



Treasury Chambers, Parliament Street, SW1P 3AG

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

13 October 1982

Dear Secretary of State

BRITISH AIRWAYS

Thank you for your letter of 6 October responding to mine of 10 September and that from the Prime Minister's office of 6 September. I have now also seen the Prime Minister's further comments of 11 October.

The publication of BA's accounts has now become very urgent. One American lender has already given notice of default (expiring 27 October) and other lenders have acquiesced in the delay in publishing the accounts following written advice from BA that they would be published in early October. Advising of further delay would cause concern amongst BA's creditors and if publication is not attained by mid-October it would be open to any lender to give notice of immediate default which taken with the various cross default clauses in the loan agreements could require the Treasury to make immediate repayment of a large proportion of BA's foreign debt.

It could be argued that given the existence of the Treasury guarantee on all these loans such precipitous action is unlikely. However, the consequences should it occur are so serious that neither the Treasury nor the Bank of England would wish to take the risk. The accounts should therefore be published no later than 18 October and the rest of this letter is written on that assumption.

I will not dwell on the remarks in your second paragraph except to note that I am quoted out of context. You may also be interested to know that since March 1979 BSC have cut numbers by 44% and will have cut them substantially more by the end of this financial year.

Of course I accept that Sir John King cannot be held responsible for the appalling inheritance he took over in 1981. But I must make two points. First, any business must be expected to recoup

its losses. The request for a massive capital reconstruction is an admission of failure and is much more than a mere reflection of past methods of finance. Second, we need to be satisfied that giving BA a fresh start is justified both in relation to its competitors and in relation to the likely proceeds of sale. These two considerations will have to be borne in mind when we come to consider whether any special assistance is called for, and if so how much.

Turning to the questions of pay, cost of redundancies and pensions, I agree with the Prime Minister's comments on these. The case for making a special provision of £50 million in the accounts for the possible adverse effect on the pension of redundancies is particularly questionable. I think this should be removed from BA's accounts altogether. In any event it should be made clear to Sir John King that the Government is looking to him to make reductions in both the pensions and the other exceptional costs.

One important issue is whether the measures BA are now taking will give a real prospect of early privatisation. We are due to discuss this, together with BA's revised plan, when you have received merchant bank advice. We should consider at the same time whether it would be right to press BA to do more to bring home to their staff and employees the reality of the airline's situation.

Meanwhile the accounts must be published. I agree therefore that a letter of comfort should be sent to Sir John King on the lines suggested in your paragraph 18. The conditions which you intend to stipulate on this are right and I am grateful to you for agreeing to them.

I generally agree with the line you intend to take in public when the accounts are published. However I would make one point. It would not in my view be right for us to get trapped into defending all aspects of the existing management and blaming everything on past mistakes or misfortunes. It is quite correct to observe that action is being taken to reduce manpower and that underlying profitability was better in 1981-82 than 1980-81. But there are too many question marks still standing to be fully satisfied. We would do best to indicate that we are still looking for very considerable improvements.

I should also take this opportunity to remind you that before any further finance for BA can be provided from the National Loans Fund (or from other sources subject to Treasury guarantee) it will be necessary to advise Parliament that this is to be done whilst the Government pursues measures to restore the viability of the Corporation. My officials are already in touch with yours about the terms of a suitable statement.

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

Yours sincerely

LEON BRITTAN

J.S. Gier

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

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*From the Private Secretary*

14 October, 1982

British Airways

Many thanks for your letter of 12 October.

As I told you on the telephone this afternoon, the Prime Minister now agrees, in the light of the Chief Secretary's letter of 13 October to your Secretary of State, to the issuance of the letter of comfort on the lines suggested in your Secretary of State's earlier minute, and on the conditions which have now been agreed.

