

Economic regulation of Gatwick Airport Limited: notice of licence modifications

CAP 2144



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About this document

This document gives notice under section 22(6) of the Civil Aviation Act 2012 (“CAA12”) of the CAA’s decision to modify Gatwick Airport Limited’s (“GAL”) economic licence. The modifications are to implement GAL’s proposed new commitments for the four year period from 2021/22 to 2024/25.

The decision on these licence modifications follows on from the notice issued under section 22(2) of CAA12 in February 2021 and the consultation on our proposed approach in October 2020.

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

Executive summary and introduction

Purpose of this document

1. This document is the notice under section 22(6) of the Civil Aviation Act 2012 (“CAA12”) of the CAA’s decision to modify the licence granted to Gatwick Airport Limited (“GAL”) on 13 February 2014.
2. The modifications reflect the CAA’s decision to accept the commitments put forward by GAL for the four year period from 2021/22 to 2024/25. They will take effect from 18 June 2021, but they will apply to GAL’s revenues from 1 April 2021.
3. This notice follows on from the notice issued under section 22(2) of CAA12 in February 2021 (“the February 2021 Consultation”)¹ and the consultation on our proposed approach in October 2020 (“the October 2020 Consultation”).² In accordance with section 22(8) of CAA12, it sets out the modifications that the CAA has decided to make to the licence, the reasons for making those modifications and their effect. It also sets out how we have taken account of the representations made in response to the February 2021 Consultation and the reasons for any differences between the modifications we have decided to make and those we proposed in the February 2021 Consultation.
4. This document also deals with other matters raised in the October 2020 and February 2021 Consultations, including issues related to service quality targets and changes to our ongoing monitoring of GAL’s performance.

Main issues raised in this document

Licence modifications to implement the new commitments

5. Since 2014 our economic regulation of GAL has been based on a set of commitments given by GAL during the ‘Q6’ price control review and which expired on 31 March 2021. They cover, among other things, the maximum level of airport charges that GAL can levy, a system of rebates if GAL misses certain service quality targets, and a minimum level of investment that GAL will undertake.³

¹ Economic regulation of Gatwick Airport Limited: notice of proposed licence modifications www.caa.co.uk/cap2103.

² Economic regulation of Gatwick Airport Limited: consultation on new commitments www.caa.co.uk/cap1973.

³ See Appendix B of the [October 2020 Consultation](#) for a summary of the original commitments. The

6. Following our June 2018 consultation on the timetable and process for the current review,⁴ GAL and airlines entered discussions on several different aspects of the commitments, including possible changes to service quality metrics and targets, and changes to the investment consultation process.
7. GAL then finalised its proposals for a new set of commitments for our review in January 2020,⁵ before the impact of Covid-19 was clear. These proposals included a cap of Retail Prices Index (RPI) + 0% for published charges (but no separate cap on charges after allowing for discounts – we refer to these as “net charges”), a number of detailed changes to service quality targets, and a minimum investment commitment of £120 million per year on average.
8. In the October 2020 Consultation we said that, viewed as a whole and bearing in mind the significant impact of Covid-19 on the future outlook, we considered that the package of changes set out by GAL was likely to be in consumers’ interests.⁶ Having considered the responses received, in the February 2021 Consultation we confirmed our proposal to accept GAL’s commitments and set out the proposed licence modifications required to implement this.

Stakeholders’ views

9. GAL, the Airport Consultative Committee (ACC) and British Airways (BA) responded to the February 2021 Consultation. Regarding the proposed licence modifications:
 - GAL welcomed the CAA policy outlined in the February 2021 Consultation. Its only comment on the proposed licence modifications was to suggest revised definitions of ACC and PAG (in Schedule 4 of its Conditions of Use) to clarify the difference between these two bodies;
 - the ACC stated that it had no further comments on the proposed licence modifications; and
 - BA stated that the proposed modifications were aligned with its expectations. It said that the points and concerns raised in its previous consultation response remain and reaffirmed its view that GAL is well positioned to see a strong recovery in passenger numbers and continues to hold significant market power.

commitments are also conditions of GAL’s licence.

