



Airport Regulation

price control review - consultation on policy Issues

CAA briefing
20 December 2005

Contents

The CAA's statutory function and objective

The current price controls

Market context

Key challenges

Policy proposals

Timetable for review



The CAA's statutory function is:

to set maximum limits on airport charges at airports designated by the Secretary of State

- **Heathrow, Gatwick, Stansted for 5 years from April 2008**
[fifth quinquennial control period, **Q5**]
- **Manchester for 5 years from April 2009**

within a clear statutory framework:

- **Government designates airports for price control**
- **Competition Commission reference - mandatory**
- **Public interest issues reviewed by Competition Commission**



CAA's statutory objective

To set price controls in the manner best calculated by the CAA to:

further **reasonable interests of users** of airports within the UK;
promote the **efficient, economic** and **profitable** operation of such airports;

encourage **investment** in new facilities **in time** to satisfy anticipated demands by the users of such airports; and
impose the **minimum of restrictions** consistent with the performance by the CAA of its functions;

and in doing so, to take into account such of the international obligations of the UK as may be notified to it by the Secretary of State.

The current price controls

Maximum revenue per passenger

2003 – 2008

Heathrow – £6.48, followed by RPI + 6.5%

Gatwick - £4.32, followed by RPI + 0%

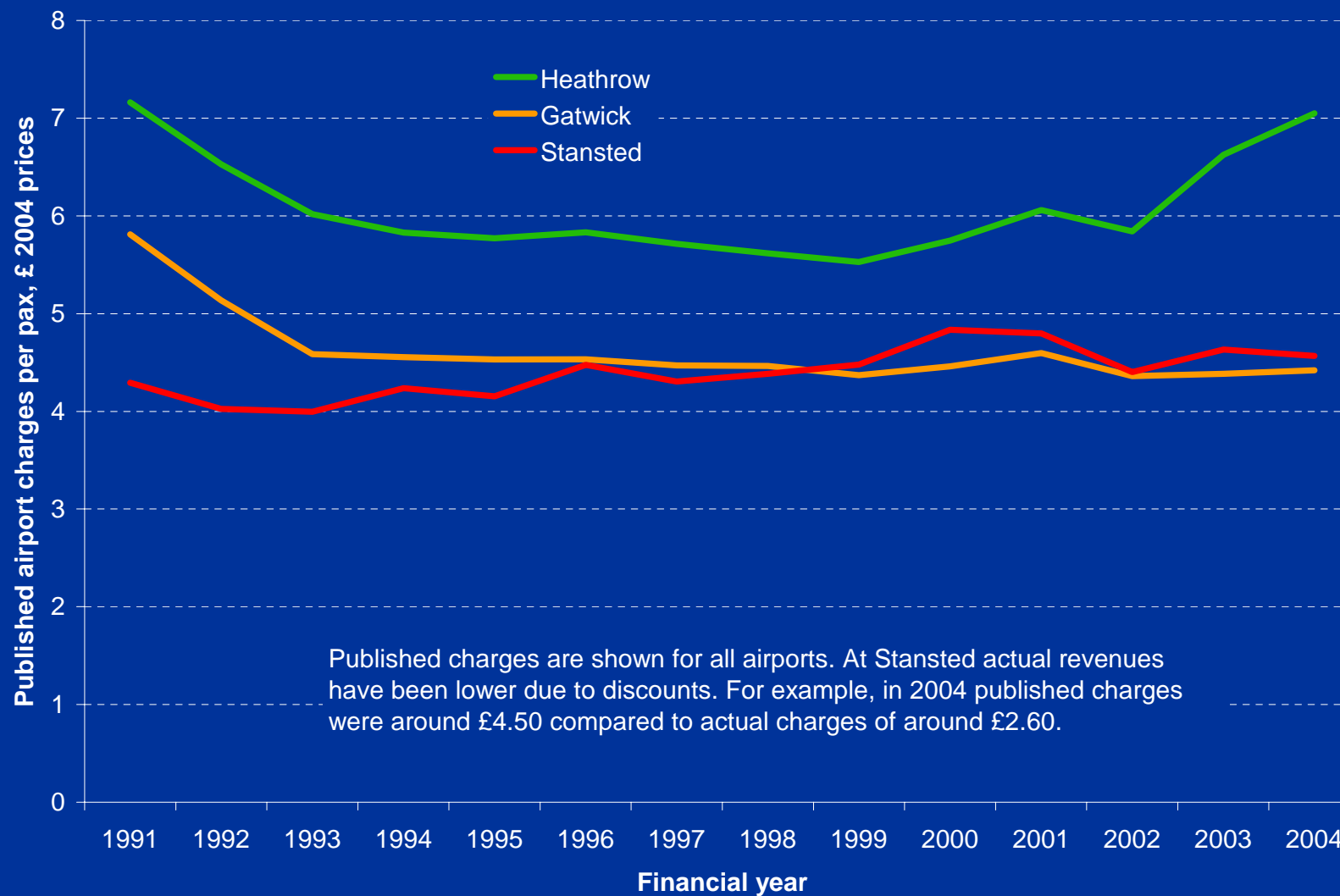
Stansted - £4.89, followed by RPI + 0%

[actual revenue per passenger at Stansted significantly lower – e.g. £2.61 in 2004/05]

