

# **Q6 - SETTING THE SCENE**

**INITIAL VIEWS ON THE REGULATORY CONTEXT**

**2<sup>nd</sup> CAA STAKEHOLDER ROUNDTABLE**

**14 JUNE 2011**

# Outline

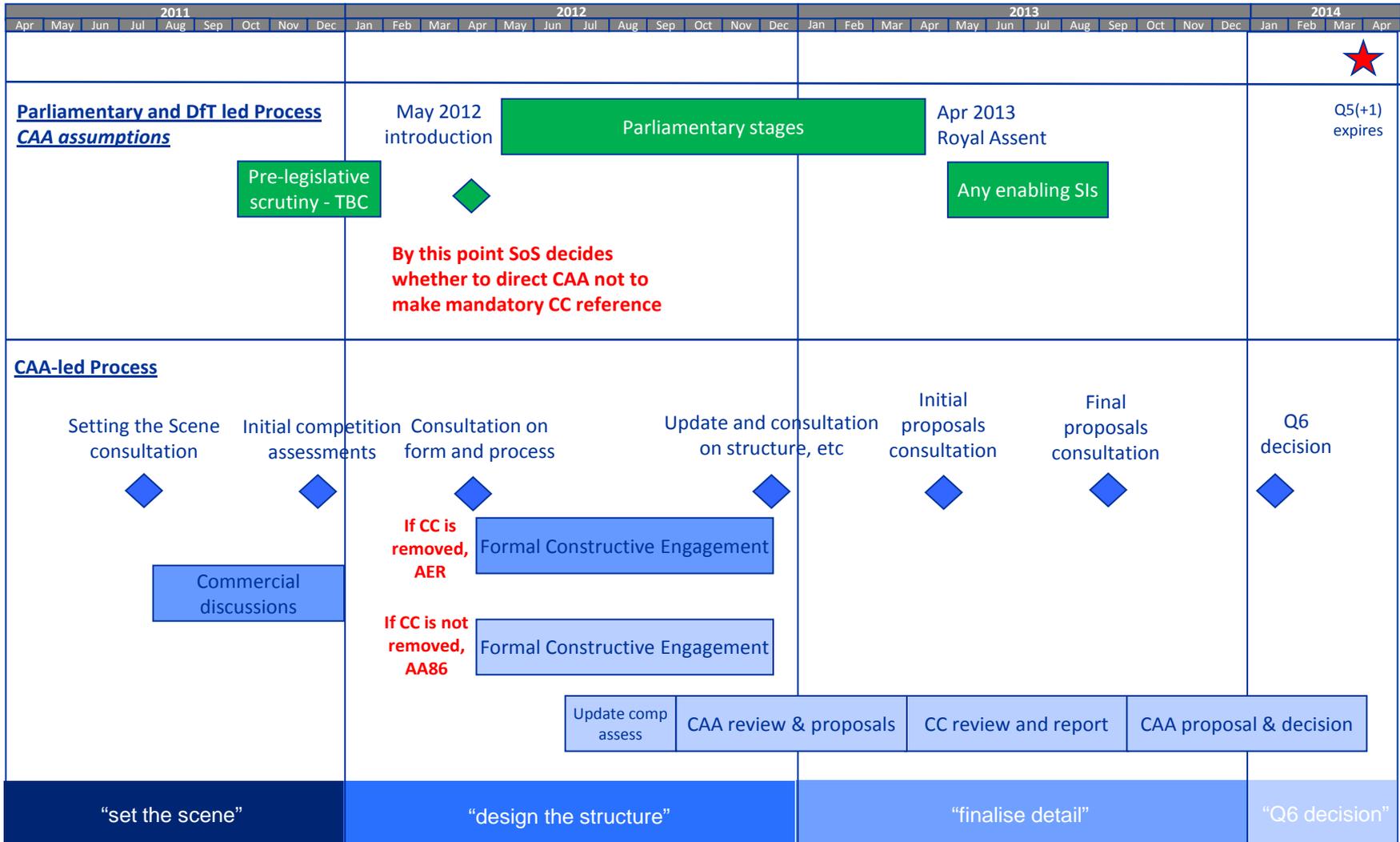


- **Current planning and process assumptions**
- **Defining the strategic context**
- **CAA context - new duties, strategic plan**
- **Approach to the consumer**
- **Market context – competition assessments**
- **Overarching themes emerging**
- **Key issues emerging at each airport**
- **Encouraging commercial outcomes**
- **Rules of engagement**
- **Next steps**

# CURRENT CAA PLANNING ASSUMPTIONS FOR Q6



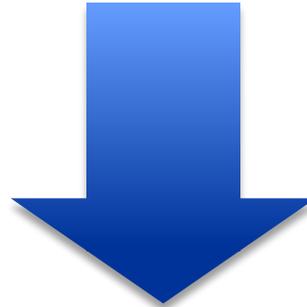
- Difficult to be more definitive given Parliamentary timetable and with 33 months to go...



