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PRIME MINISTER

BA PRIVATISATION AND THE LAKER SUITS

1. We need to decide very quickly how to handle the British Airways (BA) flotation in view of problems arising from civil suits against them in the US courts. President Reagan's intervention to prevent any criminal indictments on matters under investigation by the Department of Justice was helpful, but neither it nor the current talks with US departments will affect cases concerned with alleged anti-trust violations in the past.

The current civil suits are:

(i) the Laker liquidator's case;

(ii) the current class action.

The attached note by officials (Annex A) summarises the complications and uncertainties of these cases. It shows that there is a possibility of further class actions which might arise from evidence revealed through the process of discovery in the US courts, encouraged by the widely reported and damaging statements by Department of Justice officials immediately after President Reagan's intervention.

2. The Government as vendor of the shares in BA plc must disclose any information in its possession which would falsify any information already in the prospectus and correct any conclusion or inference which could otherwise reasonably be drawn from the prospectus. We shall therefore need to make a considered judgment (about which I am separately consulting the Attorney General) about what it is necessary to disclose, and whether we can proceed with the flotation on the basis of that disclosure.

3. BA's US legal advisers say that they should win the liquidator's case and the class action as currently constituted.

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But they cannot give any assurance that this will be the outcome. The case will not come to trial before summer 1985 and the class action a good deal later. Meanwhile a statement in the prospectus must point to the risks both as to the outcome and to the quantum of damages which a jury might award against BA. Hill Samuel and Lazards have considered a draft (annex C) for the prospectus on these lines, and advise that such a statement would not allow a successful flotation.

4. In addition there is the possibility that the class action might be further amended or further class actions begun, which could generate other potential liabilities. BA's advisers think that such risks are remote, but from the knowledge in the Government's possession, they cannot be ruled out.

5. Under the timetable for a flotation in mid-February (the key dates for which are set down in annex B), Hill Samuel will need within the next few days to issue invitations to the marketing seminars beginning on 7 January. I must decide quickly whether this timetable can be adhered to. Once the invitations have been issued it will be difficult to abort the sale without an adverse reaction in the stockmarket. If it became known that the Laker litigation was the reason for postponement, it would be very damaging to BA's chances of success in the US civil suits.

Possible settlement

6. More than 90 per cent of US civil anti-trust actions are settled out of court because, with high legal costs, the risks of losing are too high. The best solution to the present problems would be a global settlement of the liquidator's suit by all ten defendant airlines, and a settlement of the class action. The former could not be achieved within a reasonably short period, and the class action has not yet reached the point where settlement could be considered.

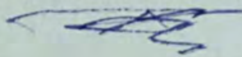
7. BA are urgently exploring the possibilities of an individual settlement with the liquidator. They believe that such a settlement would greatly improve the chances of a successful flotation, particularly if BA were to insure against liabilities from the class action. It would, however, leave the rest of the liquidator's case still active and it would remain possible for documents to be released which could give rise to further class actions against BA. I shall separately be consulting the Attorney General about what would have to go into the prospectus if BA settled on this basis, and will need to consult Hill Samuel about whether that disclosure would allow a successful flotation.

8. It is extremely difficult to estimate the cost to BA of settling. The liquidator has mentioned eight figure dollar sums. BA tell me that insurance against the liability arising from the liquidator's action would not be feasible. BA consider that insurance against liability under the class action may be possible, but this has yet to be firmly established.

9. Any settlement will take time to achieve. Until a settlement, at least by BA, of the liquidator's suit has been confirmed we cannot safely proceed with flotation. Therefore some delay in the timetable may be inevitable unless we take the exceptional course of insulating BA against the risks.

Insulating BA

10. For this option to be effective, the Government would need to undertake to BA to pay the airline any sum which it is, or becomes, liable to pay as a result of the existing actions and any other anti-trust actions which are brought in relation to anti-trust violations before flotation. It can be argued that the cost to the Government of giving an indemnity might not be much greater than the Government's present exposure while BA remains in the public sector, but I find this option very unattractive, because:



(a) no upper limit could be set to the Government's contingent liability:

(b) it would remove from BA any incentive to fight the cases or settle economically. Further if HMG, in effect, took on the defence of the cases, it would be more likely that the US courts would view our action to block UK documents under the Protection of Trading Interests Act as a matter of expediency rather than principle. That could make the cases harder to fight;

(c) there would be problems in the coverage of an indemnity. To enable a satisfactory prospectus to be published, an indemnity would need to cover all potential treble damage liabilities. We could not confine it to liabilities from behaviour by BA which we argue is legitimate under Bermuda 2;

(d) politically it would be difficult not to indemnify BCal also, although the case against BCal is on different grounds.