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

M. C. SCHOLAR

John Whitlock, Esq.,  
Department of Trade



Prime Minister (2)

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From the Secretary of State

Rt Hon Leon Brittan  
 Chief Secretary  
 H M Treasury  
 Treasury Chambers  
 Parliament Street  
 London SW1 3AG

14 October 1982

*Des Lem*

BRITISH AIRWAYS: 1981/82 ACCOUNTS

Thank you for your letter of 13 October. <sup>- TPM</sup>

You will be pleased to know that I have now prevailed upon Sir John King to leave out of the accounts the special provision of £50m for the effect of the redundancies on the pension scheme. I have accordingly now sent Sir John a letter of comfort on the lines agreed. British Airways will now proceed with publication of the accounts on the planned date, 19 (not 18) October.

As you say, we shall now have to decide in E(NI) which way we are to go over British Airways - and, in particular, whether we should keep open the option of privatising the airline in late 1983 or soon thereafter. I shall circulate a paper shortly.

I note what you say about our public line over the accounts and about British Airways' future borrowings.

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

*J. Cockfield*  
*Arthur*

LORD COCKFIELD

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10 DOWNING STREET

*From the Private Secretary*

14 October, 1982

British Airways' Financial Position

Thank you for your minute of 12 October.

The Prime Minister found this helpful in reaching her decision, recorded in my letter to John Whitlock of today's date, about the comfort letter to British Airways.

M. C. SCHOLAR

John Sparrow, Esq.

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cc J.V.

APPOINTMENTS-IN-CONFIDENCE

Qa 06081

To: MR SCHOLAR

Prime Minister

12 October 1982

From: JOHN SPARROW

BRITISH AIRWAYS' FINANCIAL POSITION

1. I have seen the correspondence leading up to the Secretary of State for Trade's letter of 6 October.

Pay Settlement and Redundancy Schemes

2. I agree with the Secretary of State that whether or not the Board might have been able to negotiate less generous agreements originally they should not now renege on the agreements they have made. I think we must accept Sir John King's judgement that to do so would probably precipitate a damaging strike that would cost much more than the settlements agreed. As the Secretary of State says the severance scheme represents a good investment for BA, with a payback period of less than 1 $\frac{1}{4}$  years. A less generous scheme (perhaps with a different response) might or might not have been an even better investment, but that water is under the bridge.

3. One could speculate on an alternative, high-risk strategy which would have been to hold out for a pay freeze, or even pay cuts, and for compulsory redundancies at the statutory minimum cost, accepting the various expensive consequences that might have followed. These might have included a long and bitter strike and the possible destruction of the business as a going concern, leaving the Government to pick up some major costs including BA's guaranteed debts. On the credit side, a very much smaller but profitable business might have emerged. This would have been a very risky course - which incidentally might well have been unacceptable to Sir John King

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and have precipitated his resignation and replacement. Given the risks I cannot myself recommend that the Government should pursue this type of strategy now. The Government's policy, firmly held so far, has been to try to return BA to profit and to privatise it at the earliest opportunity in roughly its present form. I see no reason to alter this policy now.

4. Given the present dreadful financial situation in BA it is unfortunate that Sir John King did not consult the Secretary of State before committing the Board (and ultimately the Exchequer) to the pay and severance agreements. It would be a sound general principle for Chairmen of loss-making Nationalised Industries to consult their sponsor Ministers about such matters, particularly where the agreement appears likely to cause a breach of a previously agreed EFL.

## Recovery Plan

5. The Secretary of State has now obtained from Sir John King a financial plan, endorsed by the Board, for the next 5 years. I understand that the plan outlines a strategy involving large manpower reductions (by means of the severance scheme referred to above) and withdrawal from a small proportion of routes; on the basis of this strategy the Board expects to be able to achieve a sufficient level of profitability to enable BA to be privatised at an early date, thereby meeting the Government's main objective for BA. Hill Samuel has been asked to assess the prospects for privatisation, both for next year and for later, on the basis of the plan. The Secretary of State will doubtless report Hill Samuel's assessment when he brings

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his proposals for privatising BA to E(NI), probably in about one month's time. Ministers will then have an opportunity to judge the adequacy of the plan.

