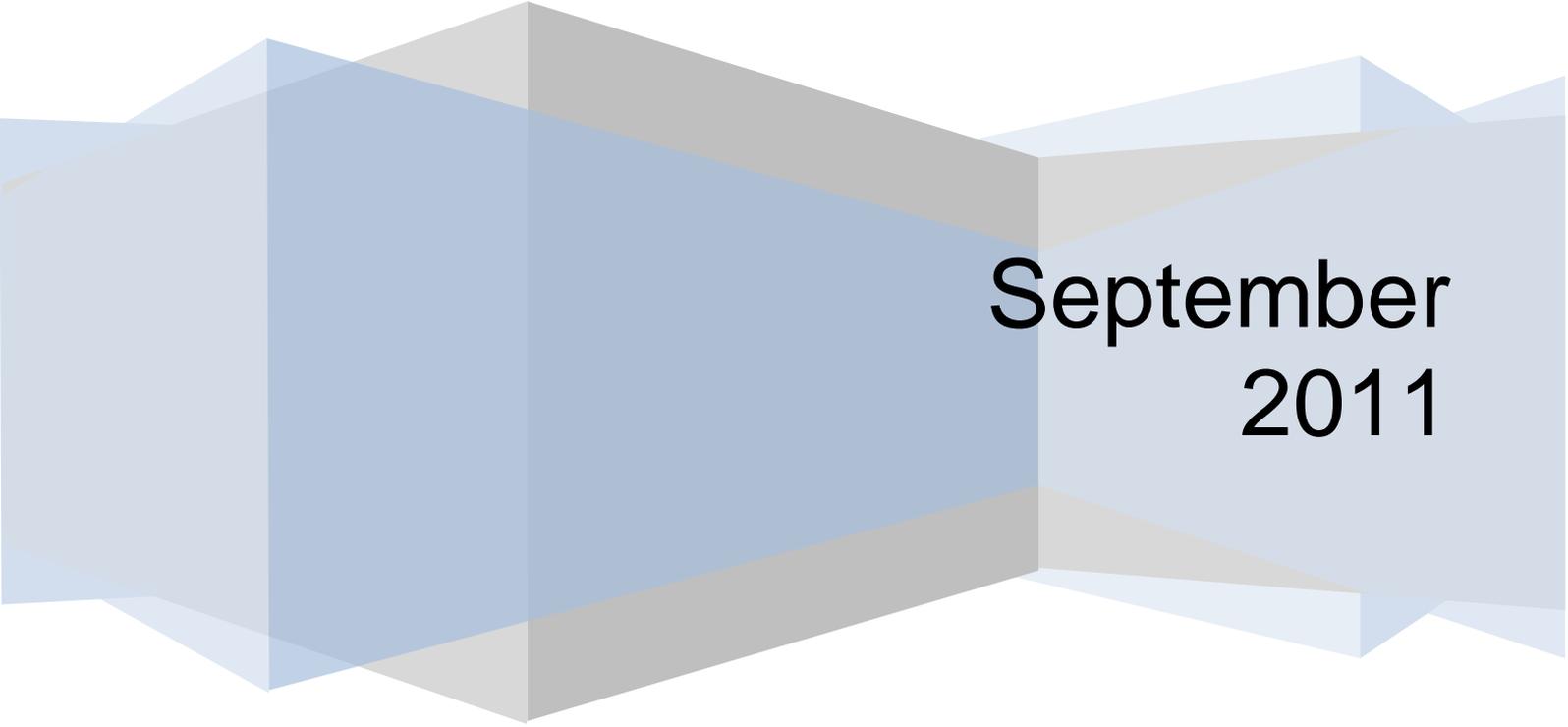


UK Civil Aviation Authority

**Investigation under
Section 41 of the Airports
Act 1986 of a complaint
made by Flybe against
Gatwick Airport Limited**

A Consultation



September
2011

Contents

SUMMARY	3
INTRODUCTION	4
BACKGROUND.....	5
GAL’s changes to its structure of charges	5
Section 41 of the Airports Act 1986 and the CAA’s policy and process	8
THE CAA’S PROVISIONAL VIEWS.....	11
Is Gatwick in a position of market power?.....	11
Is there an objective justification for the pricing structure that GAL has adopted? 11	
Does GAL’s revised pricing structure cause harm or have the potential to cause harm to passengers and/or the competitive process?.....	16
Views Invited	19

