

CONFIDENTIAL FILING

Prime Minister's meeting with
Sir Peter Emery M.P.

PRIME MINISTER

July 1986

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
22.1.87							
PREM 19/24/24							

Cite
SP
SUBJECT CC MASTER10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

22 January 1987

Dear Richard

BRITISH CALEDONIAN: THE PRIME MINISTER'S MEETING WITH
SIR PETER EMERY, MP

The Prime Minister held a meeting with Sir Peter Emery this afternoon, at his request. Mr. Spicer was also present.

Sir Peter opened the meeting. He summarised the points set out in his memorandum to the Prime Minister (copy attached). The British Caledonian board believed the Government had misled them into believing they would get preferential treatment. British Caledonian faced serious difficulties and an early and satisfactory conclusion on the London-Tokyo route would be of considerable help to them. They needed to be in a position to catch summer traffic. The delay in reaching an agreement was costing them a great deal. There was a risk, if the discussions could not be satisfactorily resolved, that British Caledonian would put out a financial statement commenting on the difficulties facing the airline industry, which could have a general and damaging effect on confidence in the sector.

Sir Peter went into some detail about the current state of negotiations on the route. He concluded that the current offer from the Japanese was as good as the Government were likely to achieve at this stage. He suggested that Sir Adam Thomson might be informed privately now that the Government would accept the current offer when the next round of negotiations began.

In discussion, Mr. Spicer noted that if the Government were to tie itself to reaching a conclusion by a specific date, that would undermine its negotiating position. There were signs that the Japanese were serious about continuing the negotiations to a mutually acceptable conclusion.

The Prime Minister noted what Sir Peter had said. She pointed out that there could be no question of taking up Sir Peter's recommendation for a private approach to British Caledonian, as he had suggested, particularly in view of its possible impact on the prospectus to be issued by BA shortly.

She hoped Sir Peter would understand that it was not possible for her to say anything further.

I am copying this letter to Susan Rooke (PUSS's office, Department of Transport).

Le

Mark Addison

MARK ADDISON

Richard Allan, Esq.,
Department of Transport



HOUSE OF COMMONS
LONDON SW1A 0AA

MEMORANDUM

TO: PRIME MINISTER
FROM: SIR PETER EMERY MP
REASON: VISIT SPE ON THURSDAY 22 JANUARY 1987 AT 15.45
SUBJECT: POSSIBLE POLITICAL DAMAGE. NEED FOR PM'S INTERVENTION.

BACKGROUND

Sir Adam Thomson founded B/CAL in Scotland in 1961 initially flying the aircraft himself. In over 25 years he has brought B/CAL to become the largest private independent scheduled airline in Europe. The company has had a fantastic amount of route development and is accepted as the most efficient operator in the business. It has also had a marked effect on sharpening up British Airways and is an established supporter of the Conservative Party *AND OF THE P.M.*

DIFFICULTIES

With the introduction of ~~our~~ Competition Policy for airlines the CAA review in 1985 set out ^{that} the relative sizes of B/CAL and BAA should change to greater equality and to that end B/CAL should be given the BAA routes to Saudi Arabia and to Zimbabwe. The BA service at Gatwick should also be split with B/CAL benefitting. Nick Ridley decided that B/CAL should only be given the Saudi Arabia route *AT THE EXPENSE OF SOUTH AMERICA.*

Whilst B/CAL ~~was~~ affected this decision, they have since been adversely affected to a very major extent through no fault of their own.

SAUDI START UP - *PASSENGERS AND* Profits were nothing like those predicted because of the collapse of the oil price.

LIBYA - US action meant the complete loss of a very profitable route.

NIGERIA - Great difficulty and considerable loss in obtaining Naira repatriation to sterling. HMG slow to help. *with Money* - still owing



- 2 -

since last February.

HELICOPTER LINK HMG refused (for political reasons) to allow this vital and very profitable (£5m) service linking Heathrow & Gatwick - Not withstanding opening of M25.

