

CONFIDENTIAL



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10 DOWNING STREET

*From the Private Secretary*

20 July, 1984

CAA REVIEW - BRITISH CALEDONIAN

BF Sir Adam Thomson has written to the Prime Minister requesting a meeting. I would be grateful for early advice on whether she should agree to this, in the light of the decision of Cabinet that your Secretary of State and the Chancellor should try to secure agreement on a limited transfer of routes between British Airways and British Caledonian.

I am copying this letter to David Peretz (HM Treasury).

(A. Turnbull)

Miss D.A. Nichols,  
Department of Transport

CONFIDENTIAL

NR

me

GENO

## British Caledonian

Caledonian House  
Crawley West Sussex  
RH10 2XA England

Telephone: Gatwick (0293) 27890  
Cables: Scotair Gatwick Telex: 87161

Sir Adam Thomson, C.B.E.  
Chairman

Ack'd 20/7

19th July, 1984.

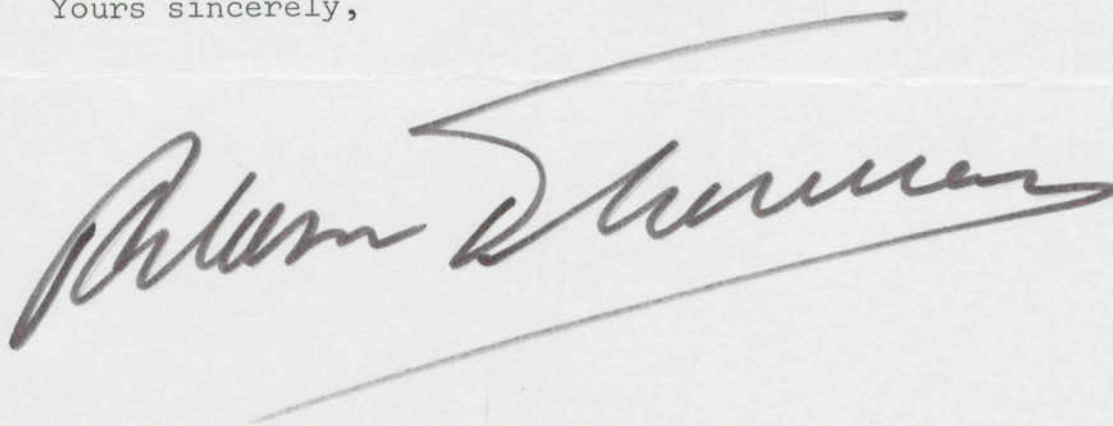
The Rt. Hon. Margaret Thatcher, MP,  
Prime Minister,  
10 Downing Street,  
London SW1.

Dear Prime Minister,

The Civil Aviation Authority has reported to the Secretary of State for Transport following the Authority's investigation into the implications of privatising British Airways for competition and the sound development of the British Airline Industry. In this report there are many far reaching consequences for British Air Transport and certainly the final outcome, whatever that may be, will have significant implications for British Caledonian Airways.

I do believe that this matter is sufficiently important for me to respectfully request a meeting with you. Discussing British Caledonian's position in isolation inevitably will lead to the effect the CAA's proposals will have on the British Air Transport Industry as a whole.

Yours sincerely,



BRIEF FOR PRIME MINISTER'S MEETING WITH SIR ADAM THOMSON

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Background to the CAA review of airline competition policy

1. British Caledonian Airways (BCal) have been lobbying the Government for some years to transfer some routes to them from British Airways. They wrote to the Prime Minister and the Secretary of State for Trade in August 1981, who in reply repudiated the idea. A year later Sir Adam Thomson again wrote to the Prime Minister about BA privatisation and towards the end of a long letter returned to the idea of a transfer of routes. The Prime Minister replied encouraging him to agree a voluntary transfer with British Airways. (Copies of this earlier correspondence are attached.) Sir Adam achieved no success in negotiating a voluntary transfer with British Airways, and in September 1983 he sent the then Secretary of State for Transport (Mr King) a further letter on the subject, accompanied by a lengthy supporting paper entitled "A Strategy for British Civil Air Transport in Private Ownership", which has come to be known as "BCal's Blue Book".
  