SUMMARY

- S1. Flybe has complained to the CAA that Gatwick Airport Limited (GAL) has unreasonably discriminated against it and/or other operators of small aircraft at Gatwick.
- S2. Flybe's case concerns changes to GAL's pricing structure from 1 April 2011, in particular that it increased landing charges significantly between April and October, but from November to March these same charges have effectively been abolished by being set at zero¹. Flybe is concerned the flat charge takes no account of the size or weight of the aircraft.
- S3. GAL contends that the charging structure is based on objective criteria designed to ensure the most efficient use of scarce airport capacity – its single runway.
- S4. After a preliminary assessment of this case the CAA is currently minded not formally to investigate the complaint further under Regulation 11(1) of The Civil Aviation Authority (Economic Regulation of Airports) Regulations 1986. This is because the CAA's provisional view is that GAL does have an objective justification for the charging structure it has adopted. Consequently, on the available evidence, it does not appear to the CAA that GAL may be pursuing a course of conduct described in section 41(3) of the Airports Act 1986.
- S5. Before confirming its view, the CAA is inviting representations from interested parties to be sent to it by no later than 4 November 2011.

¹ GAL has set to zero landing charges for all Chapter 3 Base and Minus and Chapter 4 aircraft between November and March (the winter off peak season)

INTRODUCTION

1.1 Flybe made a complaint to the CAA on 29 March 2011 that when GAL set its structure of airport charges for 2011/12, the airport carried out a course of conduct specified in section 41 (s41) of the Airports Act 1986 (the Act). In particular, Flybe alleges that:

- the new charging structure represented an unreasonable discrimination against Flybe and/or against all operators of small aircraft at Gatwick and that GAL (as a dominant operator) is subject to a special responsibility not to act in a way which harms competition, without objective justification;
- the charging structure introduced by GAL will not achieve the airport's declared objective of seeking to increase the average number of passengers per aircraft movement at Gatwick; and
- the charging structure may not be in the reasonable interests of the users of airports in the United Kingdom because it will limit the potential for point to point travel to/from London and regional points and the chance for the UK regions to connect to the world.

1.2 This document sets out the main arguments made by Flybe and GAL. Non-confidential copies of the representations made by Flybe and GAL have been placed on the CAA's website. The CAA sets out its initial views following its preliminary assessment in section 3.

1.3 For the interests of the parties and market certainty, the CAA is keen to resolve this matter as soon as possible. Its current intention is not to proceed to a formal investigation of the complaint but, before doing so, the CAA is inviting representations to be sent by no later than 4 November 2011 preferably by email to airportregulation@caa.co.uk².

1.4 If you would like to discuss any aspect of this complaint please contact James Mackay on 0207 453 6233 or james.mackay@caa.co.uk.

² Alternatively you can email your response to susie.talbot@caa.co.uk or post it to Susie Talbot, Civil Aviation Authority, 45-59 Kingsway, London, WC2B 6TE.

BACKGROUND

GAL's changes to its structure of charges

- 2.1 Gatwick Airport is designated by the Secretary of State under section 40(10) of the Act for price control. In March 2008, the CAA set a price control that limits the maximum per passenger revenue that GAL can receive from airport charges at the airport for each of the five years from 1 April 2008 to 31 March 2013³.
- 2.2 The current price control does not prescribe the structure of airport charges at Gatwick and the airport therefore has discretion to structure its charges within the constraint of the overall price cap. In its decision of March 2008 that set the current price control the CAA said that the structure of charges was first and foremost the responsibility of the airport operator following consultation with its airline users. The CAA did not propose to involve itself in the determination of the structure of airport charges although it would consider under its s41 powers, and in line with its guidelines for the operation of these powers, any case brought by an airline which alleged undue discrimination which might have been effected through changes in the structure of charges⁴.
- 2.3 GAL's airport charges for 2011/12 consist of charges on departing passengers, aircraft parking charges, an emissions charge (NOx charge), and aircraft landing charges. Flybe's complaint relates to the aircraft landing charges levied by GAL.
- 2.4 GAL commenced discussions around changes to the structure of charges with the airline community in July 2010 through the Finance Performance and Regulatory Charging Group (FPRCG). GAL set out that one of its priorities was to optimise the utilisation of its single runway⁵. GAL also stated the following would be key elements of the new charging structure:
- level;
 - balance between passenger and landing charges;
 - peak / off peak and summer / winter differentials; and

³ In April 2011, the CAA extended the price control for an additional year so it expires on 31 March 2014.

