Consumers and Markets Group

UK Civil Aviation Authority

Economic regulation of Gatwick Airport Limited: consultation on proposal to extend the current commitments

CAP2554

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Introduction and summary

1. Our economic regulation of Gatwick Airport Limited (GAL) is based on a set of "commitments" that include, among other things, 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 is intended to be a proportionate and targeted approach to economic regulation, which encourages bilateral contracting and facilitates commercial rather than regulator-led decision making.
2. The current commitments were introduced in 2021 and cover the four year period to 31 March 2025. They include a cap of Retail Prices Index (RPI) + 0% on GAL's published charges and a minimum investment requirement of £120 million per year, on average, over the six years from 2019/20 to 2024/25.
3. Following discussions with airlines, GAL has submitted for our evaluation a proposal to extend the current commitments by four years from 1 April 2025 to 31 March 2029. GAL says that its proposed extension will provide for stability and certainty as the economy and aviation industry stabilise and the outcome of its northern runway planning application becomes known. Key features of the proposal include:
   - a revised price cap for the extension period: Consumer Prices Index (CPI) - 1% for the first two years, followed by CPI + 0% for the final two years;
   - a review of service quality metrics and targets was already scheduled, though GAL has now identified two new measures that it will put forward for consideration: a new metric on air traffic control performance at Gatwick, and financial incentives for the Special Assistance passenger satisfaction measure (which is monitored at present but without financial incentives); and
   - the investment commitment is unchanged at an average of at least £120 million per year, though the average will now be assessed over the ten years from 2019/20 to 2028/29.
4. We are now inviting views from stakeholders on GAL's proposal. This should include specific analysis and evidence as far as possible, and also indicate whether the stakeholder has already raised its concerns with GAL. Chapter 3 includes details of how to respond.
5. We will take account of respondents' views when considering our next steps. As the current commitments expire in March 2025, we would have needed to start considering what kind of regulatory arrangements should apply after then even if GAL had not come forward with its current proposal.

Chapter 1
Overview of the commitments framework

1.1 Since 2014 our economic regulation of GAL has been based on a set of "commitments" from GAL 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 (these cover passenger satisfaction measures, security queues, passenger operational measures, airline operational measures and runway availability).[1] The commitments are conditions of GAL's economic licence are therefore subject to the licence modification process (including appeal rights) set out in the Civil Aviation Act 2012.

1.2 The commitments framework was intended to be a proportionate and targeted approach to the economic regulation of Gatwick. By encouraging bilateral contracts, the commitments framework could support more targeted service offerings, better incentivise traffic growth and promote competition. All these considerations suggested that the commitments would be in the best interests of consumers.[2]

1.3 We carried out an early review of the new framework in 2016, to consider whether any aspect of this framework was operating against consumers' interests. We found that many aspects of the framework appeared to be working well, but we also identified some potential concerns about the progress of airfield investment projects, on-time performance and some aspects of GAL's relationships with airlines. Significantly, however, none of the airlines we spoke to suggested that there should be a return to the previous form of regulation.

1.4 The initial set of commitments expired in 2021. Following engagement with stakeholders during 2018 and 2019, in January 2020 GAL submitted proposals for our review for a new set of commitments. We wrote to airlines and the Passenger Advisory Group asking for their views on GAL's proposals. However, this process was overtaken by the impact of the Covid-19 pandemic, which had a severe effect on the whole aviation industry and led to very low traffic levels at Gatwick for a prolonged period.

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1 The commitments also include obligations to prepare and maintain plans on continuity of service and operational resilience, to provide an annual confirmation of adequate resources, and to provide certain accounting information. For more details, see Part C of GAL's licence and the sections of GAL's Conditions of Use referenced therein.

2 In this document we use the term "consumers" to refer to passengers and cargo owners. This is equivalent to "users" of air transport services as defined in the Civil Aviation Act 2012.

1.5 By October 2020 we reached a view that, bearing in mind the significant impact of Covid-19 on the future outlook, the overall package of changes proposed by GAL was likely to be in consumers' interests. We therefore consulted stakeholders again, saying among other things that we considered GAL's proposed price cap was now more likely to strike a reasonable balance between the interests of GAL and those of its passengers and airlines.

