

Preparing for a more competitive airports sector

Recent developments in the aviation sector are likely to lead to a change in the structure of the airport industry and the nature of competition within it. In particular, the Competition Commission (CC) recently decided that BAA should divest Stansted, Gatwick and either Glasgow or Edinburgh airports. If implemented this would result in a new ownership structure, while the Department for Transport (DfT)'s Review of the Economic Regulation of airports (RER) would also entail changes to the CAA's powers and the way it regulates.

In order to ensure that these changes maximise benefits to consumers, the CAA needs to consider its approach accordingly. The CAA is therefore carrying out preparatory work on how to assess competition faced by airports and how to ensure that regulation minimises distortions to competition and investment. Today it is launching a consultation on the objectives and process of two projects looking separately at each of these issues.

Background

Following its investigation into BAA, the Competition Commission (CC) concluded that in order to remedy the adverse effect on competition caused by common ownership of airports, BAA should be required to sell Gatwick and Stansted and one of Edinburgh or Glasgow airports. BAA is currently progressing the sale of Gatwick. The CC expects that these divestments will increase competition among the airports, reducing their market power and therefore lessening the need for regulation.

However, regulation might remain at some airports, either as an enduring feature or as part of a transitional arrangement, while competition develops. The CC report recognised the potential for a RAB-based approach to price regulation to distort investment incentives and competition, and supported the CAA considering alternatives to the current RAB-based methodology.

In addition, the DfT is currently reviewing the economic regulation of airports. It has proposed a licence-based approach to regulation which would give the CAA greater flexibility in how it regulates. It has also proposed that the CAA's Competition Act powers be widened to include airports, broadening the range of tools available

to the CAA.

Prior to these recent developments, the CAA examined competition between airports in its reviews of the designation of Manchester and Stansted airports. This led to the DfT deciding that, in the case of Manchester airport, competition had developed to such an extent that price regulation was no longer warranted.

In the case of Stansted, it decided that continuing price regulation should remain. The issue of the extent to which Stansted faced competition, and how regulation should be adapted to reflect this, therefore featured in the recent periodic review of the Stansted price control.



Objectives

The CAA plans to set out an approach to assessing the degree of competitive pressure faced by an airport, both to ensure that its analysis of the need for regulation is robust, and to deal with any Competition Act cases that may arise. Furthermore, it will need to ensure that, under the current framework or any reformed regime, any continuing regulation creates incentives for efficient investment at regulated and at non-regulated airports operating in the competitive market.

Objectives for project 1: developing competition guidelines

The project to develop competition guidelines is intended to set out how the CAA will analyse airport market power and to provide greater transparency to airport operators and airlines on the CAA's methodology.

In developing the guidelines, the CAA will consider many aspects and techniques of competition analysis, including market definition, barriers to entry, substitution, ability to switch, buyer power and

factors specific to the aviation industry, such as the multi-sided nature of airport markets.

The CAA will also consider the types of evidence that could be used to indicate the existence and degree of market power, such as higher than competitive pricing, restriction of supply, underinvestment or high profitability. Consideration will need to be given to how measurable these factors are in the airport industry and whether they could be practically used as indicators of market power.

Objectives for project 2: developing alternative approaches to price cap regulation

This project is intended to identify alternative approaches to regulation that reduce distortions to competition and investment,

providing input into future price control reviews and any mid-quinquennial reviews. The project will also provide market participants with an indication as to how the CAA might regulate airports in future.

This project will review and develop the analysis already carried out and will specifically consider the impact that different regulatory approaches could have on competition. While it has been noted that the current regulatory approach has the ability to distort investment and therefore competition, other regulatory approaches may distort competition in different ways. It is therefore intended to assess the distortionary effects of different methods, with a view to identifying approaches to regulation that are both practical and consistent with allowing competition to develop in the interests of consumers.

Process

The CAA proposes to examine relevant evidence on the relationship between competition and regulation, examine experience in other regulated industries and in airport sectors in other jurisdictions and to analyse evidence submitted to it. The CAA intends to employ external resource to assist in undertaking the projects. In order to ensure high quality analysis and robust findings, the CAA will consult widely. In particular the CAA is proposing to: establish a panel of experts; involve UK competition authorities and regulators in thinking and peer review; and to consider relevant precedent in other countries

and industries.

The CAA recognises the importance of engaging stakeholders in these projects. The CAA will work closely with industry stakeholders, in order to better inform the projects' conclusions. Stakeholders will, therefore, be encouraged to participate through responses to consultations at key points in the projects, attendance at meetings with the CAA and participation in stakeholder forums to discuss developments.

What happens next?

The full initial consultation document has been published on the CAA website, at the ERG publication page. The CAA is inviting views from all interested stakeholders on its proposed objectives and process by 8th January 2010. The CAA will also host a seminar at its London offices on the 10th December at 14.00. There will be a short presentation on the paper and an opportunity for stakeholders to contribute initial views.



Project Timetable

5 November 2009	Publication: Initial consultation document – objectives and process
10 December 2009	Seminar on initial consultation document
February 2009	Publication: Statement on objectives and process
February/ March 2010	Meetings with stakeholders and expert panel regarding competition guidelines
March 2010	Publication: Competition Guidelines – issues consultation
Q2/Q3 2010	Meetings with stakeholders and expert panel regarding alternative price controls
Q3 2010	Publication: Alternative price controls: initial options consultation
Q2 2010	Publication: Competition guidelines – proposals
Q2 2010	Meetings with stakeholders and expert panel to discuss proposals
Q4 2010	Publication: Competition Guidelines
Q1 2011	Publication: Alternative price controls: decision on further analysis
Q2 2011	Meetings with stakeholders and expert panel to discuss further analysis
Q2 2011	Publication: Alternative price control options

Any comments on the CAA's proposed objectives and process should be sent, if possible by email, to airportsreview@caa.co.uk. Alternatively, they may be posted to: Kathryn Hodgson, Economic Regulation Group, CAA, 45-59 Kingsway, London WC2B 6TE. The CAA will publish all responses, except any material marked as confidential.