⁴ Economic regulation of Heathrow and Gatwick Airports 2008-2013 – CAA Decision (March 2008) paragraphs 3.28 and 3.29. Available at http://www.caa.co.uk/docs/5/ergdocs/heathrowgatwickdecision_march08.pdf.

⁵ FPRCG Presentation: Pricing Consultation – presented at meeting on 6 July 2010.

- environmental signalling.

2.5 GAL commenced a consultation on the structure of charges that concluded in January 2011⁶. The consultation on the structure of charges is summarised below along with the final decision:

Charge	Proposal	Decision
<u>Yield</u>	Tariff set by airport to cover the maximum allowable yield determined by the CAA's 2008 Price Control Decision.	Unchanged but GAL did not incorporate forecast for service quality bonus.
<u>Passenger Service Charge</u> Levied per departing terminal passenger and differentiated based on the destination of the aircraft. Differentiation between passengers on domestic, international and Republic of Ireland flights. Rebates for aircraft that are not on stand.	Unchanged structure or level but minimum charge per departing flight increased from £200 to £300. Proposed seasonal variation such that: <ul style="list-style-type: none"> • per passenger charge increases by £5 in July and August (Super Peak); • per passenger charge is unchanged for the remainder of the summer schedule, the summer shoulder (Apr – Jun and Sept – Oct); and • per passenger charge reduced by £3.50 over the winter schedule (Nov – Mar). 	As per GAL's proposal the structure and level of the charge remained unchanged. GAL did not increase the minimum departure charge to £300. GAL did not introduce a seasonal variation to the passenger service charge.
<u>Parking Charge</u> Levied based on the maximum takeoff weight of the aircraft and time.	No changes to the current aircraft parking tariff.	No change to proposal.

⁶ The details of the consultation are provided in Exhibit 8 of the Flybe complaint.

<p><u>Landing Charges</u></p> <p>The landing charge paid by the airline determined by the maximum takeoff weight of the aircraft, the NOx emission of the aircraft, and its noise classification.</p>	<p>All landing charges increased by 26.4%</p> <p>Alternative proposed seasonal variation such that:</p> <ul style="list-style-type: none"> • additional £375 premium levied for aircraft movements in July and August; • additional £125 premium levied for aircraft movements over the summer shoulder (from April to June and September to October); and • landing charges set to zero over the winter schedule (November to March). 	<p>Rather than differentiating charges in the summer peak and summer shoulder GAL introduced a single summer premium. The premium was based on an increase to the landing charge of 62.5% between April and October whilst winter charges remained at zero.</p> <p>The 62.5% increase was based on:</p> <ul style="list-style-type: none"> • the 26.4% increase as originally proposed; and • replacing the per movement premiums of £375 and £125 with a average percentage increase over the summer. GAL determined that the removal of the premiums would lead to an overall increase of 62.5%. (for the same forecast revenue).
<p><u>NOx charge</u></p> <p>An element of the landing charge designed to incentivise use of more efficient aircraft.</p>	<p>No change to the NOx charge.</p>	<p>No change to proposal.</p>
<p><u>Noise Classification Charges</u></p> <p>An element of the landing charge designed to incentivise the use of quieter aircraft.</p>	<p>No change to Chapter 2 and 3 Aircraft charges</p> <p>Changes to Chapter 4 aircraft charges such that:</p> <ul style="list-style-type: none"> • Chapter 4 High Aircraft pay an additional 0.5%; and • Chapter 4 Low Aircraft received a discount of 2.5% 	<p>No change to structure, proposed change not implemented.</p>

