

British Midland Airways Ltd

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Your Ref:

Our Ref: MDB/RAM

August 29, 1984

Rt. Hon. Margaret Thatcher, M.P.,
10 Downing Street,
London, S.W. 1.

Dear Prime Minister,

I am writing personally to you as the controlling shareholder of the largest privately owned U.K. airline group comprising three airlines; British Midland, Manx Airlines and Loganair. Together they fly from 28 airports in the British Isles, carry 2 million passengers a year, operate 40 aircraft, employ 2,000 staff and generate revenues of more than £100M per annum. British Midland Airways is the second busiest airline operating at Heathrow with more than 500 arrivals and departures each week.

I wish to express how threatened and vulnerable I consider our future prospects if satisfactory decisions are not reached by your Government following receipt of the Civil Aviation Authority's Policy Review.

My partners and I have during the past six years put into practice your philosophy of self sufficiency and enterprise by accepting a total personal financial commitment by acquiring our company through a management buy out in 1978. We did so in the anticipation that a Conservative Government, when elected, would support as a priority those individuals who were prepared to stake all they possessed in order to become owners of their own business.





I feel sure you will agree that this commitment of your Government to private sector investors taking such risks is of far greater long term importance than the short term consideration of satisfying the Board of British Airways whose members have, at the present time, no personal financial stake in their company.

I hope you will feel that since my company has been the pioneer of creating competition to British Airways at Heathrow on U.K. domestic trunk routes, it entitles me to now alert you to vitally important issues which arise from the C.A.A. Report. I ask you to ensure that the need to carry out a financially satisfactory de-nationalisation of British Airways, within the proposed timetable, is not concluded at the expense of endangering the viability of our business and achievements to date.

There is a grave danger that the Government may be forced to accept the arguments advanced by the Board of British Airways, coupled with their supporting media advertising and other lobby pressures, and so take a wrong decision in rejecting, or making substantial amendments, to the recommendations of the C.A.A. Report.

The Appendix to this letter details our specific views which, I believe, are of crucial importance in arriving at the right decisions.

Whilst a failure of the British Airways' arguments to influence the final decision would be a set-back, the consequences for us in failing to convince you of the essential issues at stake will have the most far-reaching effects and lead to a major curtailment of our activities together with a large layoff of staff. More damaging, private airlines may soon be faced with an acute credibility problem with their Bankers and Finance Houses who are likely to adopt an exceptionally cautious approach to airlines whose prospects for growth are so seriously stunted.

We have shown that we are prepared to compete, neither do we seek to merely transfer a route monopoly from the public to the private sector. Whilst we share the view of British Caledonian that the C.A.A. Report perceptively identifies the problem of providing effective airline competition and gives a lucid analysis of difficulties in implementation I must make it clear to you that we have never supported the British Caledonian case to acquire assets from British Airways.



However it may have been overlooked that to achieve the goal of having a competition policy in the airline industry there is initially the need to permit the development of sufficient soundly based airlines. They need satisfactory route networks creating adequate profits so that the scale of financial resources needed to launch new competing air services can be accumulated.

Unless this first stage is supported and the recommendations of the C.A.A. Report, particularly in respect of European air services from provincial airports and our own submission to compete with British Airways from Heathrow on international services, carried out - there is likely to remain a situation where the present dominant single airline style is perpetuated and increased instead of creating effective competing airlines.

My companies are now suffering severe predatory action from British Airways which has nothing to do with achieving improved competition between the airlines but is specifically directed towards our demise.

Furthermore, as a private sector company, our future is being determined, or significantly influenced, by no less than four elements of State patronage - the Civil Aviation Authority, the British Airports Authority, British Airways as a nationalised industry and the Department of Transport.

For a Government determined to create opportunities for individual effort free of excessive state influence, you will understand the real fear that our survival is in jeopardy through failing to get a fair and unbiased hearing of our views.

There is always a temptation for Government to compromise for short term expediencies. Resisting these temptations has been the hallmark of your Administration. However past support and subsidies both in the Railways and Coal Industry which may have appeared attractive at the time have, perhaps, in the final analysis not accelerated the targets which the Government has set itself in achieving lasting improvements of efficiency in these industries. A similar difficulty could develop in the air transport industry if decisive action is not taken now.



This is not a complaining letter neither do I seek any advantage from your Government in our future trading opportunities other than to ensure that British Airways is not sustained in a preferred and privileged position in the U.K. air transport industry.

I believe arrangements are in hand for me to meet you at an early date. I look forward to this as it will enable me to amplify some of the arguments in this letter and its Appendix and explain my approach to an equitable solution.

Yours sincerely
Michael Bishop.

Michael Bishop,
Chairman and Managing Director.