1.6 We said that while we could not rule out scenarios under which the cap might allow GAL to earn relatively high profits towards the end of the four year period, there were other scenarios under which GAL's profits might remain at a relatively low level throughout the period.[3] We provided some details of the internal analysis that informed this view, but we also noted that the wider strategic value in a lighter touch regulatory framework means that it is not necessarily intended to replicate the outcome of a full RAB-based building blocks approach.[4]

1.7 Following a further consultation in February 2021 we modified GAL's licence to accept its proposals for a new set of commitments. We said that we were mindful of the potential long-term benefits to consumers of a regulatory framework that facilitates commercial discussions rather than one that relies on regulator-led decision making.[5]

1.8 These new commitments last for four years to 31 March 2025 and include:

- a cap of Retail Prices Index (RPI) + 0% on GAL's published airport charges. Unlike the first set of commitments, there is no separate cap on net charges (i.e. charges paid after allowing for discounts);[6]
- a revised set of service quality targets and rebates. Changes from the targets and rebates in the first set of commitments include a switch from annual to quarterly moving averages for passenger survey scores, detailed changes to asset availability targets and a new runway availability measure; and
- a minimum investment commitment of £120 million per year (in 2018/19 prices) on average over the six years from 2019/20 to 2024/25.

1.9 We also said that we intended to carry out focused assessments of several issues, including GAL's net charges and the average level of discounts, service quality issues and investment issues, and we would consider a review of issues arising during the process of renewing the commitments. We have not yet

3 See paragraph 13 of the October 2020 consultation.

4 See CAA letter of 23 December 2020.

5 See paragraph 11 of the May 2021 notice of licence modifications.

6 For the first commitments period we also specified a "fair price benchmark" against which we would monitor GAL's pricing behaviour. This was a temporary measure, specific to the first regulatory period, to reflect the fact that our final view of a fair price was slightly lower than the cap included in the first set of commitments.

carried out any of these assessments, initially because GAL and airlines were still focused on operational issues as traffic recovered after the pandemic, and more recently because GAL notified us of its intention to propose an extension to the current commitments. We encouraged it to engage with airlines regarding any proposed extension, and were concerned that launching regulatory reviews might interfere with this commercial process.

Chapter 2

Summary of GAL’s proposal

2.1 GAL’s proposal is to extend the current commitments for four years from 1 April 2025 to 31 March 2029. It consulted airlines on an initial proposal in summer 2022, then sent a revised proposal for our evaluation in March 2023, requesting that we use our powers under section 22 of the Civil Aviation Act 2012 to introduce the required modifications of the terms set out in GAL’s licence.

2.2 It says that its proposed extension will provide for stability and certainty as the economy and aviation industry stabilise and the outcome of GAL’s northern runway planning application becomes known. GAL says this will allow the airport and its airlines to focus on delivering resilient operations, high service quality, a large investment programme and the anticipated growth, rather than engaging in “time consuming zero-sum games which characterise other regulatory regimes”.[7]

2.3 GAL’s revised proposal document has been circulated to airlines and is also available on CAA’s website.[8] The following sections summarise GAL’s main proposals on airport charges, service quality and investment.

Price commitment

2.4 The proposal includes a price cap of:

- Consumer Prices Index (CPI) - 1% for the first two years of the extension (2025/26 and 2026/27); and
- CPI + 0% for the final two years of the extension (2027/28 and 2028/29).

2.5 This is subject to the proviso that the cap should not fall in nominal terms during the first two years of the extension.[9] And, as at present, there is an additional allowance outside of the cap for costs incurred as a result of changes in required security standards (including recent changes in requirements relating to Explosive Detection Systems Standard 3 and Next Generation Security Checkpoints, as well as any future changes).

2.6 GAL’s original proposal to airlines (in July 2022) included a price cap of RPI + 0% for all four years. GAL states that it modified this proposal in response to airline feedback that RPI was no longer an appropriate metric to use and also in

[7] See p3 of GAL’s proposal document.

[8] www.caa.co.uk/CAP2554A

[9] So, for example, if the relevant increase in CPI was only 0.75%, the price cap would remain constant rather than falling by 0.25% (i.e. 0.75% - 1%).

recognition of the particularly high levels of cost pressure and economic uncertainty currently being experienced by all stakeholders.[10]

Service commitment

2.7 Irrespective of the proposal to extend the current commitments, GAL had already committed to consult airlines and the Passenger Advisory Group on the structure and content of the service commitments, to ensure they remain appropriate and relevant, and to present passenger research and evidence to inform this consultation.[11]

2.8 GAL's proposal document sets out a timetable and process for this review, which it states has been agreed with airlines. This includes new passenger research and a review with airlines of the existing measures and targets. As part of the latter, GAL states it intends to review with airlines the introduction of two further service metrics which feedback shows are important to airlines and passengers:

- a metric on air traffic control performance at Gatwick; and
- financial incentives for the Special Assistance passenger satisfaction measure (which is monitored at present but without financial incentives).

