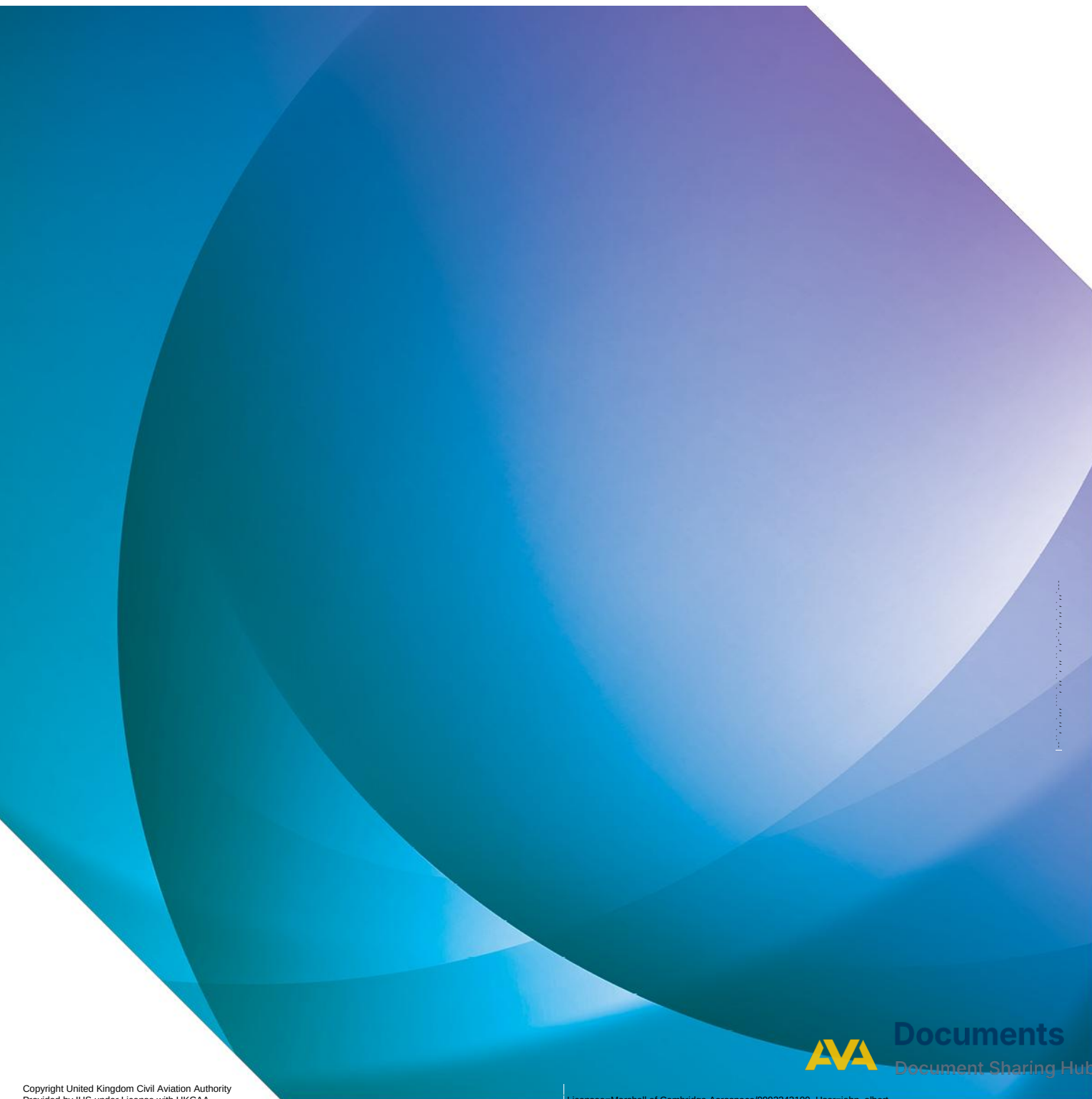


Economic regulation: A review of Gatwick Airport Limited's commitments framework

A consultation document

CAP 1387



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Enquiries regarding the content of this publication should be addressed to: economicregulation@caa.co.uk
Consumers and Markets Group, CAA, 4th Floor, CAA House, 45-59 Kingsway, London WC2B 6TE.