2. BCal argued that a privatised British Airways - dominating the UK industry with modern aircraft, a large marketing organisation, much reduced interest burden and freed from Government controls - would present unfair competition. It therefore recommended a transfer by the Government of a number of routes from BA to BCal to go some way to redress this uneven balance of market power. BCal were prepared to take over the aircraft and staff needed to operate the routes, and to pay BA for them. The routes and assets to be transferred would, BCal recommended, be identified by a DTp/CAA Working Party assisted as necessary by the airlines concerned, but in the appendix to their Blue Book, they indicated which ones they were interested in.
  
3. The Department of Transport prepared an assessment of the BCal's proposals, and it was clear that while such a transfer of routes, if it could be carried out, would benefit BCal, and help

the establishment of Gatwick as an alternative scheduled service hub to Heathrow. That was a desirable objective to try to reduce pressure on Heathrow's capacity, and on the working of the limit which will be imposed for environmental reasons next year. But it was also clear that removing routes on the scale suggested from British Airways would be prejudicial to the privatisation of the airline.

4. Towards the end of last year Mr Ridley sought the CAA's advice about this problem, and accepted their suggestion that they should undertake a formal review of the implications of BA's impending privatisation for competition in the UK airline industry, and for a policy on air transport licensing. Mr Ridley announced this review during the course of a Parliamentary statement in which he also announced the Government's plans to privatise British Airways early in 1985.

#### The review proposals

5. The CAA review has made a number of recommendations aimed at reducing the dominance of British Airways in the UK industry, strengthening BCal's operations so that it is better equipped to compete with BA, and potentially to replace it on major routes, and to reinforce the development of Gatwick as a second centre for London of a network of international scheduled services.

6. The proposals of particular interest to BCal are that British Airways' routes from Heathrow to Saudi Arabia and Zimbabwe should be transferred to BCal; while BA's routes from Gatwick to Spain, Portugal and a few other European destinations should also be transferred to BCal and/or other independent carriers who were interested in them. BCal are most likely to be interested in four of the Iberian "business" destinations, rather than the more leisure-related places. This group of routes represents the CAA's judgment, after consulting BCal during the course of its review, of a

less ambitious package of routes than BCal originally asked for, which would nevertheless achieve the desired effect while keeping to a minimum the effect on BA's total operations.

Present Government position

7. The Government's response to the CAA recommendations has been discussed at the last two meetings of Cabinet, and the Secretary of State for Transport has circulated a further paper for discussion at Cabinet this week. That paper explains that Lord King, when he met the Chancellor of the Exchequer and Mr Ridley last week, showed no disposition to cooperate in a transfer of routes on any scale, even something less than the total CAA proposal. Cabinet will need to consider whether further pressure should be exerted on British Airways, in one way or another, to try to change their attitude.

Suggested line to take

8. Until the Cabinet have decided what further action, if any, they intend to take on the CAA proposals, the Prime Minister will not be able to say anything positive or encouraging to Sir Adam. It is suggested therefore that she should use her meeting with him mainly in order to listen to what he says, and to explain that the Government are still considering the CAA's recommendations. They raise complex issues, and he will understand that they merit careful consideration and not hasty decisions. But it is only fair to point out that they do raise a number of formidable problems, and since the transfer of routes from one carrier to another does not of itself enhance competition, the Government has to weigh the benefits which that would yield to British Caledonian (and other independent airlines who might benefit as well) against the consequences for British Airways' profitability, the prospects of privatisation, and the commitment of its employees - which now seems to be very strong - to that objective. There have been debates in the last week in both Houses of Parliament, at which

there was a considerable amount of support for British Airways, and opposition to the Authority's proposals, and the Government have received a number of other representations from various quarters since they were published. All these comments, and of course Sir Adam's at this meeting, will be taken carefully into account, but at this stage no promises can be made.