⁴ Future economic regulation of Gatwick Airport Limited: initial consultation www.caa.co.uk/cap1684.

⁵ GAL’s finalised, extended Commitments, 27 January 2020
[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).

⁶ 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 CAA12.

Our decision to modify GAL's licence

10. Having considered stakeholders' responses, we have decided to modify GAL's licence (including the commitments as set out in GAL's Conditions of Use) in order to implement GAL's proposed new commitments for the period from 2021/22 to 2024/25.
11. We remain of the view that they form part of a package of changes that is likely to be in consumers' interests, and we welcome the fact that GAL has not sought to amend its proposals despite the very significant deterioration in the medium term outlook since they were finalised. We have also taken account of the potential long-term benefits to consumers of a regulatory framework that facilitates commercial discussions rather than one that relies on regulator-led decision making.
12. The modifications to GAL's licence are set out in Appendix B. We do not consider that these differ significantly from the modifications set out in the February 2021 Consultation as they are almost identical, with the only exceptions being:
 - a very minor amendment to condition 6.4 of GAL's Conditions of Use, to bring the terminology into line with the revised service standards; and
 - revised definitions in Schedule 4 of GAL's Conditions of Use, as proposed in GAL's response to the February 2021 Consultation, to clarify the difference between the two consultative bodies.

Other issues

13. The February 2021 Consultation covered several other issues:
 - we noted that GAL planned to install a new security queue measurement system, but the timing of this was uncertain and new service quality targets would need to be agreed once the new system has been installed;
 - we said that we would add two items to our ongoing monitoring of GAL's performance. These were:
 - GAL's performance in relation to seating facilities in its departure lounges, which was one of the areas for improvement highlighted in GAL's 2019 passenger research;
 - the average level of discounts that it offers to airlines, which we will monitor as there will no longer be a separate cap on net charges;
 - we said that we planned to carry out three focused assessments to review:
 - GAL's net charges and the average level of discounts, to see whether there is any evidence that the absence of a cap on net charges is acting against consumers' interests;

- service quality issues, to check that the outstanding issues have been resolved and that the new metrics (including new security queue targets) are working as intended;
 - investment issues, to consider how the new consultation process is working and whether airfield investment is being reinstated sufficiently quickly; and
 - we said that we would consider whether to carry out a focused assessment of issues that have arisen during the current process in order to support the next review.
14. Airlines welcomed the proposed focused assessments but asked for greater clarity on the timing and nature of the assessments, and BA also made some comments about the next review of the commitments. GAL stated that the focused assessments should be undertaken in a time-efficient way, and should remain specific in scope and proportionate to its reduced market power in the aftermath of Covid-19.
15. Having considered stakeholders' responses, we intend to proceed with the additional monitoring and focused assessments as described above.
16. Our view remains that, if there is a reasonable prospect of traffic recovering, GAL should take the actions necessary to ensure that a suitable security queue measurement system is in place for the peak summer period this year. However, we also recognise that there is considerable uncertainty about when traffic will recover, and that a flexible approach will be required.
17. Regarding the focused assessments, it would be premature to make decisions now about the precise timing, scope or potential outcomes of these assessments. We will decide these at a later stage, taking account of factors including:
- how far passenger numbers have recovered;
 - specific milestones relevant to each assessment (such as the installation of the new security queue measurement system);
 - whether we are aware of any problems arising in each area; and
 - whether we expect the findings from any assessment to be useful in contributing to and/or shaping the next review of the commitments framework.

Next steps

18. As stated above, the licence modifications set out in Appendix B will take effect on 18 June 2021. However, as set out in the February 2021 Consultation, they will apply to GAL's revenues from 1 April 2021.