11. An indemnity of this kind would be different in nature from the guarantee enshrined in the Memorandum of Understanding (MOU) between British Airways plc and me. Under that, the Government stands behind the company and will not allow it to default. This guarantee will lapse on flotation. An indemnity insulating BA from anti-trust liability would, on the other hand, have to be honoured by the Government irrespective of BA's own ability to pay. The one merit of this option would be that it would allow a marketable prospectus to be written.

Nullifying the effects of the suits

12. The courses of action described above are extremely unpalatable. They involve either BA or the Government paying substantial sums to meet liabilities under US anti-trust laws, which we firmly believe should not apply to matters governed

by our air service agreement with the USA (Bermuda 2). This suggests that the right course in principle would be to take powers to prevent BA (and perhaps BCal) from paying any damages awarded against them by the US courts in anti-trust suits. But as that would probably lead to seizure of our airlines' assets in the USA, we should also need to take powers to seize a comparable amount of the assets of US airlines here.

13. I am advised that to be able to enact (or at least use) such legislation without a breach of international law, we should need to demonstrate that permitting the continuation of the private suits was a breach of Bermuda 2 and that the action proposed by HMG was a reasonable and proportionate response. Arbitration under Bermuda 2 is the proper remedy (although this is uncertain both as to its timing and result). Since the US have taken the position that there has not been a breach of Bermuda 2, and there has been ample time for HMG to take the matter to arbitration, I am advised that retaliatory action could not be justified under international law as being a reasonable and proportionate response.

14. Whatever the legal arguments, retaliatory action would also cause a row with the US. Though the US Government might be brought to understand our position of principle, we could not rely on their being willing or able to back down to what they would see as an attack on their system - still less on their being able to carry legislation in the Congress even if they were willing to propose it. At best it would take time to resolve the deadlock, and - given the uncertainties for Anglo-US air services in the meantime - privatisation of BA would be held up.

15. If, for these reasons, we adopt either a settlement or an indemnity to enable privatisation to go ahead, the dilemma is how to reconcile acquiescence in the application of anti-trust laws for the past with maintaining our position of principle from which to negotiate arrangements for the future.

16. I am minuting you separately on what tactics we should use to make progress with the US government towards removing the possibility of treble-damage suits from our civil aviation relationship. I do not rule out threatening tougher action if that proves necessary. And if we decide that we have to acquiesce in the application of US anti-trust law in the present suits, to enable privatisation to proceed, we should make it clear to the US government that this is a political response to President Reagan's decision to stop the Department of Justice indictment, which does not alter our position of principle.

Conclusion

17. (i) the only option which we could be sure would be consistent with keeping to the present timetable of flotation in mid-February would be to give BA a wide indemnity against liabilities arising from civil anti-trust suits. This is open to the objections in paragraph 11;

(ii) we may just be able to keep to the present timetable, if BA can reach an early settlement with the liquidator at a reasonable cost; and can insure against liabilities arising from the class action. But it would not be safe to take public steps towards the flotation until this solution has been secured and the Government's obligations in relation the prospectus have been completely clarified (paragraph 8). It may well be necessary to defer the flotation beyond the end of the current financial year, we would have to explain the delay by referring to the difficulty of settling BA's capital structure with Lord King;

(iii) the most logical solution is to threaten retaliatory action against US airlines in the event of damages being awarded against BA. It would have widespread consequences for Anglo-American relations. It maintains our principles but would not offer a safe route to early privatisation.

18. Copies of this minute to go to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Attorney General and to Sir Robert Armstrong.

Dinah Nichols
Private Secretary

pp NICHOLAS RIDLEY
4 December 1984

(approved by the Secretary of State & signed in his absence)