

Economic Regulation Group

Head of Economic Policy and International Aviation

9 August 2005

Dear Consultee

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

This consultation is aimed at those who consider they might be involved in bidding for traffic rights under the UK's scarce bilateral capacity procedures. Where the relevant Air Service Agreement includes a Community Designation clause, eligible non-UK carriers could contest rights granted to the UK under a bilateral agreement. This consultation may therefore be of interest to European carriers based outside of the UK. If you have no interest in such traffic rights then the rest of this consultation is unlikely to be of relevance to you.

The Purpose of the Consultation

Following the recent scarce capacity hearing on India¹, the CAA has been reviewing its methodology and procedures for the allocation of traffic rights. We consider this to be best practice in view of the fact that parts of the CAA's Statement of Policies on Route and Air Transport Licensing and accompanying Guidance (Annex 8), last reviewed in 2001, were used for the first time in the India hearing.

The existing guidance on scarce capacity procedures can be found at Annexes 7 and 8 of the CAA's Official Record 1, which are available on the CAA's website, www.caa.co.uk

Review of Annex 8 Guidance

Although the procedures and the methodology generally stood up well in the complex India hearing, a number of problems were experienced by the parties and the panel, in particular when addressing the completion and analysis of the pro-forma data tables contained within Annex 8. The purpose of Annex 8 is to guide the parties on the economic data expected by the CAA as one of the inputs to the scarce capacity hearing. The Annex 8 data would be tested by the other parties and provide an input to the CAA's consideration which, although important, will form only part of the evidence that the CAA will need to take into account.

The intention of the existing version of Annex 8 was to standardise the data, so as to make its testing and assessment easier for both the parties and the CAA. The Annex sets out the methodology used in assessing the economic efficiency and consumer benefits that would

¹ The last scarce capacity hearing was held on 11 and 12 November 2004 and concerned the allocation of rights to India. The CAA's final decision was published on 3 December. Under the terms of the bilateral in place at the time, the rights were only available to UK airlines. Full details of the decision, and subsequent appeal, are available on the CAA's website, www.caa.co.uk.

arise from competing service proposals and describes in detail the data that airlines are expected to submit to assist the evaluation of these benefits.

The CAA found during the India scarce capacity procedure that the data submitted under this process was not consistent between airlines. There were differences in the way that airlines defined markets and the ways in which they then compiled and submitted their data for each of the routes in question, using varying assumptions about, for example, the reaction of competitors, and the size of the existing markets. This meant that, although the Annex 8 data in the airline submissions proved useful, it was not possible to use the data in a standardised fashion to compare proposals².

Furthermore, in the lead-up to the hearing, airline representatives expressed strong reservations about sharing the disaggregated tariff information requested in Annex 8 with the other parties to the hearing. Although the CAA can take confidential evidence into consideration, there is a loss in transparency and subsequent scrutiny from omitting this information from the public hearing.

Consideration of these issues has led the CAA to explore amending Annex 8 to make it more fit for purpose. In looking at the options for doing this, the CAA's objective is still to provide guidance for airlines on the evidence we would like to take into account in our decision, whilst avoiding the more mechanistic approach enshrined in the existing Annex 8.

We are therefore consulting on a redraft of Annex 8. Although Annex 8 is a relatively technical document, and any changes could be minor, their effect could be significant. The CAA believes the emphasis should be on giving guidance to airlines as to the information they should provide, and on clarifying the criteria that the CAA will use in judging the merits of competing proposals, whilst leaving flexibility as to how airlines present their case.

We would welcome any views you may have on the proposed draft attached as Appendix A. In particular:

- 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?
- 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?
- 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 draft 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?
- 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 presumption?

² This point was made in the CAA's Statement of Key Issues released before the India hearing.

Procedures for Scarce Capacity Hearings

In addition to considering what changes should be made to the text of Annex 8, we have also taken this opportunity to examine more generally whether there are any changes to the CAA's procedures that should be made to ensure consistency with best practice.

In informal discussions with stakeholders subsequent to the India hearing, one of the points raised is that the current hearing procedure may be too adversarial, with excessive weight placed on detailed cross-examination of the arguments. The CAA has considered whether this should be changed.

The CAA's provisional view is that there are strong arguments for continuing to allow competing cases to be scrutinised by other parties to the hearing. Firstly, this allows peer review of the arguments, enabling the expertise of competing airlines to be brought to the fore. And secondly, this approach seems to best comply with the principles of a "fair trial" enshrined in the Human Rights Act.

In light of the above considerations, we are minded to preserve the current cross-examination approach to scarce capacity hearings. However, we would be grateful for consultees' views on whether this, or any other element of the CAA's scarce capacity procedures, should be revisited.

