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British Airways response to CAA CAP3012:
Second consultation on extending the current commitments for the economic regulation of Gatwick Airport Limited

Thank you for the opportunity to respond to the consultation on the extension of the Commitments Framework from 2025 to 2029 for Gatwick Airport Limited (GAL). We set out below our views and areas of feedback.

Our response to this consultation is made on behalf of British Airways and is supported by our parent company International Airlines Group (IAG) as well as its subsidiary companies Iberia Express and Vueling Airlines operating at Gatwick (collectively, the "IAG Airlines"). IAG and its subsidiary airlines may individually submit their own response to this consultation.

Executive Summary

1. While we support the commitments framework in principle, it is our clear opinion that GAL's current proposal to extend for a further four years will not be delivering for consumers in several areas. In particular, our assessment shows that the proposal will lead to continued excessive charges and allow GAL to generate excess profits in the face of ongoing poor service quality and key investments in improving service levels being deprioritised. We therefore cannot support GAL's proposal in its current form or the CAA's initial view that this is "likely" to be in the consumer interest.

2. Importantly, we believe that the CAA ought to require GAL to fundamentally improve on its proposal on both price and service levels if it wants to retain the current commitments framework. Our evidence, as well as the evidence published by the CAA in the present consultation, demonstrates that GAL's proposal is overwhelmingly not in best the interest of consumers. Prices will be significantly higher than required for a regulated monopoly while poor service performance cannot be adequately addressed (or even reflected) by the current framework on the Core Service

Standards and capital oversight. In doing so, the CAA ought to incentivise GAL to negotiate with users in good faith to remedy those concerns within the current deals where relevant.

3. Based on our analysis, GAL's proposal for an evolution to headline charges of CPI-1% for the first two years of the extension period and CPI+0% for the final two years will result in excessive charges, excess profits of at least £1 billion over a reasonable cost of capital and annual operating margins for GAL approaching 60% during the extension period. The CAA acknowledges the fact that GAL is realising very high profits which are projected to increase even further in future[1]. It is therefore unclear to us as to why the CAA would consider this to be a reasonable proposal, particularly as it risks setting dangerous precedent for customers of UK regulated infrastructure.

4. To the contrary, our analysis suggests that, under price cap regulation for an entity with significant market power, the CAA would have to instruct GAL to amend its proposal reduce charges by between CPI-20% and CPI-30% for the extension period. We have shared our assumptions and analysis with GAL and it has acknowledged our position but argues that it has no incentive to reopen its commercial agreements that are already in place with airlines. However, to the extent that deals provide for discounts off published charges, any reductions to the headline charges offered by GAL will immediately deliver benefits to consumers in combination with the terms of commercial airline agreements.

5. Indeed, we have no visibility of GAL's costs to inform our negotiation and there is no regulatory backstop by the CAA to incentivise GAL to negotiate in good faith. The agreements reached are therefore one-sided and restrict any negotiation leverage that an airline may otherwise have. In other words, there is no alternative outcome to negotiate from other than GAL's proposal, which in turn results in an asymmetric and imbalanced negotiation in favour of GAL in any bilateral engagement.

6. In addition, we believe that GAL must negotiate in good faith to solve the significant operational failures at the airport currently being experienced by airlines and consumers, by implementing far-reaching improvements to the Customer Service Standard (CSS) framework. The weaknesses of the service level framework provide little incentive for GAL to negotiate deals on tighter service levels that correspond to the airline's needs. The CAA ought to ensure that the right incentives are in place to motivate GAL to deliver an improved service level framework and service quality for consumers.

7. We do not agree that it is necessary to reward GAL with excess profits over and above a reasonable cost of capital, and significant operating margins way above those of a competitive entity in order to encourage expansion at the airport. In fact, our analysis suggests that GAL is able to fund its Northern Runway Project (NRP) with the excess profits collected under the existing commitments. GAL would also be able to

[1] See Chapter 3 of the CAA's consultation document.

finance the NRP works earmarked for the extension period even after reducing charges by at least 20%. Therefore, any further "incentives" in the form of outsized returns over and above what a competitive entity would earn are not required.

8. The CAA's proposal to justify GAL's proposal by benchmarking the airport's financial performance, profits and revenues against other UK airports is too simplistic an approach, is subject to methodological limitations, does not adequately reflect the complexity of GAL's approach to setting and calculating charges as compared to other airports and ignores the airport's significant market power. It is also unnecessary in the presence of GAL's cost information published by the CAA pointing to the need for deep price cuts.

