

CAA consultation on proposed regulatory policy on capacity expansion at Heathrow or Gatwick

1. The British Air Transport Association (BATA) welcomes the opportunity to submit evidence to the Civil Aviation Authority's consultation on its draft policy for the economic regulation of new runway capacity.
2. BATA is the trade body for UK registered airlines. Our eleven members cover all sectors of the airline industry – including freight, charter, low cost, regional operations and full service. In 2013, BATA members employed 74,000 people, operated four-fifths of the UK commercial aircraft fleet and were responsible for some 96% of UK airline output, carrying 133 million passengers and 1.1 million tonnes of cargo. The eleven BATA member airlines are: British Airways, DHL, easyJet, Flybe, Jet2.com, Monarch, RVL Group, Thomas Cook, Thomson Airways, Titan Airways and Virgin Atlantic.
3. BATA endorses the consultation response submitted jointly by the ACC at Gatwick and the LACC at Heathrow and wishes to highlight some of the key points.

Chapter 2 - the CAA's duties

4. Given that the CAA's primary duty is to passengers it is vital that their needs are central to any regulatory policy and interventions regarding new airport capacity. The CAA is right to emphasise that the interests of airlines and those of passengers often overlap. Given the intensively competitive nature of their business, airlines are best placed to represent passengers' interests.
5. The consultation states that the CAA uses a range of sources to inform its views of users' interests including the CAA Consumer Panel and passenger surveys, but no further detail is provided. It would be helpful for the CAA to publish any research or advice from the Consumer Panel that has informed the contents of the consultation paper.
6. In a perfectly competitive market commercial or market agreements between airlines and airports would have the potential to facilitate better outcomes for passengers than regulatory interventions. However, the CAA has determined that Gatwick and Heathrow hold Significant Market Power which they have the potential to exploit when negotiating commercial or market agreements with airlines. Clearly this creates the risk that any such agreements could lead to outcomes that are sub optimal for passengers. Therefore the CAA should not place too much weight on commercially negotiated agreements delivering the best outcome for consumers.
7. The CAA should have regard to its other duties when setting its regulatory policy, but its primary duty to passengers must have the greatest weight. Passenger interests should not be compromised or 'balanced off' against airport interests and any allocation of risk to passengers must be minimised and balanced by a clear and commensurate passenger benefit.

Chapter 3 – treatment of category C costs – principles

8. BATA agrees that it is right for the CAA to be setting out principles rather than a more detailed design for a regulatory regime at this stage given the timing of the consultation and current levels of uncertainty.
9. BATA also agrees in general that risk should be allocated to those that can manage it best. However, it would be quite wrong and contrary to the CAA's primary duty for risk to be passed downstream to users on the basis that 'no other party is better placed' (paragraph 3.9). Passengers should only be allocated risk when it is in their best interests and they are demonstrably best placed to manage that risk.
10. As discussed in paragraph 6, the fact that Heathrow and Gatwick have Significant Market Power means that commercial negotiations between these airports and airlines may not result in risks being appropriately allocated.
11. BATA is opposed to the pre-funding of new runway capacity and does not believe it is in the interest of passengers
12. The consultation paper states that pre-funding is 'likely to reduce the overall cost of the product', but provides a theoretical argument rather than hard evidence for such a conclusion. The joint LACC and ACC response is right to point out that the total cost of the project in Net Present Value terms will depend on both the timing of payments and the discount rate.
13. The CAA should consider whether minimising the overall cost of the project is in the best interest of passengers if it means them being allocated risk and costs that could be borne by other stakeholders.
14. The CAA is right to highlight the inter-generational concerns raised by pre-funding. Today's passengers should not pay for capacity they may never use. Pre-funding also raises significant competition concerns. Airlines operating at Gatwick and Heathrow today might be not operating there when new capacity become operable and new entrants will get the benefit of new capacity without any of the costs of pre-funding.
15. BATA is unconvinced that pre-funding is consistent with the working of a competitive market. Prices rise in markets with scarce capacity due the lack of supply, not to pre-fund investment in additional capacity, and investment decisions are based on future prices and costs, not existing ones. Higher prices caused by lack of supply may enable investment to take place in such a market, but the investment is not itself the cause of the higher prices as would be the case with pre-funding. Furthermore, in a competitive market you would expect prices to fall to a new market clearing level following an increase in capacity, whereas paragraph 3.37 suggests the CAA is considering allowing airport prices to rise.
16. The CAA must consult fully on any changes to its current regulatory approach. We are concerned that the CAA considers that it may be appropriate to allow airport prices to rise to levels higher than the current 'cost-plus approach'.

Chapter 4 – Price Control Structures

17. It is clear that Licence Based regulation will be required given that the CAA has determined that Heathrow and Gatwick have Significant Market Power. The CAA should continue to consider a variety of options and not settle on one type of regulatory structure at this stage.
18. BATA supports the regulatory principles set out in the joint LACC and ACC response.

Chapter 5 – Recovery of category A and B costs

19. BATA agrees that category A costs should be borne by proposers and not passed on to users.
20. We disagree that passengers should reasonably be expected to carry some or all of category B costs. They have no control over the quality of an airport's planning application or the political environment during the planning process. It is not in the interests of passengers to pay for the costs of seeking planning permission if permission is not granted and the capacity expansion never realised.
21. The CAA should explore whether Category B and C costs should be treated in the same way.
22. The CAA should explain why £10 million is an appropriate amount to recover should it proceed as it proposes.

Chapter 6 – Scrutiny of costs

23. BATA agrees that both ex-ante and ex-post cost scrutiny is needed to ensure that only efficient capex costs are passed through to consumers. It will be important for the CAA to set out criteria for determining efficient investment and there must be proper incentives to ensure that the winning airport specifies and costs the project accurately, delivering on the costs that were submitted to secure the right to increase capacity, and not artificially inflating prices after that decision has been made.

Chapter 7 – Market power

24. BATA welcomes the CAA's suggestion that it will not carry out any new market power assessments until new capacity is open or close to opening.

BATA
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