6. But even if we conclude that the plan is adequate BA could yet be blown off the course charted by the plan. International airlines generally are in difficulties at present, with far too much capacity and continuing uncertainty about future demand. As we know from the Price Waterhouse report BA's profits are particularly vulnerable to adverse events on a small number of routes. BA's performance should therefore be monitored carefully. If events should start to turn against them we might need to ask Sir John King to re-examine the assumptions in his present plan about the size of the airline; a more drastic pruning of loss-making routes might then be required in order to transform BA into a secure and profitable business in the longer term.

## Management Team

7. The Secretary of State suggests that, as one of the conditions attached to a letter of comfort, Sir John King should be pressed to complete his reorganisation of the senior management team quickly.

I support this suggestion. But the reorganisation may include new Board appointments, for which the Secretary of State himself is formally responsible; the position of Mr Watts, presently Chief Executive and Deputy Chairman, is likely to be a key factor. The Prime Minister may therefore wish to invite the Secretary of State to discuss the reorganisation, including Board appointments, with Sir John King, and to report back with a firm plan for making the

I understand  
that this happened,  
yesterday.

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necessary changes as soon as possible. The earlier the new management team can be completed the greater the opportunity for it to display a convincing track record in the period leading up to privatisation and, thereby, to gain the confidence of potential investors.

8. I am not entirely convinced by the Secretary of State's argument that BA needs a full-time Chairman. Sometimes a part-time Chairman can be more effective in a Nationalised Industry because of his independence and detachment, as perhaps Sir John King has been. But you do need a good full-time Chief Executive if you have a part-time Chairman; hence the particular importance of resolving the uncertainty about Mr Watts' position.

## The 1981/2 Loss

9. I agree with the Secretary of State that BA are within their rights to make the proposed large provisions for extraordinary items (for accelerated depreciation and redundancies) and for pension liabilities. I accept that the Government cannot overrule them. However there seem to be grounds for believing that at least some of these provisions could have been spread out over later years. BA's decision may be prudent and proper but it makes the 1981/2 loss look worse than it need have done and should make the profit for future years look better. This presentation may facilitate an early flotation and to that extent it may serve the Government's interests. Notwithstanding the size of the loss there is no need for the Government to promise now to supply a large injection of capital when restructuring.

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Any pressure for this should be resisted. The amount of capital injection required can be calculated at the appropriate time in the light of all the relevant information then available.

Letter of Comfort

10. A letter of comfort is needed urgently for BA to continue trading. I agree with the Secretary of State that it should be issued with the three conditions he suggests. I also agree that the letter should imply no Government commitment to any particular level of capital reconstruction; in my view this could best be achieved if the letter made no mention whatsoever of reconstruction.

*RS.*

Copy to: Sir Robert Armstrong

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Address:

Enid of B.A.  
3182

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cf: Econ Pol.  
Inflation Proofed Pensions.  
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10 DOWNING STREET

*From the Private Secretary*

11 October 1982

BRITISH AIRWAYS

The Prime Minister has seen a copy of your Secretary of State's letter of 6 October to the Chief Secretary.

The Prime Minister feels that Ministers have been bounced by the action which British Airways have taken. She remains of the view that British Airways should have imposed a pay freeze, given the extent of their losses; and that the redundancy terms are too generous and the pensions scheme too costly. The Prime Minister enquires whether it would be possible to change the Trust Deed governing the British Airways' pensions scheme. If legislation would be required, the Prime Minister asks what other public sector pension funds would be involved.

B/P  
I would be grateful if you would let me have this information as soon as possible, so that the Prime Minister can consider whether she can now agree to your Secretary of State's proposals. You will see from my letter of today's date to John Gieve in parallel, that the Prime Minister has asked the Treasury to let her have a note on the position of public sector pension schemes across the board.

I am sending a copy of this letter to John Gieve (HM Treasury) and Richard Hatfield (Cabinet Office).

M.C. SCHOLAR

John Whitlock, Esq.,  
Department of Trade.

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