

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

Findings and conclusions

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Contents

Contents	1
Executive summary.....	3
Background	3
Main findings	3
Conclusions.....	5
Next steps	6
Chapter 1	8
Introduction	8
Purpose of this document.....	8
Our primary statutory duty	9
Overview of the commitments framework	10
Chapter 2	12
GAL's service quality and airport resilience	12
Introduction	12
Developments since the start of the commitments period	13
On-time performance	13
Other aspects of service quality	16
Our assessment	21
Conclusion	23
Chapter 3	25
GAL's investment performance	25
Introduction	25
Developments since the start of the commitments period	25
Overview of GAL's investment programme	25
Views on GAL's investment programme	28
Our assessment	30

Conclusion	33
Chapter 4	34
GAL's relationship with airlines and other stakeholders.....	34
Introduction	34
Developments since the start of the commitments period	35
Overview of GAL's engagement with airlines and passengers' representatives ...	35
GAL's relationship with airlines and its Passenger Advisory Group	36
Our assessment	38
Conclusion	40
Chapter 5	42
GAL's charges	42
Introduction	42
Developments since the start of the commitments period	43
Our assessment	46
Conclusion	48
Chapter 6	50
Conclusions	50
Our conclusions on how well the commitments framework is working	50
Our policy conclusions.....	53

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Executive summary

Background

1. In 2014 we introduced a new lighter touch framework for our economic regulation of Gatwick Airport Limited (GAL). This 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. Following a consultation in March 2016 and confirmation of the scope of the review in July 2016, this document sets out the findings of our mid-term review of the new framework.
2. Reflecting the fact that on-time performance at Gatwick has been poor in recent summers, and taking account of feedback from stakeholders, our review has focused on three main issues:
 - GAL's service quality and airport resilience (including on-time performance);
 - GAL's investment performance; and
 - GAL's relationship with airlines and other stakeholders.

Main findings

3. Many aspects of the new framework appear to be working well. Among other things:
 - GAL has agreed bilateral contracts with airlines representing more than 85 per cent of passengers;
 - traffic growth has exceeded expectations and overall passenger satisfaction has increased since the start of the commitments period;
 - GAL has held its charges below the 'fair price' benchmark we established in 2014 and met most of its service quality targets; and

- none of the airlines we spoke to argued for a return to the form of regulation we previously applied to GAL (and continue to apply to Heathrow Airport Limited).
4. One of the potential advantages of the commitments framework is that GAL has more flexibility to tailor its **investment** to the needs of airlines and in response to changing circumstances. GAL has implemented a number of new or accelerated investment projects, especially in terminal facilities and processing. The total volume of investment each year has been close to the forecasts that underpinned our fair price benchmark, and substantially higher than the annual average of GAL's minimum commitment. However, GAL has not yet expanded airfield capacity in response to stronger than expected traffic growth. It is now discussing some proposed projects with airlines.
 5. GAL and its airline users have quite different views on whether or not the resulting capacity constraints on the airfield are contributing to poor **on-time performance**. There are many different causes of delay (including air traffic control delays and ground handling problems) and GAL has introduced a number of operational initiatives, in co-operation with airlines and others, to address some of the likely causes of poor on-time performance. It is unfortunate, therefore, that GAL and the airlines have made little progress in agreeing whether airfield capacity constraints are exacerbating delays and, if so, taking action to address the situation.
 6. GAL's **relationships with airlines** appear mixed, with certain aspects of these relationships raising possible areas of concern. On the positive side, some airlines told us of good relationships at the commercial, strategic and financial level and of some recent improvements for example in capital investment consultations. GATCOM's Passenger Advisory Group told us of GAL's enhanced willingness to engage with them under the new framework and to give serious consideration to their comments. But airlines also told us of a poorer relationship at operating level and with airline representative bodies. They feel that there can be a lack of genuine

engagement and that, when they raise issues, GAL's response can be defensive and sometimes abrasive.

7. We welcome GAL's decision to set its **charges** below our fair price benchmark during the first few years of the new regulatory framework, and also its recent offer to airlines that, over the commitments period as a whole, it does not intend to exceed our fair price benchmark. If GAL were to increase its charges above our fair price benchmark, we would need to consider the most appropriate regulatory response.

