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DEPARTMENT OF TRANSPORT
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Andrew Turnbull Esq
Private Secretary
10 Downing Street
LONDON SW1

5 March 1984

Dear Andrew,

BRITISH AIRWAYS PRIVATISATION

In your letter of 22 February, recording Lord King's conversation with the Prime Minister you mention certain matters on which the Prime Minister requests information.

The proposal for route transfers from British Airways was made by Sir Adam Thomson, Chairman of British Caledonian Airways, last autumn. He argued that the privatisation of British Airways would confirm a situation of gross imbalance in the UK airline industry; and that if (as he speculated) the Government gave substantial financial help to the restructuring of British Airways' balance sheet, this would unfairly favour British Airways as compared with the existing private sector in the industry.

When Ministers discussed BA privatisation in E(DL), doubts were expressed about the case for route transfers. They noted that the Government had no power to require British Airways to divest themselves of routes - route licensing being a matter for the Civil Aviation Authority. Nonetheless, they noted that there was much sympathy among Government supporters in the House for the points made by the independent private sector airlines about "unfair competition", and, if routes were transferred, the sale of the associated assets might contribute towards the reduction of British Airways' debt. Ministers thought that the possibilities of route transfers should be explored with British Airways, though it should not be suggested that such transfers were a condition of privatisation. The Prime Minister endorsed the conclusions of E(DL) and agreed that my Secretary of State should hold further talks with Lord King on the question of route transfers (your letter of 30 November 1983 to John Kerr). Mr Ridley accordingly asked Lord King

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to consider strengthening British Airways' balance sheet by the sale of assets, including the possibility of voluntary route transfers to British Caledonian (or other independent airlines). In fact it now looks as if BA's balance sheet might conceivably be strong enough through its own efforts - by making profits and by revaluing its assets.

Mr Ridley has also had in mind the wider concern expressed in the House about whether privatisation of British Airways would in itself produce unfair competitive conditions in the airline industry. He believes that if any significant changes in the structure of the airline industry or in the licensing and competition regime within which it operates are to be made, they should be made before BA's privatisation. He therefore asked the Civil Aviation Authority to consider the implications of the privatisation of BA for competition and the sound development of the British airline industry. When Mr Ridley announced this Review in the House in December it was well received. The CAA are now well into the Review and they have promised their report by the second half of July.

Turning to the Prime Minister's first question: the CAA's Review is a formal consultation with the airline industry and users of its services. Insofar as the questions raised involve a review of the Authority's licensing policy, and the Authority conclude that changes are called for which are possible within the statutory framework in the Civil Aviation Act 1982, they will effect these by issuing a revised statement of licensing policy. If they conclude that legislative or other action is called for that falls to the Government rather than to the Authority they will make recommendations to my Secretary of State.

It is at this stage uncertain what recommendations the CAA may make. They will probably not recommend an immediate transfer of routes from British Airways, but rather some change in the criteria for awarding licences (which might or might not require new legislation). If so, the effect of their recommendations would emerge progressively through the operation of the new licensing criteria as applications are received and considered. We do not consider that this would inhibit the sale of BA's shares, so long as the policy and its likely effects are known.

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The Prime Minister asks whether, if the CAA recommended a major reallocation of routes, we should be in the difficult position of either rejecting this recommendation or, by accepting it, of putting the privatisation timetable at risk. If the CAA were to recommend this, or a fundamental change in licensing policy, and the recommendation were accepted, there could be some delay in privatisation; particularly if there were a need for new legislation. Such an outcome is unlikely. It is more likely that the CAA will have regard both to the Government's timetable for flotation and for the need to remove uncertainty about future licensing policy as soon as possible. A more marginal change in the operation of the licensing system in favour of the independent airlines of the kind mentioned above, while being of some help to British Caledonian and the other independents, would be unlikely to call into question the integrity of British Airways' central route structure and their basic profitability. We have to take that risk in order to respond to the Parliamentary concerns. Mr Ridley is keeping closely in touch with the way in which the CAA's thinking develops, and will let you know if things look like going wrong.