PRESENT POSITION:

B/CAL expected to rectify part of ~~other~~ problems with opening of London - Tokyo route across Siberia. Nick Ridley made it clear that B/CAL would be given preference in initiating a Trans-Siberia Service while seeking opportunities for BA. Lord King, although operating service via Anchorage, furious at the announcement of this preference.

PROBLEM:

B/CAL initiated this project over 24 months ago. Whilst negotiations essential with USSR and Japanese Government a project date accepted by HMG ~~to support~~ ^{for start up} was ~~April~~ ^{APRIL} '87. Agreement with Japanese could have been obtained in Tokyo in December but certainly in London last week.

B/CAL requested 3 Trans-Siberian services to Tokyo. Giving way to pressure from Lord King HMG initiated negotiations demanding 6 flights London - Tokyo - 3 for B/CAL and 3 for BA. The Japanese have constantly refused this and finally as a positive last offer for the operating year 87/88 were willing to extend to 5 landings which would have meant 3 for B/CAL and 2 for BA. HMG still refused this although it was understood that the 6th landing ~~was likely to be offered~~ ^{was likely to be offered} for operating year 88/89.

Discussions have been postponed until middle or possibly end of March. This is disastrous for B/CAL who have been promised preferences. They cannot begin to sell in time for the summer. ~~They~~ have an Aeroplane in April with some Japanese Cabin Crew already contracted to work on the route.

OUTCOME

B/CAL Board believe that HMG are just not fulfilling their pledges and consider that rather than giving preference as promised to B/CAL they are leaning over to protect BA.

Cont..3..



REASON FOR VISIT

I am most concerned about the possible reaction of the Board which could have unpleasant repercussions for HMG and also *FOR EMPLOYMENT IN SUSSEX WHICH ARE THE LARGEST EMPLOYERS.*

I understand the problem which must relate to some extent to BA's privatisation. However, I would like to suggest a solution which I believe could only be *WISDOM* on the initiative of the PM.

15.

Enclosed is the last response dated 8.1.87. from S.J.S
for Transport to me on this issue.

PERSONAL

DEPARTMENT OF TRANSPORT
MINISTRY OF TRANSPORT LONDON SW1P 3EB

Sir Peter Emery MP
House of Commons
LONDON
SW1A 0AA

7 January 1987

Dear Peter,

Thank you for your letter of 11 December about British Caledonian's problems.

I recognise Adam Thomson's success in developing British Caledonian from small beginnings to becoming the largest independent air line in Europe. I am most anxious to do as much as possible to safeguard the interests of the company and to foster its further development as far as is possible consistently with the wider national interest and our own airline competition policy.

I fully recognise the importance which British Caledonian attach to commencing their proposed London/Tokyo services at the beginning of April. We are going all that we can to make the necessary arrangements as quickly as possible. Although we have made considerable progress in our discussions, both with the Japanese and the Soviet aeronautical authorities, certain points still remain unresolved and we shall need further discussions with each of them before a final agreement is possible. In the meantime, both BA and BCal have had separate discussions with JAL about those aspects of the arrangements which would affect them and I hope that these discussions will help us make more rapid progress in the government discussions.

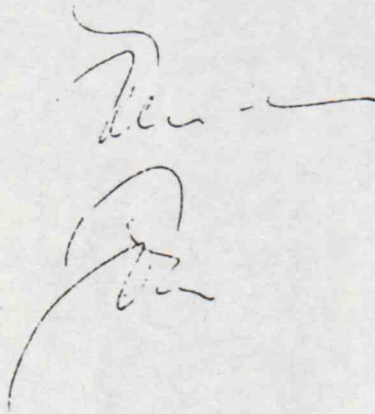
My colleagues - both here and in the Foreign Office - and I are well aware of British Caledonian's problems in Nigeria and have discussed them, on a number of occasions, with Adam Thomson and David Coltman. Our officials and the staff of the High Commission in Lagos are keeping in regular touch with the company about developments. We have taken - and shall continue to take - every appropriate opportunity of pressing the company's case with the Nigerian authorities in Lagos and with the Nigerian High Commission here. The

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Nigerians do, of course, face very serious economic difficulties. I hope, however, that we shall be able to persuade them to make arrangements which will take full account of British Caledonian's problems.

