



John Dent Esq CBE  
Chairman  
Civil Aviation Authority  
CAA House  
45-59 Kingsway  
LONDON WC2B 6TE

Dear Mr. Dent,

#### CIVIL AVIATION LICENSING POLICY REVIEW

Thank you for your helpful letter of 13 December in which you let me have your thoughts on how the Authority might proceed with a review of air transport policy. I am grateful to you and your colleagues for your ready response and for the thought you have already given to this matter.

In responding, may I first deal with the key issue of the timing. I would wish to have the results of your Review available well before the flotation of BA plc proceeds, so that the inevitable uncertainty created by it can be removed again in good time for the market and potential investors to assess the value of BA well in advance of flotation.

You indicate that you hope to be in a position to issue your conclusions by about September of next year; but I would very much hope that you can in fact complete it by July. If, for example, your Review poses some questions for Government decision, as it may well do, we could aim to resolve these questions and make public our

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01-212 3434

MR Knight  
with papers

CC PS / MR Mitchell

MR Blants

MR Stevens

MR Bootham

16 December 1983  
MR Clarke

MR Twyman

MR Baker

MRS Ramay

PS / S/S

~~PS / file~~

decisions before the Summer Recess, thus improving by perhaps 2½ months on what you have suggested. With this in mind, I hope that you and your colleagues would agree to aim for a target date of 16 July.

You refer to the possibility of a slow response from the industry. Given agreement between us on the date for completion of your Review, I have in mind that I could issue a formal Notice under section 69(2) of the Civil Aviation Act 1982 timed so that the six months statutory period ended at that date.

A review under section 69 is confined to questions of licensing policy within the terms of the Act, but of course the Authority is free to offer advice to me on other matters if it thinks it desirable. If you considered it useful I could, in parallel with a Notice under section 69(2), require you, under section 16(1) of the Civil Aviation Act, to provide your assistance and advice on my functions relating to civil aviation.

I am pleased to see from your letter that, as well as considering the impact of privatisation of British Airways, you propose to cover in your Review the central aspects of the possible liberalisation of domestic air transport licensing arrangements. This does indeed seem an appropriate time for the Authority to reconsider whether readier access should be given to these routes. I was also pleased to learn that you will review the extent to which it continues to be necessary to require the approval of fares on domestic routes.

I also understand your wish to consider the implications of the limit on air transport movements at Heathrow for domestic route licensing policy. As you know, my Department is currently considering as part of the Government's airport policy, how the limit is to be implemented, and we may wish to initiate a more formal consultation on this with interested parties in the coming months.

It will be important for your people and mine to keep in close touch on how you intend to handle this aspect of your consultation so that confusion among those consulted is avoided: for example, if your consultation were to make assumptions about the way in which the ATM limit will be administered when we had not reached a final view on that. I understand that there have already been preliminary discussions on this.

On the international aspects of your review, I need only say that I agree that the Government will continue to bear responsibility for our bilateral aviation relations with other countries and thus for making effective any international route opportunities for British airlines which may result from the Authority's licensing policy. I presume that in framing any policy changes or recommendations in this area you would, as usual, have regard to our advice with respect to the likely outcome of any negotiations with other countries that might be entailed. The effective constraint is, of course, what is negotiable at acceptable overall cost with other countries. We will continue to fight hard for additional competitive opportunities, both in terms of policy within Europe and generally.

May I conclude by expressing my thanks for the rapid response which you have made following our earlier discussion. The announcement of your review seems to have been generally well received.

Yours sincerely,

Dinah Nichols

pp NICHOLAS RIDLEY

(Approved by the Secretary of State  
& signed in his absence)

Secretary of State to see BA file

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(10)

Advice please (ASAP)  
Mr Twyman.  
for Mr Ridley

John Dent CBE  
Chairman

13 December 1983

cc AS/Mr Mitchell

The Right Hon. Nicholas Ridley MP  
Secretary of State  
Department of Transport  
2 Marsham Street  
LONDON SW1P 3EB

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AS/Mr Lazarus  
Mr Clarke  
Mr Tass

Mrs Ramsey

Dear Secretary of State

When we met on 28 November 1983 you asked whether the Authority would be ready itself to take the initiative in reviewing the policy issues that arise in the context of the proposed privatisation of British Airways.