Finally, the Prime Minister asks about Lord King's argument that a reallocation of routes between BA and other UK carriers will not affect competition in the industry. The real point is not so much about competition: it is about the imbalance of size between BA and the independents. BA has 83% of the scheduled service output of British airlines. The CAA does what it can to enable scheduled service routes, international as well as domestic, to be operated by more than one British airline in competition, where this can be done profitably and without damage to the UK's share of total traffic on the route. British airlines now compete with one another on the main domestic routes and between London and Hong Kong, between London and Los Angeles, and between London and a number of points in the rest of Europe. But most international scheduled service routes cannot be operated by two British carriers in competition, either because there is insufficient traffic, or because the country at the other end of the route refuses to accept more than one British airline. British Airways' scheduled services could be said to be in competition with foreign airlines on these routes - but it is real competition. If British Caledonian's proposals were accepted they would not be competing directly with British Airways on any more international routes: but they would have a stronger base from which to compete on domestic routes, and in respect of charters. The real question is whether the financial strength of British Airways might be used to crush the independents on domestic routes and charters. The CAA are considering these questions in their review.

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Mr Ridley considers both the substantive issues and the political aspects of this require careful handling. As regards the latter he considers that the arguments about competition are best set out by an independent report by the CAA. The criticism about financial help to British Airways can probably be met by reducing the need for such help to zero. Lord King seems to accept the need for further self-help by the airline. In this it is helpful if during the next few months Lord King is kept guessing about route transfers. Lord King now feels he must seek Parliamentary support against route transfers by a massive publicity campaign. Mr Ridley feels this may well prove counter-productive. The right policy is to await the CAA review, which will give us the authority to take action if action is necessary.

Yours sincerely,

Dinah Nichols

MISS D A NICHOLS
Private Secretary

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Future of B.A.

March 82

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7 March 1984
Policy Unit

MR TURNBULL

c Mr Redwood

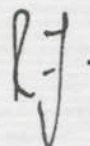
BRITISH AIRWAYS PRIVATISATION

There is undoubtedly a difficult trade-off to be achieved between:

- (i) privatising BA as smoothly and quickly as possible;
- (ii) responding to British Caledonian's clamour;
- (iii) recognising backbench feeling and
- (iv) respecting the CAA's quasi-independent methods of working.

We judge that Nicholas Ridley's tactics for stepping through this minefield are absolutely right (Dinah Nichols' letter to you of 5 March).

Only in one respect would we offer a counter-view. That is that BA should not remain silent in the face of continuing allegations, mainly by BCal, that it enjoys a dominant position which ought to be dismantled before BA is privatised. Certainly BA should avoid being crass - perhaps Lord King's use of the term 'massive publicity campaign' worries Nicholas Ridley. The key points which we think have to come out are that BA is not being privatised with a huge State handout and that its real competitors are not the British independents but a swarm of subsidised State airlines overseas.



ROBERT YOUNG

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FILE

cc: MR. YOUNG. (6)

10 DOWNING STREET

From the Private Secretary

12 March, 1984

BRITISH AIRWAYS PRIVATISATION

The Prime Minister has seen your letter to me of 5 March and she was grateful for this full report on the CAA review and its likely outcome. She has commented that there is a difficult trade-off to be achieved between privatising British Airways as smoothly and quickly as possible; responding to British Caledonian's pressure; recognising backbench opinion; and respecting the CAA's quasi-independent methods of working. She has noted that a massive publicity campaign by BA could hinder rather than help resolution of these difficult issues.

(Andrew Turnbull)

Miss Dinah Nichols,
Department of Transport

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File

Prime Minister

LORD KING

Lord King telephoned this morning to let you know that he takes issue strongly with today's Leader in the Daily Mail (copy attached).

The Leader alleges that Lord King has threatened to resign if British Caledonian get a slice of BA's action. Lord King said that they completely distorted what he had said and that this was not true.

MICHAEL ALISON
14.5.84

cc. Andrew Turnbull