

RESPONSES TO THE CAA'S CONSULTATION ON THE ALLOCATION OF SCARCE CAPACITY RIGHTS: REVIEW OF THE CAA'S STATEMENT OF POLICIES ANNEX 8 OFFICIAL RECORD SERIES 1 AND HEARING PROCEDURES

Purpose of this document

- 1.1 This paper details the main points made by consultees in the recent consultation on the CAA's scarce capacity procedures undertaken between 9 August and 8 November 2005 and sets out the CAA's response to them.
- 1.2 The following bodies responded to the consultation:
 - Airport Operators' Association (courtesy response only)
 - bmi
 - British Airways
 - Council on Tribunals
 - Lane and Partners
 - Virgin Atlantic
- 1.3 This document covers all of the responses received to the two areas on which we consulted: a suggested revision to the Annex 8 guidance, and the scarce capacity hearing procedures.
- 1.4 Copies of the respondents' replies are available from the CAA's website, at www.caa.co.uk. (Go to: 'Economic Regulation' → 'Download Publications')
- 1.5 An up-dated version of the Annex 8 guidance document and associated pro-forma table is attached to the back of this summary document.

Part 1: Review of Annex 8 Guidance

The CAA's Initial proposals

- 1.6 Annex 8 of the CAA's Official Record 1 sets out the methodology that the CAA intends to adopt when assessing the economic efficiency and consumer benefits that would arise from competing service proposals. It also sets out the information that the CAA expects to receive from the parties and the form it should take.
- 1.7 The CAA's consultation proposed a revision of the Annex 8 guidance document aimed at making it less prescriptive and allowing greater flexibility in the way that parties to the hearing can present the economics of their case.
- 1.8 The consultation letter asked a number of specific questions about the CAA's proposal. Most of the respondents used these questions to frame their answers and this paper is structured in the same way.

Q. Is it helpful to the proper consideration of the competing proposals that some guidance is given to the airlines on the presentation of their economic case?

Respondents' Views

- 1.9 Most respondents thought that there was merit in having some form of guidance, in broad terms, on the types of information that the CAA would need for its assessment of scarce capacity cases.
- 1.10 However, all of the respondents commenting on this element of the consultation considered that the standardised quantification of economic benefit set out in the previous Annex 8 document had not worked in practice. A number of reasons were given: bmi noted that there was going to be doubt as to the accuracy of such quantitative approaches, particularly as they were *'based on assumptions and projections which may or may not turn out to be realistic'*. British Airways' reply noted that the set pro-forma used in Annex 8 *'did not provide sufficient flexibility to accommodate the parties own in-house network model and statistical systems'*. This meant that these systems had to be adapted to fit the pro-forma requirements, with negative effects on the coherence of the parties' cases. A similar point was made in Lane and Partners response, which suggested that Annex 8 had the effect of *'impeding the parties in the presentation of their respective cases and therefore did not achieve its purpose'*.
- 1.11 The draft revised Annex 8 guidance proposed by the CAA was reasonably well received, largely because it introduces greater flexibility for the parties in the presentation of their cases than was possible under the previous version. BA noted that the draft revised Annex 8 is *'a great improvement on the current version'*, a view shared by Virgin Atlantic in their response: *'We agree with the CAA that, in general, the procedures and methodology in the existing Guidance have stood up reasonably well in recent scarce capacity hearings. However, we also concur with the view that a number of problems were experienced in the recent India scarce capacity hearing when addressing the competition and analysis of the Annex 8 pro-forma data tables and we commend the approach being taken by the CAA to improve the current procedure.'* Lane and Partners response was more circumspect, noting that Lane and Partners has *'no problem with the proposed new version of Annex 8 except that it really does not add very much to the knowledge that the airlines already have of what the CAA expects by way of written evidence.'*

The CAA's Response

- 1.12 As set out above, a number of the respondents above saw merit in the existence of an Annex 8 document and were supportive of the redrafted text on which the CAA consulted.
- 1.13 Although one respondent considered that the new Annex 8 added little to the knowledge that airlines already have about what is expected in such situations, the CAA still considers there to be benefit in clarifying what it is expecting by way of evidence, particularly as future scarce capacity cases may involve carriers or personnel with less experience of scarce capacity cases. This is potentially the case where the UK has signed European Community designation articles with its bilateral partners and other, non-UK, EU carriers are consequently bidding for traffic rights.
- 1.14 The CAA therefore believes that there is merit in retaining an Annex 8 document to help steer the parties' presentation of their cases.