The latest developments in Nigeria are that our High Commissioner (Sir Martin Ewans) discussed BCal's problems privately with the President just before Christmas and is now, at the President's suggestion, giving him a very short memorandum (the text of which we have agreed with BCal) summarising their major concerns. Lynda Chaiker will be taking suitable opportunities of raising BCal's problems during her visit to Nigeria this week. We can consider what further action we should take in the light of her discussions. In the meantime, I doubt whether there is any action which you yourself could take to help the situation.

A handwritten signature in dark ink, appearing to be 'John Moore', written in a cursive style. The signature is positioned above the typed name 'JOHN MOORE'.

JOHN MOORE

PERSONAL

CONFIDENTIAL

CC: BG.
B/UP.



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Duty Clerk
10 Downing Street
LONDON SW1

21 January 1987

mt
Dear Duty Clerk,

BRITISH CALEDONIAN: PRIME MINISTER'S MEETING WITH SIR PETER EMERY MP, 22 JANUARY 1987

/ Following recent telephone conversations between Mr Michael Alison's office and Mr Spicer's office here, I attach briefing for the Prime Minister's meeting with Sir Peter Emery at 3.45 pm tomorrow. The briefing has been seen in draft both by my Secretary of State and by Mr Spicer, and reflects their comments.

Mr Spicer will be attending the meeting, which we understand will take place in the Prime Minister's room at the House of Commons.

Yours,
Richard Allan

R A ALLAN
Private Secretary

CONFIDENTIAL

CALL BY SIR PETER EMERY MP, 22 JANUARY 1987

OBJECTIVES

The best approach to the meeting will be to listen to what Sir Peter Emery has to say, but avoid any comment on or commitment to any proposals he may make. Our objective remains to get BCal on to the London-Tokyo route, but it would be wrong for us to do so in a way that gives the Japanese a continuing competitive advantage over British airlines. (Confidential: the imminence of BA privatisation makes the handling of this issue particularly delicate. Sir Peter Emery will be aware of that, but the Prime Minister is advised not to refer to it.)

KEY POINTS

1. It is fundamental to our airline competition policy that the UK should have more than one airline able and willing to compete on international routes. That is why we approved the route swap in 1984 which gave BCal Saudi Arabia in exchange for their loss-making routes to Latin America. That is why we put so much effort into advancing BCal's interests around the world eg in Nigeria and elsewhere in Africa, in the Bermuda 2 negotiation last year, in our efforts to liberalize air services in Europe and now in our negotiations with the Japanese and Russians to establish a BCal service across Siberia to Tokyo.

2. But competition means what it says. It is obviously better to have two British airlines operating non-stop services across Siberia to Tokyo and not just one, if we can persuade the Russians and Japanese to accept that situation. The Russians have accepted it. The best the Japanese have been able to offer so far is 4 Siberian services each, knowing full well that their arrangements with the Russians would allow them to operate all 4 non-stop, whereas we would have to operate 2 non-stop and 2 stopping at Moscow. This would give Japanese airlines a big advantage over their British counterparts. We think this gap can and should be bridged in further negotiations with Japan, now scheduled for

March.

3. Our airline competition policy is qualified by the requirement that such competition should be fair and Britain's interests should not be prejudiced. It is essential to any concept of fair competition in the national interest that we should continue to insist that British and Japanese airlines have an equal number of non-stop services across Siberia. We are not prepared to give the Japanese a continuing advantage, and put ourselves in a position where we had to ask them for more later.

