

SECRET AND PERSONAL

SECRET



File

S/LW

3

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

8 July 1987

BRITISH CALEDONIAN

The Prime Minister was grateful for your Secretary of State's minute of 7 July about his conversation with Lord King over the approach by British Caledonian to British Airways and has noted that Mr. Channon intends to raise this with Sir Adam Thomson.

I am copying this letter to Alex Allan (HM Treasury) and Tim Walker (Department of Trade and Industry).

(DAVID NORGROVE)

Roy Griffins, Esq.,
Department of Transport.

SECRET

SECRET AND PERSONAL

dg



PRIME MINISTER

BRITISH CALEDONIAN

1. Lord King has told me in strict confidence that British Airways have been approached by British Caledonian about the possibility of a take-over. Last week he and Sir Colin Marshall met Sir Adam Thomson (at Thomson's request) to discuss the possibilities. According to Lord King, BCal have also been in touch with a number of foreign airlines, including both Americans and Europeans.

2. As a result of last week's meeting, the Merchant Banks acting for both BA and BCal are now having discussions about details. Lord King clearly favours a take-over, providing the terms are right. He believes that it would put British Airways in a stronger position to compete against the large US airlines, and against the rapidly growing Far Eastern carriers. There is force in this argument. We need strong airlines to maintain our leading position in civil aviation worldwide.

3. On the other hand, such a take-over would not be easy to reconcile with our policy of increasing competition. As recently as October 1984, the Government produced a White Paper on airline competition policy, and negotiated an exchange of routes between British Airways and BCal which was intended to strengthen the latter as a second major British international carrier before British Airways privatisation. The take-over would give British Airways an even greater dominance of British scheduled airline capacity than it has now, and would mean that we had no effective competitor to them for inter-continental routes.

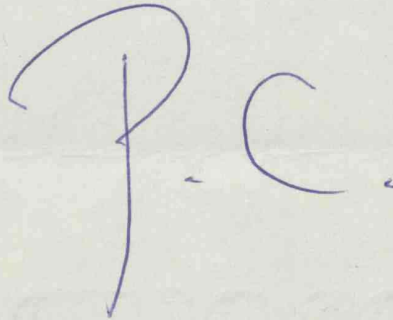
4. For a foreign airline to take over BCal (or acquire a stake sufficiently large to enable it to have a measure of control over the company) would be very undesirable. Air services depend on agreements which are bilaterally negotiated. If a US carrier took over BCal, that could mean that it would have a complete monopoly of certain UK/US routes, with feeder services penetrating both Europe and the USA. That could give it a great competitive advantage over British Airways. Similarly, a European carrier, such as Alitalia, might use BCal as a way of buying itself into some very lucrative commercial opportunities both inside and outside Europe, while the Italian Government maintains its highly protective policy to Alitalia. And if BCal fell under the control of a foreign carrier that would weaken our ability to defend its interests in other foreign markets.

5. A proposed take-over by either British Airways or a foreign operator would be likely to be a referable merger under the Fair Trading Act. If the Director General of Fair Trading were to recommend a reference to the MMC, it seems to me unlikely that, in view of our commitment to a strong and competitive British airline industry, the Secretary of State for Trade and Industry would disagree. But that is for David Young.

6. I am disposed to reserve judgement about whether the Government should seek to influence events before the question of a reference emerges. I propose to ask Sir Adam Thomson to come and see me to explain BCal's intentions. The Government have done a great deal to create opportunities for BCal to become a stronger competitor to British Airways. So far as we know, trading conditions this year are satisfactory. I propose to ask Adam Thomson whether he has considered other options, such as a take-over by non-airline British interests, or smaller carriers than British Airways.

? Virgin

7. I shall keep you closely in touch with developments. For the present, because of the highly sensitive nature of this information, I am copying this minute only to Nigel Lawson and David Young. Knowledge of the position in my own Department is confined to the smallest number of people.



PAUL CHANNON

7 July 1987