

British airways

British Airways Plc, Cleveland House, St. James's Square, London SW1Y 4LN
Telephone: 01-930 9766

Lord King of Wartnaby
Chairman

CONFIDENTIAL

The Rt Hon Nicholas Ridley MP
Secretary of State for Transport
2 Marsham Street
London SW1

26 September 1984

Dear Nicholas

I think that we have now between us explored all avenues and examined every plan that can be produced to find a satisfactory settlement on the future of Airline Competition Policy.

The objective throughout our discussions has been to find a solution which allows further competition within British Civil Aviation, helps British Caledonian compete with us on more routes, and helps the healthy growth of the smaller British independent airlines. We have been at pains to honour the commitments that were made to our staff and to ensure that the privatisation programme proceeds on time.

BA Position on BCAL

Following the meeting on Monday evening, 24th September between your officials, led by David Holmes, and Colin Marshall and Gordon Dunlop, I am writing to confirm a package of route exchanges which I can recommend to my Board.

This route exchange which is set out on Attachment 'A' should be read in conjunction with this letter and represents the minimum we could accept from BCAL in return for our licences to Saudi Arabia. We would give up 12 departures per week from London and would receive 9 per week in return.

The adverse effects on BA will be to reduce current annualised pre-tax profits by around £20m and the corresponding effect on BCAL, we estimate, is to increase their profits by £17m. We will require to spend about £50m on additional equipment but we estimate BCAL will not require any more equipment.

If my Board agree to this, the benefit to BCAL, whose current pre-tax profits are estimated to be around £10m, will be substantial - at the expense of BA, and therefore its owners.

BA Position on the Rest

We are in the course of reaching a commercial agreement with BMA. We believe your fears about "predatory pricing" in the charter market are unfounded. This was accepted by Thomson/Britannia during a recent discussion with their Chief Executive. We believe there is already adequate machinery in the CAA and in the Office of Fair Trading to regulate such practices; added to which we have no intention of indulging in practices that could be seen to be "predatory" or embarrassing to the Government. As regards the other independents, our previous offer of financial help remains available to enable them to start up new or competing routes to Europe out of any of our UK regional airports at the rate of £450,000 per route spread over the first three years, with an overall maximum of £6.75m.

CONCLUSION

I would appreciate your early decision for two reasons. Firstly, I must obtain the agreement of my Board to these proposals. Secondly, any further delay is now certain to impede the progress that is being made towards an early and successful privatisation.

In Attachment 'B' to this letter I have referred to the more important of the exchanges that have led us to the present proposals, which have, of course, been formulated upon the initiatives of your Department and in response to your desire to resolve the issues raised by CAP 500.

I am sending copies of this letter to Nigel Lawson and Norman Tebbit in view of their personal involvement, which I hope is in order.

John King

John King

ROUTE EXCHANGE

HMG to arrange for:-

- (a) British Airways' existing licences to Dhahran and Jeddah to be exchanged for British Caledonian's licences to Atlanta, San Juan, all points in South America and Morocco, together with all necessary authorisations being obtained.
- (b) BA's existing services from Gatwick to Barcelona, Lisbon and Madrid to be able to be operated from Heathrow in exchange for the transfer of an equivalent number of BA Mediterranean services from Heathrow to Gatwick but after taking account of the transfers referred to in (a) above.
- (c) BA to be granted licences and all necessary authorisations to operate to Orlando and Tampa from Summer 1985.
- (d) Export Credits Guarantee Department to make available to BA insurance against the remittability risk of local funds to the UK, which are generated by BA in countries in South America, as a result of BA serving the points there. BA understand this cover is, in principle, available from ECGD.
- (e) DoT to give the necessary consents to the purchase or lease of the additional equipment which BA will require for certain of these routes.

Other matters:

Other matters which the BA Board believe must be dealt with under these arrangements are as follows:

- (a) DoT will reject recommendations (2) (4) (5) (6) and (9) in the CAP 500 dated July 1984. In the case of recommendation (1) it is necessary to reject the recommendation that "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." BA accepts that "Additional competition by British airlines on intercontinental routes should be licensed wherever possible". In the case of recommendation (3) it is necessary to reject the words under paragraph 56(a) "even at the price of some reduction in the frequency, capacity and market share of British Airways' corresponding services from Heathrow" and to reject all of paragraph 56(b).

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Recommendation (8) can be accepted provided the words "...if necessary by reducing British Airways' frequencies" are deleted. Additionally the recommendation under (8) to reduce British Airways' frequencies is inconsistent with recommendation (7) to increase available capacity at Heathrow and Gatwick, which British Airways supports very strongly.