9. Capital oversight is weak and meaningful consultation on investment is absent, resulting in GAL unilaterally deciding to deprioritise key investments in improving service levels. We believe that the CAA should consider methods by which airlines and consumers can be actively engaged in influencing the prioritisation of capital projects, be consulted on the size and individual components of the airport's capital plan and can ensure that the NRP works will not be consuming capital capacity that could otherwise be used to improve operational performance, add resilience and improve the service offered to the consumer. GAL should be held to account for its investment decisions by providing full transparency including justification for projects, planned budgets, regular look backs and summaries as projects progress. There must be fair and adequate investment for all customers using the airport.

10. Should the current commitments framework need to be extended for a period to allow CAA to further engage with GAL on improving its proposal, then there must be a clawback provision to recapture the excess profits collected by GAL during any such extension. In terms of the NRP works already earmarked by GAL for the extension period, we agree with CAA's position that should the NRP not obtain a Development Consent Order (DCO) there must be a reopener hard coded into the license for the extension period.

11. Further, in order to fundamentally improve the commitments framework, we urge the CAA to consider introducing a backstop to provide an incentive for GAL to negotiate in good faith with airlines (on behalf of consumers) on both price and service levels. There is currently no repercussion on GAL for not doing so which unduly strengthens GAL's negotiating power and negates the possibility of a fair deal being reached between GAL and its customers. We would remind CAA that when the commitments framework was extended in 2021, it made a commitment to examine and audit the commercial agreements put in place between GAL and its airline customers. We have yet to see this audit. This will allow the CAA to establish whether the discounts offered by GAL as part of its deals are sufficient to bridge the very significant gap between its current headline charges and what charges would have been had charges been based on costs.

12. We believe that the CAA needs to take a more active role in the monitoring and oversight of GAL to ensure it does not exploit its significant market power – by regularly verifying if the deals being negotiated by GAL are in line with the backstop, establishing mechanisms to allow users to hold GAL to account for its delivery of agreed investments, and putting in place dispute resolution where the parties are unable to reach agreement (e.g. on the CSS framework).

13. If the CAA believes that it cannot assume this role, it can appoint an independent reviewer or, as a last resort, implement fully-fledged price cap regulation for GAL (including assessing reasonable return) to guarantee that consumers are not being harmed.

1. Statutory Duties and the Commitments Framework

1.1. Given the circumstances and timing of the consultation, as well as the aviation industry recovering from the Covid-19 pandemic, it does appear reasonable to consider the extension of the commitments framework. However, there remain serious concerns with the effectiveness of the framework in best fulfilling the CAA's statutory duties, notably its primary duty on consumers under the Civil Aviation Act 2012 (CAA12). The extension should therefore offer the CAA an opportunity to implement significant improvements and strengthen the regulatory framework.

1.2. GAL has been determined by the CAA to hold significant market power with respect to the provision of airport operation services to passenger airlines at the Airport[2] and as a consequence is subject to economic regulation by the CAA. The CAA noted in its market power determination that GAL could abuse its significant market power "*through excessive pricing, inefficiency, inferior service quality or investment*"[3] . It is therefore fundamental to assess GAL's proposal for the extension of the Commitments Framework against the CAA's duties in full to ensure that consumers interests are protected.

1.3. The CAA's economic regulation of GAL is based on a set of "commitments" that include a cap on the average level of airport charges, a minimum level of investment and a system of rebates if GAL misses certain service quality targets. The Commitments Framework represents a significant change to the cost based regulatory framework applied to GAL prior to 2014 and that continues to be applied to the other UK airport determined to hold significant market power, Heathrow Airport Limited.

1.4. The CAA's stated intention for the Commitments Framework is that it presents a proportionate and targeted approach to regulation that encourages bilateral contracting and commercial led decision making, rather than at the direction of the

[2] CAP1134: Market Power Determination in relation to Gatwick Airport – Statement of Reasons. See, for example, paragraph 5.27

[3] CAP1134: Market Power Determination in relation to Gatwick Airport – Statement of Reasons. See, for example, paragraph 6.22

regulator itself. The theory that this light touch approach to regulation furthers the interests of consumers through the benefit of greater competitive pressure on GAL arising from the requirement for commercial interactions with airlines lacks consideration of the behaviours and interests of a monopoly provider with significant market power.

1.5. Users negotiate from a significantly disadvantaged position and lack sufficient visibility and power to challenge GAL. This is further exacerbated by the lack of a regulatory backstop by the CAA to incentivise GAL to negotiate in a meaningful way.

1.6. The agreements reached are therefore one-sided and eliminate any negotiation leverage that an airline may otherwise have. In other words, there is no alternative outcome to negotiate from which results in an imbalanced negotiation in favour of GAL in any bilateral engagement. While we do not dispute that GAL does engage in negotiations with airlines to secure bilateral agreements, any such negotiation will always operate in an asymmetric fashion due to the imbalance between the negotiating parties.

