

**CIVIL AVIATION AUTHORITY**



**FOR PUBLICATION**

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**MINUTES OF THE 467<sup>th</sup> BOARD MEETING HELD ON WEDNESDAY 18 SEPTEMBER 2013 at  
11.30 a.m. IN CONFERENCE ROOMS 1 AND 2, CAA HOUSE**

**Present:**

**Dame Deirdre Hutton**

**Chair**

**Mr Andrew Haines**

**Chief Executive**

**Dr Catherine Bell**

**Mr David Gray**

**Mr Richard Jackson**

**Miss Chris Jesnick**

**Mr David King**

**Mr Iain Osborne**

**Mr Mark Swan**

**Mrs Kate Staples**

**In Attendance:**

**Dr Stephen Rooney**

**Director, Corporate Communications**

**Mr Keith Richards For Item I**

**Chair, Consumer Panel**

**Mr James Tallack For Item I**

**Consumer Panel**

**Mr Richard Moriarty For Item III**

**Director, Economic Regulation**

**Mr Tim Griffiths For Item III**

**Senior Economic Regulatory Policy Advisor**

**Mr Peter John For Item III**

**Senior Economic Regulatory Policy Advisor**

**Mr Rob Cowle For Item III**

**Senior Regulatory Policy Advisor**

**Mr Duncan Kernohan For Item III**

**Regulatory Policy Adviser**

**Ms Anneli Howard For Item III**

**Standing Counsel to CAA, Monckton Chambers**

**Mr Philip Clarke For Item VIII**

**Senior Regulatory Policy Adviser**

**Mr Ray Elgy For Item VIII**

**Head of Licensing & Training Standards**

**Mr Mike Barnard For Item VIII**

**General Aviation Programme Manager**

**Mr Peter Drissell For Item IX**

**Aviation Security Director**

**Mr Peter Gardiner    Minute Taker**

**Miss Liz Mingo    Minute Taker**

**Maggie Kwok    Minute Taker**

**Dilsha Caldera    Minute Taker**

**Consumer Panel Discussion - Doc 2013-114 by Iain Osborne & Keith Richards**

1. Dame Deirdre Hutton introduced Keith Richards and James Tallack to the Board. Mr Richards advised the Board that an Executive Summary was being prepared for the Consumer Panel Annual Report, but that he would welcome feedback on the main body of the draft report.
2. Mr Richards reported that it had been a very busy period for the Panel and that this had been driven by the CAA's agenda. He advised that there were eight Panel members, each of whom had a wealth of experience (for instance, in consumer policy and regulation), although none had an aviation background. The Panel planned to focus its efforts in the coming year on two areas: data and research and what consumers are really interested in. As regards research and data, the Panel wished to use existing and develop new material, and to do so with a particular concentration on the needs of vulnerable consumers.
3. The Board sought Mr Richards' views on three areas: work carried out in the past year, in particular on Q6 matters; the future work programme; and how the Panel was working in practice. With regard to Q6 matters, Mr Richards advised that the Panel was interested in how any licensing system could be operated and keen to ensure that any such system did not lead to a 'watering down' of the levels of

quality and service delivered under a RAB-based framework. Mr Richards noted that the role of the Panel had been to challenge the CAA's views in relation to all three airports. Whilst there would be bilateral contracts at Stansted, that might not be the case at Gatwick or Heathrow. At each airport, however, the CAA would need to assess the impact of the operator's actions on consumers. The Panel would look at airport licensing through the consumer lens at its meeting in November.

4. The Board stated that the Panel's interest in these areas was shared by the CAA. The Board agreed that effective monitoring of the impacts of the regimes adopted at each airport would be very important, with the CAA always seeking to strike the right balance between intervention and oversight.

5. Mr Richards expressed the view that other regulators' consumer panels could be a useful source of views on how to address the needs of vulnerable consumers and how to monitor the impacts of a licensing system. The Board discussed the provision of information to consumers, especially infrequent flyers and disabled travellers. The Board considered consumer vulnerability, noting Mr Richards' view that care was needed in labelling a consumer as vulnerable because that label might trigger assumptions about an individual's level of self-reliance. Mr Richards explained the Panel's view that it was important to develop awareness in order to open up opportunities for disabled passengers. For example, raising awareness of pre-notification of an intention to fly amongst disabled consumers could allow the industry to meet the needs of such clients more easily.

