



CF To await  
JW comments.  
DBW  
ccBG

Prime Minister

ECONOMIC REGULATION OF AIRPORTS

In my absence abroad, Lynda Chalker circulated, on 4 October, a minute to colleagues explaining our proposals for the economic regulation of airports and setting out the outstanding points of principle that needed to be resolved. You will have seen the replies that I have received from George Younger, John Moore, and Michael Howard, the colleagues with the most direct interest in the proposed regulatory regime. I think that the outstanding issues can now be resolved satisfactorily and the purpose of this minute is to seek your agreement to the way in which I propose to deal with the points that colleagues have raised.

No - I did  
not bother  
you with it  
while there  
was so much  
uncertainty.

I am happy to accept all the refinements to my proposals that Michael Howard suggests in his letter and shall see that these are reflected in the clauses drafted by Parliamentary Counsel. His letter also replies, in part, to the suggestion made by George Younger, that we should think again about a statutory separation of the respective areas of jurisdiction of the CAA and DGFT. I was initially attracted by the idea of excluding the DGFT altogether from any involvement in core airport activities, but after much consideration, concluded that statutory separation would give rise to serious practical difficulties. The nub of the problem, as Michael Howard's letter explains, is our international obligation to ensure that income from commercial activities is taken into account in setting traffic charges. While it may be relatively straightforward to differentiate between the core and commercial businesses in terms of



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activity, the cross-subsidy requirement blurs the financial picture. This means that however tightly and carefully the core of an airport's business might be defined, there would always be the risk of a grey area which would either span or fall between the duties of the two regulators.

So, in practice, some degree of overlap is inevitable and I believe that the arrangements that I have agreed with Michael Howard are the ones most likely to lead to a clear, workable system. First, the voluntary agreement route is already precedented in the aviation field by the agreement reached by the CAA and DGFT on competition matters affecting airlines; this sets out respective roles and specifies where one agency takes precedence over the other. Second, the reserve powers I am proposing, to make regulations governing the activities of the two bodies (if in the final analysis they cannot agree), must go still further to reassuring potential investors that double regulation will be avoided.

Our merchant bank advisers have assured us that, provided these arrangements are in place by the time the prospectus is issued, the effects on investor confidence will be minimal.

I hope that these assurances will go a long way to meeting John Moore's concern about the effect of our regulatory proposals on the price investors will be prepared to pay for the BAA. John has proposed trying to avoid overlap between the CAA and DGFT in a way opposite to that suggested by George Younger. He would limit the role of the CAA strictly to regulation of aeronautical charges. Lynda Chalker's minute explained why I felt that the CAA's role should be extended to cover all activities, not just charges, relating to core airport activities. I have already gone into the problems of the dividing line between an airport's core and commercial activities; they become even more acute when one tries to draw a line between aeronautical charges and trading activities within the core of the airport's business. Virtually every core trading activity at an airport is likely





to have some impact on aeronautical charges. While I fully support John Moore's wish to avoid excessive regulation - indeed it is my express purpose to make the regulatory regime no more burdensome than is necessary - I also agree with Michael Howard's view that normal competition legislation was not designed to cope with "natural" monopolies in the private sector.

So, in the case of airports, it is my firm belief that the CAA should be the prime regulators of all core activities, in view of their expertise in aviation matters affecting both airports and airlines. This does not mean that the CAA will have the same wide powers as the DGFT.

Under the terms of the Bill their role will be framed specifically to the task of ensuring that airports cannot adopt a trading practice which discriminates against a class of user. Rather than protecting the powerful airlines - as John Moore fears - this will serve to protect the smaller airlines so that they are able to compete on a fair basis.

For example, the CAA might decide that a small airline should be able to handle its own baggage and not rely on a large airline's handling service, or that smaller airlines were being unfairly treated by being given the most inconvenient boarding gates and parking stands. The CAA's expertise places it in a good position to both detect and remedy discriminating practices of this kind, and our merchant bank advisers agree. I hope therefore that John will understand why I cannot accept this one of his two main concerns.

His other point, about the reference in the CAA's duties to promoting the "reasonable profitability" of airports is, I think, a matter of wording and not a difference of principle between us. I fully endorse the need to avoid profit regulation. The phrase "reasonable profitability" was intended to be descriptive rather than definitive: the thought behind it was that the regulatory regime must allow for increases in both profits and profit margins,





otherwise the CAA could conceivably set levels of aeronautical charges which allowed airports only to break even. Given that our objectives are the same, there should not be a problem in ensuring that the Bill contains a form of words that reflects our shared view.

I trust that you and colleagues will be content for me to proceed on the basis that I have outlined.

I am copying this to members of E(A) and to Sir Robert Armstrong.

A handwritten signature in dark ink, consisting of stylized initials 'NR' followed by a flourish.

NICHOLAS RIDLEY

4 November 1985



