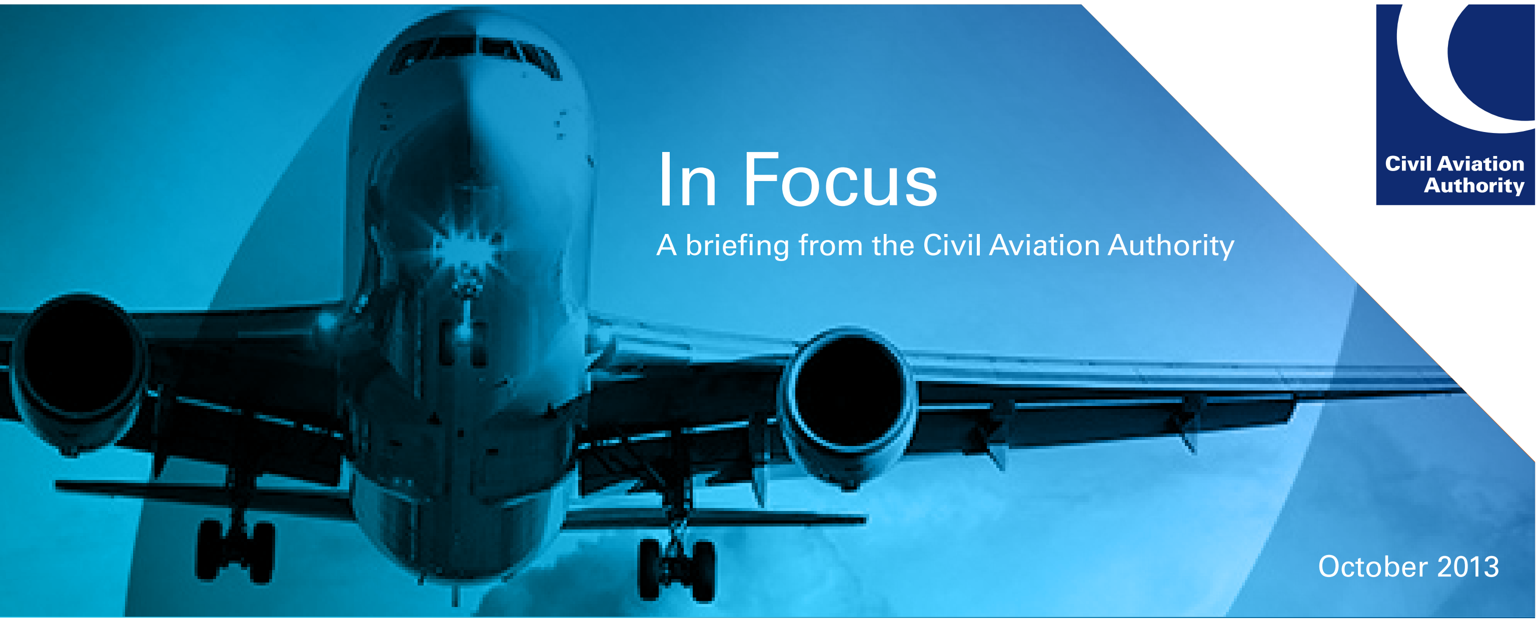
Civil Aviation Authority



In Focus

A briefing from the Civil Aviation Authority

October 2013

Preparing for a future with passengers at its heart

Economic regulation at Heathrow and Gatwick

Context

On 3 October 2013, the Civil Aviation Authority published its final proposals for the regulation of Heathrow and Gatwick airports for the five years after April 2014. It also announced that it would be consulting further on the future of regulation at Stansted.

This is the first review of economic regulation carried out under the Civil Aviation Act 2012. This Act gave the CAA a clear duty that its economic regulation had to be undertaken with the consumer interest at its heart (including that of cargo-owners). The final proposals therefore aim to protect end-users and further their interests. We will do this partly by promoting the development of further competition between airports. The proposals also ensure that regulated airports are able to invest in new infrastructure, when it is in the passenger interest.

A key market change over the last five years is that Heathrow, Gatwick and Stansted now all have different owners. New management teams have taken quite different approaches: we have seen significant operational innovation at Gatwick, and Stansted's new owners have quickly struck long-term agreements with their main customers. Although the scope for competition between London airports is limited by capacity shortages, diversity of management approach can make an important contribution to competition.

Why we regulate airports

We only regulate airports when competition (including competition law) will not fully protect passengers' interests and where the benefits of regulation outweigh the risks.

