



CC No

20
Prime Minister

ECONOMIC REGULATION OF AIRPORTS

In Nicholas Ridley's absence abroad I am writing to you and members of EA about the scheme we propose to introduce in the forthcoming Civil Aviation Bill to provide for the economic regulation of airports.

You will recall that the Government's proposals for legislation were outlined in the White Paper on Airports Policy (Cmnd 9542) published on 5 June. Our main objectives are the privatisation of the British Airports Authority, and the conversion of major local authority airports to companies, with powers for their owners to sell shares to the private sector or to other local authorities. We hope in this way to encourage a more business-like approach in regional airports which hitherto have developed rather slowly as public utilities. However, these new airport companies, particularly the BAA's, will have many of the features of natural monopolies and new arrangements are needed to prevent the exploitation of these monopolies.

The White Paper stated in Section 10 that privatised airports should be subject to the competition laws that apply to other private sector enterprises, and that the Civil Aviation Authority's powers would be extended so that it can regulate airport charges with help from the Monopolies and Mergers Commission. We have elaborated these proposals in consultation with the Department of Trade and Industry, the Treasury and others concerned, and have sent Instructions to Counsel for the drafting of the necessary clauses in the forthcoming Bill. I attach an outline of the scheme for the information of colleagues.



You may find it helpful if I comment on the main aspects noting the points which have caused us some difficulty. First, it was agreed in Cabinet when the draft White Paper was considered, that the CAA should be the regulatory body for aeronautical charges at airports. The Authority is already responsible for aerodrome safety licensing and air transport licensing. It has detailed knowledge of the operation of airports and the economics of airline operations and is the most appropriate body to undertake this new function. However, we found in developing these proposals that there were a range of core activities at an airport which could not be included in the narrow definition of aeronautical charges, but which should be subject to special regulation because they presented opportunities for the airport operator to penalise particular users. One example of this is the arrangements for baggage handling, where some airlines complain that the BAA unnecessarily restrict competition. Nicholas Ridley felt that it was important for the CAA to have powers to regulate all these activities and we have therefore widened the scope of their duties beyond what we had originally envisaged. Where they cannot resolve the problem by agreement with the airport operator they would of course seek the help of the MMC.

This brings me to the main difficulty we have encountered, which is the potential overlap between the duties of the CAA and those of the Director General of Fair Trading. Broadly speaking, the DGFT would be concerned with commercial activities at airports (duty-free shops, car parks, catering, renting of property) whilst the CAA would be responsible for regulating the core activities and implementing public interest findings by the MMC including those which are outside the scope of the Authority's responsibilities. A similar problem was dealt with in Section 50 of the Telecommunications Act 1984 by giving the Director General of Telecommunications and the DGFT concurrent powers and a structured relationship. However, this does not seem to provide the clear definition of the role of the two bodies and the predictable pattern of regulation which we believe is



so important in the case of airports. More relevant in our view are the voluntary arrangements set up by the CAA and the DGFT on their respective functions in relation to the licensing of air services. We propose that the CAA and the DGFT should reach and publish a similar understanding in relation to the regulation of Airports. But since we have an opportunity for legislation, it would be sensible to make provision in the Bill for the Secretary of State to have power to set out the division of responsibilities and the procedures in Regulations, should no satisfactory agreement emerge. We would of course envisage that, as a matter of administration, the Secretaries of State for Transport and for Trade and Industry would act jointly in preparing such Regulations.

I hope that colleagues will be content with the broad outline of the scheme. My officials will be consulting DTI, Treasury and other interested Departments on the detailed drafting of the clauses. Meanwhile, I would be pleased to provide a copy of the Instructions to Counsel to any colleague who wishes to see them.

I am copying this letter and enclosure to members of EA and to Sir Robert Armstrong.

LC

4 October 1985

OUTLINE OF SCHEME FOR ECONOMIC REGULATION OF AIRPORTS

Summary

1. (a) Competition and Fair Trading Law will apply in principle to all airport companies.
(b) The new scheme will superimpose a system of special regulation of airports to be exercised by the CAA, who will be given new functions.
(c) The purpose of this scheme is to regulate prices and terms and conditions of core activities, defined as services or facilities provided at the airport for the movement of aircraft, passengers, luggage and cargo; this is intended to cover, for instance, baggage handling, but not car parks, restaurants, shops or renting of property.