1.7. We are concerned that the CAA's current assessment of GAL's proposal demonstrates a lack of appropriate consideration towards the interests of both current and future consumers, and disregards significant evidence pointing to excessive charges, excess profits and service level shortcoming at Gatwick. While it has been previously been difficult to conduct an appropriate assessment of GAL's proposal due to the limited information, there has been new evidence over the 6 months, including the CAA's own data modelling in the current consultation, revisions to GAL's Capital Investment Programme ("CIP") and significant traffic growth.

1.8. To remedy these concerns, the CAA ought to require GAL to significantly improve on its proposal on both price and service levels if it wants to retain the current commitments framework. Should the current commitments framework need to be extended for a period to allow CAA to further engage with GAL on improving its proposal, then there must be a clawback provision to recapture the excess profits collected by GAL during any such extension.

1.9. In addition, GAL's Northern Runway Project ("NRP") is an unknown that remains present at this stage – specifically whether the NRP project will gain the necessary approvals to proceed. Whilst cost details have been recently updated in GAL's Draft CIP24 that indicate GAL's plans for scenarios with and without the NRP, the full extent and implications of a granted or denied Development Consent Order ("DCO") for capital and operational expenditure as well service standards have not been disclosed. In our conversations with GAL it has been apparent that an undefined portion of the NRP allocated capex in Draft CIP24 for the extension period would be repurposed and is actually already required for current planned capacity levels and service standards.

1.10. To remedy these unknowns and associated uncertainties we believe that GAL should set forth a set of ex ante commitments for the scenario that the NRP DCO is not approved, detailing its implications to service standards and capital and operational expenditure, with an appropriately adjusted price path. We therefore agree with CAA's position that should the NRP not achieve approval to proceed that there must be a reopener hard coded into the license for the extension period.

2. Issues with the CAA's assessment of GAL's proposal - benchmarking

2.1. The broad range of factors considered by the CAA provide a reasonable basis for a high-level review of GAL's proposal but fall short of conducting a comprehensive review of the evidence presented. Given the maturity of the commitments framework, the longstanding concerns voiced by users, the significant increases in charges since the entry into force of the commitments framework (see figure 1 below) and the substantial future capex in capacity developments planned by GAL, a thorough review is highly appropriate. This would ensure that consumers in the extension period for undertaking if not immediately then in the imminent future to avoid baking in inefficiencies and at potentially much larger scales. However, the CAA's approach to assessing these factors has significant shortcomings and is not reflective of the available evidence.

2.2. To support its assessment, the CAA has considered a benchmarking of profitability, financial performance and aviation revenues against a comparator group of UK airports that are not subject to economic regulation. We consider that the benchmarking of charges and profits to competitive airports is not relevant or appropriate where an airport has been determined to have significant market power and is, effectively, a monopoly. Airport charges, and thus profits, will differ significantly across airports depending on size, location, facilities, services offered by any such airport. In addition, airports will have (i) different methodologies on their approach to setting and calculating charges; (ii) inconsistent cost structures; (iii) varying pricing strategies based on market conditions, competition, service levels and markets served; and (iv) differing regulatory environments.

2.3. Indeed, benchmarking presents significant methodological flaws:

"*[C]omparing prices across different geographic markets, competitors and/or time periods […] presents risks. Markets are rarely so homogenous that a meaningful comparison can be made immediately and automatically. A number of 'adjustments' to the data which emerges from the market(s) used as a point of comparison may be necessary before that data can be used to determine the benchmark price.*"[4]

2.4. We would therefore argue that benchmarking airport costs or profits in isolation is too simplistic an approach without comparing all the relevant factors that lead to an individual airport's charges. While benchmarking can provide an informative source for the assessment of specific areas, such as opex and capex efficiency or service quality and could form part of a wider assessment of cost requirements, it should not be the

[4] See AG Wahl. Opinion in Case C-177/16, Court of Justice of the European Union.

sole basis of CAA's decision on the future airport charges at Gatwick. This is all the more relevant as there is overwhelming cost-based evidence that GAL's proposal will lead to excessive charges and excess profits.

2.5. The Thessaloniki Forum of European Airport Charges Regulators highlights the limitations in relation to benchmarking airports for the purposes of price regulation:

"*3.5 An inherent weakness of the comparison [of different airports] is the difficulty of gathering all the necessary information and the significant number of assumptions that need to be made to adjust the data set for reasons of comparability.*

6.5 Differences between airports (efficiency levels, quality, costs financed by the government, the level of use of capacity, current investment activities as they may have large impact on charges since depreciation is usually included in the relevant cost base, etc.) should also be adequately taken into account."[5]

2.1. Similarly, the ICAO Manual for Airport Economic Analysis note that benchmarking may be a useful tool for comparing the cost efficiency and productivity of airport, but great care must be taken when conducting this exercise as comparisons of performance are difficult and can often be misleading due to the differences in the operating models and investment cycles[6]. The Thessaloniki Forum similarly states that: "*it might be relevant to consider benchmarking of other aspects of airport operations, such as costs of construction and levels of aviation OPEX, quality of services or cost of capital, given that local differences are properly accounted for.*"[7] Benchmarking could be an effective tool to identify areas where airports may be able to improve efficiency and reduce costs, but given that the CAA is not conducting a detailed analysis of GAL's costs in this instance (for instance, through a bottom-up assessment), using benchmarking as a tool to solely assess profitability without factoring in the detailed differences that may exist in comparative airports does not appear to be reasonable.