Conclusions

8. We are encouraged by the general support the new regulatory framework continues to receive, and have not seen evidence that the problems noted above are leading to a material adverse impact on passengers. Indeed, traffic growth has continued and GAL has met most of its service quality targets.
9. Therefore, we are not proposing specific changes to the commitments framework at this stage. However, we have potential concerns about the progress of airfield investment projects and some aspects of GAL's relationships with airlines, and will include both of these issues in our ongoing monitoring of GAL's performance under the commitments framework.
10. We look to GAL to make good progress with its current proposals to provide additional pier capacity and to accommodate passengers arriving from the Common Travel Area, and to adopt a proactive approach to identifying and addressing possible future airfield capacity constraints. If capacity constraints are not being addressed, or if there is evidence that airfield capacity constraints are having a material impact on on-time performance, then we may need to consider further measures.
11. It is important that GAL takes steps to improve its relationships with airlines, especially at operating level. This requires a genuine willingness to listen to and respond constructively to airline views. If there is evidence

in future that GAL is acting in a way that risks having a material adverse impact on passengers' interests, then we will consider whether further intervention might be required.

12. The quality of GAL's relationships with airlines and other stakeholders is also an important factor (along with others, including GAL's investment performance and any impact on on-time performance) that we will take into account in any future consideration of the need for and form of economic regulation at Gatwick, including any future Market Power Determination or any review of the form of economic regulation to apply at Gatwick after March 2021.

Next steps

13. We will continue our ongoing monitoring of GAL's performance under the commitments framework. As well as requiring an annual performance report, we will continue to have regular meetings with both GAL and its main airline customers to review recent developments and consider any problems arising.
14. Separate from this review of the commitments framework, CAA is carrying out a wider programme of work to understand the challenges facing congested airports in the UK (see box).

Operating resilience of the UK's aviation infrastructure

CAA is currently carrying out a wider review of the operating resilience of UK aviation infrastructure. This will examine the current balance of delay and punctuality against the number of flights, particularly in the industry's planning and operational processes, and will comment on how well it reflects the user interest. We are also undertaking an independent study of the causes of delay at Gatwick, focusing on planning and scheduling processes and the operation of the first wave. We intend to publish our recommendations in spring 2017.

15. We are not setting a specific date for any future reviews of the commitments framework. If GAL makes good progress on the issues

noted above, and if no significant new problems arise, then our next review of the framework could well form part of a wider programme of work looking at the regulation of GAL beyond the current commitments period (which ends in March 2021). We are likely to need to start considering these issues within the next two to three years.

16. However, if any serious problems arise, and especially if there is a risk of a material adverse impact on passengers' interests, we will consider whether earlier intervention is required. In addition, if we were to conclude in the light of further evidence, such as our wider work on the causes of delay at Gatwick, that an economic regulation remedy was necessary and proportionate, we would expect to discuss this with stakeholders within the current regulatory period.

Chapter 1

Introduction

Purpose of this document

- 1.1 This document reports the findings and conclusions of our 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 2016¹ and an update that we published in July 2016 confirming the scope of the review.²
- 1.2 When implementing the new framework in 2014, we said that we would carry out a 'short and focused' review in the second half of 2016 to consider whether it was operating in passengers' interests. In our consultation document we described the review as an early 'health check' on a new regulatory framework, rather than a reopening of the conclusions we reached during the 'Q6' review.
- 1.3 Nevertheless, in our July 2016 document we also noted that on-time performance at Gatwick had been poor in recent summers. Reflecting this, and the possible ways that the commitments framework might affect on-time performance, we proposed that the review should focus on three main areas: GAL's service quality and airport resilience (including on-time performance); GAL's investment performance; and GAL's relationship with airlines and other stakeholders.
- 1.4 Our findings in each of these areas are reported in Chapter 2 to Chapter 4 below. We also looked at some aspects of GAL's charges, as described in Chapter 5. Our conclusions on how well the commitments framework is working and our overall policy conclusions are set out in Chapter 6.

¹ CAP 1387, Economic regulation: A review of Gatwick Airport Limited's commitments framework – A consultation document. Available at www.caa.co.uk/cap1387.

