on similarly false premises and with equally or even more damaging results.

In my view it would be wrong for the Government to provide the kind of assurance of continuing support which Sir John King seeks, let alone to commit or half-commit itself to a fresh injection of capital, until satisfactory understandings have been reached on these and any other crucial points. I suggest that such understandings should now be urgently sought. There would also be advantage in letting it be known that the Government is undertaking a radical re-appraisal of the situation, in advance of publication of the accounts which will otherwise come as a substantial shock. This will give us a better negotiating base both to get the things done which need to be done and for taking sensible decisions about any future capital reconstruction.

May I also suggest that Hill Samuel as your merchant bank advisers on BA should be asked to do a thorough and objective appraisal of the prospects for early privatisation? In doing so they could take account of the measures we have taken in response

to the accounts, assess the Board's response and advise on the prospects for a sale in the light of them and any other action which they might recommend ought to be taken. We shall need a sound commercial assessment of the position for E(NI)'s discussion later in the Autumn and for considering the desirability and size of a possible capital reconstruction which I agree would almost certainly require legislation.

The proposal to mention estimates of the unfunded past service liability for pensions in a note to the accounts causes us enormous concern. We are far from convinced of the need for this and my officials are seeking legal advice from Treasury Counsel. The main motive for mentioning it now, when it has been thought unnecessary to do so in the past, seems to be to maximise future claims for capital funding from the Government. Such liabilities in respect of past service are common to most pension funds and are funded by employers' contributions in the normal way. There is no reason to suppose that they cannot be funded in the BA case unless we close the airline down in which case the extent of any deficiency requiring to be met by BA is extremely uncertain. That point will need to be clarified for any prospectus for privatisation but BA and its auditors should be dissuaded from mentioning figures which almost certainly beg the issue.

Finally, if we decide, in the light of understandings on the lines I have suggested, to give some assurance of continuing support, it will be important to make clear to BA that it is only intended to cover obligations arising over the next financial year, and thus to satisfy the auditors for the purpose of the 1981-82 accounts: it does not prejudice the Government's decisions on any capital reconstruction, or in particular the longer term obligations of the BA pension fund, where I agree with you it is very questionable whether the Government has any duty to step in.

I am sending a copy of this letter to the Prime Minister and to Sir Robert Armstrong.

yours sincerely



LEON BRITTAN

[Approved by the Chief Secretary  
and signed in his absence]

10 SEP 1982





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10 DOWNING STREET

*C. M. V. Verelst*

From the Private Secretary

13 September 1982

Dear John,

British Airways Financial Position

The Prime Minister was grateful for your Secretary of State's minute to her of 10 September. She has also seen the Chief Secretary's letter to Lord Cockfield of the same date.

The Prime Minister has commented that she entirely agrees with the Chief Secretary that there is a strong case for a pay cut or at least a pay freeze rather than the pay increase recently negotiated for mid-October. She thinks, too, that rather than a generous voluntary redundancy scheme for the latest tranche of demanning, the Board should now move towards compulsory redundancies at minimum statutory cost. She considers, with the Chief Secretary, that it would be wrong for the Government to provide the kind of assurance of continuing support which Sir John King seeks until satisfactory understandings have been reached on these and any other similar points.

I am sending a copy of this letter to John Gieve (Chief Secretary's Office) and Richard Hatfield (Cabinet Office).

Yours sincerely,

*Michael Scholar*

John Whitlock Esq  
Department of Trade

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*S*



PRIME MINISTER

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CP JV  
Prime Minister

MUS 10/9

BRITISH AIRWAYS' FINANCIAL POSITION

I have seen your Private Secretary's letter of 6 September to mine.

As I said in my letter of 1 September to the Chancellor I regard the situation as quite appalling. It is a combination of two things: gross mismanagement over a long period of years with huge undisclosed or potential liabilities which are now coming home to roost; and a determination on Sir John King's part to dress up the accounts to provide the most favourable scenario for privatisation.

The accounts are not our responsibility and if the Board of British Airways can get their Auditors to certify them, however much we dislike them there is nothing we can do. But it does not follow that we accept the accounts as the basis on which we should pay for the reconstruction and this has been and will continue to be forcibly put to British Airways.

I too have serious reservations about the pay settlement, not least because it savours too much of blowing hot and cold - a freeze one year followed by a bonanza next year. Arithmetically it is worth 5½% per annum - the 11% figure in itself is misleading - but of course the real point is whether there should have been any increase at all although, as you know, the biggest loss-makers among the Nationalised Industries tend to have the biggest pay increases. We were not told. And there is nothing we can now do about it.

I am asking the Department to prepare a factual note on British Airways' redundancy payments and pensions liabilities which my Office will send you in a few days, in my absence overseas. On all these matters Sir John King's strategy has been to limit employee benefits to the greatest extent possible without provoking a confrontation. He has shown some skill in this, succeeding, for example, in beating his own ambitious target for the rate of run-down of manpower. The alternative strategy would be to crack down severely, from now on, on all generous-seeming benefits to employees at British Airways, allowing no increases in expenditure beyond what is inescapable. But I have no doubt that Sir John King would take the view that this would lead inevitably to industrial confrontation, which would be costly in itself and would put paid to our target, recently re-affirmed by E(NI), of privatising British Airways as quickly as possible.



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The only bright spot in this dismal picture is that British Airways are still on target for a pre-interest profit this year of about £180m. This compares with a pre-interest profit for 1981/82 of £13m, and a pre-interest loss in 1980/81 of £95m.

I am copying this minute to the Chancellor of the Exchequer and to Sir Robert Armstrong

Department of Trade  
1 Victoria Street  
London, SW1H 0ET

*John Whitton*

for LORD COCKFIELD

10 September 1982

[Approved by the Secretary of State and signed in his absence.]

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