Rt. Hon. Margaret Thatcher, M.P.

APPENDIX
to letter 29.8.84.

1. Competition of British Airways with other Airlines and particularly its role at Heathrow

It is clear to us that the Government must take decisive action to ensure that British Airways in whatever form it is de-nationalised is not in a position to seriously undermine the activities of the gradually developing competing airlines.

The best qualified body to undertake the role of licencing and monitoring an expansion of competition is the Civil Aviation Authority. Rather than relegate its influence and powers - they should be augmented in the short term to ensure a satisfactory transition as new competition policies are implemented.

Whilst we wholeheartedly support the Government plans for bringing as many nationalised industries as possible to the Stock Market, including British Airways, we question whether enough thought and preparation has been given to the problem so familiar in the United States where effective Anti-trust legislation is needed to ensure that large dominant companies do not exercise anti-competitive practices in the market place.

I believe it is important for us to know how the Government proposes to deal with this very urgent problem.

More important, unless British Airways has competition from other British airlines on European and Intercontinental routes at its main base of operations at Heathrow the objectives of the Government in implementing its policies for airline competition cannot be realised.

This is best illustrated when in 1982, after three applications to operate competing services to Glasgow, Edinburgh and Belfast had been refused by the C.A.A., Lord Cockfield, then Secretary of State for Trade and Industry, farsightedly upheld our Appeal. This was the first time ever that another British airline had been permitted to compete with British Airways on any route out of Heathrow.

I outlined some of the problems we were facing, prior to this important decision allowing us to compete, in my last letter to you on April 1, 1982. Since inaugurating these services we have, by general consent, transformed the standards offered

to customers using these routes. We introduced a meal service and reduced fares. More significantly we provided the catalyst for forcing British Airways to improve its own product. Our presence on the routes, combined with the efforts of the new management at British Airways galvanised their staff in understanding the realities of competition. The combination of our new services and the later reaction by British Airways in introducing Super Shuttle resulted in a very substantial increase in total traffic on the routes as we had always forecast. We remain the only British airline providing exactly parallel competition at Heathrow to British Airways.

The Government can act positively to promote real competition by allowing my company and other British airlines currently using Heathrow to operate domestic routes, to now extend their operations to permit competition with British Airways on European and Intercontinental routes.

The Civil Aviation Authority has remained silent in its report on our request to give British Airways the same competition on international routes to complement our pioneering work on domestic route competition.

At the moment British Airways alone is the sole British airline operator of intercontinental and European scheduled services from Heathrow. They carry approximately 40 per cent of the traffic from Heathrow while nearly 60 per cent of the passenger business is carried by overseas airlines. It is quite wrong, in our view, that this situation has been allowed to develop and we criticise the C.A.A. for not acting before now.

It is claimed that British Airways competes with numerous international airlines from Heathrow. This mis-states the position. In the case of many highly profitable services to European capital cities British Airways "collaborates" not "competes" with reciprocal state airlines. They enter into profit sharing pool agreements and other anti-competitive practices which fly in the face of the Government's declared aim to promote competition and reduce fares. These arrangements are among the least attractive features of prevailing airline monopolies within the E.E.C. Indeed the C.A.A. have stated in their report (CAP500 page 5 para. 21) that if they were the sole regulatory authority they would prohibit these agreements as they are anti-competitive and create excessive profits.

It will be said that present Government airport policy does not permit the development of competing British airlines at Heathrow. If that is the case I ask you to change the policy. A minor amendment only is required to permit this essential element of promoting airline competition. There are sufficient existing British airlines now operating

domestic routes from Heathrow to allow competition on international routes to be started. We believe the reaction of overseas airlines to a change in the airport policy, only affecting current operators, would not be as hostile as officials at the C.A.A. and Department of Transport predict. Such a change in policy would not permit for example any major airline now based at Gatwick to transfer its routes to Heathrow but would allow the expansion of British airlines already operating there.

Heathrow is not as congested as the British Airports Authority has indicated. The C.A.A has identified the practicality of creating, subject to environmental considerations, a further 55,000 air transport movements per annum at Heathrow within the capability of existing Air Traffic Control procedures. We have proved from our competition on the domestic trunk routes that space can be provided for additional services through applying improved working practices and greater efficiency in the use of existing resources. In consideration of environmental issues it cannot be stated too clearly that the airline industry has invested hundreds of millions of pounds in greatly reducing aircraft noise. The noise contour for some of our newest aircraft does not extend beyond the perimeter of the airport itself and we believe operators are entitled to a dividend from this investment by being permitted to use airports with such commercial value as Heathrow to the maximum of their capacity.