9. The Prime Minister might also try to draw Sir Adam out on the minimum level of route transfer which would be of value to BCal (see para 7 of 'C(84) 21.ry of Staff's paper'). So far he has asserted that nothing less than the CAA proposals would do, but if he shows a willingness to lower his sights, that would be useful to know before Cabinet meet.

## SUMMARY OF MAIN CONCLUSIONS AND RECOMMENDATIONS

- (1) There should be some reduction in the relative size of British Airways so that other airlines have adequate opportunity to develop and prosper including at least one airline fit to replace British Airways on any major intercontinental route should the need arise. Additional competition by British airlines on intercontinental routes should be licensed wherever possible (paragraphs 4-14, 25 and 46).
- (2) Specified intercontinental routes should be transferred from British Airways at Heathrow to British Caledonian at Gatwick (paragraph 49).
- (3) The Authority, acting within existing policies and powers, will seek to increase the range and market penetration of European scheduled services from Gatwick (paragraphs 56-57).
- (4) British Airways' scheduled service routes from Gatwick should be taken over by other British airlines (paragraphs 56-58).
- (5) British Airways' European routes from provincial airports should be taken over by other British airlines (paragraph 63).
- (6) The Government should take specific powers to give effect to the reallocation of routes in recommendations (2), (4) and (5) above. These powers should then lapse (paragraph 90).
- (7) The Government should look again at the possibility of increasing available capacity at Heathrow and Gatwick (paragraphs 26-38).
- (8) Provision should be made for access to Heathrow for competing services on those of British Airways' domestic trunk routes where direct competition does not already exist, if necessary by reducing British Airways' frequencies (paragraph 66).
- (9) The Authority would favour a strengthening of its air transport licensing powers in order to promote the sound development of a competitive British airline industry and deal with anti-competitive behaviour (paragraph 88).
- (10) The Authority does not propose any immediate restriction on British Airways' or British Airtours' charter operations but, given a strengthening of its powers, will not hesitate to set a quantitative limit to their penetration of the holiday charter market if it is shown there is abuse of a dominant position (paragraphs 77-78).
- (11) The Authority proposes to introduce, on a two-year experimental basis, an area facility allowing airlines to serve any domestic route other than those specifically excluded (paragraph 93).
- (12) The Authority proposes to cease regulating domestic air fares but will still require fares to be filed with it so that it can intervene to prevent predatory or monopoly pricing. It will consult the Channel Islands and Isle of Man before extending the new arrangements to them (paragraphs 94-95).
- (13) The Authority has decided at least for the present not to amend the general exemption so as to allow the carriage of separate fare traffic on aircraft with ten or fewer seats on any route covered by the area facility (paragraph 96).
- (14) The Authority has updated its Statement of Policies so as to reflect those changes of emphasis that are within the scope of its present statutory powers and duties (paragraph 102).



RECEIVED

10 SEP 1982

SECRETARY

10 DOWNING STREET LONDON

THE PRIME MINISTER

10 September 1982

*Richard Thompson*

Thank you for your letter of 26 August expressing your concern that the Government's desire to proceed as soon as possible with the privatisation of British Airways might overlook the consequences which this change would have for the rest of the civil aviation industry. I can assure you that we are most anxious to see a thriving and healthy airline industry in this country and are very concerned that our airlines should recover as quickly as they can from the problems which have been created for them by the economic recession. Indeed it is because we have confidence in their ability to do so that we believe British Airways will be more successful in the private than in the public sector.

In your letter you speculate about various changes which may be made to pave the way for privatisation. While some re-organisation of British Airways' finances may be necessary, the Government have not yet received nor approved any specific proposals.

