cc BG

DEPARTMENT OF TRANSPORT
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6 AUG 1987

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H OET

1. Mr Wicks to see.
2. Prime Minister - for information only.

MEA 6/8

Dear David,

BA/BCAL PROPOSED MERGER

WILL REQUEST IF REQUIRED

Robin Leigh-Pemberton has written to you to express the Bank's concern that a reference of the BA/BCal merger proposal to the MMC might rapidly lead to the collapse of BCal. I thought you might find some comments helpful.

Firstly, legislation to enhance the CAA's powers could not be introduced until after the recess, and in the meantime the CAA does not consider that it has the power to substitute one airline for another purely to alter the structure of the industry, or to secure binding undertakings as to future conduct from BA and BCal. Under the Take-over Panel's rules, the merger would have to be completed within sixty days in the absence of a reference - ie before legislation could be introduced. Parliament is rightly wary of approving legislation with retrospective effect, and I would not be attracted to the idea of allowing the merger to proceed and then trying to disentangle it if it were to be concluded that the merger was not in all respects acceptable. Although there could be some circumstances in which a CAA investigation might be an acceptable alternative to one by the MMC, I do not see how legislating to enhance the CAA's powers could be relevant to this case. The Bank's concerns do, however, point to the need for the MMC to complete its investigations as quickly as possible if you decide to refer the case. The Director General of Fair Trading has emphasised the importance of a quick investigation in his advice to you.

Secondly, the Bank have argued that BCal's financial position is so precarious that this is in practice a rescue case. The financial information about BCal which has been given to the Bank appears to be more pessimistic than the information in the possession of the CAA who have the statutory duty to monitor the financial fitness of airlines. Indeed if BCal were on the verge of insolvency the CAA would have to consider withdrawal of its operating licences. BCal seem to have shown some tendency to adjust the financial information they have produced to secure a particular reaction from the intended audience. I do not think that a reference would have much immediate effect on BCal's revenue, though if it led to a loss of confidence they could lose forward bookings for the next summer season which would affect their cash flow in the new year. Whether a reference would lead to a loss of confidence among BCal's trade creditors and short term lenders is a matter of speculation. This possibility also points to completion of the MMC's investigation as quickly as possible if there is a reference.

Finally, I agree that there is a possibility that this might turn into a rescue case, even if it is not one at present. There is widespread agreement that BCal has started a process which cannot be reversed and that it is unlikely to survive in the long term in its present form. The precipitate collapse of BCal would undoubtedly be embarrassing to the Government, given the attempts that have been made to foster it over the years. But it is likely that several airlines in addition to BA would be willing to take on parts, if not all of BCal's business. If BCal were to cease trading, it would be open to any airline to apply for its licences and to apply for its slots at Gatwick and the CAA would be able to test the competing claims for licences at a public hearing.

I am copying this letter to the Prime Minister, Chancellor of the Exchequer and Governor of the Bank of England.

Yours,

Paul

PAUL CHANNON