2.2. In any event, in the case of GAL's proposal there is cost-based evidence pointing to significant overcharging and excess profits that would require sizeable price cuts, and therefore the value of benchmarking should be even more limited in informing the CAA's decision-making. We note in this regard a study by the International Communications Union (ITU) in 2014 which stated that:

"Regulators should only use benchmarks as short-term measures to obtain an improvement in prices pending a more detailed cost analysis – '<u>If deep price cuts are required there is no substitute for cost-based analysis and any regulator attempting to use benchmarks for this purpose will end up trying (and probably failing) to defend their benchmarks in court. …. benchmarking [should be applied] only in situations</u>

[5] See paper on Benchmarking Airport Charges Level, December 2019 here.
[6] https://www.icao.int/publications/Documents/9562_cons_en.pdf
[7] Ibid, point 9.8.

where there is no available costing data, or only rudimentary data is available." [8] [our emphases added]

2.3. Moreover, we note that the benchmarking report commissioned by the CAA points to significant profitability by GAL, with EBITDA margins exceeding 40-50% between 2011-2019. The fact that other UK airports that are deemed to be competitive have had similar margins may be indicative of other issues which the CAA ought to investigate if called to conduct a market power assessment regarding those airports. As demonstrated below, GAL's profitability is expected to grow further during the extension period under the terms of its proposal. This cannot be viewed by a regulator as being in the best interest of consumers.

3. Airport charges and GAL's financial performance

3.1. We strongly agree with the CAA that "ensuring that airport charges are reasonable is an integral part of protecting the interests of consumers" and that "the CAA's primary duty in carrying out our assessment of GAL's proposals is to further the interests of consumers."[9]

3.2. GAL's proposal for the headline charges to evolve by CPI-1% for the first two years and then aligned with CPI for the remainder of the extension period should lead to a modest decrease in real cost per passenger by 2029. This may on surface appear to be a reasonable evolution of GAL's aeronautical revenue requirement over the period. Critically however, GAL's proposal fails to recognise that charges are significantly inflated, being between 20-30% higher than required, will result in excess revenues of more than £1 billion over and above a reasonable cost of capital and will yield annual operating margins of over 55% during the extension period. This can simply not be viewed as being in the best interest of consumers.

3.3. Under the current commitments period, consumers have seen GAL's headline charges increasing by over 70% (2015-2024) driven by the inflationary environment, with the price path aligned to RPI (see figure 1). These increases have happened despite increasing passenger numbers, a deflated capital program, and growing commercial revenues that should theoretically be driving airport charges down. Our assessment of GAL's underlying costs and revenues reported in its financial accounts indicate that GAL's business has not evolved in a corresponding fashion, resulting in the link between GAL's airport charges, including those proposed for the extension period 2025-2029, and its underlying revenue requirements being broken. This is evident not only in the dramatic growth in GAL's financial performance in 2023 and the first half of 2024 but also in the CAA's own data modelling of GAL's profitability for the extension period.

3.4. In fact, the extent of GAL's excessive charges and excess profitability, under all scenarios we considered in section 4, overwhelmingly demonstrate that its charges

[8] ITU, A practical guide on benchmarking telecommunications prices, 2014, page 1

[9] CAP3012 para 3.9

are not reasonable and thereby are not in the consumers' interest. GAL's proposal to continue significantly overcharging consumers by an additional 4 years will therefore harm consumers and amounts to a clear demonstration of monopolistic behaviour.

3.5. It is important to note that commercial businesses, including our own, continue to make significant multi-billion-pound investments into their businesses without the excessive profits and operating margins that would accrue to GAL under this proposal. Our parent company, International Airlines Group (IAG), recently announced a £7 billion investment in British Airways as part of our transformation program to deliver (i) a world class customer experience; (ii) a leading-edge commercial program; (iii) modernisation of our IT estate; and (iv) operational and technical excellence. IAG's full-year operating margin for 2023 was 11.9%, far below the margins anticipated by GAL's proposal, but its incentive to make significant investments in the business has not been undermined.