- (b) HMG will recognise that the price of BA, when privatised, is bound to be less than it otherwise would have been, and its debt similarly may be greater. The consequences of these features must be for the account of HMG.
- (c) In view of all the recent publicity given to route transfers, it will be necessary for HMG to give assurances in the prospectus that BA will be given fair treatment by the CAA on future route applications, and that HMG will not increase the powers of the CAA nor change its own policy in relation to route licencing.

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BACKGROUND

A. BA's Dual Designation Plan

BA has worked on a wide range of alternative schemes since the CAA recommendations were announced in July. BA put proposals to the DoT 23rd August for BCAL to be dual designated from Gatwick on a number of overseas routes, which BA currently operate out of Heathrow. This proposal was discussed and varied considerably at the request of DoT officials, however BA understand it is not acceptable either to the Secretary of State or to BCAL. This scheme would have increased competition and given consumers greater genuine choice on a number of routes. BA believed BCAL would have been able to earn about £5m in the first year of dual designation and between £10/12m in a mature year. Moreover BA's proposals included providing BCAL with a considerable amount of financial help and support in order to get such operations going.

B. Subsequent main meetings between BA and DoT1. 29 August

DoT stated it wished to limit the adverse effect on BA's profits to £10m per annum as a result of route changes involving BCAL and others.

2. 5 September

DoT tabled 5 alternatives of which 3 were transfers, one was dual designation as proposed by BA, and the last was to do nothing.

3. 18 September

DoT proposed two major exchanges between BA and BCAL, one of which included the transfer of BA's existing Saudi operations to BCAL.

4. 22 September

BA informed DoT of the consequential effects on BA. BA were then told that DoT required an enhanced swop package that would give BCAL an initial benefit in pre tax profits of about £15 million per annum.

5. 24 September

DoT informed BA that it believed BCAL would not be prepared to give up any U.S. points, but after some discussion it was agreed that it was reasonable for BA to have one, namely Atlanta. The package in Attachment 'A' includes only Atlanta and represents the absolute minimum which BA is prepared to accept.

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Lord King of Wartnaby
Chairman

26th September, 1984

The Rt. Hon. Michael Alison,
Parliamentary Private Secretary,
10 Downing Street,
London, S.W.1.

Dear Michael

As you know I am seeing the Prime Minister tomorrow morning at 9.45a.m. Obviously the Department of Transport will have kept the Prime Minister fully briefed. Nevertheless I am sending you a copy of my letter of today's date to Nicholas Ridley in case you feel it necessary to show the letter to her.

*Yours sincerely
Peter*

File

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British Airways plc, Cleveland House, St. James's Square, London SW1Y 4LN
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Lord King of Wartnaby
Chairman

27th September, 1984

The Rt. Hon. Nicholas Ridley, MP,
Secretary of State for Transport,
Department of Transport,
2 Marsham Street,
London, S.W.1.

Further to my letter of yesterday and subsequent conversations yesterday evening between your Officials and Colin, we agree to change paragraphs (a), (b) and (c) in Attachment 'A' to the following effect.

British Airways will transfer to British Caledonian its licences to Dhahran and Jeddah upon completion in a manner satisfactory to British Airways of the following actions:-

- (a) British Caledonian surrendering and the CAA transferring to British Airways the licences held by British Caledonian to Atlanta, San Juan and Morocco, and to all points in South America.
- (b) CAA awarding British Airways licences to Tampa and Orlando to be effective from the summer of 1985.
- (c) British Airways obtaining agreement from the Department of Transport to operate from Heathrow its services to Barcelona, Lisbon and Madrid - in exchange for the transfer of an equivalent number of British Airways' Mediterranean services to Gatwick but after taking account of the transfers referred to above.
- (d) British Airways to receive all the necessary authorisations from the appropriate governmental and regulatory authorities in the UK and the affected overseas countries.

Obviously the foregoing will take time. However, if we are both to make a success of privatisation within the present financial year, it seems essential that the necessary procedures be completed by no later than 31st December, 1984.

In addition, British Airways understands that the Department of Transport believe that the ECGD insurance sought in paragraph (d) of Attachment 'A' may not be forthcoming automatically. British Airways therefore is willing to rely on the best efforts and support of the Department of Transport and other relevant departments to obtain such insurance.

We would expect British Caledonian to use its best efforts to take over our own local staff in Saudi and we would give similar consideration to their local staff in the areas they give up, it being understood that each party will be responsible for meeting its own share of any severance/redundancy costs incurred.

I reaffirm our desire for an early decision which will enable me to seek the approval of my Board to the entire proposal.