- 1.15 In line with the majority of responses received, the CAA no longer believes that the benefits of the pro-forma approach applied in the previous version of Annex 8 warrants the additional burdens that these requirements place on the parties. The CAA has therefore decided to issue a new Annex 8 document, omitting many of the pre-existing pro-forma data requirements.

Q. To the extent that you consider guidance to be necessary, does the proposed text strike the right balance between the need to ensure consistency on core elements of the evidence, and the flexibility sometimes requested by parties wanting to present different aspects of their case?

Respondents' Views

- 1.16 Respondents made a number of points in response to this question. Virgin Atlantic noted that the CAA was always likely to have to apply some degree of qualitative judgement in its deliberations and although Virgin Atlantic may not 'always agree with these judgements...it believes that this is still preferable to an overly rigid process that does not give airlines the ability to submit the data and the arguments that they wish.'
- 1.17 Both bmi and Virgin Atlantic's responses made the point that there is likely to be an imbalance in the level of data available to the competing parties at a hearing, as an incumbent would be in a privileged position with regard to understanding the market and therefore better able to provide good quality information. This necessarily places new entrants at a disadvantage in presenting their assessments of current and future trends.
- 1.18 The Council on Tribunals noted that '*it would be appropriate in this case for the guidance to state that reasons would always be given for decisions.*'

The CAA's Response

- 1.19 Having considered the responses received, the CAA is content that the redrafted Annex 8 guidance document meets the need for a minimum level of commonality in the information that is presented to the Authority in its consideration of the case, whilst giving the parties the flexibility to present other arguments.
- 1.20 The CAA acknowledges the point made by Virgin Atlantic and bmi about the likely asymmetry in information and knowledge between an incumbent operator and a new entrant. It should be noted that the removal from Annex 8 of many of the pro-forma requirements would have the effect of limiting the degree to which these asymmetries in information would be laid bare in the written evidence. Nevertheless, a level of information asymmetry may be inescapable in some circumstances given the nature of the bidders, and the CAA can legitimately do little more than acknowledge this to be the case.
- 1.21 Lastly, in response to the Council on Tribunals' point on providing reasons for decisions, the CAA notes that it is committed to giving a reasoned decision on all scarce capacity cases. However, it does not view it as appropriate to include a reference to this in Annex 8, which is concerned principally with narrower technical elements of the case.

Q. Should the emphasis be on ensuring maximum transparency at the hearing, even if this means that the Authority is less able to consider potentially valuable commercially confidential information in reaching its decision? Or should the Authority, as proposed in the attached Annex 8, also be free to consider commercially confidential information from an airline that is not made available to the other parties at a hearing, albeit whilst placing less weight on such restricted information?

Respondents' Views

- 1.22 Respondents views on the treatment of commercially confidential information varied, with a number of respondents noting that evaluating the economic benefit from the parties' competing proposals might necessitate taking account of restricted information.
- 1.23 British Airways' response stated that *'As a practical suggestion, the Authority, when drawing up its list of key issues, could request such commercially sensitive data if it is relevant to one of the (small) number of key issues which are to be debated at the hearing.'* British Airways went on to state in its response that *'confidential information should be given the same weight as public information (although the Authority should set a high standard with regard to what information it will agree to regard as confidential).'* Virgin Atlantic took a similar line, noting that the CAA should be free to consider such restricted information but the weight to be given to such information should be determined *'on a case-by-case basis.'*
- 1.24 The Council on Tribunals noted that it had concerns about a situation where the CAA would be free to consider confidential information, as this would be in conflict with the *'ordinary requirements of fairness in the context of an adversarial hearing where in principle each party has the right to know and comment upon all the evidence adduced.'* In a similar vein, bmi noted that *'if the authority is to retain the adversarial nature of proceedings the other parties will not be in a position to properly cross examine on such information. Our preference is therefore to see maximum transparency and for other information not to be taken account of at all.'*

The CAA's Response

- 1.25 The CAA notes the concerns expressed about giving any consideration to confidential information in its decision-making process, and has considered whether or not it should be free to take such information into account in reaching its final decision.
- 1.26 On the one hand, the CAA considers that there may be instances where commercial information might have significance for a case. Equally, however, the CAA agrees that it would be detrimental to the transparent and fair nature of the hearing procedures if it were to open up the possibility of information that was not made available to the other parties in the case becoming a decisive factor in the CAA's decision.
- 1.27 On balance, the CAA considers that protecting the transparent and fair nature of the hearing is key to this process and therefore agrees with those respondents to the consultation who were in favour of the Authority disallowing the submission of confidential information to the panel. In the future, the CAA will only accept information from the parties that has been subjected to the hearing's fully transparent procedures. For this reason, the Authority when reaching its decision will not consider confidential evidence from the Parties.