4. We are hopeful that we shall in March be able to negotiate an agreement which is satisfactory for both BCal and BA, and which gives us the best national position. We shall do all we can to get that outcome quickly. But we cannot promise to deliver by any given date (see Points To Watch below).

POINTS TO WATCH

When the Secretary of State for Transport approved BCal's license for Tokyo services on appeal, the Department's letter (attached) said (paragraph 4.6) that if as a result of negotiations with the Russians and Japanese there were not enough non-stop services available to satisfy the requirements of both BA and BCal, BCal should have priority for the first two such services. The Japanese (possibly encouraged by BCal) may have seen this as a signal that we would settle for no more than BCal's requirements and we have had a hard job persuading them otherwise. Sir Peter Emery may suggest that a deadline be set for the implementation of this decision. Any such request must be refused. The Secretary of State will of course honour the commitment in his letter, but he must remain free to decide whether and if so when to give up pressing for a better deal in negotiation. If any deadline is set it will almost certainly leak back to the Japanese and confirm them in their belief that they can settle for just enough to satisfy BCal and keep BA out of the competition, to the considerable advantage of JAL as well as BCal.



BACKGROUND

At present, London-Tokyo services are flown by British Airways and Japanese Airlines (JAL). JAL operate one non-stop service over the USSR: the rest of their flights and all BA's are on the much longer Polar route stopping at Anchorage. BCal were licensed in July 1986 to operate non-stop services over the USSR. BA already are so licensed, but cannot operate non-stop services without the agreement of the Japanese and Russian Governments. We have been negotiating with both over the past year, with the aim of starting non-stop services on 1 April 1987.

The present position in the negotiations is that the Japanese have agreed BCal's entry in principle (with an eye to their second airline ANA in due course) and they have agreed a sufficient number of flights to accommodate the needs of both BA and BCal, but they are trying to establish a competitive advantage for JAL on the new non-stop services across Siberia. They have offered to allow each side 4 flights a week, (not 5 as Sir Peter Emery's note says) and for a single year 1987/8 with no guarantee of any Siberian services at all after that; and whereas their agreement with the Russians would not oblige them to operate any London/Tokyo services stopping at Moscow (they can put their Moscow stops on services to other European points) our agreement with the Russians would require one Moscow stopping service for every two non-stop. As a result the practical effect of the Japanese offer would be 4 non-stop services by JAL against 2 non-stop and 2 Moscow stopping services by British airlines. We have not been prepared to concede such a long-term advantage to the Japanese for the sake of any short term benefit in getting BCal onto the route quickly. We believe that if the Japanese can be brought to accept that we will not settle for less than 4 non-stop services for each side (4 for JAL and 2 each for BA and BCal) they will in the end reach agreement with us on that basis and find a way to allow us to operate the 2 compulsory Moscow stopping services as well. We shall continue to press for this at further negotiations in Tokyo in March, and meanwhile we have increased the pressure on the Japanese by withdrawing our support from the BA/JAL commercial agreement on which many of their London services depend, with effect from the end of March if we are unable to reach a better agreement before then.

If Sir Peter Emery demands instant action to extract BCal's blocked funds from Nigeria, the Prime Minister should draw attention to the constant efforts made by the Department of Transport and our High Commission in Lagos to achieve this, most recently during the visit by Mrs Chalker. We will continue to do all we can to help but the Nigerians are short of money and we have real difficulty in finding enough leverage to get BCal's money out as quickly as they and we would like.

BA PROSPECTUS

The BA Pathfinder prospectus, issued 8 January, refers to the negotiations taking place with the Japanese, and says that HMG and BA are hopeful that they will be successful. If Ministers decided that there were no longer grounds for hoping for a successful outcome from BA's point of view, the directors of BA would have to be informed, and they might well decide that the change would have a material effect on profits which should be disclosed in the prospectus to be issued on 27 January. If the change occurred after that date, and before dealings begin on ~~11th~~ February, it is likely that supplementary listing particulars would have to be issued. Either outcome would be very damaging to the privatisation.