Airports within scope

2. The CAA's new regulatory functions will apply to all airports (except the CAA's own airports) above the threshold (£1m turnover) above which local authority airports may be directed to be transferred to a company. However, there will be two levels of regulation:

(a) the generality of these airports, where the CAA will have, effectively, a watching brief, with powers to regulate aeronautical charges and other terms and conditions if it sees fit (eg as a result of a complaint which is sustained after investigation); and

(b) major airports designated by the Secretary of State (eg BAA's South East airports and Manchester), where the CAA will in addition have a duty to set a 5-yearly limit on aeronautical charges.

CAA'S General duties

3. The CAA will have to exercise its new functions in the manner best calculated to:

(i) further the reasonable interests of persons using the airports for the purpose of air transport;

(ii) promote the efficiency of British airports and their reasonable profitability and encourage investment in new facilities in time to meet demand;

(iii) impose the minimum restrictions consistent with the performance by the CAA of its duties.

Details of the scheme

4. The basic proposition is that any airport operator within the scope of the provisions will require a

permission to levy aeronautical charges, to be issued by the CAA (although the Secretary of State will have a power to issue the initial permissions). The CAA (or the Secretary of State initially) will be able to attach conditions to the permission governing the operation of the airport undertaking's business. The permission, and the conditions attached to it, will provide the vehicle for regulation. The following additional features will be noted:

(a) the CAA will be able to refuse permission only if the airport fails to provide the information (eg accounts, etc) required by the CAA;

(b) an airport without a permission will be unable to enforce recovery of charges, but will not be subject to criminal proceedings;

(c) the CAA will be able to grant a single permission covering a system of airports but may impose specific conditions on each individual airport.

5. Conditions can only be imposed for certain specific purposes: at the generality of airports (those not designated) only for -

(i) protecting users from unfair trading practices;

(ii) protecting other airports from predatory pricing;

(iii) ensuring that airport accounts are transparent, revealing any subsidy (including subsidised capital) from an airport within the same group or from a holding company or other owner (eg a local authority).

Where the CAA having investigated a practice under (i), or (ii) decides that corrective action is necessary it may seek undertakings from the airport concerned; or it may propose a condition. But where the airport operator does not agree to the condition, the CAA will be required to make a reference to the MMC who will investigate and report on the practice in question. If the MMC reports that a practice is contrary to the public interest, the CAA will be under a duty to impose an appropriate condition to correct the abuse, and the airport will have to comply.

6. At designated airports (ie the major ones nominated by the Secretary of State), the CAA shall additionally be under a duty to impose conditions -

(a) to ensure disclosure of subsidisation, and

(b) to govern the upper limits of aeronautical charges for a period of 5 years (most probably by means of a formula).

For the purpose of (b) the MMC will carry out quinquennial reviews, unless the Secretary of State determines otherwise in relation to any airport, to investigate the limits to

which the level of charges should be subject over the next 5 years and any practices which may be contrary to the public interest. Where the MMC makes recommendations as to a price limit formula the CAA will have a duty to impose a condition; if it varies the formula recommended by the MMC it must state its reasons. These conditions will be valid for five years and can only be modified with the agreement of the airport operator. Where the MMC finds a practice to be against the public interest, the CAA will be obliged to impose a condition to prohibit the practice. Only the Secretary of State will have power to prevent implementation of a public interest finding.

Complaints and enforcement

7. Breach of a condition by an airport will not give rise to criminal proceedings. The CAA shall investigate any complaints (other than frivolous ones) made by a person who has paid or is due to pay charges or by another airport; and may investigate complaints by other persons at its discretion.

8. A mechanism will be provided for "compliance orders" to be issued by the CAA where there is a breach of condition, and the airport will have a duty to comply. However it will be able to apply to a court if it feels the compliance order is unjustified. We have not provided for appeals to the Secretary of State.

Information etc

9. The CAA will have powers to obtain the information it needs from any airport to enable it to issue permissions, determine conditions and advise the Secretary of State whether the airport should be designated. There are further provisions to prevent disclosure without the consent of the airport concerned of certain information obtained by the CAA or MMC.

Overlap of OFT and CAA responsibilities

10. In order to avoid uncoordinated action by the CAA and OFT over the same matter, it is proposed that CAA and the DGFT reach a voluntary agreement on the division of responsibilities, as has been achieved on Air Services. However, the Secretary of State would have powers to make regulations prescribing the circumstances and procedures for each body to exercise its functions should a sensible agreement not emerge.



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