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Executive summary

Purpose of this document

1. In 2014 we changed the way that we regulate the charges and services Gatwick Airport Limited (GAL) offers to airlines – and ultimately passengers. Specifically, we moved from using a price cap calculated by us to a more deregulatory approach of relying on specific commitments given by GAL. They cover, among other things, the maximum level of airport charges that GAL can levy over the seven years from April 2014 to March 2021, and a system of rebates if GAL misses certain service quality targets.
2. We issued an economic licence for GAL, as we found that it met the requirements of the market power test in the Civil Aviation Act 2012 ('the Act'). GAL's commitments were backed by obligations included in this licence and hence enforceable by us. In addition to offering a suite of commitments applicable to all airlines, GAL also entered into a number of bilateral commercial contracts with individual airlines.
3. We said that we would carry out a 'short and focused' review of the new commitments framework in the second half of 2016, to consider whether it was operating in passengers' interests.
4. The purpose of this consultation document is to seek views from all interested parties on the proposed scope of our mid-term review before we formally launch it later this year.

Proposed scope of our review

5. The overarching aim of the review will be to identify any aspect of the new framework that is acting against the interests of passengers. The Act gives us a single primary duty to further the interests of users of air transport services.
6. In the short time since the new framework was introduced, traffic growth has been significantly stronger than expected and GAL has held its charges below what we calculated a 'fair price' to be in 2014. Passengers have suffered delays, however, as on-time performance at the airport has been relatively poor in each of the last two summers.

7. Poor on-time performance in recent summers, when combined with strong traffic growth, raises questions about future capacity requirements and also whether stakeholders are working together effectively to deliver a better service for passengers. With this in mind, we expect the main focus of the review to be on issues within GAL's commitments framework that could influence on-time performance:
 - GAL's service quality and airport resilience;
 - GAL's investment performance; and
 - GAL's relationship with airlines and other stakeholders.
8. We recognise that on-time performance may be influenced by the actions of others such as airlines, ground handlers and air navigation service providers. We will also want to take into account evidence of on-time performance this summer, or any other changes that affect the service provided to passengers.
9. In relation to GAL's service quality and airport resilience, the main issues that we expect to cover include:
 - how the current service quality targets and rebates were agreed, whether they appear to be working well, and any possible risk of distortions especially in relation to on-time performance;
 - how all parties are working within the new commitments framework to deliver an appropriate level of service quality and performance; and
 - how passengers' interests are taken into account.
10. When reviewing GAL's investment performance, we expect to consider questions such as:
 - how its investment programme has changed compared with the programme we considered during the last periodic review (Q6) and the main reasons for this;
 - whether there is any evidence that GAL's investment decisions have affected on-time performance (or are likely to do so in future); and
 - how passengers' interests are taken into account.
11. When addressing GAL's relationship with airlines and other stakeholders, we expect to consider questions such as:
 - whether airlines have sufficient opportunities for constructive dialogue with GAL, either individually or collectively;

- whether the overall framework is working in a way that encourages parties to work together to deliver a better service for passengers; and
 - whether sufficient attention is given to passengers' interests during discussions between GAL and airlines.
12. We also propose to briefly review certain other issues, such as how GAL's bilateral contracts are operating in practice and the level of airport charges.
13. This consultation takes place against the backdrop of the Government developing its response to the work of the Airports Commission on new runway capacity in the South-East of England. We have already published a number of documents on our proposed approach to the regulation of new runway capacity. These include a Policy Update in September 2015,¹ setting out our current thinking on a range of issues, and a further Policy Update in February 2016 specifically on the treatment of planning costs associated with new runway capacity.²
14. Our mid-term review will focus on how the new framework is operating at present, rather than its potential suitability for regulating charges and services if GAL is given permission to build a second runway. Neither does the review cover the airspace change process (including changes to flight paths for aircraft landing and taking off at Gatwick), which is a separate process that is not affected by the form of economic regulation applied at Gatwick.³

Next steps

15. We expect to issue the final scope of our review in July 2016. At present, we expect to start the review in September and reach conclusions by the end of the year.