6. Mr Richards advised the Board that the Panel was supported by James Tallack, who spent 50% of his time working with the Panel. Mr Richards explained that the Panel had sought to work flexibly, and did not limit its activity only to its formal meetings. This might generate some pressure on Panel members' ability to give their time without remuneration. Mr Richards stated that he had now started to evaluate the expertise of the individual Panel members, in order to best use that experience and knowledge in ad-hoc meetings on individual subjects but, he emphasised that the members as a whole did not want to lose visibility or oversight of the wider work that the Panel is involved in.

7. Mr Richards spoke favourably about the reception that the panel had received within the CAA and particularly noted the open-mindedness and willingness of those staff they had engaged with. There was however, a need to ensure that the Panel's role was well understood across the wider CAA, particularly within the Safety and Airspace Regulation Group (SARG). Mr Swan confirmed that this was an objective of the newly merged Group. The Board noted that it would be particularly important to secure the Panel's input during policy development work, which made it wise for the Policy Programmes Team (PPT) to become the main point of contact for such work.

8. The Board noted that the Panel was getting good access to the CAA, thanked Mr Richards for his time and for the Panel's hard work, and confirmed that that the Board was content with the Panel's

report and the work programme going forward.

## **II. Apologies**

9. Apologies were received from AVM Stringer.

## **III Q6 Final Proposals including Licence Condition– Doc 2013-124 – Overview Document, Doc 2013-125 – Gatwick Paper, Doc 2013-126 – Heathrow Paper by Iain Osborne**

10. Mr Osborne opened the discussions by reminding Board colleagues that the proposals under consideration had been prepared under the new regulatory framework of the Civil Aviation Act 2012. He reminded the Board that the Act required the CAA to consider which airports in the UK have substantial market power (“SMP”). The Board had not yet reached conclusions on that question and the discussion today would be on the assumption that the existing ‘minded to’ positions in relation to Gatwick and Heathrow remained unchanged. The Board would take its final decisions on both SMP and the regulatory consequences in December. Mr Osborne brought to the Board’s attention its statutory duties under the Act.

11. Mr Osborne advised that the form of regulation proposed for Heathrow had not been strongly contested, whereas in relation to Gatwick this had been a major element of exchanges with interested parties. Mr Osborne emphasised that the Board would need to assess how best to further passengers’ interests in the matters identified in section 1(1) of the Act. The Board would also need to reflect on the CAA’s supporting duties in section 1 of the Act and identify the most appropriate conclusions based on the evidence submitted by interested parties, the expert analyses commissioned by the CAA and the CAA’s consideration of the available evidence and material.

12. Mr Osborne advised the Board that in view of the very recent deal agreed between Ryanair and Stansted Airport Limited a further consultation would be carried out. Views would be sought on the impact of this deal on the tests required under section 6 of the Act.

### **Gatwick**

#### **Price**

13. Richard Moriarty set out the findings in relation to the “fair price”. Gatwick Airport Limited (“GAL”) had amended their offer during the course of the regulatory process. GAL’s blended rate was now RPI + 0.5% over the same period. The CAA’s assessment of the fair price was RPI + 1.7% over 5 years and RPI + 0.4% over seven years.

14. The Board considered the evidence presented, noting that the range of uncertainty in setting X (in the context of an RPI – X price path) was likely to be at least 0.5% over a 5 year period. The uncertainty was likely to be greater over a 7 year period, with a material risk that cost pressures would emerge so prices in years 6 and 7 might rise more. In relation to enforcement, the Board acknowledged that GAL could lawfully treat airlines differently, but only where the differentiation could be objectively justified. The Board also acknowledged that the Airport Charges Regulations would apply, enabling the CAA to intervene where necessary. The Board also considered whether the proposed outcomes were sufficiently demanding of GAL, noting that the counterfactual had been prepared in the same way as the Heathrow final proposals, and that GAL’s charges were comparable with the average within an appropriate peer group.