Timing of Responses

This consultation is being undertaken under the Cabinet Office's Code of Practice on Consultation that applies to all public bodies. A summary of the consultation criteria is attached at Appendix B. In addition, a list of bodies to whom this consultation has been sent is attached at Appendix C. If you know of anyone else you believe might have an interest in this consultation, please let us know.

We would be grateful if responses could be sent by close on 8 November 2005, marked for the attention of:

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Affant

Please note that we intend to publish all responses to the consultation on the CAA's website. If you do not wish all or any part of your response to be made public, please mark the document accordingly.

Yours faithfully,

Alex Plant

Suggested revision to Annex 8 of the CAA's Official Record 1: Guidance on the Economic Framework for Considering Cases Relating to the Allocation of Scarce Bilateral Capacity:

Introduction

- The CAA's decisions regarding the grant of scarce bilateral capacity are based on all the evidence presented by the parties concerned after it has been tested at a Public Hearing. The evidence an applicant airline uses to support its case is a matter for its commercial judgement. This annex is intended to inform that judgement by offering guidance on that part of the evidence that would be most helpful in the CAA's consideration of the likely benefits to users of the competing proposed uses of scarce bilateral capacity.
- This guidance can only be set out in broad terms since experience has shown that detailed and precise guidelines are unlikely to be useful: circumstances differ from case to case and airlines differ in their views of market definition and other issues.

Passenger benefits

- The CAA's Statement of Policies indicates that it is concerned that scarce capacity be used in a way that sustainably produces the most benefit to passengers. So, the CAA will expect each applicant to have a section as part of its written submission which sets out the passenger benefits it intends to generate from its proposal.
- An air route will often serve a number of different types of demand, such as point-to-point and connecting passengers. For example, a new service between London and Johannesburg may affect not only those passengers just travelling between the two cities but also passengers who want to fly from Edinburgh to Johannesburg for whom a connection over London is an attractive option. The passengers may be further divided by journey purpose (business, VFR³, leisure) and by residence (UK-originating or foreign-originating). The benefits to passengers of a new service might stem from lower prices and/or from a more convenient and higher quality product⁴. In some cases the benefits may be restricted to those enjoyed by passengers who travel on the proposed service but in other cases benefits may be enjoyed by all the passengers on the route, for example because of increased competition. In addition to the existing passengers travelling directly or indirectly, other passengers who may benefit are those who might otherwise have travelled but to another destination ("diverted" passengers) or those who would not have travelled at all without the new service ("generated" passengers).
- 5 So, the CAA expects each applicant to set out what the benefit to passengers of its proposals will be, with supporting evidence on how this benefit is distributed among the different traffic flows and the different passenger types, distinguishing between fare and nonfare benefits.
- 6 This supporting evidence, quantified to the maximum extent possible, should indicate:

³ A VFR passenger is one whose air journey is made in order for them to visit friends and relatives.

⁴ For example, the non-fare costs experienced by a passenger might fall because: a greater flight frequency provides a more convenient departure time; a more direct flight reduces the inconvenience of changing aircraft and possibly airlines; a new service leaves from a nearby airport; and a new service offers greater in-flight comfort or a better chance of getting a seat on the passenger's preferred flight.

- the main traffic flows affected by an applicant's proposals;
- the current size of those flows and their expected growth rate in the near future;
- the current passenger mix in these flows;
- the pricing and service proposals for each of the affected flows;
- the extent to which traffic from these existing flows will use the proposed services;
- the degree to which demand is stimulated;
- the price and other benefits that the applicant's proposals will bring compared with the existing situation; and
- the way in which the benefits of these proposals split between UK and foreign residents.
- The applicant should state what assumptions have been made not only about its own proposal but also about the expected commercial responses of other airlines.
- Airlines are required to submit a three-year cost/revenue forecast to CAA hearings (a pro-forma table for this data is attached). The evidence on passenger benefits should reflect this forecast and indicate how the level of benefits may change over the forecast period.
- It should be noted that the CAA will consider all the information presented to it and will not exclude from its consideration information presented by any party on a confidential basis. Evidence provided on a confidential basis and not tested by cross-examination will have less probative value and the CAA may give less weight to such evidence. Finally, it must be stressed again that it is the decision of each party to present the factors it considers most important and to put forward factors other than those described here if it believes them to be of relevance.

UK Cabinet Office's Code of Practice on Consultation

The code of practice applies to all UK national public consultation documents in electronic or printed form.

Though the criteria may have no legal force, and cannot prevail over statutory or other mandatory external requirements (e.g. under European Community Law), they should otherwise generally be regarded as binding on UK departments and their agencies, unless Ministers conclude that exceptional circumstances require a departure.

The criteria should be reproduced in consultation documents, with an explanation of any departure, and confirmation that they have otherwise been followed.

