Consumers and Markets Group

Future economic regulation of Gatwick Airport Limited: initial consultation

CAP 1684

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About this document

This consultation discusses the process and timetable for reviewing the economic regulation of Gatwick Airport Limited (GAL) and possible issues to be addressed during this process. The current regulatory arrangements are based on a set of commitments made by GAL during the course of the 'Q6' price control review that are also conditions of GAL's licence. These are due to expire in March 2021.

While we are launching this initial consultation, we are encouraging GAL and the airlines operating from Gatwick to discuss the best way forward and develop joint proposals on their preferred process for the review and, in due course, agreed proposals for new regulatory arrangements. We would consider whether any such proposals offer appropriate protection for the interests of consumers at Gatwick.

Views invited

We welcome views on all the issues raised in this document.

Please note that we have extended the original deadline for consultation responses to 28 September 2018.

Please e-mail responses to economicregulation@caa.co.uk no later than 28 September 2018. We cannot commit to take into account representations received after this extended date.

We expect to publish the responses we receive on our website as soon as practicable after the period for representations expires. Any material that is regarded as confidential should be clearly marked as such and included in a separate annex. Please note that we have powers and duties with respect to information under section 59 of the Civil Aviation Act 2012 and the Freedom of Information Act 2000.

If you would like to discuss any aspect of this document, please contact Stuart Holder (stuart.holder@caa.co.uk).

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Executive summary

Introduction

1. In 2014, following the introduction of a new legal framework for our economic regulation of airports, we completed a market power determination for GAL. We concluded that GAL met the market power test set out in section 6 of the Civil Aviation Act 2012 (CAA12) and should therefore be regulated by means of an economic licence. We are not currently planning to carry out a further market power determination for GAL.

2. Since 2014 our economic regulation of GAL has been based on a set of commitments given by GAL during the course of the 'Q6' price control review. These 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.

3. The commitments also set out the basis on which GAL will consult airlines and passenger representatives each year on its rolling investment programme and on operational resilience. This is in addition to regular multilateral consultation meetings with airlines on strategic and operational issues, and bilateral discussions between GAL and individual airlines.

4. The intention was that the commitments regime would be a proportionate and targeted approach to the economic regulation of Gatwick. By encouraging bilateral contracts it could support more targeted service offerings, better incentivise traffic growth and promote competition. All these considerations suggested that the commitments would be in the best interests of consumers.[1]

5. The experience of the commitments since 2014 has included a number of positive developments at Gatwick, including stronger than expected traffic growth and generally high levels of passenger satisfaction. To date GAL has held its charges below the 'fair price' benchmark that we calculated during the Q6 review. However, on-time performance has been worse than it was in the period before 2014, particularly during peak summer periods.

6. We carried out an early review of the new regulatory framework in 2016, to consider whether any aspect was operating against passengers' interests. We found that many aspects of the framework appeared to be working well, and none of the airlines we spoke to suggested that there should be a return to the

[1] In this document we use the term 'consumers' to refer to passengers and cargo owners. This is equivalent to 'users' of air transport services as defined in the Civil Aviation Act 2012.

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previous form of regulation. But we also identified some potential concerns about the progress of airfield investment projects, on-time performance and some aspects of GAL's relationships with airlines.

7. We are now seeking stakeholders' views on the process and timetable for determining the economic regulation that will apply to GAL after March 2021, and on possible issues to be addressed during this process. To allow time for the required licence modifications, we will need to reach final decisions on the new regulatory arrangements by the end of 2020 at the latest.

Process and timetable

8. As we are at the initial stage of the review there is an opportunity for the airlines and GAL to propose the process and timetable, and then to lead that process by negotiating a new set of regulatory arrangements. We would welcome a process that is both designed and implemented by agreement between the airlines and GAL.

9. Nevertheless, we have an important role to carry out to protect the interests of consumers. We will need to review any set of proposals agreed between the airlines and GAL to consider whether they are in consumers' interests. And we will need to be ready to play a more prominent role in the process if the airlines and GAL are not able to reach agreement in some areas.

10. If the process is led by negotiations between the airlines and GAL, then one possible high-level timetable is shown below. It will be important to retain flexibility so that the timetable and process can be adapted as negotiations progress. There is scope for the process to finish sooner, for example if negotiations are successful and the agreed proposals do not raise any material issues for consumers' interests.