19. CAA12 also provides both GAL and materially affected airlines with the right of appeal to the Competition and Markets Authority (CMA) following a notice by the CAA to modify GAL's licence. It is for GAL and airlines to decide whether to exercise these rights, consistent with the procedures set out in CAA12.
20. Once the licence modifications have taken effect, and subject to the outcome of any appeal to the CMA, GAL will be required to make the required changes to its Conditions of Use as soon as reasonably practicable.
21. We will also proceed with the additional monitoring and focused assessments described above.

Our duties

22. In developing this policy we have had full regard to our statutory duties under CAA12, which are set out in Appendix A.

Structure of this document

23. The structure of this document is as follows:
 - Chapter 1 confirms our intention to accept GAL's new commitments and summarises our reasons for, and the effects of, the modifications to GAL's licence;
 - Chapter 2 addresses other issues raised in the February 2021 Consultation, which relate to unresolved service quality targets and our ongoing monitoring of GAL's performance;
 - Appendix A summarises our statutory duties;
 - Appendix B sets out the specific modifications to GAL's licence; and
 - Appendix C sets out the reasons for and effects of each modification.

Chapter 1

Licence modifications to implement the new commitments

Introduction

- 1.1 Following the February 2021 Consultation we have decided to modify GAL's licence to implement its proposed new commitments for the period from 2021/22 to 2024/25.⁷ The specific licence modifications are set out in Appendix B and will take effect from 18 June 2021. They will apply to GAL's revenues from 1 April 2021.
- 1.2 In summary, the new commitments include:
- 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 service standards commitment which features 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
 - an investment commitment which increases GAL's minimum average spend to £120 million per year.⁸
- 1.3 Our decision to accept GAL's proposed new commitments is consistent with the proposed approach set out in both the October 2020 and February 2021 Consultations. We said then that, taken as a whole and bearing in mind the impact of Covid-19 on the future outlook, our view was that the package of changes would strike a reasonable balance between the interests of GAL and airlines, and was likely to be in consumers' interests.

Responses to the February 2021 Consultation

- 1.4 GAL stated that its Commitments represent an appropriate and stable base for GAL and its airline customers to plan for the recovery from Covid-19 and it welcomed the CAA policy outlined in the February 2021 Consultation. It made

⁷ GAL's proposals are described in full in the document "GAL's finalised, extended Commitments", dated 27 January 2020, which has been distributed to airlines and is available on CAA's website at [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).

⁸ This is assessed over the six years from 2019/20 to 2024/25.

one comment on the proposed licence modifications. Following feedback from GATCOM it suggested amended definitions of 'ACC' and 'PAG' in Schedule 4 of its Conditions of Use in order to avoid any potential confusion. It suggested the following definitions:

- 'ACC' means the Airport Consultative Committee. This is the airlines' consultative body at Gatwick Airport. It should not be confused with GATCOM, which is the Airport Consultative Committee in the meaning of Section 35 of the Civil Aviation Act 1982; and
- 'PAG' means GATCOM Passenger Advisory Group - a subgroup of GATCOM (the Gatwick Airport Consultative Committee - constituted to meet the requirements of Section 35 of the Civil Aviation Act 1982).

1.5 Among the airline respondents:

- the ACC had no further comments on the proposed modifications to GAL's licence; and
- BA stated that the proposed modifications were aligned with its expectations. However, it also stated that the points and concerns raised in its previous consultation response remain. It acknowledged that the impact of Covid-19 had been a key consideration in our acceptance of GAL's proposed new commitments, but it reaffirmed its view that GAL is well positioned to see a strong recovery in passenger numbers and continues to hold significant market power.