15. The Board discussed the degree of insight that the CAA would have into the actions that GAL could take in managing its relationships with its airline customers. It was acknowledged that the degree of insight would be largely unchanged were the final proposals to be implemented without additional monitoring by the CAA. Mr Osborne reminded the Board of the extensive information gathering powers now available, which would form the basis of an appropriate monitoring regime.

16. The Board agreed that the two prices offered by GAL were fair.

### ***Non-price items***

17. The Board moved on to consider the form of regulation and its practical implementation. Mr Moriarty explained that a licence would be required to ensure that the commitments that GAL had offered were enforceable and that all important areas were covered fully. Moreover, the Board was advised that there was no clear statutory provision for the CAA to accept commitments in lieu of statutory regulation.

18. Mr Moriarty and Mr Osborne explained that a key benefit in the adoption of a “licence plus commitments” was the additional flexibility afforded to the airport and airlines to enter into contracts that would be of greater benefit to passengers and cargo owners. Whereas a traditional Regulatory Asset Base (RAB)-based regime interposed the CAA as a key player in the relationship between airlines and airport, a licence plus commitments would distort those relationships less.

19. The Board considered the nature and strength of the “licence plus commitments” model over time. The Board acknowledged that the management of GAL might change in future. It was noted that seeking to work well with your best customers was commercially sensible, and not of itself evidence of substantial market power, or abuse of such. The Board noted that the licence could be modified over

time, as could the monitoring regime, and that the licence (and other powers under EU legislation) would enable the CAA to consider airport and other charges and to take action in the passenger interest.

20. In view of the importance of the airport capacity debate the Board also considered the treatment of the costs associated with the development of any second runway at Gatwick. The Board was content that policy guidance would be published during the Q6 period, and that the CAA would respond swiftly (including if appropriate by modifying GAL's licence) to any failure by GAL to take appropriate account of the guidance.

21. The Board noted that no conditions were proposed in the licence to address discrimination or transparency on the basis that these matters were already governed by legislation. Having considered non-price items the Board concluded that the final proposals should be based on a "licence plus commitments" approach.

22. The Board delegated final approval of the documentation to a sub-group comprising Mr Osborne, Mr Haines and Mrs Staples. It was noted that further refinement of the financial analysis would be carried out; the Board agreed that any material changes that resulted would need to be referred back to the whole Board. Minor changes should be cleared with Mr Gray.

23. The Board considered the media handling of the publication. Dr Rooney explained the planned activity, highlighting the need to explain the changes made and the reason why the final proposals would not address the capacity issues in the South East.

### **Heathrow**

24. Mr Moriarty reminded the Board that there had been no real debate during the process on the form of regulation for Heathrow Airport Limited ("HAL"). Both the airport and airlines had approached the issues on the basis of a traditional RAB-based regulatory structure. Mr Moriarty explained that key issues for the final proposals as presented to the Board were Operational expenditure ("Opex") and Weighted Average Cost of Capital ("WACC"). Mr Moriarty addressed each in turn.

### **Opex**

25. As regards Opex the forecast expenditure had been reduced, taking into account evidence available from updated analyses of elements of Opex and the recent savings made by HAL in relation to baggage handling contracts. There had also been adjustments made in relation to wage cost efficiency. In that context, the Board was content that an appropriate level of challenge was set for

HAL.

26. Members of the Board reported that they had received a letter from Mr Williams, Chief Executive of British Airways. The Board was advised that the letter should not be given consideration at this time, as it purported to offer views in a confidential manner, which was inconsistent with the consultative approach that the CAA had taken thus far. Mr Osborne emphasised that all substantive consultation responses from both airport and airlines had been fully investigated and that the CAA had been discerning in relying on the work of external consultants. One report had been put to one side because of concerns about the robustness of its findings.

### **WACC**

27. The discussion turned to the WACC. Mr Moriarty explained that HAL's arguments in support of the co-skewness of returns had been unpersuasive because they depend on the data being cut at a particular point in time. However, it was proposed that the allowance for the cost of debt be adjusted to account for an increase since the spring in forward-looking interest rates, and for a greater weighting on longer-term averages as opposed to spot rates. The cost of debt now fell in the range 2.9 to 3.2% contributing to a WACC of 5.6%.