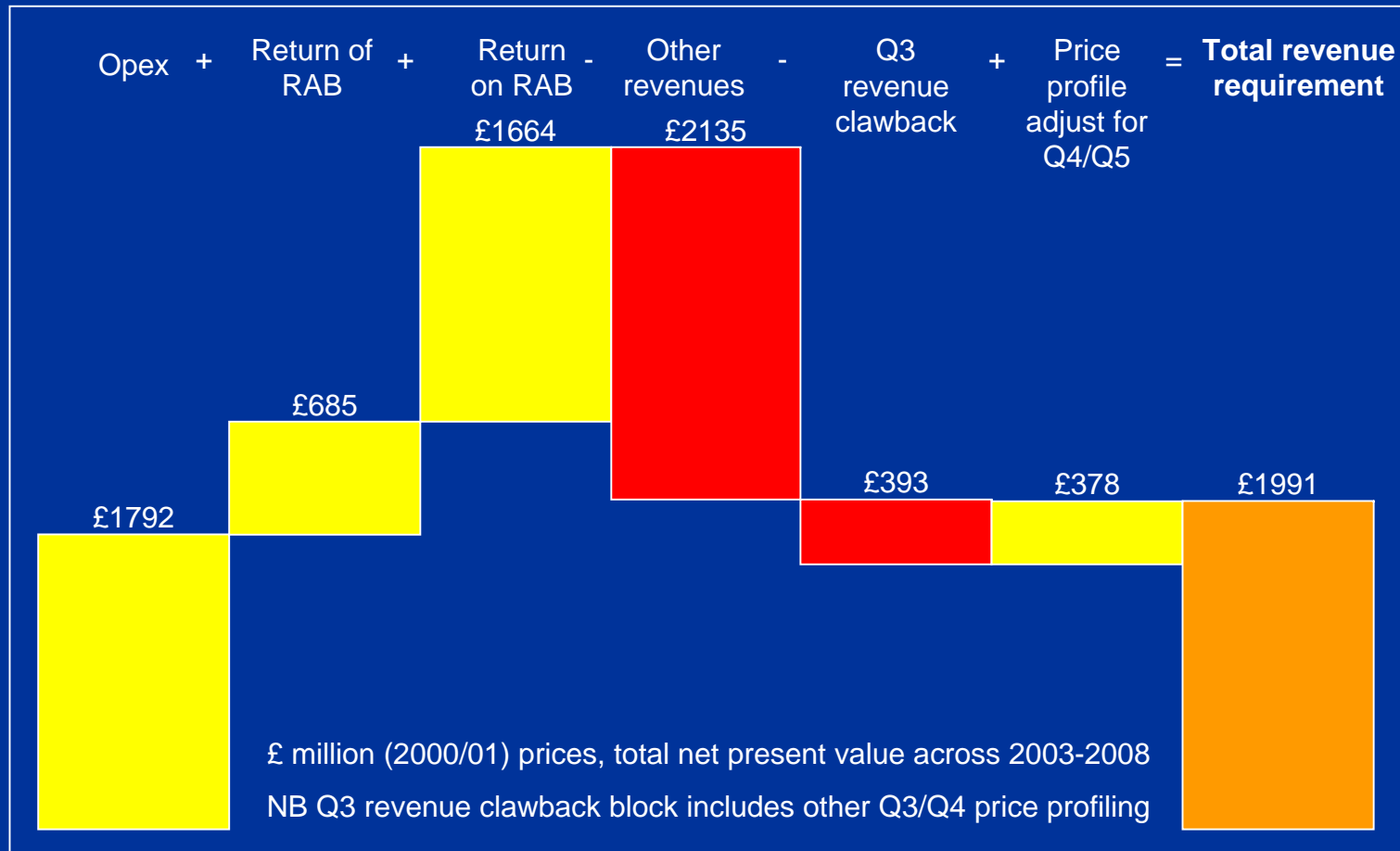
2003 – 2009

Manchester - £6.50, followed by RPI – 5%

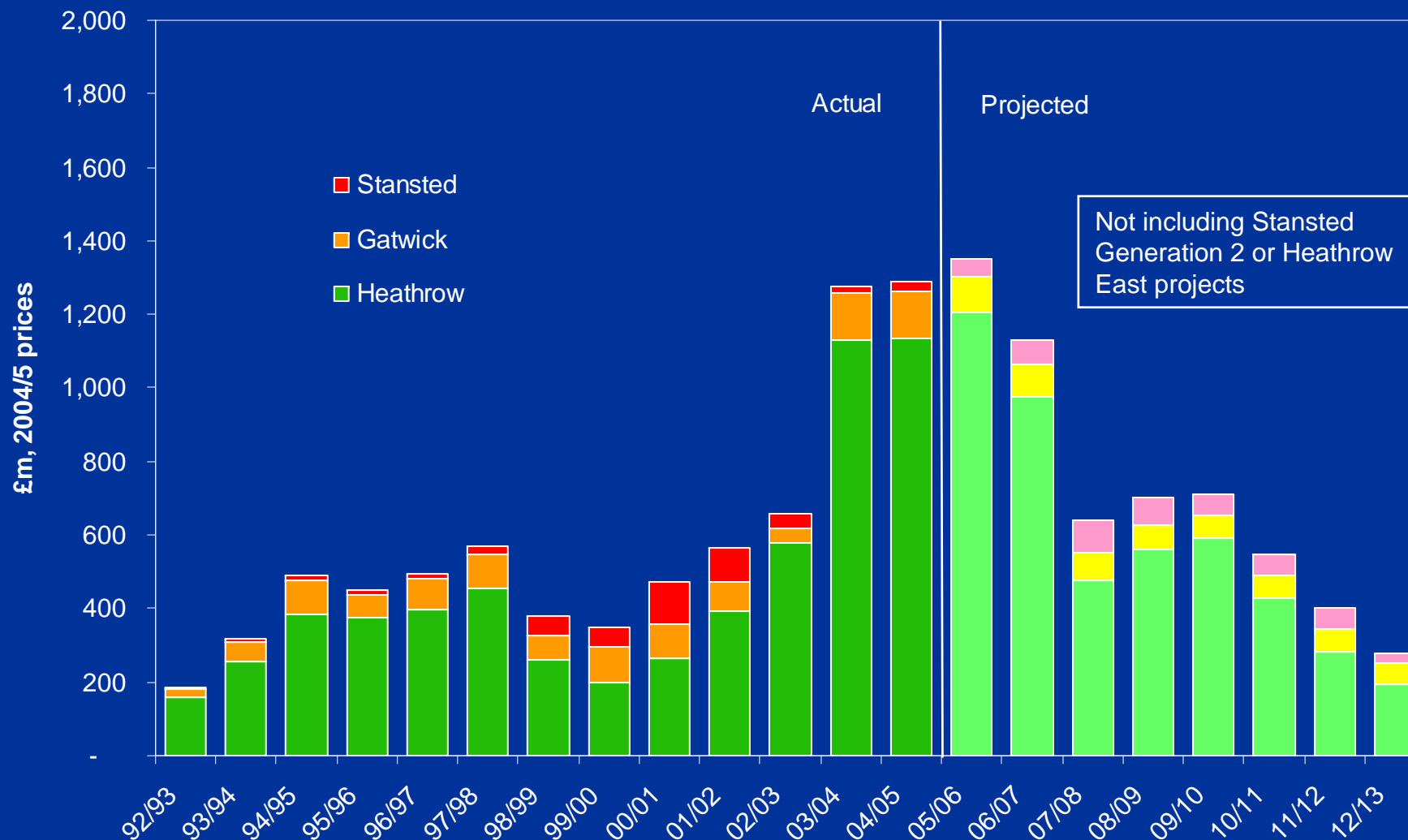
Airport charges over time



Composition of Q4 revenue requirement: Heathrow



Investment at BAA's designated airports over time



Market context

On demand side:

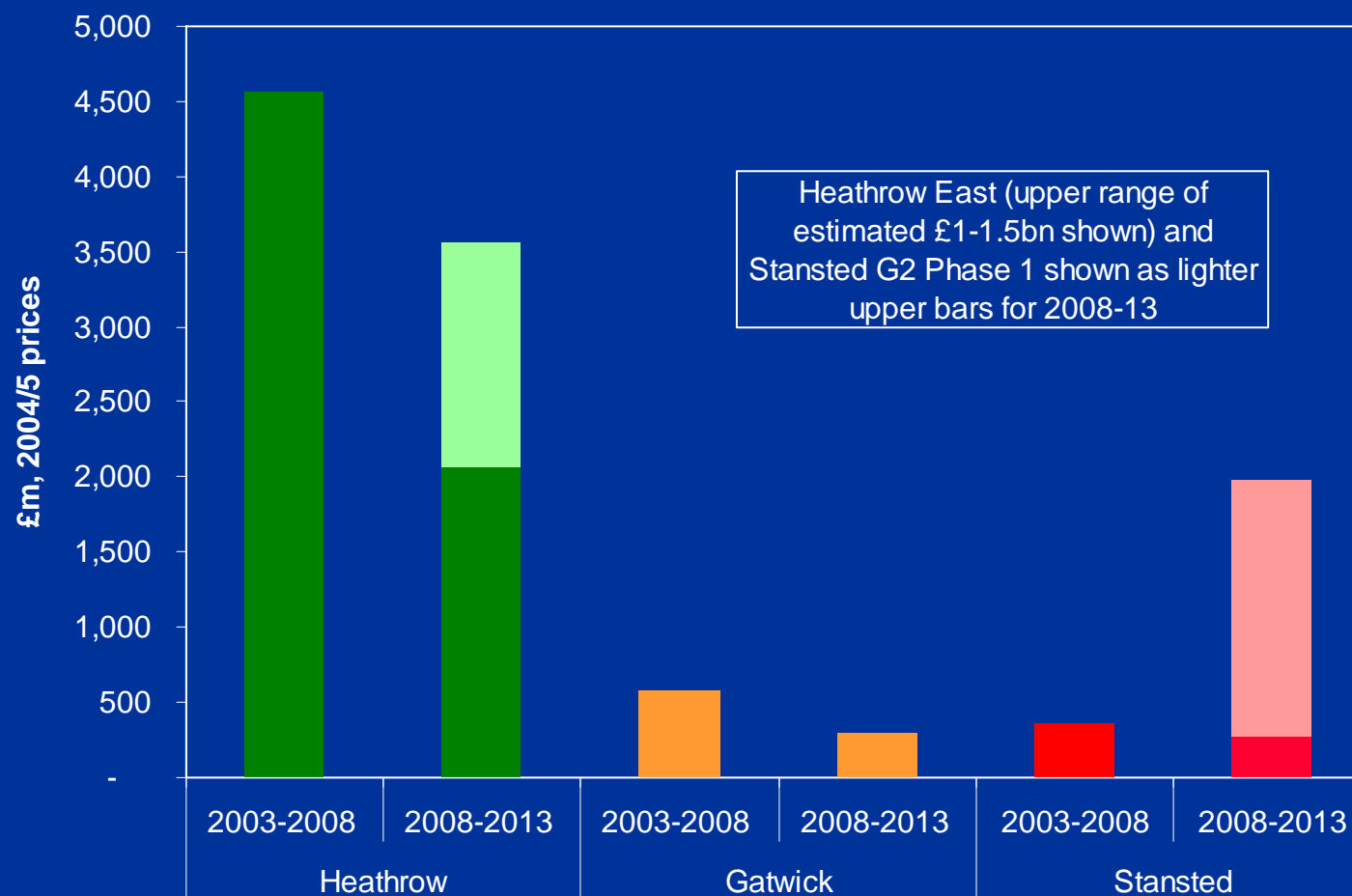
- Continuing growth of passenger demand
- Uncertainties around future rate of growth in demand at some airports
- Changing airline business models
- Continuing pressure on all costs, including airport charges

On the supply side:

- Lumpy, long-lived assets
- Government White Paper creating framework for development

... which present particular challenges for the CAA in this review ...

