



# Potential framework for price monitoring at Gatwick and Stansted airports

## Specification Terms of Reference

### **Objectives**

- A. To develop the potential regulatory framework for a system of price monitoring that could be applied at Gatwick or Stansted airports

It is important to emphasise that this brief does not prejudge the output of any market power assessment being undertaken by the CAA or the selection of the CAA of any particular form of regulation for Gatwick and Stansted airports.

### **Background**

1. The overall model or form of price regulation for each airport that remains subject to continued economic regulation should reflect the market power of that airport and the potential for abuse and be designed in a manner that furthers the CAA's proposed duties.
2. In November 2009 the CAA launched a detailed work programme with stakeholders to identify and assess alternative ways of regulating airports<sup>1</sup>. As part of this work the CAA commissioned consultants Europe Economics to consider alternative forms of regulation<sup>2</sup>. In March 2011, the CAA issued a stock-take on this work, which identified a number of potential improvements to

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<sup>1</sup> Preparing for a more competitive airports sector, CAA, November 2009. This document can be accessed at: <http://www.caa.co.uk/docs/5/ergdocs/20091105CompetitiveAirports.pdf>

<sup>2</sup> Alternative approaches to price cap regulation to minimise distortions to competition and investment incentives, Europe Economics for the CAA, July 2010. This document can be accessed at: <http://www.caa.co.uk/docs/5/ergdocs/20100708AlternativeReg.pdf>

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regulatory design within, and beyond, a standard RAB-based framework<sup>3</sup>. The CAA set out its assessment of the potential regulatory options as part of its Q6 policy update<sup>4</sup>. Two of the potential regulatory options were capping charges based on charges at comparator airports and price monitoring. To take forward work in this area the CAA commissioned consultants Leigh Fisher to compare charges across airports and assess the potential for capping charges based on charges at comparator airports. The CAA has published the draft emerging findings from this work<sup>5</sup>.

3. In parallel to the work on the next price control, the CAA has been undertaking a market power assessment. The CAA's initial view was that Heathrow had the strongest market position amounting to a position of substantial market power<sup>6</sup>, followed by Gatwick. The CAA considered that Stansted airport could have substantial market power. The CAA's view was that where there was SMP there was a significant risk that, absent some form of safeguard, may result in adverse outcomes for consumers in terms of service quality, investment decisions, consultation, innovation and prices charged<sup>7</sup>.

### ***Detailed scope***

#### **4. Develop potential price monitoring regulatory framework**

- Review price monitoring frameworks that exist in other regulatory environments, for example Australian airports, and identify lessons for airport regulation in the UK, in particular for Gatwick and Stansted airports.
- Review the output of the Leigh Fisher study into comparing and capping airport charges at regulated airports.
- Develop a potential regulatory framework for price monitoring. This must draw on experience from elsewhere and the Contractor's own analysis and seek to address the potential harm that might result from the abuse of

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<sup>3</sup> Identifying alternative forms of regulation for airports: Stock take and way forward, CAA, March 2011. This document can be accessed at: <http://www.caa.co.uk/docs/5/ergdocs/AltRegulationWayForward.pdf>

<sup>4</sup> Q6 Policy Update, CAA, May 2012. This document can be accessed at: <http://www.caa.co.uk/docs/5/Q6PolicyUpdate.pdf>

<sup>5</sup> Comparing and Capping Airport Charges: Workshop on draft emerging findings, Leigh Fisher, September 2012. This document can be accessed at: <http://www.caa.co.uk/docs/78/ComparingCappingAirportCharges.pdf>

<sup>6</sup> The CAA's initial views on market power can be found at: <http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=12275>

<sup>7</sup> See paragraph 44 of Heathrow, Gatwick and Stansted – market power assessments: Summary of the CAA's initial views, January 2012. This document can be accessed at: <http://www.caa.co.uk/docs/5/MarketAssessmentsJan12.pdf>

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significant market power<sup>8</sup>. . The potential regulatory framework must consider:

- The key elements of a price monitoring framework that would need to be set out in an airport licence. This could encompass a service quality regime, cost transparency, consultation and price discrimination conditions. A clear rationale for the requirements should be identified.
  - Whether a price monitoring framework should be based on airport comparators or some other basis such as inflation, RAB or LRAIC.
  - The degree to which the framework for the assessment of airport charges needs to be set out prior to the start of price monitoring, for example whether airport price comparators should be agreed in advance or whether simply the criteria for the selection of airports is set in advance, with airports themselves identified ex-post.
  - If, at the end of the monitoring period, prices are identified as in excess of the benchmark, the extent to which the regulatory approach needs to be identified in advance, for example the penalty mechanism or the approach to re-regulation.
  - How price monitoring might be adapted to reflect the degree of market power and the suitability of price monitoring as a transition strategy to removing regulation.
  - What are the key risks and issues related to the proposed price monitoring framework and how might these be addressed.
  - Any other issues the Contractor deems relevant.
- The Contractor must identify a clear rationale for the approach chosen and the degree to which this will depend on the degree of market power found at the airport.

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<sup>8</sup> The potential harm should be based on that identified in the CAA's initial views on the market power assessment