- 2.6 In March 2011, GAL announced by means of its Gatwick Airport Directive (GAD) the revised charges that would apply from 1 April 2011. As noted above passenger service, aircraft parking, Nox and noise related charges were unchanged from those in effect in 2010/11. The full increase was applied to landing charges.
- 2.7 Flybe argues that the revised structure of charges, with all of the increase allowed under the CAA price cap loaded onto charges per aircraft landing, unreasonably discriminates against it as well as other operators of smaller aircraft at Gatwick. Flybe and other operators of smaller aircraft have more aircraft landings per passenger than operators of large aircraft. Flybe estimates that the total airport charges it pays at Gatwick will rise on average by 18% per departing passenger in 2011/12 compared to the previous year. On a route by route basis the increase ranges from 5% to 22% on domestic routes and between 35% and 68% on Flybe's international routes. Since it was the largest operator of domestic scheduled services at Gatwick, and the third largest overall in terms of aircraft movements, Flybe argues that an average increase of 18% would have a significant impact upon a large number of users through higher fares or the withdrawal of services on particular routes. Therefore, in the context of its duties under s39 of the Act (see below) Flybe contended that the CAA should consider the impact of the structure of Gatwick's charges on a wide circle of consumers including those travelling point to point between London and regional points and those wishing to connect to the world over Gatwick⁷.
- 2.8 Flybe argues that GAL has a special responsibility not to abuse its special position, because of airport capacity constraints, and should therefore not set out overtly to adopt a special preference for wide-body operations which is prejudicial to other users of Gatwick.

Section 41 of the Airports Act 1986 and the CAA's policy and process

- 2.9 Under s41 the CAA may, if it thinks fit, impose a condition on an airport operator where it appears that it is carrying out a course of conduct specified in s41(3). One of the courses of conduct is:

the adoption by the airport operator, in relation to any relevant activities carried on by him at the airport, of any trade practice, or any pricing policy, which unreasonably discriminates against any class of users of the airport or any particular user or which unfairly exploits his bargaining position relative to users of the airport generally.

⁷ Flybe Submission paragraph 1.13.

2.10 Relevant activities are defined in section 36(1) of the Act as the provision at the airport of any services or facilities for the purposes of:

- (a) the landing, parking or taking off of aircraft;
- (b) the servicing of aircraft (including the supply of fuel); or
- (c) the handling of passengers or their baggage or of cargo at all stages while on airport premises (including the transfer of passengers, their baggage or cargo to and from aircraft).

2.11 Under Regulation 11(1) of The Civil Aviation Authority (Economic Regulation of Airports) Regulations 1986 (the Regulations), if it appears to the CAA that an airport operator *may* be pursuing one of the courses of conduct specified in section 41(3) of the Act, it *shall* investigate the matter (italics added). In assessing the complaint, the CAA must take into account its statutory duties under section 39 of the Act. These are:

- to further the reasonable interests of users of airports within the United Kingdom;
- to promote the efficient, economic and profitable operation of such airports;
- to encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports; and
- to impose the minimum restrictions that are consistent with the performance by the CAA of its functions.

2.12 In December 2006, the CAA published its policy and processes for handling s41 cases⁸. It said it would handle cases consistent with its statutory powers and duties in the Act and would expect to adopt an approach that is consistent with the application of competition law, except where the circumstances of a particular case suggest it should follow a different approach.

2.13 The CAA set out a three-stage process for handling complaints:

- Stage one: an initial consideration of a complaint – to determine whether it fell within the scope of s41, was not trivial, frivolous or vexatious, and whether there was a more effective alternative way to address the complainant's concerns;

⁸ The CAA's use of section 41 of the Airports Act 1986 – the CAA's policy and processes (December 2006), available at <http://www.caa.co.uk/docs/5/ergdocs/section41policy.pdf>

- Stage two: preliminary investigation by the CAA – to determine whether the available evidence raised any concerns that the airport might be carrying out a course of conduct specified in s41(3); and
- Stage three: a formal investigation, in which the CAA would invite representations from interested parties into the matter.

2.14 The rest of this document sets out the CAA's views following its stage two assessment. The CAA's policy does not require it to consult stakeholders at the conclusion of its stage two assessment. However, given the nature of the concerns and issues raised in this complaint, the CAA considers it prudent to consult all interested parties before confirming its proposed decision or deciding an alternative course of action.

THE CAA'S PROVISIONAL VIEWS

3.1 The CAA considers that it should broadly adopt the approach used in European and domestic competition cases when investigating complaints of this nature. Accordingly, the CAA considers that the principal points it would expect to be relevant in this case are:

- Is Gatwick in a position of significant market power?
- Is there an objective justification for the pricing structure that GAL has adopted?
- Does GAL's revised pricing structure cause harm or have the potential to cause harm to passengers and/or the competitive process?

3.2 The CAA's provisional views on the above issues are set out below. Given that part of Flybe's complaint relates to the impact on regional connectivity the CAA also addresses this issue.