Figure 1: A possible timetable for a process led by airline-GAL negotiations

11. We would welcome specific proposals from stakeholders (either separately or jointly) for the timetable and process to be followed for the review, bearing in

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mind the backstop of the end of 2020 for us to reach a final decision on the arrangements to take forward as proposed licence modifications.

Protecting consumers' interests

12. The expiry of the current set of commitments provides a good opportunity to consider whether the framework can be refined in order to work more effectively and better promote consumers' interests. GAL has already started consulting airlines and passenger representatives on its current service quality targets and rebates. This review is welcome, and we would expect that it will be underpinned by a strong evidence base.

13. We also consider that it would be useful for there to be a wider dialogue about the services and infrastructure that GAL should be delivering for airlines and consumers, and how these should be reflected in the new regulatory arrangements. Future traffic growth could pose challenges for punctuality and other aspects of service quality. Any new regulatory arrangements are more likely to be effective if they are underpinned by a shared understanding of the most suitable way of maintaining services to consumers in such an environment.

14. In reviewing whether any agreed proposals are in consumers' interests, we will also consider whether they are likely to provide value for money for consumers. We will look to GAL to provide compelling evidence that this will be the case under a range of plausible scenarios for the next regulatory period.

Key questions for consultation and next steps

15. We are inviting views on how best to improve the current commitments, including both the timetable and process to be followed and how best we can ensure that this process protects the interests of consumers. Chapter 2 highlights key issues for consultation on the timetable and process and chapter 3 highlights key issues for consultation on how best we can protect consumers' interests.

16. Views are welcome on all these issues, including any responses jointly agreed between the airlines and GAL, or individual submissions from any stakeholder. We are also happy to meet with stakeholders to discuss issues raised in this consultation paper.

17. We expect to publish an update once we have considered the responses to this consultation in October 2018.

Our duties

18. In developing this consultation we have had full regard to our statutory duties under CAA12, which are summarised in Appendix A.

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Structure of this document

19. The structure of this document is as follows:

- Chapter 1 sets out the background to this consultation, including our current regulation of GAL, our 2016 review and recent trends at Gatwick;
- Chapter 2 describes some high-level options for the timetable and process to support the introduction of new regulatory arrangements by April 2021; and
- Chapter 3 discusses some of the issues that we might need to take into account to best protect the interests of consumers.

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Chapter 1

Background

Overview of our regulation of GAL

1.1 In 2014, following the introduction of a new legal framework for our economic regulation of airports, we completed a market power determination for GAL. We concluded that GAL met the market power test set out in section 6 of CAA12 and should therefore be regulated by means of an economic licence. For the avoidance of doubt, we are not currently planning to carry out a further market power determination for GAL.[2]

1.2 Following this determination and our Q6 price control review we introduced a new form of economic regulation for GAL in 2014. This is based on a set of commitments offered by GAL covering the seven years to March 2021.[3]

1.3 Although the commitments form part of GAL's Conditions of Use, they are also conditions of GAL's licence and therefore enforceable by us. Appendix B describes the commitments in more detail. In summary they include:

- a price commitment – this is based on price paths of the Retail Price Index (RPI) +0% for the average blended price (which takes accounts of discounts agreed in bilateral contracts) and RPI+1% for the average published price;
- a service standards commitment – a system of rebates payable if GAL misses certain service quality targets;
- continuity of service plan, operational and financial resilience – this includes an obligation to prepare and maintain plans on continuity of service and operational resilience;
- an investment and consultation commitment – GAL will maintain the airport to comply with safety/environmental requirements and develop the infrastructure to allow it to meet service quality targets. It will invest at least £700 million during the seven years of the commitments; and

[2] We have discretion to carry out a market power determination whenever we consider it appropriate to do so. Interested parties can also request that we carry out a market power determination. In this case we can decide not to carry out a determination in situations where we have already made a market power determination and we consider that there has not been a material change of circumstances since then. For further details see CAP 1433, Market Power Test Guidance. Available at www.caa.co.uk/cap1433.

[3] The commitments also state that GAL will notify airlines and us by 31 March 2019 of its intention with regards to the continuation of commitments, if any, on pricing, service standards, continuity of service, operational and financial resilience, investment consultation and financial information.

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