3.6. The limited and simplistic justification presented by the CAA that these levels of returns would be in the consumer interest because they allow GAL to pursue capacity expansion via its NRP is erroneous and risks setting dangerous precedent. It is also at odds with UK cross-sector regulatory precedent of determining a fair financial return for entities delivering far greater capex programmes. Our analysis suggests that GAL could fund its Northern Runway Project through the excess profits generated today, notwithstanding any extension to the commitments framework. As shown in section 4, GAL can also finance the NRP works earmarked for the extension period, earn a reasonable financial return and still reduce charges by over 20%.

3.7. It is therefore wholly unnecessary for GAL to profiteer to the extent that the CAA sets out in order to deliver its capex plan including the NRP.

3.8. The CAA state "*relatively high levels of profits and returns support further investment in the airport*"[10] but this is not guaranteed to be the case. In fact, airport investment needs to be supported by appropriate incentives to ensure that, as a monopoly, GAL does not reduce investment at the harm of service quality and consumers in order to achieve the maximisation of shareholder return. We further elaborate on this in the DCO and capital investment sections.

4. A cost-based model would yield significant reductions in charges, even after financing the Northern Runway

4.1. To understand whether GAL's proposal is in the consumer interest, we have examined to what extent it corresponds to its costs as a regulated monopoly. We have developed six different scenarios of how GAL's charges would develop with cost-based price cap regulation using information from a variety of sources including GAL's CIP (for capex) and traffic forecasts, publicly available data from its financial reports and allowing a reasonable return similar to the Weighted Average Cost of Capital

[10] CAP3012 para 4.8

(WACC) allowed by the CAA for Heathrow airport in its H7 Final Decision of March 2023[11]. We applied conservative assumptions for those elements where we extrapolated publicly available information into the proposed extension period and have developed scenarios including and excluding the DCO cost earmarked for the extension period in GAL's CIP24.

4.2. Our analysis shows that:

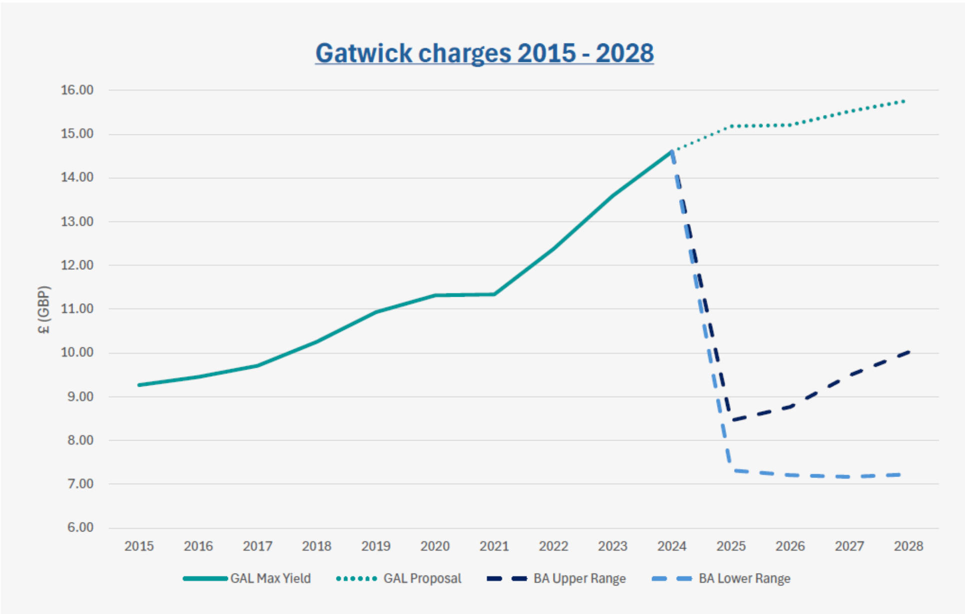
a. Under all scenarios charges should decrease between approximately CPI-20% and CPI-30% during the proposed extension period, indicating a very significant disparity to GAL's proposal for CPI-1% and CPI.

b. GAL's proposal would yield charges that are ca.20% higher than needed, even if it realised its low traffic forecast and had to finance the works for the Northern Runway foreseen for the extension period.

c. GAL would generate excess profits of at least £1 billion during the extension period on top of earning a reasonable return.

4.3. We share our analysis as an appendix to this response and we are available to explain our modelling assumptions to the CAA.

Figure 1: GAL's historic and future charge development scenarios



Source: BA analysis

4.4. The CAA's modelling assumptions shared as part of the consultation show a similar trend to our analysis, although we have some concerns over the pessimistic traffic

[11] Including an additional uplift to HAL's allowed WACC to reflect the absence of a Traffic Risk Sharing mechanism.

forecast, the cost efficiency applied and the projected lack of growth in commercial revenues despite GAL's recent strong performance in the area.

