



CAA's review of price and service regulation at Heathrow, Gatwick and Stansted airports
London First submission
17 July 2012

1. London First is a business membership organisation with a mission to make London the best city in the world in which to do business. We do this by mobilising the experience, expertise and enthusiasm of the private sector to develop practical solutions to the challenges facing London. London First delivers its activities with the support of the capital's major businesses in key sectors such as finance, professional services, property, transport and infrastructure, ICT, creative industries, hospitality and retail.
2. We welcome the opportunity to comment on the Civil Aviation Authority's (CAA) review of price and service regulation at London's three largest airports. We have long pressed for a regulatory regime better able to respond to the needs of passengers. We broadly welcome the new duties proposed for the CAA in the Government's Civil Aviation Bill – particularly the duty to put the interests of users at the heart of economic regulation, and the duty to carry out its functions in a manner it considers will promote competition.
3. We respond briefly to the questions below of most relevance to us. In doing so, we note both the recent changes and the continued policy uncertainty that characterise the market for air services in London and the South East. Since its sale Gatwick has placed considerable focus and investment in improving its offer to passengers – with measurable results in terms of service quality. It has strengthened its ability to compete with other London airports. In turn we recognise that growing competitive forces – both from London airports and European hubs – may provide sufficient market incentives to Heathrow's operator to provide a better, more passenger-focused service. Operational and investment decisions at Heathrow over the last review period have delivered such improvements. And while there remain uncertainties around the possible sale of Stansted, should a sale proceed it may well influence the scope for further competition, particularly between Gatwick and Stansted. Finally, while the Government has yet to conclude its review of national aviation policy, its Draft Policy Framework confirms "The Government supports competition as an effective way to meet the interests of air passengers and other users."¹
4. Against this context, and in reviewing price and service regulation, the CAA should seek the flexibility to respond to evidence of growing competition and to changes in the market as investment decisions evolve – in the stable policy setting required for long-term investment. It should base this flexibility on a robust, ongoing assessment of market power. It remains to be seen, for example, whether continued economic regulation of Gatwick and Stansted remains appropriate in the short term.

¹ Draft Aviation Policy Framework, Department for Transport, July 2012

How should the CAA approach a strategy for airport licensing?

5. We welcome the CAA's early analysis of options for licence conditions and look forward to the conclusion of this work. We make two brief comments at this stage. First, we concur that the duration of licences and some licence conditions should be tailored to the specific characteristics of each airport. Given this, we think an evolutionary approach should be pursued that allows a timely review of the first licences and dovetails with any changes in – or removal of – price cap regulation (if necessary including a provision to re-open the price control).
6. Second, we believe the case for including operational resilience obligations into a licence condition is strong. The outward and inward-bound value chains at our major airports are fragmented by a variety of process owners and potentially conflicting incentives. The airlines' incentives to bear the cost of addressing the causes of delay and variability may be weakened by the difficulty of gaining competitive differentiation as a result. Moreover, the high demand for limited runway capacity has locked airlines into a "free rider" problem whereby marginal additional slots have a high positive value to the airline acquiring them, but can impose a cost on airlines and passengers in general. Variable and excessive waiting times in the terminal caused by runway congestion constitute an important element of this negative cost on passengers.
7. In simple terms, we believe a standard should be set for flight delays. This will require a scheduling system based on stronger governance arrangements with a clear set of performance metrics. At Heathrow, an operational resilience obligation should take into account the operational freedoms now being trialled and enshrine the resilience required to cut delays on a sustained basis, should those freedoms become permanent, balanced against demand for extra flights.

How can the CAA ensure that its review of economic regulation is passenger focused?

How can regulatory incentives towards service quality be improved?

8. The CAA should build on recent progress by having at its disposal all the data – quantitative and qualitative consumer research and transparent, independently audited operation information – needed to assess the efficiency both of the operator and of the interfaces between different process owners. Given price cap regulation is poor at acting on signals from consumers over service quality, and should such regulation remain in place, the burden is on the CAA to require information – regularly and to sufficient detail – on what constitutes good passenger experience to different groups of customers.
9. Information should similarly be gathered on the important parts of the passenger journey over which the CAA cannot impose license conditions (given the airport is not their provider), such as rail access, check-in and baggage, and border controls. The CAA should publish information on the totality of services defining the air passenger's end-to-end journey in an intelligible and easily accessible form.

10. This information should provide the starting point for assigning the operator responsibility for the total throughput time of the passenger. The Service Quality Rebate (SQR) regime should be extended accordingly – over time and where practical – with financial incentives sharpened by the introduction of bonus payments.

What is your view on the rationale for economic regulation at Heathrow, Gatwick and Stansted?

What do you think is the most appropriate form or model for price regulation at each of the airports?

11. The rationale for continued economic regulation at London's three largest airports clearly rests on the CAA meeting the three tests set out in the Bill. We look forward to the conclusion of this work, and in particular the results of the market power review, as the prima facie case for removing Gatwick and Stansted from price regulation in the short term appears to us to be strong.
12. If it is concluded that economic regulation is required, we believe it should be framed so that it can respond to short-term changes in the market and can increasingly rely on competitive pressures to restrain prices. The CAA should describe possible paths to deregulation. In doing so, it should ensure sufficient protection against substantial market power (SMP) while encouraging greater flexibility, service differentiation and commercial deals.
13. We would support a framework that allows airports and airlines greater room to set their own contractual and service requirements. We see the merits of some form of a regulatory default price cap that specifies a maximum average price per passenger based on an acceptable level of service quality (allowing for the airport to agree contracts with airlines for appropriate degrees of change), combined with ex-post price monitoring. Ex-post price monitoring could here act as a transition strategy to deregulation when, even with evidence of SMP, growing competitive pressures over time can be relied on to restrain prices.
14. Even if it is concluded that Gatwick has SMP, we believe the CAA should seek in the first instance de minimus ex ante regulation, for example through some backstop appeal powers, in preference to a complex and restrictive price control. Nonetheless, a default settlement and ex-post monitoring could encompass both the RAB-based calculation required at Heathrow and – in the absence of short-term deregulation – a path to de-designation for Gatwick and Stansted.