- 1.28 A corollary of this emphasis on full transparency is that the parties should all have reasonable opportunity to absorb and prepare a response to all of the evidence that is put before them. However, the panel reserves the right to require the submission of written or other supplementary evidence during the hearing. The CAA is minded to move to a position where the panel reserves the right not to admit evidence where it considers there is no justifiable reason for late submission. The CAA will consult further on this proposal, alongside changes to appeal procedures covered in Annex 7, Official Record series 1. It expects to do this during 2006.

Q. Should the CAA set out its views on the definition of the market in its Statement of Key Issues sent out in advance of the hearing? Or would it be better if, as now, there is the opportunity to consider at the hearing all the relevant facts determining market definition without any prior presumptions?

Respondents' Views

- 1.29 A couple of the respondents felt that there would be benefit in the CAA doing more in advance of the hearing to set out its provisional view on the appropriate market definition for the hearing. bmi noted that *'this would be helpful but should not prevent parties arguing that an alternative definition is justified.'* BA went further in detailing how this might be done: *'The Authority should set out its views on market definition in its draft statement of key issues, which should be followed by a meeting of the Parties. If market definition remains a key issue after that meeting, it should be possible to challenge it at the hearing. On the other hand, the parties may agree with the Authority's view and thus market definition would be an underlying assumption at the hearing, well known to all parties, forming the background to debate on other key issues.'* Lane and Partners also supported this view, noting that *'it would be helpful if the CAA were to include in its Statement of Key Issues its views on the definition of the market. Whilst airlines would be able to contest the CAA's preliminary view, such an indication would be of assistance in confining the debate.'*
- 1.30 Virgin Atlantic was more neutral on this point, noting that *'it is important that the parties to a scarce bilateral hearing are given the opportunity to provide alternative opinions on key issues such as market definition.'* Virgin Atlantic did not offer a view on whether market definition should be included in the CAA's Statement of Key Issues.

The CAA's Response

- 1.31 The issue of market definition is central to any discussion of competition and to the differential impact of different capacity awards. It is therefore understandable that a number of respondents see considerable benefit in the CAA setting out its provisional views on this in advance of the hearing.
- 1.32 The CAA can see that there could be some advantage in its setting out a provisional view of market definition in advance of the hearing, particularly as this might help to focus discussion at the hearing. However, the CAA also sees drawbacks to this approach. Market definition is such a critical in decisions on the allocation of scarce capacity that it would be inappropriate for the CAA to seek to reach a position - albeit a provisional one - before it has a chance to consider all the evidence at a hearing.

- 1.33 On balance, therefore, the CAA believes that including a provisional view on market definition in its Statement of Key Issues would not be conducive to a full and fair hearing.

Part 2: Review of Scarce Capacity Procedures

The CAA's Initial proposals

- 1.34 The CAA took the opportunity presented by the review of the Annex 8 guidance to ask some more general questions about the appropriateness of the existing scarce capacity hearing as a whole. In particular, the consultation invited views on whether the adversarial nature of the proceedings should be changed.

Respondents' Views

- 1.35 On the adversarial nature of the hearing, respondents were split, with bmi and British Airways both arguing against the use of an adversarial process. bmi noted that *'we are not convinced that the cross-examination of witnesses by each party is a particularly helpful exercise when conducted in the 'trial' manner which some advocates appear to favour.'* These respondents argued that the panel should take the lead in questioning the parties, with bmi adding that the panel could be assisted, where necessary, by their own legal counsel. In contrast, the Council on Tribunals, Lane and Partners and Virgin Atlantic all argued that the adversarial approach in the hearing was essential to ensure that the arguments and data put forward by each of the parties were properly scrutinised. Lane and Partners note that *'it is undeniable...that the adversarial process, and detailed cross-examination, ensure that the issues are minutely addressed. Given that the CAA's decisions will often determine rights to operate on a particular route for many years to come, it seems to me that such a detailed examination is highly appropriate.'* Virgin Atlantic made the point that the panel may not have the same detailed technical knowledge as the airline parties to a hearing, and may therefore be less able to scrutinise some of the issues.
- 1.36 Another procedural point raised by the respondents was in relation to the use of the pre-meeting procedure allowed for under Regulation 23. This allows for a pre-meeting to discuss the "conduct of the case" with the parties. This could take place after the written evidence has been received but prior to the hearing.
- 1.37 Some respondents thought it would be helpful if greater use were made of the pre-meeting to discuss issues of substance relating to the case. British Airways noted in their response that *'the CAA at this point should circulate to parties a statement of the issues which it intends to cover at the hearing. This should then be formally debated with the parties at a meeting where the Authority could hear arguments that its draft statement of issues could be amended.'* Lane and Partners adopted a similar position: *'The CAA should as a matter of course, fix a preliminary meeting to take place three working days (or longer if time permits) after the date of submission of the written evidence in support of the application(s). The preliminary meeting would be used for the CAA to indicate*
- a. *whether the parties' written evidence satisfactorily met the requirements of the Guidance and, if not, to indicate in what areas the CAA would expect to receive additional, or amended, evidence, and*

