



**CAA'S JULY 2011 CONSULTATION:
'SETTING THE SCENE FOR Q6'**

Summary of responses

16 December 2011

***Civil Aviation Authority
CAA House, 45-59 Kingsway, London, WC2B 6TE***

1. Introduction

Responses

- 1.1 The CAA's consultation closed on 31 October 2011¹ and 25 November 2011 for those stakeholders with an interest in Stansted. The CAA would like to thank the following 15 organisations and people who submitted written responses².

British Midland International (bmi)
British Airways (BA)
Consumer Council for Northern Ireland (CCNI)
easyJet
Gatwick Airport Limited (GAL)
Heathrow Airline Operators Committee (AOC) and IATA London Airline Consultative Committee (LACC)
Heathrow Airport Limited (HAL)
National Express
Ryanair
Stansted Airport Limited (STAL)
Star Alliance (Star)
David Starkie
Stop Stansted Expansion (SSE)
The States of Guernsey (Guernsey)
Virgin Atlantic Airways

Purpose of this document

- 1.2 This document sets out a brief summary of the written responses and is structured around the six questions set out in consultation document. It does not attempt to summarise all of the comments made by respondents. All comments have been, and will continue to be, considered, whether or not they are mentioned in this document. Where possible views are summarised across respondents, although respondents are identified separately where they have made unique points.

Next steps

- 1.3 The CAA's response to the issues raised in this consultation will be published in its planned "Q6: Policy Update" document in April 2012. In the lead up to this document, the CAA expects to discuss its emerging views with stakeholders and at further workshops in February/March 2012. The CAA also expects to publish its market power assessments for each of the airports in January 2012 and issue its detailed Guidelines for Constructive Engagement (CE) in March 2012.

¹ This document is available at: <http://www.caa.co.uk/docs/5/Q6SettingScene.pdf>

² Responses are available at: <http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12761>

- 1.4 The CAA remains keen to discuss with all stakeholders their priorities for Q6. Please contact Ken Cheong at ken.cheong@caa.co.uk or 0207 453 6270 if you would like to discuss any issue relevant to the Q6 programme.

2. The CAA's proposed objectives and outcomes for Q6

- 2.1 Respondents, in general, supported the CAA's proposed objectives and outcomes. HAL stated that, building on the CAA's proposals and in conjunction with the airlines, it had developed its own set of objectives and outcomes for the Q6 review of Heathrow. These include cost effective delivery for passengers and users and support for Heathrow as a hub. BA and STAL considered that, in undertaking Q6, the CAA's primary focus should be on furthering its formal statutory duties. Ryanair went further and felt the CAA's strategic objectives were irrelevant and the sole focus should be on the statutory duties.
- 2.2 In general respondents supported the CAA's interpretation of its statutory duties. In particular airlines strongly supported the CAA's interpretation of the proposed financing duty as they felt it should not be for passengers to bear the costs of inefficiency or the risks from a highly leverage capital structure. HAL however emphasised that financing should recognise local circumstances and should consider an efficient Heathrow rather than an efficient airport. STAL emphasised the need to maintain investors' confidence.
- 2.3 Some respondents wanted further clarity on the CAA's interpretation of its statutory duties. BA was concerned that the CAA had not set out how it would deal with all of its duties, for example those on efficiency. Ryanair asked the CAA to set out how it would promote competition. Both SSE and STAL raised concerns over the CAA's potential treatment of environmental and social responsibility measures. Regional representatives (CCNI and Guernsey) were concerned that passenger growth should not be at the expense of the needs of regional or existing passengers.
- 2.4 Some respondents raised issues relevant to the context for the Q6 agenda. Ryanair stated that the key influences on the Q6 agenda should include the Competition Commission's market investigation findings about BAA ownership and the concerns raised by the CC on the adequacy of the current regulatory regime. STAL felt it was important that CAA maintained a separation between its role as an independent economic regulator and its wider role supporting the delivery of government policy initiatives.
- 2.5 While most respondents supported CAA's outcome focused success factors, BA suggested a further set of success factors which might be more amenable to measurement such as trends in unregulated and regulated charges, traffic growth and service quality.
- 2.6 While most respondents supported the CAA's approach to stakeholder engagement, Ryanair stated that it was important to have separate workshops for Gatwick and Stansted to reflect the different issues at each airport. STAL stated that attendance at some meetings should be limited to those with a material interest in the airport.