Investment at BAA's designated airports over time



Key challenges



1. **Efficient costs:** Setting and justifying allowances for operating and capital costs (and commercial revenues) that reflect efficient management
2. **Demand:** Handling the implications for investment of the uncertainties around future rate of growth in airport demand
3. **Investment:** Deciding how much of the costs of long-lived and lumpy investments should be recovered from users in 2008 to 2013

1 Promoting efficiency

Airlines focused on capacity and service outputs from airports, versus the costs of airport charges

Airlines have better earlier opportunities to influence regulation, through Constructive Engagement discussions with airports

- Heathrow and Gatwick constructive engagement progressing well
- No substantive progress at Stansted, so CAA will undertake its own review of issues assigned to Constructive Engagement
- But CAA remains open to airlines' evidence, and to any rekindled talks between BAA and Stansted airlines

Scrutiny of costs:

- Constructive Engagement
- CAA / airports / airlines joint working
- CAA's own scrutiny of costs

2 Dealing with demand uncertainties

Strong demand growth in South East England, but some uncertainties about future rate of growth in demand at certain airports, especially Stansted

Implications for the timing of future investment

Places premium on good quality information: forecasts, views of airlines, market data

May be role for ‘price discovery’ as well – some scope for prices to rise in Q5 to assess sensitivity of demand in advance of investment (with compensating adjustment in later control periods)

3 Dealing with 'lumpy' investment

Prospects of substantial lumpy investment in Q5 at both Stansted and Heathrow, with lead times that mean new investments not operational until late Q5 / Q6

As far as possible, reduce the size of the lump:

- **stand-alone regulation**
- **emphasis on BAA consulting airlines**
- **CAA scrutiny of plans**

May be role for price profiling - advancing revenue into Q5 - to strengthen incentives to invest

- **Adopted for Heathrow at Q4 to deal with Terminal 5**
- **Compensating adjustment in later control periods**

4 Overall approach

Dealing with demand uncertainties and / or lumpy investment could involve putting prices in Q5 onto a path towards a level that would meet investment costs

How this would translate into prices would depend on:

- **detailed consideration of costs, volumes and commercial revenues**
- **judgement as to the degree of price profiling best calculated to meet the CAA's statutory duties, taking into account evidence available**

All within framework of 'stand-alone'

(charges set by reference to each airport's own demand, costs & revenues)

- **Level playing field between airports & each airport focused on its users' requirements**
- **Incentives to invest via flexibility *across time* rather than *across airports***

Other policy issues

1. **Single till:** CAA proposes to maintain the current basis for price controls (airport charges set to cover airport costs less commercial revenues of airport)
2. **Surface access:** relevant costs included in single till - CAA propose principles for sharing costs between airport and Government
3. **Competition within airports:** CAA sets out issue and invites views
4. **Cost of capital:** CAA sets out approach to setting airport-based costs of capital, and invites views
5. **Price control design:** CAA identifies aspects for review, linked to key challenges of demand uncertainty and lumpy investment at some airports

Timetable for review



20 December 2005	CAA initial consultation document
16 January 2006	CAA industry seminar
20 March 2006	Deadline for responses
May 2006	CAA review of responses
June 2006	Output from constructive engagement
September 2006	CAA initial proposals
December 2006	Deadline for responses
January 2007	Oral hearings
February 2007	CAA refer to Competition Commission
August 2007	Competition Commission reports
October 2007	CAA publish firm proposals
December 2007	Deadline for responses
January 2008	Oral hearings
February 2008	CAA publish decision
1 April 2008	New controls come into effect



airportsreview@caaerg.org.uk

20 March 2006