Mr Knighton  
Mr Blanks  
Mr Stevens  
Mr Baker

As we see it, privatisation in itself is a neutral action in terms of regulatory policy. If in the process of privatising British Airways there were to be, one way or another, a substantial writing off of debt, this would intensify an already existing situation of competitive imbalance within the industry. It would not however be the writing off of the debt as such which would give rise to the basic difficulty but rather that it would aggravate the fact that British Airways is now becoming a keener and more efficient competitor so that the imbalances which have always existed become far more significant for the future development of the industry.

The basic policy question goes back to the Edwards Report and even before. The Edwards Committee recommended and all subsequent Governments have accepted that the country is better served by having a number of profitable and keenly competitive airlines than by depending on a single flag carrier. The fundamental question is whether the national interest continues to be best served by this policy, which envisages the maintenance of opportunities for airlines other than British Airways to enter its markets, either in direct competition where the institutional framework permits or in substitution for it where direct competition is ruled out. If it is in the national interest to maintain this policy, then it is important to ensure that the alternative carriers are not squeezed out through the extensive use of dominant market power by British Airways.

Continued.....

In the Authority's view these issues are of sufficient moment and immediacy to warrant a substantial policy review and the Authority would be willing to initiate and conduct this. A first question to be asked would be whether the situation does indeed warrant the taking of corrective action and a further question is what the action should be. British Caledonian has offered its own solutions, although it has to be asked whether and in what ways these would lead to greater competition among British airlines or a strengthening of the ability of the British industry to compete with foreign airlines. If the present independent sector is unfairly disadvantaged and if the industry is structurally unbalanced, it is primarily because the independent airlines have only very limited access to international routes generally and to Heathrow's traffic potential in particular. If corrective action is needed, it should be focused mainly upon the resolution of these two problem areas. It is unfortunate of course that the possible solutions to the problem tend towards a greater degree of regulatory intervention in the industry rather than the reverse, at least when viewed in classical terms. For this reason it would be desirable that a policy review should also encompass the possibility of adopting more innovatory techniques.

If the Authority is to consult the industry about these fundamental issues, the process will subsume some of the main elements of the proposed review of policies on domestic routes that we have had in mind. One such issue is the question of access to Heathrow for operators of domestic services. It would not be our intention to review the policy and machinery for allocating Heathrow capacity among different classes of airline but a relevant question would be whether, within any given entitlement for domestic services, other airlines should have some opportunity to displace British Airways in whole or in part on some of its present routes. Another issue which might be subsumed concerns the machinery that would be needed for regulating domestic fares so as to enable the Authority to deal with anti-competitive behaviour while giving airlines the greatest possible managerial freedom to determine their own prices. A third issue which might be subsumed is the possibility of introducing a freer regime for small scale services. In order however to avoid unduly complicating the task and delaying the conclusions it will be necessary to defer certain other aspects of the domestic policy review that are not immediately relevant.

I would not wish to predict at this stage what the likely outcome of such a consultation might be. Depending on whether a case is made for substantial changes of policy and depending also on what measures would be best and also practicable, one might envisage a range of possible outcomes. To the extent that it was concluded that greater opportunities should be provided for airlines other than British Airways to compete, we would not envisage any undue problems of accommodating revised policies within the Authority's present statutory powers since these are already biased in favour of competitive solutions; insofar as greater opportunities for competition brought in

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questions of our bilateral relationships with other countries, the outcome would of course be dependent at least in large part on the readiness of your own Department to go along with them. However, if for example it were to be concluded that substantial transfers of routes should take place without the agreement of those concerned, going beyond what might be achieved by some sharpening of the Authority's present policies on substitution, our restatement of policies might need to be accompanied by recommendations to you to take legislative or other action.

More important perhaps is the question of timing. The issues are weighty and, if the parties are to be given ample time to express their views and the Authority a full opportunity to consider its conclusions, the six month limit that is entailed by invoking Section 69(2) of the Act may well prove insufficient. If the Authority initiates the review itself it is not bound by this limit and can take a little time longer. It is in any case desirable to initiate the consultation at the earliest possible moment and we have in mind a relatively brief initial statement that will be a signal to the industry to start preparing its submissions. Given an early start we would hope to be in a position to issue our conclusions by about September 1984. We believe it is important to allow this length of time in order to arrive at sound and robust conclusions. If by the early Spring it seemed that progress was falling behind due to a slow response from the industry, the option of using Section 69(2) would still be open.

You have told me that, subject to further discussion about timing, you are content that we should proceed on this basis and you have already made it clear in your statement yesterday that the review has your approval. We do of course look forward to your continuing support in ensuring that these important issues are given serious attention by all concerned.

Yours sincerely