3. How the CAA should take account of the interests of passengers

- 3.1 Respondents welcomed the CAA's focus on passenger interests. Both Heathrow and Gatwick airports had commissioned research to better understand passengers' requirements and looked forward to working with airlines and the CAA to come to a common view. GAL felt that current airlines may not reflect future passengers' interests, particularly if future passengers were different to those currently using the airport. The CCNI supported regulatory intervention where competition did not deliver benefits. STAL welcomed further discussions with the CAA how it might input its views and evidence on passenger priorities.
- 3.2 Airlines generally felt that they represented passenger interests. BA, in particular, considered that the perceived mismatch between airlines' and airports' requirements reflected airports' misplaced ambitions rather than misaligned incentives. Ryanair stated that airlines always operate in their passengers interest unless it can be demonstrated otherwise, i.e. where they are shown to block or prevent growth or competition. BA considered that the circumstances where airlines and passengers interests diverged were theoretical curios. BA also considered that, while airlines would not cater for uncommercial passenger needs, the requirements of passengers with reduced mobility were already protected by EU legislation. bmi, CCNI and Guernsey felt that protection should be given to the prices charged for certain groups of existing passengers. The AOC emphasised that both current and future passengers would be concerned about affordability of airport charges.
- 3.3 bmi and the Heathrow AOC welcomed further work to understand passengers' interests although BA was concerned that surveys could be biased as passengers might often express a preference for something they are not prepared to pay for and there was a risk that CAA could become the arbiter of what is in the passengers' interest based on conflicting survey evidence. Ryanair raised concerns about the 'intelligence' that CAA could derive from the small number of customer complaints.
- 3.4 Respondents supported the service quality regime with airlines, in general, preferring specific measurable targets rather than perception based surveys, particularly where perception surveys were carried out by the airport. Airports, and some airlines, felt that the service quality regime should be improved. HAL suggested that the number of service quality measures should be reduced to sharpen incentives and focus on where passenger priorities are not being met by the airport. GAL felt that service quality incentives were not adequately aligned with the passenger interest as demonstrated by the divergence between the service quality regime scores and the performance under the perception based airport service quality measures. Virgin felt that there was a need to take a more holistic approach to considering service quality which included airport ambiance. Ryanair queried the need for incentives to improve service quality when the rise in low cost carriers had demonstrated that what matters most to passengers was low fares and efficiency. STAL stated that the CAA should not assume that the same service quality issues exist at all regulated airports.

4. Market trends and competition dynamics that may influence the Q6 agenda

- 4.1 Airports stated that the CAA should be clear about the main competition concerns and the form and structure of regulation should focus on solving market failure and potential consumer harm. HAL felt that, while it supported a continuation of a RAB-based framework, there may be scope for a more proportionate set of remedies. For example HAL felt that service quality regulation should not be a solution if the concern is over excessive prices and ex-post regulation could be used where the chance of exploiting market power is small. GAL believed that, given the change in ownership and behaviour, there was no need for the regulation of Gatwick airport or that the need for regulation was greatly reduced. STAL stated that Stansted faced more competition than Heathrow or Gatwick and that the current regulatory framework was distorting competition with other airports, in particular Luton. STAL looked forward to working with the CAA to identify the impact of competitive constraints and the most appropriate form of regulation.
- 4.2 At Stansted there was a difference of opinion over the degree to which airlines provided countervailing market power to the airport, with Ryanair stating that the lack of airline power was demonstrated by the inability to prevent Stansted airport substantially increasing airport charges over recent years.
- 4.3 GAL and STAL stressed the need for the CAA to be clear about its views on substantial market power. In addition both airports stated that there was a need for clarity on the form of regulation in spring 2012 to allow CE to be effective, with GAL suggesting that the CAA should draw on lessons on the introduction of competition from other regulators.
- 4.4 Airports said that traffic forecasts made at the last review overstated traffic relative to the outturn and it was important to consider the balance of risks. Ryanair stated that previous traffic forecasts had been wrong as they failed to take account of airlines' own predictions. Heathrow AOC stated that, regardless of the forecasts, airlines bear much of the traffic risk and that airport price increases were not sustainable. BA stated that airports had until recently been happy to take traffic risk and received a higher cost of capital to deal with demand volatility. Virgin emphasised the need to introduce greater independence and stability to the traffic forecasting process.
- 4.5 David Starkie suggested that the comparison of airline and airport returns may be misleading as it does not reflect the specific airlines or networks operating at individual airports, with STAL stating that 'pre-exceptional items' rates of return should be used as a basis of comparison. Furthermore Starkie was concerned that the airports were not making the assumed cost of capital and this could require a significant change of approach. However BA stated that the cost of capital had been set too high as airports had been able to lower their financing costs and delay investments.