You suggest that some re-allocation of routes might be of benefit to British Airways as well as to your own company, and I understand that you have recently given some specific examples to Iain Sproat of route exchanges between your two airlines which you have proposed to Sir John King. I am sure that this is the most constructive and fruitful way for you to proceed, and if you are able to agree on some mutually acceptable proposals to put to the Civil Aviation Authority, I have no

/ doubt



don't they will respond helpfully. John Biffen in his reply to your letter of August 1981 explained why he did not think the Government should initiate such a redistribution, and I am sure you will appreciate that that would be quite contrary to the change which we brought about in the Civil Aviation Act 1980, which made the Authority, rather than the Secretary of State, responsible for policy on route licensing.

Finally may I thank you for your support for our stance in the Falkland Islands dispute, and I am sorry that those events have made life more difficult for you.

Kind very good wish.

Yours sincerely

Raymond Delisle

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Adam Thomson, Esq., C.B.E.

# British Caledonian

Caledonian House  
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RH10 2XA England

Telephone Crawley (0293) 27893  
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From the Chairman's office

27th August, 1982.

The Rt. Hon. Margaret Thatcher, MP,  
Prime Minister,  
10 Downing Street,  
London, SW1.

Dear Prime Minister,

I wrote to you on the 14th August 1981 expressing concern about the British Air Transport industry and making suggestions which I felt could place it on a sound basis for the future. I received an acknowledgement from your office and then a letter from John Biffen on the 30th September 1981, which stated in the last sentence "I do not think that a major reorganisation of the nation's air transport industry is necessary".

Since that time Iain Sproat and John King have been energetically tackling the longstanding problems within British Airways and, if I may say so, obtaining some promising results. The objective of privatising at least part of that airline is still being promised before the next Election. I have no fundamental objection to this, indeed I would like to see complete privatisation rather than part. However, I am concerned lest the consequences of this action on British Caledonian are not fully understood. A massive change in the financial structure and goals of 75% of the U.K. scheduled industry represented by British Airways must, de facto, cause a major reorganisation of U.K. air transport.

1980 was a disastrous year for the airline industry; 1981 was another and in 1982 the hoped for return towards prosperity has not materialised and the industry is in the throes of the worst crisis in its history; no airline is exempt although some, like British Caledonian, are faring better than others. We were estimating a return to profitability this year and, had it not been for the Falklands War, which had a £5M negative effect on our profit, we would still be forecasting a profit

/ .../...

for airlines in emerging countries, which not infrequently break Air Service Agreements; the difficulties with remittance of funds from African countries to cover costs already incurred have recently been raised. Overall we are in a business that is simply more dependent than most on Government policies at home and abroad.

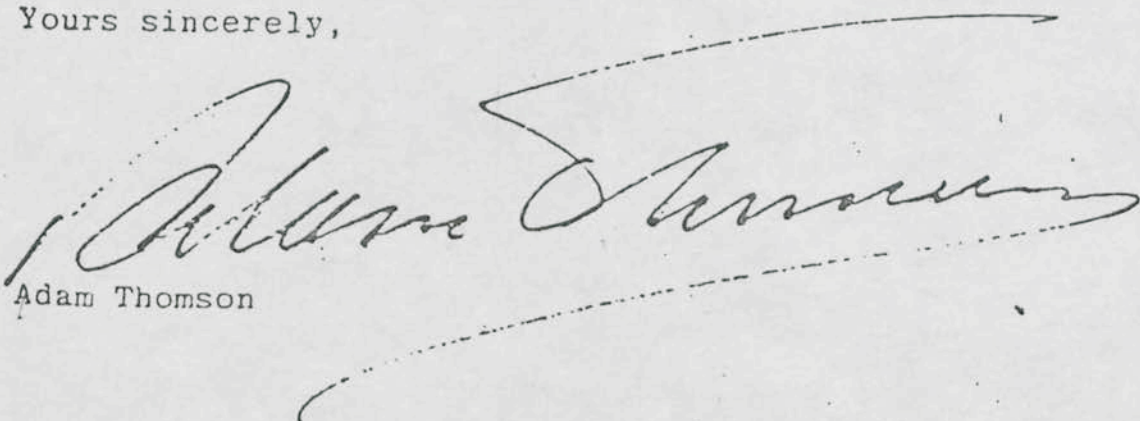
There are a number of actions that can be taken between British Airways and British Caledonian that could result in improvements for both. In the past we have been rebuffed by the British Airways' management when we have put these forward. I have recently put such proposals to Iain Sproat and John King and received much more positive responses and a willingness to give them consideration. I expect serious discussions to take place on this subject during September.