² CAP 1437, Economic regulation: A review of Gatwick Airport Limited's commitments framework – Update. Available at www.caa.co.uk/cap1437.

- 1.5 During the course of the review we benefited from discussions with GAL, airlines and passenger representatives, and from GAL's response to a previous information request. We thank all of these parties for their co-operation.

Our primary statutory duty

- 1.6 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.
- 1.7 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*.
- 1.8 In discharging this primary duty we must also have regard to a range of other matters.³ 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.

³ See section 1(3) of the Act.

Overview of the commitments framework

1.9 The commitments framework was introduced in 2014 at the conclusion of our Q6 review of the price caps at Heathrow and Gatwick airports. For Gatwick, we decided to base our regulation on a set of commitments offered by GAL, rather than a price cap set by us. Among other things, we felt that the commitments framework would encourage bilateral contracts that could be better tailored to the needs of individual airlines and their passengers, and would facilitate efficient investment as GAL would have flexibility to tailor investment to the needs of airlines.

1.10 In summary, the commitments include:⁴

- a price commitment – based on price paths of the Retail Prices Index (RPI)+0% for the ‘blended’ price (which takes accounts of discounts agreed in bilateral contracts) and RPI+1% for the published price;
- a service standards commitment, incorporating a system of service quality rebates similar to those included in GAL's Q5 price cap;
- an investment and consultation commitment, including a commitment to develop the infrastructure to allow GAL to meet service quality standards and to invest at least £700 million during the seven years of the commitments; and
- other conditions relating to a continuity of service plan, operational and financial resilience, and a financial information commitment.

1.11 We decided that the commitments would be backed by a licence, to ensure that they are honoured and so that we can continue to act where appropriate to protect passengers. We also made it clear that we would monitor how the new commitments and licensing regime was operating in practice.

1.12 During the Q6 review we continued to develop our own view of a fair price (based on our calculation of a traditional price cap). By the end of the

⁴ Formally, the commitments are a collection of specific contractual obligations included in GAL's Conditions of Use. These are listed in Condition C1.11 of GAL's licence.

review our fair price benchmark was RPI-1.6%, somewhat lower than GAL's commitment for the blended price.

1.13 To date, our ongoing monitoring of GAL's performance under the commitments has focussed on four main areas:

- the level of charges – specifically we compare the outturn blended price with our fair price benchmark;
- service quality, and especially any repeated failures (since if GAL misses a particular target for six months in a financial year then no further rebates are payable for that target during the rest of the year and GAL's incentives are therefore diluted);
- shadow regulatory asset base (RAB) – we require GAL to calculate a shadow RAB in case tighter regulation needs to be reintroduced;⁵ and
- operational resilience – GAL is required to consult on and publish its operational resilience plan by 1 October 2014, and then to review the plan annually.

1.14 GAL publishes an annual performance report each year, including information on traffic growth, airport charges (including a comparison with our fair price benchmark) and service quality. These reports are available on GAL's website.⁶

⁵ We also said, however, that there would be no presumption that GAL's shadow RAB number would be used as the basis for a future price cap.

⁶ See www.gatwickairport.com/business-community/about-gatwick/company-information/how-we-are-regulated.

Chapter 2

GAL's service quality and airport resilience

Introduction

- 2.1 In our July update document we confirmed that on-time performance would feature prominently in our review of GAL's service quality and airport resilience. On-time performance is important to passengers and had been poor at Gatwick in each of the previous two summers. However, we noted that on-time performance is affected by many different factors, and we are also carrying out a wider review of the operating resilience of UK aviation infrastructure. We stressed, therefore, that the current review would focus on whether any aspect of the commitments framework is making the problems associated with poor on-time performance worse.
- 2.2 Our wider review of operating resilience will examine the current balance of delay and punctuality against the number of flights, particularly in the industry's planning and operational processes, and will comment on how well it reflects the user interest. In support of this we have undertaken an industry request for information⁷ and qualitative consumer research.⁸ We are also undertaking an independent study of the causes of delay at Gatwick, focusing on planning and scheduling processes and the operation of the first wave. We intend to publish our recommendations in spring 2017.
- 2.3 In relation to other aspects of service quality, as well as looking in general at how well the system of service quality rebates in the commitments framework is working, we said that we would consider how exemptions

⁷ CAP 1420, Operating resilience of the UK's aviation infrastructure: A request for information. Available at www.caa.co.uk/cap1420.