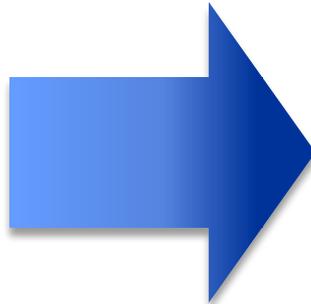
# DEFINING THE STRATEGIC CONTEXT FOR Q6



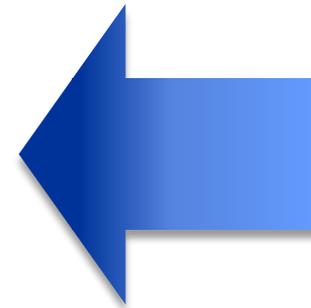
1. CAA AND CONSUMER CONTEXT



2. MARKET AND  
COMPETITION  
CONTEXT



**KEY  
INFLUENCES  
ON Q6  
AGENDA**



3. POLICY  
CONTEXT



+ lessons from other regulators  
+ lessons from Q5 and Q5 + 1

4. STAKEHOLDER CONTEXT

# CAA (NEW) DUTIES



## AIRPORTS ACT 1986

### Four equal duties

To further the reasonable interests of users of airports within the UK

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

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

## AER BILL (2012)

### - DRAFT -

Primary duty to promote the interests of existing and future passengers

Pursue this objective where appropriate by promoting competition

Supplementary duties including:

- a financing duty
- the need to ensure that all reasonable demands are met
- better regulation principles

# ALIGNMENT WITH CAA STRATEGIC PLAN



## CAA STRATEGIC OBJECTIVES 2011–16

1. To enhance aviation **safety** performance by pursuing targeted and continuous improvements in systems, culture, processes and people.

*Ensuring safety remains a baseline for all aviation stakeholders*

2. To improve choice and value for aviation **consumers** now and in the future by promoting **competitive markets**, contributing to consumers' ability to make informed decisions and protecting them where appropriate.

*For Q6 this means monitoring the effectiveness of competition at the designated airports, and where it cannot be relied upon to protect consumers, establishing the most appropriate regulatory incentives aligned to consumer priorities*

3. To improve **environmental** performance through more efficient use of airspace and make an efficient contribution to reducing the aviation industry's environmental impacts.

*How can CAA best contribute? For example, we could encourage airports to be more transparent about all costs, including carbon in capital planning*

4. To ensure that the CAA is an efficient and effective organisation which meets **Better Regulation** principles and gives value for money.

*For Q6 this means ensuring regulation is demonstrably necessary, proportionate, transparent and accountable. The CAA will need to prioritise its work and consider informal and well as formal tools*

# APPROACH TO THE CONSUMER

**1** Improving outcomes for consumers



Core remit of CAA

**2** Develop understanding of whether the market fails to deliver important consumer outcomes



**Assume across a broad range of outcomes, the following 'rebuttable presumptions':**

- that competition and innovation in aviation and airport markets is generally aligned to consumers interests
- airports and airlines collectively can generally represent consumer interests for CE/long-term capital planning

**... unless there are good reasons not to:**

- market power
- consumer behaviour bias
- 'uncommercial' consumer sub-groups
- misaligned incentives .e.g. resilience
- recognise not one type of 'consumer' but different groups including future consumers

**3** Develop clear evidence-based understanding of what matters to consumers



**This will be informed by:**

- framing evidence held by all stakeholders, including airlines and airports
- CAA's "Choice, Value and Fair Treatment" project, which will inform what consumers value and include some primary research

**4** Develop regulatory toolkit to remedy key consumer risks



**Consider both 'soft' and 'hard levers'.**

- Q6 context can include both – encourage collaboration and set regulations. Bias towards informal tools
- Questions over future of Service Quality Regime (SQR), e.g. how it should be more aligned to interests and outcomes?