4.5. Furthermore, we remind the CAA that GAL's proposal for the extension period will form the baseline for the regime that will be retained post-2029, and as such baking in such significantly higher charges and inefficiencies during the extension period will unnecessarily inflate prices for years to come and ahead of significant expansionary capex for the NRP. This will be to the consumers' detriment.

4.6. We therefore believe that the CAA has not justified how GAL's proposal is in the consumer interest considering that its charges and profits would be significantly outstripping what it would need to finance its operations, earn a reasonable profit and even finance its NRP works.

5. DCO scenario

5.1. We disagree with the CAA's assertion that the high level of profits and returns during the extension period would be justified in order to finance substantial investments in the airport, notably GAL's DCO for its NRP. As demonstrated above, GAL would be earning very significant excess returns and levy charges way above what a competitive entity could be reasonably entitled to.

5.2. GAL's proposed headline charges and ensuing returns would also be excessive even after allowing for the financing of the NRP works provided for the extension period in the 2024 CIP.

5.3. In fact, consumers would be pre-funding around a quarter of the DCO's expected cost during the extension period despite GAL not yet obtaining the DCO. We therefore agree with CAA's position that, should the NRP not obtain a DCO, there must be a reopener hard coded into the license for the extension period.

5.4. We also challenge the CAA's assumption that the capacity expansion brought about by the DCO will reduce incentives on GAL to exploit its market power. If GAL's extension proposal is approved, charges will not only be significantly high during the extension period but will inflate charges for years to come. Additional capacity will also be progressively added (i.e. coming online in tranches), and assuming it would be taken up quickly, it would be insufficient to constrain GAL's market power.

5.5. We note GAL's incentive to "rebalance" investments during the extension period in favour of the DCO and to the detriment of much-needed projects on improving the existing terminals, airfield and capacity. The minimal oversight over GAL's CIP process is a key impediment in holding GAL to account, and we expand on this in the subsequent section.

5.6. With respect to the cost of the DCO, we continue to be concerned with GAL's assertions that the cost envelope presented captures the total extent of airfield and terminal investments that will be required to deliver an appropriate level of service for consumers and operators in the case that the forecast passenger demand fully, or even in part, materialises are not supported by the evidence provided. That said, if the £2.2 billion budget suggested by GAL does accurately reflect the full extent of investment required then the GAL proposal appears to deliver a significant capacity increase to the London and Southeast market at a relatively reasonable cost in comparison to other airport expansion plans, particularly the most recent Heathrow Runway 3 plan.

6. Capital Investment

6.1. A key pillar of the commitments framework is ongoing consultation and collaboration with airport users on investment decisions. It is our view that the current engagement model does not provide for a meaningful role for airlines to participate in defining of upcoming investment requirements, nor the prioritisation of such investments. While GAL does provide updates on its investment plans and future investment requirements in the annual CIP, we are concerned with the level of transparency provided – specifically surrounding performance to budget and timelines – and critically the ability for airlines to influence how future capital spend is to be prioritised. We consider stakeholder management as a best practice and core responsibility of GAL as it develops and implements its capital plans.

6.2. As a general point, we believe that there is a significant lack of capital oversight in place which results in sub-optimal outcomes for consumers both in terms of capital invested and experience outcomes. We would encourage the CAA to take a more active role in understanding the direct connection between the capital invested and the CSS at Gatwick, and to ensure that GAL is held accountable for efficient capital investment. A material example of this point is GAL's ability to pre-fund its NRP within the 2024 CIP without engagement with airport users, which in turn raises the question whether this investment is being made at the expense of other critical investment areas to remedy existing customer and operational pain points. The answer to this question remains unclear solely because GAL has not engaged with airport users on the question itself.

6.3. The current annual CIP process places no requirement on GAL to actively consult with airlines, airport users and consumer groups to explain and/or justify its investment decisions. There is no mechanism to call GAL to account if they fail to acknowledge consumer or airline requests – except for the CSS – which in our opinion does not currently adequately capture the areas on the airport that are lacking and the frustrations experienced by consumers at an airport operating at almost full capacity (see section on service levels below).

6.4. GAL last published a CIP in July 2023 covering the period 2023/4-2028/9. A refreshed CIP was published in 2024, [redacted]. In August 2024, our parent company IAG wrote to GAL to outline [redacted]

[redacted]

[redacted]

[redacted]

6.5. The lack of engagement by GAL with airport users on prioritisation of capital investment has led to obvious examples whereby the experience of consumers is degraded because of lack of investment at the expense of other projects within the CIP. As an example, our customers regularly experience significant congestion in the departure lounge, and this congestion was planned to be addressed in the 2023 CIP. [redacted] This is not an isolated incident and we have experienced similar investment decisions deprioritising key projects by GAL including investments in the departure piers, coaching gates and ongoing maintenance of existing capital assets.

