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From the Private Secretary

1 August 1984

CAA REVIEW: BRITISH CALEDONIAN

Sir Adam Thomson came to see the Prime Minister today to put B Cal's case on the CAA Review. He was accompanied by his deputy chairman, Sir Peter Masefield. Your Secretary of State was also present.

Sir Adam said he had four major points to make. First, B Cal did not seek to undermine British Airways or to obstruct privatisation. If the CAA recommendations were implemented, BA would still have 70 per cent of the market. He did not believe implementation of the recommendations need delay privatisation by 3-4 years as claimed, nor need it reduce the sale proceeds as B Cal would be prepared to buy equipment from BA to service the routes transferred. Secondly, BA was at present effectively a public sector monopoly which it would be wrong to turn into a private sector monopoly. Thirdly, B Cal strongly supported the thrust of the review in favour of greater freedom and competition. Finally, it was essential to establish a better balance within the private sector.

Sir Adam said that BA and B Cal had always operated within a framework set by the Government; indeed B Cal had come into existence as a result of the Government's wish to see a strong second force. While BA operated effectively under Government supervision there was a limit to any predatory behaviour, but as a private company it would have

a duty to its shareholders to compete as hard as it could. It had a number of major advantages, eg some very profitable routes and a better airport to operate from. In areas where BA and B Cal competed head to head, a tiny diversion of BAs turnover, eg into travel agents' commissions, could rob B Cal of its markets.

Sir Adam said B Cal had originally recommended to the CAA that BAs market share be reduced from 80 per cent to 60 per cent, B Cal's share increased from 15 per cent to 30 per cent and the independent share be increased from 2 per cent to 10 per cent. The CAA was recommending a smaller adjustment which would reduce BAs share to 70 per cent. This would leave B Cal as a strong viable airline and was therefore acceptable to it. The recommendations would increase from 10 per cent to 30 per cent the areas of the market where BA and B Cal competed head to head, giving an extra 70 million passengers a choice. There would be no need for any redundancies as B Cal would be prepared to take on staff on similar terms and conditions. BA would be prepared to buy aircraft worth \$165 million which would be useful to BA in reducing its debt.

The Prime Minister commented that B Cal's balance sheet was weak, being very highly geared. In addition very large sums were owed from abroad, for which there were difficulties in securing remittance. She asked Sir Adam how B Cal would manage if the status quo were maintained. Sir Adam said this would present no problem for B Cal. It had firm plans to raise an additional £30 million capital. If the CAA recommendations were not acted upon, it would be difficult to raise even this amount as B Cal would be under attack from BAs aggressive marketing. If, however, the CAA recommendations were acted upon, it would be possible to raise even larger sums. He would seek an additional £75 million of capital plus additional loans for the

purchase of aircraft. This extra capital, in conjunction with the improvement in route structure and profits would allow B Cal to reduce its gearing from its present 211 which though very high was not unusual for airlines.

The Prime Minister asked what B Cal would do if the CAA recommendations were not accepted. Sir Adam said that competition from BA would probably force B Cal into a period of retrenchment; far from improving competition in the industry it would weaken it. B Cal would apply to operate from Heathrow which could improve its profits by £30 million. (Your Secretary of State said there was no realistic prospect of this). The final option, which was not one he recommended, was for BA and B Cal to merge. This would leave the UK with one very large airline, representing a reversal of the policy towards more competition.

Sir Adam acknowledged that in the recent Debate in the House B Cal had been outgunned by the lobbying of BA. It was also unfortunate that not many B Cal supporters had been called to speak. He remained confident because there was substantial backbench support and he had now sent a letter to all MPs setting out B Cal's position.

Summing up, Sir Adam said the industry was at a crossroads. Either the industry would move towards total domination by one airline or the opportunity would be taken to achieve a better balance, with two major well-based airlines.

The Prime Minister thanked Sir Adam for presenting his case with such care. She asked him to ensure that she received a copy of the letter B Cal had sent to all MPs.

I am copying this letter to David Peretz (H M Treasury), Callum McCarthy (Department of Trade and Industry), David Morris (Lord Privy Seal's Office) and Murdo McLean (Chief Whip's Office).

ANDREW TURNBULL

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