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Prime Minister

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The Deputy-Governor has been keeping me in touch by telephone on next lines.

I, too, think a CAA solution

much preferable to an Industry Act rescue.

*Agreed*

PRIME MINISTER

LAKER AIRWAYS

Officials of the Departments concerned, together with a representative of the Bank of England, met under Treasury chairmanship this morning to explore in what ways the Government might be able to contribute to tiding Laker Airways over their present difficulties if efforts to mobilise sufficient credit from the banking sector ran into difficulties, as requested in your Private Secretary's minute of 25 November. You will wish to know the conclusions they reached. To summarise: a private sector solution is still being pursued; and officials consider that the preferred course for providing Government backing, should this be needed, would be by continuing the Department of Industry subsidy with a sale and lease-back arrangement, which would mean overcoming the difficulties set out in Patrick Jenkin's minute of 25 November; this course would be greatly preferable to new assistance under Section 8 of the Industry Act 1972.

Ms 27/11

Prospects for a private sector solution

Negotiations between the airline and the banks are in progress continuously and the position, and the prospect for a successful outcome, changes constantly. The sale and lease back arrangement which was the subject of Patrick Jenkin's minute of 25 November was a way of meeting the stipulation of Laker's bankers that, in return for an additional £3.5 million overdraft facility which the airline thought might be needed to see it through the winter months, the disposal of some aircraft must be accelerated. It had the merit of being quicker to arrange than sale to another airline,

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and improving the balance sheet while enabling Laker to retain the use of the aircraft. However in case the Department of Industry should prove unable to transfer its subsidy (without which the lease terms would offer little or no benefit to Laker's cash flow), the airline and the Banks have been exploring the possibility of obtaining guarantees from the manufacturers of its aircraft (McDonnell Douglas, Airbus Industrie and General Electric) for an extra overdraft up to £5 million. Sir Freddie claims that he has had a favourable reaction from the two American companies; British Aerospace are still considering the proposition. The Department of Industry are encouraging British Aerospace to co-operate.

Hence it is still possible that a satisfactory solution can be found without involving the Government financially.

#### Possible vehicles for Government assistance

A guarantee under Section 8 of the Industry Act 1972 would be a possibility, but it would raise many problems both practical and political.

The most fundamental point is that this would represent a new measure of Government help clearly directed to Laker (as distinct from a continuation of a past measure - the interest rate subsidy - in the changed circumstances of a private sector rescheduling). So the Government, as the lender of last resort, would come to the centre of the stage. The House would, remembering the Court Line case, undoubtedly seek an assurance that the public could safely book next year's holiday. (Air transport is an unusual industry in that the customer is required to pay before delivery.) A qualified assurance would deter them and bring the company down;

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but if it gave a firm reassurance and the airline subsequently failed, the Government might well find itself liable for most or all of Laker's debts.

There would be a number of other aspects. Laker would have to request assistance and submit detailed financial forecasts for evaluation. We should need to consider whether to consult the Industrial Development Advisory Board as has been customary. Assistance over £5 million requires Parliamentary approval; but in any case I think that Parliament would need to be informed. And a Section 8 guarantee would also have to be cleared with the EC, and it would be difficult to justify in relation to our stance in the Community about the application of the competition rules to air transport.

Finally - a key point at this stage - as soon as the banks learned that Laker had sought a Government guarantee there would be no further progress towards a private sector solution.

Because of these disadvantages, officials concluded that an Industry Act guarantee should only be contemplated as a last resort. I endorse this view.

The preferred course

Officials felt that if the difficulties explained in Patrick Jenkin's minute could be overcome, the best way of providing Government support would be to continue the present Department of Industry subsidy arrangements for the benefit of a sale and lease-back scheme.

The subsidy which the Department of Industry gives at present to lower the interest rate on Laker's Airbus is provided under Section 1 of the Civil Aviation Act 1949. This is drawn in wide



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terms, and authorises inter alia "measures to assist the development of civil aviation". However in practice the powers have been used only to provide launching aid for the development and manufacture of aircraft and engines, but never to subsidise an airline, and when the Act was passed there were no private sector airlines in operation. Officials concluded that it was most doubtful that this wording in the Act conferred powers which could be used as a basis for some completely new financial assistance clearly directed to an airline - in this case Laker Airways.

Officials therefore considered again how the present subsidy originally given for aircraft manufacturing could be continued on the same grounds. The Attorney General had advised that if the Secretary of State for Industry could be satisfied that the continuation of the subsidy would benefit Airbus production, this could provide sufficient legal basis for this. So far, British Aerospace have not been prepared to support this proposition. However, it transpired that BAe firmly believed that if the sale and lease-back went ahead, Airbus Industrie would be asked to increase their exposure by guaranteeing a loss or resale of more than the 25% which they have already agreed to bear. If this fear were removed, BAe's response might be different. Officials are exploring urgently whether this may offer a solution to meeting the Attorney General's stipulation, and hence towards satisfying Patrick Jenkin.

I hope that it will, because I feel that although for contractual reasons, as the Attorney General has pointed out, there would have to be a new agreement between the Department of Industry and the leasing company, in substance the new arrangements can be seen as a continuation of those already in operation, provided the important question of vires can be dealt with.

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I consider that officials should urgently follow up this line of approach. Although the deadline of noon today was lifted, it appears that Laker's lenders will require some evidence by 5 December of significant progress to ensure that the airline has adequate resources to support its operations during the coming year.

I am copying this minute to the Chancellor of the Exchequer, the Chief Secretary, the Lord Privy Seal, the Secretary of State for Industry, the Attorney General, the Governor of the Bank of England and Sir Robert Armstrong.

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W J B

(Approved by the Secretary of State and signed in his absence.)

26 November 1981

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