✓ cc BQ
B/UP

HOUSE OF COMMONS
LONDON SW1A 0AA

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*Entered in the last response dated 8.1.87. from S.J.S
for Transport to me on this issue.*

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DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-12-1987

Sir Peter Emery MP
House of Commons
LONDON
SW1A 0AA

7 January 1987

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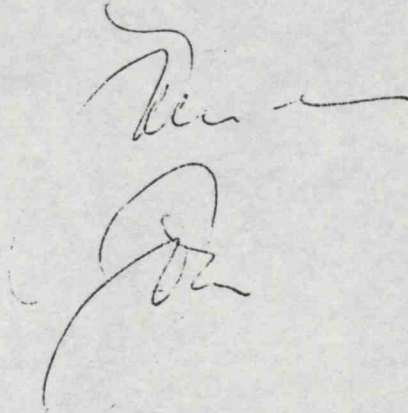
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JOHN MOORE

PERSONAL

The Secretary
Civil Aviation Authority
CAA House
45-59 Kingsway
LONDON
WC2B 6TE

23 July 1986

Dear Madam

LONDON TO TOKYO AND SEOUL SCHEDULED SERVICES

1. I refer to the appeal by British Caledonian Airways Limited against the decision of the Civil Aviation Authority in respect of British Caledonian's application 1B/10/P06 to vary the licence held by British Airways Plc so that:

1.1 the London to Seoul sector would be deleted from British Airways' licence;

1.2 British Airways' operations to Japan would be restricted to no more than five (or six depending on the bilateral arrangements) frequencies a week in each direction;

1.3 all British Airways' operations to Japan would have to be via an intermediate point.

2. Having considered very carefully all the arguments and evidence put to him, the Secretary of State has reached the conclusions set out below.

3. Seoul

3.1 The Secretary of State accepted the view of both airlines and of the Authority that the volume of traffic which might be attracted to direct services between the UK and Korea would be insufficient to support profitable operations by more than one British airline. He agreed with the Authority's conclusion that the service from Gatwick to Seoul over Tokyo proposed by British Caledonian was to be preferred to that by British Airways from Heathrow in view of the significantly shorter journey times which the trans-Siberian service would permit. He also noted that, in the Authority's opinion, the extension to Seoul would

Continued....

...in British Caledonian's profitability, thus improving its effectiveness in competing with other airlines on the routes to Japan; and that British Caledonian had demonstrated greater commitment to serving Korea.

3.2 The Secretary of State was, however, conscious that the traffic rights to provide services from the UK to Korea over Japan would have to be negotiated with the Japanese and Korean authorities, and that the right to overfly the USSR on non-stop services to Japan and Korea would also have to be negotiated with the Soviet authorities. The Department would use its best endeavours to obtain these rights; and if it succeeded, and if British Caledonian were then willing and able to extend its Tokyo service to Seoul, the Secretary of State would be minded to designate British Caledonian for the route. But there could be no certainty at this stage as to what rights would ultimately be available and which services these would permit. In the circumstances the Secretary of State considered that it would be wrong to delete Seoul from British Airways' licence, so denying it the opportunity to serve Korea if British Caledonian's proposed service did not go ahead.

4. Tokyo

4.1 The Secretary of State acknowledged the Authority's conclusion that licensing British Caledonian to serve the Gatwick/Tokyo route and to do so non-stop would be an important step to further the interests of users and would be consistent also with the Authority's duty under Section 68(1) of the Act to ensure that British airlines compete as effectively as possible with foreign airlines.

4.2 In considering in response to the appeal whether British Airways' frequencies to Japan should be restricted, and whether its operations to Japan should have to be via an intermediate point, the Secretary of State addressed in particular two arguments cited by British Caledonian in support of such restrictions, namely:

(a) that it was necessary in response to, or in anticipation of, anti-competitive behaviour by British Airways; and

(b) that the bilateral arrangements would make it necessary to apportion rights and frequencies from the UK to Japan between the competing British airlines.