Investment commitment

2.9 GAL proposes to maintain the existing investment commitment, which requires it to invest a minimum of £120 million (in 2018/19 prices) per year, on average. Under this proposal, the average will now be assessed over the ten years from 2019/20 to 2028/29. GAL states that it invested £430 million during the first four years of this period (as investment was scaled back during the pandemic), and the commitment will require it to invest at least a further £1 billion (in 2022 prices) over the remaining six years of the extended period.[12]

2.10 Its proposal document also outlines some of its planned investments, including its northern runway programme and an acceleration of sustainability investment. GAL announced in March 2023 an acceleration of its commitment to be net zero (for its own Scope 1 and 2 carbon emissions) by 2030. It stated that it will invest over £250 million to reduce carbon emissions, such as moving to an electric vehicle fleet and replacing gas boilers and refrigerants with low carbon alternatives.[13]

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[10] See p51 of GAL's proposal document.

[11] See paragraph 9.1 of Schedule 3 of GAL's Conditions of Use.

[12] See p46 of GAL's proposal document. GAL also states that the average commitment of £120 million (in 2018/19) will be uplifted in line with CPI rather than RPI after March 2025.

[13] See GAL press release of 16 March 2023.

2.11 Depending on the outcome of its planning application, GAL currently expects its average investment over the ten years to March 2029 to be between 40 per cent and 76 per cent above the minimum commitment. However, it also notes that, over the six years to March 2025, the average annual spend would be marginally below the amount required under its current investment commitment.

Chapter 3
Views invited

3.1 To inform our review of GAL’s proposal, we are inviting views from stakeholders (including airlines and the Passenger Advisory Group).

3.2 We welcome views on any aspect of GAL’s proposal, including:

- the general principle of extending the current commitments;
- the length of the proposed extension period;
- the specific conditions of the proposed extension (including the proposed price cap and investment commitment, though noting that the service commitment will be reviewed in any case); and
- any other factors we should take into account.

3.3 As far as possible, respondents’ views should be backed up by specific analysis and evidence, with specific reference to consumers’ interests. If respondents have concerns about GAL’s proposals, they should explain why they do not consider they are in consumers’ interests. And we would encourage respondents to indicate what alternative they would view as appropriate, again backed up as far as possible by specific analysis and evidence.

3.4 Where respondents raise concerns about GAL’s proposals, we would ask them to indicate whether they have raised these same points with GAL (for example during engagement on GAL’s initial proposal) and, where relevant, to provide further details of that engagement (such as GAL’s response, and whether there was any further discussion following this).

3.5 We welcome views on all the issues raised in this document. Please e-mail responses to economicregulation@caa.co.uk by no later than 19 July 2023.

3.6 We expect to publish the responses we receive on our website. Any material that is regarded as confidential should be clearly marked as such and included in a separate annex. Please note that we have powers and duties with respect to information under section 59 of the Civil Aviation Act 2012 and the Freedom of Information Act 2000.

3.7 If you would like to discuss any aspect of this document, please contact Stuart Holder (stuart.holder@caa.co.uk).

Appendix A

Our duties

A1 The CAA is an independent economic regulator. Our duties in relation to the economic regulation of airport operation services (AOS) are set out in the Civil Aviation Act 2012 (CAA12).

A2 CAA12 gives the CAA a general ('primary') duty to carry out its functions under CAA12 in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of AOS.

A3 CAA12 defines users of air transport services as present and future passengers and those with a right in property carried by the service (i.e. cargo owners). We often refer to these users by using the shorthand of 'consumers'.

A4 The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS.

A5 In discharging this primary duty, the CAA must also have regard to a range of other matters specified in CAA12. These include:

- the need to secure that each licensee is able to finance its licensed activities;
- the need to secure that all reasonable demands for AOS are met;
- the need to promote economy and efficiency on the part of licensees in the provision of AOS;
- the need to secure that the licensee is able to take reasonable measures to reduce, control and/or mitigate adverse environmental effects;
- any guidance issued by the Secretary of State or international obligation on the UK notified by the Secretary of State; and
- the Better Regulation principles.

A6 CAA12 also sets out the circumstances in which we can regulate airport operators through an economic licence. In particular, airport operators must be subject to economic regulation where they fulfil the Market Power Test as set out in CAA12. Airport operators that do not fulfil the Test are not subject to economic regulation. As a result of the market power determinations we completed in 2014 the airport operators of both Heathrow and Gatwick airports are subject to economic regulation.

A7 We are only required to update these determinations if we are requested to do so and there has been a material change in circumstances since the most recent determination. We may also undertake a market power determination whenever we consider it appropriate to do so.