# MARKET CONTEXT – COMPETITION ASSESSMENTS



- **Key evidential question is the degree to which there is, and is likely to be, high degrees of market power. Q6 needs to use this to address the most appropriate regulatory response**
- **CAA initial assessment in Dec 2011 of evidence at the three airports**
  - Unlikely a yes/no result: question of degree of market power and relevant markets
  - Will prioritise key data and evidence required to confirm assessment in lead up to Q6
  - Evidence basis will influence other CAA work such as views on market development, Section 41 disputes, ACD, licensing requirements under AER, etc
- **Discussions early 2012 on what competition assessments mean for Q6 incl:**
  - whether price controls are required at the airports
  - appropriate form economic regulation should take (costs and benefits of suitable options)
  - confirmation of process for rest of Q6 programme

# OVERARCHING THEMES EMERGING FOR Q6

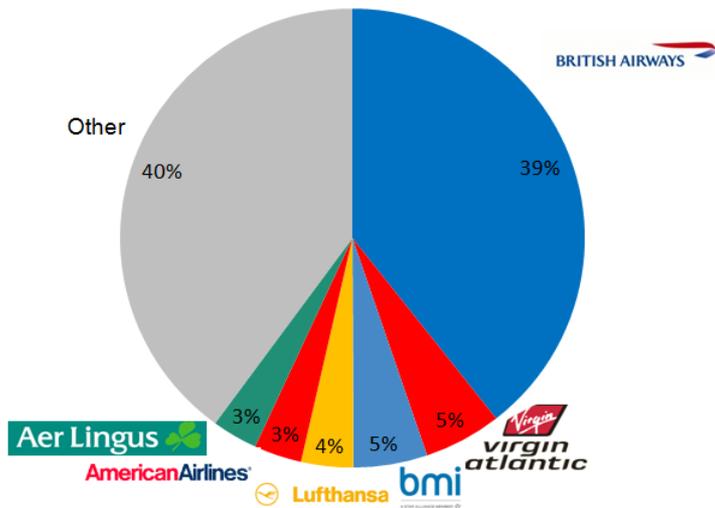


- **Early CAA focus on “outcomes” or key success factors**
  - Difficulty gaining stakeholder consensus on “vision” at each airport
  - Key success factors emerging include being able to demonstrably:
    1. further consumers’ interests
    2. incentivise the ‘right’ commercial behaviours for airports and airlines
    3. take into account airlines’ affordability
    4. maintain airport investor confidence and financeability
- **Recognise ‘one size may not fit all’**
  - Different business models, ownership, and issues at airports
  - New flexibilities afforded by AER Bill to tailor regulation to airport
- **Regulation supporting commercial outcomes not replacing them**
  - All sides need confidence in the regulatory framework
  - Supporting greater collaboration
- **Agreed ‘rules of engagement’**
  - Evolve constructive engagement
  - Stakeholders have confidence in process

# HEATHROW Q6: SCENE SETTING

- **Airlines' priorities**
  - **Affordability** (300% price increase in 10 years)
  - **Transparency and accountability for CE**
  - **More 'responsive' design of price regulation to commercial drivers** (esp. capex and opex)
  - **'Competitive equivalence'** (x-campus issues)
  - **Clarity on airport obligations**

- **Airport priorities**
  - **Focus on passenger experience**
  - **Risk/reward balance** (e.g. approach to traffic forecasts)
  - **Airport/airline collaboration**
  - **Enhancements to RAB approach**
  - **Recognise importance of 'hub'**

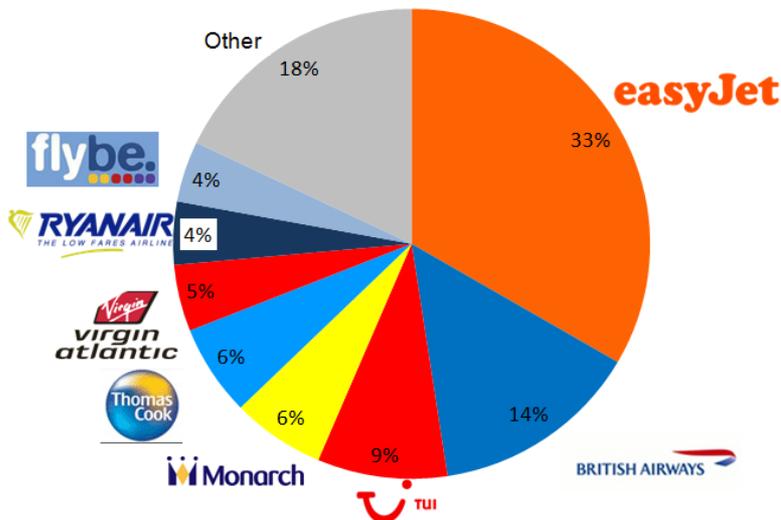


Passengers (million)	Average Regulatory Asset Base (RAB) (£m)	Regulated revenue (£m)	Price limit per passenger (£)
66.1	10,236	955	14.66

Nb: 2009/10 figures

# GATWICK Q6: SCENE SETTING

- **Airlines' priorities**
  - 'Competitive' outcomes for prices
  - Service level agreements (regulated)
  - Regulation to drive airport to take competitive and customer focused approach to capex and opex
  
