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P.01367

PRIME MINISTER

Civil Aviation Authority Review

(C(84)21)

BACKGROUND

The Civil Aviation Authority (CAA) was invited by the Secretary of State for Transport to review the implications of the privatisation of British Airways (BA) for competition and the sound development of the British airline industry. The report of the CAA in response to that invitation was published on 16 July. Its main recommendations were as follows.

- i. Relinquishment by BA of scheduled service routes out of Manchester and Birmingham to a wide variety of destinations in Western Europe; between Glasgow and Paris; between Heathrow and Saudi Arabia and between Heathrow and Harare; and between Gatwick and points in Spain, Portugal, Gibraltar, Italy and Scandinavia. Apart from the Manchester and Birmingham routes which would pass to the smaller airlines, the routes concerned would be likely to be awarded by the CAA to British Caledonian (B.Cal).
- ii. A number of measures to increase competition in the British airline industry.
- iii. A strengthening of the CAA's own powers, notably to give the CAA a direct statutory duty to secure the sound development of the British airline industry, for example by suitable use of its licensing powers.
- iv. Relief of capacity constraints at Heathrow and Gatwick.

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2. The Ministerial Sub-Committee on Economic Affairs (E(A)) has already approved the recommendations at (ii) and agreed that the recommendation at (iv) should be rejected because the Government already has a clear policy regarding air traffic movements at Heathrow and Gatwick (and is about to issue a consultative document on the subject). E(A) expressed some scepticism about the recommendation at (iii) (E(A)(84)19th Meeting, Item 3).

Flag A

3. The most difficult recommendations are the proposed route transfers covered by (i). A majority of E(A) favoured rejecting the recommendations. However, when the conclusions of E(A) were reported to them on 19 July the Cabinet agreed that the best solution would be a compromise which would provide for an agreed transfer of routes from BA to B.Cal; the Secretary of State for Transport and the Chancellor of the Exchequer were invited to discuss a compromise, which would not require primary legislation, with the Chairmen of the two airlines (CC(84)27th Conclusions, Minute 1). On 26 July the Secretary of State for Transport reported that he and the Chancellor, after discussions with the two Chairmen, had concluded that no compromise transfer could be agreed. The Cabinet invited him to circulate a memorandum setting out the issues for decision (CC(84)28th Conclusions, Minute 1).

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4. The memorandum by the Secretary of State for Transport (C(84)21) answers this invitation. It puts forward (paragraphs 15 and 16) two options for consideration:

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(i) rejection of the route transfers suggested by the CAA; or

(ii) insistence on the transfer of sufficient routes to strengthen B.Cal's position: a possible package would be BA's most profitable routes out of Gatwick (to Madrid, Lisbon, Barcelona and Bilbao), plus the Harare route from Heathrow.



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Mr Ridley also recommends endorsement of the CAA's proposals for increased competition, but rejection of the proposal that the CAA should be given extended powers to reallocate routes (see paragraphs 1(ii) and (iii) above). The Government's decisions should be announced without delay in order to resolve uncertainty in the industry.

MAIN ISSUES

5. The main issues before the Cabinet are as follows.
 - i. What should be done about the route transfers recommended by the CAA?
 - ii. What should be the Government's response to the CAA's other recommendations?
 - iii. When should the Government's decisions be announced?

Route transfers

6. There are three issues:
 - a. should there be any route transfers at all?
 - b. if there are, what routes should be transferred?
 - c. how is it to be done - by legislation, by the Government's powers as sole shareholder, or by persuasion?
7. On a., the Cabinet are already familiar with the main arguments. We do not want to harm the prospects of privatising BA. Equally we want a viable B.Cal. Although it is unlikely that B.Cal could ever be a major contender in the world airline market like BA, it is useful to have more than one UK airline on those routes profitable enough to support two UK carriers. For B.Cal to compete effectively



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it needs to be the sole UK carrier on some profitable routes. It must be admitted that B.Cal's existing international routes are not intrinsically very profitable, especially bearing in mind the problems now being encountered in Nigeria. Collapse of B.Cal would be embarrassing, especially since it is the only UK operator of the Airbus A 310 and is a launch customer for the new A320. If we can strengthen B.Cal without seriously harming BA and the prospects for privatisation, it would be helpful both on political grounds and in the interests of UK civil aviation.

8. Mr Ridley suggests that a more modest transfer of routes than that proposed by the CAA might meet this requirement. BA would keep the Heathrow to Saudi Arabia routes (worth £30 million a year) and the Manchester and Birmingham services. It would lose some profitable Iberian routes from Gatwick (worth £3 million a year) and the Heathrow-Harare route (worth £7 million a year). BA's annual profits would be reduced from £280 million to £270 million; B.Cal's would be increased from £18 million to £28 million. This ought not to harm BA significantly or to prejudice a successful privatisation. But is it good enough, both politically and in substance, for B.Cal?

9. On the method of effecting such a transfer, Mr Ridley is not entirely clear. His soundings have established that Lord King is resolutely opposed to a voluntary transfer but in paragraph 16 he talks of persuading the two parties BA and B.Cal to accept the compromise. If persuasion is not possible, should the Government nevertheless go ahead with a limited transfer? Since the Cabinet on 26 July were not disposed to favour legislation (which would undoubtedly delay privatisation), this leaves the Government's use of its powers as sole shareholder. What would be the attitude of Lord King and the BA Board to such action? Is there a legal problem (see letter of 1 August from the Law Officers' Department)? The Attorney General is being invited for this item to give his views on this point.

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Other CAA recommendations

10. It is not strictly necessary for the Cabinet to go over matters already decided by E(A). However, it seems unlikely that the Cabinet will disagree with the proposal to approve the CAA's recommendations to increase competition and to reject their proposals for additional powers for themselves.

Announcements

11. There are strong arguments in favour of an early announcement of the Government's decisions. You will no doubt wish to invite the Secretary of State for Transport to circulate a draft.

HANDLING

12. You will wish to invite the Secretary of State for Transport to open the discussion. The Chancellor of the Exchequer will wish to comment, both because of his responsibility for the privatisation programme and because he has been associated with the discussions with the Chairmen of BA and B.Cal. The Secretary of State for Trade and Industry will wish to comment because of his responsibilities for competition policy and from his previous experience. The Secretary of State for Scotland has an interest because of B.Cal's Scottish connections.

CONCLUSIONS

13. You will wish the Cabinet to reach conclusions on the following:
- i. Should the Government seek to arrange route transfers from BA to B.Cal?
 - ii. If so:
 - a. what routes should be transferred?
(ie the CAA proposals or the smaller package in C(84)21)



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b. how should the transfer be achieved?
(ie only if it can be done by persuasion?
or should it be imposed on BA and, if so,
how?)

iii. Should the Government reject the CAA's suggestion that
it should be given greater powers to transfer routes in the
interests of the structure of the British ariline industry?

iii. How should the Government's decisions be announced?

PLG

P L GREGSON

1 August 1984

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