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PRIME MINISTER

THE NOTT UNDERTAKINGS

You asked to see the context of the John Nott undertakings quoted in Lord King's letters to MPs - Flag A. 17.7 84  
The first of the undertakings, which is the most difficult, appears in the statement to the House announcing the Government's intention to privatise BA - Flag B. It was subsequently repeated in John Nott's letter of 29 October to the then Chairman of British Airways - Flag C. Much hinges on whether a reallocation following a thorough review of airline policy would be construed as arbitrary.

(Flag D)

The second undertaking quoted by Lord King also appeared in the statement, but it is clear from John Nott's speech on the Civil Aviation Bill that the reference is to ancillary activities such as hotels, travel agencies and tour operations, rather than to routes.

AT

12 September 1984



[Mr. Nott.]  
American airlines to fly around the world in a totally de-regulated atmosphere.

**Mr. Michael Neubert (Romford):** I must declare an interest in matters of air travel. What limitation will be placed on British Airways fringe activities? Although my right hon. Friend said that British Airways is not a monopoly—and that is true in its international operations—within the United Kingdom it certainly has a dominant position in the air travel market. Activities on the margins, such as hotel keeping, running retail travel agencies and tour operating which might be accepted as fair competition from an ordinary commercial company, might be regarded as unfair competition from a company that still has a substantial Government majority holding. I believe that that is why the United States places restrictions on its national airlines, which are privately owned.

**Mr. Nott:** I do not foresee any directions or other instructions being given to British Airways to divest themselves of these activities. One of the principal purposes of what we intend, namely, allowing other shareholders to have a substantial minority interest in the airline, is that then financial sanctions and the sanctions of the market will apply to British Airways in the same way as they apply to other companies. I believe that British Airways must make a decision within that context as to what they intend to do with these activities. I do not propose that any part of British Airways should be broken up or sold off. I propose that the airline as a whole should be quoted and it will then be for the board of directors to take decisions on how they organise their business.

I was talking about the real meaning of "open skies". It does not just mean freedom on the route between New York and London; it means de-regulation in the sense that we could compete with the United States openly in what is the most profitable and the largest internal market in the world. That is something that we would look at with considerable interest if it were proposed to us. I mention this only to emphasise that in the last resort the decisions of the CAA are dictated by the facts of what my Department is able to negotiate in air service agreements.

I shall outline briefly a few details of the policy. The Civil Aviation Act 1971 which established the CAA, gave it certain statutory functions, but also provided for Ministers to issue guidance to the Authority. The Authority was required to perform its functions in such a manner as it considered would best attain the statutory objectives and give effect to the guidance given to it. This approach was an innovation, but I must say that it has not proved satisfactory. Guidance has been given in 1972 and 1976, but an important part of the 1976 guidance was found, as I have already said, to be ultra vires, in the case of Laker Airways Department of Trade.

When the Under-Secretary of State announced the policy, we concluded that it was wrong to place responsibility for an area of policy on an independent organisation and then so to hamper its freedom that it was hardly able to pursue an independent line. If we wish to hive off certain functions of Government—the CAA provides an excellent example of the way in which independent bodies can undertake this task—we must be ready to take both hands off the wheel or as the Under-Secretary would say, both hands off the joystick.

Clause 10 therefore removes the power for me to give guidance and instead describes those statutory duties within which the CAA must operate. I hope that the House will consider this to be a constitutional improvement. In principle it must be right for the Act to express the will of Parliament—rather than have the Act provide a paving stone for ministerial guidance.

Under the 1971 Act—I am referring to section 3—the CAA had two principal objectives: first, to secure that British airlines provide services which satisfy substantial categories of public demand at the lowest charges consistent with a high standard of safety and an economic return to efficient operators and secondly, securing the sound development of the civil air transport industry in the United Kingdom—it was not notable for grammatical elements; secondly, to secure that at least one major airline other than British Airways has opportunities to participate in providing those services. Subject to those two objectives, the Act was required to encourage the development of the United Kingdom civil air transport industry.



REGISTERED PAPERS .....

EXTRACT FROM OFFICIAL REPORT (HANSARD)

DATED 20.7.79.....  
COL(S) 21.83-98.

BRITISH AIRWAYS (FINANCING)

The Secretary of State for Trade (Mr. John Nott): With permission, Mr. Speaker, I will make a statement on the 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. As our principal national carrier, it is operating in an increasingly competitive market and, while the world energy situation creates considerable uncertainties, I am none the less confident that the airline will, with the Government's full encouragement, face these challenges successfully.

Clearly there must be some flexibility about the rate of expansion in the face of these uncertainties. Nevertheless, the present appraisal is that British Airways will require a substantial increase in capital investment from both internal and external sources over the next few years in order to meet its objectives. 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.

First, the Government are concerned to give British Airways the most effective form of organisation for carrying out its programme in response to the changing demands of the market rather than on the basis of Government targets and support.

Second, I propose therefore that the framework of the Companies Acts should be used to provide British Airways with a new capital structure and that a substantial minority shareholding in the enterprise should be offered for sale to the public.

Third, the Government will give up control, for example, over British Airways' investment programme and it will in future satisfy its financial requirements from capital markets both at home and overseas.

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

Fifth, special arrangements will be made to enable employees of British Airways to take up shares in the enterprise should they wish to 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.

Seventh, I will put forward proposals later in the year for the legislation which will be required. The timing of any issue of shares will depend on market and other circumstances.

Eighth, I will also set out the Government's thinking on the licensing provisions administered by the Civil Aviation Authority. I can say now, however, that there will be no arbitrary reallocation of routes.