28. The Board discussed whether indexation of debt was appropriate. The Board acknowledged that indexing the cost of debt for one company was not comparable with indexation practices that apply across a whole regulated sector (e.g. Ofgem's approach), raised practical difficulties, and would have the effect of passing interest rate risk to consumers who were not well placed to deal with it. The Board decided not to adopt indexation but agreed that work should be done to generate a shadow index.

### ***Capital Expenditure (Capex)***

29. On the subject of Capex, Mr Moriarty explained that the Constructive Engagement process had worked well, resulting in an agreed programme of £3bn. Although the exact make-up of the programme had changed as a consequence of further review over the summer, the Board was advised that around £3bn was an appropriate level of Capex to consider. The Board considered how to address any under-spend during the quinquennium so as to ensure that passengers are not adversely affected. The Board noted its concern that there were some projects that HAL had stated it would not take forward, and it was agreed that further consideration would be given to how to protect users in such a scenario, including consideration during 2014 of a licence amendment to this effect. This should complement rigorous monitoring of service quality levels and performance.

***Crossrail***

30. Discussion moved to Crossrail. HAL had previously agreed with the Secretary of State for Transport to contribute to the costs of Crossrail subject to approval by the CAA. Following the Government's change of position in relation to a third runway at Heathrow however, the business case is now less persuasive. The Board noted and agreed with the rationale for and proposed amount of contributions, and asked that steps be taken to ensure that this decision should not set a precedent for industry contributions to other infrastructure schemes.

**Action: Mr Osborne**

***Other***

31. Having discussed the key elements in establishing an appropriate price cap, the Board considered the level of the cap. Mr Moriarty emphasised that the conclusions were based on thorough analysis, which combined a large number of individual issues, each bringing a margin of uncertainty. The Board therefore acknowledged that there is a limit to the degree of precision achievable and the degree to which apparent precision was meaningful in practice. The Board was content to adopt in the final proposals a RPI + 0% cap and asked the team to provide an update on any changes made in light of today's discussions.

**Action: Mr Osborne**

32. With regard to licence provisions, Mr Moriarty explained that the proposed licence for Heathrow was more extensive than Gatwick as operational resilience was covered in some detail, as was financial resilience. There would also be a licence condition governing procurement, designed to ensure that HAL secures best value.

33. Finally the Board considered the questions of a P0 adjustment. The Board was advised that such an adjustment should have no impact on the Net Present Value of the final proposals, but might be justified if it improved consistency with financability ratios. The Board did not object in principle to the adjustment, but asked that it should be avoided if possible for the sake of clarity.

34. In conclusion, the Board approved final proposals as outlined above and agreed to delegate sign off of the final document to Mr Osborne, Mr Haines and Mrs Staples. The Board expected to be kept informed and involved should there be any significant changes. Dr Bell should also be asked to confirm that any non-material changes were acceptable.

**Action: Mr Osborne**

#### **IV Minutes of the Previous Meetings and Matters Arising**

The Board were keen to highlight that in relation to paragraph 28 of the previous Minutes, Corporate Communications Department had in fact made a very strong contribution to the CAA's corporate communication over the past year. The draft Minutes of the Board Meeting held on 17<sup>th</sup> July 2013 were approved and signed by the Chair.

#### **V Chairs Update – by Dame Deirdre Hutton**

36. The Chair provided the Board with a brief update on her activity. In particular, the Chairs of the economic and competition regulators group, had recently discussed the intermittent use of economic and competition experts by the regulators, which incurred significant expenditure. The group had discussed the idea of sharing a pool of experts. This could provide a consistent approach amongst the regulators and also be more cost effective. The Board agreed that this was a good idea although it noted that it would be difficult to put into practice.

37. The Chair reported that both she and Mr Haines had held constructive meetings with both the Minister of State and the Secretary of State to ensure that DfT were fully briefed on the Q6 proposals.

#### **VI Chief Executive's Report - Doc 2013-115 by Andrew Haines**

38. Mr Haines reported on the recent Super Puma ditching which had resulted in 4 fatalities. There had been a voluntary grounding of the fleet until it had become clear that the ditching was not related to the technical issues which had arisen in previous accidents. It had been decided that an in-house review would be carried out of North Sea helicopter operations, which would be subject to an external peer review. Of particular interest to the review would be whether the difference between the UK and Norway accident rates was significant.