- **Airport priorities**
  - Regulation must be proportionate to competition assessment
  - Long-term bilateral contracts with airlines can promote passenger interests
  - Tailor approach to regulation at each airport
  - Recognise regulation can influence incentives to contract

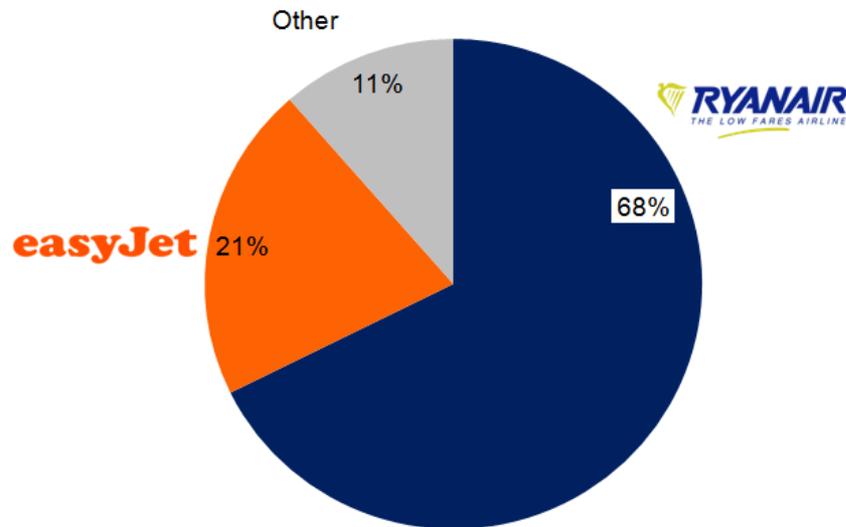


Passengers (million)	Average Regulatory Asset Base (RAB) (£m)	Regulated revenue (£m)	Price limit per passenger (£)
32.4	1,660	242	7.40

Nb: 2009/10 figures

# STANSTED Q6: SCENE SETTING

- **Airlines' priorities**
  - 'Competitive' outcomes for prices
  - Service level agreements (regulated)
  - Regulation to drive airport to take competitive and customer focused approach to capex and opex
  
- **Airport priorities**
  - Approach to form of regulation should recognise competition assessment
  - Regulation should also recognise differential features of Stansted such as excess capacity, concentrated LCC airline power, and limited capex programme



Passengers (million)	Average Regulatory Asset Base (RAB) (£m)	Regulated revenue (£m)	Price limit per passenger (£)
19.8	1,248	133	6.53

Nb: 2009/10 figures

# ENCOURAGING COMMERCIAL OUTCOMES



- **Use Q6 to encourage airlines and airports to have confidence to reach more commercial solutions, whilst taking into account degree of market power of airports**
  - Encourage differentiation and innovation based on commercial drivers
  - Recognise airlines' concern that market power cannot be simply 'contracted away', but requires regulatory oversight to ensure deals are 'fair'
  - Credible and appropriate regulatory fallback proportionate to market power
- **Can operate at a number of levels**
  - Agreement on specific issues (e.g. capex outputs) through constructive engagement
  - Negotiated Settlements on a 'package' (e.g. Q5 + 1)
  - Commercial Contracts, either bilateral or multilateral
  - Clarity on rights and responsibilities

## Issues for CAA

- Guidance on circumstances for standing over a deal (consumer interest)
- Protection for airlines not covered by deals
- CAA 'stance' will influence incentives to deal

# RULES OF ENGAGEMENT



- **Build on Q5 constructive engagement**
  - Phase I (2011): seek commercial agreement on outcomes and develop initial airport business plans
  - Phase II (2012): formal CE process reflecting outcome of competition assessments and progress with commercial discussions. Earlier formal engagement should parties agree (e.g. at Heathrow)
  
- **Agreed operating principles**
  - **Accountabilities**
    - agreed governance structure
  - **Transparency:**
    - timely exchange of relevant data
    - wider scope than Q5 (inc opex etc)
    - protection of commercial data
    - price impact and trade-offs should be clear up-front
    - “no surprises”
  - **Collaboration:**
    - shared development of key outputs where possible
  - **Dispute resolution:**
    - informal role for CAA (step in/step out)
    - facilitators?

# THE YEAR AHEAD



Date	Step
16 May 2011	1 <sup>st</sup> Industry roundtable on stakeholder strategic priorities
14 June 2011	2 <sup>nd</sup> Industry roundtable on “Setting the Scene”
End July 2011	CAA publish “Setting the Scene” consultation document
End 2011	CAA publish Initial Competition Assessments
To 2011	Commercial discussions/informal CE
Early 2012	CAA publish initial thoughts on form of regulation

- Regular meetings with stakeholders
- Stakeholder Sounding Board (Quarterly)