**Mr. John Smith:** Is the right hon. Gentleman aware that the decision to make a statement of this gravity and importance on a Friday allocated to Private Members' business is contemptuous of the House? What possible reason is there for not making this statement next week on one of the days allocated to public business? Is it not a further example of how the Leader of the House is allowing the rights of hon. Members to be overridden by those of departmental Ministers?

On the substance of this alarming statement, may I ask whether the right hon. Gentleman is aware that it will be greeted with shock and dismay by all those who wish well to one of our most important public utilities? Will he confirm that there is not a word about such a proposal in the Conservative Party manifesto and that the present Government, who did not have the guts to put these proposals before the electorate—it was obviously a preconceived proposal—have no mandate to sell off a profitable section of a public industry to their private sector friends and to their party contributors?

Is the right hon. Gentleman aware that in the statement he cannot and does not seek to justify this change of ownership—because that is what is involved—in terms of increased efficiency, profitability or industrial relations? Will he say what problems have existed in the past in raising the necessary finance for British Airways? The truth is that such finance can in the future, as in the past, be found from public resources.

What is meant in this Delphic statement by the phrase "a substantial minority shareholding"? Will the legislation—and I want the right hon. Gentleman to give a definite answer on this question—



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From the Secretary of State

PC/RUSST  
PC/SECRETARY  
MR STEELE  
MR SALMON  
MR WHITAKER  
MR GILDEA  
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PA 52/02

27 October 1979

Dear Ross

Thank you for your letter of 19 October which raised a number of questions relating to the Civil Aviation Bill and the sale of shares in British Airways. I will deal with each point in the order of your letter.

As regards the future financial relationship between the Government and British Airways, I appreciate the need to clarify the position and thus remove any uncertainty in the minds of the board or the financial institutions with which you deal. As you know, the Government's policy is that British Airways should stand entirely on its own feet financially from the time when the running of the airline is vested in the nominated company. Consistent with that policy, the Bill includes no powers for the Government to provide financial assistance or Treasury guarantees after the appointed day although guarantees given before the appointed day will remain valid for the duration of the loans and leases to which they apply. Between now and the appointed day the Government will, in principle, be prepared to issue Treasury guarantees for loans to be drawn down before the appointed day but not afterwards. I believe this strikes a sensible balance between our longer term policy towards the airline and your need to plan ahead in the period before the change of status becomes effective. We hope that the appointed day will be as close as possible to the public flotation of shares and since I shall arrange to consult the Board before setting the appointed day, you will have a period of notice of the date from which no new Treasury guarantees will be issued.





*From the Secretary of State*

Your letter proposes that Treasury guarantees should be made available to cover finance for the programme of fleet replacement and expansion agreed with the Government before the appointed day. So that you and your Board are in no doubt about the Government's policy, I should make it clear that the arrangements I have outlined above are not intended to cater for all aircraft acquisitions so far approved by the Department. In so far as you require to draw down loans to pay for such aircraft (in whole or in part) before the appointed day then such loan amounts can be covered by guarantee but guarantees will not be available for loans to be drawn down thereafter. I know that you probably have in mind particularly the contract for 19 Boeing 757s which are due to enter service in 1983 and for which the great bulk of progress payments are not due until 1982/85 and later years. However, I would certainly hope that by that time shares will have been sold to the public in which case it would be quite contrary to our policy of allowing BA complete freedom to operate on a fully commercial basis if we were to have given Treasury guarantees in respect of finance to be drawn down by the privatised company. The extent to which future loans will enjoy Treasury guarantee will in practice depend on the timing of the appointed day but I cannot give the general undertaking you seek about finance for the entire fleet programme and I think it is only sensible to make this point quite clear now so that the Board can plan accordingly.

As regards your second point, the provisions of Part II of the Bill are in general quite neutral in their effects as between one airline and another. But as I made clear at our meeting, the size, status and prestige of BA confirm its position as our national flag-carrier. The only particular point is the repeal of section 3(1)(b), which is certainly not harmful to British Airways and this is fully consistent with my own statement that there will be no arbitrary reallocation of routes.





*From the Secretary of State*

In connection with the timing of an offer of shares to the public, I appreciate the point you make about the deterioration in BA's financial prospects over the past few months and that this may have a bearing on the timing of the flotation. We shall of course keep the situation under close and continuous review and I have no doubt that you and your Board are doing everything possible to reverse the present trend in this year's results and maintain the airline's longer term prospects. I have noted with interest some of the announcements which you have made concerning a number of BA's loss making routes. Naturally I would like to feel that the difficult prospects faced by the world's airlines in the immediate future will lead to a continuing and vigorous search for offsetting economies.

Your letter also referred to the reaction of the airline's employees to the sale of shares and expressed the view that the incentives presently available to encourage employee share participation are very small. You will have gathered from our previous conversations and from my statement to the House on 20 July that I believe it essential to establish as wide a holding of shares by employees as possible when the flotation takes place. I am therefore pleased to note that you are continuing to examine what scheme(s) may be appropriate and my officials will be discussing this with your people in greater detail.

Your last substantial point concerned the BA pension fund and the liability this places on the British Airways Board and which will be inherited by the successor company. I recognise that, because of the generous nature of the benefits, this is a matter which will be weighed in the balance by the investing public. But although the pension arrangements will be rather unique for a private sector company I do not believe that they will preclude a successful sale of shares by the Government. There will not be any form of Government support to underwrite the pension arrangements.





*From the Secretary of State*

I understand that a number of these points were recently discussed in greater detail between officials and representatives of BA and that such consultation will continue. But I look forward to seeing you this Wednesday to discuss these matters with you personally.

*Forus*

*Shu.*

JOHN KOTT