Why then am I writing to you? Simply because the Government's objective appears to be singular - turn British Airways into an efficient, effective operating unit and privatise it. I would like to see British Caledonian's own efforts in creating an international airline, operating to 48 cities in 31 countries, recognised through an objective which is designed to take consideration of our industry crisis. I would suggest that an appropriate strategy would be "encourage the profitable development of the two British international airlines through the privatisation of British Airways and an allocation of routes to both which will allow them to compete effectively in the international market place".

I believe that right now, with the enormous financial difficulties of the U.S. airlines, we have a unique opportunity to lead the world in air transportation and I think it would be ironic indeed if this Government's constructive plans for British Airways excluded consideration of the significant part the existing British wholly private enterprise flag carrier has played in the past and could play in the future. British Caledonian has a good track record and I would suggest deserves better than being excluded from current Government policy.

Certainly I am talking constructively to Iain Sproat and John King and they are being as constructive as they can be under the present policy - but right now it seems to me that they must be severely limited as they are working to a directive which they are determined to fulfil - "Privatise British Airways" - Regardless? Beyond that shouldn't the Government's clear objective be to encourage the development of a strong profitable air transport industry of which the nation can be proud.

Yours sincerely,



Adam Thomson

534-379

DEPARTMENT OF TRADE

1 VICTORIA STREET LONDON SW1H 0ET

Telephone 01-215 7877



SECRETARY  
MR. KENNEDY  
MR. BEAVER  
MR. ROBERTS  
MR. TAYLOR  
(ON FILE)

From the Secretary of State

Adam Thomson Esq CBE  
Chairman  
British Caledonian Airways Ltd  
Caledonian House  
Crawley  
West Sussex  
RH10 2XA

30. September 1981

Dear Mr. Thomson,

You kindly sent me a copy of a letter you had written to the Prime Minister about the reorganisation of the British airline industry. As you say, your letter raised a number of the issues which you put to me during our interesting luncheon on 26 July.

After our discussion I gave considerable thought to the views that you had expressed but at the end of the day I decided that it would be wrong to embark on such a radical reorganisation of our air transport industry. You are no doubt familiar with the Civil Aviation Authority's interim policy statement which they published in November 1979 and with their April 1981 "Statement of Policies". I would agree with the Authority that while there may be scope for what might be called "natural evolution" it would be wrong to set out to build up one airline relative to another as a deliberate act of policy. Arbitrary route transfers in order to achieve structural changes in our aviation industry are not really appropriate.

You may say, of course, that the present position of British Airways is such that some sort of drastic solution involving a major re-distribution of routes is necessary. I would not agree with this point of view. I confidently expect that British Airways efforts to put their house in order will succeed and, while it is always open to other airlines to apply for their routes, I think it would be wrong to force British Airways off any of their routes and give them to other operators.



*From the Secretary of State*

Leaving aside my basic policy objections to what you propose, there are also a number of more detailed difficulties. For example, we would need to give a great deal of thought to the specific routes to be transferred. You say that one airline would be formed around British Caledonian with new routes: but these could only be profitable routes which British Airways would not like to give up, or unprofitable ones - and I doubt whether you would welcome a portfolio made up of unprofitable routes transferred as part of a package deal. It would also be very difficult to transfer assets as a temporary Government investment as you suggest. We would also run into difficulties over our international Air Services Agreements and so on. All in all, although I found your proposals very interesting I do not think it would be a sensible use of our time - or yours - to set up a working group to take the ideas further. I do not think that a major reorganisation of the nation's air transport industry is necessary.