Is Gatwick in a position of market power?

3.3 During Stages 1 and 2 of its consideration of Flybe's complaint, the CAA has worked on the presumption that Gatwick has significant market power while it remains an airport designated by the Secretary of State for the purposes of Part IV of the Act. The CAA is currently gathering evidence for assessing the degree of market power of the designated airports and is due to report its initial assessment in December 2011.

3.4 The CAA does not consider it appropriate to delay consideration of this case prior to the preliminary results of its wider market power assessment. The CAA has adopted a pragmatic approach to prioritise its analysis. The CAA has considered the conduct of GAL, and in particular if there is an objective justification for its pricing structure, before any detailed assessment of Gatwick's market power is undertaken for this case.

Is there an objective justification for the pricing structure that GAL has adopted?

3.5 Unreasonable discrimination in the terms of s41(3) can generally be thought of as applying, without an objective justification, dissimilar terms for equivalent transactions

or similar terms for dissimilar transactions⁹. Discrimination can either be by design or by effect.

- 3.6 Gatwick has charged flat landing fees for a range of aircraft based on their noise classification over a number of years. The revised charges for 2011/12 maintain that approach with the addition of seasonal variations in the charging scheme. The seasonal variation includes a 62.5% increase in charges over summer and the summer shoulder accompanied by a reduction to zero in the landing charge in the winter (paragraph 2.5 refers). The significance of the change made in April 2011 was that Gatwick chose to apply all of the increase allowed under the CAA's price cap to landing charges. Other charges were left unchanged.
- 3.7 Flybe submits it is the effect of the increase in landing charges on its relatively small aircraft¹⁰ that amounts to discriminatory conduct by GAL. A key issue for the CAA is therefore whether GAL has an objective justification for levying the same charge when operators land aircraft of different sizes.
- 3.8 The CAA has previously said that one objective justification for differentiating prices would be variations in the cost to the airport of providing the service to different users¹¹. But prices could also be differentiated for other reasons that would typically be considered an objective justification, for example where the supplier of a good wants to incentivise certain behaviour to secure a more efficient use of its resources or assets throughout the day or throughout the year. This is the case in many industries that are based on fixed assets that face fluctuating demand, including, for example, hotels, cinemas, trains or flights. Efficient use of assets also benefits passengers. As well as the benefits of higher passenger throughput, an airport operating a single till can maximise its commercial revenue and use it to offset the costs associated with aeronautical activities. In this case changes to the charging structure are purely based on creating incentives that ensure that those that value the product or service most can access it in cases where demand exceeds supply, or that lower prices encourage use at times when supply exceeds demand. It is common ground between the parties that the structure of charges at Gatwick has been designed with the aim of incentivising efficient use of the single runway by setting prices in a way that prices out some demand in peak periods with the aim of encouraging use of the runway when there is excess capacity. It is also recognised

⁹ Deutsche Lufthansa AG v ANA – Aeroportos de Portugal SA (Case C – 181/06)

¹⁰ Flybe operates two main aircraft types with either 78 or 118 seats.

¹¹ See the CAA's recent decision in relation to the Ryanair v Gatwick Airport Limited Appeal under the 1997 Ground Handling Regulations for a discussion on the principles that support objective justification in relation to pricing conduct. Available at <http://www.caa.co.uk/docs/5/GH111GALRyanair.pdf>.

by both parties that this approach to charging may lead to the exit of carriers operating smaller aircraft at certain times (summer) where demands on runway capacity are at their highest¹².

- 3.9 The differences between the parties are first whether or not this incentive mechanism is fair and reasonable in its own terms and second whether it is likely to have its intended effect in practice. The positions of the two parties are summarised below.

	Is it fair and reasonable?	Will it work in practice?
Flybe Position	<ul style="list-style-type: none"> -Runway is scarce resource – special obligation on GAL not to abuse its position of dominance. -Approach is unreasonable because users of small aircraft are less able to absorb these costs because of fewer passengers. -Unreasonable effects on regional UK interests. 	<ul style="list-style-type: none"> -Will not work because there will be insufficient feeder traffic to support the 'hub'.
Gatwick Position	<ul style="list-style-type: none"> -Runway is a scarce resource. -Structure of charges introduces incentives. Price signals to ensure efficient use of the asset in peak and off peak periods. Those who value asset most pay for it. -Accepts that this may discriminate against the operators of small aircraft. -Does not consider this approach <u>unfairly</u> discriminates – users of the runway face the same cost. 	<ul style="list-style-type: none"> -Yes. -However, Gatwick has noted publicly that it will monitor the situation and review the charging structure if the incentives do not have the intended effect.