39. Mr Swan explained that Terms of Reference for the review group had been issued and that he had met with the Norwegian CAA's Mr Hamre, who chairs the Norwegian Helicopter Safety Committee, a cross-industry body that proactively manages helicopter safety. Mr Hamre had agreed to co-chair and lead the UK review. Rear Admiral Simon Charlier CBE FRAeS, a Senior Defence and Political Advisor to MBDA, UK, would be asked to lead the peer review team and other team members were discussed, including a member from the Scottish Transport Executive. A report would be submitted to the Board in January 2014.

40. Mr Haines reported on his meeting with Mr Williams, the CEO of British Airways (BA). They had

discussed the claims for compensation after BA's A319 engine cowling incident in May 2013 and the importance of BA understanding the value of the claims to enable an informed discussion to take place. The Board agreed that BA's handling of the claims for compensation and the safety implications of the incident should be kept under review. Mr Osborne confirmed that a US law firm was said to be putting together a class action in relation to the incident, but we understood this was likely to be directed at the manufacturer Airbus rather than BA.

41. The Board approved the re-appointment of Mrs Staples and the appointment of Mr Armstrong as CAA Management Trustees for the CAA Pension Scheme (CAAPS). The Board also approved the appointment of David Howson as the new CAA Member Nominated Trustee to replace Mr Leatherbarrow. The Board also authorised Mrs Staples to sign the amendment to the CAAPS Trust Deed & Rules, on behalf of the CAA, in relation to the application of different inflation indices.

42. In addition, the Board approved the amendments to the Articles of Association of ASSI Ltd subject to the insertion of 'include' instead of 'comprise' in line 1 of the new Article 4.1.

#### **VII Performance & Process Improvement (PPI) Progress Update Doc – Doc 2013 - 116 by Chris Jesnick**

The Board agreed to defer this item to next month's meeting to allow time for a full discussion of the PPI programme.

#### **VIII Reforming General Aviation (GA) Oversight within the UK CAA - Doc 2013-117 by Andrew Haines**

44. Mr Haines reported that meetings with Grant Shapps MP had ultimately been constructive because there was common ground between Mr Shapps and the CAA on the need to reform regulation of the GA sector. Mr Shapps accepted the CAA's proposition that a separate competent authority for GA should not be pursued. Nevertheless, Mr Shapps wanted to reserve the power in primary legislation to allow such an oversight structure in the future. The Board agreed that the reform proposals would require a significant degree of constructive engagement and support from the GA community. The Board agreed that in governance terms the programme should ensure external involvement and challenge, but that the programme board should report to ExCo and the Board and not to any external panel.

45. Mr Clarke stated that with regard to timing the CAA was moving forward and that the Red-Tape

Challenge had given impetus to the reform programme. Mr Barnard stated that the focus provided by the Red-Tape Challenge was very useful. The CAA's initiative, Recreational Aviation 2 (RA2), was an attempt to provide a proper regulatory framework for light recreational aviation. The Red-Tape Challenge had highlighted considerable discontent at working level within the GA community, which had accelerated the development of a GA unit within the CAA. The Board agreed that it was important for the costs of GA to be established and disclosed, to aid transparency, and that the costs needed to be actively managed to eliminate cross-subsidy from the commercial sector.

46. The Chair noted the importance of the Board giving the reform proposals a sufficient level of support but also noted that there was no plan for any deregulation of airspace. A discussion of any potential increased risk to the public followed. The Board agreed that GA (as defined for the purpose of the new GA unit) should be treated as a sector in its own right, not subject to diluted Commercial Air Transport rules. A risk-based approach should be taken, founded on the degree of risk to society and the acceptance of risk by participants ("informed consent"). Work was already underway on this latter concept and the underlying philosophy was that deregulation could be supported where there was a negligible risk that uninformed and uninvolved third parties would be affected.

47. The Board noted that the GA unit would sit within SARG as a regulatory entity accountable for delivering proportionate regulatory oversight and minimised regulatory burden on aircraft operated non-commercially by private pilots and their associated maintenance and training activities. GA policy was to be managed jointly between SARG and PPT. Delegation of regulatory responsibility would be pursued where industry appetite, competence and resilience existed and deregulation would be pursued where adequate protection of uninformed third parties could be assured.