⁸ CAP1472, Consumer research attitudes to journey disruption - A qualitative research report. Available at www.caa.co.uk/cap1472.

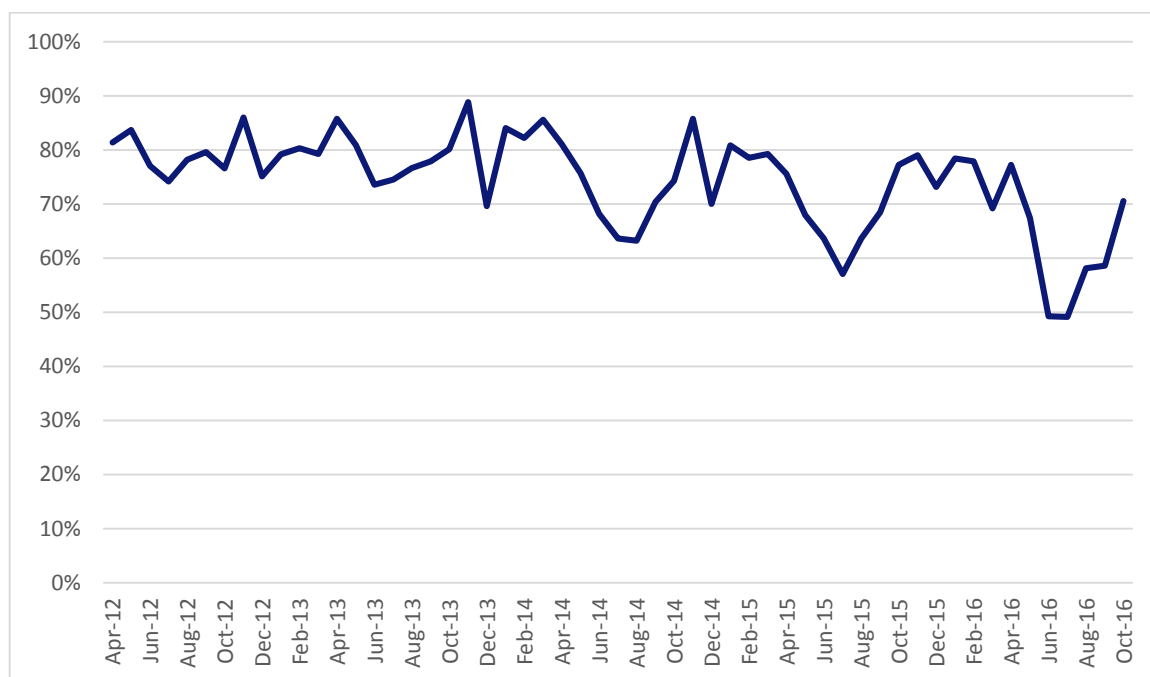
from these rebates have been applied and how this has affected passengers' interests.

Developments since the start of the commitments period

On-time performance

2.4 Figure 1 below shows that on-time performance at Gatwick has been deteriorating over the last few years. Each year, the proportion of delayed flights has increased during the peak summer months. In June and July 2016, more than 50 per cent of flights were delayed.

Figure 1: On-time departures at Gatwick,⁹ April 2012 to October 2016



Source: Eurocontrol

2.5 A number of different factors are likely to have contributed to this situation. In each of the last three summers at least one of the ground handlers operating at Gatwick has experienced significant resourcing problems. Congestion in European airspace has been increasing. And in summer

⁹ This is the proportion of flights departing Gatwick within 16 minutes of the scheduled time.

2016 there were two temporary closures of the main runway due to damage to the runway surface.