Way forward

- 1.6 Having considered stakeholders' responses, we have decided to modify GAL's licence (including the commitments as set out in GAL's Conditions of Use) in order to implement GAL's proposed new commitments for the period from 2021/22 to 2024/25. We remain of the view that they form part of a package of changes that is likely to be in consumers' interests, and we are also mindful of the focused assessments and additional monitoring described in Chapter 2. Taken together, our overall approach should ensure that consumers' interests are properly protected and they can benefit from the innovative approaches that greater competition and lighter touch regulation can encourage.
- 1.7 The modifications to GAL's licence, which are set out in Appendix B, are almost identical to those set out in the February 2021 Consultation. The only exceptions are:
- revised definitions of the ACC and PAG in Schedule 4 of GAL's Conditions of Use, as set out in paragraph 1.4 above; and

- a very minor amendment to condition 6.4 of GAL's Conditions of Use, to change "airfield availability" to "runway availability" in order to use terminology consistent with the revised service standards.

The reasons for and effect of the proposed modifications

- 1.8 GAL's previous commitments expired on 31 March 2021. Absent any modification to GAL's licence:
- some parts of the commitments would cease to apply after 31 March 2021. These include the limit on the maximum airport charges that GAL can levy, the requirement to undertake a certain minimum level of investment and to consult airlines and PAG on its annual capital investment programme, and the requirement to ensure certain financial information is available to airlines;
 - other parts of the commitments would continue to apply in their current form. These include the service quality targets and rebates, the requirement to maintain and develop the airport infrastructure to allow GAL to meet its service quality targets, and requirements in relation to continuity of service, operational and financial resilience.
- 1.9 It is necessary to modify GAL's licence, therefore, to ensure that there remains a limit on the maximum level of airport charges that it can levy and a specific obligation to carry out a minimum level of investment. Without such continuing protection, there would be a risk that GAL would be able to exploit any substantial market power that it possesses to the detriment of consumers.
- 1.10 In addition, modifying GAL's licence to implement the proposed new commitments provides an opportunity to update the service quality targets and the investment consultation process in order to introduce changes that are likely to benefit consumers in future.
- 1.11 Our reasons for accepting GAL's proposed new commitments and therefore making the modifications set out in Appendix B are summarised below. A more detailed commentary on the reasons for and effect of specific changes is provided in Appendix C.

The price commitment

- 1.12 The price commitment remains an important protection for consumers. We continue to consider that a price cap of RPI+0% applied to GAL's published charges is likely to strike a reasonable balance between the interests of GAL and those of its passengers and airlines. While we cannot rule out GAL being able to earn relatively high profits towards the end of the period, there are a number of other scenarios under which GAL's profits will remain at a relatively low level for the whole of the period. We also welcome the fact that GAL has not sought to amend its proposed price cap, despite the very significant deterioration in the medium term outlook since it finalised its proposed new commitments.

- 1.13 In reaching this view on the price commitment, we have also taken account of the potential long-term benefits to consumers of a regulatory framework that facilitates commercial discussions rather than one that relies on regulator-led decision making.
- 1.14 We remain mindful that airline respondents to the October 2020 Consultation expressed concerns about the removal of the cap on GAL's net charges. However, taking account of GAL's pricing decisions over the previous regulatory period and the likely impact of Covid-19 on GAL's market power at the start of the current period, we continue to consider that monitoring GAL's average discounts and carrying out a focused assessment of its net charges is a proportionate way of addressing such concerns.
- 1.15 As stated in the February 2021 Consultation, we see a relatively strong case for GAL's price cap switching from RPI to CPI indexation in the future, but we do not believe the arguments are sufficiently strong to justify changing the proposal that GAL has already put forward to airlines.

The service standards and investment commitments

- 1.16 The modifications to the service standards and investment commitments reflect two sets of changes that were agreed between GAL and airlines, and which are likely to benefit consumers in future. They are:
- a number of detailed changes to service quality targets; and
 - changes to the investment consultation process.
- 1.17 Some airline responses to the October 2020 Consultation suggested possible further changes to particular service standards or to the investment commitment. In the February 2021 Consultation, we said that GAL's proposed new commitments should be viewed as an overall package that would be in consumers' interests, rather than a menu from which we should pick and choose. The significant uncertainty currently facing the aviation industry is a further argument against imposing additional service quality or investment requirements on GAL at this time.
- 1.18 As described in Chapter 2, in order to address some of airlines' specific concerns in these areas we will be monitoring GAL's performance in relation to seating facilities in its departure lounges. We will also carry out focused assessments of how the new service quality targets and the new investment consultation process are working.