*Yours sincerely*

*John Biffen*

JOHN BIFFEN

RECEIVED IN  
- 3 SEP 1981  
SECRETARY OF STATE FOR  
TRADE'S OFFICE



*Mr. Hodgson  
for case files &  
also to general file  
SIC*

10 DOWNING STREET

THE PRIME MINISTER

2 September 1981

*Mr. Clavin*

*Mr. Tymon*  
CAP  
Mr. Blanks CAP  
Mr. Roberts CAP  
S. & P. see case

*Dear Mr. Thomson.*

Thank you for your letter of 14 August, giving me your interesting ideas for a major reorganisation of the United Kingdom air transport industry.

As you acknowledge yourself, what you are suggesting is a very significant shift in policy. While I recognise that the industry, worldwide, is facing a difficult operating environment, I am not at all sure that such a fundamental restructuring of the United Kingdom industry is necessary. However, I am asking the Secretary of State for Trade to make a detailed examination of your proposals and let you have a full reply.

*Yours sincerely  
Margaret Thatcher*

Adam Thomson, Esq., C.B.E.

# British Caledonian

Caledonian House  
Crawley West Sussex  
RH10 2XA England

Telephone: Crawley (0293) 27890  
Cables: Scotair Gatwick Telex: 87161

From the Chairman's office

14th August, 1981.

RIS

The Rt. Hon. Mrs. Margaret Thatcher, MP,  
Prime Minister,  
10 Downing Street,  
London, SW1.

Dear Prime Minister,

I write to express the concern of all of us in the British air transport industry, at the present situation and to express a view on what might be done with some urgency to place it upon a sound basis for the future.

There is no doubt that 1980 was, financially, the worst year in the history of air transport - and 1981 does not promise much better. British Caledonian is not immune to the crisis within the industry, and unlike last year, we do not expect to make a profit in the current year. Our problems are, however, of a short term nature and we expect recovery in 1982. British Airways' difficulties appear to us to be much more intractable because they are rooted in structural definitions. While fundamental changes appear warranted, they also present opportunities which - wisely promoted - could achieve an industry structure which would substantially improve its economic results and its effectiveness in world markets.

In spite of the report of the Edwards Committee in February 1969, which led to the formation of British Caledonian Airways Ltd in 1970, the industry has been dominated by nationalised airlines - for forty years. - Today, British Airways, with its 100% State ownership, is seven times the size of British Caledonian, the British private enterprise airline which operates the most extensive network of scheduled services in the Private Sector. Altering this ratio has presented problems, as any British Caledonian proposed expansion impinges on the very extensive British Airways' route network.

As we see things, the paramount requirements are, undoubtedly, first, the elimination of the internal circumstances which have led to British Airways' substantial losses and secondly, the setting up of a structure for the industry which will both ensure its sound and profitable development in the future and create a climate for the ready injection of private capital to replace State funds. Such a policy must, I suggest, start from a re-balancing of the route networks - with their profitable and not-so-profitable elements - at present so predominantly apportioned to British Airways which, for the requirements of efficient management is too big (and over manned), whereas the rest of the industry is too small and constricted.

One promising approach might be for British air routes to be re-allocated so as to form strong British airlines. One would be British Airways, restructured into manageable and viable operating units based on a nucleus of its present worthwhile routes. Another would be formed around British Caledonian with new routes, increased private capital and making use of surplus assets transferred from British Airways as a temporary Government investment. Between them these two airlines already fly the majority of British flag routes but in addition there would be specialist operators such as those involved in domestic services or inclusive tours or, as in the case of Laker, mainly low-fare services over dense North Atlantic routes.