- 2.6 GAL has devoted considerable effort to identifying and addressing the causes of the current poor on-time performance. Among other things, it has commissioned independent analysis that identified five main causes of poor on-time performance: poor first wave performance; late or slow turnaround of aircraft between flights; late inbound aircraft; on-stand aircraft maintenance; and congestion in European airspace. In collaboration with airlines and ground handlers, GAL has implemented a number of operational measures in response to this analysis, including initiatives to ensure all parties are 'first wave ready', reduce ground movement delays, stabilise the flow of traffic, ensure more timely boarding of passengers, recover from late incoming aircraft and improve turnaround times. In addition, GAL has worked closely with ground handlers, for example introducing direct financial incentives for good performance, assisting with ramp staff resources to help with turnarounds, and encouraging resource planning to improve their readiness for the summer peak.
- 2.7 An important related factor is the strong traffic growth that has occurred in recent years at Gatwick, which has put increasing pressure on an already congested airport. In response to strong demand from airlines, GAL has increased the maximum number of movements per hour to 55 (up from 50 in 2009). The pressures created by strong traffic growth are not directly connected to the commitments framework. However we note that the commitments framework does strengthen GAL's incentives to increase passenger volumes (because of the longer regulatory period than previously), and it has also encouraged GAL to agree bilateral contracts which may contain incentives for individual airlines to grow volumes. GAL may also have encouraged traffic growth by holding its charges at a relatively low level (below our fair price benchmark) during the early years of the commitments period.

2.8 A stronger direct connection between the commitments framework and poor on-time performance may arise as GAL has not yet expanded airfield capacity in response to stronger than expected traffic growth. As described in Chapter 3, GAL appears to have adopted a cautious approach to identifying and responding to the need for additional airfield capacity as traffic has grown.

2.9 A number of airlines argued that airfield capacity constraints (including stands and taxiways) are exacerbating the impact of delays. Among other things, airlines have argued that:

- there is now a greater volume of towing and push and hold operations as aircraft are removed from stands in order to free up the capacity for other aircraft. This contributes to a greater volume of movements on an already congested airfield, ties up ground handling resources that may be needed elsewhere, and in some cases an aircraft that was towed away from a stand can be delayed when it needs to return to a stand prior to departure;
- a shortage of remote hold stands, or insufficient ground movement control capacity to facilitate push and hold movements, means that aircraft may remain on the stand when they could move instead to a remote hold stand. This reduces the stand capacity available for incoming aircraft and also ties up ground handling resources that may be needed elsewhere; and
- the high volume of traffic means that airline staff can experience difficulties contacting ground movement control over the existing communications frequencies. This can delay departures or prevent aircraft from freeing up stands (and associated ground handling resources).

2.10 GAL disagreed that airfield capacity constraints are exacerbating the problem of poor on-time performance. ANS Limited, which provides air traffic control services at Gatwick, told us that tows have the lowest priority so would not be allowed to hold up a departing or arriving aircraft (also that tows are planned and the total volume of tows is capped).

Similarly it stated that push and hold movements do not delay other services as (except in times of extraordinary disruption) aircraft use push and hold stands that are on their normal route to the runway. And it argued that congestion on communications frequencies is caused by non-essential communications from airline staff rather than the high volume of movements.

- 2.11 Instead, GAL has argued that successful on-time performance at Gatwick is dependent on aircraft turnaround times and airline schedule adherence. It argues that airline schedules that incorporate insufficient resilience and overambitious aircraft turnaround times are a major contributory factor. It states that stand availability is dependent on airlines operating to plan, and that in practice late departures, early arrivals and other changes lead to changes in stand usage that add to operating complexity.

Other aspects of service quality

- 2.12 GAL's service quality commitment includes a set of service quality rebates, similar to those included in GAL's Q5 price cap,¹⁰ that are payable if GAL misses certain service quality targets. The targets cover passenger satisfaction measures, security queues, passenger operational measures, airline operational measures and an aerodrome congestion term. GAL's performance is assessed monthly, and separately for each terminal. The maximum amount of revenue at risk is 6.75 per cent (South Terminal) and 7.25 per cent (North Terminal). GAL's performance is documented in monthly reports that are published on its website and displayed at the airport.
- 2.13 As shown in Figure 2, GAL has met the majority of its service quality targets, and has maintained the high pass rate it achieved towards the end of the previous regulatory period.

¹⁰ Some changes were introduced for the current regulatory period. These include the elimination of performance bonuses, a daily measure for central search (in addition to a standard based on monthly average) and new standards (daily and monthly average) on outbound baggage performance.