

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

CAP 1437

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Executive summary

1. In March 2016 we consulted on the scope of a mid-term review of the economic regulatory framework that we have applied to Gatwick Airport Limited (GAL) since April 2014. Rather than a price cap calculated by us the new framework is based on a set of commitments, given by GAL, which include a maximum level of airport charges over the seven years to March 2021 and a system of service quality rebates.
2. We described the review as an early 'health check' with the overarching aim of identifying any aspect of the new commitments-based framework that is acting against the interests of passengers. We noted that, while traffic growth has been significantly stronger than expected and that GAL has held its charges below our 2014 view of a 'fair price', on-time performance at Gatwick has been poor in each of the last two summers.
3. While recognising that on-time performance is influenced by the actions of a number of different parties, the combination of poor on-time performance and strong traffic growth could raise questions about whether GAL is providing sufficient capacity and whether stakeholders are working together effectively to deliver a better service for passengers. We therefore said that we expected the mid-term review to focus on three main issues:
 - GAL's service quality and airport resilience – including how current targets were agreed, whether the system is working well, how all parties are working together within the new framework, and how passengers' interests are taken into account;
 - GAL's investment performance – including how the investment programme has changed since the Q6 review, how investment affects on-time performance, and how passengers' interests are taken into account; and
 - GAL's relationship with airlines and other stakeholders – including whether airlines have sufficient opportunities for constructive

dialogue with GAL, whether the overall framework encourages parties to work together to deliver a better service, and whether sufficient attention is given to passengers' interests.

4. In addition, we said that we expected to carry out a brief review of the bilateral contracts agreed between GAL and individual airlines. We also expected to validate GAL's calculation of the comparison between its blended price and our fair price benchmark, and to consider the arguments for GAL to provide airlines with a forward view of expected charges for the remainder of the seven year period.
5. Most consultation responses were supportive of our overall approach and the main issues we proposed to consider. Some respondents suggested specific examples for us to consider under each of our proposed main issues.
6. There were also some suggestions to widen the scope of the review, for example to see whether the reasons for adopting the commitments framework have come to fruition or to identify aspects of the new framework that are working well. We are not minded to consider such questions at this stage, only two years into a seven year regulatory period, and instead intend to focus on identifying any aspects of the new framework that are acting against the interests of passengers and therefore might require early remedial action.
7. We have decided to retain the overarching aim and the main issues for the review as set out in the March 2016 consultation document. When considering these issues, however, we will investigate some of the examples highlighted by consultation respondents. In particular:
 - when assessing GAL's service quality and airport resilience, we will consider how exemptions from service quality rebates have been applied (both in general and specifically in relation to pier service levels); and
 - as part of our assessment of GAL's investment performance, we will examine case studies such as the postponement of the Pier 6

southern extension project and the delays in delivering the rebuilding of Pier 1 and redevelopment of Pier 5.

Chapter 1

Introduction

Purpose of this document

- 1.1 This document describes the scope of the mid-term review of the economic regulatory framework that we now apply to Gatwick Airport Limited (GAL). It follows a consultation document that we published in March 2016.¹
- 1.2 Since 2014 our regulation of GAL's charges and service quality has been based on a set of commitments given by GAL, including a maximum level of airport charges and a set of service quality rebates. Further details of the commitments, our reasons for preferring these to a formal price cap, and the current monitoring framework are set out in the consultation document.

Our primary statutory duty

- 1.3 The Civil Aviation Act 2012 ('the Act') gives us a single primary duty to carry out our economic regulation functions in a manner that we consider will *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 CAP 1387, Economic regulation: A review of Gatwick Airport Limited's commitments framework – A consultation document. Available at www.caa.co.uk/cap1387.

- 1.5 In discharging this primary duty we must also have regard to a range of other matters.² These include:
- the need to secure that GAL is able to finance its provision of airport operation services;
 - to secure that all reasonable demands for airport operation services are met;
 - to promote economy and efficiency in the provision of airport operation services;
 - the need to secure that GAL is able to take measures to reduce, control or mitigate adverse environmental effects;
 - any guidance issued by the Secretary of State or international obligation on the UK notified by the Secretary of State; and
 - the better regulation principles.

Wider context

- 1.6 Our review of the commitments framework 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 2015,³ 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.⁴
- 1.7 The current 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

² See section 1(3) of the Act.

³ CAP 1332, Economic regulation of new runway capacity – update. Available at www.caa.co.uk/cap1332.

⁴ CAP 1372, Recovery of costs associated with obtaining planning permission for new runway capacity: policy update. Available at www.caa.co.uk/cap1372.