There are a number of ways in which such an approach could be developed. To achieve this we would like to propose that you should consider setting up a rapid and effective working group to assess the potentials which, with the right people allocated to the job, could be completed in - say - three months from the start - two for studying the various options and one for assessing their merits and reaching a conclusion.

We in British Caledonian, with our track record of profitable operations in highly competitive international markets, are ready to participate and to produce a detailed memorandum on this subject, should you wish. We shall, of course, be glad to submit it to the Secretary of State for Trade, Mr. John Biffen - to whom I am sending a copy of this letter.

Our whole objective is to see a strong and healthy British air transport industry formed out of the present unsatisfactory situation in which one, loss-making nationalised component, dominates the scene. This can be seen as an opportunity to be achieved by:

- a) Urgently restructuring British Airways into leaner and more efficient units which would be attractive to private investment.
- b) Adjusting routes as part of the process of restructure.

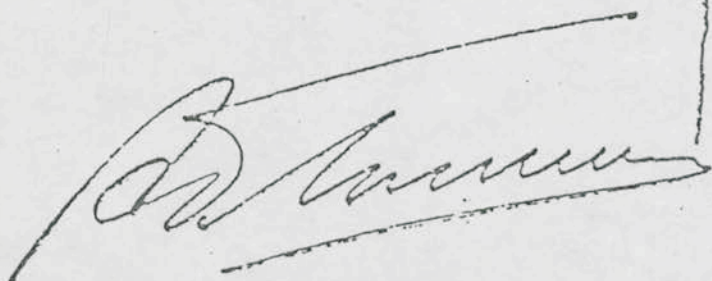


c) Diminishing HMG's investment in British Airways through a transfer of surplus assets which would constitute a minority and temporary shareholding in British Caledonian until private capital could take over the investment.

The opportunities are great. The rewards for Britain and British overseas trade, substantial. The knowledge and experience exists and a great deal of private capital will be ready to invest in a soundly structured solution.

If you will take the initiative we propose, I am sure that, though the situation is complex, a solution can be found which will place the industry in a commanding position for years to come.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'Adam Thomson', is written over a horizontal line. The signature is fluid and cursive, with a long horizontal stroke at the end.

Adam Thomson

done  
DMS  
3/17  
OK  
put in diary.

ROBIN

Sir Adam Thomson is seeing the Prime Minister at 9.30 tomorrow morning. His Secretary telephoned to ask if it would be in order for him to bring Sir Peter Masefield, Deputy Chairman of the Caledonian Aviation Group.

I said someone would be in touch with her -  
930-5746

Angela  
4.40 pm



CC/NO  
DEPARTMENT OF TRANSPORT  
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

Andrew Turnbull Esq  
Private Secretary  
10 Downing Street  
LONDON SW1

26 July 1984

Dear Andrew,

CAA REVIEW - BRITISH CALEDONIAN

Thank you for your letter of 20 July about Sir Adam Thomson's request for a meeting. If the Prime Minister were to see Sir Adam Thomson at this stage, she would need to be advised to do no more than listen. In fact Sir Adam Thomson has asked to see my Secretary of State and a meeting has been fixed for Thursday afternoon. Mr Ridley therefore suggests that the Prime Minister should not see Sir Adam Thomson, at least for the time being.

I am copying this letter to David Peretz (HM Treasury).

Yours,

*Dunich*

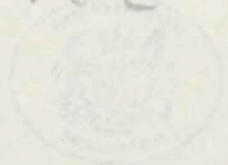
MISS D A NICHOLS  
Private Secretary

AEROSPACE &

CAA Review &

R-2

DEPARTMENT OF TRANSPORT  
11, ABINGDON STREET, LONDON SW10 3AP



Director General  
Civil Aviation  
11, ABINGDON STREET  
LONDON SW10 3AP

Dear Sir,  
I am writing to you in regard to the...  
of the...  
I am writing to you in regard to the...  
of the...  
I am writing to you in regard to the...  
of the...

Yours faithfully,  
(Signature)

11, ABINGDON STREET  
LONDON SW10 3AP