6.6. When such decisions have been taken by GAL, it has offered no rationale behind the decision to delay investment and the steps it will take to ensure that the CSS targets are met in the interim period until the investment has in fact been made. We are concerned that this lack of engagement, or indeed a requirement on GAL to engage meaningfully under the current framework, can result in the deferral of investments to meet other financial metrics that GAL is looking to achieve in any given period.

6.7. An additional area of concern surrounding transparency is the lack of detailed information provided at a project level to airport users. Information that is provided is inadequate and lacks information to truly assess project health, realisation of benefits – both financial and non-financial – progress towards improvement to CSS, schedule adherence and customer service impact.

6.8. Any decision by the CAA to extend the current commitments framework must include a robust solution to improve capital oversight, and should include an obligation on GAL to target capital investment at areas of the operation and customer experience that are currently underperforming expectations of airport users – such as departure lounge capacity, check-in desk capacity, airfield congestion, and the quality of gate areas and piers.

6.9. The CAA ought to consider how to incentivise GAL to meaningfully engage with airport users to ensure that investment decisions are made in the best interests of consumers and are not made solely by GAL itself. It is crucial that the CAA operates as an arbiter in discussions between GAL and the airport users where they fail to agree. The existence of the commitments framework itself does not, as noted elsewhere in this response, mean that GAL acts as a rational or reasonable negotiator due to the lack of a regulatory backstop – in this case the direct involvement of CAA – while creating its capital plans.

6.10. Our view is that the incentive for GAL to invest efficiently and target investment in areas to improve customer and operational outcomes under the CSS is broken. We urge CAA to take action to solve for this issue should it elect to extend the commitments framework as proposed.

7. Service Quality

7.1. We agree with the CAA's assertion it is consistent with its statutory duties that the regulatory regime needs to appropriately incentivise GAL to provide good services to passengers and airlines and that good quality of service is an integral part of protecting the interests of consumers.

7.2. It is important that service standards not only focus on core service requirements but can evolve over time to address areas of emerging issues. Similarly, measurement of the standards should be appropriate realistic to ensure it delivers actual and positive consumer outcomes. Currently the CSS framework largely incentivises GAL to focus on the customer security product and assisting passengers with reduced mobility but fails to consider other key operational and customer pain points including those noted earlier in this response – e.g. departure lounge congestion, check-in desk availability, stand availability, airfield congestion, air traffic control performance and others.

7.3. Without a regulatory obligation to do so, GAL will not engage with airport users to expand the CSS metrics to address evolving issues experienced at the airport. Indeed, our experience to date is that GAL is unwilling to address any such issues. We urge the CAA to assess how GAL can be incentivised to appropriately maintain, expand and measure the CSS metrics over time.

7.4. The Gatwick Airport Consultative Committee (ACC) has engaged with GAL for some time to redesign the current CSS metrics to more accurately reflect the airport's capabilities. In March 2024, the ACC wrote to GAL summarising the status of the review in the hope it would reenergise the process. In the ensuing 6 months, engagement has been minimal with no agreement on additional metrics or changes to the formulas by which existing metrics are measured. While GAL has proposed to include two additional metrics - a measure on air traffic control performance at Gatwick and the introduction of financial incentive on arrival wait times for special assistance – it has refused to engage in any additional metrics being introduced to the CSS framework.

7.5. In addition, our experience is that measuring and reporting of CSS metrics is flawed and extended measurement periods have resulted in a "sea of green" on performance dashboards which results in GAL not engaging in resolving significant issues (and prioritising investment accordingly) that have been masked by such extended periods. The expectation that the framework would incentivise GAL to target investment to meet and exceed CSS targets has led GAL in limiting investment to meet the current limited unambitious CSS targets. As noted, the current CSS metrics no longer reflect the true nature of the airport's current operations, and GAL is not incentivised or motivated to alter them.

7.6. As an example, a proposal by airport users to alter the CSS metric for security queue times to match those already being achieved by GAL has been rejected as it would result in a long-term commitment for GAL to continue to achieve this higher level of performance as opposed to the standard set out in the CSS. Similarly, a proposal to shorten the measurement period for pier service levels (PSL) to accurately reflect the number of non-pier operations has also been rejected, on the grounds the investment and disruption needed to maintain the 95% target during peak mornings would be too significant to counteract. Moreover, it is measured per passenger and not by departure, meaning that an Airbus A380 on stand would offset several short haul flights. Continuous improvement should be embraced by GAL and the CSS framework should evolve over time to reflect improved performance and better consumer outcomes, but without CAA requiring GAL to do so, customer outcomes will not improve.

