

Economic regulation of Gatwick Airport Limited: consultation on new commitments

CAP 1973



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About this document

This consultation document seeks stakeholders' views on our proposed approach to updating the economic regulation of Gatwick Airport Ltd (GAL).

The current regulation of GAL is based on a set of commitments that expire on 31 March 2021. Following discussions with airlines and other stakeholders, GAL finalised a set of new proposed commitments earlier this year. Our initial assessment, for consultation, is that these commitments are consistent with protecting the interests of consumers and this document consults on accepting GAL's commitments for the four year period from 2021/22 to 2024/25.

Views invited

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

Please e-mail responses to economicregulation@caa.co.uk by no later than 30 November 2020. We cannot commit to take into account representations received after this 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).

Executive summary and introduction

Introduction

1. Since 2014 the economic regulation of GAL has been based on a set of commitments given by GAL during the 'Q6' price control review. As part of that review we decided that the commitments should be conditions of GAL's licence. The commitments cover, among other things, the maximum level of airport charges that GAL can levy over the seven years from April 2014 to March 2021, a system of rebates if GAL misses certain service quality targets, and a minimum level of investment that GAL will undertake.¹
2. The commitments framework was intended to be a proportionate and targeted approach to the economic regulation of GAL. By encouraging bilateral contracts it could support more targeted service offerings, better incentivise traffic growth and promote competition. All of these considerations suggested that the commitments would be in the best interests of consumers.²
3. We carried out an early review of the new regulatory framework in 2016, to consider whether any aspect of this framework was operating against consumers' 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 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.
4. There had been a number of positive developments at Gatwick since 2014,³ including stronger than expected traffic growth and generally high levels of passenger satisfaction. For the first five years of the period GAL held its charges below the 'fair price' benchmark that we calculated during the Q6 review. However, on-time performance had been worse than it was in the period before 2014, particularly during peak summer periods.
5. Covid-19 has had a particularly strong impact on traffic at Gatwick. There was almost no traffic at all for several months, and in August 2020 the number of passengers was more than 80 per cent lower compared with August 2019. There is significant uncertainty about how quickly traffic will recover over the next few

¹ See Appendix B for a summary of the current commitments.

² 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.

³ See Appendix C for more details.

years. Nonetheless, it is clear that Gatwick airport, airlines and other aviation industry stakeholders will continue to face severe difficulties for a period of time.

The review process to date

6. In June 2018 we published a consultation document seeking stakeholders' views on the process and timetable for determining the economic regulation that would apply to GAL from April 2021.⁴ We said we would welcome a process designed and implemented by agreement between the airlines and GAL. But we also made clear that we would need to review any proposals that resulted from this process to consider whether they are in consumers' interests.
7. We received a joint response from GAL and the Airport Consultative Committee (ACC) saying that they would collaborate with each other and attempt to negotiate a new set of commitments, and setting out a proposed work programme and timetable.⁵ We responded by letter in October 2018 welcoming the proposed approach and noting our role in protecting the interests of consumers.⁶
8. GAL then made an initial proposal to airlines in December 2018. Subject to airline responses, GAL envisaged that these new commitments could be implemented in April 2019 for a period of six years (i.e. until March 2025). They would therefore supersede the existing commitments for the final two years of the current period.
9. Rather than accepting GAL's proposals, however, airlines said that they wished to see through to completion several workstreams that were underway, including new passenger research by GAL (with input from airlines and the Passenger Advisory Group⁷) and discussions of possible changes to the existing service quality metrics and targets. Among other things, the research highlighted that passengers would like to see improvements to the lounge, gate, immigration and baggage hall experiences. The joint work between GAL and airlines continued for much of 2019.
10. In October 2019, GAL consulted airlines and the Passenger Advisory Group on an updated set of proposals. It then issued its updated and finalised proposals for our review in January 2020. These proposals include:

⁴ [CAP 1684](#).

⁵ [Joint letter from Gatwick Airport Limited and the Gatwick Airport Consultative Committee, 25 September 2018](#).

⁶ [Letter from Paul Smith, 8 October 2018](#).

⁷ The Passenger Advisory Group forms part of the Gatwick Airport Consultative Committee (GATCOM). For details see <http://www.gatcom.org.uk/passenger-advisory-group/>.

- a price commitment with a cap of Retail Prices Index (RPI) + 0% for published charges, but no separate cap on net charges (i.e. charges paid after allowing for discounts);
 - a number of detailed changes to service quality targets, including a switch from annual to quarterly moving averages for passenger survey scores, detailed changes to asset availability targets and a new runway availability measure; and
 - a minimum investment commitment of £120 million per year on average.
11. To inform our review of GAL's proposals, we wrote to airlines and the Passenger Advisory Group in February 2020 inviting formal submissions to indicate their degree of support for the proposals. However, as this period coincided with the onset of Covid-19 in the UK, we received only a single response plus multiple requests to extend the deadline for responses. Since then, we have maintained informal contacts and continued to engage with both GAL and its largest airline customers.