Chapter 2

Other issues

Introduction

- 2.1 In the February 2021 Consultation, in addition to setting out proposed licence modifications, we made a number of comments on our ongoing monitoring of GAL's performance.
- 2.2 We noted that GAL planned to install a new measurement system for security queues, but the timing of this was uncertain and new service quality targets would need to be agreed once the new system has been installed. We said that we would monitor progress on this issue and that, if there is a reasonable prospect of traffic recovering, we will expect GAL to ensure that a suitable measurement system is in place for the peak summer period this year. We also said that GAL and airlines should work constructively together to discuss any interim measures that may be required before the new system is installed.
- 2.3 We said that we would add two new items to our ongoing monitoring. These are:
- GAL's performance in relation to seating facilities in its departure lounges. This was one of the areas for improvement highlighted in GAL's 2019 passenger research, and the current target survey 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 (where 1 is extremely poor and 5 is excellent) as amber rather than green; and
 - the average level of discounts that GAL offers to airlines, which we will monitor as there will no longer be a separate cap on net charges. We acknowledged, however, that the level of discounts is primarily a commercial decision for GAL, and that there are legitimate reasons why the average level of discounts may change from year to year.
- 2.4 We said that we planned to carry out three focused assessments to review:
- GAL's net charges and the average level of discounts, to see whether there is any evidence that the absence of a cap on net charges is acting against consumers' interests;
 - service quality issues, to check that the outstanding issues have been resolved and that the new metrics (including new security queue targets) are working as intended; and

- investment issues, to consider how the new consultation process is working and whether airfield investment is being reinstated sufficiently quickly.

2.5 Finally, we said that we would consider whether to carry out a focused assessment of issues that have arisen during the current process in order to support the next review.

Responses to the February 2021 Consultation

- 2.6 GAL stated that it is important to recognise that market fundamentals are likely to have changed significantly since work on the new commitments started in 2017/18. It stated that our proposed focused assessments should be undertaken in a time-efficient way, and should remain specific in scope and proportionate to GAL's reduced market power in the aftermath of Covid-19.
- 2.7 The ACC welcomed our proposal to carry out several focused assessments, though it stated that further clarity is required regarding the timing, format, criteria to be applied and the form of outcome of the reviews.
- 2.8 BA supported the principle of focused assessments. But it also requested greater clarity on the intended scope and timing, stating that it strongly believes the assessments should be after the first year of the new period but before the end of the second year. It also stated that there should be an option to delay any assessment, for example if low traffic volumes mean that service quality measures have not been sufficiently tested.
- 2.9 BA also made some comments about the next review of the commitments, including welcoming our comments about a possible switch from RPI to CPI indexation and seeking confirmation that we intend to undertake a full quantitative analysis in preparation for the next review. It requested transparency that the published price path can be supported by an assessment of efficient commercial revenues and operating costs, and stated that the price mechanism might also be adjusted to reflect actual capital expenditure. It also stated that the removal of the net yield price commitment will be an important issue for the regulatory period beginning in 2025.

Way forward

- 2.10 Having considered stakeholders' responses, we intend to proceed with the additional monitoring and focused assessments as described above.
- 2.11 Our view remains that, if there is a reasonable prospect of traffic recovering, GAL should take the actions necessary to ensure that a suitable security queue measurement system is in place for the peak summer period this year. And we expect GAL and airlines to work constructively together to discuss the potential need for interim measures, such as reverting to a manual measurement system, if this is required before any new system is installed.