CAA Provisional Views

- 3.10 As noted in paragraph 2.10 the CAA has to consider Flybe's complaint about landing charges and Gatwick's justification for its pricing policy in respect of these charges against the four objectives in section 39 of the Airports Act 1986. The CAA's provisional views on the application of each of its statutory objectives in this case are as follows:

¹² Paragraph 1.4 and 1.8 of Flybe submission.

To further the reasonable interests of users of airports

- 3.11 To the extent that Gatwick's charging policy has the object of incentivising greater passenger throughput through more efficient use of the single runway it could be regarded as furthering the interests of passengers using the airport overall. Flybe's complaint is that the airport's charging policy has distributional effects on passengers according to their particular origins or destination. While distributional effects raise important issues for different types of passengers and may give rise to policy issues for local and central governments, these distributional effects alone do not provide a robust basis for the CAA to take economic policy decisions under the Act.

To promote the efficient, economic and profitable operation of airports

- 3.12 Gatwick's single runway is very highly utilised at certain times of the day and year. Equally there are times throughout the year when there is significant excess. It is also clear that the demand for runway slots exceeds supply during certain hours and seasons. Against this background, the CAA considers that incentivising a more efficient use of the single runway that takes into account the differences in value airlines attach to slots at different times of the day and in different seasons would be consistent with the achievement of this objective.

To encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of airports

- 3.13 There is excess demand for runway capacity at Gatwick at certain times of the day and year. However, given Government policy, planning restrictions and the long lead times involved, the CAA does not expect Gatwick's pricing policy to have any significant effect on the airports policy towards providing more runway capacity over the short or medium term. Where additional investment in terminal facilities is required to enable Gatwick to meet the reasonable demands of users in peak times, the CAA would expect a pricing policy that leads to greater passenger throughput at the airport to encourage investment in these facilities.

To impose the minimum restrictions that are consistent with the performance by the CAA of its functions

- 3.14 This objective requires that the CAA intervene to restrain the conduct of an airport only where it is necessary and proportionate.

- 3.15 In balancing these four objectives the CAA therefore considers that incentivising a more efficient use of the runway that takes into account the value airlines attach to landing at different times of the day and in different seasons can be an objective and justifiable reason for a charging structure that is designed to this end. This is particularly relevant where Government policy is that there will be no runway expansion at the existing major airports in the southeast of England for the foreseeable future. In this context the value an airline places on landing rights (also referred to as slots) may be related to the maximum number of passengers it can pass through the airport per aircraft movement, or high value routes where passengers are willing to pay a higher premium for access to the airport at peak times. For this incentive to work it may take airlines some time to react, particularly because many of their schedules for the following year have been set.
- 3.16 GAL defines the efficient use of its runway and runway slots as giving access to those airlines who value it most. The CAA also recently considered this incentive effect in the context of a complaint under s41 by bmi in respect of Heathrow. The CAA consulted on the issue. In the consultation document the CAA set out its reasoning for being minded to accept that this form of incentive can support efficient use of scarce capacity¹³. In general, operators of larger planes with more passengers and/or those with higher yields per passenger could be expected to place a greater value on runway as the cost is a smaller share of the per passenger ticket price of that flight. GAL argues this is a logical consequence of managing its runway efficiently in a capacity constrained environment, because it is the only way to increase the total number of passengers using its airport. GAL has acknowledged this could potentially lead to the exit of operators of small aircraft.
- 3.17 GAL argues that the strategy has demonstrably worked because Flybe has already withdrawn its most unprofitable routes from the airport. The CAA notes however, that although Flybe has withdrawn two routes from Gatwick, some of these slots have been redeployed by Flybe for services to other destinations. This suggests that airlines are making their own commercial choices on the use of their slot portfolio for the most viable routes.
- 3.18 Flybe argues GAL's approach does not work, because to fill large planes going long distances requires a good short haul feeder network. In Flybe's view, demand arising from Gatwick's local catchment area is not sufficient to fill larger aircraft operating on longer routes. Flybe argues that seeking to price out smaller aircraft providing feeder