4.3 The distinction between anti-competitive behaviour and normal commercial actions is not always an easy one. There will often be a suspicion that any measures taken by the incumbent to consolidate or strengthen its position on a route were, at least in part, anti-competitive. The Authority, in considering British Airways' increase in frequencies to Japan, concluded that there was no evidence to support the inference that British Airways' purpose in making these increases was anti-competitive in

Continued....

ent, but rather was consistent with a normal response to foreign competition on the route. On the basis of the arguments and evidence put to him in this appeal, the Secretary of State has no grounds for reaching a different view such as would justify varying British Airways' licence.

4.4 Discussions with the Japanese and Soviet authorities about the necessary rights have commenced, and further discussions will take place over the coming months. Until these discussions have been concluded, it is difficult to say whether the new bilateral arrangements as negotiated will be sufficient to allow both British Caledonian and British Airways to serve Japan with the frequencies and routeings that they wish. The Secretary of State has, therefore, concluded that it would be wrong at this time to vary British Airways' licence so as to reduce the frequency of its operations to Japan or to deny it any possibility of non-stop services in advance of the outcome of the current bilateral discussions.

4.5 The Secretary of State noted British Caledonian's argument that, even where there are no bilateral constraints, a powerful incumbent should be restrained for a transitional period in order to enable a new entrant to establish itself on a route and so be able to compete effectively. In the case of London-Tokyo services, however, although every effort will be made to obtain the desired rights and frequencies for British Caledonian and British Airways, the Secretary of State is bound to recognise the probability that the frequency and capacity of services on the routes will remain subject to bilateral constraints. The question of restraining the incumbent airline in the absence of such constraints is therefore unlikely to arise.

4.6 If, then, the new bilateral arrangements are insufficient to meet the full aspirations of British Caledonian and British Airways for the route, the question of apportioning the available rights and frequencies between the competing British airlines will arise. The Secretary of State considers that, whilst it would be wrong at this stage either to deny British Airways any opportunity of increasing its frequencies to Japan or to deny it any possibility of non-stop services, it is nevertheless important to ensure that sufficient of whatever rights are obtained are available to British Caledonian to enable it to mount a viable minimum of services overflying the Soviet Union. Accordingly, the Secretary of State directs the CAA to vary its decision in respect of British Caledonian's application 1/10/106 so that British Airways' licence is made subject to a condition that, from the date when the necessary rights become available for British airlines to serve the London/Tokyo route over Siberia non-stop, British Airways shall not fly more than 7 services a week on the London/Tokyo route or route any of those services over Siberia if it would take up the available rights in such a way as to deprive British Caledonian of the opportunity to operate up to two non-stop services a week over Siberia; this condition shall cease to have effect:-

Continued....

(1) after a period of one year from the date on which the rights referred to above become available unless during that period British Caledonian has commenced services on the London/Tokyo route under its licence, or

(2) at any time if British Caledonian ceases to operate such services.

4.7 In the event that the bilateral arrangements confer more new rights on the trans-Siberian route than are necessary to permit British Caledonian to mount two non-stop services to Japan, then, in the Secretary of State's opinion, it will in the first place be for British Airways and British Caledonian to seek to reach agreement between themselves on how the additional rights and frequencies should be divided. In saying this the Secretary of State is not to be taken as implying that he thinks that British Caledonian should operate at the outset more services on the London/Tokyo route than were contemplated in their case to the Civil Aviation Authority. If agreement between the airlines cannot be obtained, then it is open to either airline or both to apply to the Authority to vary the other's licence so as to impose a restriction which will have the effect of apportioning the available rights and frequencies. The Secretary of State considers that the Authority would be able to decide such applications consistently with its statutory powers and duties and its Statement of Policies.

