



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley Esq MP
Secretary of State for Transport
Department of Transport
2 Marsham Street
LONDON SW1

29 October 1985

Nicholas

ECONOMIC REGULATION OF AIRPORTS

I have seen a copy of Lynda Chalker's minute of 4 October to the Prime Minister which describes your proposals for the economic regulation of airports after the privatisation of the BAA. I have two related reservations about the functions which you envisage for the CAA in these proposals.

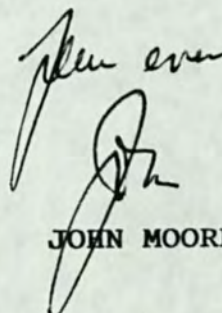
My first reservation is with the proposed definition of the CAA's new general duties. The suggestion in Lynda's minute is that the CAA, in carrying out its new duties, should have regard among other things to promoting the "reasonable profitability" of airports. This formulation could be taken to imply that the CAA not only has a role in the regulation of aeronautical charges but also in regulating airports' profits as a whole. Such a role for the CAA would be difficult to reconcile with the approach to economic regulation described in the airports' White Paper which implicitly rejected profit regulation for reasons which are already well understood. Profit regulation could only soften the incentive on management to cut costs and to improve the service to airport users and would mitigate many of the key benefits of privatisation. A regulatory role for the CAA which extends to profits would have fundamental and deleterious effects on investors' perceptions of the BAA as an investment opportunity. For these reasons I hope you will agree to drop the reference to promoting "reasonable profitability" from the CAA's general duties.

My second concern was mentioned by George Younger in his letter to you of 21 October. It is with the proposal that the CAA should be able to regulate trading practices. I cannot see any benefit or justification for extending the CAA's jurisdiction into this

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area when presumably the OFT and the normal competition laws should restrain airport companies from unfair trading practices not only in their commercial activities but also in their aeronautical activities. Your proposed arrangement seems unnecessary and I can only see disadvantages in it. First, I fear it risks giving too much of a weapon to the already powerful airlines. Secondly, the overlap between the regulatory functions of the OFT and the proposed new powers of the CAA means that certain core activities will be subject to two regulators enforcing different powers aimed at the same potential abuses. This can only lead to a significant element of imprecision and uncertainty about how the regulatory regime will operate. Investors and the BAA itself will not be faced with a clearly defined and stable framework. There will inevitably be ambiguities and potential investors will be unable to form a clear judgement about the extent to which core aeronautical activities will be regulated and by whom. This uncertainty can only feed through into more cautious forecasts of BAA's likely earnings potential and into the price which investors will be prepared to pay. My strong preference is to avoid overlap and duplication between the regulators by limiting the role of the CAA strictly to the regulation of aeronautical charges as we envisaged in the White Paper. I understand that Leon Brittan will shortly be commenting on Lynda's minute and I should be interested in his observations on this particular aspect of your proposals.

I am copying this minute to the Prime Minister and to other members of E(A).


JOHN MOORE

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