Consultation Criteria

- Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
- Be clear about what your proposals are, who may be affected, what questions are being asked and the time scale for responses.
- Ensure that your consultation is clear, concise and widely accessible.
- Give feedback regarding the responses received and how the consultation process influenced the policy.
- Monitor your department's effectiveness at consultation, including through the use of a designated consultation coordinator.
- Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

More information about the code of practice is available on the Cabinet Office website: http://www.cabinet-office.gov.uk/regulation/consultation/code.asp

List of Bodies to whom this consultation has been sent.

Government

Competition Commission Aldernev Department for Trade and Industry Gibraltar Department for Transport Guernsev **European Commission** Isle of Man Office of Fair Trading Jersey

Trade Associations

European Low Fares Airline Association Airport Operators Association (AOA) Airports Council International Europe (ACI (ELFAA) European Regional Airline Association Association of European Airlines (AEA) (ERAA) Board of Airline Representatives in the UK International Air Carrier Association (IACA) International Air Transport Association (BAR UK) (IATA)

European Civil Aviation Conference

(ECAC)

Consultants

Aviation and Tourism Law Consultants Ltd KN Associates Ltd David Hurst & Associates Martin Clough & Associates

Lawyers

Lane & Partners Allen & Overv Barlow, Lyde & Gilbert Linklaters Beaumont and Son at Clyde & Co Mr M Crane QC **Bond Pearce** Mr C Haddon-Cave QC Denton Wilde Sapte Mr H O'Donovan DLA Piper Rudrick Gray Cary Norton Rose Field Fisher Waterhouse Richards Butler Harbottle & Lewis Royal Aeronautical Society Air Law Group Holman Fenwick & Willan Slaughter & May

Ince & Co

Other Independent bodies

Air Transport Users Council Council on Tribunals

UK Operating Licence holders (excluding sole cargo and North Sea helicopter services)

Air Atlanta Europe Ltd Atlantic Air Transport Limited Air Kilroe Ltd t/a Eastern Airways Aurigny Air Services Ltd Air Southwest Ltd bmibaby Ltd Air Wales Ltd Britannia Airways Ltd AirX Ltd t/a LeCocqs.com British Airways CitiExpress Ltd

Astraeus Ltd British Airways Plc British Mediterranean Airways Ltd British Midland Airways Ltd British Midland Regional Ltd Channel Express (Air Services) Ltd

easyJet Airline Company Ltd

Emerald Airways Ltd

European Aviation Air Charter Ltd

Excel Airways Ltd

First Choice Airways Ltd

Flightline Ltd Flyjet Limited GB Airways Ltd Globespan Airways Ltd t/a Flyglobespan Jersey European Airways (UK) Ltd t/a

Flybe

Loganair Ltd

Monarch Airlines Ltd MyTravel Airways Ltd

Suckling Airways (Cambridge) Ltd t/a Scot

Airways

Thomas Cook Airlines (UK) Ltd

Titan Airways Limited

Veritair Ltd t/a British International

Virgin Atlantic Airways Ltd

EEA Airlines (major airlines only including large regional carriers)

Adria Airways Aegean Airlines Aer Lingus Plc Air Atlanta Icelandic

Air Baltic

Air Berlin GmbH Air Dolomiti, Spa Air Europa

Air France
Air Luxor SA
Air Malta

Air Mediterranee Air Nostrum Air One Airlinair SA Alpi Eagles Spa

Alitalia Linee Aeree Italiane, Spa

Austrian Airlines

Blue1

Braathens, AS

Brit Air CCM Airlines

Condor Flugdienst GmbH

Corsair

CSA Czech Airlines Cyprus Airways Ltd

DBA Luftfahartgesellschaft

Edelweiss Air AG Estonian Air

Euroatlantic Airways SA Eurocypria Airlines Europe Airpost

Eurowings Luftverkehrs AG

Finnair

Flugfelag Islands, h.f. Futura International Airways Germania Fluggeselischaft mbH Germanwings GmbH Greece Airways, S.A Hapag-Lloyd Flug GmbH Hapag-Lloyd Express

Helios Airways

Helvetic Airways, AG

Hollandexel Icelandair

KLM - Royal Dutch Airlines

Lauda Air

Lithuanian Airlines LOT Polish Airlines

Lufthansa German Airlines

Lufttransport Unternehmen Gmbh Luxair - Luxembourg Airlines

Maersk Air A/S

Malev Hungarian Airlines Ltd

Malmo Aviation AB Meridiana Spa Nordic Airlink

Norwegian Air Shuttle, AS Olympic Airlines, S.A PGA Portugalia Airlines

Ryanair Ltd

SAS Scandinavian Airlines Skyeurope Airlines AS Skyways Express AB SN Brussels Airlines

Spanair SA

Sterling European Airlines Swiss International Air Lines Ltd

TAP Air Portugal Transavia Airlines CV

Tyrolean Airways, Tiroler Luftfahrt GmbH

Virgin Express SA Volare Airlines SA