5. Conclusions

5.1 The Secretary of State is minded to give British Caledonian preference over British Airways in designating a British airline for a route to Seoul, in the circumstances described in paragraph 3.2.

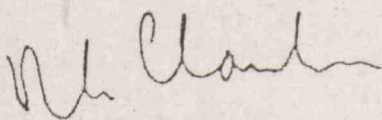
5.2 The Secretary of State has decided to direct the Authority to vary British Airways' licence in the manner described in paragraph 4.6 above.

5.3 Subject to this the Secretary of State has decided to dismiss the appeal by British Caledonian against the decision of the Authority in respect of British Caledonian's application to vary British Airways' licence.

5.4 The Secretary of State has made no order as to costs.

6. I am copying this letter to British Caledonian Airways Limited, British Airways Plc and Messrs Knapp-Fishers.

Yours faithfully



R E CLARKE

The Secretary
Civil Aviation Authority
CAA House
45-59 Kingsway
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2. Having considered very carefully all the arguments and evidence put to him, the Secretary of State has reached the conclusions set out below.

3. Seoul

3.1 The Secretary of State accepted the view of both airlines and of the Authority that the volume of traffic which might be attracted to direct services between the UK and Korea would be insufficient to support profitable operations by more than one British airline. He agreed with the Authority's conclusion that the service from Gatwick to Seoul over Tokyo proposed by British Caledonian was to be preferred to that by British Airways from Heathrow in view of the significantly shorter journey times which the trans-Siberian service would permit. He also noted that, in the Authority's opinion, the extension to Seoul would

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erpin British Caledonian's profitability, thus improving its effectiveness in competing with other airlines on the routes to Japan; and that British Caledonian had demonstrated greater commitment to serving Korea.

3.2 The Secretary of State was, however, conscious that the traffic rights to provide services from the UK to Korea over Japan would have to be negotiated with the Japanese and Korean authorities, and that the right to overfly the USSR on non-stop services to Japan and Korea would also have to be negotiated with the Soviet authorities. The Department would use its best endeavours to obtain these rights; and if it succeeded, and if British Caledonian were then willing and able to extend its Tokyo service to Seoul, the Secretary of State would be minded to designate British Caledonian for the route. But there could be no certainty at this stage as to what rights would ultimately be available and which services these would permit. In the circumstances the Secretary of State considered that it would be wrong to delete Seoul from British Airways' licence, so denying it the opportunity to serve Korea if British Caledonian's proposed service did not go ahead.

4. Tokyo

4.1 The Secretary of State acknowledged the Authority's conclusion that licensing British Caledonian to serve the Gatwick/Tokyo route and to do so non-stop would be an important step to further the interests of users and would be consistent also with the Authority's duty under Section 68(1) of the Act to ensure that British airlines compete as effectively as possible with foreign airlines.

4.2 In considering in response to the appeal whether British Airways' frequencies to Japan should be restricted, and whether its operations to Japan should have to be via an intermediate point, the Secretary of State addressed in particular two arguments cited by British Caledonian in support of such restrictions, namely:

(a) that it was necessary in response to, or in anticipation of, anti-competitive behaviour by British Airways; and

(b) that the bilateral arrangements would make it necessary to apportion rights and frequencies from the UK to Japan between the competing British airlines.

4.3 The distinction between anti-competitive behaviour and normal commercial actions is not always an easy one. There will often be a suspicion that any measures taken by the incumbent to consolidate or strengthen its position on a route were, at least in part, anti-competitive. The Authority, in considering British Airways' increase in frequencies to Japan, concluded that there was no evidence to support the inference that British Airways' purpose in making these increases was anti-competitive in

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ent, but rather was consistent with a normal response to foreign competition on the route. On the basis of the arguments and evidence put to him in this appeal, the Secretary of State has no grounds for reaching a different view such as would justify varying British Airways' licence.