7.7. Indeed, we would advocate for the CSS metrics to be expanded to include services provided by third parties where GAL has negotiated service level agreements and/or targets. A primary example is provision of air traffic control services by NATS to the airport. Gatwick has experienced numerous issues with performance by NATS over the past number of years and consumers have received no meaningful compensation for such poor performance by NATS. CAA should require that third party services be included in the CSS framework.

7.8. On time performance (OTP) is a key measure of customer satisfaction and operational performance by airlines. OTP is generally measures in terms of flights departing within 15 minutes of the scheduled departure time. While many different factors exist within the calculation of OTP, our recent analysis of the performance of Gatwick vs. other European and global airports highlights that Gatwick is an outlier [redacted]. We recognise that we as airport users have a direct involvement in ensuring good OTP at Gatwick, but the fact that Gatwick performs [redacted] indicates that customer and operational targets are not being met – and indicates that the CSS framework must be adapted, refreshed and expanded to incentivise GAL to improve overall performance at the airport. This could include addressing issues such as airfield delays, particularly when the aircraft is ready to depart on time from its stand.

7.9. The dataset below clearly taken over a recent 5-week period demonstrates that GAL is underperforming its peer airports in terms of OTP and highlights why the CSS framework needs to be adapted.

Figure 2: BA OTP15D at LGW, August-September 2024

[---Redacted---]

7.10. We encourage CAA to investigate how the CSS framework can be improved to address the concerns outlined in this response to create the right incentive for GAL to negotiate in good faith to improve customer and operational outcomes for airport users.

8. Bilateral Contracts and the CAA's role

8.1. We note that the CAA's role in the economic regulation of GAL is different from that at Heathrow airport which is the only other UK regulated airport. Under the commitments framework, GAL may enter into bilateral agreements with airlines to govern airport charges, service levels and other terms and conditions applicable to such airline.

8.2. We agree with the CAA that these agreements are "*intended to provide a clear framework which is well understood by stakeholders, [and] enables positive commercial engagement between GAL and its airline customers*". However, we stress that the existence of the commitments framework and bilateral agreements does not in itself replicate a normal commercial negotiation environment considering that one party holds significant market power.

8.3. In particular, we have no visibility of GAL's costs to inform our negotiation and there is no regulatory backstop by the CAA to incentivise GAL to negotiate in good faith. Similarly, the weaknesses of the CSS framework above provide little incentive for GAL to negotiate deals on tighter service levels that correspond to the airline's needs or to avoid the deadlocks on CSS and capital that we have been seeing.

8.4. The agreements reached are therefore one-sided and eliminate any negotiation leverage that an airline may otherwise have. In other words, there is no alternative outcome to negotiate from, which in turn results in an imbalanced negotiation in favour of GAL in any bilateral engagement. While we do not dispute that GAL does engage in negotiations with airlines to secure bilateral agreements, any such negotiation will always operate in an asymmetric fashion due to the imbalance between the negotiating parties.

8.5. We noted earlier in our response that CAA had previously committed to completing an audit of bilateral agreements in place between GAL and airlines to ensure the "*robustness of the service measurement process and rebate calculations*". We are disappointed that this audit has not yet been completed and encourage CAA to undertake such audit with haste. This will allow the CAA to establish whether the discounts offered by GAL as part of its deals are sufficient to bridge the very significant gap between its current charges and what charges would have been had charges been based on costs.

8.6. Further, and despite the existence of the commitments framework and bilateral agreements, we actively support the CAA maintaining an engaged and active role in the monitoring and oversight of GAL to ensure it does not take advantage of its significant market power – such as through regularly verifying that the deals being negotiated are in line with the regulatory backstop. Our view is that CAA has not taken such a role to date, and we encourage it to outline how it intends to do so in the future. If the CAA believes that it cannot assume this role, it can appoint an independent reviewer or, as a last resort, implement fully-fledged price cap regulation for GAL (including assessing reasonable return).

9. Conclusion

9.1. For the reasons outlined above, we cannot support the extension of the current commitments under the terms proposed by GAL or the CAA's initial view that this is "likely" to be in the interest of consumers. The evidence we presented on GAL's excessive prices, excess profits, the issues with capital investment and the significant operational failures overwhelmingly demonstrates that GAL's proposal will not be delivering in the consumer interest.

9.2. We urge the CAA to require GAL to significantly improve on its proposal on both price and service levels if it wants to retain the current commitments framework. It should equally provide the necessary incentives for GAL to negotiate with airlines in good faith to remedy the concerns on price and service levels within the current deals where relevant.

9.3. Should the current commitments framework need to be extended for a period to allow CAA to further engage with GAL on improving its proposal, then there must be a clawback provision to recapture any excess returns or profits collected by GAL during any such extension.

Public

Please feel free to approach us with any questions on our response to this consultation.

Yours sincerely,

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