2. Route Transfers from British Airways to other U.K. Scheduled Airlines

Route transfers are appropriate where it can be demonstrated that another airline can operate low volume or marginally profitable routes more successfully than the incumbent airline. These transfers have two benefits; they relieve British Airways of the need to invest resources at a low rate of return and thus enhance their own profitability. Similarly they offer smaller airlines the prospect of operating these routes profitably because their size and scale including lower unit costs create a more cost effective operation.

We have proved on previous occasions that this process permits improved consumer benefits both in terms of increasing the frequency of flights and lowering fares.

It is argued this process does not advance competition but in many cases there is insufficient traffic for more than one operator. There is a great danger in attempting to deregulate and liberalise air routes from the bottom upwards. The process has to start at the top with the high volume routes where profits can be generated by more than one carrier, as in the example of the U.K domestic trunk routes which are amongst the highest volume services in Europe.

British Airways have co-operated with us frequently in the past and achieved highly successful route transfers which have greatly enhanced their profitability. Their motives for not being prepared to do so on this occasion would appear to have little to do with their present or future financial performance but rather with specific commitments made to their staff to ensure a smooth transition for de-nationalisation.

It has been represented that any reduction in the size and shape of British Airways would have a calamitous effect on the price the Government realised from the sale of the company. This again is a distortion. There can be no doubt that if British Airways did not operate the majority of their domestic routes and the European services from provincial airports the profitability of British Airways as a whole would rise rather than fall.

Two outstanding examples of route transfers within the past six years well illustrate this point. In 1978 we took over all British Airways' routes at Liverpool where we understand they were losing more than £1M a year. Our investment in Merseyside now exceeds £5M. I would be surprised if any other private company in Britain has contributed more, pro-rata to its size, than my company has to Merseyside.

Since assuming the operation of these routes Liverpool has suffered its sharpest ever economic decline and we have had to constantly adapt our operation to remain viable. Yet we have never abandoned the target of making these routes profitable.

In spite of considerable political provocation and uncertainty concerning the future of Speke Airport, we have persevered towards our targets. Recently the airport was closed by Merseyside County Council for a day, with the Airport Committee Chairman posted on the picket line, costing us more than £10,000 in lost revenue. The reason for the airport closure was a protest against the Government's action in trying to restore sanity to the City administration.

We have finally turned the corner into profitability on these routes. In contrast to the performance of the Merseyside County Council, the cost to public funds for our efforts and achievements in Liverpool has been nil.

It is therefore regrettable that British Airways should enlist the active participation of two Metropolitan County Councils with similar political sympathies - Manchester and Birmingham - to block the recommended transfer of routes from those airports. Together they are adopting a tactic of deliberately introducing political issues which have no relevance to the recommendations of the C.A.A. Report but are designed to give the Metropolitan County Councils further ammunition to thwart Government policies when determining future airport ownership policies.

This has taken the form of a liaison between British Airways, its Trades Unions and their affiliated Members of Parliament.

At Birmingham, where we have declared an interest in adopting the C.A.A. recommendations, British Airways is using the liaison described above in an attempt to obtain support for retaining its remaining nine routes. British Airways has already abandoned seven routes from Birmingham during the past six years having failed to make them profitable.

In the case of one particular route, Birmingham/Brussels, this service was pioneered by British Midland in 1972 and was profitable. In 1978 we exchanged the route with British Airways for the Liverpool operations. Within four years the British Airways operation of the Birmingham/Brussels service was losing money heavily and the route abandoned. British Midland then restarted the service a second time and have subsequently restored profitability. This kind of record at Birmingham hardly qualifies British Airways to be retained as a suitable operator of domestic and international services from that and other provincial airports.

It is our firm understanding that, in order to achieve a substantial reduction in staff numbers, specific undertakings have been given to the British Airways Trades Unions guaranteeing no further redundancies or reduction in operations before de-nationalisation regardless of whether or not the routes concerned are really profitable and irrespective of if they have any long-term viability for the airline once it is in the private sector.

The relationship between the Trades Unions and British Airways is not a matter with which we can be concerned. However, it is quite improper that these undertakings, if given, should now be used as a pistol to the head either of the Government or the C.A.A. in an attempt to frame the outcome of the C.A.A. Review in favour of British Airways.

It appears that British Airways is prepared, in order to avoid further network cuts or route transfers to operate its entire domestic network, including the Shuttle, and practically all its European services from Manchester, Birmingham and Gatwick at such wafer thin profit margins that if the results from these activities were to be representative of the financial performance of British Airways as a whole - there would be little prospect for a successful Stock Market flotation.

You will, therefore, understand our great reluctance to be used once again as a back up facility in the event of the routes, after de-nationalisation, failing to produce acceptable returns for the new shareholders of British Airways.