4.4 Discussions with the Japanese and Soviet authorities about the necessary rights have commenced, and further discussions will take place over the coming months. Until these discussions have been concluded, it is difficult to say whether the new bilateral arrangements as negotiated will be sufficient to allow both British Caledonian and British Airways to serve Japan with the frequencies and routings that they wish. The Secretary of State has, therefore, concluded that it would be wrong at this time to vary British Airways' licence so as to reduce the frequency of its operations to Japan or to deny it any possibility of non-stop services in advance of the outcome of the current bilateral discussions.

4.5 The Secretary of State noted British Caledonian's argument that, even where there are no bilateral constraints, a powerful incumbent should be restrained for a transitional period in order to enable a new entrant to establish itself on a route and so be able to compete effectively. In the case of London-Tokyo services, however, although every effort will be made to obtain the desired rights and frequencies for British Caledonian and British Airways, the Secretary of State is bound to recognise the probability that the frequency and capacity of services on the routes will remain subject to bilateral constraints. The question of restraining the incumbent airline in the absence of such constraints is therefore unlikely to arise.

4.6 If, then, the new bilateral arrangements are insufficient to meet the full aspirations of British Caledonian and British Airways for the route, the question of apportioning the available rights and frequencies between the competing British airlines will arise. The Secretary of State considers that, whilst it would be wrong at this stage either to deny British Airways any opportunity of increasing its frequencies to Japan or to deny it any possibility of non-stop services, it is nevertheless important to ensure that sufficient of whatever rights are obtained are available to British Caledonian to enable it to mount a viable minimum of services overflying the Soviet Union. Accordingly, the Secretary of State directs the CAA to vary its decision in respect of British Caledonian's application 1/10/106 so that British Airways' licence is made subject to a condition that, from the date when the necessary rights become available for British airlines to serve the London/Tokyo route over Siberia non-stop, British Airways shall not fly more than 7 services a week on the London/Tokyo route or route any of those services over Siberia if it would take up the available rights in such a way as to deprive British Caledonian of the opportunity to operate up to two non-stop services a week over Siberia; this condition shall cease to have effect:-

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(1) after a period of one year from the date on which the rights referred to above become available unless during that period British Caledonian has commenced services on the London/Tokyo route under its licence, or

(2) at any time if British Caledonian ceases to operate such services.

4.7 In the event that the bilateral arrangements confer more new rights on the trans-Siberian route than are necessary to permit British Caledonian to mount two non-stop services to Japan, then, in the Secretary of State's opinion, it will in the first place be for British Airways and British Caledonian to seek to reach agreement between themselves on how the additional rights and frequencies should be divided. In saying this the Secretary of State is not to be taken as implying that he thinks that British Caledonian should operate at the outset more services on the London/Tokyo route than were contemplated in their case to the Civil Aviation Authority. If agreement between the airlines cannot be obtained, then it is open to either airline or both to apply to the Authority to vary the other's licence so as to impose a restriction which will have the effect of apportioning the available rights and frequencies. The Secretary of State considers that the Authority would be able to decide such applications consistently with its statutory powers and duties and its Statement of Policies.

5. Conclusions

5.1 The Secretary of State is minded to give British Caledonian preference over British Airways in designating a British airline for a route to Seoul, in the circumstances described in paragraph 3.2.

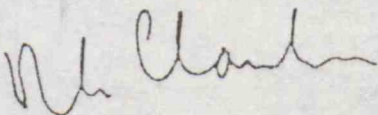
5.2 The Secretary of State has decided to direct the Authority to vary British Airways' licence in the manner described in paragraph 4.6 above.

5.3 Subject to this the Secretary of State has decided to dismiss the appeal by British Caledonian against the decision of the Authority in respect of British Caledonian's application to vary British Airways' licence.

5.4 The Secretary of State has made no order as to costs.

6. I am copying this letter to British Caledonian Airways Limited, British Airways Plc and Messrs Knapp-Fishers.

Yours faithfully



R E CLARKE



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