¹ CAP 1332, Economic regulation of new runway capacity – update. Available at www.caa.co.uk/cap1332.

² CAP 1372, Recovery of costs associated with obtaining planning permission for new runway capacity: policy update. Available at www.caa.co.uk/cap1372.

³ For more information see <http://www.caa.co.uk/Commercial-industry/Airspace/Airspace-change/Airspace-Change/>.

Views invited

16. We would welcome views on the proposed scope of our review. Please email them to economicregulation@caa.co.uk by no later than **noon Friday 6 May 2016**. We cannot commit to take into account responses received after this date.
17. If you would like to discuss the issues raised in this document before the deadline please contact Stephen Gifford (stephen.gifford@caa.co.uk) or Stuart Holder (stuart.holder@caa.co.uk).
18. Responses will be made available on the CAA's website. Any material considered confidential should be clearly marked as such. Please note that we have powers and duties with respect to Section 59 of the Act and the Freedom of Information Act 2000.

Chapter 1

Economic regulation of GAL

Introduction

- 1.1 This chapter provides background to, and the outcomes from, the most recent regulatory settlement (Q6) at Gatwick. Specifically, this chapter describes:
- our primary statutory duty;
 - the process that led to our acceptance of the commitments;
 - GAL's licence and the commitments;
 - our main reasons for accepting the commitments rather than continuing to impose a formal price cap on GAL's charges; and
 - the current monitoring regime.
- 1.2 Further information on the Q6 settlement for GAL is available from our website.

Our primary statutory duty

- 1.3 The Act gives us a single primary duty to *further the interests of users of air transport services*. Under the Act, users of air transport services are defined as present and future passengers and those with a right in property carried by the service i.e. cargo owners.
- 1.4 The scope of our primary duty concerns the *range, availability, continuity, cost and quality of airport operation services*. We must carry out our functions, where appropriate, in a manner that will *promote competition in the provision of airport operation services*.
- 1.5 In discharging this primary duty, we must also have regard to a range of other matters.⁴ These include:
- the need to secure that GAL is able to finance its licensed activities;

⁴ See section 1(3) of the Act.

- to secure that all reasonable demands for airport operating services are met;
- to promote economy and efficiency in the provision of airport operating services;
- the need to secure that GAL is able to take measures to reduce, control or mitigate adverse environmental effects;
- any relevant guidance issued by the Secretary of State or international obligation on the UK notified by the Secretary of State; and
- better regulation principles.

Summary of the Q6 review process

- 1.6 The Q6 review of GAL's charges started in 2011 with our initial 'setting the scene' consultation, and ended in 2014 with our final notice of the licence granted to GAL. The Q6 review was unusual, as it was carried out while the Civil Aviation Bill was passing through Parliament.
- 1.7 From an early stage in the review, we stated that we wished to explore the merits of some form of default regulatory settlement at Gatwick, which would provide greater scope for commercial agreements of service differentiation as compared with a traditional price cap underpinned by a regulatory asset base (RAB).⁵
- 1.8 In 2012, GAL put forward proposals for a framework based on airport commitments that would provide airlines with an agreed level of service at a capped average price, as an alternative to a RAB-based price cap. Initially, GAL's proposed cap was significantly higher than our own view of a fair price (based on our calculation of a traditional RAB-based price cap).
- 1.9 For the remainder of the Q6 review, therefore, we followed two parallel approaches. We continued to consider GAL's proposed commitments, which were revised several times before the end of the review, and we also continued to refine our own assessment of a fair price, using the same analysis and calculations that underpin a RAB-based price cap. This provided us with a suitable alternative if we could not accept GAL's final

⁵ See, for example, chapter 5 of ['Review of Price Regulation at Heathrow, Gatwick and Stansted Airports \("Q6"\)': Policy Update](#), May 2012 (archived).