48. Mr Swan informed the Board that in terms of infringements and collisions, working groups in these areas had already carried out an immense amount of work. He added that the core regulatory framework would always be there and that this reform proposal was about looking at creating, over time, a proportionate regulatory framework that did not diminish the current safety net.

49. It was noted that there was a proposal that the chair might be given an objective to promote GA by the SofS. Concern was expressed about this development. The Board confirmed that it was not appropriate to promote one form of aviation over another and noted that such an approach would be inconsistent with the current legislative framework and the CAA's priority: safety.

50. The Board endorsed the approach set out in the paper.

## **IX Aviation Security Transfer: Update on Progress Doc 2013-118 by Kate Staples**

51. Mrs Staples highlighted that there were now only 6 ½ months to the transfer and that the consultation on charging would close in a few days. Therefore, the intention was to begin to update the Board on a monthly basis. There would be a more detailed update to the Board in October and a lengthy workshop for the January 2014 Board to prepare for the transfer.

52. Mr Drissell focused on three themes:

**53. Business as usual** – this was relatively unchanged. The aviation security directorate group was quite active at the moment.

54. The recent US Emergency Amendment regarding the Yemen incident highlighted the need to identify and understand the division of responsibilities between the CAA and DfT.

55. **Transition** – This phase of activity would finish shortly after 1 April 2014. Transition was going well and the personnel strategy put in place had worked. There had been 1100 applications for up to 20 inspector posts and the diversity of applicants was encouraging. The forthcoming discussion at the Policy & Information Exchange on 2 October would need to look at understanding costs, risk and resourcing. Mrs Staples reported that feedback from the structural consultation showed that industry had deep concerns regarding the costs. In addition, the financial baseline remained unclear.

56. IT had been a problem. However, a director of the service provider had promised to deliver personal oversight of the programme in the coming weeks and months.

57. **Future plans strategy** – The move to outcome focussed risk-based regulation was going well.

58. The Board noted the update.

## **X Safety and Airspace Regulation Group – Doc 2013-119**

59. The Board noted the SARG report.

## **XI Report from Nominations Committee – Doc 2013 – 119**

60. The Chair reported that the Secretary of State had agreed that the number of CAA non-executive directors could be reduced by one on the departure of Dr Bell. However, the ability to reinstate the original number would remain.

61. The Board noted the report and approved the revised Terms of Reference.

## **XII Finance Report – Doc 2013–120 by Chris Jesnick**

62. Miss Jesnick reported that there was strong growth in CAA International (CAAi) income. CAAi had won a major contract for maintenance oversight for the MoD. Mr Swan confirmed that SARG and CAAi were alive to the issue of adequate resourcing and had identified where resource was required.

63. Miss Jesnick reported some sad news regarding CAAi in that a contractor in Kuala Lumpur had died suddenly. The CAA was helping with the necessary arrangements. The Board offered its sincere condolences.

64. Costs in general across the CAA were contained and being managed well. A number of contractors on the PPI project had left the organisation on the basis that SARG would release resources.

65. Mr Swan informed the Board that the Department of Business, Innovation and Skills had awarded the CAA £750k from its Catapult Programme to fund the regional improvement programme of the Future Airspace Strategy.

## **XIII Live Issues – Directors Reports**

*RPG Doc 2013-121*

66. The report was taken as read.

*CCD Doc 2013-123*

68. Dr Rooney reported that the Transport Select Committee report on Flight Time Limitations (FTL) had triggered a debate on FTL in Europe. It was essential to ensure that officials were suitably briefed on the topic.

**Action: Dr Rooney / Mr Swan**

## **XIV. AOB**

69. The Board approved the appointment of Mr Ward as Chair of the Audit Committee. The Chair informed the Board that she would be looking at committees generally and how they would be resourced. Nominations would be requested at the next Board meeting.

70. The Board external visit in November would be at White Waltham and include a strategic

discussion with representatives of the GA community.

**Date and Time of Next Board Meeting: The next CAA Board meeting will be held on 16 October 2013, at 9.30am in Conference Room 1 at Aviation House, Gatwick.**