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cc MASTER

10 DOWNING STREET

27 September 1984

*From the Private Secretary**Dear Dinah,*CAA REVIEW

Your Secretary of State came to see the Prime Minister at 0915 hours today to discuss progress in formulating the Government's response to the CAA review. He described the package which had emerged from discussions with Lord King. (This was along the lines of Annex A of the note attached to your letter to me of 26 September). He thought Lord King would agree to the proposals provided they included Atlanta. The effect would be to reduce BA's profits by around £20m which would reduce the sale proceeds by £80-100m. Surrender of the Saudi routes implied a loss of 12 flights a week in return for which BA would get initially 10 a week of which 7 were to Atlanta. The routes gained would require more staff to operate and so would enable Lord King to fulfil the pledges on future employment given to BA staff.

There were two remaining obstacles. First, Sir Adam Thomson would only accept the deal if BCal got Atlanta. Secondly, there was still not an adequate response to the needs of the smaller independent airlines, particularly BMA. Mr. Bishop had accepted that, in practice, it would not be feasible to transfer BA's regional routes to it in the face of strong political opposition at those airports. The Department of Transport were working on an idea which would allow airlines currently operating from Heathrow to retain their existing entitlement to flights but with freedom to switch destinations. This would allow BMA to fly some foreign routes in exchange for some of its domestic routes. The routes would be tradeable between airlines. This idea had emerged only recently and required possibly another 2 to 3 weeks work.

The choice was between putting more pressure on Lord King to surrender Atlanta or putting the existing proposals to BCal on a take it or leave it basis. The Prime Minister

said Lord King had moved a long way from his initial position and the benefits to BCal were substantial. She doubted whether more could or should be extracted from BA.

At 0945 hours Lord King and Mr. Marshall joined the meeting. The Prime Minister said she recognised Lord King's efforts in improving the performance of British Airways and also the distance BA had moved in search of a solution. She was anxious, however, to ensure that the Government responded adequately to the position of the independent airlines.

Your Secretary of State explained that Atlanta remained the only item in dispute. Lord King explained why he could not accept a package without Atlanta. Not only would this further reduce BA's profits but it would leave BA with only 3 services in exchange for the 12 surrendered. This would be bound to mean redundancies. Furthermore Atlanta would fit in well with BA's proposed routes to Orlando and Tampa.

Mr. Marshall said BA had negotiated a number of commercial arrangements which would be helpful to BMA, eg interlining and the provision of back-up services.

Lord King said he hoped BCal would accept. If it did not he would regard it as a demonstration that BCal did not wish BA to join it in the private sector.

The discussion then turned to the Laker cases. Mr. Marshall said that there were two aspects to the criminal charges, price fixing and scheduling. He was hopeful that BA would be cleared on the former and even if convicted of the latter would incur a fine of only \$1m. On the civil case, he said American companies were used to claims of this sort. He was hopeful that the Laker liquidator would eventually agree to a settlement but even if he did not he thought BA would be able to insure against damages above a certain level.

Your Secretary of State said the Government hoped to issue a White Paper shortly setting out its response to the CAA in full. Lord King said that British Airways intended to say nothing publicly until it had seen the Government's proposals.

Sir Adam Thomson subsequently telephoned Robin Butler during the early afternoon and said that he had now heard the revised proposals which Lord King had made. He recognised (when Robin Butler pointed it out) that these appeared to move in his direction, but said that the loss of Atlanta was the sticking point. If Lord King dropped this proposal, Sir Adam said that he would recommend the proposals to his Board: if not, he would call an emergency

meeting of his Board and recommend rejection, but his Board was a lively and democratic one and he could not be sure of the view they would take. Sir Adam asked whether Lord King's proposals had been approved: Robin Butler said that they had been reported to the Prime Minister, but it was not so much a question of approval as what Lord King would be induced to accept. Sir Adam acknowledged this point and agreed that an account of this should be given to your Secretary of State before Sir Adam called on him.

I am copying this letter to David Peretz (HM Treasury) and Callum McCarthy (Department of Trade and Industry).

Yours sincerely

Andrew Turnbull

ANDREW TURNBULL

Miss Dinah Nichols,
Department of Transport.