¹³ Investigation under s41 of the Airports Act of a complaint made by bmi against Heathrow Airport Limited – A Consultation July 2011. Available at <http://www.caa.co.uk/docs/5/HeathrowBmiConsult.pdf>

traffic will not support the development of longer routes operated by larger aircraft carrying higher passenger numbers. Flybe has provided evidence showing that in 2010 it carried some 37,400 passengers to and from Gatwick who were making same day connections there with another airline. The CAA notes however that this traffic represented less than 3% of Flybe's total Gatwick passengers. The vast majority of Flybe's traffic would therefore have origins or destinations in Gatwick's catchment area and would not support using Gatwick as a transfer point. We have not seen further evidence from either Flybe or Gatwick supporting or rejecting the argument that increasing the number of wide-body, long-haul services from/to Gatwick would also require a higher share of connecting passengers using smaller short haul feeder services.

- 3.19 In any case, the revised charging structure has only been in place at Gatwick since 1 April 2011 so it is too soon fully to assess its actual impact. Data from Airport Coordination Limited (ACL) shows that the average aircraft size at Gatwick has increased only marginally from 173 to 174 seats comparing the positions at the end of summer 2010 and at the start of summer 2011. The share of slots occupied by aircraft with more than 200 seats has fallen slightly, from 20.6% to 18.9% of the total¹⁴. The slots for summer 2011 would, however, have been allocated well before the start of the summer season and airline slot bids might not therefore have fully anticipated the changes in Gatwick's pricing structure.
- 3.20 The CAA does, however, accept in principle that an airport using its discretion to encourage more profitable traffic can be an efficient means of using capacity constrained facilities such as a single runway. Applying that principle in this case to the evidence as set out above leads the CAA to the conclusion that GAL was seeking to incentivise efficiency and so its new charging structure was objectively justified. To intervene to restrain GAL in respect of the new charging system would therefore not be consistent with the need to impose minimum restrictions that are consistent with performing the CAA's function under s41.
- 3.21 In order to comply with the price control GAL's charges are revenue neutral and thus the amount charged to airlines in total should not change with the new pricing structure. The issue is primarily one of distributional effects between users and their passengers. As noted above, distributional effects alone do not provide a robust basis for the CAA to take economic policy decisions under the Act.

¹⁴ ACL Statistics available at <http://www.acl-uk.org/reportsStatistics.aspx?id=98&subjectId=27> .

If there is not an objective justification, does GAL's revised pricing structure cause harm or have the potential to cause harm to passengers and/or the competitive process?

3.22 In this case the CAA's initial view is that GAL does have an objective justification. If GAL did not have an objective justification for its conduct then it could be argued that this type of pricing behaviour by an airport with market power would lead to distortions to the competitive process in terms of the prices airlines could then charge passengers. This could harm different users, or classes of users, in different ways with increases in fares for some or reduction in route choice. Given its view on the objective justification for the conduct, the CAA has not examined this issue further.

Regional Connectivity

3.23 Flybe argues that a major element of its case is that the impact on its users will ultimately be route reduction and it has urged the CAA to consider regional feeder traffic as part of any s41 investigation at Gatwick. This view was supported by several representations the CAA has received focusing on the adverse effects on passengers on domestic services to and from regional airports in the UK.

3.24 Despite not being able to use its formal economic regulatory tools to address this issue, given the importance of regional access to congested London airports, in particular for the regions themselves, over the years the CAA has reviewed the development of regulatory policy on such access and statements made on the subject.

3.25 The CAA first consulted on regional access in 1993 when it concluded that in the absence of a clear statement of policy from the Government it should not have consideration of access of regional services in its mind in discharging its duties under the Airports Act 1986¹⁵. During the consultation there had been calls for the re-arrangement of airport charges so that the average per passenger charge was equalised irrespective of the size of aircraft used. The CAA did not consider that this was an appropriate way forward in the absence of the strongest arguments for maintaining small aircraft operations at congested airports with a shortage of runway capacity. The CAA also concluded that:

if the Government were to decide that a priority should be given to maintaining access to regional services at congested airports, actions on airport charges alone would not be enough to secure this objective. Other mechanisms such

¹⁵ CAP 615 Access to Congested Airports For Regional Services – Result of a Consultation

as Traffic Distribution Rules, ring fencing of slots etc... would have to be deployed. These instruments are not presently in the Authority's gift¹⁶.

