BANK OF ENGLAND

Prime Minister. 2

A matter for Lord Young.

MEA 5/8

With the Governor's Compliments

Agreed

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PERSONAL AND CONFIDENTIAL

Bank of England

The Governor

London EC2R 8AH

5 August 1987

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
Department of Trade & Industry
1 Victoria Street
London
SW1H OET

Dear David,

You are no doubt inundated with advice on the handling of the British Airways bid for British Caledonian, and I am reluctant to burden you with yet more. But on hearing that, after the meeting of his Mergers Panel yesterday, Gordon Borrie is expected to recommend you to refer this bid, I thought that I should register a serious concern that continues to trouble us at the Bank.

This does not relate to the competition question, though I should say that I am surprised to hear the view that the only way in which enforceable conditions could be attached if the merger were allowed to proceed would be via the MMC process. I would have thought that, if a major problem is how to make appropriate conditions stick, serious consideration should be given to enhancing the powers of the CAA as the appropriate regulatory body, if necessary through quick (and presumably very brief) new primary legislation.

But my main concern relates to the financial position of BCal which, as the Bank has indicated to the OFT, to your Department and to the Department of Transport, is at best uncertain and could move quite quickly to become precarious. This is, of course, a

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matter of prediction and judgment, with scope for differing assessments, but I am drawing on the very close experience of the Bank in the Laker case some five years ago. The speed with which confidence in a prominent airline can disintegrate, and the impact of that disintegration when superimposed on an already weak financial position, can be dramatic. You will understand therefore our concern at the real possibility that BCal will find it increasingly difficult to survive the duration of an MMC reference.

In the event of an MMC reference, there could be considerable and growing reluctance on the part of BCal's bankers to continue to support the group through a process about the outcome of which they could have no confidence. Moreover, such knowledge as we have of other domestic groups that might bid for BCal separately or on some joint basis, gives us little confidence about any relief coming from there. I understand (obviously in confidence) that one representative at the Mergers Panel discussion expressed the view that it would matter little if in the event BCal went into liquidation: I have to say that I wonder whether that would be an outcome which, at the end of the day, would be likely to be found tolerable either politically or in any other way.

It is because of these doubts, and mindful of the pressure that you are likely to be under to make a reference, that I express the hope that you will give serious consideration to alternative possible ways of attaching conditions on the basis that the bid is allowed to proceed forthwith. I know that this would be a difficult decision for you now but I believe that it could well be the means of averting a great deal more difficulty later.

I am sending copies of this letter to the Prime Minister, the Chancellor of the Exchequer and the Secretary of State for Transport.

Yours ever,

Robin