CAA's proposed approach

12. Our current view is that we should accept GAL's proposed new commitments. Viewed as a whole, and bearing in mind the impact of Covid-19 on the future outlook, the package of changes set out by GAL is likely to be in consumers' interests.
13. Regarding the individual elements of the proposals:
- our analysis suggests that GAL's proposed cap on published charges is now more likely to strike a reasonable balance between the interests of GAL and those of its passengers and airlines. While we cannot rule out scenarios under which the cap might allow GAL to earn relatively high profits towards the end of the next period, there are other scenarios under which GAL's profits might remain at a relatively low level throughout the period;⁸
 - the proposed changes to GAL's service quality targets and rebates reflect the outcome of detailed discussions between GAL and airlines, and should lead to a number of improvements compared with the current service quality targets. While GAL did not agree to every change put forward by airlines, we consider that the changes that GAL is proposing form part of an overall package that is likely to be in consumers' interests. There are also some issues on which GAL expects discussions with airlines to continue, and this flexibility is also helpful;

⁸ Higher than expected profits are not necessarily a concern within an economic regulation framework, particularly if they result from improved outcomes that benefit consumers, such as increased choice, better facilities and improved service quality.

- the new minimum investment commitment is slightly higher than the current commitment. We have not seen any evidence to suggest that the investment commitment should be changed or that additional specific obligations should be included, and in any case any such changes would be unlikely to be appropriate given the current uncertainty about how fast traffic will recover over the next few years. We currently monitor GAL's investment in airfield infrastructure and will continue to do so during the next period.
14. We also continue to consider that an economic regulation framework that facilitates bilateral discussions and contracts between Gatwick and airlines can be in the longer term interests of consumers. It allows the airport and airlines to develop price and service propositions that are tailored to their interests and consumers interests, rather than being subject to a single set of overarching price and service settings.
15. During the next period it will be important that GAL and airlines continue their discussions on the unresolved aspects of service quality metrics and targets. These include security queues, for which GAL has committed to invest in new measurement technology, and airfield assets, where GAL has indicated its willingness to examine an alternative approach suggested by airlines. We stand ready to assist the parties in this process, if that would be helpful. And if there is not sufficient progress, we will consider whether any further action is required to protect consumers' interests.
16. We also plan to add two specific items to our ongoing monitoring of GAL's performance. These are:
- GAL's performance in relation to seating facilities in its departure lounges, which we will monitor both through GAL's monthly passenger survey scores and through any other feedback that is available. We intend to monitor this as it was one of the areas for improvement highlighted in GAL's 2019 passenger research, and the target score is lower than those for other service standards measured by passenger surveys. Although the new target has been tightened as a result of the switch from annual to quarterly moving averages, GAL resisted requests for a further increase and instead offered to report any survey score between 3.8 and 4.0 as amber rather than green; and
 - the average level of discounts that GAL offers to airlines, which will we monitor as we note there will no longer be a separate price cap on net charges.
17. Following the completion of this review, we will consider whether to carry out a 'lessons learned' exercise from this review and/or other work to support the continued evolution of the commitments framework at Gatwick.

Views invited

18. Views are invited on any of the issues raised in this document and, in particular, on the policy proposals summarised above and described in more detail in Chapter 2.

Our duties

19. In developing this consultation we have had full regard to our statutory duties under the Civil Aviation Act (CAA12), which are set out more fully in Appendix A.

Structure of this document

20. The structure of this document is as follows:
- Chapter 1 provides an overview of GAL's proposed new commitments;
 - Chapter 2 sets out our policy proposals for the next regulatory period; and
 - Chapter 3 discusses next steps.

Chapter 1

Overview of GAL's proposed new commitments

Introduction

- 1.1 This chapter summarises the main features of GAL's proposed new commitments. They are described in full in the document "GAL's finalised, extended Commitments", dated 27 January 2020, which has been distributed to airlines and is also available on CAA's website.⁹
- 1.2 The following sections highlight the main proposed changes to the price, service quality and investment commitments. Most other parts of GAL's proposals are unchanged from the current commitments, including the financial information commitment and the commitment to maintain and develop continuity of service, operational resilience and financial resilience plans.
- 1.3 One further proposed change is the removal of a provision¹⁰ that would have allowed GAL to recover certain costs related to its proposal for an additional runway to the south (which in 2014 was still under consideration by the Airports Commission). While GAL is no longer actively pursuing plans for this additional runway, in 2019 it published a new Master Plan which includes a proposal to bring its current standby runway into routine use for flight departures.¹¹ Under GAL's proposed new commitments, it would bear all of the planning, development and delivery costs associated with this project during the next regulatory period, with no impact on its proposed price cap.¹²

Price commitment

- 1.4 The main element of GAL's proposed new price commitment is a cap of RPI+0% on the annual increase in its published charges. Specifically the cap applies to GAL's 'core yield', which measures the average revenue per passenger from regulated services that would have resulted from applying GAL's published tariffs (rather than any discounted or alternative charges specified in bilateral contracts between GAL and individual airlines).

⁹ [https://www.caa.co.uk/uploadedFiles/CAA/Content/Accordion/Standard_Content/Commercial/Airports/GAL_Extended_Commitments_\(Jan2020\).pdf](https://www.caa.co.uk/uploadedFiles/CAA/Content/Accordion/Standard_Content/Commercial/Airports/GAL_Extended_Commitments_(Jan2020).pdf)

¹⁰ Paragraph 6.2 of Schedule 2 of GAL's Conditions of Use.

¹¹ <https://www.gatwickairport.com/globalassets/business--community/growing-gatwick/master-plan-2019/gatwick-master-plan-2019.pdf>.

¹² See p49 of GAL's finalised, extended Commitments.