Airports with market power are not constrained by competition with other airports. They can abuse that market power to the detriment of passengers, or air cargo owners. So the CAA regulates them to ensure that passengers are protected, by not being overcharged or having to use facilities that aren't up to standard.

If we de-regulated airports with significant market power they could simply increase charges to passengers who have nowhere else to go, or reduce service quality, for the benefit of their shareholders. They may have no significant incentives to invest their profits in new terminals, or in ensuring their current ones meet passenger expectations. When an airport has significant market power, regulation is the best way to ensure airport charges fund future investment not short-term gains, while offering a fair return to investors.

Regulating to support a competitive market

Well-designed regulation promotes competition, and does not hinder it. For instance, under the CAA's price controls airports are free to discount charges to individual airlines (within the constraint of competition law), so they can compete hard to win new business. The CAA has promoted the conditions that allow such markets to develop over time, which can remove the need to regulate altogether. This was the approach we took with Manchester Airport, which was regulated until 2009, when sufficient competition from nearby airports had developed to assure us that competition was strong enough to protect passengers in the absence of regulation. Regulation does not stifle competition; it only protects passengers in its absence.

Process so far

The final proposals rest on market power assessments, which set out the CAA's view of the level of market power each airport has. They set out what tailored approach to regulation would best match the individual issues at each airport in the event that our final assessment is that they have substantial market power requiring regulation. In each case, our aim is to ensure the best deal for the travelling public and cargo-owners. The CAA set out in April the approach it was minded to take on market power, and will publish final market power assessments in January, alongside the final decisions about regulation.

The final proposals build on initial proposals published by the CAA in April 2013. These were based on extensive discussions with airports and airlines, substantial research and a programme of surveys to find out directly what passengers want from these airports.

Since April, we have consulted with industry stakeholders for three months, and have refined our proposals. Today we begin consulting on our final proposals for regulation at Heathrow and Gatwick. This consultation will close on 4 November. The CAA will then take final decisions on market power and, where appropriate, the form of regulation, which will be published in January.

Stansted's new owners, Manchester Airport Group (MAG), have reached long-term commercial agreements with their two principal customers, easyJet and Ryanair. The CAA announced on 17 September that it would consult on how these agreements may affect the market power assessment, before making final proposals on regulation. This is why the CAA has not published any final proposals relating to Stansted.

A new licensing system

The Civil Aviation Act 2012 allows much more flexible regulation as rules will be set within a licence that can be amended (subject to due process). Consistent with better regulation principles, we have not sought to regulate for all eventualities but pick only key priorities for inclusion in the first licences granted to the airports.

Because we understand how important service quality during disruption is to passengers, one of the first licence conditions will strengthen each airport's approach to operational resilience. The rules will ensure that the airport has robust plans to deal with disruption, and an effective approach to collaboration; and will ensure full communication with affected passengers.

Our proposals

Heathrow – investment & efficiency

Heathrow has called for a 4.6% annual real-terms increase in its charges over five years. Its airlines have asked for a 9.8% per year cut. **We propose a price control that will not allow prices to rise by more than inflation (measured by RPI).** That compares to our initial proposals for RPI minus 1.3%. A key reason for this is due to an increase in the cost of capital driven by higher debt costs, offset to some degree by more challenging targets for operating efficiency.

The proposals will put an end to over a decade of prices rising faster than inflation at Heathrow. This has supported significant investment in Heathrow over the last decade and our current proposals will also create a supportive environment for further capital expenditure.

Gatwick – allowing competition to develop

Gatwick has set out a series of price commitments to its users, with the average price to grow by RPI + 0.5% per year for seven years. The CAA has today published its detailed analysis that suggests that this is a fair price. **In addition, we believe that the airport's commitments are in passengers' interests, so they are the basis of our final proposals.** They will be backed by a licence to ensure that they are honoured. The licence will also ensure the CAA can continue to act where appropriate to protect users, for instance if there are reductions in service quality that are against the passenger interest.

Next steps

Our final proposals will be consulted on until 4 November. Details of how to respond to the consultations can be found within the documents themselves, which can be found below. Following the end of the consultation, we will bring forward our Final Decision documents in January 2014, alongside licences for the two airports, before the licences come in to effect on 1 April 2014.

Final Proposals

Economic Regulation of Heathrow, Gatwick and Stansted web page

Economic Regulation of Heathrow Airport Limited after April 2014: the CAA's Final Proposals

Economic Regulation of Gatwick Airport Limited after April 2014: the CAA's Final Proposals

Estimating the cost of capital: a technical appendix to the CAA's final proposals for economic regulation of Heathrow and Gatwick after April 2014