5. The CAA's expectations for airport-airline engagement

- 5.1 Respondents in general supported CE. HAL stated that negotiated settlements would produce the best outcomes and GAL stated it was committed to a full and transparent process. Ryanair stated that it was important to learn lessons from Q5 where CE broke down at Stansted.
- 5.2 Both airline and airport respondents supported the CAA's operating principles for formal CE. Airlines welcomed CAA involvement in the CE process with BA and easyJet, in particular, concerned about the impact of airport market power on negotiations. HAL also welcomed CAA's involvement arguing that it was important to allow CAA to take forward subsequent stages of the process. GAL was more reticent and raised concerns that CAA involvement could result in regulator-led discussions. STAL supported limited CAA involvement to help 'unblock' discussions.
- 5.3 A number of respondents asked the CAA to provide more detailed guidance before the start of formal CE in April 2012 which set out the required outputs and governance arrangements for CE. The AOC stated that the CAA should use the output from CE to establish a regulatory settlement or to facilitate a commercial agreement between parties. The AOC and bmi were therefore concerned that the output from CE would inform BAA's business plans rather than leading to the development of a joint business plan. Ryanair, Virgin and BA were concerned that regulatory gaming could prevent a proper review of information and would welcome steps to address this. Ryanair felt that this should encompass the imposition of sanctions or penalties where the airport refused to participate openly and transparently. STAL felt that the form of CE would be dependent on the form of regulation, with non-designated airports typically negotiating commercial terms with airlines without the need for full disclosure of operating costs and commercial revenues.

6. The emerging issues at Heathrow, Gatwick and Stansted

- 6.1 While there was general agreement across respondents on the form of regulation at Heathrow, there was less consensus at Gatwick and Stansted. Respondents agreed on the need for a RAB-based framework at Heathrow. However there was less agreement at other airports with airlines in general supporting the continuation of a RAB-based framework, although this was strongly opposed by GAL. STAL stated that given the precedent established in Q5, there were reasonable grounds to expect that the CAA would adopt a tailored approach to regulatory Stansted in the future.
- 6.2 At Stansted, apart from easyJet, there appeared to be some concern over the impact of a RAB-based framework. Ryanair felt that RAB-based regulation at Stansted had led to regulatory gaming and a lack of focus on reducing operating expenditure to reflect the decline in traffic. STAL felt that the CAA should undertake a critical review of the impact of the RAB-based model and whether it was capable of providing investors at Stansted with a reasonable rate of return.
- 6.3 There was a divergence of views across respondents on the scope of the till. Airlines generally felt that a single till approach should be retained. HAL however supported an examination of the precise scope of the till whereas GAL felt that the CAA should undertake a first principles review of single, dual or hybrid till regulation as part of the work on alternative forms of regulation. National Express felt that the CAA should consider whether revenue from coach services should subsidise other activities at the airport.
- 6.4 Airlines emphasised the importance of affordability across each of the three designated airports. BA stated that airlines should indicate the overall level of affordability of airport charges. They considered that this would incentivise the airport to minimise operating cost expenditure so that it could maximise capital expenditure. GAL was concerned that there would not be a consensus between the airport and airlines and indeed between airlines due to their different business models. GAL emphasised the need for flexibility to enable it to compete, for example the ability to accommodate A380s.
- 6.5 bmi, Star and Virgin were concerned over competitive equivalence at Heathrow airport. Star felt that further work would be required in terminal 2 to deliver a comparable level of service to that enjoyed by BA at terminal 5. BA, however, considered that charges should not be differentiated by service quality and that business cases were the best means of prioritising different projects.
- 6.6 In general respondents supported the benefits of a split between core and flexible capital programme, although a number of respondents noted that further work would be required to define how this would work in practice. There was also general support for the benefits of capital investment triggers and the need to develop these so that they could become more outcome-focused. In addition BA supported the introduction of gain sharing although BMI stressed the need for a stable cost base for gain sharing to be effective which might be difficult to achieve for operating costs. Airlines in general stressed the importance of controlling operating costs for future price levels with bmi supporting improved incentives and BA stressing the need for appropriate

benchmarking. In addition BA stated that as set out in the last review, the CAA should undertake a review of security costs at Heathrow and Gatwick and the reasonableness of pension assumptions.

- 6.7 Ryanair and SSE were concerned that airlines at Stansted would continue to carry the cost of the abortive work on the second runway. In particular SSE felt that the costs of houses purchased to allow the second runway should be removed from the RAB.

7. The current process and timetable for Q6

- 7.1 At Heathrow there was some concern over the interaction of the Q6 timetable with that of the airport. HAL stated that it had put forward its own timetable for deliverables during Q6 which included the publication of a draft business plan in July 2012 and a revised business plan, following CE, in January 2013. The AOC and bmi stated that HAL's proposed timetable was not consistent with CAA's timetable for Q6. STAL stated that the CAA should consider extending the duration of the Stansted Q5 period to March 2015 to provide time for a more detailed consideration of the policy issues in relation to competition and the appropriate regulatory model for Stansted.

Regulatory Policy Group
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