- 3.26 In evidence to the Transport Committee's 1998 inquiry into regional air services, the CAA took the view that while economic forces taken together might lead to the exclusion from the most congested airports of some regional routes and services, there did not seem to be a potential problem on a scale that would warrant intervention by Government at national level because of the costs of doing so. If there were believed to be significant benefits to consumers or to the local or regional economy over and above those which could be reflected in the airlines' profits, these would be better assessed at the local or regional level, possibly through considering the use of direct subsidy or the purchase of runway slots at congested London airports.
- 3.27 In 2005 and 2007 the CAA published reports into UK Regional Air Services¹⁷. These reports recognised that access to Heathrow was an important issue for regional economic development, and in particular for passengers wishing to connect to other services. There had been some reductions in services between UK regional airports and Heathrow over the decade preceding the report, but services to other London airports more than offset the loss of Heathrow services, and links to other European hubs provided an alternative means of making international or long haul connections. Overall the CAA found there had been improvements in the connectivity of UK regions, delivering benefits to passengers and, potentially wider economic benefits to UK regions through the aviation industry responding to incentives created through liberalisation. The reports recognised that there could be alternative policy interventions open to the Government, for example by public funding via Regional Development Funds, or through Public Service Obligations¹⁸.
- 3.28 In March 2009 the Department for Transport (DfT) consulted on the issue of regional connectivity as part of a more comprehensive review of the economic regulatory framework. The DfT noted that it had never received applications to impose PSOs on London routes, and given PSOs were a policy option, additional policy interventions, either through the proposed new regulatory framework or otherwise were unnecessary. The CAA supported this approach and noted that the maintenance of

¹⁶ CAP 615 Access to Congested Airports For Regional Services – Result of a Consultation

¹⁷ CAP 754 UK Regional Air Services – a study by the UK Civil Aviation Authority (2005), available on the CAA website at: <http://www.caa.co.uk/docs/33/CAP754.PDF>.

CAP 775 Air Services at UK Regional Airports – An update on Developments (2007), available on the CAA website at <http://www.caa.co.uk/docs/33/CAP775.pdf>.

¹⁸ Under European law Public Service Obligations would be permitted where there is no access from a region to a city, e.g. London. However, it is less certain whether they could be used to protect a route to Gatwick if there are routes to other London airports.

routes between regional airports and any particular airport should not be an obligation of the regulator.¹⁹

- 3.29 The DfT is currently consulting on developing a sustainable framework for UK aviation. This includes consideration of UK connectivity, both internationally and regionally, and of making better use of existing capacity. The consultation specifically invites views on whether provision should be made for regional access into congested airports²⁰.
- 3.30 In its recent consultation on setting the scene for the next price control review of Heathrow, Gatwick and Stansted airports, the CAA has recognised that airports in search of growth are likely to seek ways of using their scarce resources more efficiently. This might mean encouraging higher yield traffic at the expense of lower yielding traffic, perhaps through their pricing structures²¹.
- 3.31 Against this background, the CAA does not consider there are compelling reasons to depart from the view it has long held that s41 should not be used to pursue wider policy goals of regional connectivity. The CAA has to apply s41 against its statutory duties in the Airports Act. The regulatory regime of Part IV of the Act is not designed for wider policy issues that could risk importing distortions and where such wider purposes are more properly addressed by alternative mechanisms open to the Government.

Views Invited

- 3.32 This document sets out the CAA's views based on its preliminary assessment of the matters raised in Flybe's complaint. On the basis of that assessment the CAA is currently minded not to proceed to a formal investigation. As noted above, while the complaint might raise important aviation policy issues relating to regional connectivity, the CAA has to apply s41 against its statutory duties in the Airports Act. The CAA does not consider that these point towards exercising its powers to achieve a structure of airport charges that protects particular services or types of service at Gatwick. Before deciding the matter the CAA welcomes further views from any interested party on the issues raised in this case.
- 3.33 To enable a timely resolution of this complaint, the CAA seeks views by no later than **4 November 2011**.

¹⁹ CAP 775 Airservices at UK Regional Airports – An update on Developments (2009)

²⁰ A Sustainable Framework for UK Aviation: Available at <http://www.dft.gov.uk/consultations/dft-2011-09>

²¹ Setting the Scene for Q6: Available at <http://www.caa.co.uk/docs/5/Q6SettingScene.pdf>