If the existing independent airlines are to have a place in creating airline competition we cannot be expected always to be held waiting in the wings to be used as a stick to prod British Airways into competitive action as in the case of the U.K. domestic trunk routes, or to rescue faltering routes when it is convenient.

It has been said that a commitment was made by Sir John Nott in Parliament on November 19, 1979 that British Airways would be de-nationalised with its present route network intact. Furthermore this alleged commitment has been used as leverage to be dismissive towards the recommendations of the C.A.A. Report in respect of some route transfers and personal criticism has been made of the C.A.A. Chairman for his attempt to explain in public the Authority's judgement.

We believe the truth of the matter to be different. We are sure that Sir John Nott intended in his remarks to indicate that the Board of British Airways had freedom to run and shape their business as they wished and, when ready, whatever size the airline was at that time - it would be brought to the Stock Market as one unit and not be sold off in parts.

3. Predatory Action against us by British Airways

There is already adequate evidence of predatory practices by British Airways against us even before it is de-nationalised. A company, other than a nationalised industry, could never achieve the dominant market situation now enjoyed by British Airways without coming into conflict, during its development to that position, with the Monopolies and Mergers Commission or the provisions of the Competition Act. Every effort is being made by British Airways to sustain this preferred position after de-nationalisation.

The excess profits generated by the British Airways' monopoly of international services from Heathrow in collaboration with foreign airlines are used to sustain the highly marginal U.K. domestic route operation and other low volume services. It is this cushion of profitability which enables British Airways to take severe predatory action against our company.

This predatory action has taken a number of specific forms:

A) Domestic Trunk Routes.

1. Fares have been frozen on all U.K. domestic services for two years. Conversely basic European and Intercontinental fares have risen with inflation.

2. A large increase in route capacity on the trunk services has been operated in an attempt to drive down, though so far unsuccessfully, our market share to a point where it would be uneconomic for us to compete.

The resulting "profit" from British Airways' domestic operations is so miniscule it must be very doubtful if the new shareholders of British Airways would regard such a return adequate for the effort employed.

We assume that after de-nationalisation, and having reached a certain threshold of profitability to secure a successful flotation, the private investors and institutional shareholders will need to see a progressively increasing profit performance from British Airways. It seems to us that the present cross-subsidisation will have to cease and we therefore assume that the present willingness to accept very slim profitability stems from an attempt to curtail our own operations.

B) North Atlantic Scheduled Service Route Applications from Provincial Airports.

We applied to restore the Manchester/Glasgow-New York service, it having lapsed since being abandoned by British Airways in 1981. Although British Airways subsequently stated they had made a decision to re-start part of this route in 1985 their public announcement was delayed until the day before our licence application was heard by the C.A.A. This tactic was both irresponsible and unreasonable and compounds the difficulties for companies like British Midland to make application to restore lapsed routes.

As a result of various licencing manoeuvres, now the subject of an Appeal by us to the Secretary of State for Transport, British Airways have retained a licence to fly from Manchester to New York but have been unwilling to restore the lapsed service from Glasgow. Consequently by denying us the opportunity to operate successfully from Manchester they have denied the prospect of the route being restarted from Glasgow since the combination of the two airports was a vital factor in sustaining the revived route on a year-round basis.

C) Heathrow/Belfast Trunk Route Application.

When the Civil Aviation Authority finally granted us permission to operate this route in July 1983 - British Airways chose to challenge this decision in the High Court. This action hardly squares up with an airline that has made its strongest public statement in dismissing the C.A.A. Report in claiming that it welcomes competition.

Directly as a result of this action the introduction of the route was delayed by some six months with the consequential deferment of consumer benefits on this service and large additional legal costs which we had to meet.

You will understand how damaging this action has been in Northern Ireland for British Midland since we have sustained scheduled air services from the Province throughout the current difficulties. Furthermore we were the first airline whose aircrew agreed to stay overnight in Belfast whilst other

airlines had to ferry their staff back to other parts of Britain for overnight accommodation.

We have further supported the economy of Northern Ireland in a practical way through being the largest U.K. operator of Shorts SD360 prop-jet aircraft which are built in Belfast. Our Group has invested £14million in this type of aircraft and currently operates six units. As in the case of our Liverpool operations we have made no call on Government funds or subsidy in making our commercial decision to support Northern Ireland industry.

M. BISHOP



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Act 31/8

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For Wednesday meeting

12/9

10 DOWNING STREET

From the Private Secretary

31 August, 1984

I enclose a copy of a letter the Prime Minister has received from Mr. M. Bishop, Chairman and Managing Director of British Midland Airways Limited.

I should be grateful if you could let me have a draft reply for the Prime Minister's signature by Friday, 14 September.

(Timothy Flesher)

A. Melville, Esq.,
Department of Transport.

JK