b. *what the CAA perceived to be the Key Issues, and to invite oral submissions before a formal Statement of Key Issues was circulated to the parties.'*

- 1.38 Lane and Partners note that the use of this kind of pre-meeting procedure may lengthen the process and may not be fully covered by the scope of the powers contained in the Regulations, which allows for a pre-meeting to discuss matters solely relating to the "conduct of the case".
- 1.39 On a purely logistical issue, Lane and Partners' response noted that the number of days allocated for the proceedings in the case of the recent India hearing¹ was insufficient given the number of participants and the complexity of the case being considered. The respondent suggested that the longer days allowed in that hearing were an insufficient substitute, as *'this is too demanding upon advocates and witnesses (and the Panel) and is counter-productive because tired advocates tend to ramble.'* Furthermore, *'the CAA should not underestimate the amount of preparation which is required outside of the hearing both before the beginning of the case and during the case.'* Lane and Partners suggested one solution would be to allow a day for each participant taking part in the hearing, and that the hours of the hearing should *'reflect the practice of the High Court, which sits from 10:30am until 4:00 or 4:30pm.'*

The CAA's Response

- 1.40 As noted in the consultation letter, the CAA's provisional view was that the adversarial nature of the proceedings was worth retaining. After considering all of the responses to the consultation, the CAA remains of the view that the adversarial nature of the hearing assists in giving the parties the opportunity to scrutinise and respond to arguments made by others in the case. It allows expert scrutiny of the arguments presented, and best complies with the principles of a "fair trial" enshrined in the Human Rights Act. Lastly, it also strengthens the ability of the panel to judge the robustness of the positions presented. Equally, however, it is important that the procedures are not abused in order to 'score' irrelevant or inappropriate points. It is the responsibility of the parties to the hearing, enforced by the chair of the panel where necessary, to ensure that this type of behaviour is avoided.
- 1.41 On the question of widening the role of the pre-hearing meeting to allow discussion of the issues of substance, the CAA does not believe this would be a sensible change to the procedures, despite the support given to this approach by respondents to the consultation. From a purely legal perspective, widening the scope of the pre-meeting to cover matters of substance relating to the hearing would, as pointed out by Lane and Partners in their response, probably require a change to Regulation 23 of the Civil Aviation Authority Regulations 1991, which restricts discussion at the pre-meeting to matters relating to the "conduct of the case". A change to the regulations would of course be possible by way of secondary legislation. However, the CAA does not consider this would be desirable; consideration of parties' views on matters of substance at a pre-meeting could have a material effect on the CAA's final decision. It is the CAA's view that any exchanges on the substance of the case should take place under the formal procedures of the full hearing process. This rules out any discussion of such issues in the pre-meeting, which will remain focused solely on issues relating to the "conduct of the case".

¹ The last scarce capacity hearing, which was related to India, was held on 11 and 12 November 2004 and involved three parties competing for the rights: bmi, British Airways and Virgin.

1.42 The CAA has also considered the issue of the time that should be made available to the hearing. The outcomes of scarce capacity hearings are often regarded by airlines as being of vital commercial value, reflected in the managerial and legal resources dedicated to the process. However, the CAA also recognises the need to minimise the burden on the management of the airlines concerned, as well as on the Authority. Consequently, deciding on the amount of time to be dedicated to the hearing will always necessitate a balance being struck between the need to ensure a full and fair hearing of the issues and the desire to minimise the burden of the process on the hearing's participants. The CAA therefore believes that this issue is best decided on a case-by-case basis, taking into account the number of parties to the hearing, the complexity of the case, and any other influencing factors.

Economic Regulation Group

CAA

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